

This is an unofficial English translation of the Public Notice of the State Administration of Taxation on Issuing the “Administrative Measures of Special Tax Investigation and Adjustment and Mutual Agreement Procedure” (Public Notice of the State Administration of Taxation [2017] 6). In the event of any conflict between this translation and the original Chinese text, the text of the original Chinese version shall prevail.

SAT Public Notice [2017] No.6

**Public Notice of the State Administration of Taxation on Issuing the
“Administrative Measures of Special Tax Investigation and Adjustment and
Mutual Agreement Procedure”**

In order to further implement the “The Plan for Deepening the Reform of Collection and Administrative Systems of State and Local Tax Administrations”, improve the administration of special tax investigation and adjustment and mutual agreement procedure, actively apply the outcomes of the Base Erosion and Profit Shifting (hereinafter as “BEPS”) action plans and effectively implement treaties, agreements or arrangements concluded between China and other countries or regions on the avoidance of double taxation, the “Administrative Measures of Special Tax Investigation and Adjustment and Mutual Agreement Procedure” is hereby issued by the State Administration of Taxation in accordance with the Enterprise Income Tax Law of the People’s Republic of China and its implementation regulations, and The Tax Collection and Administration Law of the People’s Republic of China and its implementation regulations. The Measures will take effect from 1 May 2017.

Attachments:

1. Special Tax Adjustment Self-adjustment Form
2. Related Party Relationships Confirmation Form
3. Related Party Transactions Confirmation Form
4. Special Tax Investigation Conclusion Notice
5. Negotiation Records
6. Special Tax Investigation Preliminary Adjustment Notice
7. Special Tax Investigation Final Adjustment Notice
8. Application for Initiating Mutual Agreement Procedure Concerning Special Tax Adjustment
9. Notice of Tax Payment (or Refund) to Implement a Mutual Agreement Concerning Special Tax Adjustment

The State Administration of Taxation

17 March 2017

Article 1

The Administrative Measures of Special Tax Investigation and Adjustment and Mutual Agreement Procedure (hereinafter referred to as the “Measures”) are enacted in accordance with the Enterprise Income Tax Law of the People’s Republic of China (hereinafter referred to as the “Enterprise Income Tax Law”) and its implementation regulations, and the Tax Collection and Administration Law of the People’s Republic of China (hereinafter referred to as the “Tax Collection and Administration Law”) and its implementation regulations.

Article 2

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; enhance taxpayer compliance through special tax adjustment as result of monitoring, administration and investigation.

Article 3

Tax authorities can monitor and administer special tax adjustment issues through various measures such as review of the related party filings, management of contemporaneous documentation, monitoring of enterprise profitability and others. Where a special tax adjustment risk is identified, tax authorities can deliver a “Notice on Tax Matters” to the enterprise to inform it of the risk.

Where an enterprise receives the aforementioned Notice or identifies a special tax adjustment risk on its own, it can make a self-adjustment for the underpaid tax. Enterprise making a self-adjustment shall file a Special Tax Adjustment Self-adjustment Form.

Self-adjustment performed by the enterprise does not preclude tax authorities from conducting special tax investigation on the enterprise and making adjustment accordingly provided that the investigation is in accordance with relevant rules and regulations.

Where an enterprise seeks the tax authority’s confirmation of its tax position on matters concerning special tax adjustment, such as pricing principle and

method adopted for related party transactions, the tax authority should initiate the special tax investigation procedure.

Article 4

Tax authorities should pay special attention to enterprises with the following risk indicators to identify special tax investigation targets:

1. Enterprise with large related party transaction amount or multiple types of related party transactions;
2. Enterprise with long-term losses, thin profit margin or fluctuating profit;
3. Enterprise with profit lower than the industry level;
4. Enterprise with profit level that does not align with its functional and risk profile or with returns shared that do not align with cost allocated;
5. Enterprise that enters into transactions with related parties located in low-tax countries (regions);
6. Enterprise that fails to report the related party transaction or prepare contemporaneous documentation as required;
7. Enterprise with a related party debt-to-equity ratio exceeding the prescribed threshold;
8. Controlled by Chinese resident enterprises or jointly controlled by Chinese resident enterprises and Chinese resident individuals, established in a country (region) with effective tax rate lower than 12.5%, enterprise that does not distribute or under-distribute profits without reasonable business needs; and
9. Enterprise that implements other tax planning schemes or arrangements

without proper commercial purposes.

Article 5

The tax authorities should issue a Tax Inspection Notice (I) to the enterprise identified for special tax investigation. Where an enterprise under investigation is a non-resident enterprise, the tax authorities may deliver the Tax Inspection Notice (I) to it via its domestic related parties or other domestic enterprises relevant to the investigation.

Enterprise that has submitted the “Advance Pricing Arrangements (hereinafter as “APA”) Letter of Intent” to apply for APA with rollback after reaching agreement with the tax authorities in pre-filing meetings or that has submitted the “APA Renewal Application” can be temporarily exempt from special tax investigation to the extent of the years and the related-party transactions covered by the APA.

Article 6

In the course of a special tax investigation, tax authorities can request relevant information from the enterprise under investigation, its related parties, or other enterprises relevant to the investigation.

1. The tax authorities should issue a “Notice on Tax Matters” to request the information from the enterprise under investigation, its related parties or other enterprises relevant to the investigation. Where the requested enterprise is located outside China, the tax authorities can deliver the “Notice on Tax Matters” to it via its domestic related parties or other domestic enterprises

relevant to the investigation.

2. Where on-site evidence collection is needed from the related parties of the enterprise under investigation or other enterprises relevant to the investigation, a “Tax Inspection Notice (II)” should be issued.

