

Observations on OECD peer review on implementation of CbCR and MAP in Mainland China and Hong Kong SAR

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In brief

The Organisation for Economic Co-operation and Development (OECD) recently published the fourth annual [peer review report](#) of Base Erosion and Profit Shifting (BEPS) Action 13 – Country-by-Country (CbC) Reporting and the seventh batch of the Stage 2 peer review reports of Action 14 – Mutual Agreement Procedure (MAP) for [Mainland China](#) and [Hong Kong SAR](#).

The peer review reports evaluate the progress made by jurisdictions of the OECD/G20 Inclusive Framework on BEPS (IF), including Mainland China and Hong Kong SAR, in implementing the BEPS Action 13 and Action 14. The reviews show positive results for Mainland China and Hong Kong SAR, which indicate both competent authorities' continuous efforts and commitment to participate in global efforts to address BEPS issues.

Action item: To navigate through the evolving international tax environment, businesses should establish a well-thought-out tax strategy from a holistic standpoint, including compliance, dispute prevention, and dispute resolution.

In detail

BEPS Action 13 - Implementation in Mainland China and Hong Kong SAR

Overall results of the review

Mainland China and Hong Kong SAR have fully implemented BEPS Action 13. In this regard, the OECD recommends that Mainland China make the following three improvements to its CbC reporting regime:

- Clarify the exact scope, conditions, and legal basis under the OECD minimum standard and/or the exchange of information framework for the filing exemption of information relating to National Security;
- Amend its legislation or otherwise take steps to ensure that local filing of CbC reports is only required in circumstances prescribed in the OECD's terms of reference (i.e., an agreed set of criteria for evaluating the implementation of the minimum standard, found on [pages 11 to 18](#) of BEPS Action 13 on Country-by-Country Reporting – Peer Review document); and

- Implement a process to ensure that each of the mandatory fields of information required in the CbC reporting template is present in the information exchanged.

Observations

Mainland China: For Mainland China-headquartered Multinational Enterprises (MNEs) having filing exemption, if they are requested, by the competent authorities of tax jurisdictions where their oversea subsidiaries operate, to file CbC reports, the companies' finance teams should actively communicate with their management and the tax authorities in the companies' ultimate parent company jurisdictions to form effective solutions.

Mainland China does not require local subsidiaries of MNEs to file CbC reports or CbC reporting notifications in Mainland China, which eases the compliance burdens of taxpayers. According to the State Taxation Administration's (STA) Public Notice Regarding Refining the Reporting of Related Party Transactions and Administration of Transfer Pricing Documentation (Public Notice 42), a subsidiary of a MNE in China may be required to submit the CbC report in a transfer pricing investigation, if its ultimate holding company prepares the CbC report according to the regulations of the jurisdiction in which it resides and one of the following conditions is met:

1. The MNE group has not provided the CbC report to any jurisdiction;
2. Although the group has submitted the CbC report, the jurisdiction collecting the report has not had the exchange of information mechanism with Mainland China; or
3. Although the MNE group has provided the CbC report and the jurisdiction collecting the CbC report has the exchange of information mechanism with Mainland China, the CbC report has not been successfully exchanged to Mainland China.

While the above requirements seem reasonable from a transfer pricing administrative perspective and have taken into consideration taxpayers' compliance burdens, it is not clear whether the STA will revise the relevant provisions of Public Notice 42 in response to the OECD's suggestions.

Hong Kong SAR: Taxpayers should take steps intended to achieve full compliance with the local CbC reporting regulations, particularly on filing timing and data accuracy, with the objective of avoiding any penalty or triggering review by the Inland Revenue Department (IRD).

The annual peer review will continue to monitor the implementation of the BEPS Action 13 minimum standard by IF member jurisdictions. With the international landscape on CbC reporting becoming more developed and aligned, taxpayers should monitor and assess the level of tax risks associated with their CbC reports and proactively seek to manage the risks.

BEPS Action 14 – Implementation in Mainland China and Hong Kong SAR

Overall results of the review

Mainland China and Hong Kong SAR maintain good MAP relationships with their peers, and no significant problems have surfaced throughout the peer review period. These positive developments underline Mainland China's and Hong Kong SAR's commitment to MAP implementation and provide clarity to taxpayers considering initiating a MAP request.

A. Preventing disputes

Mainland China and Hong Kong SAR generally meet the requirements regarding prevention of disputes, including (1) having in most of their tax treaties a provision that requires the competent authority to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of tax treaties and (2) providing rollback of bilateral advance pricing arrangements (APAs) in appropriate cases.

Observations

Mainland China: Mainland China has demonstrated a positive attitude toward the prevention of double taxation as well as a commitment to continuing to improve the quality of taxation services. In particular, the STA has entered into multiple bilateral APAs with a rollback provision during the peer review period.

Hong Kong SAR: The IRD streamlined the administrative process for an APA from five stages to three stages and allows roll-back of bilateral APAs. Among the 12 bilateral APA requests received during the period from January 2016 to July 2020, three included requests for rollback. These measures demonstrate Hong Kong SAR's continuous effort in the prevention and resolution of potential tax disputes.

B. Availability and access to MAP

Mainland China and Hong Kong SAR basically meet the requirements regarding availability and access to MAP — e.g., (1) allowing submission of a MAP request to either treaty partner's competent authority or introducing a bilateral consultation or notification process, and (2) providing a clear, comprehensive, and accessible MAP guidance.

Observations

Mainland China: The STA has strengthened the management of MAP application processes through a series of regulations including Public Notice 56 to protect the rights of taxpayers during the application processes. Mainland China's competent authority has not denied any MAP request during the peer review period.

