

立法會
Legislative Council

LC Paper No. CB(1)441/18-19
(These minutes have been seen
by the Administration)

Ref : CB1/BC/1/18

Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2018

**Minutes of the first meeting on
Tuesday, 27 November 2018, at 10:45 am
in Conference Room 2A of the Legislative Council Complex**

Members present : Hon Kenneth LEUNG (Chairman)
Hon WONG Ting-kwong, GBS, JP
Hon WU Chi-wai, MH
Dr Hon KWOK Ka-ki
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHAN Chun-ying, JP

Member absent : Hon Dennis KWOK Wing-hang

Public officers attending : Mr Chris SUN, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services)1

Ms Estrella CHEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)3

Mr Robert PROBYN
Senior Manager (Resolution Office) (Policy)3
Hong Kong Monetary Authority

Ms Helen CHAN
Acting Senior Manager (Resolution)(Policy)1
Hong Kong Monetary Authority

Mr CHIU Kwok Kit, JP
Deputy Commissioner (Technical)
Inland Revenue Department

Ms WONG Pui Ki
Senior Assessor (Research)2
Inland Revenue Department

Ms Mandy NG
Senior Government Counsel
Law Drafting Division
Department of Justice

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

Staff in attendance : Miss Linda CHAN
Assistant Legal Adviser 11

Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Ms Vivian CHAN
Clerical Assistant (1)4

Action

I Election of Chairman (and Deputy Chairman)

Election of Chairman

Mr WONG Ting-kwong, the member with the highest precedence among those who were present at the meeting, presided over the election of the Chairman of the Bills Committee and invited nominations for the chairmanship of the Bills Committee.

2. Mr Kenneth LEUNG was nominated by Mr CHAN Chun-ying and the nomination was seconded by Mr WU Chi-wai. Mr Kenneth LEUNG accepted

Action

the nomination. There being no other nomination, Mr WONG Ting-kwong declared that Mr Kenneth LEUNG was elected the Chairman of the Bills Committee. Mr LEUNG then took the chair.

Election of Deputy Chairman

3. Members agreed that there was no need to elect a Deputy Chairman.

II Meeting with the Administration

(LC Paper No. CB(3)49/18-19	— The Bill
File Ref: B&M/2/1/29/4/1C(2018)	— Legislative Council Brief
LC Paper No. LS8/18-19	— Legal Service Division Report
LC Paper No. CB(1)212/18-19(01)	— Marked-up copy of the Inland Revenue (Amendment) (No. 6) Bill 2018 prepared by the Legal Service Division (Restricted to members only)
LC Paper No. CB(1)212/18-19(02)	— Letter dated 22 November 2018 from the Legal Service Division to the Administration
LC Paper No. CB(1)212/18-19(03)	— Background brief prepared by the Legislative Council Secretariat)

Discussion

4. The Bills Committee deliberated (Index of proceedings attached at **Appendix**).

Invitation of views

5. Members agreed to post a notice on the website of the Legislative Council ("LegCo") to invite written views on the Inland Revenue (Amendment) (No. 6) Bill 2018 ("the Bill").

Action

(Post-meeting note: The notice was posted on the LegCo website on 29 November 2018 to invite interested parties to provide submissions on the Bill.)

III Any other business

Legislative timetable

6. The Chairman said that the Bills Committee had completed clause-by-clause examination of the Bill. Subject to any views members might have on the submissions received (if any), the Chairman would decide whether a further meeting was necessary.

(Post-meeting note: The written submissions were issued to members vide LC Paper No. CB(1)397/18-19(01) and (02) on 28 December 2018. No further meeting was held.)

7. Members noted that the Administration planned to resume the Second Reading debate on the Bill at the Council meeting of 30 January 2019 if no further meeting was held. If it was the case, the Chairman would report the Bills Committee's deliberations at the House Committee meeting on 18 January 2019. The deadline for giving notice of amendments to the Bill would be 21 January 2019.

8. There being no other business, the meeting ended at 12:10 pm.

Council Business Division 1
Legislative Council Secretariat
11 January 2019

**Proceedings of the first meeting of
the Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2018
on Tuesday, 27 November 2018, at 10:45 am
in Conference Room 2A of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Election of Chairman (and Deputy Chairman)			
000603 – 000812	Mr WONG Ting-kwong Mr CHAN Chun-ying Mr WU Chi-wai Mr Kenneth LEUNG	Election of Chairman	
Agenda item II — Meeting with the Administration			
000813 – 001454	Chairman Administration	Briefing by the Administration on the Inland Revenue (Amendment) (No. 6) Bill 2018 ("the Bill") <i>(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)230/18-19(01)) were issued to members vide Lotus Notes e-mail on 27 November 2018.)</i>	
001455 – 002432	Chairman Mr Christopher CHEUNG Administration Mr CHAN Chun-ying	Mr CHEUNG's views and enquiries as follows: (a) he supported the Bill in principle; (b) the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules ("the Rules"), which prescribed loss-absorbing capacity ("LAC") requirements for authorized institutions ("AIs") and their group companies that were covered by the Financial Institutions (Resolution) Ordinance (Cap. 628) ("FIRO"), were still under scrutiny by the relevant Subcommittee of the Legislative Council ("LegCo"). As the Bill set out the tax treatment for LAC debt instruments, it would be more appropriate for the Bill to take effect	

