

# China Advance Pricing Arrangement Annual Report

(2009)



State Administration of Taxation  
People's Republic of China



# Foreword

In recent years, with the rise of economic globalization and the development of multinational enterprises (“MNEs”), revenue sources and tax arrangements have become increasingly internationalized, leading to a need for new requirements and creating new challenges with respect to international tax administration, and strengthening international tax coordination and cooperation has now become a common goal for tax authorities worldwide.

Transfer pricing has become an area of focus and challenge in the context of international tax administration and cooperation. The methods and principles selected to price such cross-border intercompany transactions impact not only the profits and tax burdens of headquarters or subsidiaries subject to different tax regimes but also the tax revenue allocation between the countries or regions involved. As a result, MNEs and international taxation administrations in many countries have recently devoted increased attention to transfer pricing. The Advance Pricing Arrangement (“APA”) represents a change in philosophy as well as a method of international taxation administration. The APA mechanism can be an effective tool for resolving transfer pricing issues and minimizing the potential for a transfer pricing dispute through collaboration between taxpayers and tax authorities. It helps to improve mutual understanding and strengthen collaboration between enterprises and tax authorities. It reduces administration costs for the tax authority and compliance costs for the taxpayer, as well as providing increased



certainty regarding enterprises' tax burdens and tax authorities' revenues, to the benefit of both parties. In addition, bilateral APAs, which allow for communication and collaboration between the competent tax authorities of different jurisdictions, serve as an effective mechanism to resolve international transfer pricing disputes and prevent double taxation.

The APA mechanism has now become an important part of China's anti-avoidance administration. With the growing volume of inbound and outbound investment flows resulting from the increasingly profound development of China's opening-up to the outside world and continued integration with the world economy, transfer pricing issues arising from cross-border intercompany transactions have become increasingly prominent. Recently, the State Administration of Taxation of China ("SAT") has held firm to the target of focusing on "both prevention and investigation", creating a "three-in-one" standard anti-avoidance system which integrates "administration, services and investigation". One of the important implementation measures involves improving services to the taxpayers through the promotion of the APA and mutual agreement procedure ("MAP") mechanisms. This allows increased certainty for taxpayers from tax and business perspectives while endeavoring to avoid international double taxation and implement an administrative philosophy of improved tax compliance with an emphasis on the prevention of tax avoidance. Since 2005, through the issuance of administration laws and regulations, China has gradually improved its APA system, thus enhancing APA negotiations and allowing increasing numbers of enterprises to apply for the APA. The numbers of APA under examination and concluded have also been increased steadily. From 2005 to 2009, Chinese tax authorities concluded and signed 41 unilateral APAs and 12 bilateral APAs, and there are still some APAs under examination. China has also established bilateral APA negotiation mechanisms with nearly ten countries to improve its working system and administration. Following the laws and regulations, the Chinese tax authorities are continuously developing its APA administration.

The periodic disclosure of APA-related regulations and statistics in order to strengthen APA administration and improve transparency is a useful initiative for us to undertake. Taking reference to international practice as well as the realities in China, the SAT hereby issues China's inaugural annual APA report, which includes an introduction to China's APA program, implementation procedures, and development of APA practices. This report also contains statistics and analyses of China's APA program for the period from 2005 through 2009. We hope it will provide useful guidance to taxpayers, especially MNEs investing in China as well as Chinese enterprises with overseas investments, thus helping our society as well as international organizations to deepen their understandings of China's APA practices.

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## Notes

This is the first annual APA report released by the State Administration of Taxation (“SAT”) to describe the mechanisms, procedures, and implementation of the APA program in China. This report is intended to provide guidelines to enterprises interested in entering into APAs with the Chinese tax authorities, and to serve as a reference for competent authorities of other countries<sup>①</sup> and the general public to better understand the APA program in China.

This report provides statistics for the period from 1 January 2005 to 31 December 2009.

This report does not have legal validity, and therefore should not be regarded as a legal basis for enterprises or any Chinese tax authorities to negotiate or conclude an APA.

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① For the purpose of this report, “other countries” include the regions with independent tax jurisdiction.

# I Introduction to China's APA Program

## 1. Definition

An APA refers to an arrangement whereby an enterprise applies in advance to negotiate and reach agreement with the tax authorities in respect of the transfer pricing methods and corresponding calculation methods to be applied to its related party transactions for future years in accordance with the arm's length principle. An APA covers related party transactions for three to five consecutive years starting from the year subsequent to the year during which the enterprise submits its formal written application.

## 2. Categorization

An APA may be categorized as unilateral, bilateral or multilateral based on the number of competent authorities involved in the APA.


In a unilateral APA, the enterprise enters into the APA with one country's tax authority. A unilateral APA can only provide certainty to the enterprise's pricing policy and method with respect to its related party transactions within one country, but cannot ensure that the overseas related party (ies) will effectively avoid transfer pricing audits or adjustments with respect to its transfer pricing with the enterprise by the tax authority of the related party. Thus, a unilateral APA cannot prevent international double taxation.

In a bilateral or multilateral APA, the enterprise negotiates and enters into the APA with two or more countries' competent authorities. These authorities will need to reach an agreement with regard to the pricing policies or methods used in the cross-border related party transactions of the enterprise in question. Bilateral and multilateral APAs can be used to effectively avoid international double taxation and provide certainty regarding the transfer pricing policies of the enterprise.

## 3. Advantages

An APA is an effective approach to deal with transfer pricing issues and potential transfer pricing disputes with the collaboration between tax authorities and an enterprise. An APA between the tax authority and the enterprise is binding on all parties. The enterprise shall proactively conform to all the





provisions and requirements of the arrangement, while tax authorities shall monitor the implementation of the agreement.

An APA is a voluntary agreement conducted on the basis of equality and mutual trust. It provides an effective way to enhance understanding, strengthen collaboration, and mitigate disputes between enterprises and tax authorities. APAs have the following benefits:

a) Provide certainty for tax authorities and enterprises in regards to transfer pricing issues for future years, which will offer certainty with regard to taxpayers' operations and relevant tax obligations and provide tax authorities with an expectation of stable revenue;

b) Reduce tax authorities' costs related to transfer pricing administration and audit as well as enterprises' tax compliance costs by mitigating the risk of a transfer pricing audit; and

c) Improve the tax compliance services provided by the tax authorities, facilitate the balanced development of administration and service, and assure taxpayers of the relevant rights and benefits.

Bilateral and multilateral APAs can also provide the following additional advantages:

a) Facilitate communication and collaboration among the competent tax authorities of different jurisdictions; and

b) Help enterprises avoid transfer pricing audits as well as double taxation risks in two (for bilateral APA) or more (for multilateral APA) tax jurisdictions.

