China sets priorities for its anti-tax avoidance initiatives

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In brief
China’s State Administration of Taxation (SAT) recently emphasized that the general principles underlying its anti-tax avoidance initiatives are seeking improvement while ensuring stability, with the priority being cross-border profit-level monitoring. A pilot system for profit-level monitoring, rolled out in Jiangsu Province, is anticipated to be gradually expanded to other provinces or municipalities. Multinational groups operating in China should strengthen their transfer pricing risk prevention and early warning systems, to actively manage tax compliance and mitigate risks.

In detail
Background
Since the 18th National Congress of the Communist Party of China (CPC), the SAT has sought the development of a fair and modern international tax system, and actively implemented the requirements of the Central Committee of the CPC and the State Council on optimizing the business environment and promoting reform to ‘streamline administration, delegate power, strengthen regulation and improve services.’ An area of significant public concern is the gradual evolution of anti-tax avoidance concepts to strengthen cross-border profit-level monitoring and administration.

As early as 2015, the SAT took steps to adapt to changes in the domestic and international economic environments. In the China Advance Pricing Arrangement Annual Report issued in 2015, the SAT stated in the foreword that it would establish a three-pillar anti-tax avoidance administration system with a balanced approach for ‘administration, service and investigation’ and would place the administration of cross-border related-party transactions in a prominent position.

On March 17, 2017, the SAT released the Administrative Measures for Special Tax Investigation and Adjustment and Mutual Agreement Procedures (Public Notice No. 6 [2017] of the SAT, hereafter referred to as ‘Public Notice No. 6’), which stipulates that “taking a risk-oriented approach, tax authorities shall build and develop a tracking system to monitor the profitability of enterprises and their related-party transactions.”

Recently, officials in charge of anti-tax avoidance from the SAT International Taxation Department summarized the future direction of China’s initiatives when attending the China Tax Policy Briefing jointly organized by the SAT and the Korean Embassy in China:

For a certain period of time to come, the general principle of China’s anti-tax avoidance work is to seek improvement while ensuring stability. By sticking to the priority of cross-border profit level monitoring, it is imperative to build a comprehensive three-pillar anti-tax avoidance administration system with a balanced approach for “administration, service and investigation”,

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constantly consolidate the institutional foundation, enhance the talent development mechanism, deepen international tax cooperation, promote the modernisation of taxation in the new era with high quality, and add momentum to the formation of a new landscape in all-around opening up.

On the basis of maintaining the rigidity of “investigation”, China’s anti-tax avoidance work will focus more on the flexible “administration” and “service”, and help multinational enterprises reduce transfer pricing risks by promoting communication and cooperation between tax authorities and enterprises.

**Specific measures**

The SAT also clarified the detailed plan for future anti-tax avoidance work at the abovementioned tax policy briefing:

To strengthen the profit level monitoring of cross-border related-party transactions, it is critical to establish a “globally-integrated” profit level monitoring system for multinational enterprises with a unified statistics standard and risk evaluation system; to conduct panoramic scanning and risk testing on single enterprises from the global, national and provincial levels to understand the overall operation profile of multinational groups; to rank them by risk level and compliance willingness; to develop transfer pricing risk and compliance files for each enterprise; and to carry out risk assessment from the dimensions of nationality, industry, fiscal year, transaction type and taxpayer so as to achieve a comprehensive upgrade of the transfer pricing management level of multinational enterprises.\(^3\)

Since 2015, many provincial tax administrations have been prioritizing the administration of cross-border related-party transactions, including building information systems to monitor cross-border tax information. An example is the Jiangsu Provincial Tax Bureau’s initiative to monitor and control multinational enterprises’ profit levels.

In April 2018, the Jiangsu Provincial Tax Bureau made presentations to local taxpayers on multinational enterprise profit level monitoring and administration in several cities in Jiangsu Province. During the presentations, the Jiangsu Provincial Tax Bureau said that the Bureau had selected 150 enterprises with large related-party transactions and complicated related-party businesses as the first batch of monitoring targets in the province.

Subsequent to these presentations, local tax authorities have compiled internal statistics, requested the selected enterprises provide additional data, and developed an analytics database which contains key information of the 150 enterprises for 2008-2016 (e.g., information from contemporaneous transfer pricing documentation). Using the database, the Jiangsu Tax Bureau plans to introduce a big data analytics platform to continuously monitor multinational enterprises’ profit levels.

The dynamic monitoring of multinational enterprises’ profit levels by the Jiangsu Provincial Tax Bureau includes the following aspects:

1. Collect tax return information (including country-by-country reports), transfer pricing documentation (including master file, local file, and special issue file), annual reports of listed companies, data exchanged between government bodies, information from commercial databases, internationally exchanged information, public information (e.g., from enterprise websites, securities analyst reports, industry association reports, and news reports), information collected from taxpayers’ responses to tax authorities’ risk assessment requests, and information related to potentially comparable domestic companies.

2. Set 39 qualitative risk indicators using concepts from the Base Erosion and Profit Shifting (BEPS) initiatives of the G20 and the Organisation for Economic Co-operation and Development (OECD), and conduct quantitative risk assessments using value chain analysis so as to comprehensively evaluate related-party transaction tax risks.

3. Assess enterprises’ tax compliance using from six indicators, including the degree of aggressiveness of a group’s global tax planning, the quality of related-party transactions reporting, the quality of transfer pricing documentation, internal control systems for related-party transactions taxation, the performance of related-party transactions in response to risk, and the willingness of management to actively communicate.

4. Classify the assessed enterprises into different administration levels based on their tax base erosion risk and willingness to comply, using an administration level classification model.

5. Build an administration framework based on risk
classification which considers tax authorities’ administration resources; adopt different countermeasures for enterprises with different administration levels to guide and promote enterprises’ active compliance.

**The takeaway**

Monitoring multinational enterprises’ profit levels is the SAT’s priority for future anti-tax avoidance work in China, with the pilot program already being rolled out to begin collecting basic data for taxpayers in Beijing, Sichuan, Jiangsu, Ningbo, Shenzhen, and other places. Therefore, taxpayers with large cross-border related-party transactions should be prepared for increased provincial and even national monitoring of multinational enterprises’ profit levels.

Taxpayers should look to manage their risk in the following ways:

- Re-examine and evaluate the potential risks of transfer pricing policies at the group level based on BEPS initiatives, and identify potential conflicts and double taxation exposures between the China tax authorities and other tax authorities.
- Develop risk-warning systems that consider the China tax authorities risk-monitoring indicators, and construct information management platforms to manage the formulation and adjustment of transfer pricing policies, financial forecasts, actual financial performance (including segmented financial performance), and comparable data.
- Regularly monitor the implementation of transfer pricing policies to achieve consistency between the pricing policies and their implementation, and identify and control potential risks by data monitoring.
- Maintain communication with the local tax authorities, keep up to date with the latest transfer pricing administration trends, and ensure entities meet all necessary obligations by adhering to legislative requirements or applying for advance pricing arrangements.

Lastly, the trend of tax authorities using more data tools for monitoring will require tax staffs in corporations to frequently collect or process large amounts of data. Therefore, an urgent task for many corporations is to upgrade current manual processing methods, to fulfil the demand for robust, accurate, and real-time data.

Management should consider building appropriate data analytics methods and digitizing information from daily operations, which will facilitate the company’s reporting and management requirements. Digital thinking also can help management to analyze the company’s transfer pricing information instantaneously and comprehensively, and thus more accurately manage transfer pricing risks in the rapidly changing international economy.

**Endnotes**


2. China Tax News reported on 7 September 2018, ’Tax Policy’

3. Ibid.
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