

Inland Revenue (Amendment) (No. 6) Bill 2018

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A BILL

To

Amend the Inland Revenue Ordinance to treat certain loss-absorbing capacity debt instruments as debt securities for profits tax purposes; to deem certain sums received by or accrued to certain entities as trading receipts; to allow deduction of interest on money borrowed by certain entities in respect of a regulatory capital security in ascertaining chargeable profits; to provide that certain entities are not eligible to be qualifying corporate treasury centres; and to provide for related matters.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 6) Ordinance 2018.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 14.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

“banking LAC requirement (銀行LAC規定) means a LAC requirement as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

LAC banking entity (LAC銀行實體) means—

- (a) an HK affiliated operational entity, as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules, that is required to meet a banking LAC requirement under those Rules; or
- (b) a clean HK holding company, as defined by rule 2(1) of those Rules, that is required to meet a banking LAC requirement under those Rules;”.

4. Section 14D amended (qualifying corporate treasury centre: profits tax concession)

Section 14D(9), after “a financial institution”—

Add

“or LAC banking entity”.

5. Section 14F amended (qualifying corporate treasury centre: Commissioner’s determination)

Section 14F(2)(a), after “a financial institution”—

Add

“or LAC banking entity”.

6. Section 15 amended (certain amounts deemed trading receipts)

(1) After section 15(1)(ia)—

Add

“(ib) sums, not otherwise chargeable to tax under this Part, received by or accrued to a LAC banking entity, by way of interest, in respect of a regulatory capital security, that arises through or from the carrying on by the entity of its business in Hong Kong, even if the moneys laid out for the acquisition of the security in respect of which the interest is received or accrues are made available outside Hong Kong;”.

(2) After section 15(1)(la)—

Add

“(lb) sums, not otherwise chargeable to tax under this Part, received by or accrued to a LAC banking entity, by way of gains or profits arising through or from the carrying on by the entity of its business in Hong Kong, from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a regulatory capital security, even if—

- (i) the moneys laid out for the acquisition of the security were made available outside Hong Kong; or
- (ii) the sale, disposal or redemption is effected outside Hong Kong;”.

(3) After section 15(1C)—

Add

“(1D) Subsection (1)(ib) and (lb) applies, subject to sections 17B, 17C, 17D, 17E and 17F, in relation to a regulatory capital security.”.

7. Section 16 amended (ascertainment of chargeable profits)

(1) After section 16(2)(a)—

Add

“(ab) the money has been borrowed by a LAC banking entity by way of issuing a regulatory capital security;”.

(2) After section 16(2AA)—

Add

“(2AAB) Subsections (1)(a) and (2)(ab) apply, subject to sections 17B, 17C, 17D, 17E and 17F, in relation to a sum payable by a LAC banking entity in respect of a regulatory capital security issued by the entity.”.

8. Section 17A amended (financial institution: interpretation)

(1) Section 17A(1)—

Repeal the definition of *fair value***Substitute**

“*fair value* (公平價值), in relation to a regulatory capital security—

- (a) if the security is accounted for in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board—has the meaning given by International Financial Reporting Standard 13 (Fair Value Measurement) as issued by the board and in force from time to time; and
- (b) otherwise—has the meaning given by Hong Kong Financial Reporting Standard 13 (Fair Value Measurement) as issued by the Hong

Kong Institute of Certified Public Accountants
and in force from time to time;”.

- (2) Section 17A(1), definition of *fair value accounting*—

Repeal

“means a basis of accounting under which assets and liabilities are shown in a balance sheet at their”

Substitute

“, in relation to a regulatory capital security, means a basis of accounting under which the security is shown in a balance sheet at its”.

- (3) Section 17A(1)—

Repeal the definition of *regulatory capital security*

Substitute

“*regulatory capital security* (監管資本證券) means, subject to subsection (2)—

- (a) a security that, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee—
 - (i) qualifies or has qualified as an Additional Tier 1 capital instrument; and
 - (ii) forms or formed a component of Additional Tier 1 capital;
- (b) a security that, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee—

- (i) qualifies or has qualified as a Tier 2 capital instrument; and
 - (ii) forms or formed a component of Tier 2 capital;
- (c) an instrument issued by a financial institution that, for the purposes of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules—
 - (i) qualifies or has qualified as a banking non-capital LAC debt instrument; and
 - (ii) forms or formed a component of banking loss-absorbing capacity;
- (d) an instrument issued by a LAC banking entity that, for the purposes of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules—
 - (i) qualifies or has qualified as a banking LAC debt instrument; and
 - (ii) forms or formed a component of banking loss-absorbing capacity; or
- (e) in relation to an entity established or incorporated outside Hong Kong, an instrument that—
 - (i) is not a security referred to in paragraph (a) or (b); and
 - (ii) constitutes a liability that is recognized in the way as described in paragraph (c) of the definition of ***loss-absorbing capacity*** in rule 2(1) of the Financial Institutions

(Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;”.

