

China STA publishes Public Notice on the application of simplified procedures for unilateral APAs

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In brief

China's State Taxation Administration (STA) on July 26 issued the Public Notice on Matters Regarding the Application of Simplified Procedures of Unilateral Advance Pricing Arrangements (STA Public Notice [2021] No.24, hereinafter referred to as "Public Notice 24"). The STA previously sought public consultation on the draft simplified procedures for unilateral APAs (Consultation Draft) on March 19, 2021 (see PwC's prior [Tax Insight](#)). Public Notice 24 consolidates feedback and opinion of all relevant stakeholders. Compared with the Consultation Draft, Public Notice 24 further relaxes the conditions for the application of simplified procedures for unilateral APAs, effective September 1, 2021.

Takeaway: With the issuance of Public Notice 24, more companies can apply for unilateral APAs under the simplified procedures. The public notice reflects the STA's commitment toward improving the level of taxation services and promoting the balanced development of tax management and services.

In detail

China APA program

APAs are a key tool for taxpayers seeking to obtain tax certainty in their cross-border transfer pricing arrangements. Since APAs were introduced in China over 20 years ago, they have proved effective in reducing transfer pricing compliance costs for multinational companies and facilitating cross-border investments. According to the "China Advance Pricing Arrangement Annual Report (2019)," from 2005 to 2019 China signed 101 unilateral APAs and 76 bilateral APAs with other countries and regions, accounting for 57% and 43% of the total cases, respectively.

The number of unilateral APAs signed in 2019 (a total of 12 unilateral APAs including one renewal) increased significantly over 2017 (3 cases) and 2018 (2 cases). This reflects the increasing flexibility of the China tax authorities toward unilateral APAs, and reflects a trend of a growing number of companies seeking tax certainty through unilateral APAs.

Background of Public Notice 24

Public Notice 24 represents an important measure from the STA to simplify taxation matters, i.e., as part of the STA's 'Spring Breeze Actions.' In its work plan issued in February 2021, the STA stated that it was necessary to

complete, within the year, the legislative work to simplify procedures for unilateral APAs to “improve efficiency in providing tax certainty for taxpayers’ cross-border investment and operations.”

Public Notice 24 further relaxes — as compared with the Consultation Draft — the conditions for the application of simplified procedures of unilateral APAs, including:

- Removal of the requirement that enterprises submit contemporaneous transfer pricing documentation at least three months in advance of the application;
- Removal of rules around rejecting the application if there are errors in the taxpayer’s annual related-party transaction disclosure forms; and
- Removal of rules around rejecting the application if the related-party transactions, business environment, or functional and risk profile have undergone substantial changes during the applicable period compared with previous years.

Eligibility for the simplified unilateral APA procedures

According to Article 3 of Public Notice 24, the simplified procedures apply to enterprises with annual related-party transactions exceeding RMB 40 million for the three years prior to the tax year in which the in-charge tax authority serves its “Notice of Tax Related Issues” to formally accept the unilateral APA application.

In addition, one of the following conditions also must be met in order to be eligible:

- **Condition 1:** The enterprise has provided contemporaneous transfer pricing documentation for the past three tax years to the tax authority. **Observation:** This is the most basic condition for enterprises that intend to apply for the simplified procedures. This also means that the applicant must meet two pre-conditions: (i) the company’s related-party transaction amounts must have met the threshold for preparing transfer pricing local file; and (ii) the company must have been operational for at least three years. These requirements effectively exclude the possibility for newly established enterprises to apply for the simplified unilateral APA procedures.
- **Condition 2:** The enterprise has had an APA executed within the past 10 tax years, and it has been compliant with the requirements of that APA.
- **Condition 3:** Over the past 10 tax years, the enterprise has been subject to a special tax investigation and adjustment by the tax authority and has settled the adjustment.

Observation: In practice, companies that meet either Condition 2 or Condition 3 may find it easier to conclude unilateral APAs under the simplified procedures with the in-charge tax authorities.

