

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

INLAND REVENUE (AMENDMENT) (TAX DEDUCTIONS FOR LEASED PREMISES REINSTATEMENT AND ALLOWANCES FOR BUILDINGS AND STRUCTURES) BILL 2024

INTRODUCTION

At the meeting of the Executive Council on 8 October 2024, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024 (“Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”).

A

2. The Bill amends the Inland Revenue Ordinance (Cap. 112) (“IRO”) in order to implement the following tax measures as proposed in the 2024-25 Budget starting from the year of assessment (“YA”) 2024/25–
 - (a) introduction of a tax deduction for expenses incurred for reinstating the condition of premises under a lease to their original condition (“reinstatement costs”); and
 - (b) removal of the time limit for claiming annual allowances in respect of a commercial or industrial building or structure.

JUSTIFICATIONS

Guiding principles in formulating the Budget proposals

3. When formulating the Budget proposals, we adhere to the following guiding principles –

- (a) keeping Hong Kong's tax regime simple and competitive;
- (b) benefiting a wide scope of businesses and persons with due regard to the risk of abuse; and
- (c) minimising the compliance burden of taxpayers.

Proposed tax deduction for reinstatement costs

4. Section 17(1)(c) of the IRO provides that 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 tax¹. Generally, a lease that confers an exclusive possession of a property is a capital asset, and any cost incurred for its acquisition (including reinstatement costs) is also of a capital nature. Hence, reinstatement costs are currently precluded from profits tax deduction.

5. It is common for enterprises to lease premises (such as office or shop) to carry out their businesses in Hong Kong, and they are generally required to reinstate the premises at the end of or on an early termination of the lease. Therefore, reinstatement costs are incurred whenever enterprises need to relocate, upsize or downsize their operating sites. The 2024-25 Budget proposed allowing tax deduction for reinstatement costs despite their capital nature so as to relieve the tax burden of enterprises.

6. To implement the Budget proposal, we propose amending the IRO to allow tax deduction for reinstatement costs when certain conditions are met. Having balanced the need for a wide scope of application of the proposed tax deduction and the risk of abusive claims, the following conditions will be included in the Bill –

- (a) the person claiming the deduction is a lessee of the lease;
- (b) the person claiming the deduction has an obligation (whether express or implied, and whether arising from the lease or from another agreement between the lessor and lessee of the lease) to reinstate, or pay (whether in full or in part) for the reinstatement of, the premises under the lease to their original condition at the end of the lease term, or on an early termination of the lease;

¹ Hong Kong has a simple and competitive tax system which does not tax income of a capital nature. Correspondingly, no deduction shall be allowed for any expenditure of a capital nature or any loss or withdrawal of capital.

- (c) the reinstatement costs do not relate to any provisions made under 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. This requirement ensures that the reinstatement costs to be claimed have been incurred²; and
- (d) the amount of the reinstatement costs claimed is reasonable in the circumstances.

The above conditions are formulated after taking into account the feedback from the stakeholders concerned and making reference to other tax jurisdictions providing similar tax deductions. To preclude tax abuse, tax deduction will only be allowed for reinstatement costs that have actually been incurred.

7. The proposed tax deduction will apply to a YA beginning on or after 1 April 2024.

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

8. Under the IRO, a taxpayer who is entitled to the relevant interest in relation to the capital expenditure incurred on the construction of a commercial or industrial building or structure may claim an annual allowance³ of 4% on the expenditure. If certain event (i.e. sale, demolition or cessation of use) occurs in relation to the building or structure in any YA, the assessable profits of the taxpayer for that YA will be adjusted by making a balancing charge or allowance (herein referred to as “balancing adjustment”⁴).

² 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 is unknown. 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. The provision is subject to review and adjustment in each year during the lease term to reflect the latest estimate. Hence, the costs that relate to any provisions made under the relevant accounting standards are not yet incurred.

³ If the taxpayer incurs capital expenditure on the construction of an industrial building or structure, an initial allowance of 20% of the expenditure may be granted for the YA in which the expenditure was incurred, in addition to the annual allowance.

⁴ If the sale proceeds exceed the residue of expenditure immediately before the sale, the excess amount, which is limited to the total amount of initial allowance and annual allowances previously granted in respect of the commercial or industrial building or structure, is taxable as a balancing charge. If the

9. Currently, claims for annual allowances for a commercial or industrial building or structure are subject to a maximum limit of 25 years or 50 years⁵ starting from the YA in which the building or structure was first used⁶ (“usage period”). If a commercial or industrial building or structure is sold before the end of the usage period, the seller will be subject to a balancing adjustment whilst the buyer will be able to claim annual allowances based on the residue of expenditure immediately after the sale over the remaining years within the usage period. However, if the building or structure is sold after the end of the usage period, the seller will still be subject to a balancing adjustment (which will have the effect of recouping the allowances previously granted if the adjustment is a balancing charge), but the buyer will not be entitled to claim any annual allowance because the usage period has expired when the buyer purchased the commercial or industrial building or structure.

