

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

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# A BILL

## To

Amend the Inland Revenue Ordinance to provide for enhanced tax deductions for certain expenditures incurred in relation to research and development activities; to introduce further safeguards to prevent the abuse of tax deductions in respect of research and development activities; to deem certain sums to be trading receipts chargeable to tax; and to provide for related matters and minor textual amendments.

Enacted by the Legislative Council.

### **Part 1**

#### **Preliminary**

**1. Short title**

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 3) Ordinance 2018.

**2. Enactments amended**

- (1) The Inland Revenue Ordinance (Cap. 112) is amended as set out in Part 2.

- (2) The Specification of Public Offices Notice (Cap. 1 sub. leg. C) is amended as set out in Part 3.
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## Part 2

### Amendments to Inland Revenue Ordinance

#### 3. Section 2 amended (interpretation)

Section 2(1)—

##### Add in alphabetical order

“*Commissioner for I&T* (創科署署長) means the Commissioner for Innovation and Technology;”.

#### 4. Section 4 amended (official secrecy)

(1) Section 4(4)(a)—

##### Repeal

“Commissioner, or”

##### Substitute

“Commissioner;”.

(2) Section 4(4)(c)—

##### Repeal

“any public officer authorized by him, for the purpose of reporting under section 68(5) an appeal to the Board of Review, or”

##### Substitute

“a public officer authorized by the Secretary for Justice, for the purpose of reporting under section 68(5) an appeal to the Board of Review;”.

(3) Section 4(4)(d)—

##### Repeal

“document.”

**Substitute**

“document; or”.

- (4) After section 4(4)(d)—

**Add**

“(e) to the Commissioner for I&T, or a public officer authorized by the Commissioner for I&T, for the purpose of seeking advice under section 18 of Schedule 45.”.

**5. Section 15 amended (certain amounts deemed trading receipts)**

- (1) After section 15(1)(ba)—

**Add**

“(bb) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person—

(i) for the use, or the right to the use, outside Hong Kong of any intellectual property or know-how generated from any R&D activity in respect of which a deduction is allowable under section 16B in ascertaining profits of the person under this Part; or

(ii) for imparting or undertaking to impart knowledge directly or indirectly connected with the use outside Hong Kong of any such property or know-how;”.

- (2) After section 15(6)—

**Add**

“(7) The amendments made to this section by the Inland Revenue (Amendment) (No. 3) Ordinance 2018 ( of 2018) do not have the effect of rendering chargeable to tax sums received by or accrued to a

person before the day on which that Ordinance comes into operation which were not otherwise chargeable to tax.

(8) In this section—

***intellectual property*** (知識產權) includes—

- (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.”.

## 6. Section 16 amended (ascertainment of chargeable profits)

(1) Section 16(1)(g)—

**Repeal**

“notwithstanding”

**Substitute**

“despite”.

(2) Section 16(1)(ga)—

**Repeal**

“16B.”

(3) After section 16(1)(ga)—

**Add**

“(gb) despite section 17, any deduction allowed under section 16B;”.

(4) Section 16(2)(e)(i)(B)—

**Repeal**

“research and development”

**Substitute**

“R&D activities within the meaning of section 2 of Schedule 45”.

**7. Section 16B substituted**

Section 16B—

**Repeal the section**

**Substitute**

**“16B. Expenditures on R&D activities**

(1) This section applies despite section 17.

(2) In ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under this Part for a year of assessment, a deduction in relation to R&D activities is to be allowed under this section for payments made, and



other expenditures incurred, by the person during the basis period for the year of assessment.

- (3) The total amount of deduction to be allowed under this section is to be determined in accordance with Schedule 45.
- (4) However, no deduction is to be allowed under this section for an amount that is allowable as a deduction apart from this section.
- (5) The proceeds of sale of any plant or machinery for, and rights generated from, R&D activities are to be treated as a trading receipt in accordance with Schedule 45.
- (6) In this section—

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

**8. Section 37 amended (initial and annual allowances, machinery or plant)**

- (1) Section 37(1)—

**Repeal**

“16B(1)(b) or”

**Substitute**

“6(1)(c) of Schedule 45 or section”.