Public Notice 24 also clarifies that the in-charge tax authority will not accept the application submitted by the enterprise under the following circumstances:

- The enterprise is undergoing special tax investigations or other tax-related investigations by tax authorities that have yet to be settled.
- The enterprise fails to file its annual related-party transaction disclosure forms as required by the relevant regulations and does not make corrections on time.
- The enterprise fails to prepare, maintain, and provide contemporaneous documentation as required by the relevant regulations.
- The enterprise fails to provide related information, or the information provided does not meet the tax authority’s requirement, and the enterprise fails to provide supplemental or revised information in a timely manner.
- The enterprise fails to cooperate with the tax authority in carrying out on-site functional and risk interviews.

As compared with the Consultation Draft, Public Notice 24 has fewer conditions where the in-charge tax authority will not accept the applications for simplified procedures. The public notice also clarifies that for enterprises that refuse to cooperate with the tax authority to conduct on-site interviews, the in-charge tax authority will not accept application submissions. This reflects that the STA's hopes for increased cooperation from taxpayers, so as to promote timely completion of APA work.

Other requirements of the simplified unilateral APA procedures

- **Three stages:** The simplified procedure consists of three stages — application assessment, negotiation and signing, and execution and monitoring.
- **Analysis and evaluation period for tax authorities:** The tax authority shall conduct analysis, assessment, and on-site functional and risk interviews, and deliver the “Notice of Tax Related Issues” to the enterprise within 90 days.
- **Specific time requirements for the negotiation and signing phase:** The negotiation with the enterprise shall be completed within six months from the date when the “Notice of Tax Related Issues” is delivered to the enterprise (i.e., when an agreement on the unilateral APA is reached). If the agreement cannot be reached, the simplified procedures will be terminated.
- **Unilateral APAs where simplified procedures are applicable:** The simplified procedures currently are not applicable for unilateral APAs involving tax authorities in two or more provinces, autonomous regions, municipalities directly under the Central Government, and cities with independent planning.
- **Time period covered by unilateral APAs under simplified procedures:** The unilateral APAs under simplified procedures would cover three to five consecutive years starting from the tax year during which the in-charge tax authority issues the “Notice of Tax Related Issues” to the enterprise on the acceptance of the application.

Observations

The simplified procedures are mainly embodied in the following two aspects:

- **Simplified procedures**, according to Public Notice 64 (“State Taxation Administration Public Notice [2016] No. 64 on Matters Regarding Refining the Administration of Advance Pricing Arrangements”), the negotiation, signing, and implementation of an APA involve six stages: (1) pre-filing meeting, (2) letter of intent, (3) analysis and evaluation, (4) formal application, (5) negotiation and signing, and (6) execution and monitoring. The simplified procedures for unilateral APAs involve only three stages: (1) application assessment, (2) negotiation and signing, and (3) execution and monitoring. Compared with the normal procedures, the pre-filing meeting stage is not required, while three stages (i.e., letter of intent, analysis and evaluation, and formal application) are combined into a single application assessment, thereby improving the efficiency of unilateral APA applications.
- **In terms of processing time**, according to Public Notice 24, where an enterprise submits an application for simplified unilateral APA procedures, tax authorities shall conduct analysis, assessment, and the functional and risk interviews within 90 days, and deliver the “Notice of Tax Related Issues” to the enterprise to inform whether the application is accepted. On the other hand, if the application is not accepted, the enterprise shall be informed of the reasons. Public Notice 24 further clarifies that once the application is accepted, the tax authorities should analyze and assess whether the enterprise's related-party transactions comply with the arm's-length principle and if so, shall conclude the APA with the enterprise within six months. If the tax authority and enterprise are unable to reach an agreement within six months, the application through simplified procedures will be terminated. This places pressure on tax authorities to resolve the simplified unilateral APA

procedures within a short period of time, and is encouraging to enterprises that qualify for the simplified procedures.

