



Capital expenditure on the purchase of a copyright, registered design or registered trade mark

The Inland Revenue (Amendment) (No. 2) Bill 2011 (the Bill) was gazetted on 25 February 2011 to amend the Inland Revenue Ordinance (IRO) to affect the tax concession announced in the 2010-11 Budget.

Section 16E of the IRO currently provides a deduction for capital expenditure incurred on the purchase of patent rights or rights to any know-how used in the production of assessable profits. The Bill extends the categories of intellectual property rights that qualify for deduction to copyrights, registered designs and registered trade marks. The Bill also amends the section so that it is no longer a requirement that the patent rights or rights to any know-how must be used in Hong Kong.

Where a deduction has been allowed to a person under section 16E(1) in respect of patent rights or rights to any know-how, and those rights are subsequently sold by the person, the proceeds of the sale are to be treated as trading receipts, but only to the extent of the deduction previously allowed. In addition, section 16E(7) will provide that where any such rights in respect of which a deduction is allowable under section 16E(1) of the IRO are purchased or sold together or with any other assets for one consideration, the Commissioner of Inland Revenue may allocate a consideration for each individual right for the purposes of section 16E. Further, where the Commissioner is of the opinion that the consideration for the purchase or sale does not represent a true market value, section 16E(8) enables the Commissioner to determine the true market value for that purchase or sale.

The proposed changes are to be given effect by new sections 16EA, 16EB and 16EC.

Section 16EA provides that any capital expenditure incurred on the purchase of a copyright, registered design or registered trade mark may be deducted in ascertaining profits chargeable to profits tax.

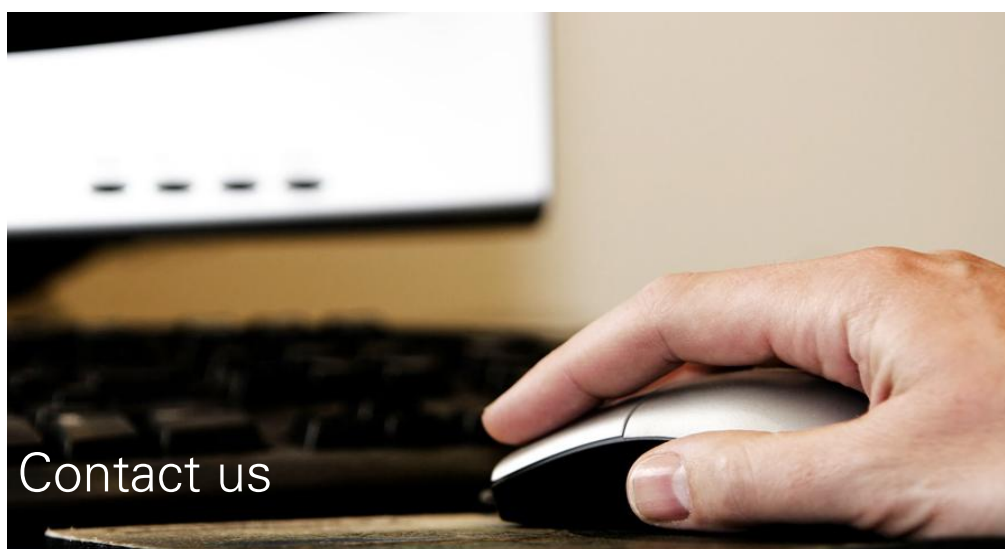
The deduction will be over five succeeding years of assessment or a lesser number of years of assessment in the case of a copyright or registered design whose maximum period of protection is due to expire earlier than the five year limit.

Section 16EB provides that if a deduction has been allowed to a person under section 16EA in respect of a copyright, registered design or registered trade mark, and the copyright, registered design or registered trade mark is subsequently sold by the person, the proceeds of the sale are to be treated as trading receipts.

Section 16EC is an anti-avoidance provision. It provides that a deduction will not be allowed for expenditure on patent rights and rights to any know-how as well as copyrights, registered designs and registered trade marks under “sale and licence back” and “leveraged licensing arrangements” or where purchased wholly or partly from an associated party. There will be an escape clause so that normal business activities are not affected.

Comment

The widening of the categories of intangibles that qualify for deduction is welcome. However, it is pertinent to note that the Government has not expanded the deduction provision to include expenditure on all types of intangible assets. The provisions only apply to expenditure on the acquisition of copyrights, registered designs and registered trade marks, as opposed to ‘in-house’ expenditure on the development of such intangibles.



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