First cost sharing agreement APA concluded in China

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In brief

The China State Administration of Taxation (SAT) recently concluded the first advance pricing agreement for a cost sharing agreement (CSA-APA) with a Fortune 500 enterprise in Guangdong Province. The successful signing of the first CSA-APA is an important milestone for Chinese taxpayers and tax authorities and opens a new page in the China tax authorities' history of administering transfer pricing for intangibles. We expect more taxpayers and tax authorities will follow suit to conclude CSA-APAs, particularly given the heightened international focus on the value contributed by intangibles as a result of the OECD and G20 Base Erosion and Profit Shifting (BEPS) project.

In detail

The successful signing of the first CSA-APA is a beneficial outcome for the tax authorities and taxpayer. The CSA-APA focuses on global R&D costs and confirms that the R&D costs borne by the taxpayer relating to the development of intangible assets are deductible for corporate income tax (CIT) purposes and exempt from withholding tax during the eight-year period covered by the CSA-APA.

CSAs are newly added content in the Implementation Measures of Special Tax Adjustments (Trial version) (Circular 2), to encourage investment in new technology and development of intangible assets in China. The participants to CSAs share in the costs of R&D activities and have the right to enjoy the benefits from the developed or transferred intangible assets. CSAs are a complex area of transfer pricing and involve issues such as the proper aggregation of global R&D costs and the matching of shared costs and benefits from intangible assets.

Successfully concluding an APA for a complex issue like CSAs substantially reduces the taxpayer's transfer pricing risk and future compliance and dispute costs. It also enhances the taxpayer's confidence to increase its investment in developing intangible assets in China and exploit those intangibles in the China market.

The takeaway

China's first CSA-APA is an important milestone for Chinese taxpayers and tax authorities. It paves the way for other taxpayers to follow suit to conclude APAs in this complex and commonly disputed area of transfer pricing. The OECD and G20 BEPS project has heighted the international focus on transfer pricing issues involving intangibles, and has been accompanied by increased scrutiny by tax authorities in China and many other countries. The successful conclusion of China's first CSA-APA means that APAs now represent a viable means of managing transfer pricing risk in China for complex issues involving intangibles.

Let's talk

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