

立法會
Legislative Council

LC Paper No. CB(1)359/12-13
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 5 November 2012 at 10:45 am
in Conference Room 3 of the Legislative Council Complex

Members present : Hon Starry LEE Wai-king, JP (Chairman)
Hon CHAN Kin-por, BBS, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon Christopher CHEUNG Wah-fung, JP
Hon SIN Chung-kai, SBS, JP

Public officers attending : Agenda Items IV

Miss Salina YAN, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services) 1

Mr Jackie LIU
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)5

Mr Daryl HO
Head (Market Development)
Hong Kong Monetary Authority

Ms Carrie CHAN
Senior Manager (Market Development)
Hong Kong Monetary Authority

Mr WONG Kuen-fai, JP
Deputy Commissioner (Operations)
Inland Revenue Department

Mr Allen NG
Senior Assessor (Research)2
Inland Revenue Department

Agenda Item V

Ms Mable CHAN, JP
Deputy Secretary for Financial Services and the
Treasury (Treasury)2

Ms Shirley KWAN
Principal Assistant Secretary for Financial Services
and the Treasury (Treasury) (Revenue)

Mr CHIU Kwok-kit, JP
Deputy Commissioner of Inland Revenue (Technical)

Miss Agnes CHEUNG
Senior Government Counsel (Treaties and Law) 1
Department of Justice

Agenda Item VI

Mr Maurice LOO
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services) 4

Attendance by invitation : Agenda item VI
The Hong Kong Institute of Certified Public Accountants

Mr Johnny CHAN
General Counsel

Ms Linda BIEK
Director of Compliance

Ms Jessie NG
Deputy Director of Compliance

Ms Tracy WONG
Head of Admission

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

Staff in attendance : Miss Winnie LO
Assistant Legal Adviser 7

Ms Angel SHEK
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I Confirmation of minutes of meetings and matters arising

(LC Paper No. CB(1)88/12-13 — Minutes of the meeting on
16 October 2012)

The minutes of the meeting held on 16 October 2012 were confirmed.

II Information paper issued since the regular meeting on 10 July 2012

(LC Paper No. CB(1)2341/11-12(01) — Administration's paper on second quarterly report of 2012 on Employees Compensation Insurance — Reinsurance Coverage for Terrorism

LC Paper No. CB(1)2381/11-12(01) — Administration's paper on "Comprehensive Avoidance of Double Taxation Agreements"

LC Paper No. CB(1)2601/11-12(01) — Administration's paper on final version of the "Guidelines on Conduct Requirements for Registered Intermediaries"

LC Paper No. CB(1)29/12-13(01) — Administration's paper on third quarterly report of 2012 on Employees Compensation Insurance — Reinsurance Coverage for Terrorism

LC Paper No. CB(1)78/12-13(01) — Administration's paper on the Executive Summary of the consultation paper on "Key legislative proposals on establishment of an independent Insurance Authority")

2. Members noted the information papers issued since the regular meeting held on 10 July 2012.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)91/12-13(01) — List of outstanding items for discussion)

3. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 3 December 2012:

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation;
- (b) 2013-2014 Budget consultation; and
- (c) Proposed legislation on trust law reform.

4. The Chairman suggested and members agreed that the next regular meeting on 3 December 2012 would start at 9:30 am to allow sufficient time for discussion of the above three items.

IV Proposed legislation to facilitate development of an Islamic Bond (sukuk) market in Hong Kong – Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill

(LC Paper No. CB(1)91/12-13(02) — Administration's paper on "Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill"

LC Paper No. CB(1)91/12-13(03) — Background brief on the proposed legislation to facilitate development of an Islamic Bond market in Hong Kong prepared by the Legislative Council Secretariat)

5. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services)1 ("DS(FS)1") briefed members on the background leading to the proposed legislative amendments to the Inland Revenue Ordinance (Cap. 112) ("IRO") and Stamp Duty Ordinance (Cap. 117) ("SDO") (referred to as "the Bill" in the ensuing discussion) to provide a comparable taxation framework for Islamic bonds ("sukuk") vis-à-vis conventional bonds, in order to facilitate the development of a sukuk market in Hong Kong. With the aid of a powerpoint presentation, the Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)5 ("PAS(FS)5") introduced the characteristics of sukuk, the objectives and coverage of the Bill, the qualifying conditions in relation to the proposed tax treatments, as well as the consultation conducted on the draft provisions to be included in the Bill. He informed members that the

Administration aimed to introduce the Bill into the Legislative Council ("LegCo") in early 2013.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)129/12-13(01)) were issued to members vide Lotus Notes e-mail on 5 November 2012.)

