

立法會
Legislative Council

LC Paper No. CB(1)107/11-12
(These minutes have been seen
by the Administration)

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

Fifth meeting on
Thursday, 7 July 2011, at 8:30 am
in Conference Room A of the Legislative Council Building

- Members present** : Hon Paul CHAN Mo-po, MH, JP (Chairman)
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
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
- Member absent** : 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)

Ms Judy YIP
Senior Assessor
Inland Revenue Department

Miss Betty CHEUNG
Senior Assistant Law Draftsman
Department of Justice

Mr Manuel NG
Government Counsel
Department of Justice

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

I Meeting with the Administration

Follow-up to issues raised at previous meeting

Continuation of discussion of tax deduction arrangements for intellectual property rights involved in cross-border activities

LC Paper No. CB(1)2437/10-11(01) — Paper provided by the Administration on the tax treatment for various scenarios cited by members at the meeting on 21 April 2011 (paras. 8 to 14 are relevant)

LC Paper No. CB(1)2447/10-11(01) — Administration's letter dated 10 June 2011 on matters arising from the meetings on 21 April 2011 and 28 May 2011 (Items No. 6 and 7 of Annex A are relevant)

Clauses-by-clause examination of the Bill

(LC Paper No. CB(3)517/10-11 — The Bill

LC Paper No. CB(1)2628/10-11(01) — Letter from the Administration dated 29 June 2011 regarding the Administration's proposed Committee Stage amendments

LC Paper No. CB(1)1988/10-11(01) — Marked-up copy of the Bill prepared by the Legal Service Division

File Ref: TsyB R 183/535-1/8/0 (10-11) (C) — The Legislative Council Brief issued by the Financial Services and the Treasury Bureau

LC Paper No. LS37/10-11 — The Legal Service Division Report on Inland Revenue (Amendment) (No. 2) Bill 2011

LC Paper No. LS42/10-11 — The Legal Service Division further Report on Inland Revenue (Amendment) (No. 2) Bill 2011

Discussion

The Committee deliberated (Index of proceedings attached at **Appendix**).

(Post-meeting note: Two submissions respectively from the Joint Liaison Committee on Taxation and the Hong Kong Institute of Certified Public Accountants (LC Papers No. CB(1)2687/10-11 and CB(1)2688/10-11 respectively) tabled at the meeting were issued to members on 8 July 2011.)

Admin

Follow-up actions to be taken by the Administration

2. The Administration was requested to take the following follow-up actions:

- (a) relay members' suggestion of extending the proposed tax deduction scheme to more types of intellectual property rights (IPRs) to the Financial Secretary for future consideration outside the context of the Bill;
- (b) provide examples to facilitate members' understanding of the apportionment arrangement under the proposed section 16E(2);
- (c) consider using the same term, i.e. either "true value" or "true market value", in the Inland Revenue Ordinance (Cap. 112) to eliminate potential ambiguity;
- (d) consider whether the drafting of the proposed section 16EC(1)(b) should be refined to reflect the policy intent; and
- (e) provide diagrams at the next meeting to illustrate the various tax avoidance scenarios to be tackled under the proposed section 16EC(4) and the other ensuing anti-avoidance provisions, as well as the relevant escape clauses, in the Bill to facilitate members' understanding of the proposed provisions.

The Administration undertook that the relevant public officer would, in his speech to be delivered upon the resumption of the Second Reading debate on the Bill, state the arrangements to be adopted by the Commissioner of Inland Revenue for determination of the true market value of IPRs for tax deduction purpose.

II Any other business

Date of next meeting

3. Members agreed that the meeting scheduled for 12 July 2011 would be cancelled and the next meeting would be held in the first week of August 2011.
4. There being no other business, the meeting ended at 10:30 am.

**Proceedings of the
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011
Fifth meeting on Thursday, 7 July 2011, at 8:30 am
in Conference Room A of the Legislative Council Building**

