

立法會
Legislative Council

LC Paper No. CB(1)1670/12-13
(These minutes have been seen
by the Administration)

Ref : CB1/BC/2/12

**Bills Committee on Inland Revenue and Stamp Duty Legislation
(Alternative Bond Schemes) (Amendment) Bill 2012**

**Third meeting on
Friday, 5 April 2013, at 2:30 pm
in Conference Room 3 of the Legislative Council Complex**

- Members present** : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Abraham SHEK Lai-him, SBS, JP
Hon Starry LEE Wai-king, JP
Hon Kenneth LEUNG
Hon SIN Chung-kai, SBS, JP
- Members absent** : Hon Ronny TONG Ka-wah, SC
Hon Christopher CHEUNG Wah-fung, JP
- Public officers attending** : Mr Jackie LIU
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services) 5
- Mr Herbert LAM
Assistant Secretary for Financial Services and the
Treasury (Financial Services)(5)3
- Ms Carrie CHAN
Senior Manager (Market Development)
Hong Kong Monetary Authority

Ms Doris LEE, JP
Assistant Commissioner 1
Inland Revenue Department

Mr Allen NG
Senior Assessor (Research)
Inland Revenue Department

Mr Eric WAN
Senior Assessor (Business Registration)
Inland Revenue Department

Ms Betty CHEUNG
Senior Assistant Law Draftsman
Department of Justice

Mr Manuel NG
Government Counsel
Department of Justice

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

Staff in attendance : Mr KAU Kin-wah
Senior Assistant Legal Adviser 3

Mr Hugo CHIU
Council Secretary (1)4

I Meeting with the Administration

(LC Paper No. CB(1)480/12-13(01) — Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to Members)

LC Paper No. CB(3)264/12-13 — The Bill

File Ref: B9/33/2C — Legislative Council Brief

LC Paper No. LS16/12-13 — Legal Service Division Report

LC Paper No. CB(1)480/12-13(02) — Background brief on the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012 prepared by the Legislative Council Secretariat)

Discussion

The Committee deliberated (Index of proceedings attached at **Appendix**).

II Any other business

Date of next meeting

2. The Chairman reminded members that the next two meetings would be held on 15 April 2013 at 4:30 pm and 30 April 2013 at 10:45 am respectively.
3. There being no other business, the meeting ended at 4:17 pm.

Council Business Division 1
Legislative Council Secretariat
7 August 2013

**Proceedings of the
Bills Committee on Inland Revenue and Stamp Duty Legislation
(Alternative Bond Schemes) (Amendment) Bill 2012
Third meeting on Monday, 5 April 2013, at 2:30 pm
in Conference Room 3 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
000133 – 000519	Chairman Administration	In response to the Chairman's enquiry, the Administration remarked that it would provide its response to views of deputation on the Bill before the next meeting scheduled for 15 April 2013.	
Clause by Clause Examination of the Bill			
000520 – 000909	Chairman Administration Mr Kenneth LEUNG	<p>Part 1</p> <p>Preliminary</p> <p><u>Clause 1 – Short title</u></p> <p><u>Clause 2 – Enactments amended</u></p> <p>Part 2</p> <p>Amendments to Inland Revenue Ordinance—Part 6A and Schedule 17A Added</p> <p><u>Clause 3 – Part 6A added</u></p> <p><i>Part 6A – Specified Alternative Bond Scheme and its Tax Treatment</i></p> <p>Mr LEUNG enquired why the relevant clauses of the Bill were incorporated into the Inland Revenue Ordinance (Cap. 112) ("IRO") as Part 6A instead of other Parts.</p> <p>The Administration responded that Parts 4 to 7 of IRO were on Profits Tax, Allowances, Depreciation, etc. and Personal Assessment respectively and it would be more appropriate to place the relevant content of the Bill before Part 7 of IRO. There was no particular purpose to include the relevant content of the Bill before Part 7.</p>	

