



By email (iptax_consultation@cedb.gov.hk)

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Commerce and Economic Development Bureau
22/F, West Wing, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Attn: Mr Alex Leung

Dear Sirs,

Consultation on proposals on intellectual property tax deduction

The Hong Kong Institute of Certified Public Accountants (“the Institute”) appreciates the opportunity to provide feedback on the proposals to expand the scope of profits tax deduction for capital expenditure incurred for the purchase of intellectual property (“IP”) or the rights to use IP. The Institute’s Taxation Faculty Executive Committee has reviewed the proposals in the consultation paper (“CP”). We are pleased to note in the 2025-26 Budget Speech that the government has considered proposals that we have been advocating to review the deduction rules for IP-related expenditures, including lump-sum licence fees and expenses incurred on the purchase of IP rights or the rights to use IP from associates. In principle, we support the proposed measures in the CP, while offering some specific comments and suggestions, which, if implemented, would, in our view, further strengthen Hong Kong’s appeal as an international IP trading centre. Our general and more specific comments are set out below for your consideration.

1. General comments on the proposals

We appreciate the government’s ongoing and concerted efforts to bolster the development of innovation and technology in Hong Kong. In addition to enhancing the tax deductions for research and development (“R&D”) expenditures, in 2018, and introducing a patent box regime, which provides a 5% concessionary tax rate on certain types of IP income, in 2024, we are pleased to see the proposals in the CP to permit deductions for covered IP acquired from associates, and to allow deductions for upfront licence fees for the right to use covered IP.

At the same time, we believe that the government should take a step back and assess whether, taken as whole, Hong Kong’s IP tax regime is sufficiently attractive and competitive. While it is important to take note of developments in the taxation of IP and R&D in other jurisdictions, the ultimate objective should not be to compete by aiming to match any of these exactly, as this could just result in continuous efforts between markets to undercut each other. Instead, building on our existing regime, the government should consider what would work best for Hong Kong and how to balance flexibility with sufficient and, hopefully, fairly light-touch, safeguards to prevent revenue leakage through misuse of incentives and concessions.

There is certainly scope for introducing additional tax benefits, including super deductions on other types of IP-related expenditure, to ensure Hong Kong is seen as an attractive location for IP investment, R&D, and regional licensing activities. One example of this, Singapore's Enterprise Innovation Scheme¹ ("EIS"), offers enhanced tax deductions (up to 400% on the first SGD 400,000 of eligible costs) for qualifying R&D, IP acquisition and licensing, among other activities, with an option for a cash payout. The government could consider the pros and cons of offering similar fixed-term incentives and whether this would provide a strong impetus for business innovation and for locating IP management and licensing activities in Hong Kong.

In practice, many Hong Kong taxpayers outsource part of their R&D activities to associated entities, particularly in the Chinese Mainland. However, payments to these associates are generally non-deductible in Hong Kong. We are pleased that the Financial Secretary indicated in the 2026-27 Budget that the tax arrangements for R&D expenditures will be reviewed and enhanced. It is hoped that this issue will be addressed, so that the tax rules are better aligned with commercial realities. In addition to considering, for example, the extension of tax deductions to expenditure on some outsourced R&D activities undertaken outside Hong Kong, particularly in the Greater Bay Area, deductions should also be extended to qualifying group R&D centres registered in Hong Kong. The provision of R&D tax credits for start-up businesses, or Base Erosion and Profit Shifting initiative-compliant "Qualified Refundable Tax Credits", should also be considered, where appropriate.

In the Institute's 2026-27 budget proposals² submission, we also reiterated a recommendation to consider introducing non-tax incentives, such as financial subsidies, to encourage more local R&D activities, and provide subsidies to cover, at least in part, the costs incurred by companies to invite international experts to provide professional training to their Hong Kong R&D staff.

As the CP indicates, the government targets introducing the amendment bill into the Legislative Council within 2026. In this regard, we would suggest (i) allowing the tax deduction of the acquisition cost of certain IP acquired from associates (Proposal 1) to be applied to IP rights acquired on or after 1 January 2026; and (ii) allowing a tax deduction for upfront fees for the right to use IP in a licensing arrangement (Proposal 2) to be applied to licensing agreements entered into on or after 1 January 2026.

