

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

INLAND REVENUE (AMENDMENT) (NO. 5) BILL 2018

INTRODUCTION

A At the meeting of the Executive Council on 29 May 2018, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (No. 5) Bill 2018 (“Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”). The Bill seeks to implement the following measures starting from the year of assessment (YA) 2018/19 as proposed in the 2018-19 Budget –

- (a) to allow husband and wife the option of electing for personal assessment (“PA”) separately;
- (b) to allow enterprises to claim tax deduction for capital expenditure incurred for procuring environmental protection installations in full in one year instead of over five years; and
- (c) to extend the scope of tax exemption for debt instruments under the Qualifying Debt Instrument (“QDI”) Scheme.

JUSTIFICATIONS

Election for PA by married persons separately

2. The Inland Revenue Ordinance (Cap. 112) (“IRO”) provides for the levying of direct tax under three distinct and separate heads, namely salaries tax, profits tax and property tax. PA is not a tax levy. It is a relief for individual taxpayers who are subject to profits tax and/or property tax, with or without salaries income. A person who only derives income chargeable to salaries tax will not benefit by electing for PA.

3. At present, if a couple are both subject to salaries tax, each of them is separately assessed unless they elect for joint assessment. On the other hand, where a married person and his/her spouse have income assessable under the IRO and both are eligible to elect for PA, that person can make an election only when his/her spouse also does so (“current restriction”). In the case where both spouses elect for PA, a single assessment will be made on their total income resulting from aggregation of the total income of each spouse as reduced by relevant allowances.

4. The current restriction has been imposed because PA is already a tax relief measure which may reduce the tax liabilities of individuals. The tax burden of a couple would generally be further reduced if each of them is assessed to tax separately. So, if married persons are allowed to elect for PA separately, this would grant additional tax relief to them. Moreover, relaxing the current restriction would bring additional workload for IRD which needs to work out more scenarios to identify the one most beneficial to the taxpayer concerned.

5. In order to provide taxpayers who are married with greater flexibility in tax assessment, the Financial Secretary proposed in the 2018-19 Budget to relax the requirement for the election of PA commencing from YA 2018/19 by allowing married persons the option to elect PA separately.

Accelerated tax deduction for environmental protection installations

6. The Financial Secretary also proposed in the 2018-19 Budget that the Government will provide tax concessions to enterprises for capital expenditure incurred in procuring eligible energy efficient building and renewable energy installations by allowing tax deduction to be claimed in full in one year instead of over five years as provided for under section 16I of the IRO so as to encourage the procurement of such installations. This will be in line with the tax deduction arrangement for capital expenditure on environmental protection machinery/plant. The new arrangement applies in relation to YAs commencing on or after 1 April 2018. Details of the proposal are set out at **Annex B**.

B

Enhancements to the QDI Scheme

7. To promote further development of the bond market, the Financial Secretary proposed in the 2018-19 Budget to enhance the QDI Scheme by (a) extending the 100% profits tax exemption, from debt instruments with an original maturity of not less than seven years to debt instruments of any duration; and (b) allowing debt instruments listed on the Stock Exchange of Hong Kong Limited to be qualified for tax exemption, in addition to instruments lodged with and cleared by the Central Moneymarkets Unit of the Hong Kong Monetary Authority. The new arrangements will apply to QDIs issued on or after 1 April 2018. Details of the proposal are set out at **Annex C**.

C

OTHER OPTIONS

8. Amending the IRO is the only way to give effect to the relevant proposals in paragraphs 5 to 7. There is no other option.

THE BILL

9. The major provisions of the Bill are set out below –

- (a) **Clause 9** amends section 41 of the IRO to allow an individual who has a spouse to elect for PA separately or jointly with the spouse. However, if the individual or the spouse is chargeable to salaries tax in respect of their aggregated net chargeable income under section 10(3) of the IRO, they

should jointly make an election for PA because allowing either one to elect for PA separately will result in additional deduction of personal allowances. The clause also requires a written notice of withdrawal of election for PA by an individual (and the spouse, if applicable) within a certain period of time and provides for the effect and consequence of the withdrawal.

