

立法會
Legislative Council

LC Paper No. CB(1)1336/17-18
(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 the second meeting held on
Tuesday, 12 June 2018, at 4:30 pm
in Conference Room 1 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 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 WU Chi-wai, MH
- Public Officers attending** : Agenda item I
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

**Attendance by
invitation** : Agenda item I

Mr Jimmy KWOK
Chairman
Federation of Hong Kong Industries

Mr Kenneth WONG
Co-chairman, Tax Sub-committee
ACCA Hong Kong

Ms Gwenda HO King-wah
Partner
PricewaterhouseCoopers Limited

Mr CHOI Heng-chio
Vice President
The Taxation Institute of Hong Kong

Ms FAN Ping
Chairperson
Capital Markets Tax Committee of Asia

羅昌澤先生
Member
Liberal Party Youth Committee

Mr Michael HUI Wah-kit
Deputy Spokesperson of DAB Industry and
Commerce Group
Democratic Alliance for the Betterment and
Progress of Hong Kong

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. Meeting with deputations and the Administration

Matters arising from previous meeting

(LC Paper No. CB(1)1073/17-18(01) —List of follow-up actions
arising from the meeting on
18 May 2018

LC Paper No. CB(1)1073/17-18(02) —Administration's response to
the issues raised at the meeting
on 18 May 2018

LC Paper No. CB(1)994/17-18(01) —Hon WU Chi-wai's letter dated
18 May 2018 (Chinese version
only)

LC Paper No. CB(1)1075/17-18(01) —Hon Charles Peter MOK's
letter dated 31 May 2018
(Chinese version only))

Other relevant papers

- (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)

Submission from deputation/individual not attending the meeting

- (LC Paper No. CB(1)1073/17-18(06) —Submission from Plover Bay Technologies Limited (English version only))

(Post meeting note: The Administration's written response to the letter by Hon Charles Peter MOK dated 31 May 2018 and two submissions from deputations, which were tabled at the meeting, were circulated to members vide LC Paper Nos. CB(1)1123/17-18(01), CB(1)1124/17-18(01) and (02) on 13 June 2018 in electronic form.)

The Chairman reminded the deputations that their written submissions provided to the Bills Committee and views presented at the meeting would not be covered by the protection and immunity provided under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382). At the invitation of the Chairman, seven deputations attending the meeting presented their views on the Inland Revenue (Amendment) (No. 3) Bill 2018 ("the Bill").

2.. The Bills Committee deliberated (index of proceedings in the **Appendix**).

Follow-up actions to be taken by the Administration

- 3.. The Administration was requested to provide the following information:
- (a) elaboration on the provisions in the Inland Revenue Ordinance and/or the Bill which served to prevent abuses or tax evasion which might arise under the enhanced tax deduction regime for research and development expenditures proposed by the Bill;
 - (b) response to the views expressed by the deputations attending the meeting and in their written submissions on the Bill; and
 - (c) in due course after the passage of the Bill, the draft Departmental Interpretation and Practice Note regarding the eligibility of claims for tax deductions under the enhanced tax deduction regime or draft guidelines, if any, for that purpose for Legislative Council's information/consideration.

(Post-meeting note: The Administration's written response was issued to members vide LC Paper No. CB(1)1150/17-18(02) on 21 June 2018.)

Date of next meeting

4.. The Chairman reminded members that the next meeting would be held on Friday, 22 June 2018 at 10:45 am.

II. Any other business

5.. There being no other business, the meeting ended at 6:41 pm.

