William Turnbull

HOW TO MAKE MONEY LICENSING IN THE PACIFIC WITH PARTICULAR REFERENCE TO HONG KONG

by
*William Turnbull, Jr., LL.B.**

1. *A BRIEF OUTLINE OF HONG KONG*

(i) *The Status and Government System of Hong Kong*

Hong Kong is a British Colony founded in the mid 19th Century which today floats on the edge of the China Sea like an iceberg in the North Atlantic. It has drifted from the 19th Century where it belonged into the 20th Century and on paper at least its days are numbered and yet in spite of the buffeting that it has received from the oceans of world opinion, it remains at least for the present as a source of wonderment and inspiration for those who come in contact with it, and gives every appearance of being able to endure forever.

Hong Kong is a place of convenience which, for more than a Century, has attracted people with ambition to make money and who are prepared to make sacrifices to achieve their ultimate goal. The theme of this meeting is particularly appropriate for Hong Kong. If Hong Kong had a national anthem, then the first words of the opening line should be "How to make money".

I have now lived and practised as a lawyer in Hong Kong for 16 years during which time the Colony has moved from the 1950s through the 1960s into the present decade like a Roller Coaster Car going faster and faster from boom to crisis gathering speed and money as it has gone along.

Politically Hong Kong has a Governor who is the representative of the Queen in the Colony. The Colony is administered by a civil service which is recruited both locally and amongst British Subjects mainly from England, and to a lesser extent, from Australia and New Zealand. The civil service is employed in the name of the Government of Hong Kong, and the Colony is administered with little reference to London.

The legal system originates from the Colonial history of Hong Kong. In theory when Hong Kong first became a Colony, the entire law of England as it was then was transported to the Colony including statute law and the English Common Law System. The present law in Hong Kong is still this original law subject to such statutory modifications as may have been passed in Hong Kong by the local Legislative Council which has full power to make whatever laws it wishes without reference to London. In making law, the Colony tends to follow the modern legislation of the United Kingdom and on occasions, of other British Jurisdictions, for example, Australia. Where law is dependent upon international conventions, the Colony is subject to decisions of the Crown in London. This does not mean that international conventions entered into by the United Kingdom will automatically apply to Hong Kong and a separate Order by the Queen-in-Council in London is necessary to apply a Convention to Hong Kong with such modifications as may be prescribed. This is particularly important in industrial property matters which are a combination of local legislation and Orders-in-Council introducing some, but by no means all, of the Conventions to which the United Kindgom is a party or adheres.

The foreign policy of Hong Kong is partly controlled through London and the external security of the Colony is dependent upon the British Government. We are, however, entirely independent financially. The money making theme of Hong Kong is typified by the present embarrassment between the Colony and the United Kingdom because one of the largest holders of sterling deposits is Hong Kong and in an era of under developed countries and foreign aid, Hong Kong stands almost alone in the world in giving more financial support than it receives

The Court system is modelled on that of the United Kingdom and has proved to be fast efficient and impartial. This I feel is a most important aspect of the Colony so far as industrial property is concerned because ultimately industrial property is purely a number of legally enforceable rights dependent upon the efficiency of the judicial system of enforcement for their very existence.

The population of the Colony is estimated to be approaching 4-1/2 million people and has risen to this level in a matter of a few decades from only a few hundred thousand persons in the 1930s or 1940s. The vast majority of persons are of Chinese origin either born in Hong Kong or having come from Mainland of China. The flow of Chinese persons coming from China to Hong Kong to settle and find work has been continuous since 1950 and on occasions has been very large. Those coming from China together with the high birth rate in Hong Kong has created a large young population most of whom support the theme of this meeting, namely making money.

The education level and the standards of living have both risen dramatically in recent years. The future of Hong Kong as a manufacturing centre lies in the production of quality merchandise rather than the traditional cheap low quality goods for which Hong Kong has become famous. This market will be replaced by areas having a lower cost of living such as Taiwan, the Philippines, Indonesia, etc.

