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LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

Inland Revenue (Amendment) (No. 4) Bill 2015

INTRODUCTION

At the meeting of the Executive Council on 1 December 2015, the Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue (Amendment) (No. 4) Bill 2015 ("the Bill"), at **Annex**, should be introduced into the Legislative Council ("LegCo") to enhance the existing interest deduction rules for the intra-group financing business of corporations, introduce a concessionary profits tax rate for qualifying corporate treasury centres ("CTCs")[1], and clarify the profits tax and stamp duty treatments in respect of regulatory capital securities ("RCSs") issued by banks in compliance with Basel III capital adequacy requirements.

JUSTIFICATIONS

(A) Revised tax rules for CTC operations

2. In recent years, more multinational corporations are looking to Asia to establish global and regional CTCs, given the expansion of their business in Asia (particularly China) as a key growth and revenue-generating market. The external volatility in the global financial environment has generated greater demands for these corporations to centralise more efficiently their groups' treasury management of liquidity and risks, as well as hedging transactions. These CTCs have to be strategically located to cater for business, cost and tax considerations, ideally in a financial centre which can

[1] In essence, a CTC is an "in-house bank" within a multinational corporation focusing on the optimal procurement and usage of capital for the operations of the entire group. Typical CTCs perform the functions of intra-group financing, optimising multi-currency cash management and liquidity management, cash pooling, central or regional processing of payments to vendors or suppliers for the corporate group, conducting transactions for financial or treasury-related risk management, and supporting the raising of external capital by the group.

provide corporate treasurers with excellent financial, banking and professional services, as well as deep capital markets for liquidity and portfolio management.

3. Hong Kong is Asia's premier location for business and treasury management. In terms of strengths as a business location, a growing number of multinational corporations have set up their regional headquarters, regional offices, or local offices in Hong Kong. As an international financial centre, Hong Kong offers an extensive banking network, deep capital markets, robust financial infrastructure, and effective professional services crucial for corporations to establish their regional CTCs and expand their business presence in Asia. A unique advantage of Hong Kong is its proximity to the Mainland and its status as the premier offshore Renminbi ("RMB") centre, with a deep offshore RMB bond market, and critical market infrastructure in settlement and pricing for managing treasury transactions denominated in RMB. Enhancing Hong Kong's global competitiveness in attracting corporate treasury activities will help strengthen Hong Kong's position as a major platform for Mainland enterprises to go global and for multinational corporations to manage liquidity for operations on the Mainland and in the region. If more CTCs are established in Hong Kong, this will contribute to the development of headquarters economy, and the Belt-Road initiative by facilitating multinational or Mainland corporations to raise funds and manage financial resources and risks through Hong Kong.

4. We have examined whether Hong Kong's taxation framework is conducive to attracting corporate treasury activities. Our low and simple tax regime (with no interest withholding tax, and no tax on dividends and capital gains), together with our established network of signed agreements with trading partners to avoid double taxation[2], is favourable for multinational companies to operate their CTCs in Hong Kong. That said, our profits tax regime has yet to make provisions customised for CTC operations. Some market players and corporate treasurers have perceived that our interest deduction rules in the Inland Revenue Ordinance ("IRO") are relatively less favourable for multinational corporations to engage in intra-group borrowing and lending of funds with other associated corporations outside Hong Kong[3].

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[2] As in November 2015, Hong Kong has signed 33 comprehensive avoidance of double taxation agreements with our trading partners.

[3] At present, under section 16(2) of the IRO, if a corporation obtains a loan from a non-financial institution in the ordinary course of its intra-group financing business, the interest expense is deductible if the corresponding interest income of that non-financial institution is chargeable to Hong Kong profits tax. From the perspective of CTCs located in Hong Kong engaging in an intra-group financing business, its interest expense payable to associated corporations outside Hong Kong (being non-financial institutions whose profits are not subject to Hong Kong tax) is currently not deductible, whereas the interest income arising from its intra-group financing business is chargeable to profits tax.

We therefore propose enhancing the relevant tax rules on interest incurred in an intra-group financing business for corporations (see paragraph 5 below), and introducing a concessionary profits tax rate for qualifying CTCs (see paragraph 6 below), with a view to upgrading Hong Kong's status as a preferred base for CTCs.

5. To this end, we propose adjusting our interest deduction rules in the IRO to allow a corporate borrower carrying on in Hong Kong an intra-group financing business deduction of interest payable on money borrowed from a non-Hong Kong associated corporation under specified conditions[4], which will require, among others, that the interest income arising from the same loan transaction is subject to tax in a jurisdiction outside Hong Kong, in order to forestall aggressive tax avoidance schemes creating interest expenses to reduce assessable profits in Hong Kong. Correspondingly, in respect of the symmetric tax treatment for interest income as deemed trading receipts, we propose amending the IRO to make it clear that the "operation test"[5] applies in the determination of the source of interest income, as well as relevant gains or profits, arising from the carrying on in Hong Kong by a corporation (other than a financial institution[6]) of its intra-group financing business[7]. That is to say, if a corporation (other than a financial institution) lends money to a non-Hong Kong associated corporation in the course of its intra-group financing business carried on in Hong Kong, the relevant interest income is

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[4] The specified conditions are –

(a) the deduction claimed is in respect of interest payable by a corporation (i.e. borrower) on money borrowed from a non-Hong Kong associated corporation (i.e. lender) in the ordinary course of an intra-group financing business;

(b) the lender is, in respect of the interest, subject to a similar tax (i.e. such tax has been paid or will be paid) in a territory outside Hong Kong at a rate that is not lower than the reference rate; and

(c) the lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm's length.

[5] It was held in *Orion Caribbean Limited v Commissioner of Inland Revenue* (4 HKTC 432) that, where the taxpayer earned its profits by borrowing and lending of money, the source of profits should not be solely determined by the place where money was lent. The proper test to determine the source of the profits is the "operation test", i.e. "one looks to see what the taxpayer has done to earn the profit in question and where he has done it". In the case of a money borrowing and lending business carried on in Hong Kong, the profits arise from the business transacted in Hong Kong encompassing a broader range of activities such as fund raising, negotiation and approval of loan arrangements, as well as servicing of loans.

[6] Under section 2(1) of the IRO, a "financial institution" essentially means an authorized institution (i.e. a licensed bank, a restricted licence bank, or a deposit-taking company) within the meaning of section 2 of the Banking Ordinance (Chapter 155) or its relevant associated corporation.

[7] As such, interest income and profits from the sale or on the redemption on maturity or presentment of a relevant instrument earned by a corporation (other than a financial institution) in respect of its intra-group financing business are deemed trading receipts chargeable to profits tax. This is equivalent to the current application of the "operation test", under section 15(1)(i) and (l) of the IRO, in respect of the similar interest income and profits received by or accrued to a financial institution arising through or from the carrying on by a financial institution of its business in Hong Kong.

regarded as trading receipts derived from Hong Kong, and hence chargeable to profits tax, even though the loan is made available outside Hong Kong.

6. In addition, to promote further our competitiveness in this respect, we propose providing for a regime under the IRO in which the tax rate on qualifying profits of a qualifying CTC derived from specified lending transactions, or from specified corporate treasury services or transactions, is 50% of the prevailing profits tax rate for corporations (i.e. 16.5% x 50% = 8.25%). To prevent taxpayers from shifting non-CTC incomes into the half-rate regime, we propose that a qualifying CTC which elects to enjoy the half-rate should be a standalone corporate entity engaging only in corporate treasury activities. A safe harbour rule is prescribed to allow corporations having income and assets primarily for corporate treasury activities to enjoy the half-rate. Also, we propose empowering the Commissioner of Inland Revenue ("CIR") to determine that a corporation is a qualifying CTC and hence eligible for the half-rate regime if the CIR is of the opinion that the relevant conditions or safe harbour rule would, in the ordinary course of its business, have been satisfied. To prevent abuses, anti-avoidance provisions are prescribed to ensure, among others, that the half-rate concession will apply to assessable profits in respect of which the corresponding payments made are not tax deductible in Hong Kong, so as to prevent revenue loss in the circumstances where there is half taxation of qualifying profits by qualifying CTCs but full deduction of the corresponding payments by associated corporations.

7. We are mindful of the international pressure on financial centres to make sure that their incentive schemes would meet the latest standards to combat base erosion and profit shifting ("BEPS")[8] so as to avoid the occurrence of double non-taxation or the shifting of profits to low-tax regimes. With the proposed requirement for a qualifying CTC to be a standalone corporate entity and other safeguards such as the "operation test" and safe harbour rule described in paragraphs 5 and 6 above, we are satisfied that the proposed tax scheme for CTCs would not be labelled as harmful tax practices by the international community under the BEPS regime and action plans as promulgated by the Organisation for Economic Co-operation and Development and endorsed by the Group of Twenty in November 2015.

[8] BEPS refers to tax planning strategies that exploit the gaps and mismatches in tax rules (which may exist among economies) to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. The final BEPS package released by the Organisation for Economic Co-operation and Development in October 2015 seeks to ensure multinational corporations paying a fair share of taxes, realign taxation with economic activities, and standardise international tax rules to eliminate double non-taxation.

