Hong Kong (SAR) Tax Alert

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The proposed tax deduction for spectrum utilisation fees for the telecommunication industry

Summary

The draft legislation on introducing a tax deduction for spectrum utilisation fees (SUFs) in the Hong Kong SAR (Hong Kong) was gazetted on 1 December 2023. Subject to enactment of the draft legislation, the proposed tax deduction will apply prospectively to the SUFs incurred by mobile network operators in respect of auctions on radio spectrum conducted on or after the commencement date of the legislation.

In this tax alert, we summarise the key features of the proposed tax deduction and share our observations.

The existing assessing practice of the Hong Kong Inland Revenue Department is that, SUFs (whether payable in a one-off lump sum or by annual instalments) incurred by mobile network operators (who are the successful bidders in auctions conducted on radio spectrum) are regarded as capital expenditure and not tax deductible. The non-deductibility treatment was confirmed by the Court in *China Mobile Hong Kong Limited v Commissioner of Inland Revenue (China Mobile Case)*[1].

In view of the telecommunication industry's concerns and the growing importance of telecommunication, innovation and technology developments in Hong Kong, the Financial Secretary announced in the 2023/24 Budget[2] that a tax deduction will be provided for SUFs incurred by mobile network operators. In this regard, the Inland Revenue (Amendment) (Tax Deductions for Spectrum Utilization Fees) Bill 2023[3] (the Bill) was gazetted on 1 December 2023.

Key features of the proposed tax deduction

The key features of the proposed tax deduction include:

- SUFs incurred by a taxpayer would be deductible provided that the expenditures are incurred in the production of the chargeable profits for the taxpayer's use of the radio spectrum in the carrying on of its trade or business.
- The deduction will generally be spread evenly over the spectrum assignment term (i.e. 15 years in general) in both cases of one-off lump sum payment and payment by instalments. However, if a taxpayer starts to use the spectrum in a year of assessment (YOA) after the "assignment year of assessment" (i.e. the YOA in which the assignment term begins), the deduction period will start from the YOA in which the taxpayer first uses the spectrum.

1 For details of the China Mobile case, please refer to our previously issued Hong Kong (SAR) Tax Alert - Issue 29, December 2022.
2 The 2023/24 Budget Speech can be accessed via this link: The 2023-24 Budget – Home
3 The Bill can be accessed via this link.

- There are special rules to deal with the situations when the use of the spectrum is unilaterally transferred[4](see Example 3 below) or transferred on a swap[5].
- The transfer of the use of the spectrum on a swap (i.e. exchange of radio spectrum for use between transferor and transferee) would not affect the deduction claim. That is, for the purpose of applying the proposed deduction, the use of the spectrum (after the swap) by either the transferor or the transferee is deemed to remain the same as the original one throughout the assignment term as if the transfer had never occurred.
- Any SUFs that are reimbursed by way of any grant, subsidy or similar financial assistance are not deductible.
- The proposed tax deduction has no retrospective effect. That is, it will only apply to SUFs incurred for **auctions on radio spectrum conducted on or after** the commencement date of the new legislation on the tax deduction. SUFs paid or to be paid for all past auctions will continue to be non-deductible.

Please refer to the below numerical examples that illustrate the operation of deduction rules in different scenarios.

Example 1: Year of assignment and year of first usage of the radio spectrum are the same

- In November 2024, Taxpayer A (with a December accounting year-end) is assigned the use of certain spectrum for 15 years for a total amount of SUF of HK$600 million
- The assignment term runs from 1 October 2025 to 30 September 2040 – i.e. the assignment year of assessment is YOA 2025/26
- First usage of the spectrum by Taxpayer A also takes place in YOA 2025/26

SUFs payment method	Tax deduction
(i) By annual instalments (i.e. HK$40m per year to be paid for 15 years)	• Deduction period: YOA 2025/26 to YOA 2039/40 (i.e. 15 years) • Deduction amount in each YOA = Instalment payable = HK$40m
(i) By other means (e.g. a one-off lump sum payment)	• Deduction period: YOA 2025/26 to YOA 2039/40* • Deduction amount in each YOA = Total SUFs payable / Total number of eligible YOAs = HK$600m / 15 years = HK$40m ** Each being an eligible YOA as defined*

Example 2: Year of assignment and year of first usage of the radio spectrum are different

Same facts as Example 1 except that the first usage of the spectrum by Taxpayer A takes place in YOA 2027/28 (i.e. 2 years after the assignment year of assessment)

SUFs payment method	Tax deduction
(i) By annual instalments (i.e. HK$40m per year to be paid for 15 years)	• Deduction period: YOA 2027/28 to YOA 2039/40* (i.e. 13 years) • Deduction amount in YOA 2027/28 = HK$40m + HK$40m x 2 = HK$120m • Deduction amount in YOA 2028/29 onwards = HK$40m
(i) By other means (e.g. a one-off lump sum payment)	• Deduction period: YOA 2027/28 to YOA 2039/40* (i.e. 13 years) • Deduction amount in YOA 2027/28 = HK$40m + HK$40m x 2 = HK$120m • Deduction amount in YOA 2028/29 onwards = HK$40m

** No deduction in YOA 2025/26 and 2026/27 as Taxpayer A only begins to use the spectrum in YOA 2027/28*

4 The radio spectrum is regarded as unilaterally transferred if (a) the transferee replaces the transferor as the assignee of the use of the radio spectrum and (b) the transferor does not replace the transferee as an assignee of the use of any other radio spectrum.

