

Legislative Council Brief

Inland Revenue Ordinance
(Chapter 112)

INLAND REVENUE (AMENDMENT) (NO. 2) BILL 2018

INTRODUCTION

A At the meeting of the Executive Council on 13 March 2018, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (No. 2) Bill 2018 (“the Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”) to expand the scope of profits tax deductions for capital expenditure incurred for the purchase of intellectual property rights (“IPRs”) from the existing five types to eight. The additional three IPRs are rights in layout-design (topography) of integrated circuits, plant varieties and performances.

JUSTIFICATIONS

Existing tax deduction regime for IPRs

2. Under Hong Kong’s tax regime, an enterprise’s revenue expenditure is generally deductible when computing profits tax. As such, an enterprise’s revenue expenditure for the use of IPRs (such as royalties and licence fees) 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 deduction of capital expenditure is not allowed and we do not tax capital receipts. Nevertheless, certain exceptions have been made over the years under the Inland Revenue Ordinance (“the Ordinance”). At present, the following types of capital expenditure on the existing five specified types of IPRs are deductible under specific provisions of the Ordinance –

- (a) registration expenditure on designs, patents 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 designs and registered trade marks (section 16EA).

4. The current exercise seeks to expand the scope to cover three more types of IPRs. If the legislative proposal is approved, capital expenditure incurred for the purchase and registration (where applicable under the relevant regimes) of various major types of IPRs will be deductible under the Ordinance.

Layout-design (topography) of integrated circuits

5. Integrated Circuits (“ICs”) are widely adopted in almost all kinds of industrial and consumer products and services¹. Layout-design (topography) means the three-dimensional disposition, however expressed, of the elements, at least one of which is an active element, and of some or all of the interconnections of an integrated circuit; or means such a three-dimensional disposition prepared for an integrated circuit intended for manufacture. In Hong Kong, layout-design (topography) of ICs is protected by the Layout-design (Topography) of Integrated Circuits Ordinance (Cap. 445). 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 under Cap. 445.

6. 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 ten years after the end of the year in which it was first commercially exploited.

¹ 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 be part of the IP portfolio of product level companies such as car manufacturers, industrial production / medical equipment manufacturers, consumer goods manufacturers, and logistics companies (e.g. location based tracking devices).

Plant varieties

7. Plant variety rights are rights granted to plant breeders (or owners of the variety) over cultivated plant varieties they have bred or discovered and developed. The Plant Varieties Protection Ordinance (Cap. 490) provides owners of plant varieties with the legal means to apply for proprietary rights over plant varieties they have bred or discovered and developed. Cap. 490 covers all plants except inedible algae and inedible fungi.

8. Varieties of all types of plants covered by Cap. 490 (e.g. food crops, vegetables, ornamentals) are eligible for protection, subject to certain conditions. A grant under Cap. 490 is in force for a term of 25 years in the case of trees and vines and of 20 years in other cases.

Performances

9. Pursuant to section 200(1) of the Copyright Ordinance (Cap. 528), a 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.

10. Performers are recognized for the pivotal role they play in the creative process in presentations to the public. Generally speaking, rights in respect of reproduction, distribution and making available to the public of copies of a fixation of their performances, and the right for renting to the public copies of a sound recording of their performances (as provided in section 215(1) of Cap. 528), which are generally referred to as “economic rights” are assignable. The proposed tax concession, in practice, can apply to rights in performances so long as they are assignable (also known as “economic rights”).

11. Rights in a performance 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 the fixation is released.

Conditions for tax concession, and deemed trading receipts

12. Presently, under the Ordinance, taxpayers should fulfill the following conditions in order to be eligible for tax concession for the existing five specified types of IPRs (such as copyright, registered designs and registered trade marks) –

- (a) a taxpayer must have acquired the “proprietary interest” of the relevant IPR. 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 to encourage innovation and upgrading (sections 16E(1)&(9); 16EA(11)&(13));

- (b) the relevant IPR is used in the production of chargeable profits (sections 16E(1); 16EA(6));
- (c) if the 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 (sections 16E(2); 16EA(7)); and
- (d) if the 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 (sections 16E(5); 16EA(12)).

The tax concession for the three additional types of IPRs covered by the current legislative exercise would also be subject to the above existing conditions.

