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COMMERCE, INDUSTRY AND TOURISM BRANCH
**COMMERCE AND ECONOMIC
DEVELOPMENT BUREAU**

GOVERNMENT OF THE HONG KONG
SPECIAL ADMINISTRATIVE REGION

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21 May 2018

Mr Desmond LAM
Clerk to Bills Committee
Legislative Council Secretariat

Dear Mr LAM,

**Inland Revenue (Amendment) (No. 2) Bill 2018
Government's Responses to Written Submissions**

The attached table (at Annex) sets out our response to the written submissions referred to us by the Bills Committee.

Yours sincerely,

A handwritten signature in blue ink, consisting of a large loop followed by a series of smaller, connected strokes.

(Miss Alice CHOI)
for Secretary for Commerce and Economic Development

c.c. Assistant Legal Adviser 5, Legislative Council

Commissioner of Inland Revenue
(Attn: Mr KK CHIU)

Department of Justice
(Attn: Mr Alan CHONG)

Director of Intellectual Property
(Attn: Ms Michelle CHONG)

Inland Revenue (Amendment) (No. 2) Bill 2018

Government's Responses to Written Submissions received by the Bills Committee

Views / comments raised	Organisations ¹	Government's Responses
(1) Support the expansion of the scope of profits tax deduction for capital expenditure incurred for the purchase of intellectual property rights ("IPRs") to cover three additional types of IPRs.	ACCA, AHKA, ASTRI, HKBPA, HKCPAA, HKICPA, HKIPA, HKKPPMUA, HKPC, PWC, TIHK	- We note that all 11 organisations have expressed support to the proposed expansion of the scope of profits tax deduction as set out in the Inland Revenue (Amendment) (No. 2) Bill 2018 ("the Bill").
(2) Suggest that deduction should also be allowed for registration expenditure on copyright and rights to know-how.	AHKA	- In line with the international norm, copyright and rights to know-how do not require registration in Hong Kong, and there is no issue of incurring any expenditure on registration for these two types of IPRs.
(3) Enquire how IRD will conduct tax assessment and tax collection in respect of a non-resident person who is chargeable to tax in respect of sums deemed by the proposed section 15(1)(bb) to be trading receipts arising in or derived from Hong Kong.	TIHK	- The proposed section 15(1)(bb) under clause 3(3) of the Bill is applicable to both Hong Kong residents and non-residents. In case non-residents are involved, the Inland Revenue Department ("IRD") has an established mechanism for tax assessment and collection which has been working well over the years. In short, where section 20B of the Inland Revenue Ordinance ("IRO") applies, the non-resident person concerned (say a non-resident performer / organizer) would be chargeable to tax in respect of the sums concerned in the name of any person in Hong Kong who paid or credited those sums (say a resident entity) to that or any other non-resident person, and the tax so charged shall be recoverable by all means

¹ A list of the organisations and their abbreviations adopted are set out at the [Appendix](#).

Views / comments raised	Organisations ¹	Government's Responses
		<p>provided in the IRO from that person in Hong Kong. That person in Hong Kong shall, at the time he makes the payment or credit, deduct from those sums so much thereof as is sufficient to produce the amount of such tax.</p> <ul style="list-style-type: none"> - It is important to note that, notwithstanding the proposed section 15(1)(bb), expenditures incurred by a performer to earn fees from performances or incurred by an organizer to earn fees from arranging or managing performances are eligible for profits tax deduction. Moreover, any further expenditures incurred to produce sums chargeable to tax under the proposed section 15(1)(bb) for an assignment of, or an agreement to assign, a performer's right are also eligible for profits tax deduction.

Views / comments raised	Organisations ¹	Government's Responses
<p>(4) In relation to the proposed section 15(1)(bb) -</p> <p>(a) suggest that the sums covered by the proposed section 15(1)(bb) should exclude: (i) receipts which are capital in nature; and (ii) receipts corresponding to acquisitions for which the expenditure incurred by the assignee are not deductible in Hong Kong; and</p> <p>(b) enquire why the arrangement under the proposed section applies to performers' rights only, but not to the other types of IPRs.</p>	<p>AHKA, HKICPA, PWC</p>	<ul style="list-style-type: none"> - Sums received for an assignment of, or an agreement to assign, a performer's right are trading receipts of a performer. Such sums are no different from the performance fees received by the performer (revenue in nature, i.e. chargeable to profits tax) since they are derived directly or indirectly from performances given in Hong Kong. The proposed section 15(1)(bb) makes it clear that such sums are trading receipts (revenue in nature) that are chargeable to profits tax in Hong Kong. In contrast to a performer's right, in most cases sums received from the sale of other types of IPRs are capital in nature (not chargeable to profits tax) except for cases where the IPRs are the taxpayers' trading assets. - If certain sums are paid to a performer or an organizer in connection with a Hong Kong performance, such sums are deductible under section 16EA (subject to section 16EC) if the payer is carrying on business in Hong Kong. In any event, as long as the sums received by the <u>recipient</u> are derived from business activities carried out in Hong Kong with a Hong Kong source, such sums should be subject to Hong Kong profits tax. Whether the corresponding <u>payer</u> could successfully obtain tax deduction in Hong Kong under section 16EA is not a relevant factor.
<p>(5) Suggest that deduction should also be allowed for lump-sum payment made for licences conferring permission to use IPRs.</p>	<p>AHKA</p>	<ul style="list-style-type: none"> - The profits tax deduction arrangement for IPRs seeks to cover capital expenditures incurred for the purchase of specified types of IPRs and the registration expenditure of those which are registrable among these specified types of IPRs. The major policy objective of the Bill is to expand the scope of the existing profits tax deduction to cover three more types of IPRs. To claim profits tax deduction in relation to an IPR, a taxpayer must have obtained the proprietary interest (i.e. both legal and economic interests) in the relevant IPR which the taxpayer has acquired.

