



**Inland Revenue Department**

The Government of the Hong Kong Special Administrative Region  
of the People's Republic of China

**DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES**

**NO. 48 (REVISED)**

**ADVANCE PRICING ARRANGEMENT**

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

These notes replace those issued in March 2012.

WONG Kuen-fai  
Commissioner of Inland Revenue

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# DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

## No. 48 (REVISED)

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## INTRODUCTION

### *Context for APA*

Many multinational enterprises (MNEs) operating in Hong Kong participate regularly in world trade with sizable controlled transactions across the border. As a necessary consequence, there has been an increasing focus and emphasis on transfer pricing. The Commissioner recognises that these MNEs face transfer pricing risks internationally and domestically.

2. Charged with administering Hong Kong's tax system, the Commissioner faces risks posed by profit shifting and transfer pricing. By entering into an advance pricing arrangement (APA), the Commissioner places an explicit emphasis on assuring Hong Kong's tax base by working with MNEs to ensure profits are reflective of the true economic contribution made in Hong Kong.

3. MNEs will also seek to manage and mitigate their transfer pricing risks. An APA provides a tool for them to manage and mitigate such risks on a prospective basis. Having regard to the totality of the controlled transactions, the APA should provide a practical and commercial outcome for MNEs with operations in Hong Kong.

### *Definition of APA*

4. An APA is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.

5. In this Practice Note, controlled transactions refer not only to transactions between associated persons, but also transactions between different parts of the same person<sup>1</sup>. In addition, attribution of profits to a permanent establishment of a non-Hong Kong resident person in Hong Kong can be the subject matter of an APA.

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<sup>1</sup> An APA can cover domestic controlled transactions. Transactions between different parts of the same person refer to internal dealings between: (a) an overseas branch and the Hong Kong head office; (b) the Hong Kong branch and the overseas head office; and (c) the Hong Kong branch and an overseas branch of a non-Hong Kong resident person.

6. An APA will not agree precisely the actual profit which should be taxed in Hong Kong in the future. It should fix arrangements according to the arm's length principle for determining the transfer pricing outcomes for the future transactions. In general, an APA will cover a period of 3 to 5 years.

### ***Types of APA***

#### ***Unilateral APA***

7. A unilateral APA is an arrangement between the Commissioner and a person concerning the transfer pricing of controlled transactions. It does not involve the agreement with the competent authority of a foreign jurisdiction. As such, it does not guarantee the agreement of the competent authority of a foreign jurisdiction to the arrangement made.

8. If the tax administration of a foreign jurisdiction involved forms a different view as to the application of the arm's length principle to the controlled transactions covered by a unilateral APA, double taxation may arise. If the jurisdiction is a territory outside Hong Kong with which a double taxation arrangement (DTA) has been made (i.e. DTA territory), the Commissioner will seek to support the transfer pricing outcomes of the unilateral APA during the mutual agreement procedure (MAP), but may have to deviate from the transfer price under the original terms of the unilateral APA to arrive at a solution with the competent authority of the DTA territory.

#### ***Bilateral APA***

9. A bilateral APA is an arrangement between the Commissioner, as the competent authority of Hong Kong, and the competent authority of a DTA territory concerning the transfer pricing of controlled transactions. It is concluded under the MAP Article of the relevant DTA. Upon mutual agreement having been made, the competent authority of each side confirms the terms of the APA in writing with the person concerned and agrees to be bound by the terms. A bilateral APA therefore provides certainty to the person that double taxation will not arise.

#### ***Multilateral APA***

10. A multilateral APA is an arrangement between the Commissioner and the competent authorities of two or more DTA territories concerning the transfer

pricing of controlled transactions. It strictly involves multiple and complementary bilateral APAs concluded under the MAP Articles of the relevant DTAs. A multilateral APA binds the competent authorities of all relevant DTA territories and provides certainty to the person concerned that double taxation will not arise. It may be more appropriate where there is essentially only one activity, but several persons or parts of a person contribute to it. For example, where an enterprise resident in Hong Kong is engaged in global financial trading through branches in Jurisdiction-F1 and Jurisdiction-F2, it may be appropriate for similar agreements to be reached between Hong Kong and Jurisdiction-F1 and Hong Kong and Jurisdiction-F2 in order to determine how the profits from the activity are to be allocated to each of the 3 jurisdictions, with a view to eliminating double taxation.

### ***Advantages of APA***

11. An APA provides certainty on an appropriate transfer pricing methodology in relation to the controlled transactions. APAs concluded bilaterally or multilaterally with DTA territories provide an increased level of certainty in Hong Kong and these territories, lessen the likelihood of double taxation and may proactively prevent transfer pricing disputes.

12. The APA process, which is voluntary, supplements the objection, appeal and other DTA mechanisms for resolving transfer pricing issues. It prevents costly and time consuming audit and litigation of transfer pricing issues. Its scope is flexible and it may cover all or part of the transfer pricing issues of a person. The discussion of complex transfer pricing issues in a non-adversarial environment can stimulate the free flow of information and promote mutual understanding.

13. An APA requires the compliance with particular requirements and depends on critical assumptions being met. If the requirements are complied with and the assumptions are met, the Commissioner will not impose additional profits tax on the covered controlled transactions other than the tax payable on the pricing worked out under the APA. Upon the expiration of the period covered by the APA, the person who has applied for the APA may seek to renew it, thus prolonging the advantages.

## THE STATUTORY APA REGIME

### *Relevant legislation*

14. The Inland Revenue (Amendment) (No. 6) Ordinance 2018 (the Amendment Ordinance) was enacted in July 2018. The Amendment Ordinance has incorporated, among other things, the international transfer pricing rules into Division 2 of Part 8AA of the Inland Revenue Ordinance (IRO). Provisions have also been added in Division 4 of Part 8AA to allow the Commissioner and a person to agree in advance on a method for computing the person's profits under such transfer pricing rules in an arrangement (i.e. an APA). The APA can be unilateral, bilateral or multilateral.

15. The main provisions in Division 4 of Part 8AA, the supplementary rules in Schedule 17H and the penal provisions in Part 14 relating to APA are summarised as follows:

#### *Main provisions in Division 4 of Part 8AA*

- (a) Section 50AAP allows the Commissioner to make an APA with a person relating to how the person's income or loss is to be computed under section 50AAF or 50AAK for a fixed period of time.
- (b) Section 50AAQ requires a person, in respect of whom an APA is made, to disclose the existence of the APA made in the person's return.
- (c) Section 50AAR empowers the Commissioner to revoke, cancel or revise an APA.
- (d) Section 50AAS imposes obligations on a person, in respect of whom an APA is made, to notify the Commissioner of a breach of any critical assumption and to provide the Commissioner with all reports (e.g. annual compliance report) and other information as required under the APA.

- (e) Section 50AAT requires a person, in respect of whom APA is made for a period, to retain for not less than 7 years after the end of the period all the relevant records and data.
- (f) Section 50AAU empowers the Commissioner to resolve questions through the MAP with the competent authority of a DTA territory for the purpose of making an APA.
- (g) Section 50AAV refers to Schedule 17H which prescribes the detailed requirements for an APA application and the fees payable for the application.
- (h) Section 50AAW provides that no liability is to rest on the Government, the Commissioner or any other public officer in respect of the exercise of any power or performance of any duty in good faith in relation to an APA or an APA application.

*Supplementary rules in Schedule 17H*

- (i) Section 2 prescribes the content of an APA application.
- (j) Section 3 requires the applicant to provide further information for purposes of an APA application if required by the Commissioner.
- (k) Section 4 empowers the Commissioner to appoint an independent expert to inquire into and report on any matters in relation to an APA application.
- (l) Section 5 allows an applicant to withdraw an APA application by written notice to the Commissioner.
- (m) Section 6 requires the Commissioner to give the applicant a written notice stating the decision and the reasons if the making of an APA is refused.
- (n) Section 7 specifies the fees payable and deposit required for an APA application.



*Penal provisions in Part 14 relating to APA*

- (o) Sections 80(2L), 82(1AAB) and 82(1AAC) provide that a person commits an offence if the person makes an incorrect statement, provides incorrect information or omits anything from a statement made or information provided, or fails to comply with the requirements for provision of information, making of notification and record keeping, in connection with an APA or an APA application.
- (p) Sections 80(2M), 80(2N), 80(2O), 80(2P), 82(1A) and 82A(1H) impose penalties in relation to the offences in subparagraph (o) above.

16. The provisions and supplementary rules in paragraph 15 apply to a year of assessment beginning on or after 1 April 2018. Section 4(5) of Schedule 44 provides that the principles developed in an APA are not prevented from being applied under section 50AAQ(4) in relation to a period which wholly or partly falls before 1 April 2018 if the arrangement is made on or after 1 April 2018.

***Mutual expectations under the APA process***

17. While the APA process is a statutory one, it is a co-operative process requiring a relationship of mutual trust to achieve an effective outcome. In building mutual trust as part of a constructive relationship, expectations that the stakeholders may have of each other include the following:

- (a) all parties will co-operate fully with each other, including undertaking open and ongoing dialogue in the development of the APA;
- (b) each APA request will be treated on its merits according to its own facts;
- (c) each party will act transparently, in particular each party will disclose all relevant and material facts;
- (d) each party will provide prompt and complete replies to any reasonable queries.

## ***Suitability of concluding APA***

### *Single indicators not determinative*

18. While single indicators may point in one direction or the other, the Commissioner will consider each APA request on balance having regard to all the relevant facts and circumstances. No one indicator is, of itself, determinative. However, transparency as to the material facts is essential.

### *More likely for the Commissioner to enter into an APA*

19. The Commissioner may be more likely to enter into an APA where one or more of the indicators set out below are present:

- (a) the transfer pricing methodology adopted under the proposed APA best achieves consistency with the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG) published by the Organisation for Economic Co-operation and Development (OECD) on 10 July 2017;
- (b) the controlled transactions covered by the proposed APA have already been entered into and are unlikely to change significantly in the period of the APA;
- (c) a proposed arrangement is under serious contemplation and the proposed actual provisions are unlikely to change significantly in the period of the APA;
- (d) the transfer pricing issues are complex and there is uncertainty as to how the transfer pricing rules apply;
- (e) without an APA, the probability of double taxation is high.

### *Less likely for the Commissioner to enter into an APA*

20. The Commissioner may be less likely to enter into an APA where one or more of the indicators set out below are present:

- (a) the actual provisions are simple or routine with arm's length

provisions being relatively certain without any significant transfer pricing risk;

- (b) the controlled transactions to be covered by the APA are only a small portion in terms of value of the total controlled transactions;
- (c) the proposed APA would not ensure that there is alignment between true economic activity and profit outcomes in Hong Kong;
- (d) the collateral issues would affect the Commissioner's ability to enter into the APA;
- (e) the proposed APA application would result in double non-taxation;
- (f) the arrangements that are the subject of the proposed APA appear to lack commerciality or be primarily tax driven (e.g. the proposed APA covers activities which involve structures, restructuring or greenfields arrangements where the commercial benefits to the operations of the MNE in Hong Kong are questionable).

21. Exemption from preparing the master file and local file does not preclude the Commissioner and the person from entering into an APA. However, in instances where a person is not required under section 58C of the IRO to prepare such transfer pricing documentation, the Commissioner considers that the person may be less likely to request an APA.

#### *Losses carried forward*

22. Where carried forward losses are available to a person, the Commissioner will treat this aspect as a collateral issue and understand the reasons behind those losses being incurred. Presence of losses carried forward from back years, however, will not prevent the Commissioner from entering into an APA.

#### *Presence of tax avoidance issues*

23. In determining the arm's length outcomes, the consideration required is more than just pricing. This can include consideration of the global value chain, structures, functions, assets and risks, transfer pricing methodologies, etc. Consideration of such matters is part of the process of dealing with an APA request or application.

24. In rare instances, the Commissioner may also need to consider whether the controlled transactions to be covered by the proposed APA might lead to the application of:

- (a) the general anti-avoidance provisions in section 61 or 61A of the IRO; or
- (b) other specific anti-avoidance provisions of the IRO.

