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Capital Markets Tax Committee's response to the Legislative Council of the Hong Kong Special Administrative Region Bills Committee relating to the Inland Revenue (Amendment) (No. 6) Bill 2017

Dear Sirs/Madams

We enclose a copy of the Capital Markets Tax Committee's (CMTC) response to the Legislative Council of the Hong Kong Special Administrative Region Bills Committee relating to the Inland Revenue (Amendment) (No. 6) Bill 2017 in Appendix 1.

CMTC is a financial services industry body consisting of 42 financial institutions operating in Asia who are represented through their regional tax directors. CMTC's membership comprises major commercial banks, investments banks, securities houses, insurance companies and asset managers with a presence in Asia. A CMTC List of Member Firms is included in Appendix 3.

In CMTC, we seek to provide a forum for discussion of topical taxation issues in Asia affecting Asia capital markets and the financial services industry. In addition, we represent the interests of its members through acting as the respected voice of investment banks, securities firms, asset managers, insurance companies, banks and other diversified financial services institutions and actively participate in discussions with tax authorities and regulators within the region on tax matters and issues.

We hope the comments appended will help you to understand our thoughts and recommendations.

If you have any questions on our submission, or would like to have further clarification, please do not hesitate to contact us at Ping.Fan@morganstanley.com.

Yours sincerely,

Ms Ping Fan
Chair person, Capital Markets Tax Committee of Asia

Enclosed:

Appendix 1 - Capital Markets Tax Committee's targeted response to the Legislative Council of the Hong Kong Special Administrative Region Bills Committee on the Inland Revenue (Amendment) (No. 6) Bill 2017

Appendix 2 – Capital Markets Tax Committee's full response to the Legislative Council of the Hong Kong Special Administrative Region Bills Committee on the Inland Revenue (Amendment) (No. 6) Bill 2017

Appendix 3 - CMTC List of Member Firms

Appendix 1

Capital Markets Tax Committee's targeted response to the Legislative Council of the Hong Kong Special Administrative Region Bills Committee on the Inland Revenue (Amendment) (No. 6) Bill 2017

The CMTC would like to extend its thanks to the Bills Committee for the opportunity to comment on the draft legislation.

The CMTC has throughout the consultation process and continues today to extend its full support to the Hong Kong Government in relation to the introduction of Base Erosion and Profit Shifting ("BEPS") measures in Hong Kong and the message this sends to the international tax community, on the premise that this does not conflict with Hong Kong's policy of maintaining a simple, business friendly, predictable and territorial-based tax regime. This policy has been a cornerstone of the territory's long term success and competitiveness.

Objectives of the amendments to the tax legislation in Hong Kong

We invite our esteemed legislators to continue to keep in mind the overarching aims and objectives of the amendments to Hong Kong's tax legislation, during the debates and discussions of the upcoming legislative process. As stated in the BEPS consultation paper and throughout the consultation process, the aim of introducing and implementing the BEPS minimum standards in Hong Kong has always been to bring Hong Kong's tax regimes in line with international standards and best practices. In fact, as covered by Chief Executive Carrie Lam in the introduction of her policy address, Hong Kong needs to consolidate and enhance its traditional advantages while developing new areas of economic growth, with the government playing the role of a 'facilitator' and 'promoter'.

Our current reading of the draft amendment indicates that Hong Kong is not only intending to implement the BEPS minimum standards, a welcome move, but in fact intending to go beyond what is required of these minimum standards. It is important to recognize that the aim of the BEPS initiative is to introduce standardization globally, while not creating undue and disproportionate burden to the taxpayers, not to mention the tax administrations around the world.

An illustrative example of how the proposed amendments can be more onerous than the international standards adopted by the OECD members would be the requirements set out for transfer pricing compliance and transfer pricing principles. Transfer pricing master file has been adopted by OECD members and observers around the world. The master file is a group level document that is generally prepared by the headquarters of a multinational enterprise group. The current draft amendments have a much more stringent time requirement for preparing this master file as compared to the international best practice recommended by the OECD. This could lead to a situation where the Hong Kong subsidiary of an overseas group is required to submit the group master file when this document itself has not yet been prepared by the overseas headquarters. This means that the Hong Kong subsidiary would either have to prepare, or request that its headquarters prepare, the master file just to meet the requirements in Hong Kong, otherwise the Hong Kong subsidiary could face penalties for not adhering to a process that lies outside of its control. For more details on the issues and our views

on how these may be resolved, please refer to the specific line item in Appendix 2 (CMTC Comment Number 22).

Another example of how the proposed amendments can be, at times, more onerous or more stringent than international norms would be the transfer pricing law stating that only one price can be considered to be at arm's length, instead of a range of prices being arm's length, as would more often be the case in international norms. Similarly, the current amendments require taxpayers to document and analyse all their related party transactions, and give no consideration to the relative transactional amounts. This creates undue compliance costs, in terms of time and monetary costs, as taxpayers will have to defend their transfer pricing position against transfer pricing laws that have overly high requirements. For more details on how these are issues and our views on how they may be resolved, please refer to the specific line item in Appendix 2 (CMTC Comment Numbers 9 and 27).

In addition to the above, we would recommend that as part of the overall implementation of the transfer pricing legislation, a rule is added to allow for a reduction in the compliance burden imposed on taxpayers. Specifically this rule would allow taxpayers to make an application to the Commissioner, and the Commissioner to then have the discretion to provide relief from specific rules and requirements under the provisions of the transfer pricing rules. A proper framework with formal channels should be implemented to introduce this, for example by means of a Private Letter Ruling.