Article 7

The enterprise under investigation, its related parties, and other enterprises relevant to the investigation should provide authentic and complete documents and information requested by the tax authorities.

1. Where original documentary evidence preserved by the enterprise is requested, the requested enterprise should submit master copy, original copy or duplicate. In a case where the requested enterprise has difficulty in providing the originals, it may provide copies that have been verified against the originals, such as photocopies, photos and excerpts. The submitted documents should be marked with the statement of “verified against the originals preserved by us” and signed and stamped by the requested enterprise.

2. When providing copies, photocopies or excerpts of the original documents preserved by the relevant parties, the provider should mark the submitted document with the statement of “verified against the originals” and specify the source of the documents. The submitted documents should be signed and stamped by both the relevant parties and the provider.

3. When written documentary evidence or audio/visual information in a foreign

language is provided, the provider should also submit the Chinese translation.

The provider should be responsible for the accuracy and completeness of the translation;

4. When relevant overseas information is provided, the provider should state the source of the information. Where tax authorities have doubts about the authenticity and completeness of the overseas information, they can request the provider to further provide a notarial certificate.

Article 8

Tax authorities should abide by the legally prescribed authorization and procedures to carry out special tax investigations, during which different approaches can be used to collect evidence to substantiate the facts of the case, such as on-site investigation, review of hard-copied or electronic data, inquiry of accounting records, inquiry of information on deposit accounts or saving accounts, requesting for assistance from other tax authorities in the form of desk-bound review, international information exchange, request for assistance from other tax authorities in the form of on-site investigation. For the purposes of evidence collection, tax authorities can take notes, make tape recordings or video recordings, take photographs and make copies of original documents. Tax authorities should notify the inquired party before making tape recordings, video recordings, or taking the photographs. The records made by the tax authorities should be signed by (two or more) inspectors and confirmed by the inquired party with signature and stamp. If the inquired party refuses to

confirm the records with signature and stamp, (two or more) inspectors should note it as such on the records.

Article 9

Where electronic data is collected to substantiate the facts of the case, tax authorities can collect the evidence through the following means.

1. Request the information provider to provide electronic data in print copies with a clear indication of the data source, place of printing, and the statement of “verified against electronic data” and signed and stamped by the provider.
2. Collect the electronic data through a storage medium. The data should be copied into a read-only storage medium and sealed in a package by the inspectors together with the persons designated by the provider. The sealed package should be marked with the content of the electronic data, data source, data production methods and time, data producers, document format and size, etc., with the statement of “verified against electronic data stored in the original medium”, and signed and stamped by the provider.

Article 10

Where tax authorities request the accounting books, accounting vouchers, financial accounting reports and other relevant materials of prior years for inspection, they should issue a “Notice for Requesting Accounting Records” to the enterprise under investigation, and prepare a “List of Requested Accounting Records” for the enterprise to verify, sign and stamp in accordance with the relevant provisions of the Tax Collection and Administration Law and

its implementation regulations. The requested materials should be properly preserved and returned to the enterprise within the legally prescribed time limit.

Article 11

Where tax authorities need to collect evidence through inquiry, the process should be jointly conducted by two or more designated inspectors and a “Record of Inquiries (Investigation)” should be made.

Article 12

Where the party under investigation or a witness is required to make a statement or provide testimony, it should be informed in advance of the legal liabilities for misrepresentation or false testimony. The party under investigation or the witness may make the statement or provide the testimony in written or oral form. Where the statement or testimony is in oral form, the inspectors should record the statement or testimony by taking notes, tape recordings or video recordings. Notes taken by the tax authorities can be written down by a writing tool that is capable of producing eligible writings for a long period of time, or typed and printed out from a computer, and should be signed and stamped by the party under investigation or the witness page by page.

The statement or testimony should include the basic information of the party under investigation or the witness including names, employers, contact information, etc, specify the issuance date, and enclose with copies of

identification documents such as identity card of the party under investigation or the witness.

Where the party under investigation or the witness proposes modification to the statement or the testimony orally, the inspectors should revise the changed part of the statement or the testimony and specify the reason for the change.

The changed statement or the testimony should be signed and stamped by the party under investigation or the witness page by page. Where the party under investigation or the witness proposes changes to the written statement or the testimony, the original records will not be returned to them.

Article 13

Taking into account of the Enterprise Annual Reporting Forms for Related-Party Transactions and other relevant materials filed by the enterprise under investigation, tax authorities should determine its related party relationships and amounts of related party transactions by filling in the “Related Party Relationships Confirmation Form” and the “Related Party Transactions Confirmation Form”, which will be confirmed with signature and stamp by the enterprise. If the enterprise refuses to confirm the forms, (two or more) inspectors from tax authorities should specify as such on the forms.

Article 14

Where the enterprise under investigation does not provide information relevant to the special tax investigation, or provides false or incomplete information, the tax authorities should specify a time frame for the enterprise to make

corrections. Where the enterprise does not make the corrections within the specified time frame, the tax authorities should address the situation in accordance with the Tax Collection Administration Law and its implementation regulations and determine the taxable income accordingly.

Article 15

When carrying out a transfer pricing investigation, tax authorities should conduct comparability analysis. Comparability analysis normally consists of the following five aspects. Tax authorities may tailor the analysis to the circumstances of the case.

