

# **立法會**

## ***Legislative Council***

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### **Bills Committee on Inland Revenue (Amendment) (No. 2) Bill 2018**

#### **Background brief**

#### **Purpose**

This paper provides background information on the Inland Revenue (Amendment) (No. 2) Bill 2018 ("the Bill") which seeks to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to expand the scope of profits tax deductions for capital expenditure incurred for the purchase of intellectual property rights ("IPRs") to cover three categories of IPRs, i.e. rights in layout-design (topography) of integrated circuits ("ICs"), plant varieties and performances. It also summarizes the major views and concerns expressed by members of the Panel on Commerce and Industry ("the Panel") on the proposed legislative amendments.

#### **Background**

2. At present, capital expenditure on five prescribed categories of IPRs, i.e. purchase cost of copyright, registered designs, registered trade marks, patent rights and rights to know-how, are deductible under sections 16E and 16EA of IRO when assessing profits tax. Besides, expenditure relating to the registration of a trade mark or design, or the registration or grant of a patent that is used for producing taxable profits is deductible under section 16(1)(g) of IRO.

3. To encourage enterprises to engage in the development of related business, and to promote Hong Kong as an intellectual property ("IP") trading hub in the region, the Financial Secretary announced in his 2016-17 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 three proposed additions are layout-design (topography) of ICs, plant varieties and performances.

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

4. The Layout-design (Topography) of Integrated Circuits Ordinance (Cap. 445) protects the layout-design (topography) of ICs 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 ICs 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 ICs to be protected, the layout-design (topography) must be original, and must be recorded in documentary form or incorporated into an IC.

### Plant varieties

5. The Plant Varieties Protection Ordinance (Cap. 490) ("PVPO") provides plant breeders (or the owners of the varieties) with the legal means to apply for proprietary rights over plant varieties they have bred or discovered and developed. 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>1</sup> A grant under PVPO shall be in force for a term of 25 years in the case of trees and vines and of 20 years in other cases. 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.

### Performances

6. 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 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.

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<sup>1</sup> One of such conditions is that the variety needs to be new, distinct, stable and homogenous.

## **Inland Revenue (Amendment) (No. 2) Bill 2018**

7. The Bill was published in the Gazette on 23 March 2018 and received its First Reading at the Council meeting of 11 April 2018. The Bill seeks to amend IRO to expand the scope of profits tax deduction for capital expenditure incurred for the purchase of IPRs to cover three new categories of IPRs as mentioned in paragraphs 4 to 6; allow deduction of expenses for the grant of plant variety rights; deem certain sums to be trading receipts chargeable to tax; and provide for related matters. The Bill, if passed, would come into operation on the day on which it is published in the Gazette as an Ordinance.

### **Major views and concerns expressed by members**

8. The Panel was consulted on the proposed legislative amendments on 15 November 2016. The deliberations and concerns of members are summarized in the ensuing paragraphs.

#### *Scope of intellectual property rights for tax deduction*

9. Some members considered that the three newly proposed categories of IPRs for inclusion in the scope of tax deduction might not be very relevant to major industries in Hong Kong. They enquired about the justifications for the proposed additions and whether the scope of tax deduction would be further expanded to cover other categories of IPRs in future. The Administration advised that the expansion of the scope of tax deduction for the purchase of IPRs was one of the measures recommended by the Working Group on IP Trading in March 2015 for promoting Hong Kong as a regional IP trading hub. Upon the inclusion of the proposed three categories of IPRs, all major IPRs in Hong Kong would have been covered by the tax deduction measure.

#### *Expected economic benefits*

10. In response to a member's enquiry about the economic benefits expected to be generated by the proposed expansion of the scope of tax deduction, the Administration advised that the proposed expansion, whilst only an extension of the prevailing tax exemption scheme, should encourage businesses to further consider using and purchasing the three categories of newly added IPRs. This would bring about some positive effects to the development of the IP industry in Hong Kong and the status of Hong Kong as a premier IP trading hub in Asia. The proposed expansion, together with other research and development related initiatives, should help contribute to a more favourable environment for innovation in Hong Kong.

### *Coverage of tax deductible costs*

11. At a member's request, the Administration clarified that the one-off purchase cost of the prescribed IPRs as well as the associated legal fees and maintenance costs were tax deductible. There was no ceiling set for the relevant tax deduction.