- (2) Section 37(3)—

**Repeal**

“his trade, profession or business where such machinery or plant represents expenditure of a capital nature which pursuant to section 16B(1)(b) or 16G has been allowed as a deduction”

**Substitute**

“the person’s trade, profession or business where the machinery or plant represents expenditure or expenditures of a capital nature which have been allowed under section 16B or 16G as a deduction or deductions”.

**9. Section 37A amended (initial and annual allowances in respect of machinery and plant acquired under hire purchase agreement)**

(1) Section 37A(1)—

**Repeal**

“16B(1)(b)”

**Substitute**

“6(1)(c) of Schedule 45”.

(2) Section 37A(4)—

**Repeal**

“his trade, profession or business where such machinery or plant represents research and development expenditure of a capital nature which pursuant to section 16B(1)(b) has been allowed as a deduction”

**Substitute**

“the person’s trade, profession or business where the machinery or plant represents expenditure or expenditures of a capital nature which have been allowed under section 16B as a deduction or deductions”.

**10. Section 39B amended (initial and annual allowances on machinery or plant under the pooling system)**

(1) Section 39B(1)—

**Repeal**

“16B(1)(b) or”

**Substitute**

“6(1)(c) of Schedule 45 or section”.

(2) Section 39B(10)—

**Repeal**

“his trade, profession or business where such machinery or plant represents expenditure of a capital nature which pursuant to section 16B(1)(b) or 16G has been allowed as a deduction”

**Substitute**

“the person’s trade, profession or business where the machinery or plant represents expenditure or expenditures of a capital nature which have been allowed under section 16B or 16G as a deduction or deductions”.

**11. Section 40 amended (interpretation)**

Section 40(1), definition of *industrial building or structure*, paragraph (f)—

**Repeal**

“research and development”

**Substitute**

“R&D activities within the meaning of section 2 of Schedule 45”.

**12. Section 68 amended (hearing and disposal of appeals to the Board of Review)**

Section 68(5), Chinese text—

**Repeal**

“導”

**Substitute**

“道”.

**13. Schedule 45 added**

The Ordinance—

**Add**

**“Schedule 45**

[ss. 4, 15, 16, 16B, 37,  
37A, 39B & 40]

**Deduction of R&D Expenditures**

**Part 1**

**Preliminary**

**1. Interpretation**

(1) In this Schedule—

**2018 Amendment Ordinance** (《2018年修訂條例》) means the Inland Revenue (Amendment) (No. 3) Ordinance 2018 ( of 2018);

**amended Ordinance** (《經修訂條例》) means this Ordinance as amended by the 2018 Amendment Ordinance;

- commencement date** (生效日期) means the day on which the 2018 Amendment Ordinance comes into operation;
- designated local research institution** (指定本地研究機構) means a designated local research institution designated under section 19 of this Schedule;
- interim Type A expenditure** (中期甲類開支)—see section 9 of this Schedule;
- interim Type B expenditure** (中期乙類開支)—see section 11 of this Schedule;
- pre-amended Ordinance** (《原有條例》) means this Ordinance as in force immediately before the commencement date;
- qualifying expenditure related to trade, profession or business** (關乎行業、專業或業務的合資格開支)—see section 12 of this Schedule;
- qualifying R&D activity** (合資格研發活動)—see section 4 of this Schedule;
- qualifying R&D activity related to trade, profession or business** (關乎行業、專業或業務的合資格研發活動)—see section 5 of this Schedule;
- R&D activity** (研發活動)—see section 2 of this Schedule;
- R&D activity related to trade, profession or business** (關乎行業、專業或業務的研發活動)—see section 3 of this Schedule;
- R&D expenditure** (研發開支)—see section 6 of this Schedule;
- specified period** (指明期間) means the period beginning on 1 April 2018 and ending immediately before the commencement date;

*Type A expenditure* (甲類開支)—see section 8 of this Schedule;

*Type B expenditure* (乙類開支)—see section 10 of this Schedule.

- (2) For the purposes of this Schedule, a reference to rights includes a share or interest in rights.

