



# Transfer Pricing **Country Summary**

## **China**

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## 1. Introduction

China is not a member state of the OECD, yet the OECD Guidelines influenced the TP legislative framework of China. China has formal transfer pricing documentation requirements to submit the master file, local file and country-by-country reporting in accordance with OECD Guidelines.

## 2. Laws & Regulations

### a) References to OECD/EU/Local Rules

The transfer pricing legislation in China is mainly contained in the following documents issued by the China State Administration of Taxation:

- Implementation Measures of Special Tax Adjustments, Trial Implementation (Guoshuifa [2009] No. 02).
- Public Notice on Matters Regarding Refining the Filing of Related Party Transactions and Administration of Contemporaneous Transfer Pricing Documentation [2016] No. 42 ("Notice 42").
- Public Notice on Issues Concerning Improving the Administration of Advance Pricing Arrangements, SAT Bulletin [2016] No. 64. ("Notice "64").
- Public Notice on Supervisory Measures for Special Tax Investigation Adjustments and Mutual Agreement Procedures [2017] No. 6 ("Notice "6").
- Public Notice of the State Administration of Taxation on Clarifying Country-by-Country Reporting Related Issues [2017] No. 46 ("Notice 46").

### b) Definition of Related Party

Any of the following relationships of an enterprise (one party) with other enterprises, organisations or individuals (the other party) shall constitute a "related party relationship" as stipulated in Notice 42:

1. One party directly or indirectly owns 25% or more shares of the other party; or a common third party directly or indirectly owns 25% or more of shares of both parties.

a. Where one party indirectly holds the other party's shares through an intermediate party, so long as it owns 25% or more shares of the intermediate party, the percentage of the other party's shares held by it is equal to the percentage of the other party's shares held by the intermediate party.

b. Where two or more natural persons, who are spouses, related by lineal consanguinity, siblings, or in other custodianship/family maintenance relationships, hold the shares of a same enterprise, the percentage of shares held by them shall be aggregated in the calculation to determine related party relationship.

2. One party owns shares of the other party, or a common third party owns shares of both parties, even though the percentage of shares held in either situation is less than the percentage as specified in item 1, the total debt between both parties accounts for 50% or more of either party's total paid-in capital, or 10% or more of one party's total debt is guaranteed by the other party (except for loans or guarantees from or between independent financial institutions).

3. One party owns shares of the other party, or a common third party owns shares of both parties, even though the percentage of shares held in either situation is less than the percentage as specified in item 1, the business operations of one party depend on the proprietary rights, such as patents, non-patented technological know-how, trademarks, copyrights, etc., provided by the other

4. One party owns shares of the other party, or a common third party owns shares of both parties, even though the percentage of shares held in either situation is less than the percentage as specified in item 1, the business activities, such as purchases, sales, receipt of services, provision of services, etc., of one party are controlled

by the other party. a. The aforementioned “controlled” refers to the case where one party has the right to make decisions on the other party’s financial and operational policies and can therefore derive benefits from the other party’s operations.

5. More than half of the directors or senior management (including secretaries of the board of directors of listed companies, managers, deputy managers, financial controllers and other personnel specified in the company’s articles of association) of one party are appointed or assigned by the other party, or simultaneously serve as directors or senior management of the other party; or more than half of the directors or senior management of both parties are appointed or assigned by a common third party.

6. Two natural persons who are spouses, related by lineal consanguinity, siblings, or in other custodianship/family maintenance relationships have one of the relationships as specified in items 1 to 5 with one party and the other party respectively.

7. Two parties substantially have common interests in other ways.

Except for item 2, the aforementioned related party relationship should be recognized for the period during which it exists, in the event it changes during the filing year.

Any shareholding by the State or association through assignment of directors or senior management by the state-owned assets management authorities, and therefore qualified as the relationship as specified in Items 1 to 5, will not be deemed to constitute a “related party relationship”.

### c) Nature of Transfer Pricing Documentation

The regulatory framework surrounding transfer pricing has been greatly influenced by the OECD Guidelines, although not expressly mentioned.

