

# **HONG KONG TRANSFER PRICING 2020**

## **APPROACHING DEADLINES AND TAX EFFICIENT PLANNING**

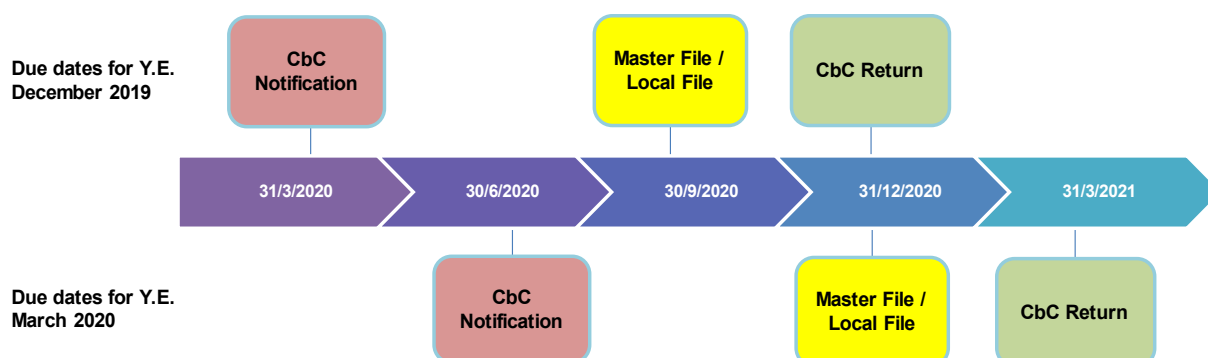


## Background

If your Hong Kong entity is part of a multinational enterprise ("MNE") group carrying out related party transactions and meets the relevant conditions, it could be subject to Hong Kong Transfer Pricing ("TP") documentation requirements in 2020, which consist of the Country-by-Country ("CbC") Notification, Master File and Local File, and the CbC Return (which includes a CbC Report). As illustrated in our previous newsletters, the first financial years that are subject to the CbC requirements and Master File/ Local File requirements are the year ended on 31 December 2018 and the year ended on 31 March 2019 respectively.

In fact, your MNE group should have worked or started working towards **the approaching deadlines now** if your Hong Kong entity has a financial year ended on 31 December 2019 or ending on 31 March 2020. We have summarized these approaching deadlines as follows:-

Deadline for CbC Reporting, Master File and Local File	Year ended 31 December 2019	Year ending 31 March 2020	General rule
CbC Notification	<b>31 March 2020</b>	30 June 2020	3 months from Y.E. date
Master File and Local File	30 September 2020	31 December 2020	9 months from Y.E. date
CbC Return and CbC Report	31 December 2020	31 March 2021	12 months from Y.E. date



## How We Can Help

As the TP documentation deadlines are just around the corner, it is imperative for your Hong Kong entity to work towards the above deadlines if the relevant conditions are met. We would be pleased to assist you in any of the above TP documentation procedures upon your request. Please feel free to contact your usual PKF Hong Kong Tax tax executives or our Tax Partner, Henry Fung ([henryfung@pkf-hk.com](mailto:henryfung@pkf-hk.com) or +852 2806 3822) for further information.