1. Characteristics of the assets or services transacted. For tangible assets, the physical attributes of the assets, quality and quantity of the assets; for intangibles, the type of the intangibles, nature of the transaction, protection level and protected period, and anticipated benefits derived from the intangibles; for services, the nature and description of the services; for financial assets, the nature and characteristics of the assets, risk management etc.;

2. Functions performed, risks assumed and assets used by each party to the transaction. Functions include research and development, design, purchase, processing, assembly, manufacture, repair, distribution, marketing, advertising, inventory management, logistics, warehousing, financing, general administration, financial and accounting services, legal and human resource management, etc. Risks include investment risk, research and development

risks, procurement risks, production risks, market risks, management and financial risks, etc. Assets include tangible assets, intangible assets, financial assets, etc.;

3. Contractual terms, including: the goods/service transacted, quantity and prices of the goods/service, the forms and terms of payment, the terms of delivery, the scope and terms of after-sale services, conditions for provision of additional services, rights related to modifying or amending contractual terms, duration of the contract, and the right to terminate or renew the contract, etc.

The analysis of contractual terms should focus on the ability and behavior of the enterprises to perform the contract as well as the reliability of contract terms concluded by related parties;

4. Economic environment, including: industry overview, geographic location, market scale, market level, market share, degree of market competition, consumer purchasing power, substitutability of the goods/services, price of production factors, transportation costs, governmental regulations and location specific factors such as cost saving, market premium, etc.; and

5. Business strategies related to innovation and development, business diversification, synergy, risk aversion, and market penetration, etc.

Article 16

Tax authorities should select the appropriate transfer pricing method(s) to analyze and examine enterprises' related party transactions based on comparability analysis. Transfer pricing methods include comparable

uncontrolled price method, resale price method, cost plus method, transactional net margin method, profit split method, and other methods consistent with the arm's length principle.

Article 17

Taking into account of the transaction type, comparability analysis under the comparable uncontrolled price method should examine, in particular, the differences in the characteristics, contractual terms, operational strategies and economic conditions of the transacted assets and services between related and unrelated party transactions:

1. Transfer of the right to use or the ownership of tangible assets, including:
 - 1). Transfer process, including the time and place of the transaction, terms of delivery, conditions of delivery, payment terms, transaction volume, description of after-sale services, etc.;
 - 2). Stage where the transfer takes place, i.e., production, wholesale, retail, and export, etc.;
 - 3). Characteristics of the circumstances where the transfer takes place, such as ethnic customs, consumer preferences, political stability, fiscal, tax and foreign exchange policies, etc.;
 - 4). Performance, specifications, model, structure, type and depreciation method of the tangible assets etc.;
 - 5). For transfer of the right to use, time and place of the transfer, term of the right to use, the standard to calculate the fee charged, etc.; and

6). Investment and maintenance expenses incurred by the owner of the intangibles.

2. Transfer of financial assets, including actual holding period, liquidity, security and profitability of the financial assets. For equity transfer, the analysis of the transferred enterprise includes its legal form, operation structure, asset composition, industry in which it operates, industry cycle, operating model, size of operation, asset allocation and utilization, operation stage, growth potential, operational risks, financial risks, time of the transfer, geographic location, ownership structure, description of historical and future operation, goodwill, tax benefits, liquidity, economic trend, macro-economic policy, income and cost structure, and others;

3. Transfer of the right to use or ownership of intangibles, including:

1). Type, use, industries where it can be used and expected returns derived from the intangibles; and

2). Development investment, conditions of the transfer, exclusivity, substitutability, level and term of legal protection as provided by the applicable legislations, geographic location and useful life of the intangibles, stage of research and development, the right to maintain and enhance the intangibles, the right to update the right to use, cost and expenses incurred by the transferee, functional and risk profile of the parties involved, amortization method of the intangibles, and other special factors that may result in the substantial fluctuation in the intangibles' value.

4. Financing transactions, including the transaction amount, currency, term, guarantee, credit rating of the borrower, payment terms, and interest calculation method, etc.; and

5. Service transactions, including the nature of the service, technical requirements, professional proficiency, responsibilities assumed, forms and terms of payment, and direct/indirect costs, etc.

If there are significant differences between related party transactions and unrelated party transactions in the aforementioned aspects, reasonable adjustments should be made to the price to account for the effect of these differences. If it is not possible to make such adjustments, other appropriate transfer pricing method(s) should be selected.

Article 18

The resale price method determines the arm's length price of the product purchased by the enterprise from a related party by subtracting the gross profit in comparable unrelated transactions from the price at which the product is resold to an independent enterprise. The computation formula is as follows:

Arm's length purchase price = Resale price to an independent party x (1 - gross margin in comparable unrelated transactions)

Gross margin in comparable unrelated transactions = gross profit in comparable unrelated transactions / net sales in a comparable unrelated transactions x 100%

The resale price method is usually applied to simple processing or pure

buy-sell transactions where the reseller does not undertake substantial value-added processing activities such as changing the product appearance, performance and structure, or replacing trademarks, etc.

The comparability analysis under the resale price method should examine, in particular, the differences in functions performed, risks assumed, assets used by enterprises, and the contractual terms between related party transactions and unrelated party transactions, as well as other factors affecting gross margins, including marketing, distribution, product warranty and service functions, inventory risks, value and useful life of equipment and machinery, the use and value of intangibles, valuable marketing intangibles, whether in wholesale or retailing, business experience, accounting treatment of the product, and management efficiency, etc.

If there are significant differences between related party transactions and unrelated party transactions in the aforementioned aspects, reasonable adjustments should be made to the gross margin to account for the effect of these differences. If reasonable adjustments cannot be made, other appropriate transfer pricing method(s) should be selected.

Article 19

The cost plus method determines the arm's length price of a related party transaction by adding the gross profit in comparable unrelated transactions to the reasonable costs incurred in the related party transaction. The computation formula is as follows:

Arm's length price = reasonable costs incurred in a related party transaction x
(1 + cost plus mark-up in comparable unrelated transactions)

Cost plus markup in comparable unrelated transactions = gross profit in
comparable unrelated transactions/ costs in the comparable unrelated
transactions x 100%

The cost plus method is usually applied to related party transactions including
transfer of the right to use or the ownership of tangible assets, financing and
service transactions.