(ii) *Hong Kong as an Industrial Centre*

Hong Kong today is finding that the cottage industry of the 1950s and 1960s is not competitive in the present decade. Industrial organisations are becoming larger and are looking for more foreign expertise and help. This foreign expertise and help is not in the form of foreign government aid, but rather as a private enterprise operation in partnership with other businessmen from elsewhere to exploit jointly the foreign expertise and local ability. There can be no doubt that Hong Kong will, for many years, continue to compete in the low price cheap quality market, but I do not feel that I can recommend Hong Kong for this type of investment any more. As mentioned, there are better opportunities in the Pacific in other territories.

One of Hong Kong's main shortages is available space for building. The result is that land prices are extremely high. Factories, like all other buildings in Hong Kong, are multi-storey with different companies buying or renting separate floors in the same building. One of the difficulties facing Hong Kong in the future will be to find adequate employment for the labour force available during the transition from the traditional cottage industries to the new more financially rewarding industries of the future. Realising this, our Government has attempted to attract foreign investment of a higher quality and the first such investment is by the Outboard Marine Corporation who have received from the Government comparatively inexpensive land to establish a factory for the assembly and production of outboard engines. The Shell Oil and Petroleum Group are negotiating with the Hong Kong Government to obtain the necessary land to establish an oil refinery within the Colony and present indications are that the Government will agree to the establishment of a refinery, but are not likely to agree to favour any one oil company. The Government is more likely to proceed by way of public tender. The standard methods of the Government making land available are either by means of public auction or by public tender.

As a result of the financial boom which swept the Colony off its feet at the end of last year and the beginning of this year, there are many more public companies in Hong Kong, having substantial backing in the form of business and profits. Though the heady wine of last night's stock market boom has left the Colony with a monumental hangover today, it has also caused local industrialists to seek their own identity in the world rather than to manufacture goods for others outside of Hong Kong. It will be some years yet before Hong Kong Corporations are selling goods under their own trade marks world-wide, but brand names such as "Crocodile", "Texwood", "Smart", "Watsons", "Garden", "Atlas", "Wicking" and many others are rapidly spreading into the world's market places.

The two types of industrial corporation which will be of interest to yourselves are those in which foreign corporations have licensed local Hong Kong Corporations to make use of technical knowledge and those in which foreign corporations with expertise or valuable industrial property rights have an equity participation. There are many examples of both.

The one company manufacturing air-conditioning equipment in Hong Kong does so under licence from Westinghouse and I believe has, for many years, enjoyed good sales in the Colony. In the clothing and textile industry, many factories operate equipment and systems under licence, for example, in the permanent pressing of clothing and in the utilisation of patented machinery.

In the joint venture equity field, foreign corporations participate from small minorities right through to 100% ownership of the equity utilising foreign technical expertise in conjunction with local labour and management. For example, many American and other foreign corporations have invested capital in such Hong Kong industries as the transistor radio and electronic business, toy making, watch making, a large aluminium plant and other businesses too many to mention.

There are no restrictions on foreign investment in Hong Kong. Directors and shareholders may be of any nationality and resident anywhere in the world. This is in contrast to so many countries where local persons must have control either now or in the future.

(iii) *Hong Kong as a Commercial Centre*

I have included this heading as I feel that it will be of interest to members of your Society though it concerns rather taxation advantages than the actual licensing of products and know-how within the Colony. In recent years, Hong Kong has steadily developed as a financial and commercial centre in the Far East. With its more than adequate banking and communications services, Hong Kong forms a very convenient centre for commercial operations. Many large international corporations have their regional headquarters in Hong Kong and though the cost of living has risen dramatically, Hong Kong still has many advantages to offer, not least of which is its position as a tax haven. As I will be outlining taxation later, I will not comment further at this stage. Perhaps I can summarise Hong Kong today by saying that the financial crisis left by the collapse of the stock market is turning into a boom of merchant banks and financial institutions. I find it difficult to see what they all hope to do but perhaps the most significant factor is that the world's leading financial institutions have decided almost simultaneously that they cannot exist without a Hong Kong operation. As there is not sufficient domestic business to support every one, I can only assume that they are either looking to the Far East generally or feel that they want to have an office close to the Mainland of China.

