

# SAT Distributes "Guide for Large-scale Enterprises to Manage Taxation Risks (Provisional)"

Circular Guoshuifa [2009] No. 90

State taxation bureaus and local taxation bureaus of all provinces, autonomous regions and municipalities directly under the central government and cities under separate state planning,

In order to strengthen tax administration and tax services for large enterprises and guide them to carry out tax risk management, and to prevent lawbreaking and implement the duty of taxpaying, this "Guide for Large-scale Enterprises to Manage Taxation Risks (Provisional)" has been issued to you. Please publicize the notice, assist enterprises with implementation and give feedback to the SAT regarding any problems and recommendations for implementation.

May 5, 2009

## 1 General Provisions

1.1 The purpose of the guidelines is to encourage reasonable control of large enterprises' tax risks, prevent any illegal tax activities and implement the duty of taxpaying, thus potentially avoiding legal punishments, asset losses or damage to reputation for non-compliance.

1.2 The main objectives of tax risk management include:

- Tax planning based on reasonable business purposes and in accordance with the provisions of tax laws;
- Business decision-making and daily business activities taking into account impact of tax factors and in line with the tax regulations;
- The accounting treatment of tax matters in line with the accounting system or guidelines, as well as the relevant laws and regulations;
- Tax filing and payment of taxes in line with the tax provisions;
- Tax registration, management of certificate documents, tax records management, and the preparation of tax information and tax-related matters in line with the tax provisions.

1.3 Enterprises can refer to this guideline and, in light of their own operating situations, tax risk characteristics and the existing internal risk control system, establish corresponding tax risk management systems. Tax risk management systems mainly include:

- The organization, roles and responsibilities of tax risk management structure;
- The mechanisms and methods of tax risk identification and assessment;
- The mechanisms and measures of tax risk control and management activities;
- Tax information management systems and communication mechanisms;
- The supervision and improvement mechanisms of tax risk management.

1.4 Tax authorities refer to this guideline to evaluate the effectiveness of enterprises' establishment and implementation of enterprise tax risk management, as well as to determine the appropriate tax management measures.

1.5 The enterprise should advocate law-abiding and tax risk management concepts of honest taxpaying and enhance employees' awareness of tax risk management concepts, which should form an important component of its corporate culture.

1.6 Tax risk management is supervised by the Board of Directors, who monitor and participate in the decision-making process. The Board of Directors and management team should recognize the prevention and control of enterprise tax risk as an important operational element in effectively promoting the interaction between internal management and external supervision.

1.7 The enterprise should establish effective motivation and restriction mechanisms. The organization should assess the effectiveness of tax risk management together with the performance of the relevant persons.

1.8 The enterprise should combine the tax risk management systems with other internal risk control and management systems to form a comprehensive and valid system of internal risk management.

## 2 Tax Risk Management Structure

2.1 Enterprises should integrate operational characteristics with internal tax risk management requirements to set up tax management institutions and positions with clear responsibilities and authorities.

2.2 Enterprises that have complex organizational structures should set up tax management departments or positions based on their needs:

- For enterprises with branches, the tax department or tax management positions are set up in the branch offices;

- For corporate groups, the tax department or tax management positions are established separately in the regional head offices, production segments or subsidiaries.

2.3 The tax management department is mainly responsible for the following duties:

- To establish and improve the corporate risk management systems and other tax-related rules and regulations;
- To participate in the tax-impact analysis of corporate strategic planning and significant business decision-making to provide the recommendations of tax risk management.
- To establish and implement the identification, assessment and monitoring, as well as response measures of daily tax risks of the enterprise;
- To guide and supervise the relevant functional departments, the business segments and wholly-owned or holding enterprises to develop their tax risk management;
- To establish information and communication mechanisms of tax risk management;
- To organize the tax training and provide the tax advice to other departments within the enterprise;
- To undertake or assist the relevant functional departments to carry out the preparation and storage of tax filing materials, tax payment materials, book vouchers and other tax-related information;
- Other tax risk management duties.

2.4 The enterprise should establish a scientific and effective separation of duties and checks-and-balances system to ensure the separation, restriction and supervision of different positions in tax administration. Incompatible duties of tax administration include:

- Drafting and approval of tax planning;
- Preparation and review of tax information;
- Completion and approval of tax filing forms;
- Completion and approval of the certification of the payment of tax;
- Purchase and storage of the invoices and financial seals;
- Treatment and reconfirmation of tax risk items;

- Other tax administration duties that should be separated.

2.5 Personnel in the tax-related business must have professional qualifications, good conduct and discipline, and must abide by laws.

2.6 Personnel in the tax-related business should be trained regularly to continuously improve their professional knowledge and ethical standards.

### 3 Tax Risk Identification and Assessment

3.1 The enterprise should, on a comprehensive, systematic and continuous basis, collect both internal and external information and, in combination with the actual situation, discover tax risks generated during the organization's operating activities and processes, analyse and describe the probability and conditions of the risks, as well as assess the impact of risks on the realization of the goal of tax management, through risk identification, risk analysis, risk assessment and other steps in order to determine the priorities for risk management and strategy. Enterprises should integrate their own tax risk management mechanisms with the actual operating conditions. The following are the main elements of tax risk:

- Tax compliance awareness and attitudes towards tax risks of the Board of Directors, Board of Supervisors and management team;
- Tax staff ethics and professional competence;
- Organizational structure, operational models and business processes;
- Technical inputs and the use of information technology;
- Financial position, operating results and cash flow;
- The design and implementation of related internal control system;
- Economic situation, industrial policies, market competition and trade practices;
- Laws, regulations and regulatory requirements;
- Other relevant risk elements.

