



Inland Revenue Department  
Hong Kong

## **DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES**

**NO. 48**

### **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.

CHU Yam-yuen  
Commissioner of Inland Revenue

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## **INTRODUCTION**

### ***Transfer pricing and APAs***

This Departmental Interpretation and Practice Note (DIPN) is intended to provide guidance for enterprises seeking an Advance Pricing Arrangement (APA). It explains the APA process and the terms and conditions of the APA process prescribed by the Commissioner.

2. The Commissioner agrees that the arm's length principle is the international transfer pricing standard that should be used for tax purposes and the behaviour of independent enterprises should be used as a benchmark to determine the arm's length consideration or profits in relation to controlled transactions.

3. In the comprehensive double taxation agreements (DTAs) concluded by Hong Kong, the Associated Enterprises Article has incorporated provisions which mandate the adoption of the arm's length principle for pricing controlled transactions. When administering the provisions of the Inland Revenue Ordinance (IRO), the Commissioner will ensure that enterprises operating in Hong Kong declare a level of profit from controlled transactions that is commensurate with the functions carried out, the assets used, and the risks assumed in Hong Kong.

4. The APA process, which is voluntary, will supplement the objection, appeal and other DTA mechanisms for resolving transfer pricing issues. Its scope is flexible and it may cover all or part of the transfer pricing issues of an enterprise. The discussion of complex transfer pricing issues in a non-adversarial environment can stimulate the free flow of information and promote mutual understanding among all parties concerned. The Commissioner does not charge any fee on enterprises during the APA process but enterprises need to be aware that some overseas tax administrations may do so.

### ***Purpose of the APA process***

5. The APA process gives enterprises the opportunity to reach agreement with the Commissioner on the method of applying the arm's length

principle to controlled transactions so that transfer pricing issues can be more efficiently dealt with in real time as they arise rather than retrospectively years later. It prevents costly and time consuming audit and litigation of transfer pricing issues covered by the APA. Upon the expiration of the term of an APA, the enterprise may have the opportunity to renew the APA, thus prolonging the advantages.

## **ADVANCE PRICING ARRANGEMENT**

### ***Definition of APA***

6. 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 of those transactions over a fixed period of time. Controlled transactions refer to transactions between enterprises that are associated enterprises with respect to each other under the Associated Enterprises Article of the relevant DTA. For the purpose of the present DIPN, the Commissioner would extend the scope of an APA to cover transactions between a permanent establishment and its head office or between two permanent establishments of the same enterprise.

7. The APA will not agree precisely the actual profit which should be taxed in Hong Kong in the future. The APA should fix arrangements according to the arm's length principle for determining the transfer pricing for the future transactions in the APA. In general, an APA will apply for three to five years.

8. The APA is concluded under the Commissioner's power of general administration of the IRO, including the DTAs which form part of the tax legislation of Hong Kong.

9. A unilateral APA is an arrangement between the Commissioner and the enterprise concerning the transfer pricing of controlled transactions. The APA process does not involve the agreement with a DTA partner. As such, it does not guarantee the agreement of the DTA partner to the arrangement made.

10. A bilateral APA is an arrangement between the Commissioner and a DTA partner concerning the transfer pricing of controlled transactions. It is concluded under the Mutual Agreement Procedure (MAP) Article of the relevant DTA. Upon mutual agreement having been made, each side confirms the terms of the APA in writing through a letter or similar document with their respective resident enterprises and agrees to be bound by them. A bilateral APA therefore provides certainty to enterprises that double taxation will not arise.

11. A multilateral APA is an arrangement between the Commissioner and two or more DTA partners concerning the transfer pricing of controlled transactions. It is likewise concluded under the MAP Articles of the relevant DTAs. Upon mutual agreement having been made, each side confirms the terms of the APA in writing through a letter or similar document with their respective resident enterprises. A multilateral APA binds all parties and provides certainty to enterprises that double taxation will not arise.

12. Due to resource constraints and the deficiency as mentioned in paragraph 9 above, the Commissioner is only prepared to consider bilateral or multilateral APA applications, at least at the initial stage of the programme. Exceptionally, a unilateral APA can be considered in the following situations: (i) where the DTA partner in a bilateral APA process, or all the DTA partners in a multilateral process, does not/do not wish to participate in or continue the process; (ii) where the Commissioner is unable to reach agreement with the DTA partner(s) (see paragraph 82 below); and (iii) where a non-DTA state is prepared to give a unilateral APA regarding transactions which are integrally linked to the controlled transactions covered by the bilateral or multilateral APA. In a case falling under situation (i) or (ii), a unilateral APA may be concluded with the agreement of both the enterprise and the Commissioner. (For a multilateral APA process, the withdrawal of one or more DTA partner(s) in the aforesaid circumstances may result in a bilateral/multilateral APA with the remaining DTA partner(s), and not necessarily a unilateral APA). In a case falling under situation (iii), the Commissioner can consider granting a unilateral APA covering those linked transactions in the non-DTA state.

#### ***Assurance provided by an APA***

13. If the enterprise has agreed to and complied with the terms of an

APA, the Commissioner will be administratively bound by the terms of the APA. The APA requires the enterprise to comply 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.

14. Double taxation may arise under a unilateral APA if a DTA partner forms a different view as to the application of the arm's length principle to the covered controlled transactions. The Commissioner will seek to support the transfer pricing outcomes of the unilateral APA during Competent Authority negotiations but may have to deviate from the transfer price under the original terms of a unilateral APA to arrive at a solution with the Competent Authority of the DTA partner.

#### ***Timeframe and threshold***

15. The APA process is most suitable for complex controlled transactions with high transfer pricing risk (e.g. few comparables can be found; a significant amount of tax is involved; significant profits are shifted out of Hong Kong). During the APA process, the Commissioner may make an attempt to resolve the related collateral issues, if any.

16. The tentative timeframe for concluding an APA is 18 months from the acceptance of the formal application. The timeframe however would depend on the progress of negotiation with the Competent Authority(ies) of the DTA partner(s), which could take an extra 6 months depending on the scheduling of the Competent Authorities meetings concerned. Generally, a longer timeframe is required in more complex cases.

17. The threshold for an APA application, which is subject to review by the Commissioner from time to time, is \$80 million for *each* year covered in the APA if the controlled transactions involve sale and purchase of goods. If the APA application relates to services, the threshold is \$40 million per annum. If the APA application relates to the use of intangible properties, the threshold is \$20 million per annum. The same threshold applies whether it is a new application or renewal. While the threshold will be 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 partner(s), may relax the eligibility criteria to allow an enterprise access to the APA process.

### *Mutual expectations*

18. The APA process enables enterprises to assure themselves that their controlled transactions comply with the arm's length principle. The Commissioner however would like to make it clear that the APA process must not be abused so as to achieve double non-taxation of profits (e.g. allocate profits to tax shelters which do not have the capacity to perform genuine business functions). The APA process gives rise to the mutual expectations between the enterprise and the Commissioner as set out in **Appendix 1**.

### *Advantages of APAs*

19. In the APA process, the Commissioner, the enterprise and the DTA partner(s) will endeavour to agree on a transfer pricing methodology that will result in an arm's length amount of income or profits accrued to each associated enterprise in relation to the controlled transactions. An APA provides certainty on an appropriate transfer pricing methodology and eliminates or reduces the risk of double taxation arising from controlled transactions. It reduces compliance cost by eliminating the risk of audit and reduces the record keeping burden as enterprises know in advance the records which are required to be kept.

### *Application for an APA*

20. Any resident enterprise or non-resident enterprise with a permanent establishment in Hong Kong, chargeable to profits tax and having controlled transactions, may apply for an APA. In view of the technicalities involved, it is in the interest of the enterprise to consider seeking professional advice throughout the APA process.

21. In the first place, the enterprise should seek a pre-filing meeting to discuss the requirements of the proposed APA. The request for a pre-filing meeting should be made in writing to:

Senior Assessor (APA)  
Tax Treaty Section  
Inland Revenue Department  
36/F Revenue Tower  
5 Gloucester Road, Wan Chai, Hong Kong

## **THE APA PROCESS**

### *Five stages of the APA process*

22. The APA process has five distinct stages:

- Stage 1: Pre-filing
- Stage 2: Formal application
- Stage 3: Analysis and evaluation
- Stage 4: Negotiation and agreement
- Stage 5: Drafting, execution and monitoring

## **STAGE 1 - PRE-FILING**

### *Pre-filing meeting*

23. The pre-filing meeting allows all parties to assess the likely success of the APA. It allows the Commissioner to make an informed judgment on whether the application will be acceptable. It can be used to clarify upfront the expectations of both sides. The model pre-filing meeting agenda set out in **Appendix 2** will normally be followed to:

- (a) identify the nature and scope of the APA process;
- (b) identify the specific matters to be agreed; and
- (c) discuss in detail the APA process.

24. The Commissioner is willing to conduct the pre-filing meeting on an anonymous or a named basis. If it is on an anonymous basis, sufficient information about the operations must nonetheless be provided in order to make any discussion meaningful. It should be noted that nothing binding can

be agreed on an anonymous basis and the anonymous approach must not be a protracted process.

25. In the pre-filing meeting, the Commissioner will define the scope of the APA, identify the collateral issues and work out the resolution approaches. The Commissioner and the enterprise will discuss what information/documentation should be included in the formal APA application and the content of the APA application.

