

30 December 2016

Ms Elizabeth Tse  
Permanent Secretary for Financial Services and the Treasury (Treasury)  
Financial Services and the Treasury Bureau  
24/F, Central Government Offices  
2 Tim Mei Avenue, Tamar  
Hong Kong

Dear Elizabeth

### **Consultation Paper on Measures to Counter Base Erosion and Profit Shifting**

The Hong Kong General Chamber of Commerce (“HKGCC”) appreciates the opportunity of commenting on the Consultation Paper (“CP”) on proposed measures to counter Base Erosion and Profit Shifting (“BEPS”) in Hong Kong.

We note that while the Government is committed to the BEPS’ principles of transparency and fairness, it is conscious of the need to meet the international standard without compromising our simple and low tax regime. We welcome the Government’s recognition of maintaining a balance between “the need for IRD to gather necessary information and to minimise the compliance burden on enterprises” when implementing the BEPS package in Hong Kong.

**The Chamber supports the Government’s efforts to promote tax transparency and combat tax evasion but we are concerned that we may go way beyond those set out under the four minimum standards<sup>1</sup>.** For instance, in countering treaty abuse, the Government has proposed the implementation of a Multilateral Instrument (“MLI”) as given under Action 15. We recognise that conformation with international development is inevitable and, at times, necessary and mandatorily required. That said, we urge the Administration to do its utmost to strike a balance between protecting local interests and aligning with international standards.

Our comments on BEPS implementation are as under:

- We recognise that the consequences of not complying with the latest global standard on BEPS can be serious. **Adoption of the BEPS package would dispel the risk of being described as an uncooperative jurisdiction and a tax haven**, labels that carry severe implications on our international reputation and competitiveness as an international financial and business centre.

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<sup>1</sup> As a BEPS Associate, Hong Kong is committed to adopting, in first instance, 4 of the 15 Action Items outlined under the BEPS project, including *Action 5 Countering Harmful Tax Practice*, *Action 6 Countering Treaty Abuse*, *Action 13 Adopting Country-by-country reporting* and *Action 14 Improving Dispute Resolution*.

- In line with the foregoing and to achieve global alignment, **we support the proposal to codify transfer pricing rules into the tax laws of Hong Kong**, which remains one of the few jurisdictions without a dedicated set of transfer pricing rules. The current transfer pricing framework in Hong Kong relies on general tax provisions in the Inland Revenue Ordinance (“IRO”) relating to deductibility (section 16) and anti-avoidance (section 61A). By enshrining the Rules into law, this would address existing uncertainties and demonstrate Hong Kong’s commitment to being a responsible tax jurisdiction while putting taxpayers on a level-playing field with other jurisdictions. **We would however stress the importance of providing clear technical guidance in the legislation on such issues as setting and testing transfer prices.**
- As to the proposed level of penalty in respect of incorrect tax returns arising from non-arm’s length pricing, **the Government could draw on practices in other jurisdictions where transfer pricing penalties may be reduced or waived** if the taxpayer is able to provide contemporaneous transfer pricing documentation to indicate that there has been a genuine effort to reach an arm’s length outcome. We would therefore suggest that Hong Kong adopts similar measures to achieve parity with international norms.
- With respect to the proposed contents on the statutory Advance Pricing Arrangement (“APA”) regime, this appears to be reasonable and in line with international standards. We would however like to point out that **the CP’s proposal to empower the Commissioner for Inland Revenue to “...revoke, cancel or amend any APA concluded where he considers appropriate to best protect the interest of the Government” appears to be quite unilateral and does not sit well with the spirit and intention of an APA.**
- In the interest of clarity and certainty, **we urge the Government to provide guidance on certain aspects of the proposed transfer pricing framework.** For example, it would be helpful to address situations where there is a disconnect between source rules and transfer pricing rules. We look to IRD in clarifying the definition of related party relationships. China’s approach to related party transactions is quite instructive as Bulletin 42 provides very detailed and prescriptive definitions, such as, 25% shareholding as the primary test. We would welcome clarification on the issue of the corresponding relief mechanism.
- Despite the Government’s good intentions to avoid imposing undue compliance burden on enterprises, **we remain concerned about the proposal of exempting certain enterprises from preparing master file and / or local file documentation based only on the criterion of company size.** As such, companies that fit the definition of a “small private company” under the Companies Ordinance (Cap. 622) would be exempted from preparing transfer pricing documentation. This approach is too narrow and **we would suggest that consideration be given to the size of the related party transactions,** which has been adopted in the Mainland and the United Kingdom.

- As far as the proposed CBC reporting protocols are concerned, there may be practical difficulties in fulfilling demands under a secondary filing mechanism. This is especially the case for a subsidiary, which cannot freely or legally access information of its parent company or other group companies that are higher up in the organisation hierarchy. We would also like clarification in such areas as financial criteria thresholds to determine small company exemption, and the timing for preparing master file and local file documentation, i.e., whether reporting should be done on a ‘real time’ basis or after the fact.
- We note that the CP focuses mainly on the mechanics of a MLI and its application with respect to Action 2 on countering hybrid mismatches and Action 6 on countering treaty abuse, but is largely silent on Actions 7 and 14, which relate respectively to countering the artificial avoidance of permanent establishments and treaty-based dispute resolution mechanisms.
- **We support the introduction of a statutory dispute resolution mechanism** as proposed in the CP but consider it useful if more details could be provided on such issues as the types of arbitration considered, the scope of the arbitration process and whether additional resources would be allocated to dispute resolution in order for the mechanism to succeed. The Government should also consider leveraging on MLI to expand Hong Kong’s network of Comprehensive Double Tax Agreements (“CDTAs”) that include a mandatory arbitration provision.
- **We welcome the proposal to extend the period for claiming tax credits from two to six years.**

We would like to reiterate our longstanding call for the Government to review the extent of compliance burden on Hong Kong businesses when implementing new regulations. We believe that Hong Kong should work with other jurisdictions as in the case of BEPS to anticipate and reduce the burden and cost that may be imposed on businesses while doing our utmost, as a responsible member of the international community, to discharge our obligations to promote transparency. We look forward to providing further views on the detailed legislative proposals when they are available.

Sincerely,



Shirley Yuen  
CEO