

Clerk to the Bills Committee on Inland Revenue  
(Amendment)(No.2) Bill 2011  
Legislative Council  
8 Jackson Road  
Central  
Hong Kong

20 May 2011

Dear Sir

**Inland Revenue (Amendment) (No.2) Bill 2011 (The Bill)**

We refer to your letter dated 26 April 2011. On behalf of ACCA (Association of Chartered Certified Accountants) Hong Kong, we would like to further elaborate our views as expressed in our letter to Hon Paul CHAN Mo-po dated 29 March 2011 regarding the abovementioned Bill.

***Original Intent of the Bill***

As stated in the Legislative Council Brief on the Bill, the justification of the Bill is *"to promote the wider application of intellectual property rights (IPRs) by enterprises, to encourage innovation and upgrading and to facilitate the development of creative industries in Hong Kong"*. With this in mind, ACCA Hong Kong is of the view that the Bill, as currently drafted, will not provide any incentives to achieve this objective, especially with the section 16EC restricting the deduction of the capital expenditures on the IPRs that are licensed to be used outside Hong Kong.

***Licensing specified Intellectual Property for use outside Hong Kong***

Whilst section 16EA provides deduction of capital expenditure on specified intellectual properties, section 16EC confines the deduction to those licensed IPRs that are used in Hong Kong. This means a Hong Kong company which acquires an IPR but license the use outside Hong Kong will be unable to get the deduction under the proposed Bill, even if the IPR is developed by the Hong Kong creative industries.

In the response to our letter, the Administration states *"If a Hong Kong enterprise which has purchased a relevant IPR licenses that relevant IPR to another enterprise for use outside Hong Kong, its royalties (i.e. licensing fees)*

*so derived will generally be regarded as non-Hong Kong sourced income and hence will not be subject to Hong Kong tax .....*". This may not be in line with the current practice and interpretation of the law. We like to draw the Bills Committee's attention to the case law CIR v HK-TVBI Limited [1992] in which the Privy Council ruled that the taxpayer's profits from sub-licensing film rights were sourced in Hong Kong even the rights were only exercisable outside of Hong Kong. The crux of this decision is the royalty could be taxable if the license contract is effected in Hong Kong. In view of the inconsistency, we therefore consider further clarification is necessary.

If the Administration is right (i.e. the royalties income from licensing the relevant IPR to another enterprise for use outside Hong Kong is not of source in Hong Kong), then the deduction of the capital expenditure would be automatically denied under the proposed section 16EA(2) as the right is not used "*in the production of profits in respect of which the person is chargeable to tax...*". As such the exclusion of specified Intellectual Property licensing to be used outside Hong Kong under section 16EC is not necessary. Any abuse of the proposed legislation could also be tackled by the anti-avoidance provision under section 61 and section 61A.

#### ***Use of the IP outside Hong Kong under sub-contracting***

We still hold our view that the proposed section 16EC(4)(b) may also cause problem to the owner of a relevant IP which uses the IP to produce goods through sub-contractors outside Hong Kong. It is common that Hong Kong owns an IP which is used in a production process carried out by a subcontractor outside Hong Kong. In such case, as the production is carried out by a sub-contractor outside Hong Kong, strictly speaking, the IRD may disallow the deduction of the cost of the IP on the ground it is not used by the owner but by someone else (sub-contractor) under license outside Hong Kong. As such, deduction on the cost of the IP will be denied under section 16EC(4)(b). The situation will be similar to the denial of depreciation allowances on plant and machinery under the existing section 39E.

Should you wish to discuss the above suggestions in more detail, kindly please feel free to contact us at 2524 4988.

Yours faithfully



Rosanna Choi  
Chairman