

Briefing for Bills Committee

Inland Revenue and Stamp Duty Legislation
(Alternative Bond Schemes) (Amendment) Bill 2012

Why developing Islamic finance?

- Among the fastest growing segments in international financial system
- Help diversify products and services available to HK' s financial markets
- HK' s role as a leading IFC and asset management centre: matching the needs of fund raisers and investment demand for Islamic finance products from China, Middle East and other regions

Characteristics of sukuk

- “Sukuk” : financial instruments economically equivalent to conventional bonds but structured to conform with the principles of Islamic law (“Shariah”)
- The Shariah prohibition on interest means that the creation of a purely debt based saleable security is not possible
- A typical structure of sukuk (with special purpose vehicles and multiple asset transfer) may attract additional profits or property tax exposures, or stamp duty charges under HK tax laws

Objective of the Bill

- To amend the Inland Revenue Ordinance (IRO) and the Stamp Duty Ordinance (SDO) to provide a comparable taxation framework for sukuk vis-à-vis conventional bonds, thereby removing an impediment perceived by market to developing a sukuk market in HK
- Not conferring special tax favours – simply ensuring financial instruments of similar economic substance are afforded similar tax treatments

Approach of the Bill

- Prescriptive
- Religion-neutral
- No specific references to Shariah terminologies
- Empower Financial Secretary to include additional types of sukuk and amend existing features by subsidiary legislation

Features of the Alternative Bond Scheme

IRO: Schedule 17A, Sections 2-4

SDO: Section 47C

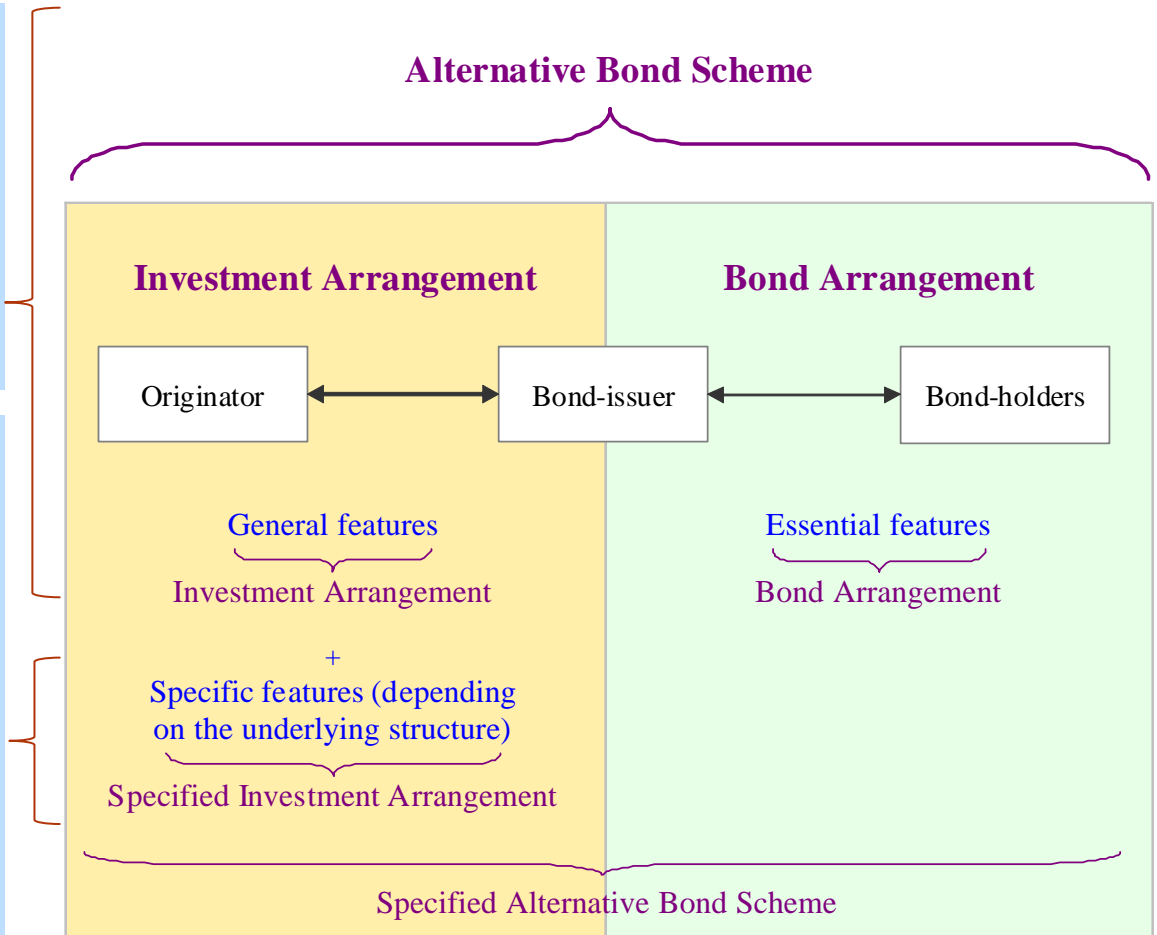
- Alternative Bond Scheme (ABS) = Bond Arrangement (BA) + Investment Arrangement (IA)
- Features of BA and IA

