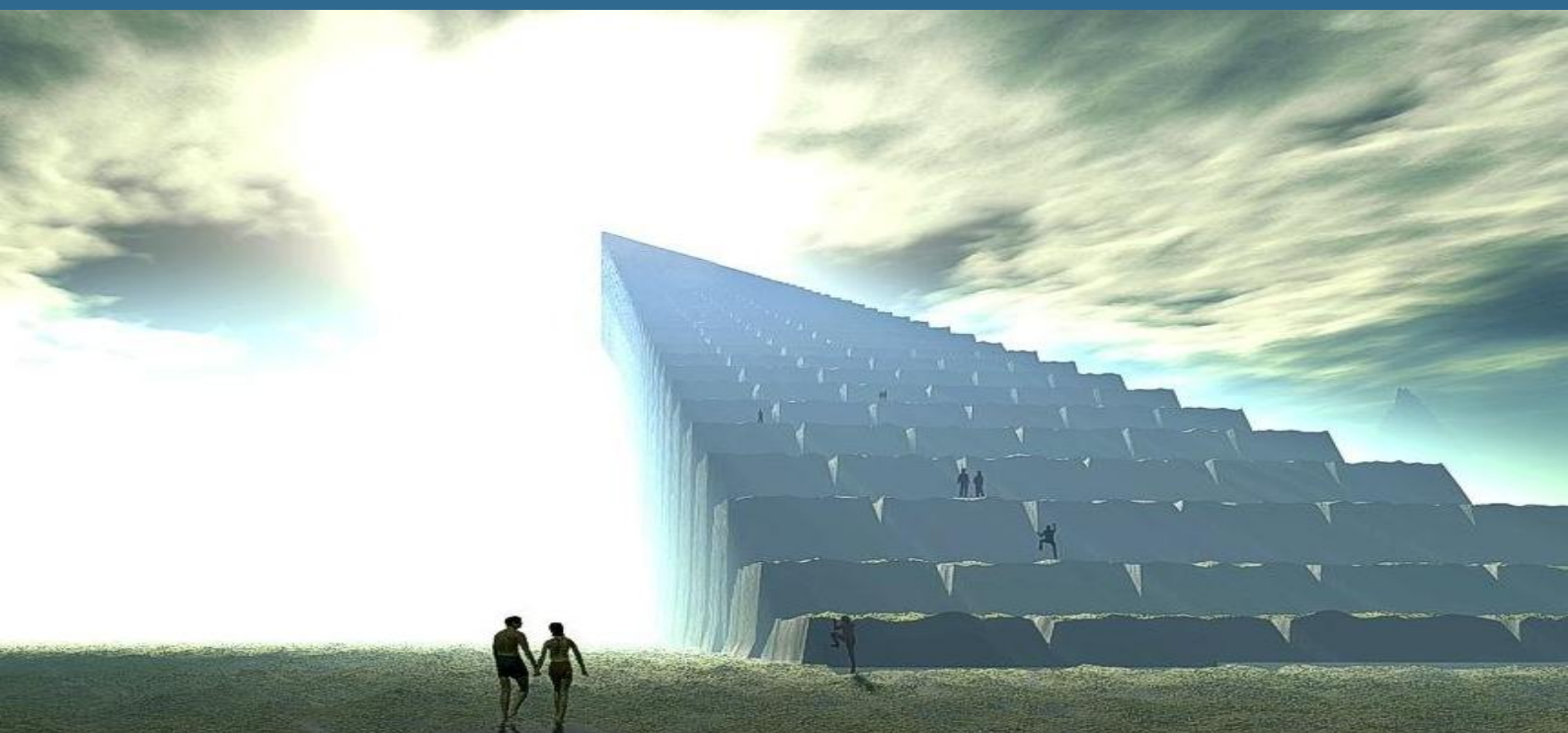




Hendersen
Taxand

HENDERSEN TAXAND IN CHINA

Transfer Pricing Service - Contemporaneous Documentation



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Contents

Background	3
Contemporaneous TP Documentation	3
Our comments	5
Our Service	6
Our Professional Service	8
Our Professional Fee	8
About Hendersen Taxand	9
Contact Us	9



Background

On 8 January 2009, the State Administration of Taxation issued the Implementation Measure of Special Tax Adjustments (Trial Version) (hereinafter referred to as “the Measures”). The Measures are elaboration of “Chapter 6 - Special Tax Adjustments” of the new Enterprise Income Tax Law and its Detailed Implementation Regulations. The Measures also consolidate and update the provisions of the previous Chinese transfer pricing regulations. After the issuance of the Measures, the previously issued circulars (Guoshuifa [1998] No. 59, Guoshuifa [2004] No. 143 and Guoshuifa [2004] No. 118) will be revoked.

The Measures cover various aspects of special tax adjustments regarding Transfer Pricing (“TP”), Thin Capitalization, Controlled Foreign Corporations and General Anti-avoidance Rules, etc. The Measures take retrospective effect from 1 January 2008.

