TPA Global

Transfer Pricing
Country Summary

Hong Kong

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1. Introduction

The Hong Kong TP documentation requirements are in line with the OECD TP Guidelines.

2. Laws & Regulations

a) References to OECD/EU/Local Rules

The legal framework for transfer pricing includes:

● On December 29, 2017 a draft bill to implement key actions arising from the OECD BEPS agenda was gazette (Inland Revenue (amendment) No. 6 Bill, 2017). The rules will be applicable for tax years of assessment commencing on April 1, 2018 ;

● Departmental Interpretation and Practice Note No. 46 (DIPN 46) issued in December 2009, provides the Inland Revenue Department (IRD) views and practices on methodologies of transfer pricing and related issues;

● Departmental Interpretation and Practice Note No. 45 (DIPN 45), issued in April 2009, deals with double taxation relief due to transfer pricing or profit re-allocation adjustments;

● Departmental Interpretation and Practice Note No. 48 (DIPN 48), issued in March 2012, provides guidance for enterprises seeking an Advance Pricing Arrangement

b) Definition of Related Party

There is no statutory definition of the term "related party" in the IRO. In DIPN 46, "associated enterprises" is defined as being two enterprises where one of them meets the conditions under Article 9(1) of the OECD Model Tax Convention on income and on Capital which is read as follows: (a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or (b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly

c) Nature of Transfer Pricing Documentation

In a query or audit situation, the IRD is likely to request a copy of the taxpayer's transfer pricing policy and documentation showing compliance with the arm's length principle in support of the taxpayer's transfer pricing arrangements. The IRD will expect local input from the taxpayer. A globally prepared

d) Tax Havens & Blacklists

The EU finance ministers updated the EU's list of non-cooperative tax jurisdictions, also known as the EU tax havens blacklist, on March 12, 2019. As Hong Kong businesses will recall, the first list was created on December 5, 2017 after a screening of 92 third-country jurisdictions based on three criteria: tax transparency, good governance, and real economic activity, as well as one indicator, the presence of a zero corporate tax rate.

The grey list, which previously included Hong Kong, was also subject to revision. According to a Commission Fact Sheet, 34 jurisdictions have already taken many positive steps to comply with the requirements of the EU listing process, but must finish this work by the end of 2019 to avoid being blacklisted the following year.

While Hong Kong made relevant changes to its tax regime in 2018, specifically under the 'transparency' criterion, it remained on the grey list under the fair taxation criterion as recently as 20 December 2018. However, Hong Kong traders should be relieved that, as of March 12, 2019, Hong Kong is no longer on the EU grey list. The EU delisted 25 jurisdictions, including Hong Kong, for failing to meet the promised reforms and commitments in 2017. As a result, the EU currently considers Hong Kong to be fully compliant with good governance tax standards. However, the Code of Conduct Group will continue to monitor the proper implementation of its legislative and enforcement provisions, as well as those of other delisted jurisdictions, on an annual basis.

e) Advance Pricing Agreement (APA)

Bilateral and multilateral APAs are available. Unilateral accords are allowed rarely. The IRD may consider a unilateral APA application when:

- the double taxation agreement (DTA) partner in a bilateral APA application process does not wish to participate in or continue the process;
- the IRD is unable to reach agreement with the DTA partner; or
- a state with which Hong Kong does not have a DTA is prepared to give a unilateral APA regarding transactions that are integrally linked to the controlled transactions covered by the Hong Kong bilateral or multilateral APA

DIPN 48 says Hong Kong resident enterprises, as well as non-resident enterprises with a permanent establishment in Hong Kong, may apply for an APA if they have controlled transactions of:

- HKD 80 million or greater for each year covered in the APA if the controlled transactions involve sale and purchase of goods;
- HKD 40 million or greater per annum if the APA application relates to services; or
- HKD 20 million or greater per annum if the APA application relates to the use of intangible properties.

Controlled transactions refer to transactions between enterprises that are associated enterprises with respect to each other under the Associated Enterprises Article of the relevant DTA. An executed APA would apply for three to five years. The APA would take 18 months to negotiate, but may take longer, depending on the progress of competent authority negotiation. Currently, there is no APA application fee.

f) Audit Practice

In a query or audit situation, the IRD is likely to request a copy of the taxpayer's transfer pricing policy and documentation showing compliance with the arm's length principle in support of the taxpayer's transfer pricing report without any localization or consideration from a Hong Kong perspective is unlikely to be sufficient by itself. Transactions and situations that may arouse the IRD's interest in transfer pricing may include (but are not limited to):

- Significant related party transactions, especially payments of services fees or royalties;
- Volatility in profit levels, especially where there are losses for the Hong Kong taxpayer;
- Related party transactions with "tax haven" jurisdictions;
- Group structures resulting in double non-taxation (e.g. offshore regimes).