IRO: Schedule 17A, Sections 5-11

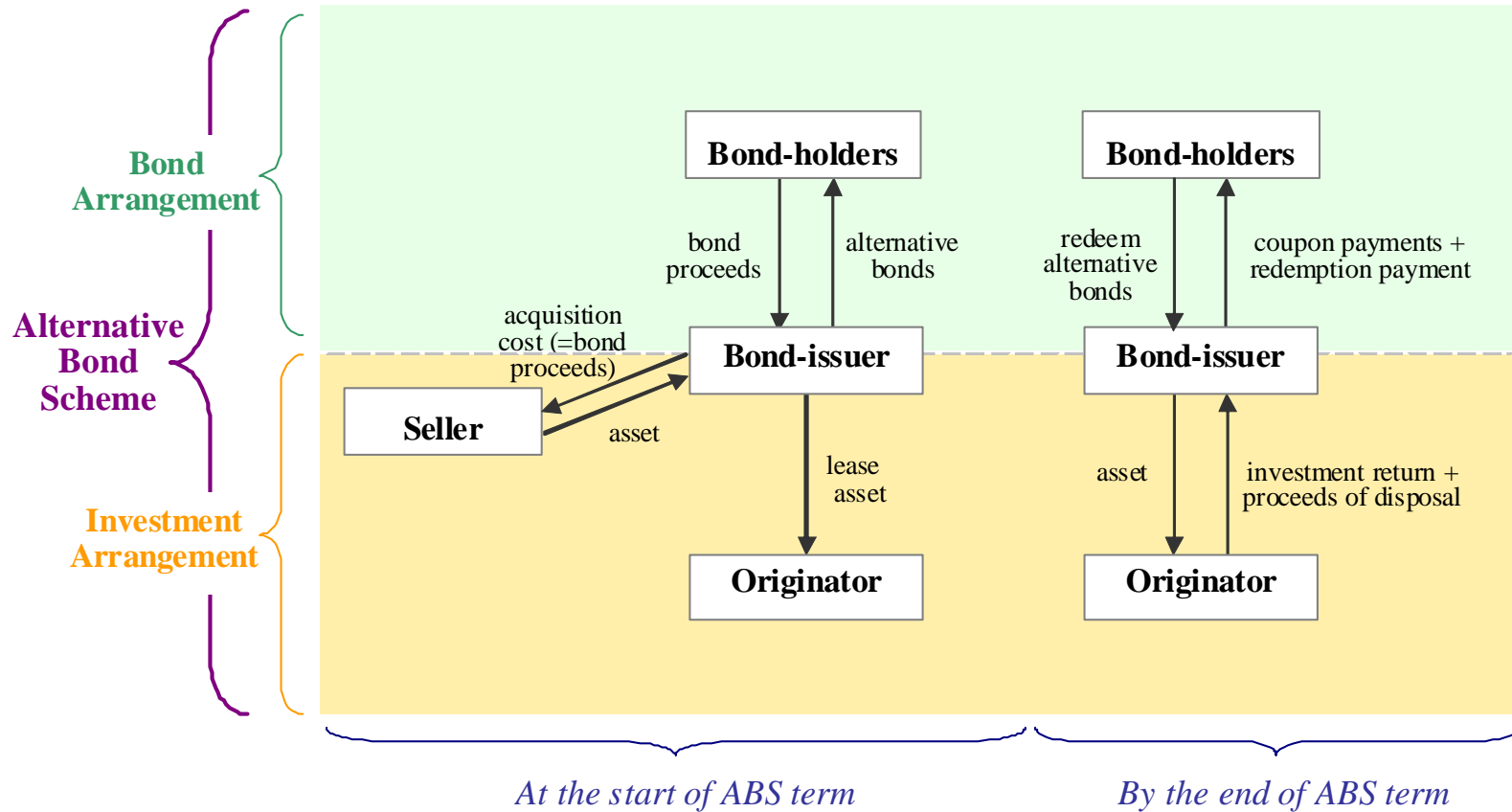
SDO: Section 47C

Types of specified investment arrangements

- Lease (Ijarah)
- Purchase and Sale (Murabahah)
- Profits Sharing (Musharakah and Mudarabah)
- Agency (Wakalah)



Example: Lease arrangement (Ijarah sukuk)



Qualifying conditions

- We need to ensure –
 - A prospective ABS is economically equivalent to a typical conventional bond structure, hence its eligibility for the proposed tax treatment under HK laws
 - Reasonable safeguards to minimise tax avoidance
 - Encourage the sukuk benefiting from the taxation treatment would have a nexus with HK, hence directly promoting HK' s financial market development