13. At present, capital expenditure on the existing five specified types of IPRs under the Ordinance and their corresponding rights subsisting / protected under the laws of other places is deductible when assessing profits tax, so as to encourage the creation and commercialization of IP. This arrangement will also apply in relation to the three additional IPRs and their corresponding rights subsisting / protected under the laws of other places. On the other hand, the Ordinance provides that any sum, not otherwise chargeable to profits tax, received by or accrued to a person for the use of, or the right to use, of the existing five specified types of IPRs in Hong Kong or outside Hong Kong should be deemed as receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. This arrangement will also apply in relation to the three newly added IPRs.

Miscellaneous amendments

14. For the sake of tax clarity, we propose to add certain provisions to stipulate clearly that sums received or receivable by a performer or an organizer of a performer for an assignment of, or an agreement to assign, a performer's right in relation to a performance given in Hong Kong are deemed as trading receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. Amendments will also be made to

section 20B of the Ordinance in relation to the chargeability of such sums received by a non-resident person in relation to a performance given in Hong Kong.

THE BILL

15. The main provisions of the Bill are as follows –

- (a) **Clause 3** amends section 15 of the Ordinance to provide that certain sums received or receivable by a person in relation to layout-design (topography) right, plant variety right and performer's right are deemed trading receipts; and
- (b) **Clause 5** amends section 16EA of the Ordinance to expand the scope of the profits tax deduction for capital expenditure incurred for the purchase of IPRs to cover the three new types of IPRs.

LEGISLATIVE TIMETABLE

16. The legislative timetable will be as follows-

Publication in the Gazette	23 March 2018
First Reading and commencement of Second Reading Debate	11 April 2018
Resumption of Second Reading Debate, Committee Stage and Third Reading	To be notified

IMPLICATIONS OF THE PROPOSAL

17. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no civil service, competition, environmental, family, gender or productivity implications. It will not affect the current binding effect of the Ordinance. The financial, economic and sustainability implications are set out in **Annex B**.

PUBLIC CONSULTATION

18. We briefed the LegCo Panel on Commerce and Industry on the legislative proposals on 15 November 2016. Members were generally supportive of the proposed measure. We have also kept key stakeholders including the Hong Kong Bar Association, the Law Society of Hong Kong and the Joint Liaison Committee on Taxation informed during the formulation of the proposal. They have not raised objection.

PUBLICITY

19. A press release will be issued on 23 March 2018. A spokesman will be available to answer enquiries.

BACKGROUND

20. Tax concession for the purchase of patent rights and know-how was introduced in 1983 and 1992 respectively. The scope was expanded to cover copyright, registered designs and registered trademarks in 2011, as announced in the 2010-11 Budget.

21. Expanding the scope of tax deduction for capital expenditure incurred for the purchase of IPRs is one of the recommendations in the report of the Working Group on IP Trading released in March 2015 to promote Hong Kong as an IP trading hub in the region.

22. The 2016-17 Budget announced that the Government would expand the scope of tax deduction to cover rights in layout-design (topography) of integrated circuits, plant varieties and performances.

ENQUIRIES

23. Any enquiries on this brief may be addressed to Miss Alice Choi, Principal Assistant Secretary for Commerce and Economic Development (Commerce and Industry) at telephone number 2810 2862.

**Commerce, Industry and Tourism Branch
Commerce and Economic Development Bureau
21 March 2018**

A BILL

To

Amend the Inland Revenue Ordinance to expand the scope of profits tax deduction for capital expenditure incurred for the purchase of intellectual property rights to cover performer's economic rights, protected layout-design (topography) rights and protected plant variety rights; to allow deduction of expenses for the grant of plant variety rights; to deem certain sums to be trading receipts chargeable to tax; and to provide for related matters.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 2) Ordinance 2018.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 7.

3. Section 15 amended (certain amounts deemed trading receipts)

(1) Section 15(1)(b)—

Repeal

everything after “a person for”

Substitute

“the use, or the right to the use, in Hong Kong of any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant

variety right, secret process or formula, or other property or right of a similar nature, or for imparting or undertaking to impart knowledge directly or indirectly connected with the use in Hong Kong of any such patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right;”.

(2) Section 15(1)(ba)—

Repeal

everything after “a person for” and before “which are deductible”

Substitute

“the use, or the right to the use, outside Hong Kong of any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right of a similar nature, or for imparting or undertaking to impart knowledge directly or indirectly connected with the use outside Hong Kong of any such patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right;”.

(3) After section 15(1)(ba)—

Add

“(bb) sums, not otherwise chargeable to tax under this Part, received by or accrued to a performer or an organizer for an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong on or after the day on which the Inland Revenue (Amendment) (No. 2) Ordinance 2018 (of 2018) comes into operation;”.

