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TRANSFER PRICING LEGISLATION UPDATES

The Hong Kong Government has published the first batch of amendments on 24 April 2018 to the Inland Revenue (Amendment) No. 6 Bill 2017. The proposed amendments relating to transfer pricing rules include relaxation of transfer pricing documentation thresholds and timeline, and clarification of the arm's length provision. Amendments relating to the exemption for certain domestic transactions from the transfer pricing rules and from the requirement in relation to master file and local file are covered in the consolidated version of the proposed amendments on 10 May 2018.

On the international side, the OECD released 14 additional country profiles on 9 April 2018, containing key aspects of transfer pricing legislation and practices of each country. The country profiles are now available for 44 countries.

In addition to the regulatory impact, businesses should also be aware of the potential tax and customs duty implications that may be resulted from transfer pricing adjustments.

In this Tax Flash, we will provide you the salient points of the above.

1. HONG KONG – PROPOSED AMENDMENTS TO THE BILL¹

On 29 December 2017, the Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill") was published in the Gazette by the Hong Kong Government proposing the codification of certain transfer pricing principles into the IRO and implementing the transfer pricing documentation including CbC Reporting. Please refer to our March 2018 Tax Flash for details.

Further to recent meetings of the Bills Committee in the Legislative Council, the Hong Kong Government has published the first batch of amendments to the Bill on 24 April 2018 and a consolidated version of the proposed amendments on 10 May 2018. Discussion on the proposed amendments by the Bills Committee is ongoing. Key amendments relating transfer pricing proposed are summarized below:

¹ <https://www.legco.gov.hk/yr17-18/english/bc/bc02/papers/bc0220180425cb1-847-2-e.pdf>
<https://www.legco.gov.hk/yr17-18/english/bc/bc02/papers/bc0220180514cb1-941-1-e.pdf>

a) Transfer pricing documentation thresholds and timeline

The Government proposes to relax business size thresholds as follows:

	Original (HKD) per financial year	Proposed (HKD) per financial year
Total Annual Revenue	≥ 200 million	≥ 400 million
Total Assets	≥ 200 million	≥ 300 million
Employees	≥ 100	No change

There is no change to the proposed thresholds with respect to the exemptions for related party transactions.

Based on the amendments, a taxpayer (who exceeds the above thresholds) must prepare the relevant Master File and Local File(s) within **9 months** after its year-end, as compared to the previously proposed 6 months.

b) Arm's length provision

Clarification has been made to the application of the OECD rules in determining the arm's length provision, which may not produce an exact figure but may instead produce a range of figures that are equally reliable to establish the arm's length amount. The taxpayer would be accepted as having substantiated the reported or claimed amount if such amount falls within the arm's length range.

c) Commencement date of specific provision (S. 15F) – Intellectual Property and DEMPE Functions

S. 15F concerns attributing profits derived from intellectual property by an overseas related person when a Hong Kong taxpayer was involved in development, enhancement, maintenance, protection and exploitation of intangibles (“DEMPE”) functions or makes value creation contributions with respect to the intellectual property.

The commencement date of this provision has been amended from the previously stipulated year of assessment beginning on or after 1 April 2018 to **1 April 2019**.

d) Domestic related party transactions

The Government stated in the first batch of amendments on 24 April 2018 that the exemption for certain domestic transactions from the transfer pricing rules and from the requirement in relation to master file and local file will be covered in the second batch of the proposed amendments shortly. Highlights of the proposed amendments are now summarized in the consolidated version issued on 10 May 2018.

The proposed amendments waive the requirement to prepare local file for specified domestic transactions between associated persons if such transaction meets the following conditions:-

- (a) Either —
 - (i) the transaction is undertaken in connection with each entity's trade, profession or business carried on in Hong Kong; or
 - (ii) both —
 - (A) the transaction is undertaken in connection with either entity's trade, profession or business carried on in Hong Kong; and

(B) the other entity is resident for tax purposes in Hong Kong and the transaction is not undertaken in connection with that other entity's trade, profession or business; and

(b) either of the following conditions is also met—

- (i) each entity's income arising from the transaction is chargeable to Hong Kong tax or each entity's loss so arising is allowable for the purposes of Hong Kong tax; or
- (ii) the transaction relates to lending money otherwise than in the ordinary course of a business of lending money or an intra-group financing business.

Clarification has also been made as to whether a recipient of a deemed trading receipt would be regarded as carrying on a trade, profession or business in Hong Kong for this purpose. The mere fact that an entity receives or is accrued with a deemed trading receipt sourced from Hong Kong will not be regarded as carrying on a trade, profession or business in Hong Kong for the purpose of determining whether a transaction is a specified domestic transaction.

