

For discussion  
on 15 November 2016

## **Legislative Council Panel on Commerce and Industry**

### **Profits Tax Deduction for Capital Expenditure incurred for the Purchase of Intellectual Property Rights**

#### **PURPOSE**

This paper seeks Members' views on a legislative proposal to implement the 2016-17 Budget initiative in respect of the expansion of the scope of tax deduction for capital expenditure incurred for the purchase of intellectual property rights ("IPRs").

#### **BACKGROUND**

2. Under Hong Kong's tax regime, an enterprise's revenue expenditure is generally deductible under profits tax. As such, an enterprise's revenue expenditure for the use of IPRs (e.g. royalties, licence fees and other forms of regular payments which are revenue in nature) is deductible for determining profits tax liability. If an enterprise develops its intellectual property ("IP") in the ordinary course of business, the revenue expenditure so incurred, such as rent, salaries and promotion cost, is also deductible as ordinary business expenditure.

3. It has long been the Government's taxation policy and principle that capital receipts should not be taxed, and therefore deduction of capital expenditure should not be allowed. However, exceptions have been made over the years under the Inland Revenue Ordinance (Cap. 112) ("IRO") to encourage the creation and commercialisation of IP. At present, certain types of capital expenditure on prescribed IPRs are deductible under specific provisions of the IRO, including –

- (a) registration expenditure on patents, designs and trade marks (section 16(1)(g));
- (b) purchase cost of patent rights and rights to know-how (section 16E); and

- (c) purchase cost of copyright, registered trade marks and registered designs (section 16EA).

4. The three types of IPRs set out in paragraph 3(c) above were last added in December 2011 by the Inland Revenue (Amendment) (No. 3) Ordinance 2011 following a proposal announced in the 2010-11 Budget. The current exercise seeks to further expand the scope beyond the 2011 exercise.

## **THE PROPOSAL**

5. The Government announced in the 2016-17 Budget that it shall expand the scope of tax deduction for capital expenditure incurred for the purchase of IPRs from the existing five categories to eight. The three additions are layout-design (topography) of integrated circuits, plant varieties and rights in performances. Expanding the scope of tax deduction for the purchase of IPRs is one of the 28 measures recommended by the Working Group on IP Trading<sup>1</sup> in March 2015 for promoting Hong Kong as a regional IP trading hub. We believe that the proposal will encourage enterprises to engage in the development of IP-related business, and give the business sector and creative industries a clear signal of the Government's determination to develop IP trading in Hong Kong.

### ***Layout-design (topography) of integrated circuits***

6. Integrated Circuits ("ICs") are widely adopted in almost all kinds of industrial and consumer products and services<sup>2</sup>. Layout-design (topography) of ICs is protected by the Layout-design (Topography) of Integrated Circuits Ordinance (Cap. 445) ("L(T)ICO") in Hong Kong. While protection is automatic and registration is not required, a layout-design (topography) must be original and recorded in documentary form or incorporated into an integrated circuit, if it is to enjoy protection.

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<sup>1</sup> The Government set up the Working Group in March 2013 to advise on the overall strategy to promote Hong Kong as a premier IP trading hub in the region, and identify possible policies and measures in support.

<sup>2</sup> Layout-design (topography) of ICs may not only be part of the IP portfolio of IC design houses, electronics companies or fabless foundries, but also product level companies such as car manufacturers, industrial production / medical equipment manufacturers, consumer goods manufacturers, and logistics companies (e.g. location based tracking devices).

7. Rights in layout-design (topography) of ICs subsist immediately when the layout-design (topography) is created. The duration of protection depends upon whether the layout-design (topography) is commercially exploited. If a layout-design (topography) has not been commercially exploited anywhere in the world, the term of the protection will end 15 years after the end of the year in which it was created. On the other hand, if a layout-design (topography) has been commercially exploited anywhere in the world, the term of the protection will end 10 years after the end of the year in which it was first commercially exploited.