Qualifying conditions

IRO: Schedule 17A, Sections 12-19

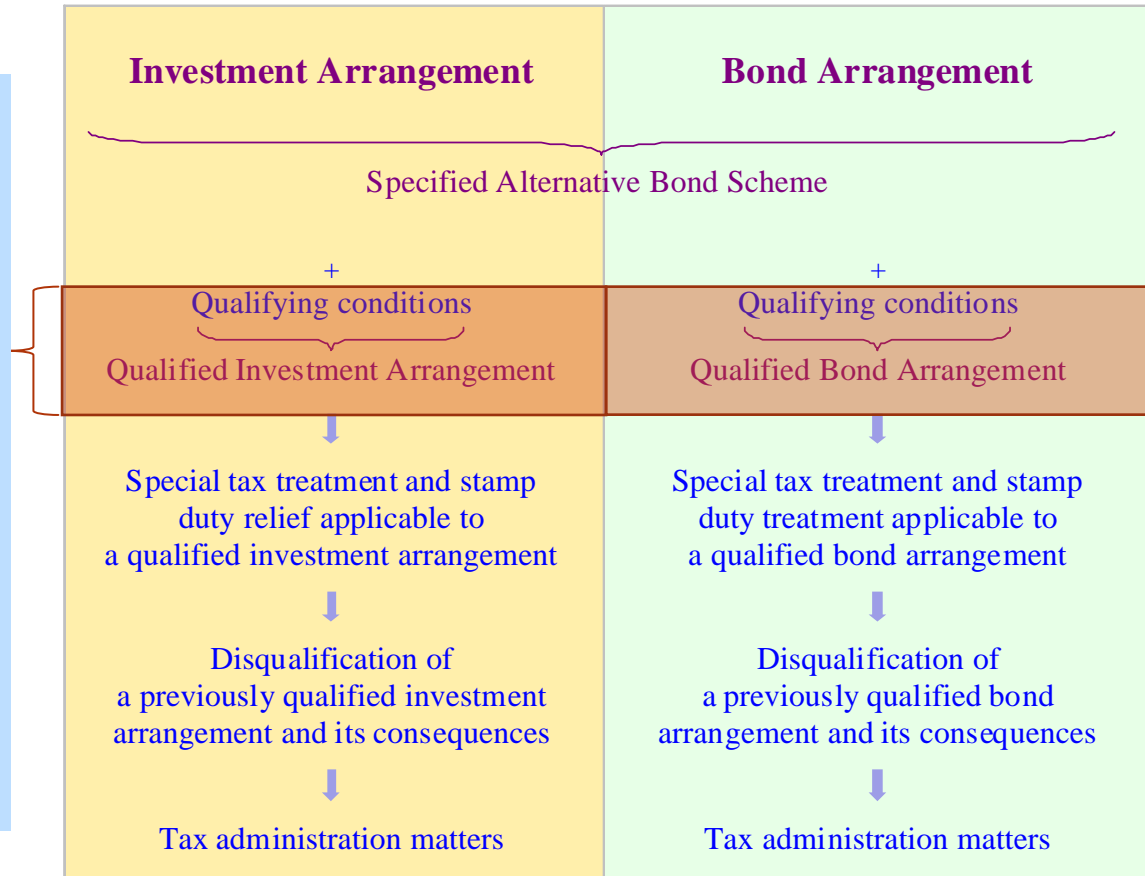
SDO: Section 47D

Qualified BA

- Reasonable commercial return
- BA as financial liability
- Hong Kong connection
- Maximum term length
- Arrangements performed according to terms

