立法會
Legislative Council

LC Paper No. CB(1)114/18-19

Ref : CB1/BC/9/17

Paper for the House Committee meeting on 2 November 2018

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

Purpose

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2018 ("the Bills Committee").

Background

2. To provide married individuals with greater flexibility in tax assessment and enhance certain profits tax concessions, the Financial Secretary announced in the 2018-2019 Budget the proposed implementation of the following measures starting from the year of assessment ("YA") 2018-2019:

(a) relaxing the requirement for the election of personal assessment ("PA") by allowing husband and wife the option to elect for PA separately;

(b) enhancing tax incentives to enterprises by allowing them to claim tax deduction for capital expenditure incurred for the procurement of eligible environmental protection installations ("EPIs") in full in one year instead of over five years; and

(c) enhancing the Qualifying Debt Instrument ("QDI") Scheme to promote further development of the bond market by extending the scope of tax exemption for debt instruments under the QDI Scheme and allowing debt instruments listed on the Stock Exchange of Hong Kong Limited ("SEHK") to be qualified for tax exemption in addition to instruments lodged with and cleared by the Central Moneymarkets Unit ("CMU") of the Hong Kong Monetary Authority ("HKMA").

Inland Revenue (Amendment) (No. 5) Bill 2018

3. In seeking to implement the above proposed measures, the Inland Revenue (Amendment) (No. 5) Bill 2018 ("the Bill") was published in the Gazette on 8 June 2018 and received its First Reading at the Council meeting of 13 June 2018. The objects of the Bill are to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to: (a) provide for the option for married persons to elect for PA separately for any YAs commencing on or after 1 April 2018; (b) accelerate tax deductions for capital expenditure incurred in relation to EPIs; (c) provide for tax exemption to cover certain debt instruments issued on or after 1 April 2018; and (d) provide for related matters. The major provisions of the Bill are set out below.

Amendments relating to personal assessment (Part 2 of the Bill)

4. Currently, under section 41(1) of IRO, an individual who is married may elect for PA on the individual's total income. Section 41(1A) of IRO provides, among other things, that in case the individual and the individual's spouse have income assessable under IRO and both are eligible to elect for PA, the individual may only elect for PA when the individual's spouse also does so.

5. Clause 9 of the Bill seeks to amend section 41 of IRO to allow an individual who has a spouse to elect for PA separately or jointly with the spouse. Yet, if the individual or the individual's spouse is chargeable to salaries tax and they have elected to be jointly assessed in accordance with section 10(3) of IRO, the individual and the individual's spouse must make an election for PA jointly under the proposed section 41 of IRO. Clause 9 of the Bill also seeks to add a requirement of giving 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.

Amendments relating to environmental protection installations (Part 3 of the Bill)

6. Section 16I(3) of IRO provides that any specified capital expenditure incurred in relation to EPI ("EPI expenditure") during the basis period for a YA shall be deducted over five succeeding YAs (i.e. 20% to be deducted for the YA during which the expenditure was incurred and the remaining part by four equal amounts for each of the succeeding four YAs), so long as the EPI has not been sold at the end of the basis period for the YA concerned. Under section 16H(1) of IRO, EPI is

defined as any installation, or part of any installation, that is specified in Part 2 of Schedule 17 to IRO and forms a commercial or industrial building or structure as referred to in section 40(1) of IRO. These EPIs include: (a) renewable energy ("RE") installations such as solar water heating installations; and (b) energy efficient building installations registered under the Hong Kong Energy Efficiency Registration Scheme for Buildings administered by the Electrical and Mechanical Services Department ("EMSD").

7. Clause 14 of the Bill seeks to amend section 16I of IRO by adding a new subsection (3A) to the section to allow any part of EPI expenditure that remains to be deducted for any YA commencing on or after 1 April 2018 under section 16I(3)(b) of IRO to be deducted in the YA commencing on that date so long as the EPI concerned has not been sold on or before that date. The clause also seeks to add a new subsection (3B) to section 16I of IRO to allow any EPI expenditure incurred in any YA commencing on or after 1 April 2018 to be deducted in full for the YA in which the expenditure is incurred.

