

立法會
Legislative Council

LC Paper No. CB(1)2276/10-11
(These minutes have been seen
by the Administration)

Ref : CB1/BC/4/10/2

Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011

First meeting on
Thursday, 21 April 2011, at 10:45 am
in Conference Room B of the Legislative Council Building

Members present : Hon Paul CHAN Mo-po, MH, JP (Chairman)
Hon James TO Kun-sun
Hon Miriam LAU Kin-ye, GBS, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Audrey EU Yuet-mee, SC, JP
Hon WONG Ting-kwong, BBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Members absent : Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Hon CHAN Kam-lam, SBS, JP

Public officers : Miss Cathy CHU
Attending Deputy Secretary for Financial Services and the
Treasury (Treasury)

Ms Shirley KWAN
Principal Assistant Secretary for Financial Services and
the Treasury (Treasury) (Revenue)

Mr WONG Kuen-fai
Deputy Commissioner of Inland Revenue (Technical)

Ms Judy YIP
Senior Assessor
Inland Revenue Department

Miss Betty CHEUNG
Senior Assistant Law Draftsman
Department of Justice

Mr Manuel NG
Government Counsel
Department of Justice

Clerk in attendance : Ms Anita SIT
Chief Council Secretary (1)5

Staff in attendance : Ms Wendy KAN
Assistant Legal Adviser 6

Mr Hugo CHIU
Council Secretary (1)5

Ms Haley CHEUNG
Legislative Assistant (1)5

I Election of Chairman

Mr James TO, the member with the highest precedence among those who were present at the meeting, presided over the election of the Chairman of the Bills Committee. He invited nominations for the chairmanship of the Bills Committee.

2. Mr Paul CHAN was nominated by Miriam LAU and the nomination was seconded by Mr WONG Ting-kwong. Mr Paul CHAN accepted the nomination. There being no other nomination, Mr James TO declared that Mr Paul CHAN was elected Chairman of the Bills Committee.

II Meeting with the Administration

(LC Paper No. CB(3)517/10-11 — The Bill

File Ref: TsyB R 183/535-1/8/0 — The Legislative Council Brief
(10-11) (C) issued by the Financial Services
and the Treasury Bureau

- LC Paper No. LS37/10-11 — The Legal Service Division Report on Inland Revenue (Amendment) (No. 2) Bill 2011
- LC Paper No. LS42/10-11 — The Legal Service Division further Report on Inland Revenue (Amendment) (No. 2) Bill 2011
- LC Paper No. CB(2)1469/10-11(01) — Letter dated 29 March 2011 from The Association of Chartered Certified Accountants in Hong Kong to Hon Paul CHAN Mo-po
- LC Paper No. CB(2)1469/10-11(02) — Letter dated 6 April 2011 from the Financial Services and the Treasury Bureau
- LC Paper No. CB(1)1988/10-11(01) — Marked-up copy of the Bill prepared by the Legal Service Division
- LC Paper No. CB(1)1987/10-11 — Background brief on Inland Revenue (Amendment) (No. 2) Bill 2011 prepared by the Legislative Council Secretariat)

Discussion

3. The Committee deliberated (Index of proceedings attached at **Appendix**).

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Follow-up actions to be taken by the Administration

4. The Administration was requested to take the following follow-up actions:
- (a) to provide information on the taxation relief arrangements in respect of trading of intellectual property rights (IPRs) under the model double taxation relief agreement of the Organization for Economic Co-operation and Development (OECD), and the Administration's position regarding the pursuit of taxation relief for Hong Kong enterprises engaged in the trading of IPRs with entities in other jurisdictions;
 - (b) to provide a comparison of the taxation arrangements proposed in the Bill with those of comparable jurisdictions, including relevant arrangements in the Mainland where appropriate;

- (c) to set out in writing the various scenarios cited by members and explain the applicability of the proposed tax deduction for each scenario; and
- (d) to provide information on relevant arrangements under the Closer Economic Partnership Arrangement (CEPA) and the view of the Mainland authority on transfer pricing.

III Any other business

Invitation for views

- 5. Members agreed to invite relevant organizations to attend a Bills Committee meeting to express their views and/or provide submissions on the Bill, and to post an invitation notice on the Legislative Council website.

Date of next meeting

- 6. The Chairman said that he would work out with the Clerk a schedule of meetings and members would be informed of the details in due course.

