

China's first unilateral APAs under the simplified procedures have been signed

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In brief

China recently signed unilateral Advance Pricing Arrangements (APAs) with two companies located in the Jiangsu Province and the Guangdong Province, respectively. These were the first two signed unilateral APA cases under the simplified procedures in China since the Public Notice on Matters Regarding the Application of Simplified Procedures of Unilateral Advance Pricing Arrangements — [STA Public Notice \[2021\] No.24](#) (Public Notice 24) became effective. The two cases took four months from application to formal signing, providing the companies with tax certainty on their transfer pricing arrangements in a quick and efficient manner.

Takeaway: The introduction of the simplified procedures for unilateral APAs represents an important step by China's tax authorities to continuously expand the benefits and radiating effects of the APA services, and to promote a taxation environment intended to benefit both the tax authorities and enterprises. Enterprises should assess the feasibility of the simplified procedures for unilateral APAs to mitigate transfer pricing risks arising from the COVID-19 pandemic and from global trade uncertainties. Enterprises also can benefit from the convenience and tax certainty brought by the simplified procedures of unilateral APAs.

In detail

Background

In order to deepen the reform of tax administration, contribute to a more business-friendly environment, promote tax-enterprise cooperation, and improve on customized service levels and tax certainty for cross-border investors, the State Taxation Administration (STA) issued the Public Notice 24 on July 26, 2021, which became effective from September 1, 2021.

According to Public Notice 24, the advantages of simplified procedures mainly are reflected in the two aspects: "simplification of procedures" and "faster processing."

Simplification of procedures

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.

Faster processing

According to Public Notice 24, when an enterprise submits an application, 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 indicating whether the application has been accepted. Once the application has been accepted, the tax authorities must analyze and assess whether the enterprise's related-party transactions comply with the arm's-length principle and, if so, must conclude the APA with the enterprise within six months.

Under ideal conditions, the enterprise should be able to complete the negotiation and signing of the unilateral APA under the simplified procedures within nine months. In comparison, the entire process under the normal procedures may take one to two years.

Observation: The release of Public Notice 24 has received widespread attention and positive responses. Its advantages — simplicity and speed — have attracted a considerable number of companies to utilize the "fast track" through the simplified procedures of unilateral APAs, in seeking to quickly obtain tax certainty. See our detailed insights - [China STA publishes Public Notice on the application of simplified procedures for unilateral APAs](#), published August 30, 2021.

Case brief

The first two companies that signed unilateral APAs under the simplified procedures belong to different enterprise groups, and are incorporated in Wuxi, Jiangsu Province and Guangzhou, Guangdong Province, respectively. The common feature was that the tax authorities indicated to the companies that they had certain historical transfer pricing risk.

The two companies submitted formal applications to their respective competent tax authorities in September 2021, and immediately carried out detailed technical analysis of the issues identified by the tax authorities. The companies outlined their transfer pricing position, and responded quickly to the information and data requests from the tax authorities. After multiple rounds of negotiations, both tax authorities and enterprises reached an agreement, completed the closing and approval process, and signed unilateral APAs in December 2021.

The key points that both tax authorities and enterprises addressed and committed to solving during the negotiation and signing of the unilateral APAs included:

- Clarification of certain reasons for the discrepancies between the financial data in the enterprise's books and the pricing policy of related-party transactions, in particular, provision of a reasonable explanation for the fiscal years with low profit margins;
- Whether it is applicable to conduct a fair and reasonable adjustment to the historical fluctuation of an enterprise's profit based on the term test for the retrospective years and arm's-length range from the benchmarking analysis;
- How to demonstrate in detail the impact of scale, agglomeration effects, and upstream-downstream integration on enterprise's profits, based on a cross-section industry analysis, in particular the business trends of leading companies in the industry;
- Accurately defining the role of the enterprise in the group value chain (particularly the role played by the China companies in R&D, marketing, etc.) based on functional on-site interviews, and verifying the reasonableness of the transfer pricing method adopted in the APA by testing the allocation of profits within the value chain;
- Methods to analyze and verify the significant impact of special factors during the COVID-19 pandemic on business operations, with actual business data as evidence (such as procurement costs, labor operation costs, logistics and storage costs, and final shipping prices);

- Verifying the reasonableness of cross-border payments, such as royalties and service fees paid to overseas related parties from different perspectives, such as the arm's-length principle and benefit test; and
- Forecasting the future operation of the enterprise through a reasonable economic model, including the basis of the forecast and the comparison with historical data.