Time Marker	Speaker	Subject(s)	Action Required
000910 – 002131	Administration Mr SIN Chung-kai Chairman	<p><u>Clause 4 – Schedule 17A added</u></p> <p><i>Schedule 17A – Specified Alternative Bond Scheme and its Tax Treatment</i></p> <p><i>Section 1 – Interpretation</i></p> <p><i>Section 2 – Alternative bond scheme, bond arrangement and investment arrangement</i></p> <p>Mr SIN referred to sections 2(3)(a) and 2(3)(b) of the proposed Schedule 17A and enquired about:</p> <ul style="list-style-type: none"> (a) whether the tax position of a bond-issuer would be affected if it engaged in businesses other than those specified in the Islamic bonds ("sukuk"); (b) whether the bond-issuers had to obtain credit ratings for the sukuk; (c) whether the parent company of a bond-issuer would be responsible in the event of the default of sukuk and whether the interests of the investors of the sukuk concerned would be protected; and (d) whether approval from the Hong Kong Monetary Authority ("HKMA") was required for the issuance of sukuk products. <p>The Administration's responses as follows:</p> <ul style="list-style-type: none"> (a) In practice, a bond-issuer was established solely for the purpose of the issuance of sukuk and it would be unlikely for it to engage in businesses other than those specified in the offering circulars/prospectuses of sukuk. (b) A bond-issuer would obtain credit ratings for sukuk if necessary, and such ratings would usually be the same to that of its parent company. (c) The responsibilities of a bond-issuer's parent company (i.e. the originator) and the arrangements for the default of sukuk would be disclosed in the sukuk's offering 	

Time Marker	Speaker	Subject(s)	Action Required
		<p>circulars/prospectus. The originator would usually be responsible for the bond-issuer's liabilities and the default of sukuk as (i) it was the lender of the last resort; and (ii) the bond-issuer was set up as a special purpose vehicle ("SPV") to fulfill the relevant Islamic laws ("Shariah"). As the capital of the bond-issuer would be provided by the originator, the credit risks of sukuk would depend on the financial position of the originator.</p> <p>(d) HKMA was not responsible for the approval of sukuk products. Similar to other financial products, products offered under Alternative Bond Schemes ("ABS") would be subject to the prevailing regulatory regime in respect of product offering, marketing, disclosure and intermediaries requirements in accordance with relevant provisions of the Securities and Futures Ordinance (Cap. 571) ("SFO") and the Companies Ordinance (Cap. 32) ("CO"). Approval from the Securities and Futures Commission ("SFC") on the offering circulars/prospectus of sukuk would also be required if the products were offered to the public.</p>	
002132 – 002518	Mr Kenneth LEUNG Administration	<p>Mr LEUNG pointed out that the bond-issuer and originator would usually be the subsidiaries of the same parent company yet the current drafting of the Bill allowed the bond-issuer and originator to be unrelated entities.</p> <p>The Administration responded that in general the bond-issuer and originator would be associated entities with the former usually established by the latter. However, some schools of Shariah required that the bond-issuer and the originator had to be independent entities in order to protect investors' interests. Under such scenario, the stocks of the bond-issuer would usually be held by a charitable organization. The Bill had to provide flexibility to cater for various scenarios and only mentioned the main features of sukuk.</p>	

Time Marker	Speaker	Subject(s)	Action Required
002519 – 002654	Mr SIN Chung-kai Administration	In response to Mr SIN's concern that some issuers might structure their investment products similar to sukuk in order to evade tax, the Administration explained that the Bill had specified qualifying conditions for sukuk products to be eligible for tax exemption and included anti-tax avoidance provisions. Chances of abuse of the ABS for tax avoidance would be low.	
002655 – 003047	Administration Mr Kenneth LEUNG	<p><i>Section 2 – Alternative bond scheme, bond arrangement and investment arrangement</i></p> <p>Mr LEUNG referred to section 2(4)(a) of the proposed Schedule 17A and enquired about:</p> <ul style="list-style-type: none"> (a) whether the term "specified asset" would usually cover the originator's stocks; (b) whether the term "specified asset" would include both the legal ownership and beneficial ownership of the assets held by SPV, and (c) where the legal title would vest in if only the beneficial interests were included. <p>The Administration responded as follows:</p> <ul style="list-style-type: none"> (a) The term "specified asset" covered the business undertaking, immovable properties and other assets of the originator. (b) The term "specified asset" covered either the beneficial interests or both the beneficial interests and legal ownership. (c) The legal title would be reserved by and vested in the originator if only the beneficial interests were included. 	
003048 – 003144	Administration	The Administration pointed out that upon liaison with the Legal Adviser to the Bills Committee, it might move a Committee Stage Amendment to refine the drafting in relation to SPV in section 2(3)(b) of the proposed Schedule 17A.	
003145 – 003251	Mr Kenneth LEUNG Administration	In response to Mr LEUNG's suggestion that the Administration should clarify the meaning of the term "the scheme" in section 2(3)(b) of the proposed Schedule 17A (e.g. whether the term	