3. Transfer Pricing Documentation

a) Level of Documentation

No specific requirement to maintain / submit transfer pricing documentation but contemporaneous documentation prepared in accordance with the OECD Transfer Pricing Guidelines is encouraged in DIPN 46, providing that the taxpayer satisfies the requirement under Section 51C of the IRO of in keeping business records in sufficient details with regard to the nature, size and complexity of the transactions. For cases involving APA, taxpayer is required to prepare and submit annual compliance report for each year of the APA. The annual compliance report is required to be supported by a financial analysis of compliance with the APA and detail any compensating adjustments made. The taxpayer is also required to keep the records listed in paragraph 89 of DIPN 46 (essentially the transfer pricing documentation in the OECD Transfer Pricing Guidelines)

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

e) Choice of Transfer Pricing Method

The following methods described in OECD Transfer Pricing Guidelines are acceptable:

Traditional transaction methods:

- Comparable uncontrolled price (CUP) method

Cost plus method;

- Resale price method.

Transactional profit methods:

- Profit split method;
- Transactional net margin method.

It is specified in DIPN 46 that where a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferred.

f) Economic Analysis - Benchmark Study

There are no instructions or guidance available to the public regarding which issues the tax authorities should focus on. There is no protocol regarding economic analysis.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the ''conduct of parties'' the prevailing concept.

h) Financial Statements

The Hong Kong Companies Ordinance requires a company's directors to prepare financial statements for each fiscal year end.

Holding companies are required to prepare consolidated financial statements unless the company is a partially owned subsidiary and no member requests or all members agree in writing not to prepare consolidated financial statements. The company must, however, continue to prepare company-level financial statements. If the company is a wholly owned subsidiary, financial statements at the company level or consolidated must be prepared.

Unless the company qualifies for a reporting exemption, the financial statements must provide a true and fair picture of the company's financial position and performance.

The financial statements must adhere to the Hong Kong Institute of Certified Public Accountants' Hong Kong Financial Reporting Standards (HKFRS) (HKICPA). Auditing of financial statements is required.

i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. These information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
Corporate Income Tax	File	BIR	April, 1st.	N/A	No	No
Master File	Prepare	Paper or electronic form	9 months after the end of the accounting period	N/A	Yes	No
Local File	Prepare	Paper or electronic form	9 months after the end of the	N/A	Yes	No

			accounting period			
CbCR	File	CbC Return XML Schema	12 months after the end of the relevant accounting period or the date specified in the assessor's notice, whichever is the earlier	3 months after the end of the relevant accounting period	Yes - EUR 750 million (HK$ 6.8 billion)	No
Local Form	File	Supplementary Form S1 and S2	April, 1st.	N/A	No	No
Annual Accounts	File	NAR1	42 days after the YE	N/A	No	No
Segmented P&L	N/A	N/A	N/A	N/A	N/A	N/A
* Hong Kong has signed the MCAA agreement for the filing of CbCR.						
* Hong Kong does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.						

j) Mandatory Language

TP documentation shall be submitted in either English or Chinese

k) Notification Requirement

There is no specific notification requirement.

l) Record Keeping

Generally, taxpayers are obligated to keep their business documents for 7 years. This includes TP documentations.

m) Penalties and Interest Charges

No specific transfer pricing penalties currently exist, however, the Consultation Paper proposes to enforce the new TP documentation requirements by introducing penalty provisions in the IRO. TP adjustments General penalty provisions under Part XIV of the IRO provide for maximum penalties of HKD 10,000 plus 300% of the tax undercharged.

If the taxpayer willfully intended to evade tax, they are subject to a fine of HKD 50,000, penalties of up to 300% of underpaid tax and 3-year imprisonment.

Master file and local file The Consultation Paper proposes that if a taxpayer does not comply with the requirements relating to the master file and the local file without any reasonable excuse, the proposed penalty upon conviction is a fine at level 6 (HKD 100,000 at present).

CbC-reporting The Consultation Paper proposes that if a taxpayer does not submit CbC reports without any reasonable excuse, the proposed penalty is a fine at level 6 (HKD 100,000 at present).

In case of a continuing offence after conviction for failure to comply, a further fine of HKD 500 will be imposed for each day of the offence.