The comparability analysis under the cost plus method should examine, in
particular, the differences in functions performed, risks assumed, assets used
by enterprises, and the contractual terms between related party transactions
and unrelated party transactions, as well as other factors affecting cost plus
mark-up, including manufacturing, processing, assembly and testing functions,
market and foreign exchange risks, value and useful life of equipment and
machinery, use and value of intangibles, business experience, accounting
treatment of the product/asset transferred, and production and management
efficiency, etc.

If there are significant differences between related party transactions and
unrelated party transactions in the aforementioned aspects, reasonable
adjustments should be made to the cost plus margin to account for the effect of
these differences. If reasonable adjustments cannot be made, other
appropriate transfer pricing method(s) should be selected.

Article 20

The transactional net margin method determines the profit that arises from a related party transaction by reference to the net profit indicator earned in comparable unrelated transactions.

Net profit indicators include operating margin, full cost mark-up, return on assets and Berry ratio, etc.

Calculation formulae are as follows:

1. Operating margin = (earnings before interests and taxes (EBIT) / operating revenue) x 100%
2. Full cost mark-up = (EBIT / full cost) x 100%
3. Return on assets = EBIT / [(total assets at the beginning of the year + total assets at the end of the year) / 2] x 100%
4. Berry ratio = [gross profit / (operating expenses + general & administration expenses)] x 100%

The profit level indicator selected should reflect the functions performed, risks assumed and assets used by the parties to the related party transaction. The calculation of profit indicators should be based on the financial data calculated for accounting purposes, however, appropriate adjustments may be made to certain data when necessary.

The transactional net margin method is usually applied to related party transactions including transfer and purchase of the right to use or ownership of tangible assets, purchase of the right to use intangibles, and service

transactions where parties involved do not own significant intangibles.

The comparability analysis under the transactional net margin method should examine, in particular, the differences in functions performed, risks assumed and assets used by enterprises, and the differences in economic environments between related party transactions and unrelated party transactions, as well as other factors affecting profits, including industry and market overview, business scale, economic cycle and product life cycle, allocation of revenue, cost, expenses and assets, accounting treatment, and operation and management efficiency, etc.

If there are significant differences between related party transactions and unrelated party transactions in the aforementioned aspects, reasonable adjustments should be made to the profit to account for the effect of these differences. If reasonable adjustments cannot be made, other appropriate transfer pricing method(s) should be selected.

Article 21

The profit split method determines the profits to be allocated to the enterprise and its related parties based on their respective contribution to the combined profits (actual or estimated) of the related party transactions. The profit split method mainly includes the general profit split method and the residual profit split method.

Under the general profit split method, each of the parties to the related party transaction is allocated with arm's length profits based on the functions

performed, risks assumed and assets used respectively. Where it is difficult to obtain information on comparable transactions but reasonably easy to determine the consolidated profit, factors relevant to value contribution such as income, cost, expenses, assets and employee headcount can be used, taking into account of the circumstances, to analyze value contribution made by each party and allocate profits accordingly.

Under the residual profit split method, in the first stage, each of the related parties is allocated with a routine profit. In the second stage, any residual profit remaining after subtracting the sum of the routine profits from the combined profit is allocated to each of the related parties based on their respective contribution to the residual profit.

The profit split method is usually applied to related party transactions where both the enterprise and its related party make unique contribution to profit creation, engage in highly integrated operations and thus difficult to separately assess each party. The application of the profit split method should reflect the basic principle that profits are taxed where economic activities take place and value is created.

The comparability analysis under the profit split method should examine, in particular, the functions performed, risks assumed, and assets used by each party, allocation of revenue, cost, expenses and assets to each party, location savings, market premium and other location specific factors, together with other value creating factors, to determine the reliability of information and

assumptions used to evaluate the contribution of each related party to the residual profit.

Article 22

Other methods that satisfy the arm's length principle include asset valuation methods applying cost approach, market approach, or income approach, and methods that reflect the basic principle that profit attribution aligns with economic substance and value creation.

The cost approach is a valuation method that uses substitution cost or replacement cost to reconstruct a cost that generates an asset similar to the asset under valuation in the current market place. The cost approach is applicable to valuation of a replaceable asset.

The market approach is a valuation method that determines the value of an asset by directly referring or indirectly comparing to the latest trading price of the assets same or similar to the asset under valuation. The market approach is applicable to asset valuation where the information on unrelated party transactions that are same or similar to the tested transaction is available in the market.

The income approach is a valuation method that determines the value of an asset based on the present value of the expected returns derived from the asset. The income approach can be used to determine the value of an enterprise as a whole or evaluate individual asset with future returns that can be reasonably forecasted.

Article 23

When analyzing and evaluating the related party transactions entered into by the enterprises under investigation, tax authorities should analyze the functions and risks of each of the parties to the transaction and select the party with relatively simpler functions as the tested party.

Article 24

When conducting comparability analysis, publicly available information should be the first choice of tax authorities. Non-public information may also be used as supplemental data source.

Article 25

When analyzing and evaluating whether a related party transaction is consistent with the arm's length principle, tax authorities may calculate different statistics, such as arithmetic average, weighted average or the inter-quartile range to determine the point or range of the profit or price of the comparables. The calculation can be done on a year-by-year basis or multiple-year average basis.

The tax authorities should use the comparable profit or price to test the related party transaction entered into by the enterprise under investigation on the year-to-year basis and make adjustments accordingly.

