

# Hong Kong IRD issues guidance regarding TP Documentation and CbCR

On 19 July 2019, the Hong Kong (HK) Inland Revenue Department (IRD) published three Department Interpretation and Practice Notes (DIPNs):

- DIPN 58: TP Documentation and CbCR which aligns the HK documentation requirements with the OECD' three-tiered standardised approach (i.e. MF, LF and CbCR), with specific HK thresholds for exemption
- DIPN 59: TP Between Associated Persons which elaborates on the IRD's approach to the application of the OECD TP principles
- DIPN 60: Attribution of Profits to PEs in HK which adopts the authorised OECD approach (AOA) in the allocation of profits to PEs.

## TP DOCUMENTATION REQUIREMENTS

- Size of business – Exemption from preparing MF and LF if they meet the following:
  - Total revenue <HKD400m\*
  - Total asset value <HKD300m
  - Average number of employees <100
- Amount of related party transactions – Exemption from covering transactions under the following thresholds:
  - Transfer of moveable/immovable properties: HKD220m
  - Transfer of intangibles/Transactions with respect to financial assets: HKD110m
  - Other types of transactions: HKD 44m
  - Specified domestic transactions and transactions before 13 July 2018

Regardless of any exemptions, transactions still need to be conducted at arm's length. There is a useful roll-forward rule for certain elements of the LF (e.g. benchmarking study and descriptions of comparables) can be rolled forward for a maximum of three years if the conditions of the controlled transactions or operations remain unchanged. There are penalties, including a fine of HKD50,000 for failing to prepare MF and LF under Section 58C. Maintaining MF and LFs can reduce the likelihood of being audited and mitigate the risk of penalties when such audits do occur.

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\* 1 EUR is approximately 8.68 HKD

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## ***SUBSTANCE OVER FORM AS APPLIED TO TP***

DIPN 59 provides guidance as to how the substance over form rule may be applied in a TP context in which the IRD has the power to recharacterise the transaction if it lacks commercial rationality. DIPN 59 explicitly states that where reliable data show that comparable uncontrolled transactions exist, it cannot be argued that such transactions between associated persons would lack commercial rationality.

In relation to the application of TP methods, the IRD provides specific guidance:

- Where a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferred
- Whilst there is no preference for the use of commercial databases, the IRD disclosed that it has subscribed to the Orbis/Osiris databases
- Local comparables are preferred and, in their absence, overseas comparables can be accepted if they are based on a similar market principle.
- The IRD rejects the use of statistical tools that do not increase the reliability of the data and cites the explicit rejection of pooled ranges.

## ***ALLOCATION OF PROFITS TO PE***

The HK definition of PE is consistent with that of the OECD Model Tax Convention and relies on the AOA to allocate taxable profits to the PE. This comprises two steps under DIPN 60. First, identify the related party dealings in which the PE is involved and determine the relevant functions, assets and risks of the PE. Next, the taxpayer must apply the arm's length principle to the recognised dealings, including the comparability analysis and application of the OECD TP methods.

## ***CbC REPORT***

A HK taxpayer is part of a reportable Group if total consolidated group revenue exceeds certain threshold amounts for the immediately preceding accounting period as follows:

- If the Ultimate Parent Entity (UPE) is a HK tax resident, the specified threshold amount is HKD6.8m
- If the UPE is not a HK tax resident and that jurisdiction requires a CbC report to be filed, the specified threshold amount is the amount as stipulated in the said jurisdiction
- If the UPE is not a HK tax resident and that jurisdiction does not require a CbC report to be filed, the specified threshold amount is an amount in the currency of that jurisdiction equivalent to €750 million as at January 2015

The filing deadline for a CbCR is 12 months after the accounting year-end. A HK taxpayer of a reportable Group is required to file a CbCR notification in electronic form via the CbCR Portal within three months after the accounting year-end (unless another HK taxpayer of the same Group has filed the notification).

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## **SUMMARY**

While the HK DIPNs are largely consistent with OECD guidelines, it is worth noting the specific guidance around the use of TP methods, substance over form recharacterisation and the adoption of the AOA for PEs, which not all countries across Asia have adopted.

Groups with a HK presence should consider the following:

- Whether existing HK operations will trigger any TP documentation obligations. If so, instead of merely replicating pre-existing Group TP documentation, ensure that the TP documentation accurately reflects the functional profile of HK transactions.
- Regardless of exemptions, ensure that TP analyses supporting the related party pricing, allocation of profits to PEs, intercompany agreements and records of TP adjustments are properly kept in HK.
- For HK headquartered groups, whether it crosses the threshold and becomes liable to file a CbCR notification. For non-HK headquartered groups, the UPE or surrogate entity of which is subject to CbCR, the HK taxpayer needs to ensure that it files the annual CbCR notification with the IRD.
- As a major financial services hub, the adoption of the AOA will mean that HK branches must take a prudent approach and have their profit allocation analysis updated and documented. This also ties in with the recent queries raised by IRD on proper remuneration of HK entities and fund managers in the context of offshore fund structures.

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