

立法會
Legislative Council

LC Paper No. CB(1)1337/17-18
(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 third meeting held on
Friday, 22 June 2018, at 10:45 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

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)

Mr Patrick CHU
Senior Manager (Innovation and Technology
Venture Fund)

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. Meeting with the Administration

Matters arising from previous meeting

(LC Paper No. CB(1)1150/17-18(01) — List of follow-up actions arising from the meeting on 12 June 2018

LC Paper No. CB(1)1150/17-18(02) — Administration's response to the issues raised at the meeting on 12 June 2018

LC Paper No. CB(1)1155/17-18(01) — Submission from Hong Kong Institute of Certified Public Accountants (English version only)

LC Paper No. CB(1)1170/17-18(01) — Draft amendments to the Bill proposed by the Administration)

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)
- 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)
- LC Paper No. CB(1)1123/17-18(01) — Administration's response to the letter dated 31 May 2018 from Hon Charles Peter MOK)

Discussion

The Bills Committee deliberated (index of proceedings in the **Appendix**). The paper showing the draft amendments to the proposed clause 13 of the Inland Revenue (Amendment) (No. 3) Bill 2018 ("the Bill") proposed by the Administration was tabled at the meeting.

(Post-meeting note: The paper showing the draft amendments was issued to members vide LC Paper No. CB(1)1170/17-18(01) on 22 June 2018 in electronic form.)

Follow-up actions to be taken by the Administration

2. The Administration was requested to provide the following information:
 - (a) pursuant to the agreement with members at the meeting, the revised draft amendments to the Bill to be proposed by the Administration, i.e. the period stipulated in sections 6(2A) and 10(2) of the proposed Schedule 45 be amended as "within 6 months after the date of payment";
 - (b) in connection with the draft amendments to the Bill in (a) above, explanation on the discretionary power that the Commissioner for Innovation and Technology and/or Commissioner of Inland Revenue might exercise in considering whether a payment to a local institution was a payment to a research and development institution/a designated local research institution, if the local institution was yet to be designated as a designated local research institution beyond the period mentioned in the draft amendments to the Bill;
 - (c) elaboration with example(s) on the scope of "any other property or right of a similar nature" of intellectual property stipulated in subsection (g) in the proposed section 15(8) in the Bill; and
 - (d) written response to the submission by Hong Kong Institute of Certified Public Accountants of 20 June 2018.

(Post-meeting note: The Administration's written response was issued to members vide LC Paper No. CB(1)1250/17-18(01) on 13 July 2018.)

II. Any other business

3. There being no other business, the meeting ended at 12:33 pm.

Council Business Division 1
Legislative Council Secretariat
21 August 2018

**Proceedings of the third meeting of the
Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2018
on Friday, 22 June 2018, at 10:45 am
in Conference Room 2 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
Agenda item I – Meeting with the Administration			
000418 – 000945	Chairman Administration	<p>Opening remarks by the Chairman.</p> <p>The Administration briefed the Bills Committee of the content of the Administration's response to the matters arising from the previous meeting on 12 June 2018 [LC Paper No. CB(1)1150/17-18(02)] and undertook to provide a written response to the submission by the Hong Kong Institute of Certified Public Accountants of 20 June 2018 (LC Paper No. CB(1)1155/17-18(01)).</p>	The Administration to follow up as stated in paragraph 2(d) of the minutes
000946 – 001247	Chairman Administration	<p>The Administration explained the draft amendments to the proposed clause 13 of the Inland Revenue (Amendment) (No. 3) Bill 2018 ("the Bill") (LC Paper No. CB(1)1170/17-18(01)) as follows –</p> <p>(a) the Administration added the proposed section 6(2A) to Schedule 45 in the Bill to address members' concerns about the uncertainty during the period between the payment made to a research institution before being designated as a designated local research institution ("DLRI") and its subsequent designation by the Commissioner for Innovation and Technology ("CIT");</p> <p>(b) the proposed section 6(2A) widened the scope of the meaning of "research and development ("R&D") expenditure" to include payments made to a local institution within three months before its designation as a DLRI; and</p> <p>(c) the proposed amendments necessitated consequential changes to the proposed section 10 of Schedule 45 in the Bill, namely renumbering section 10 as section 10(1) and addition of section 10(2), which concerned the scope of Type B expenditure under the proposed Schedule 45.</p>	

