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(By Fax 2877 5029)
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Mr CHUI Ho-yin, Alvin
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Legislative Council Secretariat
Legislative Council Complex
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Dear Mr CHUI,

Inland Revenue (Amendment) (No. 3) Bill 2018

Referring to your letter dated 8 May 2018, the clarification is detailed below.

Clause 13 - sections 12 and 13 of the new Schedule 45 to Cap. 112

Section 12(2) and (3) of the new Schedule 45 serves to attribute an appropriate amount of the relevant expenditure on employees and consumables to Type B expenditure which qualifies for a higher rate of tax deduction.

Section 13(3) of the new Schedule 45 is to prevent multinational corporations from using their global expenditure on research and development (“R&D”) to completely off-set their tax liabilities in Hong Kong for years. It empowers the Commissioner of Inland Revenue (“the Commissioner”) to attribute an appropriate portion of Type A expenditure incurred on R&D activities (other than qualifying R&D activities) carried on outside Hong Kong to the part of trade or business in Hong Kong.

The “appropriate proportion of the expenditure” under section 12(2) and (3) of the new Schedule 45 can be determined by direct attribution or indirect allocation (e.g. allocation keys or cost drivers) in a single year. The claimant should keep sufficient records on the staff costs of employees

engaged directly and actively in a qualifying R&D activity and on the expenditures incurred on consumables used directly in such activity. If an employee is only partly engaged directly and actively in the qualifying R&D activity, the staff costs should be apportioned accordingly. Only that portion attributed or allocated to the qualifying R&D activity is eligible for enhanced deduction. Similarly, apportionment can be applied to expenditures incurred on the consumables partly used directly in the qualifying R&D activity.

The appropriate proportion of Type A expenditure under section 13(3) of the new Schedule 45 may 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 may differ from year to year. Thus, the Commissioner is given a discretionary power to determine the deductible amount on a reasonable basis.

Clause 13 - section 14(a) of the new Schedule 45 to Cap. 112

Section 1(2) of the new Schedule 45 provides that a reference to rights includes a share or interest in rights. If the rights generated from an R&D project are jointly and fully vested in more than one taxpayer, the R&D expenditures incurred by the taxpayers can be deducted under the new section 16B. If any part of such rights is vested in another person who has not incurred the R&D expenditures, such expenditures cannot be deducted. With such provisions, tax symmetry would be maintained since the royalties derived from such rights would be assessable whereas the R&D expenditures would be deductible.

Yours sincerely,



(WONG Wang-wah)

for Commissioner for Innovation and Technology

c.c. Department of Justice

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