For discussion
on 5 December 2016

Legislative Council Panel on Financial Affairs

Consultation on measures to counter Base Erosion and Profit Shifting

PURPOSE

The Government is conducting a consultation exercise on Hong Kong's implementation strategy on the measures formulated by the Organisation for Economic Co-operation and Development ("OECD") to counter base erosion and profit shifting ("BEPS"). The consultation paper is at **Annex**. This paper seeks Members' views on the proposed implementation strategy.

OVERVIEW OF THE BEPS PACKAGE

2. BEPS refers to tax planning strategies of multinational enterprises ("MNEs") that exploit the gaps and mismatch in tax rules to artificially shift profits to low or no-tax locations where the MNEs have little or no economic activity. Apart from causing tax revenue loss[1], BEPS undermines the fairness and integrity of tax systems. MNEs may deploy BEPS strategies to gain a competitive advantage over their domestic counterparts, thereby creating an unleveled playing field.

3. In October 2015, OECD released a package of 15 action plans to tackle BEPS. The Group of Twenty and OECD have called on all countries and jurisdictions to join an inclusive framework for implementation of the BEPS package[2]. Being an international financial centre and a responsible member of the international community, Hong Kong has joined the inclusive framework as an Associate, and indicated to OECD in June 2016 its **commitment to the BEPS package and the consistent implementation of the package**. Our commitment is subject to the timely passage of the necessary legislative

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1 According to OECD's estimates, revenue losses due to BEPS range from USD100 billion to 240 billion a year, representing 4% to 10% of global corporate income tax revenue.

2 As at 24 November 2016, 90 jurisdictions have joined the inclusive framework.

amendments.

IMPLEMENTATION STRATEGY OF HONG KONG

4. Hong Kong will focus on the four minimum standards of the BEPS package as well as measures of direct relevance to their implementation. The four minimum standards cover countering harmful tax practices (Action 5), preventing treaty abuse (Action 6), imposing country-by-country ("CbC") reporting requirement (Action 13) and improving cross-border dispute resolution mechanism (Action 14). In formulating the way forward for Hong Kong, we are mindful of the need to meet the international standard without compromising our simple and low tax regime.

5. Specifically, our priority is to **put in place the necessary legislative framework** for transfer pricing rules which cover the latest guidance from OECD (Actions 8 to 10), spontaneous exchange of information ("EOI") on tax rulings (Action 5), CbC reporting requirement (Action 13), cross-border dispute resolution mechanism (Action 14) as well as the Multilateral Instrument ("MLI") (Action 15). Our proposals are outlined in the ensuing paragraphs.

LEGISLATIVE PROPOSALS

Transfer Pricing Regulatory Regime (Chapter 3 of the consultation paper)

6. Transfer pricing refers to the setting of prices for transactions of goods, services and intangible property between associated enterprises. The internationally agreed standard for setting transfer price is the arm's length principle. Currently, the Inland Revenue Department ("IRD") implements the arm's length principle by way of administrative guidelines. We propose to **codify such principle into the Inland Revenue Ordinance (Cap. 112) ("IRO")** such that enterprises operating in Hong Kong are required to compute their profits or loss from transactions with associated enterprises on an arm's length basis for tax purposes. The transfer pricing rules will apply to cases where the **affected persons are associated**, and **dealings between different parts of an enterprise**[3].

7. Moreover, we propose to put in place a mechanism to **provide for**

[3] In this connection, profits will be attributed to each part of the enterprise in the amount that it would have made as if the part were a distinct and separate enterprise.

corresponding relief resulting from transfer pricing adjustments made by the authorities. We also propose to provide a **statutory basis for IRD's current advance pricing arrangement ("APA") regime.** Under the APA regime, enterprises may reach prior agreement with IRD on the method of applying the arm's length principle to transactions or arrangements between associated enterprises. Moreover, any taxpayer who makes an incorrect tax return arising from non-compliance with the transfer pricing rules, with a willful intent to evade tax or without reasonable excuses, will be liable to a **penalty**.

Transfer Pricing Documentation and CbC Reporting (Chapter 4)

8. OECD has developed a **three-tiered standardised approach** to transfer pricing documentation (i.e. master file, local file and CbC report). This approach requires an enterprise to articulate consistent transfer pricing position and provide tax administration with useful information for assessing transfer pricing risks. Our proposals are as follows:

(a) We propose to **require enterprises engaged in transactions with associated enterprises to prepare master and local files**, unless they can satisfy **any two of the three conditions**[4] below –
    (i) total annual revenue not more than HK$100 million;
    (ii) total assets not more than HK$100 million; and
    (iii) no more than 100 employees.

(b) As regards CbC reports, filing would be required, as mandated by OECD, for MNEs with **annual consolidated group revenue equal to or exceeding EUR750 million** (or an equivalent amount in domestic currency as of January 2015, i.e. about **HK$6.8 billion**). We envisage that, in Hong Kong, about 150 enterprises will be caught by the above criteria. Our current plan is to rely on Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") or Tax Information Exchange Agreements ("TIEAs") as the basis for automatic exchange of CbC reports with our CDTA and TIEA partners on a bilateral basis.

(c) To ensure compliance with the requirements in relation to the preparation of master files and local files, and the filing of CbC reports,

[4] The proposed exemption criteria are drawn up with reference to the reporting exemption provided for "small private company" under the Companies Ordinance (Cap. 622).

we propose to **introduce corresponding penalty provisions** in the IRO.

Multilateral Instrument (Chapter 5)

9. The MLI seeks to ensure swift, co-ordinated and consistent implementation of treaty-related BEPS measures in a multilateral context (e.g. avoid abuse of CDTA provisions). These would involve a set of modifications to the existing CDTAs signed by various jurisdictions. As these measures are meant to tackle aggressive tax planning strategies, enterprises not involved in such strategies will not be affected. Given Hong Kong's extensive CDTA network, we intend to modify the relevant provisions of our CDTAs by way of the MLI, so as to obviate the need for bilateral negotiations with individual CDTA partners.

Other related matters (Chapter 6)

10. Our proposals on a number of other related matters are set out below:

(a) ***Dispute Resolution Mechanism (Action 14):*** In the post-BEPS regime, the number of cross-border treaty-related disputes requiring resolution via mutual agreement procedure ("MAP") or arbitration will inevitably increase. We propose to **introduce a statutory mechanism to facilitate the handling of MAP and arbitration cases** in Hong Kong.

(b) ***Spontaneous EOI on Tax Ruling (Action 5):*** To combat harmful tax practices by improving transparency, OECD mandates compulsory spontaneous EOI in respect of tax rulings under six specific categories[5]. While it remains our policy not to conduct spontaneous EOI, we propose to **make an exception in respect of the six specified categories of tax rulings**, having regard to OECD's latest requirements. Our current plan is to conduct such spontaneous exchange with our CDTA or TIEA partners on a bilateral basis.

(c) ***Double Taxation Relief:*** With the implementation of statutory transfer pricing rules and the continued expansion of Hong Kong's CDTA

5 The six categories are: (a) rulings relating to preferential regimes; (b) unilateral APAs and any other cross-border unilateral rulings in respect of transfer pricing; (c) cross-border rulings providing for a downward adjustment of taxable profits; (d) PE ruling; (e) related party conduit ruling; and (f) any other type of ruling that, in the absence of spontaneous information exchange, could give rise to BEPS concerns.

network, we envisage that there would be more claims for double taxation relief by way of tax credits. We propose to **enhance the current tax credit system**. The proposed changes include allowing a longer period for claiming tax credit (i.e. six years), and disallowing tax credits in respect of a foreign tax payment if unilateral relief has already been granted.

CONSULTATION

11. The Government launched a two-month public consultation exercise on 26 October 2016 to gauge views on the proposals. We have conducted engagement sessions with relevant key stakeholders such as accountancy and legal professional bodies as well as business chambers. The consultation paper has been uploaded onto the website of the Financial Services and the Treasury Bureau[6]. The consultation will end on 31 December 2016 and we welcome views and suggestions from the interested parties.

WAY FORWARD

12. The implementation timetable for BEPS is very tight. Members of the BEPS inclusive framework are expected to develop a monitoring process for the four minimum standards as well as put in place review mechanisms for other elements of the BEPS package. As regards CbC reporting, our plan is to require the relevant MNEs to gather the information in 2018 and file their first CbC reports to IRD in 2019, so as to tie in with OECD's global review in 2020. To meet OECD's requirement, our current target is to introduce the relevant amendment bill(s) into the Legislative Council in mid-2017.

Financial Services and the Treasury Bureau
Inland Revenue Department
November 2016

[6] www.fstb.gov.hk/tb/en/docs/BEPS-ConsultationPaper-e.pdf

Consultation Paper on measures to counter Base Erosion & Profit Shifting

EXECUTIVE SUMMARY

The international tax landscape has been evolving very rapidly in recent years. Protection of revenue by combating cross-border tax avoidance and tax evasion is the concerns not only of individual economies, but also of major international bodies such as the Group of Twenty ("G20") and the Organisation for Economic Co-operation and Development ("OECD").

2. The Base Erosion and Profit Shifting ("BEPS") package was first launched by G20 and OECD in 2013. It represents the concerted efforts of the international community to design common responses to international tax challenges. The ultimate objective of the BEPS package is to restore public confidence in tax systems and level the playing field for businesses. The BEPS package, comprising 15 action plans, seeks to improve the coherence of international tax rules, realign taxation with economic substances and value creation, and promote a transparent tax environment.

3. To ensure a consistent and effective global approach, G20 and OECD have called on all countries and jurisdictions to join the inclusive framework for implementation of the BEPS package. Participants will together develop international standards and participate in the subsequent review and monitoring mechanism. As at 15 July 2016, 85 countries and jurisdictions have joined the inclusive framework. Being an international financial centre and a responsible member of the international community, Hong Kong indicated to OECD in June 2016 **our commitment to the BEPS package and its consistent implementation**. We have clearly stated that our commitment would be subject to the timely passage of the necessary legislative amendments.