Observation

Based on the cases above, the application of simplified procedures of unilateral APA can bring the following advantages:

1. Seek to avoid double taxation

The entities in the above unilateral APA cases are Taiwan-headquartered and US-headquartered enterprises, respectively. For Taiwan-headquartered enterprises, since no taxation agreement (arrangement) has been signed between Mainland China tax authorities and Taiwan tax authorities, any transfer pricing investigation and adjustment of related-party transactions will result in double taxation. Therefore, applying for a unilateral APA can be the most effective method for Taiwan-headquartered enterprises in seeking to obtain transfer pricing certainty in Mainland China and to avoid double taxation arising from transfer pricing adjustments.

In addition, due to the large number of APA cases between Chinese tax authorities and tax jurisdictions of key regions such as Japan, South Korea, Europe, and United States, there may be long waiting lines for the application or the negotiation process may be slow-paced. Therefore, applying for the simplified procedures of unilateral APAs could be a more time-efficient and effective alternative to reduce the risk of double taxation.

2. Building mutual trust and cooperation between tax authorities and enterprises

During the application and negotiation process, both tax authorities and enterprises had the opportunity to engage in deeper communication and interaction, based on the principles of cooperation and mutual trust under the APA framework. Throughout the process, the tax authorities sought to understand the issues and business challenges that the enterprises faced in the prior years and those that they may encounter in the future. Meanwhile, the enterprises could explain their situation and requests more effectively in the context of an APA negotiation. The simplified procedures of unilateral APAs represent a key tool for improving the Chinese taxation business environment as they provide an effective approach to improve understanding and cooperation between tax authorities and enterprises.

3. Improving tax certainty

Against the backdrop of increasing tax controversies and tax competition worldwide, an APA also has become a key tool for enterprises to achieve their objectives of mitigating tax risks and improving tax certainty. According to the prevailing tax regulations, an APA provides certainty not only for transfer pricing arrangements for three to five years in the future, but also for historical years — up to 10 years — through retroactive adjustments.

In the cases above, the tax authorities discussed with the enterprises their business situations in the prior and future years, applied a "multi-year test" and the "arm's-length range test," and listened to the enterprises' justifiable requests, with the result that the enterprises obtained tax certainty in their transfer pricing arrangements for their future and historical years through negotiating the unilateral APAs. The APAs also enabled the local governments to obtain the enterprises' commitments to ongoing operations and stable taxation expectations, contributing to a beneficial scenario for both the tax authorities and the enterprises.

4. Reduce time costs

Public Notice 24 specifies the timeline for each stage of the APA for tax authorities to receive applications, conduct assessments, and conduct negotiations and signings, such that both parties have a clear timetable. With clear time

requirements, both parties should be more willing to proactively exchange information and conduct technical discussions, which can improve the efficiency of unilateral APA negotiations and help enterprises obtain tax certainty at a lower time cost. In the two cases mentioned above, the tax authorities and enterprises worked together on the premise of mutual trust and understanding, and finally reached an alignment in less than four months after several round of discussions on the proposal, industry analysis, data analysis, and technical aspects.

Based on the above observations and experience, the simplified procedures of unilateral APAs can have a wide range of applications, and more specifically, the following types of enterprises may benefit from Public Notice 24:

- 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 with relatively simple functions and risks, but conduct large amounts of cross-border related-party transactions, and therefore may have a high transfer pricing exposure;
- Enterprises where intangible asset related-party transactions, such as technology royalties, trademark, and cross-border financing related-party transactions, have a significant impact on their profit levels (they may initiate separate application of simplified procedures of unilateral APA for specific related-party transactions);
- 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; and
- “Going abroad enterprises” that have similar related-party transactions between the Chinese parent enterprise and their overseas subsidiaries. It would be costly for a “going abroad enterprise” to obtain tax certainty through a multilateral APA. By applying for the simplified procedures of unilateral APA with Chinese tax authorities, enterprises may be able to demonstrate the rigor of their transfer pricing policies and the position of the Chinese tax authorities to the tax authorities of various countries, thus avoiding unnecessary bilateral tax disputes.

Let's talk

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

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