

# China Tax Alert

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## APA empowers the development of multinational enterprises

### Summary :

- According to the China Advance Pricing Arrangement Annual Report (2022) ("2022 APA Annual Report" or "the Report"), the Chinese tax authorities had signed a total of 116 bilateral APAs and 144 unilateral APAs with increasing negotiation and signing efforts by the end of 2022, reflecting its active support to promote the development of multinational enterprises, provide tax certainty and create a favourable tax environment for "bringing in" enterprises and "going global" enterprises.

### Background

On 19 December 2023, the State Taxation Administration ("STA") published the 2022 APA Annual Report in both Chinese and English. This is the fourteenth annual report on APA published by China. The report introduces the latest system, procedures, data, and implementation of APA in China, covering the statistical data of the APAs from 2005 to 2022. China tax authorities actively promoted APA negotiation and signing, being committed to assisting enterprises to avoid or eliminate double taxation and providing taxpayers with high-quality tax services.

### Overview of the Report

**Upward trend on the number of signed APAs.** The Chinese tax authorities signed a total of 34 APAs in 2022. Among them, 16 out of 19 unilateral APAs and 8 out of 15 bilateral APAs were signed for the first time. The total number of signed APAs is showing an upward trend. By phase, 34 unilateral APAs and 145 bilateral APAs are 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 in order to avoid or eliminate international double taxation and obtain tax certainty.

**Main industry covered by signed APAs is still the manufacturing industry, and wholesale and retail industries related APAs are growing fast.** 203 APAs are related to the manufacturing industry, accounting for 78.1% of the total 260 signed APAs. 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., 27 cases accounting for 10.4% of the signed APAs from 2005 to 2022. With the increasing diversification of China's economy, it is expected that the number of APAs involving the service industry and other industries will also increase in the future.

**APAs related party transactions still focused on tangible asset transactions, but the proportion of other transactions are also increasing.** 213 signed APAs from 2005 to 2022 are related to the transfer of the right to use or the ownership of tangible assets, accounting for 55.5% of all transaction types<sup>1</sup>. Other types of related party transactions have shown an upward trend in recent years. For example, 167 signed APAs involve the transfer of the right to use or ownership of intangibles, and service transactions, accounting for 43.5%, and 4 cases involve related party financing transactions. It is expected that APAs would increasingly involve multiple types of related party transactions related to the transfer of the right to use or ownership of intangibles, services, financing and transfer of financial assets.

<sup>1</sup> 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.

**APA negotiation efficiency improved significantly.** Among the 19 unilateral APAs signed in 2022, all 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 2022, among the newly signed 15 bilateral APAs, 10 of them have been negotiated and signed within 24 months, and 5 of them were completed within more than 24 months. The completion of a bilateral APA depends on many factors, including but not limited to the quality of the taxpayer's submitted documents, 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.

**The transaction net margin method is still the most used transfer pricing method applied by APAs.** The transactional net margin method is still the most used transfer pricing method in signed APAs from 2005 to 2022, being used 258<sup>2</sup> times and accounting for 83.5%. In addition, the Chinese tax authorities have also actively tried to use other methods to reasonably evaluate the important contributions of both parties in value creation, as well as special factors such as market premiums and cost savings.

## KPMG Observations

Faced with the complex and changing international economic environment, the Chinese tax authorities are making unremitting efforts to promote the development of multinational enterprises. The number of APA cases has been steadily increased.

- **The number of APA signed has significantly increased.** In 2022, Chinese tax authorities successfully signed 34 APAs, and efficiency largely increased compared with previous years. Among them, the negotiation efficiency of unilateral APAs has improved even more significantly. This shows Chinese tax authorities' continuous efforts to promote the development of multinational enterprises and to create a stable tax environment in the current unstable international economic environment.
- **Implementation of simplified procedures drives unilateral APA applications.** Among the 34 APAs signed by Chinese tax authorities in 2022, 19 were unilateral APAs, accounting for 55.9%, a significant increase of 10.9% compared with last year, and all 19 cases were signed within 24 months. This shows that more and more eligible taxpayers tend to obtain tax certainty through the application of the simplified procedure for unilateral APAs.
- **Newly signed APAs in the finance industry, industries covered will be more diverse.** 2 APAs in the finance industry were successfully signed in 2022, and it is expected that the industries covered by APAs will be more diverse. This shows that, in the face of the increasing diversification of China's economy, Chinese tax authorities insist on conforming to the trend of the times and improving tax service capabilities, thereby safeguarding the development of enterprises and stimulating the vitality of business entities.
- **APA reviews are getting stringent.** At the same time, we also observed that as countries strengthen their international tax administrations, more multinational companies are considering APAs to address cross-border tax risks. Chinese tax authorities become more stringent in their APA review and evaluation, and tend to prioritize cases with complete value chain analysis, innovative analysis methods, and sufficient quantitative analysis of intangible assets, cost savings, and market premiums.
- **"Going global" enterprises seeking APA to resolve cross-border tax disputes.** The post-epidemic global economic turmoil triggered worldwide inflation, and the international industrial supply chain is facing adjustments. Some countries have initiated transfer pricing investigations against multinational enterprises operating locally to safeguard their own tax interests. In practice, we have also seen that many Chinese "going global" enterprises face transfer pricing challenges from local tax authorities from Southeast Asia and Europe. Therefore, it is expected that more and more "going global" enterprises will be willing to apply for bilateral or unilateral APAs to resolve cross-border tax disputes and enhance business certainty.

In recent years, Chinese "going global" enterprises encountered more and more tax investigations or disputes overseas. It is suggested that the "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.

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



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