Discussion

Development of Islamic finance

6. Mr CHAN Kam-lam observed that while Islamic finance had been growing fast in Asia, in particular in Muslim economies in the region, Hong Kong seemed to have lagged behind in this regard. Noting the growth of Islamic finance in major financial centres like London, New York, Paris and Kuala Lumpur, Mrs Regina IP urged the Administration to step up efforts in the development of Islamic finance, with a view to encouraging the market to introduce more diversified financial services in Hong Kong in reinforcing its status as a renowned international financial centre, and to tapping potential investment from oil-producing countries having regard to their abundant liquidity.

7. Mr CHAN Kin-por considered that introducing more types of financial products and services like sukuk could help consolidate Hong Kong's position as an international financial and asset management centre. He noted that the policy initiative to develop an Islamic bond market was put forward as early as in the 2007-2008 Policy Address but limited headway had been made over the years. Referring to the latest development of issuance of Renminbi-denominated sukuk in Malaysia, Mr CHAN was concerned that Hong Kong had been overtaken by some Asian economies in the development of Islamic finance. He enquired about the difficulties the Administration had encountered in taking forward the initiative. Mr James TO opined that Hong Kong should ride on the development of offshore Renminbi business to develop financial products (including sukuk) denominated in Renminbi in view of the appreciation expectation of Renminbi and the "petrodollar warfare" against the dominance of the United States ("US") dollars for the pricing of oil. Mr James TIEN asked whether the development of an Islamic bond market would remain a policy initiative of the Government with the new Chief Executive taking up office in mid 2012.

8. DS(FS)1 said that, to further expand the coverage of financial services and increase the depth of Hong Kong's financial market, the Administration and relevant regulators had been stepping up efforts to develop the bond market in recent years. This was among the policy initiatives enshrined in the

election manifesto of the Chief Executive. There were calls from the financial industry and Muslim communities alike for developing a local platform for Islamic finance. The Administration considered that, leveraging on a simple tax regime and its role as a premier offshore Renminbi business centre, Hong Kong was well-placed to provide a platform to match liquidity from around the world with investment demand for sukuk. DS(FS)1 explained that the current priority was to introduce legislative amendments to provide a comparable tax framework that catered for issuance of sukuk, thereby removing an impediment perceived by the market in developing a sukuk market in Hong Kong. Drafting of the Bill had posed some challenges as the Administration needed to take into account a prescriptive and religion-neutral approach in lieu of making specific references to terminologies of the Islamic law ("Shariah"). Besides, the scope of the legislative proposals would cover both listed and non-listed sukuk, and include five most common types of sukuk product structures which were much broader than those covered in some other jurisdictions where their tax treatments applied to listed or limited scope of sukuk products only. It was also necessary to refine the legislative proposals in response to views received during the public consultation. All these had accounted for a relatively longer process to develop the Bill. Notwithstanding the difficulties encountered, the Administration was finalizing the Bill with a view to introducing it into LegCo in early 2013.

9. Mr NG Leung-sing noted that there had been substantial growth of 40% in global sukuk issuances in the first half of 2012 as compared with the same period in 2011 and enquired about the factors leading to the growth. The Head (Market Development), Hong Kong Monetary Authority ("H(MD)/HKMA") said that the significant growth in the issuance of sukuk was seen in the Muslim economies, in particular, Malaysia, Saudi Arabia and the United Arab Emirates. Amidst the lacklustre economic growth in the US and the sovereign debt crisis in Europe, investors around the world were looking for investment opportunities in emerging markets to diversify their investment, and this had provided impetus to the increasing demand for and issuance of sukuk globally in recent years.

