

# China Law Update

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## China Enhances Supervision of Cross-border Related Party Transactions

On July 6, 2009, the China State Administration for Taxation (“SAT”) issued a Notice Regarding Enhancement of Supervision and Investigation of Cross-border Related Party Transactions (the “Notice”). The Notice aims at preventing overseas companies from shifting losses to their related-parties in China against the backdrop of the financial downturn.

### **Major Points**

The Notice underlines that companies set up in China by multinational companies shall not burden risks of marketing and decision-making incurred by the financial crisis, given that such companies operate for limited functions and risks of production, distribution and contractual research and development.

Moreover, the Notice clarifies that, if the foregoing companies were in loss, the companies should prepare contemporaneous documentation and other relevant documents in the year when such losses incurred regardless of whether the underlying transactions has exceeded the threshold for contemporaneous documentation. The companies shall submit those documents to tax administrations prior to June 20 of the following year.

In addition, pursuant to the Notice, local tax administrations are bestowed to heighten the supervision of cross-border and related party transactions as well as decide a reasonable transfer pricing method. Multinational companies who are committed to shifting their overseas losses (including potential losses) to China and diverting their profits to tax heavens via various vehicles will be subject to more supervision and investigations by local tax administrations.

### **Conclusion**

In a nutshell, the Notice, issued after the promulgation of Implementation of Measures Regarding Special Tax Adjustments in China, further demonstrates the Chinese tax administrations' confidence that they strengthen the enforcement of transfer pricing as well as protect the tax base. Importantly, multinational companies, especially the aforementioned companies, should balance all facts of their related party transactions and maintain stable policies regarding their transfer pricing by taking into consideration China's legal policies.

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