立法會
Legislative Council

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Paper for the House Committee Meeting on 11 March 2011

Legal Service Division Report on Inland Revenue (Amendment) (No. 2) Bill 2011

I. SUMMARY

1. **Objects of the Bill**	To amend the Inland Revenue Ordinance (Cap. 112) (the Ordinance) to provide for the deduction in ascertaining profits chargeable to tax under the Ordinance of capital expenditure incurred on the purchase of a copyright, registered design or registered trade mark and to make related modifications to tax deduction on the purchase of patent rights and rights to know-how.
2. **Comments**	The Bill, amongst other things – (a) implements the 2010-11 Budget for providing profits tax deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trade marks; (b) for tax deductions allowed on the purchase of patent rights and rights to any know-how, caps at such deductions the taxable sales proceeds upon subsequent disposal and removes the "use in Hong Kong" element requirement; and (c) provides for some commonly used measures against avoidance in respect of the above deduction schemes to deal with (1) "sale and licence back" and "leveraged licensing" arrangements, (2) the purchase of rights at unreasonable consideration, and (3) the determination of the true market value of the rights purchased or sold.
3. **Public Consultation**	The Administration briefed the Joint Liaison Committee on Taxation on the outline of the legislative proposal on 7 October 2010.
4. **Consultation with LegCo Panel**	The Panel on Financial Affairs discussed the legislative proposal on 1 November 2010. The practical benefits that the proposed scheme would bring, the measures to prevent abuse, the tax deduction period and other issue relating to taxation were discussed.
5. **Conclusion**	Members may wish to consider whether a Bills Committee should be formed to discuss the legislative proposal in detail. The scrutiny of the Bill is continuing. The Legal Service Division will report further if necessary.

II. REPORT

Objects of the Bill

To amend the Inland Revenue Ordinance (Cap. 112) (the Ordinance) to provide for the deduction in ascertaining profits chargeable to tax under the Ordinance of capital expenditure incurred on the purchase of a copyright, registered design or registered trade mark, to modify the provisions of the Ordinance governing such deduction of capital expenditure incurred on the purchase of patent rights and rights to any know-how[1], and to provide for incidental matters.

LegCo Brief

2. Members may refer to the LegCo Brief issued by the Treasury Branch of the Financial Services and the Treasury Bureau dated 23 February 2011 (File Ref: TsyB R 183/535-1/8/0 (10-11) (C)) for further information.

Date of First Reading

3. 9 March 2011.

Comments

Background

4. Under our current tax regime, an enterprise's expenditure of a capital nature is not deductible in ascertaining profits chargeable to tax save for certain exceptions. If an enterprise purchases intellectual property rights (IPRs), the purchase consideration which is capital in nature, is generally not deductible except for the capital expenditure incurred on the purchase of patent rights and rights to any know-how.

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1 Know-how means any industrial information or techniques likely to assist in the manufacture or processing of goods or materials.

Copyrights, Registered Designs and Registered Trade Marks

5. In order to promote the wider application of the IPRs by enterprises, to encourage innovation and upgrading and to facilitate development of creative industries in Hong Kong, the 2010-11 Budget proposed to provide profits tax deduction for capital expenditure incurred on the purchase of three types of IPRs, namely copyrights, registered designs and registered trade marks (the specified IPRs).

6. Clause 6 of the Bill proposes to add new sections to the Ordinance for implementing this proposal. Proposed new section 16EA provides that in ascertaining profits chargeable to profits tax, any capital expenditure (including legal expenses and valuation fees) incurred on the purchase of the specified IPRs for use in the production of chargeable profits is deductible[2]. Tax deduction for the specified IPRs is to be spread over five succeeding years on a straight-line basis commencing from the year of purchase. According to the LegCo Brief, this proposed tax deduction period is on par with or more generous than similar tax concessions in other tax jurisdictions. Where a specified IPR, being a copyright or registered design, reaches the end of its maximum period of protection within the five-year deduction period, the deduction is to be spread in equal amounts over the number of years during which the protection of the specified IPR subsists.

7. Proposed new section 16EB states that if a deduction has been allowed to a taxpayer in respect of a specified IPR under the proposed tax deduction scheme and that such specified IPR is subsequently sold by him, the sales proceeds of the specified IPR to be subject to tax are capped at the deduction previously allowed. This is in line with the proposed amendment suggested to be made to the current tax deduction regime in respect of patent rights and rights to any know-how as set out in paragraph 9 below.

Patent Rights and Rights to any Know-how

8. Section 16E of the Ordinance contains the current scheme which allows the expenditure on the purchase of patent rights or rights to any know-how for use in Hong Kong in the production of profits to be deducted in ascertaining the profits chargeable to tax.

