中華人民共和國
香港特別行政區政府
商務及經濟發展局
香港添馬添美道二號
政府總部西翼二十三樓

COMMERCE AND ECONOMIC DEVELOPMENT BUREAU
THE GOVERNMENT OF THE
HONG KONG SPECIAL ADMINISTRATIVE REGION
OF THE PEOPLE'S REPUBLIC OF CHINA
23/F, WEST WING
CENTRAL GOVERNMENT OFFICES
2 TIM MEI AVENUE
TAMAR, HONG KONG

Our Ref : CEDB CR 06/18/23
Your Ref :

Tel : (852) 2810 3152
Fax : (852) 2147 3065

By Email (dsin@legco.gov.hk)

4 June 2024

Mr Daniel Sin
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Mr Sin,

Bills Committee on Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024

The Government's Responses to Comments / Suggestions Raised in the Written Submissions

Thank you for your email dated 28 May 2024 on the five written submissions regarding the captioned Bill received by the Bills Committee. The Government's responses to the comments and suggestions raised therein are set out at the Annex for Members' perusal.

Your attention is particularly drawn to the comments in item 23 of the Annex, in response to which the Government is prepared to move a committee stage amendment to refine the formulation of section 23(1)(a)(i) of the proposed Schedule 17FD with a view to clarifying that the three-year transitional period will run from the beginning of the taxpayer's basis period for the year of assessment 2023/24. The proposed draft of the committee stage amendment (to be finalised) is at the Appendix.

Yours sincerely,

(Ms Vivian Chan)
for Secretary for Commerce and Economic Development

c.c. Director of Intellectual Property (Attn: Mr Thomas Tsang)
Commissioner of Inland Revenue (Attn: Mr Benjamin Chan)
Department of Justice (Attn: Mr Jonathan Luk)
Director of Agriculture, Fisheries and Conservation (Attn: Mr Stephen Lai)

Annex

Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024

The Government's Responses to Comments / Suggestions Raised in the Written Submissions

I. Key Parameters of the Patent Box Tax Incentive

Item	Summary of Views	Respondents	Government's Response
A. General			
1.	• The proposal of implementing a patent box tax incentive in Hong Kong by way of the Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024 ("Amendment Bill") is welcomed and supported. • The Amendment Bill seeks to implement Hong Kong's highly anticipated patent box regime.	CDTT, PwC, TIHK	• We are pleased to note the support of the Amendment Bill to introduce a patent box tax incentive, which is aimed to encourage the innovation and technology ("I&T") sector to forge ahead with more research and development ("R&D") activities and create more intellectual properties ("IPs") with market potential as a catalyst for promoting I&T and IP trading activities with a view to maintaining Hong Kong's competitiveness as a regional IP trading centre.
2.	• The Government should be expressly empowered to make detailed application guidance and procedures in relation to the patent box regime.	LP	• Currently, the Inland Revenue Department ("IRD") provides useful guidance, practical examples and procedures in respect of various tax regimes on its website to facilitate compliance. IRD will adopt the same approach for the patent box tax incentive.

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B. Eligible IP			
3.	• Similar to the Israeli Innovation Box regime, an eligible IP can also include medicinal products, patented or not, registered under local requirements of Hong Kong.	TIHK	• Under the nexus approach, IPs that could qualify for tax benefits under the patent box regime are patents and other IPs that are functionally equivalent to patents. • Medicinal products may involve inventions that are protected by patents. In that case, the income derived from such patents would qualify for the preferential tax treatment.
4.	• The definitions of "eligible IP" and "eligible patent" defined in the Amendment Bill should be reviewed periodically and updated where necessary to ensure coverage is as broad as possible provided that it is allowable under the Organisation for Economic Co-operation and Development ("OECD")'s nexus approach.	KPMG	• Under the nexus approach, IPs that could qualify for tax benefits under the patent box regime are patents and other IPs that are functionally equivalent to patents. The scope of IPs proposed under the Amendment Bill already covers the widest possible IPs permitted by the OECD at this stage. • Subject to the LegCo's approval, the Amendment Bill provides that the Government may amend Schedule 17FD, including the definition of eligible IP, by way of subsidiary legislation. This allows flexibility in the legislation such that the parameters of the regime can be adjusted swiftly in response to any market or regulatory development.