4. Hong Kong has been practising a simple and territorial-based tax regime, which is a cornerstone of our long-term success and competitiveness. Implementing the BEPS package in Hong Kong will inevitably entail changes to our existing tax laws. In formulating the implementation model of the BEPS package in Hong Kong, we need to ensure that our model meets the international standard without compromising our simple and low tax regime. In this regard, we will

draw up a **pragmatic strategy** and implement the corresponding international requirements.

5. The key components and requirements of the BEPS package are summarised in **Chapter 1** of this paper. We have set out our policy intent and priorities for Hong Kong in relation to the implementation of the BEPS package in **Chapter 2**. Our priority is to put in place the necessary legislative framework for a transfer pricing regulatory regime (**Chapter 3**), transfer pricing documentation and country-by-country reporting (**Chapter 4**), Multilateral Instrument (**Chapter 5**), dispute resolution mechanism and spontaneous exchange of information on tax rulings (**Chapter 6**). We have flagged up the key areas for gauging public views (**Chapter 7**) and will consult stakeholders from 26 October to 31 December 2016. Our plan is to introduce the relevant amendment bill(s) into the Legislative Council in mid-2017.

CHAPTER 1

OVERVIEW OF THE BEPS PACKAGE

What is BEPS?

1.1 Base Erosion and Profit Shifting ("BEPS") refers to tax planning strategies of multinational enterprises ("MNEs") that exploit the gaps and mismatch in tax rules to artificially shift profits to low or no-tax locations where the MNEs have little or no economic activity. According to the estimates by the Organisation for Economic Co-operation and Development ("OECD"), revenue losses due to BEPS range from **USD100 to 240 billion a year**, representing 4% to 10% of global corporate income tax revenue.

1.2 Tax revenue loss aside, BEPS undermines the fairness and integrity of tax systems. MNEs may deploy BEPS strategies to gain a competitive advantage over their domestic counterparts, thereby creating an **unleveled playing field**. Thus, OECD sees an imminent need for all countries and jurisdictions to work together to restore public confidence in tax systems and ensure fair competition.

Components of the BEPS package

1.3 In October 2015, OECD released a final package of **15 action plans** to tackle BEPS. Endorsed by the Group of Twenty ("G20") in November 2015, the BEPS package aims to ensure that MNEs pay a fair share of taxes in respect of their profits and plug the loophole of "double non-taxation" among jurisdictions.

1.4 The 15 action plans can be grouped into **four main categories** –

(a) **New minimum standards** seek to tackle issues where no action by some jurisdictions would have created negative spillovers (including adverse impacts of competitiveness) on other jurisdictions. These include countering harmful tax practices, preventing treaty abuse, imposing country-by-country ("CbC") reporting requirement and improving cross-border dispute resolution mechanism;

(b) **Reinforced international standards** seek to update the prevailing international standards. These include preventing artificial avoidance of permanent establishment ("PE") status and aligning transfer pricing outcomes with value creation;

(c) **Common approaches and best practices** seek to facilitate the convergence of national practices. These include neutralising effects of hybrid mismatch arrangements, designing effective controlled foreign company rules, limiting base erosion involving interest deductions and other financial payments, and introducing mandatory disclosure rules; and

(d) **Analytical reports** provide recommendations on tackling other BEPS-related issues. These include addressing tax challenges of digital economy, measuring and monitoring BEPS, and developing a Multilateral Instrument ("MLI") to modify bilateral tax treaties.

An overview of the BEPS package is at **Annex A**.

Inclusive Framework for Implementation of the BEPS Package

1.5 In February 2016, G20 Finance Minsters endorsed a new inclusive framework to allow interested countries and jurisdictions to participate **on an equal footing** with OECD and G20 countries. The inclusive framework aims to develop international standards relating to BEPS and implement the BEPS measures in a consistent manner. On 20 June 2016, Hong Kong accepted OECD's invitation and joined the inclusive framework in the name of "Hong Kong, China". As at 15 July 2016, 85 countries and jurisdictions have joined the inclusive framework.

1.6 For those countries and jurisdictions which decide not to join the inclusive framework, OECD may identify them as **"jurisdictions of relevance"** whose adherence to the minimum standards will still be required so as to uphold a **level-playing field**. These jurisdictions will be informed of the minimum standards and invited to commit to the BEPS package. They will also be subject to monitoring and review by OECD.

Review of Implementation of Minimum Standards

1.7 OECD's **top priority** is to monitor the implementation of the four minimum standards. It will put in place a monitoring mechanism on jurisdictions' compliance as well as the impact of the BEPS package over time. All members of the inclusive framework will be invited to participate in the review process.

1.8 The **implementation timetable for BEPS is very tight**. Members of the inclusive framework are expected to develop a monitoring process for the four minimum standards as well as put in place the review mechanisms for other elements of the BEPS package. OECD is aware that the timing of implementation may vary among jurisdictions having regard to the level of their development and the need for some jurisdictions to pass the necessary domestic legislation. The implementation plans for specific BEPS Actions will be elaborated in the ensuing chapters.

1.9 Implementing the BEPS package signifies the concerted efforts of the international community to improve the tax regime. Various countries / jurisdictions have been taking proactive actions to implement the BEPS package. Some of these examples are in **Annex B**. Being a member of this inclusive framework, Hong Kong needs to draw up a pragmatic strategy and implement the corresponding international requirements.

CHAPTER 2

IMPLEMENTATION STRATEGY OF HONG KONG

Policy Intent

2.1 Hong Kong has all along been supportive of international efforts to promote tax transparency and combat cross-border tax evasion. We need to commit to the BEPS package so as to uphold our reputation and fulfil our obligations as an international financial and business centre.

2.2 As a member of the inclusive framework, Hong Kong is **committed to implementing the BEPS package**, **including the four minimum standards,** i.e. countering harmful tax practices (Action 5), preventing treaty abuse (Action 6), imposing CbC reporting requirement (Action 13) and improving cross-border dispute resolution mechanism (Action 14).

2.3 We would not under-estimate the challenges of implementing the BEPS package, given the wide range of measures involved and the need to amend our tax laws to put the relevant measures in place. We have indicated to OECD that our commitment to implement the BEPS package is subject to timely passage of the necessary legislative amendments. Moving forward, we will continue to uphold a simple and low tax regime, which is widely recognised as a cornerstone of Hong Kong's success and competitiveness.

Priorities for Hong Kong

2.4 On priority setting, we will focus on the four minimum standards as well as measures of direct relevance to their implementation.

2.5 Our priority is to **put in place the necessary legislative framework** for transfer pricing rules which cover the latest guidance from OECD (Actions 8 to 10), spontaneous exchange of information ("EOI") on tax rulings (Action 5), CbC reporting requirement (Action 13), cross-border dispute resolution mechanism (Action 14) as well as MLI

(Action 15). Our considerations are –

(a) Actions 8 to 10 recommend a set of revised guidelines on **transfer pricing** for aligning the taxation of profits with economic activities. While Actions 8 to 10 are not part of the minimum standards imposed by OECD, implementing the revised transfer pricing guidelines and establishing a dedicated regulatory framework are integral to addressing other minimum standards (e.g. Actions 13 and 14). In addition, the proposed regulatory framework will provide a clear legal basis for the Inland Revenue Department ("IRD") to systematically address the transfer pricing issues;

(b) **Spontaneous EOI on tax rulings, CbC reporting and cross-border dispute resolution mechanism** are minimum standards under the BEPS package. We are obliged to enact local legislation to implement these minimum standards in Hong Kong; and

(c) **MLI** seeks to modify our existing Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") so as to implement tax treaty-related BEPS measures in a synchronised and efficient manner. Two minimum standards of the BEPS package (i.e. Action 6 – Preventing Treaty Abuse and Action 14 – Improving Cross-border Dispute Resolution Mechanism) will be addressed in the context of MLI.

2.6 Countering harmful tax practices is a minimum standard required by Action 5. To this end, Hong Kong will strive to maintain a simple, neutral and highly transparent tax regime. IRD will continue to review our tax regime from time to time to ensure that Hong Kong does not offer any harmful tax practices.

Remaining BEPS Actions

2.7 While no immediate action is required for other BEPS Actions, the Government will keep in view the pace of international developments, and draw up our response plan as appropriate.

CHAPTER 3

TRANSFER PRICING REGULATORY REGIME

Objective

3.1 We propose to codify the international transfer pricing standard into our domestic legislation such that enterprises operating in Hong Kong are required to transact with their associated enterprises at arm's length.

What is transfer pricing?

3.2 Transfer pricing refers to the setting of prices for transactions of goods, services and intangible property between associated enterprises. For tax purposes, transfer pricing rules determine the conditions, including the price, for transactions among these enterprises resulting in a fair allocation of profits. OECD is seeking to ensure that transfer pricing outcomes are aligned with value creation. This will help avoid manipulations by MNEs which shift profits to low tax jurisdictions.

3.3 The internationally agreed standard for setting transfer price is the **arm's length principle**. This mandates the intra-group transfer prices to be comparable to those that would be charged between independent persons' dealings at arm's length under similar circumstances. This principle has been incorporated in OECD's Model Tax Convention ("MTC") and Transfer Pricing Guidelines ("TPG").

Our current tax regime

3.4 At present, IRD has been relying on the general provisions in the Inland Revenue Ordinance ("IRO") and its Departmental Interpretation and Practice Notes ("DIPNs") to deal with the transfer pricing issues. There are limitations in relying on the administrative rules under the DIPNs, as against codified regulations, to deal with non-arm's length pricing under certain situations. Codifying the relevant rules in statutes would also offer greater clarity and certainty on how the transfer pricing rules interface with other provisions in the IRO.

3.5 Whilst the general anti-avoidance provisions in section 61A of the IRO[1] can be invoked to combat transfer pricing schemes, these provisions only deal with transactions entered into for the sole or dominant purpose of obtaining a tax benefit. The scope of their application is thus limited. It is worth noting that not every transfer pricing scheme involves a transaction and tax avoidance may not always be the sole or dominant purpose of entering into a non-arm's length transaction. The prerequisite for invoking section 61A of the IRO makes it difficult for IRD to effectively combat the increasingly complex transfer pricing schemes.

Transfer pricing rules

3.6 In view of the above, we consider it necessary to specify the transfer pricing rules under the IRO so as to address non-arm's length transactions.

