

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance (Cap.112)

INLAND REVENUE (AMENDMENT) BILL 2000

INTRODUCTION

A At its meeting held on 26 September 2000, the Executive Council **ADVISED** and the Chief Executive **ORDERED** that the Inland Revenue (Amendment) Bill 2000, at *Annex A*, should be introduced into the Legislative Council, to reflect more clearly the legislative intent and to strengthen the anti-avoidance safeguards, in the light of operational experience.

BACKGROUND AND ARGUMENT

The Inland Revenue Ordinance

2. The Inland Revenue Ordinance (“the Ordinance”) requires amendments to:

- (a) revise the provisions relating to royalty income, in the light of a recent ruling of the Court of Final Appeal (CFA), for revenue protection reason;
- (b) strengthen the anti-avoidance provisions on deduction of interest expenses;
- (c) revise the provisions relating to the depreciation of industrial and commercial buildings, in the light of changes in the market;
- (d) remedy some irregularities in a number of other provisions so as to reflect more clearly the legislative intent, in the light of

operational experience;

(e) revise the provisions relating to the determination of certain costs and fees for tax appeal cases handled by the Board of Review; and

(f) repeal spent provisions.

(A) Revisions Relating to Royalty Income

3. Section 15(1)(b) of the Ordinance charges to Profits Tax sums which are received for the “use of” or “right to use” a patent, design, trademark, copyright, etc in Hong Kong and which are not otherwise chargeable to tax under Part IV of the Ordinance. This is done by deeming them to be receipts arising in, or derived from, Hong Kong from a trade, profession or business carried on in Hong Kong. This deeming provision serves to give effect to the territorial-based taxation principle in Hong Kong. In December 1999, the CFA handed down a decision relating to the application of section 15(1)(b) which is inconsistent with the long-standing assessing practice of the Commissioner of Inland Revenue (CIR).

4. By way of background, an American corporation (the parent) owned a trademark comprising its name. The parent also owned a subsidiary in Hong Kong (the subsidiary). In 1987, the parent and subsidiary entered into a royalty agreement whereby the subsidiary agreed to pay the parent for the use of the parent trademark on products the subsidiary sold to its US customers. The subsidiary contracted with manufacturers in various places, including Hong Kong, to manufacture products bearing the parent trademark to be exported to the US.

5. The subsidiary (as agent for the parent) filed Profits Tax returns with respect to all royalties paid to the parent. The royalties were taxed under section 15(1)(b) as sums deemed to be receipts arising in, or derived from, Hong Kong from a trade, profession or business carried on in Hong Kong. The parent appealed against this assessment and the case was ultimately decided by the CFA.

6. The CFA ruled that only the royalty income attributable to the sale of goods **manufactured in Hong Kong** could be deemed to be profits arising from the use of the parent's trademark in Hong Kong for the purpose of levying Profits Tax. The royalty payments attributable to goods manufactured elsewhere should not be taxable in Hong Kong. The CFA's reasoning was as follows:

- (a) since rights conferred by the registration of trademarks were territorial-based, the royalty agreement between the parent and the subsidiary must have licensed only the use of the US registered trademark and it was not possible for any of the rights under the US registered trademark to be used in Hong Kong;
- (b) however, the parent had conceded that it was an implied term of the royalty agreement to allow the subsidiary to use the Hong Kong registered trademark (the same trademark was registered in both the US and Hong Kong) if it was necessary to use the trademark in Hong Kong for the purpose of manufacturing goods. On that basis, the trademark had been used in Hong Kong to the extent that it was applied to those goods which were manufactured in Hong Kong;
- (c) therefore, only that part of the royalty income which was paid in relation to goods manufactured in Hong Kong could satisfy section 15(1)(b).

7. This court ruling on the interpretation of section 15(1)(b) deviates from the CIR's long-standing assessing practice. Prior to the ruling, the CIR has maintained that this section had the effect of subjecting royalty income to Profits Tax in cases where the payer (a business entity in Hong Kong) was allowed a deduction as an expense incurred in deriving assessable profits arising in or derived from Hong Kong. The CIR considered that where a Hong Kong business could be said to have incurred royalty expenses in producing its Hong Kong sourced profits, the intellectual property concerned must have been used in Hong Kong, and the royalty income for the use of the intellectual property should be taxable in Hong Kong. Such construction had been practised by the CIR ever since section 15(1)(b) was enacted in 1971, and

was generally accepted by the taxpayers who had organised their affairs accordingly.

8. The CFA ruling, if nothing is done, would lead to a substantial loss of revenue from Profits Tax. The estimated revenue loss is in the order of \$200 million a year. The loss amount may increase in multiples as and when more enterprises are aware of this ruling and take advantage of it to reduce their tax liability, given that most of our manufacturing base has been relocated outside Hong Kong. There is, thus, an imminent need, for revenue protection reason, to amend the Ordinance to enable the CIR to continue with the established assessing practice on section 15(1)(b) .

9. We **propose** to amend section 15(1)(b) to include income or receipts for the use of, or right to use intellectual property, which are **deductible expenses of the payer in ascertaining the latter's profits chargeable to tax in Hong Kong.**

(B) Revisions Relating to Anti-avoidance Provisions on Deduction of Interest Expenses

10. Interest payable by a person upon any money borrowed by him for the purpose of producing taxable profits is one of the allowable deductions under Profits Tax. To qualify for this deduction, the interest payment has to satisfy the conditions prescribed for anti-avoidance purposes under section 16(2) of the Ordinance. In essence, they aim at combating tax avoidance schemes which seek to create allowable interest deduction where the corresponding interest income is not taxable.

11. In recent years, the CIR has seen increasing evidence of aggressive tax avoidance schemes which cannot be readily caught by the existing anti-avoidance provisions under section 16(2). Various tax planning tools are used, such as trust, alienation of interest income, and the artificial issue of debentures in overseas stock exchanges. The proposed amendments to the specific provisions and their underlying reasons are set out in the following paragraphs.

