

How to Respond by Hong Kong to the Revision of Special Tax Adjustment Rules in Mainland?

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- September 17, 2015
- SAT released for public comments a discussion draft of Implementing Measures of Special Tax Adjustment
- New rules would replace the existing Implementation Measures of Special Tax Adjustment (Trial) (Guoshuifa [2009] 2) (Circular 2) issued by the SAT on January 8, 2009.



Two aspects of revision

- Localizing BEPS proposals
- Incorporating SAT experiences



Big Changes (I) – Chapter 3

- requirements for contemporaneous transfer pricing documentation and country by country (CbC) reporting
- three-tier files: master file, local file, and special issues file
- CbC reporting rules



- special considerations for transfer pricing aspects of intangibles
- income from intangibles should be allocated in accordance with the economic activities and value creation of parties related to the MNE
- value creation factors such as group synergies should be considered in determining the income from intangibles



- special considerations for intragroup services
- Payments by taxpayers being limited to intragroup services of a beneficial nature
- an independent enterprise in the same or similar circumstances would have been willing to pay if performed by another independent enterprise or in-house



I. transfer pricing methods

- value contribution allocation method
- asset valuation method

II. Comparability analysis factors

- assets used, functions performed, risks assumed, local special advantages, group synergies, and capacities of contract performance



Small Changes in Chapter 5

- special tax investigation and adjustment
- non recognition or re-characterization of the intragroup transaction
- condition: not being made between independent enterprises in comparable circumstances



Small Changes in Chapter 10

- controlled foreign enterprises
- the scope of attributable income of CFC
- from full inclusion system to partial inclusion system
- passive income earned by a CFC as attributable income



Small Changes in Chapter 11

- thin capitalization
- debt investment from a group cash pool being as intragroup debt investment
- debt-to-equity ratio being calculated on a transaction basis, not a monthly basis



Small Changes in Chapter 12

- GAAR
- the sole or main purpose test introduced
- any transaction without a reasonable business purpose other than a sole or main purpose of acquiring tax benefits being subject to GAAR investigation



Localizing BEPS proposals

- Chapter 3
- Chapter 6
- Chapter 7
- Chapter 4
- Chapter 5
- Chapter 10
- Chapter 11
- Chapter 12
- Action 13
- Action 8
- Action 10
- Action 3
- Action 4
- Action 6



Incorporating SAT's experiences (I)

- the administration of intergroup equity transfer transactions
- As a separate type of intragroup transaction in Chapter 2
- Setting out local file disclosure requirements in Chapter 3
- Outlining consideration factors for comparability analysis in Chapter 4
- asset valuation methods, including cost method, market method, and income method, as alternative transfer pricing methods in Chapter 4



Incorporating SAT's experiences (II)

- Focusing on value creation factors
- Focusing on value chain analysis
- disclosing them in local files by MNEs
- considering them in selecting a reasonable transfer pricing method
- Using them under a value contribution method



Incorporating SAT's experiences (III)

- Chapter 8 on APA
- refines APA procedures and the conditions under which tax authorities may prioritize or decline APA applications
- Chapter 9 on cost-sharing agreements
- Agreements by taxpayers no longer need approval by tax authorities
- New Chapter 13 on profit level monitoring
- Setting out guidelines and requirements for tax authorities monitoring MNE profit levels,
- Chapter 14 on corresponding adjustments and mutual agreements
- Setting out conditions under which tax authorities may decline MAP applications or stop MAP procedures



- Leading industries relevant to MNEs -
 - Financial services
 - Wholesales and retails
- Tight economic link with Mainland
- What kind of position within the global value chain of MNEs?
- Competitor from Mainland or other areas – Shanghai, Singapore
- Main factors of tax system
 - Low tax rate in profit tax
 - Territorial tax base
 - Limited tax treaty network
 - A tax arrangement with Mainland including many tax benefits



Proposed response of HK

- Underlying goals:
- Raising public funding vs stimulating economic growth
- Strengthening existing tax advantages -
- Tax incentives for financial services
- e.g. expanding tax exemption to offshore private fund
- Creating new opportunities for MNEs –
- Value creation activities, e.g.
- Capital raising and management
- IP developing
- Digital economy



Thanks for your attention !

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