According to the Measures, enterprises in China will have to comply with the following documentation requirements each year since the 2008 tax year:

1. Annual filing of Related Party Transactions (“RPT”) disclosure forms to be submitted together with Annual Enterprise Income Tax Returns by 31 May (specified in Guoshuifa [2008] No.114);
2. Contemporaneous TP documentation.

Contemporaneous TP Documentation

As abovementioned, in addition to submitting various disclosure forms of the RPT in the annual enterprise income tax filing, enterprises are required to prepare, maintain and provide upon tax bureau’s request more comprehensive documentation to substantiate the arm’s length nature of their related party transactions.

- **Applicability**

According to the Measures, contemporaneous TP documentation is not required for enterprises meeting any of the following requirements:

1. Annual amount of related-party purchase and sales is less than RMB200 million and annual amount of other RPT is less than RMB40 million;
2. RPT are covered by an Advance Pricing Agreement;
3. Foreign shareholding of the enterprise is below 50% and the enterprise only has domestic RPT.

- **Content**

Such contemporaneous TP documentation should include the following five categories of information:

1. Organizational structure - including the organization and ownership structure of the group that the taxpayer is affiliated with; change of relationships between the taxpayer and its related parties, information on RPT; and information on related parties (i.e. applicable tax rate and tax incentives).
2. Overview of business operations - including major economic and legal issues affecting the taxpayer and its industry (e.g. overview of the taxpayer's development, business strategy, industrial policy, etc.); composition of core businesses and structure of its revenue and profit; market and competition analysis; the taxpayer's internal organizational structure, function and risk analysis (with a requirement to complete an official "Functional and Risk Analysis" form); and consolidated financial report of the group.
3. Information about RPT - including detailed information of the RPT (e.g. types, participants, timing, amount, currency, contractual terms, etc.); description of transactional model, changes during the year, together with explanations; comparison of operation flows between RPT and third-party transactions, including information flows, logistics flows and cash flows; intangible assets involved and their impact on the pricing; copies of contracts in connection with RPT and their execution status; analysis of the major economic and legal factors affecting pricing of RPT; and segmented financial analysis regarding revenue, cost, expenses and profits (with a requirement to complete an official "Financial Analysis on Annual RPT" form).
4. Comparability analysis - including factors considered in a comparability analysis (e.g. characteristics of properties or services involved, functions and risks of the parties involved, contractual terms, etc.); information on the functions, risks and assets of the comparable companies; description of the comparable transactions; source, criteria and rationale for selection of comparable information; and adjustments made to the comparable data together with rationale.
5. Selection and application of transfer pricing methods - including rationale and support for selection of transfer pricing method; assumptions and judgments made when determining comparable prices or profits; and determination of the comparable prices or profits and justification of complying with the arm's length principle.

The measures list six acceptable methods in the course of transfer pricing investigations:

1. Comparable uncontrolled price method
2. Resale price method
3. Cost plus method



4. Transactional net margin method
5. Profit split method
6. Others in compliance with the arm's length principle

A comparability analysis regarding the following factors should be conducted in order to select appropriate transfer pricing method (with a requirement to complete an official "Analysis on Comparable Factors" form during a TP investigation):

1. Characteristics of the assets transacted or services provided
2. Functions and risks of each party engaged in the RPT
3. Contractual terms
4. Economic circumstances
5. Business strategies

Please note that additional elements of documentation are required for Cost Sharing Agreements and for taxpayers with thin capitalization issues.

- **Timing**

Contemporaneous TP documentation must be prepared for each tax year by May 31st of the following year (the deadline for the tax year of 2008 has been extended to 31 December 2009). Taxpayers should submit their contemporaneous TP documentation within 20 days upon request by the tax bureau. Contemporaneous TP documentation should be maintained for 10 years.

- **Language**

All documents must be submitted to the tax authorities in Chinese. If the source material is in a foreign language, a Chinese copy should be submitted as well.

- **Legal Liabilities**

Failure to provide accurate documentation or other information will currently result in a fine in accordance with the general tax law. The Measures also empower the tax authorities to deem the enterprise's taxable income. Where tax authorities make special tax adjustment, interest will be levied on underpaid enterprise income tax of RPT that occur after 1 January 2008. Interest levy is determined based on the RMB loan base rate applicable to the relevant period of tax delinquency as published by the People's Bank of China, plus 5% points. If an enterprise submits the contemporaneous documentation and other relevant information in accordance with the Measures, the above-mentioned additional 5% points may be waived when calculating the interest levy.

Our Comments

The Measures throw new lights on China's anti-avoidance and transfer pricing



administration environment. It also sends the message of more scrutiny from tax authorities in this area in the coming years.

In this regard, it is highly recommended that your company should proactively review its related party transaction models, its transfer pricing positions, identify high risk areas, and take appropriate actions so that its operations are in compliance with the relevant regulations. We also suggest that if your company falls under the category, you should start preparation of the contemporaneous TP documentation as soon as possible.