(a) Money borrowed from a financial institution

12. Section 16(2)(d) provides as a condition that if the money has been

borrowed from a financial institution or an overseas financial institution, the repayment of the principal or interest must not be secured or guaranteed either in whole or in part, and whether directly or indirectly, by any instrument executed or any undertaking given by or on behalf of the borrower or an associate of the borrower against a deposit made with that or any other financial institution or overseas financial institution **where any sums payable by way of interest on the deposit are not chargeable to tax under the Ordinance**. In a tax avoidance scheme which circumvents this provision, the taxpayer **raises a loan from a financial institution so that the interest payable by the taxpayer can be deductible**. However, the financial institution thereafter **assigns the loan and the right to receive the interest to an overseas associate of the taxpayer**. Such assignment will take place outside Hong Kong. The associate has in effect obtained funds within the group to pay the consideration for the assignment. In the group context, no funds have actually been raised from outside the group but a stream of deductible interest expenses has been created for the taxpayer. On the other hand, the overseas associate which is the actual recipient of the interest is not chargeable to tax.

13. To counter such tax avoidance practices, we **propose** to amend section 16(2)(d) to ensure that **any person** who is entitled to the interest payment on the money borrowed by the taxpayer from a financial institution or an overseas financial institution will not be the borrower or an associate of the borrower, including the situation where the borrower or an associate of the borrower assumes the role of a trustee of a trust estate or corporation controlled by such a trustee, or a beneficiary under the trust who is entitled to the interest payment. We also **propose** to strengthen the provision so that, in essence, the present condition concerning borrowings secured by deposits would also apply where they are secured by loans.

(b) Money borrowed from a non-financial institution

14. Section 16(2)(e) provides that if the money has been borrowed from a non-financial institution for the purpose of financing the purchase of machinery or plant, or trading stock, the following conditions have to be satisfied before the interest payable is deductible for the purpose of assessing taxable profits:

- (a) the lender is not an associate of the borrower; and

(b) where the money is borrowed from, or the relevant sum payable by way of interest upon the borrowed money is payable to, a trustee of a trust estate or a corporation controlled by such a trustee, each of the trustee, the corporation and the beneficiary under the trust is not an associate of the borrower.

15. To combat tax-avoidance practice whereby the lender assigns, under a separate contractual arrangement, the right of receiving the interest payment upon the money borrowed to another person who is either the borrower or an associate of the borrower, we **propose** to revise section 16(2)(e) to the effect that, for interest to be deductible, any person who is entitled to the interest payment on the money borrowed is neither the borrower nor an associate of the borrower, including the situation where the borrower or an associate of the borrower is assuming the role of a trustee of a trust estate or a corporation controlled by such a trustee, or the beneficiary under the trust. We also **propose** to add a condition stipulating that where the borrowing is secured by a deposit or loan, the interest on the deposit or loan must be chargeable to Profits Tax.

(c) Interest payments on debentures and financial instruments

16. Section 16(2)(f) allows the deduction of interest paid by a taxpayer who is a corporation on certain debentures and financial instruments which are issued either by the taxpayer or its associated corporation, provided that the interest does not exceed the interest payable by the associated corporation to the holders of its debentures or the relevant financial instruments. It does not regulate the relationship between the debenture holders and the taxpayer. A simple form of an avoidance scheme which circumvents this section works like this. The taxpayer borrows money from an associate. The associate raises the necessary funds from the issue of debentures listed in an overseas financial market. The debentures are all subscribed for, and held by, the overseas associates of the taxpayer. The assumption is that these overseas associates have obtained funds from within the group for the subscription of the debentures. For the taxpayer itself, it has not incurred any genuine interest expenses on the money borrowed from outside the corporation. Again, without making any external borrowing, the group obtains tax benefit as a result of the debenture interest deductions claimed by the taxpayer.

17. To tackle the above tax-avoidance practice, we **propose** to amend Section 16(2)(f) to the effect that where a taxpayer who is a corporation is claiming deductions for interest payment on debentures or other financial instruments issued by itself or on money borrowed from an associated corporation which is lending from the proceeds of debentures or other financial instruments issued by the associated corporation, such deductions will only be allowed if none of the holders of the debenture or instrument, or any other person who is entitled to any interest payable upon that debenture or instrument, is the taxpayer corporation itself or its associate. The proposed amendment will also cover the situation where the taxpayer corporation or its associate is assuming the role of a trustee of a trust estate or a corporation controlled by such a trustee, or a beneficiary under the trust.

18. All the above tax-avoidance arrangements which cannot be tackled under the existing section 16(2) are currently being dealt with by a general anti-avoidance provision under section 61A on a case-by-case basis. However, this general provision does not guarantee success in each individual case and hence cannot be taken as a long-term solution. We, therefore, **propose** to counteract such tax-avoidance arrangements through the above specific amendments to section 16(2) to restrict more stringently the deduction for interest payable to non-associated persons.

(C) Revisions Relating to Depreciation of Industrial and Commercial Buildings

19. Depreciation allowances provide for the exhaustion of capital expenditure on the acquisition of assets for the purpose of the business which yields profits assessable to tax. Industrial and commercial buildings (and structures) are two areas of capital expenditure for which depreciation allowances are provided. For industrial buildings and structures, the initial allowance is 20%, and the annual allowance thereafter is 4%. For commercial buildings and structures, there is no initial allowance and the annual allowance is 4%.

20. When a building asset is disposed of, a balancing allowance or balancing charge is made, on the basis of the difference between the disposal price and the written down value on disposal. When the disposal price is lower than the written down value on disposal, a balancing allowance is given to the

taxpayer concerned. Conversely, when the written down value is lower than the disposal price, a balancing charge is imposed as the sale of the building asset has generated profits.

21. As the position now stands, when a building used exclusively throughout its period of ownership as either an industrial building or commercial building is disposed of, the balancing allowances or charges are computed by reference to the full amount of the allowances granted during that period of ownership. However, where a commercial building previously used as an industrial building is sold, only the allowances granted in respect of the building's use as a commercial building are taken into account in determining the balancing allowance or charge. The industrial building allowance granted is ignored. The same position applies when an industrial building previously used as a commercial building is disposed of, namely, the commercial building allowances granted in earlier years are likewise ignored. This arrangement is not our policy intention. As it is now quite common for industrial buildings to be converted into commercial buildings, the existing provisions are vulnerable to abuse through deliberate tax planning.

