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By email (mleung@legco.gov.hk)

24 July 2018

Legislative Council Secretariat
1 Legislative Council Road
Central, Hong Kong
(Attn: Mr Desmond Lam)

Dear Mr Lam,

Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2018

I refer to your letter dated 3 July 2018 enclosing the list of follow-up actions arising from the Bills Committee meeting on 26 June 2018. Please find the Government's response at **Annex**.

Yours sincerely,

(William LEUNG)
for Secretary for Financial Services and the Treasury

c.c.
Commission of Inland Revenue (Attn: Mr KK CHIU)

<u>Annex</u>

Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2018

Government's Response to Follow-up Actions Arising from meeting on 26 June 2018

At the meeting of the Bills Committee on 26 June 2018, the Government was requested to –

(a) provide justifications of the proposed enhancements to the QDI Scheme in terms of details of, inter alia, the competition from other regional financial centres such as Singapore;

(b) provide major relevant data of the QDI Scheme in the past years since its implementation in 1996 to illustrate the effectiveness of the Scheme in fostering the development of the bond market; and

(c) consider a member's suggestion of reporting to the Panel on Financial Affairs the progress of the proposed enhancements to the QDI Scheme after the implementation for a certain period of time.

Proposed Enhancements in terms of competitiveness

2. Launched in 1996 and having gone through a number of revisions since then, the Qualifying Debt Instrument ("QDI") Scheme has been set up with the policy objectives of attracting overseas issuers to Hong Kong and developing the local bond market. As the local bond market continues to evolve amidst keen competition from other regional financial centres, the current QDI Scheme has proved inadequate in delivering the intended policy outcomes.

3. First, the current eligibility criterion of being lodged with and cleared by the Central Moneymarkets Unit ("CMU") does not correspond with the landscape of Hong Kong's corporate bond market. Most of the debt issuances in Hong Kong are internationally marketed, which tend to

be lodged with and cleared by international clearing houses. The requirement of lodging with the CMU hinders many debt securities from participating in the QDI Scheme.

4. Second, the current arrangement of applying a lower (i.e. 50%) profits tax concession to debt instruments with an original maturity of less than seven years means that issuers intending to issue debt instruments with a shorter maturity have less incentive to do so in Hong Kong. At the same time, many of the regional financial centres have introduced incentive measures to promote their bond markets. For example, Singapore has launched a similar Qualifying Debt Securities Scheme since 1998, and introduced the Asian Bond Grant Scheme in 2017 to attract enterprises to issue bonds in Singapore.

5. To promote the development of Hong Kong's bond market, we propose to enhance the QDI Scheme by aligning the tax concessions across debt instruments of different tenors and scoping in a broader range of instruments with a Hong Kong nexus.

Effectiveness of QDI Scheme

6. The Hong Kong bond market has grown substantially since 1996. It is currently the third largest in Asia (excluding Japan). A snapshot of QDI usage and corporate bond issuances in Hong Kong in the past years[1] is summarised below.

Year	Bond issuances registered for QDI (million USD)	Total corporate bond issuances (million USD)
1996	833	9,218
2006	1,871	35,619
2016	4,360	76,280

7. The enhanced scheme will incentivise the use of Hong Kong as a platform for bond investing and trading. They would in turn allow Hong Kong to capture the growing international interest in the Asian

[1] Source: Inland Revenue Department and Asian Development Bank. Corporate bond issuances comprise HKD corporate issuances and G3 currency (USD, EUR and JPY) aggregate (i.e. sovereign and corporate) issuances. G3 currency issuance figures are only available after 2000.

bond market, attract more investors to issue bonds in Hong Kong and expand their bond market operations here, bringing benefits to the professional services sector and the wider economy. The further development of the local bond market will also enhance Hong Kong's competitiveness as an international financial centre.

8. The Government stands ready to provide a progress update to the Panel on Financial Affairs after implementing the enhanced scheme for some time.

Financial Services and the Treasury Bureau
July 2018