

立法會
Legislative Council

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by the Administration)

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**Bills Committee on
Inland Revenue (Amendment) Bill 2000**

**Minutes of meeting
held on Monday, 20 November 2000, at 9:00 am
in Conference Room A of the Legislative Council Building**

- Members present** : Hon Eric LI Ka-cheung, JP (Chairman)
Hon CHAN Kam-lam
Hon SIN Chung-kai
Hon Mrs Miriam LAU Kin-ye, JP
Hon Ambrose LAU Hon-chuen, JP
- Public officers attending** : Ms Esther LEUNG
Principal Assistant Secretary for the Treasury
- Miss Maisie CHAN
Assistant Secretary for the Treasury
- Mr E C D' SOUZA
Acting Commissioner of Inland Revenue
- Mr C C SO
Chief Assessor, Inland Revenue Department
- Mr J G A GRADY
Senior Assessor, Inland Revenue Department
- Mr TAM Tai-pang
Senior Assessor, Inland Revenue Department
- Ms Betty CHOI
Senior Government Counsel

Clerk in attendance : Ms LEUNG Siu-kum
Chief Assistant Secretary (1)4

Staff in attendance : Ms Bernice WONG
Assistant Legal Adviser 1

Ms Rosalind MA
Senior Assistant Secretary (1)6

I Meeting with the Administration

Concerns raised at the last meeting

The Acting Commissioner of Inland Revenue (CIR(Atg)) responded to some of the concerns raised at the last meeting held on 6 November 2000. In relation to concerns about clause 8 on home loan interest, he said that having considered Assistant Legal Adviser 1's suggestion of adding a separate provision to allow taxpayers to apply for interest deduction within a specified period, the Administration was of the view that it would be adequate to put an advertisement on principal newspapers (both Chinese and English ones) as well as to post a notice on the web site of the Inland Revenue Department (IRD) on the retrospective effect of the amendments.

2. Mrs Miriam LAU expressed concern about the detailed arrangements of advertising through the press and the Internet. She pointed out that effective means should be used for announcing the changes to ensure that all affected taxpayers would be aware of their rights to apply for the deduction. The Chairman shared her concern.

3. CIR(Atg) responded that the detailed arrangements for announcing the changes had yet to be finalized. He informed members that since a considerable number of taxpayers had already applied to the Commissioner of Rating and Valuation for consolidation of the separate assessments of their flats and car parking spaces into joint assessments, it was expected that only a small number of taxpayers would seek revision of their tax assessments with the retrospective application of the proposed amendments. The Administration would employ appropriate publicity measures taking into consideration the number of taxpayers involved. Members agreed that the detailed arrangements should be left to the Administration as long as adequate notice would be given to the affected taxpayers.

Admin 4. On other areas of concern raised at the last meeting, members requested the Administration to give the Bills Committee a written reply so that these could be considered at future meetings. The Chairman suggested and members agreed that the discussion at this meeting should be focused on the proposed amendments to section 16(2) of the Inland Revenue Ordinance (the Ordinance).

Proposed amendments to section 16(2) of the Ordinance
(LC Paper No CB(1)185/00-01(01))

Section 16(2)(d)

5. The Chief Assessor of Inland Revenue Department (CA/IRD) brought members through examples 1 and 2 in the information paper, which illustrated the different taxation consequences under the existing and the proposed section 16(2)(d). The proposed amendments aimed at ensuring that any person entitled to the interest payment on the loan made by the taxpayer would not be the borrower or an associate of the borrower. Moreover, the proposed amendments sought to extend the existing condition of non-deductibility of interest payment concerning borrowings secured by deposits to cases where these borrowings were secured by loans.

6. In response to Mrs Miriam LAU's enquiry on the definition of "associated company" used in the examples, the Chairman referred members to the definition of "associated corporation" in section 16(3) of the Ordinance or page 13 of the marked-up copy of the Ordinance (LC Paper No CB(1)129/00-01(02)). He also drew members' attention to the fact that the term "associate" instead of "associated corporation" was used in section 16(2)(d). He asked members to refer to the definition of "associate" in section 16(3) of the Ordinance. According to the definition, an associate could be a natural person, a corporation or a partnership, thus having a much broader meaning compared with the examples given in the information paper in which only associated companies were used to illustrate the difference between the existing legislation and the proposed amendments.

