

立法會
Legislative Council

LC Paper No. LS42/10-11

**Paper for the House Committee Meeting
on 18 March 2011**

**Further Report by the Legal Service Division on
Inland Revenue (Amendment) (No. 2) Bill 2011**

Members may recall that at the meeting of the House Committee on 11 March 2011, the Legal Service Division reported that the scrutiny of the Inland Revenue (Amendment) (No. 2) Bill 2011 was continuing. The purpose of the Bill is to implement the 2010-11 Budget for providing profits tax deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trade marks, to make related modifications to the current tax deduction regime on the purchase of patent rights and rights to know-how, and provide for some commonly used measures against tax avoidance in respect of these schemes under the Inland Revenue Ordinance (Cap. 112) (the Ordinance). This paper reports on the outcome of the scrutiny.

2. The Legal Service Division made enquiries regarding the Bill on 11 March 2011 (copy of the letter is at Annex I). The Administration replied to us on 16 March 2011 (copy of the letter is at Annex II).

Committee Stage Amendments (CSAs) Proposed by the Administration in Response to our Enquiries

3. To guard against tax avoidance, tax deductions will not be allowed for the above intellectual property rights purchased wholly or partly from an associate. Proposed new section 16EC(8) provides for the definition of "associate" in relation to a person in question. Under the current drafting, where the person in question is a natural person (Mr X), a corporation which is controlled by a relative of Mr X is not an associate of Mr X whereas a corporation which is controlled by a relative of Mr X's partner is. We have clarified with the Administration regarding this interpretation. The Administration confirms that it is in fact the policy to include such corporation as an associate of Mr X. Accordingly, the Administration will propose CSA to the definition of "associate" to reflect this policy.

4. We have enquired whether there is any inconsistency to use "expenditure" in the current section 16E of the Ordinance (which concerns with patent rights and rights to any know-how) and "capital expenditure" in the proposed new section 16EA (which deals with copyright, registered design and registered trade mark) given that both sections refer to the expenditure of the same nature. The Administration agrees to propose CSA to replace references to "expenditure" by "capital expenditure" in section 16E(1) of the Ordinance and other appropriate provisions in the Bill for consistency sake.

5. Currently under section 16E(5) of the Ordinance, "share" is inaccurately rendered as "股份" in the Chinese text. CSA will be proposed to replace "股份" by "部分".

6. With respect to Chinese text of the definition of "控制" under proposed new section 16EC(8), "該法團" whenever it appears should be substituted by "首述法團". The Administration confirms that it will propose CSA to make amendments.

The Administration's Responses to our other Enquiries

7. Upon our enquiries, the Administration has clarified on the following matters –

- (a) the difference in policy approach regarding the tax deduction period under the proposed tax deduction scheme in respect of copyrights, registered designs and registered trademarks (where tax deduction will be spread over five succeeding years on a straight-line basis starting from the year of purchase or a lesser number of years in specified circumstances) and the current tax deduction regime applicable to patent rights and rights to any know-how (where a one-off tax deduction will be made in the relevant year of assessment);
- (b) the policy reason for excluding a registered trade mark from the scope of the proposed new section 16EA(4); and
- (c) Whether in the Chinese text of proposed new section 16EA(12), where "a share or interest" is rendered as "部分或權益", the term "部分" for "share" is the appropriate rendition.

8. The Legal Service Division has no follow-up queries in relation to the Administration's responses set out in paragraph 7 above. No further issue in the drafting and legal aspects of the Bill have been identified.

Encl.

Prepared by

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Legislative Council Secretariat
17 March 2011

LS/B/6/10-11

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By Fax (2868 5279)
11 March 2011

Miss Fiona CHAU
Assistant Secretary for Financial Services &
the Treasury (Treasury) (R)2
Financial Services and the Treasury Bureau
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Central Government Offices
Hong Kong

Dear Miss CHAU,

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

I am scrutinising the Inland Revenue (Amendment) (No. 2) Bill 2011 (the Bill) and should be grateful if you could clarify the following issues:

(a) Tax Deduction Period

Under the proposed tax deduction scheme in respect of copyrights, registered designs and registered trademarks contained in proposed new section 16EA, tax deduction will be spread over five succeeding years on a straight-line basis starting from the year of purchase (or a lesser number of years in specified circumstances). This is to be contrasted with the tax deduction regime applicable to patent rights and rights to any know-how under section 16E of the Inland Revenue Ordinance (Cap. 112) (the Ordinance) where a one-off tax deduction will be made in the relevant year of assessment. Please clarify the difference in policy approach.