26. Pre-filing meetings do not bind the enterprise and the Commissioner to the APA process. Having such a meeting does not mean the enterprise has applied for an APA or has been accepted into the APA process.

27. Pre-filing meetings for an APA should commence at least 6 months prior to the anticipated commencement date for the APA (i.e. for an APA commencing from 1 January 2013, an enterprise should commence pre-filing meetings no later than 30 June 2012). Any specific corresponding requirements of the DTA partner(s) should also be taken into account.

28. At the commencement of the APA process, the enterprise should ensure that its overseas associated enterprise(s) meet(s) the APA application requirements of the DTA partner(s). The DTA partner(s) will undertake its/their own evaluation and analysis of the case from its/their perspective and may contribute information or insights not known to the Commissioner, or take different positions in relation to the appropriate transfer pricing methodology.

### ***APA proposal***

29. The APA proposal, which is required for the pre-filing meeting, should be submitted to the Senior Assessor (APA) no later than 1 month before the scheduled pre-filing meeting date. The APA proposal should contain the details set out in **Appendix 3**.

30. The APA proposal will be reviewed and discussed at the pre-filing meeting. This ensures that both the Commissioner and the enterprise have a common understanding of the APA requirements and of the materials in the APA proposal. The enterprise should also provide a draft APA case plan (see paragraph 42 below) with the APA proposal.

31. The APA proposal should describe the specific issues for which certainty is sought in relation to the controlled transactions and collateral issues, if any. The enterprise should attach clear and adequate supporting documentation to outline the scope of the APA, including the methodology to be used and the way the collateral issues can be resolved.

### ***Scope of the APA***

32. The scope of an APA should include such controlled transactions as are relevant for the purposes of the Associated Enterprises Article in the relevant DTA. It may cover different groups of controlled transactions, including transfers of tangible or intangible property, services, global trading, and global manufacturing.

33. The primary purpose of the APA is to determine an appropriate transfer pricing methodology which will be applied to arrive at an arm's length consideration or profits in respect of future controlled transactions or continuing arrangements with associated enterprises. The APA in most cases will be used to fix a particular price, range of prices, pricing formula, margin, or share of profit.

34. A specific issue or limited APA will not be appropriate where the transactions covered by the proposal are highly interrelated with transactions not covered by the proposal or where there is a need to analyze transfer pricing issues in a wider context because of intentional set offs. The Commissioner may nevertheless be prepared to consider APA applications which are limited to specific groups of controlled transactions.

35. The formal application for an APA should be submitted only if agreement has been reached on the scope of the APA, as well as the identification and treatment approach for any collateral issues.

36. After the scope of the APA has been agreed, changes to it will only be made in exceptional circumstances, including:

- (a) changes to the enterprise's controlled transactions;
- (b) identification of a new issue involving significant tax risk;

- (c) need to interpret how the transfer pricing methods should apply to new controlled transactions; or;
- (d) new issues that are raised by the DTA partner(s).

37. Any changes to the scope of the APA must be agreed between the Commissioner and the enterprise. If agreement on changes cannot be reached, the development of the APA may not be able to proceed.

38. Upon acceptance of the formal APA application, an APA team will be formed within the Department to handle the processing of the APA.

### *Collateral issues*

39. A collateral issue is an issue which is material and in addition to the covered controlled transactions in question (e.g. legal issue, tax treaty issue or tax avoidance issue). It should be distinguished from ancillary or administrative issues integrally linked with the transfer pricing issues. Collateral issues, if any, will be processed in parallel with the APA wherever possible while the APA can cover ancillary or administrative issues.

40. The leader of the APA team will co-ordinate the resolution of the collateral issues, if any, with the finalization of the APA while the enterprise should provide an analysis of the application of the law to any identified technical collateral issues. The resolution may involve application for an advance ruling under section 88A. Examples of collateral issues include but are not limited to the following:

- (a) whether the covered controlled transactions involve a permanent establishment;
- (b) whether the nature of income is royalty or business profit;
- (c) whether the profits of an associated enterprise overseas are chargeable under section 20;
- (d) whether the covered controlled transactions constitute, include or relate to transactions under section 61 or 61A of the IRO (e.g. the business structure);
- (e) any legal issues that the Commissioner has not taken a position.

41. Where the Commissioner rules that section 20, 61 or 61A applies to the covered controlled transactions, he will withdraw from the APA process as no APA will be agreed.

#### *APA case plan*

42. The APA case plan contains a structured timeline and work plan jointly developed with the enterprise. Before a pre-filing meeting can be arranged, the enterprise would need to provide a draft APA case plan to the Senior Assessor (APA) (see paragraph 30 above). A model APA case plan is given in **Appendix 4**.

43. After the formal APA application is received, the Commissioner will, where possible, contact the DTA partner(s) to establish a timetable for the APA. The Commissioner and the enterprise will then finalise and execute the APA case plan. The agreed APA case plan will set out the information/documentation required by the Commissioner, the date it is required, an explanation of the relevance of the information/documentation requested, and the agreed processes for gathering information.

44. The agreed scope of the APA and treatment approach for collateral issues should form part of the APA case plan. The Commissioner and the enterprise should adhere to the timeline and the work plan. If and when required, the APA case plan will be updated.

45. If it becomes necessary to alter the scope of the APA (see paragraphs 36 and 37 above) or the treatment approach for collateral issues, the Commissioner will seek agreement of the changes with the enterprise and will amend the APA case plan to reflect those changes.

#### *Acceptance into APA process*

46. The Deputy Commissioner (Technical) will decide whether or not to accept an enterprise into the APA process. The Senior Assessor (APA) will notify the enterprise of the decision of the Deputy Commissioner (Technical) accordingly.

47. Where an enterprise is accepted into the APA process, it will be invited to submit a formal APA application. The letter of acceptance will state that the APA proposal is accepted and that the enterprise may submit a formal application which reflects the agreement reached at the pre-filing stage. Where an APA request is not accepted into the APA process, reasons will be provided for that decision.

## **STAGE 2 - FORMAL APPLICATION**

### ***APA application***

48. If the enterprise intends to proceed, it should submit to the Senior Assessor (APA) a formal APA application within the timeframe agreed at the pre-filing stage or set out in the agreed APA case plan. The application should set out the scope of the APA and the treatment approach of the collateral issues on the basis of the agreement reached at the pre-filing stage. Another formal application should also be submitted to the DTA partner(s) concerned where appropriate.

49. In the formal APA application, the principal officer of the enterprise must declare that he has examined the APA application, including accompanying documents, and to the best of his knowledge and belief, the facts presented in support of the application are true, complete and accurate; and agree that no liability shall rest upon the Government, the Commissioner or any other public officer in respect of the bona fide exercise of any power or performance of any duty under and in accordance with this DIPN. A sample of the Formal Application for APA is given in **Appendix 5**.

50. While the Commissioner does not intend to prescribe a set format for an APA application, the enterprise must indicate clearly the transfer pricing methodology proposed and the reasons in support of that method. All documentation should be clearly labelled, indexed and referenced.

51. The APA application should detail the scope of the APA and the way collateral issues, if any, are to be addressed. It should include:

- (a) a functional analysis and industry analysis;
- (b) details of the proposed transfer pricing methodology;
- (c) the terms and conditions governing the application of the transfer pricing methodology including critical assumptions;
- (d) data showing that the transfer pricing methodology will produce an arm's length result; and
- (e) information/documentation as agreed in the pre-filing meeting.

52. The Senior Assessor (APA) will acknowledge receipt of the formal APA application in writing. The acknowledgment letter will state whether the APA application reflects the Commissioner's understanding of the agreement reached at the pre-filing stage. Where the application does not reflect the Commissioner's understanding of the agreement reached at the pre-filing stage, the enterprise will be informed of the required amendments to the application for the Commissioner to proceed with the APA.

53. Following the filing of the formal APA application, all subsequent correspondence and negotiations should be made through the APA team handling the case. The enterprise will be informed of the name of the APA team leader as soon as possible.

54. As soon as is administratively practicable, but no later than 1 month after receipt and acceptance of a formal APA application, the Chief Assessor (Tax Treaty) as the Competent Authority delegate will notify the relevant DTA partner(s) and enquire whether it/they wish(es) to participate in the APA process and to establish the timetable for the APA.

#### ***Treatment of collateral issues***

55. Where a collateral issue is identified, the Commissioner and the enterprise will need to agree during the pre-filing stage how the collateral issues should be resolved. The Commissioner may have to resolve the collateral issues by way of an advance ruling. Where an application for an advance ruling is requested by the enterprise, the leader of the APA team will co-ordinate the request with the APA process.



56. Where a collateral issue arises for which there is no established position, the Commissioner may, whilst ensuring confidentiality of the enterprise's transactions, provide external stakeholders with the opportunity to have input into the development of the Commissioner's position. This is because the Commissioner's position on a collateral issue may represent a general position of wider application (e.g. change in risk profile within an industry as a result of the replacement of key entrepreneurial risk taking functions by self-developed computer programmes).

57. There may be circumstances where the issue to be considered has implications to a particular class of transactions/arrangements or enterprises. This may mean that the APA will be progressed in parallel with the development of the Commissioner's position.

