

Transfer pricing risk in Asia

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Asia's diverse transfer pricing rules and audit practices mean this is a complex issue for fund managers. With many managers downsizing their businesses, now is a good time to revisit their transfer pricing policies.



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Globally, transfer pricing is regularly cited as the number one international tax issue for financial services tax payers. In the fund management industry, the breadth of international audit activity and tax authority commentary means that there is no question that transfer pricing is a real tax risk.

Transfer pricing rules are typically designed to ensure that tax payers price their transactions with related parties on an arm's length basis. In many countries, the transfer pricing legislation also includes a requirement to retain transfer pricing specific documentation, and there are often significant penalties for non-compliance in this area.



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What of Asia? The reality is that almost all countries in Asia now have some form of transfer pricing regulation, including documentation compliance requirements in some countries. In China for example, the introduction of the new corporate income tax law in 2008 coincided with the introduction of detailed new transfer pricing legislation, and more than 100 pages of transfer pricing guidance. In 2008 China also introduced contemporaneous documentation requirements and a transfer pricing specific penalty regime, and began investing significant time and effort in training its tax inspectors to deal with transfer pricing issues, including those relating to the financial services industry. Even in Hong Kong, which has traditionally been considered a relatively benign jurisdiction from the transfer pricing perspective, the tax authorities have indicated their intention to issue two tax circulars in 2009, focused specifically on the interpretation of Hong Kong's transfer pricing legislation and case law. It is, therefore, likely that transfer pricing will come under more scrutiny even in Hong Kong going forwards.



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Specific issues for fund managers

For fund managers, transfer pricing means ensuring that the management fees (and performance fees, if relevant) paid by the fund are reasonably allocated between the different companies and partnerships making up the management group. In many cases, the fund manager has a clear geographical nexus, and the focus of the transfer pricing exercise is on remunerating its satellite offices around the world – often using a mark-up on full costs.

Audit activity in Asia to date has often been associated with tax authorities questioning the application of this type of mark-up on costs methodology, and attempting to implement, under audit, their own form of profit or revenue split. In addition, tax authorities often investigate the taxable status of the profits/gains of the fund, or overseas management companies, and question whether part or all of those profits/taxable gains should be taxable in the local jurisdiction. Of course, Asia is a large region, and not all tax authorities are playing on the same field. To date, for example, a large amount of audit activity has been focused in Japan and Korea. In Japan, audits have targeted the entire fund management industry: from large, traditional fund managers through to private equity, real estate and hedge fund specialists. In addition, the transfer pricing at issue in those audits has related to both fund management/advisory activities and capital raising/distribution. In contrast, other countries have turned their attention to transfer pricing documentation and developing their experience. This may change over time as those other tax authorities gain more transfer pricing experience generally, and become more familiar with the fund management industry in particular.

Effect of the downturn

In 2009 many fund managers may have to revisit their transfer pricing policies, regardless of the approach they have adopted historically. Management and performance fees are down, offices are being rationalised, and market data from past "good" years is becoming less relevant in the current economic climate. At the very least, all of these changes should lead tax payers to ask themselves first, whether their business has changed, and secondly, whether their transfer pricing method continues to be appropriate in the current environment.

In conclusion, transfer pricing is and will continue to be a real issue for fund managers with operations in Asia. In fact, the array of transfer pricing rules and regulations in Asia, and the differences in audit practice amongst Asian tax authorities, mean that transfer pricing may currently be more of an issue here than elsewhere in the world.

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