5 The radio spectrum is regarded as transferred on a swap if the transferee replaces the transferor as the assignee of the use of radio spectrum assigned to the transferor and the transferor replaces the transferee as the assignee of the use of the radio spectrum assigned to the transferee on the same date, with the original assignment terms for and SUF payables by the transferor and transferee continue to apply.

Example 3: (a) With a unilateral transfer and (b) the transfer year of assessment and the year of first usage by the subsequent assignee are the same

- Both Taxpayer A and Taxpayer B use a December accounting year-end
- In November 2024, Taxpayer A is assigned the use of certain spectrum for 15 years for a total amount of SUF of HK$600 million
- The assignment term runs from 1 October 2025 to 30 September 2040 - i.e. the assignment year of assessment is YOA 2025/26
- First usage of the spectrum by Taxpayer A also takes place in YOA 2025/26
- The use of the spectrum is unilaterally transferred to Taxpayer B on 1 July 2027 – i.e. the assignment term for Taxpayer A ends on 30 June 2027 and the transfer year of assessment is YOA 2027/28.
- First usage of the spectrum by Taxpayer B takes place in YOA 2027/28.

SUFs payment method	Tax deduction
(i) By annual instalments (i.e. HK$40m per year to be paid for 15 years)	For Taxpayer A: • In the year of transfer* - A deduction of HK$40m assuming the annual instalment for YOA 2027/28 is payable by Taxpayer A • Deduction period: YOA 2025/26 to YOA 2027/28 (i.e. 3 years) • Deduction amount in each YOA = HK$40m For Taxpayer B: • Deduction period: YOA 2028/29 to YOA 2039/40 (i.e. 12 years) • Deduction amount in each YOA = HK$600m / 15 years = HK$40m • *In the year of transfer, the deduction will be granted to the party that is liable to pay the annual instalment of the SUFs for that year*
(i) By other means (e.g. a one-off lump sum payment)	For Taxpayer A: • In the year of transfer – Since the basis period of YOA 2027/28 ends after the last day of the assignment term, Taxpayer A is not eligible to claim a deduction in YOA 2027/28 • Deduction period: YOA 2025/26 to YOA 2026/27 (i.e. 2 years) For Taxpayer B: • Deemed capital expenditure on SUF incurred = HK$600m – (HK$40m x 2) = HK$520m • Deduction period: YOA 2027/28 to YOA 2039/40 (i.e. 13 years) • Deduction amount in each YOA = HK$520m / 13 years = HK$40m

** No deduction in YOA 2025/26 and 2026/27 as Taxpayer A only begins to use the spectrum in YOA 2027/28*

Released liabilities to pay SUFs treated as trading receipts

Since the proposed tax deduction is based on SUFs payable (as opposed to SUFs actually paid) in a YOA, if any SUFs payable have been deducted under the proposed regime but the liability to pay such SUFs is subsequently released, the liability so released will be regarded as taxable trading receipts accruing (1) at the time of the release or (2) immediately before the discontinuance of the business (if the release occurs on or after the date when the business is permanently discontinued).

KPMG observations

We are glad to see that the HKSAR Government has responded to the industry's concern on the non-deductibility of SUFs, which represent significant costs invested by mobile network operators for developing their telecommunication businesses in Hong Kong and producing profits from such businesses that are fully taxable.

Apart from SUFs, there are other "blackhole expenditures" that are currently treated as non-deductible capital expenditures under the Hong Kong tax system. These include capital expenditures incurred by taxpayers to acquire other intangible assets such as a licence, a franchise or an indefeasible right of use of data transmission capacity.

Although Hong Kong does not tax capital gains (except in the cases of foreign-sourced asset disposal gains where the tax exemption conditions under the FSIE regime are not met), these intangible assets are very often used by taxpayers in their businesses for generating taxable profits in Hong Kong rather than being sold to derive non-taxable capital gains. In such cases, taxpayers need to pay tax on the assessable profits but cannot claim a tax deduction on the capital expenditures incurred for earning such profits.

To promote greater fairness of the Hong Kong tax system and adopt consistent tax treatments for SUFs and other intangible assets, we urge the government to consider expanding the scope of the proposed tax deduction to cover other blackhole expenditures provided that they are incurred in the production of taxable profits. In the event the intangible asset concerned is disposed of with a non-taxable capital gain, there could be a claw-back of the tax deduction previously granted to preserve tax symmetry.