



New Transfer Pricing Regulation released as Guoshuifa [2009] No. 2: Disclosure and documentation obligations

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Tax notes



The long-awaited **Implementation Measures for Special Tax Adjustments (Trial)**, i.e., the new China transfer pricing (TP) regulation, was finally issued by the State Administration of Taxation (the SAT) on Jan 9, 2009, as Guoshuifa [2009] No. 2 (Circular 2).

Circular 2 has a retrospective effective date of 1 January 2008. With its release, the originally prevailing transfer pricing regulations, i.e., Guoshuifa [1998] No.59, Guoshuifa [2004] No. 143 and Guoshuifa [2004] No. 118, are annulled.

Circular 2 addresses almost all the aspects of transfer pricing. It contains 13 sections and 118 articles. It covers annual TP filing, contemporaneous documentation, TP audit and adjustment, advance pricing arrangement (APA), cost contribution arrangement (CCA), controlled foreign corporation (CFC), thin capitalisation, general anti tax avoidance and the TP penalty regime.

This issue of Tax notes focuses on **disclosure and documentation obligations** of the new regulation.

Grant Thornton is going to issue forthcoming issues of Tax notes that provide an in-depth introduction of this new regulation on:

- thin capitalisation
- transfer pricing audit in China
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- advance pricing arrangement
- CCA, CFC and general anti tax avoidance

Transfer pricing disclosure requirements

All taxpayers in China are required to submit the new **Annual Reporting Forms on Intercompany Transactions (Annual TP Filing Forms)** along with their annual tax filing forms. The new TP Filing Forms contains 9 forms:

- List of related parties
- Transaction summary
- Transaction: purchasing and sales
- Transaction: services
- Transaction: intangible assets
- Transaction: fixed assets
- Transaction: financing
- Annual reporting of overseas investments
- Annual reporting of foreign remittances

In addition to the standard disclosure, the Annual TP Filing Forms also require:

- a an indication of whether contemporaneous documentation is **in place**
- a an explanation on which **pricing method** has been adopted for related party transactions; and
- a a **comparison** between key¹ overseas related party transactions and third party transactions.

¹ Refer to any transactions whose amount is over 10% of the total transactions by value.

For entities with no intercompany transactions, a **zero declaration** might also be required based on the literal interpretation of Circular 2.

The filing deadline for the Annual TP Filing Forms is **May 31** of the subsequent year, the same as that for annual income tax filing.

Failure to fulfill the TP disclosure obligation is subject to a fine of RMB 2,000 to 10,000.

Contemporaneous documentation requirement

Exemption of documentation obligation

Contemporaneous documentation is now a mandatory obligation for taxpayers in China, based on the

China Income Tax Law. To alleviate the overall administrative burden of taxpayers, Circular 2 provides an exemption for non-significant intercompany transactions.

Exemption is granted when a taxpayer meets any of the following three criteria:

- a annual aggregated amount of buy-sell intercompany transactions below RMB 200 million; **AND** non-buy-sell intercompany transactions below RMB 40 million;
- a covered by an effective APA;
- a **pure** domestic intercompany transactions; **AND** is owned less than 50% by foreign investors.

It should be noted, for an import processor (Lai Liao Jia Gong), the export declared price will be used to calculate the intercompany buy-sell amount.

Contents of contemporaneous documentation:

Circular 2 specifies a detailed layout and contents of the contemporaneous documentation package. The requirements can be summarised as follows:

- a contemporaneous documentation:

- ◆ organisational structure
 - ◆ business and operation
 - ◆ related party transactions
 - ◆ selection and application of the transfer pricing method
 - ◆ comparable analysis
- a Functional and Risk Analysis Form;
- a Financial Analysis Form; and
- a a copy of intercompany agreement(s).

The requirements in Circular 2 are generally in line with the OECD requirements and international norm. The layout reflects the tax authorities' aim to have full knowledge of a taxpayers' background, operation, tax position, related party information, intercompany transactions and TP policy, etc. It should also be noted that comparable analysis is a recognised and required approach in determining whether the intercompany transactions are at arm's length.

Language, deadline and submission

The documentation should be prepared **in Chinese**. It should be kept in-house, but it must be submitted to the authorities within **20 days** upon request.

The deadline for completing contemporaneous documentation is May 31 of the subsequent year, with a special grace period granted for the year 2008, i.e., the deadline for 2008 documentation is extended to 31 December 2009.

Penalty/Benefit

Failure to prepare the documentation is subject to a fine of RMB 10,000 to 50,000, and may directly qualify a taxpayer as a TP audit target.

With a proper documentation study in place, by contrast, the taxpayer can get "penalty protection", i.e. it can avoid the additional 5% penalty on TP adjustment.

Implications for taxpayers

For Annual TP Filing Purpose

The Annual TP Filing Forms are likely to be used by the tax authorities as the starting point of selecting TP audit targets; thus they are worth due attention.

A taxpayer should assess:

- a whether it has a TP Policy **in place** and how to state it;
- a whether the existing TP policy is **in line with the actual results**; and
- a whether it has **TP exposure(s)** and how to defend against that.

For Contemporaneous Documentation Purposes

Enterprises should assess whether they have the documentation obligation based on Circular 2 and prepare it accordingly. In particular, if a group has a large number of subsidiaries in China, the documentation task can be even more time-consuming and burdensome. In this regard, group entities should synchronise their work to achieve synergy and ensure consistency.

How can Grant Thornton help you?

Grant Thornton has a specialised China transfer pricing team that is fully committed to your business needs. Our team consists of seasoned Transfer Pricing advisors. We aim to deliver the most efficient and flexible TP solutions that help you meet the new disclosure and documentation requirements.

We can assist you in the following aspects:

- ◆ **annual TP filing**: assist with the Annual TP Filing Forms;
- ◆ **contemporaneous documentation**: prepare contemporaneous documentation in accordance with

- Circular 2;
- **benchmarking**: provide comparable analysis which is an essential item in the documentation study;
 - **intercompany agreement**: assist with intercompany agreements that reflect your TP arrangement; and
 - **TP training**: provide general or tailor-made training courses to enhance your in-house TP capabilities.

Contact Information

Hong Kong

Gary James

Partner

T +852 2218 3137

E gary.james@gthk.com.hk

Shanghai

Rose Zhou

Partner

T +86 21 2322 0298

M +86 136 1186 2116

E rose.zhou@grantthornton.com.cn

Beijing

Wilfred Chiu

Partner

T +86 10 5908 2102

E wilfred.chiu@gthk.com.hk

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