

HONG KONG TAX ALERT

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Closer scrutiny on management fee and head office recharge arrangements

Management fee or head office recharge is one of the most common type of related party transactions that is being scrutinised by tax authorities in the region. Many companies may believe a reasonable allocation model is in place but does it really address all the key areas that tax and regulatory bodies may be after?

Summary

- While many taxpayers made a good effort on the allocation basis, there are still areas which one should review and assess if further enhancement to the existing arrangements may be required.
- When setting the transfer pricing policy, a company should take into consideration any additional requirements from other regulatory bodies or other country specific requirements to ensure consistency.

Management fee or head office recharge arrangements are nothing new to companies in Hong Kong. As noted in our [Hong Kong Tax Alert – Issue 9, July 2015](#), the Hong Kong Inland Revenue Department ("IRD") has continued to challenge rigorously on the transfer pricing arrangements on the management fee or head office recharges and request sophisticated information on the cost recharge arrangements.

The following are some common issues observed for companies with intercompany service and cost recharge arrangements:

- Costs incurred for the provision of support or regional services are not fully allocated out to the relevant group entities;
- Lack of support or not evident to tax authorities that there are no duplication of services;
- Challenges in determining stewardship or shareholder costs that are non-allocable to service recipients;
- Consistency between charges at various level within a Group (i.e., global, regional and local country-level);
- Potential conflicts between outsourcing rules in certain countries with transfer pricing policies;
- Distortion to the allocation matrix due to business restructuring or expansion; and
- Additional requirements in certain regulated industries, such as financial services.

It has become a trend that not only tax authorities are concerned with the reasonableness of these related party transactions but also in some special industries, where additional scrutiny has been seen from other regulatory bodies regarding the reasonableness on the charges. As a result, a broader holistic approach is required to address the challenges from multiple stakeholders.

Further, certain countries may have more stringent requirements or practices in determining the reasonableness of the intercompany service and cost recharge arrangements, for example:

- Additional requirements by financial regulators for foreign exchange and other regulatory purposes;
- In addition to the appropriateness of the cost allocation keys, tax authorities may request for corroborative evidence, such as comparable uncontrolled prices to support the transactions; and
- Additional analysis, such as the “six-test” approach applied by the Chinese tax authorities in evaluating the arm’s length nature of the intragroup service fees.

As highlighted, there are a number of factors which would require careful consideration when determining a transfer pricing policy on the intercompany services and cost recharges. Companies are urged to ensure that their transfer pricing arrangements can be well-supported.

In case of any questions or need assistance, please contact us:

John Kondos – Partner, Global Transfer Pricing Services
Tel: +852 2685 7457

Lu Chen – Principal, Global Transfer Pricing Services
Tel: +852 2143 8777

Irene Lee – Senior Manager, Global Transfer Pricing Services
Tel: +852 2685 7372

Chloe Li – Senior Manager, Global Transfer Pricing Services
Tel: +852 2143 8710

William Wong – Senior Manager, Global Transfer Pricing Services
Tel: +852 2685 7599

Contact us:

Khoon Ming Ho
Head of Tax, KPMG China
 Tel: +86 10 8508 7082
 khoonming.ho@kpmg.com

Ayesha M. Lau
Head of Local Market
Head of Tax, Hong Kong
 Tel: +852 2826 7165
 ayesha.lau@kpmg.com

Corporate Tax

Charles Kinsley
Partner
 Tel: +852 2826 8070
 charles.kinsley@kpmg.com

Chris Abbiss
Head of Real Estate Tax,
KPMG China
 Tel: +852 2826 7226
 chris.abbiss@kpmg.com

Stanley Ho
Partner
 Tel: +852 2826 7296
 stanley.ho@kpmg.com

Alice Leung
Partner
 Tel: +852 2143 8711
 alice.leung@kpmg.com

Curtis Ng
Partner
 Tel: +852 2143 8709
 curtis.ng@kpmg.com

John Timpany
Partner
 Tel: +852 2143 8790
 john.timpany@kpmg.com

Jocelyn Lam
Partner
 Tel: +852 2685 7605
 jocelyn.lam@kpmg.com

Matthew Fenwick
Director
 Tel: +852 2143 8761
 matthew.fenwick@kpmg.com

Ivor Morris
Director
 Tel: +852 2847 5092
 ivor.morris@kpmg.com

Sandy Fung
Director
 Tel: +852 2143 8821
 sandy.fung@kpmg.com

Nicholas Rykers
Director
 Tel: +852 2143 8595
 Nicholas.rykers@kpmg.com

Michael Olesnick
Special Advisor
 Tel: +852 2913 2980
 michael.olesnick@kpmg.com

Justin Pearce
Senior Tax Advisor
 Tel: +852 2143 8756
 justin.pearce@kpmg.com

M & A Tax

Darren Bowdern
Head of Financial Services Tax,
KPMG China
 Tel: +852 2826 7166
 darren.bowdern@kpmg.com

Benjamin Pong
Partner
 Tel: +852 2143 8525
 benjamin.pong@kpmg.com

Christopher Xing
Partner
 Tel: +852 2978 8965
 christopher.xing@kpmg.com

Yvette Chan
Principal
 Tel: +852 2847 5108
 yvette.chan@kpmg.com

Malcolm Prebble
Principal
 Tel: +852 2685 7472
 malcolm.j.prebble@kpmg.com

China Tax

Daniel Hui
Principal
 Tel: +852 2685 7815
 daniel.hui@kpmg.com

Karmen Yeung
Partner
 Tel: +852 2143 8753
 karmen.yeung@kpmg.com

Adam Zhong
Principal
 Tel: +852 2685 7559
 adam.zhong@kpmg.com

Steve Man
Director
 Tel: +852 2978 8976
 steve.man@kpmg.com

Transfer Pricing

John Kondos
Partner
 Tel: +852 2685 7457
 john.kondos@kpmg.com

Lu Chen
Principal
 Tel: +852 2143 8777
 lu.l.chen@kpmg.com

Global Mobility Services

Barbara Forrest
Principal
 Tel: +852 2978 8941
 barbara.forrest@kpmg.com

Murray Sarelius
Principal
 Tel: +852 3927 5671
 murray.sarelius@kpmg.com

David Siew
Principal
 Tel: +852 2143 8785
 david.siew@kpmg.com

Kate Lai
Director
 Tel: +852 2978 8942
 kate.lai@kpmg.com

US Tax

Wade Wagatsuma
Head of US Corporate Tax,
KPMG China
 Tel: +852 2685 7806
 wade.wagatsuma@kpmg.com

Indirect Tax

Lachlan Wolfers
Head of Indirect Tax,
KPMG China Regional Leader,
Asia Pacific Indirect Tax
 Tel: +852 2685 7791
 lachlan.wolfers@kpmg.com

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