(Post-meeting note: Members were informed vide LC Paper No. CB(1)2025/10-11 on 26 April 2011 of the schedule of the next meeting, and the organizations/individuals to be invited to give views on the Bill and/or attend the meeting on 28 May 2011.)

- 7. There being no other business, the meeting ended at 11:52 pm.

Council Business Division 1
Legislative Council Secretariat
24 May 2011

**Proceedings of the
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011
First meeting on Thursday, 21 April 2011, at 10:45 am
in Conference Room B of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000300 – 000409	Mr James TO Ms Audrey EU Ms Miriam LAU Mr WONG Ting-kwong	Election of Chairman	
000410 – 000617	Chairman	Upon the Chairman's suggestion, members agreed to invite the public, including relevant professional organizations, to give views on the Bill.	
000618 – 001356	Administration	Briefing by the Administration on the proposals in the Bill.	
001357 – 002028	Ms Miriam LAU Administration Chairman	<p>Ms LAU sought clarification on the proposed anti-avoidance measures mentioned in paragraph 13(b) and (c) of the Legislative Council Brief on the Bill.</p> <p>The Administration replied that the proposed deduction would not be allowed for a "sale and licence back" arrangement of specified intellectual property rights (IPRs). In line with the existing Inland Revenue Ordinance (Cap. 112) (IRO), the proposed escape clause introduced in the Bill specified a number of conditions to exempt commercial financing arrangements from the proposed anti-avoidance provision with regard to a taxpayer purchasing a specified IPR from an end-user who is not related or associated with the taxpayer as follows:</p> <ul style="list-style-type: none"> (a) the selling price of the specified IPR did not exceed the previous purchase price paid by the end-user; and (b) no tax deduction in respect of the purchase cost of the specified IPR had been made to the end-user before. <p>As to how the Commissioner of Inland Revenue would determine the true market price of specified IPRs, the Administration advised that professional valuating agencies would be engaged for the purpose. Such service was available in the market.</p>	

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		<p>The Chairman enquired whether, under the "sale and licence back" arrangement, the taxpayer would be eligible for exemption to the anti-avoidance provision if the arrangement provided for an option for the end-user to buy back the IPR. The Administration responded that IRO did not have provision concerning such option. As such, such option was not a relevant consideration for determining the eligibility of the taxpayer for exemption.</p>	
<p>002029 – 002629</p>	<p>Mrs Regina IP Ms Miriam LAU Administration Chairman</p>	<p>Mrs IP remarked that IPR products usually involved pools of patents and there were patent agents in the market. Valuation and evaluation of IPRs would be made based on three factors, namely, technology, market and existence of encumbrances. Mrs IP remarked that there were relevant valuating agencies and valuation services in Hong Kong. One of the industry organizations was the Hong Kong Institute of Patent Practitioners (HKIPP).</p> <p>Mrs IP pointed out that if an entity in Hong Kong conducted IPR trading or transfer with other jurisdictions, the entity might need to pay tax for the sale and purchase transactions on IPRs to overseas jurisdictions. She enquired whether Hong Kong had entered into any bilateral agreements on taxation relief for the trading of patents with jurisdictions like the United States (US), the European Union (EU) and Japan in order to enhance Hong Kong as an IPR trading or transfer centre.</p> <p>The Administration responded that Hong Kong had already signed comprehensive double taxation agreements (CDTAs) with Mainland China, Japan and some member countries of the EU including the United Kingdom, France, Belgium, the Netherlands and Luxemburg. Such CDTAs covered royalties in relation to the licensing of IPRs only and did not cover trading of IPRs. Mrs IP considered that Hong Kong should step up its efforts in negotiating taxation relief agreements with other relevant jurisdictions. The Administration responded that the Government's policy was to enter into such agreements with as many trading partners as possible, and they were working hard on this.</p>	