Item	Summary of Views	Respondents	Government's Response
5.	• Additional guidance and examples should be provided to illustrate how copyrighted software, including mobile applications, could qualify for the proposed regime.	PwC	• In our proposed regime, copyrighted software refers to a copyright subsisting in software under the Copyright Ordinance (Cap. 528) of Hong Kong or under the law of a place outside Hong Kong. While registration of copyrighted software is generally not required under the Copyright Ordinance or foreign law, it must fall within the scope of the relevant legal protection in order for it to be regarded as an eligible IP. Relevant guidance and illustrative example will be provided.
C. Eligible Expenditures			
6.	• A product-based approach should be allowed to cater for family of eligible IPs under the patent box incentive in Hong Kong.	KPMG, PwC, TIHK	• A product-based (product family) approach acknowledges that R&D activities may not be structured on an IP-by-IP basis. While the Amendment Bill does not adopt a product-based approach, if an eligible IP expenditure (as well as non-eligible expenditure) covers different IPs, the expenditure is allowed to be apportioned on a just and reasonable basis. Whether a particular basis is just and reasonable depends on the facts and circumstances of the case. We consider that this approach accords greater flexibility to taxpayers in apportioning expenditures incurred among different IPs and in turn the relevant R&D fraction, as long as the basis is just and reasonable.

Item	Summary of Views	Respondents	Government's Response
7.	• Further specifications or clarifications in the Amendment Bill or IRD's guidance of what constitutes eligible R&D expenditure ("EE") and non-eligible expenditure ("NE") of eligible persons for the purpose of calculating the R&D fraction may be required for various scenarios.	KPMG, TIHK	• The nexus ratio is a proportion of EE to the sum of EE and NE, both in respect the eligible IP to which the eligible income relates. Sections 13 and 14 of the proposed Schedule 17FD define EE and NE in a way that is consistent with the OECD's Base Erosion and Profit Shifting ("BEPS") Action 5 requirements. Further administrative guidance on the issue will be provided on IRD's website.
8.	• R&D expenditures borne by Hong Kong taxpayers under a cost sharing arrangement ("CSA") for qualifying IP should be accepted as EE, regardless of the location of the R&D activities. • It should be clarified whether a taxpayer's share of R&D costs under a CSA (or CSA payments made) could qualify as EE incurred by the taxpayer for the purpose of the patent box tax incentive.	KPMG, TIHK	• Similar to the current tax treatment for R&D expenditure[1], where the taxpayer has undertaken part or all of the underlying R&D activity under a development CSA[2], the share of R&D expenditure borne by the taxpayer under the CSA can be accepted as EE in calculating the nexus ratio so long as other conditions of eligible expenditures prescribed under the OECD's nexus approach are satisfied. • IRD will provide relevant guidance and illustrative example on its website or Departmental Interpretation and Practice Notes (DIPNs) upon passage of the Amendment Bill.

[1] See paragraphs 87 to 97 of Departmental Interpretation and Practice Notes No. 55 which is accessible at this link - https://www.ird.gov.hk/eng/pdf/dipn55.pdf.

[2] CSA or cost contribution arrangement (CCA) is a contractual arrangement among business enterprises to share contributions and risks involved in the joint development, production or obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangibles assets or services are expected to create benefits for the individual businesses of each of the participants. Since there are different types of CSA and CCA and that the terms are varied, each particular CSA or CCA should be considered based on its own facts and circumstances.

Item	Summary of Views	Respondents	Government's Response
9.	• IRD has to provide detailed guidance and examples regarding the interpretation of "R&D activity" within the context of the proposed regime, as well as tax treatments for collaboration research project with R&D institutions. • Further clarification or IRD's guidance on how the normal meaning of what constitutes R&D activities could reconcile with Schedule 17FD of the Amendment Bill may be needed.	PwC, TIHK	• To maintain consistency within the Inland Revenue Ordinance ("IRO"), "R&D activity" has the same meaning given by section 2 of Schedule 45 (Deduction of R&D Expenditures).
10.	• The nexus ratio should be allowed to be treated as a rebuttable presumption in the Amendment Bill.	KPMG	• While the OECD's nexus approach allows a jurisdiction to implement the nexus ratio as a rebuttable presumption, such design feature would not enable taxpayers to both rebut the nexus ratio and benefit from the 30% up-lift at the same time. Further, an implementing jurisdiction would need to limit the situations where the ratio could be rebutted to those that meet the following requirements: (a) the taxpayer first uses the nexus ratio to establish the presumed amount of income that could qualify for tax benefits; (b) the nexus ratio set out (excluding the up-lift) equals or exceeds 25%; (c) the taxpayer demonstrates that because of exceptional circumstances the application of the nexus ratio would result in an outcome that was

