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香港工業總會
FHKI

Hon. Paul Chan
Chairman
Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Hong Kong

CB(1)226/11-12(01)

27 October 2011

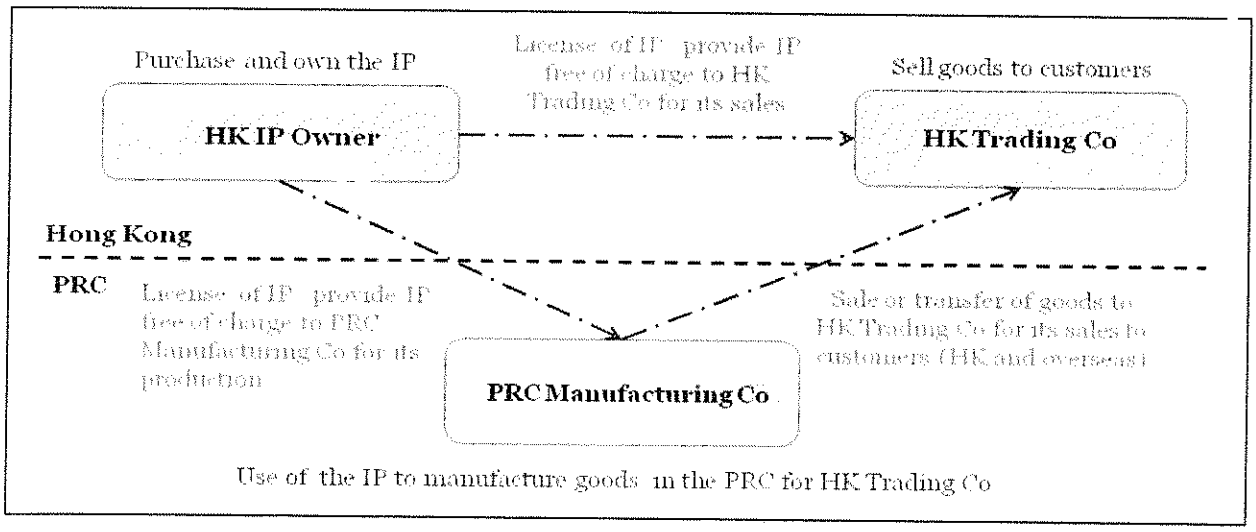
Dear Mr Chan,

Submission on the Inland Revenue (Amendment) (No. 2) Bill 2011

The intention of the Inland Revenue (Amendment) (No. 2) Bill 2011 ("Bill") is to provide tax incentive for Hong Kong enterprises to own and use intellectual property in their operations. As discussed in the meeting between the representatives of Financial Services and the Treasury Bureau ("FSTB") and the Federation of Hong Kong Industries ("FHKI") on 21 October 2011, there are concerns on the benefits that the Bill can bring to the Hong Kong manufacturing enterprises, especially for those that own and use intellectual property in a cross-border manufacturing operation. To this end, the FHKI would like to document these concerns for the Administration's further consideration.

A typical operation model

A recent survey on our members indicated that the operation models for a cross-border manufacturing group are similar and a typical cross-border manufacturing operation can be shown in the following diagram. In our submission below we will refer to this diagram to illustrate the limitation on the tax incentive of the Bill on our members..



Our submission

1. Section 16EC(4)(b) restriction – Use outside Hong Kong by another person

   With the above typical operation model where the intellectual property right ("IP") is owned by a company of the group ("IP owner") and is provided to the other operating companies within the group for use in their production / sales of goods, the current Bill cannot fully benefit most of the cross-border manufacturing businesses in Hong Kong since it disallows deduction of the purchase cost of the IP when the IP is used outside Hong Kong by another person. As we understand from the clarification provided by the Administration, there will be apportionment on the purchase cost according to the territorial use (either production or sales) of the IP. However, there is no relief for the full cost of the IP, especially if the IP is provided for the use in the production / sales without charge.

2. Section 16EA(2), (3) &(6) - Timing of deduction

   While section 16EA(2) provides that the cost of the IP can be deducted if it is purchased for use in producing assessable profits and section 16EA(3) stipulates that the deduction is over 5 years commencing in the year the expenditure is incurred, section 16EA(6) makes it clear that deduction is only allowed when the registration of the IP (in cases of trade mark or design) is in force and the IP has been used in producing assessable profits.

   This creates a limitation on the tax deduction that an enterprise can claim in practice. The time it takes to register the IP in some jurisdictions may take as long as 2 years after acquisition of the IP, This is a concern as there is likely a gap between the time when the IP is purchased (i.e. the time that the 5 years start to count) and the time when the IP is properly registered and ready for use in a given jurisdiction (i.e. the time that the deduction is allowed). As such the enterprise is unable to claim deduction on part of the cost of IP under the current draft.

3. Section 16EC(2) - Anti-avoidance provision on purchase from associate

   Being a specific anti-avoidance provision, we are of the view that section 16EC(2) should not jeopardise deduction claim in cases where common and sound commercial arrangements without any intent of avoiding tax are involved. One of the examples that is relevant to Hong Kong manufacturing groups is where an IP is developed in-house by a group company that is responsible for R&D activities and then the IP is sold to another group company (responsible for manufacturing / trading) for use in the production of assessable profits. In this situation, the use of different and separate group companies to hold the IP and carry out the manufacturing / trading activities is mainly for commercial / legal reason without any intention of avoiding tax. However, under the current broad-brush approach adopted in section 16EC(2), deduction claim of the IP cost will be disallowed.

We hope the FSTB can reconsider the concerns raised above and revise the Bill accordingly.

Yours sincerely,

Roy Chung
Chairman
c.c. Secretary for Financial Services and the Treasury