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Mr Alex Leung
Assistant Secretary for Commerce and Economic Development
Commerce and Economic Development Bureau
22-23/F, West Wing, Central Government Offices
2 Tim Mei Avenue
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By Email:
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Dear Mr Leung,

CPA Australia's submission to the proposals on intellectual property tax deduction

CPA Australia represents the diverse interests of more than 176,000 members in over 100 countries and regions worldwide, including more than 16,000 members in Hong Kong. We make this submission in response to the CEDB's consultation paper on Proposals regarding Intellectual Property Tax Deduction on behalf of our members and in the broader public interest.

We welcome the opportunity to provide comments on the consultation paper. CPA Australia supports policy settings that enhance Hong Kong's competitiveness as a regional intellectual property (IP) trading and innovation centre, while maintaining integrity and minimising unnecessary compliance costs. The consultation paper's proposals to (i) broaden deductions for IP acquisitions from associates, and (ii) allow deductions for upfront licence fees are positive in intent. These measures have the potential to support commercialisation activity and related professional services.

We set out below the following comments and key points for your consideration:

- Modernise or remove section 16EC(4)(b) to allow deductions for IP acquisition costs where the related income is chargeable to Hong Kong profits tax, regardless of where the IP is used by the licensee.
- Clarify the interaction between section 16EC(4)(b) and the 2023 Foreign-Sourced Income Exemption (FSIE) rules to avoid asymmetric outcomes, such as taxing foreign-sourced IP income while denying deductions for IP acquisition costs.
- Address potential conflicts with Base Erosion and Profit Shifting (BEPS) Pillar 2 (Global Minimum Tax) and the Hong Kong Minimum Top-up Tax (HKMTT), noting that denial of deductions can inflate effective tax rates and create tax-to-book mismatches that affect competitiveness.

- Increase the threshold for mandatory third-party independent valuation reports above HK$3 million (e.g., to HK$10 million) to reduce compliance costs, particularly for SMEs and frequent IP transfers.
- Reconsider the transfer pricing approach for domestic associate IP transfers, including whether it is necessary to carve these transfers out of the domestic transaction exemption given existing safeguards.
- Narrow the deeming rules for upfront licence fees to avoid over-taxing foreign-sourced income, recharacterising capital receipts as revenue, and creating unintended tax liabilities.
- Align the timing of taxation of upfront licence fees with the timing of the licensee's deductions (and, where feasible, the accounting treatment) to avoid timing mismatches and cash-flow distortions.
- Provide clear guidance on withholding tax timing and transitional scenarios for pre-existing licence arrangements that continue into the effective period.
- Expand the scope of eligible IP types beyond the current closed list (e.g., to cover unregistered/pending rights and portfolio acquisitions) or introduce an update mechanism.
- Apply the changes from year of assessment (YOA) 2026/27 and introduce transitional relief for recent related-party IP acquisitions and pre-existing upfront licensing arrangements to improve certainty and fairness.

Please refer to the Appendix for our responses to the two proposals outlined in the consultation paper.

If you have any questions about this submission, please contact Samantha Yim, Business Investment and International Advisor on: samantha.yim@cpaaustralia.com.au or Bill Leung, Tax Technical Advisor on: bill.leung@cpaaustralia.com.au.

Kind regards

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Appendix

Detailed Discussion

Proposal 1 — Allowing tax deduction of the acquisition cost of certain IP from associates

Paragraph 12

If section 16EC(4)(b) of the *Inland Revenue Ordinance* (IRO) remains unchanged, it is expected to create material non-neutrality for Hong Kong businesses that acquire or bring IP into Hong Kong to conduct regional or global licensing, where licensees exploit the IP outside Hong Kong. This can produce potential tax leakage or mismatches and may discourage multinationals and groups from centralising IP management or licensing operations in Hong Kong, an outcome that would be inconsistent with the policy objective of promoting IP trading activity or maintaining tax symmetry.

Furthermore, the interaction between section 16EC(4)(b) and the 2023 Foreign-Sourced Income Exemption (FSIE) rules creates a "tax trap" for Hong Kong companies. This interaction may simultaneously deny deductions for costs while taxing the resulting income if the Inland Revenue Department (IRD) maintains that eligibility for tax deduction requires Hong Kong taxpayers to “use the IP right by themselves, subject to the satisfaction of other relevant conditions”. This may create uncertainty.

For example:

1. Asymmetric tax treatment
   - Section 16EC(4)(b) denies a tax deduction for the purchase cost of Intellectual Property Rights (IPRs) if they are "wholly or principally used outside Hong Kong" by a person other than the taxpayer under a license.
   - Previously, companies could tolerate this because the resulting offshore royalty income was generally non-taxable under Hong Kong’s territorial principle.
   - Under the 2023 FSIE rules, foreign-sourced IP income is now deemed taxable if received in Hong Kong by a multinational enterprise (MNE) entity, unless strict "nexus requirements" are met.
   - The Result: A company may be taxed on 100 per cent of its offshore IP income but be allowed 0 per cent deduction for the cost of acquiring that same IP.