10. Mrs Regina IP enquired about the assessment made by the Administration on the potential source and number of sukuk issuers in Hong Kong, and whether HKMA would spearhead efforts in issuing sukuk. DS(FS)1 said that issuers from a range of financial institutions and corporates had marketed sukuk in Hong Kong. The Administration hoped that the ongoing efforts to provide comparable tax treatments to sukuk would help attract sukuk issuers in the long run.

11. In response to Mr Ronny TONG's enquiry on whether sukuk products could be sold to Muslim investors only, the Deputy Commissioner (Operations), Inland Revenue Department ("DC(O)/IRD") said that trading of sukuk products was not confined to Muslims. While sukuk were based on the principles of Islamic law, the proposed legislative amendments and tax treatment were religion-neutral.

Economic benefits to Hong Kong

12. Mr James TIEN and Mr Abraham SHEK enquired about the potential economic benefits to be brought to Hong Kong by the Bill to provide a comparable taxation framework for sukuk vis-à-vis conventional bonds. DS(FS)1 said that in recent years from 2006, six sukuk products had been listed on the Stock Exchange of Hong Kong. Given that the issuance and listing of sukuk products, similar to their counterparts, were essentially market driven and could be affected by the external economic environment, it would be difficult to forecast and quantify the number of issuance in Hong Kong after the proposed legislation was enacted. H(MD)/HKMA pointed out that Islamic finance assets had expanded from US\$150 billion in the mid-1990s to US\$1.3 trillion in 2011 in the global financial system. The development of Islamic finance was expected to enhance the competitiveness of Hong Kong's financial services industry in diversifying the scope of products and services to cater for the needs of local and international investors, who looked to diversify their investment towards emerging and developing markets, including those of the Mainland and other Asian economies. The availability of a sukuk market in Hong Kong would help attract investors from the Middle East with abundant liquidity. Those investors were generally inclined to hold more Islamic financial products in their investment portfolios and were keen to tap the developing Mainland market. At members' request, the Administration would provide further information on its assessment of the economic benefits to be brought to Hong Kong.

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Proposed qualifying conditions for tax relief

13. Mr Ronny TONG noted that one of the proposed qualifying conditions for a sukuk product to be eligible for tax treatment was the proposed "limit on return" condition, i.e. both the maximum total amount of the bond return that might be payable to the bond-holders under the terms of the scheme and the total amount actually paid to them must not exceed an amount that would be reasonable commercial return on money borrowed of the amount of the bond proceeds. Given the aspiration of some investors for safe yet high-yield investment, he queried the justification and practicability of such qualifying condition, in particular, how bond issuers could comply with the condition in setting the interest rate for sukuk and whether trading of sukuk in the

secondary market would be subject to the same condition. He opined that the proposed condition would be unfair to investors on one hand and would undermine the attractiveness of sukuk on the other. Mrs Regina IP shared similar views. Referring to the relatively high coupon rate of iBond issued by the Administration, she was concerned how sukuk could appeal to investors if there was a cap on its return. Mr James TIEN considered the "limit on return" condition too stringent and expressed doubt on its purpose and restriction in attracting sukuk investors. Mr NG Leung-sing opined that flexibility should be given to cater for the possible extent of investment return from leveraged lease arrangement in sukuk products.

14. DS(FS)1 advised that the "limit on return" condition was designed to prevent abuse by issuers to seek the proposed tax treatment for equity sukuk whose returns could be very different from those of conventional bonds. DC(O)/IRD and H(MD)/HKMA explained that the proposed "limit on return" condition was one of the qualifying conditions to ensure that the prospective sukuk product was economically equivalent to a typical conventional bond structure for determining the tax treatment. In practice, IRD would refer to the information in the offering documents of a sukuk product on the maximum rate of bond return payable to bond-holders and compare it with potential return from conventional bonds of comparable principal, product tenure and credit rating of issuer at the time of issue of the sukuk. In the event that the total amount of the bond return payable to sukuk-holders was abnormally higher than a reasonable commercial return of conventional bonds, the sukuk in question would be likely in the nature of equity and would not be deemed equivalent to a typical conventional bond structure and hence not eligible for the proposed tax treatment. The subsequent trading of the sukuk and their price fluctuations in the secondary market would not impact on the satisfaction of the "limit on return" condition.

