

Tax Alert

News and views from
Transfer Pricing

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China Transfer Pricing: Related Party Transaction Annual Reporting Forms

Set of Nine (9) Forms Required with Annual Tax Filing

On 16th December 2008, the State Administration of Taxation (SAT) published [Guoshuifa \[2008\] No. 114](#). These are the related party transaction forms required of taxpayers as a part of the annual corporate income tax (CIT) filing due on or before 31st May. The forms are in accord with Article 43 of the People's Republic of China Corporate Income Tax Law (CIT Law; Zhuxiling 63 enacted by the National Peoples' Congress 16th March 2007). This article states: *Where Enterprises submit to the tax authority the annual enterprise income tax return, they shall submit, in respect of their business transactions with related parties, forms for the annual reporting of related party transactions, along with the annual corporate income tax return.*

In addition to a cover sheet identifying the taxpayer by Name of Taxpayer (Company Seal), taxpayer identification number, legal representative, contact number and filing date, the reporting forms include:

1. **Related Parties:** This is a very straightforward information form regarding the name of the related party, foreign jurisdiction taxpayer identification number, country of incorporation, address, legal representative, and type of related party relationship. Eight [8] different types are listed: share ownership, debt, shared management, shared directors, business operations dependency, captive goods and services flows, and other based upon effective control.
2. **Related Party Transactions:** This form summarizes forms three (3) through seven (7). Here also the taxpayer must indicate the readiness of contemporaneous documentation or whether it is exempt. In addition the form asks the taxpayer to acknowledge whether it is a participant in a cost sharing agreement. Further, the taxpayer is asked to quantify the amount in RMB of related party transactions of the following categories:
 - ▶ Sale of materials (products)
 - ▶ Purchase of products (materials)
 - ▶ Income from the provision of services
 - ▶ Expenses for the receipt of services
 - ▶ Transfer in of intangibles
 - ▶ Transfer out of intangibles
 - ▶ Transfer in of fixed assets
 - ▶ Transfer out of fixed assets
 - ▶ Interest income from lending
 - ▶ Interest expense from borrowing
 - ▶ Others

