

CHINA SETS A STANDARD OF TRANSFER PRICING DOCUMENTATION – (PART 2/4)

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Contemporaneous transfer pricing documentation

Corporate Income Tax Implementation Rules, Article 114 stipulates that companies are required to prepare contemporaneous documentation on related party transactions for each year of assessment. Public Notice [2016] 42 details a set of new requirements: contemporaneous transfer pricing documentation should contain three files: (1) a master file, (2) a local file and (3) a special factor file.

Master file

A company should have a master file available for inspection where it has related party transactions during a particular year, and either the multinational group to which it belongs has already compiled a master file for that year or the total amount of related party transaction it has entered into for that year is over RMB 1 billion.

The master file should contain the organization chart(s) of a multinational group, a narrative with 5 sections on different aspects of the group, and diagrams showing the supply chains of the group's principal products, as follows:

- 1) An organization chart(s), that depicts the multinational group's global structure showing shareholding relationships with the geographical location of all member entities including corporations, partnerships and permanent establishments.
- 2) A section on the business of the multinational group, that describes,
 - a) the business including significant profit contributing value drivers;
 - b) the supply chain of the top 5 products in terms of revenue, and that of products contributing to over 5% of the operating revenue of the group;
 - c) labor services, other than those deployed for research and development, with particulars about major suppliers and the level of competence of labor supplied, distribution of labor costs, and the policy on transfer prices of labor supplied;
 - d) a value analysis of individual related parties including major functions exercised and risks assumed, and assets employed;
 - e) any changes during the accounting year, due to the reorganization of business, realignment of industry structure, or the intra-group transfer of functions and risks;
 - f) any changes during the accounting year, due to changes in legal formats, debt restructuring, mergers and acquisitions or spinoffs by way of equities or assets.

- 3) A section on intangible assets, that describes,
 - a) the overall strategy for research, development and application of intangible assets, allocation of title to such assets, including the locations of R&D facilities, that of the management of R&D activities, as well as that of principal functions, risks, assets and staffing;
 - b) intangible assets or components thereof that have significant implications for the group's transfer pricing arrangements, showing respective owners of such intangible assets or components;
 - c) by way of a list, all principal agreements concerning intangible assets entered into among related parties, including cost sharing agreements, R&D services and licensing;
 - d) the transfer pricing policy concerning intra-group R&D activities and intangible assets;
 - e) any significant transfers that occurred during the accounting year, concerning ownership or right to use of intangible assets, with details about the parties and countries involved and prices of respective transfers.

- 4) A section on financing activities, that describes,
 - a) financing arrangements made intra-group among related parties, and that made with unrelated parties;
 - b) entities in the group that can exercise a central financing function, including details of the places at which the entities are incorporated, and management actually exercised;
 - c) the transfer pricing policy concerning intra-group financing arrangements.

- 5) A section about financial and tax positions, that provides,
 - a) the latest consolidated financial statements of the group;
 - b) a list showing entities of the group that have entered into unilateral or bilateral advance pricing agreements or other tax rulings, with a summary of such agreements or rulings.
 - c) the name and address of the entity of the group required to submit a CbC Report.