Our Service

We shall be pleased to assist you in this regard and would like to provide high quality tailor-made TP services based on your company's specific situation and needs. Our full range TP services cover (but not limited to) the following professional services:

- **For enterprises which are not required for contemporaneous TP documentation**
 - Review the current related party transactions and assess the reasonableness of the current transfer pricing policies
 - Identify TP high risk area, assess potential TP adjustment risks and advise on measures to control/minimize China TP risks
 - Assist on annual filing of RPT disclosure forms
 - Assist on effective TP planning, including study on commercial structures and arrangements, TP policy formulation and substantiation through TP study
 - Provide assistance and support in case of TP audit, including preparation of information and documents required by tax authorities and negotiation with tax officials

- **For enterprises which are required for contemporaneous TP documentation**
 - Assist on annual filing of RPT disclosure forms
 - Assist on preparation of the contemporaneous TP documentation to support the company's TP policies (full version including RPT analysis, functional analysis, industry analysis, financial analysis, selection of TP methods and benchmarking study, etc.; or any part of the above as per your company's needs)
 - Review the current RPT model and TP policies, identify TP high risk area, assess potential TP adjustment risks and advise on measures to control/minimize China TP risks
 - Assist on future TP planning and advise on how to implement new TP policies in an effective and smooth way
 - Assist on preparation of special contemporaneous TP documentation for Cost Sharing Agreements and/or for companies with thin capitalization issues
 - Provide assistance and support in case of TP audit, including preparation of

information and documents required by tax authorities and negotiation with tax officials

- Assist on Advanced Pricing Arrangement (“APA”) application, including preparation of full set of application documents as well as meeting and negotiation with tax authorities

Please feel free to contact us should you have any questions on the above.

The information contained here is of general nature only. It is not meant to be comprehensive and does not constitute accounting, tax, legal, investment, consulting or other professional advice or services. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.



Our Professional Services

Hendersen Taxand formulates effective strategies for optimizing taxes through the use of efficient structuring techniques and trading arrangements, implementing innovative tax planning and effectively maintaining compliance, to minimize the clients' direct and indirect taxes. We also bring together skills and experience to help our clients shape their business the way they want it. To better understand and anticipate the issues facing our clients, we specialize across a range of industries and develop and deliver customized solutions to the clients.

For Transfer Pricing, we can provide following services:

- Review and assess the clients' transfer pricing policies, and identify transfer pricing risks and opportunities;
- Help the clients to plan and/or document their transfer pricing policies and prepare supporting materials in a systematic manner to prepare for any checks from the tax authority; and
- Help the clients to lower the overall tax burden on their China operations while in full compliance with China tax and transfer pricing regulations.

Our Professional Fee

For one-off engagement, a fixed amount of fee estimates will be ascertained based on our previous experiences on similar engagements. The service fee is collectable according to the progress of the engagement. For recurring engagement, the professional fee will be billed on a regular basis.

It is our usual practice to bill for our professional services on a per-diem basis. In case we anticipate the above fee estimates to be exceeded by the actual time costs incurred due to unforeseeable circumstances, we would consult the clients for additional fees before commencing any additional work required.

Charge Rate (USD/h)

Partner	425
Manager	240
Senior Consultant	120
Consultant	50



About Hendersen Taxand



TAXAND is the first global network of independent tax advisors. TAXAND was formed in 2005 by a respected group of premier independent tax firms from countries around the world who share a common vision of delivering seamless and responsive service to local and international clients.

The preeminent network of TAXAND has grown exponentially, and now has 300 tax partners in over 40 countries and more than 2,000 professionals serving the global marketplace.

In November 2008, the International Tax Review presented TAXAND with the "Best Newcomer Award 2008" at its Asian awards ceremony in Singapore. The win means TAXAND has won all three awards available in this category worldwide succeeding in Europe, the Americas and Asia.



Hendersen Consulting is China member firm of TAXAND which still "fills a niche market" in corporate tax, M&A, investment advisory, human capital, customs and outsourcing technology-based solutions. We are a group of experienced professionals who used to work for the top fortune 100 companies and the big 4 accounting firms. We are committed to add value - tremendous value - to our clients. Hendersen Consulting is one of the top ten tax practitioners in China.

For more information visit www.taxand.com
www.hendersen.com

Contact us

International Tax

Dennis Xu
dennis.xu@hendersen.com

Corporate Tax

Eddie Wang
eddie.wang@hendersen.com

Human Capital Service

Kevin Wang
kevin.wang@hendersen.com

Transaction Service

Thomas Ge
thomas.ge@hendersen.com

Transfer Pricing

Joyce Zhang
joyce.zhang@hendersen.com

Outsourcing

Grace Chen
grace.chen@hendersen.com

Unit 1003-1004, the Exchange
No. 299 Tongren Road
Shanghai 200040
People's Republic of China
Tel: +86 (21) 6447 7878
Fax: +86 (21) 3360 7100



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