NOTES AND INSTRUCTIONS – SUPPLEMENTARY FORM (S21)

1. An eligible investor entity (Note 3) is required to complete this supplementary form for submission together with its Profits Tax Return if it elects for the Tax Certainty Enhancement Scheme ("the Scheme") (Note 2) provided in Schedule 17K to the Inland Revenue Ordinance (Cap. 112) ("IRO") in respect of its onshore gains derived from the disposal of eligible equity interests (Note 5) in an eligible investee equity (Note 7) that accrued to it during the year of assessment.

2. The Scheme applies to a gain or profit derived from a disposal of equity interests if the disposal occurs on or after 1 January 2024; and the gain or profit accrues in the basis period for a year of assessment beginning on or after 1 April 2023. The Scheme provides that, subject to certain specified exclusions, any gain or profit (disposal gain), arising in or derived from Hong Kong, that an entity (investor entity) derives from a disposal (subject disposal) of equity interests (subject interests) in another entity (investee entity) is to be regarded as capital in nature and not chargeable to profits tax if the following eligibility criteria are met:

   (a) the investor entity must be an eligible investor entity (Note 3);

   (b) the subject matter disposed of must be an eligible equity interest (Note 5) in an eligible investee entity (Note 7); and

   (c) the equity holding conditions (Note 20) are met for the subject disposal of the subject interests or the exception conditions for long-held left-overs (i.e. disposal in tranches) (Note 26) are satisfied.

   The Scheme only applies to disposal gains arising in or derived from Hong Kong (i.e. onshore disposal gains). The Scheme does not cover any specified foreign-sourced income as defined by section 15H(1) of the IRO, even if the specified foreign-sourced income is regarded under section 15I(1) of the IRO as a receipt arising in or derived from Hong Kong.

3. To be eligible for the Scheme, the investor entity must be a legal person (other than a natural person) or an arrangement that prepares separate financial accounts, such as a partnership, a trust and a fund. Nevertheless, the Scheme does not apply to an investor entity which is an insurer (Note 4).

4. An investor entity is an insurer if its assessable profits for the year of assessment are ascertained under Subdivision 1 of Division 11 of Part 4 of the IRO.

5. For the purposes of the Scheme, an equity interest in an investee entity means an interest that carries rights to the profits, capital or reserves of the investee entity and is accounted for as equity in the books of the investee entity under applicable accounting principles (Note 6). Nevertheless, the Scheme does not apply to the following equity interests:

   (a) equity interests that are regarded as trading stock for tax purposes (Note 30); or

   (b) non-listed equity interests in an excluded entity. An investee entity is an excluded entity if it engages in property trading (Note 11), property development (Note 14) or property holding (Note 17) (collectively as "property-related businesses") and does not satisfy the exception conditions (Notes 15 and 18).

6. Applicable accounting principles in general refer to the accounting standards required to be adopted by an entity in the preparation of its financial accounts. In determining whether a financial instrument, from the perspective of an investee entity, should be classified as an equity instrument or a financial liability, Hong Kong Accounting Standard 32 (HKAS 32) and International Accounting Standard 32 (IAS 32) have provided detailed guidance on this aspect. In case the investee entity is not required to comply with any specified accounting standards for preparing its financial accounts, the applicable accounting principles should be the International Financial Reporting Standards.

7. To be eligible for the Scheme, the investee entity must be a legal person (other than a natural person) or an arrangement that prepares separate financial accounts, such as a partnership, a trust and a fund. Nevertheless, the Scheme is not applicable to non-listed equity interests in excluded entities (Note 5(b)).

8. The basis period must be the same as that stated in the relevant Profits Tax Return.

9. "Onshore disposal gain" means any gain or profit, arising in or derived from Hong Kong, that an entity derives from a disposal of equity interests in another entity. In section 2.1, you should state the total amount of onshore disposal gains in respect of which you elect for the Scheme. Details of each disposal should be provided in section 2.2. Details of up to 25 disposals can be provided in this form. In case there are more than 25 disposals, please provide details of the remaining disposals in the same format on a separate sheet. In the separate sheet, please add your file number, year of assessment concerned and a remark "Additional" and sign at the bottom of the sheet.

10. If the investee entity engaged in more than one business activity in the basis period, please select the industry sector with reference to its principal business activity.

11. Section 1(4) of Schedule 17K to the IRO provides that an entity carries on a business of property trading if it carries on a business of acquisition and sale of immovable properties (Note 12), situated in Hong Kong or elsewhere, unless the acquisition and sale of immovable properties is incidental to the undertaking of any property development (Note 14) (i.e. construction of buildings) by the entity. For the purposes of the Scheme, an investee entity that engages in a regular business other than property trading but has carried out a one-off property trading transaction which is an adventure in the nature of trade would not be regarded as an excluded entity.

12. "Immovable property", as defined in section 1(1) of Schedule 17K to the IRO, means the following but does not include infrastructure:

(a) land (whether covered by water or not);

(b) any estate, right, interest or easement in or over any land; and

(c) things attached to land or permanently fastened to anything attached to land.

