

China publishes 2018 APA Annual Report

June 5, 2019

In brief

The State Taxation Administration (STA) of China in April published the China Advance Pricing Arrangement Annual Report (2018) (2018 Annual Report) in [Chinese](#) and [English](#) versions. The 2018 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.

During 2018, Chinese tax authorities made continuous efforts to enhance their capability to promote mutual agreement procedures (MAP), including APA cases, and actively engage in base erosion and profit shifting (BEPS) projects advocated by the G20. In that year, China signed two unilateral APAs (including one renewal) and seven bilateral APAs (including one renewal).

According to the 2018 Annual Report, APA requests are expected to rise against the backdrop of uncertainty resulting from the universal implementation of BEPS projects and the increased transfer pricing scrutiny by tax administrations. The STA therefore has determined to prioritize certain APA requests, taking into account various factors. Among these factors, the one STA ranks highest is the quality of the submission. The STA will consider prioritizing those requests that include innovative application of transfer pricing methods or high-quality quantitative analyses of value chain analysis, intangible and location specific analysis on cost savings, and market premium.

In detail

Background information

Countries commonly release APA annual reports by their tax administrations. The STA of China has been issuing APA annual reports since 2009. The reports describe the latest mechanisms, procedures, and implementation of the APA program in China, provide guidance to enterprises interested in entering into APAs

with the Chinese tax authority, and serve as a reference for competent authorities of other countries (regions) and the general public to better understand China's APA program.

Overview of China's APAs

APAs by year and by phase

Since China's first bilateral APA, signed by China and Japan in 2005, through the end of 2018

China has signed 89 unilateral APAs and 67 bilateral APAs, accounting for 57% and 43% of the total number of signed APAs in China, respectively. In 2018, the STA made continuous efforts to enhance its capability to promote APA cases. During that year, China has signed two unilateral APAs (including one renewal) and seven bilateral APAs (including one renewal).

In addition to the APA statistics by year, the 2018 Annual Report summarizes the number of unilateral APAs and bilateral APAs by phase.

(See Public Notice on Matters Regarding Enhancing the Administration of Advance Pricing Arrangements (Public Notice of the

State Administration of Taxation [2016] No. 64.)

Phase	Unilateral APA	Bilateral APA	Total
Intent	7	32	39
Application	9	56	65
Signing	89	67	156

According to the figures above, the China tax authorities have received more Letters of Intent and application packages for bilateral APAs than for unilateral APAs. Even though bilateral APAs need to be filed with both competent tax authorities — which may slow progress of the application due to the limited official resources and potential disagreement between two competent tax authorities on certain issues — statistics indicate that taxpayers still prefer bilateral APAs, to gain certainty and avoid international double taxation. The figures also demonstrate that the workload of the Chinese tax administration in dealing with bilateral APA issues will dramatically increase with the growth of APA applications.

APAs by transaction type

During 2005 to 2018, related-party buy-and-sell transactions account for the largest portion of transactions covered by China’s APA program. Of the concluded APAs, 65% involve this transaction type, followed by services (20%) and transfer of the right to use or ownership of intangibles (15%).

No APA has been concluded for financing and transfer of financial assets transactions. According to the 2018 Annual Report, with the development of China’s service industry, an increasing number of service companies may decide to apply for APAs. Thus, the STA

estimated that there will be more APA applications for those types of transactions other than buy-and-sell.

APAs by transfer pricing method

The transactional net margin method (TNMM) remained the most commonly used method for APAs signed by China, being used 143 times and accounting for 79% of all the applied transfer pricing methods. Other transfer pricing methods were applied less frequently in practice since they require a higher standard of comparability.

According to the 2018 Annual Report, the STA and local tax administrations have been exploring the use of other appropriate transfer pricing methods, especially in dealing with transactions where both parties to the intercompany transaction have made significant contributions to the value creation or where location-specific advantages such as market premium or cost savings exist. Also, enterprises are expected to better cooperate with tax officers during the APA review and evaluation phase and provide sufficient information regarding transactions and prices so that other transfer pricing methods may be more frequently applied in the APA program.

APAs by country/region

China has signed the majority of its bilateral APAs with Asian countries.

By the end of 2018, China signed 44 bilateral APAs with Asian countries, 16 with European countries, and remaining seven with North American countries.

APAs by time taken

By the end of 2018, the vast majority (more than 94%) of the unilateral APAs signed by China were concluded within two years. Bilateral APAs took more time to conclude as they involve MAP negotiations with the competent tax authorities of other countries.

According to the requirements of Public Notice No. 64, before an enterprise files its formal APA application package, it must complete multiple pre-filing meetings with local in-charge tax authorities, prepare sufficient material and analyses (including the letter of intent and draft application package), and reach agreements with local in-charge tax authorities on key issues after the tax authorities’ initial assessment. Taking these pre-filing tasks into consideration, it may take a longer time for taxpayers to go through the whole APA process.

Industrial classifications covered by signed APAs

While there has been a further diversification in the industrial classifications covered by China’s APAs in recent years, 85% of the

APAs signed were still relevant to general manufacturing.

The takeaway

In recent years, the STA has devoted more efforts in MAP meetings, to help enterprises better resolve double taxation issues. **Observation:** According to our analysis, in 2018 the STA actively participated in competent authority meetings with record high frequency.

Meanwhile, the STA 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 2019, the STA comprehensively deepened the Belt and Road Initiative (BRI) tax cooperation. On April 19, 2019, the STA organized and chaired the first conference of the BRI Tax Administration Cooperation Forum in Zhejiang, China, where a joint tax mechanism has been established to create a more favourable tax environment for enterprises and regions participated in BRI.

Although the STA is committed to promoting MAP cases, taxpayers intending to apply for bilateral APAs appear to outnumber the STA's processing capacity. Multinational enterprises that are considering applying for a China APA should perform an effective feasibility analysis by taking into account 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.

In the 2018 Annual Report, the STA reiterated the factors to be considered when determining whether to prioritize certain APA requests, including the principle of "first come, first served;" the quality of the request submission; whether the applicant is in a specific industry or located in a specific region

that merits prioritized attention; and, for a bilateral APA request, whether the bilateral APA partner country (region) has the intention to accept the case and pursue the bilateral APA. Among these factors, the STA indicates that it values most the quality of the submission. According to the 2018 Annual Report, the STA will consider prioritizing those requests that include an innovative application of transfer pricing methods or presenting high-quality quantitative analyses of value chain analysis, intangible and location specific analysis on cost saving, and market premium. Therefore, multinational enterprises should take into consideration the key factors mentioned above when preparing the application package in accordance with the requirements of Public Notice No. 64, and proactively cooperate with tax administration's requests in relation to APA review and evaluation and information requests, in order to have an APA request prioritized by the STA.

Let's talk

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

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