

Hong Kong Tax Alert

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Bill¹ for tax deductions of spectrum utilization fees (SUFs) gazetted

- deductions for a year to be granted based on the annual instalment payable in the year or, if not payable by annual instalments, based on an amount equal to the total amount of SUFs payable divided by the total number of eligible years of assessment involved

Background

Different ranges of frequencies of radio spectrum by which mobile network operators (MNOs) use to transmit their telecommunication signals in their business operations in Hong Kong have been assigned to them by the Communications Authority (CA) of Hong Kong.

Previously, the assignments of radio spectrum (generally for 15 years) were made by way of the CA charging them SUFs based on their annual turnover for the period concerned, i.e., an annual royalty payment method.

Since 2007, the annual royalty payment method for such assignments has been replaced by a fixed price set at spectrum auctions, albeit the amount set could be agreed to be paid over several annual instalments.

The Inland Revenue Department (IRD) has taken the position that such SUFs, whether payable by way of several annual instalments or in one lump sum, would be non-deductible capital expenditures under the existing law.

One of the MNOs took the Commissioner of Inland Revenue (CIR) to court² for disallowing its amortization of the upfront lump-sum SUFs paid. However, its case against the CIR has been dismissed by both the Court of First Instance and the Court of Appeal.

This bill is introduced in response to the lobbies made by the MNOs that the existing law should be changed to allow for tax deductions of SUFs paid, with a view to incentivizing the MNOs to invest in and enhance the telecommunication infrastructure in Hong Kong.

This alert discusses the major provisions of the bill. Clients who have any questions on the latest developments on the tax deductibility of SUFs can contact their tax executive.

Notes:

(1) The bill can be accessed from the below link:

[The Government of the Hong Kong Special Administrative Region Gazette \(legco.gov.hk\)](http://www.legco.gov.hk)

(2) *China Mobile Hong Kong Company Limited v. Commissioner of Inland Revenue HCIA 2/2017* and *China Mobile Hong Kong Company Limited v. Commissioner of Inland Revenue CACV 500/2020*

Deduction rules under the bill

Under the bill, SUFs incurred on or after the proposed legislation comes into operation, whether paid in one lump sum or by annual instalments, which are otherwise non-deductible capital expenditures, will be tax deductible.

Deductions for SUFs payable by annual instalments

Where such fees are payable by annual instalments, each of the annual instalments will be deductible in the year the annual instalment is payable.

However, if the radio spectrum is not immediately used in the year of assignment, the assignee will only be able to claim the deduction starting from the year during which the radio spectrum is first used. The amount that can be claimed in the year of first use will be the total amount of the annual instalments payable up to the end of the basis period for the year of first use. Thereafter, each of the subsequent annual instalments will be deductible in the year during which the annual instalment is payable.

Deductions for SUFs payable other than by annual instalments

Where such fees are payable other than by annual instalments, e.g., in one lump sum, the tax deduction to be granted for each year will be an amount equal to the total amount of the SUFs payable divided by the total number of eligible years of assessment involved (referred to below as the divided amount).

Similar to those granted for SUFs payable by annual instalments, if the radio spectrum is not immediately used in the year of the assignment, the tax deduction will only be granted starting from the year during which the radio spectrum is first used by the assignee. In such case, the total amount of the tax deduction that will be granted for the year of first use will be the divided amount for the year together with the divided amounts for all the previous years of assessment. Thereafter, the tax deduction for each of the subsequent years will be based on the divided amount referred to above.

Other major provisions

Unilateral transfer of SUFs - The bill also provides for the situation where the radio spectrum in respect of which SUFs have been payable is unilaterally transferred by the first assignee to a subsequent assignee pursuant to the exercise of power granted to the CA under the Telecommunications Ordinance (Cap. 106) of Hong Kong.

The tax deduction to be granted to such a subsequent assignee is broadly on the same basis as that granted to the first assignee discussed above.

Swap of frequency bands - The bill specifically provides that a swap of radio spectrum between two persons will not affect the tax deductions to be claimed by each of the persons, i.e., as if the swap had not occurred.

Release of liability to pay SUFs - There are provisions explicitly stating that where any capital expenditure incurred by a person has been granted tax deduction under the proposed legislation, but the person's liability to pay the whole or part of the SUFs is subsequently released, the amount of the liability so released will be treated as a taxable trading receipt.

Commentary

We welcome the government introducing this bill to address the concerns of MNOs that SUFs paid would be non-deductible capital expenditures under the existing law.

With tax deductions now proposed to be granted, MNOs should have incentive to invest more proactively in telecommunications infrastructure for providing better communications services, thereby contributing to the overall economic growth and smart city development in Hong Kong.

However, given that the bill will only apply to future spectrum auctions and have no retrospective effect, MNOs who are not satisfied with the IRD's disallowance of lump-sum SUFs they have already paid under the existing law will have to further litigate the merits of their case in court.

Clients who have any questions on the latest developments on the tax deductibility of SUFs can contact their tax executive.



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