In all, while the changes we are proposing in Appendix 2 may be technical in nature, we urge that the details, reasons and suggested amendments be considered, such that the amendments to the tax legislation continue to allow Hong Kong to maintain its position as a business friendly location with a strong rule of law.

Targeted responses to the amendment

We have ordered our responses according to the running order of the bill as set out in Appendix 2. We have given particular attention to areas where the proposed new rules may have unintended negative consequences for taxpayers and areas where the bill will bring in new rules, unfamiliar to many taxpayers and not universally adopted (even by Organisation for Economic Co-operation and Development ("OECD") Member countries) without first issuing further guidance. In addition, we have highlighted areas of the bill which under current drafting may have the potential to generate uncertainty of tax treatment. If these areas are not addressed, Hong Kong could become less competitive as an international financial and business centre in Asia when compared against other territories, for example Singapore.

We set out our key comments in further detail.

1. Domestic Transfer Pricing Rules

The CMTC would like to highlight that the introduction of domestic (or international) transfer pricing rules into Hong Kong law is not a requirement for Hong Kong to meet its stated objective of complying with the BEPS minimum standards.

The CMTC recognises that certain other jurisdictions (including some of Hong Kong's treaty partners) apply domestic transfer pricing rules. Where these other jurisdictions adopt domestic transfer pricing, there are generally unique circumstances, for example different domestic tax rates (e.g. UK full corporation tax rate vs the small and medium sized taxpayers rate), different taxation rates per state/province (e.g. state taxes in the US) and indirect taxes. These specific situations represent a genuine need to those territories for domestic transfer pricing rules to manage the potential tax arbitrage. These circumstances are not prevalent due to the low tax rate and simple tax regime in Hong Kong. In addition, the bill already provides to limit deductions for taxpayers transacting with associated persons who enjoy the preferential tax rate to neutralise the tax rate arbitrage. Hence tax arbitrage in Hong Kong for domestic tax should not be a concern.

The inclusion of domestic transfer pricing rules in the bill will likely disproportionately impact the small and medium sized taxpayers in Hong Kong and impose on them an undue burden. The CMTC does not believe that this is the Government's intention and would like to point out that the current anti avoidance rules[1] and law already serve the purpose of preventing domestic tax avoidance, and that there should be no loss of revenue to the Government if the domestic transfer pricing rules are not included in the bill. For more details on how these are issues and our views on how they may be resolved, please refer to the specific line item in Appendix 2 (CMTC Comment Number 8).

The OECD Guidance referenced in the bill states explicitly that the transfer pricing rules do not apply to domestic transactions; *"...the domestic issues are not considered in these Guidelines, which focus on the international aspects of transfer pricing*[2]*."* As OECD and international standards for transfer pricing practices do not apply to domestic transactions, we would like to point out that there is no requirement for Hong Kong to go beyond the practice of the international tax community where there is little guidance on how to deal with domestic transfer pricing.

With the above context in mind, the CMTC would like to recommend that the bill be amended to remove domestic transfer pricing rules entirely. Alternatively, an additional statement could be included to bring in a de-minimis rule for domestic transfer pricing, for example as is the case in India.

[1] Inland Revenue Ordinance, Section 61A
[2] Preface, Para 12, OECD Guidelines 2017

2. Separate enterprises principle and the introduction of the Authorised OECD Approach

The CMTC would like to highlight that the introduction of *"Rule 2: Separate enterprises principle for attributing income or loss of non-Hong Kong resident person"* ("Rule 2") is not a requirement for Hong Kong to meet its stated objective of complying with the BEPS minimum standards.

The bill includes Rule 2 which will require taxpayers to apply the separate enterprises principle for attributing income or loss of non-Hong Kong residents with reference to the OECD Guidance[3]. This area of taxation is extremely complex and includes the Authorised OECD Approach ("AOA"), a concept which is not widely adopted by Hong Kong's treaty partners. The CMTC is concerned by the introduction of this complex concept to Hong Kong's domestic tax law without first a separate and thorough consultation process on this matter and second, sufficient guidance being made available to taxpayers in advance of its effective implementation date. For more details on how these are issues and our views on how they may be resolved, please refer to the specific line item in Appendix 2 (CMTC Comment Number 14).

Rule 2 requires the restatement of the branch accounts for tax purposes. This requirement raises the issue of consistency between the existing bank branch accounts submitted to regulators (e.g. Hong Kong Monetary Authority) for regulatory purposes versus the proposed branch accounts for tax reporting. We have summarised the points in the following bullet points:

- Currently, branch accounts are prepared under accounting standards and are used for regulatory reporting and for tax reporting;
- Under the AOA, branch accounts would be required to be restated for tax reporting purposes. As we have already brought to your attention, there is currently no guidance for taxpayer on how this process should be done; and
- There is no international consensus on the implementation of the AOA which creates uncertainty for taxpayers and the potential for double taxation.

The inclusion of Rule 2 in the bill may bring about the need for taxpayers to implement potentially significant changes to systems and processes that are needed in order to effectively apply the AOA. For taxpayers, there is almost no time to make the necessary changes to internal processes and assess the impact that the change have on them prior to closing their books. In addition, the CMTC is concerned that the application of Rule 2 will result in an unnecessary and high cost burden for taxpayers to follow the rules.

