



Latest Development Regarding the Proposed China's Transfer Pricing Contemporaneous Documentation Requirements

As a further step to strengthen transfer pricing enforcement in China, we understand that the State Administration of Taxation ("SAT") is drafting and considering imposing certain documentation requirements ("Documentation Requirements") on taxpayers that have transactions with related companies. Currently expected to become effective in the first half of this year, the Documentation Requirements is hence anticipated to have tremendous impact on multinational enterprises ("MNEs") with significant business operations in China.

Introduction

Transfer pricing documentation requirement is regarded as an effective mechanism to achieve balance between the interests of taxpayers and tax administrators with respect to tax management and administrative burden. Under the anticipated Documentation Requirements, we understand that taxpayers are required to submit certain transfer pricing documents, together with the annual filing of the tax return. The Documentation Requirements may also provide more detailed guidance on documents that taxpayers should prepare and maintain, or submit upon request by the Chinese tax authorities.

Overview of the Forthcoming Documentation Requirements

Based on our understanding, the anticipated Documentation Requirements may require taxpayers to prepare documentation potentially with the following details.

- group organizational structure;
- overall business operation (e.g. industrial properties, market information, financial conditions, etc.);
- description of related-party transactions;
- functional and risk analysis;
- comparability analysis;
- selection and application of the transfer pricing methods;
- explanation that the transfer pricing method adopted complies with the arm's length principle;
- analysis of commercial intangibles; and
- other business strategic factors (e.g. continuous losses, business strategies, and set-off transactions).

Conforming to Common International Practices

The Documentation Requirements refer to and model on common international practices. Particularly, we understand that the Documentation Requirements may provide specific guidelines for the application of transactional profit methods (i.e. comparable profit method, transactional net margin method and profit split method) and recognize a set of international transfer pricing concepts (such as the use of interquartile range and multiple year data) to evaluate the reasonableness of related-party transactions.

Applicability to All Related-Party Transactions

Taxpayers are required to document and analyze each type of related-party transactions in the current year, including:

- buying and selling transactions;
- financing;
- provision of services;
- intangible property transfer and licensing; and/or
- cost sharing arrangement.

Implications on MNEs with Operations in China

The SAT's enforcement efforts indicate that MNEs with significant operations in China must seriously evaluate and assess their transfer pricing exposures and consider ways to best manage their position. Since China does not allow group consolidation in filing income tax returns, MNEs with multiple operations in China may find the proposed documentation rules particularly difficult to comply with, as such documentation is expected to cover not only cross-border transactions, but also intra-China transactions.

As preparation of transfer pricing documentation is often a time consuming and potentially costly exercise, it is strongly recommended that MNEs with operations in China start planning their transfer pricing strategy from now on, and take a proactive and coordinated approach in so doing.

In the context of this China Tax / Business News Flash, China refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PricewaterhouseCoopers client service team.

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