

29 September 2023

Commerce and Economic Development Bureau
Intellectual Property Department
Inland Revenue Department
22/F-23/F, West Wing, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

By Email: pb_consultation@cedb.gov.hk

Dear Sir/Madam,

CPA Australia's response to Introduction of a Patent Box Tax Incentive in Hong Kong

As one of the largest professional accounting bodies in the world, CPA Australia represents the diverse interests of over 173,000 members working in 100 jurisdictions and regions around the world. This includes over 15,000 members in Hong Kong. We make this submission on behalf of our members and in the broader public interest.

CPA Australia has long suggested Hong Kong introduce its own patent box regime. Subject to the below comments, we support the proposed "Introduction of a Patent Box Tax incentive in Hong Kong". We provide the following comments and suggestions in response to the consultation paper.

Views on introducing a patent box

In the context of the Global Anti-Base Erosion Rules (GloBE) rules, we believe that the adoption of a patent box tax regime will send a strong and positive signal of Hong Kong's desire to attract and retain research and development (R&D) activities. This signal is even stronger when this regime is combined with the incentive regime for R&D expenditure.

Given the proliferation of patent or intellectual property (IP) box regimes in other jurisdictions, it is crucial for Hong Kong to design and establish a patent box tax regime that is more attractive than those regimes. It is also important to study such regimes as the effectiveness of many of them have yet to be proven¹.

While patent box regimes and R&D tax incentives are important to encouraging R&D activities in a jurisdiction, they cannot be the sole policy options to promote such activities. For example, Sweden, Finland, Germany and Denmark do not have special incentive mechanisms for R&D activities yet are the most advanced nations in terms of both intensity of R&D activities and their special sector in R&D

¹ Lyne Latulippe, Christine Ally, and Julie S. Gosselin, *The Revised Case of IP Regimes Under the GloBE Rules: A Canadian Perspective*, *Canadian Tax Journal / Revue Fiscale Canadienne* (2023) 71:1, p. 185,

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activities. The main reason behind their success are their well-educated labour force and strong R&D structures.²

This tax incentive will not be enough to attract businesses to produce knowledge and advanced technology in Hong Kong. The SARs broad range of support for R&D activities recognise this. From our experience in other jurisdictions, along with the R&D and patent box tax incentives, Hong Kong needs to attract, create and nurture a qualified and skilled labour force, provision of site and R&D facilities, and enact further laws to provide businesses greater protection of their intellectual property rights.

Views on eligible IP assets, i.e., patents and IP assets functionally equivalent to patents

Most nations that have a patent box tax regime allow income from more than just patented products to qualify. Some countries have proceeded further and established “innovation boxes”. They allow income from designs, copyrights, models and trademarks to also be taxed at the lower patent box rate. As an example, mainland China, with the broadest definition of IP-sourced income, extends its patent box to allow income from certain types of commercial ‘know-how’, such as process innovation, to qualify for the lower tax rate³.

A Hong Kong patent box would need to be reasonably simple while remaining competitive against jurisdictions such as Singapore in terms of effective tax rate, scope of income, and scope of intellectual property.⁴ We recommend the Hong Kong Government consider the Mainland’s IP box model and expand the scope of IP assets included in the patent box tax incentive. This will assist Hong Kong establish a patent box that has a competitive advantage over other jurisdictions.

Other IP related measures

While we welcome the introduction of patent box regime, this tax incentive is only applicable to quite limited sector i.e. R&D activities on registered patent in Hong Kong. We should also encourage R&D activities for non-patent projects that may or may not be successful. This can be achieved by relaxing tax deduction for the cost of the relevant R&D activities. The current tax rule is quite stringent and should be reviewed and enhanced. As an example, the Government could consider including costs incurred in the Greater Bay Area (including the allocation of costs to HK) irrespective of whether the companies/subsidiaries from China obtain their own R&D incentives.

In addition, not all R&D projects can start from scratch in Hong Kong. Attracting some multinational group to transfer their existing IP assets to Hong Kong and continue the R&D activities in Hong Kong may be more practical. However, the current tax rule does not allow deduction of the cost of IP assets

² Ayse Yigit Sakar, *Innovation for a New Tax Incentive: Patent Box Regime Turkey and the EU Application*, *Procedia – Social and Behavioural Sciences*, 195 (2015), p. 552

³ HTJ.Tax, *What’s a Patent or Intellectual Property (IP) Box?*, 23 May 2018, updated 23 August 2022

⁴ Jason M Brown, *Patent Box Taxation: A Comparison of Four Recent European Patent Box Tax Regimes and an Analytical Consideration of If and How the United States Should Implement Its Own Patent Box*, *Volume 46 No. 3, The International Lawyer*, 913 (2012), p. 937

purchased from group companies (for the sake of anti-tax avoidance). This discourages multinational group to transfer IP assets to Hong Kong for further development. With the amendments of the Inland Revenue Ordinance in recent years, the anti-tax avoidance can now be resolved by the transfer pricing regime. Therefore, we suggest that the rule should be relaxed and capital expenditure of IP assets acquired from group companies should be allowed for tax deduction.

