

立法會
Legislative Council

LC Paper No. CB(1)1311/17-18
(These minutes have been seen
by the Administration)

Ref : CB1/BC/8/17

Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2018

**Minutes of first meeting held on
Friday, 18 May 2018, at 8:30 am
in Conference Room 2 of the Legislative Council Complex**

- Members present** : Hon Kenneth LEUNG (Chairman)
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon Paul TSE Wai-chun, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHUNG Kwok-pan
Hon Alvin YEUNG
Hon CHAN Chun-ying
- Member absent** : Hon Dennis KWOK Wing-hang
- Public Officers attending** : Agenda item II
Innovation and Technology Bureau

Mr Ricky CHONG
Principal Assistant Secretary for Innovation and
Technology
Innovation and Technology Commission

Ms Annie CHOI, JP
Commissioner for Innovation and Technology

Mr WONG Wang-wah
Assistant Commissioner for Innovation and
Technology (I&Q Services)

Inland Revenue Department

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)

Ms Michelle CHAN
Senior Assessor

Department of Justice

Ms Mandy NG
Senior Government Counsel

Ms Annet LAI
Government Counsel

Clerk in attendance : Mr Derek LO
Chief Council Secretary (1)5

Staff in attendance : Mr Alvin CHUI
Assistant Legal Adviser 3

Ms Ada LAU
Senior Council Secretary (1)7

Ms Michelle NIEN
Legislative Assistant (1)5

Action

I. Election of Chairman

Mr WONG Ting-kwong, the member who had the highest precedence in the Council among members of the Bills Committee present at the meeting, presided over the election of Chairman of the Bills Committee. He invited nominations for the chairmanship.

2. Mr CHAN Chun-ying nominated Mr Kenneth LEUNG and the nomination was seconded by Mr Alvin YEUNG. Mr LEUNG accepted the nomination. There being no other nomination, Mr Kenneth LEUNG was elected Chairman of the Bills Committee. Mr LEUNG then took over the chair. Members agreed that there was no need to elect a Deputy Chairman.

II. Meeting with the Administration

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| (LC Paper No. CB(3)524/17-18 | — The Bill |
| File Ref: ITC CR 5/1/2168/18 | — Legislative Council Brief issued by the Innovation and Technology Bureau, the Financial Services and the Treasury Bureau, and the Innovation and Technology Commission |
| LC Paper No. LS55/17-18 | — Legal Service Division Report |
| LC Paper No. CB(1)957/17-18 (01) | — Mark-up copy of the Bill prepared by the Legal Service Division (Restricted to members only) |
| LC Paper No. CB(1)957/17-18 (02) | — Assistant Legal Adviser's letter dated 8 May 2018 to the Administration |
| LC Paper No. CB(1)957/17-18 (03) | — The Administration's reply letter to Assistant Legal Adviser's letter dated 8 May 2018 |
| LC Paper No. CB(1)957/17-18 (04) | — Paper on Inland Revenue (Amendment) (No. 3) Bill 2018 prepared by the Legislative Council Secretariat (background brief) |

LC Paper No. CB(1)982/17-18(01) — Letter dated 17 May 2018 from Dr Hon Elizabeth QUAT (Chinese version only) informing the Bills Committee of her withdrawal from the Bills Committee)

3. The Bills Committee deliberated (index of proceedings in the **Appendix**). The Chairman declared that he was a member of the Joint Liaison Committee on Taxation.

Follow-up actions to be taken by the Administration

4. The Administration was requested to provide the following information:
- (a) of the 32 new technology products or services that had been tested in the Fintech Supervisory Sandbox, a detailed account of the classification and distribution of the participating technology firms, including but not limited to universities, research institutions defined as approved research institutes under section 16B of the Inland Revenue Ordinance and other institutions;
 - (b) how the distribution pattern in (a) above compared with the distribution of institutions undertaking research and development projects for industries regarded as those in the "old economy";
 - (c) the number of local firms/institutions engaging in biometric authentication;
 - (d) questions raised by Hon WU Chi-wai in his letter of 18 May 2018 enquiring on the vetting and approving work by the Innovation and Technology Commission relating to tax deduction for expenditure on research and development [LC Paper No. CB(1)994/17-18(01)]; and
 - (e) how the Administration would incentivize overseas research and development institutions to establish their branches in Hong Kong and encourage the further development of innovation and technology by its various policy initiatives and amendments to the relevant ordinances.

(Post-meeting note: The Administration's written response was issued to members vide LC Paper No. CB(1)1073/17-18(02) on 12 June 2018.)

