



HONG KONG TAX ALERT

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Consultation paper on BEPS launched in Hong Kong

The HK Government launched a public consultation exercise on 26 October 2016 to gauge views on the implementation of the OECD's anti-base erosion and profit shifting (BEPS) initiatives.

Summary

- The HK government has said it wishes to take a pragmatic approach and to enhance clarity and certainty while striving to maintain a simple, neutral and transparent tax regime.
- The most significant proposal is for the adoption of a formal transfer pricing regime in Hong Kong, with mandatory documentation requirements.
- Along with additional compliance and reporting obligations, there will be penalties for non-compliance.

Overview

The HK Government's launching of the public consultation exercise on 26 October 2016 is a far reaching development for Hong Kong taxpayers. The most significant proposal is for the adoption of a formal transfer pricing regime in Hong Kong, with mandatory documentation requirements.

The consultation paper (click [here](#)) includes the following proposals –

- Codifying transfer pricing rules in Hong Kong's tax legislation, based on the arm's length standard. The transfer pricing regime will extend beyond payments for assets and services and will cover financial and business arrangements such as the making of loans and cost contribution arrangements. These obligations will seemingly apply to cross-border as well as domestic transactions.
- Mandating preparation of transfer pricing documentation based on the three-tier country-by-country (CbC) reporting approach (including a master file and local file). Preparation of master file and local file is required for enterprises that meet two of the following criteria – annual revenue exceeding HK\$100 million, assets exceeding HK\$100 million and workforce exceeding 100 employees. If the enterprise's consolidated group revenue exceeds the equivalent of EUR750 million, it will have to prepare a CbC report.
- Exchanging CbC reports with other countries with which Hong Kong has concluded a tax treaty (including a tax information exchange agreement, or TIEA) as well as a competent authority agreement providing for such exchange.

- Providing a statutory basis for the existing APA (transfer pricing ruling) regime.
- Amending Hong Kong's tax treaties by signing up to the OECD-coordinated multilateral instrument (MLI), to counter the use of hybrid entities and hybrid instruments, preventing the use of tax treaties to avoid tax, preventing the artificial avoidance of "permanent establishment" status, and enhancing the dispute resolution mechanism between treaty partners. To counter treaty abuse, Hong Kong proposes to adopt the "principal purpose test" but not a "limitation-on-benefits" rule in her treaties.
- Introducing legislation to formalize the adoption of mutual agreement procedures (MAP) and mandatory arbitration to resolve treaty disputes.
- Providing for spontaneous exchange with Hong Kong's tax treaty (and TIEA) partners of past and future rulings relating to preferential regimes, transfer pricing (including APAs), downward adjustments of taxable profits, permanent establishment status, related party conduits, as well as other rulings that might give rise to BEPS concerns.
- Enhancing HK's tax credit system, by extending the time period for claiming credits from the existing 2 years to 6 years after the end of the relevant tax year and by requiring taxpayers to take all reasonable steps to minimize taxes payable overseas.

KPMG observations

Other than limited exemptions for smaller taxpayers, Hong Kong taxpayers with related party dealings will need to formalize and document their transfer pricing arrangements with related parties. Along with additional compliance and reporting obligations, there will be penalties for non-compliance. The HK Government has said it wishes to take a pragmatic approach and to enhance clarity and certainty while striving to maintain a simple, neutral and transparent tax regime. The devil will be in the details to follow. Further KPMG tax alerts and commentary with our more detailed observations on the consultation paper will be issued during the consultation process.

The consultation paper is available on the website of the Financial Services and the Treasury Bureau (<http://www.fstb.gov.hk/tb/en/consultation-paper.htm>).

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