3.2 Enterprises should carry out periodic tax risk assessments. Tax risk assessments should be implemented by the enterprise tax department and relevant functional departments. Enterprises can also employ intermediary organizations with relevant qualifications and professional abilities to assist the implementation.

3.3 Enterprises should actively manage the tax risk by identifying and assessing changes to existing risks and new tax risks in a timely manner.

#### 4 Strategies for coping with tax risk and internal control

4.1 Enterprises should control their overall tax risks by developing relevant strategies, establishing effective internal control mechanisms, and designing effective and rational tax administration and control processes, based on the results of risk assessment and considering the costs and benefits of the risk management.

4.2 Enterprises should establish tax risk control points with respect to organizational structure, allocation of responsibilities, business processes, information communication and inspection and supervision based on the causes and conditions of the risks. Enterprises should adopt relevant manual control mechanisms or automatic control mechanisms according to the different characteristics of the risks. They should also establish prevention-control mechanisms and detection-control mechanisms in accordance with the occurrence rate and respective degree of the risks.

4.3 For management functions and business processes involving significant tax risks, enterprises should establish control measures covering all aspects of the entire process. For business processes involving other risks, the enterprise should set up reasonable key control processes and take appropriate control measures.

4.4 Enterprises should report to the tax authorities in a timely manner to seek guidance and assistance when significant tax risks arise due to significant changes in internal organizational structure, business model, external environment, industry practices or regulatory constraints.

4.5 The tax department of the enterprise should be involved in corporate strategic planning and significant business decision-making, and track and monitor the relevant tax risks.

4.5.1 Corporate strategic planning includes the overall planning of the organizational structure, product and market strategic planning, competition and strategic development planning.

4.5.2 Significant corporate business decisions include decisions about major outbound investments, major mergers and acquisitions or restructurings, changes of business model, as well as signing of important contracts or agreements.

4.6 The tax department of the enterprise should be involved in important business activities and track and monitor the relevant tax risks.

4.6.1 Participate in the formulation of pricing of related-party transactions, and track the implementation of the pricing policy;

4.6.2 Participate in the formulation and implementation of international business strategy to ensure compliance with the tax laws.

4.7 The tax department of the enterprise should coordinate with the relevant functional departments to manage the tax risks of daily operation:

4.7.1 Participate in the formulation or review of tax related policies and regulations with respect to daily operations;

4.7.2 Develop the process of accounting-related matters; clarify the respective responsibilities and authorities; ensure the accounting treatment of tax related matters are in compliance with relevant laws and regulations;

4.7.3 Improve the preparation, review and approval of tax returns, as well as the procedures for tax payment; clarify respective responsibilities and rights to ensure that tax returns and payment are in line with tax laws;

4.7.4 Prepare and preserve tax related documentation honestly, completely and accurately in accordance with the tax law; and report and record the documents according to relevant regulations.

4.8 Enterprises should establish a monitoring mechanism of tax risks that occur with higher frequency. They should assess their cumulative effect and take appropriate measures.

## 5 Information and Communication

5.1 Enterprises should set up tax risk management information and communication systems, clarify collection, processing and delivery procedures for tax-related information to ensure communication and feedback within the tax department and between the tax department and other departments, and between the tax department and corporate governance and management of the Board of Directors and Board of Supervisors, so that issues can be reported and responded to on a timely basis.

5.2 Enterprises should maintain effective communication with the tax authorities and other relevant authorities to ensure timely collection of relevant information and feedback.

5.2.1 Establish and improve a system for collecting and updating tax laws to ensure timely compilation and regular update of tax laws applicable to the enterprises;

5.2.2 Establish and improve a system for collecting and updating other relevant laws and regulations to ensure that the setting and alteration of enterprises' financial accounting systems is synchronized with the requirements of the laws and regulations and that the output of accounting information will reflect the latest changes in laws and regulations.

5.3 Enterprises should apply the information technology to various types of tax risk management work based on the business characteristics and the cost-effectiveness principle. They should establish risk management information systems covering basic risk management processes and various aspects of the internal control systems.

5.3.1 Utilize computer systems and network technology to automatically control tax related matters that are re-occurring and systematic;

5.3.2 Incorporate the tax filing into the computer systems and utilize relevant filing software to improve the accuracy of tax returns;

5.3.3 Establish annual tax calendars to automatically remind the responsible persons to complete tax-related business; track and monitor the status of work;

5.3.4 Establish a tax document management database, adopt reasonable processes and use reliable technology for the secure storage of tax related information;

5.3.5 Use information management systems to improve the efficiency and effectiveness of the collection, processing and transmission of laws and regulations; dynamically monitor the implementation of laws and regulations.

5.4 The recording, collection, processing, transmission and preservation of data in the enterprise tax risk management information systems should comply with the tax law and the requirements of tax risk control.

## 6 Monitoring and Improvement

6.1 Tax departments should regularly assess and review the effectiveness of corporate tax risk management, and continuously improve and optimize the tax risk management systems and processes.

6.2 The internal control and evaluation department of the enterprise should evaluate the effectiveness of the tax risk management mechanisms according to the overall control objectives of the enterprise.

6.3 Enterprises can delegate a qualified intermediary organization to evaluate the effectiveness of the relevant internal control mechanisms of tax risk management and issue evaluation reports to the tax authorities, in accordance with these guidelines and the requirements of relevant practice guidelines.