

立法會
Legislative Council

LC Paper No. LS27/10-11

**Paper for the House Committee Meeting
on 18 February 2011**

**Legal Service Division Report on
Inland Revenue (Amendment) Bill 2011**

I. SUMMARY

- 1. Objects of the Bill** To amend the Inland Revenue Ordinance (Cap. 112) (IRO) to give effect to the proposals in the Budget of 2010-11 to extend the tax concession for qualifying debt instruments to those debt instruments with an original maturity of less than 3 years.
- 2. Comments** The Bill, among other things –

 - (a) amends section 14A(1) of IRO to extend the tax concession available to medium term debt instruments to short term debt instruments;
 - (b) replaces one of the eligibility requirements of "debt instrument" in section 14A(4); and
 - (c) provides additional anti-avoidance provisions in relation to the tax concession available to debt instruments.
- 3. Public Consultation** Hong Kong Monetary Authority had consulted participants of the treasury market on the principles and outline of the legislative proposals.
- 4. Consultation with LegCo Panel** The Panel on Financial Affairs discussed the legislative proposals on 5 July 2010. Some members expressed support. Certain issues were raised during the discussion.
- 5. Conclusion** In view of the issues raised by members of the Panel of Financial Affairs, members may wish to consider whether a Bills Committee should be formed. The scrutiny of the Bill is continuing.

II. REPORT

Objects of the Bill

To amend the Inland Revenue Ordinance (Cap. 112) (IRO) to give effect to the proposals in the Budget of 2010-11 to extend the tax concession for qualifying debt instruments (QDI) to those debt instruments with an original maturity of less than 3 years.

LegCo Brief

2. Issued by the Financial Services Branch of the Financial Services and the Treasury Bureau on 2 February 2011.

Date of First Reading

3. 16 February 2011.

Comments

Background

4. According to the LegCo Brief, the QDI scheme was introduced in mid 1990s with the policy objectives of attracting overseas issuers to Hong Kong, enlarging the local debt market, and enhancing the competitiveness of Hong Kong vis-à-vis other financial centres in the region.

5. The QDI scheme was subsequently amended in 1999 and 2003. At present, under IRO, a concessionary profit tax rate at 50% of the normal rate is applied to the interest income and trading profits derived from QDI with a maturity of less than seven years but not less than three years. However, as QDI only took up a small percentage of Hong Kong's total debt issuance, the Administration considers that there is room for improving the scheme to better serve its policy objectives.

6. In the Budget speech for the financial year of 2010-2011, the Financial Secretary proposed to extend the tax concession to cover QDI with a maturity of less than three years. The Bill seeks to implement the proposal.

Extending tax concession to short term debt instruments

7. Clause 3 of the Bill amends section 14A(1) of IRO to extend the existing concessionary profits tax rate available to medium term debt instruments to short term debt instruments. A "short term debt instrument" is defined in the Bill as a debt instrument issued after the commencement of the Bill that has an original maturity of less than three years or is undated, and can be redeemed within 3 years from the date with its issue.

Amending the definition of "debt instrument"

8. Under section 14A(4) of IRO, "issued to the public in Hong Kong" is one of the requirements for an instrument eligible to be classified as a "debt instrument". According to the LegCo Brief, the purpose of this requirement is to prevent potential tax avoidance through intra-group or inter-group issuances that are otherwise not necessary so as to enjoy tax concession.

9. The Administration proposes to replace the "issued to the public in Hong Kong" requirement, which may lead to uncertainties, with a new requirement that the instrument is issued in Hong Kong to "ten or more persons; or if less than ten persons, none of whom is an associate of the issuer of the instrument". According to the LegCo Brief, in drawing up this proposal, the Administration has made reference to similar overseas schemes.

Additional anti-avoidance provisions

10. To further prevent potential tax avoidance, clause 4(3) of the Bill introduces a new section 14A(1A) to IRO, which provides that the concessionary tax rate will not apply in respect of any interest income and trading profits received by or accrued to a person in relation to QDI if, at the time during which such interest income or trading profits is/are so received or accrued, the person is an associate of the issuer of QDI.

11. "Associate" is defined in the Bill. In drawing up the definition, the Administration has made reference to the definition of the same expression in section 16(3) of IRO. In essence, "associate" means an entity which controls the issuer, or is subject to the control of the issuer, or is subject to the control of the same person as is the issuer, either directly or indirectly. However, the Administration considers it necessary to carve out from the definition of "associate" companies which are associated merely because of common ownership by the central government of a country or its sovereign

wealth funds or similar state-owned enterprises but in practice operate independently as separate commercial entities. This would encourage and attract such companies to make use of the debt market platform in Hong Kong.

Commencement

12. The Bill, upon enactment, will come into operation upon its gazettal.

Public Consultation

13. According to the LegCo Brief, through the Treasury Markets Association, the Hong Kong Monetary Authority (HKMA) has consulted the treasury market participants on the principles and outline of the legislative proposals, which were supported generally. Upon our enquiry, HKMA indicated that the consultation was conducted between January 2009 and mid 2010.

Consultation with LegCo Panel

14. The Panel on Financial Affairs discussed the legislative proposals to enhance the QDI scheme on 5 July 2010. Some members expressed support for the initiative, and the following issues were raised during the discussion –

- (a) the efficacy of the enhanced QDI scheme in promoting the debt market in Hong Kong;
- (b) the amount of profits tax foregone as a result of the extended tax concession;
- (c) whether adequate safeguards are in place to regulate the debt market to protect the investing public;
- (d) coverage of the QDI scheme particularly in relation to structured products;
- (e) the criteria and legal backing for determining whether an instrument is a QDI;

- (f) the proposed new requirement to replace the existing "issued to the public" criterion; and
- (g) the definition of "associate" under the proposed anti-avoidance provision for the QDI scheme.

15. The Administration responded on the issues set out in (a) to (c) above at the Panel meeting. As regards the issues in (d) to (g) above, the Administration provided supplementary information after the meeting vide LC Paper CB(1)2664/09-10(01) dated 27 July 2010. There is no request for further meeting after the circulation of the supplementary information.

Conclusion

16. In view of the issues raised by members of the Panel of Financial Affairs, members may wish to consider whether a Bills Committee should be formed.

17. The scrutiny of the Bill is continuing. The Legal Service Division will report further if necessary.

Prepared by

Kelvin Ka-yun LEE
Assistant Legal Adviser
Legislative Council Secretariat
17 February 2011