



**Submission to Subcommittee on Three Regulations under the Telecommunications Ordinance (Cap. 106) gazetted on 16 May 2014**

1. Hong Kong Telecommunications (HKT) Limited (“**HKT**”) notes that under the “Telecommunications (Method for Determining Spectrum Utilization Fee) (Administratively Assigned Spectrum in the 1.9-2.2 GHz Band) Regulation”, the Secretary for Commerce and Economic Development (“**SCED**”) intends to:
  - (a) Set the minimum Spectrum Utilization Fee (“**SUF**”) payable by the 3G operators for that part of their spectrum which is offered to them on a right-of-first-refusal basis (“**RFR Spectrum**”) at the higher of:
    - (i) \$66,000 per kHz; or
    - (ii) The average SUF obtained per kHz as derived from the forthcoming 3G spectrum auction in which the opening price has already been set by the SCED at \$48,000 per kHz. If the average SUF per kHz derived from the spectrum auction is higher than \$86,000 per kHz then the SUF payable shall be capped at \$86,000 per kHz.
  - (b) Require the SUF to be paid by the spectrum holder upfront and in one lump sum.
2. HKT objects to these proposals for the reasons below.

***Level of the SUF***

3. HKT sees no reason why the minimum SUF payable by the 3G operators for their RFR Spectrum needs to be set at \$66,000 per kHz given that the opening price for the spectrum auction is only \$48,000 per kHz. By doing so, the SCED is discriminating against the existing 3G operators and directly favoring any potential new entrants taking part in the spectrum auction who may be able to obtain the 3G spectrum at a lower price (\$48,000 per kHz) via the auction as compared to the existing 3G operators who exercise their right-of-first-refusal (\$66,000 per kHz). This discriminatory result is now even more likely given that the market has just lost

one licensee (CSL) and the spectrum auction will have two fewer bidders (HKT and CSL, who are not permitted to participate).

4. To ensure fair play, the minimum SUF payable by the 3G operators for their RFR Spectrum should be set at the same level as the opening price for the spectrum to be auctioned, i.e. \$48,000 per kHz.
5. HKT notes that even at \$48,000 per kHz, this price is still significantly higher than overseas benchmarks for spectrum of this nature. For instance, please refer to the report prepared by Plum Consulting which suggested a reasonable SUF to be set at \$20,000 per kHz.<sup>1</sup>

### ***Upfront lump sum payment of the SUF***

6. When the 3G spectrum was first assigned in 2001, the SUF was payable by the operators on an annual basis over 15 years. As the SUF payments were recurring in nature, the Inland Revenue Department (“**IRD**”) treated the annual SUF payments as “revenue expenditure” and hence tax deductible. Indeed, the Information Memorandum published in respect of the 2001 3G spectrum auction specifically stated that the annual SUF payments would be tax deductible.
7. For spectrum auctions which have taken place since 2001, however, the SCED changed the SUF payment basis from annual payments to an upfront lump sum. HKT understands that the change was intended to reduce the administrative burden of the Government in collecting and ensuring payment of the SUF. Importantly, the underlying nature of the payment for the use of the frequency spectrum remains unchanged despite a change in the payment method.
8. Nevertheless, because of the SCED’s change in SUF payment basis from annual payments to an upfront lump sum, this has resulted in unintended tax consequences. The IRD has regarded the nature of the SUF payment as changed from “recurrent” to “non-recurrent”, therefore this has triggered a change in the nature

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<sup>1</sup> See Plum Consulting’s submission to the Legislative Council Panel on Information Technology and Broadcasting dated 20 March 2013 [LC Paper No. CB(4)523/12-13(02)]

of the expenditure from a deductible “revenue expenditure” to a non-deductible “capital expenditure”. In addition, any corresponding finance costs incurred for funding the SUF payment would have become capital in nature and hence also non-deductible. The IRD is currently challenging one of the 3G operator’s right to treat its upfront lump sum SUF payment as tax deductible.

9. This sudden reversal of position is clearly harsh and unnecessary. Because of the SCED’s decision to change the SUF payment basis, each operator will be required to incur a substantial amount of additional tax (16.5%) in respect of the SUF pertaining to spectrum awarded in auctions going back several years. This additional tax cost would inevitably have to be passed on to the consumers.
10. Going forward, as the IRD will likely adopt the same approach for all SUF which is paid on an upfront lump sum basis, including the SUF pertaining to the 3G spectrum, HKT suggests that the SUF for the RFR Spectrum and the auctioned 3G spectrum be payable on an annual basis so as to enable the SUF payments to continue to be tax deductible.
11. Reverting back to annual SUF payments would be consistent with the basis on which the SUF for the 3G spectrum was previously paid and the manner in which the 2G spectrum SUF payments were handled back in 2006 and 2009. It would also greatly ease the burden on each operator’s cash flow and create no significant burden on the regulator.

Submitted by:

**Hong Kong Telecommunications (HKT) Limited**  
**12 June 2014**