The CMTC supports the business friendly and competitive business environment that the Government promotes in Hong Kong. The commercial attractiveness of Hong Kong due to the low tax rate and simple tax regime makes Hong Kong competitive in attracting businesses looking to set-up in the Asia

[3] Commentary on the associated enterprises article (Article 9 of the Model Tax Convention) or the business profits article (Article 7 of the Model Tax Convention).

Pacific region. The introduction of Rule 2, and specifically the AOA may make Hong Kong less competitive when compared to other jurisdictions, such as Singapore where the AOA is not adopted.

As our primary recommendation, the CMTC would like for Rule 2 to be taken out of the bill.

As an alternative suggestion, the CMTC would suggest that Rule 2 is included as an anti-avoidance provision and not a strict requirement under the law. This would be consistent with the existing approach applied to Regulated Capital Securities under S17G of the Inland Revenue Ordinance and as stated in Departmental Interpretation and Practice Notes ("DIPN") 53.

At the very least, we would recommend that the application of Rule 2 is deferred until after a point at which a separate consultation exercise has been undertaken and sufficient guidance is available to taxpayers, for example through the issuance of a specific DIPN.

3. The interaction of the determination of a permanent establishment and the new transfer pricing rule

Under the proposed amendment, "Without limiting Section 14, a non-Hong Kong resident person who has a permanent establishment in Hong Kong is regarded as carrying on a trade, profession or business in Hong Kong for the purposes of charging profits tax". This implies that a non-resident could carry on a business in Hong Kong even if it does not have a permanent establishment in Hong Kong. If a taxpayer falls into this gap, it is unclear whether the taxpayer would be eligible for treaty relief under the applicable double tax treaty in the event of double taxation.

It is generally unhelpful to have two sections of the Ordinance that seek to define the same thing but in different ways for purposes of applying separate charging mechanisms as it creates uncertainty to businesses and the potential for double taxation. We have counter proposed language to align the applicable definitions and/or intended tax treatment to provide for greater certainty. For more details on how these are issues and our views on how they may be resolved, please refer to the specific line item in Appendix 2 (CMTC Comment Number 13).

Conclusion

In summary, the CMTC extends its support to the passing of the bill and the introduction of the rules necessary for the Hong Kong Government to comply with its stated objective of compliance with the BEPS minimum standards.

In many instances outlined above and in Appendix 2 the scope of the bill goes beyond what is required for the Hong Kong Government to meet their stated objective and the CMTC would like to express its concern that in many of these instances there is the potential for the new rules to create tax uncertainty and put an unnecessary and onerous burden on taxpayers.

We would therefore ask that the consequences of the extensive scope of the bill are carefully considered and that appropriate amendments, updates or rescindments are made to protect taxpayers and to maintain Hong Kong's reputation as a jurisdiction with a low and simple tax regime.

CMTC Comment Number	**Clause reference in the Bill**	**Amendments to the IRO**	**Issues**	**Reasons**	**Suggested Changes**	**Required to satisfy the OECD BEPS Minimum Standards**
1	3	Proposed amendment to section 8(1A)(c) (C2723)	Under the proposed amendment, a salaries taxpayer who is subject to foreign tax in a Double Taxation Agreement ("DTA") jurisdiction will not be able to claim exemption under 8(1A)(c). They can only claim tax credit under section 50. As a result they will be worse off than under the current situation; in addition, a person rendering services in a DTA territory will be worse off than one rendering services in a non-DTA territory.	This is inconsistent with international tax practice which usually allows taxpayers to apply for domestic law relief if this is more beneficial than the relief under the DTA. This would effectively discriminate against employees working in DTA territories.	To remove the amendment and the corresponding reference in proposed section 50AA.	No
2	**3**	**Proposed amendment to section 16(1)(c) (C2725)**	**This section restricts the availability of a Hong Kong tax deduction for foreign tax where the foreign tax is incurred in a non-DTA territory. This proposed amendment assumes that the taxpayer is eligible for treaty relief for foreign tax incurred in a DTA territory. However, there are situations where a taxpayer suffers foreign tax in a DTA territory and is unable to obtain any form of relief for the foreign tax paid.**	**Hong Kong taxpayers which are not regarded as Hong Kong tax resident would suffer double taxation. They would neither be eligible for relief under Hong Kong's double tax treaties nor for a Hong Kong tax deduction. This is because the proposed amendment denies a deduction on the basis of where the taxes are paid (DTA vs non-DTA territory) but does not consider further whether relief is available to the taxpayer.** ***Example:*** ***A Hong Kong branch of an overseas corporation is taxpaying in Hong Kong but may not be regarded as Hong Kong tax resident. The branch suffers foreign tax in a DTA territory.*** ***The branch cannot claim a deduction in Hong Kong on the foreign taxes suffered because the proposed amendment limits a tax deduction to "a non-DTA territory". The Hong Kong branch does not qualify to use the DTA entered into by Hong Kong because the branch is a non-Hong Kong tax resident. The Hong Kong branch is therefore unable to obtain any form of relief for the foreign tax paid.*** **This may seriously impact the banking industry as many overseas banks have branches in Hong Kong currently claiming foreign tax deduction on overseas interest and certificates of deposit, etc.**	**To remove the amendment, and the corresponding reference in proposed section 50AA, pending further consideration as to how to address situations where a Hong Kong taxpayer is not able to obtain relief under one of Hong Kong's DTAs.**	**No**