15. Mr Kenneth LEUNG observed that the proposed "limit on return" condition was more restrictive than that in similar regimes of other jurisdictions where the condition would only be applied to the whole sukuk term, vis-à-vis in Hong Kong the condition would apply to the payments in each period starting from the commencement of the specified term up to the date of any periodic payments. He further considered that issuers should be allowed to rectify a disqualifying event within a time limit such that the exemption on profits tax would not be withdrawn. DC(O)/IRD responded that the bond-issuer was required to report to the Commissioner of Inland Revenue ("CIR") in writing of the occurrence of any disqualifying event within one month after the event. The Administration was contemplating to incorporate in the Bill a one-month grace period for delay in disposing the specified asset to deal with market's concern.

Admin 16. To address members' concerns, the Administration was requested to provide further information explaining the operation of the "limit on return" condition for qualifying the proposed treatment, in particular the concern about the impact on the attractiveness of sukuk if such condition had to be met.

Admin The Administration was also requested to clarify if the first series of a sukuk fulfilled, amongst others, the "limit on return" condition for tax relief when it was first issued but exceeded the limit in its subsequent series, whether these subsequent series of the product would be disqualified and recoverable of the tax payable.

17. Mr Kenneth LEUNG enquired about the latest position for the "diverse holding" condition, which was proposed in the public consultation, to require not more than 50% of sukuk in a bond arrangement to be beneficially held by or acquired with funds provided by an originator, a bond-issuer and their associated persons. DC(O)/IRD said that taking on board the market views, the Administration had decided to remove the "diverse holding" condition to minimize compliance burdens on issuers.

Prevention of tax avoidance

18. Mr CHAN Kin-por enquired about the measures to address tax avoidance concerns. Mr Kenneth LEUNG pointed out that some industry players had raised the view that the record keeping requirement, i.e. not less than seven years after the end of the sukuk term instead of after the completion of the relevant transactions, would put sukuk at a less favourable position than a conventional bond.

19. DS(FS)1 said that apart from the set of qualifying conditions to be met to ensure that a prospective sukuk was economically equivalent to a typical conventional bond structure before it could be eligible for the proposed tax treatment, a reasonable record-keeping period would be imposed on any originator or bond-issuer of the sukuk eligible for the tax relief. These parties would also be obliged to inform CIR or the Collector of Stamp Revenue (as the case required) of any disqualifying event, which might lead to withdrawal of the relief granted in its entirety under IRO or SDO. A security would be required in respect of the payment of stamp duty charge to reduce the risk of irrecoverable duty in the event of any withdrawal of stamp duty relief. DC(O)/IRD added that the legislative amendments would provide for relevant assessment and procedural matters to prevent tax evasion.

Admin 20. At the request of Mr James TO, the Administration agreed to provide information on the possible downside risks involved in the proposed legislative amendments apart from tax avoidance concerns.

Legal framework and handling of sukuk-related disputes

21. Given that sukuk was based on the principles of Islamic law, Mr Abraham SHEK asked about the law governing sukuk-related disputes and the handling of such disputes. Mr Kenneth LEUNG was concerned that should a dispute arise in relation to the application of Shariah in sukuk, it might be necessary to seek legal advice from Muslim jurisdictions or their religious leaders on the Islamic law, and there might be risks of conflicting with the Basic Law. DS(FS)1 said that the Bill would be religion-neutral. Religious issues over the interpretation and application of Shariah underlying sukuk would be a matter for sukuk issuers and their legal expertise to deal with. At the request of Mr Abraham SHEK, the Administration would provide information on whether the laws of Hong Kong or the Islamic law would prevail in the event of sukuk-related disputes.

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22. Mr Dennis KWOK noted that the Law Harmonization Committee in Malaysia had taken efforts in reviewing and harmonizing Malaysian laws to make them compatible with Shariah so as to create a legal system conducive to the development of Islamic finance. He also highlighted that the Financial Services Authority of the United Kingdom ("UK") conducted in 2004 a consultation and review on UK's legislative framework for the regulation of sukuk with a view to clarifying issues and creating a level playing field between comparable instruments. He considered that the Administration should make reference to such overseas experiences and, where appropriate, adopt similar initiatives to ensure enforceability of laws with regard to Islamic finance transactions and afford equivalent regulatory treatment for economically comparable financial instruments. DS(FS)1 took note of the views and said that the Administration would closely monitor developments in the legal regimes of other jurisdictions. The Administration had already made reference to the relevant legal reform of UK when drawing up the legislative proposals, and had been in liaison with the financial authorities and institutions of leading sukuk markets on matters relating to the development of Islamic finance.