Amendments relating to qualifying debt instruments (Part 4 of the Bill)

8. Section 14A(1) of IRO provides, among other things, for the half-rate at which profits tax is chargeable in respect of a medium term debt instrument[1] or a short term debt instrument.[2] Section 26A(1) provides for profits tax exemption in respect of a long term debt instrument.[3] A "debt instrument" is defined in section 14A(4) of IRO to

---

[1] Under section 14A(4) of the Inland Revenue Ordinance (Cap. 112) ("IRO"), a "medium term debt instrument" means a debt instrument that is issued before 5 March 2003, has an original maturity of not less than five years (or is undated) and cannot be redeemed within five years from the date of its issue; or a debt instrument that is issued on or after 5 March 2003, has an original maturity of less than seven years but not less than three years (or is undated) and can be redeemed within seven years from the date of its issue but not within the first three years.

[2] Under section 14A(4) of IRO, a "short term debt instrument" means a debt instrument that is issued on or after 25 March 2011, has an original maturity of less than three years (or is undated) and can be redeemed within three years from the date of issue.

[3] Under section 26A(2) of IRO, a "long term instrument" means a debt instrument as defined in section 14A(4) that is issued on or after 5 March 2003, has an original maturity period of not less than seven years (or is undated) and cannot be redeemed within seven years from the date of its issue.

include an instrument specified in Part 1 of Schedule 6 to IRO[4] in respect of a debt issue which, among other things, in its entirety has been lodged with and cleared by CMU of HKMA.

9. Clause 18 of the Bill seeks to amend section 14A of IRO to extend the scope of profits tax exemptions to cover debt instruments of any original maturity issued on or after 1 April 2018 and to amend the definition of debt instrument which is defined in section 14A(4) to cover any debt instrument that is listed on SEHK so that such instruments would also become eligible for tax exemption.

The Bills Committee

10. At the House Committee meeting on 15 June 2018, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Hon Kenneth LEUNG, the Bills Committee has held two meetings to discuss the Bill with the Administration. The Bills Committee has also invited written views from relevant organizations and the public on the Bill, and has received a total of five written submissions. The list of deputations that have provided written submissions to the Bills Committee is in **Appendix II.**

Deliberations of the Bills Committee

11. Members of the Bills Committee in general support the Bill. The deliberations of the Bills Committee are summarized in the ensuing paragraphs.

Election for personal assessment by married persons separately

Rationale for the proposal

12. The Bills Committee notes that at present, where an individual and the individual's spouse are not living apart and both have income assessable under IRO and both are eligible to elect for PA, the individual may not elect for PA unless the individual's spouse also elects to be so assessed. The Administration has advised that the family has all along been referred to as the unit of taxation and the incomes of married

[4] These instruments include a bill of exchange and a promissory note as referred to in the Bills of Exchange Ordinance (Cap. 19).

couples are aggregated and assessed under salaries tax before the introduction of separate taxation for salaries tax. Under separate taxation, husbands and wives are separately assessed unless they have elected for joint assessment. Further, PA is a tax relief measure and married couples are still required to make the election jointly after the introduction of separate taxation. The proposed measure as announced in the 2018-2019 Budget to relax the requirement for the election of PA commencing from YA 2018-2019 by allowing married persons the option to elect PA separately will provide taxpayers who are married with greater flexibility in tax assessment.

Impact of the proposed measure on the Government's tax revenue

13. While raising no objection to the proposed measure which will provide greater flexibility to married individuals, the Bills Committee is concerned about the impact of the proposed separate election of PA by married persons on the tax revenue of the Government. Members have sought information on the estimated number of cases that will benefit from the proposed measure and the estimated amount of tax revenue to be forgone as a result of the measure.

