Transfer pricing and the offshore tax regime in Hong Kong

Base Erosion Profit Shifting or “BEPS” initiated by the G20 economies and endorsed internationally aims to close tax loop holes and achieve reporting transparency. Hong Kong based companies with offshore claims need to anticipate the impact of greater reporting. Conflicts with transfer pricing (“TP”) and possible permanent establishment (“PE”) challenges must, more than ever, be carefully managed.

Summary

- How well does your offshore claim arrangement coincide with your TP policies?
- While there is a legitimate basis to make an offshore claim in Hong Kong, is your company ready to defend potential challenges from other tax authorities?
- Can your company sustain a challenge to the offshore claim from the HK IRD?

Does your company have any offshore sourced profits and claim part or all of its profits as offshore for Hong Kong tax purposes? If so, how does this coincide with your transfer pricing policies in light of BEPS?

The territorial source principle of taxation has been fundamental in the Hong Kong tax system. However, the practice of making offshore claims may increasingly come into conflict with transfer pricing. For companies which are making or intend to make offshore claims, have the following been thought about?

- Any people activities or substance in Hong Kong?
- Will this become a red flag when filing a country by country report (CbCR)?
- Is the profit concerned subject to tax in another jurisdiction?
- Does it create a PE exposure in a jurisdiction outside Hong Kong?

The BEPS initiatives are designed to mitigate double non-taxation with an increase in transparency of tax information. While there may be a legitimate basis for companies in Hong Kong to make an offshore claim, tax authorities overseas may start questioning whether those profits that are not subject to tax in Hong Kong should be subject to tax in their jurisdiction instead.

To mitigate and manage potential exposures, it is all the more important to get the transfer pricing right. Having established and implemented an appropriate TP policy, one may still apply the offshore framework. However, PE exposures
will also need to be considered bearing in mind that under the new PE definition under BEPS, PE risk may increase in a number of jurisdictions.

One must therefore carefully consider all the potential ramifications. Companies in Hong Kong need to consider the possible consequences from a wider group perspective and ensure robust supporting documentation is in place to support such arrangement.

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