

# China issues Q&A regarding the Administration on forex cash in-flows and out-flows of TP adjustments

March 30, 2021

---

## In brief

Under China's foreign exchange control system, enterprises, banks, and individuals cannot move money in or out of the country except in accordance with strict rules. The State Administration of Foreign Exchange (SAFE) and the People's Bank of China (PBOC) regulate forex flow in or out of China.

In practice, changes since 2020 in the external business environment and other uncontrollable factors (e.g., the COVID-19 pandemic) may have caused the implementation results of MNCs to deviate from their transfer pricing policies. Accordingly, MNCs may consider using transfer pricing adjustments (TPA) to adjust their actual implementation results.

In recent years, the SAFE bureaus and banks nationwide have conducted pilot programs aimed at streamlining the procedures for Chinese companies to receive transfer pricing compensation from overseas related parties, which are based on authenticity and compliance checks on transactions. On January 19, 2021, the national SAFE issued on its official website [Questions & Answers regarding Foreign Exchange Administration for Service Trade \(II\)](#) (SAFE Q&A). Question 1 of the SAFE Q&A addresses how banks shall process the forex cash in-flows and out-flows of transfer pricing adjustments under the special tax adjustment for MNCs. Through this question, SAFE for the first time has clarified the Administration measures for forex cash in-flows and out-flows relating to TPA, and provided operational guidelines for banks and MNCs to apply for TPA in the future.

---

## In detail

### Interpretation of SAFE Q&A

The SAFE Q&A quotes the Circular of the State Administration of Foreign Exchange on the Measures for Administration of the Current Account (2020 Version) Circular Huifa [2020] No.14 (Circular 14) issued by the SAFE on August 31, 2020. The SAFE Q&A emphasizes that banks, in accordance with principles of business development, shall conduct reasonable verification on the authenticity and legitimacy of the transactions, as well as on the consistency of such transactions with the forex cash in-flows and out-flows. In addition, the SAFE Q&A also explains how banks must verify and declare TPA-related forex cash in-flows and out-flows in the following three approaches:

### ***Approach I: Forex cash in-flows/out-flows based on transfer pricing methods***

Under Approach I, in order to verify the authenticity and legitimacy of TPA and consistency of transactions with the forex cash in-flows and out-flows, banks must review "the relevant written documents issued by tax authorities or customs authorities, profit adjustment agreement(s) and invoices." The relevant forex cash in-flows and out-flows must follow the original trade mode (Goods Trade or Service Trade).

The SAFE Q&A does not provide further clarification on the specific requirements of format and content on "the relevant written documents issued by tax authorities or customs authorities." Specifically, the transfer pricing downward adjustment (i.e., to decrease the profitability of Chinese companies) can be conducted through customs authorities. Based on the discussion, customs authorities may issue a declaration form for TPA. On the other hand, tax authorities will issue the "relevant written documents" under limited circumstances, mainly:

1. The package for advance pricing agreement/arrangement.
2. Special Tax Investigation Adjustment Notice, which Chinese tax authorities will issue to enterprises upon settlement of formal transfer pricing investigation.

Approach I specifies the approaches that enterprises could adopt to conduct forex cash in-flows and out-flows for TPA during the implementation/renewal period of an APA or after the settlement of TP investigations. **Note:** Enterprises may conduct transfer pricing self-assessments on their historical related-party transactions, either due to their own internal management policies, or as required by Chinese tax authorities. In the latter situation, in theory and by regulations, the self-assessment is conducted by enterprises, even though enterprises may discuss with tax authorities about the self-assessment methodology or amount (without the establishment of the formal investigation).

Tax authorities will not issue any legal document, i.e., Special Tax Investigation Adjustment Notice. As a result, enterprises cannot apply for Mutual Agreement Procedures (MAP), nor can they apply for TPA under Approach I. **Observation:** In practice, it remains to be seen whether SAFE can consider the *Special Tax Adjustments Self-Payment Form* (issued under self-assessment) stamped by tax authorities as the "relevant written documents issued by tax authorities," and taking these as the basis to allow the enterprise to conduct forex cash in-flows and out-flows under Approach I.