## 2. **Meaning of *R&D activity***

An R&D activity is—

- (a) an activity in the fields of natural or applied science to extend knowledge;
- (b) a systematic, investigative or experimental activity carried on for the purposes of any feasibility study or in relation to any market, business or management research;
- (c) an original and planned investigation carried on with the prospect of gaining new scientific or technical knowledge and understanding; or
- (d) the application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved materials, devices, products, processes, systems or services before they are commercially produced or used.

## 3. **Meaning of *R&D activity related to trade, profession or business***

- (1) An R&D activity related to a trade, profession or business includes—

- (a) an R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the trade, profession or business; and
  - (b) an R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the trade, profession or business.
- (2) An R&D activity related to a class of trade, profession or business includes—
- (a) an R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the class of trade, profession or business; and
  - (b) an R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the class of trade, profession or business.

#### **4. Meaning of *qualifying R&D activity***

- (1) A qualifying R&D activity is an R&D activity that—
- (a) falls within the description in section 2(a), (c) or (d) of this Schedule; and
  - (b) is wholly undertaken and carried on in Hong Kong.
- (2) A qualifying R&D activity does not include—
- (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.

**5. Meaning of *qualifying R&D activity related to trade, profession or business***

- (1) A qualifying R&D activity related to a trade, profession or business includes—
  - (a) a qualifying R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the trade, profession or business; and
  - (b) a qualifying R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the trade, profession or business.
- (2) A qualifying R&D activity related to a class of trade, profession or business includes—
  - (a) a qualifying R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the class of trade, profession or business; and



- (b) a qualifying R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the class of trade, profession or business.

## 6. Meaning of *R&D expenditure*

- (1) An R&D expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—
  - (a) a payment to an R&D institution for an R&D activity related to the trade, profession or business;
  - (b) a payment to an R&D institution which has, as an object, the undertaking of an R&D activity related to the class of trade, profession or business to which the trade, profession or business belongs, where the payment is used for pursuing that object; or
  - (c) any other expenditure on an R&D activity related to the trade, profession or business, including capital expenditure except to the extent that it is expenditure on land or buildings or on alterations, additions or extensions to buildings.
- (2) A payment referred to in subsection (1)(a) or (b) does not include a payment to the R&D institution for acquiring rights generated from an R&D activity.
- (3) An expenditure referred to in subsection (1)(c)—
  - (a) includes an expenditure for carrying out, and providing facilities for carrying out, an R&D activity; and

(b) does not include an expenditure for acquiring rights generated from an R&D activity.

(4) In this section—

**R&D institution** (研發機構) means—

- (a) a designated local research institution; or
- (b) a university or college that is not a designated local research institution.

## 7. When R&D expenditure is incurred

(1) An R&D expenditure is incurred by a person—

- (a) for a payment referred to in section 6(1)(a) or (b) of this Schedule—at the time the payment is made by the person; or
- (b) for an expenditure referred to in section 6(1)(c) of this Schedule—at the time the expenditure is incurred by the person.

(2) However, for a person who is about to carry on a trade, profession or business, the following R&D expenditures are treated as if they had been incurred on the first day on which the person carries on the trade, profession or business—

- (a) a payment referred to in section 6(1)(a) or (b) of this Schedule made by the person;
- (b) an expenditure referred to in section 6(1)(c) of this Schedule incurred by the person.

## 8. Meaning of *Type A expenditure*

A Type A expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—

- (a) for a payment made, or other expenditure incurred, on or after the commencement date—  
an R&D expenditure other than a Type B expenditure within the meaning of section 10(a) of this Schedule; or
- (b) for a payment made, or other expenditure incurred, during the specified period—an interim Type A expenditure.

### 9. Meaning of *interim Type A expenditure*

- (1) An interim Type A expenditure is a payment made during the specified period that—
  - (a) would have been deductible under section 16B(1)(a) of the pre-amended Ordinance; and
  - (b) would not be a Type B expenditure within the meaning of section 10(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that Ordinance were in force.
- (2) Also, an interim Type A expenditure is a payment that—
  - (a) is made during the specified period to a university, college, institute, association, organization or corporation (*entity*) that is, on the commencement date, a designated local research institution;
  - (b) would not have been deductible under section 16B(1)(a) of the pre-amended Ordinance; and
  - (c) would be a Type A expenditure within the meaning of section 8(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that

Ordinance were in force and the entity were a designated local research institution.