14. The Administration has explained that the revenue foregone is difficult to estimate because whether a married person will elect for separate or joint PA depends solely on his/her individual circumstances and the types of income of the couple, which may change from year to year. As a reference information to facilitate the Bill Committee's consideration, the Administration has advised that according to the data of the Inland Revenue Department ("IRD") for YA 2016-2017, there were 235 000 PA elected cases, in which 107 000 were exempted cases and 128 000 were taxable cases with tax assessed of HK$4.851 billion. Out of the 128 000 taxable cases, about 81 000 cases involved married couples who had jointly elected for PA with tax assessed of HK$3.4 billion. On the assumption that 50% of those married couples (i.e. 40 500 cases) will separately elect for PA pursuant to the proposed measure, the estimated amount of tax revenue to be foregone will be about HK$1.7 billion.

Eligibility for election of personal assessment

15. The Legal Adviser to the Bills Committee ("Legal Adviser") has requested the Administration to confirm that despite the proposed section 41(1A) explicitly refers to the requirements for a married individual and the individual's spouse to elect for PA jointly, an individual (whether married or not) may rely on the proposed section 41(1) to elect for PA if the conditions stated in the proposed section 41 are satisfied. The Legal

Adviser has further requested the Administration to explain the reason for not providing explicitly under the Bill that each of a married couple may separately make an election for PA to better reflect the object of the Bill, which is stated, among other things, to provide for the option for married persons to elect for PA separately.

16. The Administration has advised that the proposed section 41(1) under Clause 9 of the Bill provides that an eligible individual may elect for PA on his/her total income in accordance with Part 7 of IRO. This individual can be single or married given there are no such restrictions specified. As such, the provision serves to allow an individual (irrespective of whether he/she is married or not) to elect for PA on his/her own (or, in other words, separately in the case of a married individual), which relaxes the current restriction under section 41(1A) of IRO that a married individual may not make an election for PA unless his/her spouse does so too. At the same time, the proposed section 41(1A) under Clause 9 of the Bill seeks to allow a married couple to jointly elect for PA if either or both of them are eligible to do so. Against the above, the Administration is of the view that there is no need to provide explicitly that each of a married couple may separately make an election for PA. The proposed section 41(1) is sufficiently clear to reflect the policy objective in a concise manner.

17. The Legal Adviser has enquired how the tax in relation to a married individual and the individual's spouse who have jointly elected for PA under the proposed section 41(1A) under Clause 9 of the Bill will be assessed where: (a) only one of them is eligible for PA; and (b) both of them are eligible for PA. The Administration has explained that if a married individual and the individual's spouse jointly elect for PA under the proposed section 41(1A), 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. The tax assessment is the same irrespective of whether only one or both of them are eligible to elect for PA.

Publicity

18. The Bills Committee is concerned that members of the public may not be aware of the option of allowing married persons to elect for PA separately as proposed under the Bill, and has enquired about the Administration's publicity strategy in this regard. The Administration has advised that IRD will update its website and the Departmental Interpretation and Practice Notes to provide more information on separate PA election by married persons. The relevant part of the tax return will also be updated to reflect the change.

<u>Accelerated tax deduction for environmental protection installations</u>

Rationale for the proposal

19. The Bills Committee notes that as proposed in the 2018-2019 Budget, Clause 14 of the Bill provides for enhanced tax incentives to enterprises for capital expenditure incurred in procuring EPIs by allowing tax deduction to be claimed in full in one year instead of over five years as provided for under section 16I(3) of IRO. This aims to encourage the use of such installations and demonstrate the Government's commitment to promoting environmental protection. In other words, capital expenditure on environmental protection machinery/plant as well as EPIs as set out in Part 2 of Schedule 17 to 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 deduction period, the Administration expects that it will be more attractive to the business sector to use EPIs. The shorter deduction period may help reduce the significant upfront capital expenditure on businesses to procure EPIs.

20. The Bills Committee further notes that if any loss is incurred by enterprises in the YA when deduction of EPIs is fully allowed, such loss can be carried forward to set off their assessable profits for the next year. Since EPIs form part of a commercial or industrial building, the enterprises concerned may choose to claim annual allowances in respect of the relevant capital expenditure incurred, which is currently 4% a year.