Time Marker	Speaker	Subject(s)	Action Required
		<p>"scheme" should be capitalized), the Administration advised that the section could be read in conjunction with section 2(1)(a) of the proposed Schedule 17A and the term "the scheme" in the Bill referred to ABS.</p>	
003252 – 004240	Administration Mr Kenneth LEUNG	<p><i>Section 3 – Construction of references in section 2(3)(b) and (4)(b) of this Schedule</i></p> <p>Mr LEUNG referred to section 3(2) of the proposed Schedule 17A and enquired:</p> <ul style="list-style-type: none"> (a) about the meaning of the term "management" given that a SPV might not have a substantial structure and relevant employees to discharge management work; (b) in the scenario that the specified asset was an hotel, whether the SPV had to manage the hotel; (c) whether the Bill had imposed restrictions on the change of asset, and if so, whether the asset for exchange had to be of comparable quality, as mere replacement of asset with the same market value might not protect investors' interests because the market value of asset might fluctuate greatly. It would thus be more appropriate to stipulate that the asset for exchange should be of comparable quality. <p>The Administration replied as follows:</p> <ul style="list-style-type: none"> (a) The term "management" had a broad meaning and could include "to manage" and/or "to own". Sections 6 to 9 of the proposed Schedule 17A had out details of how the specified assets were to be managed under different types of specified investment arrangements; and (b) There was no provision in the Bill imposing restriction on asset replacement. The Administration noted that the offering circulars/prospectuses of sukuk would set out the arrangements for asset replacement under which it would be specified that the value of the replacement asset must be comparable to those of the original asset. 	

Time Marker	Speaker	Subject(s)	Action Required
		<p>In response to Mr LEUNG's enquiry about specifying the "reasonable commercial return" condition ("RCRC") for a qualified bond arrangement, the Administration explained that there were both equity-financed and debt-financed activities in Islamic finance, and the purpose of RCRC was to prevent equity-financed activities from enjoying special tax treatment under the Bill.</p>	
<p>004241 – 005050</p>	<p>Administration Mr SIN Chung-kai</p>	<p><i>Section 4 – Specified alternative bond scheme</i></p> <p><i>Section 5 – Specified investment arrangement</i></p> <p>Mr SIN's enquiries as follows:</p> <p>(a) How investor would be aware that the specified investment arrangements would be sukuk as the names of the five types of sukuk were not provided in the Bill; and</p> <p>(b) Whether issuers would obtain tax exemption before issuance of sukuk.</p> <p>The Administration's replies as follows:</p> <p>(a) As the Bill had adopted a religion-neutral drafting approach, it did not explicitly set out the names of the five types of sukuk but the core features of each sukuk were described in the provisions. Stakeholders responding to the public consultation and deputations giving views on the Bill had indicated support for this approach.</p> <p>(b) The offering circulars/prospectus of sukuk would state the names of the sukuk and provide details of the products and the relevant investment arrangements. Such documents would be subject to the scrutiny and approval of SFC if the products were offered to the public. In addition, the issuers would explain the products' details to the investors.</p> <p>(c) Sukuk issuers had to disclose the tax positions of the sukuk in the offering circulars/prospectus. If necessary, they might obtain advance ruling from the Inland Revenue Department ("IRD") on the tax position.</p>	