Where the actual profit of the enterprise is lower than the median of the inter-quartile range of comparables, generally, tax authorities should adjust the profit to the median.

Article 26

When analyzing and evaluating toll processing provided by the enterprise under investigation to its related parties, if the comparables selected do not adopt such business model and the differences in business models will affect the profit level, tax authorities should make adjustment to reestablish the value of the imported materials and equipments of the enterprise that would have been if they were provided with charge. For enterprise that provides authentic and complete information on the entire value chain of which toll processing is a part, and the information provided can reflect the overall profit levels of the related parties, tax authorities may make a comparability adjustment to the comparable profit level to account for the difference in capital employed between the enterprise under investigation and the comparables due to the reestablishment of the cost of materials and equipments. But if the adjustment exceeds 10% of the comparable profit level before the adjustment, comparables should be reselected.

Except for the situation referred to in the first paragraph of this article, differences in profit derived from working capital difference should not be adjusted.

Article 27

When analyzing and evaluating whether a related party transaction is consistent with the arm's length principle, if comparable companies selected and the enterprise under investigation are under different economic

environments, tax authorities should analyze location specific factors, such as cost savings, market premium, etc., and select an appropriate transfer pricing method to determine the contribution to profits derived from the location specific factors.

Article 28

Generally, enterprises engaged in simple manufacturing such as toll processing or processing with imported materials, simple distribution or contract research and development, should maintain a reasonable level of profit.

If the aforementioned enterprise incurs a loss, regardless of whether it exceeds the thresholds for preparing contemporaneous documentation as prescribed in State Administration of Taxation's Public Notice on Matters Regarding Refining the Reporting of Related Party Transactions and Administration of Transfer Pricing Documentation (SAT Public Notice [2016] No. 42), it should prepare contemporaneous documentation local files for the loss-making years. Tax authorities should focus on reviewing the local files of the aforementioned enterprise and strengthen the monitoring and administration.

If the aforementioned enterprise assumes risks and losses resulting from wrong decisions made by related parties, under-utilization, sluggish sales, R&D failure, etc. that should have been assumed to the related parties, tax authorities have the right to make a special tax adjustment.

Article 29

When investigating and analyzing a related party transaction, the tax authorities should determine if the returns earned by the enterprise align with the functions performed and risk assumed.

Where a concealed related party transaction between an enterprise and its related parties directly or indirectly reduce total tax revenue of the country, tax authorities may make a special tax adjustment by reconstructing the concealed transactions.

Where an offset of related party transactions between an enterprise and its related parties directly or indirectly reduce total tax revenue of the country, tax authorities may make a special tax adjustment by reconstructing the offset transactions.

Article 30

When determining the contribution made by an enterprise and its related parties to the value of intangibles and the corresponding allocation of returns, it is necessary to conduct a comprehensive analysis of the global operation process of the group to which the enterprise belongs, and fully consider the value contribution of each party in the development, enhancement, maintenance, protection, exploitation and promotion of the intangibles, how the value of intangibles is realized, and the interaction of the intangibles with business within the enterprise group with respect to functions performed, assets used and risks assumed.

The enterprise that only has legal ownership of the intangibles but has made no contribution to the value of the intangibles should not be allocated with income derived from the intangibles. The enterprise that only provides funding during the development and exploitation of intangibles, but does not undertake relevant functions and assume relevant risks, should only be entitled to a reasonable return on the funding cost.

Article 31

Royalty paid by an enterprise to its related parties or royalty received by an enterprise from its related parties for the right to use intangibles should be adjusted in a timely manner under the following circumstances. Tax authorities may make a special tax adjustment to royalty if such adjustment has not been made timely:

1. There is a material change to the value of the intangibles;
2. The business norm in comparable unrelated transactions is to have a mechanism in place to adjust the royalty;
3. The functions performed, risks assumed or assets used by the enterprise and its related parties change during the exploitation of intangibles; and
4. The enterprise and its related parties contribute to subsequent development, enhancement, maintenance, protection, exploitation and promotion of the intangibles but are not appropriately compensated.

Article 32

Royalty paid by an enterprise to its related parties or royalty received by an

enterprise from its related parties for the right to use intangibles should aligns with the economic benefits conferred to the enterprise or its related parties by the intangibles. Tax authorities can make a special tax adjustment on royalty that does not align with the economic benefits and thus resulting in a reduction in the taxable revenue or income of the enterprise or its related parties. If the intangibles do not confer economic benefits and the royalty is not consistent with the arm's length principle, tax authorities can make a special tax adjustment to the extent of the full amount of the royalty deducted for income tax purposes.

If an enterprise pays royalty to an overseas related party which has only the legal ownership of the intangibles without making contribution to the value creation of the intangibles, and if such payment is not consistent with the arm's length principle, tax authorities can make a special tax adjustment to the extent of the full amount of the royalty deducted for income tax purposes.

Article 33

If the primary purpose of establishing an overseas holding company or a financing company is corporate financing or public listing, and royalty paid to the overseas related parties is solely for incidental benefits attributable to the financing and listing activities, and if such payment is not consistent with the arm's principle, tax authorities can make a special tax adjustment to the extent of the full amount of the royalty deducted for income tax purposes.

Article 34

Where an enterprise enters into a service transaction with its related parties, and pays or receives a service fee that is not consistent with the arm's length principle and thus resulting in a reduction in the taxable revenue or income of the enterprise or its related parties, tax authorities can make a special tax adjustment.

A related party service transaction that is consistent with the arm's length principle should be a beneficial service transaction, and the pricing of the transaction is consistent with the business norm and the arm's length principle observed by unrelated parties under the same or similar circumstances. Beneficial services refer to services which confer direct or indirect economic benefits to the service recipients and, under the same or similar circumstances, an unrelated party would have been willing to pay for the services or performed the services itself.

