

# **立法會**

## ***Legislative Council***

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### **Report of the Bills Committee on Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024**

#### **Purpose**

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024 (“the Bills Committee”).

#### **Background**

2. Currently, the Inland Revenue Ordinance (Cap. 112) (“IRO”) does not allow the costs of reinstating the condition of premises under a lease (“leased premises”) to their original condition to be deducted from the lessee’s chargeable profits as it is considered as expenditure of a capital nature.<sup>1</sup> In respect of expenditure incurred on the construction of a commercial or industrial building or structure, a qualifying taxpayer may claim an annual allowance for depreciation by wear and tear (“annual allowance”) during a specified period<sup>2</sup> starting from the year of assessment (“YA”) in which the building or structure was first used

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<sup>1</sup> Pursuant to section 17(1)(c) of IRO, any expenditure of a capital nature shall not be deducted for the purpose of ascertaining profits in respect of which a person is chargeable to profits tax.

<sup>2</sup> For an industrial building or structure that was first used on or after the commencement of the basis period for YA 1965-1966 or a commercial building or structure, annual allowances can be claimed for a maximum of 25 years, starting from the year of the first use or, in the case of a commercial building or structure, YA 1998-1999. For an industrial building or structure that was first used before the commencement of the basis period for YA 1965-1966, annual allowances can be claimed for a maximum of 50 years starting from the year of the first use.

(“usage period”). The buyer of the building or structure sold before the expiry of the usage period may claim annual allowances over the remaining YAs within the usage period. If the building or structure is sold after the expiry of the usage period, the buyer will not be entitled to claim any annual allowance even if there is residue of expenditure.<sup>3</sup> It is proposed in the Budget for the 2024-2025 financial year to introduce two enhancement measures for deduction of expenses under profits tax, namely (a) tax deduction for reinstatement costs for leased premises; and (b) removal of the time limit for claiming annual allowances for commercial and industrial buildings and structures.<sup>4</sup> The Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024 (“the Bill”) is introduced to give effect to the above policy initiatives.

### **Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024**

3. The Bill was published in the Gazette on 18 October 2024 and received its First Reading at the Legislative Council (“LegCo”) meeting of 30 October 2024. The Bill seeks to :

- (a) introduce a tax deduction for reinstatement costs for premises under a lease;
- (b) remove the time limit for claiming annual allowances for commercial and industrial buildings and structures; and
- (c) provide for related matters.

The key features of the Bill are summarized in paragraphs 4 to 8 below.

#### Proposed new tax deduction for reinstatement costs for leased premises

4. Clauses 3(1) and 3(2) of the Bill seek to add new sections 16(1)(gc) and 16(2K) to IRO respectively to provide for a tax deduction allowable for the costs of reinstating any leased premises to their original condition at the end of or on an early termination of the lease (“reinstatement costs”), if all of the following conditions are met:

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<sup>3</sup> Please refer to section 40(1) of IRO for the definition of “residue of expenditure”.

<sup>4</sup> Please refer to paragraph 54 of the 2024-2025 Budget Speech.

- (a) the person claiming the tax deduction is a lessee of the lease;
- (b) the person has an obligation (express or implied, and whether arising from the lease or from another agreement between the lessor and the lessee) to reinstate or pay (in full or in part) for the reinstatement of the leased premises to their original condition at the end of the term or on an early termination of the lease;
- (c) the reinstatement costs do not relate to any provisions<sup>5</sup> made under the Hong Kong Financial Reporting Standard 16 (Leases) as issued by the Hong Kong Institute of Certified Public Accountants and in force from time to time, or any other similar accounting standards;<sup>6</sup> and
- (d) the amount of the reinstatement costs is reasonable in the circumstances.

5. Clause 3(5) of the Bill seeks to add a new section 16(5D) to IRO to provide that the proposed tax deduction for reinstatement costs for leased premises would apply only in relation to a YA beginning on or after 1 April 2024.

Proposed removal of time limit for claiming annual allowances for commercial and industrial buildings and structures

6. Clauses 4(3) and 5(3) of the Bill seek to amend sections 33A(2) and 34(2)(b) of IRO respectively to provide that, where the sale of the relevant interest in a commercial or industrial building or structure takes place in the basis period for a YA before YA 2024-2025 (“pre-2024 basis period”), the annual allowances, in YAs the basis periods for which end after the time of the sale, would be calculated by reference to the residue of

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<sup>5</sup> “Provision” in accounting refers to the amount that is generally put aside from the profit in order to meet a probable future expense or a reduction in the asset value although the exact amount incurred is unknown.

