

財經事務及庫務局
(庫務科)
香港下亞厘畢道
中區政府合署



FINANCIAL SERVICES AND
THE TREASURY BUREAU
(The Treasury Branch)
Central Government Offices,
Lower Albert Road,
Hong Kong

傳真號碼 Fax No. : 2234 9757
電話號碼 Tel. No. : 2810 2229
本函檔號 Our Ref. :
來函檔號 Your Ref. :

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1 June 2011

Ms Anita SIT
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road, Central
Hong Kong
(Fax: 2121 0420)

Dear Ms SIT,

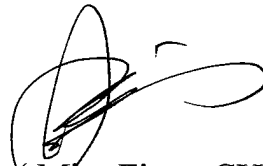
Inland Revenue (Amendment) (No. 2) Bill 2011
Administration's Response to Submissions from Deputations

I refer to the submissions from deputations on the Inland Revenue (Amendment) (No. 2) Bill 2011 ("the Bill"). Due to time constraint, the Administration will provide its responses to the deputations' submissions in two batches. The first batch of the Administration's response is enclosed in the **Annex** of this letter.

The second batch of the Administration's response to the deputations' submission, which covers mainly suggestions/comments on the anti-avoidance provisions proposed by the Bill, will be provided before the meeting of Bills Committee scheduled for 16 June 2011. The

comparison of anti-avoidance provisions in other jurisdictions will also be provided together with the second batch of the Administration's response to the deputations' submissions.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Fiona Chau', written in a cursive style.

(Miss Fiona CHAU)

for Secretary for Financial Services and the Treasury

c.c. Commissioner of Inland Revenue (Attn: Mr Wong Kuen-fai)
Department of Justice (Attn: Miss Betty Cheung)

**Inland Revenue (Amendment) (No. 2) Bill 2011 (“the Bill”)
The Administration’s Responses to Submissions from Deputations
(Part I)**

Item No.	Views/Comments from Deputations	Organisations	The Administration’s Responses
A. General			
1.	No comment on the legislative proposal.	HKBA LSHK	Noted.
B. Coverage			
2.	<p>The proposed scope of tax deduction is not wide enough. For example, the cost for acquiring a government licence for the operation of a telephone network in Hong Kong should be covered.</p> <p>The Administration should clarify whether “customer lists” are covered by the Bill.</p>	HKICPA HKICPA JLCT	<p>The purpose of the Bill is to implement the proposed tax deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trade marks (“the specified IPRs”) as announced in the 2010-11 Budget. Apart from capital expenditure incurred on the purchase of patent rights and rights to any know-how, for which tax deduction has already been provided under the existing Inland Revenue Ordinance (“IRO”), the Bill proposes to provide tax deduction for capital expenditure incurred on the purchase of the specified IPRs as these are commonly used in various industries and are conducive to innovation and upgrading of enterprises in different sectors. This is in line with our “tax neutrality” principle. For the same reason, the proposed tax deduction will not cover the capital expenditure incurred by the telecommunication sector in obtaining a government licence to operate a telephone network in Hong Kong, which does not constitute an IPR.</p> <p>We have compared our tax deduction proposal with similar tax deduction arrangements in other jurisdictions and found that it is common for other</p>

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			<p>jurisdictions to provide tax deduction for the specified IPRs, except in Australia where trade marks are not tax deductible. Moreover, "customer list" per se is not covered by the tax deduction regimes of other jurisdictions. Indeed, IPRs may be used in various commercial activities. We could hardly, if at all possible, spell out specifically all the products and materials containing elements of IPRs for tax deduction purpose. The guiding principle is that tax deduction would be provided as long as it is supported by documentary proof that the subject claim concerned constitutes any elements of the specified IPRs.</p>
3.	<p>The Bill should specify that costs incurred in developing IP in-house or under a cost-sharing arrangement¹ are eligible for tax deduction.</p>	HKICPA	<p>Under the existing section 16B of the IRO, tax deduction will be provided for research and development (R&D) expenditure incurred in developing IP in-house or payment made to an approved research institute for R&D. Cost incurred in developing IPs under a cost-sharing arrangement is not deductible under the said provision as such arrangement is prone to tax abuse.</p> <p>Under the Bill, the above-mentioned cost-sharing arrangement for development of IPs is not eligible for the proposed tax deduction as the Bill seeks to provide tax deduction for capital expenditure incurred on the purchase (not development) of the specified IPRs.</p>
C. Deduction Arrangement			
4.	<p>The Administration should re-affirm that where an IPR owner licenses his/her IPR for use by another person in Hong Kong, the IPR owner would be regarded as having fulfilled the requirement of using the IPR for production of chargeable profits under</p>	HKICPA	<p>The term "use" in the proposed section 16EA(2) has its ordinary meaning which encompasses licensing of IPRs to a licensee.</p>

¹ Where a Hong Kong taxpayer co-develops an IP with its overseas group companies and shares the related costs with those companies.

