

China Tax Alert

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China has signed more than 100 Bilateral APAs

Abstract:

The China Advance Pricing Arrangement Annual Report (2021) ("2021 APA Annual Report" or "the Report") recapitulates the progress of the APA program in China. According to the Report, the Chinese tax authorities had formally signed a total of 101 bilateral APAs through negotiations with other tax authorities by the end of 2021, which reflects that the Chinese tax authorities have strengthened negotiation on cross-border tax-related disputes, to provide tax certainty and create a favourable tax environment for "bringing in" enterprises and "going global" enterprises.

Background

On 21 November 2022, the State Taxation Administration ("STA") published the 2021 APA Annual Report in both Chinese and English. This is the thirteenth annual report on APA published by China. The report introduces the latest mechanisms, procedures, data, and implementation of the APA program in China, covering the statistical data of the APA from 2005 to 2021. China tax authorities steadily promoted APA negotiation and signing, assisted enterprises to avoid or eliminate double taxation, and provided taxpayers with high-quality tax services despite facing the adverse impact of COVID-19.

Overview of the Report

Bilateral APAs attract more attention. The Chinese tax authorities signed a total of 20 APAs in 2021, including 9 unilateral APAs and 11 bilateral APAs. Among them, a total of 16 cases were signed in the first round, and 4 cases were renewed. Despite the negative impact of COVID-19, the Chinese tax authorities still actively carried out online communication and negotiation to maintain high efficiency. From 2005 to 2021, Chinese tax authorities have signed 226 APAs in total, including 125 unilateral APAs and 101 bilateral APAs. Signed bilateral APAs exceeded 100 cases. In addition, 137 bilateral APAs and 14 unilateral APAs are in the pipeline (including in the intent phase and application phase). This shows that in the current environment of deepening international tax cooperation, enterprises are more willing to apply for bilateral APAs to avoid or eliminate international double taxation and obtain tax certainty.

The main industry covered by signed APAs is still the manufacturing industry, and other industries related APAs are growing. 178 APAs are related to the manufacturing industry, accounting for 78.8% of the total 226 signed APAs. The manufacturing industry forms a big chunk of the APA tally. This demonstrates the role of taxation in serving the real economy. In addition, there are an increasing number of enterprises signing the APA which operates in the wholesale and retail industry, i.e., 25 cases accounting for 11.1% of the signed APAs between 2005 to 2021. With the increasing diversification of China's economy, it is expected that the number of APAs involving the service industry and other types of industries will also increase in the future.

The types of related party transactions involved in APAs are increasingly diverse. 189 signed APAs relate to the transfer of the right to use or the ownership of tangible assets, accounting for 56.6% of all transaction types¹. Other types of related party transactions have shown an upward trend in recent years. For example, 144 signed APAs involve the transfer of the right to use or ownership of intangibles, and service transactions, accounting for 43.1%. Compared with previous years, there was also one new case involving related party financing transaction in 2021. It is expected that APAs would increasingly involve multiple types of related party transactions.

Unilateral APAs are signed faster than bilateral APAs. Among the 9 unilateral APAs signed in 2021, most (7 cases) unilateral APAs were signed within 24 months. With the announcement of the simplified procedures for unilateral APA, it is expected that the efficiency of unilateral APA negotiations could be further improved. In 2021, among the newly signed 11 bilateral APAs, 2 of them have been negotiated and signed within 24 months, and 9 of them were signed within more than 24 months. The completion of a bilateral APA depends on many factors, including but not limited to the quality of the documents provided by the taxpayer, the complexity of the case, the timing of the taxpayer's filing, and the willingness of both tax authorities to move forward with the case.

Transfer pricing methods applied would be more diverse in the APAs. The transactional net margin method is still the most commonly used transfer pricing method in signed APAs, being used 225² times and accounting for 81.8% of all the applied transfer pricing methods. In recent years the Chinese tax authorities have also actively tried to use other appropriate methods, such as the cost-plus method, and the profit-split method.

KPMG's Observations

Despite the adverse impact of the COVID-19 environment, the Chinese tax authorities are still making unremitting efforts to promote the business environment and support the development of cross-border investments. The number of APA cases has steadily increased.

- **The number of bilateral APA applications has increased year by year.** By the end of 2021, China has signed more than 100 bilateral APAs, and 137 bilateral APAs are in the intent and application phase. This shows that more and more enterprises prefer to obtain tax certainty by applying for bilateral APA, to avoid or eliminate international double taxation. It is noted that as more enterprises apply for APA, tax authorities have become more stringent in their review requirements for APA and tend to prioritize certain APA requests with complete value chain analysis, innovative analysis methods, and sufficient quantitative analysis of intangible assets, cost savings and market premiums.
- **Chinese tax authorities promote unilateral APA flexibly.** With the announcement of the unilateral APA simplified procedure for more than a year, the efficiency of unilateral APA negotiations and conclude has been further improved. The Chinese tax authorities are also focusing on strengthening the cross-departmental cooperation. In May 2022, Shenzhen Tax Service and Shenzhen Customs explored the way of joint administration and synergetic law enforcement, taking a lead in launching the collaborative transfer pricing management by combining customs advance ruling and tax unilateral APA. KPMG China assisted an MNE in Shenzhen to successfully conclude China's first collaborative transfer pricing management case by signing a memorandum with Shenzhen Customs and Shenzhen Tax Service, resolving the issue of double recognition and double taxation of related-party imports between Customs and tax authorities.

With the implementation of the BEPS Action Plan and tax authorities in various countries that have strengthened the management of cross-border related party transactions, our "going global" enterprises might encounter more and more tax investigations or disputes overseas. It is suggested that Chinese "going global" enterprises could use MAP or APA to solve overseas tax problems through the support of Chinese tax authorities, effectively protecting their legal rights.

¹ Note: As some APAs involve multiple types of related party transactions, the total number of related party transactions is greater than the number of APAs.

² Note: Some APAs involve two or more types of transactions and multiple transfer pricing methods may be used.

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