Views / comments raised	Organisations ¹	Government's Responses
		<p>Since a licensee has not acquired the legal ownership of an IPR, an upfront payment for a license is not eligible for profits tax deduction under the current regime.</p> <ul style="list-style-type: none"> - Notwithstanding the above, it is important to note that an enterprise's revenue expenditure for the use of IPRs (such as royalties and licence fees) is all along deductible under section 16(1) of the IRO, and will continue to be so deductible, for determining its profits tax liability.
<p>(6) Suggest that the restriction under the existing section 16EC(4)(b) of the IRO should be reviewed / removed.</p>	<p>AHKA, TIHK</p>	<ul style="list-style-type: none"> - Section 16EC(4)(b) of IRO was introduced in 2011 as an anti-avoidance provision, following similar principles behind section 39E of the same ordinance. The purpose of section 16EC(4)(b) is to deny tax deduction for IPRs which are used outside Hong Kong by a party other than the taxpayer for production of profits not chargeable to tax in Hong Kong. - On the issue of section 39E and the related issue of section 16EC, as stated in the reply given by the Secretary for Financial Services and the Treasury to a question raised in the LegCo meeting on 21 March 2018, the subject matter is not only concerned with Hong Kong's tax policy, but also the tax arrangements in the Mainland of China. In the light of possible economic integration that may be brought about by the Bay Area development, the HKSAR Government has communicated with the industry and is re-examining the issue, and will study and explore feasible options that comply with the principles of "tax symmetry" and transfer pricing, etc. - The present Bill seeks to expand the scope of the existing tax deduction to cover three more types of IPRs, and is not an ideal platform for dealing with the issue of

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		<p>section 16EC(4)(b). We would like to seek early passage of the Bill so that the trade can be benefited early. We will relate the views expressed to FSTB to facilitate its study mentioned in the above bullet.</p>
<p>(7) Suggest that the existing section 16EC(2) of the IRO should be removed as Hong Kong will soon put in place transfer pricing rules vide another bill, namely the Inland Revenue (Amendment) (No. 6) Bill 2017.</p>	<p>PWC, TIHK</p>	<ul style="list-style-type: none"> - The Inland Revenue (Amendment) (No. 6) Bill 2017, which was introduced into LegCo for first and second readings on 10 January 2018, seeks to, among others, codify the transfer pricing principles into the IRO. It is being examined by another Bills Committee and has yet to be enacted. - The transfer pricing provisions in the Inland Revenue (Amendment) (No. 6) Bill 2017 seek to cover the pricing of goods and services between associated enterprises for the purpose of tax computation, whereas section 16EC(2) of the IRO was introduced mainly to prevent tax abuses by denying tax deduction of capital expenditure incurred for acquiring IPRs under sale and buyback transactions between associated enterprises (i.e. creation of a non-taxable capital gain with a corresponding deductible capital expenditure). Section 16EC(2), if removed, will create opportunities for abuses. Therefore, we consider that there are legitimate reasons for retaining section 16EC(2). It is also important to note that an enterprise's revenue expenditure for the use of IPRs (such as royalties and licence fees) is all along deductible under section 16(1) of the IRO.

List of Organisations (Note)

	Organisations	Abbreviations
1.	Association of Chartered Certified Accountants	ACCA
2.	Association of Hong Kong Accountants	AHKA
3.	Hong Kong Applied Science and Technology Research Institute	ASTRI
4.	Hong Kong Brands Protection Alliance	HKBPA
5.	Hong Kong Chinese Patent Attorneys Association	HKCPAA
6.	Hong Kong Institute of Certified Public Accountants	HKICPA
7.	Hong Kong Institute of Patent Attorneys	HKIPA
8.	Hong Kong and Kowloon Plastic Products Merchants United Association	HKKPPMUA
9.	Hong Kong Productivity Council	HKPC
10.	PricewaterhouseCoopers	PWC
11.	Taxation Institute of Hong Kong	TIHK

Note: Listed in alphabetical order of the English titles of the organisations.