(b) The Scope of Proposed New Section 16EA(4)

It is noted that proposed new section 16EA(4) only deals with the circumstances where a copyright or registered design reaches the end of its maximum period of protection within the five-year deduction period, but not in respect of a registered trade mark. Please clarify the policy reason for such exclusion where the registration of a trade mark is not renewed.

(c) Definition of "Associate"

Proposed new section 16EC(8) provides for the definition of "associate" in relation to a person in question. Where the person in question is a natural person (Mr X), it appears from paragraph (a)(v) of the definition that a corporation which is controlled by a relative of Mr X is not an associate of Mr X whereas a corporation which is controlled by a relative of Mr X's partner is. Please clarify.

(d) Drafting Issues

- (i) When delineating the expenditure incurred on the purchase of the relevant intellectual property rights, proposed new section 16EA (which deals with copyright, registered design or registered trade mark) uses the expression "capital expenditure" whereas the current section 16E of the Ordinance (which concerns with patent rights and rights to any know-how) simply refers to "expenditure". Is there any inconsistency in wording in apparently similar contexts?
- (ii) In the Chinese text of proposed new section 16EA(12), "a share or interest" is rendered as "部分或權益". Please clarify whether "部分" for "share" is the appropriate rendition.

(iii) In the Chinese text of the definition of "控制" under proposed new section 16EC(8), should "該法團" whenever it appears rather be "首述法團"?

(e) The Chinese text of section 16E(5) of the Ordinance

Under section 16E(5) of the Ordinance, the mirrored section of proposed new section 16EA(12), "share" is rendered as "股份" in the Chinese text. Please note also our comments set out in paragraph (d)(ii) above.

It is appreciated that if your reply in both languages could reach us as soon as possible, preferably before noon on 16 March 2011.

Yours sincerely,

(Ms Wendy KAN)
Assistant Legal Adviser

c.c. DoJ (Attn: Miss Betty CHEUNG, SALD) Fax No.: 2869 1302
DoJ (Attn: Mr Manuel NG, GC) Fax No.: 2536 8104
Clerk to House Committee

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16 March 2011

Ms Wendy KAN
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Dear Ms KAN,

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

I refer to your letter dated 11 March 2011, seeking clarifications from the Administration on a number of issues in relation to the Inland Revenue (Amendment) (No. 2) Bill 2011 ("the Bill"). The Administration's replies are set out in ensuing paragraphs.

(a) Tax Deduction Period

As indicated in the Legislative Council Brief on the Bill (File Ref.: TsyB R 183/535-1/8/0 (10-11) (C)), we have taken into consideration the protection life of a copyright, registered design and registered trade mark in proposing the tax deduction period. A registered trade mark can be perpetual provided that the registration is renewed every ten years. Broadly speaking, depending on the type of copyright work, a copyright may be protected in Hong Kong for 25 years; 50 years; or the life of the author of the work plus 50

years posthumously. Design registration is valid up to 25 years provided that the registration is renewed every five years.

As the protection life of each of the above three types of intellectual property rights (“specified IPRs”) is generally longer than that of patent rights and rights to any know-how¹, we have proposed to spread the tax deduction for specified IPRs over five succeeding years on a straight-line basis starting from the year of purchase. For tax deduction period for capital expenditure on purchase of specified IPRs, some tax jurisdictions adopt similar or even longer period of deduction e.g. Singapore (in general five years), the United Kingdom (in line with amortization charged to the accounts) and the United States (15 years). Our proposed five-year deduction period is therefore on par with or even more generous than deduction periods applicable to similar tax concessions in other tax jurisdictions.