Item	Summary of Views	Respondents	Government's Response
			inconsistent with the principle of the nexus approach. This would impose more burdensome record-keeping requirements on the part of taxpayers, and require the implementing jurisdiction to establish monitoring procedures and notify the OECD's Forum of Harmful Tax Practice ("FHTP") of the circumstances in which the nexus ratio could be treated as a rebuttable presumption. The implementing jurisdiction also needs to spontaneously exchange information relating to such cases and provide statistics to the FHTP for monitoring on an annual basis[3]. • For the sake of simplicity and to minimise the compliance burden for taxpayers, we do not consider it appropriate to treat the nexus ratio as a rebuttable presumption.
11.	• The Amendment Bill does not specify at what point of time the original owner needs to be a Hong Kong resident person under sections 13(3)(a) and 14(3)(a) of the proposed Schedule 17FD.	TIHK	• Under sections 13(3)(a) and 14(3)(a) of the proposed Schedule 17FD, the original owner must be a Hong Kong resident person at the time when the subject IP or any right in respect of the property is or was vested.

[3] See paragraphs 67 to 69 of Chapter 4 of OECD's Action 5 Report which is accessible at this link - https://www.oecd.org/ctp/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report-9789264241190-en.htm.

Item	Summary of Views	Respondents	Government's Response
12.	• The Government is recommended to explore the possibility for Hong Kong companies across different industries to establish branches and/or representative offices in the Mainland, particularly in the Greater Bay Area ("GBA") cities, to conduct R&D activities.	PwC	• We will continue to maintain communication with the industry to understand the situation of Hong Kong companies setting up branches and/or representative offices in the Mainland and explore possible arrangements that comply with the requirements of the jurisdictional approach.
D. Local registration requirement			
13.	• The requirement of local filing/registration should be removed so as to make our proposed regime on par with some other jurisdictions. Instead of making local filing/registration a pre-requisite requirement for enjoying the tax incentive, other means of promoting the Hong Kong patent filing system should be considered.	KPMG	• Under our proposed patent box regime, eligible patents include patents applied for and granted anywhere including Hong Kong.[4] If an eligible patent generating eligible IP income is not a Hong Kong patent application or granted patent, there will be an **additional** requirement for the taxpayer to file an **additional** application for original grant patent ("OGP") or short-term patent ("STP") in Hong Kong in respect of the same invention, and request for substantive examination in the case of a STP application after its grant. The taxpayer is **not** required to **first** file a patent application in Hong Kong for enabling a non-Hong Kong patent to qualify as an eligible patent or fulfill the local registration

[4] Standard patents (R) and their applications are excluded after the expiry of 24 months after the patent box's commencement.

Item	Summary of Views	Respondents	Government's Response
			requirement. Such additional requirement will not apply if the date of filing of an eligible patent is within a transitional period of 24 months after the commencement date of the patent box tax incentive. • The local registration requirement is introduced to encourage and promote more filings under the local patent system (in particular the OGP system), and to ensure that the relevant inventions or R&D outcomes comply with Hong Kong's requirements for patent registrations. • In most cases, the taxpayer just needs to prepare a single specification with minor adjustments for filing patent applications in multiple jurisdictions (including Hong Kong). As such, the filing of an additional OGP or STP application in Hong Kong will not create undue burden on the taxpayer in terms of costs and efforts. Furthermore, the taxpayer will also obtain patent protection for its invention in Hong Kong where it derives IP income. • Many patent box regimes have confined their scopes of eligible IPs to those that are successfully granted or registered. Some regimes that allow taxpayers to claim tax concessions when the IP applications are still pending (e.g. Ireland and Singapore) provide for a clawback mechanism (i.e. the claimed IP income to be subject to normal tax rate) if such IP applications do not

Item	Summary of Views	Respondents	Government's Response
			result in grant. Our proposed patent box regime is in line with such common practice. • Under Hong Kong law, two patents cannot be granted for one invention made by the same inventor in Hong Kong to ensure that there is no double patenting. If, for instance, a taxpayer has already been granted a standard patent (re-registration) ("standard patent (R)") in respect of an invention, it cannot be granted an OGP in respect of the same invention. In view of such requirement, we have excluded standard patents (R) and their applications from the scope of eligible patent if the date of filing is after the expiry of the aforesaid 24-month transitional period, because the taxpayer may not be able to fulfill the local registration requirement in such cases due to double patenting.
14.	• More support and guidance should be provided to taxpayers with respect to the local registration procedures.	PwC	• In the course of implementing and promoting the patent box regime after the enactment of the Amendment Bill, we will reach out to the stakeholders via various channels and explain and draw their attention to the local registration requirements. • Relevant information on the local registration procedures of patents is available on IPD's website (https://www.ipd.gov.hk/en/home/index.html).

