

# China publishes 2017 APA annual report with further efforts to resolve international disputes

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## In brief

In November 2018, the State Administration of Taxation (SAT) of China published the China Advance Pricing Arrangement Annual Report (2017)<sup>1</sup> (Annual Report) in both Chinese and English versions. The Annual Report describes the regulations, procedures, latest statistics, and implementation status of the advance pricing arrangement (APA) program in China, and provides references for enterprises and competent tax authorities in other countries and regions. These statistics show that China had concluded a total of 147 APAs by the end of 2017, and a number of other APAs (yet to be concluded) were in the application process at that time.

In addition to becoming increasingly active in negotiating APAs, in recent years the Chinese tax authorities also have made significant efforts to enhance their capability in negotiating mutual agreement procedure (MAP) cases for historical disputes. According to the latest statistics released by the Organisation for Economic Co-operation and Development (OECD) in 2017, China has made significant progress in increasing its efficiency in resolving MAP cases and eliminating double taxation for enterprises. In the past two years, Chinese tax authorities have been actively participating in competent authority MAP meetings with tax authorities of other countries/regions. The frequency and number of MAP meetings in 2018 reached an historical high.

## In detail

### **Background information**

An APA is an arrangement where an enterprise applies in advance to negotiate and reach agreement with the tax authorities regarding the arm's length transfer pricing methods and corresponding calculation methods to be applied to its related-party transactions for future years. Since China signed its first bilateral APA with

Japan in 2005, China has concluded a total of 87 unilateral APAs and 60 bilateral APAs as of December 31, 2017. Bilateral or multilateral APA applications must be agreed to by two or more competent tax authorities before conclusion, which therefore can provide multinational groups with greater cross-border tax certainty and effectively reduce double taxation risk.

It is a common practice for countries to release APA annual reports and the SAT of China has been issuing them since 2009. The annual report provides an overview of China's APAs, discloses statistics as of the end of that year, and provides references for enterprises and competent tax authorities in other countries and regions.

**Key statistics for China APAs in 2017**

		<b>Unilateral APAs</b>	<b>Bilateral APAs</b>
<b>Number of APAs signed</b>	First-time signatures	3	2
	Renewal	0	3
<b>Region</b>	Asia	-	2
	Europe	-	3
<b>Time taken</b>	<1 year	1	3
	1-2 years	2	0
	2-3 years	0	0
	>3 years	0	2

**Overview of China's APAs****APAs by phase**

According to China's transfer pricing regulations<sup>2</sup>, the negotiation and conclusion of APAs includes three phases: intent, application, and signing (or signed). By the end of 2017, 84.5% of unilateral APAs (cumulative) were in the signing (or signed) phase; however, only 44.1% of the bilateral APAs (cumulative) were in the signing (or signed) phase. Most bilateral APAs were in the intent and application phases.

In this Annual Report, the SAT has reiterated the factors to be considered when determining whether to prioritize certain APA requests:

- Overall principle: first come, first served.
- The quality of the request submission, e.g., whether all required documents have been submitted, whether sufficient documentation clearly evidencing the transactions throughout the entire value chain or supply chain has been provided, whether the applied transfer pricing method is appropriate, and whether the calculation is correct.
- Whether the applicant is in a specific industry or located in a

specific region that merits prioritized attention.

- For a bilateral APA request, whether the bilateral APA partner country (region) intends to accept the case and pursue the bilateral APA also is an important factor for consideration.

**Observations**

Based on our observation, the Chinese tax authorities value most the quality of the submission. When reviewing APA requests, the Chinese tax authorities may require applicants to provide financial information for their overseas related parties, as well as the overall profit and profit distribution of the group across the value chain. In practice, whether an applicant can provide various overseas data, including value chain analysis, is a key factor used to judge if its APA request should be accepted or prioritized.

**APAs by transaction type**

By the end of 2017, 65% of concluded APAs in China addressed transactions involving tangible goods (i.e., buy-and-sell transactions), 16% involved transactions related to intangible assets, and the remaining 19% related to service transactions. By the end of 2017, no APA related to financing or transfer of financial

assets had been negotiated and concluded.

**APAs by country/region**

Since China is closest to the neighboring Asian countries, it has signed more bilateral APAs with Asian countries. By the end of 2017, China signed 39 bilateral APAs with Asian countries, 15 with European countries, and six with North American countries.

**APAs by time taken**

By the end of 2017, most (94%) unilateral APAs signed by China were concluded within two years. Bilateral APAs took more time to conclude, as they involve negotiations with the competent tax authorities of other countries/regions.

**APAs by transfer pricing method**

The transactional net margin method (TNMM) was the most commonly used method for APAs signed by China, accounting for 78% of APAs. Other transfer pricing methods were applied less frequently, since they require a higher standard of comparability.

