

Our Ref. : ITC CR 6/1/2168/18

(By Fax 2869 6794)

10 Jul 2018

Mr Derek LO
Clerk to Bills Committee
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Mr LO,

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

I refer to your letter dated 26 June 2018 on the follow-up items arising from the meeting on 22 June 2018. Our responses are as follows:

(a) pursuant to the agreement with members at the meeting, revise the draft amendments to the Inland Revenue (Amendment) (No.3) Bill 2018 ("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"

The proposed draft amendment to the Bill is at **Annex A**. The period stipulated in sections 6(2A) and 10(2) of the proposed Schedule 45 has been amended to “within 6 months after the date of payment”.

(b) in connection with the draft amendments to the Bill in (a) above, provide explanation on the discretionary power that the Commissioner for Innovation and Technology and/or Commission of Inland Revenue may exercise in considering whether a payment to a local institution is a payment to an R&D institution/a designated local research institution, if the local institution is yet to be designated as a designated local research institution beyond the period mentioned in the draft amendments to the Bill

In assessing organisations' applications for designation as "designated local research institution", the Innovation and Technology Commission ("ITC") will examine the documentary evidence provided by the applicants and seek their clarification in order to verify their compliance with the designation criteria. If necessary, an on-site assessment will be arranged with the applicants. The assessment time for each application would depend on the complexity and number of research fields for which designation is sought and whether an on-site assessment is needed. In general, for a less complex single field application where no on-site assessment is needed, ITC would require six weeks to complete the assessment upon received all the required information and clarifications from the applicant. In case where an applicant is unable to provide some of the supporting documents, ITC will review its application and determine whether there is sufficient evidence to substantially demonstrate its compliance with the specified criteria as well as its competence to conduct the research work.

We believe extending the eligibility period from 3 months to 6 months would cover almost all applications. We do not consider that a discretion provision must be inserted having regard to the draft amendment mentioned in (a) above.

(c) elaborate 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) to the Inland Revenue Ordinance

The intent of including "any other property or right of a similar nature" in the definition of "intellectual property" under the proposed section 15(8) is to cover any other property or right which is of similar nature as copyright material, design, layout-design (topography) of an integrated circuit, patent, plant variety right or secret process or formula. Thus, a new invention or discovery which does not fall within the aforesaid categories of intellectual properties will be covered. In fact, similar expression "other property of a similar nature" has been used in the existing section 15(1)(b) and (ba) of the Inland Revenue Ordinance, which deems any sums accrued to a person for the use of or right to use in Hong Kong certain intellectual properties as trading receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong.

(d) provide written response to the submission by Hong Kong Institute of Certified Public Accountants of 20 June 2018

The Administration's response to the views of HKICPA is set out at **Annex B.**

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Wong Wang-wah', written in a cursive style.

(WONG Wang-wah)
for Commissioner for Innovation and Technology

c.c. Hon Kenneth LEUNG (Chairman)
Department of Justice
(Attn.: Ms Mandy NG, Senior Government Counsel) (Fax: 3918 4613)
Inland Revenue Department
(Attn.: Ms. CHAN Shun-mei, Senior Assessor) (Fax: 2511 7414)

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

Committee StageAmendments to be moved by the Secretary for Innovation and Technology

<u>Clause</u>	<u>Amendment Proposed</u>
5(1)	By deleting “15(1)(ba)” and substituting “15(1)(bb)”.
5(1)	By renumbering the proposed section 15(1)(bb) as section 15(1)(bc).
5(2)	By deleting “15(6)” and substituting “15(7)”.
5(2)	By renumbering the proposed section 15(7) as section 15(7A).
5(2)	By deleting the proposed section 15(8).
5	<p>By adding—</p> <p>“(3) Section 15(8), English text, definition of <i>performer</i>—</p> <p>Repeal the full stop</p> <p>Substitute a semicolon.</p> <p>(4) Section 15(8)—</p> <p>Add in alphabetical order</p> <p>“<i>intellectual property</i> (知識產權) includes—</p> <ul style="list-style-type: none"> (a) copyright material; (b) a design; (c) a layout-design (topography) of an integrated circuit; (d) a patent; (e) a plant variety right; (f) a secret process or formula; and (g) any other property or right of a similar nature;

know-how (工業知識) means any industrial information or techniques likely to assist in the manufacture or processing of goods or materials;

R&D activity (研發活動) has the meaning given by section 2 of Schedule 45.”.”.

- 13 In the proposed Schedule 45, in section 6, by adding—
- “(2A) For the purposes of subsection (1)(a) and (b), a payment to a local institution—
- (a) that is not a university or college; and
- (b) that is not, and never has been, a designated local research institution,
- is a payment to an R&D institution if the local institution is designated as a designated local research institution within 6 months after the date of payment.”.
- 13 In the proposed Schedule 45, in section 8(a), by deleting “section 10(a)” and substituting “section 10(1)(a)”.
- 13 In the proposed Schedule 45, in section 9(1)(b) and (3)(b), by deleting “section 10(a)” and substituting “section 10(1)(a)”.
- 13 In the proposed Schedule 45, by renumbering section 10 as section 10(1).
- 13 In the proposed Schedule 45, in section 10, by adding—
- “(2) For the purposes of subsection (1)(a)(i) and (ii), a payment to a local institution—
- (a) that is not a university or college; and
- (b) that is not, and never has been, a designated local research institution,
- is a payment to a designated local research institution if the local institution is designated as a designated local research institution within 6 months after the date of payment.”.
- 13 In the proposed Schedule 45, in section 11(1)(b) and (2)(b), by deleting “section 10(a)” and substituting “section 10(1)(a)”.