China's tax authorities have accumulated extensive experience in handling and concluding unilateral APAs in a shorter time frame with enterprises that previously have undergone special tax (i.e., transfer pricing) investigations or signed APAs. This enables tax authorities to provide better services to taxpayers during the APA application. For example, according to the statistical data of the 2019 China APA Annual Report published by the STA, China signed a total of 101 unilateral APAs from 2005 to 2019, of which about 52% were signed within one year, while 37% were completed between one and two years; only 11% of APAs took more than two years to complete.

Currently, the procedures for converting unilateral APAs to bilateral APAs is still unclear. The provisions of the simplified procedures for unilateral APAs are all within the current APA framework based on Public Notice 64. The existing underlying regulations remain unchanged, while offering more possibilities for enterprises (e.g., bilateral and multilateral APAs).

Practical significance of Public Notice 24

A number of aspects need to be considered:

From the STA's perspective:

- The simplified procedures for unilateral APAs and the formulation of specific regulations indicate that the STA intends to **provide more effective taxation services to enterprises** by improving the unilateral APA system during a period of economic uncertainty.
- Since the implementation of the APA program in China over 20 years ago, it has played a significant role in helping companies achieve tax certainty, avoid double taxation, facilitate cross-border investment and trade, and contribute to a stable taxation environment.

From the in-charge tax authority's perspective:

- Due to the complexities in transfer pricing and the limited amount of internal resources for the tax authority, objectively speaking the number of APAs signed does not meet from meeting the actual needs of enterprises. Therefore, the formal establishment of the simplified procedures is a driver for the in-charge tax authorities to act on more applications for unilateral APAs, and should help enterprises **better avoid double taxation, gain certainty in their transfer pricing arrangements, and gain relief during periods of economic uncertainty.**

From the enterprise's perspective:

- If enterprises and tax authorities have concluded unilateral APAs, besides achieving certainty, they also are able to carry out year-end transfer pricing adjustments:
 - According to the Questions & Answers Regarding Foreign Exchange Administration for Service Trade (II) ([SAFE Q&A](#)) recently issued by the State Administration of Foreign Exchange, when processing the "Forex cash in-flows/out-flows based on transfer pricing methods," banks must review "the relevant written documents issued by the tax authorities or the customs authorities, profit adjustment agreement(s) and invoices."
 - According to the current transfer pricing regulations in China, tax authorities will issue the "relevant written documents" under very limited circumstances, mainly: (1) the APA package; and (2) Special Tax Investigation Adjustment Notice, which China's tax authorities will issue to enterprises upon settlement of formal transfer pricing investigation.

If an enterprise is able to reach a unilateral APA quickly with the tax authority through the simplified procedures, the APA package can be provided to the bank for it to complete its review of "Forex cash in-flows/out-flows based on transfer pricing methods."

Companies that may benefit from Public Notice 24

The following types of companies may benefit from this public notice:

- Enterprises that have conducted transfer pricing adjustments in the form of, but not limited to, transfer pricing investigations, response to transfer pricing risks, and self-adjustments carried out under risk alerts from tax authorities, etc.;
- Enterprises that are included in the scope of multinational companies profit level monitoring system of the STA and local tax authorities, and are required by tax authorities to submit supplementary data;
- Enterprises that have implemented bilateral or unilateral APAs, but have not applied for renewal after expiration, and/or have significant fluctuations or changes in their profit levels after expiration of their APAs;
- Enterprises that have long-outstanding bilateral APA applications where no significant progress has been made, and are facing a higher risk of retrospective tax adjustments;
- Enterprises with a single type of related-party transaction and that have relatively simple functions and risks, but conduct large amounts of cross-border related-party transaction and therefore have a high transfer pricing risk exposure;
- Enterprises facing questions or challenges from both tax and customs authorities with respect to the related-party import transactions;
- Enterprises experiencing operation difficulties since 2020 due to the COVID-19 pandemic; and
- Enterprises that have an overseas business structure with related-party transactions and expect to be publicly listed, whereby the domestic and overseas related parties are highly compliant in terms of transfer pricing.

Let's talk

For a deeper discussion of how Public Notice 24 might benefit your business, please contact:

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