

News Flash

China Tax and Business Advisory

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We have over 170 dedicated transfer pricing professionals in China with wide knowledge in economics, accounting, law, industry expertise and project management. We strive to assist clients in developing tax efficient structures that help them increase compliance with transfer pricing regulatory requirements, prepare for rapid audit response, resolve disputes, and decrease adjustment exposure in future. To offer our clients with global support, we work closely with our global transfer pricing network of more than 100 partners and 1500 dedicated professionals in over 50 countries.

A Heads-up of Upcoming Transfer Pricing Documentation Requirements and Disclosure Forms

As mentioned in our earlier News Flashes, the State Administration of Taxation (“SAT”) in March this year drafted a set of administrative measures for contemporaneous transfer pricing documentation (the “TPD Requirements”). This set of TPD Requirements, to be included as part of the “Administrative Regulations on Special Tax Adjustments (Provisional)” (the “Administrative Regulation”), has been the subject of much discussion within the Chinese tax administration, and among scholars, professionals, and other selected parties.

The SAT have collected a large volume of useful feedback, especially on the TPD Requirements. Our intelligence indicates that, at the time of the release of this News Flash, the latest draft of the TPD Requirements, together with the other parts of the Administrative Regulation, are in the final stages of review at the SAT.

In this News Flash, we aim to share our insights on what potential changes are being proposed to the critical areas in the draft TPD Requirements.

(To note, the content below is prepared based on insights gathered from frequent dialogue with the SAT and regional / local tax authorities as well as our understanding of the key provisions in the latest draft of the TPD Requirements, as at the time of writing. We wish to highlight that, prior to the statutory approval, the draft is still subject to further debate and changes.)

Timing of Release

Given the SAT’s work progress on the TPD Requirements, we anticipate that the release of the TPD Requirements and the related policies will be in two stages:

- **First stage:** We expect that the related-party transactions disclosure forms (“Disclosure Forms”) will be released first, probably by the end of November 2008.
- **Second stage:** The SAT are still deliberating on the TPD Requirements. However, they are fully aware of the anxiety of the taxpayers in respect of the compliance burden as well as the time pressure to be imposed by these new requirements. So, the SAT are striving to finalise and release the TPD Requirements, as part of the Administrative Regulations, in final form by the end of December 2008.

Timing of Completion / Submission

The Disclosure Forms and the detailed completion / submission procedures have not been released yet. However, it is not unreasonable to expect that the Disclosure Forms will need to be completed by the taxpayer and submitted, together with their 2008 Annual Corporate Income Tax Return Package (“CIT Return Package”), to their in-charge local-level tax bureaus before the statutory due date in May 2009.

With respect to the deadline for completing and maintaining the contemporaneous transfer pricing documentation for 2008, taxpayers have been hoping for an extension of time so that they are able to study the TPD Requirements more thoroughly and then better prepare for this new requirement. We have conveyed such a request to the relevant SAT officials, and understand that they are inclined to address it. One of the options under consideration is to extend the completion date to 31 December 2009.

So far, the SAT have not indicated that they will make any changes to their original position that taxpayers will not be required to submit the contemporaneous transfer pricing documentation to the local-level tax bureaus until, and unless, so requested.

Threshold for TPD Requirements

Through our on-going communication with the SAT, we understand that they have gone through several revisions to the thresholds for the TPD Requirements since the release of the draft TPD Requirements in March 2008.

The latest expectation is that the thresholds will be increased as summarized in the table below. (Although the thresholds are still subject to possible changes before statutory approval, we anticipate that more taxpayers will be exempt from the TPD Requirements than under the March 2008 draft TPD Requirements.)

	<i>TPD Requirements in the March 08 draft</i>	<i>Latest expectation of SAT in November 08</i>
Full TPD	For entities with annual cross-border related party transactions of over RMB 100m	For entities with annual cross-border related party: <ul style="list-style-type: none"> ○ tangible goods transactions over a threshold of RMB 100m – 200m (final threshold amount to be released); ○ non-tangible goods transactions (e.g. services, royalty, etc.) over a threshold of RMB 30m – 50m (final threshold amount to be released).
Simplified TPD	For entities with annual cross-border related party transactions between RMB 20m and RMB 100m	Removed - No simplified version
Exempt from TPD Requirements	Entities within the covered period of an Advance Pricing Arrangement; or entities with annual cross-border related party transactions of less than RMB 20m	Below the aforementioned thresholds for full TPD

PwC Observations

- The 2008 CIT Return Package was released by the SAT in early November 2008 [under SAT Circular Guoshuifa (2008) 101]. However, it did not include the Disclosure Forms. The CIT Return Package, together with the Disclosure Forms, are important for the local-level tax bureaus to prepare for their set up for the filing administration work which is supposed to start after the 2008 year end. Doubtless, taxpayers are also keen to receive them for their preparation. So there is a strong push for the SAT to release the Disclosure Forms sooner rather than later. In addition, much of the information requested in the Disclosure Forms is factual and should be readily available in

the taxpayers' accounting systems and records. As such, the SAT should not have too much concern about publicizing the Disclosure Forms before the TPD Requirements.

- The 2008 CIT Return Package allows a company to make a post transaction transfer pricing adjustment as a "special tax adjustment." However, the relevant form of the CIT Return Package indicates that the taxpayer can only make "upward" transfer pricing adjustment to increase its taxable income. This could allow the taxpayer to have certain flexibility to manage their transfer pricing audit risks by voluntarily making upward transfer pricing adjustments. It remains to be seen, though, if the forthcoming TPD Requirements will offer further guidance on this; for example, guidance on how the company can reverse the upward adjustment impact in subsequent years.
- The delay in publishing the TPD Requirements (and the Administrative Regulations) is mainly caused by the fact that the SAT are very conscious about the increased compliance burden on taxpayers, as well as the additional workload on local-level tax bureaus. The SAT are trying to reduce the number of taxpayer-groups subject to the TPD Requirements by raising the thresholds; and to alleviate the time pressure by postponing the completion due date.
- Preparation of transfer pricing documentation can be a very time-consuming exercise. Although the deadline for completing and maintaining the contemporaneous transfer pricing documentation for 2008 may be extended to 31 December 2009, we continue to recommend that companies with significant amounts of related-party transactions begin preparing their 2008 transfer pricing documentation immediately. This could avoid the last-minute rush next year and better ensure that the information to be stated in the Disclosure Forms, which need to be submitted in May 2009, is consistent with the TP documentation. Moreover, this could support any upward post transaction transfer pricing adjustments that may have to be made in the CIT Return Package.
- For those groups with multiple entities in China, we recommend that the entity with oversight responsibility starts collecting key financial information for all group entities in China. Key financial information may include revenue, accounting profit / loss of each entity, the quantum and nature of international related party dealings, etc. We also suggest that the oversight entity begin gathering all relevant intercompany agreements and any group "master file" or other global / regional transfer pricing documentation. Such "profile" information that is readily available will facilitate the process of assessing the Chinese TPD Requirements for each entity, thereby enabling the China group to achieve efficiencies / synergies in the preparation of transfer pricing documentation for the Chinese entities.

It is extremely important that businesses stay tuned for upcoming announcements, as we anticipate that the SAT and/or the Chinese Ministry of Finance will release a large number of new tax policies (not only transfer pricing-related ones) in the coming months, both before and after the year end.

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

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