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Panel on Financial Affairs
Meeting on 1 November 2010

Background brief
on proposed profits tax deduction for capital expenditure
on intellectual property rights

Purpose

This paper provides background information on the Administration's proposal to implement profit tax deduction for capital expenditure on registered trade marks, copyrights and registered designs, and summarizes relevant views of Members when relevant issues were discussed at Council and Panel meetings.

Background

2. At present, under section 16(1)(g) of the Inland Revenue Ordinance (Cap. 112), enterprises may claim tax deduction on expenditure related to the registration of trademarks, designs or patents that are used for producing taxable profits. Besides, section 16E provides that expenditure on the purchase of patent rights or rights to any know-how is tax deductible. In this context, "know-how" is defined as any industrial information or techniques likely to assist in the manufacture or processing of goods or materials. To promote wider application of intellectual property by enterprises and the development of creative industries, the Financial Secretary proposed in the 2010–2011 Budget that the profits tax deduction should be extended to cover expenditure for purchase, and subsequent use, of registered trademarks, copyrights and registered designs.

3. Creative industries in Hong Kong include film, television, music, design, comics and animation, games and digital entertainment. There are around 32 000 creative industry-related establishments, engaging more than 176 000 practitioners. Their activities account for more than \$60 billion

annually in added value to Hong Kong's Gross Domestic Product (GDP), representing 4% of GDP. In the 2007-2008 Policy Address, the Chief Executive (CE) pledged that Hong Kong should accelerate the development of creative industries in order to maintain the city's competitive edge. In April 2009, the Task Force on Economic Challenges identified cultural and creative industries as one of the six economic areas with high growth potential. Following CE's announcement in the 2008-2009 Policy Address that a dedicated office should be set up to support creative industries, the Finance Committee approved, on 22 May 2009, the proposal for establishing a dedicated office, i.e. the Create Hong Kong (CreateHK), under the Commerce and Economic Development Bureau to expedite the development of the industries and to co-ordinate the work of different departments in this regard. The Finance Committee also approved on the day the establishment of the \$300 million CreateSmart Initiative to provide financial support to projects with objectives that are in line with the strategic direction to drive the creative industries but not covered by the DesignSmart Initiative, the Film Development Fund, the Film Guarantee Fund. CreateHK is responsible for administering the various funding schemes related to creative industries.

Members' views and concerns

4. Two motions relating to the development of local creative industries were carried at the Council meetings on 4 February and 29 April 2009. The terms of the motions are at **Appendices I and II**. During the debates, Members generally expressed support for promoting the development of cultural and creative industries, as well as industries based on innovation and technology. Members urged the Administration to offer various incentives, including tax concessions, to help Hong Kong enterprises and manufacturers upgrade their business and transform into high value-added industries.

5. During the debates, Members pointed out that enterprises of creative industries often needed to use intangible assets such as patent rights, copyrights, trademarks and franchises in their operations. However, under Hong Kong's existing taxation system, while expenditure on tangible assets such as machinery and plant, vehicles and renovation was deductible in the calculation of chargeable profits, such deduction in respect of intangible assets was confined to the purchase of patent rights and the rights to any know-how of the relevant industry. Since Hong Kong's economy had restructured from manufacturing industries to services industries since the 1980s, and tax concessions on purchase of copyrights, trademarks or designs were offered in many neighbouring areas such as the Mainland, Australia and Singapore, it was important for Hong Kong to act promptly to implement more tax concessionary measures to support the development of local creative industries.

6. In the discussion related to the initiatives of CreateHK and CreateSmart Initiative at the Panel on Information Technology and Broadcasting on 9 February and 9 March 2009, Members urged the Administration to formulate comprehensive long-term plans and develop practicable strategies for building Hong Kong into a regional creative capital. Members suggested that the Administration should introduce measures, including granting tax concessions, to facilitate start-ups and the development of local small and medium-sized creative establishments, and to attract overseas creative industry establishments to invest and develop businesses in Hong Kong.

Latest development

7. The Administration will brief the Panel on Financial Affairs on 1 November 2010 on the legislative proposals to implement the 2010-2011 Budget initiative in respect of profits tax deduction for capital expenditure on registered trademarks, copyrights and registered designs.

Relevant papers

Motion moved by Dr Hon Samson Tam on "Promoting the development of local creative industries" at the Council meeting on 4 February 2009

<http://www.legco.gov.hk/yr08-09/english/counmtg/hansard/cm0204-translate-e.pdf>

Motion moved by Hon Regina Ip on "Developing new economic strategies to meet economic challenges" at the Council meeting on 29 April 2009.

<http://www.legco.gov.hk/yr08-09/english/counmtg/hansard/cm0429-translate-e.pdf>

Paper provided by the Administration for the Information Technology and Broadcasting Panel meeting on 13 May 2010 on "Promoting the development of creative industries"

<http://www.legco.gov.hk/yr09-10/english/panels/itb/papers/itb0513cb1-1843-5-e.pdf>

Paper on promoting the development of creative industries prepared by the Legislative Council Secretariat (background brief)

<http://www.legco.gov.hk/yr09-10/english/panels/itb/papers/itb0513cb1-1843-6-e.pdf>

(Translation)

**Motion on
“Promoting the development of local creative industries”
moved by Dr Hon Samson TAM Wai-ho
at the Legislative Council meeting
of Wednesday, 4 February 2009**

Motion as amended by Hon Cyd HO Sau-lan and Hon Paul CHAN Mo-po

That Hong Kong’s economic development is already at a crossroads where there is a pressing need to develop a new economy and the creation of jobs has become a social consensus; this Council urges the Government to make reference to the experience of successful countries or regions to formulate expeditiously the long-term policies, objectives and implementation timetables for creative industries in coping with the development of a new economy, as well as to:

- (a) safeguard free flow of information and freedom of thoughts and speech to stimulate creativity and imagination;
- (b) secure Hong Kong as the locomotive for developing creative industries in the region, with a view to assisting the industries in expanding their markets, in particular the highly promising Mainland market, and strengthening its cooperation with the industries in the Pearl River Delta region;
- (c) facilitate cross-sector collaboration among creative industries, take proactive measures, such as building a one-stop platform and using the internet and technologies of new media, to enhance the competitiveness of local creative industries and assist the conventional industries in transforming their business successfully;
- (d) offer various incentives, including tax concession, to ensure that adequate resources are available for implementing the policies and realizing the objectives;
- (e) nurture and engage talents needed by creative industries;
- (f) promote creative commons, strike a balance between retaining of copyright and the right of reasonable utilization to further broaden the room for developing creative industries; and
- (g) foster a social culture which is conducive to promoting the development of creative industries, encourage the general public to have the values of exploration and innovation, and build up a local cultural identity; and

- (h) offer various incentives to help Hong Kong enterprises and manufacturers upgrade their business and transform into high value-added industries, which include, but not limited to, the following tax concessions:
 - (i) extending the current practice of allowing deduction of expenditure incurred in the purchase of patent rights in calculating assessable profits to cover the purchase of trade marks and copyrights; and
 - (ii) increasing the amount of tax deduction for expenditure on research and development from the existing 100% to 200% of the actual expenditure.

(Translation)

**Motion on
“Developing new economic strategies to meet economic challenges”
moved by Hon Mrs Regina IP LAU Suk-ye
at the Legislative Council meeting
of Wednesday, 29 April 2009**

Motion as amended by Hon Audrey EU Yuet-mee, Hon LEE Wing-tat and Hon WONG Kwok-hing

That the economy of Hong Kong lacks diversification in recent years, which aggravates the disparity between the rich and the poor as well as undermines social mobility, and Hong Kong's short-term and long-term economic development will face enormous challenges, with short-term challenges arising from the global financial tsunami and the economy entering recession; while in the long term, with the industries in the Pearl River Delta gradually transforming and upgrading, the enterprises in Hong Kong are facing big challenges and the risk of being hollowed out, coupled with the fact that China and ASEAN will form a free trade area and the State Council has decided to develop Shanghai into an international financial centre, the competitive edge of Hong Kong's traditional economic pillars, including finance, trading and logistics, tourism as well as the related service sectors, etc, is on the wane, Hong Kong must therefore promote new economic strategies which can create higher economic value and benefit various social strata, and the Task Force on Economic Challenges headed by the Chief Executive also announced earlier its decision to develop industries including those based on innovation and technology as well as cultural and creative industries; in this connection, this Council urges the Government to adopt the following measures to develop these new industries:

- (a) formulating long-term and practicable development strategies for the new industries and implementing them in a down-to-earth manner to ensure that the new industries will not become ‘empty talks’;
- (b) drawing reference from the successful experience of countries such as the United Kingdom, Korea and Australia, etc, for example, assigning the work relating to the promotion of innovation and technology as well as cultural and creative industries to suitable policy bureaux or assigning the work to a higher-level body for overall co-ordination and setting up new policy bureaux in respect of individual areas of the innovative industry or cultural industry as necessary, as well as restructuring the organization of the various policy bureaux to achieve a more rational distribution of work among them;
- (c) making good use of the land available for development in the Lok Ma Chau Loop and the North East New Territories, putting emphasis on supporting the development of innovation and technology as well as cultural and creative industries, and utilizing the geographical advantage to complement the development of the Pearl River Delta so as to achieve synergy;

- (d) recruiting talents from the private sector, making good use of society's resources and introducing new ideas to ensure that the new industries will not lose vitality due to the Government's bureaucratic way of doing things;
- (e) studying the impact of the establishment of China-ASEAN Free Trade Area on Hong Kong, and formulating corresponding strategies;
- (f) while developing new industries, exploring the creation of more jobs that are related to the new industries for non-skilled workers, so that sufficient employment opportunities are available to such workers; and
- (g) improving the education and training systems to provide more talents for the new industries, and promoting a social climate that respects talents engaging in scientific and technological research and creative work, so as to attract the young generation to join the new industries;
- (h) reviewing the current subsidies on cultural arts provided by the Government so as to nurture budding performing arts groups and, apart from subsidizing performing arts, extending the scope of subsidies to other forms of arts such as literature or installation arts, etc, thereby enabling arts development in Hong Kong to be more diversified and fostering a social culture which is conducive to promoting the development of the creative industry;
- (i) increasing the opportunities for local artists to display their works, including improving the management and operation mode of cultural venues as well as the operation of their supporting facilities, and providing more exhibition space to enable artists to have more opportunities to display their works to the public, thereby enhancing their popularity and augmenting the economic contributions of the cultural and creative industries;
- (j) promoting public art and increasing the display of art works in public space or at venues other than museums and art galleries to enable the community and the public to enjoy more local art works, so that cultural arts can integrate into the community to nurture the local audience, thereby boosting the development of cultural and creative industries; and
- (k) opening up public service broadcasting to promote and encourage public participation in the diversified broadcasting businesses, and setting up radio and television channels for use by the public, so as to boost the creative industry through broadcasting businesses;
- (l) examining the provision of tax concession and land assistance as well as how to make good use of vacant factory buildings, constructing infrastructural facilities, opening up areas for research and development, as well as nurturing relevant talents, etc for the new industries; and
- (m) providing one-stop support services to centrally process all applications relating to the creative industry, including those for licences required for setting up business, government subsidy and tax concession, etc.