

# *Standing out from the competition*

## Transfer pricing in Hong Kong and China



***The Global Tax Monitor recognises PwC as the leading adviser in Hong Kong and Asia Pacific for Transfer Pricing by reputation, with a very strong lead over the competition.***

These results are based on the year ending Q4 2013, with a sample size of 100 and 1030 primary buyers of tax services in Hong Kong and Asia Pacific respectively.

\* Launched in 2000, the Global Tax Monitor (GTM) is an independent survey conducted by research agency TNS, that examines the competitive position of the top firms in the tax advisory market - globally, regionally, nationally and on an industry basis. It provides a comprehensive measure of firm reputation, client service and brand health, gained currently from just over 4,000 telephone interviews annually with key decision makers (CFOs and Tax Directors) in 40 key markets.

# Today's challenges in Hong Kong and China

## Mounting attention on transfer pricing (“TP”) strategies:

Use of Hong Kong as a gateway to China

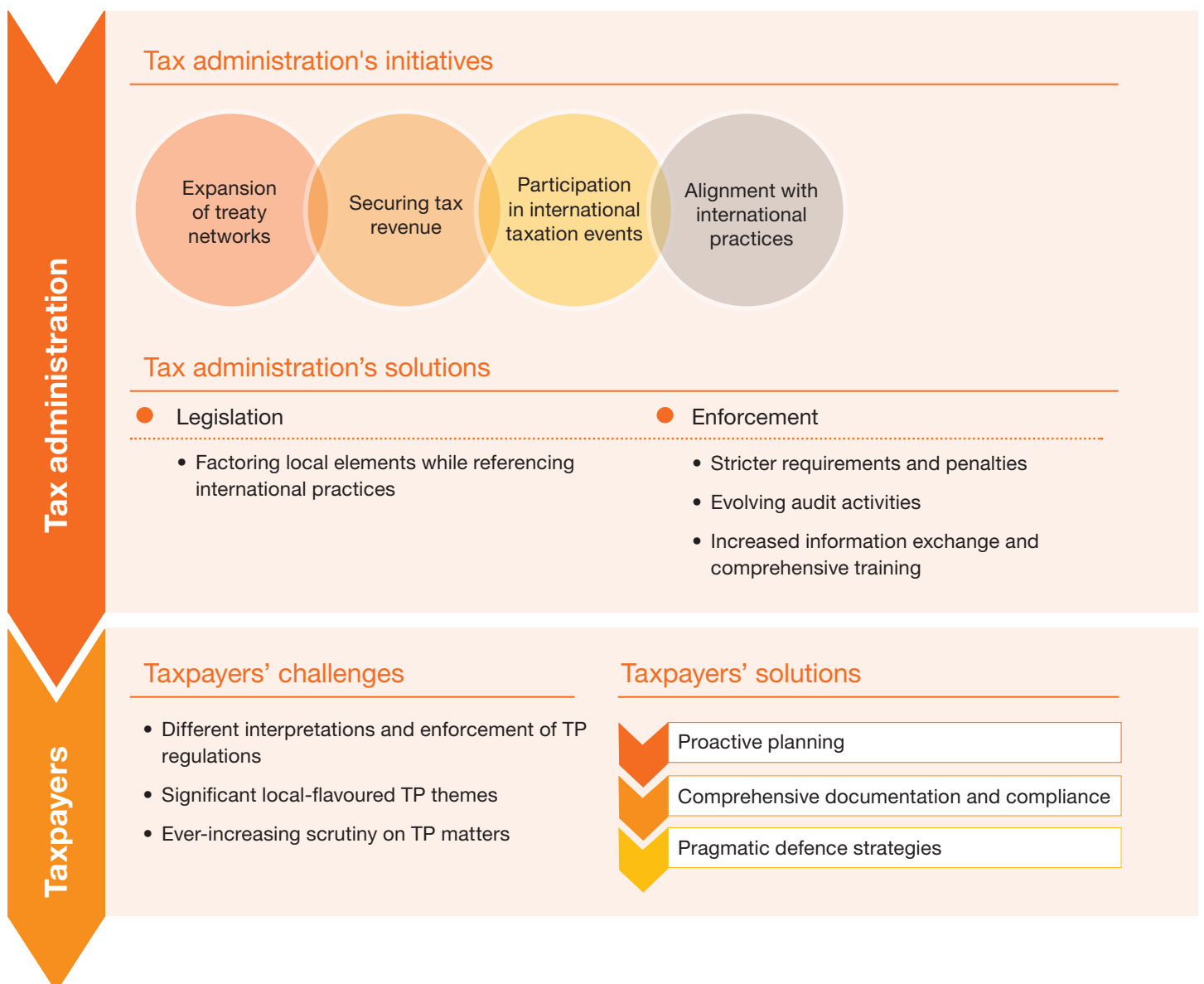
Increasing appetite for Hong Kong as a regional hub