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
3	4	Section 49(1C) - Double tax relief (C2727)	The proposed amendment potentially allows domestic provisions to override DTAs in certain circumstances, although it is unclear why this should be so and the extent of application envisaged by the Government.	The inclusion of subsection (1C) will operate to allow domestic law to override DTAs in certain circumstances. The Explanatory Memorandum is silent on the intent of this addition. As of this stage, it is therefore difficult to determine the extent of these limitations which may be contrary to the objectives of the Bill in seeking to enhance the current provisions for double taxation relief under DTAs.	Given the potentially limiting effect on DTAs, more guidance should be provided before enactment. To delete section 49(1C) until further explanation can be provided as to the need for its inclusion.	No
4	8	Add 50AAB (C2743)	The CMTC extend their full support to the Hong Kong Government in giving effect to the mutual agreements made with other treaty jurisdictions under the Mutual Agreement Procedure ("MAP") or arbitration of a tax treaty.	N/A	N/A	Yes
5	8	Add 50AAB(3) (C2743)	Any "costs and reasonable expenses" incurred by the Commissioner under MAP may be passed on to the taxpayer.	It is unreasonable to ask taxpayers to bear costs under an international agreement. There is also insufficient information on what "costs and reasonable expenses" may include. While expenses may be limited to what is "reasonable", a similar limitation is not given to restrict costs to "reasonable costs". Furthermore, it is unclear whether "costs and reasonable expenses" would be passed on to the taxpayer where the MAP is raised by the Competent Authority on the other side.	To delete sections 50AAB(3) and 50AAB(4) for further consideration and until clarification can be provided.	
6	9	50AAD(1) Application of Part 8AA (C2759)	Under the proposed amendment, section 50AAD applies to property tax, salaries tax and profits tax.	Inclusion of salaries tax and property tax will significantly broaden the application of the transfer pricing rules to cover situations where an owner-manager enters into transactions (employment, loans, etc.) with the business that he/she controls. This has the potential to significantly increase the compliance burden on owner-managed businesses (which are often small and medium sized enterprises) and which will struggle to comply.	To restrict the application to only profits tax in line with international transfer pricing practices.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
7	9	50AAF 1(a) (C2765)	When referring to an arm's length provision, the proposed amendment broadly refers to transactions between associated "persons" instead of using the more narrowly defined term "enterprise" - which is defined in s50AAC(1) as "a person who carries on a trade, profession or business."	This appears inconsistent with Article 9 of the tax treaty and the OECD Guidelines which both refer to conditions made or imposed between two "enterprises". This definition means that Hong Kong's domestic transfer pricing law would have a significantly wider application than the OECD model treaty/OECD Guidelines position. *Example:* *Domestic transfer pricing law could apply to an individual who is not conducting a trade, profession or business (e.g. an employee or passive shareholder). If that individual transacts with a counterparty in a DTA territory, the individual would not be protected against double taxation under the treaty.*	To change the term "persons" to "enterprises" for the whole section to ensure consistency with wording in DTAs and the OECD Guidelines.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
8	9	50AAF (C2765)	Contrary to normal international practice*, the Bill proposes to cover domestic transactions under the transfer pricing rules. * While certain jurisdictions do apply domestic transfer pricing rules, there are generally unique circumstances (e.g. different domestic tax rates, state/provincial tax rates, indirect taxes, etc.). (Refer to Appendix 1)	The inclusion of domestic transactions adds a significant compliance burden to domestic small and medium enterprises who might otherwise not have to think about transfer pricing.	Exclude domestic transactions from compliance requirements, or provide exemptions in relation to domestic TP or include specific safe harbours (to consider specific potential rate arbitrage / loss adjustments) or de minimis rules. Examples of exemptions and safe harbours adopted by Hong Kong's trading partners: Singapore: Para 6.19 of Singapore's Transfer Pricing Guidelines (4th Edition) provides a list of exemptions for preparing transfer pricing documentation, including exemptions for transactions between domestic related parties that are subject to the same Singapore tax rates China: Article 18 of Public Notice No. 42 [2016] allows for enterprises with only domestic related party transactions to choose not to prepare master file or local file. In addition, Article 38 of Public Notice No. 6 [2017] also excludes transfer pricing adjustments on domestic transactions between related parties with the same effective tax burden, so long as the transactions do not directly / indirectly reduce overall domestic tax revenue. Japan: Articles 66-4 and 68-88 of the Act on Special Measures concerning Taxation provide that transfer pricing in Japan does not apply to domestic transactions.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
9	9	50AAF 1(d) (C2765)	The phrase "the arm's length amount" implies that there is only one arm's length price that would have been agreed between independent persons.	This is inconsistent with international tax practice, as stated in the OECD Guidelines (para 3.55). An "arm's length amount" usually refers to a range instead of an exact price. This is because 1) transfer pricing is not an exact science, and 2) because true third parties often enter into seemingly identical transactions at different prices meaning there is often no one single arm's length price. Assuming that a transfer pricing analysis has been done correctly, then all points in the range of prices or margins can be argued to be arm's length. The OECD Guidelines specifically state in para 3.60 that "if the ...price or margin is within the arm's length range, no adjustment should be made." The current wording has the potential to empower an IRD Assessor to select an arbitrary point in the range and adjust a taxpayer's return who has otherwise complied with the law.	To replace the phrase "the arm's length amount" with "an arm's length amount".	No
10	9	50AAF (3) to (6) (C2767)	The burden to prove that the arm's length price has been applied lies with the taxpayer, and it has to be proved to the "satisfaction of the Assessor" that another amount applied by the taxpayer, which is different to the amount estimated by the Assessor, is a more reliable measure of the arm's length amount.	This can be broadly interpreted and if the taxpayer fails to convince the tax Assessor that the arm's length price has been applied, then the Assessor is at liberty to decide what the arm's length price is. This could result in protracted litigation, As any point in an arm's length range is "equally reliable", then it would be unreasonable to require the taxpayer to prove that a point in the range selected by the taxpayer is a more reliable measure than any other point in the range estimated by the Assessor.	To change the requirement of "more reliable" to "equally or more reliable".	No
11	9	50AAH (2)(b) (C2769)	The current bill would assert that A controlled B if "person B is accustomed or under an obligation (whether expressed or implied, and whether or not enforceable or intended to be enforceable by legal proceedings) to act, in relation to person B's investment or business affairs, in accordance with the directions, instructions or wishes of Person A". This definition is very broad.	This definition is very broad and has the potential to bring in a number of situations where it may be unnecessary to apply the "arm's length" principle because by nature of the arrangement, the transaction is entered into between two unrelated parties and therefore it may be problematic to adjust prices (e.g. joint venture situations, investors and fund manager under widely held investment funds, trustee acting for beneficiary under a trust deed, etc.).	To delete or rephrase this section to bring it in line with other existing definitions, for example: - The definition included in Article 9 of the Model Tax Convention - The definition included in Hong Kong Inland Revenue Ordinance Chapter 112, Section 20AE To exclude genuine unrelated parties (such as widely held investment funds, trusts) from the definition of associated person.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
12	9	50AAH (3)(a) (C2769)	The current bill asserts that "...if person A has a direct beneficial interest in Person B, the extent of the beneficial interest of Person A in Person B is – (a) if person B is a corporation that is not a trustee of a trust estate-the percentage of the issued share capital (however described) of the corporation held by person A."	It is unclear if share capital includes all classes of shares or just common shares. If multiple share classes are to be taken into account, the percentage in share capital may not be aligned with the value of the shares issued and hence the result could be distorted.	To rephrase this section: "...if person A has a direct beneficial interest in Person B, the extent of the beneficial interest of Person A in Person B is – (a) if person B is a corporation that is not a trustee of a trust estate-the percentage of the issued common share capital (however described) of the corporation held by person A."	No
13	**9**	**50AAK (1)) – Rule 2 Separate enterprises principle for attributing income or loss of non-Hong Kong resident person (C2779)**	**Under the proposed amendment, "Without limiting section 14, a non-Hong Kong resident person who has a permanent establishment in Hong Kong is regarded as carrying on a trade, profession or business in Hong Kong for the purposes of charging profits tax." This implies that a non-resident could carry on a business in Hong Kong even though it did not have a permanent establishment in Hong Kong. If one falls into this gap, the proposed amendment does not provide a basis for determining assessable profits.** **In any event, much needed certainty would be brought to the Hong Kong rules if the thresholds used for charging tax are defined, rather than leaving open the possibility of being taxable without a permanent establishment in the event of which there is no guidance on assessable profit determination.**	**It is generally unhelpful to have two sections of the ordinance that seek to define the same thing but in different ways, as it creates uncertainty to businesses.** **In addition, as Rule 2 would not apply to a non-resident carrying on a trade or business in Hong Kong that didn't have a PE, then there would also be two separate charging mechanisms.**	**To amend the phrase "~~Without limiting~~ For the purposes of interpreting section 14, a non-Hong Kong resident person who has a permanent establishment in Hong Kong is regarded as carrying on a trade, profession or business in Hong Kong for the purposes of charging profits tax" in order to align the definition of "carrying on a trade or business in Hong Kong". This will also align domestic law with the position of non-Hong Kong residents of DTA jurisdictions.**	**No**