25. Where the possible application of section 61 or 61A or other specific anti-avoidance provisions of the IRO may arise in relation to the controlled transactions to be covered by the proposed APA, the Commissioner will consider the transfer pricing issues arising as part of the APA request or application and the aforementioned matters concurrently. In such instances, this may result in the Commissioner making further enquiries in the early engagement stage.

26. Analysis of the transfer pricing issues in tandem with potential tax avoidance issues can assist in the resolution of those issues. The Commissioner will use the most appropriate strategy and intervene as early as possible to resolve such tax avoidance issues and thereby reduce the possibility for dispute.

27. Consistent with the above approach, the Commissioner will also resolve such tax avoidance issues in parallel with progression of the proposed APA in instances where the general anti-avoidance provisions in section 61 or 61A or other specific anti-avoidance provisions may apply to transactions other than those to be covered by the proposed APA.

28. The Commissioner will discuss the resolution of such tax avoidance issues with the person and factor it into the development of agreed case plans.

## **THE APA PROCESS**

### ***Three stages of the APA process***

29. The APA process, which is explained in this Practice Note, has replaced the former process. The APA process, after revision, reflects: a principle-based approach; a more streamlined process; and revamped procedures to improve timeliness. The revised APA process has been reduced to three stages and the key

changes are:

- (a) delivery of a more balanced approach to understand the totality of the controlled transactions;
- (b) deliberate early engagement stage with a more rigorous approach if necessary;
- (c) greater focus on identifying and appropriately considering collateral issues.

30. The revised APA process has three stages:

- Stage 1: Early engagement
- Stage 2: APA application
- Stage 3: Monitoring and compliance

31. An APA request enters an early engagement stage before progressing to an APA application. Once the APA application is received, it passes to the APA application stage. After an APA has been made, there is a further stage of monitoring and compliance.

32. The APA process is not necessarily a linear one. In particular instances, some steps or combinations of steps may need to be repeated. For example, if insufficient information is provided to support the APA request, the Commissioner may need to develop a greater understanding of the controlled transactions or the application of the proposed methodology.

### ***Timeframe for concluding an APA***

33. The tentative timeframe is: 6 months for the early engagement stage; and 18 months for the APA application stage. For bilateral or multilateral APAs, the timeframe would also depend on the progress of negotiation with the competent authorities of the relevant DTA territories. Generally, a longer timeframe is required in more complex cases.

### ***Thresholds***

34. APA is most suitable for complex controlled transactions with high

transfer pricing risk (e.g. few comparables found; significant amount of tax involved and significant profits shifted out of Hong Kong). To better utilise resources of the Commissioner and stakeholders, it is therefore necessary to set a threshold for APA applications.

35. The thresholds<sup>2</sup> for an APA application, which is subject to review by the Commissioner from time to time, are as follows:

- (a) sales or purchases of \$80 million per annum if the APA application relates to the sale or purchase of goods;
- (b) service fees of \$40 million per annum if the APA application relates to the provision of services;
- (c) royalties of \$20 million per annum if the APA application relates to the use of intangible properties;
- (d) business profits of \$20 million per annum if the APA application relates to the attribution of profit to a permanent establishment in Hong Kong; or
- (e) amount of \$20 million per annum if the APA application relates to transactions not falling within subparagraphs (a) to (d) above.

The thresholds refer to the expected amounts of transactions and these thresholds will apply to new and renewal applications.

36. While the thresholds are operated consistently, the Commissioner after taking into account the number and relative size of the transactions, the transfer pricing risk and the likely attitude of the DTA territories, may relax the eligibility criteria to allow a person access to the APA process.

### ***Communicating with other competent authorities***

#### ***Early communication with other competent authorities***

37. For bilateral or multilateral APA, when making the APA request, a person should ensure that the person and associated persons meet the APA application

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<sup>2</sup> Thresholds are in Hong Kong currency.

requirements of the relevant DTA territories. It may also be useful for the Commissioner and the related competent authorities to have an early exchange of views on whether a bilateral or multilateral APA would be appropriate. This could avoid unnecessary work if it is unlikely that one of the competent authorities will participate. These discussions may be of an informal nature and do not necessarily require a formal face-to-face meeting. The competent authority of each DTA territory will undertake its own evaluation and analysis of the case from its perspective and may contribute information or insights not known to the Commissioner, or take different positions in relation to the appropriate transfer pricing methodology.

*Other competent authorities kept informed about the process*

38. Where a bilateral or multilateral APA is being sought, the Commissioner will:
- (a) expect the person to continue to make the relevant information available at the same time to the DTA territory involved, such that the DTA territory will be kept informed about the progress of its examination of the APA application; and
  - (b) seek to discuss with the DTA territory key issues arising at the earliest opportunity and will keep the person informed about the progress of the bilateral process.

The person should also relay to the Commissioner feedback and views, if any, from the competent authority of the DTA territory in relation to the APA.

## **STAGE 1: EARLY ENGAGEMENT**

### ***Request for APA early engagement***

#### *Model request*

39. A person can request for an APA by submitting a request for APA early engagement (APA request)<sup>3</sup>. Content of model APA request is given in **Appendix 1**. In view of the technicalities involved in the APA process, it is in the interest of the

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<sup>3</sup> If an APA request is made on an anonymous basis with reasons, sufficient information about the operations must nonetheless be provided to make any discussion meaningful.

person making the APA request to consider seeking professional advice throughout the APA process.

#### *Type of APA requested*

40. The person should decide which type of APA (i.e. unilateral, bilateral or multilateral) should be applied for. In general, the Commissioner expects that the proposed APA is bilateral or multilateral rather than unilateral except where:

- (a) the person or associated persons are resident in a jurisdiction with which Hong Kong has no DTA;
- (b) the relevant DTA territory has no APA process or will not process the bilateral or multilateral APA application;
- (c) the bilateral or multilateral APA sought is not technically meaningful and cost-effective from Hong Kong's perspective (e.g. Hong Kong is at the hub of arrangements with associated persons in many different jurisdictions and the trade flows involved with any one particular jurisdiction are relatively modest in scale); or
- (d) most of the transfer pricing risk lies in Hong Kong.

#### *Scope of request*

41. An APA request should describe the specific transfer pricing issues for which certainty is sought in relation to the controlled transactions and collateral issues if any. Clear and adequate supporting documentation should be attached to the APA request to outline the scope of the proposed APA, including the methodology to be used and the way how the collateral issues can be resolved.

#### *Draft APA case plan*

42. When submitting the APA request, the person should also provide a draft APA case plan which contains a structured timeline. A model APA case plan is given in **Appendix 2**.



### *Deadline for submitting request*

43. An APA request together with a draft APA case plan should be made, at least 6 months prior to the proposed commencement date for the APA requested, in writing to:

Chief Assessor (Tax Treaty)  
Tax Treaty Section  
Inland Revenue Department  
GPO Box 10851, Hong Kong

### *Setting up the APA team*

44. Upon receipt of the APA request, an APA team will be formed within the Department to process the APA request. The person making the APA request will be informed of the name and contact number of the APA team leader as soon as possible.

45. In the early engagement stage, the APA team will:

- (a) explain the APA process;
- (b) provide feedback on the APA request;
- (c) evaluate whether the person making the APA request should be invited to apply formally for an APA; and
- (d) develop agreed plans with the person, one for the APA request to proceed through the early engagement stage, and the other to conclude the APA itself.

### *Developing a tailored solution*

46. This stage involves initially a robust and holistic strategic level review of the APA request and supporting documentation, including an examination of the relevant global value chain. In later steps of this stage, the APA team and the person making the APA request will discuss the proposed APA in more detail. Throughout this stage and as part of planning for later steps and stages, the APA team will seek to develop a tailored solution that meets the needs of the person making the APA request.

### ***Preliminary discussions***

47. Preliminary discussions are held with the person making the APA request as part of the cooperative relationship to explore avenues for the appropriate treatment of the covered controlled transactions and any collateral issues. The Commissioner and the person will then know what to expect if and when the person lodges an APA application.

48. Openly discussing the APA request should stimulate a free flow of information and lead to a more robust review of the request and any supporting documentation. Such discussions should better facilitate submission of an APA application and subsequent agreement to a workable and practical APA.

49. During preliminary discussions, the APA team should:

- (a) confirm the scope of the proposed APA;
- (b) classify the proposed APA (unilateral, bilateral or multilateral) and identify the appropriate timeline for the APA process;
- (c) ensure appropriate stakeholders within the Department are involved in the APA process providing the necessary technical assistance and support;
- (d) review and confirm the worldwide structure of the group and the role of the person making the APA request within the global value chain relating to the controlled transactions;
- (e) identify the preferred transfer pricing method, methods or combination thereof;
- (f) identify and confirm any collateral issues and agree with the person on the approach to resolve those issues;
- (g) consider whether the person may need to address the exceptions to the general rule of recognising the transaction or arrangement as actually undertaken and structured (see Appendix 1 to Departmental Interpretation and Practice Notes No. 59 *Transfer Pricing between Associated Persons*). If the APA team considers

that it is possible that such exceptions might apply, the APA team needs to discuss with the person whether this aspect needs to be addressed in the APA application;

- (h) agree with the person or the person's representatives an early engagement case plan up to lodgment of the APA application;
- (i) agree with the person a draft plan for concluding the APA after lodgment of the APA application; and
- (j) in a bilateral or multilateral APA, keep the person informed to the best extent possible of discussions held with the competent authorities of the relevant DTA territories.

50. After the scope of the proposed APA has been agreed, changes to it will not be made other than in exceptional circumstances, which may include one or more of the following:

- (a) changes to the covered controlled transactions;
- (b) identification of a new issue with significant tax risk;
- (c) the need to interpret how the transfer pricing provisions apply to new controlled transactions;
- (d) new issue raised by the competent authority of the relevant DTA territory.

51. If the person making the APA request intends to make changes to the scope of the proposed APA, the Commissioner has to be consulted. The case plan will then be updated to reflect such changes.

52. Preliminary discussions do not bind the person making the APA request and the Commissioner to the APA process. Having such a discussion does not mean the person has been accepted into the APA application stage.

53. Generally, preliminary discussions should commence at least 5 months prior to the anticipated commencement date for the APA (e.g. for an APA commencing from 1 January 2021, the APA request should be submitted no later

than 30 June 2020 while the first preliminary discussions should be held no later than 31 July 2020). For a bilateral or multilateral APA, any specific requirements of the relevant DTA territories should also be taken into account.

***Inviting the submission of an APA application***

54. The APA team will consider the information contained in the APA request, the APA team's preliminary research and the greater detail provided during the preliminary discussions, and make recommendations to the Commissioner.

55. The Commissioner will make a decision on whether the person making the APA request will be invited to submit an APA application based on terms discussed previously, and will ensure consistency of approach across all APA requests.

56. Where the Commissioner agrees, the APA team leader will extend a written invitation to the person making the APA request to lodge an APA application. Where the Commissioner does not accept the request, the APA team leader will provide written reasons for that decision.

57. In determining whether the Commissioner will invite the person to submit an APA application, the Commissioner should consider the person's relevant facts and circumstances in the context of the global value chain and other steps or arrangements with which they might be linked.

58. The Commissioner should also consider these facts and circumstances against all relevant matters, rather than restrict the analysis only to the controlled transactions that are the subject of the proposed APA.

59. In addition to the indicators in paragraphs 18 to 20, the Commissioner will consider whether:

- (a) the information provided allows for a full and proper consideration by the Commissioner of the proposed APA;
- (b) there is an explanation demonstrating that the controlled transactions covered by the proposed APA are relevant and material to the person's business;

- (c) the transfer pricing risks and issues arising from the controlled transactions warrant the allocation of resources required for an APA;
- (d) an APA is a suitable solution for the person given the risks involved, the person's compliance history (locally and globally) and the person's performance under any previous APA;
- (e) one of the persons to the controlled transactions or an associated person is likely to get a tax advantage from the structures, transactions or actual provisions that are the subject of the proposed APA and that tax advantage may be obtained to the detriment of another person to the transactions;
- (f) the transfer pricing method adopted under the proposed APA is unlikely to result in the person getting a tax advantage and the transfer pricing method best achieves consistency with the TPG published by the OECD on 10 July 2017;
- (g) in the absence of an APA, there is a likelihood that the actual provisions of the controlled transactions may result in double taxation or a dispute;
- (h) the controlled transactions covered by the proposed APA are ongoing in nature and there is a significant part of a limited life project left;
- (i) the Commissioner anticipates that the persons will agree all aspects of the APA in a timely manner; and
- (j) collateral issues are capable of being resolved prior to or in parallel with the conclusion of the APA.