Transformation from a global manufacturing powerhouse into diversified economies/sectors

Shifting from “made IN China” to “made FOR China”

Increasing appetite for China outbound investments

## Responses from tax administrations



# Transfer pricing environment in Hong Kong and China

## International legislation

- Organisation for Economic Co-operation and Development (“OECD”) - Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“OECD Guidelines”)
- United Nations’ Practical Manual on Transfer Pricing for Developing Countries (“UN TP Manual”) – China Country Practices

## Major TP legislation

### Hong Kong

The Inland Revenue Department (“IRD”) has issued the following Departmental Interpretation and Practice Notes (“DIPN”) that relate to transfer pricing:

- DIPN 45 on “Relief from Double Taxation due to Transfer Pricing or Profit Reallocation Adjustments” outlines the IRD’s views and practices on granting relief from double taxation due to a transfer pricing or profit reallocation adjustment under a double taxation agreement.
- DIPN 46 on “Transfer Pricing Guidelines – Methodologies and Related Issues” outlines the IRD’s views and practices on the methodologies of transfer pricing and related issues.
- DIPN 48 on “Advance Pricing Agreement” (“APA”) provides guidance for taxpayers seeking an APA, explains the APA process and the terms and conditions of the APA process prescribed by the Commissioner.

### China

- Guoshuifa [2009] No. 2 “Implementation Measures of Special Tax Adjustments (Trial Version)”
  - General TP legislations governing compliance requirements, Advance Pricing Arrangements (“APA”), TP levies and penalties etc
- Guoshuifa [2005] No. 115 “Provisional Measures for Applications by Chinese Residents for Launching Mutual Agreement Procedure”
  - General guidelines on Mutual Agreement Procedure (“MAP”) governing double taxation avoidance and prevention of income tax evasion

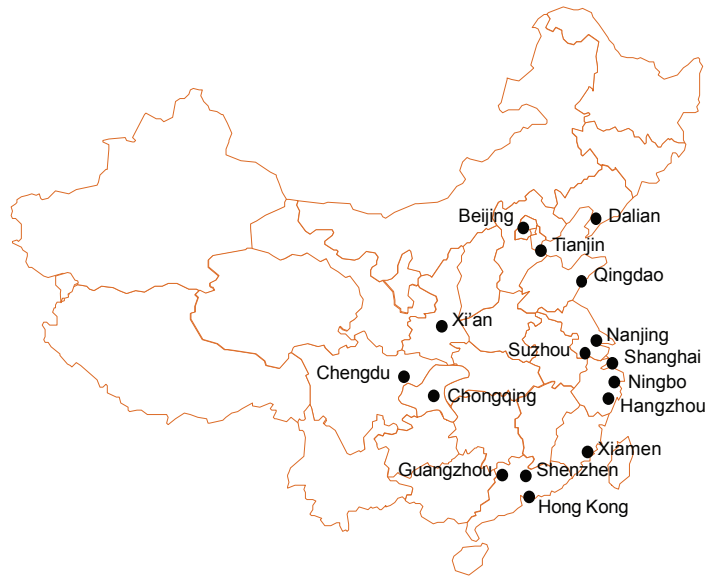
## What does this mean

- APA thresholds for Hong Kong
- Defense tool in negotiations and discussions with tax administrations in Hong Kong and China
- Maturing technical expertise means TP tax officials have started to question if the Transactional Net Margin Method is always the most appropriate method
- Location specific advantages and local market intangibles
- Wider definition of “Related Parties” in China
- Legal obligations to prepare China contemporaneous TP documentation:
  - Related party transactions exceeding:
    - RMB 200M in tangible goods buy/sell transactions
    - RMB 40M in related party transactions other than the above
  - Loss making companies with limited function/risk profiles
  - Thinly capitalised companies wishing to claim deductions for excessive interests
  - Companies facing general anti-avoidance allegations