- (b) **Clause 12** is a consequential amendment to give effect to separate election for PA by an individual. It amends section 59 of the IRO to enable an assessor not to make an assessment of profits tax in respect of the assessable profits of an individual who carries on a trade, profession or business in Hong Kong (whether solely or jointly with another person) under certain circumstances.
- (c) **Clause 14** amends section 16I of the IRO to add a new subsection (3B) to allow any specified capital expenditure incurred on any environmental protection installation on or after 1 April 2018 to be deducted in full for the YA in which the expenditure is incurred. The clause also adds a new subsection (3A) to allow any remaining part of the capital expenditure incurred but not yet deducted under section 16I(3) to be fully deducted in the YA commencing on 1 April 2018.
- (d) **Clause 18** amends section 14A of the IRO to extend profits tax exemptions to cover debt instruments of any maturity issued on or after 1 April 2018 and debt instruments issued on or after 1 April 2018 that are listed on the Stock Exchange of Hong Kong Limited.

LEGISLATIVE TIMETABLE

10. The legislative timetable is as follows –

Publication in the Gazette	8 June 2018
First Reading and commencement of Second Reading debate	13 June 2018
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

IMPLICATIONS OF THE PROPOSAL

11. The proposals are in conformity with the Basic Law, including the provisions concerning human rights. The proposals will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. The financial, economic, environmental, sustainability and family implications of the proposals are at **Annex D**. The proposals have no productivity, gender or civil service implications.

PUBLIC CONSULTATION

12. We have formulated the proposals after taking into account views received from LegCo Members and relevant stakeholders during the Budget consultation process. Owing to the confidentiality of the Budget before announcement, we have not carried out prior consultation for the proposed measures. After the announcement made in the Budget, the Environment Bureau and the Electrical and Mechanical Services Department discussed the implementation details of providing accelerated deduction for building energy efficiency installations with relevant stakeholders. For the QDI Scheme, key market players were sounded out following the announcement of the Budget.

PUBLICITY

13. We will issue a press release on 6 June 2018. A spokesperson will be available to answer media and public enquiries.

ENQUIRIES

14. Enquiries on this Brief can be addressed to Ms Pecvin YONG, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2370.

Financial Services and the Treasury Bureau
6 June 2018

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A BILL

To

Amend the Inland Revenue Ordinance to provide for the option for married persons to elect for personal assessment separately for all years of assessment commencing on or after 1 April 2018; to accelerate tax deductions for capital expenditure incurred in relation to environmental protection installations; to provide for tax exemption to cover certain debt instruments issued on or after 1 April 2018; and to provide for related matters.

Enacted by the Legislative Council.

Part 1

Preliminary

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 5) Ordinance 2018.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in Parts 2, 3 and 4.

Part 2

Amendments Relating to Personal Assessment

3. Application

The provisions of the Inland Revenue Ordinance (Cap. 112) as amended by this Part apply in relation to all years of assessment commencing on or after 1 April 2018.

4. Section 19C amended (treatment of losses after 1 April 1975)

(1) Section 19C(1)—

Repeal paragraph (b)

Substitute

“(b) either of the following conditions is met—

- (i) the individual (whether married or not) does not elect for personal assessment under section 41(1) for the year of assessment;
- (ii) the individual and the individual’s spouse do not jointly elect for personal assessment under section 41(1A) for the year of assessment.”.

(2) Section 19C(2)—

Repeal paragraph (b)

Substitute

“(b) either of the following conditions is met—

- (i) the individual (whether married or not) does not elect for personal assessment under section 41(1) for the year of assessment;

- (ii) the individual and the individual's spouse do not jointly elect for personal assessment under section 41(1A) for the year of assessment.”.

(3) Section 19C(3)—

Repeal paragraphs (a) and (b)

Substitute

- “(a) the individual (whether married or not) is personally assessed under Part 7; or
- (b) the individual and the individual's spouse have jointly elected to be personally assessed under Part 7.”.

5. Section 26C amended (approved charitable donations (Part 4A))

Section 26C(2)(b)(ii)—

Repeal

“that is required to be aggregated with that of the person under section 42A(1)”

Substitute

“under Part 7”.

6. Section 29 amended (married person's allowance)

(1) Section 29—

Repeal subsection (1)

Substitute

- “(1) An allowance (*married person's allowance*) is to be granted to a person in any year of assessment if—
- (a) the person is, at any time during the year of assessment, married; and
- (b) either of the following conditions is met—

- (i) the person's spouse—

- (A) did not have assessable income in the year of assessment; and
- (B) has not made an election under section 41(1) for the year of assessment;

- (ii) the person and the spouse have made an election under section 10(2) for the year of assessment.”.