- (4) After section 15(6)—

Add

“(7) The amendments made to this section by the Inland Revenue (Amendment) (No. 2) Ordinance 2018 (of 2018) do not have the effect of rendering chargeable to tax sums received by or accrued to a person before the day on which that Ordinance comes into operation which were not otherwise chargeable to tax.

- (8) In this section—

organizer (籌辦人) means a person who obtains a performer’s right in a performance in Hong Kong through arranging the participation of the performer in the performance or managing the performance;

performance (表演) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528);

performer (表演者) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528).”

4. Section 16 amended (ascertainment of chargeable profits)

- (1) Section 16(1)(g)—

Repeal

“patent,”

Substitute

“patent or plant variety right.”

- (2) After section 16(5A)—

Add

“(5B) The amendment made to subsection (1)(g) by the Inland Revenue (Amendment) (No. 2) Ordinance 2018 (of 2018) applies only in relation to a year of assessment beginning on or after 1 April 2018.”

5. Section 16EA amended (purchase of specified intellectual property rights)

- (1) Section 16EA(4)—

Repeal paragraph (a)

Substitute

“(a) is a copyright, performer’s economic right, protected layout-design (topography) right, protected plant variety right or registered design; and”.

- (2) After section 16EA(6)(b)—

Add

“(ba) (in the case of the specified intellectual property right being a performer’s economic right) the performer’s economic right has not expired;

(bb) (in the case of the specified intellectual property right being a protected layout-design (topography) right) the protection of the layout-design has not ceased;

(bc) (in the case of the specified intellectual property right being a protected plant variety right) the grant of the protected plant variety right is in force;”.

- (3) Section 16EA(11), Chinese text, definition of **最長保護限期**—

Repeal

“(maximum period of protection)在”

Substitute

“(maximum period of protection)”.

- (4) Section 16EA(11), Chinese text, definition of **最長保護限期**, paragraph (a)—

Repeal

“有關指明知識產權是”

Substitute

“在有關指明知識產權是”。

- (5) Section 16EA(11), definition of *maximum period of protection*, after paragraph (a)—

Add

- “(ab) in the case of a specified intellectual property right that is a performer’s economic right—
- (i) (if the right is conferred by Part III of the Copyright Ordinance (Cap. 528)) the maximum period for which the right may be conferred under that Ordinance; or
- (ii) (if the right subsists under the law of a place outside Hong Kong) the maximum period for which the right may subsist under the law of that place;
- (ac) in the case of a specified intellectual property right that is a protected layout-design (topography) right—
- (i) (if the right is in a layout-design (topography) that is protected under section 3 of the Layout-design (Topography) of Integrated Circuits Ordinance (Cap. 445)) the maximum period for which the layout-design may be protected under that Ordinance; or
- (ii) (if the right subsists under the law of a place outside Hong Kong) the maximum period for which the right may subsist under the law of that place;
- (ad) in the case of a specified intellectual property right that is a protected plant variety right—

- (i) (if the right is granted under Part III of the Plant Varieties Protection Ordinance (Cap. 490)) the maximum period for which the grant of the right may be in force under that Ordinance; or
- (ii) (if the right subsists under the law of a place outside Hong Kong) the maximum period for which the right may subsist under the law of that place;”.

- (6) Section 16EA(11), Chinese text, definition of *最長保護限期*, paragraph (b)—

Repeal

“有關指明知識產權是”

Substitute

“在有關指明知識產權是”。

- (7) Section 16EA(11), at the end of the definition of *specified capital expenditure*—

Add

“Note—

Please also see subsection (14).”.

- (8) Section 16EA(11)—

Repeal the definition of *specified intellectual property right***Substitute**

“*specified intellectual property right* (指明知識產權) means a copyright, performer’s economic right, protected layout-design (topography) right, protected plant variety right, registered design or registered trade mark.”.

- (9) Section 16EA(11)—

Add in alphabetical order

“*performer* (表演者) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528);

performer’s economic right (表演者的經濟權利) means—

- (a) a right mentioned in section 215(1)(a), (b), (c) or (d) of the Copyright Ordinance (Cap. 528) and conferred by Part III of that Ordinance on a performer; or
- (b) a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong;

protected layout-design (topography) right (受保護的布圖設計(拓樸圖)權利) means—

- (a) a right in a layout-design (topography) that is protected under section 3 of the Layout-design (Topography) of Integrated Circuits Ordinance (Cap. 445); or
- (b) a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong;

protected plant variety right (受保護植物品種權利) means—

- (a) a right granted under Part III of the Plant Varieties Protection Ordinance (Cap. 490); or
- (b) a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong;”.