Item	Summary of Views	Respondents	Government's Response
15.	• The Government is recommended to explore the possibility with the relevant Mainland authorities of extending protection of patents registered via the OGP or STP systems to the Mainland (or at least the GBA cities).	PwC	• IP protection is in general territorial in nature. Different jurisdictions have their own IP protection systems and laws to deal with different IP issues and policies (including applications for IP registrations) and there is no direct reciprocal recognition of IP registrations granted by other jurisdictions. However, facilitation measures on cross-boundary IP protection can be implemented through bilateral or multilateral arrangements, shortening the procedures and lead time for filing multiple applications for registrations in different jurisdictions. • Mainland China and Hong Kong are separate jurisdictions, and will handle patent and trade mark registration matters in accordance with their own IP protection systems and law. To facilitate cross-boundary IP protection between the Mainland and Hong Kong, the IPD has all along been exploring with the relevant Mainland IP authorities the feasibility of implementing cross-boundary IP protection facilitation measures. • For instance, to facilitate Hong Kong applicants to seek patent protection in the Mainland, the China National Intellectual Property Administration, in collaboration with the IPD and the IP authorities of Guangdong Province and Shenzhen, launched a pilot project on 1 January 2023 for prioritising examination of

Item	Summary of Views	Respondents	Government's Response
			qualified invention patent applications filed by Hong Kong applicants in the Mainland.
E. Eligible IP Income			
16.	• With respect to income arising from the sale of an eligible IP, it is suggested that such income will only be subject to tax if the underlying eligible IP is a revenue asset of the taxpayer, i.e. neither the normal nor the concessionary tax rate under the proposed patent box regime will be applicable to sale of an eligible IP held on capital account.	PwC, TIHK	• Section 14 of the IRO clearly provides that capital gain is not chargeable to profits tax. Our intent is that the preferential tax treatment will only apply to IP disposal gain where the gain is regarded as revenue in nature.
17.	• Safe harbour provisions should be added so that an eligible IP would be treated as a capital asset for the purpose of profits tax if specified conditions are met. Reference can be made to section 14H(8) of the IRO. Taxpayers who do not satisfy the safe harbour rule may still claim the relevant gains as capital based on a "badges of trade" analysis.	PwC	• Whether an IP disposal gain is capital or revenue in nature should continue to be determined by the badges of trade analysis.

Item	Summary of Views	Respondents	Government's Response
18.	• For embedded income, an approach similar to that of the UK should be adopted to allow taxpayers to elect for Small Claims Treatment under which the eligible IP income would, for low-level profit cases, be ascertained by way of a simplified method instead of the more complicated transfer pricing principles. • It would be desirable for the IRD to set up a designated hotline to handle taxpayers' enquiries on how the proposed tax incentive works in practice.	TIHK	• The full transfer pricing approach is recommended by the OECD as it would deliver outcomes commensurate with the facts and circumstances of each transaction. • To facilitate tax compliance, guidance and illustrative examples on how the proposed regime applies to embedded income will be provided on IRD's website. IRD will also provide technical support and advice to taxpayers in relation to the regime.
19.	• It is recommended that section 16(1A) of the IRO should be removed.	TIHK	• Section 16(1A) will have no application to the proposed regime.
F. Concessionary tax rate			
20.	• It is recommended that the concessionary tax rate under the proposed regime should be reduced from 5% to 4.5% to enhance competitiveness.	LP	• We are mindful of the need to ensure the competitiveness of the proposed regime. Having considered the concessionary tax rates under our existing preferential tax regimes (which are mostly 8.25%) and those of overseas patent box regimes, the CE announced in the 2023 Policy Address that the concessionary tax rate for the proposed regime will be

Item	Summary of Views	Respondents	Government's Response
			pitched at 5%. We believe that such tax rate should be very competitive as vis-à-vis similar regimes introduced by other jurisdictions.
G. Transitional arrangement with insufficient records			
21.	• Under the transitional arrangement, the numerator of the R&D fraction would be the EE incurred for all the eligible IPs without the need to allocate the EE to each of the eligible IPs involved, the denominator would appear to include in the NE the acquisition costs of all the eligible IPs and other IPs that are not covered by the Amendment Bill. It is proposed that to the extent the records of the taxpayers are sufficient to separate the acquisition costs of the other IPs, the relevant costs should be excluded from the NE in the denominator of the R&D fraction. • It should be clarified whether, in calculating the R&D fraction under the transitional arrangement, EE is intended to include EE linked to eligible IPs only.	KPMG, TIHK	• The design of the transitional arrangement strictly follows the OECD's BEPS Action 5 requirements[5]. • The objective of this arrangement is to enable taxpayers to claim benefits under the proposed regime based on the average amounts of qualifying expenditures and overall expenditures for the transitional years notwithstanding that they may not have tracked and traced either expenditures or income to individual IPs or products prior to the introduction of the regime. Requiring taxpayers to distinguish the expenditures in relation to eligible IPs and non-eligible IPs in applying this transitional arrangement would defeat the objective of the arrangement and prevent some taxpayers from benefiting from the regime during the transitional years if they are unable to make the required distinction based on their available records.