(2) After section 29(1)—

Add

“(1A) A married person's allowance is to be granted to a person and the person's spouse in any year of assessment if—

- (a) their marriage subsists at any time during the year of assessment; and
- (b) they have jointly elected to be personally assessed under Part 7.”.

7. Section 31 amended (child allowance)

Section 31(3)—

Repeal

“salaries tax under Part 3”

Substitute

“tax under Part 3 or 7”.

8. Section 31A amended (disabled dependant allowance)

Section 31A(3)—

Repeal

“salaries tax under Part 3”

Substitute

“tax under Part 3 or 7”.

9. Section 41 amended (election for personal assessment)**(1) Section 41—****Repeal subsections (1) and (1A)****Substitute**

“(1) An individual—

- (a) who is of or above the age of 18 years or is under that age if both parents are dead; and
- (b) who is either ordinarily resident in Hong Kong or a temporary resident,

may elect for personal assessment on the individual's total income in accordance with this Part.

(1A) If—

- (a) an individual is married and not living apart from the individual's spouse;
- (b) both of them have income assessable under this Ordinance; and
- (c) either one or both of them are eligible to make an election under subsection (1),

they may jointly make an election for personal assessment.

(1B) If an individual or the individual's spouse is chargeable to salaries tax under section 10(3), the individual may not make an election for personal assessment unless the individual and the spouse jointly make an election under subsection (1A).”.

(2) After section 41(3)—**Add**

“(3A) An election made by an individual under subsection (1) may be withdrawn by the individual. An election made by an individual and his or her spouse under subsection (1A) may only be withdrawn by them jointly.

(3B) A withdrawal under subsection (3A) must be effected by giving a notice in writing to the Commissioner—

- (a) within 6 months after the date on which a personal assessment is issued by the Commissioner pursuant to the election; or
- (b) within another period that the Commissioner considers reasonable in the circumstances.

(3C) An election withdrawn under subsection (3A) is to be regarded as not having been made.

(3D) An individual who has (or the individual and his or her spouse who have) withdrawn under subsection (3A) an election made for a year of assessment may not make an election again for that year of assessment, unless the Commissioner considers it appropriate to allow a re-election.”.

(3) Section 41(4)—**Repeal the definition of *permanent resident*.****10. Section 42 amended (calculation of total income)****Section 42—****Repeal subsection (6)****Substitute**

“(6) If—

- (a) an individual has income assessable under this Ordinance for a year of assessment;

- (b) the individual's spouse does not have income assessable under this Ordinance for that year of assessment, but an amount of loss is carried forward from a previous year of assessment under this Part to that year of assessment;
 - (c) the individual and the spouse would have been able to jointly make an election for personal assessment under section 41(1A) had the spouse had income assessable under this Ordinance; and
 - (d) the individual has elected to be personally assessed under this Part,
- subsection (5)(a)(ii) and (b)(ii) applies in relation to the individual and the spouse as if their total income had been required to be aggregated under section 42A(1)."

11. Section 51 amended (returns and information to be furnished)

Section 51—

Repeal subsections (2A), (2B) and (2C).**12. Section 59 amended (assessor to make assessments)**

Section 59—

Repeal subsections (1B) and (1C)**Substitute**

“(1B) Despite subsection (1), if an assessor is satisfied that—

- (a) an individual—
 - (i) carries on (other than jointly with another person) a trade, profession or business in Hong Kong; and

- (ii) is eligible to elect for personal assessment under section 41 on the individual's total income;
 - (b) the assessable profits of the individual in respect of the trade, profession or business for any year of assessment do not exceed the amount specified for the year of assessment in the second column of item 1 of Schedule 4; and
 - (c) the individual has no income, property or profits chargeable to tax under this Ordinance for the year of assessment, other than that in respect of the trade, profession or business,
- the assessor is not obliged to make an assessment of profits tax in respect of the assessable profits.
- (1C) Despite subsection (1), if an assessor is satisfied that—
- (a) an individual—
 - (i) carries on a trade, profession or business in Hong Kong, either solely or jointly with another person; and
 - (ii) is eligible to elect for personal assessment under section 41 on the individual's total income;
 - (b) the individual has no income, property or profits chargeable to tax under this Ordinance for the year of assessment, other than that in respect of the trade, profession or business; and
 - (c) after taking into account the allowances that would have to be deducted under Part 5—
 - (i) if the individual carries on the trade, profession or business solely—the assessable profits of the individual in respect of the

trade, profession or business for the year of assessment are such that no tax would be charged on the individual had the individual elected for personal assessment under section 41; or