60. This list is not exhaustive. No one matter is determinative. Rather, any decision is to be made on balance after considering all relevant circumstances. Furthermore, one matter does not necessarily have any greater weighting relative to another.

61. Such decisions involve the Commissioner using professional judgment in light of the APA team's analysis of these matters in relation to facts and circumstances of each case.

***Submission of APA application***

62. If a person accepts the Commissioner's invitation to submit an APA application, the person should submit to the Commissioner an APA application within the timeframe agreed at the early engagement stage. In general, if the controlled transactions fall within section 50AAF, all persons involved in the controlled transactions and chargeable to profits tax are expected to join the application.

63. While the Commissioner does not intend to prescribe a set format for an APA application, section 2 of Schedule 17H provides that an APA application must include:

- (a) the details of the person lodging the APA application (i.e. applicant) and if applicable, the associated persons of the applicant involved in the controlled transactions in respect of which the APA is applied for;
- (b) the facts and documents relating to the applicant and if applicable, the associated persons and the controlled transactions;
- (c) the proposed methodology for determining the income or loss of the applicant;
- (d) the evidence showing that the proposed methodology can produce a result that complies with sections 50AAF and 50AAK, if applicable;
- (e) the period in respect of which an APA is applied for; and
- (f) a draft APA.

64. In the case of a bilateral or multilateral APA, the applicant should also advise the Commissioner of the information or documentation requests made by the tax administrations of the relevant DTA territories in relation to the APA

application and ensure that the Commissioner will be provided with a list of information or documentation supplied by the person or associated persons to the tax administrations of the DTA territories concerned.

65. All documentation should be clearly labelled, indexed and referenced. An English or Chinese translation should be provided if the documents are in a language other than English or Chinese.

66. The applicant should provide all information and documentation as agreed in the early engagement stage and any other information that may be of assistance in progressing the APA application. The applicant may discuss with the APA team what information and documentation is required. The applicant will only be required to provide information which is material and relevant to the analysis and evaluation of the APA application.

67. Where there are a large number of records or documents in support of the APA application, the Commissioner may agree that some or all of these need not be provided with the APA application. Such records or documents should be referenced in the APA application and made available if requested.

68. In the APA application, the principal officer of the applicant must make the following statements:

*“I understand that my application would not affect the right of objection against an assessment or right of appeal to the courts under the provisions of the Inland Revenue Ordinance.*

*I agree that all documents and information submitted to the Commissioner for the purposes of the APA application may be provided to the competent authorities of the relevant DTA territories for processing the APA.*

*I declare that I have examined the APA application, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the application are true, correct and complete.”*

Content of model APA application is given in **Appendix 3**.

69. Under the transparency framework of Action 5 under the OECD/G20 Base Erosion and Profit Shifting Project, rulings including cross-border unilateral APAs are required to be spontaneously exchanged with the relevant jurisdictions. For this purpose, if a unilateral APA application involves cross-border controlled transactions, the applicant must submit at the time of application the completed template for spontaneous exchange of information on cross-border unilateral APA at **Appendix 4**.

70. For bilateral or multilateral APA application, the applicant should ensure that another APA application is submitted to the tax administration of the DTA territory concerned, and the requirements of the APA process in the DTA territory concerned are met.

71. As soon as is administratively practicable, but no later than 1 month after receipt and acceptance of a bilateral or multilateral APA application, the Commissioner will notify the competent authority of each relevant DTA territory. After the relevant competent authority or authorities agreed to participate in the APA process, a timetable will be set for the APA. The APA team will then finalise and execute the APA case plan.

### ***Payment of deposit***

72. An applicant may be required under section 7(2) of Schedule 17H to pay a deposit of an amount determined by the Commissioner before the APA application is entertained. Upon receipt of the APA application, the APA team leader will notify the applicant of the amount of the deposit required. Processing of the case will not be started until the required deposit is paid. The deposit paid will be used to settle the fees charged for the APA application.

## **STAGE 2: APA APPLICATION**

### ***Steps involved***

73. If an applicant accepts the Commissioner's invitation to submit an APA application, the APA application stage commences. The steps in this stage are:

#### **Analysis and evaluation**

- (a) The APA team analyses critically and evaluates the APA



application, including any associated documentation and comparability analysis.

Negotiation

- (b) The APA team develops an APA document containing the Commissioner's position with which the Commissioner enters negotiations. The terms and conditions of the APA are negotiated with a view to reaching agreement.

Agreement

- (c) Where agreement is reached, the relevant parties enter into an APA.

***Analysis and evaluation***

*Aim and scope*

74. The APA team will analyse critically and evaluate the APA application and the information in support with the aim of verifying that:

- (a) the proposed APA results in an arm's length outcome for the covered controlled transactions, thereby mitigating any transfer pricing risk;
- (b) there is sufficient information in support of the APA application so as to allow the Commissioner to fully evaluate it; and
- (c) the proposal in the APA application is consistent with the person's request and preliminary discussions in the early engagement stage.

75. The APA team will check the APA application in respect of the matters listed below:

- (a) controlled transactions to be covered by the APA;
- (b) structures and the allocation of functions within different parts of the MNE;
- (c) analysis of functions, assets and risks;

- (d) resultant characterisation of the controlled transactions;
- (e) transfer pricing methodology proposed;
- (f) comparability analysis;
- (g) arm's length outcome proposed; and
- (h) critical assumptions proposed.

76. The APA team will examine the transfer pricing documentation that can be expected to be available for reviewing, including those referred to in Departmental Interpretation and Practice Notes No. 58 *Transfer Pricing Documentation and Country-by-Country Reports*.

77. If the APA team considers the aims listed in paragraph 74 are satisfied, further enquiry may not be necessary.

#### *Additional information*

78. When verifying whether the proposed APA results in an arm's length outcome and having regard to the totality of the controlled transactions, the APA team may need to make further enquiries, such as:

- (a) additional information requests to the applicant and associated persons; and
- (b) interviews with key personnel of the applicant or the tested party.

79. Where the proposal in the APA application is not consistent with details arising from preliminary discussions, the APA team may request from the applicant an explanation as to the differences. Where there is insufficient information for the APA team to conduct a full evaluation of the APA application, the APA team will request the information it needs.

#### *Independent experts*

80. The APA team reviews the applicant's functional analysis, comparability study and, where applicable, suggested arm's length range. In verifying that the

outcomes arising from the APA application are consistent with the arm's length principle, the APA team may seek assistance from relevant independent expert as necessary.

81. An independent expert may be appointed by the Commissioner under section 4 of Schedule 17H to inquire into and report on any matters in relation to an APA application. The Commissioner will consult the applicant on the matter and take into account the academic qualifications, related work experience, etc. of the potential candidates for making the appointment. Any fee paid by the Commissioner to the independent expert should be reimbursed by the applicant.

82. The Commissioner will seek independent expert's advice only in exceptional circumstances (e.g. where complex transfer pricing issues are involved or a greater understanding of the relevant industry is needed). The APA team will discuss this aspect with the applicant in the early engagement or APA application stages. As a rule of practice, the independent expert should provide a fee estimate to enable the applicant to decide whether the APA application should be proceeded with or not.

83. The independent expert will have access to all relevant information provided under the APA process having regard to confidentiality and conflict of interest considerations and will be subject to the secrecy provisions of the IRO.

84. The independent expert's advice would be considered by the Commissioner in examining the transfer pricing methodology but will not bind the Commissioner, the applicant or the competent authority of the DTA territory, in accepting or rejecting the proposed transfer pricing methodology.

85. The Commissioner will share the expert's advice with the applicant. However, its release depends on finalisation of the Commissioner's position in respect of the expert's advice and any confidential third party information in that advice.

#### *Consent with the applicant*

86. If the APA team does not agree with the contentions in the APA application, the APA team will negotiate with the applicant with a view to reaching an agreement on the functional analysis, a comparability set and the arm's length outcome. If no agreement is possible, the Commissioner will withdraw from the negotiations and refuse to make the APA. In such a case, the APA team will inform the applicant of the refusal in writing.

## *Negotiation*

### *Terms of APA*

87. The APA team will prepare the APA terms in consultation with the applicant. For bilateral or multilateral APA, the APA team leader will ensure that the applicant and the Commissioner have a common understanding of the issues to be agreed in the APA which will form the basis for negotiations with the competent authorities of the relevant DTA territories.

88. Negotiation is a mutual discussion and arrangement of the terms of a transaction or agreement. In the context of an APA, negotiation refers to mutual discussions and an arrangement in respect of the transfer pricing of the controlled transactions to be covered by the APA.

89. In negotiating the terms of the APA, the Commissioner will apply the skills and attributes of an effective negotiator.

90. In negotiating an APA with each of the relevant parties, the APA team needs to have regard to the totality of the arrangements among the applicant and the associated persons and the APA being:

- (a) one method by which the perceived transfer pricing risk can be managed and mitigated; and
- (b) an inherently commercial and practical outcome for the applicant to which the Commissioner will commit.

### *Negotiating with other competent authority*

91. In the case of a bilateral or multilateral APA, the Commissioner, in consultation with the APA team, will negotiate with the competent authorities of the relevant DTA territories. Although the applicant is not a party to these negotiations, in limited circumstances, the applicant may be requested to make a presentation on factual matters where clarification of the actual fact pattern will enhance the level of understanding of the Commissioner and the competent authorities concerned.

92. Any exchange of information between the competent authorities during the course of their negotiations is conducted in accordance with the Exchange of Information Article of the relevant DTA. Exchanges between competent authorities of position papers in the course of negotiations are considered to be part of government-to-government business. Although the APA team will explain the Commissioner's position to the applicant, the position papers of the competent authorities of the relevant DTA territories will not be supplied to the applicant.

93. In the case of a unilateral APA, the APA team leader will negotiate with the applicant, endeavouring to reach agreement on the terms of the APA.

#### *Absence of agreement*

94. If, after using best endeavours, the Commissioner and the competent authorities of the relevant DTA territories cannot reach agreement on the terms of a bilateral or multilateral APA in a reasonable timeframe, the Commissioner may decide to withdraw from the negotiations and consider concluding a unilateral APA with the applicant.

95. Similarly, if after using their best endeavours, the APA team leader and the applicant cannot reach agreement on the terms of a unilateral APA, the Commissioner may decide to withdraw from the negotiations and refuse to make the APA. In such a case, the APA team will inform the applicant of the refusal in writing.

#### *Agreement*

##### *Matters specified in an APA*

96. Section 50AAP(2) provides that an APA with an applicant must specify:

- (a) the name of the applicant to which the APA applies;
- (b) the controlled transactions covered by the APA, if applicable;
- (c) the period covered by the APA;
- (d) the methodology as agreed between the Commissioner and the applicant for determining the income or loss of the applicant;

- (e) the critical assumptions on which the agreed methodology is based;
- (f) the applicant's obligations under the APA, including obligations for providing reports on the matters, and at the intervals, as specified in the APA; and
- (g) any other terms as agreed between the Commissioner and the applicant.

*APA under section 50AAP(1)*

97. For a unilateral APA, the form of the APA will normally be a document setting out the terms of the arrangement which is signed by the applicant and the Commissioner. For a bilateral or multilateral APA, when a mutual agreement is reached by the competent authorities, the applicant will be given the opportunity to accept or reject that mutual agreement. Where the applicant accepts the mutual agreement between the competent authorities, the Commissioner and the applicant will enter into the APA. The form of this APA could include:

- (a) a written agreement, based on the terms of the mutual agreement between the competent authorities, signed by the applicant and the Commissioner;
- (b) a signed statement that the applicant will abide by the terms of the mutual agreement between the competent authorities; or
- (c) some other documentation demonstrating the consent of the applicant to abide by the terms of the mutual agreement between the competent authorities.

A model APA under section 50AAP(1) with the applicant is given in **Appendix 5**.

98. The APA team leader will provide the applicant with the APA and demand note for the final fees payable. The applicant is required to pay the final fees required and return the signed APA to the APA team leader.