- (3) Also, an interim Type A expenditure is any other expenditure (*specified expenditure*) incurred during the specified period that—
- (a) would have been deductible under section 16B(1)(b) of the pre-amended Ordinance; and
  - (b) would not be a Type B expenditure within the meaning of section 10(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date on which the specified expenditure is incurred, that Ordinance were in force.

#### 10. **Meaning of *Type B expenditure***

A Type B expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—

- (a) for a payment made, or other expenditure incurred, on or after the commencement date— an R&D expenditure falling within any of the following descriptions—
  - (i) a payment to a designated local research institution for a qualifying R&D activity related to the trade, profession or business;
  - (ii) a payment to a designated local research institution which has, as an object, the undertaking of a qualifying R&D activity related to the class of trade, profession or business to which the trade, profession or business belongs, where the payment is used for pursuing that object;

- (iii) a qualifying expenditure related to the trade, profession or business; or
- (b) for a payment made, or other expenditure incurred, during the specified period—an interim Type B expenditure.

### 11. Meaning of *interim Type B expenditure*

- (1) An interim Type B expenditure is a payment that—
  - (a) is made during the specified period to a university, college, institute, association, organization or corporation (*entity*) that is, on the commencement date, a designated local research institution; and
  - (b) would be a Type B expenditure within the meaning of section 10(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that Ordinance were in force and the entity were a designated local research institution.
- (2) Also, an interim Type B expenditure is any other expenditure (*specified expenditure*) incurred during the specified period that—
  - (a) would have been deductible under section 16B(1)(b) of the pre-amended Ordinance; and
  - (b) would be a Type B expenditure within the meaning of section 10(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date on which the specified expenditure is incurred, that Ordinance were in force.

**12. Meaning of *qualifying expenditure related to trade, profession or business***

- (1) A qualifying expenditure related to a trade, profession or business is—
  - (a) an expenditure in relation to an employee who is engaged directly and actively in a qualifying R&D activity related to the trade, profession or business; or
  - (b) an expenditure on a consumable item that is used directly in a qualifying R&D activity related to the trade, profession or business.
- (2) In ascertaining the expenditure in relation to an employee who is only partly engaged directly and actively in a qualifying R&D activity related to the trade, profession or business, the appropriate proportion of the expenditure is to be taken into account.
- (3) In ascertaining the expenditure on a consumable item that is only partly used directly in a qualifying R&D activity related to the trade, profession or business, the appropriate proportion of the expenditure is to be taken into account.
- (4) For the purposes of this section—
  - (a) a person is not engaged directly and actively in a qualifying R&D activity related to a trade, profession or business only because the person provides, in support of the activity, services such as—
    - (i) any accounting service;
    - (ii) any administrative service; or
    - (iii) any secretarial service; and

- (b) a consumable item is not used directly in a qualifying R&D activity related to a trade, profession or business only because the item is used in providing, in support of the activity, services such as—
- (i) any accounting service;
  - (ii) any administrative service; or
  - (iii) any secretarial service.

(5) In this section—

**consumable item** (消耗品) means any material or item, including any fuel, power and water that, when used, is consumed or transformed in such a way that it is no longer usable in its original form;

**director** (董事) means a person who is—

- (a) a director as defined by section 2(1) of the Companies Ordinance (Cap. 622) (**Cap. 622 director**);
- (b) a shadow director as defined by section 2(1) of the Companies Ordinance (Cap. 622) (**shadow director**); or
- (c) a person who has similar functions, powers and duties to a Cap. 622 director or a shadow director under the law of a place outside Hong Kong that is similar to the Companies Ordinance (Cap. 622);

**expenditure in relation to an employee** (關於僱員的開支)—

- (a) means any salary, wages or any of the following items, paid or granted (whether in cash or any other form), to or in respect of an employee in relation to the employment—