(B) Clarification of the tax treatment for RCSs

8. In addition, we propose taking this opportunity to clarify the tax treatment for RCSs issued by financial institutions to fulfil the Basel III capital adequacy requirements[9]. In light of the gradual implementation of Basel III requirements in Hong Kong and 27 other member jurisdictions of the Basel Committee on Banking Supervision since 2013, financial institutions (whether with head office in Hong Kong, or operating in Hong Kong as a branch of a financial institution whose head office is outside Hong Kong) are strengthening their capital base through, among other means, issuing specified securities, including Additional Tier 1 or Tier 2 instruments ("AT1/T2 instruments"), to raise funds. These AT1/T2 instruments possess hybrid features of debt and equity but their terms and conditions provide for their write-down, or conversion into ordinary shares, to absorb loss either in going concern (for AT1 instruments) or at the point of non-viability of the issuer (for both AT1 and T2 instruments). They are not regarded as debt instruments under the current IRO provisions, and their distributions are therefore not deductible for profits tax purposes. These unique characteristics of RCSs warrant clarification of their treatment in our tax law. The proposed tax treatment (see paragraphs 9-11 below) will help enhance the treasury operations within financial institutions, and promote the stability and resilience of the banking sector, by facilitating the issuance of relevant securities by banks to comply with the international regulatory capital requirements applicable to them.

9. To this end, we propose adding new provisions to the IRO to treat a RCS as a debt security, so that distributions arising from the security (other than the repayment of the paid-up amount) should be treated as interest for both deduction and taxation purposes under the IRO. That is to say, section 16 of the IRO shall apply to RCSs to allow for distributions from these instruments to be treated as interest expenses, hence eligible for deduction in ascertaining the assessable profits of the issuers. At the same time, sums received by a person as distributions in respect of a RCS or profits from the disposal or on the redemption of a RCS are deemed to be trading receipts, hence chargeable to profits tax, if (a) the sums are received by a financial institution, and arising through or from carrying on of its business in Hong Kong; or (b) the sums are received by a person or a corporation carrying on a trade, profession or business in Hong Kong, and arising in or derived from Hong Kong.

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[9] The relevant requirements are set out in the Banking (Capital) Rules (Chapter 155, sub. leg. L) or the equivalent law or regulatory requirements of another member jurisdiction of the Basel Committee on Banking Supervision. In this regard, Hong Kong banks' capital ratios remain well above the minimum international standards. The consolidated total capital ratio of locally incorporated authorized institutions stood at 17.5% at the end of June 2015, with the Tier 1 capital ratio increasing to 14.4%.

10. In relation to this clarification of the tax treatment mentioned in paragraph 9 above, anti-avoidance provisions are prescribed to remove the scope for banks to use RCSs for tax avoidance purposes. Among the anti-avoidance provisions is one to ensure that the chargeable profits from a RCS transaction between a financial institution and its associate will be assessed by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associates (i.e. arm's length principle). There are also restrictions and conditions on deduction for sums payable in respect of a RCS issued to or for the benefit of, or held by or for the benefit of, a specified connected person of the issuer. In ascertaining the chargeable profits of the Hong Kong branch of a financial institution (whose head office is outside Hong Kong) with capital raised through the issuance of RCSs, profits will be attributed as if the Hong Kong branch and other parts of the financial institution were separate enterprises (i.e. separate enterprise principle), and the amount of deduction allowable for costs and expenses is not to exceed the amount that would have been incurred by the Hong Kong branch on this basis.

11. Correspondingly, with the proposed debt-like treatment of RCSs under the IRO, we see the need to clarify the treatment of RCSs under the Stamp Duty Ordinance (Chapter 117) ("SDO"). That is to say, the transfer of RCSs should, as other transfer transactions relating to debts, be given stamp duty relief.

THE BILL

12. The main provisions of the Bill are as follows–

(a) **Division 1** of **Part 2** of the Bill provides for the profits tax concession for qualifying CTCs (paragraph 6 above)–

(i) **Clause 3** adds new sections 14C to 14F to the IRO to–
(A) define a "qualifying corporate treasury centre";
(B) provide for the safe harbour rule; and
(C) provide for the CIR's power to determine whether a corporation is a qualifying CTC;

(ii) **Clause 4** amends consequentially section 19CA of the IRO to provide for adjustments in respect of relevant losses to be set off against the concessionary trading receipt chargeable to tax under new section 14D;

(iii) **Clause 6** adds a new Schedule 17B to the IRO to provide for the meaning of "corporate treasury service" and "corporate treasury transaction". It also prescribes the minimum assets and profits percentages for determining whether a corporation satisfies the proposed safe harbour rule;

(b) **Division 2** of **Part 2** of the Bill provides for the tax treatment for interest income and interest expense in relation to a corporation's intra-group financing business (paragraph 5 above)–

(i) **Clause 7** amends section 15 of the IRO to provide that the interest income and specified disposal profits earned by a corporation (other than a financial institution) in respect of an intra-group financing business are deemed trading receipts chargeable to profits tax, even though the relevant money is made available, or the transaction is effected, outside Hong Kong; and

(ii) **Clause 8** amends section 16 of the IRO to allow deductions, by a corporate borrower carrying on in Hong Kong an intra-group financing business, of interest payable on money borrowed from a non-Hong Kong associated corporation under the specified conditions;

(c) **Division 3 of Part 2** of the Bill provides for debt-like tax treatments for RCSs (paragraphs 9 and 10 above)–

(i) **Clause 12** amends section 15 of the IRO so that distributions in respect of a RCS or profits from the disposal or on the redemption of a RCS are deemed to be trading receipts in line with the existing rules applicable to taxation of interest income and gains or profits from disposal or redemption of debt-related instruments;

(ii) **Clause 13** provides for the application of section 16(1)(a) and (2)(a) of the IRO, subject to the new provisions added by **Clause 14**, in relation to the deduction for profits tax assessment purposes of a sum payable by a financial institution in respect of a RCS issued by that institution;

(iii) **Clause 14** adds new sections 17A to 17H to the IRO to–

(A) treat a RCS as a debt security, and a sum payable in respect of the RCS (other than a repayment of the paid-up amount) as interest payable on the security (new section 17B);

(B) specify the treatment of RCSs in an issuer's or its specified connected person's accounts for profits tax assessment (new sections 17C and 17D);

(C) specify the rules concerning interest deduction if a RCS is issued to or for the benefit or, or held by or for the benefit of, a specified connected person (new section 17F); and

(D) specify the application of the arm's length and the separate enterprise principles for anti-avoidance purposes (new sections 17E and 17G);

(iv) **Clauses 15 and 16** clarify the position of RCSs for the purposes of certain existing reliefs and exemption;

(d) **Division 4 of Part 2** of the Bill contains **clauses 17 and 18** to add a new Schedule 36 to the IRO to provide for transitional matters;

(e) **Division 1 of Part 3** of the Bill contains **clauses 19 to 23** to make consequential amendments to the Inland Revenue Rules (Chapter 112, sub. leg. A); and

(f) **Division 2 of Part 3** of the Bill contains **clauses 24 to 27** to make related amendments to the SDO to provide for the relief of stamp duty for transactions and transfers relating to RCSs (paragraph 11 above).

LEGISLATIVE TIMETABLE

13. The legislative timetable will be –

Publication in the Gazette	4 December 2015
First Reading and commencement of Second Reading debate	16 December 2015
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSALS

14. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It has no sustainability, productivity, environmental, civil service, family or gender implications. The amendments proposed in the Bill will not affect the current binding effect of the IRO and the SDO.

Economic implications

15. The proposals would help foster the development of Hong Kong as an international financial centre and business hub. The proposals to revise the tax rules for CTC operations will help attract more CTCs to be established in Hong Kong, thereby generating demands for the financial and professional services sectors, and contributing to the development of headquarters economy in Hong Kong. The proposal to clarify the tax treatment for RCSs will help facilitate banks' compliance with the relevant Basel III requirements, and is therefore conducive to their strengthening of capital positions.

Financial implications

16. The actual cost to revenue arising from the proposal of adjusting the interest deduction rules to enable the deduction of interest expense by a corporation on money borrowed from its non-Hong Kong associated corporation in the ordinary course of an intra-group financing business should not be significant, as currently multinational corporations tend not to arrange their relevant borrowing transactions in Hong Kong without the interest deduction. The package of profits tax concession and the revised interest deduction rules may attract more treasury operations in Hong Kong, thereby potentially bringing in additional direct and indirect tax revenue. As regards RCSs, with reference to the current information provided by the Hong Kong Monetary Authority concerning instruments that are or may be issued by the Hong Kong banking sector to meet the Basel III capital adequacy requirements, allowing interest deduction for RCSs issued by financial institutions may reduce the revenue by about $0.2 billion per year, but this has not taken into account the additional revenue brought to the Government payable by investors holding such securities and carrying on a trade, profession or business in Hong Kong. The stamp duty forgone in respect of the relief for relevant RCS transactions is unlikely to be significant.