The term "infrastructure" means any publicly or privately owned facility providing or distributing services for the benefit of the public, and includes any water, sewage, energy, fuel, transportation or communication facility.

13. "Investee entity's relevant basis period", in relation to a disposal of equity interests in an investee entity, means the basis period of the investee entity for the year of assessment in which the disposal occurs (as defined in section 1(1) of Schedule 17K to the IRO).

14. "Property development", as defined in section 1(1) of Schedule 17K to the IRO, means construction (Note 16) or causing the construction of any building or part of a building, and includes acquisition of any land or building or part of a building for such construction and sale of any building or part of a building after such construction.

15. For an investee entity which undertakes or has undertaken property development, it does not become an excluded entity under the Scheme if it has not undertaken property development for at least a continuous period of 60 months before the relevant disposal; and in the investee entity's relevant basis period (Note 13), the immovable properties held by it are used by it to carry on its trade or business (including used for its letting business) and none of the immovable properties held by it is for sale.

16. "Construction", as defined in section 1(1) of Schedule 17K to the IRO, means the following:

(a) any building operation, or demolition and rebuilding operation, in, on, over or under any land for the purpose of erecting a building or part of a building; or

(b) any alteration or addition to, or partial demolition and rebuilding of, a building or part of a building,

that requires the consent of the Building Authority under section 14(1) of the Buildings Ordinance (Cap. 123) or, if carried out in a territory outside Hong Kong, of a similar supervisory authority of that territory; but construction does not include works for the renovation or refurbishment, of a building or part of a building, with a view to maintaining the commercial value of the building or part.

17. "Property holding" covers an activity of holding immovable properties other than those which fall within the scope of property trading and property development.

18. An investee entity, not being engaged in the business of property trading and property development, is an excluded entity if its immovable property holding exceeds 50%. Section 11(1) of Schedule 17K to the IRO provides that an investee entity's immovable property holding is calculated in accordance with the following formula:

$$\frac{A}{B} \quad \text{X } 100\%$$

where: A means the aggregate of the following —

- the value of any specified immovable property of the investee entity;
- the value of any direct or indirect beneficial interest, or any direct or indirect voting rights, of the investee entity in another entity to the extent to which the value is attributable to any specified immovable property of the other entity (Note 19);

B means the total value of the investee entity's assets.

"Specified immovable property", in relation to an entity, means any immovable property, in Hong Kong or elsewhere, that is directly held by the entity, other than any immovable property used by the entity to carry on its trade or business (as defined in section 11(6) of Schedule 17K to the IRO).

In applying the above formula, section 11(3) of Schedule 17K to the IRO provides that each of the following items (each a "specified item's value")—

(a) the value of any specified immovable property of the investee entity or another entity;

(b) the value of any direct or indirect beneficial interest, or any direct or indirect voting rights, of the investee entity;

(c) the total value of the investee entity's assets,

is to be calculated in accordance with the following formula:

$$\frac{C + D}{2}$$

where: C means the specified item's value as at the beginning of the investee entity's relevant basis period (Note 13);

D means the specified item's value as at —

- the end of the investee entity's relevant basis period; or
- the time of the specified disposal.

19. The value of a direct or indirect beneficial interest, or direct or indirect voting rights, of the investee entity in another entity that is attributable to any specified immovable property of the other entity is the value arrived at by multiplying—

(a) the percentage representing the extent of the direct or indirect beneficial interest, or direct or indirect voting rights, of the investee entity in the other entity; by

(b) the value of the specified immovable property.

20. In relation to an onshore disposal gain that an investor entity derives from a disposal (subject disposal) of equity interests (subject interests) in an investee entity, the equity holding conditions are met for the subject disposal of the subject interests if:

(a) the investor entity has held the subject interests throughout the reference period (Note 21); and

(b) the subject interests by themselves, or together with certain other equity interests in the investee entity also having been held by the investor entity and/or its closely related entity/entities (Note 23) throughout the reference period, constitute qualifying interests (Note 22) in the investee entity.

21. "Reference period", in relation to a disposal of equity interests, means the continuous period of 24 months immediately before the date of the disposal (as defined in section 1(1) of Schedule 17K to the IRO).

22. Section 1(3) of Schedule 17K to the IRO provides that equity interests in an investee entity constitute qualifying interests in the investee entity if the interests, in aggregate, entitle the holder of the interests to at least a 15% share in the profits, capital or reserves of the investee entity.

23. Section 2(1) of Schedule 17K to the IRO provides that an entity is a closely related entity of another entity if one of them has control (Note 24) over the other or both of them are under the control of the same entity.

24. Section 2(2) of Schedule 17K to the IRO provides that an entity (entity A) has control over another entity (entity B) if:

(a) entity A has more than 50% of direct or indirect beneficial interest in, or in relation to, entity B; or

(b) entity A is directly or indirectly entitled to exercise, or control the exercise of, more than 50% of voting rights in, or in relation to, entity B.

