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Global Transfer Pricing Review

Hong Kong

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TAX

Hong Kong

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The Hong Kong Inland Revenue Department (IRD) released comprehensive transfer pricing guidelines in December 2009 with potential retroactive effect. The guidelines were released in the form of Departmental Interpretation and Practice Notes No. 46 (DIPN 46) and they indicate the IRD's interpretation and practices regarding transfer pricing methodologies and related issues.

DIPN 46 is generally consistent with the Organisation for Economic Co-operation and Development (OECD) Guidelines and with international transfer pricing practices. DIPN 46 states that the IRD will apply the arm's length principle and follows the preference of traditional transaction methods over the profit-based methods instead of the most appropriate method approach outlined in the revised OECD Guidelines in 2010. In practice, profit based methods are commonly applied.

The IRD released DIPN No.48 Advance Pricing Arrangement in March 2012 establishing the procedure for enterprises seeking an Advance Pricing Agreement (APA) in Hong Kong. APAs are generally available on bilateral or multilateral basis with counterparty jurisdictions with which Hong Kong has a Double Tax Agreement (DTA), although unilateral APAs are possible in certain limited circumstances. As of 30 April 2015, Hong Kong has concluded two bilateral APAs, one with the Netherlands and one with Japan.

Following the recommendation of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, Hong Kong introduced a Bill that allows Hong Kong to enter into standalone Tax Information Exchange Agreements (TIEAs) and enhances the existing exchange of information (EoI) under a DTA. The Bill was passed by Legislative Council in July 2013. The enactment of the Bill demonstrates Hong Kong's commitment to implementing internationally agreed standards. Going forward, the tax information to be exchanged under a DTA/TIEA will have much coverage and the Commissioner will have wider powers to collect and disclose tax information. In September 2014, Hong Kong indicated to the OECD its support for implementing the new standard on Automatic Exchange of Information (AEoI), with a view to commencing the first information exchanges by the end of 2018, on the basis that necessary legislation is in place by 2017.

With respect to the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan, the IRD has no immediate plans to change the current laws or practices, but has indicated in a press release in November 2013 that they will closely monitor the international development in this respect, including OECD discussions, with a view to assess the need for any corresponding measures. The IRD will embark on studies and engage local stakeholders for appropriate follow-up actions in due course.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Not applicable
Legal requirements		●
Protection from penalties	●	
Reduce risk of adjustment	●	
Shifts burden of proof		●

Basic information

Tax authority name

Hong Kong Inland Revenue Department (IRD).

Citation for transfer pricing rules

- DIPN 46 refers to relevant articles of double taxation treaties signed by Hong Kong when applicable, and to sections 14, 16(1), 17(1) (b), 17(1) (c), 20 and 61A of the Inland Revenue Ordinance (IRO) in other circumstances.
- DIPN 45, which was also released during 2009, provides guidance with regard to relief from double taxation arising from transfer pricing adjustments in the context of DTAs.
- DIPN 47, sets out the current practice on exchange of information upon requests received from treaty partners. DIPN 48 establishes the procedure for enterprises seeking an APA in Hong Kong.

Effective date of transfer pricing rules

There is no specific date, but provisions of DIPN 46 may apply retroactively to all open tax years. APA applications will be considered as of April 2012 onwards and the IRD has indicated that rollbacks may be considered in some cases.

What is the relationship threshold for transfer pricing rules to apply between parties?

No numeric threshold. Association is established via common management control or shareholding.

What is the statute of limitations on assessment of transfer pricing adjustments?

The IRD is empowered to raise additional assessment(s) for a year of assessment at any time within six years after the end of that year of assessment if it considers that the taxpayer has been under-assessed, or has not been properly assessed for that year.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes. Taxpayers are required to disclose certain information on related party transactions in the annual tax return.

What types of transfer pricing information must be disclosed?

Transaction amounts and jurisdiction(s) of related parties with which transactions have been conducted.

What are the consequences of failure to submit disclosures?