Time Marker	Speaker	Subject(s)	Action Required
005051 – 010314	Administration Mr Kenneth LEUNG	<p>Diagrams illustrating common product structures of sukuk were tabled at the meeting (LC Paper No. CB(1)815/12-13)</p> <p><i>Section 6 – Lease arrangement</i></p> <p>Mr LEUNG enquired:</p> <ul style="list-style-type: none"> (a) how sections 6(2)(a)(ii) of the proposed Schedule 17A would ensure that the replaced asset and replacing asset would be of the same value; (b) why section 6(2)(a)(ii)(B) of the proposed Schedule 17A had not explicitly specified that the compensation for any destruction or loss of asset should be paid by the originator; (c) whether it would be acceptable if the compensation was provided by a third party or in a form which did not comply with Shariah; and (d) whether the tax position of the sukuk would be affected if there were changes in its compliance status with Shariah. <p>The Administration's replies as follows:</p> <ul style="list-style-type: none"> (a) Current drafting of section 6(2)(a)(ii)(B) would provide flexibility to allow the compensation to be provided by the originator or a third party, e.g. the insurer if the issuer had taken out insurance for the assets, and the replacement asset would be of comparable value. (b) Sukuk issuers would ensure that the relevant compensation would be Shariah compliant. The Bill had provided flexibility for the payment of compensation by a third party under certain scenarios e.g. loss by negligence. (c) Sukuk's compliance status with Shariah would not affect its tax position. 	

Time Marker	Speaker	Subject(s)	Action Required
010315 – 011129	Administration Mr Kenneth LEUNG	<p><i>Section 7 – Profits sharing arrangement</i></p> <p>In response to Mr LEUNG's enquiry, the Administration responded that a specified investment arrangement involving the originator contributing the capital and its expertise and management skills into a business undertaking formed with the sukuk issuer would be a Musharakah structure (i.e. a profits sharing arrangement)</p> <p>Mr LEUNG's enquiries about:</p> <p>(a) whether business conducted by a specified investment arrangement given special tax treatment under the Bill would be subject to profits tax; and</p> <p>(b) whether profits tax would be exempted for the following scenario: the originator was an overseas entity while the business undertaking conducted its activities in Hong Kong.</p> <p>The Administration's replies as follows:</p> <p>(a) In accordance with section 21 of the proposed Schedule 17A, a qualified investment arrangement fulfilling the relevant conditions would be regarded as a debt arrangement and enjoyed the corresponding tax treatment. But any income, expenditure, profits, gains or losses arising from the activities of the business undertaking would be regarded as the income, expenditure, profits, gains or losses of the originator, and subject to tax liabilities under the existing taxation regime; and</p> <p>(b) If the business undertaking of a sukuk product conducted its business activities in Hong Kong, its income, expenditure, profits, gains or losses arising from such activities would be regarded as the income, expenditure, profits, gains or losses of the sukuk's originator. Thus the originator would be subject to profits tax regardless of its place of incorporation. The relevant treatments were set out in section 21 of the proposed Schedule 17A.</p>	

Time Marker	Speaker	Subject(s)	Action Required
011130 – 011845	Mr SIN Chung-kai Administration	<p>Mr SIN enquired about:</p> <ul style="list-style-type: none"> (a) how tax exemption would be granted for the following scenario: the underlying assets of the sukuk involved properties in Hong Kong; (b) how sukuk were issued in Malaysia; and (c) whether the Bill could attract investors to issue sukuk in Hong Kong in practice. <p>The Administration's replies as follows:</p> <ul style="list-style-type: none"> (a) It was possible that the underlying assets of sukuk issued in Hong Kong involved local assets like properties in Hong Kong. (b) Where certain land properties in Hong Kong were used in the issuance of an Ijarah (i.e. a lease arrangement) and the sukuk fulfilled the relevant qualifying conditions, the relevant stamp duties would be exempted. If the properties concerned were used for residential purpose, it was the intention that the new buyer's stamp duty ("BSD") would also be exempted. Rental income from the properties would be regarded as interest payments to the sukuk holders and would not be subject to property tax. (c) The regulatory regime and tax exemption arrangement for sukuk in Malaysia were similar to that proposed for Hong Kong. (d) The deputations providing views on the Bill at the meeting on 18 March 2013 had indicated support for the Bill in facilitating the development of a local sukuk market through reducing the relevant transaction costs. Further, Hong Kong could tap the opportunities of the rapid development of sukuk market, particularly given the growing demand for Renminbi denominated sukuk. It was important for Hong Kong to enact the Bill as soon as possible so as not to lag behind other jurisdictions in terms of development of a sukuk market. 	