10. The time limit for claiming annual allowances results in disparity of tax treatment for the buyers of commercial or industrial buildings or structures who incurred the same amount of capital expenditure before and after the end of the usage period. In the long run, such disparity may discourage buyers from purchasing old or second-hand buildings or structures. To foster a business-friendly environment, we propose removing the time limit for claiming annual allowances in respect of a commercial or industrial building or structure to the effect as follows –

- (a) if a commercial or industrial building or structure (with an unexpired usage period) is sold and used by the buyer in the basis period for a YA before the YA 2024/25, an annual allowance will be granted to the buyer for that YA in the same manner as described in paragraphs 8 and 9 above;

residue of expenditure exceeds the sale proceeds, the difference is deductible as a balancing allowance. Residue of expenditure means the amount of capital expenditure incurred on the construction of the commercial or industrial building or structure reduced by the amount of any initial allowance, annual allowance and/or balancing allowance granted, and increased by any balancing charge made.

⁵ For an industrial building or structure that was first used on or after the commencement of the basis period for the YA 1965/66 or a commercial building or structure, the maximum number of years for claiming annual allowances is 25 years. For an industrial building or structure that was first used before the commencement of the basis period for the YA 1965/66, annual allowances can be claimed for a maximum of 50 years starting from the year of the first use.

⁶ Annual allowance for commercial building or structure applies from the YA 1998/99. If a person was entitled to the relevant interest in relation to the capital expenditure incurred on the construction of a commercial building or structure before the commencement of the YA 1998/99, the YA 1998/99 will be deemed to be the YA in which the commercial building or structure was first used. Hence, the usage period for commercial buildings or structures expires from the YA 2023/24 onwards.

- (b) if—
- (i) an industrial building or structure (with an expired usage period) is sold and used by the buyer in the basis period for a YA before the YA 2024/25; or
 - (ii) a commercial or industrial building or structure (whether the usage period has expired) is sold and used by the buyer in the basis period for a YA beginning on or after 1 April 2024,

an annual allowance of 4% on the residue of expenditure immediately after the sale will be granted to the buyer starting from YA 2024/25 onwards, until the residue of expenditure immediately after the sale has been fully claimed; and

- (c) in any of the cases referred to in paragraphs (a) and (b), the seller will continue to be subject to a balancing adjustment in accordance with the existing provisions of the IRO.

OTHER OPTIONS

11. The proposals cannot be implemented without legislative amendments to the IRO. There is no other option.

THE BILL

12. The major provisions of the Bill are summarised below –

- (a) **Clause 3** amends section 16 of the IRO to allow the costs of reinstating any premises under a lease to their original condition at the end of the term of the lease or on an early termination of the lease to be deducted from the lessee's chargeable profits if certain conditions are met;
- (b) **Clause 4** amends section 33A of the IRO to remove the time limit for claiming annual allowances for the depreciation by wear and tear of commercial buildings and structures; and
- (c) **Clause 5** amends section 34 of the IRO to remove the time limit for claiming annual allowances for the depreciation by wear and tear of industrial buildings and structures. Since the time limit in respect of certain industrial buildings and structures has expired before the YA 2024/25, the amended section 34 also

provides for these buildings and structures by allowing allowances to be made in respect of them for the YA 2024/25 and the YAs after that.

LEGISLATIVE TIMETABLE

13. The legislative timetable is as follows –

Publication in the Gazette	18 October 2024
First Reading and commencement of Second Reading debate	30 October 2024
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

IMPLICATIONS OF THE PROPOSALS

14. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the binding effect of the existing provisions of the IRO. The financial and economic implications of the proposals are at **Annex B**. The proposals have no productivity, environmental, family, gender or civil service implications, and no sustainability implications other than those set out in the economic implication paragraph in **Annex B**.

B

PUBLIC CONSULTATION

15. The proposed tax deduction for reinstatement costs and the proposed removal of the time limit for claiming annual allowances for commercial or industrial buildings or structures were formulated based on suggestions received from stakeholders. We consulted the stakeholders concerned on the proposed measures in March and April 2024. They generally welcomed the proposed measures, and offered suggestions on the detailed proposals. We also briefed the LegCo Panel on Financial Affairs on the detailed proposals on 3 June 2024. The Panel members expressed general support for the proposals.

PUBLICITY

16. We will issue a press release on 16 October 2024. A spokesperson will be available to answer media and public enquiries.

