

IRD's latest approach to large business tax administration

7 March 2024
Issue 5

In brief

The need for a specialised division within a tax authority to handle the tax matters of large businesses is a reflection of the complexity of their operations and structures, especially concerning cross-border transactions, which often give rise to tax issues. Taking cues from the practices of tax authorities in other jurisdictions (such as Chinese mainland, the United States and the United Kingdom), the Inland Revenue Department (IRD) established a Large Business Office (LBO) under Unit 1 (Profits Tax) a couple of years ago. Under the IRD's latest approach to tax administration for large businesses, the profits tax files of Hong Kong entities belonging to multinational enterprise (MNE) groups that are subject to the Country-by-Country Reporting (CbCR) requirements are being transferred to the LBO team. This news flash sets out our understanding of the transfer exercise and our observations thereon.

In detail

We have seen extensive tax queries raised by the LBO to some large business groups since 2019. Issues raised in the queries include transfer pricing matters, offshore claims, deduction of various expenses, etc. Recently, we are aware that the IRD has started to transfer the profits tax files of Hong Kong entities belonging to MNE groups that are subject to the CbCR requirements (other than those under trade categories 22 or 95) to the LBO. The files of the affected Hong Kong entities within the same MNE group are handled by the same designated team in the LBO.

Our understanding of the transfer is as follows:

- At the current stage, the transfer mainly affects Hong Kong entities of MNE groups that are subject to the CbCR requirements (i.e. MNE groups with consolidated group revenue exceeding EUR750 million or HKD6.8 billion), regardless of whether the ultimate parent entity is resident in or outside Hong Kong.
- The transfer is intended to centralise all the Hong Kong entities within the same MNE group (other than those under trade categories 22 or 95) to facilitate tax administration.
- New trade categories 28, 29 or 30 will be used for these tax files, mainly for the ease of internal file routing.
- The IRD will send courtesy letters to the concerned entities, notifying them of the new file numbers, as well as the names and contact numbers of the in-charge officers, which normally consist of one Senior Assessor and two Assessors.
- Any existing outstanding tax matters will be taken over by the designated team in the LBO.

Our observation: While the transfer of the profits tax files of large MNE groups to the LBO may seem to be an administrative change by the IRD on the surface, based on the practice in other tax jurisdictions, this initiative may also suggest that more resources are being dedicated to the risk assessment and administration of tax matters for MNE groups operating in Hong Kong. In this connection, Hong Kong entities which are already or may potentially be affected by the transfer exercise are recommended to take the following actions:

- **Follow up on the existing outstanding tax matters in a timely manner:** As the existing outstanding tax matters of these files will be taken over by the designated team, it is a good opportunity for MNE groups to review and resolve the outstanding tax matters as well as build up initial communication with the newly assigned assessors.
- **Conduct a comprehensive review on historical high-risk areas:** Profits tax files of the affected entities will be handled by the new teams in the LBO, whereby the historical tax filings/tax positions of relevant entities may be further reviewed and queries may be raised. Therefore, MNE groups are advised to conduct a comprehensive review on high-risk areas, such as treatment of offshore income and allowance claim, and ensure sufficient documentation is in place to support the historical tax treatments/positions of relevant Hong Kong entities within the group.
- **Undertake a thorough review of intra-group transactions:** The centralised approach equips the designated team with a comprehensive overview of the tax matters related to various entities within an MNE group. This enables the designated team to identify potential tax risks stemming from intra-group transactions and assess whether these transactions adhere to the arm's length principle or if they involve any tax avoidance or profit shifting strategies. MNE groups are strongly advised to conduct thorough reviews of their intra-group dealings. Common examples include intra-group buy-sell transactions, intra-group financing, management fee recharges and cost allocation. Proper documentation should be maintained to justify the commercial substance of intra-group transactions and compliance with the relevant provisions. Furthermore, MNE groups should ensure that information provided to the IRD in respect of different entities is consistent.

The takeaway

The recent changes to the LBO can also be advantageous for MNE groups. When a dedicated tax team manages group tax issues, an MNE group only needs to interact with one team. This approach potentially fosters harmonised tax positions among the involved taxpayers, preventing inconsistencies that might arise from dealing with different assessors across various teams. We have extensive experience in dealing with the LBO cases, and if you require assistance, please feel free to reach out to us.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

PwC's Corporate Tax Leaders based in Hong Kong

Charles Lee
+852 2289 8899
charles.lee@cn.pwc.com

Jeremy Ngai
+852 2289 5616
jeremy.cm.ngai@hk.pwc.com

Jeremy Choi
+852 2289 3608
jeremy.choi@hk.pwc.com

Rex Ho
+852 2289 3026
rex.ho@hk.pwc.com

Cecilia Lee
+852 2289 5690
cecilia.sk.lee@hk.pwc.com

Jenny Tsao
+852 2289 3617
jenny.np.tsao@hk.pwc.com

Kenneth Wong
+852 2289 3822
kenneth.wong@hk.pwc.com



One-stop tax information platform of Shui Jie 3.0 version Your exclusive tax think tank



- For Android users, please scan the QR code to access to Tencent App store
- Shui Jie web portal - <https://shuijie.pwconsultantssz.com>

In the context of this News Flash, China, Chinese mainland or the PRC refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PwC's client service team or your other tax advisers. The materials contained in this publication were assembled on 7 March 2024 and were based on the law enforceable and information available at that time.

This News Flash is issued by **PwC's National Tax Policy Services** in Chinese mainland and Hong Kong, which comprises a team of experienced professionals dedicated to monitoring, studying and analysing the existing and evolving policies in taxation and other business regulations in Chinese mainland, Hong Kong, Singapore and Taiwan. They support PwC's partners and staff in their provision of quality professional services to businesses and maintain thought-leadership by sharing knowledge with the relevant tax and other regulatory authorities, academics, business communities, professionals and other interested parties.

For more information, please contact:

Long Ma
+86 (10) 6533 3103
long.ma@cn.pwc.com

Charles Chan
+852 2289 3651
charles.c.chan@hk.pwc.com

Please visit PwC's websites at <http://www.pwccn.com> (China Home) or <http://www.pwchk.com> (Hong Kong Home) for practical insights and professional solutions to current and emerging business issues.

www.pwchk.com

© 2024 PricewaterhouseCoopers Ltd. All rights reserved. PwC refers to the Hong Kong member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.