22. Accordingly, we **propose** to amend the Ordinance to the effect that any initial, annual and balancing allowances granted, and balancing charges made, when the building was used previously as an industrial or commercial building, will be aggregated with the allowances granted under its current use (industrial or commercial as appropriate) to derive the net overall position.

23. To cater for situations where there have been changes in the use of buildings (i.e. from industrial to commercial or vice versa), it is also necessary to amend the Ordinance with regard to annual allowances. The existing section 33A(1) sets out the rate of annual allowance for commercial buildings, which is applicable to the first user of a commercial building. Section 33A(2) sets out a different method of computation of annual allowance applicable to each subsequent user of the same building or structure, where the building or structure is sold as a **commercial** building or structure at the time of sale. Arguments will arise as to whether the method of computation set out in section 33A(2) should apply to a subsequent user who buys a building which is an industrial building or structure at the time of sale, and then uses it as a **commercial** building or structure afterwards. In line with our proposed amendment regarding the calculation of balancing allowance and charge in the

event of a change in the use of a building in paragraphs 19 to 22 above, we **propose** to amend section 33A(2) of the Ordinance so that the method of computation of annual allowances set out in that subsection will apply to a subsequent user regardless of whether the building is a commercial building at the time of the sale. We also **propose** to make similar amendments to section 34(2)(b) which sets out the method of computation of annual allowances for industrial buildings and structures applicable to a subsequent user of a building.

24. Under the Ordinance, a building or structure must be either a commercial or industrial building or structure **at the time of its disposal** in order for a balancing charge to be made. This means that such a balancing charge cannot be imposed where a building or structure is not a commercial or industrial building at the time of the disposal, even though it has been used as such before the disposal and the disposal price exceeds its written-down value. This is unsatisfactory and goes against our policy intent. We therefore **propose** to consolidate and amend the provisions relating to balancing allowances and charges for both commercial and industrial buildings, so that a balancing charge may be made even though the building is not a commercial or an industrial building at the time of disposal, so long as it has been used as such at any time before its disposal.

(D) Revisions to Remedy Some Irregularities and to Clarify the Legislative Intent

(a) Self-education expenses

25. Section 12(1)(e) of the Ordinance permits a deduction for self-education expenses under salaries tax. The policy intent is that all employment-related self-education expenses should be deductible from the assessable income of a person for any year of assessment. The term “expenses of self-education” is defined in section 12(6)(c) as “expenses paid by the taxpayer on fees, including tuition and examination fees, in connection with a prescribed course of education”. Section 12(6)(d) goes on to define “a prescribed course of education” as a course undertaken to gain or maintain qualifications for use in any employment that is a course of education provided by a school, college, university etc; or a training or development course provided by a trade, professional or business association for its members.

26. The problem that has arisen is whether a taxpayer who merely sits the examination and pays only the examination fee, has paid expenses in respect of a “prescribed course of education”. Legal advice is that it is not possible to stretch the meaning of the word “course” to cover the “examination only” scenario. Thus, whilst examination fees paid as part of a course are deductible as self-education expenses, examination fees paid to the same examination authority on a standalone basis are not deductible as self-education expenses.

27. We **propose** to expand the scope of the definition of “expenses of self-education” in section 12(6)(c) to include examination fees for any examination set by a provider of a prescribed course of education and undertaken by the taxpayer to gain or maintain qualifications for use in any employment.

(b) Mortgage loan interest deduction for car parking space

28. Section 26E(8) provides that where a home loan is applied to the purchase of both a home and a car parking space, the parking space must be valued together with the home as a single tenement in order for the car parking space to qualify for mortgage loan interest deduction under salaries tax. This has induced many taxpayers to apply to the Commissioner of Rating and Valuation (CRV) to consolidate the separate assessments of the flat and car parking space into a joint assessment. This has posed considerable inconvenience to taxpayers and additional workload for the CRV. This is also not our policy intent.

29. Accordingly, we **propose** to remove the mandatory requirement for a single rating assessment so that a car parking space will qualify for the concession, as long as the same home loan is applied also for the acquisition of the car parking space.

(c) Appeal against the imposition of additional tax

30. Section 82A authorises the CIR to assess additional tax where a taxpayer commits one of the offences specified in the section. Section 82B(1) allows a taxpayer aggrieved by such an assessment, within one month after notice of the assessment, to give notice of appeal to the Board of Review. At

present, there is no provision for the Board of Review to extend, in reasonable circumstances, the period for lodging an appeal. In a recent Board of Review case, the taxpayer was one day late in lodging his appeal. The Chairman of the Board ruled that the Board of Review had no jurisdiction to hear the appeal because it was one day late.

31. To remove the rigidity relating to the appeal period, we **propose** to amend subsection 82B(1) to allow the Board of Review to extend the time for lodging an appeal. A new subsection 82B(1A) will prescribe the circumstances under which the Board of Review may extend the time limit.

(d) Assessments taken as final and conclusive

32. Until 1997, section 68(2A) permitted a taxpayer who had appealed to the Board of Review to give the Board written notice of withdrawal of the appeal at any time prior to its hearing. Section 70 set out the circumstances under which an assessment became final and conclusive. Insofar as it was relevant, an assessment became final and conclusive if an appeal to the Board of Review was withdrawn under section 68(2A).

33. In 1997, section 68 was amended by repealing subsection 68(2A) and enacting five new subsections numbered 68(1A) to (1E) respectively. The substance of the former subsection 68(2A) is now contained in subsection 68(1A)(a). However, the consequential amendment to reflect the re-numbering of the provision was not made to section 70 which still contains a reference to the repealed “section 68(2A)”, and it is possible that taxpayers may attempt to re-open assessments and argue issues on appeals which have been withdrawn prior to the appeal hearing. To avoid any doubt that assessments become final and conclusive if an appeal to the Board of Review is withdrawn, we **propose** to amend section 70 by replacing the reference to “section 68(2A)” with a reference to “section 68(1A)(a)”.