Qualified IA

- BI as conduit
- IA as financial liability



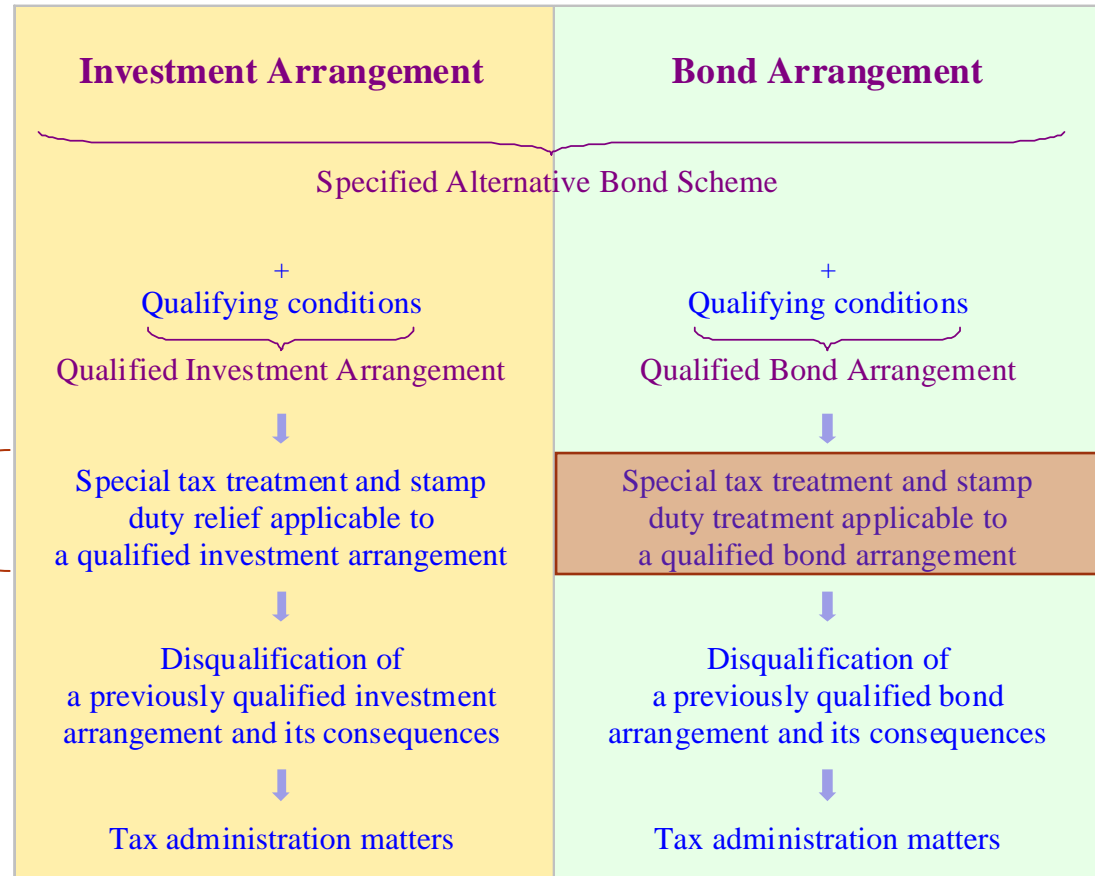
Tax treatments

IRO: Schedule 17A, Section 20

SDO: Section 47E

Qualified BA

- Qualified BA regarded as a debt arrangement (IRO)
- Bond proceeds regarded as money borrowed by bond-issuer from bond-holders (IRO)
- Coupon payments regarded as interest payable on money borrowed (deductible) (IRO)
- Tax concession and exemption for qualifying debt instruments (IRO)
- Tax exemption for certain profits on non-residents applicable to bond transactions (IRO)
- Exemption of stamp duty for certain bond transfer (SDO)