2. Failure of the "tax symmetry" principle
   - The government's original rationale for section 16EC(4)(b) was tax symmetry: if the income is offshore and non-taxable, the related expenses should not be deductible in Hong Kong.
   - With the FSIE regime now taxing that offshore income, the symmetry is broken. Taxpayers face double non-deductibility (taxed on gross income without relief for capital costs).
   - Such tax asymmetry will also happen in the scenarios in point 3 below, e.g. goods trading profits being taxable but IP cost is not deductible.

3. Barriers to common IP business models
   - Contract manufacturing: Hong Kong companies often purchase IP and license it to manufacturers in the Chinese Mainland to produce goods. Prima facie, section 16EC(4)(b) denies deductions for these IP costs even if the final trading profits are fully taxed in Hong Kong.
   - Strict nexus requirements: To avoid tax under FSIE, companies must meet the nexus requirement, which only exempts IP income in proportion to qualifying R&D expenditure.

Purchased IP often fails this test, making the income taxable while the acquisition cost remains non-deductible under section 16EC(4)(b).

4. Limited relief options
    - While a unilateral tax credit exists to prevent double taxation on foreign taxes paid, it does not resolve the domestic issue of denied cost deductions under section 16EC(4)(b).

We also highlight that the interaction between section 16EC(4)(b) and BEPS Pillar 2 (Global Minimum Tax) creates a significant conflict because Hong Kong's domestic tax rules and the OECD's Global Anti-Base Erosion (GloBE) rules use different "bases" to calculate profit. For example:

1. Distorted effective tax rate (ETR)
    - The issue: Under section 16EC(4)(b), the cost of purchasing IP is not deductible for Hong Kong tax purposes if the IP is used offshore.
    - Pillar 2 conflict: Pillar 2 calculates the ETR based on accounting Income, which generally reflects the depreciation/amortisation of IP.
    - The result: Because Hong Kong denies the deduction, the "covered taxes" (actual tax paid in Hong Kong) will be higher than they would be if the deduction were allowed., structurally pushing up the Hong Kong GloBE ETR..
    - While this may help Hong Kong entities appear safely above the 15% minimum, it does so by increasing the "real" tax cost for taxpayers relative to its competitors in jurisdictions that allow economically justified IP deductions.

2. Mismatch in "GloBE income" versus Hong Kong taxable profits
    - GloBE Income (the denominator in the ETR fraction) is starting from accounting profit with limited adjustments.
    - The denial of a deduction under section 16EC(4)(b) is a permanent difference that is not adjusted for under the GloBE rules.
    - This creates a tax-to-book mismatch: the group pays tax on a much larger "taxable income" (due to denied deductions) than the "GloBE income" it reports for Pillar 2, undermining the neutrality and transparency in the application of the global minimum tax.

3. Impact on the Hong Kong Minimum Top-up Tax (HKMTT)
    - The HKMTT is designed to safeguard Hong Kong tax revenue against other tax jurisdictions the in-scope MNE groups operate in.
    - The incongruity: If a company's ETR is already high because of section 16EC(4)(b) deduction denial, it may not trigger the HKMTT. However, the company is still economically disadvantaged because it is being denied a legitimate business expense (IP cost) that is otherwise recognised under accounting standards.

4. Interaction with the Patent Box tax incentive
    - Where a company benefits from the Hong Kong Patent Box (5 per cent rate), its ETR on qualifying income will generally fall below the 15 per cent global minimum
    - A Top-up Tax will then be imposed to bring the ETR on that income up to 15 per cent.
    - In this context, the denial of a deduction under section 16EC(4)(b) is even more punitive: the company pays a higher "base" tax at 16.5 per cent on the denied portion, while the

"qualifying" portion is taxed at 5 per cent and then topped up to 15 per cent through Top-Up Tax.
- These rules significantly erode the competitiveness of Hong Kong's IP regime relative to jurisdictions that allow full IP cost deductions and implement a more neutral minimum tax framework.

Based on the above, we submit that the overly stringent anti-abuse measures will undermine the policy's goal of attracting multinational enterprises to establish R&D centres in Hong Kong.

Recommendation 1 — Modernise or remove section 16EC(4)(b)
We submit that the most effective way to resolve the above concerns is through targeted amendments to the IRO to align it with modern global standards. Since the 2023 FSIE rules now tax foreign-sourced IP income, the original "offshore" rationale for denying deductions is obsolete.

