

5 March 2012

China's SAT Gives Overview of Anti-Avoidance Initiatives

By **Sebastien Gonnet**
and **Molvin Yiu**

This article was originally published on TP Week, International Tax Review (www.tpweek.com)

The State Administration of Taxation (SAT) in China has recently provided an overview of anti-avoidance initiatives in the Chinese media.

In 2012, the SAT will introduce on top of the electronic platform that was originally built to monitor value added tax, a new statistical indicator system, which monitors MNEs' profitability by geographic regions and industries. The new system will use data collected from related party transaction filings and mandatory documentation collected from taxpayers.

New Internal Administrative Guidelines

The SAT has introduced the Provisional Internal Procedures on Special Tax Adjustments, and the Provisional Internal Procedures on Joint Decision of Important Special Tax Adjustments Cases, which will both be effective from March 1 2012. These will serve as an official standard in anti-avoidance investigation and negotiation across different regions in China.

According to Chinese industry sources, these guidelines will cover the following main areas:

- Organisation and human resource allocation in anti-avoidance efforts;
- Performance evaluation of tax bureaus/officials on special tax adjustment efforts;
- Selection of investigation target, audit and adjustment procedure, initiation and closing of audit cases, file management, collection of taxes, following up investigation, etcetera;
- Management issues such as use of funds, confidentiality, information management, coordination between departments, monitoring tax income sources, etcetera;

- Conclusion and implementation of unilateral advanced pricing agreement (APA);
- Special tax adjustments on designated enterprises by the SAT will be coordinated and managed by the Large Enterprise Administration Department. Other enterprises' cases will be coordinated and managed by the International Taxation Department;
- The local level tax bureau in charge of daily tax matters will be encouraging taxpayers to perform self-adjustments to increase their taxable profits, based on their analysis of the taxpayer's tax return appendices and mandatory documentation; and
- For taxpayers that have already performed self-adjustments, the tax bureau still reserves the right to conduct an official transfer pricing audit.

More National Anti-avoidance Campaigns

The SAT will leverage the data collected in its new systems in order to efficiently identify industries and MNEs that have a relatively low profitability in China. These analyses will serve as the basis for industry wide investigations, as well as other national anti-avoidance campaigns.

The SAT has recently conducted national anti-avoidance investigations and industry analysis of the retail, real estate and transportation industries, which reinforced their anti-avoidance capabilities on services type of transactions.

Results of Anti-avoidance Efforts and APA in 2011

It is being reported that in 2011, anti-avoidance efforts have contributed an increase of RMB 23.9 billion (\$3.8 billion) in China's tax income.

In the past year, China has conducted 10 bilateral discussions with seven countries including the US, Japan, Korea on 29 APA and corresponding adjustment cases, in which only seven of them have reached consensus through the mutual agreement procedure (MAP).

However, on the other hand, MAP applications awaiting process by the SAT remain at an increasing number of over 120 cases.

The SAT is also promoting the use of income approach in extending its investigation targets from tangible goods transactions to inter-company transfer of shares and transfer of other intangibles.

Low Success Rate in Bilateral APA

The above developments in China confirm a higher transfer pricing scrutiny, a deepening of the overall transfer pricing knowledge, and an announced commitment to transfer pricing, with more systematic and nationwide reviews of tax payers' transfer pricing set-ups and margins left in China.

They also signal a low success rate for candidates to bilateral APAs which may be explained by relatively limited resources at the SAT's anti-avoidance team in Beijing, as well as different views put forward by Chinese SAT (notably with respect to local intangibles, market premium and location savings) potentially leading to some challenges in concluding negotiations with trading partners (developed economies) with more traditional transfer pricing views.

Finally, they show a wider use of the arm's-length concept, transfer pricing methodologies and economic analysis in related areas such as business restructurings and company intangibles valuation.

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 20 offices across North America, Europe, and Asia Pacific.

Contact

For further information and questions, please contact the author:

Sebastien Gonnet

Vice President

+86 10 6533 4397 (Beijing)

+86 21 6103 5544 (Shanghai)

Molvin Yiu

Consultant

+86 21 6103 5423 (Shanghai)