<sup>6</sup> According to paragraph 6(c) of the LegCo Brief, this requirement seeks to ensure that the reinstatement costs to be claimed have been incurred. Under the relevant accounting standards, where there is an obligation to reinstate the leased premises at the end of the lease term, a provision will be made in the profit and loss accounts in the first year of the lease term based on the estimated reinstatement costs to be incurred at the end of the lease term. As the provision is subject to review and adjustment in each year during the lease term to reflect the latest estimate, the costs that relate to any provisions made under the relevant accounting standards are hence not yet incurred.

expenditure immediately after the sale over the remaining YAs within the usage period in accordance with the existing provisions of IRO, and so on for any subsequent sale that takes place in a pre-2024 basis period.

7.       Clauses 4(6) and 5(8) of the Bill seek to add new sections 33A(2A) and 34(2)(bb) to IRO respectively to provide that, if the sale of the relevant interest in a commercial or industrial building or structure takes place in the basis period for a YA beginning on or after 1 April 2024, the annual allowance, in any YA the basis period for which ends after the time of the sale, would be an amount equal to 4% of the residue of expenditure immediately after the sale, and the annual allowance could be claimed until the residue of expenditure immediately after the sale has been fully claimed, and so on for any subsequent sale.

8.       Clause 5(8) of the Bill also seeks to add a new section 34(2)(ba) to IRO to provide that, if the sale of the relevant interest in an industrial building or structure takes place after the usage period of 25 or 50 years (as applicable) and in a pre-2024 basis period but no annual allowance has ever been made because the usage period has expired at the time of the sale, the annual allowance, in YA 2024-2025 and any YA after that, would be an amount equal to 4% of the residue of expenditure immediately after the sale. The annual allowances could be claimed until the residue of expenditure immediately after the sale has been fully claimed.

9.       Details of the major provisions of the Bill are set out in paragraph 12 of the LegCo Brief (File Ref.: TsyB R 183/535-1/9/0 (24-25) (C)) issued in October 2024. The Bill, if passed, would come into operation on the day on which the enacted Ordinance is published in the Gazette.

## **The Bills Committee**

10.       At its meeting held on 1 November 2024, the House Committee agreed to form a Bills Committee to scrutinize the Bill. Hon Holden CHOW was elected Chairman of the Bills Committee. The membership list of the Bills Committee is in the [Appendix](#).

11.       The Bills Committee has held one meeting with the Administration and invited written submissions from the public. The

Bills Committee has received one submission.<sup>7</sup> The Administration has provided a written response<sup>8</sup> on the issues raised in the submission.

## **Deliberations of the Bills Committee**

12. The Bills Committee's deliberations are set out in the ensuing paragraphs.

### Definitions of "lease" and "premises"

13. Regarding tax deduction for reinstatement costs in relation to premises under a "lease", members have enquired whether the tax deduction would apply to land or buildings and structures thereon under a lease, as well as premises under various leasing arrangements such as Government Land Licences or licence agreements.

14. The Administration has advised that for the purposes of the proposed tax deduction for reinstatement costs, there are no definitions for the terms "lease" and "premises" under IRO at present. Insofar as the application of the Bill is concerned, the Administration will make reference to the meaning of "premises" in dictionaries, i.e. "premises" would generally mean a place for carrying out a business, which may also include land and buildings. For example, land may also include "seabed". Some members have asked whether IRO should include a definition of the term "lease". The Administration has advised that while there is no such definition in IRO, flexibility would be allowed in its enforcement. The Administration has also advised that the term "lease" will be explained in the relevant website or explanatory notes. When elaborating on the reinstatement costs for leased premises, the Administration has cited an example involving a piece of land leased by a taxpayer for operating a temporary car park. If some necessary buildings and structures have been erected by the taxpayer on the land, and they would have to be demolished at the end of or on early termination of the lease of the land, the demolition cost of such buildings and structures can be regarded as meeting the relevant conditions provided under the Bill for tax deduction.

15. The Administration has further advised that under the Bill, the conditions for tax deduction under the Bill would have been satisfied if a person claiming profits tax deduction for reinstatement costs is the lessee of

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<sup>7</sup> LC Paper No. [CB\(1\)1580/2024\(01\)](#).