Invitation for views

5. Members agreed to invite views on the Bill from interested parties and members of the public by placing an invitation on the website of the Legislative Council ("LegCo") and issuing invitation letters to the 18 District Councils.

(Post-meeting note: An invitation for public submissions on the Bill was uploaded onto the LegCo website on 18 May 2018. Invitation letters for views on the Bill from the District Councils were issued on 21 May 2018.)

Date of second meeting

6. The Bills Committee agreed to schedule the next meeting on 12 June 2018 at 4:30 pm.

III. Any other business

7. There being no other business, the meeting ended at 10:30 am.

Council Business Division 1
Legislative Council Secretariat
26 July 2018

**Proceedings of first meeting of the
Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2018
on Friday, 18 May 2018, at 8:30 am
in Conference Room 2 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Election of Chairman			
000409 – 000710	Mr WONG Ting-kwong Mr CHAN Chun-ying Mr Alvin YEUNG Mr Kenneth LEUNG	Election of Chairman Mr Kenneth LEUNG was elected Chairman of the Bills Committee	
Meeting with the Administration			
000711 – 001110	Chairman Administration	Briefing by the Administration on the Inland Revenue (Amendment) (No. 3) Bill 2018 ("the Bill").	
001111- 001914	Chairman Mr CHAN Chun-ying Administration	Mr CHAN Chun-ying sought information on the following: (a) the reason that the Administration had not consulted the financial sector, in particular, the banking, financial services or insurance industry in the public consultation exercise for the Bill; (b) the reason that most of the approved research institutes under the existing tax deduction regime were those engaged in research and development ("R&D") for the old economy with few of them being engaged in R&D for the new economy industries; and (c) the amount of tax revenue forgone as a result of the proposed enhanced tax deduction regime. The Administration advised that – (a) during the public consultation, the Administration had consulted Joint Liaison Committee on Taxation, the members of which included the Hong Kong Association of Banks; (b) local universities and research institutes had been conducting R&D in financial technologies ("Fintech"). Hong Kong Applied Science and Technology Research Institute ("ASTRI") supported the Cybersecurity Fortification Initiative pursued by the Hong Kong Monetary Authority ("HKMA") and was developing a	

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		<p>Cyber Intelligence Sharing Platform in association with the Hong Kong Association of Banks for sharing intelligence on cyber attacks. Also, Hong Kong R&D Centre for Logistics and Supply Chain Management Enabling Technologies had collaborated with HKMA in developing e-Cheque;</p> <p>(c) taxpayers might apply for enhanced tax deduction for qualifying R&D activities under the restructured section 16B regardless of the nature of the industry; and</p> <p>(d) there were about 200 cases of deduction claims under section 16B of the Inland Revenue Ordinance (Cap. 112) ("IRO") per year and the amount of R&D expenditure involved was about one billion dollars per year. As the existing regime allowed 100% deduction for payments to approved research institutes and in-house expenditure on R&D, the Administration did not classify such deduction claims by nature of the R&D activities or approved research institutes.</p> <p>At the request of Mr CHAN Chun-ying and the Chairman, the Administration agreed to provide information on the institutions undertaking R&D activities for the 32 new technology products or services that had been tested in the Fintech Supervisory Sandbox and for industries regarded as the "old economy".</p>	<p>The Administration to follow up as stated in paragraphs 4(a) and (b) of the minutes</p>
001915 – 002915	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG Kwok-pan sought information on the following:</p> <p>(a) how an activity could be regarded as one which extended knowledge in the fields of natural or applied science;</p> <p>(b) the eligibility of an activity, the object of which was to materialize a conceptual inspiration, under the proposed enhanced tax deduction regime; and</p> <p>(c) the deduction arrangement for qualifying R&D expenditures under the proposed enhanced tax deduction regime.</p> <p>Citing the discovery of black holes in galaxies as an example, the Chairman sought clarification on what would be counted as a qualifying R&D activity under the proposed enhanced tax deduction regime.</p>	

