

Intangible Assets – From A Tax Perspective

Clement Lam & Wallace Ng [April 2003]

If your company acquires the right to use a trademark from other person, will the related purchase cost and annual license fee tax deductible? What are the tax obligations of the licensor and your company? Apart from trademark, your company may acquire the right of using other kinds of intellectual property (e.g. patent, design, copyright etc.) in Hong Kong. Are there any tax issues that your company should pay attention to?

Acquisition

Instead of developing its own intellectual property (“IP”), a company may acquire an existing one from others. Section 16E of the Hong Kong Inland Revenue Ordinance (“IRO”) prescribes that expenditure incurred by a taxpayer on the purchase of a patent right or know-how right is fully tax deductible if:-

- i. it is used in the production of the taxpayer’s assessable profits; and
- ii. it is not purchased from an associate*.

Under the IRO, “know-how” is defined as any industrial information or techniques likely to assist in the manufacture or processing of goods or materials; and “patent right” means the right to do or authorize the doing of anything that would, but for that right, be an infringement of a patent.

* What is the meaning of “Associate”?

A company is an associate if:-

- i. your company has control over that company;
- ii. your company is under control of that company; or
- iii. your company and that company are under common control of another company or individual.

Apportionment of the expenditure

You should note that if the purchased patent or know-how right is partly for use in Hong Kong, tax deduction is allowed only for that part of the expenditure which is reasonable and appropriate according to the extent of its use in Hong Kong.

Chargeability of the sale proceeds

Any sale proceeds derived from subsequent disposal of the IP, of which the purchase cost has been previously claimed for tax deduction under S16E of the IRO, is fully taxable.

Deductibility of the purchase costs

Expenditure incurred on the purchase of trademark or design right* is NOT tax deductible. Only the purchase cost of patent right or know-how right* is eligible for deduction under S16E of the IRO.

* Do you know the difference between the various kinds of IPs?

Trademark: It is a mark or logo used by business to identify its goods or services.

Patent: It is the legal right granted to the inventor of an invention for protection of technical innovations.

Copyright: It is the property right of the product of human creativity, e.g. book, computer software, musical works etc.

Design right: It is the legal right of using new visible shape, configuration, pattern or ornament applied to an article by an industrial process.

Licensing

Apart from acquiring the legal ownership, a company may be contracted to pay license fee to a non-resident person in return for the right to use his/her IP in Hong Kong. Unfortunately, both the licensor and licensee very often overlook their obligations in connection with the profits tax liability on the license fee income so generated.

Obligations under the IRO

S15(1)(b) of the IRO prescribes that any sum paid or accrued to a non-resident person for the use of a patent, design, trademark, secret process or formula and any other similar property are subject to profits tax in Hong Kong. S20B of the IRO further provides that the non-resident person is chargeable to tax in the name of the Hong Kong person who

paid or credited the sums to him or any other non-resident person. In other words, if your company pays any sum to a non-resident for the right to use any one of the aforesaid IP in Hong Kong, the Inland Revenue Department (“IRD”) will issue profits tax assessment against the non-resident through your company.

◆ **Payment of tax for the non-resident**

Your company will be deemed as a fully authorized AGENT of the non-resident. S20B(2) of the IRO requires your company to deduct, when making payment to the non-resident, a sum sufficient to settle the tax in question. Your company is indemnified under S20B(3) of the IRO against the

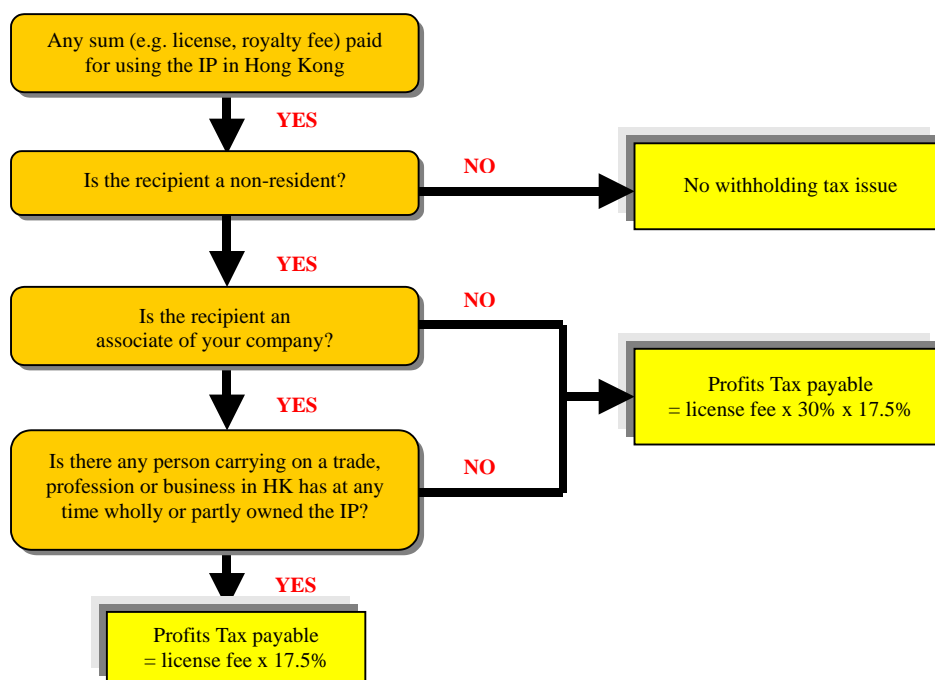
non-resident in respect of your deduction of such sum.

◆ **Amount of profits tax to be deducted**

The amount of profits tax to be deducted by your company is determined by two factors:-

- i. whether the non-resident is an associate of your company; and
- ii. whether any person carrying on business in Hong Kong has at any time wholly or partly owned the IP.

The following flowchart will assist you to figure out the amount of tax to be withheld for the non-resident.



◆ **Tax compliance matters**

If your company has paid license fee etc. to a non-resident in any year, you should inform the IRD of the fact. The IRD will issue the related Non-Resident Profits Tax Return to your company for completion and then raise

assessment against the non-resident (through your company) by reference to the information reported on the Return. Above all, your company should discuss the withholding tax issues thoroughly with the non-resident before the signing of any license agreement.

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