[5] See Annex A of OECD's BEPS Action 5 reports which is accessible at this link - https://www.oecd.org/ctp/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report-9789264241190-en.htm.

Item	Summary of Views	Respondents	Government's Response
			• Under section 23(2)(c) of the proposed Schedule 17FD, the requirement that EE should be incurred for an R&D activity that is connected to eligible IP to which the eligible IP income relates (i.e. section 13(1)(a)) is to be omitted. This reflects that EE for both eligible IPs and non-eligible IPs can be taken into account in the calculation of the R&D fraction under the transitional arrangement.
22.	• The transitional arrangement allows an eligible person with insufficient records to calculate the R&D fraction on an aggregate basis for all the eligible IP assets on a three-year rolling back basis for the initial three years. However, where the eligible IPs have already been created through R&D undertaken prior to the year of assessment 2023/24 and no further EE and NE need to be incurred for subsequent years, the R&D fraction of the eligible person for the year of assessment 2025/26 and any subsequent year of assessment would be 0%. The eligible person would then not be able to benefit from	TIHK	• The OECD's nexus approach was designed to apply a cumulative ratio of qualifying and overall expenditures. In the case where an eligible person can track and trace the EE and NE to the eligible IP, the specified period for which the cumulative amounts of the EE and NE are to be calculated for the purposes of the nexus ratio may begin before the commencement of the year of assessment 2023/24[6]. • However, if an eligible person cannot track and trace the expenditures and income to the eligible IP, as a transitional measure, the person can calculate the nexus ratio based on the three-year rolling average of EE and NE. As clearly stated in OECD's illustrative example[7], these average amounts do not include any

[6] See definition of "specified period" in section 1(1) of Schedule 17FD to the IRO.

[7] See Annex A of OECD's BEPS Action 5 report which is accessible at this link - https://www.oecd.org/ctp/countering-harmful-tax-practices-more-effectively-taking-into-

Item	Summary of Views	Respondents	Government's Response
	the proposed tax incentive. It is suggested that specific provisions should be added to cater such a situation.		expenditures incurred before the 3-year period, even if the R&D activity connected to the IP began before the commencement of the period.
23.	• Clarification is needed as to whether the differential tax treatments based on different accounting year-end dates is intended under the transitional arrangement and if so, the rationale behind.	KPMG, TIHK	• Our intent is that the transitional arrangement applies to the three-year period which begins on the first day of the eligible person's basis period for the year of assessment 2023/24 and ends on the last day of the eligible person's basis period for the year of assessment 2025/26. Having regard to the respondents' comments, we will move a committee stage amendment to clarify this point. The proposed draft of the committee stage amendment (to be finalised) is at the Appendix.

account-transparency-and-substance-action-5-2015-final-report-9789264241190-en.htm.

II. Other tax measures that are not relevant to the subject matter of the Bill

Item	Summary of Views	Respondents	Government's Response
H. Unilateral tax credits ("UTC")			
24.	• UTC should be extended to cover foreign taxes paid by Hong Kong resident taxpayers in respect of eligible IP income in jurisdictions that have not entered into a comprehensive avoidance of double taxation arrangements or agreements ("CDTAs") with Hong Kong.	PwC, TIHK	• UTC are usually provided by high tax jurisdictions (which imposes income tax on a worldwide basis) to their residents to eliminate double taxation. Given that Hong Kong adopts the territorial source principle of taxation and the profits tax rate is relatively low, providing UTC in respect of onshore IP income would in effect cede our taxing right of Hong Kong to other jurisdictions. Such UTC would adversely impact our profits tax revenue and should not be adopted lightly.
I. Relaxation of anti-abuse rules in deduction of IP-related costs			
25.	• Sections 16E and 16EA of the IRO regarding the purchase and sale of patent or specified IP rights ("SIPRs")[8] should be revisited.	KPMG, PwC	• While capital expenditure is in general not deductible under the IRO, sections 16E and 16EA allow deduction of capital expenditure on purchase of patents, rights to any known-how and SIPRs for use in the trade, profession or business in the production of profits. • As an anti-abuse measure, deduction under sections 16E or 16EA is not allowable under certain
	• Section 16EC(2) of the IRO should be removed or revisited so that capital expenditure of IPs acquired from group	KPMG, PwC, TIHK	

[8] SIPRs include copyright, performer's economic rights, protected layout design (topography) rights, protected plant variety rights, registered designs or registered trade marks.