## II Legislation and Practice Development of China's APA

### 1. History

China began using APAs on a trial basis in the late 1990s. In 1998, an APA was included as one of “other reasonable methods of transfer pricing adjustments” in Article 28 of “The Regulation on the Taxation of Transactions between Related Parties (Trial)”<sup>①</sup> (Guo Shui Fa [1998] No. 59). In 1998, the first unilateral APA was reached between a tax authority and an enterprise.

In 2002, the APA program was formally introduced in Article 53 of “The Implementation Rules of the Tax Collection and Administration Law of the People’s Republic of China”<sup>②</sup> (Guo Wu Yuan Ling No.362), and APAs were elevated from an adjustment method to a program.

In 2004, the SAT promulgated “Implementation Rules on Advance Pricing Arrangements for Transactions between Related Parties (Trial Version)” (Guo Shui Fa [2004] No. 118), which provides details of the APA program and specific procedures such as negotiation and conclusion procedures, requirements, follow-up execution and monitoring, as well as guidance on APA administration in China. Such a step further regulated the administration of China’s APA program. From 1998 to 2004, a number of local Chinese tax authorities initiated trial programs and concluded unilateral APAs with enterprises. However, due to the absence during this period of implementation guidance that was specific, standardized and imposed nationwide, concluded APAs were usually found to be defective through over-simplified APA articles and insufficient function, risk and economic analysis. For this reason, this report does not contain statistics about APAs concluded during this period.

In order to standardize and ensure consistency of China’s APA administration across the country, the SAT has implemented rules for APA monitoring and administration since 2005 requiring the local tax authorities to submit the draft unilateral agreement to the SAT for review and approval before its

① Article 28 – Transfer Pricing Adjustment Methods for Purchases and Sales of Tangible Assets: ...

(IV) Other appropriate methods: If none of the first three methods are applicable, the tax authorities can choose other reasonable methods, such as “profit-comparison method”, “profit-split method”, and “net profit method”, among others. The enterprise can also adopt an “advance pricing arrangement” after applying for and obtaining approval from the tax bureau in charge.

② Article 53 – The taxpayer may propose a pricing principle and calculation method to the in-charge tax authority concerning the transactions between them and associated enterprises. The in-charge tax authority shall examine, verify and decide whether to approve the proposal. If approval is given, an advance agreement shall be reached with the taxpayer concerning pricing related matters and the tax authority shall supervise the implementation.



conclusion. Meanwhile, local tax authorities are required to steadily promote APA programs and strictly conform to the relevant regulations to improve the administrative soundness of the APA program. China's APA administration has since stepped into a new stage of well-founded regulation. In April 2005, Japan and China concluded the first bilateral APA in China's history. Subsequently, China reached bilateral APAs with the United States, the Republic of Korea, and other countries. From 2005 to 2008, the Chinese tax authorities concluded 41 APAs, including 36 unilateral and 5 bilateral APAs.

At the beginning of 2009, Guo Shui Fa [2009] No. 2 "Implementation Measures of Special Tax Adjustments (Trial Version)" was promulgated to facilitate the implementation of the Corporate Income Tax Law of the People's Republic of China and its Implementation Regulations. Chapter Six of the Measures provides more detailed rules and implementation guidance on China's APA program. In 2009, China's bilateral APA program experienced rapid growth; the Chinese tax authorities signed 12 APAs, including Sunilateral and 7 bilateral APAs.

By the end of 2009, the Chinese tax authorities had received more than 38 written requests or formal applications for bilateral APAs. The countries involved include Japan, Korea, the United States, Denmark and Singapore, among others.

In addition, the SAT has received numerous enquiries on bilateral APAs from enterprises. It is expected that the number of APA applications will continue to increase.

## 2. Existing Legal Basis

The legal basis and relevant laws, regulations and implementation rules governing APAs primarily include the following:

- a) The relevant clauses in the agreements for the avoidance of double taxation (the "Treaty" or "Arrangement") between the government of China and the government of the corresponding country (region)
- b) Article 42 of the Corporate Income Tax Law of the People Republic of China
- c) Article 113 of the Implementation Regulations of the Corporate Income Tax Law of the People's Republic of China
- d) Article 53 of the Implementation Regulations of the Administration of Tax Collection and Administration Law of the People's Republic of China
- e) Chapter 6 and other related provisions of the Implementation Measures of Special Tax Adjustments (Trial Version) (Guo Shui Fa [2009] No. 2)

### III APA Procedures

#### 1. Prerequisites to an APA Application

In general, an enterprise meeting all of the following three formal criteria may apply for an APA:

a) The annual amount of related party transactions exceeds RMB 40 million. The types of related party transactions include the following:

- Purchase, sale, transfer and use of tangible assets;
- Transfer or use of intangible assets;
- Financing transactions; and
- Provision of services.

b) The enterprise has complied with the related party disclosure requirements according to the law.

The taxpayer should submit the “Annual Reporting Forms for Related-Party Dealings of Enterprises of the People’s Republic of China” with the annual Corporate Income Tax return to the tax authority within 5 months of the year following the year of related-party transactions.

c) The enterprise has prepared, maintained and provided contemporaneous documentation in accordance with the requirements of Guo Shui Fa [2009] No. 2.

The taxpayer shall prepare, maintain, and, upon request by tax authorities, submit contemporaneous documentation regarding its related party transactions for each tax year. The contemporaneous documentation includes the enterprise’s organizational structure, business operations, related party transactions, comparability analysis and selection and application of the transfer pricing method.

The process of applying for and negotiating an APA requires substantial commitment of resources from both the tax authority and the enterprise. In order to use its limited resources more effectively and enhance efficiency, the Chinese tax authority in practice will give priority to APA applications made by the following types of enterprises:

a) Enterprises which have provided sufficient and complete information, actively cooperate with the tax authority's examination and evaluation, and proactively submit a reasonable APA proposal.

b) Enterprises which have been investigated by the tax authorities for their transfer pricing policies

In China, enterprises are not required to pay an application fee to the tax authority in order to apply for