2. Comments on the specific proposals in the CP

Proposal 1: Allowing tax deduction of the acquisition cost of certain IP from associates (paragraphs 9 to 14 of the CP)

Scope

The proposed tax deduction would apply to the acquisition costs of patent rights, rights to know-how, and the six types of specified IP rights ("SIPRs")³ purchased

¹ [https://www.iras.gov.sg/schemes/disbursement-schemes/enterprise-innovation-scheme-\(eis\)](https://www.iras.gov.sg/schemes/disbursement-schemes/enterprise-innovation-scheme-(eis))

² https://www.hkicpa.org.hk/-/media/Document/APD/Gov-Budget/Budget-proposals-2026-27_submn.pdf

³ The six types of SIPRs include copyright, registered designs, registered trade marks, protected layout-design (topography) rights, protected plant variety rights and performer's economic rights.

from associates, subject to various anti-abuse measures. We suggest expanding the scope further to cover all kinds of IP, rather than limiting it to the eight specified types, to help ensure that the legislation does not become outdated as technology evolves over time. In this connection, we recommend providing a general tax deduction for the accounting amortization of qualifying IP acquisition costs.

Main purpose test

Similar to other preferential tax regimes, a “main purpose” test is proposed for the deduction of capital expenditure on IP acquired from associates. The government explains that this test is necessary to prevent offshore losses from being shifted to Hong Kong for deduction against assessable profits of Hong Kong companies, and has further clarified that its intention is to target abusive arrangements lacking commercial substance, rather than to discourage genuine business activities from benefiting from the deductions. However, even though incidental tax benefits will not be treated as a main purpose, the application of the test remains inherently subjective and may give rise to uncertainty for taxpayers. It is must also be the case that, if the proposed changes are effective, then more businesses will locate their IP-related activities in Hong Kong, in part, because they see it as tax efficient to do so.

In fact, tax deductions would already subject to transfer pricing rules and claw-back provisions, as well as the requirement to obtain an independent valuation (for acquisitions of IP costing HK\$3 million or more). These safeguards, together with the existing general anti-avoidance rules (“GAAR”) under sections 61 and 61A of the Inland Revenue Ordinance (Cap. 112) (“IRO”), should be sufficient to address the abusive arrangements that are of concern to the government, without introducing unnecessary uncertainty for taxpayers. The government may also wish to note that Singapore’s IP tax deduction regime does not include a “main purpose” test. In our view, introducing such a test in this context would impose additional compliance and interpretative burdens that are unnecessary and disproportionate to achieving the policy objective.

Domestic intra-group transfer of IP

The CP proposes that, to prevent group companies from obtaining an excessive tax deduction by arranging domestic IP transfer at inflated prices, the full amount of the sales proceeds received by the IP transferor, less the amount of deduction in respect of the IP not yet allowed, will be treated as a trading receipt chargeable to profits tax in the hands of the transferor.

The proposed deeming provision, which would treat IP sale proceeds, which are capital in nature, as taxable trading receipts, would dilute the fundamental principle of the non-taxation of capital gains and competitive advantage of the Hong Kong tax system. It would also put domestic intra-group transfers of IP at a disadvantage, from a profits tax perspective, when compared with transfers between domestic unrelated parties, where no deeming provision would apply and only a possible claw back would applicable. Given all the other safeguards, including the GAAR, the proposed main purpose test, if that proceeds, the application of transfer pricing rules, and the requirement for an independent valuation report in many cases, the proposed broad-brush deeming approach would be overly restrictive.

We propose that both the taxable proceeds of the transferor (before taking into account any unallowed IP deduction) and the deductible acquisition cost of the transferee should be limited to the original cost of the IP. If this approach were to be adopted, we would further recommend allowing taxpayers to transfer the IP at original cost in a domestic intra-group IP transfer, irrespective of whether a higher value is justified under transfer pricing rules.

It is important to uphold the principle of not taxing capital gains while allowing deductions that reflect economic realities. The approach proposed above would reduce compliance and administrative burden on taxpayers and the Inland Revenue Department (“IRD”), while still guarding against artificial value inflation between intra-group companies.

Section 16EC(4)(b) of the IRO

To promote Hong Kong as an international or regional licensing hub, which would commonly involve Hong Kong licensors granting licences to overseas licensees for use of IP outside Hong Kong, we recommend relaxing section 16EC(4)(b) of the IRO, which currently disallows a deduction of the acquisition costs incurred by a Hong Kong taxpayer for IP used by a licensee, other than the taxpayer, outside Hong Kong. If the acquisition costs attributed to IP registered and used outside Hong Kong are not deductible, Hong Kong will remain a less attractive location for licensing and IP-holding activities.

Furthermore, under the Foreign Source Income Exemption (“FSIE”) regime, offshore royalties (e.g., income derived from acquiring a trademark overseas and licensing it for use overseas) may be taxable in Hong Kong when they are received in Hong Kong by an in-scope company. If the acquisition cost of such IP cannot be deducted, taxpayers would effectively be taxed on gross receipts rather than net income, resulting in a higher effective tax rate and adversely affecting the competitiveness of Hong Kong’s tax regime. Therefore, we would recommend that the government relax section 16EC(4)(b) to ensure that Hong Kong’s IP tax framework remains fair, competitive and accommodative of commercial realities, particularly given the increasing cross-border nature of IP exploitation by Hong Kong businesses.