Item	Summary of Views	Respondents	Government's Response
	companies should be allowed for tax deduction under sections 16E or 16EA as there is now transfer pricing provisions contained in the IRO.		circumstances, i.e. where the patent, right to know-how or SIPR is purchased wholly or partly from an associate. This is to prevent tax abuse by exploiting tax deduction on capital expenditure on purchase of certain IP rights between associated person, e.g. sale and buy-back arrangement, leverage leasing and manipulation of the price of IPs. While the IRO has codified the transfer pricing rules in 2017, it cannot wholly prevent such abusive arrangements.
26.	• Section 16EC(4)(b), which denies tax deduction in respect of IPs used wholly or principally outside Hong Kong (even if the income derived from the licensing of the IPs is taxable in Hong Kong), should be reviewed.	KPMG, PwC, TIHK	• The purpose of section 16EC(4)(b) is to deny tax deduction in respect of IP s used outside Hong Kong by a party other than the taxpayer for production of profits which are not chargeable to tax in Hong Kong. This reflects our policy intent that such tax deduction should only be granted when the IP is used for producing profits in Hong Kong[9].
27.	• The IRO should be amended so as to permit tax deduction of upfront licence fees incurred in acquiring the use of patents, know-how and specified IP rights that are	PwC	• If the licence fees are revenue expenditure incurred in the production of the taxpayer's profits, the fees should be deductible for profits tax purpose. As Hong Kong does not tax capital gains, capital expenditures are

[9] See the Government's responses in the Legislative Council during the discussions of Inland Revenue (Amendment) (No. 2) Bill 2011 of which the anti-abuse rules including section 16EC were introduced (see Annex A of Paper CB(1)2447/10-11(01) and CB(1)2853/10-11(01)).

Item	Summary of Views	Respondents	Government's Response
	used for the operation of a business to facilitate different kinds of IP transactions in Hong Kong.		generally not deductible save for those specifically provided under the IRO. • Sections 16E and 16EA are specific provisions which allow deduction of capital expenditure on purchase of patents, rights to any know-how and SIPRs for use in the trade, profession or business in the production of profits. To be eligible for the tax deductions, the taxpayer must have acquired the proprietary interest of the specified IP rights. With such interest, the taxpayer is able to exploit the IP right for further improvement or development, which is in line with the policy objective of encouraging innovation and upgrading[10].
J. Enhanced R&D deduction			
28.	• The Government is suggested to consider treating payments made to Hong Kong related parties for outsourced R&D in the same way as R&D expenditure incurred by the taxpayer itself for the purposes of section 16B of and Schedule 45 to the IRO.	PwC	• The treatment on deduction of R&D expenditure and recognition of R&D expenditure for calculation of nexus ratio are different issues and serve different policy objectives. There is no justification to align both treatments.

[10] See Legislative Council Brief to Inland Revenue (Amendment) (No. 2) Bill 2011 (Paper TsyB R 183/535-1/8/0(10-11)(C)).

Item	Summary of Views	Respondents	Government's Response
29.	• In order to qualify for the 300% or 200% enhanced deduction for R&D expenditure, the relevant qualifying R&D activities must be conducted in Hong Kong. The Government should remove the restriction and allow at least a 100% basic deduction in respect of payments for outsourced R&D activities undertaken in the GBA. It is also suggested that the enhanced deduction should be allowed for R&D activities undertaken by the taxpayer within other cities in the GBA.	KPMG, PwC	• The policy objective of the enhanced R&D deduction is to encourage enterprises to invest more in R&D in Hong Kong, promote local R&D activities and groom local R&D talent. Granting enhanced deduction to R&D activities outside Hong Kong would run contrary to this objective and incentivise diversion of R&D activities from Hong Kong to other areas. • From the perspective of tax enforcement, it would be difficult for IRD to verify the overseas R&D expenditure in the absence of cross-border tax audits.
	• Section 16B of the IRO should be improved to include expenditures incurred for sub-contracted R&D activities undertaken by any service provider engaged by a taxpayer in or outside Hong Kong.	TIHK	
K. Interaction with Pillar Two of BEPS 2.0			
30.	• The Government should monitor the development of the BEPS Pillar Two Rules, and periodically review the impacts of the Subject-to-Tax Rules ("STTR") and the Hong Kong minimum top-up tax	KPMG	• Not all taxpayers benefiting from the proposed regime will be affected by the application of the GloBE Rules and HKMTT as only MNE groups with annual consolidated group revenue of EUR750 million or above will fall within the scope. Further, an in-scope