PUBLIC CONSULTATION

17. To attract multinational and Mainland enterprises to establish CTCs in Hong Kong to perform treasury services for their group companies, the Financial Secretary announced in his 2015-16 Budget that the Government would amend the IRO to allow, under specified conditions, interest deductions under profits tax for CTCs, and to reduce the profits tax for specified treasury activities by 50%. In this connection, we briefed the LegCo Panel on Financial Affairs on these proposals on 1 June 2015. The Panel generally supported the proposals. Questions were raised in relation to the benefits of the proposals, the impact on our simple tax regime, and measures to tackle tax avoidance. The Bill has specific provisions to address the above aspects.

18. Separately, as we briefed the LegCo Panel on Financial Affairs on 7 July 2014 on the implementation of the Basel III standards, questions were raised on the taxation aspects of RCSs. We undertook to consider ways to address the banking sector's queries on the uncertainty of the tax position of RCSs under the current tax law. The Hong Kong Association of Banks has subsequently written to the Government to request clarifications of the tax treatment for RCSs through legislative amendments.

19. We have also engaged the treasury profession, the tax advisory sector, and the banking industry in formulating the draft provisions of the Bill. Relevant technical comments have been addressed as appropriate, and the intent of certain provisions clarified.

PUBLICITY

20. We will issue press release upon the gazettal of the Bill, and arrange a spokesperson to answer media enquiries.

ENQUIRIES

21. Enquiries relating to the brief can be directed to Mr Jackie Liu, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2067.

Financial Services and the Treasury Bureau
2 December 2015

Inland Revenue (Amendment) (No. 4) Bill 2015

Contents

Clause Page

Clause Page

A BILL

To

Amend the Inland Revenue Ordinance to give profits tax concession to qualifying corporate treasury centres, to make provisions for profits tax purposes regarding interests on money borrowed from or lent to associated corporations, and to treat regulatory capital securities as debt securities; and to amend the Stamp Duty Ordinance to give stamp duty relief in relation to regulatory capital securities; and to make consequential amendments.

Enacted by the Legislative Council.

Part 1

Preliminary

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 4) Ordinance 2015.

2. Enactments amended

(1) The Inland Revenue Ordinance (Cap. 112) is amended as set out in Part 2.

(2) The Inland Revenue Rules (Cap. 112 sub. leg. A) are amended as set out in Division 1 of Part 3.

(3) The Stamp Duty Ordinance (Cap. 117) is amended as set out in Division 2 of Part 3.

Part 2

Amendments to Inland Revenue Ordinance

Division 1—Profits Tax Concession for Qualifying Corporate Treasury Centres

3. Sections 14C to 14F added

After section 14B—

Add

"14C. Qualifying corporate treasury centre: interpretation

(1) In this section and sections 14D, 14E and 14F—

associated corporation (相聯法團), in relation to a corporation, means—

(a) another corporation over which the corporation has control;

(b) another corporation that has control over the corporation; or

(c) another corporation that is under the control of the same person as is the corporation;

corporate treasury activity (企業財資活動) means—

(a) carrying on an intra-group financing business;

(b) providing a corporate treasury service; or

(c) entering into a corporate treasury transaction;

corporate treasury asset (企業財資資產), in relation to a corporation, means an asset of the corporation used by it to carry out a corporate treasury activity;

corporate treasury profits (企業財資利潤), in relation to a corporation, means any profits of the corporation that are derived from a corporate treasury activity;

corporate treasury service (企業財資服務)—see section 1 of Schedule 17B;

corporate treasury transaction (企業財資交易)—see section 2 of Schedule 17B;

intra-group financing business (集團內部融資業務), in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations;

non-Hong Kong associated corporation (非香港相聯法團) means an associated corporation that does not carry on any trade, profession or business in Hong Kong;

prescribed asset percentage (訂明資產百分率)—see section 4 of Schedule 17B;

prescribed profits percentage (訂明利潤百分率)—see section 3 of Schedule 17B;

qualifying corporate treasury centre (合資格企業財資中心)—see section 14D(2) and (9);

qualifying corporate treasury service (合資格企業財資服務)—see subsection (3);

qualifying corporate treasury transaction (合資格企業財資交易)—see subsection (4);

qualifying lending transaction (合資格貸款交易), in relation to a corporation, means a transaction under which the corporation lends money, in the ordinary course of its intra-group financing business, to a non-Hong Kong associated corporation;

qualifying profits (合資格利潤), in relation to a corporation, means the assessable profits of the corporation that fall within section 14D(1)(a), (b) or (c).

(2) For the purposes of the definition of ***associated corporation*** in subsection (1), a person has control over a corporation if the person has the power to secure—

(a) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or

(b) by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation,

that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person.

(3) A corporate treasury service provided by a corporation to an associated corporation is a qualifying corporate treasury service if the associated corporation is a non-Hong Kong associated corporation.

(4) A corporate treasury transaction entered into by a corporation that is related to the business of an associated corporation is a qualifying corporate treasury transaction if the associated corporation is a non-Hong Kong associated corporation.

(5) The Secretary for Financial Services and the Treasury may by order published in the Gazette amend Schedule 17B.

14D. Qualifying corporate treasury centre: profits tax concession

(1) For the purposes of this Part, the assessable profits of a corporation that is a qualifying corporate treasury centre

for a year of assessment are, subject to subsections (5) and (8), chargeable to tax under this Part at one-half of the rate specified in Schedule 8 to the extent to which those profits are—

(a) assessable profits derived from its qualifying lending transaction;

(b) assessable profits derived from its qualifying corporate treasury service; or

(c) assessable profits derived from its qualifying corporate treasury transaction.

(2) A corporation is a qualifying corporate treasury centre for a year of assessment if, for that year of assessment—

(a) it satisfies the conditions specified in subsection (3);

(b) it satisfies the safe harbour rule under section 14E; or

(c) it has obtained the Commissioner's determination under section 14F(1).

(3) The conditions specified for the purposes of subsection (2)(a) are that, in the basis period for the year of assessment, the corporation—

(a) has carried out in Hong Kong one or more corporate treasury activities; and

(b) has not carried out in Hong Kong any activity other than a corporate treasury activity.

(4) For the purposes of subsection (3)(b), in determining whether a corporation has carried out any activity other than a corporate treasury activity, only activities that generate income to the corporation are to be taken into account.

(5) Subsection (1) applies to a corporation for a year of assessment only if—

(a) in that year of assessment—

(i) the central management and control of the corporation is exercised in Hong Kong; and

(ii) the activities that produce its qualifying profits in that year are—

(A) carried out in Hong Kong by the corporation; or

(B) arranged by the corporation to be carried out in Hong Kong; and

(b) the corporation has elected in writing that subsection (1) applies to it.

(6) An election under subsection (5)(b), once made, is irrevocable for so long as the corporation remains as a qualifying corporate treasury centre.

(7) If subsection (1) does not apply to a corporation for a year of assessment because the corporation is no longer a qualifying corporate treasury centre for that year of assessment, then, despite anything in this section, subsection (1) is not to apply to the corporation for the subsequent year of assessment.

(8) In computing the qualifying profits of a corporation for the purposes of subsection (1), if any sum payable to the corporation by a person in respect of the transaction or service mentioned in subsection (1)(a), (b) or (c) is deductible under this Part, the amount of the qualifying profits attributable to that transaction or service is to be deducted by reference to the amount of that sum.

(9) Despite subsection (2), a financial institution is not eligible to be a qualifying corporate treasury centre.

14E. Qualifying corporate treasury centre: safe harbour rule

(1) For the purposes of section 14D(2)(b), a corporation satisfies the safe harbour rule for a year of assessment (***subject year***) if the corporation falls within—

(a) the 1-year safe harbour under subsection (2); or

(b) the multiple-year safe harbour under subsection (3).

(2) A corporation falls within the 1-year safe harbour if, for the subject year—

(a) its CTP percentage is not lower than the prescribed profits percentage; and

(b) its CTA percentage is not lower than the prescribed asset percentage.

(3) A corporation falls within the multiple-year safe harbour if, for the specified years—

(a) its average CTP percentage is not lower than the prescribed profits percentage; and

(b) its average CTA percentage is not lower than the prescribed asset percentage.

(4) In subsections (3), (7) and (8), the ***specified years*** (指明年度) for a corporation means—

(a) if the corporation has carried on a trade, profession or business in Hong Kong for less than 2 consecutive years of assessment immediately before the subject year—the subject year and the preceding year of assessment (***the 2 years***); or

(b) if the corporation has carried on a trade, profession or business in Hong Kong for 2 or more consecutive years of assessment immediately

before the subject year—the subject year and the preceding 2 years of assessment (***the 3 years***).

(5) The ***CTP percentage*** (企業財資利潤總額百分率) of a corporation for a year of assessment is calculated in accordance with the following formula—

$$\frac{CTP}{P}$$

where: CTP means the aggregate amount of the corporate treasury profits of the corporation in the basis period for the year of assessment; and

P means the aggregate amount of profits accruing to the corporation from all sources, whether in Hong Kong or not, in the basis period for the year of assessment.

(6) The ***CTA percentage*** (企業財資資產總值百分率) of a corporation for a year of assessment is calculated in accordance with the following formula—

$$\frac{CTA}{A}$$

where: CTA means the aggregate value of the corporate treasury assets of the corporation as at the end of the basis period for the year of assessment; and

A means the aggregate value of all assets, whether in Hong Kong or not, of the corporation as at the end of the basis period for the year of assessment.