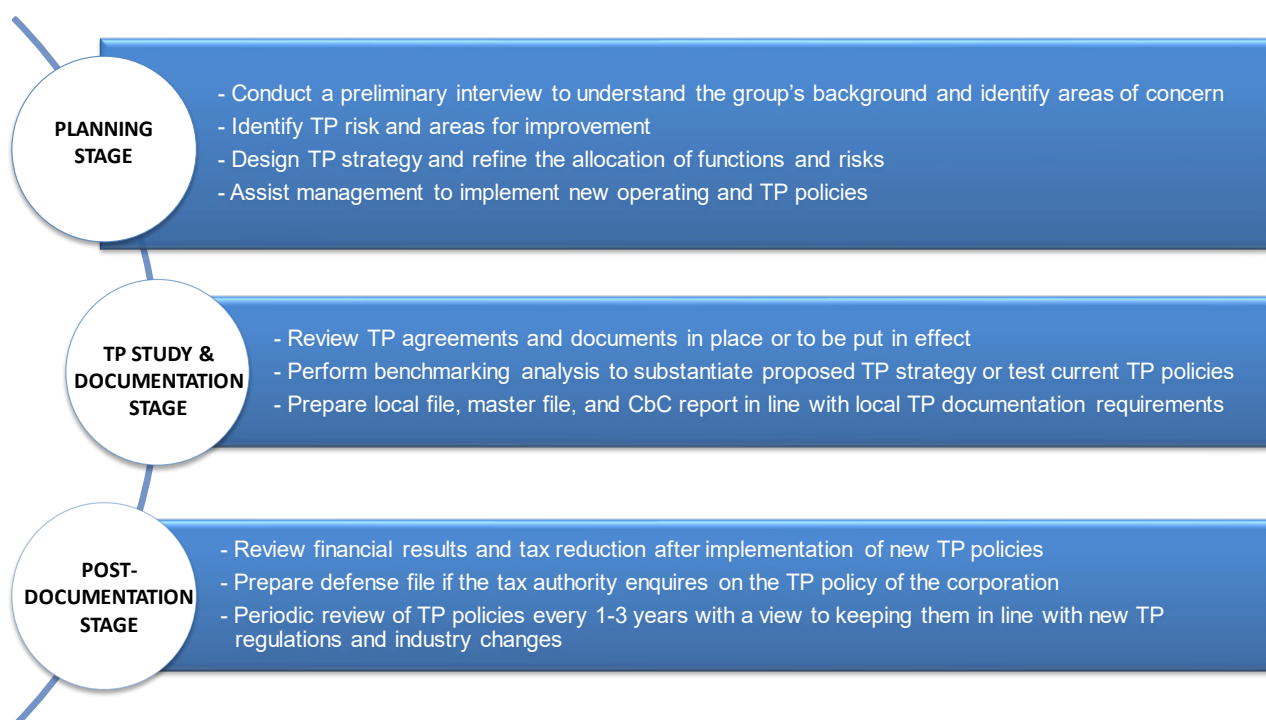
Please refer to the following parts for the comprehensive range of services we could offer and our detailed work procedures.

## How We Work

Corporations in Hong Kong, regardless of whether they are subject to the above TP documentation requirements, should be able to justify that their TP policies and related party transactions are in line with the arm's length principle. **If the related party transactions do not meet the arm's length standard and result in a tax advantage**, adjustments to the related party transactions would be required, which would cause significant time and costs to be incurred, and would give rise to **additional tax liability plus potential penalties of up to 100% of the tax undercharged**. In this regard, we highly recommend that you seek professional assistance on your corporation's related party transactions sooner rather than later. The range of services which we can assist your corporation is summarized below.

Risk assessment	Transfer pricing planning	Transfer pricing study	Transfer pricing documentation	Dispute resolution
<ul style="list-style-type: none"> <li>Identify TP adjustment risk regarding existing and proposed related party transactions</li> <li>Identify areas of improvement in terms of tax efficiency of related party transactions</li> </ul>	<ul style="list-style-type: none"> <li>Design and formulate group TP strategies/ policies in line with relevant TP regulations</li> <li>Optimize the group's business operations</li> <li>Reduce TP risks while achieving tax efficiency</li> </ul>	<ul style="list-style-type: none"> <li>Perform TP analysis, including a detailed review of functions and risks borne by related parties</li> <li>Perform benchmarking study in support of the proposed TP strategies/ policies and to test if existing TP policies require further adjustments</li> </ul>	<ul style="list-style-type: none"> <li>Prepare contemporaneous documentation</li> <li>Prepare local file, master file and CbC report</li> <li>Provide guidance on how to maintain internal supporting documents</li> </ul>	<ul style="list-style-type: none"> <li>Prepare defense file</li> <li>Negotiate with tax authorities</li> <li>Prepare adjustment settlement</li> <li>Advise on post-dispute management</li> </ul>

Depending on the specific TP matter, our work approach would usually include the following steps:



## How We Work

The close working relationship we develop with our clients is a core element of our service. We place emphasis on initiating and maintaining regular communication with our clients which enables us to provide a seamless client experience, from the timely analysis of our clients' TP policy and documentation requirements, performing TP study and providing recommendations to achieve tax efficiency, reminders for relevant deadlines, preparation and submission of TP documentation, to advising and helping our clients to handle the IRD's correspondence or enquiries.