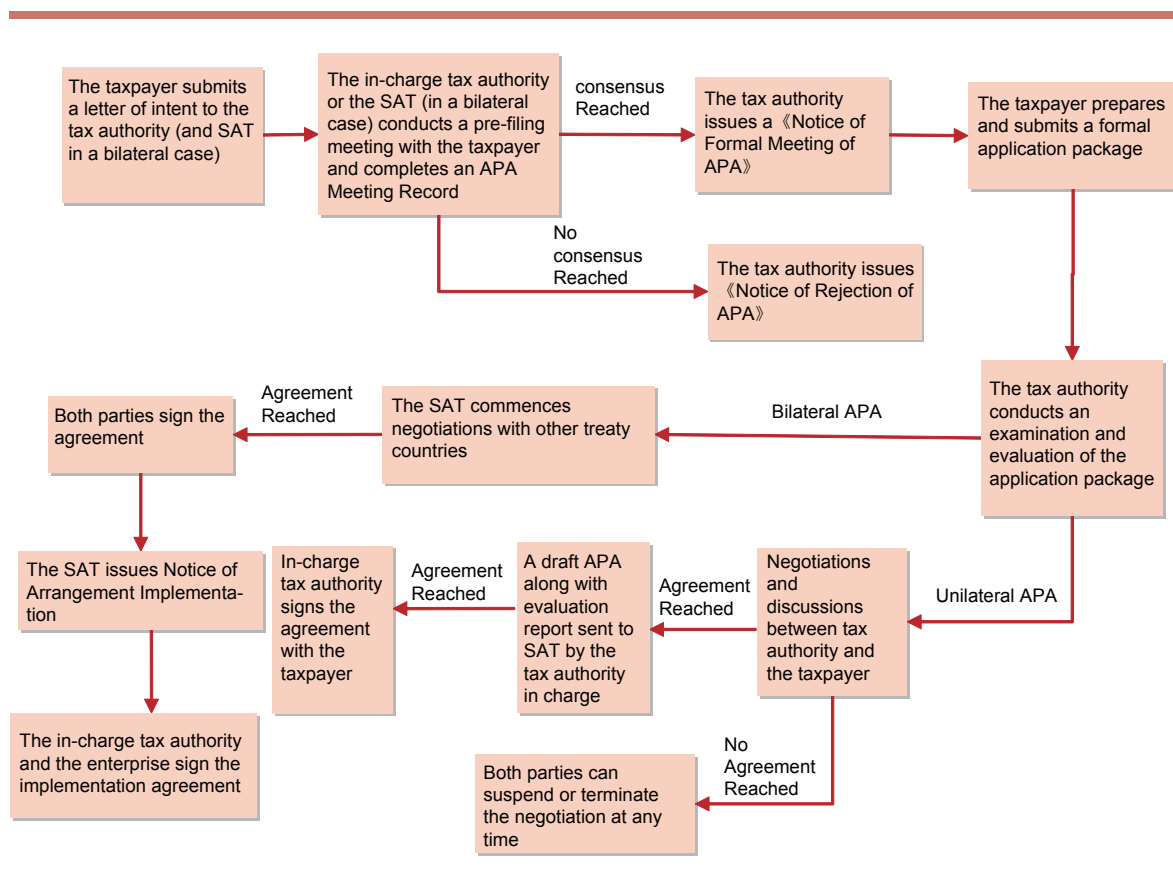
an APA.

## 2. APA Process and Implementation

The APA application and administration process involves the following six stages:

- A. Pre-filing meeting
- B. Formal application
- C. Examination and evaluation
- D. Negotiation
- E. Agreement and signing
- F. Execution and monitoring

The following chart illustrates the process:





### **A. Pre-filing meeting**

Prior to the formal application for an APA, the enterprise should submit a letter of intent (“LOI”) to apply for an APA to the tax authority. When applying for a bilateral (or multilateral) APA, the enterprise must submit LOIs to both the SAT and the in-charge local tax authority.

The in-charge tax authority (or the SAT in the case of a bilateral or multilateral APA), may conduct a pre-filing meeting with the enterprise to discuss relevant matters and the feasibility of reaching an APA, and complete an “APA Meeting Record” (see Appendix I ). During the pre-filing meeting, the tax authority will discuss with the enterprise based on the type of the APA application.

#### (1) Contents of the pre-filing meeting

If the enterprise applies for a unilateral APA, the following topics will generally be discussed in the pre-filing meeting:

- a. Years to be covered under the arrangement;
- b. Related parties involved and related party transactions to be covered under the arrangement;
- c. Overview of the enterprise’s business operations in prior and future years;
- d. Functional and risk profiles of related parties involved in the APA application;
- e. Whether the methodology in the arrangement would be applied to resolve transfer pricing issues in prior years; and
- f. Any other situations requiring explanation.

If the enterprise applies for a bilateral APA or multilateral APA, the following areas shall be discussed in addition to the items above:

- a. Any request by the enterprise for arrangement of a pre-filing meeting with relevant competent tax authority or authorities involved in the APA;
- b. Overview of business operations of related parties involved in the APA and their related party transactions in prior years; and
- c. The transfer pricing methodology and calculation method of the APA proposed to the relevant competent tax authority or authorities involved in the APA.

#### (2) Form of the pre-filing meeting and follow-up matters

The pre-filing meeting can be held anonymously.

If the two parties reach an agreement after the pre-filing meeting, the tax authority will issue the “Notice

of Formal Meeting of the APA” (see Appendix II ) to the enterprise, and inform the enterprise to submit the formal application. If the pre-filing meeting does not come to a mutual agreement, the tax authority will issue the “Notice of Rejection of Enterprise's Application for APA” (see Appendix III ) to the enterprise along with rejection reasons..

### **B. Formal application**

The enterprise shall submit the written application package to the tax authority within 3 months upon receipt of the “Notice of Formal Meeting of the APA” (see Appendix IV ), and submit the “Formal Application Letter for APA” to the tax authority. For a bilateral or multilateral APA, the enterprise shall submit the “Formal Application Letter for APA” and the “Application to Initiate Mutual Agreement Procedure” (see Appendix V ) to both the SAT and the in-charge local tax authority.

The written application package of an APA should include the following:

- (1) Descriptions of relevant group structure, internal organizational structure of the enterprise, related party relationships, and related party transactions;
- (2) Financial and accounting reports of the enterprise for the most recent 3 years, and information on product performance and assets (including intangible and tangible assets);
- (3) Types of related party transactions and tax years to be covered by the APA;
- (4) Allocation of functions and risks among related parties, including the allocation criteria used such as entities involved, personnel, expenses, assets, etc.;
- (5) Proposed transfer pricing methodology and calculation method in the APA, and the functional and risk analysis, comparability analysis and assumptions used for supporting such methodology and method;
- (6) Description for market conditions, including industry development trends and competitive environment;
- (7) Annual information on business scale, business performance forecasts and business plans for the period covered by the APA;
- (8) Information regarding relevant related party transactions, business arrangements and financial results such as profit levels etc., involved in the arrangement;
- (9) Whether there are double taxation issues; and
- (10) Relevant issues in relation to domestic and international laws and tax treaties.



Enterprises may apply for an extension to tax authorities relating to the submission of the formal written application package and submit the “Application for Extension of Submitting the Formal Application for APA” (see Appendix VI) under the following exceptional circumstances:

- (1) Certain information requiring special preparation;
- (2) Information requiring technical processing, such as translation; and
- (3) Other non-subjective reasons.