- (i) an ordinary annual contribution to a fund duly established under a recognized occupational retirement scheme;
  - (ii) an ordinary annual premium in respect of a contract of insurance under a recognized occupational retirement scheme;
  - (iii) any contributions made to a mandatory provident fund scheme at regular intervals that are either of similar or substantially similar amounts or of amounts calculated by reference to a scale or a fixed percentage of the employee's salary or other remuneration;
  - (iv) any other benefit that constitutes a cash outlay paid by the employer; and
- (b) does not include any remuneration of a director, or any item that falls within the description in paragraph (a)(i), (ii), (iii) or (iv) paid or granted (whether in cash or any other form) to or in respect of a director.

## Part 2

### Deduction for R&D Expenditures

#### 13. Total amount of deduction under section 16B

- (1) This section applies subject to sections 14 and 15 of this Schedule.
- (2) In ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 for a year of assessment, the amount allowed to be deducted under section 16B



for R&D expenditures incurred by the person during the basis period for the year of assessment is the sum of—

- (a) for Type A expenditures—subject to subsection (3), 100% of the expenditures; and
- (b) for Type B expenditures—
  - (i) if the total amount of the expenditures exceeds \$2,000,000—\$6,000,000 plus 200% of the part of the expenditures that exceeds \$2,000,000; or
  - (ii) if the total amount of the expenditures does not exceed \$2,000,000—300% of the expenditures.

(3) If—

- (a) a Type A expenditure is incurred for an R&D activity carried on outside Hong Kong in relation to a trade, profession or business; and
- (b) the trade, profession or business is carried on partly in, and partly out of, Hong Kong,

the amount allowed to be deducted for the expenditure is the appropriate proportion of the expenditure that the Commissioner considers is reasonable in the circumstances.

#### **14. Expenditures that may not be deducted**

No deduction is to be allowed under section 16B for an R&D expenditure incurred on or after the commencement date by a person if—

- (a) for an R&D expenditure incurred by the person that falls within the description in section 6(1)(a) or (c) of this Schedule—

- (i) any rights generated from the activity are not, or will not be, fully vested in the person; or
  - (ii) the activity is undertaken for another person;
- (b) the expenditure is, or is to be, met directly or indirectly by—
  - (i) the Government;
  - (ii) the government of any place outside Hong Kong;
  - (iii) any public or local authority in Hong Kong or elsewhere; or
  - (iv) another person; or
- (c) the expenditure is incurred under an arrangement the main purpose, or one of the main purposes, of which is to enable the person to obtain—
  - (i) a deduction to which the person would not otherwise be entitled under section 16B; or
  - (ii) a deduction of a greater amount than the amount to which the person would otherwise be entitled under section 16B.

### **15. No multiple deduction**

An R&D expenditure may only be deducted for one trade, profession or business.

## Part 3

### Proceeds of Sale

#### 16. Proceeds of sale of certain plant or machinery treated as trading receipts

- (1) This section applies in relation to plant or machinery representing expenditure or expenditures of a capital nature allowed under section 16B as a deduction or deductions in ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 if—
  - (a) the plant or machinery ceases to be used by the person for any R&D activity related to the trade, profession or business; and
  - (b) the plant or machinery is subsequently sold by the person, or destroyed, on or after 1 April 2018.
- (2) The proceeds of sale of the plant or machinery must be treated as a trading receipt arising in or derived from Hong Kong of the trade, profession or business accruing—
  - (a) at the time of the sale; or
  - (b) if the sale occurs on or after the date on which the trade, profession or business is permanently discontinued—immediately before the discontinuance.
- (3) However, subsection (2) applies to the proceeds of sale of the plant or machinery only to the extent that the proceeds—

- (a) are not chargeable to tax under any other provision of Part 4; and
  - (b) do not exceed the total amount of deductions allowed under section 16B for expenditure or expenditures of a capital nature represented by the plant or machinery.
- (4) If the plant or machinery is destroyed—
- (a) the plant or machinery is, for the purposes of subsection (2), to be treated as if it had been sold immediately before its destruction; and
  - (b) any insurance moneys or other compensation of any description received by the person carrying on the trade, profession or business in respect of the destruction, and any money received by the person in respect of the remains of the plant or machinery, are to be treated as if they were the proceeds of that sale.
- (5) For the purposes of this section, a sale occurs at the time of its completion or the time when possession of the plant or machinery is given, whichever happens earlier.

