

**立法會**  
**Legislative Council**

LC Paper No. CB(1)1671/12-13  
(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**

**Fourth meeting on  
Monday, 15 April 2013, at 4:30 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 Christopher CHEUNG Wah-fung, JP  
Hon SIN Chung-kai, SBS, JP
- Member absent** : Hon Ronny TONG Ka-wah, SC
- 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

Ms Betty CHEUNG  
Senior Assistant Law Draftsman  
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**

Follow-up to issues arising from previous meetings

(LC Paper No. CB(1)842/12-13(01) -- Administration's responses to  
written submissions from  
deputations)

Clause-by-clause examination of the Bill

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

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

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**).

Admin Follow-up actions to be taken by the Administration

2. The Administration was requested to refine the drafting of the English text of section 15(c) of the proposed Schedule 17A to the Inland Revenue Ordinance (Cap. 112) to clearly reflect the meaning of "sold in Hong Kong" as conveyed in the Chinese text.

**II Any other business**

Date of next meeting

3. The Chairman reminded members that the next meeting would be held on 30 April 2013 at 10:45 am.

4. There being no other business, the meeting ended at 5:59 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  
Fourth meeting on Monday, 15 April 2013, at 4:30 pm  
in Conference Room 3 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
000439 – 000546	Chairman	Introductory remarks	
000547 – 001215	Administration SALA3	<p>Briefing by the Administration on its paper responding to written submissions from deputations (LC Paper No. CB(1)842/12-13(01))("the response paper")</p> <p>Noting the Administration's responses to deputations (p. 1 of Annex B) that bond-issuers would be allowed to hold a reserve to deal with contingencies or indemnity contracts, SALA3 sought clarification on whether instruments similar to the credit default swap would be covered by such "contract of indemnity". For instance, whether a bond-issuer of Islamic bonds ("sukuk") would need to make payments to the bond-holders concerned if the underlying asset of the sukuk consisted of rental properties but tenants of the properties refused to pay rent.</p> <p>The Administration pointed out that the insurance of most sukuk in the market covered destruction and loss of asset only.</p>	
<b>Clause by Clause Examination of the Bill</b>			
001216 – 002429	Administration Mr Kenneth LEUNG	<p><b>Clause 4 – Schedule 17A added</b> (Schedule 17A – Specified Alternative Bond Scheme and its Tax Treatment, to Inland Revenue Ordinance ("IRO"))</p> <p><u>Division 3 – Qualified Bond Arrangement, and Qualified Investment Arrangement, in Specified Alternative Bond Scheme Regarded as Debt Arrangements</u></p> <p><i>Section 12 – Qualified bond arrangement, and qualified investment arrangement, in specified alternative bond scheme</i></p> <p>Mr LEUNG enquired:</p>	

<b>Time Marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action Required</b>
		<p>(a) whether the term "material time" was defined in the Bill;</p> <p>(b) whether the bond arrangement ("BA") and the investment arrangement ("IA") of a specified alternative bond scheme ("ABS") had to comply with all the conditions set out in section 12(1) and 12(2)(b) of the proposed Schedule 17A respectively throughout the specified term of the ABS in order to be recognized as a qualified BA and a qualified IA; and</p> <p>(c) whether the bond-issuer of an ABS would be allowed under certain scenario (like administrative oversight) to rectify their disqualifying events so that the ABS could comply with the qualifying conditions again.</p> <p>The Administration's replies as follows:</p> <p>(a) The term "material time" meant "any time" and the defined term was used in both sections 4 and 12 of the proposed Schedule 17A to facilitate reference to the same time in other provisions in the same section.</p> <p>(b) The BA and IA of a specified ABS had to comply with all the qualifying conditions set out in the Bill throughout the specified term of the ABS. Otherwise, the BA and IA of the ABS would be regarded as disqualified and all special tax treatment granted to the BA and IA would be revoked.</p> <p>(c) The Administration had considered scenarios under which there should be a discretion to disregard a bond-issuer's failure to fulfill the qualifying conditions. Taking into account market views from the public consultation conducted in 2012, the Bill had included a provision in section 27 of the proposed Schedule 17A to give the Commissioner of Inland Revenue a discretion to disregard delay in the disposal of the specified asset of a specified ABS if there was a reasonable cause for it. To avoid tax evasion, a specified ABS had to comply with all the qualifying conditions</p>	

