



HONG KONG TAX ALERT

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Intangible migration in the post-BEPS environment

The tax world has changed forever. Base Erosion Profit Shifting or “BEPS” initiated by the G20 economies and now endorsed internationally aims to close tax loop holes and ensure income is taxed where there is value creation. Intangible Property (“IP”) is at the forefront of this tax battle ground.

Summary

- *In a post-BEPS environment, IP related arrangements will become a focus of the tax authorities. How ready is your company in defending its IP arrangement?*
- *Corporations with IP at an offshore entity with limited economic substance should re-examine their arrangements and consider necessary changes or support that may be required to its existing arrangement.*

So who does this affect? Companies that perform Hong Kong based research and development (“R&D”) activities, own any IP developed or used in Hong Kong and especially if that IP is owned in an offshore BVI or similar entity need to ensure they are BEPS ready. If your company pays royalties to any related party you will be affected too.

Hong Kong is a centre of excellence for a number of R&D activities, along with the government’s initiatives to promote Hong Kong as a premier IP trading hub in the region, many multinational companies (“MNCs”) with operations in Hong Kong can have certain level of involvement in the Group IP. The key transfer pricing (“TP”) considerations may include:

- The roles and responsibilities of any HK based R&D personnel and how their activities coordinate with any other IP related activities in the group.
- Who truly has the capacity in controlling and managing the underlying R&D or IP risks.
- Whether the IP legal owner resides at a no or low tax offshore jurisdiction.
- Any split in legal and economic IP ownership structure.
- The structure of licensing or sub-licensing arrangement and how form and substance match.

In a post BEPS world additional care is required. At the same time there are many opportunities for companies to streamline their value chain.

An increasing number of companies in Hong Kong have started to address these issues. However, it is very important to ensure IP arrangements are carefully and correctly implemented. Possible options to consider:

- Transfers of IP. In accordance with BEPS, does it make sense to transfer of legal ownership to the entity that is principally responsible for the development, enhancement, maintenance, protection and exploitation (DEMPE) of the intangibles? What valuation issues may arise?
- Retain the IP offshore and retain legal ownerships structure. Is it sufficient to determine the appropriate arrangement in attributing the economic returns of the IP to the economic owner(s), including options such as sub-licensing arrangement?

Certain options can give rise to additional tax liabilities including withholding tax. Careful evaluation is therefore required when determining the best IP structure.

The circumstances would be different for each company. It is vital for companies to correctly assess their TP and take appropriate steps to review its tax position on IP at the earliest opportunity.

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