Hong Kong SAR: Although one treaty partner pointed out that Hong Kong SAR did not respond to one of the MAP requests, Hong Kong SAR has communicated with its treaty partners in most of the cases to provide taxpayers with effective access to MAP.

C. Resolution of MAP cases

Mainland China and Hong Kong SAR basically meet the requirements regarding resolution of MAP cases — e.g., (1) ensuring staff in charge of MAP has the authority to resolve cases in accordance with the applicable tax treaty, and (2) providing transparency with respect to the position on MAP arbitration.

Observations

Mainland China

- Mainland China has sought to resolve MAP cases more efficiently and effectively, such as by communicating with treaty partners online for some cases during the COVID-19 outbreak and establishing regular negotiation mechanisms with jurisdictions with which Mainland China has a high number of pending MAP cases.
- Although the average time needed to close MAP cases during 2016 to 2019 was 34.17 months (which exceeds the pursued average of 24 months), improvement can be seen for post-2015 cases (i.e., MAP requests submitted on or after 1 January 2016) where Mainland China on average took 16.37 months to close 35 cases.
- More than 60% of the closed cases during 2016 to 2019 were resolved with positive outcome (including fully or partially eliminating double taxation, granting unilateral relief, or resolving via domestic remedy). This shows that Mainland China strived to help MNEs resolve double taxation issues and to create a better business environment.

Hong Kong SAR

- To deal with the increasing workload relating to international taxation (including MAP), six professional officers, including two assessors and four assistant assessors, have joined the Tax Treaty Section of the IRD since 1

January 2019, totaling 35 professional officers. Funding, training, and well-established internal procedures for processing MAP cases are also available to facilitate MAP implementation.

- The average time taken to close MAP cases during 2016 to 2019 was 16.92 months, which was within the targeted timeframe of 24 months. This offers a degree of certainty to taxpayers that plan to initiate a MAP request.
- The MAP inventory had increased from six to 20 during 2016 to 2019. This, on one hand, reflects that both the IRD and taxpayers are more willing to use MAP to resolve double taxation disputes involving Hong Kong SAR, but on the other hand indicates that the IRD may require more resources to handle the caseload.
- 11 cases were closed by the IRD during 2016 to 2019, representing 44% of the number of new cases that started in the same period. 45.5% of the cases were closed by granting unilateral relief to the taxpayers.

D. Implementation of MAP agreements

Mainland China basically meets the requirements regarding implementation of MAP agreements, such as implementing all MAP agreements on a timely basis.

As Hong Kong SAR did not enter into any MAP agreements that required its implementation, it is considered that Hong Kong SAR in principle meets the requirements.

2020 MAP Statistics

For an overview of how jurisdictions around the world generally performed in handling MAP, the [2020 MAP statistics](#) released by the OECD on November 22, 2021 covering 118 jurisdictions and practically all MAP cases worldwide can be referred to. The statistics show the following trends:

- MAP remains very concentrated, with the top 25 jurisdictions accounting for 95% of the new cases started in 2020.
- Competent authorities have adapted to the COVID-19 pandemic, including allowing taxpayers to file MAP requests digitally.
- The number of transfer pricing (TP) cases started has increased by almost 15%, while the number of other cases has slightly decreased by 2% compared to 2019.
- While a significant number of cases were closed in 2020, MAP inventories have increased in the majority of jurisdictions.
- MAP outcomes remain generally positive, with around 75% of the MAPs concluded in 2020 fully resolving the issue.
- On average, it still took a long time to close MAP cases in 2020, i.e., 35 months for TP cases and 18 months for other cases.

The takeaway

The OECD peer reviews will continue to monitor the IF jurisdictions, including Mainland China's and Hong Kong SAR's implementation of CbC reporting and MAP, which should align further with the OECD standards.

More recently, to assess tax compliance and identify potential targets for tax investigation, both Mainland China and Hong Kong SAR are utilizing digital tools to collect TP and tax information (such as the establishment of a profit monitoring database by the STA, and the issuance of an e-form [IR1475](#) by the IRD to taxpayers on TP documentation information). Under the BEPS 2.0 landscape, CbC reports will serve as an important data source for the implementation of the two pillars, and new disputes may arise due to the new regulatory framework.

The following highlights steps taxpayers can take in developing their tax strategy from a holistic standpoint, including compliance, dispute prevention, and dispute resolution, as elaborated below:

- Taxpayers having CbC reporting obligations should seek to achieve full compliance with local CbC reporting regulations and accuracy of CbC reporting data to form a basis for assessing potential tax risks. Furthermore, taxpayers should monitor ongoing developments, including the EU public CbCR requirements (see PwC's [Tax Policy Alert](#) dated November 12, 2021).
- To proactively manage TP risks and reduce disputes, taxpayers in Mainland China and Hong Kong SAR are recommended to actively consider the use of APA, especially when both jurisdictions are making efforts to facilitate APA applications. Mainland China has been promoting the APA program with a new record number of concluded APAs in 2020 and introduced simplified procedures to reduce the administrative burdens of taxpayers in September 2021 (see PwC's [Tax Insight](#) dated August 30, 2021). The IRD also reformed the APA program which allows rollback for bilateral APAs and streamlined the administrative process for an APA from five stages to three stages.
- Taxpayers should consider using MAP to resolve existing or future double taxation issues. From the positive review results on MAP implementation for Mainland China and Hong Kong SAR, we expect that more multinational enterprises can benefit from more effective, efficient, and comprehensive dispute resolution mechanisms to lessen the adverse effects of potential international double taxation.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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