The tax authority shall provide a written response to the enterprise and issue the “Reply to Application for Extension of Submitting the Formal Application for APA” (see Appendix VII) to the enterprise. If the tax authority fails to reply within the specified timeframe, it is deemed to have granted an extension to the enterprise.

When the enterprise applies for a bilateral (or multilateral) APA, the reports it submit to the two (or the respective) competent authorities should be consistent. If the application report is originally prepared in a foreign language, it should be fully translated into Chinese when submitted to the Chinese tax authorities with no deletions or abridgement. The relevant foreign-language contracts should also be translated into Chinese.

### **C. Examination and evaluation**

Upon receipt of the formal APA application package and other required documents, the tax authority will evaluate the documents and form a position within five months, and may request additional information from the enterprise during the evaluation process.

The scope of examination and evaluation conducted by the tax authority will mainly cover the following:

- (1) Overview of historical operations;
- (2) Functional and risk profiles;
- (3) Comparable information;
- (4) Critical assumptions;
- (5) Transfer pricing methodology and calculation method; and
- (6) Expected arm’s length price or profit range.

If needed, the tax authority will conduct an on-site audit to evaluate the actual operation of the enterprise.



If the evaluations need to be extended due to special factors, the tax authorities should formally inform the enterprise, and issue the “Notice of Extension of Examination and Evaluation of APA” (see Appendix VIII). The delay should not exceed 3 months.

#### **D. Negotiation**

For unilateral APAs, the tax authority will arrange negotiations and discussions with the enterprise after the tax authority reaches a position following its examination and evaluation process. If both parties can reach an agreement, the draft APA along with an examination and evaluation report will be submitted to the SAT for review and approval.

For bilateral or multilateral APAs, the SAT will arrange negotiations and discussions with the relevant competent authorities based on the SAT’s position following its examination and evaluation of the relevant information provided. If all parties can reach an agreement, a draft APA should be prepared according to the memorandum of negotiation. A draft APA should include the following:

- (1) Basic information of related parties such as names and addresses;
- (2) Related party transactions and the years to be covered under the arrangement;
- (3) The selected comparable prices or transactions, transfer pricing methodology and calculation methods, and financial projections in the arrangement;
- (4) Definition of technical terms in relation to the transfer pricing applications and calculation basis;
- (5) Critical assumptions;
- (6) Obligations of the enterprise including annual reporting, record keeping, and notification of changes to the assumptions, etc.;
- (7) Legal force of the arrangement, and confidentiality of documents and information;
- (8) Provisions on mutual responsibilities;
- (9) Revisions of the arrangement;
- (10) Methods and approaches of dispute resolutions;
- (11) Effective date; and
- (12) Appendices.

#### **E. Signing**

For a unilateral APA, the legal representatives or representatives authorized by the legal representatives

of both the tax authority and the enterprise officially sign the unilateral APA (For the “Reference Text of Unilateral APA”, please refer to Appendix IX).

For a bilateral or multilateral APA, the representative authorized by the SAT and relevant competent tax authorities of the other tax treaty (or arrangement) party(ies) officially sign the bilateral or multilateral APA, and then according to the signed bilateral or multilateral APA, the in-charge tax authority signs a “Bilateral (Multilateral) APA Implementation Agreement” (see Appendix X) with the legal representative or the representative authorized by the legal representative of the enterprise in accordance with the signed bilateral or multilateral APA.

#### **F. Execution and monitoring**

The enterprise shall maintain a complete record of relevant documents and information (including accounting records and other relevant records), and shall file an annual compliance report in relation to implementation of the APA to the tax authority within five months after the end of each year.

During the term of the APA, the tax authority shall regularly inspect the enterprise’s compliance. If actual operating results of the enterprise fall outside of the agreed range of prices or profits under the arrangement, the tax authority shall adjust the actual operating results to the agreed prices or profits in accordance with the APA. In the case of a bilateral or multilateral APA, such an adjustment shall be submitted to the SAT for approval.


During the term of the APA, if there are substantial changes that affect the implementation of the APA, the enterprise should report these changes to the tax authority in writing with a detailed explanation regarding the impact of these changes on the implementation of the APA within 30 days.

Based on the review of the enterprise’s operation, the tax authority will discuss with the enterprise and either revise the provisions and relevant conditions of the arrangement or terminate the arrangement, depending on the impact of the changes on the implementation of the APA.

### **3. Rollback**

Negotiation and signing of the APA does not affect transfer pricing audits conducted and adjustments made by tax authorities on the enterprise’s related party transactions in the year during which the enterprise submits its formal written application or any prior year.

If the related party transactions in the year of application or any prior year are the same as or similar



to those covered in the APA, subject to the enterprise's application, the transfer pricing methodology and calculation method specified in the APA can be applied to the evaluation and adjustment of the related party transaction in the year of application or any prior year upon the tax authorities' approval.

The rollback stipulation has the advantage of resolving many years of potential transfer pricing issues through the APA application process. The relevant regulations for transfer pricing investigations are applicable to the rollback period, as far back as 10 years.

#### **4. Renewal**

If the enterprise wants the APA to be renewed when it expires, it can file an application for renewal 90 days prior to the expiration of the APA to the tax authority, by submitting the "APA Renewal Application" (see Appendix XI). This application should also include reliable supporting evidence to confirm that there have been no substantial changes to the facts and conditions in the existing APA and that the enterprise has been in full compliance with the provisions and requirements of the existing APA.

Upon receiving the application for renewal, the tax authority will issue a "Reply Letter on the Application of the Renewal of the APA" (see Appendix XII) to the enterprise. The tax authority will subsequently review and evaluate the application documents, and negotiate with the enterprise to draft the new APA and complete the renewal process.

#### **5. Cancellation**

An APA may become invalid or terminated under any one of the following conditions:

- (1) The APA becomes invalid automatically upon its expiration;
- (2) In case of any dispute between the in-charge tax authority and the enterprise during the term of the APA, if the dispute cannot be resolved after negotiation and discussion, it can be reported to the tax authority at the next higher level or the SAT (when a bilateral or multilateral APA is concerned) for mediation. The APA shall be terminated if the outcome of the consultation or determination of the tax authority at the next higher level or the SAT is not acceptable to the enterprise; or
- (3) The critical assumptions forming the APA have been breached or there is a fundamental change in the enterprise's business such that the APA is no longer applicable.