China also contributed to the development of the UN TP Practice Manual and outlined its transfer pricing practices in the recently published UN TP Practice Manual 2021.

### d) Tax Havens & Blacklists

Corporate Income Tax Law and the Implementation of Regulations of the Corporate Income Tax Law have identified countries and regions whose actual tax burden is significantly lower than 12.5% as tax havens. It is clear that enterprises controlled by resident enterprises and Chinese residents which are located in tax havens are eligible for the tax avoidance regime. In Hong Kong’s tax system, the tax target is the portion of the residents enterprise that is not distributed or reduced in profit due to reasonable business needs.

### e) Advance Pricing Agreement (APA)

The requirements for APA application are stated in Notice 64. APA is available for unilateral, bilateral and multilateral type. The process of an APA includes the following stages: Pre-file meetings, Intention discussion, Analysis and Assessment, Formal application, Negotiation and conclusion, Execution Monitoring.

Companies should pay special attention to the requirement on value chain analysis and location specific advantages for application of APA in China.

For company has related party transaction in excess of RMB 40 million for each of the past 3 years pay apply for an APA.

Where the related party transactions in prior years are the same as or similar to those covered by the APA, per the company’s request, the tax administration(s) may apply the agreed pricing methodologies and

calculation process specified in the APA to such related party transactions. The maximum rollback period is 10 years.

#### f) Audit Practice

A company can be audited in terms of transfer pricing if:

- It has a large number of intercompany transactions or has intercompany transaction over multiple years.
- It incurs consistent profit losses, either marginal or fluctuating.
- It has lower profit levels compared to industry average figures.
- The profit level does not match with its functional profile.
- It has transactions with affiliates registered in tax havens.
- It failed to prepare or submit Annual Related Party Transactions Reporting Forms or the transfer pricing documentation.
- The company has thin capitalization issues (Debt-to-equity ratio exceeding the stipulated threshold)
- The company is Controlled by country with less than 12.5% tax rate.
- The company's transfer pricing arrangement does not have business purpose.
- The company's transfer pricing arrangement does not comply with the arm's length principle.

Additionally, the State Administration of Taxation (SAT) has intensified industry-focused or group enterprise-oriented national joint investigations, targeting industries with potentially high transfer pricing risk profiles, although by no means have such investigations been limited to these industries.

### 3. Transfer Pricing Documentation

#### a) Level of Documentation

##### Master file

Master file shall mainly include the following information:

1. Organizational structure
2. Description of the MNE's business;
3. Intangibles
4. Financial actives
5. Financial and tax positions.

##### Local file

Local file shall mainly include the following information:

1. Overview of the enterprise
2. Related party relationship
3. Related party transactions
  - a. Overview of related party transactions
  - b. Value chain analysis
  - c. Outbound investment
  - d. Related party equity transfer
  - e. Related party services
4. Comparability analysis
5. Selection and application of transfer pricing method

##### Special issue file

Special issue file on CSAs shall include the following information:

1. A copy of the CSA.
2. Other agreements reached by the CSA participants to facilitate the implementation of the CSA.
3. Use of outcomes of the CSA by non-participants, amount paid, form of payment, and the allocation method.
4. Information on any participants entering in or withdrawing from the CSAs.
5. Description of amendments to or termination of the CSA
6. Total cost from the CSA and its breakdown during the fiscal year concerned.
7. Cost sharing among the CSA participants during the fiscal year concerned, including the amount and form of payment.
8. A comparison of expected benefits and actual benefits from the CSA, and the balancing adjustments made.
9. Calculation of expected benefits.

