

**CHINA SETS A STANDARD OF TRANSFER PRICING DOCUMENTATION – (PART 1/4)**

**Source: JFU**  
**2 December 2016**

This paper is a report on the new transfer pricing documentation requirements that the Chinese Tax Administration pronounced on 29 June 2016, under Public Notice [2016] 42.

**Outline**

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## Part 2

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**Annual filing obligations**

Firstly, all resident and nonresident enterprises whose tax base is determined according to accounting profits must file, along with their annual corporate income tax return, a report on transactions entered into during the year between related parties in prescribed forms ("Annual RPT Report").

**Related parties defined**

Related parties are defined as those with a more than 25% shareholding relationship, whether directly or indirectly. In determining if the extent of a shareholding relationship exceeds the 25% threshold, shares held by individuals who are spouse, parents, descendants and siblings are treated as part and parcel of the whole of one holding.

Where there is a shareholding relationship but the extent of which is less than the 25% threshold, the parties concerned can still be regarded as related where there exists one or more of the following relationships:

1. provision of credits or guarantees, and the amount of loans obtained from one party is over 50% of the registered capital of the other party or the over 10% of loans obtained by one party is guaranteed by the other party;
2. provision of intellectual property rights, and one party's operational capability is dependent on the provision of such rights by the other party;
3. provision of support by one party that in effect controls the other party's sales or procurement of goods and services;
4. provision of senior management, and over one-half of the senior management of one party is provided by the other party directly or indirectly through other parties.

Parties with substantive common interest can be considered related parties for transfer pricing purposes. The administrative notice does not elaborate on what may constitute a substantive common interest; any factor allowing one party to exert significant influence over the other is perhaps what the administration looks for.

### **Related party transactions defined**

There are 5 types of related party transactions:

1. The use or transfer of title to tangible assets, including goods, real properties and structures, means of transport, machinery, equipment, and implements.
2. The transfer of financial assets, including accounts, bills and others receivable, equity and loan investments and financial derivatives.
3. The use or transfer of title to intangible assets, including patents, knowhow, commercial secrets, trademarks, brands, customer lists, sales channels, franchises, licenses and copyrights.
4. Financial credits, including any short and long term loans, participation and access to funding pools of a group of companies, guarantees and interest bearing prepayments or deferrals.
5. Service transactions including surveys, sales and marketing, agencies, designs, consultation, administration, technical services, contract research and development, maintenance, legal services, financial management, auditing, employment, training, central procurement, etc.

### **Country-by-country report ("CbC Report")**

A CbC Report provides an overview of a multinational group, showing how total revenues made and taxes paid are distributed on a country by country basis, with a description of operations carried out in the respective countries.

A Chinese resident enterprise which is a member of a multinational group of companies is required to produce a CbC Report in the following circumstances:

1. The Chinese resident enterprise is the ultimate holding company of a multinational group and the total revenue as shown in its latest annual consolidated accounts is over RMB 5.5 billion.
2. The Chinese resident enterprise is specified by a multinational group as the entity responsible for submitting a CbC Report.

Condition (1) in effect applies only to Chinese based multinationals and condition (2) likely applies to Chinese based multinationals with foreign holding companies.

However, the public notice makes it clear that the tax administration is empowered to obtain a CbC or information therein from a member company of a foreign multinational group where there are international treaties or similar arrangements.

Furthermore, the tax administration pronounces that it may, in a tax investigation proceedings, require a member company of a foreign multinational group to produce a CbC Report, where the multinational has not submitted a CbC Report as required in other jurisdictions, or it has done so but the Chinese tax administration has not been able to obtain information contained therein.