Item	Summary of Views	Respondents	Government's Response
	("HKMTT") on the patent box tax incentive for in-scope multinational enterprises ("MNE") groups. • The potential interaction between the proposed patent box tax incentive and the forthcoming implementation of Global Anti-Base Erosion ("GloBE") Rules in Hong Kong should be considered.		MNE group benefiting from the regime will not be required to pay top-up tax under the GloBE Rules or HKMTT if its jurisdictional effective tax rate in Hong Kong (computed based on the aggregate covered taxes and GloBE Income or Loss of all the group's constituent entities in Hong Kong) is above the minimum rate of 15%. • For STTR, it is a treaty-based rule and Hong Kong will only consider including the STTR in CDTAs upon request from developing jurisdictions.
31.	• As part of the Government's implementation of the OECD's Pillar Two, the Government can consider to modify the existing enhanced R&D tax deduction regime to a qualified refundable tax credit ("QRTC").	PwC	• While any useful and pragmatic suggestions are most welcomed, we should be cautious about whether such incentives or support will be inconsistent with the agreed outcomes of the GloBE Rules as the OECD has put in place a peer review mechanism to combat any measures which aim to circumvent or undermine the overall integrity of the GloBE Rules. • Depending on the facts and circumstances of the case, QRTC may not always provide a more favorable outcome under the GloBE rules. Further, the cash outlay will impose burden on the Government's fiscal position and warrant careful consideration.
	• Large MNE groups that fall within the scope of the GloBE Rules and HKMTT may not be able to benefit from the patent box tax incentive which provides a preferential tax rate. Other forms of tax incentives (e.g. QRTC) related to IP should be explored.	TIHK	

Item	Summary of Views	Respondents	Government's Response
L. Others			
32.	• It is suggested that tax deduction should be allowed for amortisation expenses of intangible assets in general, provided that the intangible assets are used in generating profits subject to profits tax in Hong Kong, with a claw-back on the amortisation expenses previously allowed upon disposal of the assets at a gain.	KPMG	• In Hong Kong, the general tax principle is that capital expenditures are not deductible. Any departure from this principle (e.g. deduction for purchase costs of patents, rights to any know-how and SIPRs) requires strong justification and should not be taken lightly.
33.	• The foreign sourced income exemption ("FSIE") regime effectively limits the offshore claim on IP income due to scope and nexus requirement. The introduction of a patent box incentive in Hong Kong would not alleviate the impact of the FSIE regime, especially the filming and e-gaming industries. It is recommended that the Government should have a separate dialogue or consultation with the stakeholders in industries that are particularly impacted by the FSIE regime and seek their views on what other measures could be put in place to alleviate the potential impact of the FSIE on them.	KPMG	• Both the FSIE regime and the proposed regime need to in line with the nexus approach promulgated by the OECD, including the scope of IPs enjoying the benefits and the nexus requirement. Otherwise, the regimes will be regarded as harmful by the OECD and may risk us being blacklisted by the European Union. • Having said that, the Government will continue to listen to the views and suggestions from the trade with a view to enhancing the competitiveness of Hong Kong's tax regime.

III. Non-tax issues

Item	Summary of Views	Respondents	Government's Response
M. More incentives or collaboration			
34.	• Additional government grants, subsidies or QRTC (instead of a concessionary tax rate) should be offered as a means to encourage domestic R&D activities.	KPMG, LP	• Currently, the Government has provided various funding schemes to start-up business to encourage R&D activities in Hong Kong. Providing additional government grants/subsidies or qualified refundable tax credits will have financial impact on the Government's fiscal position. Further study is required for any new incentives. • To support digital transformation of small and medium-sized enterprises ("SMEs"), Cyberport will launch the Digital Transformation Support Pilot Programme to subsidise SMEs in the retail and food and beverage sectors in applying for electronic payment and other digital packages. • The Government has also been adopting a multi-pronged approach to enrich the I&T talent pool by attracting, nurturing and retaining talents with a series of initiatives, e.g. the Technology Talent Admission Scheme expedites the admission of overseas and Mainland technology talents to undertake R&D work in Hong Kong, and the Research Talent Hub provides funding support for engaging research talents to
	• A new formula can be adopted for calculating tax incentives, for example, to consider an expenditure of $100 as $150 for calculating taxes to encourage R&D investment.	LP	
	• It should be ensured that the proposed patent box regime is complemented by continuous investments in Hong Kong's R&D ecosystem, with a particular focus on non-tax factors such as nurturing R&D talent and providing R&D facilities to encourage investment.	PwC	
	• Cross-bureau coordinated efforts and targeted measures are required to complement the patent box regime.	LP	

