

China State Taxation Administration published the Public Notice on matters regarding the application of simplified procedures of unilateral advance pricing arrangements

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In brief

On 26 July 2021, the State Taxation Administration (“STA”) issued the Public Notice on Matters Regarding the Application of Simplified Procedures of Unilateral Advance Pricing Arrangements (“APAs”) (STA Public Notice [2021] No.24, hereinafter referred to as “Public Notice 24”)¹. The STA has previously sought public consultation on the draft simplified procedures for unilateral APAs² on 19 March 2021 (hereinafter referred to as the “Consultation Draft”). Public Notice 24 consolidates feedback and opinion of all relevant stakeholders. Public Notice 24 shall become effective from 1 September 2021.

In detail

Background

Public Notice 24 represents an important measure from the STA to simplify taxation matters, i.e. a part of the STA’s ‘Spring Breeze Actions’. In its work plan³ issued in February 2021, the STA clearly stated that it is 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.”

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

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

With the issuance of Public Notice 24, more companies are able to apply for unilateral APAs under the simplified procedures. The public notice demonstrates the STA's commitment towards improving the level of taxation services and promoting the balanced development of tax management and services.

In detail

APAs are one of the key tools for taxpayers to obtain tax certainty in their cross-border transfer pricing arrangements. Since APAs were introduced in China over 20 years ago, they have been highly effective in reducing transfer pricing compliance costs for multinational companies and facilitating cross-border investments. According to the "Annual Report on China's Advanced Pricing Arrangements (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). It reflects the increasing flexibility the China tax authorities have towards unilateral APAs, and reflects a trend of a growing number of companies choosing to achieve tax certainty through unilateral APAs.

Conditions for applying for the simplified unilateral APA procedures

According to the Article 3 of Public Notice 24, the simplified procedures are applicable to enterprises which had 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 their 'Notice of Tax Related Issues' to formally accept the unilateral APA application.

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

- 1) **Condition 1:** The enterprise has provided contemporaneous transfer pricing documentation for the past three tax years to the tax authority. PwC's view is that 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 or more. These requirements effectively exclude the possibility for newly established enterprises to apply for the simplified unilateral APA procedures.
- 2) **Condition 2:** The enterprise has had an APA executed within the past ten tax years, and it has been compliant with the requirements of said APA.
- 3) **Condition 3:** Over the past ten tax years, the enterprise has been subject to a special tax investigation and adjustment by the tax authority and has settled the adjustment.

PwC believes that in practice, companies that meet either Condition 2 or Condition 3 will 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:

- 1) The enterprise is undergoing special tax investigations or other tax related investigations by tax authorities which have yet to be settled;
- 2) 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;
- 3) The enterprise fails to prepare, maintain and provide contemporaneous documentation as required by the relevant regulations;
- 4) 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 supplement or revised information in a timely manner;
- 5) 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, i.e. 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 are currently 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.

The takeaway

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

- **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: pre-filing meeting, letter of intent, analysis and evaluation, formal application, negotiation and signing, and execution and monitoring. The simplified procedures for unilateral APAs only involve three stages: application assessment, negotiation and signing, and 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 significantly 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 on 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 analyse 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 high demands on tax authorities to resolve the simplified unilateral APA procedures within a short period of time, and highly encouraging to enterprises that qualify for the simplified procedures.

As mentioned, the Chinese tax authorities have accumulated extensive experience in handling and concluding unilateral APAs in a shorter time frame with enterprises that have undergone special tax (i.e. transfer pricing) investigations or signed APAs previously. 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% of unilateral APAs 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.

At present, 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

PwC believes that there are a number of aspects to consider:

1. From the STA's perspective

The simplified procedures for unilateral APAs and the formulation of specific regulations indicate that the STA is determined to **provide better 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 huge role in helping companies achieve tax certainty, avoid double taxation, facilitate cross-border investment and trade, and contributed to a stable taxation environment.

2. From the in-charge tax authority's perspective

Due to the complexities in transfer pricing and the lack of internal resources for the tax authority, objectively speaking the number of APAs signed is far 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 handle more applications for unilateral APAs, and help

enterprises to **better avoid double taxation, get certainty in their transfer pricing arrangements and relief during periods of economic uncertainty.**

3. From the enterprise's perspective

If enterprises and tax authorities have concluded unilateral APAs, other than certainty, they are also able to **carry out year-end transfer pricing adjustments:**

- According to the Questions & Answers Regarding Foreign Exchange Administration for Service Trade (II) (hereinafter referred to as the "SAFE Q&A")⁴ 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 Chinese tax authorities will issue to enterprises upon settlement of formal transfer pricing investigation.