ENQUIRIES

17. Enquiries on this Brief can be directed to Miss Josephine TSANG, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2370.

**Financial Services and the Treasury Bureau
October 2024**

A BILL

To

Amend the Inland Revenue Ordinance to give effect to certain proposals in the Budget introduced by the Government for the 2024–2025 financial year concerning the introduction of a tax deduction for reinstatement costs for premises under a lease and the removal of the time limit for claiming annual allowances for commercial and industrial buildings and structures; and to provide for related matters.

Enacted by the Legislative Council.

Part 1

Preliminary

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Ordinance 2024.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in Parts 2 and 3.

Part 2

Tax Deductions for Leased Premises Reinstatement

3. Section 16 amended (ascertainment of chargeable profits)

(1) After section 16(1)(gb)—

Add

“(gc) despite section 17, reinstatement costs incurred for any premises under a lease, but only if all of the conditions specified in subsection (2K) are met;”.

(2) After section 16(2J)—

Add

“(2K) The following conditions are specified for the purposes of subsection (1)(gc)—

- (a) the person claiming the deduction is a lessee of the lease;
- (b) the person has a reinstatement obligation for the premises;
- (c) the reinstatement costs do not relate to any provisions made under—
 - (i) 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
 - (ii) any other similar accounting standards;
- (d) the amount of the reinstatement costs is reasonable in the circumstances.”.

(3) Section 16(3), Chinese text, definition of 親屬—

Repeal

“女。”

Substitute

“女；”。

- (4) Section 16(3)—

Add in alphabetical order

“*original condition* (原來狀況), in relation to any premises under a lease, means the condition the premises are in at the beginning of the term of the lease;

reinstatement costs (還原費), in relation to any premises under a lease—

- (a) means the costs of reinstating the premises to their original condition at the end of the term of the lease or on an early termination of the lease; and
- (b) includes any amount paid or payable by a lessee of the lease to the lessor of the lease in order to discharge the lessee’s reinstatement obligation for the premises;

reinstatement obligation (還原責任), in relation to any premises under a lease, means an obligation (whether express or implied, and whether arising from the lease or from another agreement between the lessor and lessee of the lease) to reinstate, or pay (whether in full or in part) for the reinstatement of, the premises to their original condition at the end of the term of the lease or on an early termination of the lease;”。

- (5) After section 16(5C)—

Add

“(5D) The amendments made to this section by the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Ordinance 2024 (of 2024) apply only in relation to a year of assessment beginning on or after 1 April 2024.”。

Part 3

Allowances for Buildings and Structures

4. **Section 33A amended (annual allowances, commercial buildings and structures)**

(1) Section 33A(1)—

Repeal

“subsection (2),”

Substitute

“subsections (2) and (2A),”.

(2) Section 33A(1), English text—

Repeal

“shall”

Substitute

“is to”.

(3) Section 33A(2)—

Repeal

“a building or structure, which is the relevant interest in relation to any expenditure, is sold”

Substitute

“the building or structure mentioned in subsection (1) is sold to the person mentioned in that subsection in the basis period for a year of assessment before the year of assessment beginning on 1 April 2024 (*pre-2024 basis period*),”.

(4) Section 33A(2), English text—

Repeal

“shall” (wherever appearing)

Substitute

“is to”.

(5) Section 33A(2)—

Repeal

“sales.”

Substitute

“sale that takes place in a pre-2024 basis period.”.

(6) After section 33A(2)—

Add

“(2A) If—

- (a) the interest in the building or structure mentioned in subsection (1) is sold to the person mentioned in that subsection in the basis period for a year of assessment beginning on or after 1 April 2024; and
- (b) the building or structure has been used at any time before the sale, whether as a commercial building or structure or otherwise,

then the annual allowance, in any year of assessment the basis period for which ends after the time of the sale, is to be an amount equal to 4% of the residue of expenditure immediately after the sale, and so on for any subsequent sale.”.

5. **Section 34 amended (initial and annual allowances, industrial buildings and structures)**

(1) Section 34(2)(a)—

Repeal

“paragraph (b),”

Substitute

“paragraphs (b), (ba) and (bb),”.

- (2) Section 34(2)(a), English text—

Repeal

“shall”

Substitute

“is to”.

- (3) Section 34(2)(b)—

Repeal

“a building or structure, which is the relevant interest in relation to any expenditure, is sold”

Substitute

“the building or structure mentioned in paragraph (a) is sold to the person mentioned in that paragraph in the basis period for a year of assessment before the year of assessment beginning on 1 April 2024 (*pre-2024 basis period*),”.

- (4) Section 34(2)(b), English text—

Repeal

“shall” (wherever appearing)

Substitute

“is to”.

