

OECD releases Hong Kong's Stage 1 peer review report on implementation of BEPS Action 14 minimum standard

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Executive summary

On 28 November 2019, the Organisation for Economic Co-operation and Development (OECD) released the seventh batch of peer review reports relating to the implementation of the Base Erosion and Profit Shifting (BEPS) minimum standard under Action 14 on improving tax dispute resolution mechanisms.¹ Hong Kong was among the assessed jurisdictions in the seventh batch.²

Overall the report concludes that Hong Kong meets the majority of the elements of the Action 14 minimum standard. In the next stage of the peer review process, Hong Kong's efforts to address any shortcomings identified in its Stage 1 peer review report will be monitored.

Detailed discussion

Background

In October 2016, the OECD released the peer review documents (i.e., the Terms of Reference and Assessment Methodology) on Action 14 on *Making Dispute Resolution Mechanisms More Effective*.³ The Terms of Reference translated the Action 14 minimum standard into 21 elements and the best practices into 12 items. The Assessment Methodology provided procedures for undertaking a peer review and monitoring in two stages. In Stage 1, a review is conducted

of how a member of the Inclusive Framework (IF) on BEPS implements the minimum standard based on its legal framework for Mutual Agreement Procedure (MAP) and how it applies the framework in practice. In Stage 2, a review is conducted of the measures the member of the IF on BEPS takes to address any shortcomings identified in Stage 1 of the peer review.

Both of these stages are desk-based and are coordinated by the Secretariat of the Forum on Tax Administration's (FTA) MAP Forum.⁴ In summary, Stage 1 consist of three steps or phases:

- (i) Obtaining inputs for the Stage 1 peer review
- (ii) Drafting and approval of a Stage 1 peer review report
- (iii) Publication of Stage 1 peer review reports

Input is provided through questionnaires completed by the assessed jurisdiction, peers (i.e., other members of the FTA MAP Forum) and taxpayers. Once the input has been gathered, the Secretariat prepares a draft Stage 1 peer review report of the assessed jurisdiction and sends it to the assessed jurisdiction for its written comments on the draft report. When a peer review report is finalized, it is sent for approval of the FTA MAP Forum and later to the OECD Committee on Fiscal Affairs' to adopt the report for publication.

Minimum standard peer review reports

The report is divided into four parts, namely:

- (i) Preventing disputes
- (ii) Availability and access to MAP
- (iii) Resolution of MAP cases
- (iv) Implementation of MAP agreements

Each part addresses a different component of the minimum standard.

The report includes 20 recommendations relating to the minimum standard. In general, the performance of Hong Kong with regard to MAP has proven to be satisfactory in their respective reports. Overall, Hong Kong meets the majority of the elements of the Action 14 minimum standard.

Preventing disputes

Hong Kong generally meets the Action 14 minimum standard concerning the prevention of disputes. It has a modest Comprehensive Double Taxation Agreement (CDTA) network with 43 CDAs in place and has an established MAP program. The peer review covers 39 of the CDAs.

All of Hong Kong's 39 CDAs contain a provision equivalent to Article 25(3), first sentence, of the OECD Model Tax Convention (OECD MTC) requiring their competent authority to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the CDA.

In addition, Hong Kong has implemented a bilateral Advance Pricing Arrangement (APA) program and guidance on the program is documented in the Departmental Interpretation and Practice Notes. In general, the Inland Revenue Department (IRD) of Hong Kong accepts APAs covering three to five future fiscal years and roll-backs of bilateral APAs subject to the time limits for amending tax assessment. During the reporting period, Hong Kong has received two bilateral APA requests which included requests for roll-back. All of them are still under consideration and roll-back has not yet been granted, hence it is yet to evaluate the effective implementation of this element in practice.

Availability and access to MAP

The report notes that Hong Kong meets the Action 14 minimum standard concerning the availability and access of MAP. Hong Kong provides access to MAP in all eligible cases (including transfer pricing cases, application of anti-abuse provisions, audit settlements and when required information is submitted) since 1 January 2016, although it has not received any MAP requests concerning cases of audit settlement and application of anti-abuse provisions. Peers noted that they were not aware of any denial of access to MAP by Hong Kong in any of the eligible cases, except that one case could not be initiated because Hong Kong had doubts about the taxpayer's residency. Peers also reported not having been consulted or notified of a case where the IRD considered the objection raised in a MAP request as not justified.