### **STAGE 3 - ANALYSIS AND EVALUATION**

#### *Analysis and evaluation of data*

58. Upon receipt of the formal APA application, the APA team will analyze and evaluate the data submitted. The APA team will contact the enterprise to discuss and clarify the information/documentation submitted. If necessary, the APA team will request any further information/documentation considered relevant to the application.

59. The APA team will perform a critical analysis of the APA application rather than undertaking original work to establish the arm's length outcome. Nevertheless, the APA team may undertake original work, including fieldwork, where the circumstances warrant.

60. Where the APA team forms an evaluation different from that contained in the enterprise's application, it will discuss its evaluation with the enterprise. The APA team will seek the enterprise's agreement on its position or reconcile both positions to reach a mutually acceptable agreement with the enterprise. The Competent Authorities will also exchange their position papers setting out their views on the evaluation.

### *Information/documentation requirements*

61. The agreed information/documentation requirements should be set out in the APA case plan (see paragraph 43 above). The extent of information/documentation necessary to determine an appropriate transfer pricing methodology and arm's length outcome will depend on the facts and circumstances of each individual case and a degree of flexibility is needed by both parties. Typical information/documentation required by the Commissioner for an APA application is set out in **Appendix 6**.

62. The enterprise should provide the information/documentation to the APA team to explain the facts relevant to the appropriateness and application of the proposed transfer pricing methodology. Relevant documentation kept outside Hong Kong by an enterprise should be provided to the Commissioner within the agreed timeframe.

63. The enterprise should also advise the Commissioner of the information/documentation requested by the DTA partner(s) in relation to the APA application. The enterprise must ensure that the Commissioner is provided with copies of any information/documentation supplied to the DTA partner(s), whether supplied by itself or an associated enterprise.

64. All documents submitted in a language other than English or Chinese must be accompanied by an English translation. This requirement applies equally to any documents not submitted but described in the APA application, upon request by the Commissioner.

65. Where the records or documents to be produced are voluminous, the enterprise may agree with the Commissioner that they need not be submitted with the APA application though the documents must be described, referenced and have their location stated in the application. The enterprise must undertake that the documents will be made available upon request by the Commissioner.

### *Independent experts*

66. If complex transfer pricing issues are involved, the Commissioner may request the enterprise to provide at its expense an independent expert, mutually acceptable to the Commissioner and the DTA partner(s) to review and

evaluate the enterprise's proposed transfer pricing methodology. The appointment of an independent expert may also be required where the MAP stalls or the APA negotiation gets into a deadlock.

67. Whether an independent expert is likely to be required will be discussed at the pre-filing meeting or at a subsequent meeting with the enterprise following filing of the formal APA application. While the Commissioner may not be in a position to determine whether an expert is required until the analysis and evaluation stage, the enterprise may provide commentary in the formal application as to whether, in its opinion, an independent expert is required.

68. The independent expert should comment critically on the adequacy of the enterprise's economic study and address the questions and concerns of the Commissioner and the DTA partner(s). He should provide an opinion whether the proposed transfer pricing methodology is supportable under the arm's length principle and fairly represents the interests of all parties to the APA. He may submit a revised version of the APA which meets all requirements and produces an arm's length outcome, or may identify further information required before such a revised version could be put forward.

69. The independent expert's opinion would be considered by the Commissioner in examining the transfer pricing methodology but will not bind the Commissioner, the enterprise or the DTA partner(s), in accepting or rejecting the proposed transfer pricing methodology.

70. The Commissioner may at any stage of the APA process engage his own expert, at his own expense, to review the enterprise's proposal or that of the independent expert. In such cases, the Commissioner will advise the enterprise that he has done so. This 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.

71. Where the Commissioner is relying upon his own independent expert, where possible, the Commissioner will share the advice of that expert with the enterprise. The release of this advice will be dependent on the finalization of the Commissioner's position in respect of the advice sought and any confidential third party information contained in the report.

## **STAGE 4 - NEGOTIATION AND AGREEMENT**

### ***APA terms***

72. After the analysis and evaluation stage, the enterprise will submit an application for MAP to the Commissioner. A sample of the Application to Initiate MAP is given in **Appendix 7**. After receiving the application, the Commissioner will endeavour to reach agreement on the terms of the APA with the DTA partner(s) in consultation with the enterprise.

73. The Commissioner will inform the enterprise of the resolution of the collateral issues. The resolution of collateral issues will not form part of the content of the concluded APA. In most circumstances, the collateral issues need to be resolved prior to the agreement of the concluded APA.

74. The Commissioner will prepare the draft APA terms in consultation with the enterprise. The purpose of the draft APA terms is to ensure that the enterprise and the Commissioner have a common understanding of the issues to be agreed in the APA and to form the basis for negotiation with the DTA partner(s).

### ***Negotiations with DTA partner(s)***

75. The Chief Assessor (Tax Treaty) as the Competent Authority delegate is responsible for liaison and negotiation with the DTA partner(s). The Chief Assessor (Tax Treaty) may liaise directly with the DTA partner(s) to discuss or clarify specific issues in respect of the APA under the MAP Article of the relevant DTA.

76. The Chief Assessor (Tax Treaty) might need to have face-to-face meetings with the DTA partner(s) where significant issues need to be resolved or the APA is to be concluded within the target timeframe.

### ***Enterprise representations in an APA***

77. The enterprise does not have a right to be present at Competent Authority negotiations (which is usually on a one-on-one basis). Where approval for presentation at Competent Authorities meetings has not been

obtained from all the Competent Authorities concerned, the enterprise may be given an opportunity to present the case to the Chief Assessor (Tax Treaty) alone.

### ***MAP arrangement***

78. Following review, discussion and negotiation, the Chief Assessor (Tax Treaty) in consultation with the enterprise will formalize a MAP arrangement with the DTA partner which specifies the acceptable transfer pricing methodology, its application and critical assumptions assuming that agreement is reached.

79. The MAP arrangement may be in any form agreed to by the Competent Authority of the DTA partner. It may be in the form of an exchange of letters stipulating the agreed terms of the APA or of a more formal document.

80. The enterprise can either accept or reject the MAP arrangement. The enterprise should notify the Chief Assessor (Tax Treaty) of its decision in writing.

81. Where the MAP arrangement is not accepted by the enterprise, the APA process would cease and the enterprise would not be offered any unilateral APA in respect of the controlled transactions in question.

82. There are circumstances where the Chief Assessor (Tax Treaty) as the Competent Authority delegate is unable to reach agreement under the MAP arrangement with the DTA partner under a bilateral process, or all the DTA partners under a multilateral process, within a reasonable timeframe. Under such circumstances, a unilateral APA may be concluded with the agreement of both the enterprise and the Commissioner.

83. The Exchange of Information Article of the relevant DTA applies to the exchange of information for the purposes of the provisions of the MAP Article. The confidentiality of information exchanged for the purposes of the APA under the MAP Article is thus ensured.

84. In processing an APA, communication with DTA partners will usually be through the exchange of position papers and issues papers, as well as face-to-face meetings. The position papers outline the terms of the APA which the Commissioner and the DTA partner are prepared to accept. The Chief Assessor (Tax Treaty) will explain the position to the enterprise but will not provide a copy of the DTA partner's position paper since this is part of the government-to-government process under the relevant DTA.

## **STAGE 5 - DRAFTING, EXECUTION AND MONITORING**

### *Formulation of APA terms*

85. The Commissioner will formulate his preferred terms and conditions for the APA and negotiate with the other DTA partner(s) to resolve any differences so that one set of terms and conditions can be formulated. The Commissioner and the DTA partner(s) will then finalise the APA terms based on the outcomes of the negotiations.

86. Where the enterprise accepts the MAP arrangement, the Commissioner will enter into a bilateral/multilateral APA with the DTA partner(s). The Commissioner will confirm the terms of the bilateral/multilateral APA with the enterprise in a letter or similar document. The enterprise is required to confirm its agreement with the APA in writing. Once agreed, the Commissioner will prepare an implementation agreement and send it to the enterprise for execution. A Model Bilateral/Multilateral APA Implementation Agreement is given in **Appendix 8**.

87. In a unilateral APA mentioned in paragraph 12 above, the Commissioner and the enterprise will finalise the APA agreement. The Commissioner will provide the enterprise with written confirmation of the concluded APA and the implementation arrangement. The enterprise is required to sign the final APA and return it to the Commissioner.

### *Form and content of concluded APAs*

88. A concluded APA may generally be expected to contain at least the following information:

- (a) the names and addresses of the parties to the APA;
- (b) the controlled transactions covered by the APA;
- (c) the period and tax years covered by the APA;
- (d) the agreed transfer pricing methodology and its application to the covered controlled transactions (e.g. the calculation of gross profit or net operating profit margins);
- (e) if applicable, the arm's length range agreed under the APA;
- (f) a definition of relevant terms which have formed the basis of calculating the transfer pricing methodology (e.g. sales, cost of sales, operating profit, etc);
- (g) the accounting standards on which the financial statements are based;
- (h) critical assumptions upon which the transfer pricing methodology is based;
- (i) procedures to be followed if it is necessary to make compensating adjustments; and
- (j) the enterprise's consequential obligations as a result of the agreement to the APA (e.g. the enterprise's obligation to submit Annual Compliance Reports and the enterprise's record keeping requirements).

### ***Commencement date of an APA***

89. An APA will have prospective application only with a specific duration of three to five years. The commencement date for an APA will be discussed at the pre-filing stage and will be specified in the APA.