We recommend removing section 16EC(4)(b), or at minimum, modernising it so that a deduction is available where the acquired IP generates income chargeable to tax in Hong Kong, regardless of where the licensee uses the IP. To address potential IRD concerns with tax symmetry treatment, we submit the IRD may consider that tax deduction could be set to adjust proportionally (e.g., if only 60 per cent of the income is taxed in Hong Kong due to the nexus ratio, only 60% of the expense would be deductible) to maintain strict symmetry. This is in line with Section 16(1) of the IRO principle of allowing tax deduction on expenditure attributable to generation of assessable profits. This would better support Hong Kong's role as a regional IP trading hub without compromising integrity, which can be safeguarded via:
- the general deduction rule that expenditure must be incurred in producing assessable profits; and
- the proposed anti-avoidance test (main purpose of obtaining a tax benefit) and other general anti-avoidance provisions.

Recommendation 2 — Increase the valuation threshold
We recommend raising the threshold for mandatory valuation reports to a higher level, say HK$10 million.

Paragraph 14

At HK$3 million, the threshold is comparatively low for IP transactions, particularly for groups with frequent transfers of technology, trademarks, and bundled intangible packages. Furthermore, the HK$3 million threshold for requiring a third-party independent valuation report is also low, given that IP assets frequently have much higher values. This could create excessive compliance burdens and costs for small and medium-sized enterprises (SMEs) conducting legitimate transactions. We submit this would further reduce Hong Kong's competitiveness as an IP trading and management location, especially for SMEs and fast-growing technology businesses.

Recommendation 3 — Reconsider the need to carve out domestic transfers from the domestic transaction exemption

Given the domestic transaction exemption (in general terms) is designed to apply where there is no Hong Kong tax advantage sought, we recommend reconsidering whether carving out domestic associate IP transfers is necessary. We note that the proposed trading receipt rule and existing TP framework already provide sufficient protection without adding complexity. Furthermore, as deductions are already subject to TP rules and claw-back provisions, along with the requirement to obtain independent valuation if the IP exceeds a certain threshold. Together with the general anti-avoidance rules in sections 61 and 61A of the IRO, these safeguards should be sufficient to

address abusive arrangements without introducing additional uncertainty through paragraphs 11(b)(i) and (ii).

Paragraph 11(b)(i) and 11(b)(ii)

We understand that domestic intra-group IP transfers, i.e. where both the buyer and seller are Hong Kong taxpayers, will no longer be exempt from transfer pricing (TP) rules under paragraph 11(b)(i). Groups must now maintain full TP documentation and prove that the IP was transferred at an arm's length price, even if the transaction does not result in an overall tax difference for the group. This means businesses that previously relied on domestic exemptions must now invest significantly in TP documentation and professional valuation services for internal restructurings. Determining the "arm's length" value of unique or early-stage IP is notoriously difficult and subjective, leading to potential disputes with the IRD. The administrative costs associated with valuing IP and documenting TP for every intercompany transaction are too onerous. We recommend that the rule only apply to bundled IP rights (rather than individual assets) to make it more reasonable and in line with market practice.

We note that under paragraph 11(b)(ii), the rule that the full amount of sales proceeds is taxed, without being capped at the IP tax deduction previously allowed, could lead to unexpected tax liabilities if the IP value has increased significantly within the group. We further note this trading receipt mechanism in paragraph 11(b)(ii) already operates as a strong safeguard against group-level tax advantages from inflated prices, because it effectively brings proceeds into charge. For domestic intra-group transfers, the proposal mandates that the full amount of sales proceeds received by the transferor (less not yet allowed IP acquisition costs) will be treated as taxable trading receipts. This means if the IP has appreciated in value, the group is taxed on a "capital gain", which is typically not taxable in Hong Kong. We understand treating capital appreciation as taxable revenue in intra-group transfers acts as a deterrent, but it punishes restructuring legitimate IP value created within the group.

The strict anti-avoidance and new TP requirements make the tax deduction less attractive for genuine business restructuring, undermining the goal of making Hong Kong an IP trading hub.

Proposal 2 — Allowing tax deduction for upfront licence fees for the right to use IP in a licensing arrangement

Paragraph 20

We raise the following concerns with the proposed deeming provision:

1. **Over-taxation of foreign-sourced income:** The provision could potentially deem income as taxable in Hong Kong and also subject to HKMTT under BEPS Pillar 2 even if it is foreign-sourced.

2. **Taxing capital receipts:** By deeming income as "trading receipts," it may convert what is fundamentally a capital receipt into taxable income for the recipient, contrary to Hong Kong's tax principles.

3. **Unintended tax liabilities:** There is a risk that the sweeping nature of the provision could catch transactions that are not truly abusive, creating unintended tax liabilities for licensors.

