

立法會
Legislative Council

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Panel on Financial Affairs

**Minutes of special meeting
held on Wednesday, 14 December 2016 at 9:00 am
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Christopher CHEUNG Wah-fung, SBS, JP
(Chairman)
Hon Kenneth LEUNG (Deputy Chairman)
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, BBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon LEUNG Kwok-hung
Hon Frankie YICK Chi-ming, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon CHAN Chi-chuen
Hon Dennis KWOK Wing-hang
Dr Hon Fernando CHEUNG Chiu-hung
Dr Hon Junius HO Kwan-yiu, JP
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon Tanya CHAN
Hon CHEUNG Kwok-kwan, JP
Hon HUI Chi-fung
Hon Kenneth LAU Ip-keung, MH, JP

Members absent : Hon WONG Ting-kwong, SBS, JP
Hon KWOK Wai-keung
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon CHU Hoi-dick
Hon HO Kai-ming
Hon CHAN Chun-ying
Hon LUK Chung-hung
Hon Nathan LAW Kwun-chung
Dr Hon YIU Chung-yim

Public officers attending : Agenda Item I

Mr Andrew LAI, JP
Deputy Secretary for Financial Services and the
Treasury (Treasury)²

Mr Gary POON
Principal Assistant Secretary for Financial Services
and the Treasury (Treasury) (Revenue)

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)
Inland Revenue Department

Mr Benjamin CHAN
Senior Assessor (Research)³
Inland Revenue Department

Agenda Item II

Ms Ada CHAN
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)²

Mr Keith LUI
Executive Director (Supervision of Markets)
Securities and Futures Commission

Mr Rico LEUNG
Senior Director (Supervision of Markets)
Securities and Futures Commission

Mr Stanley NG
Associate Director (Supervision of Markets)
Securities and Futures Commission

Mr Colin LAU
Senior Manager (Supervision of Markets)
Securities and Futures Commission

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I Consultation on measures to counter Base Erosion and Profit Shifting

(LC Paper No. CB(1)190/16-17(06) — Paper on "Consultation on measures to counter Base Erosion and Profit Shifting"

LC Paper No. IN02/16-17 — Information note on "Measures to counter Base Erosion and Profit Shifting" prepared by the Research Office of Legislative Council Secretariat)

Briefing by the Administration

At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Treasury)2 ("DS(Tsy)2") briefed members on the Government's proposed work plan to counter Base Erosion and Profit Shifting ("BEPS"). He pointed out that the Organisation for Economic Co-operation and Development ("OECD") released a package of 15 action plans in October 2015 to tackle BEPS and, together with the Group of Twenty, had called on all countries and jurisdictions to join an inclusive framework for

Action

implementation of the BEPS package ("inclusive framework"). Hong Kong joined the inclusive framework as an Associate in June 2016 and indicated to OECD its commitment to the consistent implementation of the BEPS package. The Government launched a consultation exercise from October to December 2016 to gauge stakeholders' views on the implementation of the BEPS package in Hong Kong. The proposed implementation strategy and the legislative proposals were outlined in the consultation paper. As an international financial centre, Hong Kong was duty-bound to implement the BEPS package to promote tax transparency and combat cross-border tax evasion. He emphasized that implementing the BEPS package would not entail any new taxes or any changes in tax rates.

Discussion

Impact on Hong Kong's business environment

2. Mr CHAN Kin-por said that while he supported the proposed implementation strategy and measures to counter BEPS, he was concerned that implementation of the BEPS package might adversely affect Hong Kong's business environment and tax base. He enquired how the Administration would assist Hong Kong enterprises in meeting the requirements of the proposed regime to counter BEPS. He also expressed concern about the manpower resources in the Inland Revenue Department ("IRD") for implementing the proposed strategy.

3. DS(Tsy)2 explained that implementing the BEPS package could help ensure that multinational enterprises pay a fair share of taxes in respect of their profits among jurisdictions. However, as Hong Kong adopted a simple and territorial-based tax regime, the impact on our tax base and tax revenue would not be significant. To assist enterprises in meeting the new requirements, IRD would develop templates to facilitate enterprises in submitting documents and filing reports. Regarding the concern over IRD's manpower resources, DS(Tsy)2 remarked that IRD had indeed been facing manpower constraints in recent years, in particular arising from the implementation of various new international initiatives on tax cooperation, such as automatic exchange of financial account information in tax matters. Implementing these international initiatives would inevitably give rise to additional workload for IRD. IRD would review its manpower situation and seek resources for strengthening its manpower through the established mechanism where necessary.

