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Hong Kong Tax News

Hong Kong Government releases BEPS consultation report

Making another century of impact
德勤百年庆 开创新纪元

The Hong Kong SAR Government (the Government) released a report (the Report) on 31 July 2017 summarising the outcome of its consultation exercise on measures to counter Base Erosion and Profit Shifting (BEPS).

After taking into account the views in the submissions made by the industry, professional bodies, business chambers and others, the Government has also set out the fine-tune position of the proposed law to be introduced later this year, to implement measures to counter BEPS. The Government has also reiterated its commitment to upholding Hong Kong's territorial-based tax regime.

We set out in brief below the key outcomes from the consultation exercise.

Areas of new laws to be introduced	**Fine-tune position**
Transfer pricing (TP) and advance pricing arrangement (APA) regime	• The transfer pricing regime will be based on the OECD's transfer pricing guidelines and relevant commentary, with the applicable version of OECD rules specified in the legislation. • Contrary to the views in some of the submissions made, domestic

	transactions will not be excluded from the transfer pricing regime. • While thin capitalisation rules will not be introduced, there will be a specific arm's length requirement on intra-group borrowing transactions and persons carrying on the functions of development, enhancement, maintenance, protection and exploitation of intellectual property. • No safe harbour rule for arm's length return will be available. • Penalty provisions will be introduced for incorrect tax returns relating to non-arm's length transactions without reasonable excuse or with wilful intent, though the existence of OECD-compliant transfer pricing documentation may be taken into consideration when assessing whether taxpayers have a "reasonable excuse".
TP documentation and country-by-country (CbC) reporting	• In accordance with the general views expressed in the submissions, the Government will allow exemption either based on scale of business or related party transactions (RPT), for the preparation of master files and local files as follows: ○ An enterprise which satisfies any two of the three conditions below will not be required to prepare master file and local file: (i) Total annual revenue not more than HKD200million; (ii) Total assets not more than HKD200million; and (iii) Not more than 100 employees. ○ An enterprise will not be required to prepare a local file for that particular category of transactions: (i) Transfer of properties (other than financial assets and intangibles): HKD220million; (ii) Transaction of financial assets: HKD110million; (iii) Transfer of intangibles: HKD110million; and (iv) Any other transaction (e.g. service income and royalty income): HKD44million. For an enterprise with all its RPTs below the prescribed thresholds, it will not be required to prepare the master file. It is worth noting that the above thresholds are pretty much in line

	with those set out in Bulletin 42 issued by the State Administration of Taxation in China in June 2016 governing local file obligations for PRC enterprises. • A Multinational Enterprise (MNE) with annual consolidated group revenue equal to or exceeding EUR750 million (i.e. about HKD6.8 billion), with its ultimate holding company or one of its constituent entities in Hong Kong will be required to file a CbC report. The Inland Revenue Department (IRD) will utilise Hong Kong's network of Comprehensive Double Taxation Agreements (CDTAs) and Tax Information Exchange Agreements (TIEAs) as the basis for conducting automatic exchange of CbC reports. • Hong Kong will accept parent surrogate filing as transitional arrangement for CbC reporting for accounting periods commencing between 1 January 2016 and 31 December 2017.
Multilateral instrument (MLI)	• The Government has chosen to implement only the minimum standards of the MLI, being Articles 6 (Purpose of a Covered Tax Agreement), 7 (Prevention of Treaty Abuse) and 16 (Mutual Agreement Procedure), and has opted out of the remaining articles, under territorial extension of China as signatory to the MLI. • Regarding prevention of treaty abuse, Hong Kong will continue to adopt the principal purposes test only rule for all tax treaties.
Double taxation relief, and dispute resolution mechanism	• To lengthen time limit for tax credit claim to the later of (a) within six years or (b) six months after the date of notice of assessment raised by IRD imposing tax liability on the income on which foreign tax has been assessed. • Will continue to expand Hong Kong's CDTA network and negotiate with potential partners to include a mandatory arbitration article in the CDTAs as appropriate.
Spontaneous Exchange of Information on Tax Rulings	• Will ride on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (under territorial extension of China as signatory) together with bilateral CDTAs and TIEAs to conduct

	spontaneous exchange of information for the six specified categories of tax rulings (both past and future rulings), in order to meet the minimum standard of BEPS package.
Harmful Tax Practice	• No specific action contemplated at this stage.

The Government targets to introduce the amendments bill for the above matters into Legislative Council by the end of 2017, with the exception of that for the MLI by mid-2018. The IRD will also issue/ update relevant Departmental Interpretation & Practice Notes to provide more guidance in specific areas.

Overall, it is encouraging to see that the Government has taken into account some of the views in the submissions, with Deloitte's submission being one of those.

We will provide further, in-depth analysis of the relevant legislation when it is released to the public.

Tax Newsflash is published for the clients and professionals of Deloitte Touche Tohmatsu. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter.

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