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Circular of the State Administration of Taxation on Strengthening the Supervision over and Investigation of Cross-border Related Party Transactions

Guo Shui Han [2009] No. 363

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To the state taxation bureaus and local taxation bureaus of all provinces, autonomous regions, municipalities directly under the Central Government and cities specifically designated in the state plan:

For the purposes of further regulating the administration of special tax adjustments and preventing multinational enterprises from transferring the losses of their overseas enterprises to their domestic connected enterprises in the financial crisis environment, in accordance with the provisions of the Circular of the State Administration of Taxation on Printing and Distributing the Tentative Implementing Measures for the Special Tax Adjustments (Guo Shui Fa [2009] No. 2), it is hereby clarified several issues concerning the supervision over and investigation of enterprises' cross-border related party transactions as follows:

Article 1 Enterprises established by a multinational enterprise within the territory of China to bear limited functions and risks such as mono-production (processing with supplied materials or processing with imported materials), distributions or contractual research and development, are not to bear risks such as market risk, decision-making risk, etc. in the financial crisis, and shall maintain reasonable profits pursuant to the transfer pricing principle that functions and risks match profits.

Article 2 In case the said enterprise bearing limited functions and risks incurs losses, it shall, regardless whether the losses meet the requirement of providing materials of the current period, prepare materials of the current period and other relevant materials of the year in which the losses incur, and shall submit the same to the competent tax authority prior to June 20 in the following year.

Article 3 All local tax authorities shall strengthen the supervision over cross-border related party transactions, attach great importance on investigating multinational enterprises which transfer overseas losses (including potential losses) to domestic enterprise and transfer domestic profits to tax heavens through various means, strengthen the analysis of functions and risks and the comparability analysis, and select reasonable means to price the transfer in order to determine enterprise's profit level.