

## Second Reading of Bills

### INLAND REVENUE (AMENDMENT) BILL 1986

THE FINANCIAL SECRETARY moved the Second Reading of: 'A Bill to amend the Inland Revenue Ordinance'.

He said: Sir, I move and state that the purpose of the much discussed Inland Revenue (Amendment) Bill 1986 is to give legislative effect to a number of proposals made in the 1985 Budget speech:

*Firstly*, to prohibit a deduction for accounting provisions made in respect of retirement schemes other than provisions, within prescribed limits, for 'annual contributions' to retirement schemes approved by the Commissioner of Inland Revenue;

*secondly*, to limit the opportunities for tax deferral through use of certain machinery or plant under leasing arrangements by denying to a lessor initial and annual allowances where machinery or plant was acquired by him under a sale and leaseback arrangement, or, being other than a ship or an aircraft, was acquired by him through a 'leveraged lease' transaction and is used wholly or principally outside Hong Kong;

*thirdly*, to provide the Commissioner of Inland Revenue with more effective weapons to combat tax avoidance and to protect the revenue by enabling him to strike down schemes which clearly appear to have been entered into for the sole or dominant purpose of conferring a tax benefit;

*fourthly*, to restrict the trafficking in loss companies by enabling the commissioner to refuse to set off prior year losses where he is satisfied that the sole or dominant purpose of a change in a company's shareholding was the utilisation of such losses to obtain a tax benefit;

*fifthly*, to provide a profits tax deduction for interest payable by a corporation on moneys borrowed from an 'associated corporation' where those moneys arose from a debenture issue by the associated corporation and on interest payable on 'commercial paper' which is marketable in Hong Kong or other major financial centre or which has been issued under an agreement advertised with the approval of the Securities Commission; and

*sixthly*, to introduce several minor technical amendments of a remedial nature.

The need to protect the revenue is obvious. These proposals were included in a draft Bill which was published in July 1985. They have since been subjected to close scrutiny by the UMELCO ad hoc Inland Revenue Review Panel which received a large number of representations from interested persons and institutions. The Bill now tabled before this Council differs in many respects from the draft Bill published in July. The alterations have largely emanated

from the very full and helpful report of the UMELCO review panel and take account of all the recommendations made. I believe that, while retaining the overall philosophy of my proposals, the changes now incorporated into the Bill will meet with the approval of all responsible members of the business community in particular, and of the general public at large. The major amendments to the draft Bill—

- (a) eliminate the possible retrospective effect which certain clauses may have had for taxpayers whose basis period for the year of assessment 1985-86 commenced prior to 1 April 1985;
- (b) extend the circumstances in which interest payable is deductible to include that paid on all intergroup borrowings arising from a debenture issue by a member of the group;
- (c) delete the clause which would have prohibited a deduction in respect of all accounting provisions other than those relating to retirement schemes;
- (d) substitute a more objective test for determining whether a transaction falls within the scope of the new general anti-avoidance provisions;
- (e) remove any retrospective effect which the anti-avoidance provisions may have had; and
- (f) alter the provisions relating to loss companies so that non-tax motivated changes to the shareholding of a company will not affect the ability of the company to carry forward losses for tax purposes.

In view of both the detailed examination which has been made of the proposals contained in the Bill, and of the information already provided to Members, I do not intend to expand further on them today. But there is another issue on which I must speak and that is the 1984 amendments which brought into the charge to profits tax so-called 'off-shore' interest income.

This matter was included in the terms of reference of the UMELCO ad hoc Inland Revenue Review Panel. On this point they concluded that the 1984 amendments have eroded Hong Kong's basic tax philosophy and have breached the territorial source criterion. I have given careful consideration to the findings of the panel and have held useful discussions on this difficult issue. I still do not accept that the 1984 amendments breach the territorial source rule but because of drafting difficulties I accept that they may unwittingly have introduced an element of uncertainty into this most fundamental concept of our taxation system. This is most undesirable. Practice notes are not a proper palliative. I am therefore prepared in principle to consider appropriate amendments to ensure that the taxation law continues to be seen to be applying only to income arising in or derived from Hong Kong. As such amendments must involve a very considerable cost to the revenue the timing of their introduction will depend on budgetary circumstances. I will address the issue further in my Budget speech.

Sir, I move that the debate on this motion be adjourned.

*Motion made. That the debate on the Second Reading of the Bill be adjourned.*

*Question put and agreed to.*

#### **JURY (AMENDMENT) BILL 1986**

THE ATTORNEY GENERAL moved the Second Reading of: 'A Bill to amend the Jury Ordinance'.