4. Mrs Regina IP noted that Hong Kong was only an observer in some committees of OECD rather than a member of OECD, and enquired about the need for Hong Kong to implement the BEPS package. She expressed concern

Action

about arbitrage between the regulatory regime of Hong Kong and those of other jurisdictions, such as Singapore, as other jurisdictions might be less committed in implementing the BEPS package; thereby adversely affected Hong Kong's competitiveness in attracting investments from multinational enterprises.

5. Mr Charles MOK shared the concern about Hong Kong's competitiveness in attracting overseas investments, and stressed the importance for the Administration to strike a balance between implementing measures to counter BEPS in meeting international standard and maintaining Hong Kong's competitiveness. He noted that many jurisdictions had been offering generous tax incentives in attracting overseas investment and asked whether Hong Kong would develop similar tax measures.

6. Deputy Commissioner (Technical), Inland Revenue Department ("DCIR(T")) said that Hong Kong had, upon invitation, participated in several OECD's committees relating to taxation, including the Forum on Tax Administration, the Inclusive Framework on BEPS and the Global Forum on Transparency and Exchange of Information for Tax Purposes. Jurisdictions which failed to implement measures to counter BEPS might be labelled as "non-cooperative tax jurisdictions" by OECD or the European Union, and could be subject to sanctions. He added that the Government had been closely monitoring the progress of other jurisdictions in taking forward the BEPS package, including that of Singapore. DS(Tsy)2 supplemented that as at 15 July 2016, 85 countries and jurisdictions including the Mainland and Macau had joined the inclusive framework. The Government was aware of the need to ensure that Hong Kong's model for implementing the BEPS package met the international standard without compromising its simple and low tax regime and increasing the compliance costs of enterprises. The Government would focus on the four minimum standards of the BEPS package as well as measures of direct relevance to their implementation. Regarding measures to attract overseas investments, DS(Tsy)2 said that the Commerce and Economic Development Bureau and InvestHK would consider and implement strategies in this regard.

Implementation strategy of Hong Kong

7. In response to Mr Kenneth LEUNG's enquiry about the Administration's strategy for implementing the BEPS package in Hong Kong and the legislative timetable for introducing the relevant amendment bill(s) into the Legislative Council ("LegCo"), DS(Tsy)2 reiterated that the Government would focus on the minimum standards of the BEPS package as well as measures of direct relevance to their implementation. The Government's priority was to put in place the necessary legislative framework for transfer pricing rules which

Action

covered the latest guidance from OECD (Actions 8 to 10 of the BEPS package), country-by-country ("CbC") reporting requirement (Action 13), cross-border dispute resolution mechanism (Action 14) as well as the multilateral instrument (Action 15). A two-month public consultation exercise was launched on 26 October 2016 to gauge views on the proposals. The Government planned to finalize the implementation strategy in early 2017 and introduce the relevant amendment bill(s) into LegCo in the second half of 2017.

Transfer pricing documentation and country-by-country reporting

8. Mr CHAN Kin-por, Mr Kenneth LEUNG and Mr LEUNG Kwok-hung enquired about the details of the requirements of transfer pricing documentation and CbC reporting, and the estimated number of enterprises to be exempt from the requirement of preparing master and local files.

9. DS(Tsy)2 responded that under the Government's current proposal, enterprises engaged in transactions with associated enterprises would be required to prepare master and local files unless they could satisfy any two of the following three conditions: (a) total annual revenue not more than HK\$100 million; (b) total assets not more than HK\$100 million; and (c) no more than 100 employees. The Government would provide information on the number of enterprises which could satisfy both conditions (a) and (c). As the Government did not have information on the value of assets held by individual enterprises, it could not provide information in this aspect.

(Post-meeting note: The Administration's supplementary information was issued to members vide LC Paper No. CB(1)402/16-17(02) on 5 January 2017)

10. Mr LEUNG Kwok-hung urged the Administration to consider imposing penalty with sufficient deterrent effect against enterprises' non-compliance with the new requirements. Mr Kenneth LEUNG was concerned that a lot of enterprises might not meet the conditions for exemption from the transfer pricing documentation and CbC reporting requirements.

11. DS(Tsy)2 said that the Government would consider stakeholders' views on the proposed criteria for exemption and would adopt a pragmatic approach. To ensure compliance with the new requirements, the Government would need to introduce corresponding penalty provisions.

12. Mr LEUNG Kwok-hung asked whether the Government would exchange the information provided by enterprises with other tax jurisdictions including the Mainland. Mr Holden CHOW expressed concern about possible

Action

leakage of enterprises' sensitive information to other jurisdictions which could adversely affect the enterprises' interests. Mr WU Chi-wai enquired whether there were restrictions on the usage of CbC reports by tax jurisdictions. He opined that the Administration should provide information on the permitted uses of the reports when LegCo scrutinized the relevant amendment bill(s).