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		<p>Members enquired why the taxation relief agreements did not cover the trading of IPRs. The Administration replied that the agreements were based on model agreement of the Organization for Economic Co-operation and Development (OECD) which were widely used by developed countries. The OECD model agreement only covered tax relief for profits derived from the use of IPR. Mrs IP considered that the Administration should review the coverage of taxation relief agreements to facilitate IPR trading and views might be sought from relevant parties, like HKIPP, in this regard.</p>	
002630 – 002743	Chairman Administration	<p>The Chairman enquired whether other countries had reached relevant taxation relief agreements covering trading of IPRs. The Administration replied in the negative explaining that developed countries used the OECD model agreement, which did not have any provision on the trading of IPRs. At the Chairman's request, the Administration undertook to further study the issue and provide a written reply.</p>	The Administration to take action as per paragraph 4 of the minutes.
002744 – 004545	Ms Audrey EU Administration Chairman Mr James TO	<p>Ms EU enquired:</p> <ul style="list-style-type: none"> (a) which jurisdictions the Administration had made reference to in drafting the Bill; and (b) whether the Administration had compared the proposals in the Bill with the relevant arrangements in other jurisdictions. <p>Ms EU also sought clarification on the meaning of acquisition of "proprietary interests" in relation to IPRs and requested the Administration to provide concrete examples to explain the meaning.</p> <p>The Administration replied as follows:</p> <ul style="list-style-type: none"> (a) The Administration had made reference to Australia, Singapore, the United Kingdom and the United States in determining the tax deduction period and the proposed arrangement in the Bill was more or less on par or even more generous than most of these jurisdictions. (b) Anti-avoidance provisions on tax deduction for capital expenditure incurred for the 	

Time Marker	Speaker	Subject(s)	Action Required
		<p data-bbox="598 268 1204 660">purchase of IPRs were generally applied in overseas tax jurisdictions. The United Kingdom and Australia had enacted anti-avoidance provisions to combat avoidance arrangements such as "sale and licence back" and "leveraged licencing". It was noteworthy that these two countries put in place these anti-avoidance provisions in their legislations albeit they had already imposed tax on capital gains, unlike Hong Kong which did not tax capital gain;</p> <p data-bbox="534 705 1204 952">(c) On the meaning of "proprietary interests", reference had been made to other jurisdictions. For instance, in Singapore, a taxpayer had to possess both legal and economic ownership of an IPR before the tax deduction for the purchase cost of the IPR would be granted.</p> <p data-bbox="534 996 1204 1243">Noting that the policy objective of the proposed tax concession was to promote the wider application of IPRs, Ms EU enquired about the rationale for the requirement that the taxpayers must have acquired "proprietary interests" of the specified IPRs. Ms EU further asked whether "proprietary" meant "exclusive".</p> <p data-bbox="534 1288 1204 1400">The Chairman enquired whether tax deduction was not allowed for a taxpayer who partially owned a specified IPR.</p> <p data-bbox="534 1444 1204 1646">The Administration clarified that a taxpayer having partial ownership of a specified IPR could also apply for tax deduction as long as the taxpayer had a share of the legal ownership of the IPR, and the tax deduction would be proportional to the taxpayer's share in the of ownership of the IPR.</p> <p data-bbox="534 1691 1204 1915">The Chairman cited a scenario in which a taxpayer obtained a licence for use of a specified IPR for 10 years. The taxpayer needed to pay an upfront fee to the IPR owner for the licence. The Chairman enquired whether the upfront fee was tax deductible.</p> <p data-bbox="534 1960 1204 2083">The Administration responded that the proposed tax deduction would not be applicable to the scenario mentioned by the Chairman because the taxpayer did not have legal ownership of the IPR.</p>	

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		<p>Under the existing IRO, the requirement for acquisition of legal ownership applied to other tax deductible capital expenditure. The "legal ownership" for registered designs and registered trade marks could be ascertained by the relevant statutory registries which kept registers of designs and trade marks registered under the statutory regime [i.e. the Registered Design Ordinance (Cap. 522) and the Trade Marks Ordinance (Cap. 559) in case of Hong Kong]. As for copyrights for which a registration system was not available, the Copyright Ordinance (Cap 528) provided for the determination of ownership of a copyright. With regard to the upfront fee as mentioned in the scenario cited by the Chairman, the sum was not deductible under the existing IRO as it was capital in nature and it was not deductible under the current proposal as the legal ownership had not been acquired by way of the licence.</p> <p>Ms EU enquired whether tax deduction would only be applicable to outright purchase of a specified IPR and not to an upfront fee paid for acquiring the right to use the IPR for a specified period. The Administration replied in the affirmative, and added that the according to the existing IRO, the expenditure on acquisition of a patent right or right to any know-how could not enjoy tax deduction if it did not involve an outright purchase.</p> <p>The Chairman said that the scenario mentioned by him was common in a knowledge-based economy and suggested the Administration consider granting tax deduction under this scenario.</p> <p>Ms EU enquired why the expenditure incurred in the scenario mentioned by the Chairman was not regarded as operating expenditure, instead of capital expenditure, and thus was tax deductible.</p> <p>The Administration responded that the test to determine whether an expenditure was a capital expenditure or not, according to case law, was whether the expenditure on acquisition would bring into existence an asset or an advantage for the enduring benefit of a trade. In principle, capital expenditure was not a tax deductible item unless otherwise provided for in legislation.</p>	

