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Panel on Commerce and Industry

Meeting on 15 November 2016

Background brief on tax deduction for capital expenditure incurred for the purchase of intellectual property rights

Purpose

This paper provides background information on the tax deduction for capital expenditure incurred for the purchase of intellectual property rights ("IPRs"), and summarizes the views and concerns of members of the Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011 ("Bills Committee") and the Panel on Commerce and Industry ("the Panel") in the Fifth Legislative Council on issues related to intellectual property ("IP") trading.

Background

2. At present, capital expenditure on prescribed IPRs, i.e. purchase cost of copyright, registered designs, registered trade marks, patent rights and rights to know-how, are deductible under specific provisions of the Inland Revenue Ordinance (Cap. 112) ("IRO"). Of the five IPRs, copyright, registered designs and registered trade marks were added in 2011 by the Inland Revenue (Amendment) (No. 2) Ordinance 2011 ("Amendment Ordinance").

3. To encourage enterprises to engage in the development of related business, and to promote Hong Kong as an IP trading hub in the region, the Financial Secretary proposed in his 2016-2017 Budget that the Government would expand the scope of tax deduction for capital expenditure incurred for the purchase of IPRs from the existing five categories to eight. The additions are layout-design of integrated circuits, plant varieties and rights in performance.

Layout-design of integrated circuits

4. The Layout-Design (Topography) of Integrated Circuits Ordinance (Cap. 445) protects the layout-design (topography) of integrated circuits in computer

chips, and semiconductor chips used in computers and other equipment that rely on computer technology, for example, television sets, mobile telephones, medical devices such as hearing aids, and other products with electrical components. The rights in layout-design (topography) of integrated circuits are protected automatically as soon as the layout-design (topography) is created, and registration of the layout-design (topography) is not required. For layout-design (topography) of integrated circuits to be protected, the layout-design (topography) must be original, and must be recorded in documentary form or incorporated into an integrated circuit.

Plant varieties

5. The Plant Varieties Protection Ordinance (Cap. 490) provides plant breeders (or the owners of the varieties) the legal means to apply for proprietary rights over cultivated plant varieties they have bred. Owners of plant variety rights shall have the exclusive rights to produce reproductive material of the protected variety for the purpose of commercial marketing; sell or offer for sale reproductive material of the protected variety; import/export reproductive material of the protected variety; and licence others to carry out the above activities.

Right in performances

6. The right in performances refers to the performers' right to prohibit the fixation, broadcast or inclusion in a cable programme of a performance or the reproduction of such fixation. The performers can also prohibit others from importing, exporting, possessing or dealing with (such as selling or letting for hire, offering or exposing for sale or hire, or distributing) the fixations of their performances for the purpose of or in the course of any trade or business. According to the Copyright Ordinance (Cap. 528), apart from performers, the right in performances also applies to persons having exclusive fixation rights in relation to a performance.

Previous discussions

Bills Committee

7. The Bills Committee was formed in April 2011 to study the Amendment Bill. The main issues deliberated by the Bills Committee included the scope of specified IPRs covered by the proposed tax deduction, power of the Commissioner of Inland Revenue to determine true market value of any of the five IPRs, scope and application of the proposed anti-avoidance provisions, and tax deduction arrangements for any of the five IPRs involved in cross-border activities.

8. Taking into consideration that the objective of the proposed tax deduction

was to promote the wider application of IPRs, the Bills Committee requested the Administration to consider extending the tax deduction scheme to cover more types of IPRs. The Bills Committee also agreed to refer the issue to the Panel for follow-up as appropriate.

The Panel

9. Since the enactment of the Amendment Ordinance, the Panel has not discussed tax deduction for capital expenditure incurred for the purchase of IPRs. The Panel was briefed on the formation of the Working Group on IP Trading ("Working Group") in March 2013 to promote the development of Hong Kong as an IP trading hub and its progress at the meetings on 21 May 2013 and 20 May 2014 respectively.

10. At the Panel meeting on 19 May 2015, the Administration further briefed members that the Working Group had completed its work and recommended, among other things, extending the scope of tax deduction for capital expenditure incurred on the purchase of IPRs to cover more types of IPRs under IRO. At its meeting on 15 March 2016, the Panel was briefed on the latest progress of various measures to promote Hong Kong as an IP trading hub in the region. Members' major concerns are summarized in the ensuing paragraphs.