90. The commencement date for an APA undertaken to resolve transfer pricing issues 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 financial year in which APA negotiations are finalised. Any specific requirements of the DTA partner(s) should also be taken into account.

### ***Delayed finalization***

91. In the event that finalization of an APA application is delayed substantially beyond the enterprise's requested commencement date, 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 three to five years duration of an APA.

92. Where a later commencement date is specified for the APA, the Commissioner will typically seek 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.

### *Compensating adjustments*

93. The APA process envisages the use of compensating adjustments where the actual result of the tested party falls outside the agreed price, result or range, but is within the critical assumption boundaries. The APA will specify the price, result or point in the range to which a compensating adjustment should be made.

### *Critical assumptions*

94. An APA will define in advance the critical assumptions, including those not within the control of the enterprise or the Commissioner. They can be any fact about the enterprise, an affiliate, a third party, an industry or general economic conditions. The assumption is critical if its change may significantly affect the appropriateness of the substantive terms of the APA or the basis upon which it was agreed. Critical assumptions are by their nature vital to the APA and should be drafted carefully to ensure the capability of the APA to reflect arm's length pricing. Critical assumptions that should be considered include those items listed out in **Appendix 9**.

95. Facts existing, including projected facts, at the formal application stage, are critical since any changes in them will materially affect the suitability of the transfer pricing methodology or its application. They have to be addressed and included by the enterprise as critical assumptions. In particular, it is assumed that tax shelters, offshore structures (tax efficient or not) and tax schemes (discussed in paragraphs 73 to 84 of DIPN No. 46) are or will not be set up to participate directly or indirectly in the controlled transactions. Immediate disclosure or notification has to be made by the enterprise if they exist or are established subsequently.



96. If there is a breach of a critical assumption and agreement on a revised transfer pricing methodology cannot be reached after discussion with the enterprise and where applicable the DTA partner(s), the Commissioner may revoke the APA such that it was deemed not to have existed or cancel the APA such that it will not apply for any period remaining of the term of the APA.

97. The enterprise must notify the Commissioner that a breach in critical assumptions has taken place and submit supporting documentation with a proposed course of action (e.g. revision of the APA) as early as possible.

98. The Commissioner would assess whether arm's length parties could reasonably have been expected to foresee or anticipate the event or circumstances at the time the APA was entered into and whether the agreed transfer pricing methodology has sufficiently taken this into account. The Commissioner would use the arm's length test to determine whether arm's length parties would have renegotiated such an arrangement due to the change in critical assumptions.

99. In some cases, a breach in a critical assumption may not require any change in the APA. In those situations, the APA may be suspended and reactivated if circumstances change, subject to the consent of all parties, including the DTA partner(s).

100. 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 is no longer effective.

101. If a revised APA cannot be negotiated, the APA will be cancelled or suspended. The APA will be cancelled or suspended as from the beginning of the year in which the event giving rise to the change in circumstances occurred. In general, an APA is intended to be applicable for the whole of the year or to be inapplicable for the whole of that year.

### ***Annual Compliance Report***

102. The Commissioner will require the enterprise, as part of the APA process, to prepare and submit to him an Annual Compliance Report (ACR), for each year of the APA, containing sufficient information to detail the actual

results for the year and to demonstrate compliance with the terms of the APA. The ACR is distinct from the enterprise's obligation to submit a tax return under section 51(1) of the IRO.

103. The enterprise must complete the ACR in **Appendix 10** for each year of the APA that needs to be supported by a financial analysis of compliance with the APA and detail any compensating adjustments made. In the completed ACR, the principal officer has to make a declaration that the facts presented in the report and accompanying documents are true, complete and accurate.

104. The ACR is to be forwarded by the enterprise to the Senior Assessor (APA) at the time of submission of the annual tax return for the same year as the APA year. The DTA partner(s) may require a similar ACR. The Commissioner may furnish the ACR, financial statements and documents received from the enterprise, if necessary, to the Competent Authority(ies) of the DTA partner(s) (e.g. the Competent Authorities have to ensure that compensating adjustments are duly made in the two tax jurisdictions).

105. The ACR must include:

- (a) information and computations necessary to ascertain the outcome of the application of the transfer pricing methodology for the covered controlled transactions and demonstrate the extent of compliance with the transfer pricing methodology and other terms of the APA; and
- (b) an analysis of any compensating adjustment required under the APA and a detailed description of the manner in which the adjustment was effected.

106. When reviewing the ACR, the Commissioner may request further information to clarify the contents of the ACR or to verify that the enterprise has complied with the terms of the APA. If the enterprise fails to supply the additional information requested within a reasonable time, the Commissioner may revoke the APA such that it was deemed not to have existed or cancel the APA such that it will not apply for any period remaining of the term of the APA. Where the Commissioner is satisfied that the enterprise has complied

with the terms of the APA, he will make no further contact with the enterprise other than sending an acknowledgment letter.

107. If an enterprise fails to comply with the annual reporting requirements, the Commissioner will not be bound by the APA. The Commissioner will consider revoking retrospectively the APA such that it was deemed not to have existed or cancelling the APA such that it will not apply for any period remaining of the term of the APA.

108. The DTA partner(s) may also review the ACR. If a DTA partner raises any issue, the Commissioner may seek additional information from the enterprise.

109. If it is discovered that the ACR was false or misleading, the previous issue of an acknowledgment letter would not prevent follow up actions by the Commissioner.

110. 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.

### ***Record keeping requirements***

111. The enterprise must retain all records relied upon in concluding the APA and all supporting data referred to in any ACR or used in applying the APA for a period of seven years after the end of the APA period. The APA may specify the record retention period or specifically provide that certain records need to be retained.

112. As a term or condition of the APA process, the Commissioner will require an enterprise to keep the records listed out in paragraph 89 of DIPN No. 46. Upon request, any records requested by the Commissioner for the purpose of monitoring the APA are to be made available to the Commissioner within a reasonable time. The Commissioner will consider revoking retrospectively the APA such that it was deemed not to have existed or cancelling the APA such that it will not apply for any period remaining of the term of the APA, if the record keeping requirements have not been followed or

the records do not enable the Commissioner to readily confirm that the critical assumptions have been met.

## **APA RENEWALS**

### ***Renewals***

113. A unilateral/bilateral/multilateral APA may be renewed with the consent of all the parties to it, including the DTA partner(s). A request for renewal of the APA should follow the same procedures that apply to the initial APA request. The renewal may also be eligible for the APA extension process (see paragraphs 118 to 121 below) provided all parties agree.

114. The enterprise should seek renewal at least 6 months before the expiration of the existing APA. This allows the renewal to be negotiated and put in place prior to the expiration of the earlier APA period so that the renewal can be concluded prospectively.

115. When requesting renewal of an APA, the enterprise must establish to the satisfaction of the Commissioner that the terms of the APA were substantially complied with and that all material facts were disclosed and properly stated.

116. Where the renewal involves changes to the terms of the existing APA, then the renewal process will be similar to the original APA process.

117. Where the material facts, critical assumptions or computations appear to remain valid, the Commissioner may still require new or updated economic studies, analyses and supporting documentation, before agreeing to any renewal or extension of the APA.

### ***APA extension process***

118. A process to extend an APA on the same terms is available for unilateral/bilateral/multilateral APAs but subject to the agreement of the DTA partner(s). An APA extension results in the term of the existing APA being extended for a further three to five years period.

119. The APA extension process is applicable only if the following conditions are satisfied:

- (a) the terms of the previous APA are complied with/will be complied with during the remaining period of the APA;
- (b) there are no material changes in any matters relevant to the covered controlled transactions or to the terms of the APA;
- (c) it is unlikely that there will be material changes in the above matters or to the above terms over the period of the renewed APA;
- (d) it is clear that arm's length benchmarks used for the APA remain valid for the period of the APA renewal;
- (e) the covered controlled transactions are consistent with the previous APA;
- (f) there are no material changes to the functions, assets or risks for the enterprise or other parties to the covered controlled transactions;
- (g) the transfer pricing methodology used in the previous APA remains the most appropriate; and
- (h) the critical assumptions are consistent with the previous APA.

120. Eligibility for the APA extension process will need to be agreed at the pre-filing stage for the renewal of the APA.

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

## **AUDITS AND ROLLBACKS**

### ***Audits and APAs***

122. While prior years may be subject to audit as usual, the years covered in the concluded APA will also be subject to audit. However, the audit on the years covered in the concluded APA will not involve a re-evaluation of the acceptability of the agreed transfer pricing methodology previously agreed in the APA. The audit will focus on establishing whether:

- (a) the terms of the APA have been properly complied with;
- (b) the agreed transfer pricing methodology has been correctly applied;
- (c) the information supplied in the enterprise's APA application and the ACR reflect accurately all material facts.

123. Even where agreement on an APA cannot be reached for whatever reasons, or the enterprise withdraws from the APA process, the Commissioner may make subsequent use of the factual information disclosed during the APA process, e.g. in reviewing the tax position of the prior years. Non-factual information such as opinions, lines of argument, judgments and conclusions about the operation and effect of the APA, rather than about facts (projected or identified) required in applying the APA, provided by the enterprise throughout the APA process are unlikely to be relevant to the subsequent audit.

124. Though an enterprise may be under audit, the enterprise may apply for an APA in respect of future years. The fact that the enterprise has applied for an APA should not generally result in the discontinuation or postponement of an audit in relation to the prior years.

