



Revised Form IR1475 - Transfer Pricing Documentation - Master File and Local File

Executive summary

The Inland Revenue Department (IRD) has recently commenced another round of desk-based review to ensure compliance with transfer pricing documentation requirements by issuing the form “Transfer Pricing Documentation - Master File and Local File” (Form IR1475) to selected taxpayers for the year of assessment 2019/20. Notably, some revisions have been made to the Form IR1475 issued in November 2021 compared to the one issued in September 2020. One of the key features of the revision is the alignment of the master file and local file information request with the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) Action 13 recommendations. Selected taxpayers are required to complete and submit the Form IR1475 within one month upon receipt of the letter of request from the IRD.

Detailed discussion

Background

Following the enactment of the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (Amendment Ordinance) on 13 July 2018 which codified transfer pricing principles and introduced mandatory transfer pricing documentation requirements into the Inland Revenue Ordinance (Cap. 112) (IRO), Hong Kong has reached the next significant milestone in its transfer pricing regulatory environment.

Hong Kong entities which have declared in their Supplementary Form S2 - Transfer Pricing (BIRS2) to the Profits Tax Returns that they are required to prepare a master file and a local file, or whose business size exceeds the exemption thresholds, may be issued a Form IR1475 and selected for desk-based review. Desk-based compliance reviews would normally be carried out within six months after filing of the Profits Tax Returns. Currently the IRD have not indicated criteria for selection of taxpayers for review. In the event a taxpayer is issued with Form IR1475, the IRD are not accepting submission of master file and local file as an alternative to submission of Form IR1475.

Original Form IR1475

September 2020 marked the first issuance of Form IR1475. Having declared an obligation to prepare the master file and local file in the Profits Tax Return BIRS2, selected taxpayers were requested to complete the Form IR1475 electronically and submit it to the IRD within one month. The information request in the Form IR1475 was broadly aligned with the master file and local file requirements stipulated in the IRO. However, there were certain disclosures which were not readily available in the master file and local file prepared pursuant to the IRO, which effectively comprised additional disclosure requirements.

These include, for example,

- ▶ Exact date of the master file and local file;
- ▶ Transaction amounts of the group's five largest products or service offerings and important intra-group service arrangements;
- ▶ Nature, amount and tax jurisdiction of the group's five most important financing arrangements; and
- ▶ Classification of controlled transaction items into revenue or capital nature.

Revised Form IR1475

In November 2021, the IRD has commenced another round of desk-based review via issuing a letter of request embedded with the revised Form IR1475 to selected taxpayers for year of assessment 2019/20. Selected taxpayers are expected to complete and file the revised Form IR1475 to the IRD within one month. Overall, the information requested in the revised Form IR1475 have been amended to improve consistency with the recommendations under the BEPS Action 13.

The key revisions in the revised Form IR1475 are summarized as follow:

Section 1: Master File and Local File

- ▶ Taxpayers are only required to declare whether the total amount of controlled transactions exceed the regulatory thresholds instead of providing the relevant transaction amounts; and
- ▶ Removal of the section requesting information on the entity responsible for preparing the master file.

Section 2: Master File & Section 3: Local File

- ▶ Taxpayers are only required to declare whether the master file and local file are prepared within nine months after the end of the accounting period instead of providing the exact date of the master file and local file;
- ▶ The breadth and depth of information request is more aligned with the BEPS Action 13 master file and local file recommendations; and
- ▶ Removal of dividend income from the list of controlled transactions.

Notes and Instructions

- ▶ Additions and clarifications to key terminologies (e.g., grandfathered transactions, controlled transactions, etc.) are made to assist the taxpayers in completing the revised Form IR1475; and
- ▶ The eligible signatories for limited partnership fund (LPF) is added.

Notwithstanding the above, there are certain elements in the revised Form IR1475 that call for careful consideration and judgement. These include, for example,

- ▶ Whether documentary evidence should be maintained to support the disclosures made in the revised Form IR1475 (for instance, declaration of the master file and local file being prepared within nine months after the end of accounting period);
- ▶ Classification of the category of controlled transactions and the selection of transfer pricing method under each category of controlled transactions; and
- ▶ Interpretation of the nature of the controlled transactions with associated entities resident in tax jurisdictions with headline tax rate lower than that of Hong Kong.

Key takeaway

Overall, we observed that the revised Form IR1475 enhances the qualitative input and reduces the quantitative data request which represents greater alignment with the OECD's prescribed contents for the master file and local file. This is helpful in addressing taxpayers' concerns on voluminous information and data which may not be readily available in the reports or accessible to individual subsidiaries within multinational enterprises (MNEs).

The overarching objective of the IRD is to ensure transfer pricing compliance. Whilst the Form IR1475 serves as a data collection tool, the burden of proof of proper determination and execution of transfer pricing policy supported by contemporaneous documentations ultimately rests with the taxpayers. Therefore, taxpayers should ensure that the master file and local file are prepared timely (i.e., within nine months after the end of accounting period of the Hong Kong entity) and are consistent with the disclosures in the Form IR1475. Furthermore, intra-group transactions and transfer pricing models should be appropriately considered as these will be subject to more systemic and rigorous review by the IRD. Expanding on this point, taxpayers should be cognizant of the fact that any information and documents accessible to the IRD could be made available to foreign tax authorities via various information exchange mechanisms. Therefore, multidimensional analysis and consistent storyline are recommended for material cross-border transactions and transactions with distinct fact patterns (e.g., transacting with jurisdictions with lower tax rate than Hong Kong, claiming offshore status for Hong Kong profits tax purposes, considerable level of subjectivity built into the transfer pricing model).

As a final note, taxpayers are expected to keep abreast with and brace for developments in relation to new compliance requirements such as the revised Form IR1475, particularly when the IRD has been ambitiously preparing for the launch of electronic filing of profits tax returns and new tax portal where big data analytics of taxpayers information is one of the core drivers for the digital transformation.¹ Information and data available in electronic forms or capable of being converted into digital formats are expected to be scrutinized by the IRD for risk evaluation and audit target selection purposes. Hence, it is recommended that MNEs shall establish a robust mechanism in tracking and managing disclosures made available to the IRD in order to mitigate risk against potential tax and transfer pricing controversies.

1. For more details, please refer to our Hong Kong tax alert - 24 November 2021 (2021 Issue No. 9): https://www.ey.com/en_cn/hong-kong-tax-alerts/taxpayers-need-to-get-ready-for-e-filing-of-profits-tax-returns

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