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Tax alert

Issue 1 – February 2011

Qualifying Debt Instruments – further tax concessions

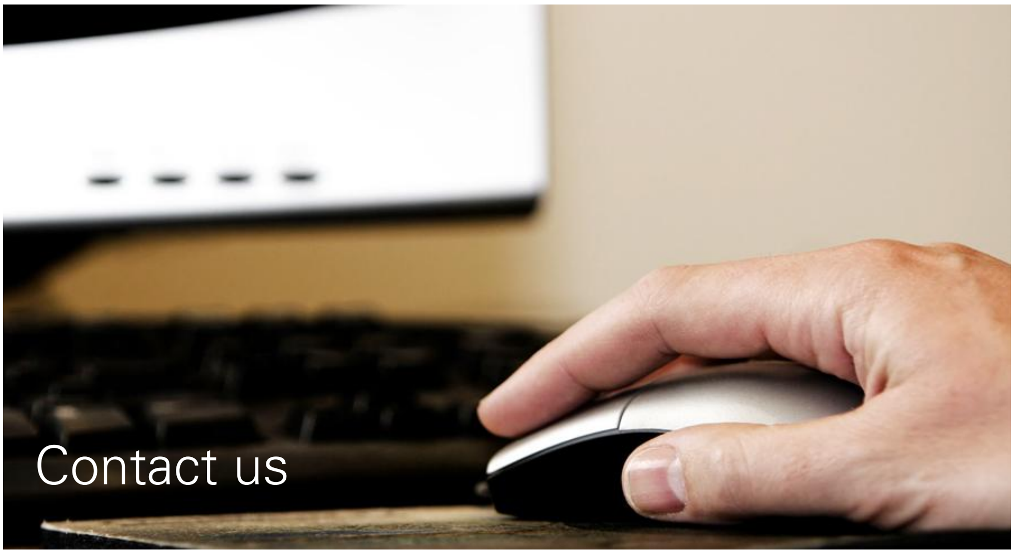
The Inland Revenue (Amendment) Bill 2011 (the Bill) was introduced into the Legislative Council on 16 February 2011. The Bill seeks to amend the Inland Revenue Ordinance (IRO) to affect the tax concessions for qualifying debt instruments (QDIs) announced in the 2010-11 Budget.

The QDI scheme was introduced in the mid-1990s to provide concessionary tax treatment in respect of interest income and trading profits derived from QDIs. Hong Kong's corporate bond market is currently dominated by privately-placed short-term debt instruments with a tenor of less than three years, but the current scheme only offers tax incentives to debt instruments of a tenor of three years or more and which are "issued to the public". Accordingly, the Government is now proposing to extend the 50 percent tax concession currently granted under section 14A of the IRO to interest income and trading profits derived from debt instruments with a tenor of less than three years. This will 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.

Under the original provisions, the term "issued to the public" was not clearly defined in the IRO and there were uncertainties about how this term should be interpreted in practice. The "issued to the public" criterion is therefore to be replaced with a new requirement. Under the proposal, the minimum number of persons a debt instrument has to be issued to will be set at 10. To cater for private-placement debt issues in Hong Kong that may be offered to a large number of potential investors but are ultimately often only issued to less than 10 investors, an alternative requirement is to be provided for such situations whereby none of the investors should be an associate of the issuer at the time of issue. 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.

Additional anti-avoidance provisions are also to be introduced. They will provide that the 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.

A definition of "associate" will also be introduced in section 14A of the IRO. However, to avoid 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 which in practice operate independently as separate commercial entities, such companies are to be carved out from the definition of "associate" for the purpose of the QDI scheme. This will 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 and is consistent with efforts to promote Hong Kong as an international financial centre.



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