Council Business Division 1
Legislative Council Secretariat
21 August 2018

**Proceedings of the second meeting of the
Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2018
on Tuesday, 12 June 2018, at 4:30 pm
in Conference Room 1 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Agenda item I – Meeting with deputations and the Administration			
000820 – 001053	Chairman	Opening remarks	
001054 – 001539	Chairman Federation of Hong Kong Industries ("FHKI")	Presentation of views [LC Paper No. CB(1)1073/17-18(03)]	
001540 – 002023	Chairman ACCA Hong Kong	Presentation of views [LC Paper No. CB(1)1073/17-18(04)]	
002024– 002447	Chairman Pricewaterhouse Coopers Limited ("PwC")	Presentation of views. The deputation considered that the proposed section 15(1)(bb) in the Inland Revenue (Amendment) (No.3) Bill 2018 ("the Bill") might violate the territorial source principle of taxation long adopted in Hong Kong and suggested that the proposed provision be removed from the Bill. [LC Paper No. CB(1)1073/17-18(05)]	
002448 – 002923	Chairman The Taxation Institute of Hong Kong	Presentation of views [LC Paper No. CB(1)1124/17-18(01)]	
002924 – 003402	Chairman Capital Markets Tax Committee of Asia	Presentation of views [LC Paper No. CB(1)1124/17-18(02)]	
003403 – 003604	Chairman Liberal Party Youth Committee	Presentation of views. The deputation welcomed the proposed enhanced tax deduction regime but expressed concerns about the adverse impact of confining tax deductions to payments made to designated local research institutions ("DLRIs") for outsourced research and development ("R&D") activities under the regime.	

Time marker	Speaker	Subject(s)	Action required
003605 – 004053	Chairman Democratic Alliance for the Betterment and Progress of Hong Kong	<p>Presentation of views. The deputation welcomed the proposed enhanced tax deduction regime but suggested that –</p> <ul style="list-style-type: none"> (a) the scope of expenditures eligible for enhanced tax deduction should be widened to include the cost for an enterprise to hire experts and/or establish its own research team to conduct an R&D activity and the capital expenditures on plant and machinery; and (b) the procedure for claiming tax deductions should be simple to follow. 	
004054 – 005223	Chairman Administration	<p>In response to the views expressed by the deputations, the Administration advised that –</p> <ul style="list-style-type: none"> (a) it was the primary policy objective of the enhanced tax deduction regime to promote locally conducted R&D activities; (b) a qualifying R&D activity might be outsourced to a DLRI or conducted in-house ("in-house R&D projects"); (c) a privately-run institution might apply to the Commissioner for Innovation and Technology ("CIT"), who would be assisted by a panel of professionals and experts with extensive experience in assessing research institutions, for designation as a DLRI; (d) for in-house R&D projects, an expenditure in relation to an employee who was engaged directly and actively in a qualifying R&D activity related to a trade, profession or business might be eligible for enhanced deduction as a "Type B expenditure"; (e) capital expenditure on the purchase of plant or machinery used in carrying out a qualifying R&D activity would be eligible for 100% deduction as a "Type A expenditure" under section 13 of the proposed Schedule 45 in the Bill; (f) the cost borne by an enterprise which conducted a qualifying R&D activity locally under a cost-sharing arrangement ("CSA") might be eligible for deduction under the enhanced tax deduction regime if certain criteria were satisfied; 	

Time marker	Speaker	Subject(s)	Action required
		<p>(g) with regard to the procedure for claiming tax deductions, a claimant was required to complete the profits tax return with the necessary information on the R&D expenditures incurred. Taxpayers who claimed basic tax deduction under the pre-amended section 16B of Inland Revenue Ordinance ("IRO") (Cap. 112) were currently required to furnish the information in their profits tax returns; and</p> <p>(h) section 14 of the proposed Schedule 45 in the Bill set out the principal purpose test which aligned with international standards and other provisions in IRO serving to prevent abuses or tax evasion.</p>	
005224 – 005534	<p>Chairman Mr CHAN Chun-ying PwC Administration</p>	<p>Mr CHAN Chun-ying sought elaboration from the representative of PwC and the Administration about the proposed section 15(1)(bb) in the Bill.</p> <p>Ms Gwenda HO of PwC explained that under the territorial source principle of taxation adopted in Hong Kong, only profits which had a source in Hong Kong were taxable while profits sourced elsewhere were not subject to Hong Kong Profits Tax. The proposed section 15(1)(bb) deemed sums for the use, or the right to the use, outside Hong Kong of an intellectual property ("IP") or know-how generated from an R&D activity, such as a royalty, in respect of which a deduction was allowable under the proposed section 16B, to be taxable Hong Kong sourced trading receipts. In this sense, the proposed section 15(1)(bb) might have violated the territorial source principle of taxation.</p> <p>The Administration responded that as the IP or know-how referred to in the proposed section 15(1)(bb) was generated from a locally conducted R&D activity and belonged to a Hong Kong enterprise, the development, enhancement, maintenance, protection and exploitation functions were performed in Hong Kong. In line with the international standards, sums for the use, or the right to the use, outside Hong Kong of the IP or know-how, should be Hong Kong sourced income and therefore taxable.</p>	