3.7 On the basis of the arm's length principle, we **propose** to provide for the **fundamental transfer pricing rule** ("fundamental rule") which empowers the Commissioner of Inland Revenue ("the Commissioner") to adjust the profits or losses of an enterprise where the actual provision made or imposed between two persons ("affected persons") departs from the provision which would have been made between independent persons and has created a tax advantage. To facilitate proper application of the arm's length principle as advocated by OECD, we **propose** to introduce a specific requirement to construe the fundamental rule in a manner that is consistent with OECD's MTC and TPG.

3.8 The fundamental rule will apply to cases where the **affected persons are associated**, i.e. one affected person is directly or indirectly participating in the management, control or capital of the other, or a third person is participating in the same of both affected persons. It will also

[1] Section 61A of IRO provides that where it would be concluded, having regard to the matters prescribed in the section, that a transaction was entered into for the sole or dominant purpose of enabling a person to obtain a tax benefit, an assessment will be made as if the transaction had not been entered into or carried out or in such other manner as considered necessary to counteract the tax benefit.

apply to the **dealings between different parts of an enterprise**, such as between the head office and a PE[2]. To address different transfer pricing issues, we will make sure that the scope of the fundamental rule is sufficiently wide to **cover not only transactions of assets and services, but also financial or business arrangements like the making of loans**[3] **and cost contribution arrangements ("CCA")**[4]. Clarification should also be made in respect of adjustments to taxable profits or allowable loss to reflect (a) any appropriation from or into trading asset; or (b) any acquisition or disposal of trading asset other than in the course of trade at market value.

3.9 For the sake of fairness, we also **propose** to put in place a mechanism to provide for corresponding relief resulting from transfer pricing adjustments made by the Commissioner or our CDTA partners.

Impact on business

3.10 IRD has all along been applying the arm's length principle to transactions between associated enterprises, regardless of the size and nature of the enterprises concerned. This remains to be our policy. The proposal to codify in law the arm's length principle currently reflected in DIPNs mainly serves to reinforce the regime to enhance **clarity** and **certainty.** It is intended to counter BEPS strategies adopted by MNEs and the impact on small and medium enterprises should not be significant.

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2 In this connection, profits will be attributed to each part of the enterprise in the amount that it would have made as if the part were distinct and separate enterprise (a) having such equity and loan capital attributed as it would reasonably be expected to have as a separate entity; (b) engaging in the same or similar activities under the same or similar conditions; and (c) dealing wholly independently with each other.

3 In determining whether a borrowing is made on an arm's length basis, consideration should be given as to whether and if so, in what amount and at what interest rate the borrowing would have been undertaken in the absence of the relationship between the lender and the borrower, or the guarantee or security provided by an associated enterprise. The borrower will be assumed to have the arm's length borrowing capacity, i.e. the debt that it could and would, as a standalone entity, have taken from an independent lender. Any interest on borrowings beyond such capacity will be disallowed for profits tax purposes.

4 CCA is an arrangement agreed amongst a group of enterprises to share the costs and risks of developing, producing or obtaining assets, services, or rights, and to determine the nature and extent of the interests of each participant in those assets, services, or rights. Employee stock incentive plan is a common example of CCA to share the stock-based compensation costs. In order for a CCA to comply with the fundamental rule, each enterprise's share of the overall contributions should be proportionate to its share of expected income to be derived from the asset or services concerned.

3.11 We acknowledge that transfer pricing documentation will become a new requirement. Having balanced the need for IRD to gather necessary information and to minimise the compliance burden on enterprises, we **propose** to exempt certain enterprises that meet the specified criteria from the documentation requirements. Our proposals are detailed in Chapter 4.

Penalty

3.12 The transfer pricing rules will impose a requirement on enterprises to consider whether taxable profits or allowable losses arising from their transactions with associated parties have to be adjusted when filing their tax returns. Any non-compliance with transfer pricing rules will render the tax returns incorrect. If such incorrect tax returns are made willfully with intent to evade tax, or without any reasonable excuses, the taxpayers concerned will be liable to a penalty.

3.13 Currently, penalties in respect of **incorrect tax returns** are provided for under sections 80, 82 and 82A of the IRO. We consider it appropriate to model on these provisions for providing **penalties** in respect of incorrect tax returns arising from non-arm's length pricing amongst associated parties. Specifically, we **propose** to sanction the enterprises for –

(a) making tax returns with incorrect information on transfer pricing **without reasonable excuse**. This will be an offence carrying a fine at level 3[5] plus an amount trebling the tax undercharged. Alternatively, the taxpayer concerned may be liable to an administrative fine imposed by the Commissioner of an amount not exceeding three times of the tax undercharged; and

(b) making tax returns with incorrect information on transfer pricing **willfully with intent to evade tax**. This will be an offence carrying the maximum penalty of a fine at level 5[6] plus an amount trebling the tax undercharged and imprisonment for 3

[5] At present, fine at level 3 is $10,000.
[6] At present, fine at level 5 is $50,000.

years.

Advance pricing arrangement regime

3.14 IRD has been implementing an advance pricing arrangement ("APA") regime which seeks to provide enterprises with an opportunity to reach prior agreement with IRD on the method of applying the arm's length principle to transactions or arrangements between associated enterprises. This enables transfer pricing issues to be more effectively dealt with as they arise and helps prevent subsequent audit and litigation in respect of transfer pricing issues covered by an APA. To assist enterprises in complying with the arm's length principle, APA regime is of paramount importance to the effective implementation of transfer pricing rules.

3.15 At present, section 88A of the IRO allows taxpayers to apply for advance rulings, but the provisions contained therein do not regulate the operation of APAs. IRD has to resort to its power of administering the IRO to undertake APAs. Due to the lack of legal certainty, our existing APA regime has not been well received by enterprises and practitioners in the accounting profession. With the implementation of statutory transfer pricing rules, there will likely be a rising demand for APAs, particularly for high-valued transactions within large enterprises. As such, we consider it necessary to strengthen our APA regime by providing it with a statutory basis.

3.16 The **proposed statutory APA regime** will encompass the following key features –

(a) prescribe transfer pricing issues that can be the subject matter of an APA;

(b) provide legal certainty for an APA;

(c) clarify the rights and obligations of the Commissioner and taxpayers in relation to an APA. For instance, the Commissioner will need to have the power to revoke, cancel or amend any APA concluded where he considers appropriate to best protect the interest of the Government. In case an enterprise seeking APA disagrees with IRD's assessment, it will still have the right to lodge objections and appeals against the assessments in accordance with the IRO;

(d) extend the application of the existing penalty provisions under the IRO to the supply of false or misleading information and failure to supply information in relation to an APA application or post-APA enquiry, for upholding the integrity and effective implementation of the APA regime;

(e) provide the Commissioner with the discretion to decide whether an APA application is to be accepted having regard to the nature and value of the transactions involved. Specifically, the Commissioner may decline an APA application if –

(i) the value of the relevant transactions does not meet the prescribed threshold;

(ii) the matter on which an APA being sought is subject to an objection or appeal;

(iii) the Commissioner considers that the relevant transactions or arrangements are not seriously contemplated;

(iv) the Commissioner considers that the relevant transactions or arrangements constitute or form part of a tax avoidance scheme;

(v) the Commissioner is undertaking an audit on the relevant transactions or arrangements;

(vi) the Commissioner considers that the taxpayer has not provided sufficient information in relation to the application; or

(vii) the Commissioner considers that it would be unreasonable to make a ruling in view of the resources available to the Commissioner; and

(f) empower the Commissioner to charge a fee in respect of an APA application.

Views sought

- Do you support codifying the transfer pricing rules in the tax laws to provide better clarity and certainty?

- Do you have views on the proposed level of penalty in respect of incorrect tax returns arising from non-arm's length pricing?

- What are your views on the proposed key features of the statutory APA regime?

CHAPTER 4

TRANSFER PRICING DOCUMENTATION AND CBC REPORTING

Objective

4.1 We propose to mandate the relevant enterprises operating in Hong Kong to comply with the requirements for transfer pricing documentation and enable the automatic government-to-government exchange of CbC reports.

A three-tier standardised approach

4.2 OECD has developed a **three-tiered standardised approach** to transfer pricing documentation (i.e. master file, local file and CbC report). This approach requires an enterprise to articulate consistent transfer pricing position and provide tax administration with useful information for assessing transfer pricing risks. The three-tiered standardised approach requires relevant enterprises to provide the following –

(a) **a Master file** – this gives a **high-level overview** of the group of enterprises, including the global business operations, transfer pricing policies and global allocation of income. The file is to be available to all relevant tax administrations;

(b) **a Local file** – this provides **detailed transactional transfer pricing information** specific to the enterprise in each jurisdiction, including details of material related party transactions or arrangements undertaken by the enterprise and associated enterprises involved, amount involved in those transactions or arrangements and transfer pricing analysis with respect to those transactions or arrangements; and

(c) **a CbC report** – this sets out the amounts of revenue, profits and tax paid as well as certain indicators of economic activity such as number of employees, stated capital, retained earnings and tangible assets **for each jurisdiction in which an MNE group**

operates. It also requires the group to identify its entity or entities operating in each jurisdiction and to indicate the business activities of each entity.

The standard templates of the master file, local file and CbC report published by OECD are at **Annex C**.

Application of the documentation requirements

4.3 It could be very costly for all enterprises to be mandated to prepare relevant documentation to demonstrate their compliance with the arm's length principle. The administration work required may not be proportionate with the amount of tax at stake. To avoid imposing an undue compliance burden, we **propose** to provide **exemptions** for the preparation of the master and local files.

4.4 Specifically, we have the following in mind –

(a) all enterprises which carry on trades or businesses in Hong Kong **and** engage in transactions with associated enterprises should be required to prepare the master and local files, except for (b) below;

(b) enterprises which satisfy **any two of the following three conditions** are **not required** to prepare the master and local files –

(i) total annual revenue not more than HK$100 million;

(ii) total assets not more than HK$100 million; and

(iii) no more than 100 employees[7].

The proposed exemption criteria are drawn up with reference to the reporting exemption provided for "small private company" under the Companies Ordinance (Cap. 622).