(e) Tax exemption for charitable bodies

34. The Ordinance grants an exemption from the taxes that would otherwise be imposed by the same Ordinance on charitable bodies. The exemption applies to any charitable institution of a public nature or any charitable trust of a public nature. We **propose** to make a technical amendment

to the wording of the exemption in the Chinese text in order to reconcile the meaning of both texts.

35. Arising from the proposed amendment, we also **propose** to make consequential amendments to the Estate Duty Ordinance, the Stamp Duty Ordinance, the Gambling Ordinance, the Elections (Corrupt and Illegal Conduct) Ordinance and the Brewin Trust Fund Ordinance.

(E) Revisions Relating to Costs and Fees

(a) Power of Board of Review to award costs

36. Section 68(9) of the Ordinance allows the Board of Review to impose costs where a taxpayer has appealed to it against an assessment and it has not reduced or annulled the assessment. In practice, the Board imposes costs infrequently and only then for frivolous appeals or appeals that are devoid of any merit. The maximum amount of costs that the Board may impose is specified in section 68(9). Currently, the cost is fixed at \$5,000.

37. Having the amount of costs specified in the main body of the legislation means that any amendment to it must be done by way of amending the Ordinance. As the amount of costs have to be reviewed and revised periodically to ensure that it carries the desired deterrent effect, we **propose** to streamline the legislative process by specifying the amount of costs that may be imposed by the Board in a schedule to the Ordinance. We also **propose** to empower the Secretary for the Treasury to vary the amount by an order, which will be subject to negative vetting by the Legislative Council.

(b) Application fee for stating a case

38. Section 69(1) provides that decisions of the Board of Review are final except where the appellant or the CIR makes an application requiring the Board of Review to state a case on a question of law for the opinion of the Court of First Instance. The proviso to section 69(1) requires the payment of an application fee of \$640.

39. As is the case with section 68(9), the amount of application fee is also specified in the main Ordinance. For the same reason as stated in paragraph 37

above, we **propose** to move the fee to a schedule. We also **propose** to empower the Secretary for the Treasury to vary it by an order, which will be subject to negative vetting by the Legislative Council.

(F) Revisions to Repeal Spent Provisions

40. Section 89(1) and Schedule 5 to the Ordinance, which concern transitional arrangements, only apply to the Year of Assessment commencing on 1 April 1989. Assessments for this Year of Assessment are now time-barred under section 60(1). Therefore, both section 89(1) and Schedule 5 are no longer necessary. We **propose** to repeal section 89(1) and Schedule 5.

Summary

41. A summary of the specific purposes underlying each of the above proposed amendments is at *Annex B*.

B

THE BILL

42. **Clause 2** specifies the years of assessment in relation to which specific amendments apply. **Clauses 3 and 18** make a technical amendment to the term “charitable institution or trust of a public character” in the Chinese text of the Ordinance. **Clauses 21, 22 and 24 to 27** amend the same term in the same way in other Ordinances.

43. **Clause 4** revises the definition of “expenses of self-education” to include fees paid by the taxpayer in respect of certain specified examinations. **Clauses 5 and 7** give legal effect to the current assessing practice that all sums payable for the use of intellectual property (whether in or outside Hong Kong) by a person carrying on a trade, profession or business in Hong Kong and deductible in ascertaining the assessable profits of that person, are deemed to be receipts arising in, or derived from, Hong Kong from a trade, profession or business carried on in Hong Kong. **Clause 6** restricts deduction for certain interest payable to non-associated persons only. **Clause 23** updates a reference in the Exemption from Profits Tax (Interest Income) Order in the light of the proposed amendments in Clause 6.

44. **Clause 8** removes the requirement that where a person applies a portion of a home loan for the acquisition of a car parking space, the car parking space must be valued together with the dwelling concerned as a single tenement under the Rating Ordinance in order for the person to be allowed a deduction in respect of the interest paid on that portion of the loan.

45. **Clauses 9 and 11** deal with the method of computation of annual allowances to be applied to a subsequent user of a building or structure. **Clauses 10 and 12** consolidate and amend relevant sections with respect to the determination of balancing allowances and charges for commercial and industrial buildings and structures. **Clause 13** revises the definition of “residue of expenditure” to allow the CIR to take into account all initial, annual and balancing allowances granted, and all balancing charges made, in respect of any prior usage of the concerned building or structure when computing the residue of expenditure.

46. **Clauses 14, 15 and 20** provide for the maximum amount of costs which may be imposed by the Board of Review and the amount of the fee payable for an application to state a case to be specified in a schedule to the Ordinance and empower the Secretary for the Treasury to vary the amount by an order.

47. **Clause 17** empowers the Board of Review to extend the time for lodging notice of appeal. **Clause 16** rectifies minor irregularities. **Clauses 19 and 20** repeal spent provisions.

LEGISLATIVE TIMETABLE

48. The legislative timetable for the Bill is -

Publication in the Gazette	5 October 2000
First Reading and commencement of Second Reading debate	18 October 2000
Resumption of Second Reading debate, Committee Stage and	

BASIC LAW IMPLICATIONS

49. The Department of Justice advise that the Bill does not conflict with those provisions of the Basic Law carrying no human rights implications.

HUMAN RIGHTS IMPLICATIONS

50. The Department of Justice advise that the Bill is consistent with the human rights provisions of the Basic Law.

BINDING EFFECT OF THE LEGISLATION

51. The Bill will not affect the binding effect of the existing provisions of the Ordinance and its subsidiary legislation.

FINANCIAL AND STAFFING IMPLICATIONS

52. The proposed amendments seek primarily to strengthen existing anti-avoidance provisions, give clear legal effect to the Inland Revenue Department's long-standing assessing practice, and rectify minor irregularities. No new provisions requiring extra assessment or enforcement efforts have been introduced. The proposed amendments would not give rise to any additional financial or staffing implications.

