



Consultation on expanding intellectual property tax deductions launched

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Issue 2

In brief

Following the 2025/26 Budget speech, the HKSAR Government (Government) released a consultation paper last Friday (30 January 2026) proposing amendments to the Inland Revenue Ordinance (IRO). The objective is to broaden profits tax deductions for capital expenditure on intellectual property (IP), with the dual aims of accelerating the growth of IP intensive industries and promoting IP trading in Hong Kong.

Specifically, the proposals seek to:

- (1) permit deductions for covered IP acquired from associates, subject to conditions such as a main purpose test, compliance with transfer pricing rules (including for domestic transfers) and the requirement to obtain an independent valuation report if the cost of the IP is HK\$3 million or more; and
- (2) allow deductions for upfront licence fees for the right to use covered IP, to be spread over the term of the licence.

However, no changes will be made to the existing restriction which denies deductions for capital expenditure on acquiring IP that is used by a licensee outside Hong Kong.

The Government targets introducing a legislative bill in 2026, with consultation open until 31 March 2026.

This news flash summarises the proposed qualifying conditions set out in the consultation paper and our observations thereon.

In detail

Overview of existing IP tax deductions

The tax deductions for IP-related expenditure are governed by the general deduction rules and certain specific provisions under the IRO, which are summarised below:

- Recurring royalties or licence fees are deductible under the general deduction rules to the extent that they are incurred in the production of the taxpayer's assessable profits. On the other hand, upfront fees for obtaining licences are considered capital in nature and not deductible under both the general deduction rules and the specific deduction rules explained below.
- Subject to satisfying the relevant conditions and provided that the specific restrictions below do not apply, capital expenditure incurred on the purchase of the following eight types of IP (covered IP) is deductible:
 - (1) patent rights
 - (2) rights to know-how
 - (3) copyrights
 - (4) registered trade marks
 - (5) registered designs
 - (6) performer's economic rights
 - (7) protected layout design (topography) rights
 - (8) protected plant variety rights

Items (1) and (2) are fully deductible in the year of purchase, while items (3) to (8) are generally deductible over five years.

- No deduction is allowed for the capital expenditure mentioned above if any prescribed circumstances apply. Notably, two of the prescribed circumstances are:
 - (i) The IP is purchased wholly or partly from an associate (such as the taxpayer's group company).
 - (ii) The IP is used wholly or principally outside Hong Kong by other persons (i.e. section 16EC(4)(b) of the IRO).

Proposals on expanding IP tax deductions

Proposal 1: Allowing deductions for IP acquired from associates

The Government proposes to relax the current restriction by allowing deductions for the acquisition cost of covered IP purchased from associates. This proposal seeks to attract more multinational corporations to bring in and manage IP in Hong Kong, reinforcing Hong Kong's role as a regional IP trading and innovation centre. The proposed deduction will be subject to the following safeguards against potential abuse:

- **Main purpose test:** Deductions will be denied if the main purpose, or one of the main purposes, of the acquisition is to obtain a tax benefit, considering all relevant facts and circumstances; incidental tax benefits alone will not trigger denial.

- **Application of transfer pricing rules to domestic intra-group IP transfers:** Domestic intra-group IP transfers will be carved out from the existing domestic transaction exemption, making them subject to both transfer pricing rules and documentation requirements. Nonetheless, documentation requirements will apply only if the existing thresholds, based on the size of business and the volume of different types of related-party transactions, are exceeded.
- **Sale proceeds deemed taxable for domestic intra-group IP transfers:** To deter inflated transfer pricing and preserve group tax neutrality, the transferor's full sale proceeds, less any unallowed IP deductions, will be treated as a trading receipt subject to profits tax¹. Nevertheless, as the transferee will be eligible for tax deduction of its IP acquisition cost, the tax position of the whole group will remain the same.
- **Independent valuation requirement:** To ensure arm's length pricing and avoid inflated IP acquisition costs between associates, an independent valuation report by an appropriate valuer possessing the relevant qualifications and experience will be required where the acquisition cost is HK\$3 million or more in a related party transaction. The report need not be filed with the profits tax return, but must be provided to the Inland Revenue Department (IRD) upon request. Details of what constitutes an appropriate valuer, including examples, will be provided in a forthcoming guidance note.

Nonetheless, other existing anti-abuse provisions under section 16EC of the IRO, including section 16EC(4)(b) on use by a licensee outside Hong Kong, will continue to apply. This is considered necessary to uphold Hong Kong's territorial source and tax symmetry principles, under which acquisition costs for covered IP are not deductible if they are not used to produce assessable profits.

Our observations

Allowing deductions for IP acquired from associates

We welcome the proposed relaxation of tax deductions for IP acquired from associates. The rules are broadly aligned with Singapore's regime, though there are some notable differences:

- (i) there is no main purpose test in Singapore;
- (ii) in a domestic intra-group IP transfer within Singapore where the IP has appreciated in value, the transferor's deemed taxable sales proceeds are capped at the amount of deductions previously allowed, while the transferee's deductible amount is determined based on the IP acquisition cost (subject to open market value); and
- (iii) an independent valuation report of the IP is required in Singapore only if the cost of the IP is at least SGD 10 million (equivalent to approximately HK\$60 million) in a related party transaction².

