

## The Latest Insight

### The First Chinese Annual Advance Pricing Report Released

[11th February, 2011 Issue 3]

The State Administration of Taxation ("SAT") issued the Chinese first annual advance pricing report ("APA") titled "China Advance Pricing Arrangement Annual Report (2009)" ("APA Report") on December 30, 2010. The groundbreaking report provides the official statistical survey on both in-progress and completed Advance Pricing Arrangements (APAs) for the period from January 1, 2005 to December 31, 2009 and reaffirm the SAT's focus on transfer pricing issues, in particular, reinforces its commitment to the APA program. This report aims to provide a useful guidance to taxpayers, especially MNEs investing in China as well as Chinese enterprises with overseas investments that intend to adopt an APA. The information and insights provided by the report increases the transparency of the APA administration in China which is welcomed by the taxpayers.

#### Overview

The contents of the APA Report mainly include the following subjects:

1. Introduction to China's APA program;
2. A history of the APA program's development;
3. The implementation procedures and related forms;
4. Statistics on in-progress and completed APA cases; and
5. Appendices of forms used in the APA application process.

#### APA procedures and process

Apart from the forms and procedural guidance previously released, the APA Report also contains new content including the statistics as well as a process flowchart detailing how an APA moves through the six phases, namely:

1. Pre-filing meeting
2. Formal application
3. Examination and evaluation
4. Negotiation
5. Agreement and signing
6. Execution and monitoring

The below flow chart illustrates the process:

## Upcoming LB Events

**Russell Brown will join China CFO Forum 2011 Breakfast Roundtable, sitting on a panel discussing "Individual Income Tax planning in China."**

17th February 2011

Beijing

**LehmanBrown supports Care for Children charity dinner**

26th February 2011

Beijing

**Lehmanbrown hosts MBA Delegation from the University of Notre Dame**

7th March 2011

Beijing

**LehmanBrown to sponsor St. Paddy's Irish Ball 2011**

19th March 2011

Beijing

**LehmanBrown organises St George's Celebrations 2011**

23rd April 2011

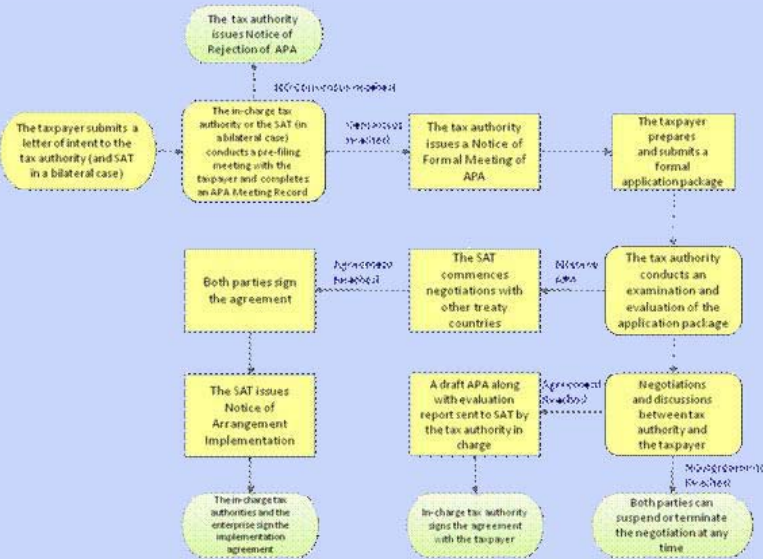
Beijing

**Lehmanbrown to Sponsor European Chamber Shanghai Gala Ball 2011**

7th May 2011

Shanghai





## Statistics

The APA Report provides a survey on the APA development in China since 2005 when the APA was formally incorporated under the corporate income tax law in China till the recent year of 2009.

