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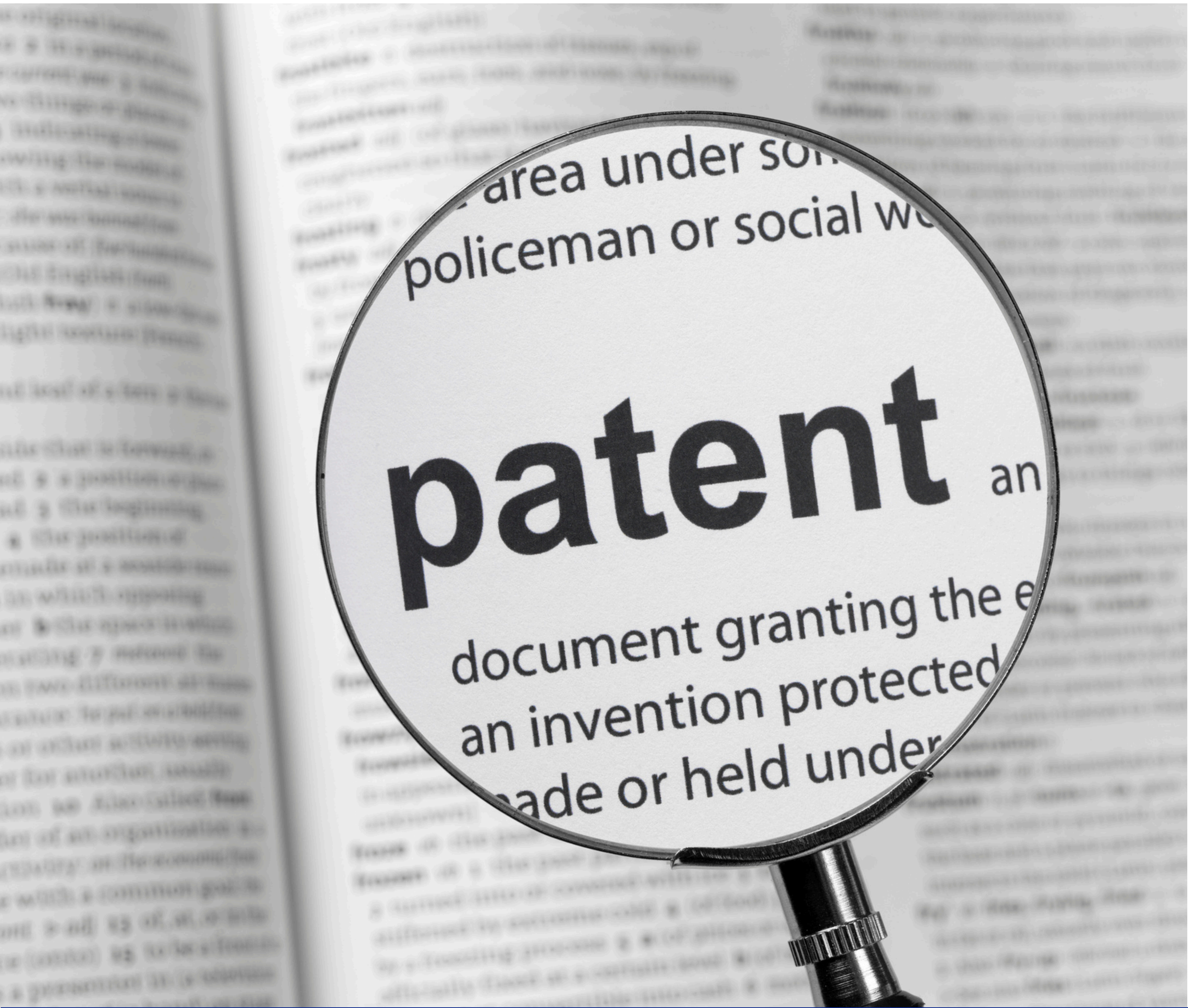
Patent Box Tax Initiative



Introduction of a "patent box" tax incentive in Hong Kong

On 28 March 2024, the Hong Kong Government published the Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Bill 2024 ("the Bill") in the Gazette to implement the "patent box" regime. The Bill aims to strengthen Hong Kong's competitiveness as a regional intellectual property ("IP") trading centre by encouraging businesses to engage in more research and development ("R&D") and IP trading activities. It offers a 5 per cent concessionary tax rate for eligible IP income derived from eligible IP assets, subject to certain conditions.

