

## Hong Kong Tax News



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### Tax Incentives for Acquisition of Intellectual Property Rights

Prior to the Inland Revenue (Amendment) (No. 3) Ordinance 2011, capital expenditure incurred by taxpayers to purchase intellectual property rights (“IPR”) would only be tax deductible if the IPR concerned were patent rights and rights to any know-how, the deduction of which is governed by Section 16E of the Inland Revenue Ordinance (“IRO”). The Financial Secretary in his 2010 Budget Speech proposed to extend the tax deduction of IPR to cover copyrights, registered trademarks and registered designs in order “to promote the wider application of intellectual property by enterprises and the development of creative industries”.

The Ordinance to effect the change, i.e. Inland Revenue (Amendment) (No.3) Ordinance 2011 (“the Amendment Ordinance”) was gazetted on 16 December 2011.

### Summary of Key Elements of the Amendment Ordinance

The Amendment Ordinance introduced 3 additional sections, i.e.

- **Section 16EA** – introduces tax deduction for copyrights, registered trademarks and registered designs.
- **Section 16EB** – governs the taxation of subsequent sale of the IPRs.
- **Section 16EC** – contains the anti-avoidance measures.

Sections 16EB and 16EC will also apply to patent rights and rights to any know-how. The Amendment Ordinance has also made some changes to the existing Section 16E which is applicable to tax deduction of capital expenditure on acquisition of patent rights and rights to any know-how.

### Effective Date

The Amendment Ordinance will apply from the year of assessment 2011/2012.



## Conditions for Tax Deduction of Copyrights, Registered Trademarks and Registered Designs

To be tax deductible, the capital expenditure incurred by taxpayers have to fulfill the following conditions:

- For capital expenditure on acquisition of designs and trademarks, tax deduction will only be allowed for “registered designs” and “registered trademarks”. These 2 types of IPR must have been registered on the date of acquisition. Registration can be done either in Hong Kong or overseas. On the other hand, there is no requirement that copyrights must be registered.
- Taxpayers must have acquired the proprietary interest, i.e. the legal ownership as well as the economic ownership.
- The taxpayers must use the relevant IPR in the production of their chargeable profits.
- In case a relevant IPR is used partly in the production of chargeable profits only, tax deduction is only allowed to the extent that it is used in the production of the taxpayer’s chargeable profit.
- If a relevant IPR is owned by more than one person, tax deduction for each person is granted for the amount of capital expenditure that is proportional to its share in the relevant IPR.

### Eligible Costs

Legal expenses and valuation fees incurred in connection with the purchase of the relevant IPRs are deductible provided that such expenditure is not deductible under any other provisions of the IRO.

### Deduction Period

The capital expenditure for copyrights, registered trademarks and registered designs will be deducted over 5 years on a straight-line basis starting from the year of acquisition. If the maximum protection period of a specified IPR expired within the 5-year period, the deduction will be spread in equal amounts over the number of years during which the protection of the specified IPR subsists.

For patent or rights to any know-how of which deduction is governed by the existing provision of the IRO, the capital expenditure will continue to be deductible in full in the year of acquisition.

### Subsequent sale of the relevant IPRs

If any patent, technical know-how, copyright, registered trademark and registered design for which tax deduction on its acquisition cost has been claimed by the taxpayer is sold, the sale proceeds (capped at the amount of tax deduction allowed) will be treated as taxable trading receipt of the taxpayer.



## Anti-avoidance provisions

The anti-avoidance measures are set out in new Section 16EC of the IRO. In brief, tax deductions will not be allowed under following circumstances:

- The relevant IPR are purchased wholly or partly from an associated party;
- At any time before 1 April 2011, a taxpayer who has been using a relevant right under a licence cancels the licence before its expiry and purchases the relevant IPR at an unreasonable consideration;
- The relevant IPRs are under sale and licence back or leveraged licensing arrangements; or
- The relevant IPRs are used wholly or principally outside Hong Kong by a person other than the taxpayer.

## Amendments to the Existing Section 16E

Before the introduction of the Amendment Ordinance, in order to be tax deductible, a patent right or technical know-how must be used in Hong Kong. The Amendment Ordinance has removed this condition from Section 16E and therefore tax deduction will be granted to the extent that the right is used in the production of chargeable profits of the taxpayer. In addition, the Amendment Ordinance also restricted the amount of taxable proceeds from subsequent sale of patent rights or rights to any know-how to the deduction previously claimed by the taxpayer.

However, it should be noted that the new anti-avoidance provision (Section 16EC) mentioned in the above also applies to patent rights and rights to any know-how. If the patent right or right to know-how is used by a person other than the taxpayer outside Hong Kong, even if the patent right or right to know-how is used in the production of chargeable profits of the taxpayer, the taxpayer is not entitled to the tax deduction.

## Further Development

To address the public concerns on tax treatments of IPR, the Inland Revenue Department indicated that it will issue a Departmental Interpretation and Practice Note on the subject soon. We will keep you informed of the development in this regard.

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