(4) Section 17A(1)—

Add in alphabetical order

“***banking LAC debt instrument*** (銀行LAC債務票據) means a LAC debt instrument as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

banking loss-absorbing capacity (銀行吸收虧損能力) means loss-absorbing capacity as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

banking non-capital LAC debt instrument (銀行非資本LAC債務票據) means a non-capital LAC debt instrument as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;”.

(5) Section 17A(2)—

Repeal everything before paragraph (a) of the definition of *security*

Substitute

“(2) For the purposes of subsection (1), ***regulatory capital security*** does not include—”.

(6) Section 17A(3)—

Repeal

“paragraph (c) of the definition of ***security*** in subsection (2)”

Substitute

“subsection (2)(c)”.

9. **Section 17D amended (financial institution: general provisions on regulatory capital security held by, or for benefit of, issuer's specified connected person)**

Section 17D(6)—

Repeal paragraph (a).

10. **Section 17E amended (financial institution: profits adjusted if associates deal not at arm's length in connection with regulatory capital security)**

(1) Section 17E(1)(a)—

Repeal

“and a person who is an associate of the financial institution”

Substitute

“or LAC banking entity (*specified institution or entity*) and a person who is an associate of the specified institution or entity”.

(2) Section 17E(2)—

Repeal

“to the financial institution”

Substitute

“to the specified institution or entity”.

(3) Section 17E(2)—

Repeal

“of the financial institution”

Substitute

“of the specified institution or entity”.

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)

(1) Section 17F—

Repeal subsection (8).

(2) Section 17F(9), after “applies”—

Add

“to this section”.

(3) After section 17F(9)—

Add

“(9A) For the purposes of this section, a connected person (as defined by section 17D(5)) of the issuer of a regulatory capital security is a specified connected person of the issuer unless the connected person—

(a) is chargeable to tax under this Part in respect of a sum payable in respect of the security;

(b) is entitled to a sum payable in respect of the security in the capacity of—

(i) a person acting as a trustee of a trust estate, or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum;

(ii) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b);
or

- (iii) a member of a retirement scheme that is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;
 - (c) is a market maker who, in the ordinary course of conduct of the market maker's trade, profession or business in respect of market making, holds the security for the purpose of providing liquidity for the security;
 - (d) is a public body; or
 - (e) is a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being.”.
- (4) Section 17F(10)—
 - Repeal**
 - “Section 17D(6) applies”
 - Substitute**
 - “However, subsection (9A) applies”.
- (5) Section 17F(10)(a)—
 - Repeal**
 - “section 17D(6)”
 - Substitute**
 - “subsection (9A)”.
- (6) Section 17F(10)(b)—
 - Repeal**

“section 17D(6)(a), (b) or (c)”

Substitute

“subsection (9A)(a), (b) or (c)”.

12. Section 89 amended (transitional provisions)

Section 89—

Add

“(23) Schedule 47 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (of 2018).”.

13. Schedule 36 amended (transitional provisions for Inland Revenue (Amendment) (No. 2) Ordinance 2016)

Schedule 36—

Repeal

“[s. 89(16)]”

Substitute

“[s. 89(16) & Sch. 47]”.

14. Schedule 47 added

The Ordinance—

Add

“Schedule 47

[s. 89(23)]

Transitional Provisions for Inland Revenue (Amendment) (No. 6) Ordinance 2018

1. In this Schedule—

- (a) **2018 Amendment Ordinance** (《2018 年修訂條例》) means the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (of 2018);
- (b) **commencement date** (生效日期) means the day on which the 2018 Amendment Ordinance comes into operation;
- (c) **specified instrument** (指明票據) means an instrument falling within paragraph (c), (d) or (e) of the definition of **regulatory capital security** in section 17A(1) that is issued before the commencement date; and
- (d) in relation to a person, a year of assessment is the **transitional year of assessment** (過渡課稅年度) if the commencement date falls within the basis period of the person for the year of assessment.

2. Subject to sections 3, 4, 5 and 6 of this Schedule, the amendments made to sections 2, 14D, 14F, 15, 16, 17A, 17D, 17E and 17F by the 2018 Amendment Ordinance apply only in ascertaining the profits in respect of which a person is chargeable to tax under Part 4 for the transitional year of assessment or any subsequent year of assessment.