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		<p>In view of the Administration's response, Ms EU commented that some IPR owners might not be willing to sell the ownership of an IPR, and enquired why the scenario mentioned by the Chairman was not regarded as an operating expenditure instead of capital expenditure.</p> <p>The Administration replied that based on relevant case law, the expenditure on the acquisition of an interest in a capital asset that resulted in enduring benefits for say five years or 10 years would be considered as capital expenditure.</p> <p>The Chairman mentioned that certain kinds of capital expenditure were tax deductible through amortization or depreciation, and that the policy objective of the Bill might be defeated if the scenario mentioned by him, which was common in a knowledge-based economy, was not covered by the tax concession proposal. He requested the Administration to further examine the issue.</p> <p>Mr TO opined that the Administration should consider extending the tax concession proposal to cover the scenario mentioned by the Chairman, if such further expansion was in line with the Administration's policy objective to encourage wider use of the specified IPRs and the chance of abuse for tax avoidance was small.</p> <p>While the Administration undertook to examine the issue and provide a written response, it mentioned that the issue of tax symmetry needed to be taken into account in view that the corresponding capital receipts in the hands of the licensor would not be taxable.</p>	
004546 – 004820	Ms Audrey EU Administration Chairman Ms Miriam LAU Mrs Regina IP	<p>Ms EU requested the Administration to provide a paper to compare the taxation arrangements proposed in the Bill with those of comparable jurisdictions. The Administration undertook to provide such information. Mrs IP suggested that reference should also be made to the taxation arrangements in the Mainland.</p> <p>Ms LAU enquired how the principle of tax symmetry would be considered in conjunction with the policy objective of the Bill. The Administration replied that while the policy objective of the Bill was to promote innovative</p>	The Administration to take action as per paragraph 4 of the minutes.

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		<p>industries through encouraging the use of IPRs, the principle of tax symmetry had to be observed in formulating the relevant proposals. Ms LAU expressed doubt on whether tax symmetry should be an overriding consideration.</p>	
004821 – 005330	Mrs Regina IP Administration	<p>Mrs IP asked whether tax deduction would apply to the situation where the sale and purchase transaction of a specified IPR was conducted in Hong Kong and the IPR was subsequently used in another jurisdiction like the Mainland. Mrs IP also opined that the tax deduction should cover ancillary expenses incurred in the acquisition of the IPR.</p> <p>The Administration responded that the coverage of proposed tax deduction was comprehensive and incidental expenses like legal expenses and valuation fees were included. As for the scenario mentioned by Mrs IP, the Administration explained that the tax deduction would be subject to a number of requirements, including (a) registration of the IPR if applicable; and (b) that the IPR had to be used in producing profits chargeable to tax in Hong Kong.</p> <p>Mrs IP further asked whether tax deduction would apply to the situation where a taxpayer purchased a patent registered in the US and subsequently conducted research and development (R&D) in Hong Kong with the patent purchased to create a new product. The Administration replied that the R&D expenditure incurred for producing profits chargeable to tax in Hong Kong was tax deductible under the existing IRO.</p>	
005331 – 010257	Ms Audrey EU Administration Chairman	<p>Noting that it was proposed in the Bill that the "use in Hong Kong" condition be removed, Ms EU asked whether the requirement that the IPR had to be used in producing profits chargeable to tax in Hong Kong was still necessary. The Administration affirmed that for the tax deduction to apply, the IPR had to be used in producing profits chargeable to tax in Hong Kong.</p> <p>The Chairman asked whether tax deduction would apply to the following scenario: a taxpayer, X, in Hong Kong set up a company, Y, in the Mainland and Y used a specified IPR purchased by X to manufacture goods and produced Hong Kong</p>	

