

Bills Committee on Inland Revenue (Amendment) Bill 2000**Summary of deputations' concerns***(Covering deputations who have agreed to release their submissions to the public)***(as at 29 January 2001)**

Section/Subject	Organization (Paper No.)	Concerns	Suggestions
1. Section 12 Self-education expenses	The Taxation Institute of Hong Kong <i>LC Paper No. CB(1)248/00-01 (03)</i>	Welcome Government's proposal to expand the scope of the definition of "expenses of self-education". It may be difficult for taxpayers to satisfy or prove "for use in any employment" when they incur the expenses. Under the proposed amendment, a "prescribed course of education" includes a training or development course provided by a trade, professional or business association for its "members". The definition of "members" requires clarification. The related fees in respect of revision courses are not taken care of.	
2. Section 15 Royalty income	The Association of Chartered Certified Accountants <i>LC Paper No. CB(1)248/00-01 (02)</i>	Section 15(1)(ba) The proposed amendment: <ul style="list-style-type: none">- has altered the traditional territorial concept of taxation; and- will create uncertainty as to whether expenses relating to the use of intellectual properties are non-deductible.	

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<p>2. Section 15 Royalty income (Cont'd)</p>	<p>The Taxation Institute of Hong Kong <i>LC Paper No. CB(1)248/00-01 (03)</i></p>	<p>Section 15(1)(ba) The proposed amendment will set a bad precedent of explicitly violating the territorial based taxation principle of Hong Kong's tax system. The business community will be uncertain as to whether the Government is considering to deviate from the territorial concept and deem other offshore income as taxable in Hong Kong, thereby creating unfair tax treatment for some taxpayers. The place where an intellectual property is used is a matter of fact which cannot be changed just because it has been used for producing profits chargeable to Hong Kong tax. The logic adopted by the Administration is wrong.</p>	<p>It would do less harm to put the legislation under Section 17(1) to disallow the deduction for the royalty payments if the income is not subject to Hong Kong tax.</p>
	<p>Hong Kong Society of Accountants <i>LC Paper No. CB(1) 248/00-01 (04)</i></p>	<p>The proposed new Section 15(1)(ba) appears to be inconsistent with the fundamental principle of "source" in the Hong Kong tax regime because it may make the recipient of royalty taxable in situations in which that person is charging the royalty for activities conducted (almost) exclusively outside Hong Kong.</p>	

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<p>2. Section 15 Royalty income (Cont'd)</p>	<p>Hong Kong Society of Accountants <i>LC Paper No. CB(1) 248/00-01 (04)</i> (Cont'd)</p>	<p>Section 15(1)(ba) The principle of "symmetry" between taxability and deductibility, which is introduced explicitly by the Bill, does not currently constitute part of Hong Kong's framework of taxation. This would represent a policy change and would create uncertainty amongst Hong Kong and non-Hong Kong companies. The direct linkage between taxability and deductibility, even if accepted, is not being applied consistently in this provision. Under Section 15(1)(b) no reference is made to deductibility.</p>	
	<p>Hong Kong Bar Association <i>LC Paper No. CB(1) 351/00-01</i></p>	<p>Section 15(1)(ba) The estimated loss in revenue of \$200 million per annum may be overstated. The pursuit of symmetry is misguided. The test should remain whether the payments are made in the production of assessable income. The proposal will deter the use of technology, is likely to impede Hong Kong's role as a service centre. The proposal may give rise to double taxation where royalty payments are made between group companies. While the subsidiary receives no relief, the parent or sister company will be assessed upon the income. This will create an impetus for multinational companies to restructure operations to avoid using Hong Kong as a base.</p>	

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<p>3. Section 16</p> <p>Deduction of interest expenses</p>	<p>The Association of Chartered Certified Accountants</p> <p><i>LC Paper No. CB(1)248/00-01 (02)</i></p>	<p>The proposal under Section 16(2)(e)(D) will result in additional business cost to taxpayers and increase the credit risk of banks.</p> <p>The proposal under Section 16(2)(f) ignores the fact that most of the issues (of debentures or marketing instruments) are for genuine fund raising, and discourages sound financial management.</p>	<p>Allowance should be granted to that part of the interest attributable to holdings by third parties.</p>
	<p>The Taxation Institute of Hong Kong</p> <p><i>LC Paper No. CB(1)248/00-01 (03)</i></p>	<p>Section 16(2)</p> <p>The proposed amendment will not only stop the perceived abuse in the tax-avoidance arrangements, but also unnecessarily hinder genuine business transactions and create unnecessary hardships for businesses to consider cost-effective sources of finance.</p> <p>It will also significantly reduce Hong Kong's attractiveness to be a debt capital market.</p> <p>There will be significant restrictions as to the persons who can participate in debt instruments issued by Hong Kong businesses, thereby increasing their financing costs.</p> <p>Section 16(2)(f)(iii)(A)</p> <p>The definition of "associate" is too wide. Taxpayers will find it extremely difficult to keep track and ensure that no associate has had at any point in time been entitled to any sum payable by way of interest from any loan instrument issued.</p> <p>The absence of mechanism of apportionment of interest expenses for deduction purpose will be very unfair to taxpayers.</p> <p>The term "entitled" requires clarification.</p>	