3. Section 15(1)(ib) and (lb) and (1D) does not apply to sums received or accrued before the commencement date.
4. Section 16(2)(ab) and (2AAB) applies only to sums payable on or after the commencement date.
5. For a regulatory capital security issued before the commencement date—
 - (a) section 17D as amended by the 2018 Amendment Ordinance applies only in ascertaining profits arising on or after the commencement date in respect of which a specified connected person of the issuer of the security is chargeable to tax under Part 4;
 - (b) in applying section 17D(2) to a specified connected person of the issuer of the security if the specified connected person has included any sums as assessable profits or losses when bringing the security into account at a fair value—
 - (i) the security is taken to have been disposed of and re-acquired at its fair value on the commencement date; and
 - (ii) any change in value between the end of the basis period for the year of assessment immediately preceding the transitional year of assessment and the commencement date is to be brought into account for computing the assessable profits for the transitional year of assessment;
 - (c) section 17D(3) applies only to a write-down or conversion effected on or after the commencement date; and

- (d) section 17D(4) applies only to a write-up effected on or after the commencement date.

6. For a specified instrument—

- (a) the following provisions apply only to sums received or accrued, in respect of the instrument, on or after the commencement date—
 - (i) section 15(1)(f), (g), (i), (ia), (j), (k), (l) and (la);
 - (ii) section 17B (in so far as it relates to a person to whom or for whose benefit a sum is payable in respect of the instrument);
- (b) the following provisions apply only to sums payable, in respect of the instrument, on or after the commencement date—
 - (i) section 16(1)(a) and (2AA);
 - (ii) section 17B (in so far as it relates to the issuer of the instrument);
 - (iii) section 17F;
- (c) in applying section 17C(2) to the issuer of the instrument who has included any sums as assessable profits or losses when bringing the instrument into account at a fair value—
 - (i) the liability under the instrument is taken to have been released and re-assumed at its fair value on the commencement date; and
 - (ii) any change in value between the end of the basis period for the year of assessment immediately preceding the transitional year

- of assessment and the commencement date is to be brought into account for computing the assessable profits for the transitional year of assessment;
- (d) section 17C(3) applies only to a write-down or conversion effected on or after the commencement date; and
 - (e) section 17C(4) applies only to a write-up effected on or after the commencement date.
7. Sections 6, 7 and 8 of Schedule 36 have effect as if section 17A had not been amended by the 2018 Amendment Ordinance.”.
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Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*principal Ordinance*)—

- (a) to treat certain loss-absorbing capacity debt instruments as debt securities for profits tax purposes;
- (b) to deem certain sums received by or accrued to certain entities as trading receipts;
- (c) to allow deduction of interest on money borrowed by certain entities in respect of a regulatory capital security in ascertaining chargeable profits; and
- (d) to provide that certain entities are not eligible to be qualifying corporate treasury centres.

- 2. Clause 1 sets out the short title.
- 3. Clause 3 amends section 2 of the principal Ordinance to add the definitions of *banking LAC requirement* and *LAC banking entity* to that section. In particular, *LAC banking entity* is defined as an HK affiliated operational entity or clean HK holding company, within the meaning of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (*Rules*), that is required to meet a requirement in respect of loss-absorbing capacity under the Rules.
- 4. Clauses 4 and 5 amend sections 14D and 14F of the principal Ordinance respectively so that a LAC banking entity is not eligible to be a qualifying corporate treasury centre for the purpose of profits tax concession.

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5. Clause 6 amends section 15 of the principal Ordinance to add new section 15(1)(ib) and (lb) to deem the following sums as trading receipts—
- (a) certain sums received by or accrued to a LAC banking entity by way of interest in respect of a regulatory capital security;
 - (b) certain sums received by or accrued to a LAC banking entity in connection with its business from the sale or other disposal, or on the redemption, of a regulatory capital security.
6. Clause 7 amends section 16 of the principal Ordinance so that interest payable on money borrowed by a LAC banking entity by way of issuing a regulatory capital security is deductible for ascertaining chargeable profits.
7. Clause 8 amends section 17A of the principal Ordinance to amend the definitions of *fair value* and *fair value accounting*, and to expand the definition of *regulatory capital security* to include—
- (a) certain non-capital LAC debt instruments within the meaning of the Rules;
 - (b) certain LAC debt instruments within the meaning of the Rules; and
 - (c) certain other instruments constituting loss absorbing capacity for the purposes of the Rules.
8. Clause 9 amends section 17D of the principal Ordinance so that it applies to a connected person of an issuer of a regulatory capital security even if the connected person is chargeable to profits tax in respect of a sum payable in respect of the security.

9. Clause 10 amends section 17E of the principal Ordinance to make it applicable to a LAC banking entity.
10. Clause 11 amends section 17F of the principal Ordinance in consequence of the amendment made to section 17D of the principal Ordinance.
11. Clause 12 amends section 89 of, and clause 14 adds Schedule 47 to, the principal Ordinance to provide for transitional arrangements.