#### **17. Proceeds of sale of rights treated as trading receipts**

- (1) This section applies in relation to rights sold on or after 1 April 2018 where the rights were generated from one or more R&D activities for which expenditure or expenditures have been allowed under section 16B as a deduction or deductions in ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4.

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- (2) This section applies despite the exclusion relating to the sale of capital assets in section 14.
  - (3) The proceeds of sale of the rights must, to the extent that the proceeds are not chargeable to tax under any other provision of Part 4, be treated as a trading receipt arising in or derived from Hong Kong of the trade, profession or business of a specified amount accruing—
    - (a) unless paragraph (b) applies—at the time of completion of the sale; or
    - (b) if the sale is completed on or after the date on which the trade, profession or business is permanently discontinued—immediately before the discontinuance.
  - (4) For the purposes of subsection (3), the specified amount is—
    - (a) if the expenditures deducted for the R&D activity or activities that generated the rights (*underlying activities*) consist of both Type A expenditure and Type B expenditure—the specified amount calculated under subsection (7);
    - (b) otherwise—the lesser of—
      - (i) the total amount of deductions allowed under section 16B for the expenditures; and
      - (ii) subject to subsection (5), the proceeds of sale.
  - (5) If any relevant Type A expenditure for the underlying activities was not allowed to be deducted in full because of the operation of section 13(3) of this

Schedule or section 16B(2) (as in force before the commencement date), the proceeds of sale referred to in subsection (4)(b)(ii) are to be adjusted downward.

- (6) The adjusted proceeds of sale are to bear the same ratio to the actual proceeds of sale as the ratio that the total amount of deduction or deductions allowed for all Type A expenditures for the underlying activities bears to those Type A expenditures.
- (7) The specified amount referred to in subsection (4)(a) is to be calculated in accordance with the following steps—

#### **Step 1**

Divide the proceeds of sale into **sale proceeds A** and **sale proceeds B** according to the ratio between—

- (a) Type A expenditures that were incurred on the underlying activities; and
- (b) Type B expenditures that were incurred on the underlying activities.

#### **Step 2**

Calculate an **amount A** which equals the lesser of—

- (a) the total amount of deductions for Type A expenditures; and
- (b) sale proceeds A.

For the purpose of calculating **amount A**, sale proceeds A are to be adjusted downward if any relevant Type A expenditure for the underlying activities was not allowed to be deducted in full because of the operation of

section 13(3) of this Schedule or section 16B(2) (as in force before the commencement date).

The adjusted amount is to bear the same ratio to sale proceeds A as the ratio that the total amount of deduction or deductions allowed for all Type A expenditures for the underlying activities bears to those Type A expenditures.

### Step 3

Calculate an **amount B** which equals the lesser of—

- (a) the total amount of deductions for Type B expenditures; and
- (b) sale proceeds B.

### Step 4

Add amount A and amount B together to get the **specified amount**.

- (8) To avoid doubt and without limiting the meaning of expenditure in this Schedule, for the purposes of subsections (1) and (4), an expenditure includes a payment.

- (9) In this section—

*proceeds of sale* (售賣得益) means the proceeds of sale that are not attributable to the sale of plant or machinery;

*Type A expenditure* (甲類開支) includes—

- (a) any payment described in section 16B(1)(a) (as in force before the commencement date) that is made before 1 April 2018; and

- (b) any expenditure described in section 16B(1)(b) (as in force before the commencement date) that is incurred before 1 April 2018.

