

立法會
Legislative Council

LC Paper No. CB(1)1824/03-04
(These minutes have been seen
by the Administration)

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Bills Committee on Inland Revenue (Amendment) Bill 2000

**Minutes of the ninth meeting
held on Thursday, 29 April 2004, at 8:30 am
in Conference Room B of the Legislative Council Building**

Members present : Dr Hon Eric LI Ka-cheung, GBS, JP (Chairman)
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai
Hon Miriam LAU Kin-yee, JP
Hon Ambrose LAU Hon-chuen, GBS, JP
Hon Audrey EU Yuet-mee, SC, JP

Public officers attending : Financial Services and the Treasury Bureau

Mr Martin GLASS
Deputy Secretary for
Financial Services and the Treasury (Treasury)

Miss Erica NG
Principal Assistant Secretary for
Financial Services and the Treasury (Treasury)

Mr Danny LEUNG
Principal Assistant Secretary for
Financial Services and the Treasury (Financial Services)

Mr Ivanhoe CHANG
Assistant Secretary for
Financial Services and the Treasury (Treasury)

Inland Revenue Department

Mr TAM Kuen-chong
Deputy Commissioner of Inland Revenue

Mr SO Chau-chuen
Assistant Commissioner of Inland Revenue

Mrs Jennifer CHAN
Assistant Commissioner of Inland Revenue

Mr LI Yiu-kuen, Thomas
Senior Assessor

Department of Justice

Mr Allen LAI
Senior Government Counsel

- Attendance by invitation** : Hong Kong Monetary Authority
Mr Francis CHU
Head of Monetary Operations Division
- Clerk in attendance** : Ms Anita SIT
Chief Council Secretary (1)6
- Staff in attendance** : Ms Bernice WONG
Assistant Legal Adviser 1
Mr Matthew LOO
Senior Council Secretary (1)3
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I Confirmation of minutes of meetings

- LC Paper No. CB(1)1295/03-04 - Minutes of meeting on 24 February 2004
- LC Paper No. CB(1)1296/03-04 - Minutes of meeting on 2 March 2004

The minutes of the meetings held on 24 February and 2 March 2004 were confirmed.

II Meeting with the Administration

- LC Paper No. CB(1)1654/03-04 (01) - Administration's paper on "Draft Committee Stage amendments (CSAs) for savings provisions and self-education expenses deduction"
- LC Paper No. CB(1)1654/03-04 (02) - Administration's letter dated 28 April 2004 on "Follow-up on issues raised at the meeting on 2 March 2004"
- LC Paper No. CB(1)1654/03-04 (03) - Administration's response to comments relating to exemption from 'tax symmetry' rule for internal borrowings by associated corporations
- LC Paper No. CB(1)1654/03-04 (04) - List of issues requiring follow-up actions by the Administration (Position as at 28 April 2004)
- LC Paper No. CB(1)1438/03-04 (01) - Submission dated 26 March 2004 from Capital Markets Tax Committee of Asia (Hong Kong Chapter)
- LC Paper No. CB(1)1438/03-04 (02) - Submission dated 26 March 2004 from Hong Kong General Chamber of Commerce
- LC Paper No. CB(1)1438/03-04 (03) - Submission dated 26 March 2004 from the Taxation Institute of Hong Kong
- LC Paper No. CB(1)1525/03-04 (01) - Submission dated 8 April 2004 from Joint Liaison Committee on Taxation
- LC Paper No. CB(1)1525/03-04 (02) - Submission dated 2 April 2004 from the Real Estate Developers Association of Hong Kong
- LC Paper No. CB(1)1654/03-04 (05) - Summary of views and the Administration's response on the impacts of proposed section 16(2C) and the proposed exemption of "market-makers" under proposed sections 16(2G) and 16(2H) (position as at 26 April 2004)

- LC Paper No. CB(1)303/03-04 (01) - Revised proposed Committee Stage amendments provided by the Administration on 7 November 2003
- LC Paper No. CB(1)303/03-04 (02) - Marked-up copy of revised proposed Committee Stage amendments provided by the Administration on 7 November 2003
- LC Paper No. CB(1)1182/03-04 (01) - Administration's letter dated 1 March 2004 on the draft CSAs on exemption of market-making activities from the operation of proposed section 16(2C)
- LC Paper No. CB(1)500/03-04 (01) - Letter dated 13 November 2003 from Assistant Legal Adviser 1 to the Administration on the technical aspects of the proposed Committee Stage amendments
- LC Paper No. CB(1)500/03-04 (02) - Administration's response dated 8 December 2003
- LC Paper No. CB(1)531/03-04 (02) - Administration's paper on response to concerns raised at the meeting on 13 November 2003
- LC Paper No. CB(1)921/03-04 (01) - Administration's paper on response to concerns raised at the meeting on 9 December 2003
- LC Paper No. CB(1)1064/03-04 (01) - Administration's paper on follow-up actions arising from the discussion at the meeting on 5 February 2004
- LC Paper No. CB(1)1104/03-04 (01) - List of statutory bodies established by legislation to register and recognise professional qualifications and status or grant permits or licences for practicing in a profession, trade or occupation (referred to in LC Paper No. CB(1)1064/03-04 (01))
- LC Paper No. CB(1)1158/03-04 (01) - Administration's paper on "Tax Treatment of Interest Income and Payments: A Comparison with Overseas Jurisdictions"

