

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

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Special factor files

Special factor files should be prepared in the following circumstances:

1. where a company has a cost sharing agreement in force, written or unwritten;
2. where a company has funding arrangements with related parties and a debt equity ratio above the thin capitalization threshold that requires an explanation if the arm's length principle is violated.

Special factor file on cost sharing agreements, should contain:

1. a copy of the cost sharing agreement;
2. other agreements entered into by parties to the cost sharing agreement, in connection with the enforcement of the agreement;
3. a section about other parties, not being a party to the agreement, the payment for the use of the resultant benefits of the agreement and how such payments are shared among parties to the agreement;
4. a section about new entries or exits of parties to the agreement during the year, their names, locations, how they are related to the group, and the exit or entry considerations made or paid by respective parties;
5. Changes in or termination of the agreement, reasons therefor, and disposal or distribution of benefits derived from the agreement;
6. the aggregate amount of costs incurred during the year, with an analysis thereof;
7. cost allocations with respect to all participating parties, including amounts paid or received by respective parties, as well as forms of such compensations or payments;
8. benefits expected to arise from the agreement during the year, actual benefits resulted and corresponding adjustments;
9. formulas and parameters used for computing the expected benefits, and reasons for any modifications.

Special factor file on thin capitalization, should contain:

1. an analysis of the company's ability to borrow and repay;
2. an analysis of the group's ability to borrow and its loan structure;
3. the company's registered capital and changes in equities;

4. the nature of borrowings from related parties, purposes and prevailing conditions of the market at the time of such borrowings;
5. amounts, currencies, interest rates, terms and conditions of loan capital from related parties;
6. a view on whether or not unrelated parties would be willing to accept a loan made on similar conditions;
7. securities that the company provides for obtaining the loans;
8. information about guarantors in the loan transactions, and conditions for providing the guarantees;
9. interest rates and conditions for obtaining similar borrowings at times when the borrowings were made;
10. conditions for conversion where the borrowings are convertible to equities;
11. other information in support of the proposition that the borrowings are obtained on an arm's length basis.

Exceptions, timing, and miscellaneous provisions

1. Companies are exempt from compiling CbC Reports or disclosing certain information in a CbC Report otherwise required where national security is involved.
2. Companies are exempt from preparing contemporaneous documentation,
 - a. in respect of matters already covered by an advance pricing agreement, and the transaction amounts of such matters are excluded from the amount of related party transactions when filing the Annual RPT Report;
 - b. where all related party transactions were entered into with domestic parties;
3. Master files should be completed within 12 months of the accounting year end of the group;
4. Local files and special factor files should be completed before 30th of June in the year subsequent to that in which the related party transactions occurred;
5. Contemporaneous documentation should be
 - a. made available within 30 days to the tax authorities upon request , or 30 days after being released from a condition beyond reasonable control, that prevents the company from submitting the documentation as required;
 - b. provided in Chinese with notes on the sources of information quoted;
 - c. duly signed and sealed by legal representatives or persons they authorize;
 - d. retained by companies continuing in existence after mergers or acquisitions or spin offs;
 - e. retained for 10 years.
6. Where back tax has to be paid as a result of special tax adjustments, companies that comply with filing Annual RPT Reports, and contemporaneous documentation will be entitled to pay surcharges according to the BOC prime rates corresponding to periods of tax adjustments.