

**立法會**  
**Legislative Council**

LC Paper No. CB(1)1067/11-12  
(These minutes have been seen  
by the Administration)

Ref : CB1/BC/4/10/2

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

**Seventh meeting on**  
**Thursday, 10 November 2011, at 10:45 am**  
**in Conference Room 3 of the Legislative Council Complex**

**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 Abraham SHEK Lai-him, SBS, JP  
Hon Audrey EU Yuet-mee, SC, JP  
Hon WONG Ting-kwong, BBS, JP  
Hon Mrs Regina IP LAU Suk-ye, GBS, 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**

### Discussion on further submission received and matters arising from the last meeting

(LC Paper No. CB(1)226/11-12(01) — Submission dated 27 October 2011 from the Federation of Hong Kong Industries (English version only)

LC Paper No. CB(1)280/11-12(01) — Administration's response to the written submission from the Federation of Hong Kong Industries and the issues raised at the Bill Committee on 4 August 2011

- LC Paper No. CB(1)305/11-12(01) — Letter dated 8 November 2011 from the Federation of Hong Kong Industries (English version only)
- LC Paper No. CB(1)3043/10-11 — Minutes of meeting on 4 August 2011
- LC Paper No. CB(1)2853/10-11(01) — Administration's letter dated 1 August 2011 on matters arising from the meeting on 7 July 2011 and responses to the submissions from the Joint Liaison Committee on Taxation and the Hong Kong Institute of Certified Public Accountants dated 5 July 2011 and 6 July 2011 respectively)

Other relevant papers

- (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)2686/10-11 — Marked-up copy of the Bill and the Committee Stage amendments proposed by the Administration prepared by the Legal Service Division)

Discussion

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

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Follow-up actions to be taken by the Administration

2. The Administration was requested to take the following follow-up actions:
- (a) to set out in writing the tax deduction arrangements for intellectual property rights (IPRs) used in the various scenarios cited by members during the discussion at the meeting; and

*(Post-meeting note: The Administration issued a letter to Bills Committee on 22 November 2011 which sets out the tax deduction arrangements for IPRs used in various scenarios cited by members.)*

- (b) to provide the final draft version of the Departmental Interpretation and Practice Notes (DIPNs) compiled pursuant to the provisions in the Bill to the Panel on Financial Affairs for its information and comments in due course.

## **II Any other business**

### Legislative timetable

- 3. The Chairman concluded that the Bills Committee had completed scrutiny of the Bill.
- 4. The Chairman informed members of the following legislative timetable:
  - (a) the Bills Committee would report its deliberations to the House Committee on 25 November 2011;
  - (b) the Second Reading debate on the Bill would be resumed on 7 December 2011; and
  - (c) the deadline for giving notice of amendment(s) to the Bill was 28 November 2011.
- 5. There being no other business, the meeting ended at 11:58 am.

Council Business Division 1  
Legislative Council Secretariat  
14 February 2012

**Proceedings of the  
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011  
Seventh meeting on Thursday, 10 November 2011, at 10:45 am  
in Conference Room 3 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
000223 – 000434	Chairman	Introductory remarks	
000435 – 000945	Administration	Briefing by the Administration on paragraphs 1 to 4 of LC Paper No. CB(1)280/11-12(01) ("the paper").	
000946 – 001150	Chairman Administration	<p>The Chairman referred to Scenario B set out in the paper and enquired whether the Hong Kong company would enjoy the proposed tax deduction if the goods, manufactured in the Mainland bearing the trade mark, were sold to the US under a contract signed between the taxpayer and the overseas buyer at a trading exhibition held in Hong Kong.</p> <p>The Administration replied that in Scenario B, the Hong Kong company had only acquired the Hong Kong registered trade mark which conferred the Hong Kong company with the right to use the trade mark solely in Hong Kong. Hence, the Hong Kong company was entitled to the proposed tax deduction only if it had used the Hong Kong registered trade mark for production of profits chargeable to tax in Hong Kong. In other words, the goods had to be sold in Hong Kong. Goods sold to the US were not using the Hong Kong registered trade mark. The same was true for Scenario A.</p>	
001151 – 001337	Administration	Briefing by the Administration on paragraphs 5 to 9 of the paper.	
001338 – 001815	Mrs Regina IP Administration	<p>In reply to Mrs IP's enquiry, the Administration further clarified the application of the proposed section 16EC(4)(b) as follows:</p> <p>(a) if a Hong Kong company purchased a Mainland registered trade mark and then licensed the right to use it to an entity in the Mainland, the license fees received by the Hong Kong company were sourced outside Hong Kong and would not be subject to tax in Hong Kong. The capital</p>	