53. The proposals relating to royalty income, anti-avoidance provisions on deduction of interest expenses, and depreciation allowances for buildings would have the effect of reducing loss of revenue from Profits Tax. Although the exact amount of revenue gain is difficult to quantify, we estimate that the amendments relating to royalty income alone may save Government from a potential revenue loss of \$200 million a year from Profits Tax.

PUBLICITY

54. We will issue a press release on 4 October 2000.

ENQUIRIES

55. In case of enquiries about this Brief, please contact Ms Esther Leung, Principal Assistant Secretary for the Treasury (Revenue), at 2810 2370.

Finance Bureau
FIN CR 1/2306/00
29 September 2000

(FIN CR 1/2306/00)

INLAND REVENUE (AMENDMENT) BILL 2000
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A BILL

To

Amend the Inland Revenue Ordinance.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) Ordinance 2000.

2. Application

(1) Section 4 applies in relation to the year of assessment 2000/01 and to all subsequent years of assessment.

(2) Section 8 applies in relation to the year of assessment 1998/99 and to all subsequent years of assessment.

(3) Sections 9(b), 10, 11(b) (i) and (iii), 12 and 13 apply in relation to the year of assessment 2001/02 and to all subsequent years of assessment.

3. Interpretation

Section 2(1) of the Inland Revenue Ordinance (Cap. 112) is amended, in the definition of "認可慈善捐款", by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

4. Adjustments to assessable income

Section 12(6) is amended by repealing paragraphs (b), (c) and (d) and substituting –

"(b) "expenses of self-education" (個人進修開支) means expenses paid by the taxpayer as -

- (i) fees, including tuition and examination fees, in connection with a prescribed course of education undertaken by the taxpayer; or
- (ii) fees in respect of an examination set by an education provider, or by a trade, professional or business association for its members, and undertaken by the taxpayer to gain or maintain qualifications for use in any employment,

but does not include -

- (A) expenses for which a deduction is allowable or has been allowed to the taxpayer in any year of assessment under any other provision of this Ordinance; or
- (B) expenses to the extent to which they have been reimbursed or are reimbursable to the taxpayer by his employer or any other person unless the reimbursement has been or will be included in the assessable income of the taxpayer;

(c) "prescribed course of education" (訂明教育課程) means a course undertaken to gain or maintain qualifications for use in any employment and being -

- (i) a course of education provided by an education provider; or
- (ii) a training or development course provided by a

trade, professional or business association for its members;

- (d) "education provider" (教育提供者) means -
- (i) a university, university college or technical college;
 - (ii) a place of education to which the Education Ordinance (Cap. 279) does not apply by virtue of section 2 of that Ordinance;
 - (iii) a school registered under section 13(a) of the Education Ordinance (Cap. 279);
 - (iv) a school exempted from registration under section 9(1) of the Education Ordinance (Cap. 279);
 - (v) an institution approved by the Commissioner for the purposes of section 16C; or
 - (vi) an institution approved by the Commissioner under paragraph (e);
- (e) the Commissioner may in writing approve an institution as an education provider and the approval may operate from a date, whether before or after the date of approval, specified in the instrument of approval and may be withdrawn at any time."

5. Certain amounts deemed trading receipts

Section 15 is amended -

- (a) in subsection (1) -
 - (i) by repealing paragraph (b) and

substituting -

"(b) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use of or right to use in Hong Kong any patent, design, trademark, copyright material, secret process or formula or other property of a similar nature, or for imparting or undertaking to impart knowledge directly or indirectly connected with the use in Hong Kong of any such patent, design, trademark, copyright material, secret process or formula or other property;"

(ii) by adding -

"(ba) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use of or right to use outside Hong Kong any patent, design, trademark, copyright material, secret process or formula or other property of a similar nature,

or for imparting or undertaking to impart knowledge directly or indirectly connected with the use outside Hong Kong of any such patent, design, trademark, copyright material, secret process or formula or other property, which are deductible in ascertaining the assessable profits of a person under this Part;"

(b) by adding -

"(6) The amendment made to subsection (1) by section 5(a) (ii) of the Inland Revenue (Amendment) Ordinance 2000 (of 2000) does not apply to sums described in subsection (1) (ba) which were received by or which accrued to a person before the commencement of that Ordinance."

6. Ascertainment of chargeable profits

Section 16 is amended -

(a) in subsection (2) -

(i) by repealing paragraph (d) and substituting -

"(d) the money has been borrowed from a financial institution or an overseas financial

institution and -

(i) where a person other than the financial institution or overseas financial institution is entitled to any sum payable by way of interest upon the money borrowed -

(A) the person entitled is not the borrower or an associate of the borrower; and

(B) if the person entitled is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust

is the borrower
or an associate of
the borrower;
and

(ii) the repayment of the
principal or interest is
not secured or
guaranteed, whether in
whole or in part and
whether directly or
indirectly, by a deposit
or loan made with or to
any person where any
sum payable by way of
interest on the deposit or
loan is not chargeable to
tax under this
Ordinance;"

(ii) in paragraph (e), by repealing subparagraphs (A) and
(B) and substituting -

"(A) the lender is not an associate of the
borrower;

(B) where the lender is a trustee of a trust
estate or a corporation controlled by
such a trustee, neither the trustee

nor the corporation nor any beneficiary under the trust is the borrower or an associate of the borrower;

(C) where a person other than the lender is entitled to any sum payable by way of interest upon the money borrowed -

(I) the person entitled is not the borrower or an associate of the borrower; and

(II) if the person entitled is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the borrower or an associate of the borrower; and

(D) the repayment of the principal or interest is not secured or guaranteed, whether in whole or in part and whether directly or

indirectly, by a deposit or loan made with or to any person where any sum payable by way of interest on the deposit or loan is not chargeable to tax under this Ordinance;"

(iii) by repealing paragraph (f) and substituting -

"(f) the person chargeable to tax is a corporation and the deduction claimed is in respect of interest payable by that corporation (in this paragraph referred to as "the relevant corporation") -