(7) The ***average CTP percentage*** (企業財資利潤總額平均百分率) of a corporation for the specified years means the percentage arrived at by—

(a) if subsection (4)(a) applies—dividing the sum of the CTP percentages of the corporation for the 2 years by 2; or

(b) if subsection (4)(b) applies—dividing the sum of the CTP percentages of the corporation for the 3 years by 3.

(8) The ***average CTA percentage*** (企業財資資產總值平均百分率) of a corporation for the specified years means the percentage arrived at by—

(a) if subsection (4)(a) applies—dividing the sum of the CTA percentages of the corporation for the 2 years by 2; or

(b) if subsection (4)(b) applies—dividing the sum of the CTA percentages of the corporation for the 3 years by 3.

(9) For the purposes of subsection (6), in computing the aggregate value of the corporate treasury assets of a corporation, if a corporate treasury asset is used partly to carry out a corporate treasury activity and partly for another purpose, only the part of the value of the asset that is proportionate to the extent to which the asset is used to carry out a corporate treasury activity is to be taken into account.

14F. Qualifying corporate treasury centre: Commissioner's determination

(1) For the purposes of section 14D(2)(c), the Commissioner may, on application by a corporation, determine that the

corporation is a qualifying corporate treasury centre for a year of assessment.

(2) A corporation may apply for the Commissioner's determination under subsection (1) only if—

(a) it is not a financial institution; and

(b) for the year of assessment, it satisfies neither of the following—

(i) the conditions specified in section 14D(3);

(ii) the safe harbour rule under section 14E.

(3) The Commissioner may make a determination under subsection (1) only if the Commissioner is of the opinion that the conditions specified in section 14D(3), or the safe harbour rule under section 14E, would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment.".

4. Section 19CA amended (treatment of losses: concessionary trading receipts)

(1) Section 19CA(4)—

Repeal

"or 14B"

Substitute

", 14B or 14D".

(2) Section 19CA(5), definition of ***chargeable concessionary trading receipts***, after paragraph (b)—

Add

"(c) where the concessionary trading receipts are of a kind in respect of which assessable profits of a corporation are chargeable to tax at the rate specified in section 14D, the amount of such concessionary trading receipts as—

(i) reduced by the aggregate of—

(A) the amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for that year of assessment by the corporation in the production of the concessionary trading receipts; and

(B) the amount of any allowances made under Part 6 for that year of assessment to the corporation to the extent to which the relevant assets are used during the basis period for that year of assessment in the production of the concessionary trading receipts; and

(ii) increased by the amount of any balancing charge directed to be made on that corporation under Part 6 for that year of assessment to the extent to which the relevant assets are used in the production of the concessionary trading receipts;".

(3) Section 19CA(5), definition of ***concessionary trading receipts***—

Repeal

"or 14B"

Substitute

", 14B or 14D".

(4) Section 19CA(5), Chinese text, definition of *關乎獲特惠的營業收入的未吸納虧損*, paragraph (b)—

Repeal the full stop

Substitute a semicolon.

(5) Section 19CA(5), definition of ***unabsorbed loss in respect of the concessionary trading receipts***, after paragraph (b)—

Add

"(c) where the concessionary trading receipts are of a kind in respect of which assessable profits of a corporation are chargeable to tax at the rate specified in section 14D, the loss ascertained by—

(i) adding to the amount of the concessionary trading receipts the amount of any balancing charge directed to be made on that corporation under Part 6 for that year of assessment to the extent to which the relevant assets are used in the production of the concessionary trading receipts; and

(ii) reducing from the resulting amount the aggregate of—

(A) the amount of any outgoings and expenses deductible under this Part to the extent to which they are incurred during the basis period for that year of assessment by the corporation in the production of the concessionary trading receipts; and

(B) the amount of any allowances made under Part 6 for that year of assessment to the corporation to the extent to which the relevant assets are used during the basis period for that year of assessment in the production of the concessionary trading receipts;".

5. Schedule 8 amended (rate of profits tax in respect of a corporation)

Schedule 8, after "14B(1)"—

Add

", 14D(1)".

6. Schedule 17B added

After Schedule 17A—

Add

"Schedule 17B

[s. 14C]

Qualifying Corporate Treasury Centre: Corporate Treasury Services, Corporate Treasury Transactions and Prescribed Percentages

Part 1

Corporate Treasury Services

1. Meaning of *corporate treasury service*

(1) For the purposes of sections 14C, 14D and 14E—

corporate treasury service (企業財資服務), in relation to a corporation, means any of the following services that is provided by the corporation to an associated corporation—

(a) managing the cash and liquidity position, including cash forecasting or pooling, of the associated corporation and providing related advice;

(b) processing payments to the vendors or suppliers of the associated corporation;

(c) managing the associated corporation's relationships with financial institutions;

(d) providing corporate finance advisory service, including—

(i) activities supporting the raising of capital, such as by way of debt or equity, by the associated corporation; and

(ii) capital budgeting for the associated corporation;

(e) advising on the management of the investment of the funds of the associated corporation;

(f) managing investor relations regarding the investors in the debt or equity instruments issued by the associated corporation;

(g) providing service in relation to—

(i) the provision of guarantees, performance bonds, standby letters of credit or other credit risk instruments to or on behalf of the associated corporation; or

(ii) remittances to or on behalf of the associated corporation;

(h) providing advice or service in relation to the management of interest rate risk, foreign exchange risk, liquidity risk, credit risk, commodity risk or any other financial risk of the associated corporation;

(i) providing assistance in the merger or acquisition of a business by the associated corporation;

(j) providing advice or service in relation to the associated corporation's compliance with—

(i) accounting standards;

(ii) internal treasury policies; or

(iii) regulatory requirements in relation to treasury management;

(k) providing advice or service in relation to the operations of the treasury management system of the associated corporation;

(l) providing business planning and co-ordination, including economic or investment research and analysis, for the associated corporation in connection with any of the activities specified in paragraphs (a) to (k).

(2) In this section—

associated corporation (相聯法團) has the meaning given by section 14C(1).

Part 2

Corporate Treasury Transactions

2. Meaning of *corporate treasury transaction*

(1) For the purposes of sections 14C, 14D and 14E—

corporate treasury transaction (企業財資交易), in relation to a corporation, means any of the following transactions that is entered into by the corporation on its own account and related to the business of an associated corporation—

(a) a transaction in relation to the provision of guarantees, performance bonds, standby letters of credit or other credit risk instruments in respect of the borrowing of money by the associated corporation;

(b) a transaction investing the funds of the corporation or the associated corporation in any of the following financial instruments for managing the cash and liquidity position of the corporation or the associated corporation—

(i) deposits;

(ii) certificates of deposit;

(iii) bonds;

(iv) notes;

(v) debentures;

(vi) money-market funds;

(vii) other financial instruments (except securities issued by a private company as defined by section 20ACA(2));

(c) a transaction in respect of any of the following contracts that are entered into for the purpose of hedging interest rate risk, foreign exchange risk, liquidity risk, credit risk, commodity risk or any other financial risk of the associated corporation—

(i) contracts for difference;

(ii) foreign exchange contracts;

(iii) forward or futures contracts;

(iv) swap contracts;

(v) options contracts;

(d) a factoring or forfaiting transaction.

(2) In this section—

associated corporation (相聯法團) has the meaning given by section 14C(1).

Part 3

Prescribed Percentages for Safe Harbour Rule

3. Prescribed profits percentage

For the purposes of section 14E, the prescribed profits percentage is 75%.

4. Prescribed asset percentage

For the purposes of section 14E, the prescribed asset percentage is 75%.".

Division 2—Interest in respect of Borrowing and Lending of Money with Associated Corporations

7. Section 15 amended (certain amounts deemed trading receipts)

(1) After section 15(1)(i)—

Add

"(ia) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation (other than a financial institution), by way of interest that arises through or from the carrying on in Hong Kong by the corporation of its intra-group financing business within the meaning of section 16(3), even if the moneys in respect of which the interest is received or accrues are made available outside Hong Kong;".

(2) Section 15(1)(l)(ii)—

Repeal

"and".

(3) After section 15(1)(l)—

Add

"(la) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation (other than a financial institution), by way of gains or profits arising through or from the carrying on in Hong Kong by the corporation of its intra-group financing business within the meaning of section 16(3), from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security, even if—

(i) the moneys laid out for the acquisition of the certificate, bill or security were made available outside Hong Kong; or

(ii) the sale, disposal or redemption is effected outside Hong Kong; and".

8. Section 16 amended (ascertainment of chargeable profits)

(1) Section 16(1)(a)—

Repeal

"and (2C)"

Substitute

", (2C), (2CA) and (2CC)".

(2) Section 16(1)(c)—

Repeal

"(j), (k) or (l)"

Substitute

"(ia), (j), (k), (l) or (la)".

(3) Section 16(2)(e)(iv)—

Repeal

"; or"

Substitute a semicolon.

(4) Section 16(2)(f)(iii)—

Repeal the full stop

Substitute

"; or".