2. The Administration was requested to consider and provide information on the following matters raised by the Bills Committee at the meeting -

Clause 4 - Adjustments to assessable income

- (a) To provide a list of the institutions approved under the existing section 12(6)(d)(i)(F), and if available, information on the criteria being used and the future guideline for the purpose of proposed section 12(6)(e); and

Clause 6 - Ascertainment of chargeable profits

- (b) Regarding Inland Revenue Department (IRD)'s investigations on interest deduction claims under section 61A, to provide further details including the amount of tax that has been assessed to which no notice of objection or appeal has been received, with a breakdown showing the amount attributable to schemes involving debenture interest.

III Any other business

Dates of next meeting

3. The next meeting of the Bills Committee was scheduled for 11 May 2004 from 4:30 pm to 7:30 pm. The Bills Committee would continue the clause-by-clause examination of the Bill and deliberate other outstanding issues at the next meeting.

4. There being no other business, the meeting ended at 10:30 am.

5. The index of proceedings of the meeting is at **Appendix**.

Bills Committee on Inland Revenue (Amendment) Bill 2000

**Proceedings of the 9th meeting on Thursday, 29 April 2004, at 8:30 am
in Conference Room B of the Legislative Council Building**

Time marker	Speaker	Subject(s)	Action required
000000 - 000631	Chairman	Welcoming and introductory remarks Confirmation of minutes of meetings on 24 February and 2 March 2004	
000632 - 002635	Chairman Administration Mr SIN Chung-kai Ms Audrey EU	Briefing by the Administration on - • draft Committee Stage amendments (CSAs) for savings provisions and self-education expenses deduction <i>[CB(1)1654/03-04(01)]</i> • update on the progress of the outstanding applications for advance ruling <i>[CB(1)1654/03-04(02)]</i> • comments relating to exemption from "tax symmetry" rule for internal borrowings by associated corporations <i>[CB(1)1654/03-04(03)]</i>	

Time marker	Speaker	Subject(s)	Action required
002636 - 003207	Chairman Mr SIN Chung-kai	<u>Draft CSAs for savings provisions and self-education expenses deduction</u> Mr SIN Chung-kai welcomed the draft CSAs and enquired whether the Administration would consider extending the scope of self-education expenses deduction to cover fees paid in respect of courses accredited or recognized by other institutions such as Hong Kong Computer Society. The Administration pointed out that there were the practical difficulties to extend the scope of proposed section 12(6)(c)(iii) further to cover institutions not falling within the categories set out in paragraph 5 of the paper because of possible abuse. Nevertheless, an institution might still seek approval from the Commissioner of Inland Revenue (the Commissioner) as an education provider under proposed section 12(6)(e) so that the fees paid for the courses provided by the institution could be eligible for salaries tax deduction.	
003208 - 003844	Chairman Ms Audrey EU Administration	Ms Audrey EU was concerned about the operation of existing section 12(6)(d)(i)(F), which was the equivalent of proposed section 12(6)(e). She requested the Administration to provide more information about the "institutions" approved by the Commissioner under this section, and the criteria being used and the future guideline for the purpose of proposed section 12(6)(e).	Administration to take follow-up action set out in paragraph 2(a) of the minutes

Time marker	Speaker	Subject(s)	Action required
003208 - 003844 (Cont'd)		The Administration said that not more than 10 institutions had been approved by the Commissioner under section 12(6)(d)(i)(F) so far. Currently, there was no guideline for the purpose of this section but IRD intended to issue guidelines upon enactment of proposed section 12(6)(e).	
003845 - 005226	Chairman Mr CHAN Kam-lam Administration	<u>Exemption from the "tax symmetry" rule for internal borrowings by associated corporations</u> Mr CHAN Kam-lam pointed out that it was common for companies to buy debentures issued by other companies of the same group in the course of normal trading or market-making activities. He enquired whether this type of commercial activities would be exempted from the restriction on interest deduction. He also enquired whether a threshold of up to a certain percentage of the debentures on issue could be held by associated companies without triggering the disallowance provisions. The Administration advised that the dual purposes of the proposed amendments to section 16(2)(f) and new section 16(2C) were to reinstate the "tax symmetry" rule and plug the tax avoidance loophole by disallowing deduction in respect of interest incurred from borrowings between connected parties, unless there was "tax symmetry".	