[7] Enterprises subject to the relevant documentation requirements include PEs of overseas companies located in Hong Kong. Such PEs will be exempt from the requirements if they (not the overseas companies to which they belong) satisfy the prescribed conditions.

4.5. As for CbC reporting, OECD mandates MNEs with **annual consolidated group revenue equal to or exceeding EUR750 million** (or an equivalent amount in domestic currency as of January 2015, i.e. about **HK$6.8 billion**[8]) to file CbC reports. We envisage that, in Hong Kong, about 150 enterprises will be caught by the above criteria. According to OECD, it is **not** necessary for jurisdictions to periodically revise the threshold in order to reflect currency fluctuations. The appropriateness of the EUR750 million threshold will be subject to review in 2020.

Compliance issues

4.6 For the purpose of effectively implementing this minimum standard, we **propose** to put in place the following arrangements –

(a) **Time frame** – The master file and local file should be prepared for each fiscal year and retained for a period of not less than 7 years after the year concerned. As regards CbC reporting, it is recognised that MNE groups would need additional time to consolidate all the relevant information from their constituents in compiling the CbC reports. They are therefore required to file CbC reports within 12 months from the last day of their fiscal year;

(b) **Language** – The master file, local files and CbC reports should be prepared in either Chinese or English; and

(c) **Penalty** – Transfer pricing documentation will be a new tax reporting requirement. To ensure compliance, we propose to introduce penalty provisions in the IRO to achieve deterrent effect as follows –

    (i) **Failure to comply with the requirements relating to master file and local file without reasonable excuse**: This will be an offence and the proposed penalty upon

[8] According to Hong Kong Monetary Authority's statistics, the average exchange rate of HKD/EUR in January 2015 is 9.02.

conviction is a fine at level 6[9], which is the same as the penalty for failure to keep proper business records under section 80(1A) of the IRO; and

(ii) **Failure to submit CbC reports without reasonable excuse**: This will be an offence and the proposed penalty upon conviction is a fine at level 6, which is the same as the proposed penalty for item (c)(i) above. In case of a continuing offence after conviction for failure to comply, a further fine of $500 will be imposed for each day of offence. The proposed penalty is the same as that imposed on financial institutions in the context of automatic exchange of financial account information in tax matters ("AEOI") under section 80B(4) of the IRO.

Implementation issues of CbC Reporting

4.7 Under normal circumstances, the **ultimate parent entity** of an MNE group is responsible for filing the CbC report in its jurisdiction of tax residence. To cater for special cases, OECD has mandated the implementation of a **secondary filing mechanism** and suggested jurisdictions consider introducing the **surrogate filing mechanism** having regard to their own needs and circumstances. We **propose** the following arrangements for Hong Kong –

(a) **Secondary filing mechanism** – In case the ultimate parent entity of an MNE group is in a jurisdiction that neither requires the filing of CbC report nor exchanges such report with IRD, the Commissioner will be empowered **to mandate a constituent of the group in Hong Kong ("Hong Kong Constituent") to file the CbC report**. This practice has been widely adopted by many overseas jurisdictions including Australia, Canada, Singapore and Switzerland. Nevertheless, the Hong Kong Constituent will be relieved from filing a CbC report if IRD can receive the report from another jurisdiction or another Hong Kong Constituent that is authorised to file the report on behalf of the group (see surrogate filing mechanism below for details);

[9] At present, fine at level 6 is $100,000.

and

(b) **Surrogate filing mechanism** – Under the secondary filing mechanism in (a) above, there is a chance where constituents of the same MNE group in different jurisdictions will be asked to submit a CbC report concurrently. To avoid creating an undue compliance burden on MNEs, we propose to allow an MNE group referred to in (a) above **to authorise a Hong Kong Constituent to file a CbC report to IRD on its behalf**, so that IRD will be able to exchange the report with other tax authorities. Furthermore, we propose, as a transitional filing option, to allow **"parent surrogate filing"** whereby the ultimate parent entity of an MNE group that is resident in Hong Kong will be allowed to voluntarily submit its CbC reports for the fiscal periods from 1 January 2016 up to the date before the proposed legislation comes into operation.

4.8 The exchange of CbC reports will give rise to concerns on privacy and confidentiality. Automatic exchange of CbC reports with other jurisdictions has to be underpinned by tax treaty agreements. First, there has to be a **bilateral agreement (i.e. CDTA or Tax Information Exchange Agreement ("TIEA")) or a multilateral agreement (i.e. the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("MCMAA"))** between / among the jurisdictions concerned to provide the legal basis for exchange of tax information. Second, the competent authorities have to enter into a **Competent Authority Agreement ("CAA")**, which provides for the modalities of exchange to ensure the appropriate flow of information in accordance with the standard promulgated by the OECD. At present, a multilateral CAA for exchange of CbC reports is available, though jurisdictions may choose to sign bilateral CAAs among themselves for the same purpose.

4.9 Hong Kong has committed to conducting AEOI with appropriate jurisdictions on a bilateral basis and intends to conduct AEOI with all our CDTA and TIEA partners. Modelled on AEOI, our current plan is to **rely on CDTAs or TIEAs** as the basis for conducting automatic exchange of CbC reports and to **exchange CbC reports with all our CDTA and TIEA partners** on a bilateral basis. We have no plan to enter into the MCMAA with other jurisdictions at this stage. Nevertheless, we will continue to keep in view the latest international development regarding the conduct of AEOI or automatic exchange of CbC reports on a multilateral basis and review our strategy as necessary.

4.10 When conducting automatic exchange of CbC reports with other jurisdictions, we will protect the privacy of taxpayers and the confidentiality of information exchanged, and ensure the proper use of the exchanged information. In this regard, the relevant article on EOI of CDTA and relevant articles of TIEA provide for safeguards to this end. Since we would implement automatic exchange of CbC reports under the existing CDTA and TIEA framework, such safeguards will be applicable. The relevant safeguards at the treaty level are set out in **Annex D**.

4.11 The model CAA for exchange of CbC reports also requires similar safeguards. Section 5 of the model CAA provides that all information exchanged is subject to the confidentiality rules and other safeguards provided for in the individual CDTA or TIEA. Section 8 provides that a competent authority may suspend the EOI by giving notice in writing to another competent authority if there is or has been significant non-compliance by the latter. The competent authority may also terminate the CAA by giving notice of termination to the other competent authority.

OECD's implementation and review plan

4.12 According to OECD's implementation timeline, the CbC reporting requirement should be implemented for fiscal years beginning on or after 1 January 2016. Nevertheless, having regard to the need for some jurisdictions to pass domestic legislation in order to implement this minimum standard, OECD is aware that the implementation timeline may vary. OECD's current plan is to conduct a review on the implementation of CbC reporting and the effectiveness of CbC reporting standards in 2020.

4.13 In Hong Kong, local legislation will be needed to introduce the transfer pricing documentation requirements and to enable automatic exchange of CbC reports with other jurisdictions. In the light of

OECD's global review in 2020, our plan is to **require the relevant MNEs to gather the information in 2018 and file their first CbC reports to IRD in 2019**.

Views sought

- To avoid imposing an undue compliance burden on enterprises, do you agree with our proposal of exempting certain enterprises from preparing the master file and local file?

- Do you have views on the compliance issues of CbC reporting (i.e. time frame, language and penalty), as well as the surrogate filing mechanism?

CHAPTER 5

MULTILATERAL INSTRUMENT

Objective

5.1 Hong Kong will need to implement an OECD-coordinated MLI so that we can modify all existing CDTAs and implement tax treaty-related BEPS measures in a synchronised and efficient manner.

Hong Kong's intention to implement MLI

5.2 Hong Kong has an extensive CDTA network with 35 jurisdictions. Implementing the OECD-coordinated MLI would obviate the need for a long series of bilateral negotiations with individual CDTA partners to amend the relevant provisions for meeting the requirements arising from the BEPS Actions. At this stage, we **do not envisage technical difficulties** in applying the provisions in the MLI to our CDTAs.

Scope of MLI

5.3 The MLI seeks to ensure swift, co-ordinated and consistent implementation of treaty-related BEPS measures in a multilateral context. OECD set up an Ad Hoc Group in May 2015 to jointly develop the MLI. Hong Kong has been participating in the Ad Hoc Group as an observer since November 2015.

5.4 The Ad Hoc Group agreed in-principle on the main text of MLI in September 2016. According to OECD's latest plan, members of the Ad Hoc Group will formally adopt and authenticate the final English and French texts in November 2016. In line with the mandate of the Ad Hoc Group, the MLI will then be open for signature starting from 31 December 2016.

5.5 Same as other bilateral and multilateral treaty negotiations, the MLI is the subject of intergovernmental discussions in a confidential setting. Hence, the text of the MLI cannot be disclosed until it is finalised and adopted by the signatories.

Tax treaty-related BEPS measures in MLI

5.6 The MLI seeks to implement measures for addressing various tax treaty-related BEPS issues. Broadly speaking, the MLI will –

(a) address issues relating to hybrid instruments and entities as well as dual resident entities. Some taxpayers may be exploiting differences in the way certain instruments or entities are treated in different jurisdictions and as a result escaping tax liabilities under both jurisdictions. One of the objectives of the MLI is to close the gap presented by these double non-taxation loopholes. A hybrid entity may be treated in one jurisdiction as opaque for tax purposes, i.e. as a taxable person; and in another as being transparent, i.e. the profits of the entity are taxable in the hands of its members. A hybrid instrument may be characterised as a debt in one jurisdiction and equity in the other. A dual-resident entity is treated as a tax resident in two different jurisdictions;

(b) prevent the granting of treaty benefits in inappropriate circumstances;

(c) prevent artificial avoidance of PE status. This refers to the deployment of tax planning strategies to avoid having a taxable presence in a jurisdiction under tax treaties; and

(d) enhance the dispute resolution mechanism in the context of tax treaties.

As these measures are meant to tackle aggressive tax planning strategies, enterprises not involved in such strategies will not be affected.

Prevention of Treaty Abuse

5.7 Treaty shopping involves strategies through which a person who is not a resident of Jurisdiction A attempts to obtain benefits that a tax treaty concluded between Jurisdictions A and B grants to residents of Jurisdiction A, for example, by establishing a letterbox company in Jurisdiction A. This would give rise to claims to treaty benefits in situations where these benefits were not intended to be granted, thereby depriving jurisdictions of tax revenues.