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		<p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) an "R&D activity" or a "qualifying R&D activity" should be one which involved "novelty" and "discovery" and sought to achieve scientific or technological advancement. It should also involve resolution of some scientific or technological uncertainties; (b) the qualifying R&D activities must be related to a trade, profession or business in order to be eligible for the enhanced tax deduction; and (c) tax deduction would be allowed for qualifying R&D expenditures in accordance with section 13 of the proposed Schedule 45 of the Bill. 	
002916 – 003229	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG Kwok-pan and the Chairman enquired about the mechanism for handling an appeal from a taxpayer against a ruling by the Commissioner of Inland Revenue ("CIR") as regards the taxpayer's deduction claim for "Type B expenditure".</p> <p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) pursuant to section 18 of the proposed Schedule 45 of the Bill, on a need basis, CIR might consult the Commissioner for Innovation and Technology ("CIT") in ascertaining whether an activity would constitute an "R&D activity" or a "qualifying R&D activity" and whether an expenditure incurred in relation to an "R&D activity" or a "qualifying R&D activity" was related to the trade, profession or business; and (b) CIR was vested with the authority in making the final decision in that regard. The person who made a claim for basic or enhanced tax deduction might lodge an appeal under the existing appeal mechanism. 	
003230 – 003833	Chairman Mr Alvin YEUNG Administration	<p>Mr Alvin YEUNG enquired about –</p> <ul style="list-style-type: none"> (a) the circumstances under which CIR might consult CIT in ascertaining the eligibility of a claim for the basic or enhanced tax deduction of R&D expenditures and whether the taxpayer concerned would be aware of such consultation; (b) whether there was a dedicated team in the Innovation and Technology Commission ("ITC") to liaise with the Inland Revenue Department ("IRD") in handling the claims for basic or enhanced tax deductions; 	

Time marker	Speaker	Subject(s)	Action required
		<p>(c) the impact of the new tax deduction regime on the manpower deployment of ITC; and</p> <p>(d) the tax deduction arrangement for a qualifying R&D activity which was spearheaded by an overseas research institute at first but was subsequently carried on by its branch in Hong Kong.</p> <p>The Administration advised that –</p> <p>(a) notwithstanding the requirement of official secrecy under section 4 of IRO, CIR could consult CIT on a need basis pursuant to section 18 of the proposed Schedule 45 of the Bill;</p> <p>(b) the information furnished by a particular claimant under the new deduction regime might be beyond the knowledge or expertise of the tax assessor in IRD. In that case, CIR would have to consult CIT for advice;</p> <p>(c) the team of professionals currently responsible for vetting applications under various funding schemes of ITC would be tasked with advising CIR. Staff strength would be expanded on a need basis in due course; and</p> <p>(d) apportionment of R&D expenditures might be required for cases where R&D activities were carried on both locally and outside Hong Kong by the same research institute for the purpose of enhanced tax deduction.</p>	
003834 – 004639	Chairman Mr Christopher CHEUNG Administration	<p>Mr Christopher CHEUNG called on the Administration to step up the publicity of the proposed tax deduction regime and enquired about the scope of the qualifying R&D activity with regard to Fintech.</p> <p>He expressed concerns about the requirement for a qualifying R&D activity to be wholly undertaken in Hong Kong and the lack of local research institutes in conducting R&D activities in biometric authentication for the financial services sector. In this connection, the Chairman asked about the tax deduction arrangement for expenditures incurred on R&D activities undertaken by research institutes overseas.</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) qualifying R&D activity included the application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved processes, systems or services before they were commercially produced or used if such activity sought to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainties; (b) the Administration adopted an activity-based, instead of industry-based approach, in assessing the eligibility of an R&D activity; (c) a number of local research institutes including ASTRI had been engaging in R&D activities in Fintech such as artificial intelligence and biometric authentication. Output of some of those R&D activities had been put on trial; (d) it was the policy intent to attract overseas research institutes (i) to set up their research institutes in Hong Kong or (ii) to deploy their professionals to conduct qualifying R&D activities in Hong Kong funded by local companies; and (e) expenditures incurred on an R&D activity undertaken by an overseas research institution (university/college) for a Hong Kong company would be eligible for basic tax deduction as a "Type A expenditure" under the Bill. <p>The Chairman requested the Administration to provide the number of local firms/institutions engaging in biometric authentication.</p>	<p>The Administration to follow up as stated in paragraph 4(c) of the minutes</p>
004640 – 010049	Chairman Mr WU Chi-wai Administration	<p>Mr WU Chi-wai enquired about –</p> <ul style="list-style-type: none"> (a) the scope of the enhanced tax deduction regime considering that R&D activities related to a trade, profession or business might be out-sourced or conducted in-house; (b) the criteria adopted by CIT in designating an institution as a designated local research institution; 	