(5) After section 16(2)(f)—

Add

"(g) the borrower is a corporation carrying on in Hong Kong an intra-group financing business and—

(i) the deduction claimed is in respect of interest payable by it on money borrowed from a non-Hong Kong associated corporation (***lender***) in the ordinary course of that business;

(ii) the lender is, in respect of the interest, subject to a similar tax in a territory outside Hong Kong at a rate that is not lower than the reference rate; and

(iii) the lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm's length.

Note—

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of ***similar tax*** and ***reference rate***.".

(6) Section 16(2A)—

Repeal

"and (2C)"

Substitute

", (2C) and (2CA)".

(7) Section 16(2B)—

Repeal

"and (2C)" (wherever appearing)

Substitute

", (2C) and (2CA)".

(8) Section 16(2C)—

Repeal

"and (2B)" (wherever appearing)

Substitute

", (2B) and (2CA)".

(9) After section 16(2C)—

Add

"(2CA) Where the condition for the application of subsection (1)(a) is satisfied under subsection (2)(g), the application of subsection (1)(a) is nevertheless qualified by subsection (2CB) if—

(a) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the lender or otherwise, by which any sum payable by way of interest on the money borrowed or on any part of the money borrowed is payable, whether directly or through any interposed person, to a related person; and

(b) the related person is, in respect of the sum—

(i) neither subject to profits tax in Hong Kong, nor subject to a similar tax in any territory outside Hong Kong; or

(ii) subject to profits tax in Hong Kong, or subject to a similar tax in a territory outside Hong Kong, but no rate at which the person is subject to such tax is equal to or higher than the reference rate.

Note—

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of ***similar tax***, ***reference rate*** and ***related person***.

(2CB) For the purposes of subsection (2CA), the amount of the deduction that, but for subsections (2A), (2B), (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, is to be reduced by an amount calculated in accordance with the following formula—

$$\frac{A}{B} \times C$$

where: A means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangements mentioned in subsection (2CA)(a) are in place;

B means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and

C means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, that, but for subsections (2A), (2B), (2C) and (2CA), would have been deductible under subsection (1)(a) for the year of assessment concerned.

(2CC) Where a deduction under subsection (1)(a) is claimed, by virtue of subsection (2)(g), for a year of assessment in respect of interest payable on money borrowed by a corporation, no deduction is to be allowed in respect of the interest if the Commissioner is satisfied that the main purpose, or one of the main purposes, of the borrowing of the money is to utilize a loss to avoid, postpone or reduce any liability, whether of the corporation or another person, to profits tax under this Ordinance.

(2CD) In subsection (2CC)—

loss (虧損)—

(a) means a loss sustained by a related person within the meaning of subsection (2I)(d)(ii) or (iii) in a trade, profession or business, whether in Hong Kong or elsewhere; and

(b) includes any balance of such loss.".

(10) Section 16(2E)—

Repeal

"subsection (2B)"

Substitute

"subsections (2B) and (2CA)".

(11) Section 16(2E)(a)—

Repeal

"that subsection"

Substitute

"those subsections".

(12) After section 16(2H)—

Add

"(2I) For the purposes of this subsection and subsections (2)(g) and (2CA)—

(a) a person is, in respect of an interest or a sum, subject to a tax at a certain rate in a territory if the Commissioner is satisfied that—

(i) for a similar tax in a territory outside Hong Kong as mentioned in subsections (2)(g)(ii) and (2CA)(b)(i) and (ii)—tax of that nature has been paid or will be paid, whether by deduction or otherwise, at that rate by that person in respect of the interest or sum concerned in that territory as required by the laws of that territory; or

(ii) for profits tax in Hong Kong as mentioned in subsection (2CA)(b)(i) and (ii)—profits tax under this Ordinance has been paid or will be

paid at that rate by that person in respect of the sum concerned in Hong Kong;

(b) ***similar tax*** (類似稅項) means a tax that is of substantially the same nature as profits tax under this Ordinance;

(c) ***reference rate*** (參考稅率) means—

(i) the rate specified in Schedule 8 for the year of assessment concerned; or

(ii) if section 14D(1) applies in respect of the borrower for the year of assessment concerned, the rate applicable under that section; and

(d) ***related person*** (有關連人士) means—

(i) the borrower;

(ii) a person (other than the lender) who is connected with the borrower; or

(iii) a person (other than the borrower) who is connected with the lender.".

(13) Section 16(3)—

Add in alphabetical order

"***intra-group financing business*** (集團內部融資業務), in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations;

non-Hong Kong associated corporation (非香港相聯法團) means an associated corporation that does not carry on any trade, profession or business in Hong Kong;".

(14) Section 16(3B), English text—

Repeal

"shall be"

Substitute

"is".

(15) Section 16(3B)(a), after "borrower;"—

Add

"or".

(16) After section 16(3B)—

Add

"(3C) In this section, a person is regarded as being connected with a lender if the person is—

(a) an associated corporation of the lender; or

(b) a person (other than a corporation)—

(i) who controls the lender;

(ii) who is controlled by the lender; or

(iii) who is under the control of the same person as is the lender.".

(17) After section 16(6)—

Add

"(7) The Secretary for Financial Services and the Treasury may by order published in the Gazette amend the definition of ***reference rate*** in subsection (2I)(c).".

9. Schedule 8 amended (rate of profits tax in respect of a corporation)

Schedule 8, before "19CA(4)"—

Add

"16(2I),".

10. Schedule 17A amended (specified alternative bond scheme and its tax treatment)

Schedule 17A, section 21(4)—

Repeal

"and (l)"

Substitute

", (l) and (la)".

Division 3—Tax Treatment of Regulatory Capital Security

11. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *debenture*

Substitute

"***debenture*** (債權證), in relation to a corporation, includes debenture stock, bond and any other debt security of the corporation, whether or not constituting a charge on the assets of the corporation;".

(2) Section 2(1)—

Add in alphabetical order

"***regulatory capital security*** (監管資本證券) has the meaning given by section 17A;".

12. Section 15 amended (certain amounts deemed trading receipts)

(1) Section 15(1)(j) and (k)—

Repeal

"on maturity or presentment of a certificate of deposit or bill of exchange"

Substitute

", on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security".

(2) Section 15(1)(l)—

(a) **Repeal**

"on maturity or presentment of a certificate of deposit or bill of exchange notwithstanding that"

Substitute

", on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security even if";

(b) Subparagraph (i)—

Repeal

"certificate or bill"

Substitute

"certificate, bill or security".

(3) Before section 15(2)—

Add

"(1C) Subsection (1)(f), (g), (i), (ia), (j), (k), (l) and (la) applies, subject to sections 17B, 17C, 17D, 17E, 17F, 17G and 17H, in relation to a regulatory capital security.".

13. Section 16 amended (ascertainment of chargeable profits)

Before section 16(2A)—

Add

"(2AA) Subsections (1)(a) and (2)(a) apply, subject to sections 17B, 17C, 17D, 17E, 17F, 17G and 17H, in relation to a sum payable by a financial institution in respect of a

regulatory capital security issued by the financial institution.".

14. Sections 17A to 17H added

After section 17—

Add

"17A. Financial institution: interpretation

(1) In this section and sections 17B, 17C, 17D, 17E, 17F, 17G and 17H—

Additional Tier 1 capital instrument (額外一級資本票據) means a capital instrument that qualifies as Additional Tier 1 capital under Schedule 4B to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee;

associate (相聯者) has the meaning given by section 16(3);

associated corporation (相聯法團) has the meaning given by section 16(3);

Basel Committee (巴塞爾委員會) has the meaning given by section 2(1) of the Banking Ordinance (Cap. 155);

Common Equity Tier 1 capital instrument (普通股權一級資本票據) means a capital instrument that qualifies as Common Equity Tier 1 capital under Schedule 4A to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee;

debt instrument (債務票據) means an instrument specified in Part 1 of Schedule 6 that is in respect of a debt issue;

fair value (公平價值)—

(a) in relation to a person's asset, means the amount that, at the time as at which the value of the asset is to be determined, the person would obtain from a knowledgeable and willing person dealing at arm's length for the sale of the asset;

(b) in relation to a person's liability, means the amount that, at the time as at which the value of the liability is to be determined, the person would have to pay to a knowledgeable and willing person dealing at arm's length for the transfer or release of the liability;

fair value accounting (公平價值會計) means a basis of accounting under which assets and liabilities are shown in a balance sheet at their fair value;

paid-up amount (已付數額), in relation to a regulatory capital security or debenture or debt instrument, means the sum paid to the issuer for the issue of the security or debenture or instrument;

regulatory capital security (監管資本證券) means a security—

(a) that qualifies or has qualified as an Additional Tier 1 capital instrument, and that forms or formed a component of Additional Tier 1 capital, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee; or

(b) that qualifies or has qualified as a Tier 2 capital instrument, and that forms or formed a component of Tier 2 capital, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of

another member jurisdiction of the Basel Committee;

Tier 2 capital instrument (二級資本票據) means a capital instrument that qualifies as Tier 2 capital under Schedule 4C to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee.

