

China STA issues consultation draft on simplified procedure for unilateral APAs

April 8, 2021

In brief

China's State Taxation Administration (STA) issued on March 19 a consultation draft (Consultation Draft) of "Public Notice on Matters Concerning the Application of a Simplified Procedure to Unilateral Advance Pricing Arrangements (APAs)" on its [official website](#). The simplified procedure introduced in the Consultation Draft requires fewer steps and provides a timeline of 9-12 months to complete a unilateral APA application process.

The proposed establishment of the simplified procedure is intended to improve the unilateral APA application process and encourage taxpayers' use of unilateral APAs to achieve tax certainty on their transfer pricing. This procedure is expected boost the popularity of unilateral APAs as taxpayers may find that APAs offer more benefits than just tax certainty.

Action item: The deadline to provide comments on the Consultation Draft to the STA is **April 18, 2021**. Enterprises can provide their comments through the [official website of the STA](#) or via mail, identifying issues where additional guidance and clarity would be helpful.

In detail

Background of the China STA Consultation Draft

Introducing a simplified procedure for unilateral APAs is part of the STA's 2021 work plan to provide better services to taxpayers. According to its work plan issued in February 2021, the STA aims to complete the legislative work within the year on the simplified procedure in order to "improve the efficiency of providing tax certainty for taxpayers' cross-border investment and operations."

Eligibility to apply for unilateral APAs under the simplified procedure

According to the Consultation Draft, an enterprise may apply for a unilateral APA under the simplified procedure if (1) its related-party transaction amounts exceed RMB 40 million in each of the last three years prior to its APA application (the minimum transaction threshold) and (2) it meets at least one of the following three conditions:

- Condition 1: The enterprise provides the tax authorities with its local files of the past three tax years and the master file where applicable, at least three months prior to filing a unilateral APA application under the simplified procedure.
- Condition 2: The enterprise had an executed APA during the past 10 tax years and complied with the terms of such APA.
- Condition 3: The enterprise was subject to a completed audit by the tax authority for transfer pricing in the past 10 years.

According to the Consultation Draft, if there is any substantial change in the enterprise's related-party transactions, business environment, or function/risk profiles during the APA period as compared with previous years, the enterprise may not be approved to apply under the simplified procedure. Instead, the enterprise may only apply under the general procedure as provided in Public Notice of the STA on Matters Concerning Improving the Administration of APAs (STA PN [2016] No. 64).

Enterprises must meet basic compliance requirements to be eligible. The Consultation Draft provides that an enterprise that has not filed annual related-party transaction forms in accordance with relevant regulations or has filed with error may not be approved to use the simplified procedure to apply for an APA. APA applications not suitable or approved to use the simplified procedure would have to follow the general APA procedure.

The simplified procedure

The simplified procedure involves fewer steps and prescribes specific and accelerated processing timelines:

- **Fewer steps:** The simplified procedure would consist of only three stages: application assessment, negotiation and signing, and execution and monitoring. In contrast, the general APA application procedure involves six stages: pre-filing meeting, letter of intent, analysis and evaluation, formal application, negotiation and signing, and execution and monitoring. Compared with the general procedure, the simplified procedure eliminates the pre-filing meeting stage, and combines three other stages (letter of intent, analysis and evaluation, and formal application) into one.
- **Accelerated timelines:** While the general procedure does not provide any specific timelines, the simplified procedure would provide that within 90 days upon receiving an enterprise's application for a unilateral APA, the tax authority shall conduct analysis, assessment, and functional risk interviews and deliver a "Notice of Tax Matters" to the enterprise to inform whether the application is accepted and the reasons if the application is not accepted to be processed under the simplified procedure. If the tax authority accepts the application, it should analyze and evaluate whether the enterprise's related-party transactions comply with the arm's-length principle and negotiate and reach an APA with the enterprise within six months. If the tax authority and enterprise cannot reach an agreement within six months, the simplified procedure shall be terminated.

Therefore, the total time to complete a unilateral APA process could be nine months for enterprises meeting Conditions 2 and 3 and 12 months for enterprises meeting Condition 1. The actual time may be longer, as the six-month timeline does not include the time it takes an enterprise to respond to information and document requests.

Observations:

The simplified procedure would not be helpful to all taxpayers. Given the accelerated timelines for tax authorities to process the APA applications, the proposed simplified procedure seems best suited for enterprises whose transfer pricing is relatively straightforward or is already familiar to the tax authorities, such as those having recently been subject to transfer pricing risk assessment or formal audit. The simplified procedure does not seem suitable for APA applications involving complex or difficult transfer pricing issues or involving group companies in multiple localities.

Despite the limitations, the fast track for and the intended ease of obtaining unilateral APAs that would be provided by the simplified procedure may open more possibilities to enterprises beyond providing tax certainty on their transfer pricing. For example, unilateral APAs may serve as the written document from tax authorities to be submitted to banks or foreign exchange administrations as required to support the settlement of transfer pricing adjustments (TPAs), with the potential that the transfer pricing can be implemented for routine entities to achieve their target returns. Enterprises, especially

those facing transfer pricing self-adjustment pressures from the tax authority, may be able to use the simplified procedure to apply for APAs to negotiate and formalize terms such as some forms of term tests that are possible only through APAs to resolve historical transfer pricing issues.

The takeaway

The simplified procedure sets a high standard for the tax authority for processing APA applications and should be welcome news for taxpayers that are interested in applying for unilateral APAs but may have been deterred by the length and complexity of the current application process.

The proposed simplified procedure appears open to all but newly established enterprises or those that fail to meet the transfer pricing compliance requirements. While Conditions 2 and 3 target the types of enterprises whose transfer pricing is already familiar to the tax authority, Condition 1 is general. To meet Condition 1, an enterprise only needs to submit its local files and the master file if applicable to the tax authority and wait three months for tax authority review. During that period, the enterprise should maintain good interactions with the tax authority. While no pre-filing is required under the simplified procedure, in practice enterprises intending to apply for unilateral APAs on the basis of meeting Condition 1 still may need to go through a pre-filing type process in order to facilitate the tax authority's review and have a better chance to be approved to apply under the new simplified procedure.

Unilateral APAs have drawbacks, which may not be outweighed ease of application alone. It will be helpful if the final circular provides more guidance and clarity on issues such as the coordination of unilateral APAs with bilateral APAs and mutual agreement procedures. Enterprises interested in unilateral APAs can take advantage of the consultation process to raise questions and provide comments to the STA.

Let's talk

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

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