Time marker	Speaker	Subject(s)	Action required
001248 – 003222	Chairman Mr CHAN Chun-ying Mr WU Chi-wai Mr CHUNG Kwok-pan Administration	<p><u>Members' views on the proposed amendments to clause 13 of the Bill</u></p> <p><i>Extending the retrospective period</i></p> <p>Mr CHAN Chun-ying and Mr CHUNG Kwok-pan expressed their concern that, given the anticipated large number of applications by research institutions for designation as a DLRI, a three-month retrospective period might not be sufficient. Mr CHAN, Mr CHUNG and the Chairman suggested that the Administration should consider extending the retrospective period to six months, nine months and four months respectively.</p> <p>The Administration responded that –</p> <p>(a) extending the period mentioned in the proposed section 6(2A) of Schedule 45 to six months would be more risky because the Administration could not verify whether the relevant research institution had the capabilities to be qualified as a DLRI at the time the payment was made by a taxpayer for a qualifying R&D activity; and</p> <p>(b) the information and documents required by the Innovation and Technology Commission ("ITC") for the application as a DLRI were only general records of the applicant which should be readily available for the application.</p> <p>Noting members' concerns in that regard, the Administration proposed to extend the period stipulated in the proposed sections 6(2A) and 10(2) of Schedule 45 to <u>six</u> months. The Administration added that the difficulty faced by the Administration in vetting the research institutions increased with the length of the retrospective period.</p> <p><i>Other provisions in the Inland Revenue Ordinance</i></p> <p>Mr CHAN enquired whether there were provisions in the Inland Revenue Ordinance (Cap.112)("IRO"), which were similar to the proposed section 6(2A) of Schedule 45 in the Bill.</p>	<p>The Administration to follow up as stated in paragraph 2(a) of the minutes</p>

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration advised that –</p> <p>(a) for the purposes of the existing section 16B of IRO, which concerned tax deduction for expenditures on R&D activities, the Commissioner of Inland Revenue ("CIR") was responsible for approving a research institute as an approved research institute; and</p> <p>(b) the workload on processing the applications for approved research institutes was manageable as the number of applications was limited in each year. It normally took about two months' time for Inland Revenue Department ("IRD") to complete the process in approving a research institute as an approved research institute.</p> <p><i>Authority of CIT</i></p> <p>Mr WU Chi-wai pointed out that there were no provisions in the Bill providing for the discretionary power which CIT and/or CIR might exercise in considering whether a payment to a research institution was a payment to an R&D institution / a DLRI, if the research institution was yet to be designated as a DLRI beyond the retrospective period mentioned in the draft amendments to clause 13 of the Bill. Mr WU suggested that the Administration should consider adding a provision for the exercise of discretionary power in the Bill to address the issue.</p> <p>The Administration advised that –</p> <p>(a) a research institution normally had a certain degree of flexibility in fixing the time of payments when negotiating an R&D contract with its customer (the taxpayer);</p> <p>(b) the procedure for designating local research institutions as DLRI would be more or less similar to that adopted by ITC in vetting proposals under various funding schemes of the Innovation and Technology Fund ("ITF"). For an application for ITF, CIT might grant a conditional approval to an applicant who had satisfied all the prerequisites but had yet to furnish all the required documentary proofs. Such conditional approval might be revoked should the applicant fail to provide such documents at the specified date; and</p>	

Time marker	Speaker	Subject(s)	Action required
		(c) the Administration would provide a written response to Mr WU's suggestion of adding a provision in the Bill for CIT and/or CIR to exercise discretion in assessing applications for designation as DLRI's.	The Administration to follow up as stated in paragraph 2(b) of the minutes
003223 – 003434	Chairman Mr Christopher CHEUNG Administration	<p>In response to Mr Christopher CHEUNG's enquiry, the Administration advised that –</p> <p>(a) expenditures incurred on a qualifying R&D activity that satisfied the criteria in section 10 of the proposed Schedule 45 would be eligible for enhanced tax deduction, regardless of the outcome of the R&D activity;</p> <p>(b) to prevent tax abuses arising from the enhanced tax deduction regime, section 14(c) of the proposed Schedule 45 in the Bill enabled CIR to tackle artificially inflated claims or other tax avoidance arrangements involving tax deductions under the proposed section 16B in the Bill; and</p> <p>(c) sections 61 and 61A of IRO were general anti-avoidance provisions which served to (i) nullify artificial or fictitious transactions that avoided tax; and (ii) empower an Assistant Commissioner of Inland Revenue to disregard or restructure any tax avoidance transaction with the sole or dominant purpose of conferring a tax benefit on a taxpayer.</p>	
003435 – 003554	Chairman Mr CHAN Chun-ying	Mr CHAN Chun-ying welcomed the Administration's proposal to extend the retrospective period mentioned in the draft amendments to clause 13 of the proposed Schedule 45 to six months. Mr CHAN considered that the extension could effectively avert the problem that a taxpayer might defer payments to a research institution which had yet to be designated as a DLRI, thereby adversely affecting the cash flow of the research institution.	

