

Speech

LegCo: Speech by SFST in moving the Second Reading of the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012

Wednesday, January 9, 2013

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 and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012 in the Legislative Council today (January 9):

President,

I move the Second Reading of the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012.

The Bill principally seeks to amend the Inland Revenue Ordinance (IRO) and Stamp Duty Ordinance (SDO) to provide a comparable taxation framework for some common types of Islamic bonds (sukuk), vis-a-vis conventional bonds, with a view to promoting the development of a sukuk market in Hong Kong.

Islamic finance is amongst the fastest growing segments in the international financial system, with a presence in both Muslim and non-Muslim communities. According to information available, globally speaking, Islamic finance assets have expanded from US\$150 billion in the mid-1990s to US\$1.3 trillion in 2011.

Sukuk are one of the most prominent instruments used in Islamic finance, and have been commonly issued by debt issuers for raising funds in some domestic and international capital markets. The first half of 2012 saw an impressive 40 per cent year-on-year growth for global sukuk issuances, while the global volume of outstanding sukuk is estimated to have exceeded US\$220 billion by the end of last year.

Hong Kong has developed a highly liquid capital market with a large presence of well-qualified financial intermediaries, a well-established market

infrastructure, a sound legal system, and a transparent regulatory framework. Given our role as a leading international financial centre and China's global financial centre, Hong Kong has the advantage of matching the needs of fund raisers and investors from China, the Middle East, and other parts of the world interested in Islamic financial products. Hence, we are well placed to promote a sukuk market in Hong Kong as a first step in developing Islamic finance.

Sukuk have more complex product structures than their conventional bond counterparts. That is to say, sukuk are usually structured with special purpose vehicles and multiple asset transfers. Sukuk issuances may therefore attract additional profits or property tax exposures, or stamp duty charges. We observe that major jurisdictions such as Malaysia, the United Kingdom, Singapore, Japan and France, have amended their tax laws to provide the necessary clarity therein to facilitate issuance of sukuk.

In view of this, we propose amending our tax laws to remove an impediment perceived by the market to developing a sukuk market in Hong Kong. This will help establish a conducive platform to enable the development of Islamic finance in Hong Kong, thereby diversifying the types of products and services available to our financial markets, and consolidating Hong Kong's status as an international financial centre and asset management centre.

President, I have to stress that the Bill will not confer special tax favours on the Islamic finance sector. The Bill is to ensure that financial instruments of similar economic substance are afforded similar tax treatments. In addition, the Bill will not make specific references to Shariah terminologies, as we have adopted a religion-neutral approach in drafting. We will use the term "alternative bond scheme" (ABS), instead of "sukuk", to denote debt security products to which the Bill will apply.

Sukuk can have a wide range of underlying structures. The Bill specifies four types of investment arrangements with reference to the different underlying structures of the most common types of sukuk in the global market. In order not to hinder market development, the Bill will propose a clause to enable the expansion of the coverage of eligible ABS by subsidiary legislation in future, to respond to evolving market developments.

We prescribe in the Bill a set of qualifying conditions for the proposed tax treatments of an ABS. Our principle is to ensure that a prospective ABS is economically equivalent to a typical conventional bond structure, hence its eligibility for the proposed tax treatments. We also need to ensure that reasonable safeguards are put in place to minimise tax avoidance, and that the proposed taxation framework would encourage the sukuk benefitted from the framework to have a nexus with Hong Kong hence promoting our financial market development.

In respect of the proposed tax treatments, the Bill provides for certainty of the tax position of relevant bond and investment arrangements under an ABS. The underlying principle is to treat those arrangements in an ABS that meet the qualifying conditions as "debt arrangements" for the purposes of the IRO and SDO, and to apply to those arrangements the tax treatments as in the comparable case of conventional bonds. We therefore need to amend the relevant provisions of the IRO and SDO.

President, to ensure that the Bill is practicable, the Administration conducted a two-month public consultation on the relevant provisions in March 2012. A large majority of respondents welcomed the legislative objectives and proposal, believing that it will enhance Hong Kong's competitiveness in financial services and will enable Hong Kong to be a gateway for international Islamic finance. The Bill has adopted a number of specific suggestions made by market practitioners, relevant organisations and professional bodies, to whom I am grateful.

Subsequently, we briefed the Panel on Financial Affairs of this Council on the major elements of our legislative proposal at a meeting on November 5, 2012. The Panel noted the Administration's plan to provide a conducive taxation platform for the development of a sukuk market in Hong Kong, with a view to diversifying the products and services in our financial markets.

President, the Bill can ensure that the tax treatments for sukuk are consistent with those for conventional bonds, thereby removing an impediment perceived by the market to developing a sukuk market in Hong Kong. It will positively enhance the competitiveness of our financial services industry and promote our asset management business. I hope this Council will pass the Bill early, so that Hong Kong can become a conducive platform for sukuk issuing

activities, thus consolidating our status as an international financial centre and asset management centre.

I so submit. Thank you, President.

Ends