3. Sales and Purchases: This form requires the taxpayer to quantify in aggregate both total sales and purchase transactions and to identify whether or not it is a toll processor. The transaction quantifications include both related and unrelated party transactions. The taxpayer must then specify the overseas party - related or unrelated - to which its export sales or overseas purchases account for more than 10% of each respective total category. Further, the taxpayer is required to declare the transfer pricing method applied to related party transactions. The methods are comparable uncontrolled price, resale price, cost plus, transactional net margin, profit split, and other.
4. Services: Here the taxpayer must quantify the services transactions where it is a service provider and/or service recipient. As with form 3, both related and unrelated party transactions must be quantified and where those transactions are more than 10% of total services income, the overseas party must be specified. The transfer pricing method applied to related party transactions (same options as with form 3) must also be specified.
5. Transfer of Intangible Assets: On this form the taxpayer must quantify transactions related to the transfer into and/or out of the taxpayer's books for use rights (land use, patent, non-patent technology, trademark, copyright, and/or other) or ownership (patent, non-patent technology, trademark, copyright, and/or other) of intangibles. Payments to related and unrelated parties must be quantified although the party itself need not be identified. Both overseas and domestic intangible asset transactions must be listed. Transfers in result in payments made by the taxpayer to related or unrelated parties; transfers out result in income to the taxpayer from related or unrelated parties.
6. Transfer of Fixed Assets: Again, the taxpayer must quantify fixed assets transactions related to the transfer into and/or out of the taxpayer's books for use rights (plants, building; planes, trains, ships, machines, devices and other manufacturing equipment; apparatus, tools, and furniture related to business operations; other transportations except planes trains and ships; electronic devices; and others). Payments to related and unrelated parties must be quantified although the party itself need not be identified. Both overseas and domestic fixed asset transactions must be listed. Transfers in result in payments made by the taxpayer to related or unrelated parties; transfers out result in income to the taxpayer from related or unrelated parties.
7. Financing: At the top of the form the taxpayer must declare a related party debt-to-equity ratio. In the form itself, it must disclose loan characteristics, whether lender or borrower, for both overseas and domestic related parties. The characteristics include the financed amount, interest rate, start/end date, interest expense/income, name of guarantor, guarantee fee, and guarantee fee percentage.
8. Outbound Investment: PRC Resident Enterprises which conduct outbound investment are required to complete this form. There are nine (9) components to this form:
- ▶ Basic information of the Investing Enterprise
 - ▶ Basic information of the Invested Enterprise
 - ▶ Whether the Invested Foreign Enterprise is located in a non-low tax country listed by the SAT
 - ▶ Whether the annual profit level of the Invested Foreign Enterprise does not exceed 5 million RMB
 - ▶ Annual effective income tax rate (tax payment/taxable income) of the invested Foreign Enterprise
 - ▶ Shareholder information of the Invested Foreign Enterprise
 - ▶ Profit and Loss Account of the Invested Enterprise
 - ▶ Balance Sheet of the Invested Enterprise
 - ▶ Dividend received from the Invested Foreign Enterprise
9. Outbound Payments: Here the taxpayer must quantify and characterize outbound payments made during the year, including those booked, but not yet remitted, made to related parties; and whether payment was subject to withholding tax and whether the payment is entitled to preferential tax treatment under the relevant tax treaty. Type of offshore payments include:
- ▶ Dividends
 - ▶ Interest
 - ▶ Rental
 - ▶ Royalties (including trademark, technology licensing)
 - ▶ Asset transfer
 - ▶ Commission
 - ▶ Design fee
 - ▶ Consulting fee
 - ▶ Training fee
 - ▶ Management service fee
 - ▶ Contractor fee
 - ▶ Construction and installation fee
 - ▶ Performance fee
 - ▶ Certification, or testing fee
 - ▶ Market spending
 - ▶ After sales service charges
 - ▶ Other
- Important Additional Notice: CIT Annual Tax Filing Forms "Special Tax Adjustment"**
- A taxpayer can make a "special tax adjustment" (line 53) in Appendix 3 of the new (2008) annual corporate income tax filing. According to the explanatory notes of Appendix 3, taxpayers can make an upward adjustment to taxable income in accordance with the provisions (or requirements) of Special Tax Adjustment circular. The adjustment can only be upwards and could arise from any special tax adjustment (e.g., CFC, thin capitalization, transfer pricing or other).

Conclusion

The release of the related party transaction annual reporting forms is the first of two steps the SAT is expected to take before the end of the year.

Clearly, as we have mentioned in the past, China has stepped up to join its global trading partners in enforcing the arm's length principle for transfer pricing.

With these forms, the SAT is requiring taxpayers, both domestic and foreign-invested, to disclose important details about related and unrelated party transactions. Our view is that while the forms appear burdensome to taxpayers, the data is already embedded in general ledger accounts. Consequently, much of the data gathering can be automated. Our view is that while the forms for the 2008 filing will take time to complete, the process can be coded into financial accounting systems so that in future years, completing the forms will be less burdensome.

Additionally, with the information in the forms, we believe the SAT can make more informed decisions about the transfer pricing risk embedded in a taxpayer's financial results.

The forms provide a rough blueprint of the relevance of transfer pricing to the taxpayer. It is to the taxpayer's advantage that the SAT make informed risk assessments rather than uninformed based upon incomplete data.

The forms are new. As such, we expect many taxpayers to have questions about how to complete the forms. Additionally, the annual tax filing forms have also been revised for 2008. From 2008 forward, taxpayers can self-initiate an upward adjustment. Note, however, the explanatory notes do not address any corresponding VAT or Business Tax issues that might arise from such an adjustment.

Ernst & Young will be in close communication with the SAT at all levels throughout the coming months to clarify issues that taxpayers will have about these forms.

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