23. Mr Dennis KWOK referred to the experience of UK in settling sukuk-related disputes through arbitration as this method was a preferred and less costly alternative to litigation. In view of the relatively few legal expertise in Islamic finance and Shariah available in Hong Kong, Mr KWOK suggested the Administration consult The Law Society of Hong Kong and the Hong Kong International Arbitration Centre on matters regarding the mechanism and expertise for resolving conflicts/disputes relating to sukuk transactions. DS(FS)1 said the Financial Dispute Resolution Centre ("FDRC") was recently set up to deal with financial disputes. The Administration would consider the member's suggestions.

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24. In response to Mr Abraham SHEK, the Administration would provide information on the tax reforms in other major jurisdictions (such as Malaysia, UK, Japan and France) to facilitate issuance of sukuk and to level the playing field between comparable instruments, and the reference made by the Administration to such reforms in formulating its legislative proposals.

Investor protection

25. Mr CHAN Kam-lam pointed out that, unlike traditional bonds, sukuk were new financing instruments with a wide range of underlying structures involving different bond and investment arrangements and complicated relationships among the originator, bond-issuer and bond-holders. He said that the regulators should be prudent in regulating the listing and sale of such products as any problem arising therefrom might seriously undermine Hong Kong's reputation as a major international financial centre. As retail investors in general would have difficulty in understanding such products, he suggested restricting the sale of sukuk to professional investors only so as to minimize the risk of mismatched transaction. Mr James TO said that in the light of the Lehman Brothers ("LB") incident and the complicated and innovative nature of sukuk, consideration should be given to prohibiting sukuk from retail sale so as to protect ordinary investors. Mr TO recalled that many retail investors were misled by bank staff about the nature of LB-related products when these products were explained and sold to them. He urged the Administration to draw on the lesson of the LB incident to prohibit the sale of sukuk to small and retail investors, in particular, at the initial stage of the sukuk market development.

26. Mr NG Leung-sing pointed out that as sukuk were usually structured with special purpose vehicles set up offshore, the Administration/regulatory authorities should exercise vigilance in risk management having regard to the credit rating of issuer/product where applicable, and maintain close liaison with the financial regulatory authorities of overseas jurisdictions and credit rating agencies on related matters.

27. DS(FS)1 noted that, similar to other financial products, sukuk were subject to the prevailing regulatory regime in respect of product offering, marketing and disclosure requirements in accordance with the relevant provisions of the Securities and Futures Ordinance (Cap. 571) ("SFO") and the Companies Ordinance (Cap. 32) ("CO"). Only where the offer was made by private placement to professional investors as defined in SFO, the marketing materials of the financial product in question would not require authorization by the Securities and Futures Commission. The "safe harbour" provisions set out in CO might also apply to the prospectus requirement for sukuk issuances in private placement. As observed, sukuk were more commonly sold to

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institutional investors than retail buyers. DS(FS)1 further said that the current proposal to provide a comparable tax framework was to deal with the taxation issues of the issuance of sukuk while their regulation would tally with the current legal framework. The Administration would work together with relevant regulators to strengthen investor protection. Upon members' request, the Administration would provide further information after the meeting on the protection for sukuk investors, especially small and retail investors.

Infrastructures supporting the development of sukuk market in Hong Kong

28. In view of the innovative and complex nature of sukuk products, Mr CHAN Kam-lam emphasized the importance to nurture adequate professionals with knowledge of Shariah in Hong Kong to support the development of Islamic finance and handle sukuk-related disputes. Mrs Regina IP shared similar views. She suggested that the Administration should make reference to the efforts of the Singaporean Government in arranging officials/professionals to learn Arabic, pay visits to, and reside in Muslim countries/economies for an extended period of time in order to obtain in-depth understanding of the Islamic law and culture. Mr James TO said that the unique characteristics of Islamic finance and culture would call for the need to make available financial and legal expertise well-versed in Shariah-compliant regimes for handling sukuk-related disputes and legal proceedings.

