

# Transfer Pricing Country Summary Hong Kong

July 2018

## Legislation

### Existence of Transfer Pricing Laws/Guidelines

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 gazetted ( 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 (APA).

### 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.

### Transfer Pricing Scrutiny

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

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).

## Transfer Pricing Penalties

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 wilfully 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.

## 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.

## Documentation And Disclosure Requirements

### Tax Return Disclosures

Tax jurisdictions or countries where related parties, who are “closely connected” non-residents and have transactions with taxpayers in Hong Kong, are incorporated; and transaction value must be disclosed in Profits Tax Return (Form BIR 51). A closely connected person is defined in Section 20 of the IRO as being a person who is, considered by the Commissioner of Inland Revenue in his discretion, substantially identical to the taxpayer or ultimately controlled by the same interests as the taxpayer is.

### 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).

### Record Keeping

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

### Language for Documentation

Chinese or English.

### Small and Medium Sized Enterprises (SMEs)

Not applicable.

### Deadline to Prepare Documentation

No requirement.

### Deadline to Submit Documentation

Under the current laws, there is no deadline requirement for submitting TP documentation. Still, the IRO requires taxpayers to keep records in sufficient details that enable the IRO to verify:

- the quantities and values of the goods and the identities of the sellers or buyers;
- the services that result in receipts and payments .

For cases involving APA, the annual compliance report is required to be submitted to the IRD at the time of submission of the annual profits tax return for the same year as the APA year.

The new TP documentation preparation and/or submission deadline for master file and local file is not yet stipulated by the IRD. The Consultation Paper proposes that CbC reports will be required to be filed within 12 months after the end of the relevant accounting period commencing on or after 1 January 2018, meaning that the first CbC reports will be filed in 2019.

### Statute Of Limitations

Generally, 6 years from the end of the year of assessment to which the transfer pricing issue relates. However, in cases of fraud or tax evasion, the time limit is 10 years.

### Transfer Pricing Methods

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.

## Comparables

Hong Kong database of comparables should be used. Foreign comparables may also be accepted by the IRD, if the Hong Kong database is not sufficient.

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