Measures to encourage non-business sectors to procure environmental protection installations

21. The Bills Committee notes a deputation's view that the Administration should consider introducing other incentive measures to attract non-business sectors, such as non-government organizations ("NGOs"), schools, education institutions as well as owners' corporations/residents' organizations of multi-ownership properties, to pursue the adoption of EPIs to further promote green buildings.

22. The Administration has advised that promoting green buildings and enhancing energy saving of buildings has always been one of the Government's priority tasks. Retro-commissioning ("RCx") [5] is a

---

[5] According to the Technical Guidelines on Retro-commissioning issued by the Electrical and Mechanical Services Department in 2017, retro-commissioning ("RCx") covers the scope of existing building commissioning, re-commissioning and continuous commissioning. There are four stages in RCx: Stage 1 – Planning, Stage 2 – Investigation, Stage 3 – Implementation and Stage 4 – Ongoing

cost-effective and systematic process to periodically check the energy performance of a building, hence a key measure to achieve energy saving in buildings. The Administration has been working with professional bodies and other stakeholders to promote RCx in the private sector for attaining energy efficiency and conservation in private buildings.

23. The Administration has also advised that the power companies also play an important role in promoting energy efficiency and conservation in buildings. Under the post-2018 Scheme of Control Agreements, more funds will be made available under the existing energy efficiency funds ("EEFs") of the power companies to support, on a matching grant basis, the carrying out of retrofitting and RCx of non-government buildings, as well as the implementation of building-based smart / IT technologies, to enhance the energy efficiency of these buildings. The new EEFs will cover both commercial/industrial and non-commercial buildings, including NGOs as well as non-government schools and education institutions.

24. In addition, Feed-in Tariff will be introduced by the two power companies to encourage the non-government sector, including NGOs, non-government schools and education institutions, to consider investing in RE systems.[6] Besides, in order to encourage the development of RE systems in the community, the power companies will facilitate grid connection and improve the relevant arrangements, while EMSD has already revamped its website to provide relevant information on RE and has set up a hotline to handle related enquiries.

Enhancements to the Qualified Debt Instrument Scheme

Rationale for the proposal

25. The Bills Committee notes that when the QDI Scheme was launched in 1996, one of the requirements for a debt instrument to be qualified for tax concession under the Scheme was that it should be lodged with and cleared by CMU of HKMA. However, with the change of time such a requirement no longer corresponds fully with the landscape

---

commissioning. The RCx commences from collection of operational data of energy consuming equipment/systems, followed with site measurement testing and data analysis and then come up with proposed Energy Saving Opportunities ("ESOs"). Through the implementation of ESOs, the operational performance of building systems improve which in turn enhances the building energy efficiency.

[6] Under the Feed-in Tariff Scheme, power generated by renewable energy systems may be sold to the power companies.

of Hong Kong's corporate bond market as most of the debt issuances in Hong Kong are internationally marketed, which tend to be lodged with and cleared by international clearing houses. The said requirement has prevented many debt securities from participating in the QDI Scheme.

26. According to section 14A of IRO, interest receipts or profits from the sale or other disposal of short or medium term debt instruments with an original maturity of less than seven years may enjoy profits tax concession of 50% if the relevant conditions are satisfied. The Bills Committee notes that the existing arrangement may affect an issuer's incentive to issue debt instruments with a maturity period shorter than seven years in Hong Kong. At the same time, many 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.

27. Against the above background and with a view to promoting the development of the local bond market, Clause 18 of the Bill provides for the enhancements to the QDI Scheme by: (a) extending the profits tax exemption to cover debt instruments of any duration; and (b) allowing debt instruments listed on SEHK to be qualified for tax exemption, in addition to instruments lodged with and cleared by CMU of HKMA. These new arrangements will apply to QDIs issued on or after 1 April 2018. As advised by the Administration, the proposed enhancement will incentivize the use of Hong Kong as a platform for bond investing and trading, and will in turn allow Hong Kong to capture the growing international interest in the Asian bond market. By attracting more investors to issue bonds and expand their bond market operations in Hong Kong, it will also benefit the professional services sector and the wider economy. The further development of local bond market will also enhance Hong Kong's competitiveness as an international financial centre.