99. If the applicant rejects the mutual agreement between competent authorities, then the bilateral or multilateral APA will not proceed and the applicant may wish to discuss with the APA team about other options available.

100. Normally the person responsible for signing the APA under section 50AAP(1) on behalf of the applicant would be an individual responsible for signing the profits tax return, subject to that person having authority to commit the applicant or each of the applicants, if there is more than one applicant, to the terms of the APA. The APA team leader will sign the APA under section 50AAP(1) on behalf of the Commissioner.

### *Critical assumptions*

101. An APA will define in advance any factors or assumptions that are so significant that neither party to an arm's length situation would continue to be bound by the APA if any of these factors or assumptions changed. A critical assumption can be a fact about the applicant, an associated person, a third party, an industry or general economic conditions that, if changed, would significantly affect the appropriateness of the substantive terms of the APA.

102. The APA team determines the suitability of a particular transfer pricing method and its application on the basis of the facts, including projected facts.

103. If the APA team considers that any changes in particular circumstances would materially affect the suitability of the transfer pricing method or its application under the APA, the APA team must include in the APA these circumstances as "critical assumptions". Critical assumptions should be included in the APA though not within the control of the applicant or the Commissioner. This may include the APA team using a range of "net profit indicators" to test whether or not the level of profit implied by the application of the person's transfer pricing method results in outcomes that are replicated by outcomes observed in the open market. In formulating or reviewing proposed critical assumptions, the APA team needs to have regard to the areas within the global group that contribute to its profit, including the profit forecasts over the period covered by the APA.

104. Any set of critical assumptions needs to be tailored to the individual circumstances of the applicant, the particular commercial environment, the methodology, and the type of controlled transactions covered.

105. Critical assumptions will vary depending on the APA itself but it is possible that assumptions will need to be made about some of the following areas:

- (a) assumptions about the relevant domestic tax law and treaty provisions;

- (b) assumptions about tariffs, duties, import restrictions and government regulations;
- (c) assumptions about economic conditions, market share, market conditions, end-selling price, and sales volume;
- (d) assumptions about the nature of the functions and risks of the enterprises involved in the transactions;
- (e) assumptions about exchange rates, interest rates, credit rating and capital structure;
- (f) assumptions about management or financial accounting and classification of income and expenses; and
- (g) assumptions about the applicant or associated persons that will operate in each jurisdiction and the form in which they will do so.

### *Compensating adjustments*

106. The APA needs to contain terms requiring a compensating adjustment to account for instances where the tested party's actual result falls outside the agreed arm's length outcome as to price, range or result, but is within the critical assumption boundaries. These compensating adjustments are made to the tax position to achieve a price, point in the range or result that reflects the agreed arm's length outcomes.

107. Where necessary in the negotiation step, the APA team will discuss with the applicant how a compensating adjustment is to be effected and the tax consequences of that adjustment.

### *Collateral issues*

#### *Defining collateral issues*

108. A collateral issue is:

- (a) an administrative or tax issue in relation to the affairs of the applicant;



- (b) in addition to the controlled transactions covered by the APA; and
- (c) relevant to, and can potentially affect, the outcomes of the APA.

109. Examples of collateral issues include but are not limited to the following:

- (a) whether a permanent establishment exists for the purposes of profit attribution, or whether the covered controlled transactions involve a permanent establishment;
- (b) whether the nature of income is royalty or business profit in the context of a particular DTA;
- (c) whether the profits of an overseas associated person are chargeable to tax under the IRO;
- (d) whether the covered controlled transactions constitute, include or relate to transactions under section 61 or 61A;
- (e) any legal issues that the Commissioner has not taken a position.

#### *Resolution of collateral issues*

110. The existence of collateral issues and the possible applicability of anti-avoidance rules may make it inappropriate for the Commissioner to proceed with an APA.

111. Where possible, collateral issues should be addressed and resolved in parallel with the development of the APA. The APA team should attempt to ensure that any collateral issues are resolved on or before the Commissioner enters into the APA. If this is not possible, then the APA team must ensure that the issue is being dealt with appropriately.

112. The applicant and the APA team will need to discuss at the preliminary discussion step how collateral issues are to be addressed. Options for the APA team in getting collateral issues addressed may include recommending that an application for an advance ruling under section 88A of the IRO be lodged by the person.

113. Where an applicant for an APA also applies for an advance ruling in relation to a collateral issue, the APA team has to ensure that the applicant is aware of any implications of the outcomes of the advance ruling may have on the APA.

***Fees payable for APA***

*Scope of charge*

114. The applicant is required under section 7(9) of Schedule 17H to pay fees in respect of an APA application. The fees payable include:

- (a) service charge which is calculated on the basis of hours spent by the officers of the Department and must not exceed \$500,000; and
- (b) payment or reimbursement of:
  - (i) the fees paid by the Commissioner to an independent expert; and
  - (ii) the costs and expenses incurred by the Commissioner in relation to the APA application.

Section 7(7) of Schedule 17H provides that any fees due and payable in respect of an APA application are recoverable as a civil debt due to the Government.

*Waiver or refund*

115. In exceptional circumstances, the Commissioner may:

- (a) waive all or part of any fees payable in respect of an APA application; or
- (b) refund to the applicant all or part of any fees paid in respect of an APA application if the Commissioner does not make an APA.

*Fees remain payable upon refusal or withdrawal*

116. Fees are payable though an application is refused or withdrawn. If an APA application is withdrawn, the applicant is liable to pay all the fees incurred in

respect of the application before the Commissioner receives notice of withdrawal. However, the Commissioner may waive all or part of any fees payable or refund all or part of any fees paid in respect of an APA application at his discretion. The discretion to waive, wholly or partly, such fees will only be exercised if the APA cannot be made because of some unforeseen circumstances beyond the control of the Commissioner and the applicant.

#### *Fees charged by overseas tax administration*

117. The applicant and any associated persons need to be aware that some overseas tax administrations may also charge a fee on an APA application.

### **STAGE 3: MONITORING AND COMPLIANCE**

#### *Disclosure of APA*

118. Section 50AAQ(2) provides that a person with whom the Commissioner has made an APA must disclose in the profits tax return for the relevant year of assessment:

- (a) the existence of the APA;
- (b) whether or not the person has relied on the APA in preparing and providing the return; and
- (c) any material change to the facts and circumstances specified in the APA.

119. If the person has disclosed in the profits tax return for the year of assessment that the person has relied on the APA in preparing and providing such return, and the APA has not been revoked, cancelled or revised, the Commissioner is to apply sections 50AAF and 50AAK in relation to the person in accordance with the APA for the year of assessment.

#### *Annual compliance report*

120. A person with an APA concluded will be required under the terms of the APA to prepare and submit an annual compliance report (ACR) signed by the

principal officer of the person for each year of assessment covered by the APA. As required under the APA concluded, the person has to submit the ACR at the time when submitting the profits tax return. The ACR has to contain sufficient information to detail the actual results for the relevant year and to demonstrate compliance with the terms of the APA. This level of documentation should provide cost savings to the persons with an APA concluded.

121. The ACR is distinct from the person's obligation to submit a profits tax return under section 51(1) of the IRO. The ACR should include:

- (a) an analysis of the compliance with the APA including the information and calculations demonstrating the outcome of the application of arm's length methodology;
- (b) details of any compensating adjustments made and how each was effected in the profits tax return; and
- (c) a statement as to whether there has been a breach of any critical assumptions.

A model ACR is given in **Appendix 6**.

122. The ACR will be reviewed by the Assessor handling the profits tax return. This review includes:

- (a) checking whether any of the critical assumptions listed in the APA have been breached, and
- (b) confirming that the terms of the APA have been met.

123. Where one or more critical assumptions or terms of a bilateral or multilateral APA have been breached, the Commissioner will inform the competent authorities of the relevant DTA territories of such breach. The Commissioner and the competent authorities concerned will discuss how to treat the breach under the MAP Article of the relevant DTA.

124. Where a critical assumption or a term of a unilateral APA is breached, the person with the APA concluded will be required to enter into discussions to provide an explanation. The Commissioner will then determine how to treat the breach. In

appropriate instances (e.g. where the breach is a material one), the Commissioner may revoke, revise or cancel the APA.

125. The Assessor will review the ACR to determine:

- (a) whether the person with the APA made is reporting results below or at the low end of any ranges specified in the terms of the APA without sufficient evidence demonstrating that external factors have caused this to occur; and
- (b) where applicable based on results that are outside any of the agreed ranges, whether the person has made compensating adjustments so as to effect a move to the closest point in the relevant ranges.

126. The compensating adjustments will be examined to verify whether they achieve a price, point in the range or result that is consistent with the agreed arm's length outcomes (e.g. a profit fell outside the agreed arm's length range under the transactional net margin method).

127. The type of results reported will be checked to see whether they are occurring consistently over the period covered by the APA. In such instances, the type of results will be taken into account when dealing with any renewal request on similar terms.

128. For bilateral or multilateral APAs, the competent authorities of the DTA territories concerned may also review the ACR. If the competent authority of the relevant DTA territory raises any issue, additional information will be sought from the person with the APA made.

129. The possible consequences of not complying with the annual reporting requirements, or failing to supply any further information as requested by the Commissioner in relation to an ACR, would be reflected in the APA itself as a condition of its continuance. In addition, the person may be subject to penal actions provided under section 80(2L)(c) or 82A(1H)(a)(iii).

### ***Record keeping***

130. Section 50AAT provides that a person in respect of whom an APA is made for a period must retain, for a period of not less than 7 years after the end of the APA period, all the records and data:

- (a) relied on in concluding the APA;
- (b) used in applying for the APA; and
- (c) referred to in any reports, including the ACR, and other information provided to the Commissioner under the APA.

131. Any records requested by the Commissioner for the purpose of monitoring the APA should be made available to the Commissioner within a reasonable time.

132. The Commissioner will consider revoking or cancelling the APA if:

- (a) the record keeping requirements have not been followed;
- (b) the records do not enable the Commissioner to readily confirm that the critical assumptions have been met; or
- (c) the person in respect of whom an APA is made fails to provide the records requested within a reasonable time.

### ***Breach of critical assumptions***

133. Section 50AAS provides that a person in respect of whom an APA is made must notify the Commissioner of a breach of any critical assumption within a reasonable time after the breach. As required in the APA concluded, the person has to notify the Commissioner of any breach of any critical assumptions as soon as possible, and in any event not later than 1 month after the breach occurs.

134. The Commissioner will clarify with the person why the breach occurred and, if needed, all parties including the competent authorities of the relevant DTA territories in a bilateral or multilateral APA will enter into discussions to revoke, cancel or revise the APA. Any supporting documentation and any proposed course

of action the person may suggest (e.g. revision of the APA) should be lodged as early as possible.

135. When looking at a change in circumstances, including general or economic downturn, the Commissioner would assess whether unrelated third parties could reasonably have been expected to foresee or anticipate that change in circumstances at the time the APA was entered into. If so, the Commissioner would consider whether the agreed transfer pricing methodology sufficiently took this into account. The Commissioner would apply the arm's length principle to determine whether any change in critical assumptions is such that unrelated third parties would have renegotiated the arrangement due to the change in circumstances.

136. If the APA is revised, the effective date of the revised APA will be stated in the revised APA. The revised APA should also note the date on which the original APA became no longer effective.

137. If a revised APA cannot be negotiated, the APA will be cancelled. Unless otherwise agreed, the APA will be cancelled as from the date the critical assumption was breached. If a transactional profit method is the primary methodology that has been used in the APA, the APA will generally be cancelled with effect from the beginning of the basis period for the year of assessment in which the critical assumption was breached. In such circumstances, the methodology will not apply to the transactions that occurred throughout the whole of the basis period.

### ***Revocation, cancellation or revision***

#### *Power to revoke, cancel or revise*

138. Despite the co-operative environment built on mutual trust being an essential part of the APA process, the person making the APA request may in rare instances make an incorrect statement, provide incorrect information, omit to make a statement, or omit to provide information.

139. Where the Commissioner has reason to believe that the person has made an incorrect statement, provided incorrect information, omitted to make a statement or omitted to provide information, and the statement or information that is incorrect or omitted is material to the APA application, the Commissioner will review the APA, though concluded, with a view to determining whether the APA should be revoked, cancelled or revised.

