



## Hong Kong Tax Newsflash

### Tax certainty enhancement scheme for onshore capital gain under consultation

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Further to the announcement by the Financial Secretary in his 2023-24 Budget speech that Hong Kong plans to enhance tax certainty around onshore gains on disposal of equity interests, the Hong Kong Government has recently released a consultation paper on the proposed tax certainty enhancement scheme.

#### Key features of the proposed tax certainty enhancement scheme

Under the proposed scheme, onshore gains on disposal of equity interests would be regarded as non-taxable, if certain conditions are met. Otherwise, the current "badges of trade" approach<sup>1</sup> would apply in determining whether the gains are taxable revenue or non-taxable capital. In other words, the proposed scheme provides an alternative option for taxpayers.

Please note that onshore losses on disposal of equity interests will not be affected under the proposed scheme and the nature would continue to be determined based on the badges of trade approach.

#### Eligible person

An investor entity disposing of its equity interests in an investee entity would be eligible for the proposed scheme. It covers a legal person (excluding a natural person) and an arrangement that prepares separate

financial accounts, such as a company, a partnership and a trust. There is no resident requirement on the investor entity.

### Eligible income

The proposed scheme is applicable to onshore gains on disposal of different forms of equity interests<sup>2</sup>, such as ordinary shares, preference shares (excluding those accounted for as financial liability under applicable accounting principles) and partnership interest. The investee entity can be a Hong Kong or non-Hong Kong entity.

### Conditions

An investor entity must have

- (i) held at least **15%** of the total equity interest in the investee entity; and
- (ii) for a continuous period of at least **24 months** immediately prior to the date of disposal of such interest.

### Exclusions

The following entities/income will be excluded from the proposed scheme and the "badges of trade" approach would continue to apply in determining the nature of the relevant gains on disposal of equity interests:

- Insurance business as the investor entity
- Non-listed equity interests in investee entities that engage in the following immovable property-related businesses, regardless of the location of the properties:
  - Property trading
  - Property development, except if:
    - a) the immovable property developed is used by the investee entity for its own business e.g. lease; and
    - b) the investee entity did not undertake any property development activity in the past 60 months before the disposal of equity interests.
  - Property holding, with value of immovable properties exceeding 50% of total assets
- Equity interests that have previously been regarded as trading stock based on the badges of trade analysis

### Effective date

The new scheme is proposed be effective from 1 January 2024.

### What's next

The Hong Kong Government is seeking comments from stakeholders (e.g. professional practitioners and institutions) on the consultation paper and will take into account the views obtained in drafting the amendment bill. The plan is to introduce the amendment bill for reading in the Legislative Council in the 2nd half of 2023.

## Our comments

We welcome the introduction of tax certainty enhancement scheme for onshore gains on disposal of equity interests. It can provide greater certainty for business expansion and restructuring through disposal of equity interests and enhance the attractiveness of Hong Kong as a premier international investment and business hub.

Taxpayers who plan for business expansion and restructuring should watch out the development.

<sup>1</sup> Under the badges of trade approach, considerations would be given to the relevant facts and circumstances of the case, e.g. the frequency of similar transactions, the holding period, the shareholding ratio, reasons for purchase or sale, etc.

<sup>2</sup> Equity interest refers to an interest that carries rights to the profits, capital or reserves of the entity and is accounted for as equity under applicable accounting principles.

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If you have any questions, please contact our professionals:

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