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003555 – 003748	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG Kwok-pan sought elaboration on the difficulty the Administration could possibly face in extending the retrospective period mentioned in the draft amendments to clause 13 of the Bill.</p> <p>The Administration advised that –</p> <p>(a) prescribing a retrospective period under section 6 of the proposed Schedule 45 in the Bill allowed a taxpayer to claim enhanced tax deduction for a payment made during the said retrospective period prior to designation of the research institution; and</p> <p>(b) the risk associated with (a) above was that the Administration would not be able to verify whether the research institution was competent as a DLRI in the retrospective period before designation.</p>	
Clause-by-clause examination of the Inland Revenue (Amendment) (No.3) Bill 2018			
003749 – 004009	Chairman Administration	<p><u>Clause 1 – Short title</u></p> <p><u>Clause 2 – Enactments amended</u></p> <p><u>Clause 3 – Section 2 amended (interpretation)</u></p> <p>Members did not raise any questions on the above provisions.</p>	
004010 – 004613	Chairman Mr CHUNG Kwok-pan Mr WU Chi-wai Administration	<p><u>Clause 4 – Section 4 amended (official secrecy)</u></p> <p>In response to the enquiries by the Chairman, Mr CHUNG Kwok-pan and Mr WU Chi-wai, the Administration advised that the amendments in relation to section 4(4)(c) and (e) were made to –</p> <p>(a) make section 4(4)(c) gender-neutral; and</p> <p>(b) empower CIR, or an IRD officer, to communicate with CIT or an ITC officer for the purpose of seeking advice under section 18 of the proposed Schedule 45.</p> <p>The Administration also advised that, the replacement of the word "any" by "a" in the amendments to section 4(4)(c) would not change the meaning of the provision as both words signified "one" or "more than one" in meaning. Same principle was adopted in drafting the newly added section 4(4)(e).</p>	

Time marker	Speaker	Subject(s)	Action required
004614 – 010036	Chairman Mr CHUNG Kwok-pan Mr WU Chi-wai Administration	<p><u>Clause 5 – Section 15 amended (certain amounts deemed trading receipts)</u></p> <p>Mr CHUNG Kwok-pan, Mr WU Chi-wai and the Chairman asked the Administration to elaborate with example(s) the scope of "any other property or right of a similar nature" in the definition of "intellectual property" stipulated in the proposed section 15(8) in the Bill. They expressed concerns about the eligibility of expenditures on R&D activities relating to performances, including fees paid to performers, for enhanced tax deduction claims and requested the Administration to provide the elaboration in writing.</p> <p>The Administration responded that –</p> <p>(a) "intellectual property" in the proposed provision referred only to the intellectual property generated from an R&D activity in respect of which a tax deduction was allowable under the restructured section 16B in the Bill;</p> <p>(b) paragraph (g) included property or right of a nature similar to the intellectual properties mentioned in paragraphs (a) - (f);</p> <p>(c) with regard to R&D activities which aimed at enhancing art or sports performances, a new or substantially improved algorithm developed through resolution of scientific or technological uncertainties was considered to be an intellectual property as defined under the proposed section 15(8) and the expenditures incurred might be eligible for enhanced tax deduction. In the circumstances, the intellectual property referred to the algorithm, not the art or sports performance concerned; and</p> <p>(d) for the purpose of (c), the fee paid to a performer might be eligible for enhanced tax deduction claim if the performer was a contract employee who was engaged directly and actively in the qualifying R&D activity.</p>	The Administration to follow up as stated in paragraph 2(c) of the minutes
010037 – 010234	Chairman Administration	<p><u>Clause 6 – Section 16 amended (ascertainment of chargeable profits)</u></p> <p>The Chairman enquired about the rationale of the proposed section 16(1)(gb).</p>	