Third-party independent valuation report

Under the proposals, a third-party independent valuation report will be required if the acquisition cost of the IP acquired from an associate is at least HK\$3 million. The report must be prepared by a valuer with the relevant qualifications and independent of any party to the transaction.

By comparison, Singapore requires an independent valuation report for related-party IP transactions only where the IP cost is at least SGD 10 million⁴ (i.e. approximately HK\$60 million). The threshold proposed in the CP is relatively low and warrants reconsideration and adjustment, as it may impose burdensome compliance on relatively small-scale transactions. If the government’s intention is

⁴ https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguides_ips-valuation-report-for-purposes-of-section-19b-of-the-ita.pdf?sfvrsn=6ee40dce_14

to set the threshold based on the fair market value of the IP, we suggest that the legislation state this intention explicitly. We also hope that further guidance will be provided on the acceptable preliminary valuation methodologies. In our view, the threshold needs to be raised significantly, so as to ensure Hong Kong can remain competitive internationally.

With respect to valuer qualifications, the CP indicates in a footnote that an appropriate valuer should possess relevant qualifications and that further details would be set out in a guidance note. Singapore provides illustrative examples of acceptable credentials, such as chartered financial analyst and chartered accountant. We suggest adopting a similar approach in Hong Kong by setting out acceptable professional qualifications/ experience requirements.

Proposal 2: Allowing tax deduction for upfront licence fees for the right to use IP in a licensing arrangement (paragraphs 15 to 21 of the CP)

Scope

The CP proposes that the deductions be limited to the eight types of IP currently covered under the existing IP-deduction regime, including patent rights, rights to know-how, and the six SIPRs mentioned in Proposal 1 above. Fees relating to non-covered IP would continue to be subject to the usual capital-versus-revenue analysis. We suggest expanding the scope of the deductions to cover the licensing of all IP, to ensure the regime remains technology-neutral and future-proof. If a full expansion is not feasible at this stage, we recommend that the government broaden the scope of IP-related rights beyond the eight listed categories, to include other commercially-significant rights such as franchise rights and industry-specific entry rights. Such “black-hole” expenditure may be essential to the conduct of business in certain industries, but, currently, is not tax-deductible. Such an approach would better reflect commercial practice and reduce the incentive for tax-driven distortion of IP structuring.

Deeming provision

The CP proposes adding a deeming provision to treat any sums, not otherwise chargeable to profits tax under the IRO, received by or accrued to a Hong Kong licensor, in relation to the right to use IP, as trading receipts chargeable to profits tax. This deeming provision may extend the IRD’s taxing rights to certain capital receipts and offshore-sourced income that would otherwise fall outside the Hong Kong profits tax net. It may also be practically difficult for a Hong Kong licensor to ascertain whether a licensee (particularly an unrelated party) has claimed a deduction for upfront licence fees. Since overly stringent anti-abuse measures may reduce the effectiveness of the preferential tax regime and could defeat the intended object of the policy, we suggest removing the deeming provision.

Should the government decide to retain the deeming provision, the timing of taxation should align with the timing of any corresponding tax deductions, i.e. revenue should be taxed over the licensing term rather than as a single lump sum. This approach is consistent with the accounting treatment, under which upfront licensing income is recognised in the profit and loss account over the licence term when certain conditions are met.



As further anti-avoidance measures, on the basis that the proposed deduction for capital expenditure is prone to abuse, the CP proposes that:

- (a) the Commissioner of Inland Revenue (“CIR”) will be empowered to determine, where the circumstances so warrant, the arm’s length price of which a tax deduction is claimed, and a provision will be added to empower CIR to request the submission of a valuation report from the licensee to substantiate its claim; and*
- (b) the CIR will be empowered to allocate the consideration when the licence to use IP is acquired, assigned or terminated with any other dealings.*

We would suggest that further details are required as to how these proposed provisions will operate, including the criteria/ thresholds for invoking them. As set out in the CP, they appear to introduce another element of discretion and subjectivity. This would create uncertainty and would be likely to detract from the effectiveness of the proposed incentives.

Against the above background, we look forward to the release of further details and the government engaging with stakeholders to ensure the proposed measures are practical and aligned with industry needs.

Should you have any questions on this submission, please do not hesitate to contact me at peter@hkipa.org.hk or on 2287 7084.

Yours faithfully,

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