125. The audit and the development of an APA are separate processes. They will be resolved separately unless the facts and circumstances of the APA and the audit years are sufficiently similar to enable the APA results to be equally applicable.

126. The audit of issues relevant to the APA may be held in abeyance if it is agreed by all parties that the APA will assist with the completion of the audit.

127. 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 enterprise, at any time, at the discretion of the Commissioner. Alternatively, the Commissioner may suggest the enterprise defer the filing of the APA application until the Commissioner is ready to state its position on an issue so that the enterprise's application can fully and completely respond to the Commissioner's concerns.

128. Where an audit has been wholly or partially suspended and the Commissioner has reason to believe that the APA is not proceeding in the best interests of finalising the audit, the Commissioner may, with written notice to the enterprise, recommence the audit. If double taxation arises as a result of the audit, the mutual agreement procedure of the relevant DTA should be used to resolve the matter.

129. 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 will not constitute a voluntary disclosure. If an audit has commenced and the Commissioner has made contact with the enterprise or their representatives, normal penalty provisions apply to any adjustments made to those assessments under review.

### ***Rollback of transfer pricing methodology***

130. The approach of the Commissioner to the rollback of transfer pricing methodology to prior years will depend on the circumstances of the case and whether the back year assessments can be reopened under the provisions of the IRO and the relevant DTA. 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.

131. Prior year transfer pricing issues will be treated as collateral issues to the APA. The principles developed in an APA might provide the basis for resolving issues in prior years audit, as well as past years not yet under audit. This will depend on the availability of all relevant information in respect of the prior years and the changes in the enterprise's circumstances.

132. Where the provision of information for an APA results in an adjustment to a prior year tax return, the adjustment will be treated as though the enterprise had made a voluntary disclosure provided audit has not already been commenced, or the Commissioner had not previously made contact with the enterprise or their representatives with respect to the prior year returns. Where an audit has not commenced, additional tax, if any, will generally be calculated on the basis of a voluntary disclosure having been made by the

enterprise in relation to each prior year. Where audit has commenced, the normal penalties apply to any adjustments made to those years under review. Nevertheless, the published penalty policy will remain relevant.

133. In summary, the following principles are incorporated into the practice for APA rollbacks:

- (a) the Commissioner will not give an undertaking that years prior to an APA will not be audited;
- (b) an APA does not have retrospective application;
- (c) there may be situations where the principles developed in concluding an APA might provide a basis for resolving issues for prior years;
- (d) prior year adjustments resulting from an APA request will be treated as though the enterprise has made a voluntary disclosure provided compliance activity has not commenced or been notified;
- (e) where audit has not commenced or been notified, any additional tax will be calculated on the basis of being a voluntary disclosure;
- (f) where audit has commenced, the normal penalty provisions apply to any adjustments made to prior years under audit.

134. The decision whether the Commissioner will seek rollback for years prior to an APA depends on the transfer pricing risks involved. It may be expected that the Commissioner will not seek rollback where prior year transfer pricing issues are considered low risk. Rollback will be sought for cases where the transfer pricing issues are considered high risk.

135. The Commissioner will be more likely to seek rollback for a lesser number of years in the case of a voluntary APA request than it would for a case resulting from the Commissioner's audit or enquiry.



## **ADMINISTRATION OF APA PROCESS**

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

136. The Commissioner will prioritize 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 of arrangements which carry higher transfer pricing audit risks.

137. The Commissioner's delegate will negotiate the terms of the APA with the DTA partner(s). The Chief Assessor (Tax Treaty) as the Competent Authority delegate has been designated to approve the terms of the agreement of a bilateral/multilateral APA.

138. The Deputy Commissioner (Technical) will take overall charge of the APA programme. He will review the following situations:

- (a) the APA proposal is not accepted;
- (b) agreement on the scope of the APA cannot be reached;
- (c) the APA team withdraws from the APA;

and will communicate his intention to the enterprise and explain his reasons. Alternatively, an enterprise can request the Deputy Commissioner (Technical) to review the processing of its APA application by the APA team where the APA negotiation breaks down.

### ***Omissions and false or misleading statements***

139. The Commissioner may either revoke the APA such that it was deemed not to have existed, cancel the APA such that it will not apply for any period remaining of the term of the APA or revise the APA, where an enterprise makes a statement that is false or misleading, or omits from a statement any matter or thing without which the statement is false or misleading, in either the APA application or any other submission, report, information or documentation regarding or supporting the APA application. Tax shelters, offshore structures (tax efficient or not) and tax schemes (described in paragraphs 73 to 84 of DIPN No. 46) directly or indirectly related to the controlled transactions must be disclosed and must not be omitted from disclosure.

140. The Commissioner would take such actions as described in the foregoing paragraph irrespective of whether the false or misleading statement (or omission) is made due to an honest mistake or is made carelessly, recklessly, knowingly or fraudulently. An APA would be revoked such that it was deemed not to have existed or cancelled such that it will not apply for any period remaining of the term of the APA, if the false or misleading statement (or omission) related to a material particular. In addition, the Commissioner may raise additional assessments on the enterprise and take appropriate penalty actions.

### Mutual Expectations

1. The enterprise can expect the Commissioner to:
  - (a) undertake open and ongoing dialogue with the enterprise in the development of the APA;
  - (b) work out the scope of the APA and the treatment approach for any collateral issues where appropriate;
  - (c) enquire into the controlled transactions, transfer pricing methodology and arm's length price;
  - (d) undertake examination of collateral issues, if any, and coordinate their resolution;
  - (e) commit to the agreed scope of the APA, which will only be changed in exceptional circumstances;
  - (f) provide timely guidance on the progress of the enterprise's application for an APA;
  - (g) work with the enterprise to agree on the information/documentation required in the development of the APA;
  - (h) jointly develop with the enterprise an APA case plan that contains a structured timeline and work plan;
  - (i) work actively with the DTA partner(s) in the development of a bilateral/multilateral APA;
  - (j) have the right to withdraw from the APA process at any time before final agreement on the APA is reached;
  - (k) keep information confidential in accordance with the secrecy provisions of the Inland Revenue Ordinance and the Exchange of Information Article in the relevant DTA(s);
  - (l) apply the APA process consistently and accelerate the APA process to align with the process of the other DTA partner(s) in a bilateral/multilateral APA.
  
2. The Commissioner expects the enterprise to:
  - (a) co-operate fully with the Commissioner;
  - (b) propose approaches that are consistent with the principles in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations;
  - (c) seek an APA only on controlled transactions that are seriously contemplated or are of a continuing nature;
  - (d) make full and true disclosure of all relevant and material facts with respect to the controlled transactions and collateral issues, if any;
  - (e) work with the Commissioner towards agreement on the scope of the APA and the treatment approach for collateral issues, if any;
  - (f) disclose any reasonably arguable position sought to apply in connection with the controlled transactions and collateral issues, if any;
  - (g) provide the same information/documentation to all DTA partner(s) which are proposed parties to the bilateral/multilateral APA;
  - (h) provide information/documentation commensurate with the complexity of the arrangement and the level of risk;
  - (i) have the right to withdraw from the APA process at any time before final agreement on the APA is reached.

### Model Pre-filing Meeting Agenda

1. The APA process will be discussed in detail so that its purpose will be understood by the enterprise (i.e. the most appropriate transfer pricing methodology will be established to arrive at the arm's length outcome or profits in relation to the covered controlled transactions).
2. The agenda should include the following matters. As a guide, the following details should be of relevance though the list below is not meant to be exhaustive or prescriptive:

#### Nature and scope of the APA process

- (a) confirmation of the non-binding nature of the pre-filing meeting;
- (b) key issues of the APA process:
  - (i) purpose of the APA process;
  - (ii) mutual expectations;
  - (iii) the five stages of the APA process;
  - (iv) exchange of information and communication;
- (c) collateral issues, if any;

#### Specific matters to be agreed

- (a) bilateral or multilateral APA;
- (b) new or renewal APA;
- (c) the term of the APA;

#### The APA process

- (a) characterisation of the controlled transactions in the context of the enterprise's business:
  - (i) an explanation of the enterprise's position in the industry;
  - (ii) an explanation of the business model adopted by the enterprise, including identifiable/foreseeable changes over the APA period and changes to existing arrangement and activities in a restructuring;
  - (iii) an explanation of the ownership structure;
  - (iv) an explanation of the capital structure of the business;
  - (v) a description of the size, nature and value of the controlled transactions; the identity of the other parties; and the nature of the controlled transactions;
  - (vi) a description of the functions undertaken, assets used and risks assumed;
  - (vii) characterisation of the enterprise's operations;
- (b) the most appropriate transfer pricing methodology or methodologies:
  - (i) the proposed methodology(ies);
  - (ii) the proposed profit level indicator;
  - (iii) the comparable data;
- (c) the most appropriate method and the arm's length outcome:
  - (i) the compensating adjustments that should be made to the results;
  - (ii) secondary tests of the reliability of the primary result;
  - (iii) likely outcomes from the methodology;
  - (iv) proposed form and structure of the APA;
  - (v) proposed critical assumptions;
  - (vi) forecast and hindcast of the financials using the method;
  - (vii) rollback of the APA methodology;
  - (viii) any other collateral issues;