MAP cases submitted that required additional information were not denied access and taxpayers were afforded opportunities to provide the missing information. In cases where a MAP request does not include the required information, or additional information is considered necessary, Hong Kong reported that the IRD will ask the taxpayer to submit the information within two months after being asked to do so. Hong Kong may also accept an extension where appropriate. Hong Kong's MAP guidance is publicly available on the IRD's [website](#).

Only a few of Hong Kong's CDTAs:

- ▶ Put forward a period lower than the three years prescribed in the OECD MTC during which the taxpayer may file a MAP request after the first notification of the action resulting in taxation not in accordance with the provisions of the CDTA; or
- ▶ Do not contain a provision under which competent authorities may consult together for the elimination of double taxation in cases not provided for in their CDTAs.

It is expected that a number of these CDTAs will be modified to include the Action 14 minimum standard through the ratification of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* (MLI).

Resolution of MAP cases

Hong Kong generally meets the Action 14 minimum standard concerning the resolution of MAP cases.

The Action 14 minimum standard recommends that jurisdictions aim to resolve MAP cases within an average time frame of 24 months. Hong Kong's MAP statistics show that its average time to resolve all MAP cases was approximately 14 months during the reporting period. However, Hong Kong's MAP inventory has increased significantly since 2016, especially for attribution or allocation cases. The report suggests that Hong Kong should closely monitor whether the increased resources for the IRD function will ensure that MAP cases are resolved in a timely, efficient and effective manner, especially for attribution or allocation cases.

Implementation of MAP agreements

As Hong Kong did not resolve any MAP cases during the reporting period, it was not possible to assess whether it meets the Action 14 minimum standard with respect to the implementation of MAP agreements.

Two out of the 39 CDTAs neither contain a provision that is equivalent to Article 25(2), second sentence, of the OECD MTC that any mutual agreement reached through MAP shall be implemented notwithstanding any time limits in their domestic law, nor both alternative provisions by setting a time limit in Article 9(1) and Article 7(2) for making adjustments to avoid that late adjustments obstruct granting of MAP relief. It is expected that one of the CDTAs will be modified through the ratification of the MLI. Hong Kong intends to initiate bilateral discussions to amend the other CDTA which will not be modified through the MLI.

Next steps

Hong Kong is already working to address deficiencies identified in its peer review and will now move on to Stage 2 of the process, where Hong Kong's efforts to address any shortcomings identified in its Stage 1 peer review report will be monitored. Under the peer review program methodology, Hong Kong will submit an update report to the Forum on Tax Administration's MAP Forum within one year of the OECD Committee on Fiscal Affairs' adoption of the Stage 1 peer review report.

Implications

Currently Hong Kong has limited experience with resolving MAP cases and it has a small MAP inventory. With the increasing investment of resources in the IRD in this area and the commitment to adopt the recommendations in the report, in the event of tax controversy, it is expected that more taxpayers may opt for MAP as an alternative dispute resolution avenue.

In a post-BEPS world, where multinational enterprises (MNEs) face tremendous pressures and scrutiny from tax authorities, the release of Hong Kong's peer review report represents the continued recognition and importance of the need to achieve tax certainty for cross-border transactions for MNEs. While increased scrutiny is expected to significantly increase the risk of double taxation, the fact that tax authorities may be subject to review by their peers should be seen by MNEs as a positive step to best ensure access to an effective and timely mutual agreement process.

Furthermore, the peer review for Hong Kong provides insights to taxpayers on the availability and efficacy of MAP. With additional countries continuing to be reviewed, the OECD has made it known that taxpayer input continues to be welcomed on an ongoing basis.

With stakeholder feedback in mind, businesses are encouraged to share their views with the OECD on the peer review for Hong Kong and any other jurisdictions, and to perhaps comment on whether the next iteration of the OECD's assessment of tax administration's MAP performance warrants greater feedback from taxpayers as the primary source. Feedback from the international tax community is the logical next step after peer review, which may help to further validate the current favorable result.

Endnotes

1. See EY Global Tax Alert, [OECD releases seventh batch of Stage 1 peer review reports on BEPS Action 14](#), dated 3 December 2019.
2. OECD (2019), Making Dispute Resolution More Effective - MAP Peer Review Report, Hong Kong (Stage 1): Inclusive Framework on BEPS: Action 14, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/46034be3-en>.
3. See EY Global Tax Alert, [OECD releases BEPS Action 14 on More Effective Dispute Resolution Mechanisms, Peer Review](#), dated 31 October 2016.
4. <http://www.oecd.org/tax/forum-on-tax-administration/about/>.

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