



Hong Kong Tax Newsflash

Passage of patent box tax concession

INspire HK

躍動香港

The draft legislation¹ on the patent box tax concession was passed by the Legislative Council today. It provides a concessionary tax rate of 5% for qualifying profits sourced in Hong Kong from eligible intellectual property (IP) created through research and development (R&D) activities. The patent box tax concession will apply retrospectively to the year of assessment beginning on or after 1 April 2023.

A bills committee was formed to scrutinize the bill prior to its passage. A minor committee stage amendment was made in relation to the period for applying the three-year average rolling basis for calculating the R&D fraction. This amendment is intended to cater for the different accounting year-end dates adopted by businesses.

In this article, we recap the key features of the patent box tax concession and highlight the discussions that took place during the bills committee meetings, where the government clarified several issues pertaining to the tax concession. For the background and details of the tax concession, please refer to our Hong Kong Tax Newsflash [Issue 194](#) and [Issue 214](#).

Key features and clarifications from the government

Eligible IP

Eligible IP means an IP that is generated from R&D activities, including patent, plant variety right² and copyrighted software. The government clarified that:

- Copyrighted software refers to a copyright subsisting in software under the Copyright Ordinance of Hong Kong or corresponding foreign laws. Although registration of copyrighted software is generally not required under the Copyright Ordinance or foreign law, it must fall within the scope of the relevant legal protection to be regarded as an eligible IP.
- Due to restrictions on patent registration in Hong Kong, standard patents (re-registration) and their applications will be excluded from the scope of eligible patents if the date of filing is after the expiry of the 24-month period following the commencement date of the Bill.

Eligible IP income

Eligible IP income includes:

- income derived from an eligible IP in respect of the exhibition or use of, or a right to exhibit or use (whether in or outside Hong Kong) the IP;
- income derived from the sale of an eligible IP;
- price of a product or service that includes an amount attributable to an eligible IP (embedded IP income); and
- insurance, damages or compensation derived in relation to an eligible IP.

The government indicated that the tax concession would only apply to IP disposal gains that are revenue in nature, as determined based on badges of trade analysis. Capital gains (i.e. disposal gains on IPs which are capital assets) would continue to be exempt from Hong Kong profits tax³.

R&D fraction for concessionary portion of assessable profits

R&D fraction is a ratio for determining the portion of assessable profits that could benefit from the preferential tax treatment. It is a fraction of eligible R&D expenditures to overall expenditures related to the IP.

- The government pointed out that only R&D expenditures directly connected to the eligible IP would be considered eligible. For instance, property rental expenditures incurred for R&D activities might be regarded as eligible R&D expenditures.
- Where the taxpayer has undertaken part or all of the underlying R&D activity under a cost sharing arrangement⁴ (CSA), the share of R&D expenditure borne by the taxpayer under the CSA can be accepted as eligible R&D expenditure in calculating the nexus ratio (i.e. R&D fraction), provided that other conditions of eligible expenditures prescribed under the OECD's nexus approach are satisfied.
- If the taxpayer obtained an IP or any right vested in a company that is a Hong Kong resident person⁵ (original owner) through amalgamation or acquisition of all equity interests in the original owner, the expenditure incurred by the original owner in respect of

the IP would be regarded as eligible R&D expenditures. The government clarified that the original owner must be a Hong Kong resident person at the time when the subject IP or any right is or was vested.

Our observations

We are pleased to note the government's clarification on several aspects of the tax concession, especially the confirmation that the share of R&D expenditures under a CSA would be considered as eligible R&D expenditures for the purpose of determining the R&D fraction. These clarifications are crucial for taxpayers to understand the legislative intent of the government and the implementation practices of the Inland Revenue Department (IRD). To facilitate tax compliance, the IRD will issue guidance and illustrative examples on its website.

The patent box tax concession is a significant initiative introduced by the government to foster R&D activities and the creation of IP in Hong Kong. It could be applicable to a broad range of businesses, not just limited to high-tech sectors such as life science and technology. Taxpayers are encouraged to seek professional advice to assess any potential opportunities in benefitting from the patent box tax concession.

Deloitte China will hold a seminar on 9 July 2024 at 2:30pm (HKT) to provide the information of the new patent box tax concession and share practical tips and strategies on how you can leverage this concession to its full potential. Please click [here](#) for registration.

¹ [Inland Revenue \(Amendment\) \(Tax Concessions for Intellectual Property Income\) Bill 2024](#)

² Plant variety rights are rights granted to the owners of plant varieties over cultivated plant varieties they have bred or discovered or developed.

³ except foreign-sourced disposal gains, which would be subject to the Foreign-Sourced Income Exemption regime.

⁴ A cost sharing arrangement is a contractual arrangement among business enterprises to share contributions and risks involved in the joint development, production or obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangibles assets or services are expected to create benefits for the individual businesses of each of the participants.

⁵ A company incorporated in Hong Kong or, if incorporated outside Hong Kong, normally managed or controlled in Hong Kong.

Tax Newsflash is published for the clients and professionals of Deloitte Touche Tohmatsu. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter.

If you have any questions, please contact our professionals:

Authors

Doris Chik

Tax Partner

+852 2852 6608

dchik@deloitte.com.hk

Carmen Cheung

Senior Tax Manager

+852 2740 8660

carmcheung@deloitte.com.hk

Kiwi Fung

Tax Manager

+852 2258 6162
kifung@deloitte.com.hk

Global Business Tax Services

National Leader

Andrew Zhu

Tax Partner

+86 10 8520 7508

andzhu@deloitte.com.cn

Hong Kong

Raymond Tang

Tax Partner

+852 2852 6661

raytang@deloitte.com.hk

Business Tax

Sarah Chan

Tax Partner

+852 2852 1628

sarahchan@deloitte.com.hk

International Tax

Kwan Yu

Tax Partner

+852 2852 1037

kwanyu@deloitte.com.hk

Transfer Pricing

Victor Zhang

Tax Partner

+852 2238 7588

viczhang@deloitte.com.hk

Get in touch



Deloitte China provides integrated professional services, with our long-term commitment to be a leading contributor to China's reform, opening-up and economic development. We are a globally connected firm with deep roots locally, owned by our partners in China. With over 20,000 professionals across 31 Chinese cities, we provide our clients with a one-stop shop offering world-leading audit & assurance, consulting, financial advisory, risk advisory, tax and business advisory services.

We serve with integrity, uphold quality and strive to innovate. With our professional excellence, insight across industries, and intelligent technology solutions, we help clients and partners from many sectors seize opportunities, tackle challenges and attain world-class, high-quality development goals.

The Deloitte brand originated in 1845, and its name in Chinese (德勤) denotes integrity, diligence and excellence. Deloitte's global professional network of member firms now spans more than 150 countries and territories. Through our mission to make an impact that matters, we help reinforce public trust in capital markets, enable clients to transform and thrive, empower talents to be future-ready, and lead the way toward a stronger economy, a more equitable society and a sustainable world.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which is a separate and independent legal entity, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Bengaluru, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Mumbai, New Delhi, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

This communication contains general information only, and none of DTTL, its global network of member firms or their related entities is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication.

© 2024 Deloitte Touche Tohmatsu in Hong Kong, Deloitte Touche Tohmatsu in Macau, and Deloitte Touche Tohmatsu Certified Public Accountants LLP in the Chinese Mainland. All rights reserved.

To no longer receive emails about this topic please send a return email to the sender with the word "Unsubscribe" in the subject line.