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		<p>(c) the qualifications and professional background of ITC officials and their insightfulness in identifying the novelty in R&D projects and assessing their eligibility under the enhanced tax deduction regime; and</p> <p>(d) whether the requirement of "related to a trade, profession or business" would impose restrictions to the applicability of the enhanced tax deduction regime.</p> <p>The Administration advised that –</p> <p>(a) an R&D expenditure in relation to a trade, profession or business that fell within the meaning of a "Type B expenditure" in section 10 of the proposed Schedule 45 of the Bill would be eligible for the enhanced tax deduction, regardless of whether such R&D activity was conducted in-house or not;</p> <p>(b) in designating any institution as a designated local research institution, CIT might require the institution to furnish information including the expertise of its staff, the facilities, equipment and its track records. Where necessary, CIT might also interview the responsible persons of the institution;</p> <p>(c) at ITC, there were two teams led and staffed by professionals in various science and technology disciplines who were responsible for vetting proposals under various funding schemes under the Innovation and Technology Fund. They and other professional grade staff at ITC had extensive experience in vetting R&D projects and would adopt largely similar criteria in identifying the novelty and assessing the eligibility for the enhanced tax deduction;</p> <p>(d) in assessing whether the requirement of "related to a trade, profession or business" had been fulfilled, ITC professionals would consider whether, in the long run, a qualifying R&D activity might lead to or facilitate an extension, or an improvement in the technical efficiency, of the trade, profession or business or the class of trade, profession or business; and</p> <p>(e) the requirement in (d) above could be satisfied if the R&D activity could result in an advancement in computation, production or design process or discovery of new materials.</p>	

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010050 – 012105	Chairman Mr Paul TSE Administration	<p>Mr Paul TSE expressed concerns that the Administration might take an overly conservative approach in assessing the claims under the enhanced tax deduction regime hence defeating the purpose of the policy and giving rise to legal challenges. Mr TSE enquired about –</p> <ul style="list-style-type: none"> (a) whether the Administration would adopt the same approach in processing tax deduction claims under the enhanced tax deduction regime as it did in vetting applications for funding support from ITC; (b) the rationale behind Singapore's R&D tax deduction policy, namely setting the rate of tax deduction exceeding 100% for R&D activities conducted overseas before and reverting to 100% after the year of assessment 2019; (c) the rationale of disallowing R&D activities conducted overseas to be eligible for the enhanced tax deduction; (d) whether the cost of procuring patents and intellectual property rights by a taxpayer was tax deductible under the enhanced tax deduction regime; and (e) competency of ITC officers in handling legal matters about patent and intellectual property rights arising from the R&D activities. <p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) the enhanced tax deduction regime aimed at promoting local R&D activities and enhancing the competency of Hong Kong in R&D. Allowing R&D activities conducted overseas to be eligible for the enhanced tax deduction would defeat the policy objective; (b) in examining a claim under the proposed section 16B of the Bill, the Administration tended to consider whether (i) the criteria set out in section 10 of the proposed Schedule 45 had been satisfied and (ii) sufficient documentary proof was furnished; (c) operationally, it was infeasible for IRD or ITC to ascertain the qualifications of overseas R&D institutions or the eligibility of tax deduction claims for R&D expenditures incurred overseas. Since Hong Kong does not accept, as a general rule, other jurisdiction's request for conducting on-site tax examinations, it is impossible for IRD or ITC to perform on-site tax audits for the R&D activities 	

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		<p>conducted overseas on the basis of reciprocity. Hence, subsidising overseas R&D activities by way of enhanced tax deduction would not be a good use of public funds. Given the official secrecy requirement, CIR should only disclose to CIT the information necessary for the purpose of seeking advice from CIT under section 18 of Schedule 45 of the Bill;</p> <p>(d) for the purpose of (a) above, enhanced tax deduction would only be allowed for "Type B expenditure" as defined in section 10 of Schedule 45 of the Bill;</p> <p>(e) R&D expenditures on R&D activities conducted outside Hong Kong might still be eligible for the existing 100% deduction as Type A expenditure;</p> <p>(f) there was no concrete information about the reason behind the policy switch of Singapore Government in respect of its tax deduction arrangement for R&D activities;</p> <p>(g) the expansion of the scope of tax deduction concerning patents and intellectual property rights was proposed under the Inland Revenue (Amendment) (No. 2) Bill 2018, which was being scrutinized by another Bills Committee at the Legislative Council; and</p> <p>(h) the Administration was aware that certain overseas R&D institutions had indicated their interest in setting up branch institutes in Hong Kong after the promulgation of the enhanced tax deduction regime.</p>	
012106 – 013145	Chairman Mr WONG Ting-kwong Administration	<p>Echoing Mr Paul TSE's call for a liberal approach in implementing the proposed enhanced tax deduction regime by the Administration, Mr WONG Ting-kwong enquired about –</p> <p>(a) the tax deduction arrangement under the enhanced tax deduction regime for an expenditure incurred on a qualifying R&D activity which originated overseas and continued in Hong Kong; and</p> <p>(b) whether tax deduction would be granted to a company for an expenditure incurred on a qualifying R&D activity undertaken or outsourced by its subsidiary under the enhanced tax deduction regime.</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) the R&D expenditures incurred for the part of the qualifying R&D activity carried on overseas might still be eligible for the existing 100% deduction as Type A expenditure as defined in section 8 of the proposed Schedule 45 of the Bill; (b) the R&D expenditures for the part of the same activity conducted in Hong Kong (by a branch institution or Hong Kong staff of the overseas institution) satisfying the criteria in section 10 of Schedule 45 of the Bill might be eligible for the enhanced tax deduction; (c) Section 14(c) of Schedule 45 served to prevent tax evasion or abuses of the enhanced tax deduction regime. If a property developer incurred an R&D expenditure on a qualifying R&D activity unrelated to its existing business of property development but claimed that the activity would be related to a new business that it intended to start some time later, CIR would consider a number of factors including whether there was a change in the business of the company concerned. 	
013146 – 015223	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN Chun-ying expressed concerns about the incomprehensiveness of the public consultation exercise, lack of R&D institutions engaging in Fintech R&D activities and the rationale behind the tax deduction policy for R&D activities in Singapore. Mr CHAN suggested holding a public hearing to gauge views from the public. Mr CHAN enquired about –</p> <ul style="list-style-type: none"> (a) the scope and examples of qualifying R&D activities; (b) the rationale of disallowing tax deduction for a payment made to a group company for carrying on a qualifying R&D activity; and (c) streamlining the vetting procedure for tenants of Cyberport or Hong Kong Science Park which applied to become a designated local research institution. <p>Further to Mr CHAN Chun-ying's suggestion of allowing some expenditures (such as cost of machinery, office rent) incurred on a qualifying R&D activity to be eligible for enhanced tax deduction, the Chairman enquired –</p>	