Time Marker	Speaker	Subject(s)	Action Required
000234 – 000640	ChairmanMs Audrey EU	The Chairman remarked that he had received two new submissions respectively from the Joint Liaison Committee on Taxation (JLCT) and the Hong Kong Institute of Certified Public Accountants. (He then instructed the Clerk to arrange tabling the submissions.) As members would need time to study the new submissions, he suggested discussing them at the next meeting. Members agreed.	
000641 – 000835	Chairman Administration	<p>Clauses-by-clause examination of the Bill</p> <p>Members agreed to examine the English version of the Bill first.</p> <p>Long title of the Bill</p> <p><u>Clause 1 – Short title</u></p> <p><u>Clause 2 – Inland Revenue Ordinance amended</u></p> <p>Members raised no questions.</p>	
000836 – 001425	Mrs Regina IP Administration Chairman	<p><u>Clause 3 – Section 15 amended (Certain amounts deemed trading receipts)</u></p> <p>Mrs IP enquired whether, apart from the three specified intellectual property rights (IPRs) set out in the Bill, other types of IPRs (like geographical indications and mask work rights) covered by the Convention Establishing the World Intellectual Property Organization (WIPO Convention) could also enjoy the proposed tax deduction.</p> <p>The Administration responded that tax deduction had already been provided in the Inland Revenue Ordinance (Cap. 112) (IRO) for capital expenditure incurred on the purchase of patent rights and rights to any know-how. The Bill was introduced to implement the initiative announced in the 2010-11 Budget to provide tax deduction for capital expenditure incurred on the purchase of three additional types of IPRs, namely copyrights, registered trade marks and registered designs. These three specified IPRs</p>	

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		<p>were chosen because they were commonly used by enterprises in different business sectors of Hong Kong. In view of members' comments, the Administration indicated that if in future the extension of the tax deduction to other types of IPRs could be justified on policy grounds, the Administration would be prepared to consider the merits of the case.</p> <p>Mrs IP suggested that more types of IPRs, e.g. trade secrets, should be covered as this would facilitate the development of a knowledge-based economy in Hong Kong.</p> <p>The Chairman remarked that he understood that JLCT had made a similar suggestion to the Government. He requested the public officers to relay Mrs IP's suggestion to the Financial Secretary.</p>	<p>The Administration to take action as per paragraph 2(a) of the minutes.</p>
001426 – 001521	Ms Miriam LAU Chairman	<p>Ms LAU said that while the suggestion of extending the tax deduction to more types of IPRs worth consideration, given that the scope of the Bill was confined to the above-named IPRs as specified in the long title of the Bill, it would not be appropriate for the Bills Committee to pursue the suggestion. She suggested that the issue be referred to the relevant Panel for follow-up. The Chairman concurred with Ms LAU's view and suggested referring the issue to the Panel on Financial Affairs.</p>	
001522 – 002313	Mrs Regina IP Administration Chairman	<p><u>Clause 4 – Section 16 amended (Ascertainment of chargeable profits)</u></p> <p>Mrs IP remarked that the trades had expressed concern that the taxation treatment in respect of licensing and multiple licensing of IPRs was unclear and requested the Administration to clarify the issue.</p> <p>The Administration reminded that registration and protection of IPRs were operated on a territorial basis. The taxation of IPR licensing would depend on the nature of business operations of individual taxpayers. The Administration explained the relevant arrangements using the following two examples:</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(a) A Hong Kong company P purchased an IPR, say an overseas patent, and licensed the overseas patent to an overseas company Q for use outside Hong Kong. As the licence fee received by company P was derived outside Hong King, it was not chargeable to tax in Hong Kong.</p> <p>(b) A Hong Kong company R purchased an IPR, say an overseas patent, and then licensed the overseas patent to another Hong Kong company S, which then sub-licensed the overseas patent to an overseas company, T, for use of that overseas patent outside Hong Kong. Company S was not the owner of the overseas patent. Company S only obtained in Hong Kong the licence to use the overseas patent from company R, and to sub-license also in Hong Kong the overseas patent to the overseas licensee, company T. Under such situation, company S carried on the business of acquisition and granting of licence in Hong Kong from which it earned sub-licensing income. Based on a relevant case decided by the Privy Council, the sub-licensing income derived by company S was sourced from Hong Kong and thus chargeable to tax in Hong Kong.</p> <p>Mrs IP cited another case where a Hong Kong company X had acquired a company Y in the United States (US), and licensed an IPR owned by company Y to an entity in the Mainland, and enquired about the relevant taxation arrangements.</p> <p>The Administration advised that if company X just acquired the shares in company Y, the ownership of the IPR still belonged to company Y. As such, the receipts in relation to the licensing of the IPR by company Y to an entity in the Mainland did not give rise to any tax issue in Hong Kong as company Y, being a US company, did not carry on any business in Hong Kong.</p> <p>Pointing out that the issue raised by Mrs IP had also been raised by an accounting firm in its submission to the Bills Committee, the</p>	

