

**立法會**  
**Legislative Council**

LC Paper No. CB(1)2719/10-11  
(These minutes have been seen  
by the Administration)

Ref : CB1/BC/4/10/2

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

**Second meeting on**  
**Saturday, 28 May 2011, at 9:30 am**  
**in the Chamber 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 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  
Hon Abraham SHEK Lai-him, 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)

Miss Fiona CHAU  
Assistant Secretary for Financial Services and the  
Treasury (Treasury) (Revenue)

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

Mr Allen NG  
Senior Assessor  
Inland Revenue Department

Miss Betty CHEUNG  
Senior Assistant Law Draftsman  
Department of Justice

Mr Manuel NG  
Government Counsel  
Department of Justice

**Attendance by Invitation** : Hong Kong Small and Medium Enterprises Association

Dr Stephen KWOK  
President

Hong Kong Small and Medium Enterprises  
Development Association

Dr Charlie CHAN  
Forming President

The Taxation Institute of Hong Kong

Mr Bernard WU  
President

Mr Patrick KWONG  
Council Member

**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

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Action

**I Confirmation of minutes of meeting**

(LC Paper No. CB(1)2276/10-11 — Minutes of meeting on 21 April 2011)

The minutes of the meeting held on 21 April 2011 were confirmed.

**II Meeting with deputations and the Administration**

*Submissions/ letters from organizations not attending the meeting*

(LC Paper No. CB(1)2274/10-11(01) — Submission from The Law Society of Hong Kong

LC Paper No. CB(1)2274/10-11(02) — Submission from The Hong Kong Institute of Patent Practitioners

LC Paper No. CB(1)2274/10-11(03) — Submission from Association of Chartered Certified Accountants Hong Kong

LC Paper No. CB(1)2274/10-11(04) — Submission from PricewaterhouseCoopers

LC Paper No. CB(1)2274/10-11(05) — Submission from The Chinese Manufacturers' Association of Hong Kong

LC Paper No. CB(1)2274/10-11(06) — Submission from Hong Kong Institute of Certified Public Accountants

LC Paper No. CB(1)2314/10-11(01) — Submission from Hong Kong Bar Association

LC Paper No. CB(1)2314/10-11(02) — Submission from The Joint Liaison Committee on Taxation)

Discussion

2. The Chairman welcomed representatives of the Administration and deputations to the meeting. He reminded the deputations that their views presented at the meeting would not be covered by the privileges and immunities provided under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382).
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 provide:
  - (a) a paper, in table form, to address the comments/enquiries raised by deputations in their written submissions and during the meeting, setting out the issues raised, the names of the organizations raising the issues and responses of the Administration with explanations on the rationale;  
  
*(Post-meeting note: The Administration provided its written response to the deputations' submissions in two batches (LC Paper No. CB(1)2368/10-11(01) and LC Paper No. CB(1)2447/10-11(01) refer).*
  - (b) information on how it would step up its efforts in negotiating favourable tax treaties (in particular with the United States (US)), and the Government's position on whether the "re-registration" system for the granting of standard patents in Hong Kong should be expanded to recognise the patents granted by the US; and  
  
*(Post-meeting note: The Administration provided information on its efforts in negotiating favourable tax treaties in LC Paper No. CB(1)2356/10-11(01) and LC Paper No. CB(1)2368/10-11(01). Moreover, the Administration provided information on the "re-registration" system for granting of patents in Hong Kong at the 4th meeting of Bills Committee on Inland Revenue (Amendment) (No.2) Bill 2011 held on 14 June 2011. )*
  - (c) written response regarding the different definitions of the term "associate" adopted in the legislation administered by the Inland Revenue Department.

*(Post-meeting note: The Administration provided written response in LC Paper No. CB(1)2447/10-11(01).)*

### **III Any other business**

#### Date of next meeting

5. The Chairman reminded members that the next meeting would be held on 2 June 2011.
6. There being no other business, the meeting ended at 10:55 am.