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<p>3. Section 16 Deduction of interest expenses (<i>Cont'd</i>)</p>	<p>The Taxation Institute of Hong Kong <i>LC Paper No. CB(1)248/00-01(03)</i> (<i>Cont'd</i>)</p>		<p>Specific terms similar to the current proposed amendments may be incorporated into Section 61A. A "motive" or "purpose" test should be included in the relevant provisions.</p> <p>Alternatively a discretionary power can be given to the Commissioner of Inland Revenue to disregard the operative provisions to avoid the denial of interest expenses incurred under genuine commercial loan or financing transactions.</p>

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<p>3. Section 16 Deduction of interest expenses (Cont'd)</p>	<p>WOO, KWAN, LEE & LO <i>LC Paper No CB(1) 248/00-01 (06)</i></p>	<p>The Government is overreacting. The Bill, in its present form, will result in:</p> <ul style="list-style-type: none"> - genuine interest expense incurred by a business being disallowed; - a taxpayer being unable to ascertain whether it can or will satisfy the conditions required for interest expense to be deductible; - increase the cost of borrowing by Hong Kong corporations; and - lending to Hong Kong corporations becoming less attractive to financial institutions. 	<p>Government should rely on Section 61 and 61A, the general anti-avoidance provision, where there are abuses.</p>
	<p>Hong Kong Society of Accountants <i>LC Paper No. CB(1) 248/00-01 (04)</i></p>	<p>It seems unfair and against the spirit of Section 16(2)(f) to deny a deduction for any interest paid to unrelated parties simply because some portion of the debentures are held by associates. Sometimes, it is beyond an issuer's control to prevent an associate acquiring debentures.</p> <p>There may be valid commercial reasons why an issuer or an associate may wish to buy some part of a debenture or bond issue.</p> <p>The proposal will have an adverse impact on Hong Kong's image as a commercial centre and will undermine the efforts to develop the debt market.</p>	<p>Consideration can be given to strengthening the existing anti-avoidance provisions under Section 61A to target more effectively the particular form of abuse involved.</p>

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<p>3. Section 16 Deduction of interest expenses (Cont'd)</p>	<p>Hong Kong Society of Accountants <i>LC Paper No. CB(1) 248/00-01 (04)</i> (Cont'd)</p>	<p>Section 16(2)(d) The current drafting appears to be too broad-brush and unclear in its meaning.</p> <p>Section 16(2)(e) There should be clarification as to the justification for expanding the restrictions under the section.</p> <p>Section 16(2)(d) & (e) The Bill seeks to extend the conditions that attach to borrowings secured or guaranteed by deposits to arrangements involving loans. It is not apparent in what sense the money borrowed could be said to be secured by a loan.</p>	<p>There should be a de minimis exemption for this provision i.e. any interest disallowance should only apply where more than a certain percentage of the issue is in the hands of associates.</p> <p>The disallowance should apply only in respect of that interest actually paid to associates.</p> <p>Consideration can be given to extending the definitions of "debentures" and "instrument" to tradable interests in global notes.</p>

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<p>3. Section 16</p> <p>Deduction of interest expenses (Cont'd)</p>	<p>The Hong Kong Association of Banks</p> <p><i>LC Paper No. CB(1) 274/00-01</i></p>	<p>Section 16(2)(f)</p> <p>The proposed amendments can have a detrimental effect on the debt capital markets in Hong Kong by denying a tax deduction for all interest payments made by a Hong Kong note issuer in circumstances where any of the note holders are "associates" of the issuer.</p> <p>Section 16(2)(d)</p> <p>The proposed amendments in para (i) of sub-section (d) are aimed at attacking sub-participation arrangements which are structured so as to permit interest on a borrowing to flow to an associate of the borrower, whereas para (ii) is aimed at attacking back-to-back loans where the customer's borrowing is secured or guaranteed by a deposit or loan. The inter-relationship between these two paragraphs needs to be clarified. This is because a sub-participation which is effected on commercial terms, does not involve an associate and is therefore acceptable under para (i) may nevertheless constitute a "deposit" or "loan" and may therefore fall foul of para (ii).</p> <p>Para (ii) will deny an interest deduction even if the interest on the deposit or loan ultimately flows to an unrelated person.</p>	

