

Information Note
Legislative Council Panel on Financial Affairs
Special Meeting on 19 June 2001

Bank of China (Hong Kong) Limited (Merger) Bill

Introduction

1. This note informs Members of the Administration's views on the Bank of China (Hong Kong) Limited (Merger) Bill (the Bill).

General

2. The Administration is of the view that the Bill relates to Government policies for the purpose of Article 74 of the Basic Law. The Chief Executive has given consent for the Bill to be introduced into the Legislative Council. Specifically, the Bill relates to policies in respect of –

- (a) bank merger;
- (b) issue of legal tender notes; and
- (c) taxation.

Bank merger

3. The Bill seeks to provide for the merger of the Hong Kong Branches of eight mainland incorporated banks, a locally incorporated bank, the Shenzhen branches of two mainland incorporated banks with Po Sang Bank Limited (Po Sang), a locally incorporated bank. It also provides for the transfer of shares held by Bank of China (BOC) in two locally incorporated banks and a locally incorporated credit card subsidiary company to Po Sang. At the appointed time, Po Sang will change its name to Bank of China (Hong Kong) Limited.

4. In view of the above, the Bill relates to government policy on bank mergers. It is the Government's policy to support consolidation of the banking sector in Hong Kong, which should improve its competitiveness and contribute to systemic stability in the longer term. As part of this policy, the Administration tries to promote and facilitate bank mergers where reasonable proposals are submitted for consolidation. This is, however, always subject to the overriding aim to promote the

stability of the banking system and to provide an appropriate degree of protection to depositors in the merged institutions and to depositors generally.

5. As regards this particular case, the Administration considers that the proposed merger will help promote stability of the banking sector. HKMA's supervision of the merged entity should also become more effective after the merger.

Issue of legal tender notes

6. Bank of China is a note-issuing bank. The intention of the Bill is to appoint the merged entity (i.e. Po Sang) as a note-issuing bank in place of BOC at the appointed time. Clause 6(2) of the Bill sets out the rights and obligations that Po Sang will assume in the event that it is authorized as a note-issuing bank. In brief, all the BOC bank notes issued at that time will continue to be legal tender notes and Po Sang, at and from the appointed time, shall have the power to produce, store, distribute and issue in the name of BOC bank notes using the same designs and in the same denominations as BOC was authorized to issue.

7. The Government's policy is to ensure that any succession of note-issuing bank should be smooth and conducive to maintaining public confidence in the notes of the bank. Further, the matters referred to in clause 6(2) are governed by existing government policies reflected in the Legal Tender Notes Issue Ordinance (Cap 65) and the Exchange Fund Ordinance (Cap 66). In the present case, we are satisfied that the proposed arrangements would be seamless and would maintain the public's confidence in the BOC bank notes.

Taxation

8. The Bill, as currently drafted, contains several clauses (namely, clauses 2(3), 5, 9 and 10) which have the effect of deeming the surviving entity as one and the same as all the merging entities; requiring the surviving entity to undertake all the rights, obligations and liabilities of the merging entities; and allowing the surviving entity, for tax assessment purposes, to carry forward any losses accumulated by any of the merging entities.

9. Section 19C(4) of the Inland Revenue Ordinance, which governs the set-off of losses incurred by a corporation, provides that where a corporation in any year of assessment sustains a loss in that trade, the

amount of that loss shall be set off against the assessable profits of the same corporation for that year of assessment, and to the extent not so set off, shall be carried forward and set off against the same corporation's assessable profits for subsequent years of assessment. In other words, this is a specific provision against loss set-off between separate corporations. The clear legal effect is that when a corporation is liquidated or ceases to exist upon merger, the loss it incurred would lapse.

10. The Government's policy is to have regard to the status of the surviving entity under operation of law (whether foreign or local) when deciding whether or not the surviving entity may carry forward the assessed losses of the merging entities.

11. As the Bank of China (Hong Kong) Limited (Merger) Bill deems the surviving entity as one and the same as the merging entities and if the Bill is enacted, the Government would implement the provisions in the enacted Ordinance, including allowing the surviving entity, for tax assessment purpose, to carry forward any losses accumulated by any of the merging entities, in accordance with Section 19C(4) of the Inland Revenue Ordinance.

12. The same would apply to other merger bills, if they carry similar provisions deeming the surviving entity as one and the same as the merging entities, and if the bills are enacted by the Legislative Council. The same would also apply if the surviving entity is domiciled in a jurisdiction where the law deems the surviving entity as one and the same as the merging entities (e.g. the legal concept of universal succession which many civil law countries in Europe have adopted). Then applying the principle under private international law, the Government must accept this status of the surviving entity. And in accordance with the provisions in section 19(C)(4) of the Inland Revenue Ordinance, the surviving entity would be allowed to carry forward the assessed losses of the merging entities for tax assessment purposes.