



Overview

Hendersen, Taxand China

Hendersen is a boutique professional tax and accounting service firm established in 2004. With extensive exposures to world-class clients and hands-on experiences in various industrial business, our technical and industrial expertise as well as practical experiences is simply among the top class in China. We have dedicated and experienced transfer pricing specialists, worldwide professional databases, close interaction with Taxand global transfer pricing network as well as strong connection with tax authorities. We always focus on clients' specific needs and aim to provide tailor-made solutions to our clients. All these enable us to provide top-quality transfer pricing services to our clients and be highly competitive in this special areas including conducting transfer pricing model and policy review, planning and restructuring, as well as transfer pricing risk and opportunity assessment; documentation client's transfer pricing policies and prepare supporting materials in a systematic manner to prepare for any checks from the tax authority, including preparation of transfer pricing contemporaneous documentation; providing transfer pricing audit defense support including risk management, documents preparation and negotiation with tax authority to achieve the best audit result; assisting in Advanced Pricing Arrangement ("APA") from pre-filing meeting, formal application, negotiation, to signing and execution of the APA; assisting the clients to review and structure intercompany transactions, in order to lower the overall tax burden on their China operations while in full compliance with China tax and transfer pricing regulations, etc.

General : Transfer Pricing Framework

Under article 110 of the Implementation Regulations of the Enterprise Income Tax Law (EITIR), the arm's length principle is defined as the principle adopted by unrelated parties when conducting business transactions based on fair transactional prices and normal business practices. Transfer pricing legislation is governed by Notice 42/2016 with the requirements of related party reporting and contemporaneous documentation. The State Administration of Taxation (SAT) issued Notice 64/2016 to improve the administration of APAs. In addition, Notice 6/2017 regulars the administration of Special Tax Investigation and Adjustment and Mutual Agreement Procedures and clarifies certain key transfer pricing issues, as well as the methodology and procedures for special tax audits and adjustments.

Accepted Transfer Pricing Methodologies

In addition to the traditional five transfer pricing methodologies recommended by the OECD principles, Notice 6/2017 introduced other methods, including asset valuation methods such as the cost method, market method, income method, etc., which are consistent with the arm's length principle as "supplementary methods".

There is no special order of the methods to be used. The taxpayer is given the right to choose any method or combination of the above methods as long as the method is reasonable and appropriate taking into account the factors such as type, nature of transactions and investigation results of the tax authority.

Transfer Pricing Documentation Requirements

In addition to the annual reporting forms on related party transactions, Notice 42/2016 introduces a three-tier documentation framework, as set out in the OECD's framework in BEPS Action 13.

Transfer pricing contemporaneous documentation consists of a Master File, a Local File and a Special Issue File.

Local entity whose annual related party transactions exceed one of the prescribed thresholds should prepare the local file. These thresholds are as follows:

- ❖ For tangible buy-and-sell related party transactions: RMB 200 million;
- ❖ For intangible buy-and-sell related party transactions: RMB 100 million;
- ❖ For all other related party transactions: RMB 40 million.

As for the Master File, the local entity shall submit the Master File if either of the following conditions is met:

- ❖ The local entity has overseas related party transactions, and the group's ultimate holding company has prepared a Master File; or
- ❖ The local entity has related party transactions exceeding RMB 1 billion during the year.

The Special Issue File is required for taxpayers engaging in a cost sharing agreement or falling under the thin capitalization requirement.

The CbCR forms are part of reporting forms on the transactions between related parties together with the annual enterprise income tax return. The CbC reporting forms are required from the Chinese resident enterprise if:

- ❖ it is the ultimate holding company of a group with consolidated revenues of over RMB 5.5 billion; or
- ❖ it is nominated as the CbCR entity.



Local Jurisdiction Benchmarks

Based on Notice 42/2016, a comparable analysis must be made in order to select reasonable transfer pricing methods. The following factors should be considered in the comparable analysis:

- ❖ characteristics of the assets or services transferred;
- ❖ functions, risks and assets of the parties involved;
- ❖ terms of contracts;
- ❖ economic environment; and
- ❖ business strategies.