28. To keep in view development of the QDI Scheme, the Bills Committee has suggested and the Administration indicated that it is prepared to provide a progress update to the Panel on Financial Affairs after the implementation of the enhanced Scheme for a period of time.

Eligibility of instruments under the Qualifying Debt Instrument Scheme

29. The Bills Committee has enquired whether debt instruments currently lodged with and cleared by CMU of HKMA are mainly those issued by the Government and related statutory organizations (e.g. The MTR Corporation Limited and the Urban Renewal Authority); and

whether retail bonds held by individuals will also be eligible for tax concessions under the QDI Scheme.

30. The Administration has advised that in addition to those issued by the Government and statutory organizations, debt instruments lodged with and cleared by CMU of HKMA include bonds issued by private sector corporations such as local and overseas banks, etc. Pursuant to the enhancements to the QDI Scheme proposed under the Bill, debt instruments listed on SEHK will also be eligible for tax concessions in the future. The Administration has advised that both legal and natural persons are eligible for tax concessions under the QDI Scheme. Individuals who are required to pay profits tax can also apply for tax concessions under the QDI Scheme should the relevant qualifying conditions be met.

Application for tax concession for qualifying debt instruments

31. The Bills Committee notes that pursuant to Hong Kong's tax regime, proceeds generated from the sale of debt instruments are taken as "debt capital", which is not subject to tax. In gist, under the proposed enhancements to the QDI Scheme, interest receipts and trading profits from the sale or other disposal of QDIs issued on or after 1 April 2018 will be eligible for profits tax exemption if certain conditions are satisfied. The list of QDIs will be published on the websites of IRD for the public's information. The Bills Committee also notes that the applications for tax concessions for QDIs are considered on a transaction basis. The treatment of and the tax concession to be enjoyed in each case will be the same irrespective of the identities of the taxpayers concerned.

Impact of the proposed measure on the Government's tax revenue

32. Expressing interest over the impact of the proposed enhancements to the QDI Scheme on the Government's tax revenue, the Bills Committee has requested the Administration to provide the estimated amount of tax revenue to be forgone pursuant to the proposal. The Administration has advised that the estimated tax revenue to be forgone would be about HK$73 million for 2018-2019, HK$147 million for 2019-2020 and HK$220 million annually thereafter. Notwithstanding the anticipated loss in tax revenue, the relevant enhancements are expected to bring in new revenue as they may incentivize local and overseas bond issuers 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.

Extending the tax incentive to private issuances

33. The Bills Committee has enquired whether the Administration will consider a deputation's suggestion of extending the tax incentives under the QDI Scheme to private issuances (i.e. private placements), taking into consideration that private placements of debt issuance are an integral part of the local debt market in Hong Kong and that such an arrangement has already been put in place in Singapore.

34. The Administration has explained that the issue of extending the tax incentives under the QDI Scheme to private issuances has already been dealt with during the legislative amendment exercise of IRO in 2011. When the QDI Scheme was implemented in 1996, one of the criteria for a debt instrument to be qualified for tax concession under the QDI Scheme was that it should be issued to the public in Hong Kong. In the light of the market's view that the criterion of "issued to the public" did not match the landscape of Hong Kong's corporate bond market which was dominated by privately placed short-term debt instruments and that it was also not clearly defined under IRO, thus giving rise to uncertainties in the market as to how this criterion should be interpreted in practice, legislative amendments to IRO were enacted in March 2011 to revise the eligibility criteria of the QDI Scheme to the effect that debt instruments of both public issuances and private placements could enjoy tax concessions if certain conditions were satisfied. Pursuant to the relevant amendments to IRO, the "issued to the public" criterion is replaced by a new requirement that at issuance, the relevant instrument is issued in Hong Kong to: (a) 10 or more persons; or (b) if less than 10 persons, none of whom is an associate[7] of the issuer of the instrument, so as to remove the uncertainties over what constitutes the meaning of "issued to the public".[8]

Relaxing the restriction on issuance to "associate"

35. As regards the eligibility criteria of the QDI Scheme that the

---

[7] The term "associate" is defined under section 14A(4) and (4A) of IRO. According to the Inland Revenue Department's interpretation, the term, in essence, means any entity which controls the issuer, or is subject to the control of the issuer or is subject to the control of the same person as is the issuer, either directly or indirectly. However, companies which are associated merely because of common ownership by the central government of a country or its sovereign wealth funds or similar state-owned enterprises but in practice operate independently as separate commercial entities are not "associates".