- (ii) if the individual carries on the trade, profession or business jointly with another person—the individual’s share of the profits in respect of the trade, profession or business for the year of assessment is such that no tax would be charged on the individual had the individual elected for personal assessment under section 41,

the assessor is not obliged to make an assessment of profits tax in respect of the assessable profits.

(1D) Subsection (1E) applies if—

- (a) an assessor has made an assessment of profits tax in respect of the assessable profits of an individual for a year of assessment; and
- (b) in relation to the individual, the assessor becomes satisfied of the matters specified in subsection (1C)(a), (b) and (c) for the year of assessment.

(1E) The assessor may, despite section 70—

- (a) annul the assessment; or
- (b) in case of an assessment of a partnership—reduce the assessment in so far as it relates to the share of profits of the individual.”.

13. Schedule 4 amended (allowances)

Schedule 4—

Repeal

“[s. 27(3)]”

Substitute

“[ss. 27 & 59]”.

Part 3**Amendments Relating to Environmental Protection Installations****14. Section 16I amended (deductions for specified capital expenditure incurred in relation to environmental protection facilities)**

(1) Section 16I(3)—

Repeal

“Any”

Substitute

“If that year of assessment commences on or before 1 April 2017, any”.

(2) After section 16I(3)—

Add

“(3A) Despite subsection (3)(b), any part of a specified capital expenditure that remains to be deducted for any year of assessment commencing on or after 1 April 2018 may be deducted in the year of assessment commencing on that date so long as the installation has not been sold on or before that date.

(3B) If that year of assessment commences on or after 1 April 2018, any specified capital expenditure incurred by the person during the basis period for that year of assessment in relation to any environmental protection installation is to be deducted.”.

(3) Section 16I(4)—

Repeal

“(2) or (3)”

Substitute

“(2), (3), (3A) or (3B)”.

15. Section 16J amended (proceeds of sale of environmental protection facilities to be treated as trading receipts)

(1) Section 16J(3)—

Repeal

“16I”

Substitute

“16I(3), (3A) or (4)”.

(2) After section 16J(3)—

Add

“(3A) If an environmental protection installation for which a deduction has been allowed under section 16I(3B) or (4) is subsequently sold, the relevant proceeds of sale are, if the conditions specified in subsection (3B) are met, to be treated as a trading receipt of the trade, profession or business, arising in or derived from Hong Kong and accruing—

(a) if the trade, profession or business is permanently discontinued and the sale occurs on or after the date of discontinuance—immediately before the date of discontinuance; or

(b) otherwise—at the time of the sale.

(3B) The conditions are—

(a) that the proceeds of sale are not chargeable to tax under any other provision of this Part; and

(b) that the proceeds of sale do not exceed the amount of the deduction under section 16I(3B) or (4).”.

(3) Section 16J(4)—

Repeal

“(2A) or (3)” (wherever appearing)

Substitute

“(2A), (3) or (3A)”.

(4) Section 16J(5)—

Repeal

“(2) and (3)”

Substitute

“(2), (3) and (3A)”.

16. Section 16K amended (environmental protection facilities owned as at commencement date)

(1) Section 16K, heading—

Repeal

“commencement”

Substitute

“certain”.

(2) Section 16K(4)—

Repeal

“16I”

Substitute

“16I(3) or (4)”.

(3) Section 16K(5)—

Repeal

“16I”

Substitute

“16I(3) or (4)”.

17. Section 16L added

After section 16K—

Add

“16L. Environmental protection installations owned before 1 April 2018

(1) If—

(a) a person has incurred capital expenditure (or is otherwise entitled to the relevant interest in relation to the capital expenditure incurred) on the construction of a building or structure before 1 April 2018;

(b) the building or structure is an environmental protection installation; and

(c) no deduction has previously been allowed under this Part for the expenditure,

the person is, for the purposes of section 16I(3B), taken to have incurred specified capital expenditure in relation to the building or structure on 1 April 2018.