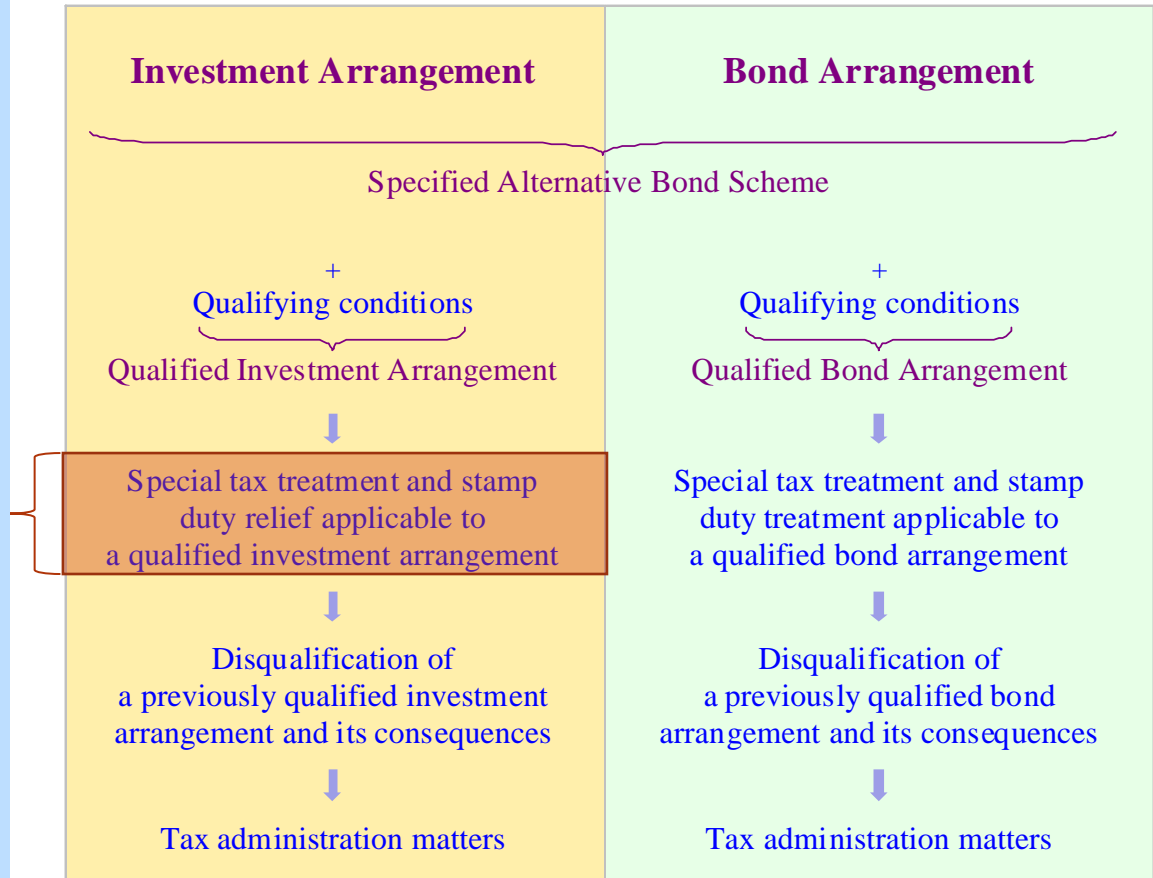
Tax treatments

IRO: Schedule 17A, Section 21

SDO: Sections 47F&47G

Qualified IA

- Qualified IA regarded as a debt arrangement (IRO)
- Certain asset transactions among bond-issuer, originator and their business undertaking disregarded for profits tax purposes (IRO)
- Stamp duty not chargeable on instruments relating to certain asset transactions; transactions disregarded in