[8] See section 14A(4) of IRO under paragraph (e) of the definition of debt instrument.

relevant debt instruments must be, at issuance, issued in Hong Kong to: (a) 10 or more persons; or (b) if less than 10 persons, none of whom is an associate of the issuer of the instrument, the Bills Committee notes a deputation's suggestion of relaxing the restriction on "associate" under (b) by allowing one associate of the issuer as maximum instead of none as currently required. The Bills Committee has enquired whether the Administration will consider relaxing the relevant requirements as suggested on the condition that the Government's tax revenue will not be affected.

36. The Administration has explained that the "public" (i.e. 10 or more investors) and the "associate" requirements are introduced to safeguard against potential intra-group tax avoidance arrangement. The Administration holds the view that relaxing such restrictions will undermine the necessary safeguards. The Administration has received no similar views from other major market stakeholders that the "public" and the "associate" requirements as currently provided for under the QDI Scheme do not align with market operations or have created any operational difficulties in practice.

Mandatory filing of qualifying debt instrument form

37. Noting a deputation's suggestion of changing the discretionary filing of QDI form at CMU of HKMA to mandatory filing so as to increase investors' incentive to trade debt instruments and as a result potentially help a more competitive price for issuers to issue debts, the Bills Committee has enquired if the Administration will take on board the suggestion. The Bills Committee notes that the suggestion may help HKMA ascertain which debt instruments lodged with and cleared by CMU are qualified for tax concession under the QDI Scheme, and that the updated information on all such qualified debt instruments could be made available in IRD's website to enhance transparency of the QDI Scheme, thereby increasing investors' incentive to invest in the bond market.

38. The Administration has advised that one of the purposes of the proposed enhancements to the QDI Scheme is to create flexibility for issuers by allowing debt instruments listed on SEHK, in addition to those lodged with CMU, to be qualified for tax concession. The Administration is of the view that mandating the filing of QDI form at CMU may run counter to this objective and create an unnecessary burden for issuers. In addition, for those debt instruments lodged with and cleared by CMU to be qualified for tax concession under the QDI Scheme, it has been the practice for the concerned issuers to submit the relevant information of the debt instruments, including their eligibility under the QDI Scheme, to HKMA in the same CMU lodgement form. As a

standing arrangement, HKMA will pass relevant information of the debt instruments which have met the criteria of the QDI Scheme to IRD for uploading onto the website to enhance the transparency of the Scheme. The current mechanism already allows issuers to declare their QDI eligibility to HKMA and hence IRD for tax exemption purpose, and investors to access the QDI list for investment purpose through IRD's website.

Proposed amendment to the Bill

39. Neither the Administration nor the Bills Committee will propose amendment to the Bill.

Resumption of Second Reading debate

40. The Bills Committee raises no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 14 November 2018.

Advice sought

41. Members are invited to note the deliberations of the Bills Committee.

Council Business Division 1
Legislative Council Secretariat
1 November 2018

Appendix I

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

Membership List

Chairman	Hon Kenneth LEUNG
Members	Hon James TO Kun-sun
	Hon WONG Ting-kwong, GBS, JP
	Hon WU Chi-wai, MH
	Hon KWOK Wai-keung, JP
	Hon Dennis KWOK Wing-hang
	Hon IP Kin-yuen
	(Total : 7 members)
Clerk	Mr Desmond LAM
Legal Adviser	Miss Evelyn LEE

Appendix II

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

List of organizations which have provided written submissions

1. An anonymous organization
2. Democratic Alliance for the Betterment and Progress of Hong Kong
3. Hong Kong Institute of Certified Public Accountants
4. PricewaterhouseCoopers Limited
5. Hong Kong Green Building Council Limited