5.8 As a minimum standard, Action 6 of the BEPS package requires jurisdictions to include in their tax treaties an express statement of their common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation by way of tax evasion or avoidance strategies (e.g. treaty shopping arrangements). Jurisdictions should implement this common intent through **adopting one of the following rules**, i.e. (a) the principal purposes test ("PPT") rule; (b) the limitation-on-benefits ("LOB") rule and the PPT rule; or (c) the LOB rule and a mechanism to deal with conduit arrangements. The PPT rule and LOB rule are explained as follows –

(a) PPT rule

Under the PPT rule, a person shall not be granted with the benefit under a tax treaty if obtaining such benefit is one of the principal purposes of the transactions or arrangements involved. This rule provides a general way to address treaty shopping situations, including those not covered by the LOB rule such as certain conduit financing arrangements.

(b) LOB rule

The LOB rule provides that a person shall not be entitled to a treaty benefit unless it constitutes a "qualified person" by reference to various attributes, or falls within the exceptions having regard to its principal purposes, general activities or ownership. This rule aims to prevent treaty shopping situations where a person who is not a resident of a Contracting Jurisdiction establishes an entity in that Jurisdiction in order to reduce or eliminate taxation in another Contracting Jurisdiction through the benefits provided under the tax treaty between these two Jurisdictions.

5.9 Amongst the aforesaid options, **Hong Kong is inclined to adopt "PPT only" as our preferred option.** Given our comparatively low tax rate, Hong Kong is less vulnerable to treaty abuse by residents of our treaty partners. From the perspective of tax administration, the option of "PPT only" should have provided sufficient safeguards for Hong Kong to prevent treaty abuse. Moreover, a number of our CDTAs have already contained special provisions to prevent treaty abuse under specific articles (e.g. dividends, interest and royalties) based on whether one of the principal purposes of any arrangement or transaction is to obtain treaty benefits. The IRO also contains general anti-avoidance provisions to deny a tax benefit if a transaction is entered into for the sole or dominant purpose of enabling the taxpayer to obtain the tax benefits. On this basis, Hong Kong should have **no technical or administrative difficulty** in applying the broader provision of PPT to our CDTAs.

5.10 Some treaty partners of Hong Kong may prefer options other than the PPT rule alone. In such circumstances, we need to consider whether we should allow asymmetrical application of the anti-abuse provisions. For the sake of fairness and equity, our current thinking is that **Hong Kong should accept symmetrical application**, rather than asymmetrical application, if our treaty partners do not adopt the "PPT only" option. If necessary, we will resolve the issue through bilateral negotiations with our treaty partners.

Implementation of MLI in Hong Kong

5.11 To facilitate the implementation of tax treaty-related BEPS measures, Hong Kong is prepared to sign the MLI in **early 2017**. Following the signature, we will proceed with the necessary legislative exercise to give effect to the MLI at the domestic level and modify the relevant provisions of our CDTAs accordingly. The effective date of each modified CDTAs will be determined at a later stage taking into account the timing of signature of the MLI by our CDTA partners and the progress of the legislative exercise.

5.12 For CDTAs to be signed in future (i.e. which will not be covered by MLI), we plan to **incorporate the relevant provisions of the MLI in CDTAs** to ensure that they are BEPS-compliant.

CHAPTER 6

OTHER RELATED MATTERS

(I) Dispute Resolution Mechanism

Objective

6.1 We propose to put in place a full-fledged statutory mechanism to ensure timely, effective and efficient resolution of cross-border treaty-related disputes.

Hong Kong's current position

6.2 In line with the OECD Model Tax Convention, most of our CDTAs contain an article on the mutual agreement procedure ("MAP") governing the resolution of cross-border treaty-related disputes. Under this MAP article, where a taxpayer considers that the actions of one or both contracting parties result in taxation not in accordance with the CDTA, he/she is allowed to present a case to the competent authority of his/her resident jurisdiction. If the case cannot be resolved unilaterally, the competent authorities of both sides will endeavor to resolve the case by mutual agreement. In some of our existing CDTAs, the MAP article also includes a provision to refer issues which cannot be settled via MAP to arbitration.

6.3 In the post-BEPS regime, jurisdictions might have divergent views on the interpretation and application of the BEPS measures at times. Coupled with the implementation of statutory transfer pricing rules, we anticipate that the number of cross-border treaty-related disputes requiring resolution via MAP or arbitration will inevitably increase. It would be highly undesirable for Hong Kong to continue relying on the administrative rules in DIPNs to tackle these disputes. We hence **propose** to introduce a **statutory mechanism** to facilitate the handling of MAP and arbitration cases in Hong Kong.

OECD's requirements

6.4 OECD considers that the measures to combat BEPS should not lead to any unintended double taxation and uncertainty for compliant taxpayers. To ensure certainty and predictability for enterprises, OECD mandates all members of the BEPS project to implement Action 14, which seeks to improve the dispute resolution mechanism such that cross-border treaty-related disputes could be resolved in a timely, effective and efficient manner. Action 14 is underpinned by three overarching principles –

(a) treaty obligations related to MAP should be fully implemented in good faith and that MAP cases are resolved in a timely manner;

(b) administrative processes should promote the prevention and timely resolution of treaty-related disputes; and

(c) taxpayers that meet the prescribed requirements should be granted access to MAP process.

Proposed features

6.5 On the basis of OECD's requirements, we **propose** that the statutory provisions in relation to MAP and arbitration may include the following –

(a) a taxpayer may apply for MAP to be initiated in accordance with the MAP Article of the relevant CDTA;

(b) a MAP application may be made notwithstanding any objection or claim for relief lodged under the IRO;

(c) it is not mandatory for the Commissioner to reach an agreement with the competency authority of the relevant CDTA state through MAP;

(d) a taxpayer may request any unresolved issues arising from a MAP case to be submitted for arbitration;

(e) a taxpayer cannot pursue the arbitration process if the issues involved have already been resolved through the domestic litigation process of either jurisdiction;

(f) the Commissioner may charge a fee in respect of a request for referral to arbitration on a cost recovery basis; and

(g) a solution or an agreement reached under MAP or arbitration should be given effect.

OECD's implementation and review plan

6.6 OECD will set up a robust peer-based monitoring mechanism to ensure that the commitments embodied in this minimum standard are effectively satisfied.

(II) Spontaneous EOI on Tax Ruling

Objective

6.7 We propose to allow for spontaneous EOI on tax rulings.

Scope of tax ruling to be exchanged

6.8 As a **minimum standard** of the BEPS package, Action 5 seeks to revamp the work on combating harmful tax practices with a priority on improving transparency. This Action, among others, sets out the transparency framework for the compulsory spontaneous EOI in respect of tax ruling. **Six categories of taxpayer-specific rulings** are covered by the framework, i.e. –

(a) rulings relating to preferential regimes;

(b) unilateral APAs and any other cross-border unilateral rulings in respect of transfer pricing;

(c) cross-border rulings providing for a downward adjustment of taxable profits;

(d) PE ruling;

(e) related party conduit ruling; and

(f) any other type of ruling that, in the absence of spontaneous information exchange, could give rise to BEPS concerns.

6.9 The proposed scope of information to be exchanged under the above transparency framework applies to **both past rulings and future rulings**.

Scope of jurisdictions receiving the tax rulings

6.10 It has been our policy that Hong Kong will not conduct spontaneous EOI with any jurisdiction. This remains our policy.

Having regard to OCED’s latest requirements, we **propose** to make an exception in respect of EOI on the above six categories of tax rulings, so that spontaneous EOI could be conducted with the following jurisdictions –

(a) the resident jurisdictions of all related parties with which the taxpayer enters into a transaction for which a ruling is granted or which gives rise to income from related parties benefiting from a preferential treatment;

(b) the resident jurisdiction of the ultimate parent company and the immediate parent company.

6.11 Spontaneous EOI on tax rulings (in respect of the six specified categories) with other jurisdictions has to be underpinned by tax treaty agreements. Again, our current plan is to conduct such spontaneous exchanges with our CDTA or TIEA partners on a **bilateral basis.** We may need to amend the CDTA or TIEA concerned if it has yet to allow for spontaneous exchange.

OECD’s implementation and review plan

6.12 Subject to the existence of necessary legal basis, OECD requires all new members of the BEPS project to implement spontaneous EOI on tax rulings along the following timeline –

(a) Completion of EOI on all past rulings: **before a date to be agreed by the OECD**; and

(b) EOI on future rulings: **as soon as possible and no later than three months** after the date on which the ruling becomes available to the competent authority of the jurisdiction that granted the ruling.

6.13 An ongoing monitoring review mechanism will be established to ensure jurisdictions’ compliance with the obligation to spontaneously exchange information on tax rulings under the transparency framework. As part of the review process, jurisdictions will be required to provide the following statistical information to the OECD –

(a) total number of spontaneous exchanges sent under the transparency framework;

(b) number of spontaneous exchanges sent by category of ruling; and

(c) for each exchange, which jurisdiction(s)' information was exchanged with.

(III) Double Taxation Relief

Objective

6.14 We propose to enhance the current tax credit system for meeting the latest international standards.

Proposed enhancement to the tax credit system

6.15 At present, Hong Kong provides for relief from juridical double taxation[10] in all our existing CDTAs by way of tax credit under section 50 of the IRO. Our current tax credit system can no longer keep up with the latest international developments. With the implementation of statutory transfer pricing rules and the continued expansion of Hong Kong's CDTA network, we envisage that more claims for relief from juridical double taxation by way of tax credits would be lodged in the future. In this connection, we see a genuine need to enhance the current tax credit system. We **propose** that the enhanced system should comprise the following key features –

(a) the IRO clearly states that **CDTAs should prevail** in case of any conflict between the provisions in the IRO and those in CDTA so as to prevent any overriding of relief and treatment agreed under the CDTAs;

(b) allow a **longer period for claiming tax credit (i.e. six years)** so as to cater for cases where no tax credit has been claimed in the first place as the income concerned is initially considered as exempted from foreign tax but the exemption is subsequently withdrawn by the source jurisdiction after expiration of the current time limit (i.e. two years after the end of the relevant year of assessment). The proposed period for claiming tax credit is the same as the current time limit for correction of assessment due to error or omission under section 70A of the IRO;

[10] Juridical double taxation occurs where the profits of a Hong Kong enterprise arising from its operation in Hong Kong are adjusted upwards without a corresponding downward adjustment in the same enterprise' profits from its operation in a CDTA state.

