

**President's ruling on
Bank of China (Hong Kong) Limited (Merger) Bill
proposed by Dr Hon David LI Kwok-po, JP**

I have been requested by Dr Hon David LI to rule whether his proposed Bank of China (Hong Kong) Limited (Merger) Bill, which he intends to introduce into this Council, relates to the restrictions prescribed in Rule 51(3) and (4) of the Council's Rules of Procedure. Before making a ruling on the Bill, I have invited the Secretary for Financial Services (SFS) to offer his comments and Mr LI to offer his response. I have also sought the advice of Counsel to the Legislature.

Rule 51(3) and (4) of the Rules of Procedure

2. Rule 51(3) and (4) reads as follows:

"51(3) Members may not either individually or jointly introduce a bill which, in the opinion of the President, relates to public expenditure or political structure or the operation of the Government."

"51(4) In the case of a bill which, in the opinion of the President, relates to Government policies, the notice shall be accompanied by the written consent of the Chief Executive in respect of the bill."

Purpose of the Bill

3. The Bill seeks to provide for the merger of the Hong Kong Branches of eight Mainland incorporated banks including the Hong Kong branch of Bank of China; a locally incorporated bank; and the Shenzhen branches of two mainland incorporated banks, with Po Sang Bank Limited (Po Sang) which is a locally incorporated bank. It also provides for the transfer of shares held by Bank of China in two locally incorporated banks and a locally incorporated credit card subsidiary company to Po Sang. Under the Bill, Po Sang will change its name to Bank of China (Hong Kong) Limited (BOC(HK)). Subject to the Financial Secretary's authorization (with the approval of the Chief Executive in Council) under the Legal Tender Notes Issue Ordinance (Cap. 65), Po Sang will become a note-issuing bank in place of Bank of China, with the power to produce, store, distribute and issue bank notes in the name of Bank of China.

The Administration's views

4. SFS is of the view that the Bill relates to Government's policies on bank merger, issue of legal tender notes, taxation, and control of tenancies.

(a) Bank merger

SFS advises that it is 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.

(b) Issue of legal tender notes

SFS advises that currently Bank of China is a note-issuing bank. The intention of the Bill is to appoint the merged entity (i.e. Bank of China (Hong Kong) Limited) ("BOC(HK)") as a note-issuing bank in place of Bank of China at the appointed time. Clause 6(2) of the Bill sets out the rights and obligations that BOC(HK) will assume as a note-issuing bank. 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).

(c) Taxation

According to SFS, clauses 2(3), 5, 9 and 10 of the Bill 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. The practical effect of these clauses is to override the provision in section 19C(4) of the Inland Revenue Ordinance (IRO) regarding prohibition of

group loss relief, i.e. the tax relief available between a holding company and its wholly owned subsidiaries, and between wholly owned subsidiary companies, irrespective of whether ownership is direct or indirect. This can be achieved by allowing losses (either current or brought forward) of one or more group companies to be deducted from profits of other group companies.

SFS states that section 19C(4) of the IRO 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. The Government's policy is to disallow group loss relief (as governed by section 19C(4) of IRO) unless it is specifically approved by law enacted by the Legislative Council and signed by the Chief Executive. The Bill, with its said provisions for group loss relief, thus relates to this policy.

(d) Control of tenancies

Under Clause 18(1)(a) and (b) of the Bill, the vesting and deemed vesting in BOC(HK) of an interest in land by virtue of the enacted Ordinance shall not:

- (i) constitute an acquisition, disposal, assignment, transfer or parting with possession of that interest for the purposes of sections 53(4)(a) or 7(a), 119E(2) or 119H(1)(a) of the Landlord and Tenant (Consolidation) Ordinance (Cap. 7) (LTCO); or
- (ii) constitute an assignment or underlease of, or an agreement to assign or underlet, that interest for the purposes of section 6(1)(b) of LTCO.

SFS considers that these provisions, if enacted, will have the effect of amending the application of those sections of LTCO referred to therein; the latter may otherwise apply but for the enactment of these provisions. Hence, they relate to government policy as reflected in the said sections of LTCO.

Response from Dr Hon David LI

5. Mr LI has advised that he has no objection to the Administration's views.

Advice of Counsel to the Legislature

6. Counsel to the Legislature advises that the Bill would have a substantive effect on Government's policies on bank merger, issue of legal tender notes, and control of tenancies in view of the respective provisions on the regulation of banks as reflected in the Banking Ordinance, the Legal Tender Notes Issue Ordinance, the Exchange Fund Ordinance, and the Landlord and Tenant (Consolidation) Ordinance.

7. As regards SFS's view that the Bill relates to Government's policy on taxation, Counsel to the Legislature advises that section 19C(4) of IRO provides that where in any year of assessment a corporation carrying on a trade, profession or business sustains a loss in that trade, profession or business, the amount of that loss shall be set off against the assessable profits of the corporation for that year of assessment, and to the extent not so set off, shall be carried forward and set off against the corporation's assessable profits for subsequent years of assessment. The effect of this provision is to enable an incorporated or registered company (as opposed to a group of associated companies) to set off any of its loss carried forward to subsequent years of assessment against the assessable profits for those years.

8. Under clause 10(1) of the Bill, BOC (HK) would be treated as if it were the continuation of and the same person in law as the merging banks for the purposes of IRO. By virtue of this provision, BOC(HK) would be able to qualify under section 19C(4) of IRO to claim set-off of loss which may have been incurred by merging banks against profits of BOC(HK). Clause 10(2)(b) makes it beyond doubt that this would be the case by deeming the aggregate amount of losses of the merging banks not yet set-off to be losses of BOC(HK) and available for set off against the assessable profits of BOC(HK).

9. Counsel to the Legislature agrees that clauses 2(3), 5, 9 and 10 of the Bill relate to Government policies. However, the policy in question as reflected in section 19C(4) of IRO, that is to provide tax relief to qualified persons or corporations by allowing loss set-off under specified conditions, rather than (as stated by SFS) a policy of prohibiting "group loss relief", which is not apparent from section 19C(4).

My opinion

10. Having considered the advice of Counsel to the Legislature in the light of SFS's views on the proposed Bill, and having regard to Mr LI's advice that he has no objection to the Administration's views, I am satisfied that the

Bill relates to Government's policies on the regulation of banks, the set-off of losses against profits of corporations, and the control of tenancies, as reflected in the relevant legislation.

Ruling

11. I rule that the Bank of China (Hong Kong) Limited (Merger) Bill relates to Government policy within the meaning of Rule 51(3) and (4) of the Rules of Procedure and requires the written consent of the Chief Executive for its introduction.

(Mrs Rita FAN)
President
Legislative Council

25 May 2001