In case of a failure to prepare or submit the tax return where the taxpayer does not have a "reasonable excuse" for the offence, the maximum penalty that can be imposed is 10,000 Hong Kong dollars (HKD) plus three times the amount of tax undercharged.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

Yes. English, Chinese.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for all transactions. Broadly, yes. DIPN 46 refers to the OECD Guidelines for the type of information which would be useful to be included in a transfer pricing study.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to

submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

Generally within 30 days of request, subject to extension.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

Available dispute resolution options include: objections to the Commissioner, appeals to the Board of Review, and appeals to the courts. DIPN 6 provides an overview of the objection channels and appeal procedures.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

Yes. General tax penalties apply. The extent of these penalties depends on the degree of the offence. Where the taxpayer does not have a "reasonable excuse" for the offence, the maximum penalty that can be imposed is HKD10,000 plus three times the amount of undercharged tax.

To what extent are transfer pricing penalties enforced?

Penalties are less common in practice.

What defenses are available with respect to penalties?

Preparation of transfer pricing documentation. Generally, in the absence of fraud or tax evasion the penalties may not be enforced.

What trends are being observed currently?

There are increasing audit cases which involve transfer pricing issues and the tax authority is continuously seeking to develop its transfer pricing resources and skills. The IRD has recently launched a large number of tax audits of asset managers in Hong Kong and it is highly likely that the IRD will look to target other prevailing industry sectors.

Continued tax scrutiny was foreshadowed in Hong Kong's 2015-2016 fiscal budget, where the Hong Kong government has specifically singled out the IRD to "step up its efforts in combating cross-border tax evasion in accordance with the latest global standard" to preserve the territory's revenue base. IRD would continue to focus audit activities on high risk areas including significant transactions with related parties in low/no tax jurisdictions, poor results not consistent with industry norms, sustained losses or fluctuating profits and losses with growing businesses, etc.

Hong Kong is also actively expanding its double tax treaty network which expands potential for an increased number of corresponding adjustments, APA negotiations and Mutual Agreement Procedures (MAPs).

Special considerations

Are secret comparables used by tax authorities?

Generally no.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

No.

Do tax authorities have requirements or preferences regarding databases for comparables?

No.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes, sometimes.

Does the tax authority have other preferences in benchmarking? If so, please describe.

No. Approaches consistent with the OECD Guidelines are generally acceptable by the IRD.

What level of interaction do tax authorities have with customs authorities?

Low.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes. Subject to the general requirement that the expense must be incurred in earning profits chargeable to tax.

Are management fees subject to withholding?

No.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. Subject to the general requirement that the expense must be incurred in earning profits chargeable to tax.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. Generally yes. In Hong Kong there is no specific law addressing subsequent transfer pricing adjustments. However, in order to be reflected in the tax return for the year in which the adjustment relates, it should be included in the audited financial statements for that year and be supported by the relevant documentation.

Other unique attributes?

None.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Minimal but developing.

If extensive, is the competent authority effective in obtaining double tax relief?

No experience yet due to relatively limited (but expanding) treaty network.

When may a taxpayer submit an adjustment to competent authority?

Subject to applicable DTA, generally only after the first notification of actions giving rise to taxation not in accordance with the DTA has been issued by the DTA state.

May a taxpayer go to competent authority before paying tax?

Currently there are no formal rules in this respect.

Advance pricing agreements

What APA options are available, if any?

Bilateral, multilateral.

Is there a filing fee for APAs?

No.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Yes. APAs are only applicable on a bi- or multilateral basis with counterparty jurisdictions with which Hong Kong has a DTA due to resource constraints, at least at the initial stage of the program. A unilateral APA may be available in cases when the DTA partner(s) do not wish to participate in developing an APA, agreement stalls with the DTA partner(s) when negotiating a bilateral or multilateral APA and in cases when a non DTA state is prepared to agree a unilateral APA regarding transactions that are integrally linked to the controlled transactions covered by a bilateral or multilateral APA. The IRD has also set a threshold for an application of HKD80 million for each year covered in the APA if the controlled transactions involve sale and purchase of goods, a threshold of HKD40 million per annum if the application relates to services and a threshold of HKD20 million if the application relates to intangible property. The threshold may be waived on a case by case basis following review by the Commissioner.

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