(2) The specified capital expenditure is to be the residue of expenditure incurred in relation to the building or structure immediately before 1 April 2018.

(3) The person may elect in writing for this section to apply if the person wishes to claim a deduction under section 16I(3B) in relation to the specified capital expenditure for the year of assessment commencing on 1 April 2018.

- (4) An election may only be made within 1 month after a notice of assessment for the year of assessment is given to the person under section 62.
 - (5) An election is irrevocable.”.
-

Part 4

Amendments Relating to Qualifying Debt Instruments

18. Section 14A amended (qualifying debt instruments)

- (1) Section 14A(1A)(a)—

Repeal

“the date of commencement of the Inland Revenue (Amendment) Ordinance 2011 (4 of 2011)”

Substitute

“25 March 2011”.

- (2) After section 14A(1A)—

Add

“(1B) For the purposes of this Part—

- (a) interest paid or payable on a debt instrument issued on or after 1 April 2018; and
- (b) any gain or profit on the sale or other disposal, or on the redemption on maturity or presentment, of the debt instrument,

received by or accrued to a person are not chargeable to tax under this Part.

- (1C) Subsection (1B) does not apply in relation to a debt instrument if, at the time the interest or gain or profit relating to the debt instrument is received by or accrued to a person, the person is an associate of the issuer of the debt instrument.”.

- (3) Section 14A(4), definition of *debt instrument*—

Repeal paragraph (a)

Substitute

“(a) is—

- (i) in respect of a debt issue which in its entirety has been lodged with and cleared by the Central Moneymarkets Unit operated by the Monetary Authority; or
- (ii) listed on a stock exchange in Hong Kong;”.

- (4) Section 14A(4), definition of *medium term debt instrument*, paragraph (b)(i), after “2003”—

Add

“but before 1 April 2018”.

- (5) Section 14A(4), definition of *short term debt instrument*, paragraph (a)—

Repeal

everything after “or after”

Substitute

“25 March 2011 but before 1 April 2018;”.

- (6) Section 14A(4A)—

Repeal

“the date of commencement of the Inland Revenue (Amendment) Ordinance 2011 (4 of 2011)”

Substitute

“25 March 2011”.

- (7) After section 14A(6)—

Add

- “(7) An amount of loss incurred or sustained by a person from a transaction in or related to a debt instrument issued on or after 1 April 2018 in a year of assessment

cannot be set off against the person’s assessable profits for the year of assessment or any subsequent year of assessment.

- (8) To avoid doubt, paragraph (a) of the definition of *debt instrument* in subsection (4) as in force on the commencement date of the Inland Revenue (Amendment) (No. 5) Ordinance 2018 (of 2018) applies to an instrument issued within the period from 1 April 2018 to the day before that commencement date.”.

19. Section 19CA amended (treatment of losses: concessionary trading receipts)

Section 19CA(5), definition of *concession provision*, paragraph (a)—

Repeal

“14A”

Substitute

“14A(1)”.

20. Section 26A amended (exclusion of certain profits from tax)

- (1) Section 26A(1B)—

Repeal

“the date of commencement of the Inland Revenue (Amendment) Ordinance 2011 (4 of 2011)”

Substitute

“25 March 2011”.

- (2) Section 26A(2), definition of *long term debt instrument*, paragraph (a), after “2003”—

Add

“but before 1 April 2018”.

Explanatory Memorandum

The objects of this Bill are to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) to provide for the option for married persons to elect for personal assessment separately for all years of assessment commencing on or after 1 April 2018, to accelerate tax deductions for capital expenditure incurred in relation to environmental protection installations, to provide for tax exemption to cover certain debt instruments issued on or after 1 April 2018, and to provide for related matters.