the specified period for determining special stamp duty liability (SDO)
- Related rental transactions disregarded for property tax purposes (IRO)



Disqualification of a qualified BA

IRO: Schedule 17A, Sections 12(3)&23

SDO: Section 47E

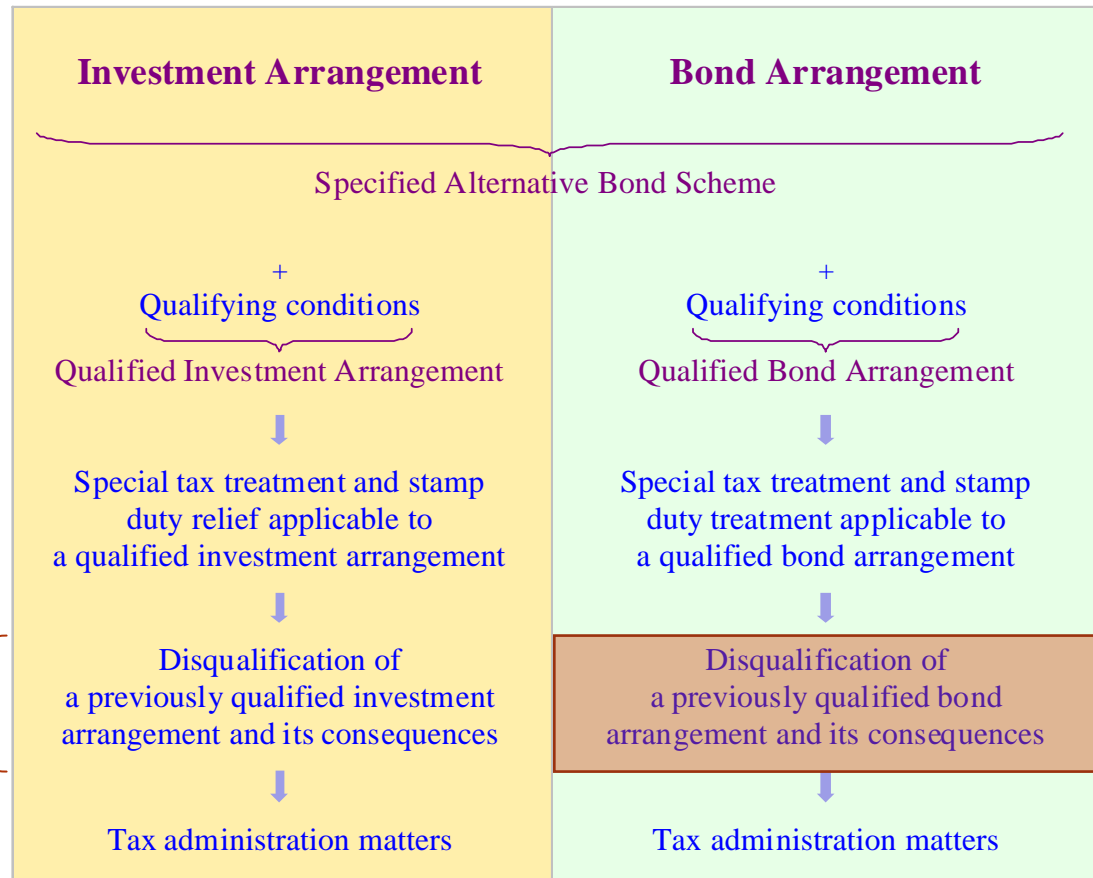
Disqualification of a qualified BA

IRO

- Consequence: never having been a qualified BA
- Special tax treatment withdrawn retrospectively