- (i) on debentures;
- (ii) on instruments (other than debentures) -

- (A) issued bona fide and in the course of carrying on business and marketed in Hong Kong or in a major financial centre outside Hong Kong

approved by the
Commissioner for
the purposes of this
subparagraph; or
(B) issued pursuant to
any agreement or
arrangements,
where an
advertisement or
invitation in respect
of the agreement or
arrangements, or a
document which
contains such an
advertisement or
invitation, has been
issued to the public
and authorized by
the Securities and
Futures
Commission before
issue under section
4(2) (g) of the
Protection of

Investors
Ordinance (Cap.
335); or

- (iii) on moneys borrowed from an associated corporation, where the moneys borrowed in the hands of the associated corporation arise entirely from the proceeds of an issue by the associated corporation of debentures or of instruments described in subparagraph (ii), in an amount not exceeding the interest payable by the associated corporation to the holders of its debentures or of such instruments,

and -

- (A) none of the holders of the debentures or

instruments is the relevant corporation or an associate of the relevant corporation;

(B) where any of the debentures or instruments is held by a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the relevant corporation or an associate of the relevant corporation; and

(C) where a person other than the holder of the debenture or instrument concerned is entitled to any sum payable by way of interest upon that

debenture or instrument

-

- (I) the person entitled is not the relevant corporation or an associate of the relevant corporation; and
- (II) if the person entitled is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the relevant corporation or an associate of the relevant corporation.";

(b) by adding -

"(7) The amendments made to subsection (2)

by section 6(a) of the Inland Revenue (Amendment) Ordinance 2000 (of 2000) do not apply to sums described in subsection (1) (a) which were payable before the commencement of that Ordinance."

7. Sections amended

Sections 20B(1) (a) and 21A(1) are amended by repealing "section 15(1) (a) or (b)" and substituting "section 15(1) (a), (b) or (ba)".

8. Home loan interest

Section 26E(8) is amended by repealing "any car parking space valued together with the dwelling as a single tenement under section 10 of the Rating Ordinance (Cap. 116), such" and substituting "a car parking space, the".

9. Annual allowances, commercial buildings and structures

Section 33A is amended -

- (a) in subsection (1) -
 - (i) by repealing "equal to" and substituting "of an amount equal to, subject to subsection (2),";
 - (ii) by adding a comma after "one-twenty-fifth of the expenditure";
- (b) in subsection (2) -
 - (i) by repealing "while the building or

structure is a commercial building or structure" and substituting "and where the building or structure has been used at any time before the sale, whether as a commercial building or structure or otherwise";

(ii) by repealing paragraph (a) and substituting -

"(a) begins with the year of assessment in the basis period for which the sale takes place; and".

10. Balancing allowances and charges, commercial buildings and structures

Section 33B is repealed.

11. Initial and annual allowances, industrial buildings and structures

Section 34(2) is amended -

(a) in paragraph (a) -

(i) by adding a comma after "that building or structure" and after "one-twenty-fifth of that expenditure";

(ii) by repealing "equal to" and substituting "of an amount equal to, subject to paragraph (b),";

(b) in paragraph (b) -

- (i) by repealing "while the building or structure is an industrial building or structure" and substituting "and where the building or structure has been used at any time before the sale, whether as an industrial building or structure or otherwise,";
- (ii) by adding a comma after "that sale";
- (iii) by repealing subparagraph (i) and substituting -
 - "(i) begins with the year of assessment in the basis period for which the sale takes place; and";
- (iv) in subparagraph (ii) -
 - (A) by repealing "the year" after "the 50th year after" and substituting "the year of assessment";
 - (B) by adding "the commencement of" before "such basis period";
- (c) in paragraph (c) -
 - (i) by adding "amount" after "such";
 - (ii) by repealing "that" before "expenditure";
 - (iii) by repealing "his" and substituting "the".

12. Section substituted

Section 35 is repealed and the following substituted -

**"35. Balancing allowances and charges,
buildings and structures**

(1) Where -

(a) any of the following events occurs in relation to a building or structure -

(i) the relevant interest in the building or structure is sold;

(ii) the relevant interest in the building or structure, being a leasehold interest, comes to an end otherwise than on the person entitled thereto acquiring the interest which is reversionary thereon; or

(iii) the building or structure is demolished or destroyed or, without being demolished or destroyed, ceases altogether to be used; and

(b) the building or structure has been a commercial building or structure or an industrial building or structure at any time before the occurrence of such event,

an allowance, to be known as a "balancing allowance", or a charge, to be known as a "balancing charge", shall, in the circumstances mentioned in this section, be made to or, as the case may be, on the person entitled to the relevant interest in the building or structure immediately before the occurrence of such event for the year of assessment in the

basis period for which such event occurs.

(2) (a) Where -

- (i) there are no sale, insurance, salvage or compensation moneys arising in respect of the occurrence of an event referred to in subsection (1) (a); or
- (ii) the residue of expenditure immediately before the occurrence of such event exceeds those moneys,

a balancing allowance shall be made and the amount thereof shall be the amount of -

- (A) in the case of subparagraph (i), the residue of expenditure; or
- (B) in the case of subparagraph (ii), the excess of the residue of expenditure over those moneys.

(b) Notwithstanding anything in this section, a balancing allowance shall not be made to a person where -

- (i) an event referred to in subsection (1) (a) occurs in relation to a building or structure and the building or structure was not a commercial building or structure or an industrial building or structure immediately before the occurrence of such event; or

- (ii) a commercial building or structure or an industrial building or structure is demolished for purposes unconnected with, or not in the ordinary course of conduct of, the trade, profession or business for the purposes of which the building or structure was used before the demolition in circumstances qualifying for annual allowances under section 33A or 34(2), as the case may be.
- (3)
 - (a) Where the sale, insurance, salvage or compensation moneys arising in respect of the occurrence of an event referred to in subsection (1) (a) exceed the residue of expenditure immediately before the occurrence of such event, a balancing charge shall be made and the amount on which it is made shall be an amount equal to the excess of those moneys over the residue of expenditure.
 - (b) Notwithstanding anything in paragraph (a), in no case shall the amount on which a balancing charge is made on a person exceed the aggregate of the allowances, if any, made to him under sections 33A and 34 in respect of the expenditure in question."

