
Transfer Pricing – A Practical Guide for China

Published by CCH China



TPA Publication

Introduction

The new Enterprise Income Tax (EIT) Law was passed on 16 March 2007 and came into effect from 1 January 2008. Under the new EIT Law, the State Administration of Taxation (SAT) is empowered to investigate and make appropriate adjustments in cases where the taxpayer implements any transfer pricing arrangements on a non-arm's length basis. Furthermore, the new EIT Law introduces a special interest levy on all anti-avoidance tax adjustments, including transfer pricing adjustments, which is the first time that interest has been imposed on the latter. This marks a milestone in the SAT's approach to transfer pricing and should send a strong financial incentive to taxpayers to ensure that their transfer pricing affairs are in order.

Following the issuance of the new EIT Law, more detailed guidance on the interpretation of the EIT Law was published on 11 December 2007 in the form of the Detailed Implementation Rules to the EIT Law (Implementation Rules). While Chapter 6 of the EIT Law generally strengthens the supervision of related party transactions, the Implementation Rules have clarified a range of measures designed to strengthen transfer pricing compliance and enforcement under the EIT law. It is expected that Measures for Administration of Documentation on Related Party Transactions ("transfer pricing circular") will be released shortly, with immediate effect, detailing a transfer pricing disclosure form to be included with the annual tax return filing and elaborating on the contemporaneous documentation requirements.

Consequences

Taxpayers should review their transfer pricing systems now and make whatever changes are necessary to ensure that those systems (specifically, the recognition and classification of related party transactions, and the manner in which they set prices on those related party transactions) are in line with the arm's length principle. If this process is delayed until the end of the year, and it is found that there are flaws or even a more fundamental problem with the arm's length nature of the transfer pricing system, it is then too late to rectify the problem. Reliable transfer pricing documentation cannot be prepared to support transfer pricing systems that are inherently incorrect in design.

Once the transfer pricing system has been reviewed and, if necessary, amended to ensure that the legal, economic and accounting realities are fully aligned, taxpayers should prepare a transfer pricing defence file, to include the following elements:

- Legal agreements (signed) governing all of the inter-company transactions taking place during the relevant financial year
- Financial statements for the year in question, along with detailed profit and loss account and balance sheet information, to allow for detailed computation of the required ratios and provision of further information if necessary
- Evidence of arm's length behaviour and bargaining such as emails and other internal documents to demonstrate the negotiations that have taken place over the price of inter-company transactions during the year or the setting of the budget for the year
- Best practice contemporaneous transfer pricing documentation as discussed above to include evidence of the broader business context and analysis of the relevant industry in China and the

world, detailed functional analysis information, group structure diagram, responsibility centre profiles, design of the transfer pricing system, selection of price-setting and price-checking methodologies, any internal data governing the application of selected methodologies (e.g. internal CUP or resale price information), and documentation of the application of the selected methodologies (such as the process and outcomes of the required benchmarking studies).

The preparation of such a transfer pricing defence file will allow taxpayers to respond promptly to future requests by the tax authorities, and to defend their transfer pricing practices from a confident position of strength. This should ideally be done during the year or at least before the tax return for the year is filed.

The key message for taxpayers is to ensure that they review their transfer pricing systems now, and then prepare full transfer pricing documentation and other supporting evidence in advance of the filing of the tax return for the year in question. Taxpayers should assume that they will be audited at some uncertain time in the future, and preparation carried out on a timely basis will therefore represent a very wise investment.

Transfer Pricing – A Practical Guide for China

This book has been prepared to enable multinationals in China to understand the transfer pricing regulations in force in China in the light of the global transfer pricing issues and developments, since this is how multinationals should approach the design of their transfer pricing systems.

- Part One of the book sets out and discusses global transfer pricing issues in the context of the need for multinationals to design and implement a workable and defensible transfer pricing system driven by commercial realities and the actual business model rather than any tax planning objectives
- Part Two of the book outlines the specific transfer pricing rules and practices that multinationals need to factor into the design and documentation of their transfer pricing systems in China
- Part Three discusses in more detail a number of particularly difficult and contentious transfer pricing issues, along with practical approaches that may be adopted by multinationals in order to deal with them properly
- Part Four discusses a number of real life examples and case studies to illustrate the concepts involved and some of the difficulties that may be encountered in practice.

Transfer pricing is one of the most difficult areas of international tax for multinationals to deal with, since every case depends on the particular facts and circumstances, and there is often no one right answer. Multinationals in China and elsewhere need to manage their global transfer pricing risks proactively, by seeking timely advice and assistance from experienced and specialist global transfer pricing advisors.

How to order

The price of this unique book is **EUR430** plus courier/postage and GST/VAT if applicable. Please refer to the Appendix to make an order.

For more information, please contact:

Douglas Fone
Sydney
O: +61 2 8249 8145
M: +61 410 678 605
E: d.fone@tpa-global.com

Steven Carey
Hong Kong
O: +852 2273 5978
M: +852 9516 2830
E: s.carey@tpa-global.com

Penelope Wong
Singapore
O: +65 6622 5344
M: +65 9857 0436
E: p.wong@tpa-global.com

Hui Ching Tan
Sydney
O: +61 2 8249 8145
M: +61 421 552 028
E: h.tan@tpa-global.com

About Us

Transfer Pricing Associates (TPA) is the leading independent provider of global transfer pricing services and part of the TPA Global group. The TPA Global group is an independent and specialist provider of expert transfer pricing, tax valuation and customs services, headquartered in Amsterdam and with our own offices and coverage in over 25 countries around the world.

TPA provides high quality transfer pricing advice and assistance to multinationals of all sizes, wherever they are located. For more details of our innovative services, please visit our website at

www.tpa-global.com

APPENDIX 1 – ORDER FORM

Company name	
Contact person	
Address for invoice	
Telephone	
Email	
Number of copies	
Issues of particular interest	

To order a copy, please complete the order form above and send to Douglas Fone at d.fone@tpa-global.com who will arrange for prompt fulfilment.