2. The Bill is divided into 4 Parts.

Part 1—Preliminary

3. Clause 1 sets out the short title.

Part 2—Amendments Relating to Personal Assessment

4. Clause 3 provides that the provisions of the Ordinance as amended by Part 2 apply in relation to all years of assessment commencing on or after 1 April 2018.
5. Clause 4 amends section 19C of the Ordinance to—
- (a) allow a loss incurred by an individual in a year of assessment in any trade, profession or business carried on by the individual to be carried forward and set off against the amount of the individual's assessable profits from the trade, profession or business for subsequent years of assessment if—
 - (i) the individual (whether married or not) does not elect for personal assessment for the year of assessment; or

- (ii) the individual and the individual's spouse do not jointly elect for personal assessment for the year of assessment;
 - (b) allow a share of a loss of a partnership incurred by an individual in a year of assessment in any trade, profession or business carried on by the partnership to be carried forward and set off against the amount of the individual's share of assessable profits of the partnership from the trade, profession or business for subsequent years of assessment if—
 - (i) the individual (whether married or not) does not elect for personal assessment for the year of assessment; or
 - (ii) the individual and the individual's spouse do not jointly elect for personal assessment for the year of assessment;
 - (c) provide for the amount of loss or share of loss in a partnership incurred by an individual to be dealt with in accordance with Part 7 (personal assessment) of the Ordinance if—
 - (i) the individual (whether married or not) is personally assessed under that Part; or
 - (ii) the individual and the individual's spouse have jointly elected to be personally assessed under that Part.
6. Clause 5 amends section 26C of the Ordinance to provide that a sum of approved charitable donations that has been allowed as a deduction to the spouse of a person against the spouse's total income under Part 7 of the Ordinance may not be allowed as a deduction to the person.

7. Clause 6 amends section 29 of the Ordinance to allow an allowance (*married person's allowance*) to be granted to a person in a year of assessment if the person's spouse did not have assessable income in the year of assessment and had not made an election under section 41(1) of the Ordinance for the year of assessment. A married person's allowance is to be granted to the person and the spouse if they have jointly elected to be personally assessed under Part 7 of the Ordinance.
8. Clauses 7 and 8 amend sections 31 and 31A of the Ordinance respectively to allow all the child allowances and disabled dependant allowances grantable under those sections in respect of the children of a married couple to be claimed by one spouse if both spouses are chargeable to tax under Part 7 of the Ordinance.
9. Clause 9 amends section 41 of the Ordinance to allow an individual (who has a spouse) to elect for personal assessment separately or jointly with the spouse. However, if the individual or the spouse is chargeable to salaries tax in respect of their aggregated net chargeable income under section 10(3) of the Ordinance, they should jointly make an election for personal assessment. The clause also requires a written notice of withdrawal of election for personal assessment by an individual (and the spouse, if applicable) within a certain period of time and provides for the effect and consequence of the withdrawal.
10. Clause 10 amends section 42 of the Ordinance to provide that if the spouse of an individual (who has income chargeable to tax for a year of assessment) has a loss carried forward under Part 7 of the Ordinance to the year of assessment in which the spouse has no income chargeable to tax, the amount of loss may be set off against the income of the individual under that Part for the year of assessment as if the individual and the spouse had jointly made an election for personal assessment for that year.

11. Clause 11 repeals obsolete provisions in section 51 of the Ordinance.
 12. Clause 12 is a consequential amendment to give effect to separate election for personal assessment by an individual. It amends section 59 of the Ordinance to enable an assessor not to make an assessment of profits tax in respect of the assessable profits of an individual who carries on a trade, profession or business in Hong Kong (whether solely or jointly with another person) under certain circumstances.
 13. Clause 13 updates a reference in Schedule 4 to the Ordinance.
- Part 3—Amendments Relating to Environmental Protection Installations**
14. Clause 14 amends section 16I of the Ordinance to add—
 - (a) a new section 16I(3A) to allow any part of a specified capital expenditure incurred in relation to an environmental protection installation that remains to be deducted for any year of assessment commencing on or after 1 April 2018 under section 16I(3)(b) to be deducted in the year of assessment commencing on 1 April 2018; and
 - (b) a new section 16I(3B) to allow any specified capital expenditure incurred in any year of assessment commencing on or after 1 April 2018 in relation to an environmental protection installation to be deducted for the year of assessment in which the expenditure is incurred.
 15. Clause 15 amends section 16J of the Ordinance to add a new section 16J(3A) to treat the sale proceeds of any environmental protection installation for which a deduction has been allowed

under the new section 16I(3B) as trading receipts chargeable to profits tax in Hong Kong.