Each one of these organisations must have carefully weighed up the business potential of the Colony and have decided that there is room for them to operate. The Roller Coaster rushes on but the problem is to decide whether we are heading for another peak or rushing crazily down a steep incline clutching our stomachs as we go. One thing is certain namely that money will be made and lost, the difference between success and failure being measured by hard work and ability. Our Hong Kong Roller Coaster is most exhilarating for those on board but is definitely not for the faint hearted.

(iv) *General Points of Interest*

The cost of sending an ex-patriate person to Hong Kong is today comparatively high. While Japan is clearly the most expensive in the Far East, rent of domestic accommodation in Hong Kong can be easily as much as or more than US $1,500.00 to US $2,000.00 per month for a three or four bedroom apartment. Office accomodation costs in the Central District, US $2.00 or more per square foot per month. Needless to say, office accommodation is almost impossible to obtain and residential accommodation is difficult though in the future residential accommodation is likely to become easier to find. As I mentioned, industrial premises are normally of a multi-storey building type. For those of you who are used to single storey factories, the idea of a ten storey building subdivided into many different factories will seem strange. If anyone wishes to build their own factory building, they would be advised to consult with the Government to ascertain what, if any, land is likely to come on the market for that purpose.

2. *BRIEF OUTLINE OF INDUSTRIAL PROPERTY LAW IN HONG KONG*

(i) *Trade Marks*

Hong Kong Trade Mark Law is based on that of the United Kingdom with one major difference. In Hong Kong to obtain Part B registration two years bona fide user prior to the date of the application is still necessary. I am assuming that those present who are interested in trade mark work will have an adequate knowledge of trade mark law and practice in London. Accordingly, I will not elaborate further, but I do stress the Part B situation as I find that in practice it is the most frustrating for foreign Corporations registering marks in Hong Kong.

The rejection of descriptive marks, surnames, geographic names and other indistinctive marks is strict and follows the practice in London. Unfortunately Part B acceptance in London can cause great difficulty if two years user cannot be shown.

Enforcement of rights to a registered or unregistered trade mark is probably most efficiently handled by means of a private prosecution provided there is a clear cut case of infringement. Civil Actions can also be brought and are particularly useful in passing off situations. Again, our law is similar to that of the United Kingdom, but I do stress the importance of criminal proceedings which, I understand, are rarely used in the United Kingdom for enforcement of trade mark rights.

The licensing of trade marks is again the same as that in England and licensing agreements should follow the usual registered user form in the United Kingdom.

(ii) *Patents*

The law relating to patents is extremely simple, but its enforcement and effect is somewhat difficult to understand or explain.

The concept of patent law in Hong Kong is that by registering a United Kingdom patent, the patent will extend to the Colony as if it had originally been granted in England with an extension to the Colony. With the exception of the Ordinance providing for registration, the Colony does not have its own separate patent legislation. As the United Kingdom patent is dependent upon the legislation of the United Kingdom, it would appear that the provisions of the United Kingdom Patent Act apply to Hong Kong so far as may be necessary. This makes the position with regard to licensing and in particular, compulsory licensing, extremely vague and complex. With the exception of the patent litigation which I handled against the Hong Kong Government, I do not know of any decided cases in Hong Kong which have laid down any guidelines as to whether or not a compulsory licence can be obtained relating to the Colony. One of the main difficulties would be to determine whether or not application would have to be made in London under the English legislation or whether the Hong Kong Courts would have jurisdiction.

There can be no doubt that voluntary license arrangements can be made either to cover the United Kingdom including Hong Kong or separately to cover Hong Kong alone. When arranging licenses of United Kingdom Patents you should not forget Hong Kong. As it is an important trading and manufacturing centre you should not leave to chance whether it is included or excluded.

With regard to infringement, the only remedy is the civil remedy of enforcement of the patent and this again is based on the rights given by the English Act. Under our Patents Ordinance, though proceedings can be brought for antecedent breaches of patent rights, it is only possible to recover damages for infringements which have occurred after the date of the registration of the patent in the Colony.

