

立法會
Legislative Council

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by the Administration)

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Panel on Financial Affairs

**Minutes of meeting held on
Tuesday, 3 July 2018, at 10:45 am
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Kenneth LEUNG (Chairman)
Hon Christopher CHEUNG Wah-fung, SBS, JP
(Deputy Chairman)
Hon James TO Kun-sun
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon WU Chi-wai, MH
Hon Alvin YEUNG
Hon CHU Hoi-dick
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon CHAN Chun-ying, JP
Hon LUK Chung-hung, JP

Members absent : Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon Charles Peter MOK, JP
Hon Dennis KWOK Wing-hang
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Dr Hon Junius HO Kwan-yiu, JP
Hon CHEUNG Kwok-kwan, JP

Public officers attending : Agenda Item III

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

Ms Pecvin YONG
Principal Assistant Secretary for Financial Services and the Treasury (Treasury) (Revenue 1)

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

Mr LEUNG Kin-wa
Chief Assessor (Profits Tax)
Inland Revenue Department

Ms WONG Pui-ki
Senior Assessor (Research)
Inland Revenue Department

Agenda Item IV

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

Mr Stephen LO
Principal Assistant Secretary for Financial Services and the Treasury (Treasury)(R2)

Mr Brian CHIU Kwok-kit, JP
Deputy Commissioner (Technical)
Inland Revenue Department)3

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

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I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)1178/17-18 — Minutes of the meeting on
3 April 2018

LC Paper No. CB(1)1166/17-18(01) — List of follow-up actions)

The minutes of the meeting held on 3 April 2018 were confirmed.

II Information papers issued since the regular meeting on 4 June 2018

(LC Paper No. CB(1)1106/17-18(01) — Process Review Panel for the
Financial Reporting Council
2017 Annual Report)

2. Members noted the information paper issued since the regular meeting held on 4 June 2018.

III Proposed amendments to the Inland Revenue Ordinance

(LC Paper No. CB(1)1166/17-18(02) — Administration's paper on
"Proposed amendments to the
Inland Revenue Ordinance")

Briefing by the Administration

3. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Treasury)2 ("DS(Tsy)2") briefed members on the Administration's plan to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to: (a) allow the computation of assessable profits arising from financial instruments on a fair value basis ("legislative proposals on fair value accounting"); (b) expand the definition of "overseas financial institutions" to cover "export credit agency" for interest deduction in relation to the borrowers;

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and (c) align the relevant provisions of IRO with the common reporting standard for Automatic Exchange of Financial Account Information in Tax Matters ("AEOI"). The Administration planned to introduce the relevant amendment bill ("the Bill") into the Legislative Council ("LegCo") in the last quarter of 2018.

Discussion

Proposed adoption of fair value accounting for financial instruments for tax reporting

4. Mr CHAN Chun-ying conveyed support of the banking industry for the legislative proposals put forward by the Administration. In relation to the proposals on fair value accounting, he enquired whether the amount of assessable profits arising from financial instruments computed on a fair value basis or a realization basis would have significant difference, and whether the Administration had assessed if the legislative proposals would be subject to judicial review. Mr Christopher CHEUNG was concerned that if a listed company was allowed to account for its financial instruments on a realization basis, it might be able to manipulate its financial results. Mr WU Chi-wai enquired whether a company could elect realization accounting for its tax computation after passage of the Bill.

5. DS(Tsy)2 pointed out that the Administration had been in contact with the Hong Kong Association of Banks and got its support for the legislative proposal. The Administration would continue to consult relevant stakeholders including the insurance industry and the securities industry on the legislative proposals. Deputy Commissioner (Technical), Inland Revenue Department ("DC(T)) added that with effect from 1 January 2018, it had been compulsory for companies other than small and medium enterprises to adopt Hong Kong Financial Reporting Standard 9 ("HKFRS 9") to account for their financial instruments. In accordance with the Court of Final Appeal's ruling in *Nice Cheer Investment Limited v CIR* (2013) 16 HKCFAR 813 ("CFA's ruling"), unrealized profits were not chargeable to tax. Therefore, profits computed on a fair value basis in accordance with HKFRS 9 would have to be recomputed on a realization basis for tax reporting. In order to facilitate companies and save their costs for re-computing their profits on a realization basis, the legislative proposal allowed companies to elect fair value accounting as a basis for tax computation in respect of their financial instruments. The election was optional but once made, it would be irrevocable and would have effect for the year of assessment in respect of which the election was made and all subsequent years of assessment. From the tax perspective, DC(T) explained that as long as both the amount of revenue and expenditure were computed on the same basis, it would not generate taxation problems. In the long run, the overall assessable profits arising from financial