## IV Statistics

### 1. APAs Signed by Year

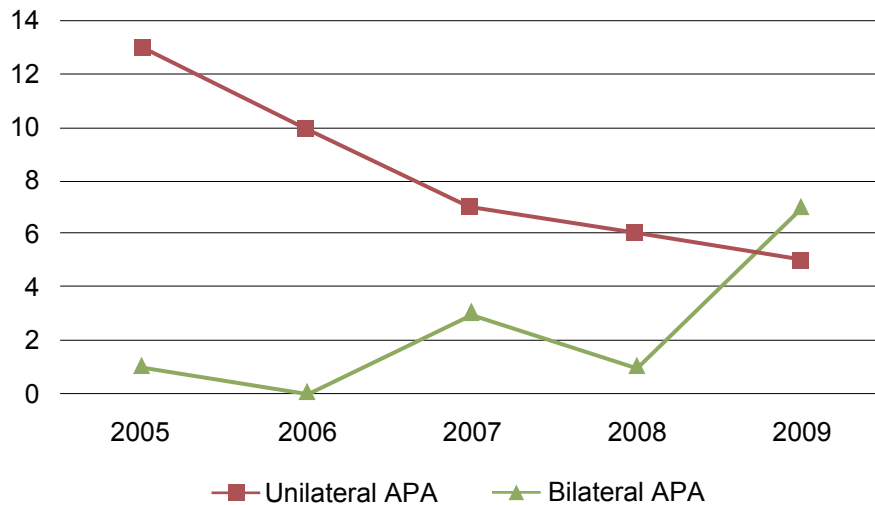
Exhibit 4-1 summarizes the number of unilateral and bilateral APAs that the Chinese tax authorities signed during each of the 2005 to 2009 calendar years.

**Exhibit 4-1 Number of APAs Signed**

Year	Unilateral APAs	Bilateral APAs	Multilateral APAs	Total
2005	13	1	0	14
2006	10	0	0	10
2007	7	3	0	10
2008	6	1	0	7
2009	5	7	0	12
<b>Total</b>	<b>41</b>	<b>12</b>	<b>0</b>	<b>53</b>

China has signed 53 APAs during this 5 year period, of which 41, or 77.36% are unilateral and 12, or 22.64% are bilateral. So far there have not been any applications for multilateral APAs.

The chart below compares the number of unilateral APAs and bilateral APAs signed from 2005 through 2009.



**Chart 4-1 Number of signed APAs from 2005 to 2009**

As shown in the chart above, the number of unilateral APAs is decreasing year by year, while the number of bilateral APAs is generally increasing. From 2005 to 2008, more unilateral than bilateral APAs were signed every year. However, the number of bilateral APAs exceeded that of unilateral APAs in 2009 for the first time so that they became the APA program's principal component. This indicates that taxpayers are attaching more importance to bilateral APAs and looking for ways to resolve bilateral international transfer pricing issues and avoid double taxation through the MAP process. It also reflects the SAT's intensified effort in promoting the MAP program.

## 2. APAs by Phase


Exhibit 4-2 provides statistics of APAs by phase as of 31 December 2009.

**Exhibit 4-2 APAs by Phase** ( as of 31 December 2009 )

Phases		Unilateral	Bilateral	Total
Pre-Acceptance	Proposal / letter of intent	0	20	20
	Pre-filing meeting	26	5	31
Accepted Applications	Examination and evaluation <sup>①</sup>	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
<b>Total</b>		<b>69</b>	<b>51</b>	<b>120</b>

The “Accepted Applications” category, as displayed in Exhibit 4-2, refers to APA applications which the tax authorities have accepted as submitted by the enterprises but where an agreement has not yet been achieved. Applications falling into this category are either under examination and evaluation or under

① There is a “Formal application” phase that is not listed in this table since the tax authority’s acceptance of the formal application should be regarded as the start of the examination and evolution phase. The first meeting between the tax authority and enterprise in a unilateral APA or between the competent authorities in a bilateral or multi-lateral APA should be regarded as the start of the negotiation phase and the end of the examination and evaluation phase.



negotiation. The other main category, “Concluded APAs”, includes APAs that have been agreed but not signed, APAs that are being executed and monitored, and APAs that have expired. China currently has 41 unilateral APAs in the “Concluded APAs” category, of which 23 have expired and 18 are under execution. There are only 2 unilateral APAs under the “Accepted Applications” category. As shown in the exhibit, there are 26 unilateral APA applications in the pre-filing meeting phase but none at the unilateral APA proposal phase. Regarding bilateral APAs, 13 bilateral APAs have been concluded, of which one is agreed but not signed and one has expired. The other 11 concluded bilateral APAs are under execution. There are 13 bilateral accepted applications, including 5 under examination and evaluation and 8 under negotiation. In addition, 5 enterprises have applied for a pre-filing meeting and 20 enterprises have indicated their intention to apply for bilateral APAs with the tax authority.

While far more unilateral APAs than bilateral APAs have been concluded, most concluded unilateral APAs were signed several years ago and have therefore already expired. In contrast, of the proposed and accepted APA applications, there are fewer unilateral than bilateral applications, suggesting that bilateral APAs should be expected to increase significantly both in terms of number and workload in the coming years. As the Chinese tax authorities aim to steadily promote the APA program and to improve the quality of the APA examination work, they have devoted special efforts to the pre-filing examination process. Therefore, many enterprises’ APA applications are still at the pre-acceptance Stage.

### 3. APAs by Transaction Type

Exhibit 4-3 below illustrates the types of transactions involved in the accepted and concluded APAs as of 31 December 2009<sup>①</sup>.

Exhibit 4-3 APA by Transaction Type					
Accepted Applications			Concluded APAs		
Transaction Type	Number of APAs	Percentage	Transaction Type	Number of APAs	Percentage
Purchase and sales of tangible assets	11	46%	Purchase and sales 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	—
<b>Total</b>	<b>24</b>	<b>100%</b>	<b>Total</b>	<b>68</b>	<b>100%</b>

As shown in Exhibit 4-3, purchase and sale of tangible assets accounts for the largest portion of transactions covered by China's APA program. Of the concluded APAs, 62% involve the purchase and sale of tangible assets, 19% involve the transfer of intangible assets, and 19% involve the provision of services. APAs involving the purchase and sale of tangible assets account for the largest proportion of accepted applications with 46% of the total, although this is lower than the proportion of concluded APAs accounted for by this type of transaction. APAs involving the transfer or use of intangible assets and the provision of services account for 33% and 21% of accepted applications, respectively, which represents an increasing trend.

<sup>①</sup> As some APAs involve multiple transaction types, the total number of related party transactions is greater than the number of APAs.



These statistics indicate that most of the enterprises which applied for APAs are manufacturing companies which are mainly involved in intercompany transactions related to the purchase and sale of tangible assets. However, based on the number of accepted applications and concluded APAs, it is anticipated that the number of APAs involving other types of transactions will increase rapidly in the future. As China's tertiary industry develops, an increasing number of service companies may decide to apply for an APA. Thus, more APAs may involve transactions related to intangible assets, services and financing.

