



Dealing with Tax Authorities in China

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In dealing with tax officials at various levels of the administration, we notice an obvious trend that the general attitude of the officers, administrative processes and inquiry techniques are all getting more sophisticated, technical and evidence based. We welcome this trend and share below some observations based on our own experiences.

The Administrative Process

Let's go beyond regular compliance processes such as tax filings and per return payments, and take a look at those involving tax refunds, handling disagreements, treaty benefits and advance agreements.

Tax refund. Many still regard obtaining tax refund as difficult if not impractical. It is not surprising that one should anticipate a sceptical response when applying for a tax refund as the case officer may think that someone has done something wrong in the first instance. An application may even be rejected outright before the claim can be fully discussed. Thus, it is important to position an application carefully and present the facts and circumstances of a claim lucidly right from the outset. Demonstrate that honest mistakes were made, and support with clear evidence that such mistakes did lead to an overpayment of tax, which should be refunded, according to Article 51 of the Tax Administration Law upon compliance of the conditions as stated therein.

Handling disagreements. Making formal objections, applying for administrative reviews or appealing to the courts are still not commonplace. While such procedures are available, we observe that the most effective way of resolving differences is to deal with tax negotiations in the normal course of business. That is, keeping proper books and records, compiling a defence file where controversial issues are anticipated, and initiating discussion before a challenge is officially raised. It is important to note that no case officers, particularly on issues involving large amount of tax, can decide what treatment is to be adopted singlehandedly. Such cases often receive multilevel attention - local, municipal, provincial and even state level - thus, good arguments can prevail on their own merits. While we favour "resolving differences in the normal course of business" approach, formal proceedings may have to be invoked at times. For example, official hearing is a formal administrative proceeding taxpayers may initiate at which both taxpayers and tax officers can challenge assertions and evidence in the presence of more senior officials and taxpayer-appointed professionals. In such proceedings, it is the quality of preparation, evidence and advocacy that decide the outcome.

Treaty benefits. Tax treaties often contain beneficial provisions that taxpayers may capitalize on, such as reduction in tax rates on the repatriation of profits. There are anti-abuse measures as one may expect, particularly on whether or not the applicant of a treaty benefit is indeed a tax resident of the relevant jurisdiction. In our dealing with the tax authorities, we see that tax enquiries are often raised far beyond superficial facts, such as possession of a tax resident certificate of the other side. Enquiries can be so penetrating in the quest to identify beneficial owners. What is interesting is that tax authorities reviewing treaty benefit applications may eventually approve an application even though the applicant's residence presence in other side may firstly appear to be flimsy. Where commercial justifications are compelling, tax authorities can be convinced by following up an application with extensive information and evidence. Note that it may take several rounds of questions and responses over a time span of several months before consensus can be reached, although sometimes approvals can be more readily available with skilful representations. All in all, we do not see unusually long or overly unnecessary enquiries as the officers dealing with treaty benefit applications are well trained and better equipped with interpretation assistance from more senior officers.

Advance agreements. Removing major uncertainties is always on the top of the to-do list of tax directors. Unfortunately, China does not have advance ruling procedures, except for obtaining advance transfer pricing agreements. Typically, when faced with grave uncertainties, taxpayers may attempt informal procedures such as meeting with the tax officer in charge of reviewing their tax return position. Keeping in touch with front line tax officers is a good practice as long as it is merely for building a trusted working relationship. However, such meetings cannot be relied upon to remove the uncertainty around issues involving a large amount of tax. As mentioned above, the tax administration has a multilevel review mechanism as a matter of internal control. Any sympathetic view afforded by front line officers should be taken as no more than a gesture of goodwill. Taxpayers must rely upon rigorous technical assessments with robust evidence readied in their defence.

Inquiry Techniques

We feel disturbed at times at practices compiling transfer pricing documentation as cutting cookies, with a pricing level to match. Transfer pricing documentation is supposed to tell the story of how a business is run, functions and risks allocated in the context of a global operation, transactions characterized, comparables obtained, and the transfer prices set with the most appropriate methodologies. The story must uniquely and fairly represent the factual situation which is analyzed and reasoned to form a well supported outcome. This cannot be achieved using a cookie cutter approach.

We have heard tax officers expressing concerns over the quality of information and analyses provided by taxpayers in their contemporaneous documentation submissions. Such concerns would no doubt lead the officers not to take such papers seriously and thus to develop strategies in response when scrutinizing transfer pricing information in a normal tax review or when handling an application for an advance pricing agreement. In our dealings with the tax authorities, we see rounds and rounds of questions strategically raised not only to validate facts and assertions but also to derive their own perspectives. Only carefully prepared positions can allow for a high degree of transparency to remove the doubt and put tax negotiations on a firmer ground.

Concluding Remarks

Over the past 30 years, we have been able to witness the tax administration is developing at a surprisingly quick pace. Today, any taxpayer insisting on due process will have their cases heard.