Item	Summary of Views	Respondents	Government's Response
	• Hong Kong should further deepen its collaboration with the Mainland (especially in the Loop) to promote the cooperation of R&D and innovation.	LP	conduct R&D work. • The Science Park and Cyberport, as Hong Kong's I&T flagships, have been committed to providing start-ups with infrastructure, incubation programmes and one-stop support. The Hong Kong Science and Technology Parks Corporation (HKSTPC) and Cyberport also provide pre-incubation support for entrepreneurial technology talent through various incubation programmes with a view to helping them bring their innovative ideas to life. • The Government has also launched the Research, Academic and Industry Sectors One plus Scheme, which seeks to promote the transformation and commercialisation of R&D outcomes from universities. In addition, as announced in the 2023 Policy Address, the Government will also attract more renowned Mainland and overseas start up services agencies to set up their operations in Hong Kong for providing incubation services and development guidance. • Separately, the Government has set up five R&D Centres, which play an important role in creating a vibrant I&T ecosystem and act as a focal point for technology collaboration among the Government, industry, academia and research sectors.

Item	Summary of Views	Respondents	Government's Response
N. Miscellaneous			
35.	• A mechanism should be established to regularly review and assess new developments elsewhere to adjust and renew tax incentives.	LP	• The Government has from time to time reviewed Hong Kong's tax system so as to enhance our tax competitiveness. We are open to ideas and welcome suggestions.
36.	• Appropriate measures should be developed to deal with use of redundant patents	LP	• One of the policy objectives of our patent box regime is to encourage taxpayers to transform and commercialise their R&D results, including those existing patents that remain unused. Under our patent box regime, eligible patents do not only include patents that are generated after the implementation of the regime, but also include those that had come into force before its implementation. • The three-tier progressive annual renewal rates for standard patents that respectively apply to the 4th to 10th year (at $450 per year), 11th to 15th year (at $620 per year) and 16th to 20th year (at $850 per year) of the protection term of standard patents were also introduced to discourage unnecessary prolongation of the ownership of those patented inventions with little or diminishing market or exploitation value, so that such inventions may be released into the public domain.

Item	Summary of Views	Respondents	Government's Response
37.	• The explanatory memorandum of the Amendment Bill should mention the continued focus on and learning from the successful experiences of other territories to guide the future direction of policy development.	LP	• Paragraph 8.1.1 of the "Drafting Legislation in Hong Kong – A Guide to Style and Practices" published by the Department of Justice stated that – "LegCo Rule 50(7) requires an Explanatory Memorandum stating the contents and objects of the Bill, in non-technical language, to be attached to every Bill. This applies to both a Bill for a principal Ordinance and a Bill for an amending Ordinance." • Given the above, the Explanatory Memorandum does not seem to be a suitable place to include matters of prospective or aspirational nature. It may also be important to note that the content of the Explanatory Memorandum could potentially be referred to as an aid to assist interpretation of the Bill. As such it must be approached with suitable caution.
38.	• The requirement of public consultation should be added in the Amendment Bill to enhance transparency.	LP	• We have conducted a one-month trade consultation on the key parameters, related legislative proposal and level of concessionary tax rate of the "patent box" tax incentive in September 2023. The trade was generally supportive of the Government's proposal to introduce the "patent box" tax incentive. We have taken into account the trade's feedback when preparing details of the proposal. We also briefed the LegCo Panel on Commerce, Industry, Innovation and Technology on the proposal on 19 December 2023. Panel members

Item	Summary of Views	Respondents	Government's Response
			generally supported the proposal. The Amendment Bill has already incorporated the comments received during the public consultation process as appropriate. • The Government has from time to time reviewed Hong Kong's tax system so as to enhance our tax competitiveness and will engage the trade and the public where appropriate. There does not seem to be a need to specifically include a requirement of public consultation in the Amendment Bill.

Commerce and Economic Development Bureau

Intellectual Property Department

Inland Revenue Department

Agriculture, Fisheries and Conservation Department

June 2024

Abbreviations of the Respondents

CDTT:	Chinese Dream Think Tank
KPMG:	KPMG Tax Services Limited
LP:	Liberal Party
PwC:	PricewaterhouseCoopers Limited
TIHK:	The Taxation Institute of Hong Kong

<u>Appendix</u>

DRAFT

Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024

Committee Stage

<u>Amendment to be moved by the Secretary for Commerce and Economic Development</u>

<u>Clause</u>	<u>Amendment Proposed</u>
12	In the proposed Schedule 17FD, in section 23(1)(a), by deleting subparagraph (i) and substituting— “(i) beginning on the first day of the eligible person’s basis period for the year of assessment beginning on 1 April 2023; and”.