140. Section 50AAR(1) provides that the Commissioner may revoke, cancel or revise an APA made if:

- (a) any condition or critical assumption specified in the APA has not been met or is no longer met;
- (b) the person has failed to comply with the person's obligations under the APA (e.g. failure to submit the ACR or keep records and data); or
- (c) in connection with the APA application, the person is found to have:
  - (i) made an incorrect statement; or
  - (ii) provided incorrect information; or
  - (iii) omitted to make a statement or provide information,and the statement or information is material to the APA application.

*Consequence of revocation, cancellation or revision*

141. If the Commissioner revokes an APA, section 50AAR(2) provides that the APA is to be treated as having never been made. If the Commissioner cancels an APA, section 50AAR(3) provides that the APA is to cease to apply from a date that the Commissioner determines. If the Commissioner revises an APA, section 50AAR(4) provides that the revision is to take effect from a date that the Commissioner determines.

142. Section 50AAR(5) provides that any revocation, cancellation or revision of an APA does not affect any criminal liability that may arise in respect of the matter. In practice, the Commissioner would also take appropriate actions, including additional assessments and penal actions, after taking into account the following factors:

- (a) whether the incorrect statement is made or the incorrect information is provided carelessly, recklessly or willfully, or due to an honest mistake; or



- (b) whether the statement or the information is deliberately omitted or due to an honest mistake.

143. When considering revoking, cancelling or revising a bilateral or multilateral APA, the Commissioner will also consult the competent authority of each of the relevant DTA territories involved.

### ***Renewal***

144. If a person having an APA concluded wishes to request a renewal of the APA, it must submit the request at least 6 months before the expiration of the APA to allow time for negotiation and conclusion. Generally, the renewal of an APA will follow the same procedure as the original APA request. In certain circumstances, however, it would be expected that the time taken to complete the renewal of an APA would be significantly less than that for concluding the existing APA.

145. For timeframes to be reduced, the person would have to provide any relevant information requested and demonstrate that:

- (a) the person complied with the terms of the existing APA;
- (b) the covered transactions are consistent with those in the existing APA;
- (c) there are no material changes to functions, assets or risks for the person or other persons to the covered transactions;
- (d) the transfer pricing methodology used in the existing APA remains the most appropriate; and
- (e) the critical assumptions in the existing APA are still appropriate.

146. The Commissioner may require new or updated economic studies and supporting documentation. This decision will be made at the early engagement stage.

147. Where a renewal involves substantial changes to the terms used in the existing APA, then the renewal process will probably have a similar timeframe to an original APA process.

148. While an APA renewal request goes through the same stages and steps outlined above for the initial request, the APA team will:

- (a) seek the consent of all parties to the renewal of the APA; and
- (b) where appropriate and as much as possible having regard to the totality of the controlled transactions between the entities, streamline the process so as to reduce the time involved and documentation required for dealing with the request.

149. The circumstances where it may be appropriate for the APA team to streamline an APA renewal process include:

- (a) there have been no material changes to the controlled transactions or the role of the Hong Kong entities within the global value chain;
- (b) there are no proposed changes to the terms of the APA; and
- (c) it is unlikely that there will be material changes to the controlled transactions over the course of the period of the renewed APA.

150. In a streamlined process, generally the APA team would only need to assure itself that:

- (a) entering into an APA with the person making the renewal request is still appropriate, including the proposed APA producing arm's length outcomes;
- (b) the existing APA produced arm's length outcomes;
- (c) there have been no material changes to the covered controlled transactions;
- (d) the updated benchmarks are appropriate; and
- (e) the person has complied with the terms of the existing APA, as evidenced by the Commissioner's review of the ACRs lodged.

151. The information required for the streamlined process is likely to be significantly less than that required where an APA renewal involves material changes to the terms of the existing APA.

## **REFUSAL AND WITHDRAWAL**

### ***Refusal***

152. Section 50AAP(3)(a) provides that the Commissioner may refuse to make an APA if:

- (a) the APA is to apply to any provision made or imposed as between any persons any of whom has income or loss to be computed for the purposes of Hong Kong tax; but the specified person, who is not an applicant for the APA, fails or refuses to join in the application; or
- (b) any fee payable under Schedule 17H for the APA application, or any deposit for the fee payable under that Schedule, is not paid.

153. Section 50AAP(3) does not limit the grounds on which the Commissioner may refuse to make an APA. If the Commissioner refuses to make an APA, section 6 of Schedule 17H requires the Commissioner to give the applicant a written notice stating the decision and the reasons for the refusal.

### ***Withdrawal***

154. Section 5 of Schedule 17H provides that the applicant may withdraw an APA application by written notice to the Commissioner. However, withdrawal from the APA process, especially at a late stage and without good cause, should be discouraged because of the inevitable waste of resources caused by such action.

## **PROSPECTIVE APPLICATION OF APA AND ROLLBACK**

### ***Duration of APA***

155. In general, an APA will have prospective application only with a specific duration of 3 to 5 years. The commencement date for an APA will be discussed

with the applicant and for a bilateral or multilateral APA, the competent authorities of the relevant DTA territories, and will be specified in the APA.

156. The commencement date for an APA is likely to be affected by considerations of rollback of transfer pricing methodology or prior year examination. It may commence from the beginning of the year in which APA negotiations are finalised. Any specific requirements of the relevant DTA territories should also be taken into account.

157. If the finalisation of an APA application is not delayed substantially, the Commissioner may make an APA under section 50AAP(5) for a period that covers a period earlier than the date of the APA but:

- (a) liability for tax is not to be increased after the expiry of the time limit for making an assessment or additional assessment under the IRO; and
- (b) liability for tax is not to be reduced after the expiry of the latest of the time limits for raising an objection or applying for relief or revision of assessment as applicable under the IRO or any relevant DTA.

158. If the finalisation of an APA application is delayed substantially and beyond the commencement date requested by the applicant, the Commissioner will normally seek to specify a later commencement date for the APA in order to preserve the prospective nature of the APA. The Commissioner will also seek to preserve the prospective 3 to 5 years duration of an APA.

159. Where a later commencement date is specified for the APA, the Commissioner will consider seeking to rollback the methodology agreed in the APA into the prior years intended to be covered in the original application and/or extend the period of the APA. Any specific requirements of the relevant DTA territories should also be taken into account.

### ***Rollback***

160. Section 50AAQ(4) provides that the Commissioner may, if the Commissioner considers appropriate, apply the principles developed in an APA to a period earlier than the date of the APA but:

- (a) liability for tax is not to be increased under this subsection after the expiry of the time limit for making an assessment or additional assessment under the IRO; and
- (b) liability for tax is not to be reduced under this subsection after the expiry of the latest of the time limits for raising an objection or applying for relief or revision of assessment as applicable under the IRO or any relevant DTA.

161. In practice, transfer pricing issues arising in years prior to the commencement of the APA are treated as collateral issues. Where the principles developed in concluding an APA provide a reasonable basis, one approach to dealing with such issues may be to apply the methodology used in the APA to the prior years (i.e. rollback).

162. Neither the Commissioner nor the person with an APA concluded are in any way obliged to apply the methodology agreed upon as part of the APA to years prior to the period covered by the APA. However, the methodology to be applied prospectively under the APA may be instructive in determining the treatment of comparable transactions in earlier years.

163. The Commissioner should consider whether the principles developed in concluding an APA provide a reasonable basis for resolving transfer pricing issues in prior years. This would depend on the availability of all relevant information in respect of the prior years and whether there are any material changes in the applicant's circumstances in those years.

164. Subject to the facts and circumstances of a particular case, the Commissioner when considering rollback:

- (a) will not seek rollback where the transfer pricing issues for prior years are rated as low risk;
- (b) will be more likely to seek rollback for a lesser number of years in the case of a voluntary APA request than it would be for a case resulting from the Commissioner's audit; and
- (c) is likely to seek rollback for issues rated as high risk.

165. As a rule of practice, the Commissioner will not consider requests for rollback in the case of unilateral APAs. However, such practice would not affect the Commissioner's power to raise additional assessments in appropriate cases.

166. The Commissioner and the person submitting the APA application should agree how and when the prior years' issues should be resolved.

167. The Commissioner will treat as a voluntary disclosure in paragraph 14 of Part H of the Penalty Policy any amendment to prior years arising from rollback where the following are satisfied:

- (a) compliance activity has not yet commenced or the Commissioner has not initiated audit with respect to the prior years' returns; and
- (b) as a result of providing information for an APA, there is a need to amend a prior year's return.

## **INTERACTION BETWEEN APA AND AUDIT**

### ***Separate treatment for APA and Audit***

168. An APA does not preclude a person from an audit of its business overall. The Commissioner will treat audit and APA development separately, unless the person's facts and circumstances are sufficiently similar to enable the methodology used in the APA to be applied to the years of assessment under audit.

169. However, leaving aside the annual compliance review process, the Commissioner will not undertake audit in relation to the controlled transactions which are the subject of an APA unless it has reason to believe that the person has omitted to provide information or provided incorrect information, and the information concerned is material and relevant to the APA application. Furthermore, the Commissioner will not duplicate in an audit work already undertaken as part of the audit process.

170. Where an APA does become part of the focus of audit, the Commissioner may verify that:

- (a) the terms of the APA have been complied with;

- (b) the agreed transfer pricing methodology has been correctly applied;  
and
- (c) the APA application and associated documentation reflect appropriately the material facts.

171. The Commissioner will not involve in such audit the acceptability of the transfer pricing methodology agreed as part of an APA unless the omitted or incorrect information mentioned above affects such matters.

***Discontinuance or postponement of audit***

172. The Commissioner is, generally, not to discontinue or postpone audit in respect of certain years where the applicant makes an APA application in respect of subsequent years.

173. However, the audit may be deferred or discontinued where all parties agree that the APA will assist in resolving these issues.

174. The Commissioner makes such decisions after consideration of:

- (a) the facts and circumstances relating to the applicant;
- (b) any advice and recommendations from the APA team; and
- (c) other factors such as:
  - (i) the co-operation and assistance provided by the applicant;
  - (ii) the stage of completion of the audit;
  - (iii) the issues in question;
  - (iv) the similarities between the facts and circumstances in respect of the years under audit and the APA application;
  - (v) the relevance of information supplied as part of the APA application to the prior years;

- (vi) whether there is likely to be any significant differences between the outcomes under the audit and the APA and the reasons for any differences;
- (vii) whether it is possible to finalise part of the audit and leave the issues related to the APA in abeyance; and
- (viii) whether entering into an APA will assist in resolving the issues in the audit.

175. It might be appropriate in some situations to defer part of the audit for a short period pending completion of the APA. The part of the audit which has been deferred can be recommenced with written notice to the applicant, at any time, at the discretion of the Commissioner. Alternatively, the Commissioner may suggest the applicant defer the filing of the APA application until the Commissioner is ready to state its position on an issue so that the application can fully and completely respond to the Commissioner's concerns.

176. Where an audit has been wholly or partially suspended and the Commissioner has reasons to believe that the APA is not proceeding in the best interest of finalising the audit, the Commissioner may, with written notice to the applicant, recommence the audit. If double taxation arises as a result of the audit, the MAP should be used to resolve the matter.

177. Where an audit has been wholly or partially suspended pending the outcome of the APA, any adjustments made to the assessments of the audit years using a transfer pricing methodology or other information from the APA would not affect the nature of transfer pricing treatment and the efforts spent to determine the arm's length amount. The penalty loading in Part H of the Penalty Policy will continue to be applicable to any adjustments made to those assessments under review.

178. In summary, the following principles are incorporated into the practice:

- (a) the Commissioner will not give an undertaking that years prior to an APA will not be audited;
- (b) prior year adjustments resulting from an APA application will be treated as though the applicant has made a voluntary disclosure in



paragraph 14 in Part H of the Penalty Policy provided compliance activity has not commenced or been notified;

- (c) where audit, including compliance activity, has not commenced or been notified before submission of an APA application, any additional tax under section 82A(1D) or (1F) will be calculated on the basis of being a voluntary disclosure in paragraph 14 in Part H of the Penalty Policy; and
- (d) where audit has commenced before submission of an APA application, paragraph 5 in Part H of the Penalty Policy will apply to any adjustments made to prior years under audit.