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		<p>expenditure incurred by the company in the purchase of the Mainland registered trade mark would not be eligible for the proposed tax deduction because no profits chargeable to tax in Hong Kong ("chargeable profits") were produced in the use of the Mainland registered trade mark; and</p> <p>(b) if a Hong Kong company purchased a Mainland registered trade mark and sub-contracted a manufacturer in the Mainland to produce goods bearing the trade mark by granting to the manufacturer a licence for the right to use the Mainland registered trade mark, the proposed section 16EC(4)(b) would be applicable, i.e. the capital expenditure incurred in the purchase of the Mainland registered trade mark for use in the production activities would not be allowed for the proposed tax deduction. If the selling of the above goods in the Mainland were conducted by the Hong Kong company itself with the use of the Mainland registered trade mark and had produced chargeable profits, then the part of the capital expenditure related to such sale activities would be allowable for the proposed tax deduction.</p> <p>Pointing out the growing economic integration between Hong Kong and the Mainland, Mrs IP enquired (a) whether the Inland Revenue Department ("IRD") had sufficient manpower to handle relevant cases arising from the passage of the Bill; and (b) whether IRD would conduct site visits to relevant factories in the Mainland for tax assessment purposes.</p> <p>In reply, the Administration remarked that the taxation regime of Hong Kong was operated under an honour system and IRD would conduct risk assessments for individual cases if necessary. IRD had no plan to conduct site visits to factories in the Mainland, because the cases handled by IRD involved only past transactions that had already taken place and IRD had no law enforcement power in the Mainland. In the generality of cases, IRD would focus on examining documents submitted</p>	

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		<p>by taxpayers. However, if necessary, IRD might collect the required information from the Mainland tax authorities through the Exchange of Information Article under the Avoidance of Double Taxation Arrangement between Hong Kong and the Mainland. Mrs IP suggested the Administration consider conducting such site visits.</p>	
001816 – 002018	Dr Raymond HO Administration	<p>Dr HO referred to Scenario A set out in the paper and enquired whether the proposed tax deduction arrangement would be different if the Hong Kong company concerned was a joint venture with the major partner being an entity in the Mainland.</p> <p>The Administration advised that neither the form of business nor the ownership in the equity interest of the Hong Kong company would affect the proposed tax deduction arrangement.</p>	
002019 – 002134	Chairman Administration	<p>The Chairman referred to paragraph 6 of the paper regarding the application of the proposed section 16EC(4)(b) and enquired whether IRD would set out relevant examples in the Departmental Interpretation and Practice Notes ("DIPNs"). The Administration replied in the affirmative and added that the DIPNs would also cover scenarios A to C set out in the paper. The Chairman suggested that the Administration use hypothetical figures in the DIPNs for illustration.</p>	
002135 – 002741	Ms Miriam LAU Administration Chairman	<p>Ms LAU asked whether the following understanding was correct: whether a Hong Kong company could enjoy the proposed tax deduction depended on whether chargeable profits had been produced by the use of the intellectual property right ("IPR") concerned.</p> <p>The Administration replied that the production of chargeable profits through the use of the IPR concerned was one of the conditions that had to be fulfilled for the proposed tax deduction. The Chairman said that it was the basic condition.</p> <p>Ms LAU expressed concern that after passage of the Bill, the actual tax deduction arrangements would depend on how IRD interpreted the</p>	

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		<p>enacted provisions and determined the applicability or otherwise of the provisions in different actual circumstances. She therefore sought assurance from the Administration that the principles/interpretations set out in the paper would be followed by IRD in its tax assessment work.</p> <p>The Administration advised that IRD had issued DIPNs on determining the source of profits. New DIPNs covering the application of the proposed section 16EC(4)(b) would be issued.</p> <p>The Chairman pointed out that one of the main concerns of the relevant trades was that under certain modes of manufacturing, a Hong Kong company might not be able to enjoy the proposed tax deduction even if the use of the relevant IPR had produced chargeable profits.</p> <p>In reply, the Administration pointed out that the three scenarios set out in the paper were compiled having regard to the comments and concerns of the relevant trades. In response to the request of the Federation of Hong Kong Industries, the DIPNs would set out relevant information including the application or otherwise of the proposed section 16EC(4)(b) under the various scenarios set out in the paper.</p>	
002742 – 003120	Mr WONG Ting-kwong Administration	<p>Mr WONG requested the Administration to clarify how the ownership of IPRs would affect the application of the proposed tax deduction.</p> <p>In reply, the Administration advised that if a Hong Kong company paid for the right to use an IPR which it did not own, the revenue expenditure could enjoy tax deduction as provided under the existing Inland Revenue Ordinance (Cap.112) ("IRO"), but the capital expenditure was not eligible for tax deduction, both under the existing IRO and under the Bill. On the other hand, if the Hong Kong company purchased the proprietary interest of the IPR, the capital expenditure incurred could enjoy the proposed tax deduction under the Bill.</p>	
003121 – 003435	Administration Chairman	Briefing by the Administration on paragraphs 10 to 13 of the paper.	