## Part 4

### Miscellaneous Matters

#### 18. Commissioner may seek advice from Commissioner for I&T on certain matters

- (1) This section applies if a claim, or an application under section 88A(1), is made by a person to the Commissioner in relation to a deduction under section 16B.
- (2) On receiving the claim or application, the Commissioner may seek advice from the Commissioner for I&T, or a public officer authorized by the Commissioner for I&T, in order to ascertain—
  - (a) for a claim made in relation to a deduction under section 16B—
    - (i) whether an activity constitutes an R&D activity or a qualifying R&D activity; and
    - (ii) whether an R&D expenditure was incurred by the claimant in relation to an R&D activity or a qualifying R&D activity; and
  - (b) for an application made in relation to a deduction under section 16B—
    - (i) whether an activity constitutes an R&D activity or a qualifying R&D activity;



- (ii) whether an R&D expenditure that was incurred by the applicant was incurred in relation to an R&D activity or a qualifying R&D activity; and
- (iii) whether an R&D expenditure to be incurred by the applicant is, if incurred, an R&D expenditure incurred in relation to an R&D activity or a qualifying R&D activity.

**19. Designation of local institutions as designated local research institution**

- (1) The Commissioner for I&T may designate any of the following institutions as a designated local research institution—
  - (a) any university or college located in Hong Kong;
  - (b) any other local institution that undertakes qualifying R&D activities in Hong Kong.
- (2) If the Commissioner for I&T decides to designate a university, college or local institution under subsection (1), the Commissioner for I&T must, as soon as reasonably practicable, give a copy of the instrument of designation to the university, college or institution.
- (3) A designation made under subsection (1)—
  - (a) takes effect on the date specified in the instrument of designation; and
  - (b) may be revoked by the Commissioner for I&T at any time.

- (4) If the designation of a university, college or local institution is revoked under subsection (3)(b), the Commissioner for I&T must, as soon as reasonably practicable, give a copy of the instrument of revocation to the university, college or institution.
- (5) The revocation takes effect on the date specified in the instrument of revocation.
- (6) In this section—

*local institution* (本地機構) means an institute, association, organization or corporation that is located in Hong Kong.

## Part 5

### Transitional Provision for Inland Revenue (Amendment) (No. 3) Ordinance 2018

#### 20. Transitional provision relating to section 16B

- (1) This section applies for the purposes of ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 for a year of assessment if the basis period of the person for that year of assessment includes all or any of the specified period.
- (2) Section 16B (other than section 16B(3) and (3A)), as in force before the commencement date, continues to apply in relation to—
  - (a) a payment made before 1 April 2018; and
  - (b) an expenditure incurred before 1 April 2018.

- (3) Section 16B, as in force before the commencement date, continues to apply in relation to a sale of plant or machinery, and to a sale of rights generated from one or more R&D activities, that occurred before 1 April 2018.”
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## Part 3

### Amendments to Specification of Public Offices Notice

#### 14. Schedule amended (specification of public offices)

- (1) The Schedule, after the entry relating to the Collector of Stamp Revenue specified for the purposes of the Betting Duty Regulations (Cap. 108 sub. leg. A)—

**Add**

“Commissioner for  
Innovation and  
Technology

Inland Revenue Ordinance  
(Cap. 112), section 19 of  
Schedule 45.”.

- (2) The Schedule, entry relating to the Commissioner of Inland Revenue—

**Repeal**

“sections 16B and”

**Substitute**

“section”.

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## Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*principal Ordinance*)—

- (a) to provide for enhanced tax deductions for certain expenditures incurred in relation to research and development activities (*R&D activities*);
  - (b) to introduce further safeguards to prevent the abuse of tax deductions in respect of R&D activities; and
  - (c) to provide that certain sums received by or accrued to a person are deemed as trading receipts chargeable to tax.
2. Clause 1 sets out the short title.
  3. Clause 3 amends section 2 of the principal Ordinance by adding a definition of *Commissioner for I&T* to that section.

### Amendments to section 15 of principal Ordinance

4. Clause 5 amends section 15(1) of the principal Ordinance to add the new paragraph (bb) to deem the following sums as trading receipts chargeable to tax—
  - (a) sums received by or accrued to a person for the use, or the right to the use, outside Hong Kong of any intellectual property or know-how generated from any R&D activity (in respect of which deduction is allowable under the new section 16B of the principal Ordinance (*new section 16B*) in ascertaining profits of the person under Part 4 of the principal Ordinance);

- (b) sums received by or accrued to a person for imparting or undertaking to impart knowledge directly or indirectly connected with the use outside Hong Kong of such property or know-how.