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[2] To be eligible for the proposed tax deduction, taxpayers must have acquired the "proprietary interest" of the specified IPRs. Besides, the specified IPRs must be in use for the production of chargeable profits. If a specified IPR is used partly in the production of chargeable profits, deduction is only allowed for the portion of expenditure that is relevant to the production of such profits.

9. Under the current regime, if the cost of patent rights or rights to any know-how has been allowed as a deduction from a taxpayer's taxable profits, then the full sales proceeds on the subsequent disposal of such rights by him will be subject to tax. Presently, all the depreciation/deduction claw-back rules in the Ordinance, except for patent rights and rights to any know-how, cap the extent of taxable sales proceeds at deductions previously allowed. For alignment purpose, clause 5(5) of the Bill proposes to modify the current section 16E(3) of the Ordinance so that if a tax deduction has been allowed to a taxpayer in the purchase of such rights, the sales proceeds obtained in his subsequent disposal of such rights to be brought to tax are capped at the amount of the deduction as previously allowed.

10. The Administration observes that with the globalization of the world economy, business activities are no longer confined to Hong Kong and that provisions governing other deductible capital assets under the Ordinance do not impose the "use in Hong Kong" condition. Clause 5(1) of the Bill therefore proposes to remove the "use in Hong Kong element" from the condition of allowing tax deduction for patent rights and rights to any know-how. Tax deduction would be allowed on the purchase of such rights regardless of whether they are used in Hong Kong as long as they are used in the production of chargeable profits.

11. The Administration currently takes the view that legal expenses and valuation fees incurred in connection with the purchase of such rights are deductible under the current scheme despite the absence of express provision. To avoid doubt, clause 5(2) of the Bill suggests to add new section 16E(1A) to the Ordinance to expressly state that such expenses and valuation fees are deductible.

Anti-avoidance Provisions

12. Tax deduction for capital expenditure on IPRs may be prone to abuse. Accordingly, clauses 5(10) and 6 of the Bill propose to add new provisions to the Ordinance to guard against possible tax avoidance.

13. Proposed new section 16EC(2) states that deductions will not be allowed for patent rights, rights to any know-how or the specified IPRs purchased wholly or partly from an associate. The definition of "associate" is contained in proposed new section 16EC(8), which is modelled upon the definition of the same expression that applies to the current tax deduction regime on patent rights and rights to know-how under section 16E(4) of the Ordinance.

14. Proposed new section 16EC(4) to (7) provides that deduction will not be allowed for the purchase of these rights under "sale and licence back" and "leveraged licensing" arrangements with an escape provision so that, according to the LegCo Brief, normal business activities would not be affected.

15. Proposed new sections 16E(8) and 16EA(9) empower the Commissioner of Inland Revenue (CIR) to determine, where the circumstances so warrant, the true market value for any purchase or sale of these rights in respect of which a tax deduction is claimed. The deduction to be allowed will be restricted to the true market value so determined. Further, where these rights are purchased or sold together or with any other assets for a single consideration, proposed new sections 16E(7) and 16EA(8) confer power to the CIR to allocate a consideration for each individual asset as purchased or sold having regard to all the circumstances of the transaction.

16. According to the LegCo Brief, in order to deter taxpayers from purchasing the specified IPRs that have already been used by them under a licence solely for tax benefits when the proposed scheme is introduced, proposed new section 16EC(1) provides, as a transitional arrangement, that a deduction will not be allowed if the taxpayer terminates the licence before its expiry and purchases the specified IPRs at unreasonable consideration.

Commencement

17. The Bill, upon enactment, will come into operation upon its gazettal.

Public Consultation

18. The Administration briefed the Joint Liaison Committee on Taxation on the outline of the legislative proposal on 7 October 2010. According to the Administration, the proposal set out in the Bill have already taken on board some of their comments as appropriate.

Consultation with LegCo Panel

19. The Panel on Financial Affairs discussed the legislative proposal to provide profits tax deduction for capital expenditure incurred on the purchase of the specified IPRs on 1 November 2010. Panel members did not raise objection to the proposal, and the following issues were discussed –

(a) the practical benefits the proposed tax deduction scheme would bring to enterprises;

(b) measures to prevent abuse of the tax deduction proposal; and

(c) the tax deduction period and reciprocal taxation arrangements.

20. The Administration responded on the above issues at the Panel meeting and members did not request for supplementary information or further discussion of the proposal. Save for the reciprocal taxation arrangements, proposed new sections 16EA and 16EC pursuant to clause 6 of the Bill deal with the issues raised by the members.

Conclusion

21. Members may wish to consider whether a Bills Committee should be formed to discuss the legislative proposal in detail. The scrutiny of the Bill is continuing. The Legal Service Division will report further if necessary.

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LS/B/8/10-11