

### **Administration Measures of Special Tax Adjustments and Mutual Agreement Procedures (“the Measures”)**

#### **【Background】**

To thoroughly implement the Blueprint for Deepening the Reform of Tax Collection and Administrative Systems of State and Local Tax Administrations, further improve the administration of special tax investigation adjustments and mutual agreement procedures, actively utilize the Action Plan from Base Erosion and Profit Shifting (“BEPS”) package and effectively implement the avoidance of double taxation agreements and arrangements concluded, in accordance with the Enterprise Income Tax Law of the People's Republic of China and the Regulations for the Implementation thereof and the Law of the People's Republic of China on the Administration of Tax Collection and the Regulations for the Implementation thereof, the State Administration of Taxation (“the SAT”) formulated the Administration Measures of Special Tax Adjustments and Mutual Agreement Procedures.

#### **【Influence】**

The Measures were formulated with consideration for the changes in domestic and international economic environment and years of field experiences in special tax adjustments. Additions, modifications and refinements were made in regards to the special tax adjustments, which further clarify the tax investigation adjustment procedures and methods for the tax authorities. Moreover, the Measures give full consideration to the legitimate rights and interests of the taxpayers and further regulate the procedures and contents of the special tax adjustments and mutual agreements. The Measures safeguard the state's rights and interests to taxation, foster a fair international tax order and facilitate the smooth running of cross-border trades, while mutual agreement procedures provide an important approach to solve tax disputes and eliminate double taxation. Meanwhile the taxpayers could have more clarity on the tax authorities' focus during transfer pricing investigations.

#### **【Main Content】**

##### **1. Special Tax Investigation and Adjustments**

The Measures further clarify how tax authorities should implement special tax investigation and adjustments with regards to related party transactions. Clause 4 to Clause 43 are on the subject of special tax investigation and adjustments, including key risk characteristics, procedure for opening investigation, content and materials for investigation, transfer pricing methodology, evaluation principles on transactions of intangible assets, related party service arrangements and loss-making enterprises with simple functions, statutory procedures for investigation and adjustments, etc.

The Measures provide that, for an enterprise that no tax adjustment is required after a special tax investigation, the tax authority should notify the enterprise in writing of its investigation conclusion, while for an enterprise that special tax adjustment is required, such adjustment should be implemented according to the prescribed procedures. It also stipulates the negotiation procedure and time schedule for both the tax authority and the enterprise to follow when the enterprise disagrees with the adjustment plan put forward by the tax authority.



If the enterprise still disagrees with the tax authority's final adjustment plan as stated on the Special Tax Investigation Adjustment Notice, it could choose to apply for an administrative reconsideration or lodge an administrative litigation after paying the tax, interests and penalty in accordance with the Adjustment Notice or providing an equivalent guarantee.

## 2. Factors for Comparability Analysis and Transfer Pricing Methodology

According to the Measures, when performing comparability analysis, factors such as each party's capability and actual performance for the execution of the contract, the credibility of the contractual provisions concluded between related parties and etc. need to be considered.

Cost saving, market premium and other regional special factors have been added as the factors to be considered during comparability analysis, and should be taken into account together with other reasonable distribution factors when allocating surplus profits under the Profit-Split Method.

The transfer of financial assets has been clearly defined as a type of related party transaction. The Measures have provided in detail the factors that should be considered in pricing and evaluating such transactions (including the transfer of shares), when applying the Comparable Uncontrolled Price Method during comparability analysis.

The Measures specify that the Transactional Net Margin Method generally applies to the transfer of tangible assets' proprietary rights or use rights and intangible assets' use rights by the enterprises with no intangible assets of great value.

While focusing on the intangible asset and share transfer transactions, the Measures also introduce other evaluation methods, including cost method, market method and income approach, to assist the transfer pricing analysis of such transactions.

The Measures also point out that transfer pricing methodologies include the Comparable Uncontrolled Price Method, the Resale Price Method, the Cost Plus Method, the Transactional Net Margin Method, the Profit-Split Method and other methods which are considered to satisfy the arm's length principle. Other methods which are considered to satisfy the arm's length principle include the assets valuation method and other methods that can reflect the matching of the place where the profits incurred and the economic activities carried out with the place where value was created.

## 3. On Intangible Assets

Clause 30 stipulates that when considering the enterprise and its related parties' degree of contribution to the value of the intangible assets and the corresponding profits allocation, comprehensive analysis should be given to the global business operations of the group of enterprises that the enterprise belongs to, also full consideration should be given to each party's contribution to the intangible assets' development, added value, maintenance, protection, application and promotion, the realization of the intangible assets' value and the way the intangible assets interact with the group's other business in terms of functions, risks and assets.

Clause 31, clause 32 and clause 33 of the Measures apply also to the royalties received from related parties for the use of intangible assets, thus compared with the previous regulations which only focus on the payments of royalties, the Measures lay foundation for a more comprehensive administration on intangible assets transactions.

## 4. On Related Party Service Arrangements

In regard of the related party service transactions, the Measures bring together the profit-making principle with the arm's length principle. It points out that the related party service transactions that satisfy the arm's length principle should be deemed profit-making service transactions, and the corresponding price should coincide with the price of the same or similar transactions with unrelated parties under regular and fair dealings. Meanwhile, the Measures also provide a list of non-profit-making services.

The Measures re-emphasize the application of the arm's length principle. The tax authorities have the authority to implement special tax adjustments, if payments were to be made to the overseas related parties which did not carry out the particular function, bear no risk and has no substantial operation, and that such transactions do not satisfy the arm's length principle.

## 5. On Mutual Agreement Procedures

Actively responding to the guidance of the BEPS Action Plan on dispute settlement mechanism, the Measures improve the working procedures for and the contents of mutual agreement, including for the negotiation and signing of the bilateral or multilateral advanced pricing arrangements and the negotiation required to eliminate double taxation under the special tax investigation. For example, it clarifies the applicability and the time frames for the initiation, suspension, termination and implementation of the mutual agreement procedures, stipulates its application to the mutual agreement cases that have already been initiated but not yet concluded before the Measures came into force, and also provides the specific procedural requirements for the submission of application and the circumstances under which the tax bureau can reject the application and etc.

In addition to the initiation and termination procedures previously exist, the Measures stipulate the situations where the suspension of the mutual agreement procedures would be applied, which grants both the enterprises and the tax authorities rights to suspend mutual agreement procedures under certain situations. Moreover, the Measures list situations where the SAT can refuse the requests for opening mutual agreement procedures made by the enterprises or the competent tax authorities of the other contracting states, which would also apply to the special tax investigation cases that have been closed but the enterprises have not yet fully settled the corresponding tax payables.

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