LCQ18: Enhanced tax deduction for research and development expenditures

Following is a question by the Hon Charles Mok and a written reply by the Secretary for Innovation and Technology, Mr Nicholas W Yang, in the Legislative Council today (November 20):

Question:

The Inland Revenue (Amendment) (No. 7) Ordinance 2018 came into operation on November 2, 2018. The expenditures incurred by enterprises on research and development (R&D) activities conducted on April 1, 2018 or thereafter are classified into Type A and Type B. Type A expenditures are qualified for the current 100 per cent tax deduction. For Type B expenditures, the deduction is 300 per cent for the first $2 million and 200 per cent for the remaining amount. "Qualifying R&D activities" are classified into out-sourced and in-house R&D activities. The amounts of (i) payments made to "designated local research institutions" (DLRIs) in respect of the former and (ii) "qualifying expenditures" (i.e. expenditures in relation to employees and consumable items) paid in respect of the latter by enterprises are Type B expenditures, which are qualified for the aforesaid tax deduction at a higher percentage. R&D service providers are required to apply to the Innovation and Technology Commission for designation as DLRIs. In this connection, will the Government inform this Council:
(1) of the respective numbers of applications for designation as DLRIs received, approved and rejected to date by the authorities; if there are rejected applications, of the reasons for that;
(2) of the number of enterprises which have applied for tax deduction for R&D expenditures since the aforesaid Ordinance came into operation, as well as the total R&D expenditures involved, with a breakdown by the following types of expenditures:
Type B expenditures
(i) expenditures on out-sourced qualifying R&D activities,
(ii) qualifying expenditures on in-house qualifying R&D activities,
Type A expenditures
(iii) other expenditures on in-house qualifying R&D activities, and
(iv) expenditures on other R&D activities; and
(3) whether it has plans to provide additional tax concessions for R&D related activities; if so, of the details?

Reply:

President,

To encourage more enterprises to conduct research and development (R&D) locally and promote technological innovation and economic development in Hong Kong, the Government implemented last year the enhanced tax deduction for expenditures incurred on "qualifying R&D activities" by enterprises. R&D

expenditures eligible for deduction are classified into "Type A expenditures" which are qualified for 100 per cent deduction, and "Type B expenditures" which are qualified for the enhanced tax deduction. Type B expenditures have a two-tiered deduction regime. The deduction is 300 per cent for the first $2 million of the aggregate amount of payments made to "designated local research institutions" (DLRIs) for "qualifying R&D activities" and expenditures incurred by enterprises from carrying out in-house qualifying R&D activities. The remaining amount is qualified for 200 per cent deduction. There is no cap on the amount of enhanced tax deduction and the deduction is applicable to all enterprises. Enterprises can claim the enhanced tax deduction in relation to the "qualifying R&D expenditures" on or after April 1, 2018.

Our reply to the respective questions is as follows:

(1) The Innovation and Technology Commission has so far received five applications for designation as DLRIs. Among these applications, three have been approved, one was withdrawn by the applicant and the remaining one was not approved mainly because the R&D activities conducted by the applicant did not meet the definition of "qualifying R&D activity" under the Inland Revenue Ordinance (IRO). Besides, we have already designated 30 local universities, colleges and public research institutions as DLRIs under the IRO. In other words, there are currently 33 DLRIs in total.

(2) According to the information provided by Inland Revenue Department, up to end October 2019, among the profits tax returns received, there are 60 applications claiming R&D tax deduction for 2018/19 assessment year pursuant to the amended IRO. The relevant expenditures for claiming tax deduction are as follows:

Category	In-house R&D ($ million)	Outsourcing R&D ($ million)	Total ($ million)
Type A Expenditures	82.0	32.4	114.4
Type B Expenditures	825.6	40.3	865.9
Subtotal:	907.6	72.7	980.3

(3) As the implementation of the R&D tax deduction measure is still in the initial stage, we need time to review the response and effectiveness of the measure. At this stage, there is no plan to further broaden the tax concessions.