



Bill to enhance tax deduction for intellectual property introduced

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Issue 16

In brief

Following the Government's enhanced proposal released in May 2026 in response to feedback received during the public consultation¹, the Inland Revenue (Amendment) (Tax Deductions for Intellectual Property Expenditure) Bill 2026 (Bill) was gazetted on 16 October 2026². The Bill largely reflects the enhanced proposal and seeks to enhance the profits tax deductions available for capital expenditure incurred in acquiring or licensing eligible intellectual property (IP) rights³.

The proposed deductions would cover:

- (i) The acquisition of eligible IP rights acquired from associates;
- (ii) The acquisition of eligible IP rights used by a licensee outside Hong Kong, to the extent that the rights generate foreign-sourced licensing income that is taxable under the foreign-sourced income exemption (FSIE) regime; and
- (iii) Upfront licence fees for the use of eligible IP rights.

Upon passage of the Bill, the new rules would apply to eligible IP rights acquired or licensed under contracts entered into on or after 1 April 2026. The existing deduction arrangements would continue to apply to contracts entered into before that date.

This news flash summarises the enhancement measures together with our observations.

In detail

Key provisions of the Bill

1. Allowing deductions for eligible IP rights acquired from associates

The following table summarises the key aspects of the proposed deduction for eligible IP rights acquired from Hong Kong business associates, being associates carrying on a trade, profession or business in Hong Kong, and from non-Hong Kong business associates.

Key aspects	Eligible IP rights acquired from Hong Kong business associates	Eligible IP rights acquired from non-Hong Kong business associates
Amount of deduction available to the purchaser	Lower of – (a) the sum of (i) deduction allowable to the seller for the purchase of the IP rights ⁴ , and (ii) any qualified research and development (R&D) expenditure incurred by the seller for any R&D activities carried out on such IP rights ⁵ ; and (b) the acquisition cost incurred by the purchaser	Acquisition cost incurred by the purchaser
Amount of taxable income to the seller	Sale proceeds received less any unallowed IP deductions, capped at the deductions previously allowed (i.e. the existing claw-back provisions would apply)	Not applicable, as the seller is not subject to Hong Kong profits tax ⁶
Third-party independent valuation report	Not required	• May be required if the Commissioner of Inland Revenue (CIR) determines that the capital expenditure incurred in acquiring a particular eligible IP right exceeds a threshold to be specified. • The valuation report must be prepared by an independent valuer with relevant qualifications and experience. Detailed requirements would be set out in future Inland Revenue Department (IRD) guidance. • The report must contain the information specified by the CIR and be submitted in the form and manner and within the period specified by the CIR.

		The report would not need to be filed with the purchaser's tax return but must be provided upon request by the IRD. A deduction may be denied if the purchaser fails to submit the report as required.
Safeguard measures	- The CIR may determine the true market value⁷ of eligible IP rights where the consideration for their purchase or sale does not represent that value, and may allocate the consideration where the rights are purchased or sold together with other property as part of one bargain. - Multiple purchases and sales between the same parties may be treated as a single purchase for deduction purposes if they constitute a single transaction in substance. - A deduction would be denied if the main purpose, or one of the main purposes, of the acquisition is to obtain a tax benefit.	

Our observations	We welcome the proposed deduction for eligible IP rights acquired from associates. As intra-group acquisitions are common in IP ownership and restructuring arrangements, removing the existing blanket prohibition should address a significant barrier to using Hong Kong as a regional IP holding hub. Although the Bill does not extend the categories of eligible IP rights, the proposed deduction framework is a reasonable and practical enhancement to the existing rules. For acquisitions from non-Hong Kong business associates, further guidance on the independent valuation requirement would be welcome. The Government stated in the enhanced proposal that one valuation report may cover multiple eligible IP rights and other assets acquired in the same transaction, provided that it includes a separate valuation for each eligible IP right whose purchase cost exceeds the specified threshold. The Bill goes a step further by allowing the CIR to treat multiple purchases forming a single transaction in substance as one purchase for deduction purposes. It would be helpful if the Government can clarify whether this means that the valuation threshold would simply apply to the total capital expenditure on the deemed single purchase. While this offers practical convenience to taxpayers acquiring a significant number of different eligible IP rights in a single transaction, aggregation also makes it easier for the threshold to be exceeded.
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2. Allowing deductions for eligible IP rights used by licensees outside Hong Kong

The Bill proposes to allow tax deductions for capital expenditure incurred for the purchase of the eligible IP rights, to the extent those rights are used to generate specified foreign-sourced IP income chargeable to profits tax under the FSIE regime. Such expenditure would be carved out from the existing deduction restriction under section 16EC(4)(b) of the Inland Revenue Ordinance (IRO).

Our observations

We welcome the proposed carve-out, which addresses the existing tax asymmetry arising where offshore royalty income is taxable under the FSIE regime but the related cost of acquiring the eligible IP rights is not deductible. However, given the amendments would only apply to eligible IP rights purchased under contracts entered into on or after 1 April 2026, it appears that deduction for eligible IP rights purchased before that date would remain subject to the existing restriction under section 16EC(4)(b), irrespective of when the rights are licensed or the relevant royalty income is generated.