### ***Plant varieties***

8. Plant variety rights are rights granted to owners of plant varieties over cultivated plant varieties they have bred or discovered and developed<sup>3</sup>. In Hong Kong, the Plant Varieties Protection Ordinance (Cap. 490) (“PVPO”) provides owners of plant varieties the legal means to apply to the Registrar of Plant Variety Rights<sup>4</sup> for such proprietary rights.

9. Except inedible algae and inedible fungi, varieties of all types of plants (e.g. food crops, vegetables, ornamentals) are eligible for protection, subject to certain conditions<sup>5</sup>. A grant under the PVPO shall be in force for a term of 25 years in the case of trees and vines and of 20 years in every other case.

### ***Rights in performances***

10. Pursuant to section 200(1) of the Copyright Ordinance (Cap. 528) (“CO”), performance means a dramatic performance, a musical performance, a reading or recitation of a literary work, a performance of an artistic work, an expression of folklore or a performance of a variety act or similar presentation. Rights in performances include the performers’ rights and the rights of persons who are entitled to make fixations of the performances for commercial

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<sup>3</sup> An owner can also be an agent of the person who bred or discovered and developed the plant variety or a successor to that person.

<sup>4</sup> The Director of Agriculture, Fisheries and Conservation is the Registrar of Plant Variety Rights.

<sup>5</sup> One of such requirements is that the variety needs to be new, distinct, stable, and homogenous.

exploitation. Rights in performances expire at the end of the period of 50 years from the end of the calendar year in which the performance takes place; or if during that period a fixation of the performance is released, 50 years from the end of the calendar year in which it is released.

### *Proposed legislative amendments*

11. For the purposes of the present legislative exercise, we propose to amend the IRO to include in the scope of tax deduction references to the existing definitions of layout-design (topography) in the L(T)ICO and protected variety in the PVPO. As for rights in performances, amendments to the IRO will also be made to specify that the performers' economic rights of reproduction, distribution, making available to the public and rental right as provided in the CO, which are assignable, should be eligible for tax deduction.

12. Under the existing IRO, taxpayers should fulfill the following conditions in order to be eligible for tax concession for the prescribed IPRs (such as copyright, registered trade marks and registered designs) –

- (a) taxpayers must have acquired the “proprietary interest” of the relevant IPRs. With the “proprietary interest” of an IPR, a taxpayer is able to exploit the IPR for further improvement or development, which is in line with the policy objective of encouraging innovation and upgrading;
- (b) the relevant IPR is used in the production of chargeable profits;
- (c) where a relevant IPR is used partly in the production of chargeable profits, deduction is only allowed for the portion of capital expenditure that is relevant to the use of that IPR for production of chargeable profits; and
- (d) where a relevant IPR is owned by more than one taxpayer, tax deduction for each taxpayer is granted for the amount of capital expenditure that is proportional to his/her share or interest (i.e. proprietary interest) in the relevant IPR.

We propose that the three IPRs to be added to the scope of tax deduction in the current legislative exercise should also be subject to the above existing conditions.

13. At present, the prescribed IPRs under the IRO and their corresponding rights protected under foreign laws are both eligible for tax deduction, so as to encourage the creation and commercialisation of IP. We propose that the present arrangement should apply to the three additions and their corresponding rights protected under foreign laws. In the same vein, we will also ensure that the relevant provision in the IRO which specifies that any sum, not otherwise chargeable to profits tax, received by or accrued to a person for the use of the prescribed IPRs, should be treated as receipts arising in or derived from Hong Kong from a trade or profession or business carried on in Hong Kong, will continue to apply after the expansion in scope.

### **LEGISLATIVE TIME TABLE**

14. We are working on the legislative amendments to the IRO to bring the proposed expansion of the scope of tax deduction into effect. Subject to progress, we aim to introduce the legislative proposal into the Legislative Council within the current legislative session.

**Commerce and Economic Development Bureau  
Intellectual Property Department  
Inland Revenue Department  
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