<sup>8</sup> LC Paper No. [CB\(1\)1610/2024\(01\)](#).

the relevant lease who has an obligation to reinstate, or pay for the reinstatement of, the premises to their original condition at the end of the term of the lease or on early termination of the lease, and the reinstatement costs (the amount of which being reasonable) have actually been incurred. The reinstatement obligation can be express or implied, and it can also arise from the lease or from another agreement between the lessor and lessee of the lease. The Administration has also advised that as the objective of the Bill is to help business operators reduce their tax expenditure as lessees, the Administration will adopt a lenient approach in determining whether the reinstatement costs are deductible, such that it will not insist on having a physical tenancy agreement as the basis of granting the relevant tax deduction. Even if the claimant is claiming tax deduction on reinstatement costs of premises under licence agreements or other forms of leasing arrangements (e.g. verbal agreement), the Inland Revenue Department (“IRD”) will consider whether the relevant leasing arrangement of the premises operates in the same way as a lease either in substance or in effect, for example, whether the claimant has been granted exclusive right of use of the premises, and whether the tax deduction claim meets the above conditions.

#### Meaning of reinstatement costs being “reasonable in the circumstances”

16. The proposed new section 16(2K)(d) provides that the amount of the reinstatement costs must be reasonable in the circumstances. Members have enquired about how to assess the reasonableness of the amount of the reinstatement costs, as well as the relevant criteria, and whether the Administration would consider specifying the person responsible for determining the reasonableness of the amount of the reinstatement costs in the Bill. In this regard, members have suggested the Administration to make reference to section 16EC(1)(c) of IRO which provides that one of the conditions for disallowing deductions for purchase of intellectual property right is the consideration for such purchase is unreasonable in the opinion of the Commissioner for Inland Revenue.

17. Separately, the Legal Adviser to the Bills Committee has sought clarification from the Administration that in the case where it is determined that the amount of the reinstatement costs claimed is not reasonable in the circumstances (e.g. on the ground that it is more than an amount that would be considered as reasonable), whether tax deduction would be allowed in respect of the part of the reinstatement costs incurred that is within an amount considered by the assessor to be reasonable, and if so, whether the same should be spelt out in the Bill.<sup>9</sup>

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<sup>9</sup> LC Paper No. [CB\(1\)1506/2024\(01\)](#).

18. The Administration has advised that in determining whether the amount of the reinstatement costs is reasonable for the purposes of the proposed new section 16(2K)(d) of IRO, one of the key references is whether the claimed costs have significantly deviated from the costs of reinstating premises of a similar nature and size to their original condition in the market. For profits tax cases in general, IRD will adopt an approach of making tax assessment first before random checking. In the conduct of subsequent random checks, the burden of proof will be on the claimant, and IRD has the right to request the claimant to furnish information on the reinstatement costs, such as a breakdown of the costs claimed and corresponding supporting documents. Where necessary, the claimant may also need to furnish independent valuations of the reinstatement works carried out. After the commencement of the enacted Bill, IRD will make available relevant information or Frequently Asked Questions on its website for explanation purpose.

19. On whether it is necessary to specify in the proposed new section 16(2K)(d) who would determine the reasonableness of the amount of the reinstatement costs and that only the part of the reinstatement costs incurred that is considered reasonable will be allowed for deduction, the Administration has advised that the assessors of IRD are empowered to make tax assessments, including ascertaining the profits that are chargeable to tax. Section 16(1) of IRO provides for a list of outgoings and expenses that shall be deducted in ascertaining profits in the calculation of profits tax, to the extent to which they are incurred in the production of the profits. Such outgoings and expenses are assessed by the assessors of IRD on the premise of reasonableness. If an IRD assessor determines that the amount of deduction claimed is not reasonable, deduction will only be allowed for the part that is considered reasonable. Since the proposed new section 16(1)(gc) adds reinstatement costs to the list and forms part of section 16(1), and section 16(2K)(d) provides for the conditions that have to be met under section 16(1)(gc), it follows that the assessors of IRD will be responsible for assessing the reasonableness of the amount of the reinstatement costs claimed. The Administration therefore does not consider it necessary for the proposed new section 16(2K)(d) to expressly provide who to determine whether an amount of reinstatement costs is reasonable. Even if the claimant considers that the amount of the reinstatement costs claimed is reasonable, it is still the assessor of IRD who will determine its reasonableness for the purpose of allowing the deduction.

20. The Administration has supplemented that the reasonableness test is also adopted in different provisions of IRO. Many of them (e.g. sections 16(2A), 26E(2)(a)(i)(B) and 26Y(6)(b)) do not specify who

will determine what is reasonable but it is well understood that the assessors of IRD will perform that duty.