(iii) *Registered Designs and Copyright*

The law on this subject has recently undergone dramatic changes in the Colony. Until recently, Copyright was based on an extension of the English 1911 Copyright Act and the more modern Universal Convention which applied in England was not extended to the Colony. The reason for this was a problem which had arisen over Copyright in television programmes and wired radio services. To obtain any copyright protection in an industrial design it was and probably still is necessary to register the design as a registered design in Great Britain. Such a registered design automatically extends to the Colony. Registered designs can be enforced by civil proceedings only and not criminal proceedings. This is in contrast to Copyright infringement which is a criminal offence. My experience has shown that it is extremely difficult and almost impossible to enforce copyright in Hong Kong not only because the law is complex and on occasions defective, but also because one must first prove that copyright exists. My experience has shown that many Corporations are extremely careless when it comes to proof of ownership of Copyright. The more modern English Legislation which includes the Universal Copyright Convention has just been extended to the Colony. The practical effect of this is not yet known and I can do little more than strongly recommend that anyone who would be dependent upon registered design or copyright protection within the Colony should take expert legal advice in advance as there is no simple summary or rule that I can give.

3. *TAXATION IN HONG KONG*

(i) *Outline of theory and principles of Hong Kong taxation*

Taxation in Hong Kong is extremely simple. We have a territorial tax under which net profits which arise in or are derived from the Colony are taxed at the standard rate of 15%. Overseas income is not taxable and dividends either within the Colony or from overseas are not taxable. There is an interest withholding tax of 15% on interest on money lent. Banks and other financial institutions pay 15% on net profit as opposed to the 15% withholding tax. The computation of taxable profit is similar to most jurisdictions, that is, gross income less allowable deductions equals net income. With the exception of taxes on the import of motor-cars, tobacco, alcohol, and petrol and diesel oil, the Colony is a free port. There is a system of stamp duty, but this basically applies to the buying and selling of shares and marketable securities and to the buying and selling of land and the mortgaging of assets.

(ii) *Hong Kong Taxation as it applies to licensing expertise and know-how*

There are special sections of the Inland Revenue Ordinance relating to the application of taxation to licensing of expertise and know-how. Basically these provide that the profits of a person arising in or derived from the Colony in respect of the exhibition of films or the use of similar items and the licensing of a patent, design, trade mark, copyright material or secret process or formula or other property of a similar nature or for imparting or undertaking to impart knowledge directly or indirectly in connection with the foregoing are deemed to be 10% of the gross receipts in respect of such exhibition, use or licencing. What this means is that 15% (being the standard rate of tax) is payable on 10% of the gross income earned in Hong Kong from the licencing. This is a very simple rule of thumb which avoids any necessity to incur the expense of trying to prove what is the profit element in a licensing arrangement.

(iii) *Hong Kong is a Tax Haven*

Hong Kong performs a dual role as a tax haven. Firstly, as tax is territorial, Hong Kong can conveniently be used as a tax haven for overseas income in the same way as any other tax free jurisdiction. As I have mentioned foreign income is totally exempt from Hong Kong tax. Hong Kong does not have any tax treaties with any other countries.

It may be possible so to structure the affairs of a company that Hong Kong tax can become payable. Though at first sight this suggestion may sound strange, it is found in practice that many companies gain a benefit by paying a flat rate of 15% on net profits rather than pay a higher tax in another jurisdiction. This is the dual role which Hong Kong can offer. The dual capacity is also helped by the fact that Hong Kong is not just a tax haven, but in addition, is a very genuine manufacturing and commercial jurisdiction having a large domestic industry and business with a very genuine but fortunately low rate of tax of 15%. Taxation and tax havens are a subject on their own and it is not possible in the short time available to me to do more than tell you what Hong Kong has to offer. It is not possible for me to elaborate on particular types of tax scheme and how it could affect other jurisdictions. I will, however, be pleased to try and answer questions. I believe that the importance of Hong Kong as a tax haven in the world, is only just beginning to be felt. There are a significantly greater number of companies operating through Hong Kong because (inter alia) of tax benefits.

