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1 September 2014

Ms Connie SZETO
Clerk to Panel on Financial Affairs
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Ms Szeto,

**Panel on Financial Affairs**

**Matters relating to tax treatment of lump sum spectrum utilization fee payment**

Thank you for your letter of 12 August 2014, inviting the Administration to provide a written response in respect of the tax treatment of lump sum spectrum utilization fee ("SUF") payment.

Over the years, it has been our taxation policy and principle that we do not tax capital receipts and that by symmetry we do not allow deduction of capital expenditure. Section 14(1) of the Inland Revenue Ordinance (Cap. 112) ("IRO") excludes any capital receipts as assessable profits, whereas section 17(1)(c) of the IRO specifically disallows deduction of any expenditure of a capital nature unless it is otherwise explicitly provided for in other sections of the IRO.

On the other hand, by virtue of section 14(1) of the IRO, profits arising in or derived from Hong Kong from carrying on a trade, profession or business in Hong Kong are subject to tax. In ascertaining the profits so charged to tax, section 16(1) of the IRO allows for the deduction of all outgoings and expenses to the extent to which they are incurred in the production of profits chargeable to tax (commonly known as "revenue expenditure").

While there is no definition of capital expenditure or revenue expenditure in the IRO, it has been revealed from case law that whether an expenditure item is capital or revenue in nature is basically a question of law to be decided by reference to the facts and circumstances of each case. In this regard, certain elements are crucial in determining whether an expenditure item is capital in nature, e.g. whether a "capital asset" could be identified for which the payment is made, and whether the expenditure is made "once and for all".

The tax deductibility of SUF payment by mobile network operators involves the issue of whether or not the payment is regarded as capital or revenue expenditure in nature, having regard to the relevant considerations as mentioned above. In other words, whether the SUF payment is made upfront or on an annual basis is not the sole factor for determining the nature of the expenditure.

All along, in assessing the profits tax liability of businesses in Hong Kong, the Inland Revenue Department ("IRD") upholds the above-mentioned principle in determining the tax deductibility of different payments including but not limited to SUF payments. As a follow-up to the concerns expressed by the Subcommittee members and the mobile network operators, the IRD has already met with the representatives of individual operators in early August 2014, as arranged by Hon Charles Mok, and explained the tax policy and related considerations in addressing questions regarding the tax deductibility of SUF payments. Given the official secrecy provision under section 4 of the IRO, the IRD is not in a position to comment or divulge any further information relating to individual cases.

Yours sincerely,

( Kelvin LO )
for Secretary for Financial Services and the Treasury

c.c. Commissioner of Inland Revenue