BY FAX AND BY POST
(2121 0420)

Our Ref.: C/TXP(2), M23953 8 December 2003

Dr. Hon Eric Li Ka-cheung,
Chairman of the Bills Committee,
Inland Revenue (Amendment) Bill 2000,
Legislative Council Building,
8 Jackson Road,
Central, Hong Kong.

Dear Dr Li,

Inland Revenue (Amendment) Bill 2000

Thank you for inviting the Society's views on the proposed Committee Stage Amendments ("CSAs") to the Inland Revenue (Amendment) Bill 2000. Our comments on the proposed changes to the Bill are as set out below.

(i) Clause 5 of the Bill (Section 15 of the Inland Revenue Ordinance)

In our view, the concerns that we raised in our submission to the Bills Committee of 1 December 2000, as well as in subsequent correspondence with the Commissioner of Inland Revenue ("CIR"), in relation to clause 5 of the Bill, have not been fully and adequately addressed. This clause amends section 15, of the Inland Revenue Ordinance ("IRO") in a way that does not appear to us to be justified by the arguments provided, or to be consistent with the "source principle" under the Hong Kong tax regime.

The Inland Revenue Department ("IRD") believes that the decision in the case of *CIR v. Emerson Radio Corp*. [(1999) 2 HKCFAR 501] gave too restrictive an interpretation to the term "use" in s.15(1)(b) and that the proposed section 15(1)(ba) merely puts the position back onto a footing that was widely accepted before the *Emerson* case. In our submission of 1 December 2000, we queried how the existing provision, which relates to the taxation of "sums…..received by or accrued to a person for the use of or right to use in Hong Kong a patent, design, trademark, copyright material…" could, before the *Emerson* case, have been interpreted to include the scope of the proposed s15(1)(ba), which extends to certain "sums…received by or accrued to a person for the use of or right to use outside Hong Kong any patent, design, trademark, copyright material….". We do not agree therefore that this amendment would merely reinstate the position that was accepted generally by taxpayers prior to the *Emerson* case.

In a letter to the IRD of 18 September 2002 (extract attached at the Appendix), the Society also queried the proposed introduction into s15(1)(b) of the IRO of a principle of "symmetry" between the deductibility of an expense by the payer of the royalty in question and the taxability of the receipts in the hands of the payee. We pointed out that to achieve symmetry by taxing an entity that may conduct no business and have

no place of business in Hong Kong was inappropriate and contrary to the source principle. Given the particular nature of the tax system in Hong Kong, we believe that the references to the use of the "deductibility test" in other jurisdictions, quoted by the IRD in response to submissions on the Bill, does not significantly strengthen for the case for introducing the new provision.

Under the circumstances, we do not support the introduction of the proposed s15(1)(ba) under clause 5 of the Bill.

(ii) Clause 6 (IRO, section 16)

(a) New section 16(5A) (grandfathering provisions)

We welcome the efforts of the IRD to define more clearly the scope of the anti-avoidance provisions under s16 of the IRO, through the proposed CSAs. We support the introduction of grandfathering provisions in the proposed s16(5A) to exclude from the operation of the new provisions sums which were the subject of an application to the CIR for advance clearance, or an application under section 88A of the IRO, made before the enactment of the Bill, where the CIR has expressed the opinion that the transaction or arrangement would not fall within the terms of s61A.

However, we would suggest that consideration be given the extending the relevant provisions in a conceptually similar way to s22B(4) of the IRO, so as to include (a) pre-existing sums which were not the subject of an application before the commencement of the Amendment Ordinance, but where the CIR is of the opinion that the transaction or arrangement is of the same type as any in relation to which, in the circumstances prevailing before the commencement of the Amendment Ordinance, he or she would have expressed the opinion that the transaction or arrangement would not fall within the terms of section 61A; and (b) applications made before the commencement of the Amendment Ordinance where the CIR expresses an opinion after that date that the transaction or arrangement would not fall within the terms of s61A.

(b) New section 16(2)(f)

The term "any other stock exchange recognized by the Commissioner for the purpose of this subparagraph" should be more clearly defined, i.e. by reference to a list to be published in an appropriate location.

We trust that you find our comments to be constructive. If you have any questions or comments in respect of the above, please contact the undersigned at 2287 7084.

Yours sincerely,

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)

PMT/ay
Encl.

c.c. Commissioner of Inland Revenue

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Appendix

BY FAX AND BY POST
(2877 1082)

Our Ref.: C/TXP(2), M14456

18 September 2002

Mr. Tam Kuen-chong,
Deputy Commissioner of Inland Revenue,
Inland Revenue Department,
G.P.O. Box 132,
Hong Kong.

Dear Mr. Tam,

Inland Revenue (Amendment) Bill 2000

Thank you for your letter dated 9 July 2002 inviting the Society's comments on the proposed Committee Stage Amendments (CSAs) to the Inland Revenue (Amendment) Bill 2002 ("the Bill"). Our comments on the CSAs are as set out below. We would also refer you to our previous submissions on the Bill, dated : December 2000 and 7 June 2001 respectively.

As a general point, the Society has felt for some time that the Inland Revenue Ordinance (IRO) is in need of an overall revision to make it more simple and easy to understand. Amendments over the years have made it increasingly complex and obscure in terms of the drafting. The proposed CSAs, which contain complex cross-referencing and arguably some ambiguity, will exacerbate this problem and make the need for such a review exercise all the more urgent.

The Scope of the Committee Stage Amendments

Clause 5 (Section 15, IRO) of the Bill

We note from your letter and explanatory note that the purpose of the CSAs is to address the concerns raised over the provisions in Clause 6 of the Bill (covering sections 16(2)(d), (e) and (f) of the Inland Revenue Ordinance (IRO)), i.e. the anti-avoidance provisions relating to deduction of interest expenses. However, the concerns that we have previously raised over Clause 5 (covering section 15, IRO) of the Bill, that it appears to undermine the "source principle" under the Hong Kong tax regime, have not been addressed.

For the reasons given in our previous submissions, we remain unconvinced that the decision in CIR v Emerson Radio Corp. was incorrect or that it changed the position that had applied prior to the decision. On this and other grounds, we have also queried the figure quoted earlier by the Inland Revenue Department (IRD) as the potential loss of revenue that would arise from accepting the outcome of the Emerson Radio case. While we note the desire of the Commissioner to seek "symmetry" between deductibility of an expense by one entity and taxability of the receipts in the hands of recipient, we believe that to achieve it by taxing an entity which conducts no

business and has no place of business in Hong Kong is inappropriate and contrary to the basic tenets of the Hong Kong tax system. Under the circumstances, we continue to oppose the introduction of the proposed section 15(1)(ba) under Clause 5 of the Bill.