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		Chairman suggested that the issue be further discussed together with other related issues at the next meeting.	
002314 – 002655	Administration Chairman	<p><u>Clauses 5(1) to 5(4) – Section 16E amended (Purchase and sale of patent rights, etc.)</u></p> <p>Regarding the proposed section 16E(2), the Chairman sought clarification from the Administration as to whether apportionment would be involved. The Administration replied in the affirmative.</p>	
002656 – 003056	Ms Audrey EU Administration Chairman	<p>Ms EU enquired how the arrangement set out in the proposed section 16E(2) (i.e. apportionment) was implemented in practice if a company changed its business mode during the relevant tax assessment period, e.g. using an IPR it owned for its own production activities for part of the year and licensing the IPR to another entity for production activities outside Hong Kong. The Administration explained that the Inland Revenue Department (IRD) would take into account all relevant facts in determining the extent of the use of an IPR in the production of profits chargeable to tax in Hong Kong for a year of assessment.</p> <p>Ms EU remarked that the apportionment computation could be very complex, and enquired whether other jurisdictions adopted similar arrangements. The Administration replied that such apportionment computation was not needed for tax assessment in many other jurisdictions because, unlike Hong Kong, they raised tax on a global basis rather than adopting the "territorial source" principle in their tax regimes. For Hong Kong, the apportionment computation was necessary in order to prevent revenue loss by disallowing deductions for the part of the IPRs not used for the production of chargeable profits.</p>	
003057 – 003532	Mr WONG Ting-kwong Chairman Administration	<p>Mr WONG enquired whether the Administration would consider setting out the relevant formula for apportionment, so that the trades could better understand the issue.</p> <p>The Administration advised that the basic principle and general rules for apportionment were set out in the existing section 16(1) of IRO and the Inland Revenue Rules (Cap. 112 sub.</p>	

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		<p>leg. A) respectively. It was not feasible to stipulate a formula for apportionment for application to all possible scenarios, given the great variety of business modes of the trades. Nevertheless, the Administration would consider enhancing the dissemination of relevant information to the trades with regard to the basic principles and rationale for apportionment.</p> <p>The Administration agreed to provide examples to facilitate members' understanding of the apportionment arrangement under the proposed section 16E(2) at the next meeting.</p>	<p>The Administration to take action as per paragraph 2(b) of the minutes.</p>
003736 – 004048	Mrs Regina IP Administration	<p><u>Clause 5(5) – Section 16E amended (Purchase and sale of patent rights, etc.)</u></p> <p>With regard to an IPR which was subsequently sold after the proposed deductions were allowed, Mrs IP enquired about the taxation arrangement of the sales proceeds of the IPRs given that there was no capital gains tax in Hong Kong and whether the profits tax rate would be applied in computing the tax payable. The Administration confirmed that Hong Kong did not impose tax on capital gains and by symmetry, no deduction would be allowed for capital expenditure save for a few exceptions specified in the IRO, including the deduction provided under the existing section 16E. Under the current section 16E(3) of the IRO, if a deduction of an IPR was allowed and the IPR was subsequently sold, the full sales proceeds would be taxed regardless of the amount previously allowed for deduction. The proposed amendment to the existing section 16E(3) was to limit the taxable amount of sales proceeds to the amount of deduction previously allowed.</p> <p>The Administration further explained that a taxpayer would recover the cost of purchasing an IPR by the sales proceeds received upon the sale of that IPR subsequently. It meant that the cost incurred by the taxpayer for using the IPR in its business was less than the amount of deduction granted to him. Thus, it was fair and logical that the part of the deductions previously allowed, which was recovered from sale proceeds, should be recaptured to tax.</p>	

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		<p>Mrs IP enquired about the circumstances to which withholding tax would be applicable in Hong Kong. The Administration explained that withholding tax would apply where a Hong Kong company licensed an IPR for use from a non-resident licensor. In order to collect tax with respect to the royalty income derived from Hong Kong and received by the non-resident licensor, who did not have any business presence in Hong Kong, the provisions on withholding tax were introduced in 1972 to require Hong Kong payers to withhold the relevant amount of tax payable before making royalty payments to non-resident licensors.</p>	
004049 – 004938	Mrs Regina IP Administration Chairman	<p><u>Clauses 5(6) to 5(10) – Section 16E amended (Purchase and sale of patent rights, etc.)</u></p> <p>Noting that under the proposed sections 16E(7) and 16E(8), the Commissioner of Inland Revenue (the Commissioner) might determine the true market value of a relevant IPR, Mrs IP enquired how the Commissioner would make such determination and whether an appeal mechanism was available.</p> <p>The Administration responded that the tax authorities of other comparable jurisdictions also had the power to determine the true market value of the IPRs in making tax assessment. In claiming the proposed tax deduction, taxpayers would not be required to file the valuation reports on the IPRs concerned together with their tax returns. However, when making tax assessment, IRD might, as it deemed necessary, request taxpayers to provide documentary proof such as valuation reports for the IPRs concerned. For warranted cases, IRD might also seek advice from independent professional valuers on the true market value of the IPRs. Such arrangements would be specified in the Departmental Interpretation and Practice Notes (DIPNs) to be issued. The Administration confirmed that taxpayers could make use of the existing objection and appeal mechanism established under the existing IRO for lodging objections and appeals against IRD's assessment on the true market value of the IPRs.</p>	