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		<p>The Administration advised that –</p> <p>(a) section 17 of IRO set out expenditures, including a capital expenditure, which were not deductible under profits tax; and</p> <p>(b) the proposed amendment allowed those capital expenditures referred to in the proposed section 16B in the Bill, which otherwise would not be deductible under section 17 of IRO, to be eligible for deduction under profits tax.</p>	
010235 – 010825	Chairman Administration	<p><u>Clause 7 – Section 16B substituted</u></p> <p><u>Clause 8 – Section 37 amended (initial and annual allowances, machinery or plant)</u></p> <p><u>Clause 9 – Section 37A amended (initial and annual allowances in respect of machinery and plant acquired under hire purchase agreement)</u></p> <p><u>Clause 10 – Section 39B amended (initial and annual allowances on machinery or plant under the pooling system)</u></p> <p><u>Clause 11 – Section 40 amended (interpretation)</u></p> <p><u>Clause 12 – Section 68 amended (hearing and disposal of appeals to the Board of Review)</u></p> <p>Members did not raise any questions on the above provisions.</p>	
010826 – 015055	Chairman Mr CHUNG Kwok-pan Assistant Legal Adviser 3 ("ALA3") Administration	<p><u>Clause 13 – Schedule 45 added</u></p> <p><i>Section 12 Meaning of qualifying expenditure related to trade, profession or business</i></p> <p>The Chairman enquired –</p> <p>(a) whether a contract staff member, regardless of the length of the employment period, was "an employee" under the proposed section 12(1)(a) of Schedule 45; and</p> <p>(b) the reason for singling out three kinds of services, namely accounting, administrative and secretarial services, in the proposed section 12(4) of Schedule 45.</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration advised that –</p> <ul style="list-style-type: none"> (a) IRD would adopt the control test, organisation test and/or economic reality test when determining whether an employer-employee relationship existed; and (b) the reason for naming the three types of services in the proposed section 12(4) of Schedule 45 was for the sake of clarity only. <p>In response to the enquiries from Mr CHUNG Kwok-pan and the Chairman about the definition of "expenditure in relation to an employee" under the proposed section 12(5), the Administration advised that –</p> <ul style="list-style-type: none"> (a) as far as Mandatory Provident Fund and a contract of insurance under a recognised occupational retirement scheme were concerned, an "expenditure in relation to an employee" referred only to the regular contributions and ordinary annual premium paid by the employer in respect of an employee; and (b) share awards or share options given to an employee directly and actively engaged in a qualifying R&D activity did not constitute an "expenditure in relation to an employee" as they did not represent a cash outlay. <p><i>Section 13 Total amount of deduction under section 16B</i></p> <p>ALA3 sought elaboration on the legislative intent and justification for adopting different approaches in ascertaining apportionment of expenditures incurred on R&D activities under section 12(2) and 12(3) as opposed to section 13(3). Mr CHUNG enquired when the said apportionment should take place.</p> <p>The Administration recapitulated its written reply dated 16 May 2018 to a letter by ALA3 [LC Paper No. CB(1)957/17-18(03)]. In gist, the Administration advised that –</p> <ul style="list-style-type: none"> (a) the "appropriate proportion of the expenditure" under the proposed section 12(2) and (3) of Schedule 45 could be determined by direct attribution or indirect allocation in a single year; (b) the appropriate proportion of Type A expenditure under the proposed section 13(3) of Schedule 45 might relate to an R&D project spanning over a few years during which the extent of the trade or business carried on in Hong Kong and the scope of trading or business activities might differ from year to year; 	

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		<p>(c) the proposed section 13(3) of Schedule 45 was phrased with a view to giving a discretionary power to CIR to determine the deductible amount on a reasonable basis;</p> <p>(d) a tax deduction claimant might lodge an appeal against IRD in respect of the decision made by CIR under the proposed section 13(3) of Schedule 45; and</p> <p>(e) a tax deduction claimant might seek an advance ruling from CIR at a specified fee in respect of the apportionment proposed by the claimant.</p> <p><i>Section 14 Expenditures that may not be deducted</i></p> <p>ALA3 sought the Administration's confirmation on its position in respect of section 14(a) as stated in LC Paper No. CB(1)957/17-18(03). The Administration replied in the positive.</p> <p>Mr CHUNG Kwok-pan enquired about the scope of "another person" under section 14(b)(iv). The Administration advised that if an expenditure on a qualifying R&D activity was not borne by the taxpayer, that expenditure would not be eligible for enhanced tax deduction.</p> <p><i>Section 16 Proceeds of sale of certain plant or machinery treated as trading receipts</i></p> <p>In response to the enquiry by Mr CHUNG Kwok-pan, the Administration advised that –</p> <p>(a) the provisions in the proposed section 16 of Schedule 45 concerned sale proceeds from the disposal of plant or machinery procured for conducting R&D activities;</p> <p>(b) under the existing section 16B of IRO, the expenditure incurred on procuring the plant or machinery for R&D purposes would be eligible for one-off tax deduction and the sale proceeds from disposal of such plant or machinery would be deemed as a taxable trading receipt; and</p> <p>(c) as section 16B of IRO was rewritten under the Bill, the relevant provisions in the existing section 16B were re-drafted as the proposed section 16 of Schedule 45.</p>	

Time marker	Speaker	Subject(s)	Action required
		<p><u>Clause 14 – Schedule amended (specification of public offices)</u></p> <p><u>Explanatory Memorandum</u></p> <p>Members did not raise any questions on the above provisions.</p>	
015056 – 015151	Chairman Administration	The Chairman remarked that the Bills Committee had completed examining the Bill clause-by-clause and requested the Administration to revise the draft amendments to clause 13 of the Bill based on the agreement with members at the meeting. The Chairman said that subject to members' views on the revised draft amendments to be proposed by the Administration, no further meeting might be convened.	
Agenda item II –Any other business			
015152 – 015229	Chairman	Closing remarks	