<b>Time Marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action Required</b>
		<p>The Chairman enquired about the treatment for unregistered IPRs. The Administration advised that under the Bill, for those IPRs for which registration systems were available (i.e. design and trade mark), only registered IPRs (i.e. registered design and registered trade mark) were eligible for the proposed tax deduction.</p>	
<p>003436 – 004001</p>	<p>Ms Miriam LAU Administration Mr WONG Ting-kwong</p>	<p>Ms LAU requested the Administration to provide an example in which the proposed section 16EC(4)(b) of the Bill would be applicable even though the relevant IPR had been used for the production of chargeable profits.</p> <p>The Administration referred to Scenario C of the paper and pointed out that the expenditure incurred by the Hong Kong company in acquiring the proprietary interest of the Mainland registered trade mark for use in the production activities could not enjoy the proposed tax deduction owing to the application of the proposed section 16EC(4)(b).</p> <p>Mr WONG pointed out that a Hong Kong company might pay a lump sum in acquiring the proprietary interest of a trade mark registered both in Hong Kong and in the Mainland, and it would be difficult to apportion this lump sum according to where and how it was used. The Administration advised that the Bill had a clause conferring on the Commissioner of Inland Revenue the power to determine the value of the respective trade marks concerned. The Administration added that it had undertaken to set out the operational details of the relevant provisions in the new DIPNs.</p>	
<p>004002 – 004926</p>	<p>Chairman Administration</p>	<p>The Chairman mentioned that a Hong Kong company A purchased from a US company a trade mark registered both in Hong Kong and the Mainland and then contracted B, a wholly owned enterprise but a separate legal entity set up by A in the Mainland, to produce goods bearing the trade mark by granting to B a licence for the right to use the Mainland registered trade mark. The Chairman then cited the following three scenarios and the respective tax deduction arrangements:</p>	

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		<p><u>Scenario (I)</u>  <i>The goods were sold only in Hong Kong by A and produced chargeable profits.</i></p> <p>The Chairman said that under the above scenario, A could enjoy the proposed tax deduction for the expenditure incurred in the purchase of the Hong Kong registered trade mark, but not the expenditure incurred in the purchase of the Mainland registered trade mark. The Administration confirmed this tax deduction arrangement.</p> <p><u>Scenario (II)</u>  <i>The goods were sold both in Hong Kong and in overseas countries by A and all the profits earned were chargeable profits, as the overseas sales were concluded in Hong Kong.</i></p> <p>The Chairman said that under the above scenario, A could enjoy the proposed tax deduction for the expenditure incurred in the purchase of the Hong Kong registered trade mark, but not the expenditure incurred in the purchase of the Mainland registered trade mark. The Administration confirmed this tax deduction arrangement.</p> <p><u>Scenario (III)</u>  <i>The goods were sold in the Mainland, Hong Kong and overseas countries and since all the sales were concluded in Hong Kong, all the profits produced were chargeable profits of A.</i></p> <p>The Chairman said that under the above scenario, A could enjoy the proposed tax deduction for the expenditure incurred in the purchase of the Hong Kong registered trade mark while apportionment would be made for the expenditure incurred in the purchase of the Mainland registered trade mark.</p> <p>The Administration advised that if the trade mark purchased by A was only registered in Hong Kong and the Mainland, the sales in overseas countries were not a relevant factor in determining the amount of tax deduction allowed for the expenditure on the purchase of the trade mark. The proposed section 16EC(4)(b) would be applicable to the part of</p>	