(c) require taxpayers to **make full use of all other available relief (i.e. CDTAs and local legislation of foreign jurisdictions) before resorting to tax credit**. Specifically, taxpayers would be denied tax credit in situations where alternative relief could be allowed under a CDTA or the laws of the relevant foreign jurisdictions. The amount of tax credit granted should under no circumstance exceed the amount which would have been allowed had all reasonable steps been taken to minimise the amount of foreign tax payable;

(d) mandate the taxpayers to **notify IRD of any adjustment to their foreign tax payments** which may result in the amount of tax credit or unilateral relief granted becoming excessive; and

(e) ensure that tax credits would **not** be allowed in respect of a foreign tax payment if **unilateral relief has already been granted**.

Views sought

- Do you support introducing a statutory dispute resolution mechanism so that cross-border treaty-related disputes could be resolved in a timely, effective and efficient manner?

- Do you have views on the proposed features of the statutory dispute resolution mechanism?

- Do you have views on the proposed enhancement to the tax credit system?

CHAPTER 7

VIEWS SOUGHT

7.1 Your views on proposals contained in this document are highly valuable to enable us to formulate an appropriate and effective implementation model of the BEPS package in accordance with the international standards. Our current target is to introduce the necessary legislative amendments for the IRO into the Legislative Council in mid-2017.

7.2 Specifically, we would like to gauge your feedback on the following key issues within the framework as required by the OECD –

- Do you support codifying the transfer pricing rules in the tax laws to provide better clarity and certainty? *(Chapter 3)*

- Do you have views on the proposed level of penalty in respect of incorrect tax returns arising from non-arm's length pricing? *(Chapter 3)*

- What are your views on the proposed key features of the statutory APA regime? *(Chapter 3)*

- To avoid imposing an undue compliance burden on enterprises, do you agree with our proposal of exempting certain enterprises from preparing the master file and local file? *(Chapter 4)*

- Do you have views on the compliance issues of CbC reporting (i.e. time frame, language and penalty), as well as the surrogate filing mechanism? *(Chapter 4)*

- Do you support introducing a statutory dispute resolution mechanism so that cross-border treaty-related disputes could be resolved in a timely, effective and efficient manner? *(Chapter 6)*

- Do you have views on the proposed features of the statutory dispute resolution mechanism? *(Chapter 6)*

- Do you have views on the proposed enhancement to the tax credit system? *(Chapter 6)*

7.3 Please send your views and comments on the above issues, as well as any other views on BEPS matters to us **on or before 31 December 2016 (Saturday)** by post, fax or email –

Post: Revenue Division
Financial Services and the Treasury Bureau
(Treasury Branch)
24/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Fax: 2179 5848
(Attn: BEPS Consultation)

Email: beps@fstb.gov.hk

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Protection of Personal Data Privacy

1. It is voluntary for members of the public to supply their personal data upon providing views on this consultation paper. The submissions and personal data collected may be transferred to the relevant government bureau and department for purposes directly related to this consultation exercise. The government bureau and department receiving the data may only use the data for such purposes.

2. The names and views of individuals and organisations who/which put forth submissions in response to this consultation paper ("senders") may be published for public viewing. We may, either in discussion with others, whether privately or publicly, or in any subsequent report, cite comments submitted in response to this consultation paper.

3. To safeguard senders' data privacy, we will remove senders' relevant data, such as residential/return addresses, email addresses, identify card numbers, telephone numbers, facsimile numbers and signature, where provided, when publishing their submissions.

4. We will respect the wish of senders to remain anonymous and/or keep the views confidential in part or in whole. If the senders request anonymity in the submissions, their names will be removed when publishing their views. If the senders request confidentiality, their submissions will not be published.

5. If the senders do not request anonymity or confidentiality in the submissions, it will be assumed that the senders can be named and the views can be published in their entirety.

6. Any sender providing personal data to this Bureau in the submission will have rights of access and correction with respect to such personal data. Any request for data access or correction of personal data should be made in writing through the above-mentioned channels to Assistant Secretary for Financial Services and the Treasury (Treasury)(Revenue)2.

Financial Services and the Treasury Bureau
Inland Revenue Department
October 2016

Annex A

Overview of BEPS Package

Action 1 – Address the Tax Challenges of the Digital Economy

The Action 1 report concludes that the digital economy cannot be ring-fenced as it is increasingly the economy itself. The report analyses BEPS risks exacerbated in the digital economy and shows the expected impact of the measures developed across the BEPS Project. Rules and implementation mechanisms have been developed to help collect value-added tax (VAT) based on the country where the consumer is located in the case of cross-border business-to-consumers transactions. These measures are intended to level the playing field between domestic and foreign suppliers and facilitate the efficient collection of VAT due on these transactions. Technical options to deal with the broader tax challenges raised by the digital economy such as nexus and data have been discussed and analysed. As both the challenges and the potential options raise systemic issues regarding the existing framework for the taxation of cross-border activities that go beyond BEPS issues, OECD and G20 countries have agreed to monitor developments and analyse data that will become available over time. On the basis of the future monitoring work, a determination will also be made as to whether further work on the options discussed and analysed should be carried out. This determination should be based on a broad look at the ability of existing international tax standards to deal with the tax challenges raised by developments in the digital economy.

Action 2 – Neutralise the Effects of Hybrid Mismatch Arrangements

A common approach which will facilitate the convergence of national practices through domestic and treaty rules to neutralise such arrangements. This will help to prevent double non-taxation by eliminating the tax benefits of mismatches and to put an end to costly multiple deductions for a single expense, deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for one amount of foreign tax paid. By neutralising the mismatch in tax outcomes, but not otherwise interfering with the use of such instruments or entities, the rules will inhibit the use of these arrangements as a tool for BEPS without adversely impacting cross-border trade and investment.

Action 3 – Strengthen CFC Rules

The report sets out recommendations in the form of building blocks of effective Controlled Foreign Company (CFC) rules, while recognising that the policy objectives of these rules vary among jurisdictions. The recommendations are not minimum standards, but they are designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries. It identifies the challenges to existing CFC rules posed by mobile income such as that from intellectual property, services and digital transactions, and allows jurisdictions to reflect on appropriate policies in this regard. The work emphasises that CFC rules have a continuing, important role in tackling BEPS, as a backstop to transfer pricing and other rules.

Action 4 – Limit Base Erosion via Interest Deductions and Other Financial Payments

A common approach to facilitate the convergence of national rules in the area of interest deductibility. The influence of tax rules on the location of debt within multinational groups has been established in a number of academic studies and it is well-known that groups can easily multiply the level of debt at the individual group entity level via intra-group financing. At the same time, the ability to achieve excessive interest deductions including those that finance the production of exempt or deferred income is best addressed in a coordinated manner given the importance of addressing competitiveness considerations and of ensuring that appropriate interest expense limitations do not themselves lead to double taxation. The common approach aims at ensuring that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities and fostering increased coordination of national rules in this space.

Action 5 – Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

Current concerns on harmful tax practices are primarily about preferential regimes which can be used for artificial profit shifting and about a lack of transparency in connection with certain rulings. The Action 5 report sets out a minimum standard based on an agreed methodology to assess whether there is substantial activity in a preferential regime. In the context of IP regimes such as patent boxes, consensus was reached on the "nexus" approach. This approach uses expenditures in the country as a proxy for substantial activity and ensures that taxpayers benefiting from these regimes did in fact engage in research and development and incurred actual expenditures on such activities. The same principle can also be applied to other preferential regimes so that such regimes would be found to require substantial activities where they grant benefits to a taxpayer to the extent that the taxpayer undertook the core income-generating activities required to produce the type of income covered by the preferential regime. In the area of transparency, a framework has been agreed for mandatory spontaneous exchange of information on rulings that could give rise to BEPS concerns in the absence of such exchange. The results of the application of the elaborated substantial activity and transparency factors to a number of preferential regimes are included in the report.

Action 6 – Prevent Treaty Abuse

The Action 6 report includes a minimum standard on preventing abuse including through treaty shopping and new rules that provide safeguards to prevent treaty abuse and offer a certain degree of flexibility regarding how to do so. The new treaty anti-abuse rules included in the report first address treaty shopping, which involves strategies through which a person who is not a resident of a State attempts to obtain the benefits of a tax treaty concluded by that State. More targeted rules have been designed to address other forms of treaty abuse. Other changes to the OECD Model Tax Convention have been agreed to ensure that treaties do not inadvertently prevent the application of domestic anti-abuse rules. A clarification that tax treaties are not intended to be used to generate double non-taxation is provided through a reformulation of the title and preamble of the Model Tax Convention. Finally, the report contains the policy considerations to be taken into account when entering into tax treaties with certain low or no-tax jurisdictions.

Action 7 – Prevent the Artificial Avoidance of PE Status

Tax treaties generally provide that the business profits of a foreign enterprise are taxable in a State only to the extent that the enterprise has in that State a permanent establishment to which the profits are attributable. The definition of permanent establishment included in tax treaties is therefore crucial in determining whether a non-resident enterprise must pay income tax in another State. The report includes changes to the definition of permanent establishment in Article 5 of the OECD Model Tax Convention, which is widely used as the basis for negotiating tax treaties. These changes address techniques used to inappropriately avoid the tax nexus, including via replacement of distributors with commissionaire arrangements or via the artificial fragmentation of business activities.

Actions 8-10 – Assure that Transfer Pricing Outcomes are in Line with Value Creation

Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the arm’s length principle the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm’s length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm’s length principle. The work has focused on three key areas. Action 8 looked at transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are often hard-to-value. Misallocation of the profits generated by valuable intangibles has heavily contributed to base erosion and profit shifting. Under Action 9, contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks. Action 10 has focused on other high-risk areas, including the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation. The combined report contains revised guidance which responds to these issues and ensures that transfer pricing rules secure outcomes that better align operational profits with the economic activities which generate them.