He said: Sir, I move that the Jury (Amendment) Bill 1986 be read the Second time.

Hon. Members will I am sure have read or heard of what is known as the 'Carrian' case which will come to trial next month in the High Court and is expected to last many months. During the pre-trial review of this case which raises complex commercial issues, the trial judge suggested that a larger jury than usual should if possible be empanelled for the trial in case some of them were to drop out before it ended. The trial judge's suggestion has secured the support of all the parties to the case, both prosecution and the several defendants. Judiciary as a whole has also welcomed the suggestion. They consider that not only should the trial judge of the 'Carrian' case be empowered to empanel a larger jury than usual, but that the courts should be given a general power to do so in similar long cases. The proposal has also attracted the support of the legal profession. And no one, so far as I know, has found reason to criticise or oppose it. Accordingly this Bill has been drafted to implement the Judiciary's proposal. And I would like to thank both the trial judge in the 'Carrian' case who first made the suggestion, and the staff of the Judiciary for developing it to the point of a bill.

Let me explain how the proposal will work in practice.

The Jury Ordinance (Cap. 3) provides for a jury of seven members in both criminal and civil cases. However, during the course of a trial, up to two jurors may be discharged where, in the interests of justice or of the juror, it appears to the court to be expedient to do so without bringing the trial to an end. Thus, a jury consisting of only five may still deliver an effective verdict.

There have regrettably been instances where trials have had to be stopped and started afresh before a new jury because the number of jurors has fallen from the original seven to less than the minimum of five because of death, illness, being posted abroad or some other cause. The risk that there will not be sufficient jurors left at the end of the trial to deliver a verdict is particularly acute in the case of complex commercial cases which can take many months to complete. If this occurs, and a new trial with a new jury has to be ordered, the cost in time, inconvenience and money to the public purse, the Crown and the defending parties, could be very high indeed.

~~seriousness of these offences. Experience in Hong Kong shows that the complexity and scale of the frauds involved in such offences often warrants a higher penalty than is presently prescribed. The proposals will put the maximum level for these offences on a par with other offences of a similar nature in the Ordinance.~~

The Law Society, the Bar Association and the Law Faculty of the University of Hong Kong were consulted on the Bill. The Law Society supported the amendments proposed. The Bar Association and the Law Faculty offered a number of detailed comments on the Bill which have since been taken into account.

Sir, I move the debate in this Bill be now adjourned.

*Motion made. That the debate on the Second Reading of the Bill be adjourned.*

~~Question put and agreed to.~~

## **INLAND REVENUE (AMENDMENT) BILL 1986**

### **Resumption of debate on Second Reading (29 January 1986)**

MR. PETER POON: Sir, I shall speak briefly on the Inland Revenue (Amendment) Bill 1986 which contains a number of important amendments to our tax legislation. In July 1985, Government published the Bill in draft form. This is highly commendable because it has enabled full consideration of the proposed measures and its implications by all affected by the change. The UMELCO ad hoc Inland Revenue Review Panel formed soon after to study that Bill invited and in fact received over 40 representations, many of which contain constructive criticisms and valuable suggestions. Meetings were held with interested parties and the Administration resulting in the group making a number of recommendations on the draft Bill. Practically all of these recommendations, I am happy to say, have been accepted by the Administration. The Bill before us was published on 17 January 1986. A Legislative Council ad hoc group was formed to study the Bill. Eight representations have since been received, most of which are highly complimentary of the Bill in its revised form but some have made further suggestions. The group has carefully studied all such suggestions and has had discussions with the Administration. Apart from the minor amendment to clause 4 of the Bill on deductions allowed in respect of interest on debentures or similar instruments, it is felt that there are no new evidence or special circumstances which would justify further amendments.