For more detailed information on Chinese companies, such as segmented profit and loss statements, Chinese specific databases (in Chinese language) such as Wind or Tianxiang are used. Public information for companies listed in Shanghai, Shenzhen and Shenzhen small-medium size enterprises are used for Chinese comparables. For comparables worldwide, China Tax authorities usually would adopt the international database such as OSIRIS, as well as their internal database.

Taxpayers are expected to determine whether internal comparable information can be found within the company. If the information is unavailable, companies are expected to carry out an external comparable study using Chinese and/or foreign comparable companies.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

Article 42 of the Enterprise Income Tax Law (EITL) provides for the possibility of negotiation and entering into an APA with the tax authority. According to Notice 64/2016, APA candidates must meet all of the following requirements for 3 years prior to the application:

- ❖ the annual related party transactions must exceed RMB 40 million;
- ❖ they have reported related party transactions in their annual tax filings properly; and
- ❖ they have maintained the required contemporaneous documentation.

According to Notice 64/2016, an APA usually covers a period of 3 to 5 years following the year of application. Notice 64/2016 also allows an APA to apply retroactively to the year of application or previous years upon approval of the tax authority.

There is no filing fee for APAs in China. The applicant can submit application to the local tax bureau, or SAT if the APA involves more than one province or if it is a bilateral/multilateral APA. Negotiation and execution of an APA usually involves six stages, i.e. pre-filing meeting, formal application, examination and appraisal, negotiation signing of arrangements and supervision of implementation.

Transfer Pricing Audits

There is a 10-year statute of limitation for tax adjustments. This does not apply in cases of fraud, wilful default or negligence.

The transfer pricing audit process is generally initiated by a request for financial and management information such as statutory accounts, tax computation, pricing information, management accounts and transfer pricing documentation. Based on this information, the tax authority will carry out a review of the documents and decide if a more detailed review is required. A field visit will be carried out if it has been found necessary after review of the submitted information.

Transfer Pricing Penalties

Taxpayers who fail to comply with the requirements for providing information or provide false information or do not provide the information in time will be fined according to the relevant articles of the Administration of Tax Collection Law (TCAL). The penalty described in the TCAL could range from CNY 10,000 to CNY 50,000 in serious cases.

Penalty interest will generally be imposed on tax adjustments made under the EITL (including transfer pricing adjustment). The interest rate shall be calculated based on an RMB loan benchmarking rate published by the People's Bank of China plus 5%. The interest on underpaid taxes is on a daily basis, starting from 1 June of the tax year following the one to which the tax payment is related until the day the underpaid tax is settled.

In addition, if a taxpayer can provide contemporaneous documentation and/or other information/documents requested by the tax authority, the additional 5% surcharge may be waived.

The additional tax assessment, together with penalty interest (if any), should be settled with the tax authority within the prescribed deadline, overdue payment would be subject to an additional 0.05% penalty interest per day.

Local Hot Topics and Recent Updates

Transfer pricings, particularly of MNCs who have extensive intercompany charges, become the focus of the Chinese tax authorities' and Customs offices' attention. We've seen cases that the tax authorities' supervision and review of related party transactions has been enhanced by the "Golden Tax Project Phase IV". Customs authorities, by leveraging the newly established Customs National Supervision Center for Duty Collection, have increased the supervision and monitoring of import transactions between related parties. Therefore, it's essential for MNCs to consider the balance between tax authority and Customs office when structuring pricing model of intercompany transactions.



Documentation threshold

Master file	Related party transactions exceeding RMB 1 billion
Local file	Tangible buy-and-sell related party transactions RMB 200 million; intangible buy-and-sell related party transactions RMB 100 million; all other related party transactions RMB 40 million
CbCR	RMB 5.5 billion

Submission deadline

Master file	Within 12 months after the fiscal year-end
Local file	30 June of the following year
CbCR	31 May of the following year

Penalty Provisions

Documentation – late filing provision	Under RMB 2,000; RMB 2,000 to RMB 10,000 in serious cases
Tax return disclosure – late/incomplete/no filing	RMB 10,000 to RMB 50,000 in serious cases Late payment interest 0.05% per day
CbCR – late/incomplete/no filing	Under RMB 2,000; RMB 2,000 to RMB 10,000 in serious cases



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