In addition to the guidance expected to be issued on how the deductible amount (i.e. the capital expenditure proportionate to the extent of the use of the licensed right in the production of taxable profits) would be determined, where the Government previously indicated that the nexus ratio might be relevant, clarification would also be welcome on the availability and timing of the deduction where (1) the relevant royalty income becomes taxable in Hong Kong only after the year of purchase of the eligible IP rights, potentially beyond the original five-year deduction period, and/or (2) the royalty income is received in Hong Kong and taxable only intermittently rather than in every year thereafter.

3. Allowing deductions for upfront licence fees for eligible IP rights

The Bill proposes allowing deductions for capital expenditure incurred on upfront licence fees⁸ for the use of eligible IP rights, under all forms of licences, provided the licensed rights are used in the production of assessable profits. The key deduction rules are summarised below.

- The deduction is generally allowed in equal instalments over the licensing term.
- Where the licensed IP rights are used only partly to produce assessable profits, the deduction is apportioned accordingly.
- The licence must not have been terminated or assigned by the end of the relevant basis period.
- The Bill also contains adjustment and clawback rules where the upfront licence fee or other licensing terms are subsequently amended, or where the licence is terminated or assigned.
- For licences acquired from associates, whether Hong Kong business associates or non-Hong Kong business associates, the CIR may require an independent valuation report prepared by a qualified valuer where the relevant capital expenditure exceeds a specified threshold. Save for the scope of application, the valuation requirements broadly mirror those for acquisitions of eligible IP rights discussed in Part 1 above.
- To prevent abuse, the CIR may (i) determine the true market value⁷ of a licence to use eligible IP rights where the consideration for its acquisition, termination or assignment does not represent that value, and (ii) allocate the consideration where a licence to use eligible IP rights is acquired, assigned or terminated together with other dealings.

Our observations

In both its original and enhanced proposals, the Government proposed to introduce a new deeming provision for licensing income, under which sums received by or accrued to a Hong Kong licensor in relation to the right to use IP would be deemed trading receipts chargeable to profits tax. We are pleased that the Government has taken on board our suggestion not to proceed with this proposal, in order to preserve the established principles for determining the taxability of income.

We also note that the proposed valuation requirement for deductions for upfront licence fees appears to differ from that applicable to acquisitions of eligible IP rights, with the latter applying only to acquisitions from non-Hong Kong business associates. The Government explained that the valuation requirement for upfront licence fee deductions is intended to guard against the payer inflating the fee. However, where both parties are Hong Kong business associates chargeable to tax at the same rate and the fee is taxable in the hands of the recipient, the domestic transaction exemption under the transfer pricing rules would appear to apply. Further guidance would therefore be helpful to clarify how the valuation requirement is intended to interact with that domestic transaction exemption.

Separately, we welcome the IRD's commitment to provide details in a future guidance on the availability of tax deductions for relevant upfront licence fees in franchise arrangements.

The Bill also includes consequential amendments concerning qualifying amalgamations, re-domiciled companies and the tax treatment of transfers of specified assets under Part 6D of the IRO.

Legislative timeline

The Bill will be introduced into the Legislative Council for first reading on 28 October 2026. Upon passage of the Bill, the proposed amendments would apply to eligible IP rights purchased, or licences to use eligible IP rights acquired, under contracts entered into on or after 1 April 2026.

The takeaway

The proposed enhancements to the IP deduction rules reflect the Government's broader policy direction of promoting innovation-led growth and strengthening Hong Kong's position as an international innovation and technology centre and a regional IP trading centre. This direction is consistent with Hong Kong's First Five-Year Plan. The measures also build on the Government's strategy to support the creation, commercialisation and trading of IP, including through the introduction of the patent box regime in 2024 and the planned review and enhancement of the tax deduction arrangements for R&D expenditure.

The Bill may provide businesses with greater flexibility in structuring IP acquisitions and ownership arrangements in Hong Kong. Businesses with significant R&D activities or valuable IP assets should monitor further developments as Hong Kong continues to refine its tax measures supporting innovation and high value-added activities.

Please contact us if you have any questions about the Bill or would like to discuss how the proposed changes may affect your IP acquisition, ownership or licensing arrangements.

Endnotes

1. Our news flash on the enhanced legislative proposal can be accessed via this link:
<https://www.pwchk.com/en/hk-tax-news/2026q2/hongkongtax-news-may2026-6.pdf>
2. The Bill can be accessed via this link:
<https://www.legco.gov.hk/yr2026/english/bills/b202610162.pdf>
3. The eight types of eligible IP rights are:
 - (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
4. The deduction allowable to the seller in relation to the purchase of eligible IP rights refers to the deduction amount that would be allowable to the seller notwithstanding the restriction under section 16EC(4) of the IRO.
5. Qualified R&D expenditure means any R&D expenditure incurred by the seller on R&D activities relating to the eligible IP rights for which a deduction is allowable to the seller under section 16B of the IRO.
6. Except in the case of a performer's right, where the deeming provision under section 15(1)(bb) applies.
7. Where, because of the special nature of the eligible IP rights or a licence to use such rights, the relevant open market consideration cannot be determined, the CIR may determine a reasonable value after considering a valuation by a qualified valuer and all relevant circumstances.
8. Under the Bill, an 'upfront licence fee' excludes any portion of a licence fee that is deductible under section 16(1) of the IRO.

Let's talk

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

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Hong Kong Tax News Flash

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