12. Some members noted that it was a common practice for local enterprises of the industrial sector to set up headquarters in Hong Kong and the production base on the Mainland. They enquired whether the cost incurred for purchasing prescribed IPRs in Hong Kong which were used in the Mainland for production purpose would be eligible for tax deduction. The Administration advised that tax deduction was allowable on the condition that the relevant IPR was used in the production of chargeable profits in Hong Kong. In general, where a relevant IPR was used partly in the production of chargeable profits, deduction would be allowed for the percentage of capital expenditure relevant to the use of that IPR for production of chargeable profits. If the relevant IPR was purchased for use partly in and partly outside Hong Kong, the expenditure allowable for tax deduction would be subject to the extent of its use in the production of Hong Kong chargeable profits, which could be determined by means of apportionment of gross profits, for example.

### *Plant varieties*

13. Some members were concerned whether there would be any contradiction in respect of the treatment of new varieties of plants deriving from genetic modifications in the current legislative proposal and other relevant local legislation, such as the Food Safety Ordinance (Cap. 612). The Administration advised that PVPO provided for the granting of plant variety rights to owners of plant varieties over cultivated plant variety they had bred or discovered and developed, regardless of the method by which they were bred or discovered and developed. PVPO had no restriction on the registration for plants variety rights by owners of new plant varieties deriving from genetic modifications.

### *Performances*

14. At a member's request, the Administration explained that rights in performances included the performers' rights and the rights of persons who were entitled to make fixations of the performances for commercial exploitation. Performers' rights also covered the performers' economic rights of reproduction, distribution, making available to the public and rental right which were assignable as provided under CO. As for the cost incurred by a company for obtaining authorization from a performer to make fixations of the concerned performances for commercial exploitation, it would be tax deductible pursuant to the proposed tax deduction arrangement relating to performances.

15. Noting that both individuals and companies could be the owner of proprietary rights in respect of an IP, some members enquired whether individual performers could enjoy the same proposed profits tax deduction in question. The Administration advised that an individual owner of an IPR could enjoy tax deduction if the relevant IPR was being owned under the person's sole proprietorship.

16. Members also enquired about the impact of the proposal on the performing arts industry. The Administration advised that the proposal aimed to encourage enterprises to engage in the development of IP-related business and promote Hong Kong as a regional IP trading hub. Recording companies and artists were expected to benefit from the relevant arrangements.

### *Publicity*

17. Some members urged the Administration to step up publicity on the proposed tax deduction measures upon passage of the legislative amendments, so that the concerned enterprises could be fully aware of the relevant arrangements. The Administration advised that the Intellectual Property Department had been organizing training programmes relating to IP management and commercialization for enterprises on an on-going basis for building up their relevant manpower capacity. The Inland Revenue Department would be tasked with disseminating information on the expanded scope of tax deduction to the concerned professionals, such as lawyers and accountants.

### **Latest development**

18. At the House Committee meeting held on 13 April 2018, Members agreed to form a Bills Committee to study the Bill.

### **Relevant Papers**

19. A list of relevant papers is in the **Appendix**.

## Appendix

### List of relevant papers

Date	Event	Paper
15/11/2016	Panel on Commerce and Industry	<p>Administration's paper on "Profit tax deduction for capital expenditure incurred for the purchase of intellectual property rights" (<a href="#">LC Paper No. CB(1)90/16-17(03)</a>)</p> <p>Updated background brief on tax deduction for capital expenditure incurred for the purchase of intellectual property rights prepared by the Legislative Council Secretariat (<a href="#">LC Paper No. CB(1)90/16-17(04)</a>)</p> <p>Administration's follow-up paper on "Profit tax deduction for capital expenditure incurred for the purchase of intellectual property rights" (<a href="#">LC Paper No. CB(1)752/17-18(01)</a>)</p> <p>Minutes of meeting (<a href="#">LC Paper No. CB(1)309/16-17</a>)</p>
21/3/2018 (issue date)	Legislative Council Brief	Legislative Council Brief on "Inland Revenue (Amendment) (No. 2) Bill 2018" issued by the Commerce, Industry and Tourism Branch of the Commerce and Economic Development Bureau (File Ref.: <a href="#">CITB CR 81/45/2</a> )
13/4/2018	House Committee	Legal Service Division Report on Inland Revenue (Amendment) (No. 2) Bill 2018 ( <a href="#">LC Paper No. LS49/17-18</a> )