7. CA/IRD said that the proposed amendments to section 16(2)(d) were not originated from problems detected in the application of the definition of "associate" or "associated corporation". The proposals were made to tighten the existing anti-avoidance provisions in the wake of increasing incidents of aggressive tax avoidance schemes. In response to the enquiry of the Chairman and Mrs Miriam LAU about the possible impact of the proposed amendments as a result of the broad definition of associate, he explained that innocent persons would unlikely be caught under the proposed provisions. As it was stated in the proposed amendments that interest payment would be non-deductible only if the repayment of the principal or interest was secured or guaranteed, in whole or in part, by a deposit or loan where the interest paid for that deposit or loan was not chargeable to tax under the Ordinance. As the act to secure or guarantee the repayment by a deposit or loan must be carried out intentionally, the person or corporation applying for deduction of interest expense should be aware of such an arrangement.

8. The Chairman pointed out that the proposed amendments would make the whole sum of interest payment tax non-deductible even if only part of the loan was secured by another loan or a deposit. This might have rather extensive impact on the financial sector, which, as a result of uncertainty under such wide application of the legislation, would be restricted in entering genuine commercial undertakings. He opined that the Bills Committee had to be particularly careful in examining anti-avoidance provisions so that the scope of the provisions would not be too wide to

hamper genuine normal commercial dealings, and the Administration would not be provided with excessive discretionary power.

9. CIR(Atg) responded that the amendments were proposed to prevent the loss of revenue as a result of aggressive tax avoidance schemes which could not be tackled under the existing provisions. These schemes had, by means of different tax planning tools, successfully escaped the existing anti-avoidance provisions and enabled taxpayers to claim tax deductions on interest payment while the actual recipient of the interest overseas was not chargeable to Profits Tax under the Ordinance. There was no intention to inhibit any genuine commercial activities and no amendment was proposed to the definition of "associate". The proposed amendments to section 16(2)(d) also sought to extend the existing restriction on tax deductibility of interest payment where the borrowings were secured by deposits to cases where these borrowings were secured by loans. Other commercial activities would not be affected by the proposed amendments.

Section 16(2)(e)

10. With the aid of a flow chart on example 3 given in the information paper, CA/IRD explained to members the major changes brought about by the proposed amendments to section 16(2)(e). He said that the proposed amendments would make the interest payment to a loan for buying trading stock non-deductible if the loan was guaranteed by a deposit or another loan, in whole or in part, and the sums paid by way of interest on the deposit or the loan were not chargeable to Profits Tax in Hong Kong. He also informed members that the references to section 16(2)(e)(i)(A) in Example (3) should be corrected as section 16(2)(e)(D).

11. Mrs Miriam LAU queried the rationale behind the policy of making the whole sum of interest payment non-deductible even if only a part of it was secured by a loan or deposit. She opined that it would be fairer and more reasonable if the taxpayer would only be disallowed to claim tax deduction for the part of interest payment secured by a loan or deposit.

12. CA/IRD explained that the arrangement of making the whole sum of interest payment non-deductible if it was secured by a deposit, in whole or in part, had been discussed in detail when the Inland Revenue (Amendment) Bill 1984 (the 1984 Bill) was considered by the then Legislative Council. CIR(Atg) added that there had been extensive discussion on this controversial issue before the enactment of the 1984 Bill. Although he did not have the detailed deliberation made by the then Legislative Council in hand, the Administration had no intention to overturn the decision made in 1984. From the administrative point of view, it would be extremely difficult to administer a tax deduction scheme with varying percentage of interest payments being deductible. Moreover, he pointed out that it was rather unusual under normal commercial practice for the whole sum of loan to be secured by a deposit which amounted to only a small percentage of the loan.

13. The Chairman disagreed that it would be unusual to have other forms of security arrangements other than a back-to-back loan or deposit. On the contrary, it was common for corporations to arrange for a mixture of different kinds of security

instead of making the security in 100% cash terms. While appreciating the administrative difficulties in handling interest payment deduction in percentage, he pointed out that the Bills Committee had to take into consideration the notion of equity and try to strike a balance between administrative convenience and fair arrangements for the tax paying community.