- (5) Section 34(2)(b)—

Repeal

“1965, and”

Substitute

“1965 (*1965 basis period*), and”.

- (6) Section 34(2)(b)—

Repeal

“such basis period, and”

Substitute

“the 1965 basis period, and”.

- (7) Section 34(2)(b)(ii)—

Repeal

everything after “with the”

Substitute

“capped year, and so on for any subsequent sale that takes place in a pre-2024 basis period.”.

- (8) After section 34(2)(b)—

Add

“(ba) If—

- (i) the interest in the building or structure mentioned in paragraph (a) is sold to the person mentioned in that paragraph in the basis period for a year of assessment (*sale year*)—

(A) after the capped year; and

(B) before the year of assessment beginning on 1 April 2024 (*2024/25 year*);

- (ii) the building or structure has been used at any time before the sale, whether as an industrial building or structure or otherwise; and

- (iii) the residue of expenditure immediately after the sale is not 0, but no allowance has ever been made under

paragraph (a) (as modified by paragraph (b)) for the sale year and all subsequent years of assessment up to and including the year of assessment beginning on 1 April 2023 because at the time of the sale—

- (A) where the building or structure was first used before the commencement of the 1965 basis period—50 or more years of assessment have passed after the year of assessment in which the building or structure was first used; or
- (B) where the building or structure was first used on or after the commencement of the 1965 basis period—25 or more years of assessment have passed after the year of assessment in which the building or structure was first used,

then despite paragraph (b), the annual allowance, in the 2024/25 year and any year of assessment after that, is to be an amount equal to 4% of the residue of expenditure.

(bb) If—

- (i) the interest in the building or structure mentioned in paragraph (a) is sold to the person mentioned in that paragraph in the basis period for a year of assessment beginning on or after 1 April 2024; and
- (ii) the building or structure has been used at any time before the sale, whether as an industrial building or structure or otherwise,

then the annual allowance, in any year of assessment the basis period for which ends after the time of the sale, is to be an amount equal to 4% of the residue of expenditure immediately after the sale, and so on for any subsequent sale.”.

(9) After section 34(2)—

Add

“(3) In this section—

capped year (上限年度), in relation to a building or structure, means—

- (a) if the building or structure was first used before the commencement of the 1965 basis period—the 50th year of assessment after the year of assessment in which the building or structure was first used; or
- (b) if the building or structure was first used on or after the commencement of the 1965 basis period—the 25th year of assessment after the year of assessment in which the building or structure was first used.”.

Explanatory Memorandum

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

- (a) to give effect to certain proposals in the Budget introduced by the Government for the 2024–2025 financial year concerning—
 - (i) the introduction of a tax deduction for reinstatement costs for premises under a lease; and
 - (ii) the removal of the time limit for claiming annual allowances for commercial and industrial buildings and structures; and
- (b) to provide for related matters.

- 2. Clause 1 sets out the short title.
- 3. Clause 3 amends section 16 of the principal Ordinance to allow the costs of reinstating any premises under a lease to their original condition at the end of the term of the lease or on an early termination of the lease (including any amount paid or payable by a lessee of the lease to the lessor of the lease in order to discharge the lessee's obligation for reinstatement) to be deducted from the lessee's chargeable profits if certain conditions are met.
- 4. Clause 4 amends section 33A of the principal Ordinance to remove the time limit for claiming annual allowances for the depreciation by wear and tear of commercial buildings and structures.
- 5. Clause 5 amends section 34 of the principal Ordinance to remove the time limit for claiming annual allowances for the depreciation by wear and tear of industrial buildings and structures. Since the time limit in respect of certain industrial buildings and structures has expired before the year of assessment beginning on 1 April 2024

(2024/25 year), the amended section 34 also provides for these buildings and structures by allowing allowances to be made in respect of them for the 2024/25 year and the years of assessment after that.

Implications of the Proposals

Financial Implications

The financial implication of the proposed tax deduction for reinstatement costs cannot be quantified because the Inland Revenue Department does not have relevant statistics on the reinstatement costs incurred by taxpayers. However, since reinstatement costs generally represent a fairly insignificant portion of a taxpayer's turnover, the proposed tax deduction should not give rise to significant revenue loss.

2. Regarding the proposed removal of the time limit for claiming annual allowances for commercial or industrial buildings or structures, the potential revenue forgone is estimated to be about \$164 million per annum based on the statistics for the YA 2022/23.

Economic Implications

3. The proposals provide more tax benefits for businesses operating in Hong Kong, thereby enhancing the business environment, though the magnitude of their impact on the overall economy is expected to be limited given that the proposed amendments to the profits tax regime are relatively minor.