



Hong Kong Tax Newsflash

Updates on proposed tax deductions related to intellectual property

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The Hong Kong government has recently released [refined proposals](#) for profits tax deductions on capital expenditure related to intellectual property (IP).

The initiative was first announced in the 2025-26 Budget, with the aim of stimulating investment in research and development (R&D), supporting the growth of IP-intensive sectors, and addressing long-standing asymmetry between taxable income and allowable deductions. Following a consultation¹ with stakeholders earlier this year, the government has incorporated key feedback into the refined proposals.

The draft legislation is expected to be introduced to the Legislative Council within 2026, with the new rules applying to IP acquisitions and licensing arrangements entered into on or after 1 April 2026.

Acquisition costs of IP from associates

Eligible IP: Patent rights, rights to know-how, copyright, performer's economic rights, protected layout-design (topography) rights, protected plant variety rights, registered designs and registered trade marks

Main purpose test: No deduction will be allowed if the main purpose or one of the main purposes of the acquisition is to obtain a tax benefit². The government clarified that if tax benefit is only an incidental consequence, it will not be regarded as a main purpose.

Domestic intra-group transfers: The deductible amount to the transferee and the taxable amount to the transferor are refined.

The deduction allowable to the transferee will be the lower of:

- the sum of the deduction allowable to the transferor in relation to the purchase of such IP³ and the qualified R&D expenditure incurred by the transferor in relation to the R&D activities carried out on such IP⁴; or
- the actual capital expenditure incurred by the transferee for the purchase of such IP.

The sales proceeds received by the transferor, capped at the amount of deduction previously allowed, will be treated as a taxable trading receipt.

The originally proposed transfer pricing rules and documentation requirements have been removed.

¹ Please refer to our [Hong Kong Tax Newsflash Issue 258](#) for details.

² Tax benefit means an avoidance, postponement or reduction of a liability to pay tax chargeable under the Inland Revenue Ordinance.

³ It means the notional deduction amount allowable to the transferor.

⁴ Qualified R&D expenditure means any expenditure incurred in relation to the R&D activities for which deduction is allowable under Section 16B of the Inland Revenue Ordinance.

Valuation report: For cross-border intra-group transfers, a third-party independent valuation report will be required upon request by the IRD if the acquisition cost of the IP exceeds a specified threshold. The originally proposed threshold of HKD 3 million has been removed upon stakeholder’s feedback. The specified threshold will be set out in a future guidance note to be issued by the Inland Revenue Department (IRD).

For domestic intra-group transfer, the originally proposed valuation requirement has been removed.

Acquisition costs of IP used outside Hong Kong

Currently, no deduction is allowed for acquisition costs of IP used by a licensee outside Hong Kong, even if the IP income is taxable in Hong Kong.

The refined proposal relaxes this rule and allows a proportionate deduction where the IP income is chargeable to tax under the FSIE regime. The tax deduction would be allowed “on a proportionate basis to the capital expenditure incurred for the purchase of the IP concerned”. According to the IRD representative’s explanation during the Legislative Council meeting, if the total IP income is HKD100 and HKD90 is taxable under the FSIE regime based on the nexus ratio, the same proportion of IP acquisition cost would be deductible.

Upfront licence fees for the right to use IP

Eligible licences: The refined proposal clarified that the new deduction will cover all forms of licences.

Eligible IP: Patent rights, rights to know-how, copyright, performer’s economic rights, protected layout-design (topography) rights, protected plant variety rights, registered designs and registered trade marks

The refined proposal added that for franchise, tax deduction will be allowed for the capital expenditure incurred for the right to use the above IPs if the relevant breakdown could be provided. Details will be set out in a future guidance note to be issued by the IRD.

Deduction period: The deduction will be spread evenly over the licensing term. If the term is amended, the remaining deduction will be spread over the revised remaining term.

Claw-back arrangement: Where a licence is terminated or assigned, any excess of proceeds over the unallowed amount will be treated as a taxable receipt, capped at the deduction previously allowed. If the license fee is reduced upon amendment of the arrangement, any excess of aggregate deductions claimed over the revised fee will be clawed back.

Deeming provision: Any sums received by or accrued to a Hong Kong licensor in relation to the right to use IP will be deemed as a taxable trading receipt.

Anti-avoidance measures: The IRD will be empowered to determine the arm’s length price of the upfront licence fees, request submission of a valuation report, and allocate consideration when the licence is acquired, assigned or terminated with any other dealings.

Legislative timeline

The government plans to introduce the amendment bill into the Legislative Council within 2026. Upon enactment, the new rules would apply to enterprises that have purchased IP or the rights to use IP since 1 April 2026.

Our observation

We are pleased to see that the government has adopted most of the stakeholders' (including our firm's) recommendations collected in the consultation and provided clarification on certain proposed tax treatments set out in the refined proposals. The removal of transfer pricing obligations and independent valuation report requirements for domestic intra-group IP transfers significantly reduces compliance burden. The refined taxable amount, limited to the amount of deduction previously allowed, reflects a more practical measure and avoids double taxation under certain circumstances. Overall, the proposal can rectify tax asymmetry in general, where IP income is taxable but related capital expenditure is not deductible, and are likely to encourage multinational enterprises to transfer their IPs to Hong Kong for conducting further R&D activities, supporting Hong Kong to become a regional hub for innovation and technology.

Having said that, the refined proposal relaxes the limitation of IP purchase cost deduction where the IP is used by a licensee outside Hong Kong to a certain extent only. It cannot fully resolve tax asymmetry. The proposed proportionate deduction of IP used outside Hong Kong is limited to cases where income is taxable under the FSIE regime. This excludes scenarios where income is taxable under Section 14 of the Inland Revenue Ordinance (IRO), for example, when the purchased IP is further developed in Hong Kong and licensed overseas; or when sub-licensing agreements are negotiated and concluded in Hong Kong. In such cases, despite the income is onshore-sourced and taxable, no deduction is permitted according to the refined proposal. We recommend the government reconsider this limitation and allow deductions whenever IP income is subject to tax in Hong Kong, regardless of the charging provision, to ensure a more consistent and supportive environment for IP-driven businesses. In addition, further clarifications would be required for the calculation of deduction amount on a proportionate basis.

Additionally, the deeming provision for a Hong Kong licensor raises concerns. It will in essence disallow all offshore claim and capital claim for licence fee income. The IRD explained that income derived by a person carrying on a business in Hong Kong from the granting the use or right to use IP to a licensee through a licensing arrangement are generally revenue in nature and chargeable to tax. This deeming provision seeks to provide tax certainty. Nevertheless, the existing provisions under the IRO (e.g. Section 14, Section 15(1)(b), (ba)), together with the established case law, can already provide a robust framework for securing the taxability of licence fee income. This deeming provision appears to be unnecessary and may reduce the flexibility of our tax system.

Businesses should review their existing and planned IP structures, assess eligibility for deductions under the new rules, and seek professional advice in evaluating the practical implications of these refined proposals on their IP strategies.

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