Many of the clauses of the Bill contain anti-avoidance provisions which are extremely difficult to draft. I have no wish to bore Members with the technical details this afternoon. The legislation have been thoroughly reviewed during a period of nearly eight months. I am reasonably satisfied that the Bill in its

present form will be able to achieve three main objectives. Firstly, it is relatively simple and conforms with Hong Kong's tax philosophy. Secondly, it gives the Commissioner of Inland Revenue adequate power to tackle tax-avoidance schemes or transactions. Lastly but just as importantly, it contains sufficient safeguards against abuse of power by the Inland Revenue Department. It is envisaged that the Commissioner of Inland Revenue will exercise his power under such anti-avoidance legislation mainly against blatant tax-avoidance schemes or contrived transactions. The new sections 61A and 61B are both subject to the overriding requirement that the 'sole and dominant motive' is tax-avoidance. Therefore, they should not affect genuine business transactions or transactions not entered into principally with tax avoidance motive, or proper deductions or allowances under the Inland Revenue Ordinance. As far as leasing is concerned, the new section 39E will only affect the two types of tax-based leasing mentioned therein, which if unabated, will continue to result in huge tax deferral and possibly in some cases eventual loss of revenue to the Government. I have been assured by the commissioner that if the Bill is passed, the anti-avoidance provision would be used with proper discretion and only when it is really necessary. I believe the deterrent effect of such provisions is of great value in protecting our tax revenue. There should be no fear that we will create a tax monster. Other countries have much more drastic and complicated anti-avoidance legislation.

One important aspect coming out of the introduction of this Bill is the demonstration of the successful consultative process. The combined efforts of the Administration, the UMELCO panel and the public through representations have resulted in a piece of legislation which I feel is both acceptable and suitable to Hong Kong. Few would doubt its necessity. The new legislation will go a long way to reduce tax avoidance opportunities which have hitherto been considerable under our simple tax law. It is, however, extremely important that the practice notes on the new legislation containing general guidelines including tax clearance procedures should be issued by the Inland Revenue Department as soon as possible.

With these remarks, Sir, I support the motion.

MRS. FAN: Sir, this Bill was first published as a draft Bill in July 1985. Following that, interested persons and institutions made many useful and constructive representations on the draft Bill to the UMELCO ad hoc Inland Revenue Review Panel. Their views were most valuable. The Administration was receptive and responsive to the suggestions raised by various parties. As a result, the Bill before us now has incorporated amendments to a number of major areas in accordance with some of the representations. I believe this is a Bill needed for Hong Kong at this point in time. I must compliment the level of understanding and co-operation achieved by the Administration and the business community in the formulation of this Bill. I also welcome the open-mindedness and reasonableness of all concerned parties. Furthermore, I am sure this exercise helps to strengthen the confidence of the business community towards our Government.

Sir, you indicated last October in this Council that this Bill was designed to close the most readily exploitable of the loopholes in our tax system. The objective of this Bill is therefore well supported by our community. There are nevertheless still concerns amongst the business community that sections 61A and B may be applied in such a manner that genuine commercial transactions could be caught, thus resulting in complications and unforeseen liabilities. I understand that this anti-tax avoidance legislation would only be invoked to counter blatant or contrived tax avoidance schemes, and it was never the intention of the Administration to cast unnecessary provisions on genuine commercial transactions even though the transaction might result in some tax benefit. In this connection, genuine intra-group regroupings or inter-company transfer of profit would not be caught by these sections, especially in view of the fact that there is no provision in group relief in our tax system. It would ease people's doubt if the Administration is able to confirm that this is in fact the main spirit of the said legislation.

The opportunity for further clarification to be made is in the Inland Revenue Department's practice notes. It is appreciated that the practice notes are internal documents used as guidelines by departmental staff, and the final interpretation of the legislation is a point of law and therefore rest with the courts. Yet realising that considerable cost and time is needed in bringing a case before court, few parties are keen to pursue this course of action unless there is no other viable option. Under these circumstances, practice notes are studied with a very fine comb, and given a status by the professionals and business community which is perhaps higher than originally intended by the Inland Revenue. The fact of life is practice notes are considered to be the rules of the game. If the rules are not clear, or the rules are not seen as fair and equitable, then the prudent businessmen simply will not play the game. On the other hand, if the rules are perceived to reflect the actual law, both in letter and in spirit, then the confidence of the businessmen will be enhanced, and the creditability and reputation of Hong Kong Government will be further strengthened both locally and internationally. This present Bill has regained some confidence of the business community. However, the proof of the pudding is in the eating. The practice notes are the first stage of the eating process. If the business community perceives and accepts these notes as reasonable, equitable and clear, then any lingering doubts about the intentions of the Administration for enacting this anti-tax-avoidance legislation can be effectively removed.

Sir, with these remarks, I support the motion.