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		throughout its specified term in other situations.	
002430 – 003919	Administration Mr Kenneth LEUNG	<p><i>Section 13 – Reasonable commercial return condition</i></p> <p>The Administration clarified that section 13 of the proposed Schedule 17A did not seek to restrict nor limit the sukuk's return rates, which were market-driven, and explained that the section was drafted to prevent equity-sukuk from enjoying treatment as debt arrangement provided by the Bill. The Administration further pointed out that the "reasonable commercial return" condition ("RCRC") had been used in the definition of "loan capital" in the Stamp Duty Ordinance (Cap. 117) since 1981. As such, the Commissioner of Inland Revenue and the Collector of Stamp Revenue had experience in applying RCRC in making stamp duty assessments. The Inland Revenue Department ("IRD") would set out the implementation details in its Departmental Interpretation and Practice Notes ("DIPNs").</p> <p>In response to Mr LEUNG's enquiry, the Administration's replies as follows:</p> <p>(a) Section 13(2) and 13(3) of the proposed Schedule 17A covered the expected payments to bond-holders set out in the offering circulars/prospectuses and the actual payments to bond-holders of a sukuk product respectively. The provisions were drafted to ensure actual payments would not blatantly exceed the expected payments so as to minimise any abuse of the special tax treatment.</p> <p>(b) Most sukuk in the market would make payments to bond-holders on a regular basis. Section 13(5) of the proposed Schedule 17A would cover sukuk of which the return would solely depend on the redemption amount.</p> <p>(c) If necessary, a bond-issuer could apply for advance ruling from IRD on its tax position in accordance with section 88A of IRO.</p>	

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		(d) IRD would set out the implementation details of RCRC in DIPNs and bond-issuers would determine whether they need to apply for advance ruling on the tax position of an instrument.	
003920 – 004013	SALA3 Administration	Using Ijarah as an example, SALA3 sought clarification on whether the amount arising as a result of the appreciation of the underlying asset of sukuk would be return on the investment. The Administration replied that Ijarah would specify the amount for redeeming the underlying assets, which would usually be the same as the principal.	
004014 – 004618	Administration Mr SIN Chung-kai Mr Kenneth LEUNG	<p><i>Section 14 – Bond arrangement as financial liability condition</i></p> <p>Mr SIN referred to sections 14(a) and enquired about the reasons for specifying the Hong Kong Financial Reporting Standards ("HKFRS") and/or the International Financial Reporting Standards ("IFRS") in the provision and the impact of changes to the relevant financial standards on the "bond arrangement as financial liability" condition.</p> <p>The Administration's replies as follows:</p> <p>(a) In general, changes in HKFRS and/or IFRS would not cause difficulties in the application of the provision; and</p> <p>(b) Section 14(a)(i) and 14(a)(ii) set out the interpretation of the term "financial liability" in the relevant accounting standards. Companies established in Hong Kong had to comply with HKFRS and IFRS. For an overseas business entity not adopting HKFRS and IFRS as its accounting standard, section 14(b) would apply.</p> <p>In response to Mr LEUNG's enquiry, the Administration advised that the definition of "financial liability" was set out in Hong Kong Accounting Standards 32 of HKFRS. HKFRS and IFRS were widely used accounting standards. Relevant stakeholders like the Hong Kong Institute of Certified Public Accountants</p>	

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		<p>and accounting firms did not raise objection to the current drafting of section 14(a) during the consultation conducted in 2012.</p>	
<p>004619 – 005432</p>	<p>Administration Mr SIN Chung-kai Mr Kenneth LEUNG</p>	<p><i>Section 15 – Hong Kong connection condition</i></p> <p>Mr SIN referred to section 15(c) and expressed concern that the English text ("are marketed in Hong Kong") might not correspond with the Chinese text (which conveyed the meaning of "are sold in Hong Kong").</p> <p>The Administration responded that similar drafting was adopted in section 16(2)(f) of IRO and confirmed that to comply with section 15(c), a BA had to be sold and marketed in Hong Kong.</p> <p>At Mr SIN's request, the Administration undertook to review the drafting of the English text of section 15(c) to ensure it clearly reflect the meaning of "sold in Hong Kong" as conveyed in the Chinese text.</p> <p>In response to Mr LEUNG's enquiry, the Administration replied as follows:</p> <p>(a) Section 16(2)(f) of IRO imposed a requirement similar to that of section 15(b) of the proposed Schedule 17A on debt instruments.</p> <p>(b) The term "in good faith" was used instead of "bona fide" in the present law drafting to facilitate reading and understanding.</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p>
<p>005433 – 010125</p>	<p>Administration SALA3</p>	<p><i>Section 16 – Maximum term length condition</i></p> <p><i>Section 17 – Arrangements performed according to terms condition</i></p> <p>SALA3 enquired whether an ABS would be disqualified if the bond-issuer could not make payments to bond-holders in accordance with the terms due to force majeure events (e.g. imposition of capital control by a certain jurisdiction or refusal of tenants to pay rent).</p> <p>The Administration responded that the issue had to be determined on a case-by-case basis having</p>	