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		<p>the capital expenditure incurred on the purchase of the Mainland registered trade mark for use in the Mainland manufacturing process. In determining the tax deduction allowed, there would be two rounds of apportionment; the first apportionment was to allocate the expenditure on the purchase of the trade mark, i.e. one on the Hong Kong registered trade mark and the other on the Mainland registered trade mark. The second apportionment was to allocate the expenditure on the purchase of the Mainland registered trade mark between the manufacturing activities and the sale activities both conducted in the Mainland.</p> <p>In reply to the Chairman's enquiry about the basis for the second apportionment, the Administration remarked that the apportionment would be made on a case-by-case basis and a possible approach was to give primary consideration to the respective quantity of the goods produced with the use of the Mainland registered trade mark and the goods sold in the Mainland.</p> <p>The Chairman requested the Administration to set out the tax deduction arrangements for each scenario in the new DIPNs.</p>	
004927 – 005421	Ms Miriam LAU Administration	<p>Ms LAU requested the Administration to provide the Bills Committee with the draft DIPNs compiled in relation to the Bill. The Administration remarked that while the drafting of the DIPNs was underway, the wording used in them would not depart significantly from that mentioned by the Administration during the deliberations of the Bills Committee. Ms LAU suggested that the Administration provide the relevant DIPNs to the Bills Committee before the Bills Committee reported its deliberations to the House Committee. If the Administration could not compile the DIPNs in time, it should forward them to the Panel on Financial Affairs ("FA Panel") for Panel members' information and comments.</p> <p>The Administration responded that it would provide a letter before the Bills Committee reported its deliberations to the House Committee setting out the tax deduction</p>	The Administration to take action as per paragraph 2 of

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		arrangements for IPRs used in the various scenarios cited by members during the discussion at the meeting. The Chairman and Ms LAU agreed to the Administration's suggestion.	the minutes.
005422 – 005715	Administration	Briefing by the Administration on paragraph 14 of the paper. The Administration added that given that the expenses on research and development ("R&D") were already tax deductible under the existing IRO, double deduction would arise if the capital expenditure incurred on the purchase of an IPR from an associate which developed the IPR in-house was allowed to claim the proposed tax deduction.	
005716 – 010338	Mrs Regina IP Administration Chairman	<p>In reply to Mrs IP's enquiry, the Administration advised that if the IPR purchased from an associate was not developed in-house by the associate, the issue of double deduction would not arise. However, IPR transactions between associates were susceptible to abuse and therefore the anti-avoidance measures on "associates" were essential.</p> <p>Mrs IP enquired whether the following expenditure would be regarded as capital expenditure or R&amp;D expenditure: a Hong Kong company exploited the economic downturn of the US and acquired a US company owning a number of IPRs at a very low price. Mrs IP said that she understood from the trades that some countries like the US charged Hong Kong companies withholding tax on IPRs purchased by Hong Kong companies from their countries. She asked whether Hong Kong would negotiate with other countries in particular the US for taxation relief for Hong Kong companies in this regard.</p> <p>The Administration replied that:</p> <ul style="list-style-type: none"> <li>(a) the acquisition of a company was not equivalent to the purchase of IPRs owned by the company;</li> <li>(b) the expenditure incurred in the purchase of IPRs could enjoy the proposed tax deduction subject to the conditions stipulated in the Bill being satisfied; and</li> </ul>	

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		<p>(c) currently, the model double taxation convention of the international community did not contain any article dealing with the type of withholding tax mentioned by Mrs IP, except an article concerning capital gains.</p> <p>The Chairman recapitulated that the issue of IPR transactions between companies involved in merger and acquisition ("M&amp;A") activities had been discussed by the Bills Committee at previous meetings, and the Administration had declined to amend the Bill to provide for an escape clause for the M&amp;A activities. However, according to the Administration, the companies concerned would usually engage professionals to ensure that the M&amp;A transactions would be tax-efficient.</p>	
010339 – 010451	Administration	Briefing by the Administration on paragraphs 15 to 17 of the paper.	
010452 – 010622	Chairman Administration	<p>The Chairman concluded that the Bills Committee had completed the scrutiny of the Bill and informed members of the legislative timetable.</p> <p>The Chairman recapitulated that the Administration would provide a letter to the Bills Committee to set out in writing the tax deduction arrangements for IPRs used in the various scenarios cited by members during the discussion at the meeting.</p>	
010623 – 011342	Administration Chairman Mr WONG Ting-kwong	To allay the concern of the trades and stakeholders, the Chairman requested the Administration to provide the final draft version of the relevant DIPNs to the FA Panel for its information and comments in due course. Mr WONG supported the Chairman's suggestion.	The Administration to take action as per paragraph 2 of the minutes.