

Challenging times come after Base Erosion and Profit Shifting actions

With the latest development in the international landscape on the implementation of the BEPS recommendations, China has been closely following and localizing the BEPS action plans by incorporating them in its tax legislative provisions. Within the space of one year, China's State Administration of Tax (SAT) has issued a series of transfer pricing (TP) and anti-avoidance regulations. With specific scope of application, each of the following regulations revises and further elaborates the general TP administration and special tax adjustment guideline set out in a circular issued in 2009 (Guo Shui Fa [2009] No.2 (Circular 2)).

→ On 29 June 2016, SAT Announcement [2016] No. 42 (Circular 42) was issued, focusing on related-party transaction reporting and TP documentation;

→ On 11 October 2016, SAT Announcement [2016] No. 64 (Circular 64) was issued for the administration of advanced pricing arrangements (APA);

→ On 17 March 2017, SAT Announcement [2017] No.6 (Circular 6) was issued detailing the special tax investigation and adjustment, and mutual agreement procedure.

In general, through these regulations, it can be seen that the battle against cross-border tax avoidance has been intensified. Higher and more stringent requirements on TP compliance are made evident by the expanded scope of information disclosure. For example, the increased reporting of related-party transactions from 9 forms to 22 forms including country-by-country (CbC) report forms, and a three-tier structure of TP documentations comprising master file, local file and special file.

The focus of TP compliance administration has also evolved from the emphasis on investigation to proactive risk management. Aside from the requirement to submit TP documentation, enterprises are also encouraged to voluntarily evaluate the TP risks and make their own adjustments. Meanwhile, dynamic monitoring of multi-national corporations' (MNCs) profit levels has also become a focus. Companies that are identified as high-risk of compliance failure may attract TP investigation, and companies whose TP has been adjusted may also be subject to active follow-up management.

In addition, the inclusion of value chain analysis under a group-wide perspective for local enterprises, the consideration of location specific factors' influence of profit contribution, the DEMPEP (development, enhancement, maintenance, protection, exploitation and promotion) evaluation methodology on intangible assets, are also introduced.

The flurry of the TP regulations issued over a ten-month period demonstrates China's strong adherence to the BEPS action plans. While TP compliance requirements are now more specific and clear, they also pose greater challenges on MNCs' overseas and local entities.

Companies are advised to comprehensively consider the international and local regulatory requirements to better plan the TP policy beforehand; the extent of information disclosure should also be carefully assessed for reasonable and accurate presentation to avoid

disadvantageous treatments.