(2) For the purposes of the definition ***regulatory capital security*** in subsection (1)—

security (證券) does not include—

(a) a share;

(b) any debt instrument the terms and conditions of which provide for the issuer of the instrument converting, or having an option to convert, the instrument into a Common Equity Tier 1 capital instrument of the issuer or any other corporation after a certain period of time; or

(c) subject to subsection (3), any debt instrument—

(i) that carries a contractual right to any distribution or redemption payment that depends to any extent on the results of the business of the issuer of the instrument or of any part of that business; or

(ii) that provides discretion to the issuer of the instrument to make any distribution or redemption payment that depends to any extent on the results of the business of that issuer or of any part of that business.

(3) A debt instrument does not fall within paragraph (c) of the definition of ***security*** in subsection (2) by reason only that the terms and conditions of the instrument

provide for the reduction in distribution or redemption payment if the results of the business of the issuer of the instrument, or of any part of that business, worsen.

17B. Financial institution: regulatory capital security treated as debt security

(1) For the purposes of this Part—

(a) a regulatory capital security is to be treated as a debt security; and

(b) any sum payable in respect of a regulatory capital security by its issuer, other than a repayment of the paid-up amount of the security, is to be treated as interest payable on money borrowed by the issuer of an amount equal to the paid-up amount of the security.

(2) Subsection (1) has effect subject to sections 17C, 17D, 17E, 17F, 17G and 17H.

17C. Financial institution: general provisions on issuer of regulatory capital security

(1) This section applies in ascertaining profits in respect of which the issuer of a regulatory capital security is chargeable to tax under this Part for a year of assessment.

(2) Profits of the issuer are to be determined as if fair value accounting were not generally accepted accounting practice in relation to the security or part of the security.

(3) A sum representing—

(a) the paid-up amount of the security being written down on a permanent or temporary basis in accordance with any laws or regulatory

requirements or the terms and conditions of the security; or

(b) the paid-up amount of the security being converted to a Common Equity Tier 1 capital instrument in accordance with any laws or regulatory requirements or the terms and conditions of the security,

is not to be treated as a receipt arising in or derived from Hong Kong by the issuer from a trade, profession or business carried on in Hong Kong.

(4) No deduction is to be allowed to the issuer under section 16(1) for any sum representing the paid-up amount of the security being written up in accordance with any laws or regulatory requirements or the terms and conditions of the security, following a write-down of the paid-up amount on a temporary basis in accordance with those laws or requirements or those terms and conditions.

17D. Financial institution: general provisions on regulatory capital security held by, or for benefit of, issuer's specified connected person

(1) This section applies in ascertaining profits in respect of which a specified connected person of the issuer of a regulatory capital security is chargeable to tax under this Part for a year of assessment if, during the basis period for the year of assessment, the security is held by or for the benefit of the specified connected person.

(2) Profits of the specified connected person are to be determined as if fair value accounting were not generally accepted accounting practice in relation to the security or part of the security.

(3) No deduction is to be allowed to the specified connected person under section 16(1) for any sum representing—

(a) the paid-up amount of the security being written down on a permanent or temporary basis in accordance with any laws or regulatory requirements or the terms and conditions of the security; or

(b) the paid-up amount of the security being converted to a Common Equity Tier 1 capital instrument in accordance with any laws or regulatory requirements or the terms and conditions of the security.

(4) A sum representing the paid-up amount of the security being written up in accordance with any laws or regulatory requirements or the terms and conditions of the security, following a write-down of the paid-up amount on a temporary basis in accordance with those laws or requirements or those terms and conditions, is not to be treated as a receipt arising in or derived from Hong Kong by the specified connected person from a trade, profession or business carried on in Hong Kong.

(5) In this section—

connected person (有關連者), in relation to the issuer of a regulatory capital security, means—

(a) an associated corporation of the issuer; or

(b) a person (other than a corporation) who—

(i) controls the issuer;

(ii) is controlled by the issuer; or

(iii) is under the control of the same person as is the issuer;

market maker (市場莊家) means a person who—

(a) is licensed or registered for dealing in securities under the Securities and Futures Ordinance (Cap. 571) or is authorized to do so by a regulatory authority in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of this section;

(b) in the ordinary course of conduct of the person's trade, profession or business in respect of market making, holds oneself out as being willing to buy and sell securities for the person's own account and on a regular basis; and

(c) is actively involved in market making in securities issued by a wide range of unrelated institutions;

specified connected person (指明有關連者), in relation to the issuer of a regulatory capital security, means a connected person of the issuer who is not excepted within the meaning of subsection (6).

(6) In this section, a connected person of the issuer of a regulatory capital security is excepted if the connected person—

(a) is chargeable to tax under this Part in respect of a sum payable in respect of the security;

(b) is entitled to a sum payable in respect of the security in the capacity of—

(i) a person acting as a trustee of a trust estate, or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum;

(ii) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum

is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or

(iii) a member of a retirement scheme that is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;

(c) is a market maker who, in the ordinary course of conduct of the market maker's trade, profession or business in respect of market making, holds the security for the purpose of providing liquidity for the security;

(d) is a public body; or

(e) is a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being.

17E. Financial institution: profits adjusted if associates deal not at arm's length in connection with regulatory capital security

(1) This section applies if—

(a) conditions are made or imposed between a financial institution and a person who is an associate of the financial institution, in their commercial or financial relations in connection with a regulatory capital security; and

(b) the conditions differ from those that would be made if the person were not such an associate.

(2) Any profits that, but for the conditions referred to in subsection (1)(a), would have accrued to the financial institution or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the financial institution or the person and taxed in accordance with this Part.

17F. Financial institution: issuer's deduction if regulatory capital security is issued to, held by or issued or held for benefit of specified connected person

(1) No deduction is to be allowed to the issuer of a regulatory capital security (***specified issuer***) under section 16(1) for any sum payable in respect of the security if it is issued to, held by or issued or held for the benefit of a specified connected person of the specified issuer.

(2) Subsection (1) does not apply to a sum payable in respect of a regulatory capital security issued to or for the benefit of a specified connected person of the specified issuer if both of the following conditions are met—

(a) the money paid by or on behalf of the specified connected person for the issue of the security has been entirely funded, either directly or indirectly, by the proceeds of an external issue of a regulatory capital security or debenture or debt instrument by the specified connected person or an associated corporation of the specified issuer;

(b) the externally issued regulatory capital security or debenture or debt instrument is not, at any time during the basis period of the specified issuer for the year of assessment concerned, held by or for

the benefit of a specified connected person of the specified issuer.

(3) The amount of any deduction allowable under subsection (2) is not to exceed the sum payable by the specified connected person or associated corporation (as the case requires) in respect of the externally issued regulatory capital security or debenture or debt instrument (other than the repayment of the paid-up amount).

(4) Subsection (5) applies to a deduction allowable under subsection (2) if the externally issued regulatory capital security or debenture or debt instrument is held by or for the benefit of an associate (other than a specified connected person) of the specified issuer.

(5) The amount of the deduction that, but for this subsection, would have been allowed under section 16(1) is to be reduced by any amount by which the sum payable to, or for the benefit of, that associate exceeds a reasonable commercial return on money borrowed of an amount equal to the paid-up amount for the externally issued regulatory capital security or debenture or debt instrument.

(6) For the purposes of subsection (5), a reasonable commercial return means a return that, at the time the security or debenture or instrument was issued, would be regarded in the prevailing market conditions as a reasonable commercial return between persons dealing with each other at arm's length in the open market.

(7) In this section, a regulatory capital security or debenture or debt instrument is externally issued if the security or debenture or instrument is not issued to, or for the

benefit of, a specified connected person of the specified issuer.

(8) Subject to subsections (9) and (10), section 17D(5) and (6) applies to this section.

(9) The definition of ***market maker*** in section 17D(5) applies as if a reference to "this section" in paragraph (a) of that definition were a reference to this section.

(10) Section 17D(6) applies for the purposes of construing a reference to specified connected person appearing in subsection (2)(b), (4) or (7) as if—

(a) the reference to "the issuer of a regulatory capital security" in section 17D(6) were a reference to the specified issuer; and

(b) each reference to "the security" in section 17D(6)(a), (b) or (c) were a reference to the externally issued regulatory capital security or debenture or debt instrument referred to in subsection (2)(b), (4) or (7) (as the case requires).

17G. Financial institution: non-resident financial institution's Hong Kong branch treated as separate enterprise

(1) This section applies in ascertaining profits in respect of which a non-resident financial institution with capital raised through the issue of a regulatory capital security is chargeable to tax under this Part in relation to its Hong Kong branch.

(2) The profits of the Hong Kong branch of the non-resident financial institution are those that the Hong Kong branch would have made if it were a distinct and separate enterprise that—

(a) engaged in the same or similar activities under the same or similar conditions; and

(b) dealt wholly independently of the non-resident financial institution.

(3) In applying subsection (2), account is to be taken of the functions performed, assets used and risks assumed by the non-resident financial institution—

(a) through the Hong Kong branch; and

(b) through the other parts of the non-resident financial institution.

(4) In applying subsection (2), it is to be assumed that the Hong Kong branch—

(a) has the same credit rating as the non-resident financial institution; and

(b) has such equity and loan capital as it could reasonably be expected to have if it were a distinct and separate enterprise as described in that subsection.