Time Marker	Speaker	Subject(s)	Action Required
011846 – 012236	Mr Kenneth LEUNG Administration	<p>The Administration confirmed that:</p> <ul style="list-style-type: none"> (a) if the underlying assets of sukuk were local properties and were let, the rental income distributed to the sukuk holders would be regarded as interest payments to sukuk holders and granted tax exemption if the relevant bond arrangement met the qualifying conditions. The detailed tax treatment was set out in sections 20 and 21 of the proposed Schedule 17A; (b) if the originator held local properties and assigned part of the properties as the underlying assets of the sukuk and used the rest of the properties for other commercial purposes, income generated from the rest of the properties would be liable to profits tax; and (c) if the relevant bills on the new BSD, the enhanced special stamp duty and the enhanced ad valorem stamp duty which were under scrutiny by LegCo were passed, it would be necessary to introduce consequential amendments to provide ABS with exemption from such duties. 	
012237 – 013239	Administration Mr Kenneth LEUNG	<p><i>Section 8 – Purchase and sale arrangement</i></p> <p><i>Section 9 – Agency arrangement</i></p> <p>Responding to Mr LEUNG's enquiry, the Administration explained that under Wakalah (i.e. agency arrangement), an originator would be allowed to delegate the agency function to its subsidiary company. It was also provided under section 9(2) of the proposed Schedule 17A that a bond-issuer may perform some of the functions of the agent.</p>	
013240 – 014553	Administration Mr Kenneth LEUNG	<p><i>Section 10 – Lease arrangement, profits sharing arrangement and agency arrangement—investment return</i></p> <p>Mr LEUNG enquired about:</p> <ul style="list-style-type: none"> (a) whether "investment return" in section 10 of the proposed Schedule 17A was the same as total coupon rate in the case of conventional bonds; 	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(b) the arrangement for the scenario that the investment return exceeded the bond return; and</p> <p>(c) whether the term "investment return" was commonly used in the market and other jurisdictions, such as the United Kingdom ("the UK"), Singapore and Malaysia, and whether the Administration should use terms recognized internationally;</p> <p>The Administration's replies as follows:</p> <p>(a) Sections 10 and 18 of the proposed Schedule 17A should be read together in interpreting the term "investment return". Under section 18, one of the qualifying conditions for a qualified investment arrangement was that the investment return must not exceed the bond return. Moreover, section 19 of the proposed Schedule 17A provided that the investment arrangement had to be treated as a financial liability of the originator. Upon fulfilling the two requirements, the investment return would be regarded as interest payable and would be deductible in assessing profits chargeable to tax.</p> <p>(b) The special tax treatment would not be granted if the investment return exceeded the bond return. In such case, it was likely that the investment arrangement would be an equity arrangement rather than a debt arrangement.</p> <p>(c) The Bill separated a specified ABS into an investment arrangement and a bond arrangement and set out their respective details. If all the qualifying conditions were met, the investment arrangement and the bond arrangement would be regarded as debt arrangements; the "investment return" would be regarded as the interest payment by the originator to the bond issuer, and "bond return" would be regarded as the interest payment from the bond issuer to the bond holders.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(d) The relevant legislation enacted in the UK in 2007 covered the bond arrangement of sukuk only. Regarding the investment return, the UK legislation only relieved the stamp duty for the transfer of land between the originator and the bond-issuer of Ijarah. As for Singapore, the relevant legislation only covered Ijarah using land properties in Singapore as the underlying asset and the income of SPV would be regarded as that of the originator.</p> <p>(e) As the relevant market practitioners and professionals were familiar with the operation of sukuk, usage of terms like "investment arrangement", "bond arrangement", "investment return" and "bond return" would not cause problem. Investors at large also had no difficulty with the terms of "investment return" and "bond return". IRD would issue Departmental Interpretation and Practice Notes to explain the operational details of the Bill.</p> <p>Noting that the Bill contained elements which were more advanced than those in relevant legislation of other jurisdictions, Mr LEUNG suggested that the Administration should promote the successful experience of Hong Kong's regime to its counterparts.</p>	
014554 – 014719	Administration	<i>Section II – Purchase and sale arrangement—investment return</i>	
014720 – 014810	Chairman	Date of next meeting	