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		<p>(a) whether enhanced depreciation allowances could be granted for the machinery purchased for carrying on a qualifying R&D activity; and</p> <p>(b) whether the costs incurred by a research institution which conducted qualifying R&D activities for its customers could be eligible for the enhanced tax deduction.</p> <p>The Administration advised that –</p> <p>(a) the enhanced tax deduction regime covered both in-house and outsourced qualifying R&D activities. Payments made by a bank/financial institution to a designated local research institution for undertaking a qualifying R&D activity on a Fintech product or service might be eligible for the enhanced tax deduction;</p> <p>(b) a qualifying R&D activity included the application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved processes, systems or services if such activity sought to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainties;</p> <p>(c) capital expenditure on the purchase of machinery or plant used in carrying out a qualifying R&D activity would be eligible for deduction as a "Type A expenditure" under sections 6(3)(a) and 8 of the proposed Schedule 45 of the Bill;</p> <p>(d) for a qualifying R&D activity undertaken for another person, no deduction was to be allowed under section 14 of Schedule 45 of the Bill;</p> <p>(e) the criteria for selection of tenants / incubatees at Cyberport or Hong Kong Science Park were different from those for designating an institution as a designated local research institution. In general, CIT would make reference to the institution's track records, facilities, equipment and the professional qualifications of its staff for designation purpose. A privately-run R&D institution might apply to CIT to become a designated local research institution; and</p> <p>(f) after passage of the Bill, IRD would provide information on the operation of the enhanced tax deduction regime on its website.</p>	

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015224 – 015909	Chairman Mr WU Chi-wai Administration	<p>Mr WU Chi-wai enquired about the tax concessions and other incentives provided by the Administration in attracting top overseas research institutions to Hong Kong.</p> <p>The Administration advised that–</p> <p>(a) it would step up its efforts in attracting top overseas scientific research institutions to Hong Kong with a view to developing innovation and technology, as mentioned in the Chief Executive's Policy Address of October 2017;</p> <p>(b) expenditures incurred on qualifying R&D activities conducted by a local branch of an overseas R&D institution on its own account were eligible for the enhanced tax deduction; and</p> <p>(c) legislative amendments to the existing IRO have been proposed (such as the Inland Revenue (Amendment) (No. 2) Bill 2018) to create an environment conducive to promotion of local R&D activities.</p> <p>Mr WU Chi-wai and the Chairman requested the Administration to elaborate in writing how the Administration would incentivize overseas R&D institutions to establish their branches in Hong Kong and encourage the further development of innovation and technology through its various policy initiatives and amendments to the relevant ordinances.</p>	The Administration to follow up as stated in paragraph 4(e) of the minutes
015910 – 020257	Chairman Mr Alvin YEUNG Administration	Mr Alvin YEUNG sought elaboration on section 14(a)(i) of the proposed Schedule 45 of the Bill.	
020258 – 020350	Chairman	Arrangements for the next meeting.	