

Chinese Transfer Pricing Regulations and Their Implications



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Introduction

Masterfile outline

Typical OECD compliant transfer pricing documentation contains:

- § **General information about shareholder relationships, business operations, organizational structure**
- § **Business transactions with related parties**
- § **Functional analysis and Value Chain analysis**
- § **Description of the transfer pricing method applied to the tested transaction**
- § **Selection of transfer pricing method to test the arm's length nature of the transfer pricing policy**
- § **Economic Analysis, including:**
 - Comparable searches aiming to identify comparable transactions and/or companies;
 - Determination of arm's length ranges of prices and/or returns ; and
 - Financial analysis including a comparison between the above-determined arm's length ranges and the prices of the tested transaction and/or the returns of the tested party.
- § **A conclusion**

Transfer Pricing Documentation

Achieving External and Internal Communication



§ More than compliance:

- Documentation should be approached as a tool for communication
- External communication
 - In Europe, communication is with and between a multitude of parties
- Internal communication
 - Controlled incentive effect?
 - Buy-in?
 - Feed back?

Approaching Transfer Pricing Policy as a Risk Management Issue



Alignment with operational realities	<ul style="list-style-type: none"> § Arm's length refers to "circumstances" of the transactions § No alignment: vulnerabilities § Alignment: assure fit
Tax Exposure Risk	<ul style="list-style-type: none"> § Primary adjustment § Double taxation § Interest/Penalties § Litigation burden § Effect on your balance sheet
Effectiveness of communication	<ul style="list-style-type: none"> § Internal/External § Documentation is Communication § Impacts compliance and tax exposure risk <ul style="list-style-type: none"> □ If successful, lower compliance and tax risk □ If unsuccessful, higher compliance and tax risk
Compliance Risk	<ul style="list-style-type: none"> § Non-compliance penalties § Cost of last minute repairs § See your non-compliance as an alarm signal regarding your control of Transfer Pricing
Tax Planning Relevance	<ul style="list-style-type: none"> § Effective tax rate management <ul style="list-style-type: none"> □ Global □ Per Region/Industry § Opportunities

New Regulations by the European Union Suggest EU-wide Documentation



Resolution of EU Council, Brussels, June 20, 2006:

The member states of the EU agree on

- § A common code of conduct for European Transfer Pricing (EU TP)
- § A Masterfile approach for harmonized documentation

The Code of Conduct consists of:

Guidelines and rules regarding the execution of a European TP

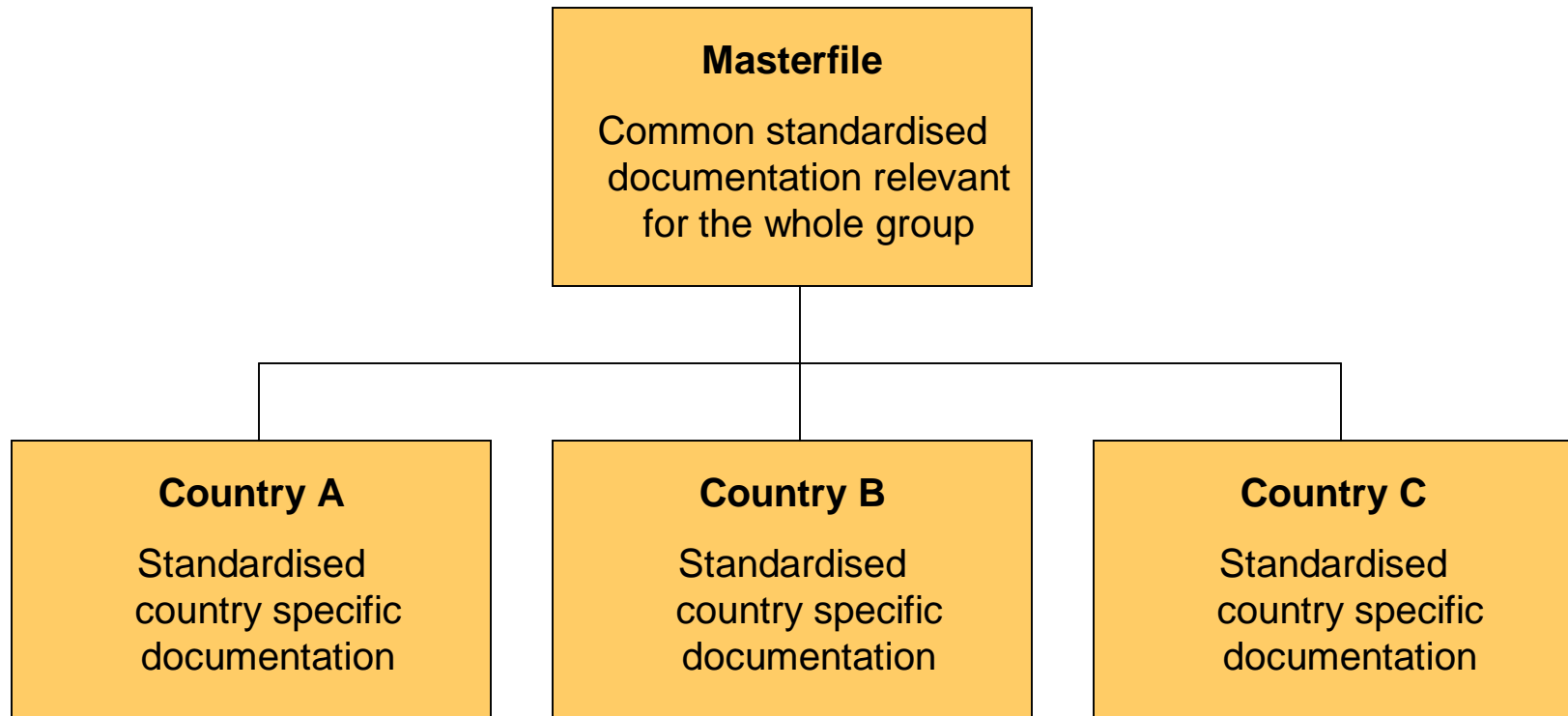
- § instrument for the implementation of standardised and partially centralised transfer pricing documentation
- § aim of simplifying transfer pricing requirements for cross-border activities

The EU Masterfile describes:

- § Documentation standards for EU documentation
- § Country-specific documentation requirements

The new approach for EU-wide documentation

The EU Transfer Pricing Documentation Concept – A Possible Solution



§ **The aim of the Masterfile and, where necessary, supporting country specific documentation is to:**

- Have centralised, standardised, and flexible documentation that would fulfill all requirements across the EU
- Reducing tax payer compliance costs and avoiding penalties

The **Masterfile** should follow the economic reality of the business and “blueprint” of the MNE group and transfer pricing system.

Country Specific Documentation supplements the Masterfile for certain countries where needed.

Comparison to company's current position – Common Masterfile



Common Masterfile

Tentative EU Documentation Requirements	Company's Position
General description of the business, the business strategy, and changes that may have occurred during the previous tax year.	
The MNE group's organisational, legal, and operational structure – including organisational chart, list of group members, and description of the parent companies role on behalf of its subsidiaries.	
Identification of the associated enterprises engaged in controlled transactions within the EU. Details of country specific controlled transactions.	
General description of the controlled transactions, including description of: transaction flows (tangible and intangible assets, services and financial), invoices, and amounts of transaction flows.	
Functions performed, risks assumed, and any changes that may have taken place in the last tax year.	
Ownership of intangibles: patents, trademarks, brand names, know-how; Also royalties paid or received.	
The group's transfer pricing policy and/or transfer pricing system that substantiates the arm's length nature of the company's transfer pricing.	
An undertaking by the taxpayer to provide supplementary information upon request within a reasonable time frame and national rules.	
A list of Cost Contribution Agreements, APAs, and Rulings	

Comparison to company's current position – Common Masterfile



Country Specific Documentation

In addition to the master-file the following information should be kept for country-specific documentation:

Tentative EU documentation requirements	Company's Position
Detailed description of the business and business strategy, including any changes to the business during the previous tax year.	
Information (description and explanation) on a country-specific controlled transaction: tangible and intangible assets: services and financial transaction flows; invoice flows; and amounts of transaction flows.	
Comparability analysis: characteristics of property and services, functional analysis, contractual terms, economic circumstances, and specific business strategies.	
Explanation about the selection and application of the transfer pricing method.	
Relevant information on internal and/or internal CUPs.	
Description of implementation and application of the group's inter-company transfer pricing policy.	

Achieving external & internal communication: documentation pyramid

