



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.

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