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
14	9	50AAK- Rule 2 (2) to (5) (C2779)	**The full adoption of the Authorised OECD Approach (AOA) contained within the commentary to Article 7 of the model convention is not universally adopted - even by OECD Member countries. From experience in jurisdictions that have fully adopted this, a true application of the AOA is extremely complex and burdensome on the taxpayer and results in significant uncertainty and additional compliance costs.**	**i) There are potentially significant changes to systems and processes that are needed in order to effectively implement the AOA. For some taxpayers (e.g. June / September year ends), there is almost no time to make the necessary changes to internal processes and assess the impact that the change has on them prior to closing their books.** **ii) A significant number of Hong Kong's DTA partners do not follow the AOA and so its adoption will not necessarily result in international consistency and coherence of approach.** **iii) Full adoption of the AOA is not required to meet the BEPS minimum standard.** **iv) It is not clear that the regulatory aspects have been considered.**	**To delete 50AAK-Rule 2** **Alternatively, the rule could be drafted to be applicable only in situations of tax avoidance, as per the approach taken in DIPN 53.** **There is a significant need for guidance on how to interpret Rule 2 - particularly for non-resident banks and insurance companies operating through a Hong Kong PE. Implementation should be delayed until detailed guidance can be provided to allow taxpayers to prepare, and such guidance should be provided for consultation with taxpayers.** **Furthermore, discretion should be given to the Commissioner as to whether the AOA should be applied or as to whether for example the existing practice of relying on branch accounts can be used.** **It would be helpful to have formal guidance or confirmation on how 50AAK Rule 2 will be applied.**	**No**
15	9	50AAN (2) Corresponding relief involving foreign tax (C2795)	Corresponding relief to a Hong Kong disadvantaged person, where the initial adjustment is to a counterparty in a DTA jurisdiction, is only available where a MAP is concluded.	DTAs allow corresponding adjustments without MAP. Typically we therefore see other jurisdictions providing the flexibility for the tax authorities to have the option and authority to provide corresponding relief even in the event no MAP is concluded. This would avoid the undue burden and cost to taxpayers to go through the MAP process where the IRD is already in agreement with the corresponding adjustment.	Amend 50AAN (2).	No
16	9	50AAP – Advance pricing arrangement Schedule 17H-7(9) (C2843)	As there is no fixed fee for the application of APA, the cost of applying for an APA is uncertain to taxpayers.	It is not common to have an hourly charging mechanism for the application of APA. For budgeting purposes, taxpayers may want to know the amount of fees for the application in order to decide whether to apply for an APA.	To have a fixed fee, or a fee cap, for the application of APA so that taxpayers can budget for this. This will make the APA program more attractive to taxpayers considering going for an APA.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
17	9	50AAQ (4) - Advance pricing arrangement (C2811)	The proposed legislation drafting implies that the Commissioner may apply the principles developed under an APA to a period earlier than the date of the arrangement.	It is not clear whether the bill intends for the APA to be open for retrospective application. As an example, taxpayers in the UK and Korea have the option under the APA application process for the agreement to apply for rollback periods.	To amend the phrase: "The Commissioner may, if the Commissioner considers appropriate, apply the principle developed in an advance pricing arrangement for a specified period commencing earlier than the date of the arrangement but-..."	No
18	9	50AAQ (4) - Advance pricing arrangement (C2811)	The proposed legislation includes that in cases where the terms of a Mutual Agreement are not consistent with an APA already made, the Commissioner must revise the arrangement so far as may be necessary for enabling effect to be given to the mutual agreement.	The drafting is not clear on whether the adjustment is to be applied for future years only, or also retrospectively to cover periods prior to the period covered under the MAP.	Include additional language in the bill to clearly define how any adjustment is to be applied.	No
19	10	Schedule 17G, Part3, 7. (C2821)	The proposed domestic law definition of a permanent establishment is stricter than the definition included in Hong Kong's existing double tax treaties.	Hong Kong should not have a domestic position which is stricter than that which is included in its double tax treaties. Taxpayers will be disadvantaged when they do business with a non-treaty partner.	Align the domestic permanent establishment definition with the definition currently included in Hong Kong's existing double tax treaties.	No
20	13	15BA – Changes in trading stock (C2847)	This section does not have a direct relationship with the transfer pricing regulations to be legislated.	The legislative intent of this section is not clear and its interaction with existing provisions in the IRO is also not clear.	Suggest to remove 15BA from the bill and to be separately introduced for future consideration.	No
21	14	15F – Sums derived from intellectual property by non-Hong Kong resident associates (C2851)	This section is not necessary to achieve the desired results as s50AAF should already provide for this together with the additional guidance in Chapter VI of the OECD Guidelines.	This section appears to be redundant given the requirement for transfer pricing principles to be applied in all related party transactions and/or dealings. In addition, including the section as it currently reads could create ambiguity that may result in double taxation where the correct transfer pricing has already been applied. This amendment would actively discourage multinational groups from locating research and development functions in Hong Kong, thereby undermining the Chief Executive's vision of making Hong Kong a Research and Development hub in Asia. This section also undermines the source principle of taxation because amounts may be deemed taxable even if royalties are earned on IP used abroad.	To delete 15F, or alternatively to amend the provision such that Section 15F will not apply in instances where transfer pricing relating to intellectual property has already been applied correctly.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
22	16	Section 58C(2) – MF and LF requirements (C2869)	The local file and master file have to be prepared within 6 months after the end of the accounting period of the taxpayer (for the local file) and of the group (for the master file).	For the Master File, this is more stringent than the deadline outlined in the OECD Guidelines (i.e. by the tax returns due date for the ultimate parent of the multinational enterprise group) and deviates from the typical requirement adopted by many of Hong Kong's trading partners (e.g. China which applies a due date falling within 12 months of the fiscal year end of the ultimate parent entity). This could possibly require overseas parent companies to expedite the preparation of Master File solely for their Hong Kong subsidiaries or branches, and the complication for the Hong Kong taxpayer is compounded due to the process of preparing Master File often lying outside the control of the Hong Kong taxpayer. Per para 5.29 of the OECD Guidelines, "These differences in the time requirements for providing information can add to taxpayers' difficulties in setting priorities and in providing the right information to the tax administrations at the right time".	For Master File and Local File, to extend the preparation deadlines to align with the requirements in OECD Guidelines (please refer to Chapter V, D.2, (5.30)) or the approach taken by Hong Kong's trading partners in line with international tax practice. For example, many jurisdictions have a deadline for preparing Master File that is 12 months after the fiscal year end of the ultimate holding company or the domestic taxpayer (e.g. China, Australia, Japan, Malaysia, Korea), in line with OECD Guidelines.	No