29. DS(FS)1 said that the Administration was fully aware of the need for provision of professionals and market practitioners with expertise in Islamic finance and had been working in this direction on various fronts. H(MD)/HKMA said that HKMA had been in close cooperation with the Treasury Markets Association in organizing seminars and workshops on Islamic finance from time to time. On cooperation with major Islamic economies, HKMA had signed a Memorandum of Understanding with the Dubai International Financial Centre Authority and Bank Negara Malaysia respectively in May 2008 and September 2009 to strengthen cooperation in the development of Islamic finance. Particularly, in an effort to strengthen collaboration in human capital development, a seminar would be organized in Hong Kong in 2013 for the relevant authorities and market practitioners from Malaysia to share with their Hong Kong counterparts the major characteristics and application of Islamic financial products. As an associate member of the Islamic Financial Services Board, HKMA participated in the seminars and workshops organized by the Board from time to time to understand the latest developments of Islamic finance globally. HKMA also maintained a close dialogue with market players with a view to understanding their latest needs

and encouraging the development of new Islamic products and services as appropriate.

30. Mr Abraham SHEK referred to the financial infrastructures for the development of Islamic finance in UK, France and Malaysia and expressed concern about the difficulty in developing a sukuk market in Hong Kong given its small size of Muslim community. He commented that the development of a sukuk market did not only involve financial issues. As a prerequisite to expanding Islamic finance in Hong Kong, it was necessary to put in place both financial and cultural infrastructures (e.g. Muslim schools and mosques) to meet the needs and nurture the growth of the Muslim investor segment.

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31. In response to members' enquiries, the Administration was requested to provide information on the financial infrastructures already in place or to be put in place to facilitate the development of a sukuk market in Hong Kong, including the provision and training of market practitioners and professionals on sukuk products, the legal expertise in Islamic law for handling related disputes and preparation of relevant officials in the Government and regulatory authorities for in-depth understanding of the Islamic law, finance and culture.

Public consultation

32. Mr James TIEN enquired about the details of the public consultation. Mr Abraham SHEK asked if there was objection raised by respondents to the legislative proposals during the consultation.

33. DS(FS)1 said that the Administration had conducted public consultation on the draft provisions to be included in the Bill in March 2012 and taken on board many useful suggestions and comments in contemplating the draft provisions. Altogether 15 responses were received from interested stakeholders, which came mainly from financial institutions. A large majority of these respondents welcomed the legislative proposals, having regard to the need to enhance Hong Kong's competitiveness in financial services. PAS(FS)5 said that only one respondent did not agree with the operation of sukuk as an investment instrument and hence did not support the proposed legislative amendments. The remaining 14 respondents from the financial, banking, legal and accounting sectors were all supportive of the proposals. At the request of Mr James TIEN and Mr Abraham SHEK, the Administration would provide details of the 15 responses received during the public consultation, with information on the background of the respondents (e.g. financial institutions/Muslims/investors) and their major concerns.

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34. Mr SIN Chung-kai anticipated that a bills committee would be formed to scrutinize the Bill after it was introduced into LegCo. He said that the prospective bills committee should examine the Bill having regard to members' views and concerns. The Chairman said that the Administration should follow up the issues raised by members with a view to resolving them before introducing the Bill into LegCo in early 2013, and that the Panel had no objection to the Administration introducing the Bill into LegCo.

V Exchange of tax information with other jurisdictions

(LC Paper No. CB(1)91/12-13(04) — Administration's paper on "Comprehensive Avoidance of Double Taxation Agreements and Exchange of Tax Information Arrangements"

LC Paper No. IN03/12-13 — Information note on "Exchange of tax information with other jurisdictions in Hong Kong" prepared by the Legislative Council Secretariat)

35. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Treasury) 2 ("DS(Tsy)2") briefed members on the Administration's efforts to expand Hong Kong's network of comprehensive avoidance of double taxation agreements ("CDTAs") and on the latest developments with regard to exchange of tax information ("EoI") arrangements by highlighting the salient points in the paper. She said that the Administration's plan was to introduce legislative amendments to IRO and the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. Leg. BI) ("the Disclosure Rules") as appropriate, so as to expand the coverage of tax types and usage of tax-related information under the existing regime on EoI and to allow the disclosure of information generated prior to the effective date of a CDTA which might in fact be foreseeably relevant to the tax assessments after the CDTA came into effect. It was proposed that the revised EoI regime under the CDTA framework should be similar to the new regime under a Tax Information Exchange Agreement ("TIEA") as the EoI arrangement under CDTA and any future TIEA should be on par and in line with the international objective and Hong Kong's commitment to enhance tax transparency. The Administration would consult the Panel again in the first quarter of 2013 when the detailed legislative proposals were available.

Discussion

Proposal to expand the EoI regime and introduce the new TIEA regime

36. Mr Kenneth LEUNG referred to the Foreign Account Tax Compliance Act ("FATCA") enacted in the US the compliance with which might require the signing of bilateral agreements between the US and other jurisdictions for EoI arrangements in relation to offshore financial accounts held by US taxpayers or held by foreign entities in which US taxpayers held a substantial ownership interest. He asked whether the enhanced EoI regime would facilitate the required reporting by local financial institutions if Hong Kong entered into such a bilateral agreement with the US in future. DS(Tsy)2 said that it would be necessary to put in place the relevant legislative framework before Hong Kong and its financial institutions could sign/participate in an agreement under FATCA. Currently, it was envisaged that the proposed legislative amendments to enhance the existing EoI regime would be instrumental to assisting the Administration/financial institutions in fulfilling the reporting obligations if and when a bilateral agreement under FATCA was reached.

37. Mr James TO expressed strong reservation on expanding the EoI regime. He pointed out that as the taxation systems of most jurisdictions were far more complex than that of Hong Kong, it was only natural and in the interests of these jurisdictions to seek more tax information from their CDTA partners. On the other hand, Hong Kong with its much simpler tax regime did not share the same extent of needs. Moreover, expanding the scope of EoI to enhance tax transparency would risk jeopardizing the attractiveness of Hong Kong as an international financial centre to foreign investment. Hence, given the great differences between the tax regime of Hong Kong and those of other jurisdictions, he considered that the Administration should not be too proactive in enhancing the EoI arrangements to bring them on par with the international standard. He further noted that in spite of the concerns raised by the tax authorities of some jurisdictions on the limitations of Hong Kong's EoI regime during negotiations, the Administration still managed to conclude CDTAs with these jurisdictions. As such, he considered that the Administration should carefully weigh the pros and cons of the proposed initiatives and should maintain the status quo of the EoI regime as long as it would not give rise to any critical problem, such as imposition of sanctions on Hong Kong. Mr SIN Chung-kai shared similar views.

38. Mr NG Leung-sing conveyed the views of the banking sector that while it respected the objective of the Administration's proposal, it considered that Hong Kong should not be following the latest international standard too readily in the development of the EoI regime. While the banking sector did not oppose to the proposal as long as there would not be adverse impact on the well-being of the local economy, it was of the view that Hong Kong should take into account similar policy initiatives in the Mainland.

39. DS(Tsy)2 said that during the negotiations with potential CDTA partners, some jurisdictions did raise serious concerns about the limitations of the existing EoI arrangement offered by Hong Kong and that the arrangement was not in line with the international standard in this regard. Hence, there was a genuine need for Hong Kong to enhance the EoI regime to better meet the latest international standard. Indeed, the Administration had adopted a cautious and restrained approach in considering whether and how far the existing EoI regime should be enhanced, having regard to the current restrictive position in the area of tax types and limitation on disclosure.

40. Mr SIN Chung-kai enquired about the past experience in exchanging information with CDTA partners and whether there were difficulties seeking information from these jurisdictions. The Deputy Commissioner of Inland Revenue (Technical) said that IRD would carefully consider requests for tax information under CDTAs having regard to a set of prescribed criteria, including whether the information under request was directly related to tax purposes and within the coverage of CDTAs. Where appropriate and necessary, IRD would seek clarifications from the tax authority of the jurisdiction in question before acceding to the request.