**New section 16B of, and new Schedule 45 to, principal Ordinance**

5. Clause 7 replaces section 16B of the principal Ordinance with the new section 16B. The new section 16B generally provides for—
- (a) the deduction of expenditures on R&D activities; and
  - (b) the treatment of the proceeds of sale of plant or machinery for, and rights generated from, R&D activities as trading receipts.

The new section 16B introduces the new Schedule 45 which provides for the operational details of the deduction of expenditures and the treatment of the proceeds of sale. The new Schedule 45 is added by clause 13.

6. The main provisions of the new Schedule 45 are as below.
7. Part 1 of the Schedule (which contains 12 sections) provides for the definitions of the key terms and expressions used throughout the Schedule. Those terms and expressions include—
- (a) *designated local research institution*;
  - (b) *qualifying expenditure related to trade, profession or business*;
  - (c) *qualifying R&D activity*;

- (d) *R&D activity*;
- (e) *R&D expenditure*;
- (f) *Type A expenditure*; and
- (g) *Type B expenditure*.

8. Part 2 of the Schedule contains 3 sections (sections 13, 14 and 15).
9. Section 13 provides for the calculation of the total amount allowed to be deducted under the new section 16B for R&D expenditures during the basis period for a year of assessment. Generally speaking, a Type A expenditure qualifies for the basic 100% tax deduction, whereas a Type B expenditure qualifies for the enhanced two-tiered tax deduction.
10. Section 14 provides for safeguards to prevent the abuse of tax deductions in respect of R&D activities. It is more comprehensive than the safeguards in the current section 16B(6) of the principal Ordinance.
11. Section 15 provides that an R&D expenditure may only be deducted for one trade, profession or business, which is the same as in the current section 16B(7) of the principal Ordinance.
12. Part 3 of the Schedule consists of 2 sections (sections 16 and 17).
13. Section 16 provides for the treatment of the proceeds of sale of plant or machinery as trading receipts. It is substantially the same as the current section 16B(3) of the principal Ordinance.

14. Section 17 provides for the treatment of the proceeds of sale of rights as trading receipts. It is a rewrite of the current section 16B(3A) of the principal Ordinance to revise the formula for calculating the amount of the proceeds to be treated as trading receipts after the introduction of the enhanced tax deduction.
15. Part 4 of the Schedule, which contains 2 sections (sections 18 and 19), deals with miscellaneous matters.
16. Section 18 empowers the Commissioner of Inland Revenue to seek advice from the Commissioner for Innovation and Technology (*Commissioner for I&T*) on certain matters related to claims and applications made in relation to the new section 16B.
17. Section 19 provides for the powers of the Commissioner for I&T in relation to the designation of designated local research institutions.
18. Part 5 of the Schedule provides for a transitional provision required as a result of clause 7.

**Consequential, related and textual amendments made to principal Ordinance**

19. Clauses 4, 6, 8, 9, 10, 11 and 12 make consequential, related and minor textual amendments to the following provisions of the principal Ordinance—
  - (a) section 4 (official secrecy);
  - (b) section 16 (ascertainment of chargeable profits);
  - (c) section 37 (initial and annual allowances, machinery or plant);



- (d) section 37A (initial and annual allowances in respect of machinery and plant acquired under hire purchase agreement);
- (e) section 39B (initial and annual allowances on machinery or plant under the pooling system);
- (f) section 40 (interpretation);
- (g) section 68 (hearing and disposal of appeals to the Board of Review).

### **Consequential amendments to other enactment**

20. Clause 14 consequentially amends the Schedule to the Specification of Public Offices Notice (Cap. 1 sub. leg. C) so that—
- (a) the Commissioner for I&T may delegate the Commissioner for I&T's powers and duties under section 19 of Schedule 45 to the principal Ordinance in accordance with section 43 of the Interpretation and General Clauses Ordinance (Cap. 1); and
  - (b) the removal of the reference to the Commissioner of Inland Revenue in the new section 16B is reflected.