(5) In accordance with subsection (2), transactions in connection with a regulatory capital security between the Hong Kong branch and any other part of the non-resident financial institution are treated as taking place on such terms and conditions as would have been agreed between parties dealing at arm's length.

(6) No deduction is to be allowed for costs and expenses in excess of those that would have been incurred on the assumptions in subsection (4).

(7) In this section—

(a) ***non-resident financial institution*** (境外財務機構) means any financial institution whose head office is situated outside Hong Kong;

(b) ***Hong Kong branch*** (香港分行) means any business carried on in Hong Kong by a non-resident financial institution.

17H. Arm's length and separate enterprise principles not prevented from application in other circumstances

Sections 17E and 17G do not prevent principles similar to those provided for in those sections from applying to a person, or in circumstances, other than the persons or circumstances mentioned in those sections.".

15. Schedule 6 amended

(1) Schedule 6—

Repeal

"[ss. 14A(4) & 26A(2) & (3) & Schs. 17A & 29]"

Substitute

"[ss. 14A(4), 17A(1) & 26A(2) & (3) & Schs. 17A, 29 & 36]".

(2) Schedule 6, Part 1, item 3, after "any other instrument"—

Add

"(other than a regulatory capital security)".

16. Schedule 16 amended (specified transactions)

(1) Schedule 16—

Repeal

"& 29]"

Substitute

", 29 & 36]".

(2) Schedule 16, Part 2, after section 2—

Add

"3. For the purposes of paragraphs (a), (b) and (c) of the definition of ***securities*** in section 1 of this Part, a regulatory capital security is treated as a bond.".

Division 4—Transitional Provisions

17. Section 89 amended (transitional provisions)

At the end of section 89—

Add

"(16) Schedule 36 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 4) Ordinance 2015 (of 2015).".

18. Schedule 36 added

At the end of the Ordinance—

Add

"Schedule 36

[s. 89(16)]

Transitional Provisions for Inland Revenue (Amendment) (No. 4) Ordinance 2015

1. In this Schedule—

(a) ***2015 Amendment Ordinance*** (《2015 年修訂條例》) means the Inland Revenue (Amendment) (No. 4) Ordinance 2015 (of 2015);

(b) ***commencement date*** (生效日期) means the day on which the 2015 Amendment Ordinance comes into operation;

(c) ***qualifying profits*** (合資格利潤) has the meaning given by section 14C(1); and

(d) in relation to a person, a year of assessment is the ***transitional year of assessment*** (過渡課稅年度) if the commencement date falls within the basis period of the person for the year of assessment.

2. For the purposes of section 14D(1), in computing the qualifying profits of a corporation, sums received by or accrued to the corporation before 1 April 2016 are not to be taken into account.

3. For the purposes of section 14E(5), in computing the corporate treasury profits of a corporation, sums received by or accrued to the corporation before 1 April 2016 are not to be taken into account.

4. Section 15(1)(ia) and (la) does not apply to sums received or accrued before the commencement date.

5. The following provisions apply only to sums payable on or after 1 April 2016—

(a) the amendments made to section 16(1), (2), (2A), (2B), (2C), (2E), (3) and (3B) by section 8 of the 2015 Amendment Ordinance;

(b) section 16(2)(g), (2CA), (2CB), (2CC), (2CD), (2I) and (3C).

6. Subject to section 7 of this Schedule, the following provisions apply only in ascertaining the profits in respect of which a person is chargeable to tax under Part 4 for the transitional year of assessment or any subsequent year of assessment—

(a) the amendments made to sections 2, 15 and 16 and Schedules 6 and 16 by Division 3 of Part 2 of the 2015 Amendment Ordinance;

(b) sections 15(1C), 16(2AA), 17A, 17B, 17C, 17D, 17E and 17F and section 17H (in so far as it relates to section 17E).

7. For a regulatory capital security issued before the commencement date—

(a) the following provisions apply only to sums received or accrued, in respect of the security, on or after the commencement date—

(i) the amendments made to section 15 and Schedule 6 by Division 3 of Part 2 of the 2015 Amendment Ordinance;

(ii) section 17B (in so far as it relates to a person to whom or for whose benefit a sum is payable in respect of the security);

(iii) section 17D(1);

(b) the following provisions apply only to sums payable, in respect of the security, on or after the commencement date—

(i) section 16(2AA);

(ii) section 17B (in so far as it relates to the issuer of the security);

(iii) sections 17C(1) and 17F;

(c) in applying section 17C(2) to the issuer of the security who has included any sums as assessable profits or losses when bringing the security into account at a fair value—

(i) the liability under the security is taken to have been released and re-assumed at its fair value on the commencement date; and

(ii) any change in value between that date and the end of the basis period is to be brought into account for computing the assessable profits for the transitional year of assessment;

(d) in applying section 17D(2) to a specified connected person of the issuer of the security if the specified connected person has included any sums as assessable profits or losses when bringing the security into account at a fair value—

(i) the security is taken to have been disposed of and re-acquired at its fair value on the commencement date; and

(ii) any change in value between that date and the end of the basis period is to be brought into account for computing the assessable profits for the transitional year of assessment;

(e) sections 17C(3) and 17D(3) apply only to a write-down or conversion effected on or after the commencement date;

(f) sections 17C(4) and 17D(4) apply only to a write-up effected on or after the commencement date; and

(g) the amendment made to Schedule 16 by section 16 of the 2015 Amendment Ordinance applies only to

a transaction carried out on or after the commencement date.

8. Section 17G and section 17H (in so far as it relates to section 17G) apply only in ascertaining the profits in respect of which a non-resident financial institution with capital raised through the issue of a regulatory capital security (whether before, on or after the commencement date) is chargeable to tax under Part 4—

(a) for the year of assessment beginning on the first day of April in the calendar year next following the commencement date; or

(b) for any subsequent year of assessment.".

Part 3

Consequential and Related Amendments Concerning Regulatory Capital Securities

Division 1—Consequential Amendments to Inland Revenue Rules

19. Cross-heading before rule 3 amended

Cross-heading before rule 3—

Repeal

"BANK WHOSE HEAD OFFICE IS ELSEWHERE THAN IN HONG KONG"

Substitute

"FINANCIAL INSTITUTION WHOSE HEAD OFFICE IS OUTSIDE HONG KONG".

20. Rule 3 amended (banks; Hong Kong branch offices)

(1) Rule 3, heading—

Repeal

"**Banks;**"

Substitute

"**Financial institution: profits of**".

(2) Before rule 3(1)—

Add

"(1A) This rule has effect to the extent to which it is not inconsistent with sections 17B, 17C, 17D, 17E, 17F, 17G and 17H of the Ordinance.".

(3) Rule 3—

Repeal paragraph (1)

Substitute

"(1) In this rule—

(a) ***non-resident financial institution*** (境外財務機構) means any financial institution whose head office is situated outside Hong Kong;

(b) ***Hong Kong branch*** (香港分行) means any business carried on in Hong Kong by a non-resident financial institution.".

(4) Rule 3(2) and (3)—

Repeal

"bank" (wherever appearing)

Substitute

"non-resident financial institution".

21. Cross-heading before rule 5 amended

Cross-heading before rule 5—

Repeal

"WHOSE HEAD OFFICE IS ELSEWHERE THAN IN HONG KONG"

Substitute

", OTHER THAN A FINANCIAL INSTITUTION, WHOSE HEAD OFFICE IS OUTSIDE HONG KONG".

22. Rule 5 amended (profit of Hong Kong branch offices)

(1) Rule 5, heading—

Repeal

"**Profit of Hong Kong branch offices**"

Substitute

"Profits of Hong Kong branch offices of person other than financial institution".

(2) Rule 5(2)—

(a) **Repeal**

"a person having"

Substitute

"a person, other than a financial institution, having";

(b) **Repeal**

"elsewhere than in Hong Kong"

Substitute

"outside Hong Kong".

23. Rule 7 added

At the end of the Rules—

Add

"**7. Transitional provisions**

The amendments made to rules 3 and 5 by the Inland Revenue (Amendment) (No. 4) Ordinance 2015 (of 2015) apply only in ascertaining the profits in respect of which a person is chargeable to tax under Part 4 of the Ordinance—

(a) for the year of assessment beginning on the first day of April in the calendar year next following the day on which the amendments come into operation; or

(b) for any subsequent year of assessment.".

Division 2—Related Amendments to Stamp Duty Ordinance

24. Section 19 amended (contract notes, etc. in respect of sale and purchase of Hong Kong stock)

Section 19(1DA), after "Schedule 8"—

Add

"or Part 2 of Schedule 9".

25. Section 63 amended (regulations)

Section 63(c)—

Repeal

"Schedule 8"

Substitute

"Schedules 8 and 9".

26. First Schedule amended

(1) First Schedule—

Repeal

"Schs. 7 & 8]"

Substitute

"Schs. 7, 8 & 9]".

(2) First Schedule, head 2(3), Note 4, after "Schedule 8"—

Add

"or Part 3 of Schedule 9".