## **ADMINISTRATION OF APA PROCESS**

### ***Management of APAs***

179. The Commissioner will prioritise his allocation of transfer pricing resources according to the complexity and risk of the covered controlled transactions and collateral issues. Priority will be given to APA applications concerning arrangements which carry higher transfer pricing audit risks.

180. The Chief Assessor (Tax Treaty) as the competent authority delegate has been designated to:

- (a) negotiate the terms of the APA with the competent authority or authorities of the relevant DTA territory or territories; and
- (b) approve the terms of the APA.

181. The Deputy Commissioner (Technical) takes overall charge of the APA programme. He will decide the following:

- (a) whether a person will be invited to make an APA application;
- (b) whether all or part of any fees payable in respect of an APA application can be waived or refunded; and

- (c) whether a change to the scope of the APA can be agreed.

## **OFFENCES AND PENALTIES**

### ***Penalties on less serious offences***

182. The penalties for non-compliance by persons with the statutory requirements relating to APA are provided under sections 80(2L), 82(1AAB), 82(1AAC) and 82A(1H). In the present context, non-compliance includes, among other things, provision of incorrect information and failure to comply with obligations specified in the IRO in relation to an APA application.

183. Section 80(2L)(b) provides that a person commits an offence if:

- (a) the person, without reasonable excuse, makes an incorrect statement or provides incorrect information in connection with the person's APA application, or omits anything from a statement made or information provided in connection with the person's APA application; and
- (b) the statement or information that is incorrect, or thing that is omitted, is material to that APA application.

184. Section 80(2L)(c) provides that a person commits an offence if the person, without reasonable excuse, fails to:

- (a) notify the Commissioner of a breach of critical assumption specified in an APA within a reasonable time after the breach; or
- (b) provide the Commissioner with reports and other information as required under an APA.

185. Section 80(2L)(d) provides that a person commits an offence if:

- (a) the person, without reasonable excuse, in purported compliance with a requirement for notification or provision of reports and information in relation to an APA under section 50AAS, provides

incorrect information or omits anything from information provided; and

- (b) the statement or information that is incorrect, or thing that is omitted, is material to the APA.

186. Under section 80(2M), a person who commits an offence under section 80(2L)(b), (c) or (d) is liable on conviction to:

- (a) a fine at level 3; and
- (b) a further fine of the undercharged amount.

187. Under sections 80(2L)(e) and (2N), if a person, without reasonable excuse, fails to retain all the relevant records and data for a period of not less than 7 years after the end of the APA covered period, the person:

- (a) commits an offence; and
- (b) is liable on conviction to a fine at level 5.

188. The court may order a person that commits an offence under section 80(2L)(e) to do, within the time specified in the order, the act that the person has failed to do. If the person fails to comply with the order, the person commits an offence under section 80(2O) and is liable on conviction to a fine at level 6.

189. Under sections 80(2L)(f) and (2P), if a person, without reasonable excuse, fails to provide information as required by the Commissioner, the person:

- (a) commits an offence; and
- (b) is liable on conviction to a fine at level 3.

### ***Penalties on more serious offences***

190. A person may be prosecuted if the person commits an offence under section 82(1AAB) or (1AAC) wilfully, with intent to evade tax or to assist any other person to evade tax.

191. Section 82(1AAB) provides that a person commits an offence if:
- (a) the person wilfully, with intent to evade tax or to assist any other person to evade tax, makes an incorrect statement or provides incorrect information in connection with the person's APA application, or omits anything from a statement made or information provided in connection with the person's APA application; and
  - (b) the statement or information that is incorrect, or thing that is omitted, is material to that APA application.
192. Section 82(1AAC) provides that a person commits an offence if:
- (a) the person either
    - (i) wilfully, with intent to evade tax or to assist any other person to evade tax and in purported compliance with a requirement under section 50AAS, provides incorrect information in relation to an APA; or
    - (ii) wilfully, with intent to evade tax or to assist any other person to evade tax, omits anything from the information provided, in relation to an APA, in purported compliance with the requirement; and
  - (b) the information that is incorrect, or thing that is omitted, is material to the APA.
193. Under section 82(1A), a person who commits an offence under section 82(1AAB) or (1AAC) is liable to:
- (a) on summary conviction
    - (i) a fine at level 3;
    - (ii) a further fine of treble the undercharged amount; and
    - (iii) imprisonment for 6 months; and

- (b) on indictment
  - (i) a fine at level 5;
  - (ii) a further fine of treble the undercharged amount; and
  - (iii) imprisonment for 3 years.

***Additional tax***

194. Under section 82A(1H), a person may be liable to additional tax if the person, without reasonable excuse:

- (a) makes an incorrect statement or provides incorrect information in connection with an APA application, or omits anything from a statement made or information provided in connection with an APA application and the statement or information that is incorrect, or thing that is omitted, is material to the APA application;
- (b) fails to comply with a requirement for notification or provision of information and reports in relation to an APA under section 50AAS; or
- (c) provides incorrect information, or omits anything from the information provided, in purported compliance with a requirement for notification or provision of reports and information in relation to an APA under section 50AAS, and the information that is incorrect, or thing that is omitted, is material to the APA; and

no prosecution for an offence has been instituted in respect of the same facts.

195. The maximum additional tax to be assessed is the amount of tax which has been undercharged in consequence of the incorrect statement or information, the omission or the failure to comply with the requirement, or which would have been undercharged if statement or information had been accepted as correct or the omission or failure had not been detected.

### ***Consideration for taking penal action***

196. In considering which penalty action should be invoked, the Commissioner would examine the facts of the case carefully and take into account whether the person concerned has not had a reasonable excuse or has acted wilfully with intent to evade tax. What constitutes a reasonable excuse depends on the facts and circumstances of the particular case.

### **Content of Request for APA Early Engagement**

#### **Person making the Request**

Name, Business Registration Number, address and details of contact person (name, post, daytime contact telephone number and email address)

#### **Details of the Proposed APA**

1. Type of application to be submitted (new/renewal) and the reference of the previous application
2. Type of APA sought (unilateral/bilateral/multilateral) and for bilateral or multilateral APA, the relevant DTA territories
3. Name and tax residence jurisdiction of the associated persons involved in the proposed APA
4. Global group structure and explanation of how the person making the request fit into the global structure of the group
5. Roles of all the Hong Kong based entities within the global value chain (except those entities not relating to the controlled transactions)
6. Period to be covered by the proposed APA
7. Description and estimated value of controlled transactions to be covered by the proposed APA
8. Description and estimated value of other similar or related controlled transactions not to be covered by the proposed APA
9. Proposed transfer pricing methodology, including applicable net profit indicator, comparable prices or margins, or expected range of results
10. Collateral issues and the proposed treatment
11. Other relevant information

#### **Authorised Representative**

1. Name of the authorised representative and details of contact person (name, post, daytime contact telephone number and email address)
2. Copy of the authorisation letter

### **Model APA Case Plan**

Name of person making the APA request

Business Registration Number

Period covered by the proposed APA

Type of APA sought

| Activity  | Date |
|---|------|
| <p><b>Stage 1: Early Engagement</b></p> <ol style="list-style-type: none"> <li>1. The person submits to the Chief Assessor (Tax Treaty) a Request for APA Early Engagement and a draft APA case plan.</li> <li>2. The APA team and the person hold preliminary discussions.</li> <li>3. The APA team and the person reach agreement on:               <ol style="list-style-type: none"> <li>(a) the scope of the APA;</li> <li>(b) the preferred transfer pricing methods to be applied;</li> <li>(c) the resolution approach of collateral issues;</li> <li>(d) an early engagement case plan up to lodgment of the APA application;</li> <li>(e) a draft plan for completion of the APA after lodgment of the APA application.</li> </ol> </li> <li>4. The APA team leader invites the person to submit the APA application.</li> <li>5. The applicant submits to the APA team leader the APA application.</li> <li>6. In the case of a cross-border unilateral APA, the applicant submits the Template for Spontaneous Exchange of Information on Cross-border Unilateral APA together with the APA application.</li> <li>7. In the case of a bilateral or multilateral APA, the applicant provides the Commissioner with:               <ol style="list-style-type: none"> <li>(a) the information or documentation requests made by the tax administrations of the relevant DTA territories in relation to the APA application;</li> <li>(b) list of the information or documentation supplied by the persons or associated persons to the tax administrations of the relevant DTA territories; and</li> <li>(c) details of another APA application submitted to the tax administration of the DTA territory concerned, if appropriate.</li> </ol> </li> <li>8. The APA team and the applicant finalise and execute the APA case plan.</li> </ol> |      |



| Activity   | Date |
|--|------|
| <p><b>Stage 2: APA Application</b></p> <p>9. The applicant pays the deposit required by the APA team leader.</p> <p>10. The APA team analyses critically and evaluates the APA application, including any relevant documentation and comparability analysis.</p> <p>11. The APA team examines the relevant transfer pricing documentation.</p> <p>12. The applicant provides the additional information requested by the APA team.</p> <p>13. The APA team interviews the key personnel of the applicant or the tested party.</p> <p>14. The APA team seeks advice from independent experts, if appropriate.</p> <p>15. The APA team develops an APA document containing the Commissioner's position with which the Commissioner enters negotiations.</p> <p>16. The APA team coordinates the resolution of collateral issues, if any.</p> <p>17. In the case of a unilateral APA, the APA team leader reaches agreement with the applicant after negotiation.</p> <p>18. In the case of a bilateral or multilateral APA, the applicant accepts the mutual agreement reached between the competent authorities of Hong Kong and the relevant DTA territories.</p> <p>19. The applicant settles the fee payable and the APA team leader and the applicant enter into the APA to implement the agreed terms.</p> |      |

| Activity   | Year |
|--|------|
| <p><b>Stage 3: Monitoring and Compliance</b></p> <p>20. The person having concluded an APA makes the relevant disclosure in the profits tax return for the relevant year of assessment.</p> <p>21. The person having concluded an APA submits the Annual Compliance Report for the relevant year of assessment.</p> <p>22. The person having concluded an APA retains, for a period of not less than 7 years after the end of the APA period, all the relevant records and data.</p> |      |

**Content of APA Application**

**The Applicant**

Name, Business Registration Number, address and details of contact person (name, post, daytime contact telephone number and email address)

**The Associated Persons**

Name, tax residence jurisdiction and tax identification number (TIN) of each associated person involved in the proposed APA (for APA relating to controlled transactions between the applicant and its associated persons)

Note: For APA relating to attribution of profits to permanent establishment, provide name, tax residence jurisdiction and TIN of each part of the applicant involved in the proposed APA

**Details of the APA**

1. Type of application (new/renewal)
2. Type of APA applied (unilateral/bilateral/multilateral)
3. Facts and documents relating to the applicant, the associated persons and the transactions including:
  - (a) General description of market conditions
  - (b) Details of transactions, products, businesses or arrangements that will be covered
  - (c) Information regarding the world-wide organisational structure, history, financial statement data, products, functions and assets (tangible and intangible) of any associated persons involved and the allocation of risks between the associated persons
  - (d) Tax and financial position of the applicant and all associated persons involved in the APA or at the aggregate tax jurisdiction wide level, for the last 3 years
  - (e) Forecast/budgeted financial position during the APA period for the applicant and all associated persons involved
4. Proposed methodology for determining the income or loss of the applicant
5. The period in respect of which the APA is applied for

6. Critical assumptions
7. Collateral issues and the proposed treatment

Note: For APA relating to attribution of profits to permanent establishment, provide information relating to different parts of the applicant involved in the proposed APA

#### **Authorised Representative**

1. Name of the authorised representative and details of contact person (name, post, daytime contact telephone number and email address)
2. Copy of the authorisation letter

#### **Note: Enclosures Required**

1. Template for Spontaneous Exchange of Information on Cross-border Unilateral APA (for unilateral APA application involving cross-border controlled transactions)
2. Draft APA
3. Evidence showing that the proposed methodology can produce a result that complies with section 50AAF or 50AAK (as applicable)
4. Information or documentation requests made by the tax administration of each relevant DTA territory in relation to the APA application
5. List of information or documentation supplied by the person or associated persons to the tax administration of the relevant DTA territories
6. Information and documentation as agreed in the early engagement stage
7. Other information that may be of assistance in progressing the APA application