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		<p>chargeable profits to X by selling the goods in Hong Kong.</p> <p>The Administration responded that when an enterprise was set up in the Mainland, it was a legal entity in the Mainland and should pay tax to the Mainland tax authority and not to the HKSAR Government. Based on the tax symmetry principle, that enterprise would not be entitled to tax deduction in Hong Kong. The Administration added that if tax deduction was granted to a taxpayer in Hong Kong for his capital expenditure incurred on the acquisition of a specified IPR and the taxpayer allowed another entity in the Mainland or another jurisdiction to use the IPR at no cost, the other jurisdiction concerned would consider its taxing rights adversely affected. Such arrangement, which was known as "transfer pricing", was discouraged by OECD and might cause other tax jurisdictions to label Hong Kong as a tax haven.</p> <p>Referring to the scenario mentioned by the Chairman, Ms EU asked whether tax deduction would apply if the taxpayer allowed an entity in the Mainland to use the IPR at a cost. The Administration responded that no tax would be collected in Hong Kong either from the Hong Kong taxpayer or the Mainland entity under the scenario. According to the territorial source principle, the profits of the Mainland entity were not produced in Hong Kong, hence not subject to Hong Kong tax. As for the Hong Kong taxpayer who allowed the Mainland entity to use the IPR at a cost, such IPR should be an IPR registered in the Mainland (since the protection of IPR was territorial based) and the licensing fee received by the Hong Kong taxpayer from the Mainland entity was therefore derived from a source outside Hong Kong which was not chargeable to tax in Hong Kong. Since the IPR was not used in producing profits chargeable to tax in Hong Kong (i.e. Hong Kong taxpayer's profits derived from the above overseas licensing arrangement was not subject to Hong Kong tax), the proposed tax deduction would not be provided to the taxpayer.</p> <p>The Chairman suggested that the issue should be further discussed upon meeting with deputations.</p>	

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010258 – 010509	Mrs Regina IP Administration Chairman	<p>Referring to the scenario mentioned by the Chairman, Mrs IP asked whether tax deduction would apply if the taxpayer in Hong Kong had set up a subsidiary instead of an independent company in the Mainland. The Administration responded that the subsidiary would be considered as a separate legal entity in the Mainland and the Mainland entity's profits would not be chargeable to Hong Kong tax.</p> <p>The Chairman considered that extending the proposed tax deduction to the scenario he had mentioned might not affect the interests of other tax jurisdictions because (a) the Mainland had regulatory arrangements in place on transfer pricing; and (b) the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) with Hong Kong might allow more flexible arrangements to be applied in this regard. The Chairman suggested discussing the issue after meeting with deputations.</p>	
010510 – 010711	Mr James TO Administration	<p>Noting that the issues discussed in the meeting were highly technical, Mr TO suggested that the Administration might consider setting out the taxation arrangements for the various scenarios cited by members. In this way, misunderstanding between the Administration and members could be minimized.</p> <p>The Administration agreed to prepare its response as suggested by Mr TO. The Administration mentioned that it was important to uphold the taxation principle that for a taxpayer to be eligible for the proposed tax deduction, the relevant IPR had to be in use by the taxpayer and for the production of profits chargeable to tax in Hong Kong. In view of the revenue loss, it would not be in the interests of Hong Kong to compromise this well-established fundamental taxation principle.</p>	The Administration to take action as per paragraph 4 of the minutes
010712 – 010746	Mr WONG Ting-kwong	Mr WONG opined that extra care should be taken in scrutinizing the proposals in the Bill to avoid creating a trap for the unwary upon implementation of the proposals. Mr WONG also stressed that the business sector did not intend to undermine the taxation principles upheld in Hong Kong.	

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010747– 010809	Chairman	Members agreed that the public and relevant parties should be invited to give views on the Bill.	
010810 – 010910	Mr Abraham SHEK Administration	At Mr SHEK's request, the Administration undertook to provide information on relevant arrangements under CEPA and the view of the Mainland authority on transfer pricing.	The Administration to take action as per paragraph 4 of the minutes
010911 – 011053	Chairman	Date and time of next meeting	

Council Business Division 1
Legislative Council Secretariat
24 May 2011