4. **Complexity in multi-jurisdictional licensing:** If the IP licence involves complex sub-licensing or international arrangements, identifying the true "Hong Kong licensor" and the appropriate apportioned income can be challenging, increasing compliance costs.

5. If the upfront licence fee is taxed when received/accrued to the licensor, but the licensee's deduction is spread evenly over the licensing term (as proposed in paragraph 18), this can create a timing mismatch between taxation and deduction.

This mismatch may:

- produce cash-flow distortions and non-neutral outcomes;
- create misalignment with accounting treatment (particularly where amortisation is used over the licensing term); and
- increase compliance burdens, especially where contract modifications, claw-backs, termination, or assignment occur.

Recommendation 4 — Limitation to revenue in nature
We recommend the need to amend the rule to only deem income as taxable if it is truly revenue in nature, rather than treating all upfront payments for the use of IP as taxable

Recommendation 5 — Exemption for non-residents
We recommend providing a safe harbour or exemption for non-resident licensors who do not have a permanent establishment in Hong Kong to avoid taxing foreign-source income.

Recommendation 6 — Clarify "use" versus "acquisition"
We recommend the IRD provide guidance to clearly define the threshold between a license for use (royalty) and a transfer of rights (capital), ensuring true capital sales are not caught.

Recommendation 7 — Align timing of taxation and deduction (and/or accounting treatment)
We recommend aligning the timing of: the licensor's taxable amount under the deeming rule; and the licensee's deductible amount (spread over the licensing term), and/or aligning both sides to the accounting treatment to the extent feasible.

This could be achieved by taxing the licensor on a matching, straight-line basis over the licence term (with appropriate rules for termination/assignment and claw-back), which would better preserve neutrality and reduce disputes.

Recommendation 8 — Provide clarity on withholding tax timing and transitional scenarios
Where a Hong Kong licensee pays an upfront licence fee to a non-Hong Kong licensor, there may be withholding tax (WHT) implications depending on the structure and source rules, therefore stakeholders will need clarity on timing and alignment.

We recommend the IRD provide clear guidance on: whether WHT (if applicable) would be triggered when the Hong Kong licensee claims deductions, or when the non-Hong Kong licensor receives/accrues the upfront fee; and how WHT timing would be treated where pre-existing licences entered before year of assessment (YOA) 2026/27 continue into the effective period (e.g., remaining term deductions). This is discussed further at Recommendation 10. This clarity will be essential to avoid double mismatches, inconsistent timing positions, and increased disputes.

Scope of eligible IP

Paragraph 6 & 17

The proposal focuses on registered trademarks and designs, potentially excluding unregistered or pending IP assets commonly used in commerce. We acknowledge the desire for integrity and definitional clarity; however, the market for intangible assets is evolving rapidly. Increasingly,

commercially valuable rights may not fit neatly within the current list, and maintaining a closed list may reduce the relevance and effectiveness of the incentive.

Recommendation 9 — Expand eligible IP types or introduce an update mechanism
We recommend taking this opportunity to revisit and potentially expand the eligible IP categories to better reflect modern commercial practice. For example, expanding the definition to include unregistered trademarks or pending applications to reflect modern, fast-moving, and digital-first IP portfolios. Another example is Marketing Authorisation Holder (MAH)-related rights in the pharmaceutical sector, which can be central to commercialisation arrangements. Furthermore, the rules may not properly address portfolios of IP acquired together. We recommend that the rules should consider and apply to the transaction as a whole, and not just individual, itemised rights to reflect market practice.

Legislative timetable

Paragraph 22

The rapid transition from consultation to legislation often leaves taxpayers with very little time to compile necessary IP and acquisition records and/or TP documentation before the first filing deadlines.

Recommendation 10 — Retrospective effective date from YOA 2026/27 and transitional relief
We recommend:

Retrospective effect from YOA 2026/27 for:
- relevant IP acquisitions from associates; and
- upfront licence fees and related deduction spreading rules.

Transitional measures to address arrangements entered into in recent years. For example:
- For IPs acquired from associates during YOA 2023/24 to 2025/26, allow a partial deduction (e.g., 50 per cent, subject to the type of IP and anti-avoidance safeguards) to be claimed starting in YOA 2026/27.
- For upfront licence fees under contracts entered into before YOA 2026/27, allow deductions for the remaining licence term from YOA 2026/27 onwards (i.e., no “catch-up” for prior years, but prospective relief for the remaining term).
- Clarification on taxability and timing with regards to pre-existing licenses entered before YOA 2026/27 would be crucial for both HK and non-HK licensors (not just on WHT scenario), specifically we need clarifications on:
    1. HK licensee’s allowable tax deduction amounts (e.g. the remaining licensing terms) and timing
    2. HK licensor’s deemed taxable amount and timing, does it match with 1 above.
    3. Non-HK licensor’s WHT taxable amount and timing, again - does it match with 1 above.