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23	**16**	**Section 58C(2) – MF and LF requirements (C2869)**	**The local file and master file have to be prepared "after the end of each accounting period..."**	**In practice, in other countries the requirements to prepare local file and master file documentation each year are limited to:** **i) review and confirmation of the functional analysis and economic analysis to confirm that these are still accurate and relevant, for example to confirm that no substantial change to the business has taken place; and** **ii) refresh and update of the financial information included in the economic analysis.** **In addition, the OECD Guidelines recognise that taxpayers should not be expected to incur disproportionately high costs and burdens in producing documentation. (2017 OECD Guidelines, Chapter V, D.1.).**	**Allow for a roll-forward approach to the local file and master file documentation so long as substantial changes to the business have not occurred in the period. This should include the searches in databases for comparables to be updated every three years rather than annually, with the financial data for the comparables and the taxpayers being updated / refreshed annually, in cases where taxpayers have not had any significant changes to the business or the inter-company transactions. This practice is recommended in the 2017 OECD Guidelines (Chapter V, D.5, (5.38))**	**No**
24	**16**	**Section 58C(3) – MF and LF requirements (C2869)**	**"The local file and master file must - cover the items of information, and reflect the format (including terminology and order of presentation)..."**	**The OECD Guidelines provide guidelines on the list of information to be centralised in the master file and local file. It does not present a fixed order and/or terminology as is included in the bill. This additional requirement may create an undue burden on taxpayers.** **Specifically, the master file is meant to be a group wide document which is generally prepared by head office. The language in the bill creates an additional and unnecessary compliance burden for taxpayers to localise the master file to meet the Hong Kong requirements.**	**To amend the wording: "The local file and master file must - cover the items of information, ~~and reflect the format (including terminology and order of presentation)~~..."**	**No**
25	16	Section 58C(6) Division 3 – Country by Country Reporting (C2873)	The CMTC extends its full support to the Hong Kong Government to introduce CBCR in Hong Kong so that Hong Kong can comply with the BEPS minimum requirements.	N/A	N/A	Yes