Article 35

Where an enterprise pays service fees to its related parties for a non-beneficial service, tax authorities can make a special tax adjustment to the extent of the full amount of the royalty deducted for income tax purposes. Non-beneficial services mainly include the following:

1. Services received from related parties that have already been purchased or undertaken by the service recipient itself.
2. Services received from related parties for the protection of the investment interests of the direct or indirect investors of the service recipients, including

control, management and supervising activities. Such activities mainly include the following:

- 1). Holding meetings such as board of directors meetings, shareholder meetings, and supervisory board meetings, issuance of stock and other services that benefit the shareholders;
- 2). Activities in relation to the preparation or analysis of operating reports or financial reports of the direct or indirect investors of the service recipient, group headquarters and regional headquarters;
- 3). Financing activities in relation to the operation management and capital management of the direct and indirect investors of the service recipient, group headquarters and regional headquarters;
- 4). Finance, tax, human resources, legal and other service activities carried out for the decision-making, monitoring, control and compliance purposes of the enterprise group; and
- 5). Other similar activities.

3. Services received from related parties that are not specifically provided to the service recipient from which it obtains benefits solely for being a part of the enterprise group. Such activities mainly include the following:

- 1). Group restructuring activities such as change in legal form of an enterprise, debt restructuring, share acquisition, asset acquisition, mergers, and spin-offs leading to synergies or economies of scale to the service recipient;
- 2). Activities leading to lower financing costs for the service recipient as a

result of improved credit rating of the enterprise group to which it belongs; and

3). Other similar activities.

4. Services received from related parties for which the service provider has been remunerated through payments for other related party transactions. Such activities mainly include the following:

1). Patented or non-patented technology related services for which the service provider has been remunerated through royalty payments;

2). Loan related services for which the service provider has been remunerated through interest payments; and

3). Other similar activities.

5. Services that are unrelated to the functions performed and risks assumed by the service recipient, or related party services that are not required in the operations of the service recipient.

6. Other related party services which do not confer any direct or indirect economic benefits to the service recipient, or which an unrelated party would not have been willing to pay for or perform.

Article 36

Enterprises receiving or providing beneficial services should take factors, such as the nature and characteristics of the service, functions performed, risks assumed, costs and expenses of the service provider, benefits conferred to the service recipient, market environment, financial conditions of both parties, pricing of comparable transactions, etc., into consideration in selecting an

appropriate transfer pricing method in accordance with the relevant provisions in the Measures and comply with the following principles:

1. If the relevant service costs and expenses of the related party services can be attributed to each service recipient and/or each service project, the service fees should be determined based on the reasonable costs and expenses attributed to the service recipient or service projects.
2. If the relevant service costs and expenses of the related party service cannot be attributed to each service recipient and/or each service project, reasonable standards and ratios should be applied to allocate the cost to each service recipient. The service fees should be determined based on the allocated costs and expenses.

Taking into account of the nature of the service, the allocation keys can be operating income, operating assets, employee headcount, salary, equipment utilized, data traffic, working hours or any other reasonable indicators, depending on the circumstances. The allocation thereof should align with the benefits conferred to the service recipient. Costs and expenses incurred for non-beneficial services should be excluded from the cost pool for allocation.

Article 37

Where an enterprise makes a payment to its overseas related party that has no functions performed, risks assumed, or any substantial operating activities, and if the payment is not consistent with the arm's length principle, tax authorities can make a special tax adjustment to the extent of the full amount

of the royalty deducted for income tax purposes.

Article 38

In principle, no special tax adjustments will be made on transactions between domestic related parties with the same effective tax burden, as long as such transactions do not directly or indirectly result in a reduction of overall domestic tax revenue.

Article 39

Upon investigation, if the tax authorities do not find any special tax adjustment issue, it should draw a conclusion for the special tax investigation, and issue a “Special Tax Investigation Conclusion Notice” to the enterprise.

Article 40

Upon investigation, if the tax authorities identify special tax adjustment issues, they should make a special tax adjustment in accordance with the following procedures:

1. Prepare a special tax investigation plan based on the calculation, verification and comparability analysis;
2. Conduct negotiations with the enterprise under investigation based on the proposed special tax investigation adjustment plan. Both the tax authorities and the enterprise should designate a primary negotiator respectively. Tax inspectors should prepare the “Negotiation Records”, which should be signed and confirmed by the primary negotiator from each party. If the enterprise refuses to sign the document, inspectors (two or more) should specify

accordingly. If the enterprise refuses to negotiate, tax authorities should deliver a “Special Tax Investigation Preliminary Adjustment Notice” to it;

3. During the negotiation, if the enterprise disagrees with the proposed special tax adjustment plan, it should provide further information within the time period specified by tax authorities. Tax authorities should review the additional information provided carefully, and draw a conclusion for the review. If a special tax adjustment needs to be made based on the review, tax authorities should formulate a preliminary adjustment plan and issue a “Special Tax Investigation Preliminary Adjustment Notice” to the enterprise;

4. The enterprise should respond in writing within seven days of receiving the “Special Tax Investigation Preliminary Adjustment Notice” if it disagrees with the preliminary adjustment. Upon receiving the enterprise’s response, tax authorities should further negotiate with the enterprise and review the case. If a special tax adjustment needs to be made based on the further review, tax authorities should formulate a final adjustment plan and issue a “Special Tax Investigation Final Adjustment Notice” to the enterprise; and

5. If the enterprise, upon receiving the “Special Tax Investigation Final Adjustment Notice”, does not raise any disagreement within the time period specified by the tax authorities, or refuses to negotiate after disagreeing with the preliminary adjustment, or disagrees with the preliminary adjustment but the tax authorities do not accept the disagreement after further review, tax authorities should formulate the final adjustment plan based on the preliminary

adjustment plan and issue a “Special Tax Investigation Final Adjustment Notice” to the enterprise.