In addition, the proposed amendments clarify that specified domestic transactions between associated persons will not be taken into account when determining whether the exemption thresholds in respect of the four categories of related party transactions (i.e. transfers of properties, transactions in respect of financial assets, transfers of intangibles and other transactions) are met. This is in line with the proposed waiver of the preparation of local file for those specified domestic transactions as mentioned above.

e) Filing thresholds and deadline for local surrogate filing of Country-by-Country Report ("CbCR")

Clarifications have been made on the following:

- (1) Applicable threshold for local surrogate filing of CbCR is either:
 - Thresholds as specified by the foreign ultimate parent entity's ("UPE") jurisdiction; or
 - The amount in the currency of UPE's jurisdiction, which is equivalent to EUR 750 million as at January 2015
- (2) When a multinational enterprise group has adopted surrogate parent entity filing mechanism to file CbCR in a foreign jurisdiction but failed to exchange the CbCR with Hong Kong, the Hong Kong entity will be required to file a CbCR in Hong Kong. In this case, the local surrogate filing date in Hong Kong will be the later of the foreign filing date or the filing date in Hong Kong as stipulated in the Bill.

2. OECD TRANSFER PRICING COUNTRY PROFILE²

The OECD has been collecting information from different countries to publish the transfer pricing country profile to reflect the current transfer pricing legislation and practices of each country, as well as to indicate to what extent their rules follow the OECD Transfer Pricing Guidelines. The transfer pricing profiles focus on the countries' domestic legislation regarding key transfer pricing principles, including the arm's length principle, transfer pricing methods, comparability analysis, intangible property, intra-group services, cost contribution agreements, transfer pricing documentation, administrative approaches to avoiding and resolving disputes, safe harbours and other implementation measures.

² <http://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm>

The OECD added 14 new country profiles (in blue) on 9 April 2018. Currently, there are 44 country profiles available with 8 forthcoming profiles (marked with *) as shown below:

Argentina*	Denmark	Israel	New Zealand	Sweden
Australia	Estonia	Italy*	Nigeria	Switzerland
Austria	Finland*	Japan	Norway	Turkey*
Belgium	France	Korea*	Peru	United Kingdom
Brazil	Georgia	Latvia	Poland	United States
Bulgaria	Germany	Liechtenstein	Portugal	Uruguay
Canada	Greece*	Lithuania	Russian Federation	
Chile	Hungary	Luxembourg	Singapore	
China (People's Republic of)	Iceland*	Malaysia	Slovak Republic	
Colombia	India	Malta	Slovenia	
Croatia	Indonesia	Mexico	South Africa*	
Czech Republic	Ireland	Netherlands	Spain	

3. IMPLICATIONS OF TRANSFER PRICING ADJUSTMENT

Under the evolving international tax/transfer pricing environment, transfer pricing adjustments to intercompany transactions may be made as required by the local government authorities or according to the transfer pricing policy of multinational groups. Such adjustments could result in turnover tax and customs duty implications for related party transactions involving the sale of goods.

a) Customs duty

In terms of customs duty, for jurisdictions which levy customs duty on imported goods or articles, changes in the reported customs value (e.g. due to a retroactive pricing adjustment) may give rise to reporting obligation within a specified time limit. In some jurisdictions, this reporting may take the form of a letter or there would be official tax forms.

In case there would be upward adjustments, there would be additional duty payments and a downward adjustment would theoretically lead to duty refund.

b) Turnover tax

For turnover tax, if a jurisdiction imposes turnover tax (e.g. Value-added Tax or Goods and Services Tax) on the importation of goods, an upward adjustment to customs value would result in the assessment of additional turnover tax in many cases. Approval for downward adjustment would generally be required from the customs authorities for a tax refund.

Although many jurisdictions indicated that a refund of tax or duty would be applicable for downward transfer pricing adjustments, these refunds are generally difficult to obtain in practice. In addition, different jurisdictions have different requirements in terms of reporting and tax/duty implications for transfer pricing adjustments which businesses should be aware of.

4. POINTS TO NOTE

Latest transfer pricing amendments in Hong Kong relieve some enterprises from the burden of preparing the transfer pricing documentation (i.e. master file and local file), in particular, the increase in the exemption thresholds, extended filing timeline and the exemption of certain domestic transactions.



OECD transfer pricing profiles provide information about current transfer pricing legislation and practices of different country. The profiles could be important resource of transfer pricing legislations for multinational enterprise group when determining the group transfer pricing policy and compliance issues.

In terms of the potential customs duty and turnover tax implications on transfer pricing adjustments, taxpayers should pay attention to the different reporting requirements in various jurisdictions to ensure compliance in those jurisdictions.

As the transfer pricing documentation requirements in various jurisdictions continue to develop and evolve, it is crucial for taxpayers to plan ahead to ensure that they are in compliance with the local requirements in terms of documentation and reporting and that the related party transactions are in line with the arm's length principle.

RSM Tax Advisory (Hong Kong) Limited

RSM Hong Kong's dedicated and experienced tax specialists can:

- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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