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instruments computed on a fair value basis or on a realization basis would be the same. Besides, it would be difficult for a listed company to manipulate its financial results because the HKFRS 9 should be applicable to all financial instruments held by the company. According to the existing accounting standards, a company had to restate its balance sheets and profit and loss accounts in the previous financial years if there was a change of adopted accounting standard.

6. The Chairman enquired about the impacts of CFA's ruling regarding tax computation of assets not yet disposed by a company.

7. DC(T) advised that according to CFA's ruling, unrealized revaluation gains in respect of listed securities held by companies for trading purpose were not chargeable to tax in Hong Kong. He added that a number of jurisdictions including the United Kingdom and Singapore had amended their legislation to tie in with the implementation of the International Financial Reporting Standard 9. The legislative proposal on fair value accounting sought to provide tax certainty for companies adopting HKFRS 9.

8. In response to Mr WU Chi-wai's enquiry about the accounting standard (i.e. fair value accounting or realization accounting) a company undergoing corporate restructuring should adopt, DC(T) advised that corporate restructuring usually involved transfer of assets, in general, if the transferee company had elected fair value accounting basis for tax computation, the same basis should be applied to the financial instruments being transferred.

Proposed expansion of the definition of "overseas financial institutions"

9. Mr CHAN Chun-ying noted that under the legislative proposal to expand the definition of overseas financial institutions, the expanded definition would include an export credit agency, which was owned or established and operated by a foreign state or government (or any sub-division or local authority of a foreign state or government) for the purposes of supporting and developing international trade by providing financing support to its local exporters or investors for international export or overseas investment activities, so that interest expenses payable by the borrowers from such export credit agency could be eligible for interest deduction under IRO. He sought details of the term "overseas investment activities", including whether it covered investment in overseas real estates.

10. Mr Holden CHOW enquired about the amount of money borrowed by Hong Kong companies from overseas export credit agencies in recent years, and the estimated amount of tax revenue forgone under the proposed legislative

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amendments. He also enquired whether other jurisdictions would offer similar tax deduction treatment to Hong Kong.

11. DC(T) explained that there were foreign companies operating in Hong Kong and chargeable to Hong Kong profits tax. Such foreign companies might borrow money from overseas export credit agencies. While the Administration did not have the information requested by Mr Holden CHOW, it was estimated that the existing amount of loans granted by overseas export credit agencies was relatively small due to the absence of relevant tax deduction measures in Hong Kong. Nevertheless, a number of subsidiaries of foreign companies were planning to participate in infrastructure projects relating to the Belt and Road Initiative and some of them requested the Administration to provide tax deduction for their interest payments made on loans from overseas export credit agencies. Many jurisdictions provided tax deduction for similar interest expenses.

Conclusion

12. The Chairman concluded that Panel members did not object the Administration's plan to introduce the Bill into LegCo in the last quarter of 2018.

IV Latest developments on the application of the Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong

(LC Paper No. CB(1)1166/17-18(03) — Administration's paper on "Latest developments on the application of the Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong"

LC Paper No. CB(1)1197/17-18(01) — Background brief on the application of the Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong prepared by the Legislative Council Secretariat)

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Briefing by the Administration