14. Mrs Miriam LAU requested the Administration to provide members with the rationale for not allowing taxpayers to claim partial deduction of interest expenses so that the Bills Committee could better understand the full picture of the existing tax deduction arrangements. The Chairman shared her view and commented that the practices in the financial and debt markets had changed rather significantly since the enactment of the 1984 Bill. Therefore, it would be important for the Bills Committee to know the detail deliberation of the then Legislative Council and the relevant committee(s) relating to the deductibility of interest expenses so that members could decide whether the reasons for having the existing tax deduction arrangements would still be valid in today's context.

Admin 15. CIR(Atg) undertook to provide members with the rationale for the existing arrangements of disallowing tax deduction of the whole sum of interest expenses even if the loan was only secured in part. Nevertheless, he said that although there had been changes in the financial market and different commercial practices might have been adopted since the 80's, the basic principles of banking remained the same.

Section 16(2)(f)

16. CA/IRD explained to members the proposed amendments to section 16(2)(f) with the illustration of example 4 in the information paper. To tackle tax-avoidance practices employed by corporations, the Administration proposed to amend section 16(2)(f) to the effect that a corporation would only be allowed to claim tax deductions for interest payment on debentures or other financial instruments it issued or on money borrowed from an associated corporation which was lending from the proceeds of debentures or other financial instruments issued by the associated corporation, if neither its associates or itself was a holder of the debenture or instrument.

17. The Chairman expressed grave concern about the impact of the proposed amendments on the development of the debt capital market, which the Hong Kong Government had been trying to promote. He pointed out that debentures and other financial instruments were generally issued worldwide and could be traded freely. It would be very difficult for the issuing corporation to ensure that its associates would not buy any of its debentures in the worldwide financial markets, bearing in mind the broad definition of "associate" which would catch even a person's relatives and the companies under these relatives' names. The uncertainty in tax deductibility of the interest expenses for the debentures would discourage Hong Kong corporations to raise funds through the debt capital market. The Chairman reiterated the concern of fairness to the taxpayer since tax deductibility on the whole sum of interest expenses would be affected even though only a small fraction of the debentures issued was held by associates of the issuing corporation.

18. Mrs Miriam LAU shared the Chairman's concern and enquired whether it was the Administration's legislative intention to disallow participation of any associate of the issuing corporation in holding the debentures. In addition, she sought information from the Administration on whether this was an international tax practice in handling deductibility of interest expenses.

19. CIR(Atg) responded that the Administration had consulted the views of participants of the debt capital market and was given to understand that in debt financing, it was extremely unusual for the issuing corporation or corporations within the group to hold its own debt. Although he could not tell off-hand whether this was an international practice, the proposed amendments should not have adverse impact on genuine financial activities. He pointed out that the corporation concerned could simply issue a directive to all companies within the group that none of them should buy any of the debentures issued by the group in order to preserve the tax deductibility of the interest on the debentures.

20. The Chairman commented that it would be impossible for any corporation to issue a directive to that effect to all its associates, taking into consideration the broad coverage of the definition of associate in the Ordinance.

Consultation on the proposed amendments

21. Mr SIN Chung-kai suggested that the Bills Committee proceed with consideration of views from the tax practitioners, trade associations and other interested parties. He sought information on the progress of the invitation for submissions on the Inland Revenue (Amendment) Bill 2000 (the Bill). Moreover, he requested the Administration to consult the views of relevant public organizations, for example, the Hong Kong Monetary Authority (HKMA), on the proposed amendments in the Bill.

22. The Chairman informed members that an invitation for submissions on the Bill had been placed on the web site of the Legislative Council and the closing date for submissions was 21 November 2000. However, up to now no submission had been received. In view of the complexity of the Bill, more time might be required for relevant parties to prepare their submissions. He suggested and members agreed that the closing date for submissions should be extended to 28 November 2000. Members also agreed that the Bills Committee would send letters to various organizations such as the Taxation Institute of Hong Kong, the Hong Kong Society of Accountants, the Hong Kong Association of Banks, major chambers of commerce and other relevant organizations to invite submissions on the Bill. The Chairman undertook to work out with the Clerk to the Bills Committee the list of organizations for invitation.

Clerk

23. The Principal Assistant Secretary for the Treasury agreed that the Administration would consult relevant organizations such as HKMA and the Hong Kong Exchanges and Clearing Limited.

Admin

(Post-meeting note: Invitation letters had been sent to 17 organizations including those mentioned above.)

II Any other business

24. There being no other business, the meeting ended at 10:35 am.

Legislative Council Secretariat
13 December 2000