Time marker	Speaker	Subject(s)	Action required
005535 – 005945	Chairman Mr CHAN Chun-ying Administration	<p>In response to the enquiry from Mr CHAN Chun-ying, the Administration advised that –</p> <ul style="list-style-type: none"> (a) the expenditures incurred on the development of the new technology products or services under the Fintech Supervisory Sandbox; and (b) an expenditure in relation to contract staff engaged directly and actively in a qualifying R&D activity, would be eligible for enhanced deduction as Type B expenditures as long as they satisfied the criteria set out in the proposed section 10 of Schedule 45 in the Bill. 	
005946 – 010912	Chairman Mr CHAN Chun-ying FHKI PwC Administration	<p>In response to the concerns expressed by Mr CHAN Chun-ying, FHKI and PwC about the eligibility of the expenditures incurred under different CSA for enhanced deduction as Type B expenditures under the proposed section 16B of the Bill, the Administration advised that –</p> <ul style="list-style-type: none"> (a) the eligibility of the expenditures incurred under a CSA depended on whether the claimant had been directly involved (i.e. not merely sharing the cost) in the qualifying R&D activity concerned; and (b) Inland Revenue Department ("IRD") had to examine the exact arrangement involving the participation of more than one enterprise in a qualifying R&D activity when determining whether the expenditures claimed by the respective participating enterprises were eligible for enhanced tax deduction. 	
010913 – 012241	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG Kwok-pan expressed concerns about –</p> <ul style="list-style-type: none"> (a) the exclusion of an expenditure on the acquisition of an IP to further an R&D activity from the enhanced tax deduction regime; (b) the susceptibility of the enhanced tax deduction regime to tax abuses; and (c) upon the implementation of the enhanced tax deduction regime, the impact of handling enquiries from the public on the workload of the staff of Innovation and Technology Commission ("ITC") and IRD. 	

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration advised that –</p> <p>(a) upon the passage of the Inland Revenue (Amendment)(No.2) Bill 2018, expenditures on the acquisition of specified IPs might be eligible for tax deduction as set out in that Bill [<i>Note: the Inland Revenue (Amendment)(No.2) Bill 2018 was passed on 20 June 2018</i>];</p> <p>(b) royalties paid for the use of patents or IPs for research purposes might be eligible for tax deduction as Type A expenditures under section 13 of Schedule 45 in the Bill;</p> <p>(c) CIT would be responsible for handling issues arising from designating research institutions as DLRI. Taxpayers might seek an advance ruling from the Commissioner of Inland Revenue ("CIR") on the eligibility of tax deduction claims they intended to make under the new section 16B. CIR might, on a need basis, seek advice from CIT under the proposed section 18 of Schedule 45 in the Bill. CIR would also be responsible for dealing with appeals involving the tax deduction claims; and</p> <p>(d) the provisions in the Bill were drafted in such a way as to strike a balance between prevention of tax abuses and promotion of locally-conducted R&D activities.</p> <p>Mr CHUNG requested the Administration to provide further information about the provisions in the IRO and/or the Bill which served to prevent abuses or tax evasion that might arise under the enhanced tax deduction regime proposed by the Bill.</p> <p>The Chairman requested the Administration to provide written response to the views expressed by the deputations on the Bill.</p>	<p>The Administration to follow up as stated in paragraph 3 of the minutes</p>
012242–012830	Chairman Mr WONG Ting-kwong Administration	<p>In response to Mr WONG Ting-kwong's enquiry, the Administration confirmed that enterprises which jointly conducted, or caused to conduct by a DLRI, a qualifying R&D activity in Hong Kong might be eligible for enhanced tax deduction for their respective shares of R&D expenditures.</p>	