Further, we are always looking to provide insight into sustainable TP practices which our clients may adopt to ensure compliance with TP laws and regulations in the long run. After all, we aim to strike a balance between TP compliance and global tax efficiency in all our TP advice and compliance deliverables.

We assist many of our clients to perform TP study in a **two-step approach**. An **initial TP study** (including reviewing their current TP policies and intercompany arrangements before the relevant year-end) is conducted so that they have **sufficient time to perform internal adjustments** to enhance the compliance status **before the closing of the financial year**. Based on the refined TP policy, we assist our clients to **finalize TP documentation to support the enhanced TP results**.

The relevant conditions and thresholds for determining the obligations for preparing the TP documentation are detailed in the Appendices to this document.

## Who needs to file the CbC Notification and Return?

### **Overview of CbC Reporting Requirements**

An MNE group is regarded as a "Reportable Group" for the financial year 2019 if its 2018 total consolidated group revenue, as shown in its consolidated financial statements, is of at least the following:-

1. if the ultimate parent entity ("UPE") of the Reportable Group is a Hong Kong tax resident, the specified threshold amount is HK\$6.8 billion of total consolidated group revenue;
2. if the UPE of the Reportable Group is a resident for tax purposes in a jurisdiction other than Hong Kong and that jurisdiction requires the filing of a CbC Report in respect of an accounting period by an MNE group that has a total consolidated group revenue for 2018 of at least an amount stipulated under the laws or regulations of that jurisdiction, the specified threshold amount is the amount so stipulated; or
3. if the UPE is a resident for tax purposes in a jurisdiction other than Hong Kong which does not require the filing of a CbC report as mentioned in (2) above, the specified threshold amount is an amount in the currency of that jurisdiction equivalent to EUR750 million as at January 2015.

### **CbC Notification**

The CbC notification contains information relevant for determining the obligation to file a CbC Return in Hong Kong. It requires a range of detailed information of the MNE group, its UPE, as well as each of its Hong Kong entities.

- A Hong Kong entity of a Reportable Group (even if its UPE is not a Hong Kong entity) must file with the Hong Kong Inland Revenue Department ("IRD") a CbC Notification within 3 months after the end of its relevant accounting period.
- If a Reportable Group has multiple Hong Kong entities, only one CbC notification is required to be filed.
- The CbC notification must be filed with the IRD electronically via the CbC reporting portal designated by the IRD. A CbC reporting account and a specialized identification e-Certificate is required to be obtained before the CbC notification can be filed.
- Please note that even if a Reportable Group is exempt from filing the CbC Return and CbC Report, it is still required to file the CbC notification in Hong Kong.

### **CbC Return and CbC Report**

The CbC Return and CbC Report contain aggregate tax jurisdiction-wide information such as the global allocation of the income, the taxes paid, certain indicators of the location of economic activity, etc. The CbC Return also requires a listing of all the Reportable Group entities for which financial information is reported, including their respective jurisdiction of incorporation (if different from the tax jurisdiction of residence) and principal business activity.

The rules for determining the obligation for filing the CbC Return and CbC Report are relatively complex. For the details on CbC Return and CbC Report requirements, please further refer to the next page.



## **Primary CbC reporting obligation**

Under the Ordinance, if the UPE of a Reportable Group is a Hong Kong entity, such UPE will have the “primary obligation” to file a CbC Return (which includes a CbC report) with the IRD within 12 months after the end of the relevant accounting period for each accounting period beginning on or after 1 January 2018. Taxpayers which fail to file the CbC Return are potentially subject to penalties.