(b) The Scope of Proposed New Section 16EA(4)

The proposed new section 16EA(4) is only applicable to those cases involving a specified IPR with a maximum protection life that is due to expire before the end of the succeeding five-year deduction period proposed in the new section 16EA(3). Upon the end of its maximum period of protection, the relevant specified IPR would expire, i.e. no longer subsist. We therefore propose in the new section 16EA(4) to shorten the deduction period by spreading the deduction in equal amounts over the number of years during which the protection of the relevant specified IPR still subsists so that the relevant taxpayer can still enjoy the tax deduction in full during the remaining time of that maximum protection period. It should be noted that the protection offered to a registered trade mark in Hong Kong can be perpetual (i.e. without time limit) provided that the registration is renewed by the owner every ten years in accordance with the Trade Mark Ordinance. Hence, the special treatment offered by the new section 16EA(4) would not be applicable to registered trade marks. In other words, the succeeding five-year deduction period proposed in the new section 16EA(3) will be applicable to –

- (i) a copyright or registered design with a maximum protection period that straddles the proposed succeeding five-year deduction period; and
- (ii) a registered trade mark.

It is also worth noting that for a design or trade mark for which the registration requirement is applicable, as stipulated in the proposed new section

¹ As far as protection of a patent is concerned, a short-term patent is renewable for a maximum term of eight years whereas a standard patent is renewable annually after the initial three years for a maximum term of 20 years. In general, rights to any know-how are protected by commercial contracts.

16EA(6)(c) and (d), tax deduction would only be allowed if its registration is in force during a part or the whole of the basis period of a year of assessment for which deduction is to be allowed. Deduction would not be allowed if a taxpayer who has the right fails to renew the registration of the relevant design or trade mark within the tax deduction period.

(c) Definition of “Associate”

The definition of “associate” in the proposed new section 16EC(8) in clause 6 of the Bill pertains to the application of anti-avoidance provisions. We confirm that it is our policy to include any corporation which is controlled by any relative of the subject person (i.e. the “*first-mentioned person*” as defined in that definition) as an associate of the subject person. To reflect this policy, we would propose Committee Stage Amendment (CSA) to paragraph (a)(v) of the definition of “associate” in the proposed new section 16EC(8), such that any corporation controlled by any relative of a person will be an “associate” of that person.

(d)(i) The use of “capital expenditure”

We confirm that the word “expenditure” used in the existing section 16E means “capital expenditure”. For consistency sake, we would propose CSA to make textual amendments to replace references to “expenditure” by “capital expenditure” in the following provisions –

- the existing section 16E(1) of the Inland Revenue Ordinance (by adding a new sub-clause under clause 5 of the Bill);
- clause 5(3) of the Bill (pertaining to the proposed new section 16E(2));
- clause 5(6) of the Bill (pertaining to the proposed new section 16E(3A));
- clause 5(10) of the Bill (pertaining to the proposed new section 16E(8)(a)); and
- clause 6 of the Bill (pertaining to the proposed new section 16EC(6)).

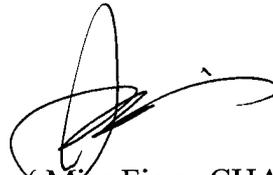
(d)(ii) & (e) The Chinese text of “a share or interest”

In the proposed new section 16EA(12), the “share” in a specified IPR refers to “part” of the specified IPR. As such, “部分” is the appropriate Chinese rendition for “share”. In fact, this Chinese rendition is used in the existing section 16B(5)(c) (Added 32 of 1998 s. 7). For consistency sake, we would propose CSA to add a new sub-clause under clause 5 of the Bill to make textual amendment to the Chinese text of the existing section 16E(5), i.e. replacing “股份” by “部分”.

(d)(iii) The Chinese definition of “控制”

While we consider that there is no ambiguity in interpretation that “該法團” (whenever it appears) refers to “首述法團” in the Chinese text of the definition of “控制” in the proposed new section 16EC(8), we have no problem to replace “該法團” (whenever it appears) by “首述法團” to tally with the English text. In this regard, we would propose CSA to make textual amendments to the Chinese text of clause 6 (pertaining to the Chinese definition of “控制” in the proposed new section 16EC(8)) of the Bill to replace “該法團” (whenever it appears) by “首述法團”.

Yours sincerely,



(Miss Fiona CHAU)

for Secretary for Financial Services and the Treasury

c.c. Clerk to House Committee
DoJ (Attn: Miss Betty CHEUNG, SALD)
DoJ (Attn: Mr Manuel NG, GC)
CIR (Attn: Ms Judy YIP)