Views on provision of tax concessions to business for profits generated from eligible IP assets

In the context of scientific uncertainty, without knowledge of whether the IP will be patented or commercialised or will eventually generate revenue, an enterprise's decision on where to locate its R&D activities could be influenced by a well-designed patent box tax regime. We submit that a patent box regime providing enterprises with a tax incentive for the commercialisation of innovation, and not just for conducting R&D activities in Hong Kong, will help boost economic growth and jobs. Therefore, we believe creating tax incentives linked to success at commercialising innovation in Hong Kong is an important strategy for economic growth, competitiveness and job creation in Hong Kong.

Requirements for registered patents and plant variety rights in Hong Kong

We support the proposed link between the Hong Kong patent box requirements to filings under the Hong Kong patent system and plant varieties protection system. We expect this will encourage and promote more local filings.

As discussed above, a Hong Kong patent box would need to establish a firm connection between the receipt of preferential taxation to domestic R&D and commercialisation activities.⁵ Therefore, for the Hong Kong regime to be effective, we recommend the requirement that further development of qualifying inventions take place in Hong Kong (or possibly other cities within the Greater Bay Area) in order to benefit from the Hong Kong patent box's lower tax rate. Research conducted on the patent box regimes of 13 European countries found that this seems to mitigate transfers for purely tax reasons and several countries with IP boxes have already modified their tax rules in this way⁶.

We submit it is crucial to adjust the patent tax incentive to stimulate innovation in Hong Kong itself or at least to curb the transfer of IP income to other jurisdictions. This could also entail the loss of R&D activities in Hong Kong, given IP boxes are proliferating around the world. After all, patents are high mobile and the most real innovative activity can be easily relocated. Therefore, it is important for the Hong Kong Government to align the patent box tax incentive with local R&D activity and not just local filing, thus rewarding these Hong Kong-based R&D businesses with a lower effective profits tax rate.

We also recommend that a post-implementation review of the regime be legislated. The purpose should be to analyse its effectiveness at achieving its objectives in stimulating innovation and research, and to make adjustments to the regime where required.

⁵ Jason M Brown, *Ibid*

⁶ Fabian Gaessler, Bronwyn H Hall and Dietmar Harhoff, *Should there be lower taxes on Patent Income?*, NBER Working Paper No. 24843, July 2018, revised June 2019, p. 52

Views on the OECD's Nexus Approach

The Organisation for Economic Co-operation and Development (OECD) recommended that favourable tax treatment be available only under a “nexus” approach. The IP regimes of more than 25 countries, including members of the European Union (EU), require “a link between the income benefiting from the IP regime and the extent to which the taxpayer has undertaken the underlying R&D that generated the IP asset.”⁷

If Hong Kong wants to design a patent box regime that has a competitive edge over other similar regimes, we suggest the government seek to differentiate its regime from the others. It should therefore consider the merits of not following the OECD's Nexus Approach provided it is functionally equivalent, similar to that of the IP regime in mainland China. Not all jurisdictions adhere to the OECD's Nexus Approach with their patent box regimes, such as mainland China, and it has been evaluated as non-harmful by the OECD⁸. If Hong Kong follows OECD's Nexus Approach verbatim, it could be disadvantaged when compared with these other more expansive and flexible IP box regimes.

Views on the concessionary tax rate for qualifying IP income

Given the recent proliferation of patent and innovation boxes among OECD members and non-members alike, it is necessary for Hong Kong's regime to be competitive to attract businesses with commercially valuable patents. Furthermore, a patent box subsidises output rather than input, so it mainly benefits enterprises that have had success with their inventions. Therefore, Hong Kong needs to focus on attracting such enterprises. Innovation is increasingly highly mobile, and talent and infrastructure to conduct innovation-based activities are available in many jurisdictions around the world with patent/innovation boxes and/or R&D incentives.

For Hong Kong to strategically position itself over other jurisdictions that have patent or innovation boxes, the concessionary tax rate must be set low and competitive. This is especially so as the consultation paper says Hong Kong has restricted its regime to patents and IP assets functionally equivalent to patents, unlike other non-OECD abiding jurisdictions. We recommend a tax rate for qualifying IP income of no more than 4.5 per cent to outcompete our rivals, in particular, Singapore, which has an IP box tax rate of 5 per cent or 10 per cent (depending on the amount of investment)⁹.

⁷ Organisation for Economic Co-operation and Development, *Intellectual Property Regimes*, “About the Dataset Intellectual Property Regimes”

⁸ “While the [Chinese] regime did not technically comply with the nexus approach, it was considered functionally equivalent and therefore evaluated as not harmful, given its distinct features and safeguards and the willingness of China to provide additional information.” OECD, *Harmful Tax Practices – Peer Review Results: Inclusive Framework on BEPS: Action 5, Update (as of June 2023)*, 2023

⁹ OECD, *OECD Intellectual Property Regimes*, 2022

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