



Hong Kong Tax Newsflash

Intellectual property tax deduction rules relaxed under newly gazetted draft legislation

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The Bill¹, which seeks to relax tax deductions for capital expenditure incurred on the purchase of intellectual property (IP) and licences to use IP, was gazetted on 16 October 2026. Upon enactment, the proposed relaxation will apply retroactively to IP, or licences for the right to use IP, acquired under contracts entered into on or after 1 April 2026.

The relaxation includes:

- (1) allowing tax deduction for purchase of IP from associates;
- (2) allowing tax deduction for purchase of IP that is used by a licensee outside Hong Kong if the relevant income is taxable under the foreign-sourced income exemption (FSIE) regime; and
- (3) allowing tax deduction for upfront licence fee for the right to use IP.

Background

The initiative was first announced in the 2025-26 Budget, aiming to stimulate investment in research and development (R&D), support the growth of IP-intensive sectors, and address long-standing asymmetry between taxable income and allowable deductions. Following a stakeholder consultation² earlier this year, the government has released refined proposals³ incorporating key feedback received.

We set out the key aspects of the Bill below, which are largely consistent with the refined proposals.

(1) IP purchased from associates

Currently, no tax deduction is allowed for capital expenditure on IP acquired wholly or partly from an associate. The Bill proposes to relax this rule by allowing a tax deduction for capital expenditure incurred on the purchase of eligible IP⁴ from associates.

Purchase from Hong Kong associates

The deduction allowable⁵ to the transferee (i.e. buyer) will be the lower of:

¹ [Inland Revenue \(Amendment\) \(Tax Deductions for Intellectual Property Expenditure\) Bill 2026](#)

² Please refer to our [Hong Kong Tax Newsflash Issue 258](#) for details.

³ Please refer to our [Hong Kong Tax Newsflash Issue 268](#) for details.

⁴ Eligible IP refers to 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

⁵ For patent rights or rights to know-how, a full deduction is allowable in the year of purchase. For other eligible IP (e.g. copyright, registered designs, and registered trade marks), the deduction is allowed in 5 equal instalments over 5 consecutive years, beginning in the year of purchase.

- the sum of the deduction allowable to the transferor (i.e. seller) in relation to the purchase of such IP and the qualified R&D expenditure incurred by the transferor (i.e. seller) on R&D activities related to such IP⁶; or
- the actual capital expenditure incurred by the transferee (i.e. buyer) for the purchase of such IP.

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

Purchase from overseas associates

For cross-border intra-group transfers, a third-party independent valuation report by a qualified valuer⁷ will be required upon request by the Inland Revenue Department (IRD) if the acquisition cost of the IP exceeds a specified threshold to be set out in the gazette.

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 benefit⁸. If a tax benefit is merely an incidental consequence, it will not be regarded as a main purpose.

(2) IP used outside Hong Kong

Currently, where a taxpayer acquires an IP and licenses it to a person which uses the IP outside Hong Kong, no deduction is allowed for acquisition costs of IP, even if the relevant IP income is taxable in Hong Kong.

The Bill relaxes this rule by allowing a deduction where the IP income is chargeable to tax under the FSIE regime. The tax deduction would be allowed in proportion to the extent the eligible IP is used to generate the chargeable foreign-sourced income.

(3) Upfront licence fees for the right to use IP

Under the existing rules, upfront licence fees (i.e. a lump sum payment made initially) are regarded as capital in nature and are not deductible.

The Bill allows a tax deduction for capital expenditure for acquiring a licence for the right to use eligible IP⁴. In other words, licence fees will be allowed for deduction irrespective of whether they are capital (e.g. upfront, lump-sum) or revenue in nature, provided they are incurred in the production of assessable profits.

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 acquired, terminated or assigned, any excess of proceeds over the unallowed amount will be treated as a taxable receipt at the time of termination or assignment, capped at the deductions 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 at the time of the amendment.

Valuation report: Similar to the cross-border intra-group transfers of IP, a third-party independent valuation report by a qualified valuer will be required upon request by the IRD if the upfront licence fees incurred for the right to use IP exceeds a specified threshold.

⁶ 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 (IRO).

⁷ The valuer must be independent of any party to the transaction and has qualifications and experience that are relevant to the valuation of the eligible IP concerned. Details will be set out in a future IRD guidance note.

⁸ Tax benefit means an avoidance, postponement or reduction of a liability to pay tax chargeable under the IRO.

Anti-avoidance measures

The IRD will be empowered to determine the arm's length price and allocate consideration when IP or a licence for the right to use IP is acquired, assigned or terminated in connection with any other dealings.

Legislative timeline

The Bill is scheduled for its first reading in the Legislative Council on 28 October 2026. Upon enactment, the proposed relaxation will apply retroactively to IP or licenses for the right to use IP acquired under a contract entered into on or after 1 April 2026.

Our observation

We welcome the government's continued efforts to promote the development of IP trading and financing in Hong Kong. The proposed relaxation will encourage more local and overseas enterprises to choose Hong Kong as their preferred platform for cross-border technology transfer and IP financing, supporting Hong Kong's development into an international innovation and technology centre and a regional IP trading centre.

We also appreciate that the government has taken our recommendation and further refined the proposal by removing the deeming provision related to upfront licence income received by Hong Kong licensors, retaining flexibility of the tax system.

Nevertheless, the tax asymmetry arising from the limitation on IP purchase cost deductions where the IP is used by a licensee outside Hong Kong has not been fully resolved. For instance, if a taxpayer purchases an IP and licenses it for use outside Hong Kong, given that no R&D work is carried out by the taxpayer, the offshore license fee income is taxable under the FSIE regime. The Bill allows a deduction of the IP purchase cost, addressing the tax asymmetry issue. In contrast, if the taxpayer enhances and further develops the IP in Hong Kong, the license fee income becomes onshore sourced and taxable. However, no deduction of the IP purchase cost is allowed under the Bill, leaving the tax asymmetry issue unaddressed. We hope the government will further consider refining this limitation with a view to encouraging R&D activities in Hong Kong.

There are some outstanding items that would need further guidance and clarifications. The deduction of upfront licence fee only covers the eight types of eligible IP under the Bill. The IRD will provide guidance regarding the applicability to franchising arrangements. The valuation report requirement is subject to a specified threshold to be announced. The IRD will also provide detailed guidance about the qualification and experience of independent valuers.

Businesses holding or developing IP should closely monitor developments and seek professional advice to assess how they may benefit from the proposed relaxation.

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