#### 4. Bilateral APAs by Region

China signed 9 bilateral APAs with Asian countries, 1 with a North American country and 2 with European countries between 2005 and 2009. The following chart displays the percentage of bilateral APAs accounted for by each of these regions.

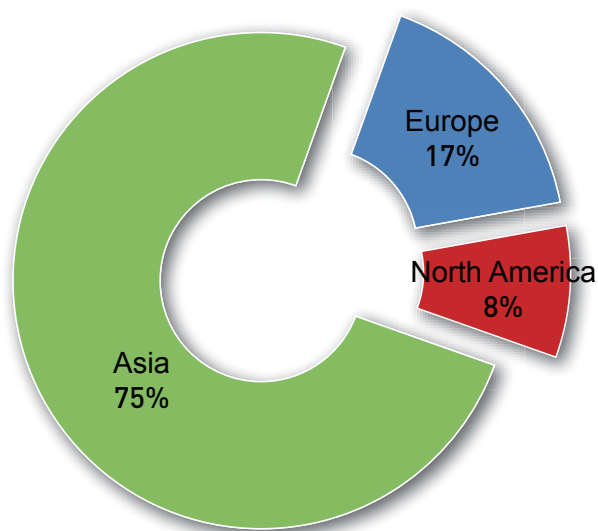


Chart 4-2 Bilateral APAs by Region

## 5. APAs by Processing Time

Exhibit 4-4 illustrates the processing times for unilateral and bilateral APAs signed by the Chinese tax authorities from 2005 to 2009.

**Exhibit 4-4 APAs by Processing Time**

Type	Processing Time from application to signing				Total
	<1 year	1-2 years	2-3 years	>3 years	
Unilateral	23	18	0	0	41
Bilateral	7	3	1	1	12

As shown in Exhibit 4-4, China's unilateral APAs were all completed in 2 years or less, with 56% completed within 1 year and 44% taking between one and two years to complete. While bilateral APAs generally take more time, many were also completed within 1 year (58%); 25% took between one and two years, 8% took two to three years to be completed, and the remaining 8% were completed in periods longer than 3 years.

The time required to complete the entire APA process depends on many factors including the type of APA (i.e. unilateral, bilateral, or multilateral), the complexity of issues involved, the quality of the files provided by the enterprises, the efficiency of the tax officers' review process, and the extent of the enterprise's cooperation (e.g. timely provision of information).

The Chinese tax authorities generally aim to complete the review and negotiation process within 12 months for unilateral APAs and within 24 months for bilateral APAs. Bilateral APAs involve negotiations with relevant competent authorities through the MAP process and therefore require more time to reach a consensus than unilateral APAs.

## 6. APAs by Transfer Pricing Method

The chart below shows the transfer pricing methods applied in both the unilateral and bilateral APAs signed between 2005 and 2009<sup>①</sup>.

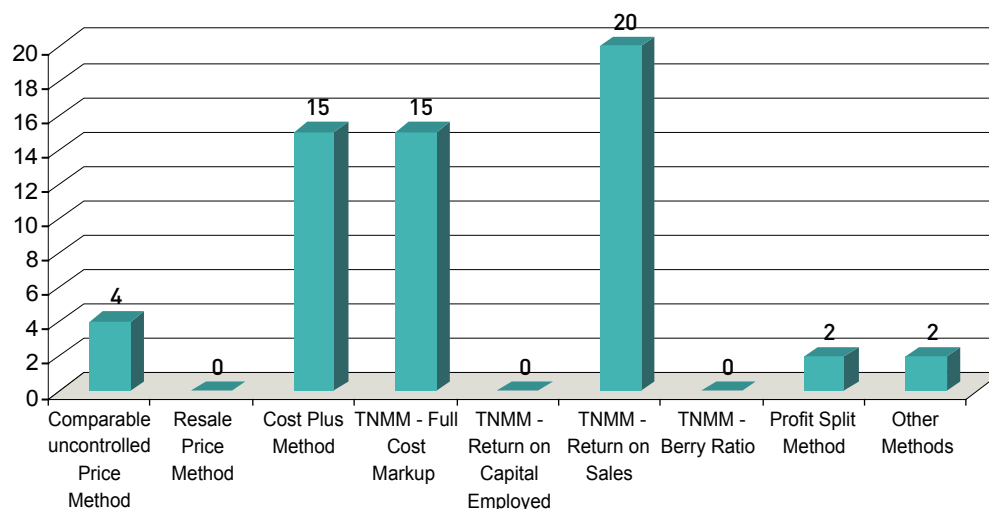



Chart 4-3 Transfer pricing methods applied in the signed APAs

The data indicates that the transactional net margin method (TNMM) is the most commonly used transfer pricing method, being used in 35, or 60%, of signed APAs. The most commonly used profit level indicators are the Return on Sales ratio (used in 20 APAs) and the Full Cost Mark-up ratio (used in 15 APAs). Recently, the Chinese tax authorities have frequently used public data, which explains why the TNMM is the most commonly used method in the signed APAs. Moreover, the TNMM is also used to determine the routine profit when applying a residual profit split method.

The second most popular transfer pricing method is the cost plus method, being used in 15 of the signed APAs. The other transfer pricing methods are applied less frequently. The comparable uncontrolled price (CUP) method is used in 4 cases; the profit split method is used in 2 cases; and other methods are used in the other 2 signed APAs. As the CUP method requires a very high standard of comparability for application

<sup>①</sup> Some APAs involve two or more kinds of transactions and multiple transfer pricing methods may be used.



and the resale price method and profit split method require a heavy amount of information regarding the transaction and price, these methods tend not to be applied frequently in practice. The Chinese tax authorities hope that enterprises will better cooperate with tax officers during the APA review and evaluation phase and provide sufficient information regarding transactions and prices so that the resale price method and the profit split method may be more frequently applied in the APA program.

## Appendices - Forms and Schedules of the APA Program

### Appendix I

### APA Meeting Record

Name of Enterprise		Name of the In-charge Tax Authority	
Taxpayer Identification Code	□□□□□□□□□□□□□□□□		
Meeting Time		Meeting Venue	
Principal Negotiator of the Enterprise (Name, Position)		Principal Negotiator of the In-charge Tax Authority (Name, Position)	
Other Personnel of the Enterprise (Name)		Other Personnel of the In-charge Tax Authority (Name)	
Meeting Content:			
Signature of Principal Negotiator of the In-charge Tax Authority		Signature of Principal Negotiator of the Enterprise	
Signature of Recorder			



## User Instructions

1. The “Advance Pricing Arrangement Meeting Record” is used when the in-charge tax authority and the taxpayer conduct meetings or negotiation discussions (including pre-filing meeting and formal meetings) in relation to the Advance Pricing Arrangement.
2. The meeting record shall consist of the detailed content of the meeting, the number of copies and the number of pages in relation to the documents provided by both parties.
3. The meeting record shall be kept confidential.