Council Business Division 1  
Legislative Council Secretariat  
14 July 2011

**Proceedings of the  
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011  
Second meeting on Saturday, 28 May 2011, at 9:30 am  
in the Chamber of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000238 – 000605	Chairman	Confirmation of minutes of meeting on 21 April 2011 (LC Paper No. CB(1)2276/10-11).  Introductory remarks	
000606 – 000854	Hong Kong Small and Medium Enterprises Association (HKSMEA)	Presentation of views. (LC Paper No. CB(1)2335/10-11(01)) HKSMEA mentioned that Hong Kong did not have a dedicated official agency responsible for keeping records of copyright owners and this might give rise to disputes, because one of the requirements for tax deduction was that the taxpayers must have acquired "proprietary interest" of copyrights, registered designs and registered trade marks [the specified intellectual property rights (IPRs)].	
000855 – 001011	Hong Kong Small and Medium Enterprises Development Association (HKSMEDA)	Presentation of views. HKSMEDA supported the Bill and suggested establishing a database on relevant IPRs like copyright. HKSMEDA also mentioned that in view of the increasing integration between Hong Kong and the Mainland, Hong Kong might conduct exchange of data on relevant IPRs with the Mainland.	
001012 – 003155	The Taxation Institute of Hong Kong (TIHK)	Presentation of views. TIHK remarked that it endorsed the submission from the Joint Liaison Committee on Taxation (JLCT). TIHK referred to certain parts of JLCT's submission and raised a number of comments, as follows –  (a) The scope of the Bill was insufficient and additional types of IPRs should be covered to achieve the policy objective of the Bill;  (b) Tax deduction should be allowed for IPRs purchased from an associate under certain circumstances, for example, when a company acquired another company, it was common for the transfer of IPRs to be effected in the group restructuring after the acquisition; TIHK advocated that the transfer of IPRs involved in such company acquisition should enjoy tax deduction;	

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		<p>(c) Unregistered trade marks and designs should also enjoy tax deduction because they might have commercial values;</p> <p>(d) The registration process of some IPRs might be lengthy and such IPRs should enjoy tax deduction retrospectively upon successful applications for registration;</p> <p>(e) The taxation arrangement for invalidated trade marks and designs should be specified clearly in the Bill;</p> <p>(f) TIHK had difficulty in seeing under what circumstances the Commissioner of Inland Revenue could form <i>"the opinion that, having regard to the early termination of the licence, the consideration for the purchase is not reasonable consideration in the circumstances of the case"</i> under the proposed section 16EC(1)(c). TIHK considered that such transactions were arm's length transactions conducted between non-associates and it was unlikely that the consideration for the purchase was not reasonable. TIHK thus submitted that section 16EC(1)(c) was unnecessary;</p> <p>(g) The proposed section 16EC(4)(b) was unnecessary and was inconsistent with the Bill's proposal to remove the condition of "use in Hong Kong". The Administration had not explicitly stated what mischief this section was targeted against;</p> <p>(h) TIHK considered that if a company in Hong Kong, A, allowed an overseas sub-contractor to use an IPR it owned to produce products for it, the profits generated should be regarded as the chargeable profits of A instead of the profits of the overseas sub-contractor; and</p> <p>(i) TIHK considered that the Administration had misinterpreted the international off-setting principle.</p>	
003156 – 003803	Mr James TO TIHK	Mr TO referred to the sentences <i>"In order to avoid any delay in the acquisition process, the Hong Kong company will instead purchase these specified IPRs from the target after the acquisition</i>	

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		<p><i>and by that time, the target has already become an associate of the Hong Kong company. In such case, the costs of acquiring the specified IPRs incurred by the Hong Kong company will be denied for deduction under the proposed section 16EC(2).</i>" in the second last paragraph of the submission of PricewaterhouseCoopers (PwC), and enquired why the purchase of IPRs was usually effected after the acquisition of a company.</p> <p>Mr TO invited deputations present to give their views on whether an escape clause should be provided in the Bill to allow tax deduction for the purchase of IPRs in such circumstances.</p> <p>TIHK remarked that it concurred with PwC's view and considered that an escape clause should be formulated for the purchase of IPRs from an associate under certain circumstances.</p>	
003804 – 004110	Mrs Regina IP	<p>Mrs IP referred to the submission from the Hong Kong Institute of Patent Practitioners (HIPP) and enquired:</p> <p>(a) whether Hong Kong would revamp its patent registration system by drawing reference from the IPR registration system of the United States (US) (which covered lots of IPRs relating to innovation industries), given that Hong Kong wished to develop the "six industries where Hong Kong enjoys clear advantages"; and</p> <p>(b) whether the Administration had signed any tax treaties with Hong Kong's major trading partners like the US to lower the withholding tax rate for cross-border transactions as this would facilitate the development of Hong Kong as an IPR trading, holding and licensing hub.</p> <p>Mrs IP also enquired about the methodology employed by the Commissioner of Inland Revenue in determining the true market value of patent rights or rights to any know-how.</p>	
004111 – 005732	Administration	<p>The Administration responded to the enquires and comments raised by members and deputations as follows:</p>	



