Inland Revenue (Amendment) (No. 3) Ordinance 2011 gazetted today
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The Inland Revenue (Amendment) (No. 3) Ordinance 2011 ("the Amendment Ordinance") was published in the Gazette today (16 December 2011). The Amendment Ordinance was enacted to implement the 2010-11 Budget initiative in respect of profits tax deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trade marks.

The relevant intellectual property rights

Since the year of assessment 1982/83, tax deduction has been granted for capital expenditure incurred on the purchase of patent rights and rights to any know-how. Commencing from the year of assessment 2011/12, the scope is expanded to cover copyrights, registered designs and registered trade marks. The relevant intellectual property rights ("IPRs"), viz. patents, rights to any know-how, copyrights, registered designs and registered trade marks that qualify for the above tax deduction are specified in the existing section 16E(4) and new section 16EA(11) of the Inland Revenue Ordinance ("IRO").

Conditions for tax deduction

Taxpayers should fulfil the following conditions in order to be eligible for the new tax deduction -

(a) Deduction is only allowable for "registered designs" or "registered trade marks". That is, these two types of relevant IPRs must have been registered on the date of acquisition. Registration in either Hong Kong or overseas would be recognized;

(b) Taxpayers must have acquired the proprietary interest, i.e. legal and economic ownership of the relevant IPRs;

(c) The relevant IPRs are in use for the production of chargeable profits;

(d) Where a relevant IPR is used partly in the production of chargeable profits, deduction is only allowed for the portion of capital expenditure that is relevant to the production of such chargeable profits; and

(e) Where a relevant IPR is owned by more than one taxpayer, tax deduction for each taxpayer is granted for the amount of capital expenditure that is proportional to his/her share in the relevant IPR.

Legal expenses and valuation fees

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.

Tax deduction period

Tax deduction for copyrights, registered designs or registered trade marks is to be spread over five succeeding years on a straight-line basis starting from the year of purchase. In specific circumstances where a specified IPR reaches the end of its maximum period of protection within the five-year deduction period, the deduction will be spread in equal amounts over the number of years during which the protection of the specified IPR subsists. For patents or rights to any know-how, the capital expenditure remains to be deductible in the year of purchase.

Sale of the relevant IPRs

Where a relevant IPR is subsequently sold, the sale proceeds to be treated as trading receipts are capped at the amount of the deduction as previously allowed. This provision will also be applicable to patents and rights to any know-how.

Anti-avoidance provisions

Anti-avoidance measures to guard against possible tax avoidance are enacted under section 16EC of the IRO. In summary, deductions will not be allowed under one or more of the following circumstances -

(a) where the relevant IPRs are purchased wholly or partly from an associated party;

(b) where at any time before the commencement date of the Amendment Ordinance, a taxpayer who has been using a relevant right under a licence cancels the licence before its expiry and purchases the relevant IPR at unreasonable consideration;

(c) where the relevant IPRs are under sale and licence back or leveraged licensing arrangements; and

(d) where the relevant IPRs are used wholly or principally outside Hong Kong by a person other than the taxpayer.

Points to note

The Amendment Ordinance will apply for any year of assessment commencing on or after 1 April 2011. Taxpayers are only required to lodge the claims by completing their profits tax returns for the year 2011/12 in the normal manner.

The Departmental Interpretation and Practice Note will be issued in due course.