Time marker	Speaker	Subject(s)	Action required
003845 - 005226 (Cont'd)		The Administration also pointed out that CSAs had been proposed to exempt market-making activities of securities dealers from the operation of the interest deduction restriction provided in proposed section 16(2C) on compliance grounds.	
005227 - 005846	Chairman Ms Miriam LAU Administration	Ms Miriam LAU raised concern that the proposed anti-avoidance provisions to disallow interest deduction for debentures subscribed by controlling shareholders and associated corporations appeared to be a blunt instrument giving no regard to genuine commercial activities. It might not be worth to introduce the proposed provisions having regard to the possible adverse impact on the development of the debt market in Hong Kong.	

Time marker	Speaker	Subject(s)	Action required
005227 - 005846 (Cont'd)		The Administration advised that several rounds of consultation had been carried out on the proposed anti-avoidance provisions and significant concessions had been given to ensure that the proposed amendments did not disrupt market operations, such as replacing the references to "associates" by "persons connected with the borrower" so as to restrict the scope of application of the new provisions, allowing apportionment in interest deduction, etc.. The present proposal represented an appropriate balance which on one hand would not adversely affect the debt market development and on the other protect government revenue.	
005847 - 010659	Chairman Ms Miriam LAU Administration	The Chairman queried that existing section 61A might already be adequate for counteracting the tax avoidance schemes targeted by the Administration. Many organizations expressed similar views in their submissions. The Administration pointed out the difficulties in relying section 61A to counteract tax avoidance schemes as this section was subject to the overriding requirement that the sole or dominant motive was tax-avoidance. The restrictive application of the provision did not empower IRD to tackle tax avoidance schemes when such schemes involved a substantial extent of commercial substance.	

Time marker	Speaker	Subject(s)	Action required
005847 - 010659 (Cont'd)		The Administration also pointed out that the policy intention of restricting the interest tax deductibility only on external borrowings instead of internal ones had not been fully reflected in the existing section 16(2)(f). Another major policy objective was to reinstate the "no deduction for borrowings between associates/for internal borrowings rule" in respect of interest expenses on debentures to make the taxation arrangements more equitable, since interest on internal borrowings in the form of a loan by a controlling shareholder of a small and medium sized corporation was also not allowed for profits tax deduction unless the tax symmetry condition was complied with.	
010700 - 010830	Chairman Mr SIN Chung-kai	Mr SIN Chung-kai said that at this stage, he was in support of the proposed anti-avoidance provisions relating to deduction of interest expenses from chargeable profits proposed by the Administration.	
010831 - 012424	Chairman Administration Ms Miriam LAU	The Administration confirmed that the proposed arrangement had no retrospective effect on those cases already assessed by IRD using section 61A, including cases that were under appeal or objection, and those transactions for which advance ruling by the Commissioner had been applied.	

Time marker	Speaker	Subject(s)	Action required
010831 - 012424 (Cont'd)		The Administration undertook to provide information regarding IRD's investigations on interest deduction claims under section 61A. The Chairman recalled that when introducing the anti-avoidance provisions of section 61A, the policy intent was that no genuine business transactions would be affected.	Administration to take follow-up action set out in paragraph 2(b) of the minutes
012425 - 014813	Chairman Administration Mr Ambrose LAU	Briefing by the Administration on illustrations set out in <i>Annex A of CB(1)1654/03-04(03)</i>. In response to Mr Ambrose LAU's enquiry, the Administration explained that part of the interest expenses should be disallowed in order to maintain the "tax symmetry" principle if a controlling shareholder took up the debenture. However, this arrangement would not be applied to debenture subscription by small shareholders because of the identification problem. The Administration explained that the exemption for small shareholders was necessary due to "identification/compliance problem". The Chairman pointed out that some organizations considered that this arrangement would be discriminating against controlling shareholders.	

Time marker	Speaker	Subject(s)	Action required
014814 -015151	Chairman Ms Miriam LAU	Ms Miriam LAU referred to the extracts from the 1984-85 Budget Speech at <i>Annex B of CB(1)1654/03-04(03)</i> and noted that the then Financial Secretary was already aware of the effect which the removal of interest tax might have on the Profits Tax. As section 16(2)(f) was introduced in 1986, she queried the possibility that the "tax symmetry" rule was inadvertently omitted when the section was introduced. The Chairman commented that the main purpose of removing interest tax was to attract foreign investments. He considered that the anti-avoidance provisions presently proposed involved a change of policy in that the Administration now argued that the "tax symmetry" rule was the fundamental principle of the taxation regime, but this rule had in fact been applied to different extents at different times. The Administration added that the policy intention of section 16(2)(f) was to extend the interest deductibility only to public issues of debt securities as opposed to private ones and only to external borrowings instead of internal ones.	
015152 - 015827	Chairman Administration	Date of next meeting	Administration to provide the Chinese version of CSAs before next meeting.