The report also contains guidance on transactions involving cross-border commodity transactions as well as on low value-adding intra-group services. As those two areas were identified as of critical importance by developing countries, the guidance will be supplemented with further work mandated by the G20 Development Working Group, which will provide knowledge, best practices, and tools for developing countries to price commodity transactions for transfer pricing purposes and to prevent the erosion of their tax bases through common types of base-eroding payments.

Action 11 – Measuring and Monitoring BEPS

There are hundreds of empirical studies finding evidence of tax-motivated profit shifting, using different data sources and estimation strategies. While measuring the scope of BEPS is challenging given the complexity of BEPS and existing data limitations, a number of recent studies suggest that global CIT revenue losses due to BEPS could be significant. Action 11 assesses currently available data and methodologies and concludes that significant limitations severely constrain economic analyses of the scale and economic impact of BEPS and improved data and methodologies are required. Noting these data limitations, a dashboard of six BEPS indicators has been constructed, using different data sources and assessing different BEPS channels. These indicators provide strong signals that BEPS exists and suggest it has been increasing over time. New OECD empirical analyses estimate, while acknowledging the complexity of BEPS as well as methodological and data limitations, that the scale of global corporate income tax revenue losses could be between USD 100 to 240 billion annually. The research also finds significant non-fiscal economic distortions arising from BEPS, and proposes recommendations for taking better advantage of available tax data and improving analyses to support the monitoring of BEPS in the future, including through analytical tools to assist countries to evaluate the fiscal effects of BEPS and impact of BEPS countermeasures for their countries. Going forward, enhancing the economic analysis and monitoring of BEPS will require countries to improve the collection, compilation and analysis of data.

Action 12 – Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements

The lack of timely, comprehensive and relevant information on aggressive tax planning strategies is one of the main challenges faced by tax authorities worldwide. Early access to such information provides the opportunity to quickly respond to tax risks through informed risk assessment, audits, or changes to legislation. The Action 12 report provides a modular framework of guidance drawn from best practices for use by countries without mandatory disclosure rules which seeks to design a regime that fits those countries’ need to obtain early information on aggressive or abusive tax planning schemes and their users. The recommendations in this report do not represent a minimum standard and countries are free to choose whether or not to introduce mandatory disclosure regimes. The framework is also intended as a reference for countries that already have mandatory disclosure regimes, in order to enhance the effectiveness of those regimes. The recommendations provide the necessary flexibility to balance a country’s need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and co-operation between tax administrations.

Action 13 – Re-examine Transfer Pricing Documentation

Improved and better-coordinated transfer pricing documentation will increase the quality of information provided to tax administrations and limit the compliance burden on businesses. The Action 13 report contains a three-tiered standardised approach to transfer pricing documentation, including a minimum standard on Country-by-Country Reporting. This minimum standard reflects a commitment to implement the common template for Country-by-Country Reporting in a consistent manner. First, the guidance on transfer pricing documentation requires multinational enterprises (MNEs) to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies in a "master file" that is to be available to all relevant tax administrations. Second, it requires that detailed transactional transfer pricing documentation be provided in a "local file" specific to each country, identifying material related-party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions. Third, large MNEs are required to file a Country-by-Country Report that will provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued and other indicators of economic activities. Country-by-country reports should be filed in the ultimate parent entity's jurisdiction and shared automatically through government-to-government exchange of information. In limited circumstances, secondary mechanisms, including local filing can be used as a backup. An agreed implementation plan will ensure that information is provided to the tax administration in a timely manner, that confidentiality of the reported information is preserved and that the Country-by-Country Reports are used appropriately.

Taken together, these three documentation tiers will require taxpayers to articulate consistent transfer pricing positions, and will provide tax administrations with useful information to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. By ensuring a consistent approach to transfer pricing documentation across countries, and by limiting the need for multiple filings of Country-by-Country Reports through making use of information exchange among tax administrations, MNEs will also see the benefits in terms of a more limited compliance burden.

Action 14 – Make Dispute Resolution Mechanisms More Effective

Countries recognize that the changes introduced by the BEPS Project may lead to some uncertainty, and could, without action, increase double taxation and MAP disputes in the short term. Recognising the importance of removing double taxation as an obstacle to cross-border trade and investment, countries have committed to a minimum standard with respect to the resolution of treaty-related disputes. In particular, this includes a strong political commitment to the effective and timely resolution of disputes through the mutual agreement procedure. The commitment also includes the establishment of an effective monitoring mechanism to ensure the minimum standard is met and countries make further progress to rapidly resolve disputes. In addition, a large group of countries has committed to quickly adopt mandatory and binding arbitration in their bilateral tax treaties.

Action 15 – Develop a Multilateral Instrument

Drawing on the expertise of public international law and tax experts, the Action 15 report explores the technical feasibility of a multilateral instrument to implement the BEPS treaty-related measures and amend bilateral tax treaties. It concludes that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly. Based on this analysis, a mandate has been developed for an ad-hoc group, open to the participation of all countries, to develop the multilateral instrument and open it for signature in 2016. So far, about 90 countries are participating in the work on an equal footing.

Annex B

Implementation of the BEPS Package in Various Countries
(As at 29 September 2016)

Countries	BEPS Action	Current Status of New Legislation / Rules	Remarks
Australia	8-10	In progress	In May 2016, it was announced that the transfer pricing rules would be amended to give effect to the recommendations in BEPS Actions 8 to10.
	13	In place	In December 2015, legislation was enacted to implement new transfer pricing documentation requirements.
Canada	5	In place	In April 2016, a revised information circular on advance income tax rulings (including spontaneous exchange of information on tax rulings) was issued.
	13	In progress	In July 2016, a draft bill on CbC reporting was issued for consultation.
China	8-10	In progress	In September 2015, a discussion draft on implementation measures of special tax adjustments was issued for consultation.

	13	In place	In July 2016, a circular was issued to provide for CbC reporting and new transfer pricing documentation requirements.
France	13	In place	In December 2015, legislation was enacted to provide for CbC reporting.
Germany	5	In progress	In September 2016, a bill was introduced to implement European Union’s directive in relation to mandatory automatic exchange of information on advance cross-border rulings and advance pricing arrangements.
	13	In progress	In May 2016, a draft bill to require the preparation of master file and local file was issued. In July 2016, a bill on CbC reporting was approved by the German Cabinet.
New Zealand	5	In place	In May 2016, a circular on OECD’s requirements for exchange of information on taxpayer rulings and determinations was issued.
Singapore	8-10	In place	In January 2016, an updated e-tax guide on transfer pricing was issued.
	13	In progress	In July 2016, a draft bill on CbC reporting was issued for consultation.

	14	In place	In January 2016, an updated e-tax guide on mutual agreement procedure and advance pricing arrangement was issued.
Switzerland	5	In progress	In April 2016, a consultation on the draft bill for automatic exchange of information in respect of advance tax rulings was launched.
	13	In progress	In April 2016, a draft bill on CbC reporting was launched for consultation.
United Kingdom	8-10	In place	In September 2016, legislation was enacted to include the OECD's latest transfer pricing rules in the United Kingdom's transfer pricing regulatory framework.
	13	In place	In March 2016, regulations on CbC reporting came into force.
United States	13	In place	In June 2016, regulations on CbC reporting were issued.

* All these countries have joined the Inclusive Framework for Implementation of the BEPS Package.

Annex I to Chapter V

Transfer pricing documentation – Master file

The following information should be included in the master file:

Organisational structure

- Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities.

Description of MNE's business(es)

- General written description of the MNE's business including:
  - Important drivers of business profit;
  - A description of the supply chain for the group's five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than 5 percent of group turnover. The required description could take the form of a chart or a diagram;
  - A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;
  - A description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;
  - A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;
  - A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.

MNE's intangibles (as defined in Chapter VI of these Guidelines)

- A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management.

- A list of intangibles or groups of intangibles of the MNE group that are important for transfer pricing purposes and which entities legally own them.
- A list of important agreements among identified associated enterprises related to intangibles, including cost contribution arrangements, principal research service agreements and licence agreements.
- A general description of the group’s transfer pricing policies related to R&D and intangibles.
- A general description of any important transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved.

MNE’s intercompany financial activities

- A general description of how the group is financed, including important financing arrangements with unrelated lenders.
- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and the place of effective management of such entities.
- A general description of the MNE’s general transfer pricing policies related to financing arrangements between associated enterprises.

MNE’s financial and tax positions

- The MNE’s annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.
- A list and brief description of the MNE group’s existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

Annex II to Chapter V

Transfer pricing documentation – Local file

The following information should be included in the local file:

Local entity

- A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.
- A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.
- Key competitors.

Controlled transactions

For each material category of controlled transactions in which the entity is involved, provide the following information:

- A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licences of intangibles, etc.) and the context in which such transactions take place.
- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (i.e. payments and receipts for products, services, royalties, interest, etc.) broken down by tax jurisdiction of the foreign payor or recipient.
- An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them.
- Copies of all material intercompany agreements concluded by the local entity.
- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years.[1]
- An indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method.

- An indication of which associated enterprise is selected as the tested party, if applicable, and an explanation of the reasons for this selection.
- A summary of the important assumptions made in applying the transfer pricing methodology.
- If relevant, an explanation of the reasons for performing a multi-year analysis.
- A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information.
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both.
- A description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method.
- A summary of financial information used in applying the transfer pricing methodology.
- A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above.

Financial information

- Annual local entity financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied.
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements.
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

Note

1. To the extent this functional analysis duplicates information in the master file, a cross-reference to the master file is sufficient.