Article 41

If the enterprise disagrees with the “Special Tax Investigation Final Adjustment Notice” issued by the tax authorities, it may apply for administrative appeal in accordance with the law after paying the relevant taxes, interests and late payment surcharges or providing required guarantees.

Upon receiving the “Special Tax Investigation Final Adjustment Notice” issued by the state tax bureau, a disagreeing enterprise can apply for administrative appeal to the state tax bureau at the next higher level. If the “Special Tax Investigation Final Adjustment Notice” is issued by the local tax bureau, the disagreeing enterprise can apply for administrative appeal to the local tax bureau at the next higher level or to the local government at the same level.

Where an enterprise disagrees with the decision of administrative appeal, it can file an administrative lawsuit in the court in accordance with the law.

Article 42

Where a special tax adjustment made is related to outbound payments of interest, rental, royalties, etc., there will be no adjustment with respect to withholding taxes already paid unless otherwise specified.

Article 43

Enterprises can pay taxes themselves before receiving the “Special Tax Investigation Final Adjustment Notice” and should fill in and submit the

“Special Tax Adjustment Self-adjustment Form”.

Article 44

When implementing a special tax adjustment, in accordance with the provisions of the Enterprise Income Tax and its implementation rules, tax authorities shall impose an interest on the underpaid tax amount for the related party transactions occurring on and after 1 January 2008. The interest shall be charged on a daily basis.

The tax payment resulting from a special tax adjustment should be allocated to the years to which underpaid tax is related in a chronicle order. To calculate the interest levy for each year, the date when the tax payment is remitted is used as the cut-off date.

1. For an enterprise that makes the tax payment before or after the delivery of the “Special Tax Investigation Final Adjustment Notice”, the interest should be calculated for the period from 1 June of the year following the tax year to which the tax payment is related to the day the tax is remitted. For an enterprise which does not settle the underpaid tax within the period specified in the “Special Tax Investigation Final Adjustment Notice”, a late payment surcharge should be imposed from the day following the last day of the aforementioned specified period according to the Tax Collection and Administration Law and its implementation regulations. No interest should be levied for the late payment surcharge period.

2. The annual interest rate equals the People’s Bank of China base interest

rate (hereinafter referred to as the base interest rate) on RMB loans with the same term as the underpaid tax published on 31 December of the tax year to which the underpaid tax is related plus 5%. The daily interest rate is calculated based on the annual interest rate, assuming 365 days per year;

3. For an enterprise that provides contemporaneous documentation and relevant information in accordance with relevant regulations, or for an enterprise which is exempted from the preparation of contemporaneous documentation in accordance with the relevant regulations but provides other relevant information upon request of tax authorities, the annual interest rate applied is the base interest rate only.

For an enterprise which is found to enter into related party transaction with amount that exceeds the threshold for preparing contemporaneous documentation after investigation by tax authorities, but has not provided contemporaneous documentation to the tax authorities in accordance with relevant regulations, the annual interest rate is applied as prescribed in Item 2 of this article.

Article 45

For an enterprise that makes a self-adjustment to pay the underpaid tax and voluntarily provide contemporaneous documentation or other relevant information, or that is exempted from the preparation of contemporaneous documentation in accordance with relevant regulations but provide other relevant information upon request of tax authorities, the interest rate applied on

the self-adjusted tax payment for the transactions occurring on and after the 1st January 2008 is the base interest rate only.

Article 46

Where an enterprise applies for a change of business address or business dissolution for tax purposes during a special tax investigation, tax authorities, in principle, should not approve the application until the investigation is concluded.

Article 47

Upon receiving the application from an enterprise or the request from a competent tax authority of a tax treaty contracting party, the State Administration of Taxation may initiate mutual agreement procedure in accordance with the relevant provisions in the tax treaty entered into by China and the other tax treaty contracting party and conduct negotiations with the other tax treaty contracting party to avoid or eliminate double taxation arisen from a special tax adjustment.

The mutual agreement procedure applies to:

1. The consultative process with respect to bilateral or multilateral APAs; and
2. The consultative process with respect to special tax adjustments made by one tax treaty contracting party that may lead to corresponding adjustments made by the other tax treaty contracting party.

Article 48

An enterprise applying for mutual agreement procedure should submit the

“Application for Initiating Mutual Agreement Procedures Concerning Special Tax Adjustment” and relevant information related to the special tax adjustment in writing to the State Administration of Taxation within the time period specified in the tax treaty. If the application is submitted in person, the application date is the submission date; if the application is submitted by mail, the application date is the date that the State Administration of Taxation receives the aforementioned application information.

Upon receiving the aforementioned materials from the enterprises, the State Administration of Taxation can initiate the mutual agreement procedure if the case is considered to be in accordance with the relevant provisions in the tax treaty; if the information is considered to be insufficient, the State Administration of Taxation can request additional information from the enterprise.

Article 49

Upon receiving the formal notification from the competent tax authority of the other tax treaty contracting party to request mutual agreement procedure, the State Administration of Taxation can initiate the mutual agreement procedure if the case is considered to be in accordance with the relevant provisions in the tax treaty.

The State Administration of Taxation can request additional information from the competent authority of the other tax treaty contracting party if the information provided in the notification is considered to be incomplete or

unclear, or request assistance from domestic enterprises involved in the case to verify the information through the in-charge tax authorities.