16. Clause 16 amends section 16K of the Ordinance to include certain consequential amendments, and clause 17 adds a new section 16L to the Ordinance to provide for the transitional arrangements for the deduction in relation to certain environmental protection installations under the new section 16I(3B).

Part 4—Amendments Relating to Qualifying Debt Instruments

17. Clause 18 amends section 14A of the Ordinance to—
- (a) provide for the profits tax exemption to cover debt instruments issued on or after 1 April 2018; and
 - (b) extend the definition of *debt instrument* in section 14A(4) of the Ordinance to cover a debt instrument that is listed on a stock exchange in Hong Kong.
18. Clause 19 makes a consequential amendment to section 19CA of the Ordinance.
19. Clause 20 amends section 26A of the Ordinance to modify the definition of *long term debt instrument* in view of the new tax exemption measure relating to qualifying debt instruments under Part 4 of the Ordinance.

Tax Incentive for Environmental Protection Installations

To encourage the business sector to use environmental protection equipment, section 16I of the Inland Revenue Ordinance (“IRO”) was amended in 2008 to provide a 100% profits tax deduction for capital expenditure on environmental protection machinery/plant in the first year of purchase. As regards environmental protection installations covering energy efficiency (“EE”) and renewable energy (“RE”) installations, the depreciation period was shortened from the usual 25 years to five years then. A list of the environmental protection installations is set out in Part 2 of Schedule 17 to the IRO, including 12 types of RE installations and energy efficient building installations used by buildings registered under the voluntary Hong Kong Energy Efficiency Registration Scheme for Buildings (“EERSB”) administered by the Electrical and Mechanical Services Department (“EMSD”).

Need for Proposed Tax Incentive

2. The Government attaches great importance to combating climate change. In early 2017, the Environment Bureau (“ENB”) promulgated the “Hong Kong’s Climate Action Plan 2030+” and set a target to reduce carbon intensity by 65-70% by 2030, using 2005 as the base. As buildings account for some 90% of electricity consumption and over 60% of greenhouse gas emissions in Hong Kong, the Government has been implementing measures to promote green building, improve energy efficiency and adopt distributed RE. The Government is pressing ahead with the various green building and RE measures outlined in the “Energy Saving Plan for Hong Kong’s Built Environment 2015~2025+”, which sets a target of reducing Hong Kong’s energy intensity by 40% by 2025.

3. To encourage the use of RE and EE installations and demonstrate the Government’s commitment to promoting environmental protection, it is proposed to shorten the depreciation period for RE and qualified EE installations from five years to one year. In other words, capital expenditure on both environmental protection machinery/plant as well as RE and qualified EE installations as set out in Part 2 of Schedule 17 to the IRO can be 100% deducted from chargeable profits in one year (i.e. the year in which the expenditure is incurred). With the proposed shortening of the depreciation period, ENB expects that it will be more attractive to the business sector to use different environmental protection installations. In particular, the shorter depreciation period may help reduce the significant upfront capital expenditure on businesses to procure RE and qualified EE installations.

4. One of the eligible environmental protection installations is energy efficient building installation for buildings registered under the voluntary EERSB administered by EMSD. The EERSB accepts applications from all types of new and existing buildings.

5. To encourage building owners and property management companies to adopt green building and achieve an energy efficiency level higher than the minimum prescribed by the Buildings Energy Efficiency Ordinance (Cap. 610), EMSD has set a higher energy efficiency standard for registration under the EERSB. Specifically, buildings concerned should reach specified standards under a green building certification system.

6. As a transitional arrangement, any remaining part of the capital expenditure on environmental protection installations which has not been deducted under section 16I may be deducted in full in the year of assessment 2018/19.

Proposed Enhancements to Qualifying Debt Instrument (“QDI”) Scheme

The QDI Scheme

Launched in 1996 and having gone through a number of revisions since then, the QDI Scheme has been set up with the policy objectives of attracting overseas issuers to Hong Kong and developing the local bond market. Under the Scheme –

- (a) Interest receipts or profits from the sale or disposal of medium or short term debt instruments with an original maturity of less than seven years could enjoy profits tax concession of 50% pursuant to section 14A of the Inland Revenue Ordinance (“IRO”);
- (b) Interest receipts or profits from the sale or disposal of long term debt instruments with an original maturity of not less than seven years or is undated could benefit from profits tax concession of 100% pursuant to section 26A of the IRO; and
- (c) The above tax concessions are subject to the criterion that the debt instruments must be lodged with and cleared by the Central Moneymarkets Unit (“CMU”) of the Hong Kong Monetary Authority.

