



Hong Kong, 31 October 2018

Newsletter Hong Kong

BEPS and TP Law Passed in Hong Kong

The base erosion and profit shifting (“BEPS”) and transfer pricing (“TP”) Bill, namely the Inland Revenue (Amendment) (No.6) Bill 2017 (the “Bill”), was passed by the Legislative Council on 4 July 2018 and came into force on 13 July 2018.

The Bill amends the Inland Revenue Ordinance (Cap. 112) (“IRO”) to:

- a) codify rules (the arm’s length principle) on transfer pricing;
- b) implement the three-tiered TP documentation;
- c) introduce the deeming provision on income from intellectual property;
- d) codify the advanced pricing arrangement (“APA”) regime;
- e) introduce a statutory dispute resolution mechanism for cross-border tax treaty-related disputes;
- f) extend the period for claiming tax credits; and
- g) revise the eligibility criteria for certain profits tax concessions.

In the following, we will summarize the key BEPS and TP measures introduced by the Bill.

1. The TP Regulatory Regime

The Bill codifies the arm’s length principle into the IRO and empowers the IRD to impose TP adjustments on either income or expense arising from non-arm’s length transactions between associated persons that give rise to a potential Hong Kong tax advantage. This applies to cross-border transactions and domestic transactions; while certain domestic transactions that do not give rise to any actual Hong Kong tax difference will be specially exempted provided that certain prescribed conditions are met. This will apply retrospectively to years of assessment beginning on or after 1 April 2018, that is, from the year of assessment 2018/19.

Besides, the Authorised OECD Approach will be adopted for the profit attribution of permanent establishment (“PE”), which require the use of the separate enterprises principle for attribution of profits to a PE of a non-Hong Kong resident in Hong Kong. This will be of particular relevance to banks and insurance companies that often maintain Hong Kong branches. This

will apply to years of assessment beginning on or after 1 April 2019, that is, from the year of assessment 2019/20.

2. TP Documentation Requirement

The Bill introduces a mandatory three-tiered TP documentation requirement in Hong Kong: the Master File, the Local File and the Country-by-Country (CbC) report.

Master File and Local File

A Hong Kong company will be required to prepare a master file and a local file if the company's related party transactions exceed any of the thresholds for the following categories of transactions during a year:

- a) Transfer of properties (other than financial assets and intangibles) of HK\$220 million or more;
- b) Transactions involving financial assets of HK\$110 million or more;
- c) Transfer of intangibles of HK\$110 million or more; or
- d) Any other transactions (e.g. services and royalty income) in aggregate of HK\$44 million or more.

However, a company with related party transactions exceeding the above-mentioned thresholds will be exempt from preparing a master file and local file if it satisfies two of the three following criteria:

- a) Revenue of not more than HK\$400 million;
- b) Total assets of not more than HK\$300 million;
- c) Employees of not more than 100 on average.

This reporting requirement commences for accounting periods beginning on or after 1 April 2018. The files should be prepared within nine months after the end of the relevant accounting period, and retained for seven years. Failure to comply to this requirement without reasonable excuse would be subject to penalty from HK\$50,000 to HK\$100,000.

CbC Reporting

Multinational Entity groups with consolidated revenues in the preceding financial year exceeding HK6.8 billion will be required to prepare CbC report in Hong Kong, unless the surrogate parent entity-filing-elsewhere exception applies. The report may be filed by the ultimate parent entity resident in Hong Kong or surrogate parent entity in Hong Kong nominated by the ultimate parent entity.

This reporting requirement commences for accounting periods beginning on or after 1 January 2018. The files should be prepared within twelve months after the end of the relevant accounting period, and retained for seven years. Failure to comply to this requirement without reasonable excuse would be subject to penalty from HK\$50,000 to HK\$100,000, and a further fine of HK\$500 for each day of offence after conviction.

3. Deeming Provision on Income from Intellectual Property

A new section 15F of the IRO is introduced such that where a person has contributed in Hong Kong to the development, enhancement, maintenance, protection or exploitation (DEMPE) of an IP and income from such IPs accrues to a non-resident who is an associate of that person from the use of or a right to use such IP outside Hong Kong, the part of the income that is attributable to the value creation contributions in Hong Kong will be regarded as a taxable trading receipts arising in or derived from a trade or business carried on in Hong Kong; that is, the new deeming provision will deem the income from IP accruing to the associated non-resident IP owner, but attributable to the DEMPE functions performed and assets deployed in Hong Kong, to be taxable receipts of the Hong Kong taxpayer.

The commencement of the deeming provision on IPs will be postponed by 12 months, i.e. applicable to years of assessment beginning on or after 1 April 2019.

4. APA Regime

The APA regime is codified and included in the IRO, and it provides for unilateral, bilateral and multilateral APAs. The IRD will be allowed to charge fees for an APA application based on the hourly rates of the IRD officers involved, subject to a cap of HK\$500,000.

5. Statutory Dispute Resolution Mechanism

The Bill introduces a statutory dispute resolution mechanism to facilitate the handling of cross-border treaty-related disputes. It specifies that a taxpayer may represent a case for mutual agreement procedure and/or arbitration under the relevant Hong Kong CDTA.

A key feature of the mechanism is that it requires the Commissioner to give effect to any solution, agreement or decision resulting from the application of the mutual agreement procedure (including arbitration) under any of Hong Kong's DTAs by making an appropriate adjustment. The form of an adjustment is left at the discretion of the Commissioner, but the Bill specifies that it may include a discharge or repayment of tax, the allowance of credit against tax payable or the making of an assessment.

6. Extending the Period for Claiming Tax Credits

The Bill enhances the current tax credit system by extending the period for claiming a foreign tax credit from two years to six years. However, under the new tax credit system, taxpayers are required to make full use of all other available relief under CDTAs and the local legislation of foreign jurisdictions before claiming a foreign tax credit, which will only be satisfied if all reasonable steps are taken to minimize the amount of foreign tax payable before restoring to a foreign tax credit; taxpayers are also required to notify the IRD of any adjustment to foreign tax payments that could result in the foreign tax credit granted being excessive.

In addition, the Bill removes the option for taxpayers to obtain relief from double taxation by way of either a foreign tax credit under section 50 of the IRO or an income exclusion or deduction under section 8(1A)(c) or 16(1)(c) of the IRO where the claim involves a CDTA

ASIAN TAX ADVISORY LIMITED

Rooms 501-2, Wilson House,
19-27 Wyndham Street, Central, Hong Kong

Business Registration Number 64059548-000

territory; in such case, only a foreign tax credit can now be claimed. This change commences from the year of assessment 2018/19.

7. Revision of the Eligibility Criteria for Certain Profits Tax Concessions

The Bill introduces provisions with the effect that concessionary tax treatments in the tax regimes for corporate treasury centres, reinsurance business, captive insurance business, shipping business, aircraft lessors and aircraft leasing managers will be available only if the specified threshold requirements for determining whether profits producing activities are carried out in Hong Kong are met. The threshold requirements commence in the year of assessment 2018/19.

For more information, please contact:

Asian Tax Advisory:

Marzio Morgante
Dottore Commercialista, LL.M.
Managing Partner

Email: marzio@atatax.hk
Tel: (852) 3102 1995
Cell: (852) 6433 8018
Fax: (852) 3102 0991
Rooms 501-2, Wilson House,
19-27 Wyndham Street,
Central, Hong Kong

Website: www.atatax.hk