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26	17	Sch17I – Part 3, 5. (x) – Local File requirements (C2917)	The Local File requirements include "a list and description of the selected comparable uncontrolled transactions (internal or external)..."	The bill does not provide taxpayers with specific details or guidance on the preparation of benchmarking studies. For example, it is not clear whether the IRD will accept global/regional benchmarking, or if the expectation will be that local comparable uncontrolled transactions are used.	To include in the subsequent guidance to the bill (e.g. DIPNs etc.) a detailed guidance on the IRD's expectations with regards to the preparation of benchmarking studies. We recommend that this is aligned with the 2017 OECD Guidelines (Chapter III, A.4.3.2 (3.35)) whereby it is accepted that *"Taxpayers do not always perform searches for comparables on a country-by-country basis, e.g. in cases where there are insufficient data available at the domestic level and/or in order to reduce compliance costs where several entities of an MNE group have comparable functional analyses."*	No
27	17	Sch17I (4) (d) – Master file and local file thresholds (C2909)	Under the proposed amendment, the definition of "Other" transactions currently includes a wide number of very different transaction types (royalties, services, interest etc), which are all aggregated in applying the HK$ 44 million threshold. Furthermore there is no guidance or clarity on whether each of the different transaction types would need to be documented and analysed individually.	Where an entity is required to prepare local file and exceeds the HK$ 44 million threshold, the current wording suggests that a company is obligated to document and analyse individual transaction types which qualify under the "Other" category but which may be negligible in terms of amounts, e.g. a company that has significant services transaction charges but negligible intercompany interest charges would also be obligated to incur the costs of preparing documentation for their inter-company financing transactions, even though these amounts may be immaterial.	It would be helpful for the purposes of limiting compliance burdens on taxpayers if additional categories to Sch17I (4) could be added. Particularly, individual or separate thresholds for Services, Royalties and Interest-type transactions, so that companies with only negligible transactions of these sub-categories can exclude such transactions from their local files. Alternatively, while the thresholds can be used to determine whether a taxpayer is obligated to prepare transfer pricing documentation, a de-minimis rule can be applied to individual transaction types in terms of documentation and / or analysis. The OECD explicitly states that "taxpayers should not be expected to incur disproportionately high costs and burdens in producing documentation" and recommends that "tax administrations should balance requests for documentation against the expected cost and administrative burden to the taxpayer of creating it".	No
28	20	80G(1)(a) – Country by country report offenses (C2941)	Steep penalties would apply for country by country report filing, for notice of, and for keeping sufficient records.	These penalties are excessive given the nature of the rules to which the penalties are applicable and they are not aligned with international practice.	To reduce or remove the penalties, in particular in respect of [notice] to bring Hong Kong's practice more in line with other jurisdictions practice.	No