41. Mr Kenneth LEUNG expressed concern that the availability of a TIEA regime might jeopardize the ongoing efforts in the negotiation of CDTAs with potential partners given that it was a bilateral matter to be discussed between two jurisdictions concerned as to whether a CDTA or a TIEA was more suitable if both options were available. DS(Tsy)2 said that the current proposal aimed to enhance the existing EoI arrangement provided under CDTAs and similar arrangement would be provided for future TIEAs, with a view to bringing it on par with the latest international standard. While the option of signing TIEAs would be made available by the proposed legislative amendments, given the economic benefits of CDTAs, it remained the policy priority of the Administration in future to expand Hong Kong's network of CDTAs with its major trading and investment partners.

42. Noting that the proposed changes to the existing regime on EoI and the provision of a legal framework for TIEA would involve legislative amendments to IRO and the Disclosure Rules, Mr Kenneth LEUNG enquired whether there would be consequential amendments to other legislation/rules to align with the proposed changes and achieve consistency in the relevant legislation. DS(Tsy)2 said that personal data privacy issues pertaining to the enhanced scope and usage of tax information under the revised EoI arrangement might necessitate corresponding amendments to relevant parts of the Personal Data (Privacy) Ordinance (Cap. 486).

Manpower resources of IRD in coping with increased workload arising from the expanded EoI regime and the new TIEA regime

43. In response to the enquiry from Mr Kenneth LEUNG about provision of additional manpower resources for IRD to cope with the anticipated increase in workload arising from the revised EoI regime and the new TIEA regime, DS(Tsy)2 said that the Administration would review the existing staffing arrangement in the light of the legislative proposal, and consult LegCo where necessary for additional manpower resources required.

44. Concluding the discussion, the Chairman recapped members' view that the existing EoI regime should only be enhanced where absolutely necessary with a view to meeting the minimum requirements of the international standard.

VI Proposed Member's Bill to amend the Professional Accountants Ordinance

(LC Paper No. CB(1)91/12-13(05) — Paper on "The Hong Kong Institute of Certified Public Accountants' Proposed Member's Bill to amend the Professional Accountants Ordinance (Cap. 50)" provided by Hon Kenneth LEUNG's office)

Briefing by Mr Kenneth LEUNG

45. At the invitation of the Chairman, Mr Kenneth LEUNG briefed members on his proposed Member's Bill to amend the Professional Accountants Ordinance (Cap. 50) ("PAO") by highlighting the salient points in the paper. Members noted that the purposes of the Bill were two-fold: (a) to

enable a certified public accountant (practising) to incorporate a company with only one director and shareholder, and register the company as a corporate practice, which was qualified to perform audits; and (b) to prohibit any company, not being a corporate practice registered with the Hong Kong Institute of Certified Professional Accountants ("HKICPA"), to use the description "certified public accountant", the initials "CPA" or the characters "會計師" in its name intended to cause, or which might reasonably cause, any person to believe that it was a practice unit. Mr LEUNG added that Mr Paul CHAN, then Legislative Councillor, had briefed the Panel on the proposed Member's Bill in the fourth LegCo.

Discussion

46. The Chairman declared that she was a member of HKICPA.

47. In response to the Chairman's enquiry, Mr Kenneth LEUNG informed members that apart from a few minor textual amendments, the contents of the current Member's Bill were same as that put forward by Mr Paul CHAN in the last legislative term.

48. The Chairman sought information about the consultation on the proposal with members of HKICPA. The General Counsel, HKICPA ("GC/HKICPA") said that HKICPA members passed a resolution at its Annual General Meeting in December 2005 to propose an amendment to PAO to allow a sole certified public accountant (practising) to register as a corporate practice. As regards the other proposed amendment prohibiting the use of misleading description in the name of a non-corporate practice company, it was approved by the Council of HKICPA in May 2011 and HKICPA's members were subsequently informed of the proposed amendment.

49. The Chairman suggested that as the consultation was conducted in last year or earlier, HKICPA might consider updating its members on the contents of the Member's Bill and the latest legislative timetable before it was introduced into LegCo by Mr Kenneth LEUNG. GC/HKICPA took note of the Chairman's suggestion.

VII Any other business

50. There being no other business, the meeting ended at 12:30 pm.