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<p>3. Section 16 Deduction of interest expenses (Cont'd)</p>	<p>The Hong Kong Association of Banks <i>LC Paper No. CB(1) 274/00-01</i> (Cont'd)</p>	<p>The proposed amendments will impact on the type of security (e.g. US government treasury bills) that borrowers can offer to banks for their facilities and will therefore make it more difficult for borrowers to raise legitimate funds in a manner that would entitle them to tax deductions.</p>	<p>It will be appropriate for para(ii) to apply only if the person entitled to receive the tax-free interest on the deposit or loan is an associate of the borrower. This will be sufficient to curb abuses without impacting on genuine commercial arrangements.</p>
	<p>Hong Kong Bar Association <i>LC Paper No. CB(1) 351/00-01</i></p>	<p>Section 16(2)(f) The present draft debars deduction even where only one of the holders of the debentures or instruments is an "associate". The proposed changes will cause particular problems for market makers who will find considerable difficulty in avoiding completely the involvement of associates.</p>	<p>Apportionment should be available where the debenture holders comprise both associates and non-associates. This can be done on a pro rata basis.</p>

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<p>3. Section 16 Deduction of interest expenses (Cont'd)</p>	<p>Hong Kong Bar Association <i>LC Paper No CB(1) 351/00-01</i> (Cont'd)</p>	<p>There are no transitional provisions. Interest accrued prior to the commencement of the amendments and becoming payable after commencement will be caught thereby giving the section retrospective effect.</p>	<p>Section 61A has generally been effective against tax avoidance arrangements which have no commercial purpose.</p> <p>It will be better to retain relative simplicity in the legislation and to rely upon the general anti-avoidance principles to control avoidance.</p>
	<p>Capital Markets Tax Committee Of Asia <i>LC Paper No. CB(1) 366/00-01</i></p>	<p>Section 16(2)(f)</p> <p>There may be genuine commercial reasons why a portion of a note issue (debenture and instrument) may be held by associates of the issuer. The proposed amendments will make Hong Kong less attractive as a debt market centre.</p> <p>The market practice now is invariably for a fund-raising to be documented by way of a single "global note" which is lodged with an independent depository. Under this arrangement, every investor is effectively a beneficial part-holder of the global note. The result of the Bill will be that the issuer will be denied a deduction for the whole of the interest that it pays on that global note.</p> <p>A "proportionality" approach is unviable. The difficulty is that in most cases involving a wide issue of notes, the issuer will not know who the note-holders are.</p>	

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<p>3. Section 16</p> <p>Deduction of interest expenses (Cont'd)</p>	<p>The Real Estate Developers Association of Hong Kong</p> <p><i>LC Paper No CB(1) 510/00-01</i></p>	<p>Section 16(2)(e)&(f)</p> <p>The ability of financial institutions to transfer their loans to third parties in the ordinary course of their business will be curtailed by the proposed amendments.</p> <p>The term "associates" is defined so loosely that genuine borrowings may be caught within its ambit. This will undermine the flexibility currently enjoyed by companies in employing different types of financial instruments in their fund-raising activities.</p> <p>It will be difficult for borrowers to comply with the law, as the lending banks are under no obligation to disclose to them if and how their loans have been transferred.</p> <p>It is not wise to tamper with the simple and efficient tax system which is commonly accepted to be a major factor contributing to the success of Hong Kong. A "total disallowance" approach may disallow the interest costs arising from genuine fund-raising activities.</p>	<p>Section 61A may be strengthened with a "motive" factor such that abusive practices may be combated head-on without affecting genuine business activities.</p>
<p>4. Section 26E</p> <p>Home loan interest deduction</p>	<p>The Association of Chartered Certified Accountants</p> <p><i>LC Paper No. CB(1) 248/00-01 (02)</i></p>	<p>The proposed amendment is welcomed.</p> <p>The retrospective application of the proposed amendment should not be used as a precedent for making retroactive amendments in the future.</p> <p>The provisions are difficult to comprehend and there are too many unnecessary limitations in the application.</p>	

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5. Section 68 Power of Board of Review to award costs	Hong Kong Society of Accountants <i>LC Paper No.</i> <i>CB(1) 248/00-01(04)</i>	The potential costs should not be set at such a level as to discourage good faith applications to the Board.	The Administration should give an assurance that the proposed changes will not encourage frequent reviews and regular increases in the ceiling figure.
	Hong Kong Bar Association <i>LC Paper No.</i> <i>CB(1) 351/00-01</i>	The amendments are practical and reflect an approach adopted elsewhere in the Laws of Hong Kong.	

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