- (d) requests of overseas associated enterprises made to the relevant DTA partner(s) for a bilateral/multilateral APA;
  - (e) joint development of the APA case plan;
  - (f) information/documentation requirements;
  - (g) requirement of independent expert advice;
  - (h) suitability of the APA proposal (e.g. cost and practicality of entering into an APA);
  - (i) timeframe for submitting a formal APA application.
3. Where there are intangible and intellectual property issues, the following matters need to be considered:
- (a) particular problems encountered when examining comparability because of the specialised nature or uniqueness of the property;
  - (b) the property protected by trademarks, registrations, copyrights or confidentiality agreements or requirements;
  - (c) existence, identification and nature of the property;
  - (d) determination of the rewards for its use;
  - (e) details that must be provided:
    - (i) exact nature of the property;
    - (ii) protection of the property;
    - (iii) documentation of the property;
    - (iv) transfer method or usage and the contractual terms;
    - (v) development of the property;
    - (vi) usage in the business;
    - (vii) value added to the business;
    - (viii) the amount of value added;
  - (f) the reasonableness of the outcome of the controlled transactions from the perspective of each party to the controlled transactions in accordance with the arm's length principle.
4. The enterprise must make a full disclosure of details where the Commissioner is undertaking or has undertaken an audit on how any provisions of the Inland Revenue Ordinance apply to:
- (a) the enterprise or its associated enterprises (including those resident in Hong Kong); or
  - (b) an arrangement similar to the arrangement which is the subject of the APA proposal, during any period for which the proposed APA would apply were the APA to be concluded.

### Content of Model APA Proposal

The content of the APA proposal and the extent of the necessary supporting information/documentation will depend on the facts and circumstances of each case. As a guide, the following details should be of relevance though the list below is not meant to be exhaustive or prescriptive:

- (a) The transactions, products, businesses or arrangements that will be covered by the proposal (including, if applicable, a brief explanation of why not all of the transactions, products, businesses or arrangements of the enterprise involved in the request have been included).
- (b) The enterprises and permanent establishments involved in these transactions or arrangements.
- (c) The other tax jurisdiction or jurisdictions which have been requested to participate.
- (d) Information regarding the world-wide organizational structure, history, financial statement data, products, functions and assets (tangible and intangible) of any associated enterprises involved and the allocation of risks between the associated enterprises.
- (e) A description of the proposed transfer pricing methodology and details of information and analyses supporting that methodology, e.g. identification of comparable prices or margins and expected range of results, etc.
- (f) The assumptions underpinning the proposal and a discussion of the effect of changes in those assumptions or other events, such as unexpected results, which might affect the continuing validity of the proposal.
- (g) The accounting periods or tax years to be covered.
- (h) General description of market conditions (e.g. industry trends and the competitive environment).
- (i) A discussion of any pertinent collateral tax issues raised by the proposed methodology.
- (j) A discussion of, and demonstration of compliance with, any pertinent domestic law, tax treaty provisions and OECD guidelines that relate to the proposal.
- (k) Any other information which may have a bearing on the current or proposed transfer pricing methodology and the underlying data for any party to the request.



**Advance Pricing Arrangement (APA)  
Model APA Case Plan**

Enterprise Name:	Company HK
File Number:	123456789
Period Subject to APA:	201X - 201X
APA Team:	APA team leader, contact telephone number
Enterprise Contacts:	Company HK contact, contact telephone number
Authorized Representative Contacts:	Firm, contact name, position and telephone number
Type of APA:	Bilateral or Multilateral

Activity	Date
<p><b>Stage 1: Pre-filing</b></p> <ol style="list-style-type: none"> <li>1. The enterprise provides the Senior Assessor (APA) with an APA proposal that describes:           <ol style="list-style-type: none"> <li>(a) the covered controlled transactions, the most appropriate transfer pricing methodology and profit level indicator;</li> <li>(b) the collateral issues, if any and treatment approach for resolution;</li> <li>(c) whether the APA proposal is bilateral or multilateral; and</li> <li>(d) whether the APA proposal is a new APA or a renewal.</li> </ol> </li> <li>2. The enterprise submits a draft APA case plan.</li> <li>3. The Senior Assessor (APA) conducts pre-filing meetings with the enterprise to identify transfer pricing and collateral issues, if any.</li> <li>4. The Commissioner and the enterprise reach agreement on:           <ol style="list-style-type: none"> <li>(a) the scope of the APA;</li> <li>(b) the resolution of collateral issues, if any;</li> <li>(c) the information/documentation required.</li> </ol> </li> <li>5. The Senior Assessor (APA) advises the enterprise acceptance into the APA process and invites the enterprise to make a formal APA application.</li> <li>6. The APA team and the enterprise develop the APA case plan jointly, including the process for resolution of collateral issues (if any) coordinated with the APA process.</li> </ol>	

Activity	Date
<p><b>Stage 2: Formal application</b></p> <p>7. The enterprise submits the formal APA application.</p> <p>8. The Commissioner notifies the DTA partner(s) of submission of the APA application.</p> <p>9. The enterprise prepares and submits to the APA team information/documentation as agreed at the pre-filing stage.</p> <p>10. The enterprise prepares and provides information/documentation for resolution of collateral issues, if any.</p> <p>11. The Commissioner commences proposed processes for resolution of collateral issues (if any) in parallel with the APA process wherever possible.</p> <p>12. The enterprise ensures its overseas associated enterprise(s) meet(s) the requirements of the APA process in the DTA partner(s).</p> <p>13. The Commissioner and the enterprise finalise and execute the APA case plan.</p>	
Activity	Date
<p><b>Stage 3: Analysis and evaluation</b></p> <p>14. The APA team starts to evaluate the APA application and undertake relevant fieldwork.</p> <p>15. The APA team requests further information/documentation if necessary:</p> <p style="padding-left: 20px;">(a) the APA team sends information/documentation request;</p> <p style="padding-left: 20px;">(b) the enterprise responds.</p> <p>16. The enterprise considers independent expert advice if requested by the Commissioner.</p> <p>17. The arm's length consideration is established.</p> <p>18. The APA team clarifies with the enterprise the facts or the interpretation of the outcome.</p> <p>19. The APA team develops a position.</p> <p>20. The APA team coordinates the resolution of collateral issues, if any.</p>	



Activity	Date
<p><b>Stage 4: Negotiation and agreement</b></p> <p>21. The APA team informs the enterprise of the resolution of the collateral issues, if any. The collateral issues usually need to be resolved prior to agreement of the APA terms.</p> <p>22. The APA team develops the draft APA terms including the transfer pricing methodology, critical assumptions and compensating adjustments.</p> <p>23. The APA team makes an endeavour to reach agreement on the APA terms with the enterprise.</p> <p>24. The Commissioner formalises a Mutual Agreement Procedure (MAP) arrangement with the DTA partner(s) in consultation with the enterprise (assuming that agreement is reached):</p> <ul style="list-style-type: none"> <li>(a) the MAP negotiations;</li> <li>(b) the enterprise accepts MAP arrangement and notifies the Commissioner of its acceptance in writing.</li> </ul>	
Activity	Date
<p><b>Stage 5: Drafting, execution and monitoring</b></p> <p>25. For unilateral APAs linked to the bilateral/multilateral APA application (see paragraph 12 of Departmental Interpretation and Practice Notes No. 48):</p> <ul style="list-style-type: none"> <li>(a) The APA team and the enterprise finalise the APA based on the outcomes of the negotiations with the enterprise.</li> <li>(b) The APA team provides the enterprise with written confirmation of the concluded APA.</li> <li>(c) The enterprise signs the final APA and returns it to the Commissioner.</li> </ul> <p>26. For bilateral/multilateral APAs:</p> <ul style="list-style-type: none"> <li>(a) The enterprise accepts the MAP arrangement.</li> <li>(b) The Commissioner enters into a bilateral/multilateral APA with the DTA partner(s).</li> <li>(c) The Commissioner confirms the terms of the bilateral/multilateral APA with the enterprise in a letter or similar document.</li> <li>(d) The enterprise confirms its agreement with the APA in writing to the Commissioner.</li> </ul> <p>27. The enterprise submits the first Annual Compliance Report.</p>	

**Controlled transactions and collateral issues**

<b>Controlled transactions (CT)</b>	<b>Process for resolution</b>
Description of CT	
CT 1:	
CT 2:	
CT 3:	
Add additional rows as required	
<b>Collateral issues (CI)</b>	
Description of CI	
CI 1:	
CI 2:	
CI 3:	
Add additional rows as required	

**Information/documentation requests and responses**

<b>Information/documentation request (IDR)</b>	<b>Date of request</b>	<b>Date of response</b>
Description of IDR and relevance		
IDR 1:		
IDR 2:		
IDR 3:		
Add additional rows as required		



To: Senior Assessor (APA), Tax Treaty Section

**Formal Application for a Bilateral/Multilateral Advance Pricing Arrangement**

In accordance with paragraph 48 of Departmental Interpretation and Practice Notes No. 48, I hereby formally apply for an Advance Pricing Arrangement (APA) between Company HK and below associated enterprises.

**(I) Associated Enterprises**

Name of each associated enterprise:

- (a) Company F1: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_
- (b) Company F2: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_
- (c) Company F3: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_

*(Note <sup>1</sup>: Explain how the claimed tax residence status is determined, and furnish supporting documentary evidence such as tax residence certificates.)*

**(II) Covered Controlled Transactions**

Description of each controlled transaction:

- (a) CT1
- (b) CT2
- (c) CT3

**(III) Authorized Representative**

Firm, contact name, position and telephone number.