13. Interpretation

Section 40(1) is amended, in the definition of "residue of expenditure" -

- (a) in paragraph (a) -
 - (i) by repealing everything after "reduced by -" and before the proviso and substituting -
 - "(i) the amount of any initial allowance made under section 34(1);
 - (ii) the amount of any annual allowance made under section 33A or 34(2);
 - (iii) the amount of any balancing allowance made under section 35,
and increased by the amount of any balancing charge made under section 35:";
 - (ii) in the proviso, by repealing "no annual allowance fell to be made under section 33A" and substituting "no allowance fell to be made under section 33A or 34";
- (b) in paragraph (b) -
 - (i) by repealing everything after "reduced by -" and before the proviso and substituting -
 - "(i) the amount of any initial

allowance made under section 34(1);

(ii) the amount of any annual allowance made under section 33A or 34(2);

(iii) the amount of any balancing allowance made under section 35,

and increased by the amount of any balancing charge made under section 35:";

(ii) in the proviso, by repealing "no initial or annual allowance fell to be made under section 34(1) or (2), as the case may be" and substituting "no allowance fell to be made under section 33A or 34".

14. Hearing and disposal of appeals to the Board of Review

Section 68 is amended -

(a) in subsection (9), by repealing "\$5,000" and substituting "the amount specified in Part I of Schedule 5";

(b) by adding -

"(9A) The Secretary for the Treasury may by order amend the amount specified in Part I of Schedule 5."

15. Appeals to the Court of First Instance

Section 69 is amended -

- (a) in the proviso to subsection (1), by repealing "\$640" and substituting "the amount specified in Part II of Schedule 5";
- (b) by adding -
 - "(1A) The Secretary for the Treasury may by order amend the amount specified in Part II of Schedule 5.";
- (c) by repealing subsection (8).

16. Assessments or amended assessments to be final

Section 70 is amended by repealing "68(2A)" and substituting "68(1A) (a)".

17. Appeals against assessment to additional tax to Board of Review

Section 82B is amended -

- (a) by repealing subsection (1) and substituting -
 - "(1) Any person who has been assessed to additional tax under section 82A may within -
 - (a) 1 month after the notice of assessment is given to him; or
 - (b) such further period as the Board may allow under subsection (1A),either himself or by his authorized representative give notice of appeal to the

Board; but no such notice shall be entertained unless it is given in writing to the clerk to the Board and is accompanied by -

- (i) a copy of the notice of assessment;
- (ii) a statement of the grounds of appeal from the assessment;
- (iii) a copy of the notice of intention to assess additional tax given under section 82A(4), if any such notice was given; and
- (iv) a copy of any written representations made under section 82A(4).";

(b) by adding -

"(1A) If the Board is satisfied that an appellant was prevented by illness or absence from Hong Kong or other reasonable cause from giving notice of appeal in accordance with subsection (1) (a), the Board may extend for such period as it thinks fit the time within which notice of appeal may be given under subsection (1). This subsection shall apply to an appeal relating to any assessment in respect of which notice of assessment is given on or after 1 April 2001."

18. Exemption of charitable bodies

Section 88 is amended by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

19. Transitional provisions

Section 89(1) is repealed.

20. Schedule 5 substituted

Schedule 5 is repealed and the following substituted -

"SCHEDULE 5 [ss. 68 & 69]

PART I

ORDER FOR APPELLANT TO PAY COSTS

1. Maximum amount which the Board of Review may order the appellant to pay as costs of the Board \$5,000

PART II

APPLICATION FEE FOR CASE STATED

1. Fee payable for application requiring the Board of Review to state a case \$640".

Consequential Amendments

Estate Duty Ordinance

21. What property is deemed to pass on death

Section 6(7) of the Estate Duty Ordinance (Cap. 111) is amended by repealing "慈善機構或公眾性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

22. Exceptions for transactions for money consideration, property situate outside Hong Kong, shares on local registers and certain land in the New Territories

Section 10(g) is amended by repealing "慈善機構或公眾性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

Exemption from Profits Tax (Interest Income) Order

23. Exemption from profits tax

Section 2(2) of the Exemption from Profits Tax (Interest Income) Order (Cap. 112 sub. leg.) is amended by repealing "where the condition specified in section 16(2) (d) of the Ordinance is satisfied" and substituting "where the conditions specified in section 16(2) (d) or (e) of the Ordinance, as the case may be, are satisfied".

Stamp Duty Ordinance

24. Interpretation of Part V

Section 38 of the Stamp Duty Ordinance (Cap. 117) is amended, in the definition of "獲豁免機構", by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

Gambling Ordinance

25. Interpretation

Section 2 of the Gambling Ordinance (Cap. 148) is amended, in the definition of "私有收益", by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

Elections (Corrupt and Illegal Conduct) Ordinance

26. How candidate must dispose of certain election donations

Section 19 of the Elections (Corrupt and Illegal Conduct) Ordinance (Cap. 554) is amended -

- (a) in subsections (2) (b), (3) and (4), by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託";
- (b) in subsection (6), by repealing "(慈善機構或屬公共性質的信託)" and substituting "(屬公共性質的慈善機構或慈

善信託) ".

Brewin Trust Fund Ordinance

27. Interpretation

Section 2 of the Brewin Trust Fund Ordinance (Cap. 1077) is amended, in the definition of "慈善機構", by repealing "慈善機構或屬公共性質的信託" and substituting "屬公共性質的慈善機構或慈善信託".

Explanatory Memorandum

The purpose of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) ("the Ordinance").