## Template for Spontaneous Exchange of Information on Cross-border Unilateral APA

*All fields are mandatory unless otherwise indicated. For joint application, please provide the details of each applicant on a separate template.*

### 1. Identification of the applicant

|  |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|--|---|--|---|---|--|---|--|------------------------------------|--|---|---|----------------------------------|---|-------------------------------------|---|--------------------------------|
| Taxpayer identification number (TIN) <sup>1</sup>  |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| Jurisdiction that issued the TIN <sup>1</sup>  |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| Jurisdiction of residence <sup>1</sup>   |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| Legal name   |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| Address  | Street  |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Building  |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Suite   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Floor   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | District Name   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Post Office Box   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Post Code   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | City  |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
|  | Country   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| State/Province/Canton  |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <p><b>Main business activity (optional) <i>(Please check the appropriate box)</i></b></p> <table style="width: 100%; border: none;"> <tr> <td><input type="checkbox"/> Research and Development</td> <td><input type="checkbox"/> Internal Group Finance</td> </tr> <tr> <td><input type="checkbox"/> Holding or Managing intellectual property</td> <td><input type="checkbox"/> Regulated Financial Services</td> </tr> <tr> <td><input type="checkbox"/> Purchasing or Procurement</td> <td><input type="checkbox"/> Insurance</td> </tr> <tr> <td><input type="checkbox"/> Manufacturing or Production</td> <td><input type="checkbox"/> Holding shares or other equity instruments</td> </tr> <tr> <td><input type="checkbox"/> Sales, Marketing or Distribution</td> <td><input type="checkbox"/> Dormant</td> </tr> <tr> <td><input type="checkbox"/> Administrative, Management or Support Services</td> <td><input type="checkbox"/> e-Commerce</td> </tr> <tr> <td><input type="checkbox"/> Provision of Services to unrelated parties</td> <td><input type="checkbox"/> Other</td> </tr> </table> |   |  | <input type="checkbox"/> Research and Development | <input type="checkbox"/> Internal Group Finance | <input type="checkbox"/> Holding or Managing intellectual property | <input type="checkbox"/> Regulated Financial Services | <input type="checkbox"/> Purchasing or Procurement | <input type="checkbox"/> Insurance | <input type="checkbox"/> Manufacturing or Production | <input type="checkbox"/> Holding shares or other equity instruments | <input type="checkbox"/> Sales, Marketing or Distribution | <input type="checkbox"/> Dormant | <input type="checkbox"/> Administrative, Management or Support Services | <input type="checkbox"/> e-Commerce | <input type="checkbox"/> Provision of Services to unrelated parties | <input type="checkbox"/> Other |
| <input type="checkbox"/> Research and Development  | <input type="checkbox"/> Internal Group Finance                     |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Holding or Managing intellectual property   | <input type="checkbox"/> Regulated Financial Services               |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Purchasing or Procurement   | <input type="checkbox"/> Insurance                                  |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Manufacturing or Production   | <input type="checkbox"/> Holding shares or other equity instruments |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Sales, Marketing or Distribution  | <input type="checkbox"/> Dormant                                    |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Administrative, Management or Support Services  | <input type="checkbox"/> e-Commerce                                 |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| <input type="checkbox"/> Provision of Services to unrelated parties  | <input type="checkbox"/> Other                                      |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |
| Name of multinational enterprise group to which the applicant belongs  |   |  |   |   |  |   |  |                                    |  |   |   |                                  |   |                                     |   |                                |

<sup>1</sup> If the applicant is a tax resident of Hong Kong SAR, the Business Registration Number is the applicant's TIN. If the application is made on behalf of a permanent establishment (PE) in Hong Kong SAR of a non-resident person, the Business Registration Number of the PE in Hong Kong is the TIN and the jurisdiction of residence is Hong Kong SAR.

**2. Accounting periods/tax years covered by the unilateral APA**

|  |
|--|
|  |
|--|

**3. Type of unilateral APA requested** *(Please check the appropriate box)*

|                          |  |
|--------------------------|--|
| <input type="checkbox"/> | Cross-border unilateral APA relating to controlled transactions between associated persons |
| <input type="checkbox"/> | Cross-border unilateral APA relating to attribution of profits to permanent establishment  |

**4. Additional information regarding the unilateral APA and the applicant** (optional)

|   |  |
|---|--|
| Transaction amount covered by the unilateral APA    |  |
| Applicant's turnover for last preceding tax year    |  |
| Applicant's net profits for last preceding tax year |  |

**5. Related entities**

*(For all types of cross-border unilateral APA)*

**(a) Ultimate parent company**

|  |                 |  |
|--|-----------------|--|
| TIN or other tax reference number, where available |                 |  |
| Jurisdiction that issued the TIN                   |                 |  |
| Jurisdiction of residence                          |                 |  |
| Legal name   |                 |  |
| Address in jurisdiction of residence               | Street          |  |
|  | Building        |  |
|  | Suite           |  |
|  | Floor           |  |
|  | District Name   |  |
|  | Post Office Box |  |
|  | Post Code       |  |
|  | City            |  |
|  | Country         |  |
| State/Province/Canton                              |                 |  |

*(For all types of cross-border unilateral APA)*

**(b) Immediate parent company**

|  |                       |  |
|--|-----------------------|--|
| TIN or other tax reference number, where available |                       |  |
| Jurisdiction that issued the TIN                   |                       |  |
| Jurisdiction of residence                          |                       |  |
| Legal name   |                       |  |
| Address in jurisdiction of residence               | Street                |  |
|  | Building              |  |
|  | Suite                 |  |
|  | Floor                 |  |
|  | District Name         |  |
|  | Post Office Box       |  |
|  | Post Code             |  |
|  | City                  |  |
|  | Country               |  |
|  | State/Province/Canton |  |

*(For unilateral APA relating to controlled transactions between associated persons)*

**(c) Related party<sup>2</sup> with which the applicant enters into transactions that are covered by the APA**

*If there are more than 1 related parties needed to be reported, please copy the below table on separate sheet.*

|  |                       |  |
|--|-----------------------|--|
| TIN or other tax reference number, where available |                       |  |
| Jurisdiction that issued the TIN                   |                       |  |
| Jurisdiction of residence                          |                       |  |
| Legal name   |                       |  |
| Address in jurisdiction of residence               | Street                |  |
|  | Building              |  |
|  | Suite                 |  |
|  | Floor                 |  |
|  | District Name         |  |
|  | Post Office Box       |  |
|  | Post Code             |  |
|  | City                  |  |
|  | Country               |  |
|  | State/Province/Canton |  |

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<sup>2</sup> The related party threshold has been set at a 25%. In other words, two parties would be considered related if the first person has a 25% or greater investment in the second person or there is a third person that holds a 25% or greater investment in both.

*(For unilateral APA relating to attribution of profits to permanent establishment)*

**(d) Head office of the applicant**

|  |                       |  |
|--|-----------------------|--|
| TIN or other tax reference number, where available |                       |  |
| Jurisdiction that issued the TIN                   |                       |  |
| Jurisdiction of residence                          |                       |  |
| Legal name   |                       |  |
| Address in jurisdiction of residence               | Street                |  |
|  | Building              |  |
|  | Suite                 |  |
|  | Floor                 |  |
|  | District Name         |  |
|  | Post Office Box       |  |
|  | Post Code             |  |
|  | City                  |  |
|  | Country               |  |
|  | State/Province/Canton |  |

**6. Declaration and signature**

I hereby declare that the information provided above is true, correct and complete.

Name \_\_\_\_\_ Signature \_\_\_\_\_  
(Person signing the template)

Designation \_\_\_\_\_ Date \_\_\_\_\_  
(Position held)



### **Model APA**

Commissioner of Inland Revenue (the Commissioner) and Company-HK (the Parties collectively),

#### ***(For bilateral APA)***

[Having regard to the mutual agreement reached by the competent authorities of Hong Kong Special Administrative Region of the People's Republic of China (HKSAR) and Jurisdiction-F on \_\_\_\_\_ regarding the application of the arm's length principle to the controlled transactions between Company-HK and Company-F pursuant to the Mutual Agreement Procedure Article of the Agreement between HKSAR and Jurisdiction-F for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the DTA),]

Intending to make an advance pricing arrangement (APA) under section 50AAP of the Inland Revenue Ordinance (Cap. 112) (IRO),

Have agreed as follows:

#### **Persons to which the APA applies**

1. Company-HK, a company incorporated in Hong Kong and a tax resident of HKSAR, (Business Registration Number: xxx, Address: xxx) imports, markets and distributes products P and Q into the Hong Kong market.
2. Company-F, a company incorporated in Jurisdiction-F and a tax resident of Jurisdiction-F, (TIN: xxx, Address: xxx) is a fellow subsidiary of Company-HK and carries on manufacturing business in Jurisdiction-F.

#### **Transactions covered by the APA**

3. The transactions covered by the APA comprise:
  - (a) Purchase of product P from Company-F (Covered Transaction 1); and
  - (b) Use of the trademark "ABC" owned by Company-F (Covered Transaction 2) in selling product Q in Hong Kong.

"Covered Transaction 1" and "Covered Transaction 2" are referred to as "the Covered Transactions" collectively.

#### **Period covered by of the APA**

4. The period of the APA is 5 years commencing on 1 January 20X1 and concluding on 31 December 20X5 (Covered Period).

## Legal effect

5. The APA is made pursuant to and for the purposes of section 50AAP of the IRO and binds the Parties, for the Covered Period, to determine questions relating to the transfer pricing matters covered by the APA in accordance with its terms.

If the Company-HK complies with the terms and conditions of the APA, then the Commissioner will not contest the application of the transfer pricing methodology as defined in paragraphs 6 and 7 below to the Covered Transactions and will not make or propose any reallocation or adjustment that would be necessary in order for effect to be given to the provisions of Part 8AA of the IRO with respect to the Company-HK concerning the transfer prices for the Covered Period.

If, for any year during the Covered Period, the Company-HK does not comply with the terms and conditions of the APA, or the critical assumptions (as defined in paragraph 11 below) cease to be valid, the Commissioner may revoke, cancel or revise the APA.

The Commissioner may also revoke, cancel or revise this agreement if, after the date of the agreement, Part 8AA of the IRO is either amended or repealed and this would have an effect on the approach to pricing within this agreement. If the APA is revoked, the APA is treated as having never been made. If the APA is cancelled or revised, the APA is to cease to apply or to take effect from a date the Commissioner determines.

### ***(For bilateral APA)***

[The terms and conditions of the APA may also be cancelled or revised upon the agreement of the Commissioner and Company-HK, subject to the terms of the mutual agreement between the Commissioner and the competent authority of Jurisdiction-F.]

## **Agreed transfer pricing methodology** *(Figures are inserted for illustration purpose)*

6. The transfer pricing methodology adopted for applying the arm's length principle in respect of Covered Transaction 1 is the Transactional Net Margin Method (TNMM). The net profit indicator to be used is: Earnings before Interest and Taxes (EBIT) to Net Sales (referred as EBIT margin). This methodology shall allow Company-HK to achieve an EBIT margin in respect of Covered Transaction 1 in the range of [3]% to [4]% for each of the years within the Covered Period.
7. The transfer pricing methodology adopted for applying the arm's length principle in respect of Covered Transaction 2 is the Comparable Uncontrolled Price (CUP) Method. This methodology shall allow Company-HK to achieve a Royalty rate (i.e. Royalty to Net Sales) in respect of Covered Transaction 2 at [5]% for each of the years within the Covered Period.
8. For the purposes of computing the EBIT margin and Royalty rate:
  - (a) EBIT is defined as net profit before interest, dividend income, gains/losses on sale of fixed assets, restructuring expenses, other non-operating items and income tax, calculated in accordance with the Hong Kong Financial Reporting Standards (HKFRS) or the International Financial Reporting Standards (IFRS);

- (b) Royalty shall mean the royalty payable by Company-HK to Company-F for the right to use the trademark “ABC” in selling product Q in Hong Kong;
- (c) Net Sales shall mean total sales less returns and allowances calculated in accordance with HKFRS or IFRS.