<b>Time Marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action Required</b>
		<p>(a) Hong Kong had already established registration systems for trade marks and designs and the Intellectual Property Department (IPD) kept the relevant registers. As for copyright, the international practice, which was based on the Berne Convention, did not require the registration of copyright. Nevertheless, the trade's views would be relayed to the relevant department and bureau.</p> <p>(b) An IPR undergoing the registration process would also be accepted for claiming tax deduction.</p> <p>(c) For an invalidated IPR, the Inland Revenue Department (IRD) would, in accordance with section 60 of the Inland Revenue Ordinance (Cap. 112) (IRO), make additional assessment as appropriate to clawback any tax deduction previously allowed because the IPR concerned was no longer eligible for the tax deduction.</p> <p>(d) The rationale for section 16EC(4)(b) was that the IPR was licensed to another enterprise for use outside Hong Kong and the use did not create any chargeable profits in Hong Kong. The Administration added that Australia had a similar arrangement in its taxation regime.</p> <p>(e) Regarding the issue of transfer pricing, the Organization for Economic Co-operation and Development (OECD) considered that such practice would have adverse impacts on the taxing rights of other jurisdictions. The Administration had liaised with the State Administration of Taxation (SAT) of the Mainland on the issue of transfer pricing and SAT confirmed that transfer pricing adjustments were also applicable to IPR transactions.</p> <p>(f) Many taxation issues raised by deputations were technical and required some time to examine. The Administration would further study the comments made by TIHK.</p> <p>(g) On the anti-avoidance provision in respect of "associate", the provision was drawn up having regard to an avoidance case revealed at</p>	

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		<p>the material time and the provision had been working well. However, the Administration would further study the trade's views.</p> <p>(h) The purpose of the Bill was to implement the proposed tax deduction for capital expenditure incurred on the purchase of the specified IPRs as announced in the 2010-11 Budget. The Administration needed to be prudent on the granting of tax deduction because this would affect public revenue. Besides, the tax symmetry principle had to be observed.</p> <p>(i) The IPR registration system did not fall within the purview of IRD and the public officers present were not in a position to comment on the issue raised by Hon Regina IP.</p> <p>(j) Hong Kong had not entered into double taxation relief agreement with the US at the moment. Hong Kong had asked the US to negotiate for such agreement and yet no feedback was received from the US. The Administration would seek to secure a lower withholding tax rate on passive income when negotiating tax treaties with other trading partners.</p>	
005733 – 010419	Mrs Regina IP	<p>Mrs IP enquired when Hong Kong would revise its IPR registration system so that IPRs registered in the US (particularly patents in the US) would be covered.</p> <p>The Administration responded that it would be more appropriate for IPD to address issues related to IPR registration in Hong Kong. As far as tax deduction in concerned, in general, an IPR registered in an overseas jurisdiction could enjoy the proposed tax deduction as long as (i) the IPR was used to produce chargeable profits in Hong Kong; and (ii) the taxpayers had acquired the "proprietary interest" of the IPR concerned. Since registration and protection of IPRs operated on a territorial basis, when a company purchased an IPR, it actually purchased the ownership of the IPR of a certain jurisdiction. Such interpretation was based on the ruling of a relevant court case.</p> <p>The Chairman cited the following scenario: a trade mark registered in the US was purchased by a</p>	