SDO

- Consequence: special tax treatment ceases to apply



Disqualification of a qualified IA

IRO: Schedule 17A, Sections 12(4)&23

SDO: Section 47H

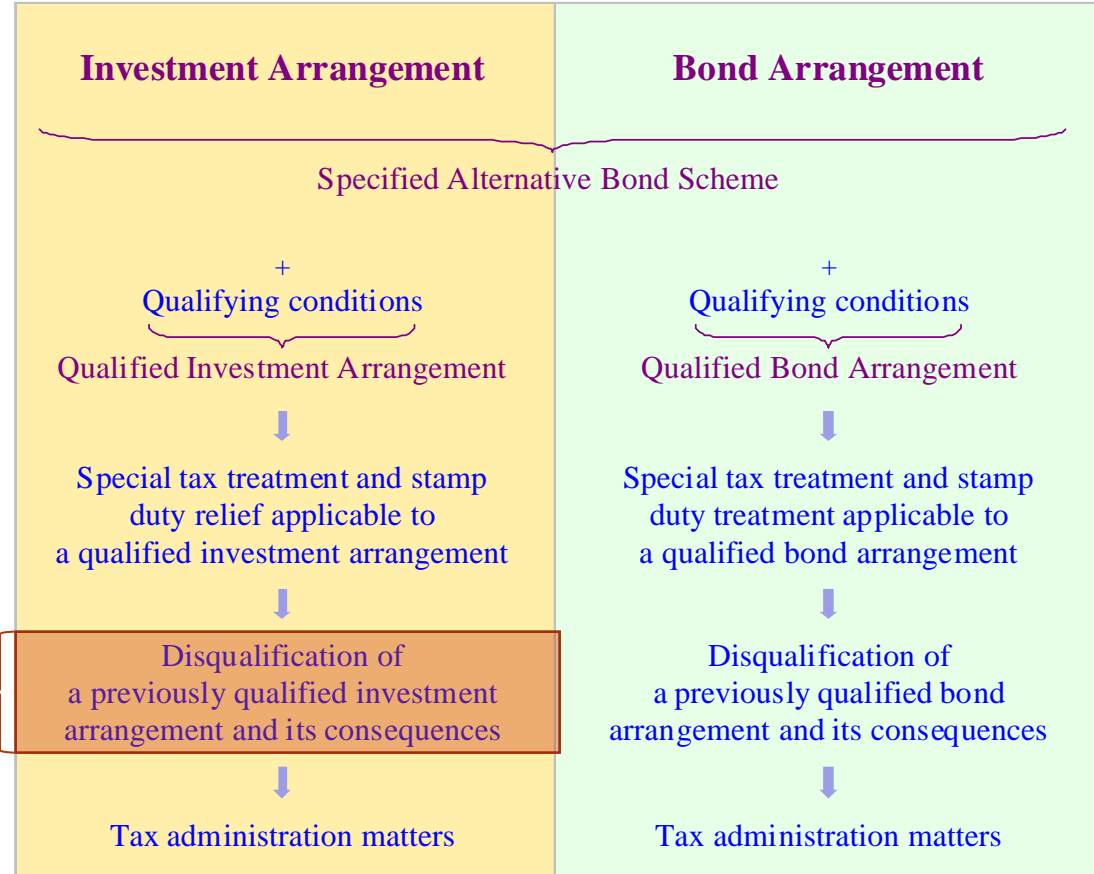
Disqualification of a qualified IA

IRO

- Consequence: never having been a qualified IA
- Special tax treatment withdrawn retrospectively

SDO

- Consequence: relief deemed to be withdrawn
- Stamp duty chargeable to be paid within 30 days after the earliest IA disqualifying event

