

## When will the BEPS Action 13 transfer pricing requirements be implemented?

The State Administration of Taxation ("SAT") released a discussion draft entitled "Implementation Measures of Special Tax Adjustments" (known as "Circular 2") for public consultation on 17 September 2015. The draft requires multinational corporations ("MNCs") to submit the new three-tier documentation: a master file, a local file, and Country-by-Country Reports ("CbCR"), if the reporting threshold is met. The new Circular 2 was expected to become effective on 1 January 2016. However, the SAT has not released the final version of the circular yet. It seems that the SAT is unlikely to enforce the new transfer pricing requirements on MNCs' 2015 transfer pricing documentation filings. Otherwise, the notice period for MNCs to respond and meet the due date in June 2016 would be too short. Since the government of China has approved the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and has agreed to its implementation beginning 1 January 2017, it is more realistic for the SAT to implement the new requirements in relation to 2016 transfer pricing documentation filings in 2017 when the information exchange mechanism becomes available.

### What information other than the three-tier documentation will be required to be reported?

Besides the three-tier documentation, the draft Circular 2 requires companies engaging in intercompany services or cost sharing agreements, as well as those exceeding a thin capitalization threshold, to submit a so-called "special documentation" file which has no transaction threshold. The special documentation file shall include information such as the relevant agreements, descriptions of the transactions, values and payment terms, etc. Notably, for special documentation concerning intercompany services, the relevant agreements, service details (including scope of services, values, forms of payment, beneficial status, relevant costs, pricing policies, and supporting reasons), a comparison to unrelated party service transactions, and a description of group transfer pricing policies on intercompany services will be required to be provided by taxpayers to the tax authorities. The requirement for Chinese taxpayers engaging in related party service transactions to prepare special documentation filings demonstrates the SAT's focus on service transactions. This follows the trend of developments in the last couple of years.

### How does the SAT approach the use of the BEPS transfer pricing guidance?

It is observed that most of the transfer pricing documentation requirements set out in the draft Circular 2 by the SAT are similar to the recommendations contained in BEPS Action 13 - Transfer Pricing Documentation, released by the OECD on 5 October 2015. However, there are extra requirements added by the SAT, such as the requirement to include a value chain analysis as part of the transfer pricing documentation. Taxpayers must provide an overview of the attribution of MNC global profits to the different jurisdictions within the value chain in its local file to the tax authority, including how profits are allocated across the value chain and the actual amounts of profits earned by each value chain participant. The SAT believes that it

is important to understand the value creation of taxpayers from the group level to ensure that the profits are fairly allocated to the Chinese taxpayers. In fact, a value chain analysis has usually been required by the SAT in transfer pricing audit cases even prior to the new requirements.