13. DS(Tsy)2 responded that under the proposed strategy, master and local files submitted by enterprises would be kept by IRD. The Government planned to rely on Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") or Tax Information Exchange Agreements ("TIEAs") as the basis of automatic exchange of CbC reports with CDTA and TIEA partners on a bilateral basis. For CbC reports which would be exchanged with other tax jurisdictions, they only contained basic information of the enterprises such as amounts of revenue, profits and tax paid as stipulated by OECD. DCIR(T) added that exchange of CbC reports would not unnecessarily expose the financial details of enterprises, as basic tax information of listed enterprises was often published in their annual reports which were available to the public. He also pointed out that, under the restrictions set by OECD, CbC reports could only be used for the purpose of risk assessment. Based on the findings of CbC reports, tax jurisdictions could initiate further investigation towards the enterprises in accordance with their relevant tax laws. As regards the exchange of CbC reports with the Mainland, DCIR(T) said that under the current CDTAs entered between Hong Kong and the Mainland, the two jurisdictions could exchange tax information and such information could only be used for enforcement of tax laws. If CDTA or TIEA partners violated the requirements of the agreements or abused the use of exchanged information, Hong Kong could suspend the information exchange or even terminate the agreements.

II Legislative proposals to enhance the position limit regime

(LC Paper No. CB(1)190/16-17(07) — Paper on "Proposed enhancements to the position limit regime in Hong Kong"

LC Paper No. CB(1)190/16-17(08) — Background brief on proposed amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap 571Y) prepared by the Legislative Council Secretariat)

Action

Briefing by the Security and Futures Commission

14. At the invitation of the Chairman, Senior Director (Supervision of Markets), Securities and Futures Commission ("SD/SFC") briefed members on the legislative proposals by the Securities and Futures Commission ("SFC") to enhance the position limit regime for the futures and options markets. He pointed out that under the regime, SFC was empowered to prescribe position limits and large open position reporting requirements for futures and options contracts in the Securities and Futures (Contract Limits and Reportable Positions) Rules (Cap. 571Y). In respect of a futures or options contract, the position limit denoted the maximum size of position that might be held or controlled by a person. In light of recent growth and developments in the Hong Kong securities and futures markets, SFC considered it timely to review the position limit regime, and proposed enhancements comprised of the following five areas:

- (a) raising the cap on the excess position limit for client facilitation;
- (b) introducing a new excess position limit for market makers of exchange traded funds;
- (c) introducing a new excess position limit for index arbitrage activities;
- (d) introducing a new excess position limit for asset managers; and
- (e) increasing the statutory position limit for stock options contracts.

He added that comments received during the consultation period were generally supportive of the proposed enhancements. SFC was studying the comments and would issue the consultation conclusions in early 2017. SFC aimed to table the proposed amendment rules before LegCo for negative vetting in the first quarter of 2017.

Discussion

Application for excess position limit for client facilitation

15. Noting that SFC had proposed to raise the net asset value requirement for applying the client facilitation excess position limit from not less than \$2 billion to not less than \$5 billion, Mrs Regina IP enquired about which types of exchange participants were expected to meet the new requirement. She was

Action

concerned that Hong Kong's position limit regime was less competitive than those of other major markets such as New York, London and Singapore. She requested the Administration and SFC to provide a paper comparing the proposed enhancements to the position limit regime in Hong Kong and the relevant rules in the regimes of the above mentioned markets.

16. Mr Holden CHOW enquired about the considerations in raising the net asset value requirement for applying the client facilitation excess position limit, including whether the proposed increase from not less than \$2 billion to not less than \$5 billion was commensurate with the proposed increase in the cap on the excess position limit from the current level of 50% to 300%.

17. Executive Director (Supervision of Markets) Securities and Futures Commission ("ED/SFC") responded that large international financial institutions were expected to benefit from or affected by the enhanced regime. Regarding competitiveness of Hong Kong's position limit regime, he pointed out that the current regime was relatively restrictive when compared to other major markets. He believed that the situation would improve under the new regime. He said that some exchange participants had pointed out to SFC that the current cap of 50% on the client facilitation excess position limit was not large enough vis-à-vis the size of their business activities. As a result, they usually relied on the over-the-counter derivatives market for hedging purposes. SFC considered that raising the cap to 300% would encourage market participants, especially large international financial institutions, to establish more of their derivative positions on the exchange market, thereby enhancing greater market transparency for better assessment of potential implications on market stability. To ensure that applicants would have sufficient financial capability to manage the risk exposures resulted from the higher position limit, SFC proposed to raise the net asset value requirement at the same time. SFC would carefully examine each application to ensure that applicants must have effective internal control procedures and risk management systems to manage the potential risks arising from the excess position.