Service company operations are deemed to operate at a profit which usually is deemed to be 10% of gross revenue on which 15% tax is payable.

It also should be borne in mind that Hong Kong is not part of the sterling area and does not have any form of Exchange Control of any description. Money in any denominations or currencies is freely remittable into or out of the Colony.

4. *SOME PRINCIPAL ADVANTAGES AND DISADVANTAGES OF FOREIGN CORPORATIONS LICENSING INDUSTRIAL PROPERTY RIGHTS IN HONG KONG*

(i) *Problems of infringement and enforcement of agreements.*

The theme of this Meeting is "How to make money from licencing" and not "How to give away technical information and know-how." If I were a corporate executive like many of yourselves, I would approach a foreign jurisdiction first from the aspect of whether or not my property would be safe and my bargains respected before embarking on the actual financial feasibility or the negotiations themselves.

As I have mentioned, we have a very fine system of law enforcement in Hong Kong, but like all systems throughout America and Europe, it can be time consuming and expensive. What I think is most important is to pick a reputable local partner who has expertise in Hong Kong and perhaps the Far East generally. A marriage to be happy must have the right partners and a mixed marriage between a Western Corporation and an Oriental Corporation needs perhaps greater care and foresight if the relationship is to be lasting. The name of the game is making money, and a joint venture can only work if both sides have adequate financial inducement. This applies to Hong Kong the same as it does to any other jurisdiction, but it should be borne in mind that Hong Kong lives off free enterprise. Accordingly, if your local partner is obliged to pay a royalty whereas his competitors can make the same or a similar article without paying a royalty, then he cannot remain in business. There is no reason in Hong Kong other than exclusive industrial property rights why one person should not approach the customers of another offering to make similar items at a lower price. Accordingly, only premium products and those having full legal protection can be licensed in the Colony. Furthermore, you must be prepared either to take legal proceedings or authorise your local licencees to take legal proceedings in the event of infringement. A licence arrangement cannot exist if the licencee is slowly strangled to death by his competitors who do not pay royalties with the foreign corporation having a grand stand seat but not intervening in the unequal fight.

(ii) *General*

I feel that the best summary that I can give of Hong Kong as a centre for making money from licensing is to remind you of the desire of the Hong Kong population to exist in the world without receiving any form of charity. Can a company afford not to participate in the Laissez-faire atmosphere of Hong Kong which has few, if any, restrictions on import/export or trade? We have the desire and ability to buy foreign expertise by licensing or joint venture and the facilities in the Colony to make it a successful and profitable enterprise. I hope that as a result of this Meeting some of you will join forces with us in Hong Kong.

**About the Speaker: William Turnbull, Jr. was born 13th November, 1933 at Plymouth, Nottingham, England. Degree - LL.B. (Honours). His qualifications are as follows: admitted solicitor of the Supreme Court of Judicature, United Kingdom, 1957; admitted solicitor of the Supreme Court of Hong Kong, 1958; admitted Notary Public 1969. He is currently Senior Partner of a firm of solicitors in Hong Kong in charge inter alia of matters relating to Industrial Property including Patents and Trade Marks.*

LICENSING IN THE REPUBLIC OF CHINA

by
*Paul S. P. Hsu**

1. *The Current State of Taiwan's Economic and Industrial Development*

During the past two decades, the gross national product of Taiwan has risen from US $1.29 billion to US $7 billion. The total value of the two way trade of the Republic of China has risen from US$326 million in 1952 to US$5,957 million in 1972. Comparing the total value of two way trade in the amount of US $4,125 million for the year of 1971 to the 1972 figure, shows a rate of increase at 44.4%. This rate is expected to grow even faster for the year of 1973 and for some years to come. The annual per capita income increase from US $128 in 1952 to more than US $400 in 1973. The average annual increase in gross national product was 10.4% from 1969 to 1972. Real per capita income increased at a rate of 10.2% per annum during the same period.

The government sponsored investment incentive program provides foreign investors benefits such as tax holiday and privileges for repatriating earnings and capital. This in-