According to the relevant Chinese APA regulations, the application materials for APAs should contain analysis of the enterprise's value chain or supply chain. This means the Chinese tax authorities are no longer

satisfied relying solely on one-sided analysis on a single enterprise, but rather they also are looking for two-sided analyses. The use of the profit split method is further clarified in the SAT Public Notice [2017] No. 6 (Public Notice No. 6)<sup>3</sup> issued in March 2017. The Annual Report once again emphasized that the Chinese tax authorities want applicants to provide sufficient transaction and pricing information, so as to increase the use of transfer pricing methods such as the resale price method and the profit split method.

#### Industries covered by signed APAs

There has been further diversification in the industries covered by China's APAs in recent years, yet 83.7% of the APAs signed still were related to the manufacturing industry.

#### **China tax authorities' recent efforts in international dispute resolution**

Currently the SAT has five teams to handle cases with different country focuses. In 2018, the SAT actively participated in competent authority meetings, with a record high frequency and number of meetings (14 to 15 competent authority meetings in 2018, a significant increase compared to prior years).

The SAT also has enhanced its organization and coordination for inter-provincial joint transfer pricing inspections and APA cases, which relieves enterprises' burdens and improves efficiency to some extent.

In addition to being more active in negotiating APAs, in recent years the SAT also has devoted effort to other competent authority meetings, including MAP meetings for historical disputes, to help enterprises better resolve double taxation.

The MAP process for historical disputes involves negotiation between the competent tax authorities of two different countries to resolve double

tax in respect of prior years (e.g., where the tax authorities of one of those two countries has made a transfer pricing assessment that resulted in double tax).

According to the Global Mutual Agreement Procedures Statistics for 2017<sup>4</sup> issued by the OECD in October 2018, the average time taken by Chinese tax authorities to resolve a transfer pricing related MAP case (for historical disputes) started after January 1, 2016 is 3.51 months, while for cases started before January 1, 2016 it was 31.86 months. While we cannot directly compare the two because different computing rules were used and different sample sizes were employed, it is clear that the SAT is making significant effort and has made substantial achievements in reducing the time taken to resolve MAP cases for historical disputes.

The OECD statistics also show that among the 16 transfer pricing-related MAP cases concluded by the Chinese tax authorities in 2017, there were seven cases in which the competent tax authorities reached an agreement to completely eliminate double taxation, three cases in which the double taxation was partially eliminated, and four cases in which unilateral tax credits were provided to taxpayers. This Annual Report also discloses that in 2017, Chinese tax authorities conducted bilateral negotiations with eight countries on 65 cases, which eliminated double taxation of RMB 1.2 billion. In Public Notice No. 6, the SAT for the first time set out how to deal with tax refund matters occurring in the MAP cases<sup>5</sup>.

#### **Observations**

We expect that the enhanced cooperation and improved efficiency of tax authorities in different countries (regions) could help multinational enterprises to eliminate double taxation issues arising from unilateral transfer pricing adjustments.

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#### **The takeaway**

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As the Chinese government focuses more on improving the business environment for enterprises, the tax authorities are putting 'tax service' in an increasingly important place among the three pillars of its anti-tax avoidance administration system (consisting of administration, investigation, and service), and are taking steady actions to promote their anti-tax avoidance work.

Lastly, although the SAT is committed to promoting competent authority processes, including APAs, at present taxpayers intending to apply for bilateral APAs still outnumber the SAT's processing capacity. We recommend that multinational enterprises considering applying for a China APA fully prepare for the application process, and take into consideration Chinese tax authorities' existing case inventory versus their processing capacity, as well as the complexity of the related-party transactions to be covered by the applications.

#### **Endnotes**

1. See China Advance Pricing Arrangement Annual Report (2017):  
[\(English version\)](#)  
[\(Chinese version\)](#)
2. Public Notice on Matters Regarding Enhancing the Administration of Advance Pricing Arrangements (Public Notice of the State Administration of Taxation [2016] No. 64)
3. Public Notice Issued by the SAT regarding Releasing the Administrative Measures for Special Tax Adjustment and Investigation and Mutual Agreement Procedures (SAT Public Notice [2017] No. 6, hereinafter "Public Notice No. 6")

4. See [OECD Global Mutual Agreement Procedures Statistics for 2017](#)
5. Article 56 of Public Notice No. 6: where a mutual agreement is reached between the State Administration of Taxation and the competent tax authority(ies) of

other contracting state (s) of the tax treaty(ies), the State Administration of Taxation shall notify the provincial tax authorities in writing and attach such mutual agreement...If it involves taxes payable (refundable), the State Administration of Taxation shall attach the Notice on Tax Payable

(Refundable) in Special Tax Adjustment and Mutual Agreement Procedures or the Notice on APA Tax Payable (Refundable), and monitor the implementation of such tax supplement and reimbursement.

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## Let's talk

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For a deeper discussion of how this issue might affect your business, please contact:

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