(Post-meeting note: The information on the comparison of position limit regimes of major markets provided by the Administration and SFC was issued to members vide LC Paper No. CB(1)503/16-17(02) on 26 January 2017)

18. The Chairman welcomed the proposed enhancements to the position limit regime. He considered that the current six to eight weeks vetting by SFC on applications for the excess position limit too long, and urged SFC to expedite the process.

Action

19. ED/SFC responded that for first-time applicants, SFC would need to carefully examine their risk management systems, and hence would require longer processing time. The vetting time for subsequent applications could be curtailed as SFC had better knowledge on the applicants' ability in risk management.

Risk management

20. Mr LEUNG Kwok-hung was concerned that the enhanced position limit regime might bring new risks to the stability of the Hong Kong market. He also considered it inappropriate to encourage market participants to establish their positions on the exchange-traded market. As the Hong Kong Exchanges and Clearing Limited ("HKEX") imposed fees on market participants for its services, Mr LEUNG queried that SFC's proposal would benefit HKEX.

21. ED/SFC responded that the proposed enhancements would bring benefits to the Hong Kong market, including minimizing the associated risks to the market and any potential adverse impact on market stability. He emphasized that the objective of SFC's proposal was to facilitate market development. The profits of HKEX were never a consideration of SFC in the review of the position limit regime.

(At 10:25 am, the Chairman ordered that the meeting be extended for 15 minutes to 10:40 am to deal with the unfinished business.)

III Any other business

Letter from Hon Regina IP regarding consultation on the listing regime

(LC Paper No. CB(1)308/16-17(01) — Letter dated 9 December 2016 from Hon Mrs Regina IP regarding consultation on the proposed enhancements to the Stock Exchange of Hong Kong Limited's decision-making and governance structure for listing regulation (Chinese version only))

22. The Chairman said that he received a letter dated 9 December 2016 from Mrs Regina IP requesting the Panel to discuss the subject of consultation jointly

Action

launched by the Securities and Futures Commission ("SFC") and the Hong Kong Exchanges and Clearing Limited ("HKEX") on the proposed enhancements to Stock Exchange of Hong Kong Limited's decision-making and governance structure for listing regulation. Mrs IP also suggested in her letter to invite the Secretary for Financial Services and the Treasury ("SFST") and the Chief Executive Officer of SFC to attend the discussion. The Chairman pointed out that the relevant consultation had ended on 18 November 2016, Mrs IP raised an oral question regarding the consultation at the Council meeting of 9 November 2016, and he also moved a motion on "Formulating a comprehensive listing policy" at the Council meeting of 30 November 2016 which was passed.

23. The Chairman further remarked that at the work plan meeting held on 31 October 2016 between the Chairman and Deputy Chairman with SFST, taking into account that SFC and HKEX would need time to consider the large quantity of views received on the consultation and to formulate the way forward, it was agreed that discussion of the subject be tentatively scheduled for the regular Panel meeting in April 2017. Noting that the securities industry had expressed grave concern on the subject, he sought members' views on how to follow up Mrs Regina IP's request, including whether the Panel should hold a special meeting before April 2017 to discuss the subject.

24. Mrs Regina IP remarked that the consultation had aroused a lot of controversies. For instance, three professors of the Asian Institute of International Financial Law of the Faculty of Law of the University of Hong Kong had raised concern that the proposal of establishing a Listing Regulatory Committee might be "ultra vires the Securities and Futures Ordinance (Cap. 571)". She considered that it would be too late to discuss the subject at the regular Panel meeting in April 2017, and suggested the Panel holding a special meeting before the Lunar New Year in January 2017 to discuss the subject.

25. Mr Kenneth LEUNG said that he understood Mrs Regina IP's concern and agreed that the subject was controversial. He also noted that the Administration planned to submit many items for the Panel's discussion in coming months. He suggested that members should be consulted on Mrs IP's proposal of holding a special meeting. Mrs IP supported Mr LEUNG's suggestion.

26. The Chairman said that he would ask the Panel Clerk to issue a circular to consult members on Mrs Regina IP's proposal, and would decide whether to hold the special meeting having regard to members' feedback.

Action

(*Post meeting-note:* Members were consulted on Mrs Regina IP's proposal of holding a special meeting before the Lunar New Year in January 2017 vide LC Paper No. 316/16-17 issued on 15 December 2016. Having regard to members' feedback, the Chairman decided that the Panel would not hold the special meeting in January 2017. Members were informed of the Chairman's decision vide LC Paper No. 367/16-17 on 28 December 2016.)

27. The meeting ended at 10:37 am.

Council Business Division 1
Legislative Council Secretariat
10 March 2017