Limitations of the Current Scheme

2. As the local bond market continues to evolve amidst keen competition from other regional financial centres, the QDI Scheme is inadequate in delivering the intended policy outcomes.
3. First, the current eligibility criterion of being lodged with and cleared by the 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.

Proposed Enhancements

5. To promote the development of local bond market, it is proposed 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. The proposals are as follows –

- (a) The 100% tax concession for debt instruments with an original maturity of not less than seven years be extended to cover debt instruments of any original maturity; and
- (b) The current requirement that a debt instrument must be lodged with and cleared by the CMU to be qualified for tax concession be relaxed, to include also debt instruments listed on the Stock Exchange of Hong Kong Limited.

Benefits of the Proposals

6. The above proposals 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 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.

Financial, Economic, Environmental, Sustainability and Family Implications of the Proposal

Financial Implications

The proposed election for personal assessment (“PA”) by married persons separately may reduce tax revenue as some individuals may pay less tax as a result. Under separate PA, the income of a couple would not be aggregated for calculation of tax and thus a smaller amount of income will be subject to the top progressive tax rate for each of the spouses. The revenue foregone is, however, difficult to estimate because whether a married person would elect for separate or joint PA depends on his or her individual circumstances and income mix of the couple, which would change from year to year.

2. Separately, the number of applications for accelerated tax deduction for environmental protection installations under section 16I has declined in recent years. The amount of deductions claimed under section 16I for YA 2015/16 was \$25.1 million, a marked decline from the peak of \$78.5 million in YA 2012/13. The revenue implication under the proposal of providing accelerated tax deduction for environmental protection installations may appear more significant in the first year of implementation, given that enterprises can claim a year’s capital expenditure in full plus all outstanding qualified expenditures incurred up to the past four years where deduction has not been fully claimed. However, the overall impact should be moderated and broadly evened out over time because the 100% deduction claimed in a year of assessment under the new arrangement would reduce the amount of deduction claimable in the subsequent four years. Assuming that the proposed incentive would achieve its intended objective, one could expect the deduction claimed on environmental protection installations to rise in future, but the quantum cannot be ascertained at this stage.

3. Regarding the proposal to enhance the Qualifying Debt Instrument (“QDI”) Scheme, the estimated revenue forgone is about \$73 million for 2018-19, \$147 million for 2019-20 and \$220 million annually thereafter. On the other hand, the enhancements are expected to bring in new revenue, as they may incentivise local and overseas bond investors to expand their operations and engage professional services in Hong Kong. It is however difficult to estimate the additional revenue so generated from these secondary activities at this stage.

Economic Implications

4. The proposed PA relaxation will help reduce the financial burden of some taxpayers, and might provide some stimulus to local consumption.

5. The enhanced tax incentive for environmental protection installations would encourage businesses to procure these installations and adopt green buildings.

This would help foster a market for energy efficiency and renewable energy in Hong Kong which is conducive to the development of a low-carbon economy.

6. Separately, the QDI enhancements will be conducive to the development of the local bond market, thereby enhancing Hong Kong's competitiveness as an international financial centre.

Environmental Implications

7. Encouraging the private sector to use environmental protection installations including renewable energy installations and energy efficiency building installations is important for Hong Kong to achieve its carbon intensity reduction target as set out in the "Hong Kong's Climate Action Plan 2030+" promulgated by the Government. The proposed tax incentive would be an important tool to promote the use of these installations and adoption of green building as a key mitigation measure against climate change.

Sustainability Implications

8. The proposals have positive sustainability implications. The proposed PA relaxation may generate economic benefits to some households through increasing their disposable incomes and promote social harmony through alleviating taxpayers' burden. The accelerated tax deduction for environmental protection installations could encourage their procurement and use and thereby help reduce carbon emissions. Extending the scope of tax exemption for debt instruments under the QDI Scheme could promote further development of the local bond market.

Family Implications

9. The introduction of the election for PA separately may help relieve the tax burden of some families.