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004939 – 005107	Ir Dr Raymond HO Administration	<p>Ir Dr HO enquired how the Commissioner would determine the true market value of an IPR. The Administration replied that determination of true market value would be made on a case-by-case basis and advice from independent professional valuers would be sought if necessary. Ir Dr HO expressed concern that the Commissioner might determine the true market value in a subjective manner.</p>	
005108 – 005846	Ms Miriam LAU Administration Chairman Ms Audrey EU	<p>Ms LAU expressed concern that the Bill did not explicitly specify that (i) the Commissioner should seek the advice of independent professional valuers in determining the true market value of an IPR; and (ii) objection or appeal could be lodged against such a determination by the Commissioner.</p> <p>The Administration remarked that IRD would need to seek the advice of independent professional valuers owing to the lack of in-house expertise in this specialised field. As for the appeal issue, the Administration explained that a statutory objection and appeal mechanism was already provided under the existing IRO. There was no need to make additional provisions about the appeal arrangement in the Bill.</p> <p>The Chairman suggested the Administration specify the arrangements for determining for tax purpose the true market value of an IPR in DIPNs. The Administration responded that it had already undertaken to do so at the last meeting. To further allay members' concern, the Administration undertook that the relevant public officer would state the relevant arrangements in his speech to be delivered upon the resumption of the Second Reading debate on the Bill.</p> <p>Noting that the terms "true value" and "true market value" were used in the existing IRO and the Bill, Ms EU enquired whether the two terms had different meanings. The Administration replied that the two terms had the same meaning for the purposes of the IRO.</p> <p>Ms EU suggested that the Administration consider using the same term, i.e. either "true value" or "true market value", in the IRO to</p>	<p>The Administration to take action as per paragraph 2 of the minutes.</p> <p>The Administration to take action as per</p>

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		eliminate potential ambiguity. The Administration undertook to consider the suggestion.	paragraph 2(c) of the minutes.
005847 – 011543	Administration Mrs Regina IP Chairman	<p><u>Clause 6 – Sections 16EA, 16EB and 16EC added</u></p> <p><i>16EA. Purchase of specified intellectual property rights</i></p> <p>Noting that the tax deduction for the specified IPRs would be spread over five succeeding years on a straight-line basis starting from the year of purchase, Mrs IP enquired whether such deduction method was the same as amortization or depreciation of physical assets.</p> <p>The Administration responded that there were specified schedules under the IRO for calculation of depreciation allowances for different types of machinery or plant, and the amount of depreciation allowance might be different from year to year. The Administration added that compared to other jurisdictions, the proposed tax deduction method for the specified IPRs was more favorable for Hong Kong taxpayers.</p> <p>Mrs IP asked about the rationale for empowering the Commissioner to determine the true market value of a specified IPR for both "sale" and "purchase" transactions. More particularly, Mrs IP queried why such provision was also applicable to "purchase" transactions as they were already historical events. The Administration explained that the Commissioner needed the power to determine the true market value of the purchase cost of an IPR in order to guard against excessive deduction with price inflated artificially. The Administration emphasized that this was an anti-avoidance measure.</p> <p>Mrs IP enquired how the Commissioner would determine the true market value of a specified IPR. The Administration responded that IRD would first request the taxpayer to provide relevant information on the transaction concerned and seek advice from independent professional valuers if necessary.</p>	