Time Marker	Speaker	Subject(s)	Action Required
		<p>after completion of the scrutiny of the Rules;</p> <p>(c) when the Administration and the Hong Kong Monetary Authority ("HKMA") would finalize the total consolidated asset indicative threshold (the starting point for determining whether an AI was an in-scope AI to be subject to LAC requirements under the Rules) which would be included in the LAC Code of Practice chapter; and</p> <p>(d) the Administration should elaborate the tax deduction arrangements for an LAC debt instrument issued to or for the benefit of, or held by or for the benefit of, a specified connected person of the issuer (i.e. paragraph 21(b) of the LegCo Brief).</p> <p>Mr CHAN said that subject to the negative vetting procedure of LegCo (the scrutiny period of which would expire on 12 December 2018), the Rules would take effect on 14 December 2018. As the Bill would come into operation after 14 December 2018, he considered that the Bills Committee could work in parallel with the Subcommittee.</p> <p>The Administration responded as follows:</p> <p>(a) the Bill would come into operation after the Rules had commenced;</p> <p>(b) it would be more appropriate to discuss issues relating to LAC requirements (including the total consolidated asset indicative threshold) at meetings of the Subcommittee; and</p> <p>(c) the Bill had not proposed to change the framework under the Inland Revenue Ordinance (Cap. 112) ("IRO") for deduction of interest in respect of regulatory capital securities ("RCS"). The tax treatment for non-arm's length</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>transaction between associates and for LAC debt instruments issued to specified connected person were set out in the proposed amended sections 17E and 17F of the IRO respectively.</p> <p>In response to the Chairman's enquiry, the Administration advised that there was no provision in the Bill setting any quantitative limit on the amount of LAC debt instruments an entity could issue to its specified connected persons. However, interest would be deductible only if the money paid by the specified connected person for the purchase of the LAC debt instrument was entirely funded by the proceeds of an external issue of a debt instrument to a third party and also, the amount of interest deduction would be restricted to the amount of interest payable to the third party in respect of the external issue.</p>	
002433 – 005121	Chairman Dr KWOK Ka-ki Mr CHAN Chun-ying Mr WU Chi-wai Administration	<p><u>Possible abuse of loss-absorbing capacity instruments and the proposed tax treatment for such instruments held by entities</u></p> <p>Dr KWOK's concerns and enquiries as follows:</p> <p>(a) whether AIs could utilize various financial arrangements (e.g. (i) mutual holding of LAC debt instruments issued by different AIs; or (ii) the purchase of LAC debt instruments issued by a subsidiary in the same banking group) to exploit the proposed profits tax deduction and stamp duty exemption provided by the Bill;</p> <p>(b) whether the proposed tax deduction and stamp duty exemption would incentivize an AI, which was still viable, to abuse the use of resolution in obtaining capital resources; and</p> <p>(c) whether a banking group could conceal the financial risks of its subsidiaries</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>through the issuance of LAC debt instruments.</p> <p>Mr CHAN's views as follows:</p> <p>(a) the purchase of a material subsidiary's LAC debt instruments by the holding company of that material subsidiary was a form of capital injection of the holding company to the material subsidiary; and</p> <p>(b) if an AI purchased LAC debt instruments issued by another AI, it had to make a corresponding reduction in its capital base. Thus, AIs could not artificially increase their capital through mutual holding of LAC debt instruments issued by other AIs.</p> <p>The Chairman remarked that the Administration should respond to members' concern by explaining the restrictions imposed on the sale and holding of LAC instruments by AIs, in particular for LAC transactions between a subsidiary and its holding company (i.e. "back-to-back transactions").</p> <p>Mr WU enquired whether the Bill had anti-avoidance provisions for "back-to-back transactions".</p> <p>The Administration responded as follows:</p> <p>(a) it confirmed Mr CHAN's understanding of the operation of LAC instruments;</p> <p>(b) the Rules had prescribed restrictions on the sale and mutual holding of LAC instruments by AIs;</p> <p>(c) if the resolution authority ("RA") classified an AI as a resolution entity, the AI had to issue external LAC instruments to external entities (which were confined to professional investors including financial institutions ("FIs"));</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(d) if RA classified an AI in a banking group as a material subsidiary, the AI could only issue internal LAC instruments to the resolution entity of the banking group;</p> <p>(e) for intra-group transactions which involved back-to-back arrangements, the purchaser of internal LAC instruments (i.e. the holding