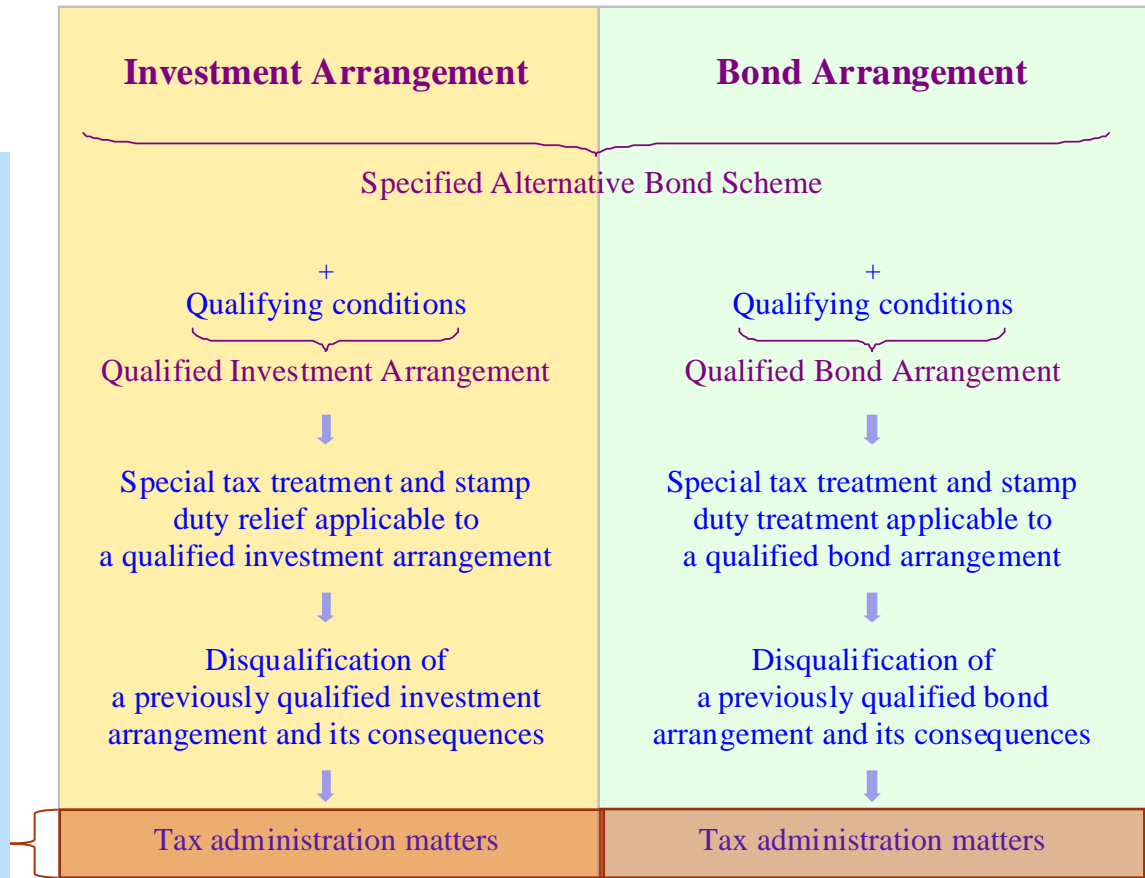


Tax administration

IRO: Schedule 17A, Sections 23-28

SDO: Section 47H-47L

- Notification of disqualifying events
- Extended record keeping period
- Return filing requirement
- Extended limitation period for tax assessment and refund, and recovery of stamp duty



Public consultation

- Public consultation on draft provisions to be included in the Bill conducted between March and May 2012
- 15 responses were received from a broad range of interested stakeholders and a large majority of respondents welcomed the legislative proposals
- Taken on board many useful comments and suggestions in contemplating the draft provisions in respect of coverage, qualifying conditions, other procedural matters and obligations
- Consultation Conclusion issued on 29 October 2012 to address suggestions and comments