Annex III to Chapter V

Transfer pricing documentation – Country-by-Country Report

A. Model template for the Country-by-Country Report

Table 1. **Overview of allocation of income, taxes and business activities by tax jurisdiction**

<table>
<tr><td colspan="11">Name of the MNE group:
Fiscal year concerned:
Currency used:</td></tr>
<tr><td rowspan="2">Tax Jurisdiction</td><td colspan="3">Revenues</td><td rowspan="2">Profit (Loss) before Income Tax</td><td rowspan="2">Income Tax Paid (on Cash Basis)</td><td rowspan="2">Income Tax Accrued – Current Year</td><td rowspan="2">Stated Capital</td><td rowspan="2">Accumulated Earnings</td><td rowspan="2">Number of Employees</td><td rowspan="2">Tangible Assets other than Cash and Cash Equivalents</td></tr>
<tr><td>Unrelated Party</td><td>Related Party</td><td>Total</td></tr>
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Table 2. **List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction**

Name of the MNE group: Fiscal year concerned:															
Tax Jurisdiction	Constituent Entities Resident in the Tax Jurisdiction	Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence	Main Business Activity(ies)												
			Research and Development	Holding or Managing Intellectual Property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to Unrelated Parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding Shares or Other Equity instruments	Dormant	Other[1]
	1.														
	2.														
	3.														
	1.														
	2.														
	3.														

1. Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

Table 3. **Additional Information**

Name of the MNE group: Fiscal year concerned:
Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the Country-by-Country Report.

B. Template for the Country-by-Country Report – General instructions

Purpose

This Annex III to Chapter V of these Guidelines contains a template for reporting a multinational enterprise's (MNE) group allocation of income, taxes and business activities on a tax jurisdiction-by-tax jurisdiction basis. These instructions form an integral part of the model template for the Country-by-Country Report.

Definitions

Reporting MNE

A Reporting MNE is the ultimate parent entity of an MNE group.

Constituent Entity

For purposes of completing Annex III, a Constituent Entity of the MNE group is (i) any separate business unit of an MNE group that is included in the Consolidated Financial Statements of the MNE group for financial reporting purposes, or would be so included if equity interests in such business unit of the MNE group were traded on a public securities exchange; (ii) any such business unit that is excluded from the MNE group's Consolidated Financial Statements solely on size or materiality grounds; and (iii) any permanent establishment of any separate business unit of the MNE group included in (i) or (ii) above provided the business unit prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.

Treatment of Branches and Permanent Establishments

The permanent establishment data should be reported by reference to the tax jurisdiction in which it is situated and not by reference to the tax jurisdiction of residence of the business unit of which the permanent establishment is a part. Residence tax jurisdiction reporting for the business unit of which the permanent establishment is a part should exclude financial data related to the permanent establishment.

Consolidated Financial Statements

The Consolidated Financial Statements are the financial statements of an MNE group in which the assets, liabilities, income, expenses and cash flows of the ultimate parent entity and the Constituent Entities are presented as those of a single economic entity.

Period covered by the annual template

The template should cover the fiscal year of the Reporting MNE. For Constituent Entities, at the discretion of the Reporting MNE, the template should reflect on a consistent basis either (i) information for the fiscal year of the relevant Constituent Entities ending on the same date as the fiscal year of the Reporting MNE, or ending within the 12 month period preceding such date, or (ii) information for all the relevant Constituent Entities reported for the fiscal year of the Reporting MNE.

Source of data

The Reporting MNE should consistently use the same sources of data from year to year in completing the template. The Reporting MNE may choose to use data from its consolidation reporting packages, from separate entity statutory financial statements, regulatory financial statements, or internal management accounts. It is not necessary to reconcile the revenue, profit and tax reporting in the template to the consolidated financial statements. If statutory financial statements are used as the basis for reporting, all amounts should be translated to the stated functional currency of the Reporting MNE at the average exchange rate for the year stated in the Additional Information section of the template. Adjustments need not be made, however, for differences in accounting principles applied from tax jurisdiction to tax jurisdiction.

The Reporting MNE should provide a brief description of the sources of data used in preparing the template in the Additional Information section of the template. If a change is made in the source of data used from year to year, the Reporting MNE should explain the reasons for the change and its consequences in the Additional Information section of the template.

C. Template for the Country-by-Country Report – Specific instructions

Overview of allocation of income, taxes and business activities by tax jurisdiction (Table 1)

Tax Jurisdiction

In the first column of the template, the Reporting MNE should list all of the tax jurisdictions in which Constituent Entities of the MNE group are resident for tax purposes. A tax jurisdiction is defined as a State as well as a non-State jurisdiction which has fiscal autonomy. A separate line should be included for all Constituent Entities in the MNE group deemed by the Reporting MNE not to be resident in any tax jurisdiction for tax purposes. Where a Constituent Entity is resident in more than one tax jurisdiction, the applicable tax treaty tie breaker should be applied to determine the tax jurisdiction of residence. Where no applicable tax treaty exists, the Constituent Entity should be reported in the tax jurisdiction of the Constituent Entity's place of effective management. The place of effective management should be determined in accordance with the provisions of Article 4 of the OECD Model Tax Convention and its accompanying Commentary.

Revenues

In the three columns of the template under the heading Revenues, the Reporting MNE should report the following information: (i) the sum of revenues of all the Constituent Entities of the MNE group in the relevant tax jurisdiction generated from transactions with associated enterprises; (ii) the sum of revenues of all the Constituent Entities of the MNE group in the relevant tax jurisdiction generated from transactions with independent parties; and (iii) the total of (i) and (ii). Revenues should include revenues from sales of inventory and properties, services, royalties, interest, premiums and any other amounts. Revenues should exclude payments received from other Constituent Entities that are treated as dividends in the payor's tax jurisdiction.

Profit (Loss) before Income Tax

In the fifth column of the template, the Reporting MNE should report the sum of the profit (loss) before income tax for all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The profit (loss) before income tax should include all extraordinary income and expense items.

Income Tax Paid (on Cash Basis)

In the sixth column of the template, the Reporting MNE should report the total amount of income tax actually paid during the relevant fiscal year by all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. Taxes paid should include cash taxes paid by the Constituent Entity to the residence tax jurisdiction and to all other tax jurisdictions. Taxes paid should include withholding taxes paid by other entities (associated enterprises and independent enterprises) with respect to payments to the Constituent Entity. Thus, if company A resident in tax jurisdiction A earns interest in tax jurisdiction B, the tax withheld in tax jurisdiction B should be reported by company A.

Income Tax Accrued (Current Year)

In the seventh column of the template, the Reporting MNE should report the sum of the accrued current tax expense recorded on taxable profits or losses of the year of reporting of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The current tax expense should reflect only operations in the current year and should not include deferred taxes or provisions for uncertain tax liabilities.

Stated Capital

In the eighth column of the template, the Reporting MNE should report the sum of the stated capital of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. With regard to permanent establishments, the stated capital should be reported by the legal entity of which it is a permanent establishment unless there is a defined capital requirement in the permanent establishment tax jurisdiction for regulatory purposes.

Accumulated Earnings

In the ninth column of the template, the Reporting MNE should report the sum of the total accumulated earnings of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction as of the end of the year. With regard to permanent establishments, accumulated earnings should be reported by the legal entity of which it is a permanent establishment.

Number of Employees

In the tenth column of the template, the Reporting MNE should report the total number of employees on a full-time equivalent (FTE) basis of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. The number of employees may be reported as of the year-end, on the basis of average employment levels for the year, or on any other basis consistently applied across tax jurisdictions and from year to year. For this purpose, independent contractors participating in the ordinary operating activities of the Constituent Entity may be reported as employees. Reasonable rounding or approximation of the number of employees is permissible, providing that such rounding or approximation does not materially distort the relative distribution of employees across the various tax jurisdictions. Consistent approaches should be applied from year to year and across entities.

Tangible Assets other than Cash and Cash Equivalents

In the eleventh column of the template, the Reporting MNE should report the sum of the net book values of tangible assets of all the Constituent Entities resident for tax purposes in the relevant tax jurisdiction. With regard to permanent establishments, assets should be reported by reference to the tax jurisdiction in which the permanent establishment is situated. Tangible assets for this purpose do not include cash or cash equivalents, intangibles, or financial assets.

List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction (Table 2)

Constituent Entities Resident in the Tax Jurisdiction

The Reporting MNE should list, on a tax jurisdiction-by-tax jurisdiction basis and by legal entity name, all the Constituent Entities of the MNE group which are resident for tax purposes in the relevant tax jurisdiction. As stated above with regard to permanent establishments, however, the permanent establishment should be listed by reference to the tax jurisdiction in which it is situated. The legal entity of which it is a permanent establishment should be noted (e.g. XYZ Corp – Tax Jurisdiction A PE).

Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence

The Reporting MNE should report the name of the tax jurisdiction under whose laws the Constituent Entity of the MNE is organised or incorporated if it is different from the tax jurisdiction of residence.

Main Business Activity(ies)

The Reporting MNE should determine the nature of the main business activity(ies) carried out by the Constituent Entity in the relevant tax jurisdiction, by ticking one or more of the appropriate boxes.

Business Activities
Research and Development
Holding or Managing Intellectual Property
Purchasing or Procurement
Manufacturing or Production
Sales, Marketing or Distribution
Administrative, Management or Support Services
Provision of Services to Unrelated Parties
Internal Group Finance
Regulated Financial Services
Insurance
Holding Shares or Other Equity Instruments
Dormant
Other [1]

1. Please specify the nature of the activity of the Constituent Entity in the "Additional Information" section.

Annex D

Safeguards on Taxpayers' Privacy and Confidentiality of Information Exchanged under CDTAs and TIEAs

(a) information exchanged should be foreseeably relevant, i.e. there will be no fishing expeditions;

(b) information received by our partners should be treated as confidential;

(c) information will only be disclosed to the tax authorities and not for release to their oversight bodies unless there are legitimate reasons given by the CDTA/TIEA partners (i.e. we have committed to the Legislative Council that the inclusion of such oversight bodies must be positively listed);

(d) information exchanged should not be disclosed to a third jurisdiction;

(e) no obligation to supply information under certain circumstances, for example, where the information would disclose any trade, business, industrial, commercial or professional secret or trade process, or which would be covered by legal professional privilege, etc.;

(f) the use of information exchanged for other purposes (i.e. non-tax related) should be allowed provided that such use is permitted under the laws of both contracting parties and the competent authority of the supplying party authorises such use. In other words, it is a prerequisite that exchange of information must first be conducted for tax purposes in accordance with the provisions of a relevant CDTA/TIEA; and

(g) not to accede to requests from our treaty partners for tax examinations abroad (i.e. we have not included such an article in our CDTA/TIEA).