company) had to meet external LAC requirements of its own. If the holding company purchased other AI's external LAC instruments, it had to make a corresponding reduction in its own capital. The corresponding deduction in AIs' capital for holding LAC instruments issued by other AIs was to mitigate the risk of financial contagion; and</p> <p>(f) if an AI issued internal LAC debt instruments to its holding company, the rules for interest deduction would be as follows:</p> <p>(i) if the holding company was chargeable to tax in Hong Kong (i.e. not falling within the definition of "specified connected person" under section 17F of IRO), interest payable by the AI would be allowable for deduction without any restrictions; and</p> <p>(ii) if the holding company was not chargeable to tax in Hong Kong (i.e. falling within the definition of "specified connected person" under section 17F), the basic rule was that the AI would not be eligible for interest deduction. However, if the holding company's funding for the purchase of the AI's internal LAC debt instruments was from the issuance of external LAC debt instruments or other debt instruments to a third party, interest payable by the AI would be</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>allowable for deduction but the amount of deduction would be restricted to the sum payable by the holding company to the third party.</p> <p><u>Exemption of stamp duty</u></p> <p>Dr KWOK enquired about the rationale for exempting the transfer of LAC debt instruments from stamp duty under the Stamp Duty Ordinance (Cap. 117) ("SDO").</p> <p>The Administration advised that RCSs (including LAC debt instruments), which were hybrid in nature (i.e. possessing features of both debt and equity), were treated as debts by the international financial community. The Bill sought to amend the definition of RCS under IRO to reflect this international practice. Currently, transfer of RCS (i.e. Additional Tier 1 capital instruments and Tier 2 capital instruments), which was treated as debt security, was exempt from stamp duty under SDO. The amendment in the Bill would extend the stamp duty exemption to all LAC debt instruments.</p> <p>Mr CHAN pointed out that the holding company of a locally incorporated AI might be a corporate (incorporated locally or overseas) which was not an FI, and enquired about the tax treatment of interest income earned by the overseas holding company in respect of LAC debt instruments issued by the AI.</p> <p>The Administration advised that as Hong Kong adopted the territorial source principle of taxation, the overseas enterprise concerned would not be chargeable to Hong Kong's profits tax if it did not carry on business in Hong Kong.</p> <p>Mr WU enquired about the reasons for making frequent amendments to the terms "fair value" and "RCS" under IRO in recent years.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Administration responded as follows:</p> <p>(a) the Bill amended the interpretation of the term "fair value" to align it with the text of the term used in International Financial Reporting Standards. The amendment would not introduce any material change to the meaning of the term; and</p> <p>(b) the definition of the term "RCS" was revised to (i) relocate the word "security" to sub-paragraphs (a) and (b) as most of the LAC debt instruments were "instrument", rather than "security"; and (ii) include the newly added non-capital LAC debt instruments of FIs (including all AIs), LAC debt instruments of "HK affiliated operational entities" and "clean HK holding companies" (both defined under the Rules) and LAC debt instrument-equivalent of overseas FIs to the interpretation.</p>	
005122 – 005730	Chairman Administration	<p>The Chairman's enquiries as follows:</p> <p>(a) whether the proposed arrangement (which was set out in page 5 of the Administration's powerpoint) to treat interest income/gains/profits arising from RCSs as trading receipts even if (i) the moneys provided for the purchase were made available outside Hong Kong; or (ii) transactions were effected outside Hong Kong was consistent with the territorial source principle of taxation adopted by Hong Kong; and</p> <p>(b) whether a mechanism was in place under the Bill or the Rules for an LAC debt instrument to be converted into equity, and whether convertible LAC debt instruments would be entitled for the proposed stamp duty exemption.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Administration responded as follows:</p> <p>(a) the arrangement referred to above was set out in the proposed amended section 15 of IRO, and would extend the existing tax treatment applicable to FIs (including all AIs) with respect to interest income/gains/profits arising from RCSs to LAC banking entities (i.e. "HK affiliated operational entities" or "clean HK holding companies" defined under the Rules). The tax treatment of interest income/gains/profits arising from RCSs received by other types of entities would follow the existing provisions of IRO;</p> <p>(b) the conversion of an LAC debt instrument into equity would not happen automatically. The conversion would happen when the AI concerned had reached the point of non-viability; and (i) the contractual provision in the LAC debt instrument was triggered or (ii) an RA used its statutory power under FIRO to effect a conversion; and</p> <p>(c) all LAC debt instruments (which were convertible into equity upon non-viability of the AI concerned) would be treated as debts for profits tax purposes and the transfer of such instruments would be exempt from stamp duty.</p>	
