

JOINT LIAISON COMMITTEE ON TAXATION

CONSTITUENT MEMBERS: THE AMERICAN CHAMBER OF COMMERCE
THE GENERAL CHAMBER OF COMMERCE
THE HONG KONG SOCIETY OF ACCOUNTANTS
THE INTERNATIONAL FISCAL ASSOCIATION - HONG KONG BRANCH
THE LAW SOCIETY OF HONG KONG
THE TAXATION INSTITUTE OF HONG KONG

14th Floor, Hutchison House, 10 Harcourt Road, Hong Kong

Telephone: 2846 1816

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1 December 2003

The Clerk to the Bills Committee
Legislative Council Secretariat
3/F Citibank Bank Tower
3 Garden Road
Central
Hong Kong

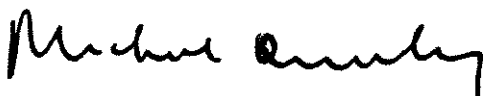
Attention: Mr Matthew Loo

Dear Sir,

Inland Revenue (Amendment) Bill 2000 -
Comments on proposed amendments

We refer to your invitation to the public to make submissions concerning proposed amendments to the Inland Revenue (Amendment) Bill 2000. In accordance with your request, we enclose a copy of our letter to the Secretary for Financial Services & The Treasury concerning the amendments, and we hope you find these useful. If you have any questions or require any further information, please call me at 2846 1716.

Yours sincerely,



Michael Olesnicky
Chairman,
for and on behalf of the
Joint Liaison Committee on Taxation

cc: Mrs Alice Lau, Commissioner for Inland Revenue

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28 November 2003

Mr Frederick Ma
Secretary for Financial Services & The Treasury
8/F Central Government Offices
West Wing, Lower Albert Road
Central
Hong Kong

Dear Mr Ma,

Inland Revenue (Amendment) Bill 2000 - Comments on proposed amendments

The Joint Liaison Committee on Taxation has reviewed the amendments to the Bill that have been proposed by you. Because we had made submissions to government with respect to the original bill, we thought it appropriate to write to you with our comments on the proposed revisions.

We appreciate that the process of reviewing and amending the Bill has been long and thorough, and we appreciate the willingness of the Administration to solicit comments from wide-ranging sources and to propose amendments to meet the concerns that were expressed with respect to the original Bill. Indeed, except in respect of one particular issue, we note that the previous concerns that we expressed have all been addressed by the proposed amendments.

That one issue concerns our proposal for a "safe harbour" or "de minimis" exemption in the case where listed debentures of marketed notes are held by an affiliate of the issuer thereof. In the case of large groups, particularly multinational groups who carry on financial services (such as banks and securities firms), it is almost inevitable that affiliates will from time to time buy paper issued by their group's companies from time to time in the course of their normal trading or market-making activities. It would be incredibly complicated, and in many cases probably impossible, for such groups to monitor the activities of all their worldwide affiliates, particularly where such paper is bought and sold within a short time frame in the course of short-term trading activities. Because of this, a taxpayer who claims a deduction for interest paid on its listed debentures or marketed notes would not always know

Joint Liaison Committee on Taxation

- (a) whether any of its debentures or marketed notes have been held by affiliates, and
- (b) if so, the quantum of such debentures held, since the amount may vary from day to day

and therefore would not be in a position to compute whether any portion of its interest expense should be reversed out of its tax computations filed with its profit tax returns.

The concern here is one of compliance. Multinational groups would be required to establish elaborate compliance procedures to monitor such holdings by their affiliates, if indeed that is possible. We had therefore suggested that an additional exemption be permitted from the interest disallowance provisions, such as (i) a holding by an affiliate where the holding is pursuant to the affiliate's genuine market-making activities (which entails that such notes would be held for very short periods of time); or alternatively (ii) a threshold whereby up to 5% of the debentures or notes on issue could be held by affiliates without triggering any interest disallowance.

In our view, the former would be preferable because it ensures relatively easy compliance, because the issuer can assume that any debentures or notes held by affiliates would fall within such exemption. The latter is less desirable because it would still require the establishment of elaborate monitoring procedures, although many groups could perhaps take the position that it is most unlikely that the 5% threshold would ever be reached in the normal course of trading activities by their affiliates, and therefore elaborate monitoring would not be required. (Others might not be willing to make such an assumption and would still need to establish monitoring procedures.)

Another alternative would simply be to give the Commissioner of Inland Revenue a statutory discretion to ignore small holdings where she is satisfied that the holding arises from genuine trading or market-making activities and not pursuant to an arrangement to secure interest deductions for interest paid by an issuer of debentures or marketed notes to its affiliates.

We would invite the Bills Committee to explore this issue again, because it is a point of genuine concern to many banking and investment groups.

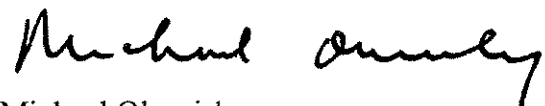
We have no comment on the other proposed amendments to the Bill, which reflect the submissions that have been made and do not give us concern.

On a separate issue, we note a technical point that the Bill could arise in a loss of deductions for interest paid to a bank where the taxpayer holds separate deposits with a bank. In such a case, the bank technically has a common law right to offset the taxpayer's liability under the loan against the amount held for the taxpayer on deposit. We understand that the Commissioner has indicated that she will issue a Departmental Interpretation & Practice Note that will make it clear that interest may continue to be deducted in such circumstances so long as the taxpayer has the ability to lift the deposit at any time (thus "de-linking" the loan from the deposit). In these circumstances, we see no reason to delay the enactment of the Bill by making further amendments to provide for this particular issue.

Joint Liaison Committee on Taxation

If you have any questions, please call me at 2846 1716.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Michael Olesnicky". The signature is written in a cursive style with a large initial "M".

Michael Olesnicky
Chairman,
for and on behalf of the
Joint Liaison Committee on Taxation

cc: Mrs Alice Lau, Commissioner for Inland Revenue

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