Appendix II

## Notice of Formal Meeting of the APA

\_\_\_\_\_ Shui Yu Yue [ ] No.

\_\_\_\_\_:

In accordance with the “Corporate Income Tax Law of the People’s Republic of China” and its Detailed Implementation Regulations, the “Law of the People’s Republic of China on the Tax Collections and Administration” and its Detailed Rules for Implementation Regulations, and relevant provisions in the tax treaty entered into and executed by the government of the People’s Republic of China and the government of \_\_\_\_\_, and given that your Enterprise has indicated during the stage of pre-filing meeting that you could provide the necessary information for an Advance Pricing Arrangement, after careful consideration, we hereby agree to proceed with to formal negotiation with your Enterprise in connection with the Advance Pricing Arrangement.

Notice is hereby given.

Tax Authority (Official Stamp):

(Date)

Appendix III

## Notice of Rejection of Enterprise's Application for APA

\_\_\_\_\_ Shui Ju Yue [ ] No.

\_\_\_\_\_:

In accordance with the "Corporate Income Tax Law of the People's Republic of China" and its Implementation Regulations, the "Law of the People's Republic of China on the Tax Collections and Administration" and its Detailed Rules for Implementation, and relevant provisions in the tax treaty entered into and executed by the government of the People's Republic of China and the government of \_\_\_\_\_, and due to the following reasons, after careful consideration, we decide not to proceed to the formal negotiation with your enterprise in connection with the Advance Pricing Arrangement, and hereby return all the information you provided during the Pre-filing Meeting back to you.

Rejection reason(s):

Notice is hereby given.

Tax Authority (Official Stamp):

(Date)



## Formal Application Letter for APA

\_\_\_\_\_ Tax Authority:

In accordance with the “Corporate Income Tax Law of the People’s Republic of China” and its Implementation Regulations, the “Law of the People’s Republic of China on the Tax Collections and Administration” and its Detailed Rules for Implementation, and relevant provisions in the tax treaty entered into and executed by the government of the People’s Republic of China and the government of \_\_\_\_\_, and in accordance with the requirements in the “Notice of Formal Meeting of the Advance Pricing Arrangement” (Shui Yu Yue [ ] No. ) issued by your bureau on [Date], we hereby formally apply for an Advance Pricing Arrangement for the transaction(s) between our Enterprise and the following related party(ies): \_\_\_\_\_. Please sign and acknowledge receipt of this application.

Enclosures: Total \_\_\_\_\_ copies \_\_\_\_\_ pages

- 1.
- 2.
- 3.

Name of Enterprise (Official  
Stamp):

Taxpayer Identification Code:

Legal Representative (Official  
Stamp):

(Date)



## User Instructions

This application letter should be supplemented with at least the following information:

1. Descriptions of relevant group structure, internal organizational structure of the enterprise, related party relationships, and related party transactions;
2. Financial and accounting reports of the enterprise for the most recent 3 years, and information on product performance and assets (including intangible and tangible assets);
3. Types of related party transactions and tax years to be covered under the advance pricing arrangement;
4. Allocation of functions and risks among related parties, including the allocation bases such as involved entities, personnel, expenses, assets, etc.;
5. Proposed transfer pricing methodology and calculation method in the Advance Pricing Arrangement, and the functional and risk analysis, comparability analysis and assumptions used for supporting such methodology and method;
6. Market conditions, including industry development trend and competitive environment;
7. Annual information on operation scale, business forecasts and business plans for the period covered under the Advance Pricing Arrangement;
8. Information regarding relevant related party transactions, business arrangements and financial results such as profit levels, etc., involved in the arrangement;
9. Whether there are double taxation issues; and
10. Relevant issues in relation to domestic and international laws and tax treaties.

## Application to Initiate Mutual Agreement Procedures

No.

Basic information of the applicant	The party in the other treaty country / region partner	Name (Chinese and English)			
		Detailed address (Chinese and English)			
		Taxpayer registration number or identification code		Postcode	
		Contact Person (Chinese and English)		Contact telephone number	
		Name and address of the tax authority in charge (Chinese and English)			
	The party in China	Name			
		Detailed address		Postcode	
		Contact person		Contact telephone Number	
		Tax authority in charge			
	The other treaty partner: country or region or special administrative region (Chinese and English)				
Summary of the issue to negotiate	Facts:				
	Issues:				
	The applicant's opinion on the issue and the relevant basis thereof		The opinion of the tax authority in charge in the other treaty country partner on the issue and the relevant basis thereof		
Attachment list (Total items):					



Declaration: I hereby declare that all the application and the attachment provided are realtruthful, complete and accurate.

Signature of Declarant:

D M Y

Application procedure Document processing information (filled by tax authority)

Accepted date		File No.		Security classification		Signature of the accepted authority
Responsible person		Contact number		Degree of urgency		
Date of feedback by from State Administration of Taxation				Date of reception delivery of result byto applicant		
Summary of negotiation results:						

## Application for Extension of Submitting the Formal Application for APA

Name of Enterprise		Legal Representative	
Taxpayer Identification Code	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>	Financial Person in-charge and Contact Telephone Number	
Reason(s) and Time Limit for Extension of Submitting the Formal Application	<div style="text-align: right; margin-right: 50px;">Name of Enterprise (Official Stamp):</div> <div style="text-align: right; margin-right: 50px;">Legal Representative (Official Stamp):</div> <div style="text-align: right;">(Date)</div>		

Appendix VII

## Reply to Application for Extension of Submitting the Formal Application for APA

\_\_\_\_\_ Shui Da Fu [ ] No.

\_\_\_\_\_:

We hereby acknowledge receipt of the “Application for Extension of Submitting the Formal Application for Advance Pricing Arrangement” submitted by your Enterprise on [Date]. Below is our reply after careful consideration:

Tax Authority (Official Stamp):

(Date)

## Notice of Extension of Examination and Evaluation of APA

\_\_\_\_\_ Shui Yu Shen Yan [ ] No.

\_\_\_\_\_:

Referring to your enterprise's formal application for Advance Pricing Arrangement on [date], the evaluation period has been extended to [date], due to the special circumstances stated below:

- 1.
- 2.
- 3.

Notice is hereby given.

Tax Authority (Official Stamp):

(Date)

## Reference Text for Unilateral APA

Pursuant to the “Corporate Income Tax Law of the People’s Republic of China” and its Implementation Regulations as well as the “Law of the People’s Republic of China on the Tax Collections and Administration” and its Detailed Rules for Implementation, upon formal application of \_\_\_\_\_ (company name) and the approval of the Tax Bureau of \_\_\_\_\_ (tax office name), both parties would like to conclude this Advance Pricing Arrangement (hereinafter referred to as this “APA”).