005731 – 010142	Chairman Mr WU Chi-wai Administration	<p>Mr WU enquired about the meaning of the term "conditions" in the proposed amended section 17E(1)(a) of IRO, and whether there would be anti-avoidance measures for transactions between an FI or an LAC banking entity (i.e. an HK affiliated operational entity or a clean HK holding company) and its associates.</p> <p>The Administration explained that the term "conditions" in the proposed amended section 17E(1)(a) of IRO referred to the terms and conditions of commercial</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>transactions. Section 17E of IRO, which set out how profits should be adjusted if associates did not deal at arm's length in connection with RCS, had prescribed anti-avoidance measures for transactions between an FI or an LAC banking entity and its associates.</p>	
010143 – 010702	<p>Chairman Administration Mr CHAN Chun-ying Clerk</p>	<p>Briefing by the Administration on its response to the letter dated 22 November 2018 from the Legal Service Division [LC Paper No. CB(1)212/18-19(02)]</p> <p>Members agreed to post a notice on the website of LegCo to invite written views on the Bill.</p>	
Clause-by-clause examination of the Bill			
010703 – 011933	<p>Chairman Administration</p>	<p>Inland Revenue (Amendment) (No. 6) Bill 2018</p> <p><u>Clause 1 – Short title</u></p> <p><u>Clause 2 – Inland Revenue Ordinance amended</u></p> <p><u>Clause 3 – Section 2 amended (interpretation)</u></p> <p><u>Clause 4 – Section 14D amended (qualifying corporate treasury centre: profits tax concession)</u></p> <p><u>Clause 5 – Section 14F amended (qualifying corporate treasury centre: Commissioner's determination)</u></p> <p><u>Clause 6 – Section 15 amended (certain amounts deemed trading receipts)</u></p> <p><u>Clause 7 – Section 16 amended (ascertainment of chargeable profits)</u></p> <p><u>Clause 8 – Section 17A amended (financial institution: interpretation)</u></p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p><u>Clause 9 – Section 17D amended (financial institution: general provisions on regulatory capital security held by, or for benefit of, issuer's specified connected person)</u></p> <p><u>Clause 10 – Section 17E amended (financial institution: profits adjusted if associates deal not at arm's length in connection with regulatory capital security)</u></p> <p><u>Clause 11 – Section 17F amended (financial institution: issuer's deduction if regulatory capital security is issued to, held by or issued or held for benefit of specified connected person)</u></p> <p><u>Clause 12 – Section 89 amended (transitional provisions)</u></p> <p><u>Clause 13 – Schedule 36 amended (transitional provisions for Inland Revenue (Amendment) (No. 2) Ordinance 2016)</u></p> <p><u>Clause 14 – Schedule 47 added</u></p> <p><i>Schedule 47 Transitional Provisions for Inland Revenue (Amendment) (No. 6) Ordinance 2018</i></p> <p>The Chairman enquired whether the profits tax assessments of LAC debt instruments would be affected by fluctuations in the fair values of such instruments.</p> <p>The Administration responded that in general, under fair value accounting, all financial instruments would be measured at fair value. For RCSs, any fluctuations in fair value would be ignored in ascertaining the issuer's chargeable profits. If the security was issued to a specified connected person of the issuer, fluctuations in fair value of the security would also be ignored in ascertaining the specified connected person's chargeable profits.</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Administration also confirmed that the Inland Revenue (Amendment) (No. 7) Bill 2018 (which covered, inter alia, amendments relating to fair value accounting) would not change the application of sections 17C and 17D of IRO in respect of RCSs.</p>	
011934 – 012422	<p>Chairman Mr WU Chi-wai Administration Mr CHAN Chun-ying</p>	<p>Mr WU enquired whether an AI could, before the commencement of the Bill, change its existing capital instruments into LAC debt instruments so that the AI could enjoy the proposed profits tax deduction when the Bill came into operation.</p> <p>The Administration replied in the negative.</p> <p>In response to Mr CHAN's enquiry, the Administration advised that it would be unlikely for HKMA to re-categorize certain existing instruments (which currently did not fall within the scope of "Additional Tier 1 capital instrument" or "Tier 2 capital instrument" under the definition of RCS) of an AI as LAC debt instruments (which would enable the AI to enjoy the proposed profits tax deduction).</p>	
Agenda item III — Any other business			
012423 – 012831	Chairman	Legislative timetable and concluding remarks	