#### Proposed removal of time limit for claiming annual allowances

21. The Bill proposes to remove the time limit for claiming annual allowances in respect of commercial or industrial buildings or structures from YA 2024-2025. Referring to the sale of commercial or industrial buildings or structures with expired or unexpired usage periods, members have enquired about the difference in the amount of annual allowances to be claimed by the relevant buyers before or after the commencement of the enacted Bill.

22. The Administration has advised that under the existing arrangement for claiming tax deductions, taxpayers may claim an annual allowance of 4% on the construction cost of a commercial or industrial building. If the commercial or industrial building is sold after the end of the usage period, the seller will be subject to a balancing adjustment, but the buyer will not be entitled to claim any annual allowance. Given the disparity of tax treatment on buyers of commercial or industrial buildings or structures with expired usage periods as a result of the time limit for claiming the allowance, buyers may be discouraged from purchasing old or second-hand buildings. Upon the commencement of the enacted Bill, for a commercial or industrial building (whether the usage period has expired) sold in the basis period for a YA since YA 2024-2025 or after, if the buyer is entitled to the relevant interest in relation to the said building and has used the building during the YAs in which the allowance is claimed, he will be granted with an annual allowance of 4% on the residue of expenditure immediately after the sale starting from YA 2024-2025 onwards. For an industrial building or structure with an expired usage period that is sold and used by the buyer in the basis period for a YA before YA 2024-2025, an annual allowance of 4% on the residue of expenditure immediately after the sale will likewise be granted to the buyer starting from YA 2024-2025 onwards.

23. For a commercial or industrial building or structure with an unexpired usage sold and used by the buyer in the basis period for a YA before YA 2024-2025, the Administration has advised that the buyer can claim an annual allowance in the same manner as the existing arrangement.

#### Drafting issues

24. Members have sought clarification from the Administration on whether the term “first used” in the Bill has the same meaning as the term



“first used substantially” in section 16F(4)(b) of IRO; and if so, whether the Bill should adopt the same wording in line with other relevant provisions of IRO. Members have also suggested that when drafting amendment provisions to IRO in the future, the Administration should ensure consistency with the wording used in other relevant provisions of IRO, as well as their readability for easy understanding.

25. The Administration has advised that section 16F of IRO provides for the deduction of capital expenditure incurred on the renovation or refurbishment of a non-domestic building or structure by a person in the production of profits chargeable to tax. Subsection (4)(b) stipulates that the deduction does not apply to capital expenditure incurred to enable a building or structure to be first used substantially by the person for the production of chargeable profits.

26. The policy intent of section 16F is to encourage businesses to maintain and upgrade the standards and quality of premises from time to time. Therefore, the deduction under section 16F does not apply to capital expenditure incurred on the initial construction, decoration or fitting out of a building or structure. The words “first used substantially” in subsection (4)(b) is to disallow such deduction, even if the taxpayer has used the building or structure temporarily or incidentally prior to or during the aforesaid works.

27. The Administration has pointed out that the above policy intent of section 16F(4)(b) does not apply to the calculation of the annual allowance in respect of capital expenditure incurred on the construction of a commercial or industrial building or structure under sections 33A and 34, which the Bill proposes to amend. The calculation is based on when the building or structure was first used for the purposes of a trade, profession or business, regardless of whether the “first use” was temporary, incidental or substantial.

### **Amendments to the Bill**

28. Neither the Bills Committee nor the Administration will propose any amendments to the Bill.

## **Resumption of Second Reading debate on the Bill**

29. The Bills Committee has completed the scrutiny of the Bill and raises no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 18 December 2024.

## **Consultation with the House Committee**

30. The Bills Committee reported its deliberations to the House Committee on 6 December 2024.

Council Business Divisions  
Legislative Council Secretariat  
10 December 2024

**Bills Committee on Inland Revenue (Amendment)  
(Tax Deductions for Leased Premises Reinstatement and  
Allowances for Buildings and Structures) Bill 2024**

**Membership list**

**Chairman** Hon Holden CHOW Ho-ding, JP

**Members** Hon Paul TSE Wai-chun, JP  
Hon Doreen KONG Yuk-foon  
Ir Hon LEE Chun-keung, JP  
Hon Andrew LAM Siu-lo, SBS, JP  
Hon Judy CHAN Kapui, MH, JP  
Hon Lillian KWOK Ling-lai  
Hon Benson LUK Hon-man  
Hon Edmund WONG Chun-sek  
Prof Hon LAU Chi-pang, BBS, JP  
Hon Carmen KAN Wai-mun, JP

(Total: 11 members)

**Clerk** Mr Derek LO

**Legal Adviser** Miss Quincy NG