

**CHINA SETS A STANDARD OF TRANSFER PRICING DOCUMENTATION – (PART 3/4)**

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**Local file**

A company should prepare a local file where the transfer values of its related party transactions in a particular year meet one of the four criteria: (1) over RMB 200 million in transfers of tangible assets, (2) RMB 100 million, in financial assets, (3) RMB 100 million, in intangible assets, and (4) RMB 40 million, in other transfers such as in the provision of services.

The local file is required to cover the following aspects of the company:

1. An overview of the company, this section should provide:
  - a. an organization chart, showing each business and functional unit, scope of responsibilities and staffing;
  - b. a management structure chart, showing each level of management, to whom the management is accountable, principal places at which the management and accountability are exercised;
  - c. a narrative of the business including a brief history of the industry, industry policy, legal and economic constraints faced by the company and the industry ;
  - d. a narrative of the strategy employed, including the business processes, mode of operation and value contributed by each of department and functional unit of the company;
  - e. financial data of the company's business units and products, showing respective revenues, costs, expenses, and profits;
  - f. an impact analysis of any reorganization or transfer of intangibles that involves and may affect the company.
  
2. Relation with related parties, this section should provide:
  - a. Particulars of the related parties including parties holding equities of the company whether directly or indirectly, and parties having entered into transactions with the company, showing their respective names, legal representatives, compositions of senior management, registered addresses, places of business, as well as names, nationalities and places of residence where the related parties are individuals;
  - b. Income tax information of the related parties, showing their applicable charges, rates and incentives available;
  - c. Particulars of any changes in related party relations during the accounting year.

3. Related party transactions, this section should provide:
  - a. general information about the related party transactions, including
    - i. copies of the contracts and details of how they were actually carried out, subjects of exchange, types of transactions, parties, time and dates, amounts, currencies, terms and conditions, formats of trade, variations of such from transactions with unrelated parties;
    - ii. transaction flows, including communications, logistics and funds, as well as variations of such from transactions with unrelated parties;
    - iii. a narrative of functions and risks undertaken and assets employed by respective parties to the transactions;
    - iv. implications of special factors for price determination, such as intangibles involved, cost savings, market or similar location specific factor premiums, which would require an analysis of a location having regard to labor cost, environmental cost, market size, degree of market competition, purchasing power of consumers, available substitutes for the subject goods and services, government controls, etc.;
    - v. transaction data including parties to the transactions, amounts of respective types of related party transactions,
  - b. (an intra-group) value chain analysis, by looking at,
    - i. the intra-group flows arising from operating cycles, logistics and fund movements in the various stages of the business cycle of the subject goods, services or value propositions including product design and development, production, marketing, sales, deliveries, settlement, consumption, after sale services, and recycling, as well as all the parties involved in such flows;
    - ii. the latest financial statements of the parties involved;
    - iii. the contribution of location specific factors in the creation of values by the company, together with quantification and attribution;
    - iv. the principles governing how the profit of the group is attributed along its global value chain and the actual outcome of attribution.
  - c. investment made by the company, including
    - i. basic information about where the projects are situated, amounts, principal activities and strategic planning;
    - ii. general information about the shareholding of the investment, organization structure, how members of the senior management are engaged, their scope of responsibilities and accountability;
    - iii. data of the investment projects, including that of operations.
  - d. equity transfers among related parties, including
    - i. general information about the transfers, such as background, parties, time and dates, consideration, how the transfers are priced, and any other factors that may have bearing on the transfers;
    - ii. information about the objects of the transfers, such as where the objects are situated, how and when the transferors acquired such objects, at what costs, and gains thus arising;
    - iii. due diligence and valuation reports in connection with the transfers

- e. labor services between related parties, including
    - i. general information, such as service providers and recipients, details of services provided, attributes, how the services are priced and paid, how the services are carried out and the resultant benefits enjoyed by respective parties;
    - ii. how data of the service costs and overheads are collected, cost centres identified, amounts determined and distributed, showing the resultant allocations with workings;
    - iii. variations of pricing methods and resultant charges to unrelated parties on the provision of similar services.
  - f. advance pricing agreements with or tax rulings obtained from any other tax administration, where such agreements or rulings are directly relevant to the related party transactions of the company.
4. Benchmarking, comparability study, this section should provide:
- a. considerations applied including characteristics of the assets and services being the objects of the related party transactions, functions, risks and assets undertaken by the parties to the transactions, terms and conditions, economic environment, business strategies employed, etc;
  - b. comparable companies' functions, risks and assets, etc;
  - c. the process of obtaining the comparables, data sources, selection criteria and the reasons for choosing particular companies as comparables;
  - d. transaction data and financial information of the transactions or companies chosen as internal or external uncontrolled comparables;
  - e. comparability adjustments, with reasons therefor.
5. Evaluation on applicability of transfer pricing methods, this section should provide
- a. choice of tested parties, and reasons therefor;
  - b. choice of transfer pricing methods, and reasons therefor, with a statement of contributions made by the company to the group's total or residual profits;
  - c. assumptions and assessments made in determining the comparable uncontrolled prices or profits;
  - d. determination of comparable uncontrolled prices or profits, based on the transfer pricing methods chosen and the results of the comparability studies;
  - e. other information that may be used in support of the transfer pricing methods chosen;
  - f. analyses and conclusions on whether or not pricing of the related party transactions was in line with the arm's length principle.