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		<p>company, which subsequently used it for selling products in Hong Kong and generated chargeable profits. He asked whether the expenditure incurred in the acquisition of the US trade mark could enjoy tax deduction in Hong Kong.</p> <p>The Administration replied that the actual tax arrangement would depend on the actual circumstances and hence the applicable IRO provisions.</p> <p>Mrs IP referred to the submission from the Association of Chartered Certified Accountants Hong Kong (ACCA) and expressed concern whether the current positions of the Bill, especially section 16EC which disallowed deduction of the capital expenditure on the IPRs that were licensed to be used outside Hong Kong, would undermine the policy objective of the Bill.</p>	
010420 – 010952	TIHK	<p>TIHK made the following remarks:</p> <ul style="list-style-type: none"> <li>(a) The Administration's response was tantamount to confirming that the proposed section 16EC(4)(b) did not target a specific mischief. The proposed provision was therefore unnecessary;</li> <li>(b) TIHK disagreed with the Administration's remark that transfer pricing would be harmful to the taxing right of other jurisdictions and the relevant arguments were set out on page 6 of JLCT's submission;</li> <li>(c) TIHK suggested the Administration release its correspondence with the SAT regarding their views on the issue of transfer pricing; and</li> <li>(d) Regarding the scenario cited by the Chairman, TIHK considered that the company should enjoy tax deduction in Hong Kong.</li> </ul>	
010953 – 011314	Chairman Administration Mrs Regina IP	<p>The Chairman requested the Administration to provide a paper, in table form, to address the comments/enquiries raised by deputations in their written submissions and during the meeting. He suggested that the paper should include the following information: (i) the issues raised; (ii) the names of the organizations raising the issues; and (iii) response of the Administration with explanation on the rationale.</p>	<p>The Administration to take action as per paragraph 4 of the minutes.</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Administration agreed to provide the information as per the Chairman's request.</p> <p>Mrs IP requested the Administration to provide information on how it would step up its efforts in negotiating favourable tax treaties (in particular with the US), and the Government's position on whether the "re-registration" system for the granting of standard patents in Hong Kong should be expanded to recognise the patents granted by the US.</p>	<p>The Administration to take action as per paragraph 4 of the minutes.</p>
011315 – 011452	TIHK	<p>TIHK remarked that the existing IRO and the Bill did not have express provisions on the taxation arrangement for invalidated IPRs, and suggested that such provisions should be introduced.</p> <p>TIHK also mentioned that the Administration had stated in its past correspondence with JLCT that customer list was covered by copyright. TIHK considered that copyright might not necessarily cover customer lists and suggested that the Bill should specify that customer list was qualified for tax deduction.</p>	
011453 – 011641	Ms Miriam LAU	<p>Ms LAU pointed out that the term "associate" appeared in a number of legislation and, as far as she could recall, had different definitions in different legislation. Ms LAU suggested the Administration conduct a review and consider standardizing the definitions of the term.</p>	
011642 – 012011	Administration	<p>The Administration stated that the purpose of the Bill was to implement the proposed tax deduction for capital expenditure incurred on the purchase of the specified IPRs as announced in the 2010-11 Budget. The specified IPRs were covered in the Bill because they were widely used by various trades and industries in Hong Kong. The Government needed to uphold the principle of "tax neutrality" and avoid giving preferential taxation treatment only for a particular business sector. It would therefore not be appropriate to spell out in the legislation a specific product such as "customer list" for tax deduction purposes. Tax deduction would be provided as long as there was documentary proof that the subject claim concerned constituted one or more of the specified IPRs. The Administration added that other</p>	

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		<p>jurisdictions did not refer to, in their legislation, "customer list" per se as a kind of IPR for tax deduction purposes.</p> <p>Regarding the various definitions of the term "associate" in different legislation, the Administration said that it would only be in a position to review the legislation administered by the IRD. The Administration remarked that the term "associate" had been defined in various legislation having regard to the respective objectives of the legislation and kinds of activities to be tackled. Therefore, it might not be appropriate to provide a standard definition for the term.</p>	
012012 – 012419	Ms Miriam LAU Chairman	<p>Ms LAU pointed out that the scope of the term "associate" was defined narrowly in the Stamp Duty (Amendment) (No. 2) Bill 2010, but widely in the Bill. It appeared that excessive emphasis had been placed on revenue protection in when defining the term.</p> <p>It was agreed that the Administration would provide a written response regarding the different definitions of the term "associate" adopted in the legislation administered by IRD.</p>	The Administration to take action as per paragraph 4 of the minutes.
012420 – 012452	Chairman	The Chairman remarked that the next meeting would be held on 2 June 2011.	