Special issue file on thin capitalization shall include the following information:

1. Analysis of the enterprise's solvency and borrowing ability.
2. Analysis of the borrowing ability and financing structure of the group to which the enterprise belong.
3. A description of changes in equity investment of the enterprise, such as changes in registered capital, etc.
4. Nature and purposes of the related party debt investment, and the market conditions at the time the debt investment was obtained.
5. Currency, amount, interest rate, term and financing terms of the related party debt investment.
6. Whether an unrelated party is capable and willing to accept the aforementioned financing terms, amount and interest rate.
7. Collaterals provided by the enterprise in order to obtain the debt investment and the relevant terms.
8. Details of the guarantor and the terms of guarantee.
9. Interest rates and financing terms of similar loans occurring during the same period of time.
10. Terms of conversion of convertible bonds.
11. Other information that can demonstrate the enterprise's conformity with the arm's length principle.

#### Country-by-country report

Country-by-country report has the same format and required information as the BEPS Action 13 and the OECD Transfer Pricing Guidelines 2017. Country-by-country report is included in the Annual Related Party Transaction Reporting Form.

### **b) Industry Analysis**

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

### **c) Company Analysis**

A description of the management structure of the local entity, a local organisation chart and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

### **d) Functional Analysis**

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

#### e) Choice of Transfer Pricing Method

In accordance with Notice 6, the following transfer pricing method can be accepted by tax authorities:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.
- Transactional net margin method.
- Profit split method.
- Other methods consistent with the arm's length principle.

#### f) Economic Analysis – Benchmark Study

In China the tax authorities are inclined to accept local comparables. Where local comparables are not at hand, the tax authorities generally also accept regional comparables. In the case of foreign comparables, the tax authorities might undertake adjustments for LSA's.

The EIT Law and the EIT Regulation do not prescribe that the comparables shall be secret or not. However, in practice, most cases may use the public data. Special Tax Adjustment and MAP Notice [2017] No. 6 gives priority to public information.

In some cases, the tax authorities may use "secret" comparables in their audits. Apparently, some local tax authorities have established their own databases containing information of companies from various industries and often use such information in making transfer pricing adjustments. The use of secret comparables has caused significant problems for taxpayers in China since taxpayers are not able to ascertain the comparability of the data. The SAT recognizes the problems in relation to the use of secret comparables and encourages the local tax authorities to use the public data. Nowadays, it is rare to use secret comparables.

#### g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

#### h) Financial Statements

Since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept, parties need to also make sure their conduct is in line with what is reported in their accounts.

#### i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. These information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
<b>Corporate Income Tax</b>	Prepare	Local GAAP	May, 31 <sup>st</sup>	No	No	Yes
<b>Master File</b>	Prepare	OECD Guidelines	December, 31 <sup>st</sup>	No	Yes	Yes
<b>Local File</b>	Prepare	OECD Guidelines	June 30 <sup>th</sup>	No	Yes	Yes
<b>CbCR</b>	File	OECD Guidelines	May, 31 <sup>st</sup>	No	Yes	Yes
<b>Local Forms (see below)</b>	See below	GII Forms	May, 31 <sup>st</sup>	No	Yes	Yes
<b>Annual Accounts</b>	Prepare	Chinese GAAP	April, 30 <sup>th</sup>	No	No	Yes
<b>Segmented P&amp;L</b>	Prepare	Excel/Other	May, 31 <sup>st</sup>	No	No	Yes
* China has signed the MCAA agreement for the filing of CBCR.						
* China does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.						

Contemporaneous documentation may include master file, local file and special issue file.

#### Master file

Any company that meets one of the following criteria shall prepare a master file:

1. The enterprise that has conducted cross-border related party transactions during the tax year concerned, and the MNE group to which the ultimate holding company that consolidates the enterprise belongs, has prepared a master file.
2. The annual total amount of the enterprise's related party transactions exceeds 1 billion RMB.

Master file shall be completed within 12 months of the fiscal year end of the ultimate holding company of the enterprise group.

#### Local file

Any company that meets one of the following criteria during the fiscal year shall prepare a local file:

1. The annual related party transfer of ownership of tangible assets exceeds 200 million RMB (for toll manufacturing transaction, the amount is calculated using the import/export customs declaration prices).
2. The annual related party transfer of financial assets exceeds 100 million RMB.
3. The annual related party transfer of ownership of intangibles exceeds 100 million RMB.
4. The annual total amount of other related party transactions exceeds 40 million RMB.