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	the proposed section 16EA(2).		
5.	The capital expenditure on the purchase of the specified IPRs should be deducted upfront instead of deducted over five succeeding years on a straight-line basis as set out in the proposed section 16EA(3).	HKICPA	The five-year straight-line deduction is proposed having regard to the protection life of the specified IPRs ² . Our proposal of spreading the tax deduction over five succeeding years on a straight-line basis is on par with Singapore and more favourable than the other jurisdictions ³ .
6.	<p>It is unclear how tax deduction would be granted if the registration of an IPR is still being processed at the end of the assessment year in which the capital expenditure for the purchase of the IPR is incurred.</p> <p>Specific provisions should be included in the Bill to retrospectively grant the tax deduction once the registration of the IPR is completed.</p>	<p>HKICPA JLCT</p> <p>JLCT</p>	<p>Recognising that the timeframe for registering IPRs varies, the Inland Revenue Department will adopt a liberal approach in considering tax deduction for IPRs undergoing registration process. For the specified IPRs for which registration systems are available (i.e. registered designs and registered trade marks), tax deduction would be provided to taxpayers for their capital expenditure incurred on the purchase of those IPRs as long as –</p> <ul style="list-style-type: none"> (a) the IPRs purchased have already been registered by the previous owners of the IPRs; and (b) the taxpayers have already submitted applications for registering the IPRs under their names. <p>Given that the registration systems and the time needed for registration of IPRs vary across different jurisdictions (both local and overseas registration are recognised for tax purpose under the Bill), we do not intend to spell out this</p>

² Registered trade mark rights can be perpetual provided that the registration is renewed every ten years. Depending on the type of copyright works, copyrights protection in Hong Kong can last for 25 years; 50 years; or the life of the author of the work plus 50 years posthumously. Design registration is valid up to 25 years provided that the registration is renewed every five years.

³ Other jurisdictions adopt similar or even longer period of tax deduction for capital expenditure incurred on the purchase of the specified IPRs, e.g. Singapore (five years), Australia (statutory effective life of the IPRs), the Mainland China (in general ten years) and the United Kingdom (in line with amortization charged to the accounts).

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			arrangement in the Bill in order not to complicate our tax laws. In this regard, we note that other jurisdictions also have no specific provisions in their tax laws dealing with similar circumstances.
7.	<p>It is unclear what measures would be taken if the registration of an IPR is invalidated, revoked or surrendered after tax deduction has been granted.</p> <p>Specific provisions should be included in the Bill if the legislative intent is that the tax deduction would be clawed back in such circumstances.</p>	<p>HKICPA JLCT</p> <p>JLCT</p>	If the registration of an IPR is invalidated, revoked or surrendered, the IPR will not be eligible for the proposed tax deduction under the Bill. Additional assessment will be made as appropriate to clawback any tax deduction previously allowed by virtue of the existing section 60 of the IRO.
D. Others			
8.	The Administration should negotiate favorable tax treaties with Hong Kong's major trading partners so as to lower the withholding tax rate in cross-border IPR transactions.	HKIPP	<p>As at end May 2011, we have signed 20 comprehensive agreements for the avoidance of double taxation ("CDTAs") with other jurisdictions (10 of which are with our top 20 trading partners).</p> <p>During CDTA discussions, we strive to seek the agreement of our treaty partners to lower their withholding tax rates on royalties to the extent possible.</p>
9.	The Administration should review the Patent Applicant Grant (PAG) Scheme and allow an applicant to obtain multiple grants under the scheme.	HKIPP	<p>We have consulted the Innovation and Technology Commission which oversees the PAG. Its response is that the PAG Scheme aims to encourage inventors to make better use of patents to protect their inventions and gain the experience of how to apply for patents. Given its objectives, the PAG Scheme provides financial support for first-time patent seekers who have no prior experience in patent registration matters.</p> <p>As announced in the 2010-11 Budget, the Government has increased the</p>

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			maximum funding support under the PAG Scheme from \$100,000 to \$150,000 per application.

Abbreviations for Organisations

HKBA	Hong Kong Bar Association
HKICPA	The Hong Kong Institute of Certified Public Accountants
HKIPP	The Hong Kong Institute of Patent Practitioners
JLCT	The Joint Liaison Committee on Taxation
LSHK	The Law Society of Hong Kong

Financial Services and the Treasury Bureau

June 2011