Eligible IP assets

To qualify for preferential tax treatment under the patent box regime, the income must be derived from an eligible IP asset. Eligible IP assets mean the following which are generated from R&D activities: -

(a) Patents
(b) Plant variety rights; and
(c) Copyrighted software.

Eligible patents and plant variety rights include not only those already granted or registered, but also those under applications, in or outside Hong Kong. However, additional requirements apply for patents and plant variety rights filed or granted outside Hong Kong if the applications for registration are filed in Hong Kong beyond the 24-month grace period after the commencement date of the Bill.

Eligible IP Income

In calculating assessable profits under the patent box regime, eligible IP income is broadly defined to cover the following: -

(a) Income derived from an eligible IP asset in respect of the exhibition or use of, or a right to exhibit or use the asset (whether in or outside Hong Kong); or the imparting of, or undertaking to impart, knowledge directly or indirectly connected with the use of the asset (whether in or outside Hong Kong);

(b) Income arising from the sale of an eligible IP asset;

(c) Where the sales price of a product or service includes an amount which is attributable to an eligible IP asset – such portion of the income from those sales that, on a just and reasonable basis (e.g. based on the transfer pricing principles), is attributable to the value of the assets; and

(d) Insurance, damages or compensation derived in relation to an eligible IP.

Nexus approach

The nexus approach adopted by the Organization for Economic Co-operation and Development under Action 5 of the Base Erosion and Profit Shifting ("BEPS") package is used to determine the extent of IP income that is entitled to preferential tax treatment. The portion of income from an eligible IP asset is calculated based on the nexus ratio of the eligible expenditures to overall expenditures incurred by the taxpayer to develop the IP asset. To track and trace R&D expenditures and income derived from eligible IP assets, detailed records must be kept.

Concessionary tax rate

The concessionary tax rate for the patent box regime is set at 5 per cent, which is substantially lower than the prevailing standard profits tax rate in Hong Kong (i.e. 16.5 per cent). This rate is comparable to other overseas "patent box" regimes and aims to encourage more R&D activities and commercialization of R&D results.

Treatment of losses and related offsets

To comply with the BEPS Action 5 Report, the IRD will adopt a similar mechanism for cross set-off of losses subject to different tax rates. This means that a loss incurred in relation to income benefiting from the patent box incentive can be set off against assessable profits subject to a different tax rate, as long as the amount of loss allowed is to be adjusted with reference to the tax rate difference.

For example, if a taxpayer sustained a tax loss of HKD 50,000 from activities eligible for the patent box regime (subject to the concessionary tax rate of 5 per cent) and derived other assessable profits of HKD 100,000 (subject to the standard tax rate of 16.5 per cent), HKD 15,152 (i.e. HKD 50,000 x 5%/16.5%) could be set off against such other assessable profits of the taxpayer.

Legislative timetable

The Bill was introduced into the Legislative Council on 10 April 2024. Once enacted, the patent box regime will apply retrospectively from the year of assessment 2023/24.

Conclusion

The patent box regime in Hong Kong is expected to encourage businesses to engage in more R&D and IP trading activities. This will lead to the creation of more business and employment opportunities for professional services such as legal, valuation, management, consultation, and agency services. With the development and strengthening of the IP ecosystem, Hong Kong is expected to become an international Innovation & Technology centre and a regional IP trading centre, aligning with the objectives set out in the "14th Five-Year Plan for National Economic and Social Development of the People's Republic of China and the Long-Range Objectives Through the Year 2035".

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