### **Procedures for making compensating adjustments**

9. Company-HK shall make compensating adjustments at the end of the basis period for each year of assessment to which the Covered Period relates so as to reflect the application of the arm’s length principle.
10. If Company-HK’s actual EBIT margin in respect of Covered Transaction 1 or actual Royalty rate in respect of Covered Transaction 2 for any year of assessment within the Covered Period deviate from the agreed range or point stated in paragraph 6 or 7, a true-up or true-down adjustment shall be made in computing the assessable profits of Company-HK for the relevant year of assessment.

#### *Shortfall*

- (a) If Company-HK’s actual EBIT margin in respect of Covered Transaction 1 is less than [3]% (i.e. the lower boundary of the arm’s length range described in paragraph 6 above), there shall be deemed to exist a “shortfall” in the compensation earned by Company-HK by an amount equal to the difference between Company-HK’s actual EBIT margin in respect of Covered Transaction 1 and [3]% in any year within the Covered Period.
- (b) If Company-HK’s actual Royalty rate in respect of Covered Transaction 2 is less than [5]% (i.e. the arm’s length rate described in paragraph 7 above), there shall be deemed to exist a “shortfall” in the compensation earned by Company-F by an amount equal to the difference between Company-HK’s actual Royalty rate in respect of Covered Transaction 2 and [5]% in any year within the Covered Period.

#### *Excess*

- (c) If Company-HK’s actual EBIT margin in respect of Covered Transaction 1 is greater than [4]% (i.e. the upper boundary of the arm’s length range described in paragraph 6 above), there shall be deemed to exist an “excess” in the compensation earned by Company-HK by an amount equal to the difference between Company-HK’s actual EBIT margin in respect of Covered Transaction 1 and [4]% in any year within the Covered Period.
- (d) If Company-HK’s actual Royalty rate in respect of Covered Transaction 2 is greater than [5]% (i.e. the arm’s length rate described in paragraph 7 above), there shall be deemed to exist an “excess” in the compensation earned by Company-F by an amount equal to the difference between Company-HK’s actual Royalty rate in respect of Covered Transaction 2 and [5]% in any year within the Covered Period.

### *Compensating adjustment*

- (e) In the event of any shortfall in respect of Covered Transaction 1 in any one year, the deduction for purchases shall be reduced by such an amount as is sufficient to produce an EBIT margin of [3]%. In the event of any excess in respect of Covered Transaction 1 in any one year, the deduction for purchases shall be increased by such an amount as is sufficient to produce an EBIT margin of [4]%<sup>1</sup>.
- (f) In the event of any shortfall in respect of Covered Transaction 2 in any one year, the deduction for royalty shall be increased by such an amount as is sufficient to produce a Royalty rate of [5]%. In the event of any excess in respect of Covered Transaction 2 in any one year, the deduction for royalty shall be reduced by such an amount as is sufficient to produce a Royalty rate of [5]%.
- (g) Compensating adjustments, if any, shall be made on a year-by-year basis for each year of assessment to which the Covered Period relates in the profits tax returns of Company-HK. In respect of any excess for Covered Transaction 1 or shortfall for Covered Transaction 2, an amount equal to the increased deduction shall be included in the profit of Company-F to ensure compliance with the intention of the DTA.

### **Critical assumptions**

- 11. For the purpose of this APA, the following matters represent the critical assumptions:
  - (a) The business activities, functions performed, assets employed, risks assumed of Company-HK and Company-F shall remain materially the same as those described in the APA application.
  - (b) The financial and tax accounting methods and classifications applicable to Company-HK and Company-F remain materially the same as those described in the APA application.
  - (c) There will be no changes or factors materially impacting the industry in which Company-HK operates and the commercial reality of the controlled transactions.
  - (d) There will be no changes to Company-HK's product or customer base that may materially impact on Company-HK's business.
  - (e) There will be no changes to any governmental policies and regulations, legal framework, regulatory and political environment, controls or mechanisms that materially impact Company-HK's business and the commercial reality of the controlled transaction.
- 12. Company-HK shall notify the Commissioner of any breach of any critical assumptions as soon as possible, and in any event not later than 1 month after the breach occurs.

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<sup>1</sup> For bilateral or multilateral APA, the method for determining compensating adjustments will be discussed during the negotiations with the competent authority of the DTA Territory.

## **Annual Compliance Report**

13. Company-HK shall submit an Annual Compliance Report (ACR) to the Commissioner, in such form as the Commissioner may prescribe, for each year of assessment to which the Covered Period relates (APA year) at the same time when it files the profits tax return for the relevant year of assessment.
14. The ACR shall include the following:
  - (a) A copy of the audited financial statements of Company-HK (including a detailed profit and loss account and balance sheet) and tax computation (including full details of all tax reconciliation adjustments) of Company-HK for the relevant APA year;
  - (b) A copy of the audited financial statements (including a detailed profit and loss account and balance sheet) of Company-F for the relevant APA year;
  - (c) A reconciliation between the amounts of the purchase costs and royalty expenses computed in accordance with the transfer pricing methodology under paragraphs 6 and 7, and the corresponding amounts charged in the financial statements of Company-HK and Company-F for the relevant APA year;
  - (d) An analysis of the compliance with the APA including the information and calculations demonstrating the outcome of the application of arm's length methodology;
  - (e) Details of any compensating adjustments made and how each was effected in the profits tax return;
  - (f) A description of any material changes in financial or tax accounting methods or principles employed in respect of the Covered Transactions, which differ from the financial or tax accounting methods employed and reflected in the APA application, and if there were no such material changes in Company-HK's opinion, an affirmative statement to that effect;
  - (g) A description of any material controlled transaction that is not covered by the terms of the APA;
  - (h) A statement as to whether there has been a breach of any critical assumptions;
  - (i) A confirmation that the record keeping requirements have been complied with;
  - (j) A confirmation that no tax shelters, offshore structures and tax schemes have been established to participate directly or indirectly in the Covered Transactions.
15. The ACR shall be sent to:

Chief Assessor (Tax Treaty)  
Tax Treaty Section  
Inland Revenue Department  
GPO Box 10851, Hong Kong

## **Confidentiality**

16. The Commissioner recognises that the secrecy provisions in the IRO and the Exchange of Information Article in the DTA will apply to safeguard the information obtained for the purpose of the APA process.

### ***(For unilateral APA)***

#### **[Spontaneous Exchange of Information]**

17. Company-HK agrees that the Commissioner may exchange information with the competent authorities of other jurisdictions pursuant to the DTAs between HKSAR and the relevant jurisdictions or the Convention on Mutual Administrative Assistance in Tax Matters.]

## **Implementation**

18. Company-HK and the Commissioner wish to continue their open relationship and Company-HK should approach the Commissioner as soon as possible if any events occur that affect the APA. In the event that difficulties, disputes or differences of opinion occur in the implementation of the APA, the Commissioner and Company-HK should endeavour to resolve them promptly.

## **Revocation, cancellation or revision**

19. The Commissioner will not revoke, cancel or revise the APA unless and until the Commissioner has explained in detail to Company-HK why and from when it is considered Company-HK is in breach of the terms and conditions of the APA and Company-HK has been given a reasonable opportunity to rectify any breach.

Signed in duplicate, at Hong Kong, this      day of      20xx, in the English language.

For the Commissioner of Inland Revenue

For Company-HK

[Name]

Senior Assessor (Tax Treaty)

Inland Revenue Department

Date:

[Name]

[Designation (must be a principal officer)]

Company-HK

Date:

## **Model Annual Compliance Report**

To: Commissioner of Inland Revenue

### **Particulars of the APA**

|    |  |                                   |
|----|--|-----------------------------------|
| 1. | APA reference number                                     | APA/00XX                          |
| 2. | Name of the person having the APA concluded              | Company-HK                        |
| 3. | Business Registration Number of the person               | 12345678                          |
| 4. | Name of the associated persons and jurisdiction involved | Company-F, Jurisdiction-F         |
| 5. | Period covered by the APA                                | 1 January 20X1 - 31 December 20X5 |

### **Details of the Compliance**

Period covered by this Annual Compliance Report (ACR)      1 January 20X1 - 31 December 20X1

Description of each Covered Transaction in the APA

Covered Transaction 1 (CT1): Purchase of product P from Company-F

Covered Transaction 2 (CT2): Use of the trademark “ABC” owned by Company-F in selling product Q

For each Covered Transaction, I hereby provide:

- an analysis of the compliance with the APA including the information and calculations demonstrating the outcome of the application of arm’s length methodology;
- details of any compensating adjustments made and how each was effected in the profits tax return; and
- a statement as to whether there has been a breach of any critical assumptions.

*Reporting format is suggested as below (Figures are inserted for illustration purpose):*

|   | <b>CT1</b>        | <b>CT2</b>        |
|---|-------------------|-------------------|
| 1. Breach of critical assumptions                 | No                | No                |
| 2. Tax jurisdiction involved                      | Jurisdiction-F    | Jurisdiction-F    |
| 3. Agreed transfer pricing methodology            | TNMM              | CUP               |
| 4. Agreed financial indicator <sup>1</sup>        | EBIT margin       | Royalty rate      |
| 5. Agreed point or range                          | [3]% to [4]%      | [5]%              |
| 6. Actual result achieved                         |                   |                   |
| CT1: Purchases of product P from Company-F        | HK\$[150] million |                   |
| Net Sales (Product P)                             | HK\$[200] million |                   |
| EBIT  | HK\$[4] million   |                   |
| EBIT margin (Computation: \$[4]/\$[200] x 100%)   | [2]%              |                   |
| CT2: Royalty payable to Company-F                 |                   | HK\$[10] million  |
| Net Sales (Product Q)                             |                   | HK\$[200] million |
| Royalty rate (Computation: \$[10]/\$[200] x 100%) |                   | [5]%              |

<sup>1</sup> Examples of financial indicators include the mark-up on costs for cost-plus method; gross margin for resale price method and net profit indicator (e.g. earnings before interest and tax (EBIT)) for transactional net margin method.

|     |   |                   |     |
|-----|---|-------------------|-----|
| 7.  | Compensating adjustment required  | Yes               | No  |
| 8.  | Compensating adjustment<br>(Computation: $\$[200] \times [3]\% - \$[200] \times [2]\%$ )  | +HK\$[2] million  | N/A |
| 9.  | Result after compensating adjustment, if appropriate<br>CT1: Purchases of product P from Company-F<br>EBIT margin<br>(Computation: $(\$[4] + \$[2]) / \$[200] \times 100\%$ ) | HK\$[148] million | N/A |
| 10. | Compensating adjustment reflected in tax return   | Yes               | N/A |

## Attachments

I attach the following information/documents as part of the ACR:

1. A copy of the audited financial statements of Company-HK (including a detailed profit and loss account and balance sheet) and tax computation (including full details of all tax reconciliation adjustments) of Company-HK
2. A copy of the audited financial statements (including a detailed profit and loss account and balance sheet) of Company-F
3. A reconciliation between the amounts of Covered Transactions computed in accordance with the transfer pricing methodology under paragraphs 6 and 7 of the APA and the corresponding amounts in the financial statements of Company-HK and Company-F
4. A description of any material changes in financial or tax accounting methods or principles employed in respect of the Covered Transactions, which differ from the financial or tax accounting methods employed and reflected in the APA application, and if there were no such material changes in Company-HK's opinion, an affirmative statement to that effect
5. A description of any material controlled transaction that is not covered by the terms of the APA
6. Any other documents/information as specified in the APA

## Confirmation

I confirm that during the ACR period:

1. Record keeping requirements for the Covered Transactions have been complied with; and
2. No tax shelters, offshore structures and tax schemes have been established to participate directly or indirectly in the Covered Transactions.

## Agreement and Declaration

I agree that this ACR may be provided to and reviewed by the competent authority or authorities of the relevant DTA territory or territories.

I declare that I have examined the information contained in this ACR, including the accompanying documents, and to the best of my knowledge and belief, the information presented in this ACR and the accompanying documents are true, correct and complete.

Name of principal officer \_\_\_\_\_ Signature \_\_\_\_\_

Position held by principal officer \_\_\_\_\_ Date \_\_\_\_\_