**(IV) Agreement, Understanding and Declaration**

I agree that no liability shall rest upon the Government, the Commissioner or any other public officer in respect of the bona fide exercise of any power or performance of any duty under and in accordance with Departmental and Interpretation Practice Notes No. 48.

I understand that my agreement 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 purpose of the APA application may be provided to the competent authority(ies) of the relevant DTA partner(s) 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, complete and accurate.

Name of Company HK: \_\_\_\_\_

Signature of Principal Officer: \_\_\_\_\_

Name and Designation of Principal Officer: \_\_\_\_\_

Date: \_\_\_\_\_

### **Information/Documentation Requirement for a Bilateral/Multilateral APA Application**

*The list provided below is not intended to be exhaustive nor prescriptive. It is indicative of the information/documentation requirements for a typical APA. Some of the documentation/information may have already been provided with the APA proposal. The actual requirements will be reviewed and notified to the applicant on a case-by-case basis.*

#### **Associated enterprises involved in the APA**

1. A statement of the names and addresses of all enterprises or parties to the APA.
2. Details of the company group of which the enterprise is a member, including details of the ownership structure (i.e. an organizational chart).
3. Details of the principal businesses and the places where such businesses are conducted.
4. Confirmation of whether the proposal is a bilateral or multilateral APA and the reasons for the choice.
5. The tax residence of the applicant, the associated enterprises or parties to be covered by the APA and the jurisdictions in or between which they conduct business.

#### **Terms of the APA**

6. Proposed years to be covered by the APA.
7. Retrospective application of the APA methodology and details of any issues affecting prior years, together with proposals for the resolution of those issues.

#### **Covered controlled transactions**

8. A description of the size, nature or characterisation and value of the covered controlled transactions.
9. General information on any other controlled transactions not intended to be covered by the APA.
10. Descriptions of the key agreements between the associated enterprises.
11. Details of any significant transfer pricing arrangements or practices.

#### **Functional analysis**

12. A description of the enterprise's business.
13. Details of the economically significant functions performed by each party to the covered controlled transactions, assets used in the process and risks assumed, with a focus on the key value drivers relevant to the dealings.

### **Industry analysis**

14. A description of the industry and the market in which the enterprise operates.
15. An explanation of the enterprise's position in the industry, including a list of major competitors.

### **Selection and application of the transfer pricing methodology**

16. A description of the proposed transfer pricing methodology and the reasons why that method is the most appropriate methodology.
17. Explain the transfer pricing method which is presently used to test or set the transfer prices of covered controlled transactions. If an unrecognised method is used, state the method used to set their prices.
18. A description of the most appropriate profit level indicator and the reasons for its selection, where appropriate.
19. Sufficient data to apply the transfer pricing methodology and to demonstrate that the outcome produced is at arm's length.
20. The proposed source of comparable data and the key characteristics or criteria to be met by any uncontrolled transaction in order to be regarded as potentially comparable.
21. A description of the proposed comparables and an analysis of the key comparability factors between the comparables and the tested party.
22. Details and calculation of any proposed adjustments to the comparables' results.
23. The proposed arm's length result or range which results from the application of the transfer pricing methodology.
24. Likely or forecast outcomes from the proposed methodology (including sensitivity analysis) during the term of the APA.
25. The process by which any necessary adjustments to the enterprise's actual results may be made during the course of the APA (compensating adjustments).

### **Others**

26. The tax and financial position of all associated enterprises involved in the APA for the last 3 years, including sales, cost of goods sold, operating expenses, profit before taxes, assets, liabilities, number of employees and any other relevant data.
27. Information on forecast/budgeted financial position during the APA period.
28. A description of any events critical to the enterprise's business operations and their ability to achieve specified results under the proposed APA (i.e. critical assumptions).

To: Senior Assessor (APA), Tax Treaty Section

**Application to Initiate Mutual Agreement Procedure (Bilateral/Multilateral APA)**

I hereby apply to initiate mutual agreement procedure (MAP) to resolve difficulties or doubts arising as to the interpretation or application of the relevant double taxation agreement regarding the proposed Bilateral/Multilateral APA between Company HK and below associated enterprises. The details and issues are given below.

**(I) Relevant Double Taxation Agreement(s)**

Long title of the double taxation agreement(s).

**(II) Associated Enterprises**

Name of each associated enterprise:

- (a) Company F1: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_
- (b) Company F2: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_
- (c) Company F3: \_\_\_\_\_ Tax resident<sup>1</sup> of: \_\_\_\_\_

*(Note <sup>1</sup>: Explain how the claimed tax residence status is determined, and furnish supporting documentary evidence such as tax residence certificates.)*

**(III) Covered Controlled Transactions**

Description of each controlled transaction:

- (a) CT1
- (b) CT2
- (c) CT3

**(IV) Summary of issues to negotiate**

Summary of issues that require resolution with the competent authority(ies) of the DTA partner(s).

**(V) Key terms of APA to negotiate**

Attachment showing the key terms of the proposed Bilateral/Multilateral APA for negotiation with the competent authority(ies) of the overseas tax jurisdiction(s).

**(VI) Authorized Representative**

Firm, contact name, position and telephone number.

**(VII) Agreement and Declaration**

I agree that all documents and information submitted to the Commissioner for the purpose of the MAP application may be provided to the competent authority(ies) of the relevant DTA partner(s) for processing the APA. I also undertake to send the same documents and information to the competent authority(ies) of the relevant DTA partner(s) according to their requirements.

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

Name of Company HK: \_\_\_\_\_

Signature of Principal Officer: \_\_\_\_\_

Name and Designation of Principal Officer: \_\_\_\_\_

Date: \_\_\_\_\_

### Model Bilateral/Multilateral APA Implementation Agreement

#### Parties to the Agreement

1. The parties to this implementation agreement, which is subject to the Departmental Interpretation and Practice Notes No. 48 and below terms and conditions, are: the Commissioner of Inland Revenue (the Commissioner) and XXX Ltd. of XXX (Company HK).

#### Bilateral/Multilateral APA

2. The Bilateral/Multilateral APA is: the APA entered into by the Commissioner and the Competent Authority(ies) of XXX (and YYY) on \_\_\_\_\_, the terms of which have been notified to Company HK on \_\_\_\_\_.

#### Years/periods covered by the bilateral/multilateral APA

3. The term of the APA is five years commencing on 1 January 20XX and concluding on 31 December 20XX.

#### Covered controlled transactions

4. Company HK imports, markets and distributes XXXX into the Hong Kong market.
5. Transactions between Company HK and Company F (a company incorporated in XXX and carrying on business in XXX), which are covered by the application of the transfer pricing methodology in paragraphs 6 and 7, are:
  - (a) Purchase of products from Company F;
  - (b) Purchase of parts and accessories from Company F; and
  - (c) Provision of warranty service to end users by Company HK on behalf of Company F.

#### Agreed transfer pricing methodology

6. The consideration given by Company HK for property acquired from Company F is calculated in accordance with the arm's length principle.
7. The methodology for applying the arm's length principle is the Transactional Net Margin Method (TNMM). The profit level indicator (PLI) to be used is: Earnings before Interest and Taxes (EBIT) to Net Sales (referred as the EBIT margin). The methodology shall be applied in the following manner:
  - (a) This methodology shall allow Company HK to achieve an annual return in the range of XX% to YY% in the income years from 201X to 201X.
  - (b) Calculation of the annual return shall be made by reference to the EBIT margin of Company HK, as defined below:
    - (i) 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).

- (ii) Sales shall mean total sales less returns and allowances calculated in accordance with HKFRS or IFRS.

### **Procedures for compensating adjustments**

- 8. Company HK will make compensating adjustments at the end of the basis period for each year of assessment to reflect the application of the arm's length principle in the form of an adjustment.

#### **Shortfall**

- (a) If Company HK's actual EBIT margin is less than XX % (i.e. the lower boundary of the arm's length range described 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 and XX % in any year of the APA.

#### **Excess**

- (b) If Company HK's actual EBIT margin is greater than YY % (the upper boundary of the arm's length range described 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 and YY % in any year of the APA.

#### **Compensating adjustment**

- (c) In the event of any shortfall in any one year, the deduction for purchases or services shall be reduced by such an amount as is sufficient to produce an EBIT margin of XX%. Any adjustment will be reflected in Company HK's tax returns. In the event of any excess in any one year, the deduction for purchases or service fees shall be increased by such an amount as is sufficient to produce an EBIT margin of YY%. In this circumstance, an amount equal to the increased deduction made for purchases shall be included in the profit of the associated enterprise to ensure compliance with the intention of the Agreement between the Government of Hong Kong Special Administrative Region of the People's Republic of China and the Government of the XXX for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on XXX.

### **Critical assumptions**

- 9. The ability of the transfer pricing methodology to accurately reflect the arm's length pricing of future transactions is based on the critical assumptions defined in paragraph 10.
- 10. For the purpose of this agreement, the following matters represent the critical assumptions:
  - (a) Company HK's business activities, functions performed, assets employed, risks assumed and financial accounting methods and classifications shall remain materially the same as those described in the APA documentation provided.
  - (b) There will be no changes or factors materially impacting the industry in which Company HK operates.
  - (c) There will be no changes to Company HK's product or customer base that may materially impact on the Hong Kong business.
  - (d) There will be no changes to any governmental regulations, controls or mechanisms that materially impact the Hong Kong business.