FINANCIAL SECRETARY: Sir, I wish to thank Mr. Peter POON and Mrs. Rita FAN for their speeches this afternoon and to extend to them in particular and their colleagues on the UMELCO committee in general my gratitude for the constructive and professional approach which they have adopted towards this Bill. Mr. POON has referred to the consultative process involved during the scrutiny of the Bill. I echo his sentiments. The Bill has been subject to the closest

examination since it was first published last July and substantial amendments have been introduced in response to the many representations made to UMELCO and the Administration by the business community and professional associations. This has clearly demonstrated the effectiveness of the consultative process and the increasingly important role that Unofficial Members are playing in examining new legislation.

I agree with Mr. POON that the Bill represents a reasonable balance between the need on the one hand to increase the powers available to the Commissioner of Inland Revenue to combat tax avoidance and on the other to ensure that there are sufficient safeguards to protect the legitimate interests of taxpayers. Of course, everyone is entitled within the law so to arrange his affairs that he attracts the minimum tax. Equally it would be a foolish and irresponsible administration that did not seek to block obvious loopholes in the laws as they appear—and appear they have and always will. From time to time, therefore, it is our job to take steps to protect the revenue. Otherwise taxes will have to be increased. This would obviously be inequitable to the large majority.

Both Mrs. FAN and Mr. POON have referred to the need to produce clear and concise practice notes as soon as possible. I can confirm that the commissioner expects to issue his practice notes covering this new legislation shortly, hope-fully before the end of April. He assures me that they will be designed to reflect the law both in letter and in spirit. I can also confirm for Mrs. FAN's benefit that sections 61A and B will only be used to strike down blatant and contrived schemes where there is a clear and dominant tax avoidance purpose. It is not the intention to use the law to penalise genuine commercial transactions.

I turn now to the amendments to clause 4 of the Bill which I propose to move during the Committee stage. These relatively minor amendments to section 16(2)(f) comprise three refinements to the proposed extension of the conditions under which interest paid by corporations will be deductible for profits tax purposes. The most important of these is the amendment to section 16(2)(f)(iii). This will extend deductibility to interest paid where the money borrowed originated in the issue by an associated corporation of marketable, albeit unlisted, 'commercial paper'. This is a logical refinement to the extension to section 16(2) proposed in the Bill and should help foster Hong Kong's position as a major financial centre.

The other refinements are minor changes designed to ensure that the section can apply to issues by corporations whose ordinary business is not the raising of funds and to treat equally issues which are marketable in approved financial centres with those which are marketable in Hong Kong.

In conclusion may I repeat my gratitude for the support received from the experienced UMELCO ad hoc committee, which was set up to consider this inevitably contentious Bill. Both they and the public at large are wise enough not to be unduly perturbed by the snarling of various vested interests as they prowl through the jungles of our tax law. I think that the final outcome from

a major consultative process is a sane and moderate compromise that serves the interests of the whole community.

*Question put and agreed to.*

Bill read the Second time.

*Bill committed to a Committee of the whole Council pursuant to Standing Order 43(1).*

## **REGIONAL COUNCIL (AMENDMENT) BILL 1986**

### **Resumption of debate on Second Reading (5 February 1986)**

MR. CHEUNG (in Cantonese): Sir, I rise to support the passing of the Regional Council (Amendment) Bill 1986.

The Regional Council will be formally established in April this year. In order that the council can operate effectively following its establishment, certain amendments should be made to the present Regional Council Ordinance. The purpose of introducing the Bill to this Council at present is to make amendments. The Provisional Regional Council has been established for 11 months since April last year. During this period, many people, particularly those residents in the New Territories, cannot clearly understand the work and terms of reference of the Provisional Regional Council and some NT villagers even mix up the work of the Provisional Regional Council with that of district boards. All these are due to the close resemblance of the Chinese names of the Regional Council (區域議局) to that of the 'district board' (區議會). There is a Chinese saying: 'Only if the name is correctly given can the business be successfully discharged'. If the nomenclature of the two bodies should lead to the general public's misunderstanding of the work of the Provisional Regional Council, the discharging of the council's duties will definitely be hampered to a certain extent.

The Provisional Regional Council is mainly responsible for the municipal services of the New Territories. In fact, its executive arm was retitled as 'Regional Services Department' (區域市政署) in April last year. It is, therefore, most appropriate to change the Chinese name of the Regional Council to be established in coming April as 區域市政局. This new Chinese title will not only avoid unnecessary confusion with the Chinese name of 'district boards', but also accurately reflects the close resemblance of the Regional Council and the Urban Council in the nature and province of their work. This will contribute greatly to helping those people whom the Regional Council will serve—the general public in the NT—to understand the council's work and its services. Furthermore, the