25. If your closely related entities have held certain other equity interests in the investee entity throughout the reference period which constituted a part of the qualifying interests in the investee entity in relation to the subject disposal, you should provide details of each closely related entity in relation to the subject disposal in Table A. Please also specify the disposal number (e.g. Disposal 1 or Disposal 2) of the subject disposal in Table A for identification. Details of up to 25 closely related entities can be provided in this form. In case there are more than 25 closely related entities, please provide details of the remaining closely related entities in the same format on a separate sheet. In the separate sheet, please add your file number, year of assessment concerned and a remark "Additional" and sign at the bottom of the sheet.

26. An investor entity may dispose of its long-held equity interests in tranches. After disposal of each tranche, the investor entity's equity holding in an investee entity may fall below the 15% threshold such that the equity holding conditions for the subsequent disposals of the remainder of the long-held interests (long-held left-overs) cannot be met. Section 6 of Schedule 17K to the IRO provides for an exception to the equity holding conditions under which onshore disposal gains arising from a disposal of long-held left-overs from a section 5(2) disposal (Notes 27 and 28) are regarded as capital in nature and not chargeable to profits tax if the disposal of the long-held left-overs occurs within 24 months after the section 5(2) disposal (Note 29).

27. Section 6(1) of Schedule 17K to the IRO provides that a disposal of equity interests (subject interests) in an investee entity by an investor entity is a disposal of long-held left-overs from a section 5(2) disposal if:

    (a) before disposal of the subject interests, other equity interests in the investee entity were disposed of by the investor entity (earlier disposal);

    (b) the earlier disposal was a section 5(2) disposal (Note 28); and

    (c) the equity holding conditions (Note 20) were met for the earlier disposal on the basis (among other things) that the subject interests had been held by the investor entity throughout the reference period (Note 21) in relation to the earlier disposal and constituted a part of the qualifying interests (Note 22) in the investee entity in relation to the earlier disposal.

28. "Section 5(2) disposal", as defined in section 6(2) of Schedule 17K to the IRO, means a disposal of equity interests to which section 5(1) of Schedule 17K applies on the basis that the equity holding conditions (Note 20) are met for that disposal of those interests within the meaning of section 5(2) of Schedule 17K.

29. Where there are more than one earlier disposal in tranches, the latest earlier disposal that is a section 5(2) disposal would be counted for the purpose of considering the 24-month time limit as mentioned in Note 26.

30. Equity interests (specified equity interests) held by an investor entity or its closely related entity (collectively as "holding entity") are regarded as trading stock from the first day of the basis period for a year of assessment if any profit, gain or loss (e.g. unrealised fair value gain or loss, or provision for diminution in value) in respect of the specified equity interests has been brought into account for tax purposes (Note 31) for the year of assessment.

    Where the specified equity interests were acquired by the holding entity together with other equity interests on the same occasion, the specified equity interests are regarded as trading stock—

    (a) from the first day of the basis period for a year of assessment if any profit, gain or loss (not arising from a disposal) (e.g. unrealized fair value gain or loss, or provision for diminution in value) in respect of any of those other equity interests has been brought into account for tax purposes for the year of assessment; or

    (b) from the date of disposal if any profit, gain or loss arising from a disposal of any of those other equity interests on that day has been brought into account for tax purposes for a year of assessment.

    For the purposes of the Scheme, equity interests are to be disregarded during the period that they are regarded as trading stock (disregarded period), i.e. not to constitute any part of the relevant period or the qualifying interests for meeting the equity holding conditions. Please see Note 32 on appropriation of trading stock for a non-trade purpose.

31. A sum has been brought into account for tax purposes for a year of assessment if the sum has been brought into account for computing the holding entity's assessable profits or losses for the year of assessment under—

    (a) an assessment made on the holding entity that has become final and conclusive under section 70 of the IRO; or

    (b) a computation of losses issued to the holding entity.

32. For any equity interests which are regarded as trading stock as mentioned in Note 30, the equity interests will cease to be regarded as trading stock on the date of the appropriation if:

    (a) the equity interests are appropriated for a non-trade purpose; and

    (b) the holding entity has the amount that the appropriated equity interests would have realized, if sold in the open market on the date of the appropriation, brought into account as a receipt in accordance with section 15BA(2) of the IRO.

33. If any equity interests held by you or your closely related entity/entities which, in aggregate, constituted qualifying interests in the investee entity in relation to the subject disposal were/had been regarded as trading stock (i.e. specified equity interests), you should provide details of each holding entity and their respective specified equity interests held in relation to the subject disposal in Table B. Please also specify the disposal number (e.g. Disposal 1 or Disposal 2) of the subject disposal in Table B for identification. Details of up to 15 specified equity interests can be provided in this form. In case there are more than 15 specified equity interests, please provide details of the remaining specified equity interests in the same format on a separate sheet. In the separate sheet, please add your file number, year of assessment concerned and a remark "Additional" and sign at the bottom of the sheet.

34. You must export the filled form to XML file and upload the XML file via the eTAX services under GovHK for submission. If you do not choose to submit Profits Tax Return through electronic filing or semi-electronic filing, you have to print and sign a paper Control List (containing details of the XML file uploaded and QR code) generated by the eTAX services for submission together with the Profits Tax Return in order to complete the submission process. The Control List of this supplementary form must be signed by the same person signing the tax return.