### **Breach of critical assumptions**

11. Company HK agrees to notify the Commissioner when it becomes aware that a breach of critical assumptions has taken place. If Company HK becomes aware of such a breach during the year giving rise to the event, then Company HK will advise the Commissioner of the change as soon as possible during that year. If Company HK becomes aware of the change subsequent to the end of the year giving rise to it, then it will advise the Commissioner of the change as soon as possible after it becomes aware of the change.
12. A breach of a critical assumption will result in a review of the terms of the APA and may lead to revocation of the APA such that it was deemed not to have existed, cancellation of the APA such that it will not apply for any period remaining of the term of the APA, revision or suspension of the APA.

### **Annual Compliance Reporting**

13. Company HK shall submit an Annual Compliance Report to the Commissioner, in such form as the Commissioner may prescribe, at the same time when it files the annual tax return.
14. The Annual Compliance Report 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 for the relevant APA year.
  - (b) Calculations of the assessable profits including full details of all tax reconciliation adjustments for the relevant APA year.
  - (c) Reconciliation of the amount of controlled transactions covered by the APA and the corresponding amounts in the statutory financial statements for the relevant APA year.
  - (d) Information and computations necessary to ascertain the outcome of the transfer pricing methodology for the covered controlled transactions between Company HK and Company F for the APA year, demonstrating the extent of compliance with the transfer pricing methodologies and other terms and conditions of the APA.
  - (e) An analysis of any compensating adjustment required under the APA, and a detailed description of the manner in which the adjustment was effected.
  - (f) A description of any material changes in financial or tax accounting methods or principles employed for the APA year in respect of the covered controlled transactions, which differ from the financial or tax accounting methods employed and reflected in the APA request, and if there were no such material changes in Company HK's opinion, an affirmative statement to that effect.
  - (g) A description of any new controlled transactions of a material amount that are not covered by the existing terms and conditions of the APA.
  - (h) A statement as to whether Company HK has operated within the critical assumptions detailed in paragraph 10 of this APA.
  - (i) A statement demonstrating how Company HK is actively targeting the agreed EBIT margin range in the setting of transfer prices.
  - (j) Audited financial statements of associated enterprises to the controlled transactions.
  - (k) A confirmation that the record keeping requirements has been complied with.
  - (l) A confirmation that tax shelters, offshore structures and tax schemes were not established in the ACR period to participate directly or indirectly in the covered controlled transactions.
15. The Annual Compliance Report shall be sent to:

Senior Assessor (APA)  
Tax Treaty Section  
Inland Revenue Department  
36/F Revenue Tower  
5 Gloucester Road, Wan Chai, Hong Kong

16. The Commissioner will review the Annual Compliance Report and, if necessary, may request further information that is reasonably needed to clarify the contents of the Report or to verify that Company HK has complied with the terms and conditions of the APA.
17. If Company HK fails to provide the Annual Compliance Report or supply the additional information requested within a reasonable time, the Commissioner may revoke the APA such that it was deemed not to have existed or cancel the APA such that it will not apply for any period remaining of the term of the APA.

### **Confidentiality**

18. The Commissioner recognises that the secrecy provisions in the Inland Revenue Ordinance and the Exchange of Information Article in the relevant double taxation agreement will apply to safeguard the information obtained for the purpose of the APA process.

### **Record retention**

19. Company HK shall keep and retain the records listed out in paragraph 89 of the Departmental Interpretation and Practice Notes No. 46 and the records relied upon in concluding the APA. Company HK agrees to retain all supporting data referred to in the annual compliance report for a period of 7 years after the end of the APA period. Company HK shall upon request make the APA records available to the Commissioner within a reasonable time of a written request. If Company HK fails to provide the aforesaid records requested within a reasonable time, the Commissioner may revoke the APA such that it was deemed not to have existed or cancel the APA such that it will not apply for any period remaining of the term of the APA.

### **Implementation**

20. 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.

### **Omissions and false or misleading statements**

21. The Commissioner may revoke the APA such that it was deemed not to have existed, cancel the APA such that it will not apply for any period remaining of the term of the APA or revise the APA, where Company HK makes a statement that is false or misleading or deliberately omits from a statement any matter or thing without which the statement is false or misleading in either the APA application or any other submission, report, information, or documentation regarding or supporting the APA application.

Signed by:

Name:  
Senior Assessor (APA)  
For the Commissioner of Inland Revenue  
Date:

Signed by:

Name:  
Designation:  
(must be a Principal Officer)  
For Company HK  
Date:

### Critical Assumptions

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:

1. assumptions about the relevant domestic tax law and treaty provisions;
2. assumptions about tariffs, duties, import restrictions and government regulations;
3. assumptions about economic conditions, market share, market conditions, end-selling price, and sales volume;
4. assumptions about the nature of the functions and risks of the enterprises involved in the transactions;
5. assumptions about exchange rates, interest rates, credit rating and capital structure;
6. assumptions about management or financial accounting and classification of income and expenses; and
7. assumptions about the enterprises that will operate in each jurisdiction and the form in which they will do so.



**Advance Pricing Arrangement  
Annual Compliance Report**

**(I) Advance Pricing Arrangement (APA) and Annual Compliance Report (ACR) Particulars**

Parties to APA:
APA reference number:
Enterprise submitting ACR:
Year/Period covered by ACR:

**(II) Details of Actual Results (Read the instruction notes before completing this section)**

	Items	CT 1	CT 2	CT 3
1.	Controlled transaction (CT)			
2.	Breach of critical assumptions? (Yes/No)			
3.	Tax jurisdiction involved			
4.	Agreed transfer pricing methodology			
5.	Agreed profit level indicator			
6.	Agreed point or range			
7.	Actual result achieved			
8.	Compensating adjustment (+/-HK\$m)			
9.	Result after compensating adjustment			
10.	Compensating adjustment has been reflected in the tax return? (Yes/No)			
11.	Controlled transaction amount			
12.	Underlying transaction			
13.	Underlying transaction value			

**(III) Documents/information to be included as part of the ACR**

Attach/Include the following documents/information:

1. All appropriate information and computations that clearly show how the selected transfer pricing methods were applied.
2. Audited financial statements (if not submitted as part of the tax return).
3. Audited financial statements of associated enterprises to the covered controlled transactions.
4. Reconciliation statements of all adjustments made between the net profit in the financial statements and the assessable profits disclosed in the tax return.

5. Any other appropriate document or information necessary to validate the basis of the calculation.
6. Any other documents/information that are required to be included in the ACR as specified in the relevant Bilateral/Multilateral APA Implementation Agreement.

**(IV) Confirmation**

Confirm the following matters:

1. Tax shelters, offshore structures (tax efficient or not) and tax schemes (discussed in paragraphs 73 to 84 of the Departmental Interpretation and Practice Notes No. 46) have not been set up to participate directly or indirectly in the covered controlled transactions during the ACR period.
2. Records listed in paragraph 89 of the Departmental Interpretation and Practice Notes No. 46 and records specified in the APA were kept for the covered controlled transactions during the ACR period.

**(V) Agreement and Declaration**

I agree that this APA ACR may be provided to and reviewed by the Competent Authority(ies) of the relevant DTA partner(s).

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

Signature of Principal Officer: \_\_\_\_\_  
 Name and Position of Principal Officer: \_\_\_\_\_  
 Date: \_\_\_\_\_

\*\*\*\*\*

**Instruction notes for completing Part (II) of the ACR**

- Item 1:** Describe each of the controlled transactions covered by the APA (e.g. cost of goods sold, services, royalty, etc.). Use additional sheets if more than 3 CTs are involved.
- Item 2:** Provide the details of breach in a separate attachment and the proposed course of action if there has been a breach of the critical assumptions.
- Item 3:** State the tax jurisdiction with which the enterprise has dealing for each CT.
- Item 4:** State the agreed transfer pricing methodology for each CT.
- Item 5:** State the agreed Profit Level Indicator (PLI) for each CT.
- Item 6:** State the agreed point or range for each CT.
- Item 7:** State the actual result achieved and the actual PLI achieved for each CT.
- Item 8:** If a compensating adjustment is required, state the amount and indicate whether it is a payment into (+) or a payment out of (-) Hong Kong. Evidence must be provided to show that any compensating adjustments can be tracked on both sides of the CT.
- Item 9:** If a compensating adjustment is necessary, state the result after the adjustment has been made.
- Item 10:** Indicate how the adjustment is reflected in the tax return (e.g. purchases, sales, reconciliation statement, etc.)
- Item 11:** Give the actual value of the CT after compensating adjustments.
- Item 12/13:** Provide details of the underlying transactions and their value. In the case of cost of goods sold, this will be the actual value of the CT shown in Item 11.

For example:

Item 11: HK\$5 million; Item 12: cost of goods sold; Item 13: HK\$5 million

In the case of say a royalty, which is based on say 5% of sales, if the royalty paid was \$5m (Item 11), then the underlying transaction would be sales (Item 12) and the value underlining the CT would be \$100 million (Item 13). For example:

Item 11: \$5 million; Item 12: sales; Item 13: \$100 million