

Hong Kong Tax Alert

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Government refines proposed tax deductions for expenditures incurred on intellectual property rights

- *the major refinements include: (i) for domestic intra-group transfers, subject to the arm's length principle, instead of allowing tax deduction based on the purchase price of the intellectual property rights (IPRs) transferred, while taxing the transferor on the full sales proceeds, including any capital gains, the proposed tax deduction is now restricted to the lower of (a) the relevant costs incurred by the transferor; or (b) the acquisition costs incurred by the transferee. The relevant costs incurred by the transferor would be the sum of the costs of the acquisition of the IPRs together with any qualified research and development expenditure incurred by the transferor on the IPRs; (ii) upfront licensing fees incurred for the right to use a franchise would be deductible to the extent that such fees are related to the eight types of IPRs covered by the proposed legislation¹; and (iii) for offshore royalty income derived from IPRs used by a licensee outside Hong Kong that is chargeable to tax in Hong Kong under the foreign-sourced income exemption (FSIE) regime, capital expenditure incurred on the acquisition of the IPRs would be tax deductible on a proportionate basis, i.e., such expenditure would be carved out from the scope of section 16EC(4)(b) of the Inland Revenue Ordinance (IRO)².*

The Government launched a two-month stakeholder consultation in the first quarter of 2026 on the proposals to allow tax deductions for (i) costs incurred on the purchase of eight types of IPRs from associates; and (ii) payments of upfront licensing fees, regardless of whether they are capital or revenue in nature, for the right to use any one of the eight types of IPRs.

Taking into account the feedback from stakeholders, the above refinements to the original proposals are outlined in a paper³ (the Paper) submitted to the Panel on Commerce, Industry, Innovation and Technology of the Legislative Council for discussion on 19 May 2026.

¹ The eight types of IPRs covered by the proposed legislation are (i) patent rights and (ii) rights to know-how as defined under section 16E of the IRO, (iii) copyright, (iv) registered designs, (v) registered trade marks, (vi) protected layout-design (topography) rights, (vii) protected plant variety rights and (viii) performer's economic rights as defined in section 16EA of the IRO.

² Section 16EC(4)(b) disallows capital expenditure on the purchase costs of an IPR allowable under sections 16E or 16EA if the IPR is used wholly or principally outside Hong Kong by a person other than the taxpayer under a license.

³ The Paper can be accessed via the link below:
<https://www.legco.gov.hk/yr2026/english/panels/ci/papers/ci20260519cb2-628-2-e.pdf>

Commentary

We welcome the Government taking into account some of the suggestions made by stakeholders, particularly EY's suggestion that upfront licensing fees attributable to the use of the eight types of IPRs should be tax deductible.

In respect of refinement item (iii) above, it appears that the "proportionate basis" may be determined based on how much the acquisition costs of an IPR are related to the relevant overseas jurisdictions versus Hong Kong. Even so, it remains unclear whether such proportionate costs allowable for tax deduction under the FSIE regime can only offset against taxable offshore royalties derived from a particular IPR after applying the nexus ratio. The complication is that while FSIE income in the form of offshore royalties derived from an IPR could be received and therefore taxable in Hong Kong in Year 1, such income in subsequent years could be arranged not to be received and therefore not taxable in Hong Kong, e.g. through dividend distributions to shareholders. In such a case, if the tax deduction for the relevant proportionate costs could be used to offset against the taxpayer's other taxable FSIE income, that would not appear to align with the tax symmetry principle.

The Paper reiterates that, based on the tax symmetry principle, section 16EC(4)(b) in its current form will remain unchanged, except for the carve-out described in item (iii) above. As such, the IRD should clarify in its guidance note that, as a matter of law or assessing practice, royalties derived from granting the right to use a purchased IPR outside Hong Kong would be treated as non-taxable offshore income under section 14 of the IRO.

An amendment bill to implement the refinements is scheduled to be introduced in 2026, such that the relevant amendments will apply to expenditures incurred on or after 1 April 2026. Clients should contact their tax executive if they have any questions or would like to discuss these developments further.



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