The Local file shall be completed by 30 June of the year following the year during which the related party transactions occur.

#### Special issue file

A company that enters into or implements a cost sharing agreement ("CSA") shall prepare a special issue file for the CSA.

A company with a related party debt-to-equity ratio exceeding the threshold shall prepare a special issue file on thin capitalisation to demonstrate its conformity with the arm's length principle.

The special issue file shall be completed by 30 June of the year following the year during which the related party transactions occur.

#### Country-by-Country report

Company is the ultimate holding company of a multinational enterprise's group having total consolidated group revenue of more than 5.5 billion RMB during the fiscal year is required to submit country-by-country report.

It should be noted that, Country-by-country report is included in the Annual Related Party Transaction Reporting Form, which is required to be submitted at the annual tax return.

#### Local forms

A tax resident enterprise that pays enterprise income tax according to its financial records and a non-tax resident enterprise that has an establishment or a place of business in China and settles corporate income tax based on its actual accounts shall, at the time of submitting its annual enterprise income tax return, report related-party transactions based on its dealings with related parties and file the People's Republic of China Enterprise Annual Reporting Forms for Related-Party Transactions (2016 version).

The new forms (2016 version) introduced under Reporting and Documentation [Notice \[2016\] No. 42](#) include 22 related-party transaction forms. The new forms replace the old forms under Guo Shui Fa [2008] Circular No. 114. The new forms include:

- The new forms (2016 version) introduced under Reporting and Documentation Notice [2016] No. 42 include 22 related-party transaction forms. The new forms replace the old forms under Guo Shui Fa [2008] Circular No. 114. The new forms include:
- corporate information form (G000000)
- annual summary form on related-party transactions (G100000)
- related-party relationship form (G101000)
- transfers of ownership in tangible assets form (G102000)
- transfers of ownership in intangible assets form (G103000)
- transfers of right to use tangible assets form (G104000)
- transfers of right to use intangible assets form (G105000)
- financial assets transaction form (G106000)
- financing form (G107000)
- related-party services form (G108000)
- equity investment form (G109000)
- CSA form (G110000)

- overseas payment form (G111000)
- overseas related-party form (G112000)
- financial analysis form for related-party transactions (unconsolidated) (G113010)
- financial analysis form for related-party transactions (consolidated) (G113020)
- form on the global distribution of revenue, tax, and operating activities (G114010)
- form on the global distribution of revenue, tax, and operating activities (English) (G114011)
- list of entities within the multinational group (G114020)
- list of entities within the multinational group (English) (G114021)
- additional information form (G114030)
- additional information form (English) (G114031)

The Enterprise Annual Reporting Forms for Related-Party Transactions (2016 version) shall be declared before 31 May each year. Enterprises that encounter actual difficulties in filing the Annual Reporting Forms for Related-Party Transactions on time, as required, may apply for an extension of time in accordance with relevant provisions of the Tax Collection and Administration Law and its implementation regulations.

#### j) Mandatory Language

Contemporaneous documentation shall be prepared in Chinese.

#### k) Notification Requirement

China does not have a CbC notification requirement.

#### l) Record Keeping

Contemporaneous documentation shall be kept for 10 years from the completion date of the preparation as required by the tax administrations.

#### m) Penalties and Interest Charges

If a company fails to prepare or submit Annual Related Party Transactions Reporting Forms or the transfer pricing documentation, delivers false or deceptive information and materials, the tax authority may impose a penalty of between RMB 2,000 – RMB 10,000.

Non-compliance may also trigger special transfer pricing investigation of taxable income by the tax authorities and may result with special tax adjustments. The tax authority may charge an additional 5% interest on top of the lending rate published by the Bank of China.

In addition, the penalty interest charge is also applied on any intercompany transaction amount that is greater than the threshold for document preparation.