

Speech

LC: Speech by SFST for the resumption of second reading debate of the Inland Revenue (Amendment) Bill 2011

Wednesday, March 16, 2011

Following is the English translation of the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, for the resumption of second reading debate of the Inland Revenue (Amendment) Bill 2011 in the Legislative Council today (March 16):

President,

First of all, I would like to thank Members for their support for the resumption of second reading debate of the Inland Revenue (Amendment) Bill 2011 (the Bill) today to allow for early implementation of the proposed enhancement to the qualifying debt instruments (QDI) scheme which was announced in the Budget for 2010-11.

The Bill aims to enhance the QDI scheme 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.

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 review the relevant tax incentives and 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.

For this purpose, we have conducted a review of the QDI scheme and consulted the market players, and identified several areas for improvement. First, 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". Therefore, we propose that the 50% tax concession currently granted under the QDI scheme in accordance with section 14A of the Inland Revenue Ordinance (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.

In addition, since the "issued to the public" criterion is not clearly defined in the IRO, 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 in 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 meeting the market development needs, we propose that an 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 profit is 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 also consistent with our efforts to promote Hong Kong as an international financial centre.

President, by implementing the enhancement measures proposed in the Bill, we hope to stimulate new demand for bond issues in the market so as to make the local debt market more active, thereby enhancing the competitiveness of Hong Kong as an international financial centre. I earnestly appeal for Members' support for passing the Bill so that the Government could implement the enhancement measures as soon as possible.

Thank you, President.

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