## **Secondary CbC reporting obligation**

If the UPE of a Reportable Group is a non-Hong Kong tax resident, a Hong Kong entity of such Reportable Group would still have a “secondary obligation” to file a CbC Return (including a CbC report) with the IRD if any of the following conditions is met:-

1. the UPE is not required to file a CbC Report in respect of the accounting period in its jurisdiction of tax residence;
2. the jurisdiction of tax residence of the UPE has entered into an international agreement which allows automatic exchange of information, but has no exchange arrangement in effect with Hong Kong by the time the CbC Return is due to be filed in Hong Kong; or
3. the jurisdiction of tax residence of the UPE has suspended or persistently failed to undertake the exchange of CbC reports with Hong Kong.

However, even if one of the above conditions is met, a Hong Kong entity of a Reportable Group can be exempted from filing a CbC Return if:-

1. a CbC Return for the relevant accounting period is filed by another Hong Kong entity with the IRD on behalf of the Reportable Group; or
2. the Reportable Group has appointed a constituent entity as its surrogate parent entity (“SPE”) to file CbC Report on behalf of the Group, and the CbC Report is filed by the SPE in Hong Kong or a jurisdiction which has an exchange arrangement in place with Hong Kong.

The CbC reporting determination process is sophisticated and may depend on the status of execution of exchange arrangements between Hong Kong and relevant jurisdictions. Please contact us for more information.

## Who needs to file the Master File and Local File?

### Master File and Local File

The Master File contains high-level information about the MNE group's business and TP policies, including the organizational structure and business of the MNE group, its intangible assets, financing activities, and financial and tax positions.

The Local File contains more detailed information and analysis of an MNE group at an entity level, including an overview of MNE group entities, related party relationships and transactions, functions performed and risks borne by relevant parties, comparability analysis, TP methods, benchmarking results and conclusion of whether the TP model meets the arm's length requirement.

An MNE group entity which is carrying on a trade or business in Hong Kong and has engaged in related party transactions will be required to prepare the Master File and Local File, unless it is eligible for any one of the two exemptions as follows:-

Business size test	
Total revenue	Not exceeding HK\$ 400 million
Total assets	Not exceeding HK\$ 300 million
Number of employees (average)	Not exceeding 100
If an enterprise meets any <u>two</u> of the above conditions (i.e. any two of the "total revenue", "total assets" and "number of employees" are below relevant thresholds) for an accounting period, the enterprise will be wholly exempt from preparing the Master File and Local File.	

Related party transaction size test (four categories of transactions)	
Transfer of tangible assets	Not exceeding HK\$ 220 million
Transactions of financial assets	Not exceeding HK\$ 110 million
Transfer of intangible assets	Not exceeding HK\$ 110 million
Any other transactions	Not exceeding HK\$ 44 million
If the total transaction amount under a category is below the relevant threshold for the accounting period, the enterprise shall not be required to cover that category of transactions in the Local File. If the total transaction amount <u>under each of the categories</u> is below the relevant threshold, the enterprise will be wholly exempt from preparing the Master File and Local File.	

Please note that even if any of the above exemptions regarding Master File and Local File applies, the IRD still recommends that taxpayers should maintain sufficient documentation to substantiate that all the related party transactions of the MNE group comply with the relevant TP rules.

For more information, please feel free to contact your usual PKF Hong Kong tax executives or our Tax Partner, Henry Fung ([henryfung@pkf-hk.com](mailto:henryfung@pkf-hk.com) or +852 2806 3822).

## Contact us

As a member firm of PKF International, PKF HK provides business solutions to clients on a global basis through sharing resources of the PKF network with our offices located across 150 countries. We offer a comprehensive scope of tax advisory and compliance services in HK and the PRC. Our tax professionals in HK and the PRC have extensive experience and knowledge on HK, PRC, and cross-border tax issues. In addition, our TP professionals in HK and the PRC are experienced in providing advisory services on tax-efficient group restructuring and compliance services with TP regulatory requirements.





Henry Fung  
Tax Partner  
[henryfung@pkf-hk.com](mailto:henryfung@pkf-hk.com)

### PKF Hong Kong Limited

26/F, Citicorp Centre, 18 Whitfield Road,  
Causeway Bay, Hong Kong

Tel:	+852 2806 3822
Email:	<a href="mailto:enquiry@pkf-hk.com">enquiry@pkf-hk.com</a>
Website:	<a href="http://www.pkf-hk.com">www.pkf-hk.com</a>

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