

Our Ref. : ITC CR 6/1/2168/18
Your Ref. : CB1/BC/8/17

(By Fax 2869 6794)
11 Jun 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 6 June 2018 regarding the enquiries from Hon Charles Peter MOK on “qualifying R&D activity” and “designated local research institution”. Our responses are as follows:

Qualifying research and development (R&D) activity

Pursuant to section 4 of the new Schedule 45 in the amendment bill, “qualifying R&D activity” is defined as an “R&D activity” that falls within the description in section 2(a), (c), or (d) of the said Schedule and is wholly undertaken and carried on in Hong Kong but does not include any of the following:

- (a) any efficiency survey, feasibility study, management study, market research or sales promotion;
- (b) the application of any publicly available research findings or other knowledge to a plan or design, with an anticipated outcome and without any scientific or technological uncertainty;
- (c) an activity that does not seek to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainty; or
- (d) any work to develop the non-scientific or non-technological aspect of a new or substantially improved material, device, product, process, system or service.

The above new definition for “qualifying R&D activity” could apply to different activities including software engineering.

Turning to the R&D projects mentioned in the letter, it is impossible to determine whether each of them is a “qualifying R&D activity” without considering all the relevant facts, including the state of knowledge and technology at the commencement of the project, the scientific or technological uncertainties involved, etc. As a general rule, if an 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.

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). This includes the adaptation of knowledge or capability from another field of science or technology in order to make such an advance where this adaptation was not readily deducible. 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.

Scientific or technological uncertainty exists when knowledge of whether something is scientifically possible or technological feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional working in the field. This includes system uncertainty. Scientific or technological uncertainty will often arise from turning something that has already been established as scientifically feasible into a cost-effective, reliable and reproducible material, device, product, process, system or service.

To enable the Inland Revenue Department (“IRD”) to process taxpayers’ claims efficiently, taxpayers should provide full and accurate information in their tax returns and sufficient supporting documents upon request. If necessary, the Commissioner of Inland Revenue may consult the Commissioner for Innovation and Technology (“CIT”) on any technical issues involved. If an enterprise wishes to know whether its planned R&D project meets the requirements of qualifying R&D activity or the expenditures to be incurred will be eligible for enhanced tax deduction, it could submit an advance ruling application to IRD.

Upon passage of the amendment bill by the Legislative Council, 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. Document requirements and examples of R&D activities in the field of software engineering will also be included in the DIPN.

Designated local research institution (DLRI)

Section 19 of the new Schedule 45 empowers the CIT to designate any university or college located in Hong Kong or any other local institution (including any institute, association, organisation or corporation) that undertakes qualifying R&D activities in Hong Kong as a DLRI for tax deduction purposes.

Irrespective of its scale, a local institution or corporation which has satisfied the specified requirements (for example, having expertise in providing R&D services in one or more specified fields of science or technology, with sufficient qualified and experienced R&D talents, equipment and facilities for the provision of R&D services in the specified fields, sound project management experience and appropriate track records, etc.) may apply to become a DLRI. We will make reference to overseas experience in drawing up a framework that will suit the needs of Hong Kong.

In regard to DLRI applications, we will also set up an expert panel comprising members from relevant industries and the academia to advise on the assessment process.

Yours sincerely,



(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)