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29	22	Section 82A (1G) (C2967)	Under the proposed amendment, a person is not liable to be assessed to additional tax under subsection (1D) or (1F) if the person proves that the person has made reasonable efforts to determine the arm's length amount understand section 50AAF(1) or 50AAK(2). However, it is unclear what "reasonable efforts" means.	There should be a clearer guidance on the meaning of reasonable efforts for taxpayers to follow.	To clarify the meaning of "reasonable efforts".	No
30	32	Section 26AB - threshold requirement for determining whether profits producing activities are carried out in Hong Kong (C2997)	The Bill states that "The Commissioner may, by notice published in the Gazette, prescribe a threshold requirement for determining whether an activity producing... assessable profits...or exempt sums... is carried out in Hong Kong by the...taxpayer..." There is lack of clarity on the requirement (i.e. number of full time employees in Hong Kong and the amount of expenditure)	This may discourage investors to use these incentives without clear guidance. These thresholds have to be commercially reasonable, and communicated clearly to taxpayers.	To consult with taxpayers and / or other stakeholders, in order to introduce thresholds that are commercially reasonable. To provide clear guidance / clarification prior to gazetting any prescribed thresholds.	No

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31	9	Section 50AAF and Section 50AAK and their interactions with Sections 17E, 17F(3),(4),(5), (6) & 17(G) regarding regulatory capital security ("RCS") (C2779)		1) In view of the introduction of the arm's length principle under Section 50AAF, Section 17E is no longer necessary and should be repealed. 2) The same holds true for Sections 17F (3), (4), (5) and (6) which serve to either limit the deduction amount payable by financial institutions to the sum payable by the specified connected person/associated corporation on the externally issued RCS, debenture or debt instruments or reducing the deduction amount if the sum payable to specified person/associated corporation exceeds a reasonable commercial return on money borrowed. After the arm's length principle is codified, related party transactions including RCS are required to comply with such principles and naturally the arm's length rate would benchmark against all the relevant factors including the prevailing market conditions, credit rating etc. Limiting the interest deduction (amount of which is otherwise determined based on arm's length principles) to the amount payable on externally issued RCS conflicts with international transfer pricing practices and the overarching arm's length principle under tax treaties that Hong Kong has entered into. Therefore, these provisions are no longer necessary and should be repealed. This may otherwise cause confusion.	Repeal s17E, s17F(3)(4)(5) and (6). If indeed the IRD is concerned that in some extreme situations where RCS are being issued by financial institutions to overseas associates for tax avoidance purpose without genuine commercial reasons, then it would be more appropriate to explicitly include such specific anti-avoidance provision in Section 17F rather than having the existing provisions which are duplicative or conflicts with the arm's length principle being codified.	No

CMTC Comment Number	Clause reference in the Bill	Amendments to the IRO	Issues	Reasons	Suggested Changes	Required to satisfy the OECD BEPS Minimum Standards
32	Others		Regional head office services are subject to undue compliance burden.	While not integral to the core business of the group, these services are often broad in nature and may therefore attract undue compliance burden for taxpayers in supporting arm's length pricing. This gives rise to the following considerations: 1. The compliance burden of supporting these services may not be commensurate with the value of these services in the context of the group's value chain; 2. The additional compliance requirements may discourage multinational groups from having regional or global headquarters in Hong Kong; and 3. It is in the interest of sound tax administration to minimise the burden of such services (for both the administrator and the taxpayer), which would typically bear low arm's length mark-ups, or even no mark-up (see US example).	Helpful solutions that have been implemented in other parts of the world include 'safe-harbour' provisions or rules that allow for certain services to be priced on a cost-basis. Hong Kong is currently competitive with Singapore as a location for multinational groups to base their regional hub, even given Singapore's current incentive scheme offerings. Under the new rules, Hong Kong will become less competitive and lose out on regional hubs setting up in the region. To avoid abuse, taxpayers can be made to specifically elect the use of such provisions and the scope of application can be explicitly defined (i.e. eligible services can be explicitly specified and/or non-eligible services can be explicitly excluded from the scope of coverage). This approach has, for example, been taken by the US Internal Revenue Service with respect to certain covered services and low-margin services (see US Treasury Regulation S 1.482-9 Methods to determine taxable income in connection with a controlled services transaction, Section 1 (b) "Services Cost Method"). Furthermore, Paragraph 107 of DIPN 46 already sets out that "*Where provision of services is merely part of the general management activity of the enterprise taken as a whole, there should be no mark-up*". An exemption for requiring a mark-up may be included by leveraging the current guidance in DIPN 46, such that regional headquarter entities in Hong Kong that do not perform these functions as a core business activity may recover the cost of performing these activities with no mark-up.	No

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33	**Others (50AAE (1))**		**The bill references that the transfer pricing rules are required to be read in a way that best secures consistency between its effect and the effect given by the OECD to the OECD Guidelines.**	**i) The bill is drafted in a way which seems to cover DTA arrangements only;** **ii) It is not clear on whether the domestic rules or the OECD Guidance will prevail in circumstances where there is a difference;** **iii) It is not clear what the term "consistency" means, for example is it the intention that taxpayer should apply other sections of the OECD guidance that are not explicitly stated in the bill (e.g. Cost Contribution Arrangements ("CCA"), Low Value Adding Services cost plus 5% mark-up safe harbour).**	**To clarify that the bill prevails and that the OECD Guidance can apply even where sections are not specifically included in the bill (e.g. CCA). However to note that the OECD Guidelines provide guidance only and is not automatically adopted into law.** **This would provide additional certainty to taxpayers as the Guidelines provide clarification on how taxpayers should perform their transfer pricing, for example CCAs and Low Value adding services.**	**No**

Note: Rows highlighted in bold are for the purpose of signifying key points.

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