### Article 1 General Definitions

For the purposes of this APA, unless otherwise defined elsewhere:

The term “in-charge tax authority” refers to the State Tax Bureau of \_\_\_\_\_ (tax office name);

The term “taxpayer” refers to \_\_\_\_\_ (company name).

### Article 2 Type of APA

This APA is a unilateral Advance Pricing Arrangement.

### Article 3 Scope of Application

Type of tax(es) covered: This APA is applicable to corporate income tax and other tax types.

Type of related party transaction(s) covered: This APA is applicable to \_\_\_\_\_ (description of the transaction type) transactions between the taxpayer and \_\_\_\_\_ (company name), which is its related party.

### Article 4 Applicable Term

This APA is applicable for \_\_\_\_\_ (number) tax years, with each taxable year covered being \_\_\_\_\_.





## Article 5 Critical Assumptions

The transfer pricing methodology and calculation method used in this APA are based on the following assumptions:

---

During the covered period, in case any of the above critical assumptions should change, the taxpayer should report to the in-charge tax authority within 30 days after the change takes place. Depending on the circumstances, the in-charge tax authority and the taxpayer may amend or terminate this APA.

## Article 6 Transfer Pricing Principle and Calculation Method

The transfer pricing principle and calculation method used in this APA for the transactions between \_\_\_\_\_ (company name) and its related party(ies) should comply with the arm's length principle. The specific transfer pricing principle and calculation method are based on \_\_\_\_\_.

## Article 7 Annual Compliance Report

During the covered period of the APA, the taxpayer should file annual compliance reports in relation to the implementation situation of the APA within 5 months after the end of the taxable year, together with the following documents:

---

## Article 8 Tax Inspection

This APA should list the content and requirements of the in-charge tax authority's review and evaluation on the taxpayer's implementation of the APA.

## Article 9 Legal Binding Force of this APA

During the covered period of this APA, as long as the taxpayer complies with all the articles and requirements set out in this APA, the in-charge tax authority should acknowledge the relevant pricing issues

as agreed with the taxpayer. If the taxpayer fails to comply with this APA, the in-charge tax authority may take actions according to the specific circumstances, or unilaterally terminate this APA.

## **Article 10** Renewal of this APA

This APA can be renewed consecutively but not automatically. If a renewal is required, the taxpayer should, within \_\_\_\_\_ months (days) before the expiration of this APA, submit a written application of renewal, together with reliable supporting documents to illustrate that the facts and the relevant environment remain substantially the same as described in this APA. Upon receipt of the application of renewal from the taxpayer, the in-charge tax authority should review and determine whether the renewal application should be accepted. If the renewal application is accepted, the in-charge tax authority will further discuss the renewal with the taxpayer to complete the renewal of the APA.

## **Article 11** Dispute Resolution

In the event of disputes over the implementation and interpretation of this APA, the in-charge tax authority and the taxpayer should first negotiate to resolve such issues. If the disputes cannot be resolved through negotiation, both parties may petition the upper level tax authority or the State Administration of Taxation for mediation. If the taxpayer cannot accept the mediation resolution, it should consider revising or terminating this APA.

## **Article 12** Confidentiality and Responsibility

In relation to the information obtained by the in-charge tax authority and the taxpayer during the negotiation and implementation process of this APA, both parties have the obligation to maintain confidentiality, and are protected and restricted by the relevant tax regulations and confidentiality law.

## **Article 13** Effectiveness, Amendment and Termination

This APA will come into effect once signed and stamped by the legal or authorized representatives of both parties.



This APA is signed by the legal or authorized representatives of the in-charge tax authority and the taxpayer in (city), (province) on (day-month-year).

If the in-charge tax authority or the taxpayer amends or terminates this APA, the party should notify the other party. The notification should include the time of and the reason for the amendment or termination in written form.

## Article 14 Avoidance of Double Taxation

The APA should list the method and content of the avoidance of double taxation.

## Article 15 Supplementary Provisions

This APA should be prepared in Chinese, in two copies, one for the in-charge tax authority and the other for the taxpayer, each of which should have full authenticity. In case one party translates the APA into a foreign language and disputes arise in the interpretation of the APA, the Chinese version should prevail.

\_\_\_\_\_ Tax Authority

\_\_\_\_\_ (Enterprise)

Signature:

Date:

Signature:

Date:

Title:

Stamp:

Title:

Stamp:

## Bilateral (Multilateral) APA Implementation Agreement

(Text for Reference)

Pursuant to the “Corporate Income Tax Law of the People’s Republic of China” and its Implementation Regulations as well as the “Law of the People’s Republic of China on the Tax Collections and Administration” and its Detailed Rules for Implementation, both parties, i.e., \_\_\_\_ (enterprise) and the Tax Bureau of \_\_\_\_\_, would like to conclude this implementation agreement. From (date-month-year) to (date-month-year), both parties should implement the bilateral (multilateral) advance pricing arrangement entered into by the State Administration of Taxation of the People’s Republic of China and the competent tax authority of (country or region) on (date-month-year).

Enclosure: “Bilateral (Multilateral) Advance Pricing Arrangement”

\_\_\_\_\_ Tax Authority

\_\_\_\_\_ (Enterprise)

Signature:

Date:

Signature:

Date:

Title:

Stamp:

Title:

Stamp:

## APA Renewal Application

\_\_\_\_\_ Tax authority Office:

The Advance Pricing Arrangement signed on (date-month-year) between our company and your bureau office will expire on (date-month-year). After expiration, the facts and relevant setting in relation to the related party transactions in the future years (i.e. from <year> to <year> ) will be the same or similar to those under the existing Advance Pricing Arrangement, without substantive changes. Therefore, we submit this application for a renewal of the Advance Pricing Arrangement for your review and approval.

Enterprise Name (Official Stamp):

Taxpayer Identification Code:

Date:

**Attachments:**

1. The existing Advance Pricing Arrangement (photocopy).
2. The annual compliance reports in relevant years regarding implementation of the Advance Pricing Arrangement.
3. Supporting documents to prove that the facts and relevant setting under the existing Advance Pricing Arrangement have not been substantively changed, and projections for future tax years to be covered by the renewal.

## Reply Letter on the APA Renewal Application

\_\_\_\_\_ Shui Da Fu [ ] No.

\_\_\_\_\_:

We hereby acknowledge receipt on (date-month-year) of the “Advance Pricing Arrangement Renewal Application” and its attachments submitted by your company on (date-month-year). After examination, we hereby reply to your renewal application, as follows:

- 1.
- 2.
- 3.

Tax Authority (Official Stamp):

(Date)