13. At the invitation of the Chairman, DS(Tsy)2 briefed members on the latest developments regarding the application of the Convention on Mutual Administrative Assistance in Tax Matters ("the Convention") to Hong Kong. He explained that the Convention was jointly developed by the Organisation for Economic Co-operation and Development ("OECD") and the Council of Europe to provide a multi-party platform enabling participating jurisdictions to mutually agree among themselves on all possible forms of administrative cooperation in the assessment and collection of taxes, including various modes of exchange of information ("EOI"). The declaration made by the Central People's Government ("CPG") for extending the application of the Convention to Hong Kong ("Declaration for Extension") was registered at OECD on 29 May 2018 which had included a list of reservations and declarations applicable to Hong Kong under the Convention. CPG also deposited with OECD a Unilateral Declaration on the effective date for exchanges of information with respect to AEOI on 25 June 2018, with a view to bringing the date of entry into effect of the Convention in line with Hong Kong's committed timeline for AEOI which was to have the first exchange in September 2018. To give effect to the Convention and the relevant declarations in Hong Kong, an order ("Order") shall be made by the Chief Executive in Council under section 49(1A) of IRO. The Order would be subject to the negative vetting procedure of LegCo. He added that the Convention would enter into force in Hong Kong on 1 September 2018. To allow the Order to commence operation on or before 1 September 2018 so that the first round of AEOI could be conducted on schedule, the Administration recommended that the date of gazettal of the Order be designated as its commencement date instead of following the normal practice of allowing a full 49-day negative vetting period for scrutiny by LegCo before the subsidiary legislation commenced operation. The Administration planned to table the Order at LegCo for negative vetting in mid-October 2018.

14. Noting that the Order would be subject to negative vetting of LegCo, the Chairman sought clarification as to whether the House Committee of LegCo could still appoint a subcommittee to study the subsidiary legislation when the Order was tabled before LegCo in mid-October 2018 even though the Order had commenced before 1 September 2018. DS(Tsy)2 replied in the affirmative.

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Discussion

Extending the application of the Convention on Mutual Administrative Assistance in Tax Matters to Hong Kong

15. The Chairman and Mr WONG Ting-kwong enquired about the need to extend the application of the Convention to Hong Kong. DS(Tsy)2 explained that Hong Kong had signed 40 Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") and seven Tax Information Exchange Agreements ("TIEAs"), which allowed Hong Kong to conduct EOI on tax matters with the respective jurisdictions so far. They only covered 18 out of the 28 European Union ("EU") Member States. However, in view of the continued expansion in the scope of EOI on tax matters in the international community, it was no longer practical for Hong Kong to solely ride on bilateral CDTAs and TIEAs to exchange tax information as required by the AEOI and the Base Erosion and Profit Shifting ("BEPS") initiatives. This was because discussions with individual jurisdictions on signing new CDTAs/TIEAs often took time, and it would require further negotiations to amend some of the existing CDTAs/TIEAs to cater for certain types of EOI, such as AEOI. Therefore, a more practical approach was to implement these initiatives through the Convention so that Hong Kong could gain access to a wide network for EOI expeditiously. At present, 122 jurisdictions had participated in the Convention. Hong Kong would be able to ride on the Convention to conduct EOI (including AEOI) with other jurisdictions. Moreover, both OECD and EU attached great importance to the timely implementation of AEOI and the BEPS package. They had drawn up their respective lists of "non-cooperative" tax jurisdictions based on a jurisdiction's compliance with the relevant international requirements. It was therefore necessary to allow the Convention to enter into force in Hong Kong as soon as possible so that Hong Kong would meet the pledge of conducting the first round of AEOI with relevant jurisdictions by September 2018.

Exchange of information under the Convention on Mutual Administrative Assistance in Tax Matters

16. Mr WONG Ting-kwong enquired about the types of tax information to be exchanged and how the exchanges would be conducted under the Convention including how the Administration would determine whether to conduct EOI on request, automatic EOI, or spontaneous EOI with the relevant jurisdictions.

17. DC(T) advised that the Convention contained various provisions on mutual assistance in tax matters among parties to the Convention including EOI on request, automatic EOI, spontaneous EOI, simultaneous tax examinations and tax examinations abroad. The Administration would only take forward the

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mandatory provisions of the Convention and had made reservations and declarations through CPG so that the optional provisions would not apply to Hong Kong. For instance, Hong Kong would not assist other jurisdictions in the recovery of tax claim/fine, service of documents, etc. under the Convention. He added that the Convention would enable Hong Kong to take a multilateral approach in implementing AEOI and taking forward the automatic exchange of Country-by-Country reports and spontaneous EOI on tax rulings under the BEPS package. He stressed that it was the Government's policy that Hong Kong, as a general rule, would neither participate in simultaneous tax examinations with other jurisdictions nor accept requests for tax examinations abroad from other jurisdictions. As a matter of policy, Hong Kong would participate in three forms of EOI, namely, EOI on request, automatic EOI and spontaneous EOI on tax rulings under the Convention. Upon completion of the legislative exercise to give effect to the Convention, the Inland Revenue Department ("IRD") would exchange the financial account information collected from the reporting financial institutions ("FIs") with relevant jurisdictions in September 2018.