The Administration's responses to the views of HKICPA

HKICPA's Views	The Administration's Responses
<p><u>Definition of R&D activity and practical guidance</u></p> <p>The Administration states that the definition of "R&D activity" is in line with the definition of "Hong Kong Accounting Standard 38" ("HKAS38"). In this connection, the Administration should clarify whether the Inland Revenue Department ("IRD") would consider an activity as a "qualifying R&D activity" so long as the activity concerned is regarded as "research" or "development" based on HKAS38 in the judgment of professional accountants.</p>	<p>In determining whether an activity is a qualifying R&D activity, IRD will have to consider all the relevant facts, including the state of knowledge and technology at the commencement of the project, the scientific or technological uncertainties involved, etc. If a research and development ("R&D") project seeks to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainty, it would be regarded as a qualifying R&D activity.</p> <p>An advance in science or technology means an advance in overall knowledge or capability in a field of science or technology (not a company's own state of knowledge or capability alone). A material, device, product, process, system or service does not become an advance in science or technology simply because science or technology is used in its creation.</p> <p>After enactment of the amendment bill, IRD will issue a Departmental Interpretation and Practice Note ("DIPN") at a suitable juncture to elaborate its interpretation and practices regarding the R&D enhanced deduction regime.</p>

The Administration's responses to the views of deputations

HKICPA's Views	The Administration's Responses
<p><u>Information confidentiality</u></p> <p>The amendment bill empowers the Commissioner of Inland Revenue to seek advice from the Commissioner for Innovation and Technology ("CIT") when processing R&D deduction claims or advance ruling applications. CIT and staff of the Innovation and Technology Commission ("ITC") should be bound by the same confidentiality obligations as currently apply to the IRD to protect taxpayers' information.</p>	<p>ITC will ensure that the taxpayers' information would be kept confidential and would not be disclosed to other parties without the consent of the taxpayers.</p>
<p><u>Subcontracting R&D activities and "R&D Institution"</u></p> <p>The Administration should clarify whether payments made to parties other than the R&D institutions in respect of subcontracted R&D activities will be permitted as general deductions under section 16(1) of the Inland Revenue Ordinance (Cap 112) ("IRO"), or otherwise be deductible.</p> <p>The Administration should allow Hong Kong entities to claim 100% tax deduction on R&D expenses paid to group entities or research organisations (including those located in Hong Kong and overseas) which are not "R&D Institutions" (i.e. a research organisation that is not a designated local research institution ("DLRI"), an university or</p>	<p>If an outgoing or expense is incurred in the production of chargeable profits, it can be deducted under profits tax by virtue of the general deduction provision in section 16(1) of the IRO provided that such deduction is not prohibited under section 17. For capital expenditures incurred on R&D, they can also be deducted under profits tax if the criteria specified in the proposed section 16B and Schedule 45 are satisfied.</p> <p>DLRI will cover local universities or colleges and local private service providers.</p> <p>To become a designated local research institution, the entity must have the capability, capacity and experience and is competent to</p>

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<p>a college).</p>	<p>undertake R&D activities in the relevant technology areas. To protect the public coffer, it is necessary to ensure that payments eligible for tax deduction are made to competent DLRI's.</p> <p>An expert panel comprising members from relevant industries, professions and the academia will be set up to advise on the assessment of DLRI's.</p> <p>To expand the definition of "R&D institution" to include overseas research organisations is inconsistent with the policy objective of promoting R&D activities in Hong Kong. It would also be difficult for CIT to verify the competence of overseas research organisations.</p>
<p><u>Co-ownership of intellectual property ("IP") and cost sharing arrangement ("CSA") within a corporate group setting</u></p> <p>The Administration should clarify whether payments made under a CSA with the IP generated from the R&D activities co-owned by the participating group entities would be eligible for tax deduction.</p>	<p>If the claimant has undertaken part or all of the underlying R&D activities under a CSA, the share of R&D expenditure borne by the claimant under the CSA may be treated as its in-house R&D expenditure and qualify for 100% deduction or 300%/200% enhanced deduction. IRD will provide further explanations in the DIPN.</p> <p>Co-ownership of IP rights is covered by the proposed section 1(2) of Schedule 45 which defines "rights" as including a share or an interest in rights.</p>

The Administration's responses to the views of deputations

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<p><u>Provide tax credit to startups</u></p> <p>The Administration should allow startups which are in a tax loss position to enjoy the enhanced tax deduction in the form of a tax credit, the amount of which should be limited to expenditure eligible for the enhanced tax deduction.</p>	<p>Any deduction not absorbed by assessable profits can be carried forward as losses to set off assessable profits in future years.</p> <p>The ITC has administered a number of funding schemes to assist and support start-ups and Small and Medium Enterprises in undertaking R&D activities.</p>