2. The Bill -

- (a) revises the definition of "expenses of self-education" in section 12(6) (c) of the Ordinance to include fees paid by the taxpayer in respect of certain specified examinations (clause 4);
- (b) amends section 15(1) of the Ordinance to ensure that all sums payable for the use of intellectual property (whether in or outside Hong Kong) by a person carrying on a trade, profession or business in Hong Kong and deductible in ascertaining the assessable profits of that person are deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong (clauses 5 and 7);
- (c) amends certain of the conditions set out in section

- 16(2) of the Ordinance which must be satisfied in order for a person to be allowed a deduction in respect of interest payable by the person upon money borrowed by him for the purpose of producing assessable profits (clause 6);
- (d) amends section 26E(8) of the Ordinance to remove the requirement that, where a person applies a portion of a home loan for the acquisition of a car parking space, the car parking space must be valued together with the dwelling concerned as a single tenement under section 10 of the Rating Ordinance (Cap. 116) in order for the person to be allowed a deduction in respect of the interest paid on that portion of the loan (clause 8);
 - (e) amends subsection (2) of section 33A of the Ordinance so that the method of computation of annual allowances in respect of commercial buildings and structures set out in that subsection applies to a buyer of a building or structure which has been used at any time before the sale, regardless of whether the building or structure is a commercial building or structure at the time of the sale (clause 9);
 - (f) amends paragraph (b) of section 34(2) of the Ordinance so that the method of computation of annual allowances in respect of industrial buildings and structures set out in that paragraph applies to a buyer of a building or structure which

has been used at any time before the sale, regardless of whether the building or structure is an industrial building or structure at the time of the sale (clause 11);

- (g) consolidates sections 33B and 35 of the Ordinance, which provide for the determination of balancing allowances and charges in respect of commercial and industrial buildings and structures, with the following amendments -
 - (i) a balancing charge may be made where a building or structure is not a commercial or an industrial building or structure at the time when the relevant event occurs but has been used as such at any time before the occurrence of that event; and
 - (ii) all initial and annual allowances granted in respect of any prior usage of a building or structure are to be taken into account when determining the maximum amount on which a balancing charge may be made, (clauses 10 and 12);
- (h) revises the definition of "residue of expenditure" in section 40(1) of the Ordinance to take into account all initial, annual and balancing allowances granted, and all balancing charges made, in respect of any prior usage of a building or structure (clause 13);

- (i) provides for the maximum amount of costs which may be imposed by the Board of Review under section 68(9) of the Ordinance to be specified in the new Schedule 5 of the Ordinance and empowers the Secretary for the Treasury to vary the amount by an order (clauses 14 and 20);
- (j) provides for the amount of the fee payable for an application to state a case under section 69(1) of the Ordinance to be specified in the new Schedule 5 of the Ordinance and empowers the Secretary for the Treasury to vary the amount by an order (clauses 15 and 20);
- (k) empowers the Board of Review to extend the time for lodging notice of appeal under section 82B(1) of the Ordinance (clause 17);
- (l) rectifies minor irregularities (clauses 3, 16 and 18) and repeals spent provisions in the Ordinance (clauses 19 and 20); and
- (m) makes consequential amendments to other Ordinances and to subsidiary legislation under the Ordinance (clauses 21 to 27).

3. The amendments made to section 12(6) of the Ordinance by clause 4 apply in relation to the year of assessment 2000/01 and to all subsequent years of assessment.

4. The amendment made to section 15(1) of the Ordinance by clause 5(a) (ii) does not apply to sums described in the new section 15(1) (ba) of the Ordinance which were received by or which accrued to a person before the commencement of the Bill as enacted.

5. The amendments made to section 16(2) of the Ordinance by clause 6(a) do not apply to sums described in section 16(1) (a) of the Ordinance which were payable before the commencement of the Bill as enacted.

6. The amendment made to section 26E(8) of the Ordinance by clause 8 applies in relation to the year of assessment 1998/99 and to all subsequent years of assessment.

7. The amendments made to sections 33A(2), 33B, 34(2) (b), 35 and 40(1) of the Ordinance by clauses 9(b), 10, 11(b) (i) and (iii), 12 and 13 apply in relation to the year of assessment 2001/02 and to all subsequent years of assessment.

Summary of specific objectives underlying proposals in the Inland Revenue (Amendment) Bill 2000

1. To revise the provisions relating to royalty income for revenue protection to subject royalty income received by non-residents from local businesses to Profits Tax, irrespective of whether the goods covered by the royalty are manufactured in Hong Kong (paragraphs 3 to 9).

2. To strengthen anti-avoidance provisions to restrict more stringently deduction for certain interest payable to non-associated persons only (paragraphs 10 to 18).

3. To revise provisions relating to the depreciation of industrial and commercial buildings to cater for changes in the market to take into account any prior usage of a building or structure in calculating balancing allowances and charges for commercial and industrial buildings and structures; to deal with the method of computation of annual allowances to be applied to a subsequent user of a building or structure; and to consolidate and amend the provisions on balancing allowances and charges for both commercial and industrial buildings and structures (paragraphs 19 to 24).

4. To remedy some irregularities to clarify legislative intent

(a) to bring claims relating to exclusively examination fees for qualifying courses within the scope of self-education expenses (paragraphs 25 to 27);

(b) to remove the requirement that a car parking space must be valued together with the dwelling concerned as a single tenement in order to qualify for the mortgage loan interest deduction (paragraphs 28 to 29);

- (c) to empower the Board of Review to extend the time for lodging notice of appeal (paragraphs 30 to 31).
- (d) to remove doubt as to when assessments become final and conclusive in case an appeal to the Board of Review is withdrawn (paragraphs 32 to 33); and
- (e) to make a technical amendment to the Chinese text of the term “any charitable institution or trust of a public character” (paragraphs 34 to 35);

5. To revise provisions on costs and fees

- (a) to provide for the maximum amount of costs which may be imposed by the Board of Review to be specified in a schedule to the Ordinance and empower the Secretary for the Treasury to vary the amount by an order (paragraphs 36 to 37); and
- (b) to provide for the amount of the fee payable to the Board of Review for an application to state a case to be specified in a schedule to the Ordinance and empower the Secretary for the Treasury to vary the amount by an order (paragraphs 38 to 39).

6. To repeal spent provisions (paragraph 40).

Section 89(1) and Schedule 5 which concern transitional arrangements, only apply to the Year of Assessment commencing on 1 April 1989. Assessments for this Year of Assessment are now time-barred under section 60(1).