

PKN – China Issues its First-ever APA Report



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Transfer pricing has become a key issue for multinational corporations with operations in mainland China and Hong Kong, with new requirements as well as opportunities brought in with China's new tax regime and expanded guidance in Hong Kong. PwC's transfer pricing services team can help with dispute resolution, compliance, planning, advance pricing arrangements, and other transfer pricing services.

China has joined Korea, Japan, the United States, Canada, Australia and Italy as one of the first countries to issue a comprehensive report regarding its Advance Pricing Arrangement (“APA”) program. The groundbreaking report, available on the web at <http://www.chinatax.gov.cn/n8136506/n8136608/n9947993/n9948014/10517889.html>, provides official statistics on both in-progress and completed APAs for the period from 1 January 2005 to 31 December 2009 and was released by China's State Administration of Taxation (“SAT”) on 30 December, 2010.¹ Titled “China Advance Pricing Arrangement Annual Report, 2009”, the APA report reaffirms the SAT's focus on transfer pricing issues and in particular reinforces its commitment to its APA programme.

Contents

The contents of the report are organized as follows:

- Preface by SAT Deputy Commissioner Wang Li;
- Introductory notes;
- Introduction to the APA program;
- A history of the APA program's development;
- Details on APA procedures;
- Statistics on completed and in-progress APA cases; and
- Appendices of forms used in the APA application process.

While many of the forms and procedural guidance were previously published in *Circular Guoshuifa [2009] No. 2*, the report also contains much new content including the statistics as well as a process flowchart detailing how an APA moves through the six phases, namely:

- Pre-filing meeting with the in-charge tax authority or, in a bilateral case, the SAT;
- Formal application prepared by the taxpayer;
- Examination and evaluation by the tax authority;
- Negotiation between tax authority and taxpayer, or in a bilateral case, between the treaty counterparties;
- Agreement and signing of the treaty by the taxpayer and the tax authorities involved; and
- Execution and monitoring on an annual basis.

Statistics

The report provides details on in-process and completed APAs for the years 2005 through 2009. Earlier years are not included because as the SAT did not start implementing a centralized APA monitoring and administration system until 2005. The majority of the statistics has never been publicly released before.

Several key trends are highlighted by the report and the statistics it contains, including:

- The rise in the number of signed bilateral APAs, which overtook the number of unilateral APAs for the first time in 2009;

¹ For further background information on APAs in China please refer to PwC's interview with the director of the SAT's Anti-Tax Avoidance Division in July 2009, http://www.pwccn.com/home/eng/tp_apa_cn_jul2009.html.

- The rise in the number of application related to intangible assets or services which now exceed the number of applications related to tangible goods transactions
- The fast processing time for unilateral and bilateral APAs; and
- The popularity of the transactional net margin method (TNMM), which was used in 60% of signed APAs.

Statistical Tables from China's APA Report

Below are the full statistics from the APA report. The statistics contained in all tables are as of the end of 2009.

Table 1: APAs by Year

| Year | Unilateral | Bilateral | Total |
|--------------|------------|-----------|-----------|
| 2005 | 13 | 1 | 14 |
| 2006 | 10 | 0 | 10 |
| 2007 | 7 | 3 | 10 |
| 2008 | 6 | 1 | 7 |
| 2009 | 5 | 7 | 12 |
| Total | 41 | 12 | 53 |

Table 2: APAs by Phase

| Phases | | Unilateral | Bilateral | Total |
|-----------------------|-----------------------------|------------|-----------|------------|
| Pre-Acceptance | Proposal / letter of intent | 0 | 20 | 20 |
| | Pre-filing meeting | 26 | 5 | 31 |
| Accepted Applications | Examination and evaluation | 0 | 5 | 5 |
| | Negotiation | 2 | 8 | 10 |
| | Subtotal | 2 | 13 | 15 |
| Concluded APAs | Agreed but not signed | 0 | 1 | 1 |
| | Executed and monitored | 18 | 11 | 29 |
| | Expired | 23 | 1 | 24 |
| | Subtotal | 41 | 13 | 54 |
| Total | | 69 | 51 | 120 |

Table 3: APA by Transaction Type

| Accepted Applications | | | Concluded APAs | | |
|--------------------------------------|----------------|-------------|--------------------------------------|----------------|-------------|
| Transaction Type | Number of APAs | Percentage | Transaction Type | Number of APAs | Percentage |
| Purchase and sale of tangible assets | 11 | 46% | Purchase and sale of tangible assets | 42 | 62% |
| Transfer or use of intangible assets | 8 | 33% | Transfer or use of intangible assets | 13 | 19% |
| Provision of services | 5 | 21% | Provision of services | 13 | 19% |
| Financing | 0 | — | Financing | 0 | — |
| Total | 24 | 100% | Total | 68 | 100% |

Table 4: Bilateral APAs, by Region of Counter-party

| Region | Signed APAs |
|---------------|-------------|
| Asia | 9 |
| Europe | 2 |
| North America | 1 |
| Total | 12 |

Table 5: APA Processing Time

| Type | Less than one year | One-to-two years | Two-to-three years | More than three years | Total |
|--------------|--------------------|------------------|--------------------|-----------------------|-----------|
| Unilateral | 23 | 18 | 0 | 0 | 41 |
| Bilateral | 7 | 3 | 1 | 1 | 12 |
| Total | 30 | 21 | 1 | 1 | 53 |

Table 6: APAs by Transfer Pricing Method²

| Method | Comparable Uncontrolled Price Method | Cost Plus | TNMM – Full Cost Markup | TNMM – Return on Sales | Profit Split | Other |
|---------------|--------------------------------------|-----------|-------------------------|------------------------|--------------|-------|
| Number | 4 | 15 | 15 | 20 | 2 | 2 |

PwC Observations

Coming at a time when an increasing number of companies have been turning to APAs to provide certainty in respect of large or complex transfer pricing issues, taxpayers will likely welcome this report as a demonstration of the SAT's commitment to China's APA program and because of the insights it gives into the way the program has developed in recent years.

The report is a clear indication of the SAT's support of the APA program, which is described as having a key role in the SAT's "three-in-one" system of taxpayer services, tax administration and tax investigation. As a method of "prospective administration", the SAT views APAs as a key way "to increase certainty from a tax and business perspective and avoid international double taxation". The fact that the preface for the report was published under the name of the SAT Deputy Commissioner is particularly noteworthy since it signifies both the importance of the APA program to the SAT and its permanence in China's transfer pricing environment. With the SAT increasing its emphasis on the APA program, and rapidly developing its taxation systems in many ways, multinationals should be aware of these trends and determine what risks and opportunities are raised by these new developments

While the APA program has clearly been a success so far, there is a concern on whether the the program's limited resources can keep up with taxpayers' growing interest in APAs, especially at the SAT level where additional economists and other technical staff are needed to prevent delays in APA applications. We have also noticed that the SAT has become more selective in accepting applications, in part due to a strategy of using APAs to set precedents for transfer pricing nationwide, and in part due to the increasing technical sophistication of the tax officials, who are now more discerning in deciding whether or not to accept APA applications. Taxpayers should consider how these changes will affect their own situation and potential APA applications.

² Total number of methods does not match total number of APAs because some APAs use more than one method.

Please call or e-mail your regular contact within the PricewaterhouseCoopers transfer pricing network, or one of the contacts listed below, for further information or if you have any questions.

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