



ALERT

CHINA

Direct & Indirect Tax Authorities Focus on Automotive Industry

The State Administration of Taxation ("SAT") has, in recent years, taken a more industry-focused approach towards transfer price audits. To achieve this, the SAT has provided its audit teams with specialized and industry focused training.

In its 2010 work plan announcement, the SAT specifically provides for national training relating to the automotive industry. This training is apparently scheduled for July 2010. Based on past training programs, the automotive industry training will include views and inputs from external experts from the private sector as well as from the Organization for Economic Co-operation and Development ("OECD"). Private sector experts may include major tax payers from the automotive industry as well as accountancy firms.

While training is a standard SAT practice of upgrading the skills of its personnel and learning industry practices, the focus on the automobile industry clearly signals the SAT's intention of placing the industry under close scrutiny. Furthermore, SAT auditors already have a considerable amount of knowledge and experience in respect to this industry due to their work on bilateral advance pricing arrangements and mutual agreement procedure cases. As such, automotive players should especially be vigilant in ensuring that their direct tax obligations, including transfer pricing policies and practices, are fully compliant.

Customs Perspective

China Customs is closely examining companies which pay royalties, license fees and commissions, or which provide assists to manufacturers. Such payments are common practices of the automotive industry and as such, the industry will face China Customs' scrutiny, in addition to the SAT. If royalty payments, license fees and commissions are made, or if assists are provided to manufacturers, then the company should review these arrangements to determine whether the payments are likely to meet the criteria for inclusion in the value declared to Customs.

The SAT and China Customs are two separate taxation points, one in-country and the other at the border; a business must meet both authorities' requirements. In general, the Customs authority would prefer a higher value declared at the border as this is the point at which duty and value-added tax ("VAT") is levied. Conversely, the direct tax authority would prefer a lower cross border price as the profit made in-country would then be greater.

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China Customs will also look closely at related party transactions. Even if a company has reached agreement that its transfer price is acceptable for SAT purposes, it may face questions on that transfer price for Customs purposes. A transfer price acceptable for direct tax purposes may not be acceptable from a Customs perspective.

All companies, including those in the automotive industry, should initiate a full customs compliance review of their cross border activities. A customs compliance review should not just focus on the value of goods. A complete review of tariff classification, goods origin, and if an approved processing trade entity, a review of inventory control systems should be conducted.

For both the SAT and China Customs, ensuring that all required records are maintained and available for inspection is equally important. Penalties for non-compliance with statutory record keeping requirements can be severe.



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If you have any comments or questions with regard to this Bulletin or any matters discussed herein, or if you are interested in finding out more about BCIT's services, please contact any of the persons listed below:

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