Intellectual Property Consultation Service Scheme

11. Members enquired about the Intellectual Property Consultation Service Scheme to provide free initial IP consultation services to small and medium enterprises ("SMEs"). At the meeting on 19 May 2015, citing some SMEs' feedback that the free advisory services on IPs could be more thorough, some members called for improvement in the provision of such services. The Administration advised that the Scheme aimed to enhance SMEs' awareness on IP-related issues such as creation, protection and application through the provision of free initial IP consultation services. SMEs had to approach the relevant professionals should they require more in-depth advice and services regarding their IPs. At the meeting on 15 March 2016, some members enquired about the issues of concern raised by SMEs during the consultation sessions. The Administration advised that SMEs had sought advice on various types of IP rights including trade marks, patents and copyright. In particular, they were interested in developing effective IP management and commercialization strategies.

Promotion strategies

12. At the meeting on 19 May 2015, some members suggested that, given the wide scope of IP trading that spanned across many different industries, the Administration should consider selecting a few industries with good potential for focus development as a start. The Administration responded that industries in

which Hong Kong had an edge, such as the textiles and apparel industries, might be considered as pilot industries in the development of IP trading.

Intellectual property protection regime

13. Some members expressed concern that the legislative exercise of the Copyright (Amendment) Bill 2014 ("Copyright Bill") could not conclude. They were deeply concerned that if Hong Kong's copyright law could not keep pace with technological and international developments to enhance copyright protection in the digital environment, it would affect the Administration's objective to promote Hong Kong as a premier IP trading hub in the region.

14. The Administration advised that while the legislative exercise of the Copyright Bill could not conclude, it would continue to liaise with stakeholders and to ensure a fair balance between protecting the legitimate interests of copyright owners and other public interests, such as fair and reasonable use of copyright works and freedom of expression.

Latest position

15. The Administration will brief the Panel on a legislative proposal which seeks to amend IRO to expand the scope of tax deduction for capital expenditure incurred for the purchase of IPRs as announced in the 2016-2017 Budget.

Relevant papers

16. A list of relevant papers is shown in the **Appendix**.

List of relevant papers

Date of meeting	Meeting	Paper
7/12/2011	Council	Report of the Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2011 (LC Paper No. CB(1)489/11-12)
21/5/2013	Panel on Commerce and Industry	<p>Administration's paper on "Fostering the development of intellectual property trading in Hong Kong" (LC Paper No. CB(1)1026/12-13(06))</p> <p>Background brief on the development of intellectual property trading prepared by the Legislative Council Secretariat (LC Paper No. CB(1)1026/12-13(07))</p> <p>Minutes of meeting (LC Paper No. CB(1)1485/12-13)</p>
20/5/2014	Panel on Commerce and Industry	<p>Administration's paper on "Promotion of Intellectual Property trading in Hong Kong" (LC Paper No. CB(1)1420/13-14(04))</p> <p>Updated background brief on the promotion of intellectual property trading in Hong Kong prepared by the Legislative Council Secretariat (LC Paper No. CB(1)1420/13-14(05))</p> <p>Minutes of meeting (LC Paper No. CB(1)1916/13-14)</p>

Date of meeting	Meeting	Paper
19/5/2015	Panel on Commerce and Industry	<p>Administration's paper on "Progress of the Working Group on Intellectual Property Trading" (LC Paper No. CB(1)831/14-15(03))</p> <p>Report of the Working Group on Intellectual Property Trading (LC Paper No. CB(1)680/14-15(01))</p> <p>Updated background brief on the promotion of intellectual property trading in Hong Kong prepared by the Legislative Council Secretariat (LC Paper No. CB(1)831/14-15(04))</p> <p>Minutes of meeting (LC Paper No. CB(1)1100/14-15)</p>
15/3/2016	Panel on Commerce and Industry	<p>Administration's paper on "Progress on the promotion of intellectual property trading in Hong Kong" (LC Paper No. CB(1)642/15-16(03))</p> <p>Updated background brief on the promotion of intellectual property trading in Hong Kong prepared by the Legislative Council Secretariat (LC Paper No. CB(1)642/15-16(04))</p> <p>Minutes of meeting (LC Paper No. CB(1)902/15-16)</p>