(10) Section 16EA—

Repeal subsection (14)

Substitute

“(14) In this section, a reference to specified capital expenditure is—

- (a) if specified capital expenditure is incurred in relation to a copyright, registered design or registered trade mark—a reference to specified capital expenditure incurred during a year of assessment beginning on or after 1 April 2011; or
- (b) if specified capital expenditure is incurred in relation to a performer’s economic right, protected layout-design (topography) right or protected plant variety right—a reference to specified capital expenditure incurred during a year of assessment beginning on or after 1 April 2018.”.

6. **Section 16EC amended (deduction under section 16E or 16EA not allowable under certain circumstances)**

Section 16EC(8)—

Repeal the definition of *commencement date*

Substitute

“*commencement date* (生效日期) means—

- (a) in relation to a specified intellectual property right that is a copyright, registered design or registered trade mark—16 December 2011;
- (b) in relation to a specified intellectual property right that is a performer’s economic right, protected layout-design (topography) right or protected plant variety right—the day on which the Inland Revenue (Amendment) (No. 2) Ordinance 2018 (of 2018) comes into operation;”.

7. **Section 20B amended (persons chargeable in respect of certain profits of a non-resident)**

Section 20B(1)(a)—

Repeal

“(b) or (ba)”

Substitute

“(b), (ba) or (bb)”.

Explanatory Memorandum

This Bill amends the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) mainly to—

- (a) allow profits tax deductions for capital expenditure incurred for the purchase of 3 additional intellectual property rights, that is to say, performer’s economic rights, protected layout-design (topography) rights and protected plant variety rights; and
 - (b) provide that certain sums received by or accrued to a person are deemed trading receipts chargeable to tax.
2. Clause 3 amends section 15 of the Ordinance to provide that the following sums are deemed trading receipts chargeable to tax—
 - (a) sums received by or accrued to a person in relation to layout-designs (topography) of integrated circuits, performer’s rights or plant variety rights;
 - (b) sums received by or accrued to a performer or an organizer for an assignment of, or an agreement to assign, a performer’s right in relation to a performance given by the performer in Hong Kong.
 3. Clause 4 amends section 16(1)(g) of the Ordinance to provide that sums expended for the grant of plant variety rights are deductible on ascertainment of chargeable profits.
 4. Clause 5 amends section 16EA of the Ordinance—
 - (a) to allow tax deduction for capital expenditure incurred for the purchase of intellectual property rights to cover performer’s economic rights, protected layout-design (topography) rights and protected plant variety rights;
 - (b) to make technical amendments to some of the existing definitions under section 16EA(11); and

(c) to add the new definitions of *performer*, *performer's economic right*, *protected layout-design (topography) right* and *protected plant variety right*.

5. Clause 6 amends section 16EC of the Ordinance to provide that the tax deduction mentioned in paragraph 4(a) is not allowable under certain circumstances.
6. Clause 7 amends section 20B of the Ordinance to provide that tax is recoverable from a person in Hong Kong who paid or credited to a non-resident person the sums deemed under a new section 15(1)(bb) of the Ordinance as trading receipts.

IMPLICATIONS OF THE PROPOSAL

Economic Implications

The proposal, whilst only an extension of the prevailing tax exemption scheme, should encourage businesses to further consider using and purchasing the three types of newly added IPRs. This would bring about some positive effects to the development of the IP industry in Hong Kong and also our status as a premier IP trading hub in Asia. Furthermore, despite the insignificant amount of revenue foregone, this proposal, together with other R&D-related initiatives, should likewise help contribute to a more favourable environment for innovation in Hong Kong.

Sustainability Implications

2. The proposal will contribute to the vibrancy of Hong Kong's economy by generating positive effect to the IP industry.

Financial Implications

3. The proposal would involve tax revenue foregone. However, it is not feasible to arrive at a precise estimation as there are limited market information and statistics on the trading volume of the three types of IPRs concerned. Nonetheless, the total amount of deduction claimed in respect of capital expenditure on the purchase of IPRs for the year of assessment 2015/16 (i.e. before the proposed expansion in the current exercise) was \$846 million, and the maximum estimated tax revenue foregone was \$140 million. The additional revenue foregone arising from the proposed expansion should only be a small fraction of the above sum, given that the existing tax deduction regime has already covered the most common types of IPRs.