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		<p>regard to the actual terms of a specified ABS. If the bond arrangement and specified investment arrangement in the specified ABS were not performed according to the terms of the arrangements as described in section 2 to the proposed Schedule 17A and the provisions in Division 2 of Part 2 of the same Schedule, the ABS might be disqualified. As such, bond-issuers could seek advance ruling from IRD if necessary. The Administration also remarked that the Bill would provide flexibility. For instance, bond-issuers were allowed to delay payments to bond-holders under certain conditions, like the making of an agreement between the bond-issuer and bond-holders to extend the maturity date of the sukuk concerned.</p>	
<p>010126 – 010922</p>	<p>Administration Mr Kenneth LEUNG</p>	<p><i>Section 18 – Bond-issuer as conduit condition</i></p> <p><i>Section 19 – Investment arrangement as financial liability condition</i></p> <p><i>Section 20 – Qualified bond arrangement regarded as debt arrangement</i></p> <p>The Administration remarked that section 20 contained deeming provisions.</p> <p>In response to Mr LEUNG's enquiry, the Administration elaborated that section 14A of IRO would apply to a qualified BA in a specified ABS for revenue collection purpose, and the existing exemptions for offshore funds under section 20AC of IRO would be extended to qualified BA in a specified ABS through section 20(6) of the proposed Schedule.</p>	
<p>010923 – 011354</p>	<p>Administration Mr SIN Chung-kai</p>	<p><i>Section 21 – Qualified investment arrangement regarded as debt arrangement</i></p> <p>In response to Mr SIN's enquiry, the Administration replied that "O" and "BI" referred to originator and bond-issuer respectively and the terms "specified asset transaction between O and BI" and "asset transaction between O and BU" were defined in the Bill.</p>	

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011543 – 012111	Administration Mr SIN Chung-kai SALA3	<p><i>Section 22 – Power to amend Division 2 of this Part, etc.</i></p> <p>Mr SIN enquired about the purpose of section 22 and how it would operate in amending Division 2 (i.e. sections 5 to 11) of the proposed Schedule 17A on specified investment arrangements: description and calculation of investment returns. He remarked that section 22(b) seemed to provide very wide power to the Financial Secretary ("FS") in making amendments to the proposed Schedule 17A.</p> <p>The Administration's replies as follows:</p> <p>(a) Amendments to Division 2 would be made by FS through notice published in the Gazette, i.e. the making of subsidiary legislation which was subject to the negative vetting procedure of the Legislative Council ("LegCo").</p> <p>(b) Section 22 would provide flexibility in making amendments to provisions in Division 2 as FS was not empowered under the current IRO to make amendments to provisions in the proposed Schedule 17A.</p> <p>(c) Section 22(a) empowered FS to amend Division 2 of Schedule 17A relating to matters such as new types of sukuk to be included as specified ABS.</p> <p>(d) The effect of section 22(b) was to empower FS to make amendments to section 1 (i.e. the interpretation clause) if the amendments were consequential on or necessary as a result of any amendments made under section 22(a).</p> <p>(e) Amendments to other Divisions of Schedule 17A would be effected by introduction of relevant bills into LegCo.</p>	
012112 – 012934	Administration Mr Kenneth LEUNG SALA3	<p><u>Part 3 – Record-keeping, Notifications, Assessments and Other Miscellaneous Matters</u></p> <p><i>Section 23 – Interpretation (Part 3 of this Schedule)</i></p>	

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		<p><i>Section 24 – Records to be kept</i></p> <p>The Administration pointed out that it had taken on board the comments of stakeholders and relaxed the requirements on record-keeping.</p> <p>Mr LEUNG declared that he had engaged in the business of sukuk.</p> <p>Mr LEUNG pointed out that section 24(1)(a) of the proposed Schedule 17A was more stringent than section 15 (i.e. the Hong Kong connection requirement) and enquired whether an overseas bond-issuer had to recruit relevant professionals in Hong Kong to take charge of record-keeping for the sukuk.</p> <p>The Administration responded that the record-keeping requirement would only apply to bond-issuers with implications for profits tax of Hong Kong.</p> <p>Mr LEUNG enquired whether section 24(1)(a) also applied to stamp duty and expressed concern that the current drafting of section 24(1)(a) might cause confusion.</p> <p>The Administration responded that an entity would only have local profits tax liabilities upon conducting activities specified in section 24(1)(a) (i.e. carrying on a trade, profession or business in Hong Kong). The record-keeping requirements of the Bill were consistent with those under the existing IRO and would not apply to offshore bond-issuers who do not carry on any trade, profession or business in Hong Kong. As for stamp duty, the bond-issuer making a BA or IA claim had to keep relevant records if the underlying assets of sukuk involved properties in Hong Kong.</p> <p>SALA3 enquired whether section 24(1)(a) would apply if the sukuk were sold in Hong Kong by the originator.</p> <p>The Administration was of the view that section 24(1)(a) should apply in this case depending on the actual issuance arrangement and pointed out that there were numerous case laws and tax cases relating to the interpretation of what constituted "carries on trade, profession or business in Hong Kong".</p>	

<b>Time Marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action Required</b>
012935 – 012947	Chairman	Date of next meeting	

Council Business Division 1  
Legislative Council Secretariat  
7 August 2013