Article 50

The State Administration of Taxation should notify the provincial tax authorities in writing and also inform the competent tax authority of the other tax treaty contracting party once it decides to initiate the mutual agreement procedure. Within 15 working days of receipt of the written notice from the provincial tax authorities, the in-charge tax authorities handling the special tax adjustment related matters should deliver the “Notice on Tax Matters” to the enterprise involved in the case to inform it of the initiation of the mutual agreement procedure.

Article 51

When conducting the mutual agreement procedure, tax authorities may request for additional information from the enterprise involved in the case. The enterprise should submit such information within the prescribed time period.

Article 52

The State Administration of Taxation can decline the application filed by an enterprise or the notification from the competent tax authority of the other tax treaty contracting party to request mutual agreement procedure in any of the following circumstances:

1. The enterprise or its related party is not a tax resident of either of the tax treaty contracting parties;

2. The issue for which the mutual agreement procedure is requested is not a special tax adjustment issue;
3. The request for the mutual agreement procedure lacks factual or legal basis;
4. The request for the mutual agreement is not in accordance with relevant provisions of the tax treaty; and
5. The relevant special tax adjustment case is not concluded or the enterprise has not paid the underpaid tax resulting from the concluded case.

Article 53

The State Administration of Taxation can suspend the mutual agreement procedure in any of the following circumstances:

1. The applying enterprise requests to suspend the mutual agreement procedure;
2. The competent tax authority of the other tax treaty contracting party requests to suspend the mutual agreement procedure;
3. The initiation of the requested mutual agreement procedure is dependent on the conclusion of a special tax adjustment case for an enterprise other than the applying enterprise, however the case is not yet concluded; and
4. Other circumstances that lead to suspension of the mutual agreement procedure.

Article 54

The State Administration of Taxation can terminate the mutual agreement procedure in any of the following circumstances:

1. Enterprise or its related party involved in the case does not provide necessary information in relation to the case, provide false or incomplete information, or is uncooperative in other manners;
2. Applying enterprise requests to withdraw or terminate the mutual agreement procedure;
3. The competent tax authority of other tax treaty contracting party withdraws or terminates the mutual agreement procedure; and
4. Other circumstances that lead to termination of the mutual agreement procedure.

Article 55

The State Administration of Taxation should notify the provincial tax authorities in writing if it decides to suspend or terminate the mutual agreement procedure. Within 15 working days of receipt of the written notice from provincial tax authorities, the in-charge tax authorities handling the special tax adjustment related matters should deliver the “Notice on Tax Matters” to the enterprise to inform it of the suspension or termination of the mutual agreement procedure.

Article 56

After signing a mutual agreement with the competent tax authority of the other tax treaty contracting party, the State Administration of Taxation should notify the provincial tax authorities in writing with the mutual agreement attached. Within 15 working days of receipt of the written notice from the provincial tax authorities, the in-charge tax authorities handling the special tax adjustment

related matters should deliver the “Notice on Tax Matters” with the mutual agreement attached to the enterprise. If a tax payment (or refund) is needed, the in-charge tax authority should attach “Notice of Tax Payment (or Refund) to Implement a Mutual Agreement Concerning Special Tax Adjustment” or “Notice of Tax Payment (or Refund) to Implement an APA”, and monitor the tax payment remittance or refund.

If the enterprise’s taxable revenue or income is calculated in foreign currencies, the underpaid tax or tax refund should be converted to RMB using the middle rate of the prevailing exchange rate on the last day of the month proceeding the day when the mutual agreement is delivered to the enterprise.

If the underpaid tax is subject to interest levy, the interest should be determined based on base interest rate on RMB loans in accordance with Article 122 of The Implementation Regulations of Enterprise Income Tax Law of the People’s Republic of China.

Article 57

All levels of tax authorities should ensure the confidentiality of the information provided by the competent tax authority of the other tax treaty contracting party, the enterprise, its tax withholding agent and other agent in the course of mutual agreement procedure.

Article 58

If an enterprise, its tax withholding agent or other agent commits fraud or other illegal acts in the course of the mutual agreement procedure, the tax

authorities should deal with it in accordance with the relevant provisions in Tax Collection and administration Law and its implementation regulations.

Article 59

An enterprise applying for mutual agreement to the State Administration of Taxation in accordance with the Measures should submit materials in both Chinese and English. The information submitted to the competent tax authorities of both tax treaty contracting parties should be consistent.

Article 60

Mutual agreement procedure in relation to interpretation and application of tax treaties should follow the relevant provisions as set out in “Public Notice Issued by the State Administration of Taxation Regarding the Implementation Measures of Mutual Agreement Procedure” (State Administration of Taxation Public Notice [2013] No. 56).

Article 61

Mutual agreement procedure cases that have been accepted but not yet concluded before the effective date of the Measures should follow the provisions as set out in the Measures.

Article 62

The Measures should take effect from 1 May 2017. Chapters 4, 5, 11 and 12 of the “Implementation Measures of Special Tax Adjustments (Trial Version) (Guo Shui Fa [2009] No. 2)”, the “Notice Issued by the State Administration of Taxation Regarding Enhancing Follow-up Administration on Transfer Pricing

Adjustments” (Guo Shui Han [2009] No. 188), the “Notice Issued by the State Administration of Taxation to Strengthen the Supervision and Investigation of Cross-border Related Party Transactions” (Guo Shui Han [2009] No. 363), the “Public Notice Issued by the State Administration of Taxation regarding Certain Matters for the Supervision and Administration of Special Tax Adjustment” (SAT Public Notice [2014] No. 54) and the “Public Notice of the State Administration of Taxation Regarding Certain Enterprise Income Tax Matters on Outbound Payments to Overseas Related Parties” (SAT Public Notice [2015] No. 16) should be annulled as of the same date.