18. Mr CHAN Chun-ying sought elaboration on the reservations (including tax recovery and tax examinations abroad) in the Declaration for Extension whereby Hong Kong would not provide certain types of assistance to other jurisdictions under the Convention. He asked whether jurisdictions such as Hong Kong's AEOI partners would refuse to offer similar assistance to Hong Kong.

19. DS(Tsy)2 responded that as Hong Kong had been practising a territorial-based tax regime, it was unlikely that Hong Kong would need to ascertain a taxpayer's liability by conducting tax examinations with other jurisdictions. As set out in item 11 in Annex C to the discussion paper (i.e. the list of reservations and declarations applicable to Hong Kong under the Convention), Hong Kong would not accept requests from other jurisdictions for conducting tax examination in Hong Kong given that tax examinations abroad was an optional provision of the Convention.

20. Noting that Hong Kong would conduct the first round of AEOI with other jurisdictions in September 2018, and that the Financial Account Information Returns ("AEOI Returns") from 600 out of some 1600 reporting FIs were still outstanding by 2 June 2018, Mr CHAN Chun-ying enquired about measures the Administration would take to help the 600 FIs to furnish their AEOI Returns in the coming two months, the follow-up actions the Administration would take if FIs failed to furnish the required information to IRD within the prescribed timeframe, and whether IRD would exercise flexibility in handling late AEOI Returns or take enforcement actions against any late returns.

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21. DC(T) advised that IRD had developed a dedicated platform, i.e. the AEOI Portal, for reporting FIs to submit their AEOI Returns electronically. The AEOI Portal had been operating smoothly and FIs had not indicated difficulty in using the system. IRD would adopt a facilitating approach and step up its work in helping FIs to submit AEOI Returns including arranging publicity to enhance FIs' awareness of their obligations for submitting the returns and ensuring the returns would meet the required format and standard. IRD would conduct analyses on the received AEOI Returns to ensure the information provided (e.g. information on tax residences of account holders) was in order. The checking exercise was still underway and IRD would request the FIs concerned to take appropriate remedial actions if required.

Impact on Comprehensive Avoidance of Double Taxation Agreements and Tax Information Exchange Agreements entered by Hong Kong with other jurisdictions

22. The Chairman and Mr WONG Ting-kwong enquired about the possible impacts of Hong Kong's participation in the Convention on its existing CDTAs and TIEAs. The Chairman sought information on the follow-up actions the Administration would take should conflicting provisions were identified between the Convention and the respective CDTAs/TIEAs signed with the jurisdictions. Mr WONG Ting-kwong was concerned whether the concessionary tax measures included in CDTAs Hong Kong had entered with other jurisdictions would be affected if such jurisdictions also participated in the Convention.

23. DS(Tsy)2 responded that the Government would continue its efforts in concluding more CDTAs with Hong Kong's trading and investment partners as such agreements served as a business facilitation initiative in minimizing the incidence of double taxation. On the other hand, the Convention only provided a basis for jurisdictions to agree on a multilateral basis to conduct AEOI and implement the BEPS initiatives without offering any taxation relief. The Convention would have no impact on the tax benefits available under CDTAs between Hong Kong and other jurisdictions. Furthermore, the exchange of tax information under the AEOI and the BEPS initiatives would be conducted based on the international standards mandated by OECD.

Conclusion

24. The Chairman concluded that Panel members did not object to the Administration's plan to designate the date of gazettal of the Order as its commencement date, and table the relevant subsidiary legislation before LegCo for negative vetting in October 2018.

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V Any other business

25. The Chairman reminded members that the Panel on Commerce and Industry, the Panel on Economic Development, and the Panel on Financial Affairs would hold a joint meeting on 20 July 2018 to discuss with the Administration the "impact of trade conflict between China and the United States on Hong Kong's economy".

26. This being the last meeting of the Panel for the 2017-2018 session, the Chairman thanked members for their participation on the work of the Panel and the LegCo Secretariat for its support.

27. The meeting ended at 11:50 am.

Council Business Division 1
Legislative Council Secretariat
5 September 2018