Time marker	Speaker	Subject(s)	Action required
012831– 013319	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN Chun-ying and the Chairman enquired about –</p> <p>(a) the effective date of designation of a DLRI; and</p> <p>(b) the eligibility of a tax deduction claim involving a payment made to a research institution before the designation of the institution as a DLRI under the new section 16B proposed in the Bill.</p> <p>The Administration advised that –</p> <p>(a) designation made under section 19(1) of Schedule 45 in the Bill took effect on the date specified in the instrument of designation given to the research institution; and</p> <p>(b) payments made to a DLRI after the effective date mentioned in (a) for a qualifying R&D activity would be eligible for enhanced tax deduction.</p>	
013320 – 015640	Chairman Mr CHAN Chun-ying Mr CHUNG Kwok-pan Mr WONG Ting-kwong Administration	<p>The Administration briefed members of its written reply to the issues raised by members in the preceding Bills Committee meeting [LC Paper No. CB(1)1073/17-18(02)].</p> <p>Mr CHAN Chun-ying, Mr CHUNG Kwok-pan and Mr WONG Ting-kwong enquired about the performance pledge of ITC, if any, in processing applications by local research institutions for designation as DLRI.</p> <p>Mr CHAN expressed concerns that –</p> <p>(a) a taxpayer might decline to enter into formal agreement with, or defer payments to, the research institution until its designation. The research institution would be disadvantaged as a result; and</p> <p>(b) the Administration should allow payments made to a research institution within a certain period before its designation to be qualified as Type B expenditures eligible for enhanced deduction.</p> <p>The Administration responded that –</p> <p>(a) under the Bill, an R&D expenditure was incurred only when the payment was made by the taxpayer;</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>(b) to manage the risk, a taxpayer might reschedule the time of payment to a research institution upon agreement with the latter such that the payment would be made after the effective date of designation of the latter as a DLRI;</p> <p>(c) as long as a research institution had submitted the required information and documents for its application for being designated as a DLRI, the Administration aimed at notifying the research institution of the outcome of its application or when necessary, arranging for an interview or on-site visit within six weeks after it had submitted all the required application documents; and</p> <p>(d) ITC would list out in detail the required information and documents for application for designation at its website.</p>	
015641 – 020055	Chairman Administration	<p>The Chairman enquired about the criteria adopted by ITC in considering the designation of a newly established research institution as a DLRI. The Administration advised that –</p> <p>(a) CIT might designate a newly established research institution as a DLRI for a specified period of time, if it was staffed by R&D professionals with proven track records and had fulfilled other requirements; and</p> <p>(b) reference would be made to the criteria used in verifying the competence of laboratories by accreditation bodies.</p>	
020056 – 021042	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG Kwok-pan expressed concerns about the effectiveness and efficiency of the hotline enquiry service of IRD in answering public enquiry on the operation of the enhanced tax deduction regime. He enquired about –</p> <p>(a) whether and when a Departmental Interpretation and Practice Note ("DIPN") would be issued for the Bill; and</p> <p>(b) whether the Administration would consult the stakeholders and Legislative Council ("LegCo") before promulgating the DIPN.</p>	

Time marker	Speaker	Subject(s)	Action required
		The Administration advised that a detailed DIPN would be issued within three months after the passage of the Bill. It would maintain communication with the stakeholders when drafting the DIPN and provide the DIPN for LegCo's information.	The Administration to follow up as stated in paragraph 3 of the minutes
021043 – 021340	Chairman Administration	<p>The Chairman enquired whether "an expenditure in relation to an employee" under section 12 of the proposed Schedule 45 in the Bill included the fee paid to a hired consultant or independent contractor who was engaged directly and actively in a qualifying R&D activity on a full-time basis.</p> <p>The Administration advised that whether a person was an employee of the claimant was a question of fact. IRD would consider the control test, integration test, economic reality test or other relevant circumstances when determining this issue. If the person was an employee, the staff costs might be eligible for enhanced deduction.</p> <p>The Chairman urged the Administration to consider addressing members' concerns by allowing payments made to a research institution within a certain period prior to its being designated as a DLRI to be eligible for enhanced deduction as Type B expenditures.</p>	
Agenda item II –Any other business			
021341– 021600	Chairman	Meeting arrangement for the next meeting.	