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		<p>The Chairman remarked that owing to certain reasons such as an abrupt downturn of the US economy, a taxpayer in Hong Kong might purchase an IPR at a very low price. He asked how IRD would handle such a case under the proposed tax deduction scheme.</p> <p>The Administration advised that IRD would assess each case taking into account all relevant facts.</p>	
011544 – 012019	Administration	<p><u>Clause 6 – Sections 16EA, 16EB and 16EC added</u></p> <p><i>16EB. Proceeds of sale of specified intellectual property rights to be treated as trading receipts</i></p> <p>Members raised no questions.</p>	
012020 – 012114	Administration	<p><u>Clause 6 – Sections 16EA, 16EB and 16EC added</u></p> <p><i>16EC. Deduction under section 16E or 16EA not allowable under certain circumstances</i></p>	
012115 – 012458	Mrs Regina IP Administration Chairman	<p><i>Proposed section 16EC(1)</i></p> <p>Mrs IP requested the Administration to explain the tax-avoidance arrangement that the proposed section 16EC(1) was intended to tackle.</p> <p>The Administration cited the following example: Company A licensed a specified IPR to company B before the commencement of the Bill. After the commencement of the Bill and before the expiry of the licence, company B bought the specified IPR from company A at an unreasonable price. Without this anti-avoidance provision, company B would obtain accelerated deduction of the licence fees by way of turning the fees into the purchase cost. For company A, the previously taxable licence fees would be converted into non-taxable capital receipts.</p> <p>In response to the Chairman's enquiry, the Administration advised that an exceptionally low purchase price in the above scenario was likely to be a transaction created for tax avoidance purpose.</p>	

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012459 – 012721	Ms Miriam LAU Administration Chairman	<p>Ms LAU remarked that when a licensee purchased the IPR under the licence from the owner, there might not be an explicit arrangement to terminate the licence. Given the current drafting of the proposed section 16EC(1)(b), the provision might only catch a "tax avoidance" transaction where there was an explicit arrangement to terminate the licence before the expiry of the licence.</p> <p>The Administration advised that the policy intent was that such an explicit arrangement to terminate the licence was not a necessary condition for the application of the anti-avoidance provision.</p> <p>The Chairman suggested the Administration consider whether the drafting of the proposed section 16EC(1) should be refined to reflect the policy intent.</p>	The Administration to take action as per paragraph 2(d) of the minutes.
012722 – 012903	Administration Chairman	<p><i>Proposed section 16EC(2)</i></p> <p>The Chairman remarked that the definition of the term "associate" would be discussed at the next meeting in the context of merger and acquisition activities.</p>	
012904 – 013147	Administration Mrs Regina IP	<p><i>Proposed section 16EC(3)</i></p> <p>Members had no questions.</p> <p><i>Proposed section 16EC(4)(a)</i></p> <p>Mrs IP enquired whether the "sale and licence back" arrangement in respect of fixed assets was subject to the same anti-avoidance measure under the existing IRO. The Administration replied in the affirmative and advised that section 39E(1)(a) was the relevant provision.</p>	
013148 – 014635	Administration Mrs Regina IP Chairman Ms Miriam LAU	<p>The Administration explained the "sale and licence back" arrangement using a diagram tabled at the meeting.</p> <p>Ms LAU remarked that the diagram only showed an example to which the proposed section 16EC(4)(a) would apply, but did not reflect the conditions set out under the proposed sections 16EC(5) and 16EC(6), which were escape clauses for normal business activities. She</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>suggested that the Administration provide a separate diagram to illustrate the proposed sections 16EC(5) and 16EC(6).</p> <p>The Chairman concurred with Ms LAU's observation.</p>	
014636 – 014806	Mrs Regina IP Administration Chairman	Mrs IP remarked that the "sale and licence back" arrangement was common in some industries like the ship-building industry. The Administration responded that it was aware of this and hence the escape clauses under the proposed sections 16EC(5) and 16EC(6) were provided to cater for normal business activities.	
014807 – 014844	Chairman Administration	The Chairman suggested the Administration provide diagrams to illustrate the various tax avoidance arrangements to be tackled under the proposed section 16EC(4) and the other ensuing anti-avoidance provisions, as well as the relevant escape clauses, in the Bill to facilitate members' understanding of the proposed provisions. The Administration agreed.	The Administration to take action as per paragraph 2(e) of the minutes.
014845– 015931	Mr James TO Chairman Administration Mr WONG Ting-kwong Ms Audrey EU Ms Miriam LAU Mrs Regina IP Mr James TO	Having regarding to the meeting schedules of other Panels and committees and the availability of members, members agreed that the next meeting scheduled for 12 July 2011 would be cancelled, and the next meeting would be held in the first week of August 2011.	
015932 – 020055	Administration Chairman	Taking into consideration that the objective of the proposed tax deduction as outlined in the 2010-11 Budget was to promote the wider application of IPRs, the Administration suggested and the Chairman agreed that it would be more appropriate to refer the issue of extending the proposed tax deduction scheme to cover more types of IPRs to the Panel on Commerce and Industry for future deliberation.	