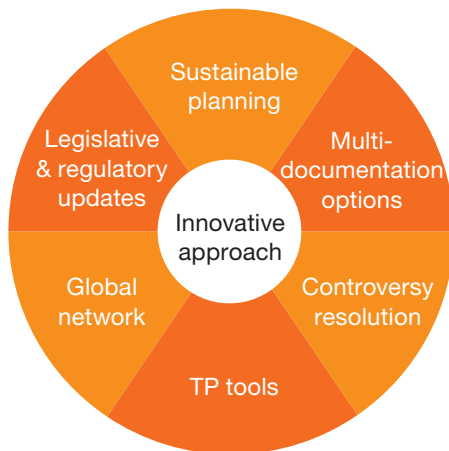
# Our services

## PwC's approach to transfer pricing –Think globally, act locally

- PwC is the leading TP service provider in China and Hong Kong
- Our dedicated team of TP professionals are strategically located in major cities across China
- As part of the PwC Global TP network, we draw on a global resource pool to provide you with a seamless service that covers a vast range of intercompany transactions within and outside of China



## What does PwC's combined experience mean for you?



## What value can we bring to you?

- Tailored solutions to meet your **specific** requirements
- A **systematic** approach to ensure an effective and efficient planning and implementation process
- Our **scalable** solutions will support you in all areas of transfer pricing

## Our services include:



# Transfer pricing planning

## What is it

In today's fast-changing business/regulatory environment, TP planning has become a dynamic process requiring constant review and fine-tuning. TP is one of the top tax audit priorities, with stringent compliance requirements and evolving legislation and enforcement.

## Do you need it

Your current state:

- Significant related party transactions
- Complicated implementation of existing group pricing policies in China
- Significant changes in operations and profit propositions

## What we do

- Identify planning opportunities
- Design, implement and maintain TP structures
- Optimise tax efficiency
- Sustainable tax strategies
- Retain legal compliance

## How we do it

- Value chain analysis to identify key value drivers of the transaction
- Economic analysis to recommend arm's length remunerations
- TP risk/exposure quantification
- Implementation assistance
  - accounting, process and data mapping
  - system integration
- Post-implementation sanity checks
- Supplemental tax-related analyses

## What you achieve

Whether you are looking to align business reality with TP strategies, or develop consistent, yet flexible, group TP policies, or even to mitigate your TP risks, we can help

- A pragmatic solution in Hong Kong and China

- General defensible position in other jurisdictions
- Minimise TP adjustment risks

## Credentials

- Guidance to a US listed domestic group to streamline its European structure
- Reviewed and supported multiple MNCs in reviewing and implementing the group royalty structures and service fee allocations





# Transfer pricing documentation

## What is it

- A report documenting the arm's length nature of a company's (or a Group's) TP policy. As the burden of proof in disputes rests with taxpayers, proper documentation

and support for your TP policies is important.

## Do you need it

- Legal obligations:
  - Related party transactions exceeding prescribed thresholds
  - Insufficient documentation to support pricing policies
  - Loss making companies with limited risk profiles
  - Thinly capitalised companies wishing to

claim deductions for excessive interests; or

- General anti-avoidance allegations

- Defense tool:

- Company restructurings and M&A
- Envisaged change in TP policy
- VAT or customs duty discussions

## What we do

- Functional analyses
- Benchmarking studies
- Audit defense files
- Global core documentation

## How we do it

- Multiple approach
  - Top-down approach – Entity specific documentation based on existing global/regional core documentation
  - Bottom-up approach – Global/regional core documentation based on entity specific documentation

- Systemic step

- Industry Analysis
- Functional Analysis
- Economic Analysis
- Arm's length Position

## What you achieve

- Ensure consistent application of TP policy
- Minimise TP adjustment risks
- Identify planning opportunities

## Credentials

- Provided Fortune 500 companies with multiple Chinese entities' TPD services
- Prepared global core-documentation for China domestic companies with international operations



# Dispute resolution

## What is it

TP is one of the top priorities of tax audits, and evolving TP legislation and interpretations / enforcements can be counter-intuitive. PwC's extensive experience in China dispute resolution allows us to assist you in defending against TP audits by formulating proven

strategies and preparing well-grounded defence to support your group's TP position.

