

HONG KONG TAX

MAY 2024

Bill on patent box tax incentive gazetted

A concessory tax rate of 5% will apply retrospectively from the year of assessment 2023/24 to the concessory portion of the Hong Kong sourced eligible intellectual property (IP) income derived by an eligible person from the use or sale of an eligible IP, typically royalties or disposal gains, once the Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024, gazetted on 28 March 2024, is enacted.

Eligible IP means IP that is developed through research & development (R&D) activities (please refer to the Appendix for the definition of the various terms), and generally does not cover market-related IP such as trademarks.

This proposed incentive aims to encourage enterprises to devote more resources to R&D and conduct commercialisation transactions making use of patents and other IP protections in Hong Kong.

We highlight below some key features of the proposed patent box regime:

Computation of the concessory portion of assessable profits

The nexus approach will apply to determine the portion of assessable profits arising from an eligible IP that will be taxed at the concessory 5% tax rate. The nexus requirement means the nexus approach adopted by The Organisation for Economic Co-operation and Development as a minimum standard under Action 5 of the Base Erosion and Profit Shifting package.

The concessory portion of the assessable profits from an eligible IP is ascertained in accordance with the following formula:

$$\text{Concessory portion} = \text{Assessable profits}^* \times \text{R\&D fraction}^{**}$$

*Assessable profits = Eligible IP income – deductible outgoings or expenses +/- tax depreciation allowances/balancing charge

$$**\text{R\&D fraction} = \frac{\text{Eligible R\&D expenditure} \times 130\%}{\text{Eligible R\&D expenditure} + \text{Non-eligible expenditure}}$$

The R&D fraction will be capped at 100% if the percentage so computed is more than 100%.

Summary

- ▶ Computation of the concessory portion of assessable profits
- ▶ Election to apply the concessory tax rate
- ▶ Subsequent abandonment, revocation, cancellation, declination or withdrawal of an eligible IP
- ▶ Records keeping
- ▶ BDO comments

The eligible R&D and non-eligible expenditure (including capital expenditure) are analysed below:

Expenditure incurred by an eligible person connected to the eligible IP	Eligible R&D expenditure	Non-eligible expenditure
i. For R&D activities carried out by the eligible person	✓	
ii. For R&D activities carried out on behalf of the eligible person		
▶ by a non-associated person	✓	
▶ by a Hong Kong resident associated person in Hong Kong	✓	
▶ by a Hong Kong resident associated person outside Hong Kong		✓
▶ by a non-Hong Kong resident associated person		✓
iii. Acquisition costs of eligible IP		✓

Interest payments, payments for any land or buildings, or for any alteration, addition or extension to any building are excluded from both eligible R&D and non-eligible expenditure.

Election to apply the concessionary tax rate

An election to apply the concessionary tax rate must be made in writing. The election, once made, is irrevocable.

Subsequent abandonment, revocation, cancellation, declination or withdrawal of an eligible IP

If the 5% concessionary tax rate has been granted but the eligible IP concerned is subsequently abandoned, revoked, cancelled, declined or withdrawn, etc, the concessionary portion of assessable profits previously taxed at the 5% tax rate will be regarded as trading receipts and taxable at the difference between the normal tax rate and the concessionary tax rate in the year when the revocation, cancellation and etc occurs.

An eligible person is also required to notify the Inland Revenue Department in writing within 4 months after the end of the year when any of the above events occurs unless a tax return has been received.

Records keeping

An eligible person must keep sufficient records to establish that the income concerned is an eligible IP income, details of all R&D expenditures incurred and details of the eligible IP to which the income relates.

BDO comments

We welcome the introduction of a patent box incentive to encourage taxpayers to undertake more R&D activities and IP commercialisation in Hong Kong.

Taxpayers wishing to understand more about the proposed patent box regime and evaluate whether their businesses can be benefited from the regime are advised to seek professional guidance. BDO's tax experts are available to assist. Please contact us to discuss.

BDO's support and assistance

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Appendix

Particulars	Definition
Eligible person	A person who is entitled to derive eligible IP income from an eligible IP
Eligible IP	<p>Eligible IP means any of the following IP generated from an R&D activity:</p> <ul style="list-style-type: none"> a. an eligible patent; b. an eligible plant variety right; c. a copyright subsisting in software under the Copyright Ordinance or under the law of any place outside Hong Kong. <p>Registration requirements apply to patents and plant variety rights.</p>
Eligible IP income	<p>An income of any one or more of the following:</p> <ul style="list-style-type: none"> a. income derived from an eligible IP in respect of: <ul style="list-style-type: none"> i. the exhibition or use of, or a right to exhibit or use the IP, whether use in or outside Hong Kong; or ii. the imparting of, or undertaking to impart, knowledge directly or indirectly connected with the use of the IP, whether use in or outside Hong Kong. b. income derived from the sale of an eligible IP (to the extent that such income is revenue as opposed to capital in nature); c. if the price of a sale of a product or service includes an amount that is attributable to an eligible IP, such portion of the sales income as attributable to the value of the IP; d. amount of insurance, damages or compensation derived in relation to an eligible IP.
R&D activity	<p>In accordance with Section 2 of Schedule 45 to the Inland Revenue Ordinance relating to deduction of R&D expenditures, ie:</p> <ul style="list-style-type: none"> a. an activity in the fields of natural or applied science to extend knowledge; b. a systematic, investigative or experimental activity carried on for the purposes of any feasibility study or in relation to any market, business or management research; c. an original and planned investigation carried on with the prospect of gaining new scientific or technical knowledge and understanding; or d. the application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved materials, devices, products, processes, systems or services before they are commercially produced or used.