



Updates on Anti-avoidance Activities by the Jiangsu State Administration of Taxation: liquid crystal display, battery, communications and related industries targeted

Summary of this issue:

- Jiangsu SAT recently held a graduation ceremony for its advanced training on anti-avoidance, and set the future path for anti-avoidance activities in the Jiangsu province.

Background

The Jiangsu State Administration of Taxation (Jiangsu SAT) held a three month advanced training on anti-avoidance at Shanghai National Accounting Institute for the 21 top performers from the various anti-avoidance teams within the Jiangsu province. The advanced training was focused on OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration, and combined with the latest global transfer pricing development and practical considerations in China. Speakers were mostly from renowned international accounting firms such as KPMG. Jiangsu SAT held the graduation ceremony for the advanced training in Nanjing on 16 August, 2011. The Director-General of Jiangsu SAT provided some insights into the future path of anti-avoidance in Jiangsu province while exchanging views with KPMG and representatives from other international firms.

Future path of anti-avoidance in Jiangsu

- *Strengthen academic training in transfer pricing and enhance cross-regional communication*

By conducting advanced training for these elite performers, Jiangsu SAT has shown dedication and commitment to investing in further education to cultivate a high-quality anti-avoidance professional team. Jiangsu SAT expects its anti-avoidance professionals to apply their learning in their daily work, and to pass on their knowledge to other anti-avoidance officials in order to further enhance the expertise of their practice. Jiangsu SAT requests the leaders of the various state tax authorities to allow convenient access for anti-avoidance

professionals, in order to facilitate their cross-regional communication and exchange on a periodical basis. Jiangsu SAT will also enhance communications with international accounting firms and closely monitor the latest domestic and international developments in the transfer pricing domain. In addition, it requests anti-avoidance professionals to promote the development of transfer pricing thought leadership that are based on the practical conditions of China and thus applicable in China.

- *Strengthen industry-wide joint investigation efforts and expand investigation scope*

Jiangsu SAT indicates that in its anti-avoidance efforts going forward, it will not only focus on key enterprises, but it will also conduct comprehensive investigations of the industries. By doing so, it aims to explore alternative solutions to deal with issues on multiple levels, including tax collection and administration. In terms of operation, Jiangsu SAT will orchestrate collaborative efforts among the local tax authorities of various regions within the province, and drive forward the implementation of expert panel review mechanism. Coordination meetings have also been held by Jiangsu SAT in respect to work arrangements for the liquid crystal display (LCD), battery and communications industries.

Jiangsu SAT also indicates that it will focus on transfer pricing issues of enterprises with large domestic related party transactions, domestic enterprises with outbound investments, and enterprises involved in equity transfers among related parties. It will also focus on the split of profit along the supply chain.

- *Review transfer pricing documentation and perform special investigations on functions and risks*

Jiangsu SAT will review the contemporaneous transfer pricing documentation of over 2,000 enterprises in the province, with a particular focus on the functional and risk profile of the enterprises in their related party transactions. Where the functional and risk profile in the documentation indicated conflicts with other representation made by the enterprise, Jiangsu SAT will conduct interviews, issue warnings or even launch anti-avoidance investigations as and when required. Jiangsu SAT will also pay particular attention to any changes in functions arising from supply chain restructuring that the enterprise has undergone.

- *Willing to accept administrative appeals*

Jiangsu SAT has expressed its hope to resolve transfer pricing controversies through a variety of channels, and in particular, its willingness to accept administrative appeals sought by taxpayers. Jiangsu SAT has emphasised that all administrative appeals handled will be impartial and transparent.

KPMG observations

As China's leading authority on the transfer pricing front, Jiangsu SAT may be followed closely by tax authorities in other locations for its stance and practices in this regard. As such, the movement of Jiangsu SAT shall be of paramount importance to enterprises both with and without related-party transactions in the Jiangsu province.

Jiangsu SAT traditionally has a strong focus on anti-avoidance, and its future work trends reflect the spirit underlying circular Guoshuihan [2011] No. 167, Notification on the Status of 2010 Anti-avoidance Practice, issued by the State Administration of Taxation. Going forward, one can expect Jiangsu SAT and its subordinate authorities to increase their anti-avoidance investigation efforts.

Industry-wide joint investigation

We advise enterprises in the LCD, battery, and communications industries and related upstream and downstream industries in the Jiangsu province to proactively review their related-party transaction model, the relevant pricing policies, and the implementation of such policies to mitigate the risk of transfer pricing investigation. Likewise, in view of the potential contagion effects of investigations in Jiangsu, we also advise that all enterprises in these industries in China to thoroughly prepare themselves for any potential industry-wide joint investigations.

Transfer pricing documentation and function profiling

Through our communication with the officials of Jiangsu SAT, we sense the authorities' dissatisfaction with the contemporaneous transfer pricing documentation prepared by enterprises within their jurisdiction, and in particular, their concern over the lack of accurate and detailed representation of functions and risks conveyed by those documentation. As such, enterprises should pay close attention to function and risk profiling when preparing their documentation, so as to steer clear of potentially contradictory representations (for instance, a simple-function contract manufacturer claiming in possession of high-tech status). In the interim, enterprises should pay extra attention to matching their profit level with the appropriate functional and risk profile.

New domain of transfer pricing investigation

For those enterprises with large related-party transactions that have not yet prepared their contemporaneous transfer pricing documentation, it is advisable to consider revisiting the reasonableness of their transactions through the retrospective preparation of such documentation. Solutions and/or risk mitigation strategies can be discussed during the process. For domestic enterprises with outbound investments, transfer pricing should be dealt with carefully in terms of global expansion and/or public listing, in order to mitigate the potential risks and improve tax efficiency. Similarly, we would recommend enterprises involved in equity transfers to further scrutinise their equity valuation from the standpoint of transfer pricing, and by doing so, steer clear of foreseeable risks.



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