## Do you need it

Your current state

- Controversial pricing policy / insufficient supporting documentation
- Vulnerable to TP audits

- Group presence in TP aggressive jurisdictions (low tax jurisdictions) or tax havens

## What we do

We pool our resources, knowledge and best practices to provide you with access to the expertise needed. Our team members include:

- experienced professionals with outstanding records of negotiation with local tax administrations

- ex-government officials who can capitalise on their "behind the scenes" understanding of process and procedures and long standing relationships
- specialists in tax and economics

## How we do it

- Recommend and assist with implementation of the best strategies
- Coordinate strategy/response to formal requests
- Prepare and assist on employee interviews and facility tours

- Develop defense strategies and position papers
- Assist with all phases of TP audits
- Consider all available alternatives to reduce or eliminate the likelihood of prolonged disputes

## What you achieve

- Limited judiciary avenues means resolution of disputes at the audit stage remains the most effective and efficient way
- Effective audit management avoids a prolonged process and mitigates financial and reputational damage

## Credentials

- Assistance in TP audit cases across Hong Kong and China in all industries, including automotive, electronic components, office equipments, heavy equipments, franchising, R&C and etc
- Played a vital role in China's first MAP case





# Advance Pricing Arrangements (APA)

## What is it

APA is an 'advance' agreement on TP methodologies between the tax administration and the taxpayer that sets out the method for determining TP for intercompany transactions:

- Unilateral APA: concluded and signed between a taxpayer and its tax administration
- Bilateral APA: concluded and signed between two tax administrations

- Multilateral APA: concluded and signed by more than two tax administrations

Often, APAs are coupled with resolutions of pending TP issues of prior years and can provide the opportunity to resolve TP issues for future years.

## Who is suitable for an APA

Companies with:

- Stable operations (e.g. contract manufacturers)
- History of TP investigations
- Controversial related party transactions and/or
- New TP policies and/or plans to update existing TP policies

If you envision difficult negotiations with joint venture partners, our APA services can help avoid potential conflicts.

## The APA process

- Feasibility assessment
- Rationalisation of TP policies
- Establish TP methodologies and profit/price target
- Pre-filing meetings with tax administrations
- Supporting documentation for APA application

- Formal applications for APA
- Negotiations with tax administration
- Final agreement draft
- Annual compliance report

## What you achieve

- Attain certainties and eliminate TP audit risks on future transactions covered by APA
- Engage in an effective collaboration with the relevant tax authorities
- Reduce exposure to senior management

- Avoid potential conflicts with JV partners
- Achieve more predictable results on financial statements

## Credentials

- PwC represented our clients to conclude the first five formal APA cases in China
- PwC by far assists in the majority of BAPAs concluded in China, including the first BAPA with Korea, Singapore and Denmark
- PwC advised on the first China outbound APA





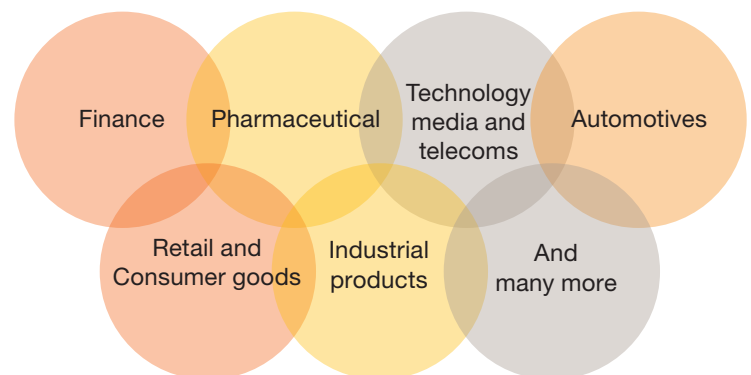
## Our TP Team

### Who are we?

Our TP team in Hong Kong and China consists of over 200 full time professionals and specialists from diverse backgrounds:

Economists	Financial and tax accountants
Ex-governmental officials	Professionals with legal qualifications

### Which industries are we serving?



### How our services are delivered – we are culturally sensitive!

Our team members are all bilingual, in addition to fluent/expert English speakers, we also have:

- **Japanese** Business Desk
- **Korean** Business Desk
- **Taiwan** Business Desk

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