We foresee that 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 them to complete their review of "Forex cash in-flows / out-flows based on transfer pricing methods".

PwC believes that the following companies may benefit from this public notice:

- Enterprises that have conducted transfer pricing adjustments in the form of, but are 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 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.

Endnote

1. For the full text of Public Notice 24, please refer to the website of STA:
<http://www.chinatax.gov.cn/chinatax/n810341/n810825/c101434/c5167276/content.html>
2. Please refer to our previous article: "[China State Taxation Administration Published the Consultation Draft of the Simplified procedures of Unilateral Advance Pricing Arrangements](#)"
3. Opinions of the State Taxation Administration on Carrying out the 2021 "I Do Practical Work for Taxpayers and Convenient Taxation Spring Breeze Actions" (Shuizongfa [2021] No. 14)
4. On 19 January 2021, the State Administration of Foreign Exchange issued the "Questions and Answers on Foreign Exchange Administration Policies for Trade in Services (II)", details refer to "The State Administration of Foreign Exchange Issues Questions and Answers on the Management Policy Regarding Transfer Pricing Adjustments to Foreign Exchange Revenue and Expenditure Business". For details, please refer to our previous article: "[The State Administration of Foreign Exchange Issues Questions and Answers on the Management Policy Regarding Transfer Pricing Adjustments to Foreign Exchange Revenue and Expenditure Business](#)"

Let's talk

For a deeper discussion of how this impacts your business, please contact **PwC's China Transfer Pricing Service Team**:

China

Jeff Yuan
+86 (21) 2323 3495
jeff.yuan@cn.pwc.com

Spencer Chong
+86 (21) 2323 2580
spencer.chong@cn.pwc.com

Mei Gong
+86 (21) 2323 3667
mei.gong@cn.pwc.com

Paul Tang
+86 (21) 2323 3756
paul.tang@cn.pwc.com

Thinker Chen
+86 (21) 2323 1329
thinker.x.chen@cn.pwc.com

Jessica Yin
86 (21) 2323 1108
jessica.yin@cn.pwc.com

John Bian
+86 (21) 2323 3149
john.bian@cn.pwc.com

Silina Zhong
+86 (21) 2323 3393
silina.s.zhong@cn.pwc.com

Winnie Di
+86 (10) 6533 2805
winnie.di@cn.pwc.com

Qisheng Yu
+86 (10) 6533 3117
qisheng.yu@cn.pwc.com

Tao Han
+86 (10) 6533 3230
tao.han@cn.pwc.com

Feng Yang
+86 (10) 6533 3042
f.yang@cn.pwc.com

Jason Yan
+86 (10) 6533 3638
jason.m.yan@cn.pwc.com

Ying Yue
+86 (10) 6533 3087
ying.yue@cn.pwc.com

Kevin Tsoi
+86 (20) 3819 2380
kevin.lk.tsoi@cn.pwc.com

Vincent Li
+86 (20) 3819 2170
vincent.li@cn.pwc.com

Rhett Liu
+86 (755) 8261 8366
rhett.k.liu@cn.pwc.com

Alex Xiang
+86 (755) 8261 8701
alex.xiang@cn.pwc.com

Marc Li
+86 (755) 8261 8232
marc.li@cn.pwc.com

William Xu
+86 (28) 6291 2018
william.xu@cn.pwc.com

Henry Zhu
+86 (512) 6273 1917
henry.hp.zhu@cn.pwc.com

Jackie Zhao
+86 (29) 8469 2661
jackie.zhao@cn.pwc.com

Hong Kong

Cecilia Lee
+852 2289 5690
cecilia.sk.lee@hk.pwc.com

Tiffany Wu
+852 2289 3662
tiffany.m.wu@hk.pwc.com

Wengee Poon
+852 2289 5675
wengee.w.poon@hk.pwc.com

Phillip Mak
+852 2289 3503
phillip.mak@hk.pwc.com

Peter Brewin
+852 2289 3650
p.brewin@hk.pwc.com

Alexandra Tse
+852 2289 3508
ali.mh.tse@hk.pwc.com

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For more information, please contact:

Long Ma
+86 (10) 6533 3103
long.ma@cn.pwc.com

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