(3) First Schedule, head 2(4), Note 2, after "Schedule 8"—

Add

"or Part 4 of Schedule 9".

27. Schedule 9 added

After Schedule 8—

Add

"Schedule 9

[ss. 19 & 63 & 1st Sch.]

Transactions and Transfers Relating to Regulatory Capital Security

Part 1

Interpretation

1. In this Schedule—

purchase (購買), ***sale*** (售賣) and ***sale or purchase*** (售賣或購買) have the meanings given by section 19(16);

regulatory capital security (監管資本證券) has the meaning given by section 17A of the Inland Revenue Ordinance (Cap. 112).

Part 2

Transactions to which Section 19(1) does not Apply

1. A sale or purchase of a regulatory capital security.

2. A transaction that is deemed under section 19(1E)(a) or (12) to be a sale and purchase of Hong Kong stock where the stock involved is a regulatory capital security.

Part 3

Transfers on which Stamp Duty under Head 2(3) in First Schedule is not Payable

1. A transfer executed for a transaction by which the beneficial interest in a regulatory capital security passes otherwise than on sale and purchase.

Part 4

Transfers on which Stamp Duty under Head 2(4) in First Schedule is not Payable

1. A transfer executed for a transaction by which a regulatory capital security is transferred.".

Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (***IRO***), the Inland Revenue Rules (Cap. 112 sub. leg. A) and the Stamp Duty Ordinance (Cap. 117) (***SDO***) for the purposes as set out in the long title of the Bill.

Profits tax concession for qualifying corporate treasury centres

2. Division 1 of Part 2 of the Bill amends the IRO to give profits tax concession to qualifying corporate treasury centres (***QCTC profits tax concession***).

3. Clause 3 adds new sections 14C, 14D, 14E and 14F to the IRO.

4. The new section 14C provides for the interpretation of terms for the QCTC profits tax concession, such as ***corporate treasury service***, ***corporate treasury transaction***, ***intra-group financing business*** and ***qualifying profits*** (new section 14C(1), (2), (3) and (4)). The Secretary for Financial Services and the Treasury is empowered to amend by order published in the Gazette certain definitions, which are specified in the new Schedule 17B (new section 14C(5)).

5. The new section 14D is the main provision for the QCTC profits tax concession—

(a) The new section 14D(1) provides that a corporation that is a qualifying corporate treasury centre for a year of assessment is entitled to have its qualifying profits for that year of assessment charged at one-half of the profits tax rate specified in Schedule 8 to the IRO (***concessionary rate***).

(b) The new section 14D(2) provides for how a corporation may be a qualifying corporate treasury centre, that is—

(i) by satisfying the conditions specified in the new section 14D(3);

(ii) by satisfying the safe harbour rule under the new section 14E; or

(iii) by obtaining the determination of the Commissioner of Inland Revenue (***Commissioner***) under the new section 14F(1).

A financial institution is, however, not eligible to be a qualifying corporate treasury centre (new section 14D(9)).

(c) The new section 14D(5) provides certain conditions other than being a qualifying corporate treasury centre for the entitlement to the concessionary rate.

6. The new section 14E provides for how a corporation may satisfy the safe harbour rule (new section 14E(1)). There are 2 alternative safe harbours—

(a) The "1-year safe harbour" requires the corporation to satisfy certain conditions regarding its corporate treasury profits and corporate treasury assets for the year of assessment concerned (new section 14E(2)).

(b) The "multiple-year safe harbour" requires the corporation to satisfy certain similar conditions for the year of assessment and the preceding 1 or 2 years of assessment (new section 14E(3)).

7. The new section 14F provides for the Commissioner's discretion to make a determination that a corporation that satisfies neither the conditions specified in the new section 14D(3) nor the safe harbour rule under the new section 14E is a qualifying corporate treasury centre for the year of assessment concerned.

8. Clause 4 consequentially amends section 19CA of the IRO to include the case where the concessionary rate is applicable in the adjustment mechanism provided under that section.

9. Clause 5 makes consequential amendment to Schedule 8 to the IRO.

10. Clause 6 adds a new Schedule 17B to the IRO to define ***corporate treasury service*** and ***corporate treasury transaction*** and to specify the prescribed profits percentage and the prescribed asset percentage for the safe harbour rule.

Interest in respect of borrowing and lending of money with associated corporations

11. Division 2 of Part 2 of the Bill amends the IRO to make provisions for profits tax purposes regarding interests on money borrowed from or lent to associated corporations.

12. Clause 7 amends section 15 of the IRO to add the new section 15(1)(ia) and (la) to deem certain sums received by or accrued to a corporation (other than a financial institution) from its intra-group financing business as having a Hong Kong source regardless of whether the moneys concerned are made available outside Hong Kong. The similar situations of a financial institution are currently dealt with by the existing section 15(1)(i) and (l) already.

13. Clause 8 amends section 16 of the IRO to add a new section 16(2)(g) to provide for the deduction in respect of interest payable by a corporation that is carrying on in Hong Kong an intra-group financing business on money borrowed from its non-Hong Kong associated corporation. It also adds the new section 16(2CA) and (2CC) to provide for 2 anti-avoidance provisions specific to the deduction under the new section 16(2)(g).

14. Clauses 9 and 10 make consequential amendments to Schedules 8 and 17A to the IRO.

Tax treatment of regulatory capital security

15. Division 3 of Part 2, and Part 3, of the Bill amend the IRO, the Inland Revenue Rules (Cap. 112 sub. leg. A) and the SDO to clarify the tax treatment of new types of regulatory capital securities issued by financial institutions to meet the requirements imposed by the Banking (Capital) Rules (Cap. 155 sub. leg. L) which implement certain standards promulgated by the Basel Committee on Banking Supervision. In essence, an Additional Tier 1 or a Tier 2 capital instrument issued, other than in the form of a share, will be taxed as if it were a debt security.

16. Clause 14 adds new sections 17A to 17H to the IRO. Existing section 16(1)(a) and (2)(a) of the IRO (on deduction of expenses) will apply subject to these new provisions (clause 13).

17. The new section 17A defines ***regulatory capital security*** and other terms for the new sections.

18. The new section 17B provides that, for the purposes of Part 4 of the IRO, a regulatory capital security is to be treated as a debt security and a payment in respect of the regulatory capital security (other than a repayment of the paid-up amount) is to be treated as interest payable on the security. This is subject to the new sections 17C to 17H.

19. For the issuer of the regulatory capital security and the issuer's specified connected person (defined by the new section 17D(5)) by whom or for whose benefit the security is held, fair value accounting of the security is not permitted for tax purposes in relation to the security or part of the security (new sections 17C(2) and 17D(2)).

20. For the issuer and specified connected person, a sum representing the paid-up amount of a regulatory capital security on a conversion, write-down or subsequent write-up of the

security arising as a result of a financial institution hitting a regulatory trigger or nearing insolvency is not to be treated as a trading receipt and is not deductible for tax purposes (new sections 17C(3) and (4) and 17D(3) and (4)).

21. Under the new section 17E, the chargeable profits from a transaction between a financial institution and its associate will be assessed by reference to the amount of profits that would have accrued had the same transaction been carried out on terms that would have been made between parties who are not associates.

22. The new section 17F sets out, in relation to a regulatory capital security issued to, held by or issued or held for the benefit of, a specified connected person of the issuer, the conditions that must be met in order for a payment in respect of the security to be deductible.

23. The new section 17G sets out the basis on which the profits attributable to a Hong Kong branch of a non-resident financial institution with capital raised through the issue of a regulatory capital security are to be determined. In essence, the profits are to be attributed as if the Hong Kong branch were a distinct and separate enterprise.

24. The new section 17H clarifies that the new sections 17E and 17G do not prevent the arm's length and separate enterprise principles from being applied in other circumstances.

25. Clause 12 amends section 15 of the IRO so that, subject to the new sections 17B to 17H, gains or profits, from the disposal or on the redemption of a regulatory capital security in certain circumstances, received by a person carrying on a trade, profession or business are deemed to be trading receipts.

26. Clauses 15 and 16 amend Schedules 6 and 16 to the IRO to clarify that the tax reliefs under sections 14A and 26A of the IRO do not

apply to a regulatory capital security whereas the tax exemption under section 20AC of the IRO applies to it.

Transitional provisions

27. Division 4 of Part 2 of the Bill (clauses 17 and 18) adds a new Schedule 36 to the IRO to provide for transitional matters in respect of the amendments in Divisions 1, 2 and 3 of Part 2 of the Bill.

Consequential and related amendments concerning regulatory capital securities

28. In view of the new section 17G (on profits assessment of the Hong Kong branch of a non-resident financial institution) added to the IRO, clauses 19 to 23 make consequential amendments to rules 3 and 5 of the Inland Revenue Rules (Cap. 112 sub. leg. A) and add transitional provisions.

29. Clauses 24 to 27 amend sections 19 and 63 of, and the First Schedule to, the SDO and add a new Schedule 9 to it. With these amendments, a contract note is not required to be executed or stamped for the sale or purchase of a regulatory capital security. Further, any other transfer of regulatory capital security is exempt from stamp duty under heads 2(3) and 2(4) of the First Schedule to the SDO.