

Speech

LC: Speech by SFST in moving the Second Reading of the Inland Revenue (Amendment) Bill 2011

Wednesday, February 16, 2011

Following is the English translation of the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, in moving the Second Reading of the Inland Revenue (Amendment) Bill 2011 in the Legislative Council today (February 16):

President,

I move the Second Reading of the Inland Revenue (Amendment) Bill 2011 (the Bill).

The Bill seeks mainly to amend the Inland Revenue Ordinance (IRO) so as to effect the tax concession proposal for qualifying debt instruments (QDI) which was announced in the Government's Budget for 2010-11. It aims to enhance the relevant debt instrument scheme of Hong Kong so that it could better attract overseas debt issuers to Hong Kong, enlarge the local debt market, and enhance the competitiveness of Hong Kong vis-à-vis other financial centres in the region.

An active and diverse debt market is important to the further development of Hong Kong as an international financial centre. One of the most commonly used and effective ways to promote the development of a debt market is to provide tax incentives to participants of the market. Some financial centres in the region are indeed providing such tax incentives to participants of their debt markets. The Government introduced the QDI scheme in the mid-1990s. The scheme provides concessionary tax treatment in respect of interest income and trading profits derived from QDIs. There is a need to improve the QDI scheme from time to time in response to the changing market landscape and measures adopted by other financial centres in the region for developing their respective debt markets in order to preserve the competitiveness of the local debt market and facilitate its development.

Having conducted a review of the QDI scheme and consulted the market players, we have identified several areas for improvement. First, the structure of the tax incentives offered under the scheme may not match the landscape of Hong Kong's corporate bond market. While Hong Kong's corporate bond market is currently dominated by privately-placed short-term debt instruments with a tenor of less than three years, the scheme only offers tax incentives to debt instruments of a tenor of three years or more and which are "issued to the public". In this regard, we propose that the 50% tax concession currently granted under section 14A of the IRO be extended to interest income and trading profits derived from debt instruments with a tenor of less than three years. This amendment seeks to place short-term debt instruments on a level-playing field with longer-term debt instruments in respect of profits tax treatment and help stimulate new demand for bond issues in Hong Kong.

Second, since the "issued to the public" criterion is not clearly defined in the IRO, there are some uncertainties in the market about how such criterion should be interpreted in practice. To provide greater certainty for interpretation, we have proposed a new requirement to replace the "issued to the public" criterion after making reference to similar schemes overseas which are considered effective in facilitating the development of their respective debt markets. Under our proposal, the minimum number of persons a debt instrument has to be issued to so that it will be eligible for the QDI scheme will be set at 10. To cater for the large amount of private-placement debt issues in Hong Kong that may be offered to a large number of potential investors but are usually only issued to less than 10 investors at the end, an alternative requirement is provided for debt instruments that are issued to less than 10 persons at issuance, under which none of the investors should be an associate of the issuer at the time of issuance. This requirement will cater for the actual development of the market on the one hand and safeguard against potential intra-group tax avoidance arrangements by the issuer on the other.

While putting forth enhancements to meet the market development needs, we propose that additional provision be introduced to minimise the risk of tax avoidance. The new provision stipulates that the relevant profits tax concession will not apply in respect of any interest income and trading profits received by or accrued to a person in relation to the QDI if, at the time during which such interest income and trading profits is/are so received or accrued, the person is an associate of the issuer of the QDI.

In connection with the newly added provisions above, we will also include a definition of "associate" in section 14A of the IRO. In considering the definition of "associate", we wish to avoid unduly undermining the participation of some practically non-associated companies in the debt market, particularly 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. Therefore, we propose to carve out such companies from the definition of "associate" for the purpose of the QDI scheme. This is important because we would like to encourage and attract more such companies to make use of the debt market platform in Hong Kong to meet their financial intermediation needs, either as an issuer or investor. It is consistent with our efforts to promote Hong Kong as an international financial centre.

President, I look forward to Members' support for the Bill so that the enhancements to the QDI scheme could be implemented early, thereby facilitating the further development of the debt market in Hong Kong.

I so submit. Thank you, President.

Ends