### ***Approach II: Forex cash in-flows/out-flows of TPA using the cost-sharing method***

The SAFE Q&A states that "for enterprises that conduct forex cash in-flows and out-flows using the cost-sharing method... (banks shall) review sales distribution agreements that contain the relevant rights and obligations clauses, financial reports, and invoices, etc...and declare such transaction as non-insurance related compensation under item '424000 Other secondary income (current transfers)'."

In business reality, group member(s) may appoint a group member to centrally enter into arrangements with external third parties or related parties based on such a principle, on behalf of the relevant constituent/involving entities. **Observation:** According to our understanding, the 'cost-sharing method' hereinafter is not the same as the 'cost-sharing agreement (CSA)' as specified in the TP regulations in China. Under Approach II, enterprises should prepare the relevant transfer pricing documents intended to show that their cost-sharing method is consistent with the arm's-length principle, and with the principle that the profitability of an enterprise is aligned with its function/risk profile.

### ***Approach III: Forex cash in-flows/out-flow using other methods***

Approach III is a catch-all provision. Due to the differences in business models and transfer pricing arrangements of enterprises, the adoption of the catch-all/miscellaneous provision would allow the local SAFE bureaus to take a flexible and reasonable approach in dealing with forex cash in-flows and out-flows for TPA. **Observation:** Based on our practical experience, enterprises should prepare a comprehensive transfer pricing analysis to demonstrate the reasonableness of their transfer pricing policies, the necessity of the TPA, and the accuracy of the TPA amount.

**Observation:** When exploring or implementing a TPA, Chinese enterprises still need to discuss with banks and the local SAFE relevant issues on a case-by-case basis. For example, issues include how the three categories of TPA are

differentiated locally and whether MNCs' TPA is in line with the spirit of Circular 14 (e.g., the profit compensation method of year-end TPA, the selection of tested party, and the cost-sharing method).

---

## The takeaway

---

Since 2020, the COVID-19 pandemic has posed significant challenges to MNCs in compliance with the arm's-length principle for their transfer pricing arrangements. Chinese enterprises may rely on year-end TPA for compliance purposes. The recent SAFE Q&A seeks to strike a balance between a recognized process of TPA for Chinese enterprises and an appropriate risk control level for the SAFE. We expect more cross-departmental cooperation among the SAFE, tax authorities, and customs authorities on TPA administration. These measures can help enterprises in mitigating their transfer pricing compliance risks and avoiding double taxation issues.

In practice, TPAs may have an impact on many aspects of a business, such as corporate income tax, indirect tax, customs duty, forex administration, and accounting treatment. MNCs should take into account the latest procedure requirements of the relevant regulatory authorities (such as the SAFE, tax authorities, and customs authorities) when conducting TPAs. MNCs also should communicate with their banks, auditors, and tax advisors in determining whether their TPA implementation is compliant and timely. Communication with the in-charge SAFE bureaus and banks also is essential to understand the local interpretations of the SAFE Q&A.

---

## Let's talk

---

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

### **Transfer Pricing – China**

Jeff Yuan, *Shanghai*  
+86 (21) 2323 3495  
[jeff.yuan@cn.pwc.com](mailto:jeff.yuan@cn.pwc.com)

Qisheng Yu, *Beijing*  
+86 (10) 6533 3117  
[qisheng.yu@cn.pwc.com](mailto:qisheng.yu@cn.pwc.com)

Paul Tang, *Shanghai*  
+86 (21) 2323 3756  
[paul.tang@cn.pwc.com](mailto:paul.tang@cn.pwc.com)

### **Transfer Pricing Global and US Leaders**

Horacio Peña, *New York*  
Global Transfer Pricing Leader  
+1 917 717 3089  
[horacio.pena@pwc.com](mailto:horacio.pena@pwc.com)

Paige Hill, *New York*  
US Transfer Pricing Leader  
+1 917 923-8412  
[paige.hill@pwc.com](mailto:paige.hill@pwc.com)

**Our insights. Your choices.**

Select 'Tax services' as your *Services and solutions* of interest to receive more content like this.

[Set your preferences today](#)

© 2021 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see [www.pwc.com/structure](http://www.pwc.com/structure) for further details. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with over 276,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at [www.pwc.com](http://www.pwc.com).