For (i), the Government explains that the main purpose test is necessary to prevent offshore losses from being shifted to Hong Kong for deduction against assessable profits of Hong Kong companies. While incidental tax benefits will not be treated as a main purpose, the application of the test remains inherently subjective. For example, if an overseas associate incurs substantial research and development (R&D) expenditure to develop an IP and suffers a loss, then subsequently transfers the IP to its Hong Kong associate for genuine commercial reasons, such as Hong Kong's strong IP protection regime, as well as its then beneficial IP tax regimes, it is uncertain whether the deduction would be denied.

While the policy intent of safeguarding against abuse is understandable, deductions are already subject to transfer pricing rules and claw-back provisions, along with the requirement to obtain independent valuation if the acquisition cost of the IP exceeds a certain threshold. These safeguards, together with the existing general anti-avoidance rules under sections 61 and 61A of the IRO, should be sufficient to address the types of abusive arrangements envisaged by the Government, without introducing unnecessary uncertainty for taxpayers.

For (ii), the consultation paper frames this safeguard as tax-neutrality within a group. However, in a domestic intra-group IP transfer where the IP has appreciated in value, taxing the transferor on the full sale proceeds would, in substance, impose tax on capital gains. This represents a departure from Hong Kong's long-standing principle of not taxing capital gains. It is also unclear whether the proceeds would remain fully taxable if the transferee is denied deductions for IP acquisition costs because certain conditions are not met. By contrast, Singapore limits the transferor's taxable proceeds to the total deductions previously allowed, thereby excluding capital gains from taxation, while allowing the transferee to deduct the IP's open market value at the time of transfer. Singapore's approach seems fairer, as it upholds the principle of not taxing capital gains while allowing deductions that reflect economic reality.

No amendments to section 16EC(4)(b)

It is disappointing that our repeated recommendation to amend section 16EC(4)(b) has not been accepted. The rationale of upholding the tax symmetry principle is premised on the assumption that profits generated from the use of such IP outside Hong Kong are offshore sourced and non-taxable.

However, following the introduction of the foreign-sourced income exemption regime in 2023, it is no longer possible for covered taxpayers to make a non-taxable offshore claim in respect of royalty income derived from licensing acquired IP for use outside Hong Kong (unless the income is not received in Hong Kong).

In an attempt to illustrate that section 16EC(4)(b) is not unduly restrictive, the consultation paper cites an example in which a Hong Kong company acquires the proprietary interest in a trade mark registered in both Hong Kong and the Chinese Mainland, licenses the Chinese Mainland registered trade mark to a Chinese Mainland manufacturer for producing goods bearing the Hong Kong registered trade mark, and sells the goods in Hong Kong to produce profits chargeable to Hong Kong profits tax. The consultation paper confirms that, if the other deduction conditions are satisfied, a deduction would be available for capital expenditure on the Hong Kong registered mark. However, while not explicitly stated in the consultation paper, the capital expenditure on the Chinese Mainland registered trade mark would in fact not be deductible. This is the case even if the profits derived from the use of the Chinese Mainland registered trademark will be chargeable to Hong Kong profits tax.

There are further common scenarios that highlight the limitations of section 16EC(4)(b). Many Hong Kong taxpayers maintain production bases outside Hong Kong and license acquired IP, such as manufacturing know-how, to manufacturers for use abroad. In addition, some Hong Kong taxpayers acquire copyrights and license them for exhibition outside Hong Kong. In these cases, because the IP is used by another person wholly or principally outside Hong Kong, no deduction is allowed for the acquisition costs even where the resulting trading profits or royalty income is fully taxable in Hong Kong. This asymmetry creates an imbalance and may result in an unreasonably high effective tax burden.

A reconsideration of section 16EC(4)(b) would therefore be appropriate to ensure that Hong Kong's tax regime remains fair, competitive and aligned with commercial reality, particularly given the increasing cross-border nature of IP exploitation by Hong Kong businesses.

Proposal 2: Allowing deductions for upfront licence fees

To support IP development and commercialisation, the Government proposes to allow tax deductions for upfront licence fees incurred for the right to use IP in a licensing arrangement, regardless of whether these fees are capital or revenue in nature, provided they are incurred in the production of assessable profits. Details of the proposed deduction are as follows:

- **Three forms of covered licences:** The deduction will apply to (i) exclusive licences; (ii) sole licences; and (iii) non-exclusive licences³.
- **Eight types of covered IP:** The deduction will be limited to the eight types of IP currently covered under the existing IP-deduction regime, as outlined in the 'Overview of existing IP tax deductions' section above.
- **Deduction period:** Instead of a full immediate deduction, the deduction will be spread evenly over the licensing term to align with the accounting treatment on amortisation. If the licensing arrangement changes, the remaining deduction will be spread over the remaining licensing term. Where deductions already claimed exceed the revised licence fee, the excess will be clawed back.
- **Claw-back arrangement for terminated or assigned licences:** If all or part of the IP licensing rights are terminated or assigned, the tax deduction will be clawed back. Consistent with existing tax rules, only the amount of the deduction previously allowed will be recouped. Any excess of proceeds over the unallowed deduction will be treated as taxable receipts, but only up to the amount of deduction that was allowed.
- **Deeming provision for upfront licensing income:** To ensure tax symmetry, any sums received or accrued by a Hong Kong licensor in relation to the right to use IP, including upfront licence fees, for which a deduction has been allowed to the licensee, will be deemed trading receipts chargeable to profits tax.
- **Anti-avoidance provisions:** To prevent abuse of the deduction, the Commissioner of Inland Revenue will be empowered to (i) determine the arm's length price in respect of which a tax deduction is claimed and require the licensee to submit a valuation report to substantiate its claim; and (ii) allocate the consideration where a licence to use IP is acquired, assigned or terminated together with any other dealings.

Our observations

Allowing deduction of upfront licence fees regardless of their capital or revenue character is a welcome simplification that reduces compliance costs and dispute risk. Hong Kong's approach is administratively simpler than Singapore's requirement to determine the capital or revenue nature of fees on a case-by-case basis.

However, the relief is confined to covered IP only, so fees relating to non-covered IP remain subject to the usual capital-versus-revenue analysis. Following the recent court decision in *Patrick Cox Asia Limited v Commissioner of Inland Revenue* [2024] HKCA 944, which treated upfront licence income as revenue in nature and noted that the same legal principles apply to both income and expenses, it remains to be seen

whether the IRD will continue to treat upfront licence fees for non-covered IP as capital in nature and thus non-deductible.

In addition, broader consideration should be given to expanding the list of covered IP to encompass other types of IP, such as franchise rights and industry-specific entry rights, for the purposes of allowing deductions for both purchase costs and upfront licence fees. These are 'black-hole' expenditures that are essential to the conduct of business in certain industries but are not tax-deductible.

In cross-border transactions involving upfront licence fees paid by Hong Kong entities where the licences are for the use of, or the right to use, IP solely outside Hong Kong, the Hong Kong payers should be mindful of the relevant withholding and reporting obligations for the non-Hong Kong licensors once such fees become deductible.

Legislative timetable and consultation

The IRO will be amended to implement the above proposals. However, the consultation paper does not mention whether the proposals, if implemented, will apply only to IPs acquired and licensing agreements entered into after the enactment of the law, or whether they will also cover existing IPs and agreements. The target is to introduce the amendment bill within 2026, and views are invited by 31 March 2026.

The takeaway

We welcome the Government's launch of a consultation on expanding the scope of profits tax deduction rules for IP-related costs, a proposal we have long advocated. We look forward to its swift implementation and hope that the observations we have shared will be taken into account to enhance both the attractiveness and practicality of the rules.

Hong Kong has already introduced a patent box regime and enhanced R&D deductions to support innovation. As R&D and IP acquisition are both essential expenditures in the innovation cycle, it is important that the rules governing them complement each other. In practice, many Hong Kong taxpayers outsource part of their R&D to associated entities, particularly in the Chinese Mainland. Yet, payments to such associates are generally non-deductible. To ensure the effectiveness of Hong Kong's tax concessions, these rules should be reviewed and better aligned with commercial realities.

By comparison, Singapore's Enterprise Innovation Scheme (EIS) provides up to 400% enhanced deductions for qualifying R&D, IP acquisition and licensing, among other activities, subject to an annual cap. A cash payout option is available in lieu of deductions. The EIS is implemented for a defined period, with the possibility of extension. The Government may wish to consider whether introducing a fixed-term incentive of this scale could provide a stronger impetus for innovation across Hong Kong businesses.

Businesses interested in understanding how the proposals outlined in this consultation paper may affect them are welcome to contact us. We are preparing a submission and encourage you to share any comments or feedback. We would be pleased to incorporate your views and relay them to the Government as appropriate.

Endnotes

1. There will be no changes to the existing rules governing transfers of IP between non-associates. The sales proceeds, capped at the amount of deductions previously allowed, will be brought to tax. No tax will be imposed on the capital gain.
2. In Singapore, an independent valuation report must be submitted, together with a prescribed declaration form, when filing the income tax return if the capital expenditure incurred in acquiring the IP is:
 - (a) SGD 10 million or above for a related party transaction; or
 - (b) SGD 40 million or above for an unrelated party transaction.
3. The consultation paper defines the covered types of licences as follows:
 - Exclusive licence: a licence under which the licensee is the only person authorised to exploit the IP, and even the IP owner cannot exploit the IP.
 - Sole licence: a licence under which the licensee is the only person that is granted a licence to exploit the IP, while the IP owner retains the right to exploit the IP.
 - Non-exclusive licence: a licence that may be granted to more than one licensee, while the IP owner may also exploit the IP.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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Hong Kong News Flash

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