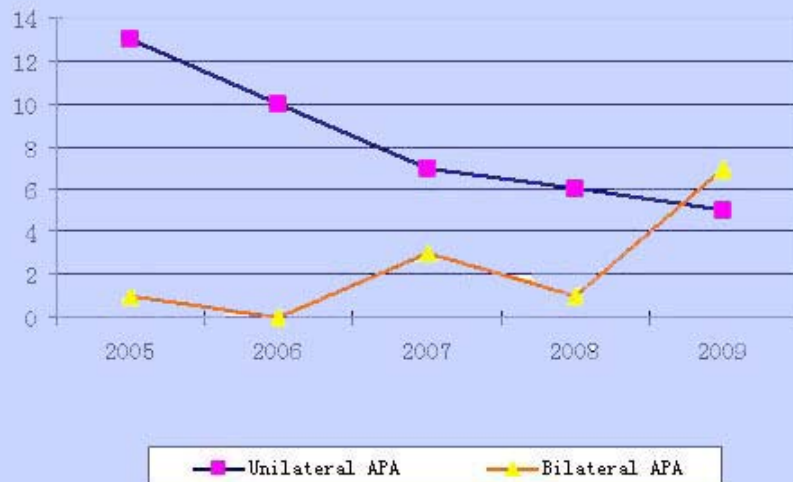
The data released by the Report demonstrates a few key trends for the APA program in China which is summarized below:

1. 53 APAs in total has been signed during 2005 to 2009, among which the unilateral APA accounts for more than 77%. Nevertheless, the bilateral APA is growing rapidly and surpasses the number of the signed unilateral APA for the first time in 2009.
2. As the end of 2009, no multilateral APA case has been concluded yet.
3. The majority of the APAs concluded is related to purchase and sales of tangible assets as of the end of 2009. However, the application of APA involving intangible assets and services is increasing continuously and the number application in process has exceeded the application related to tangible transactions.
4. The TNMM (transaction net margin method) is the most popular method adopted which accounts for 60% of the signed APA cases. Cost-plus is the second popular method whereby around 26% cases adopt it.
5. The processing times for unilateral APA and bilateral APA application are becoming more expedited.

Below are the complete statistical data extracted from the APA Report:

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>





**Table 2: APAs by Phase (as of December 2009)**

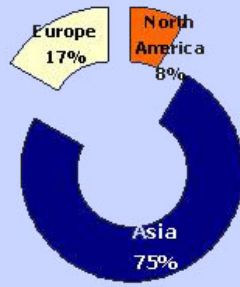
Phases		Unilateral	Bilateral	Total
Pre-Acceptance	Proposal/letter of intent	0	20	20
	Pre-filing meeting	26	5	31
Accepted	Examination and evaluation	0	5	5
	Negotiation	2	8	10
	Subtotal	2	13	15
Concluded APAs	Agreed but not signed	0	1	1
	Executed and Monitored	18	11	29
	Expired	23	1	24
	subtotal	41	13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

**Table 3: APA by Transaction Type**

Accepted Application			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	-
<b>Total</b>	<b>24</b>	<b>100%</b>	<b>Total</b>	<b>68</b>	<b>100%</b>

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

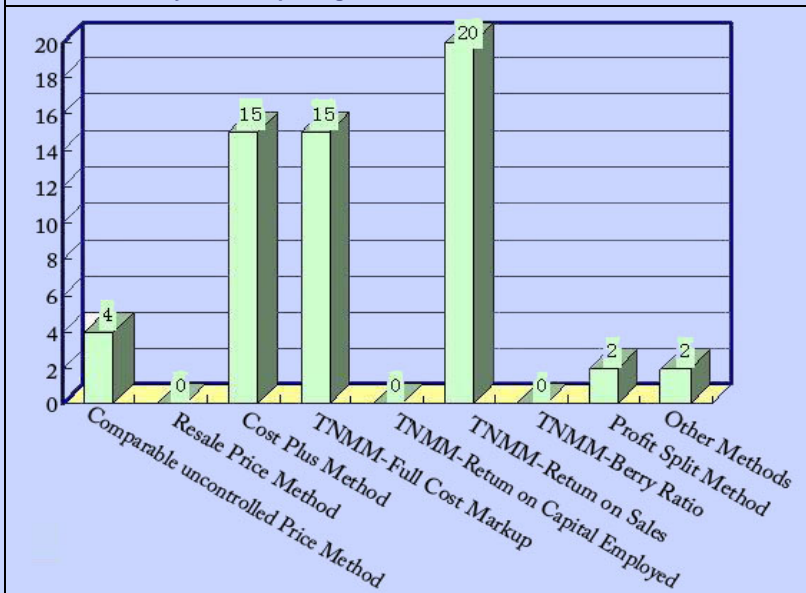
Region	Signed APAs
Asia	9
Europe	2
North America	1
<b>Total</b>	<b>12</b>



**Table 5: APA by Processing Time**

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

**Table 6: APAs by transfer pricing method**



### Our observations

APA program is viewed by SAT as an effective method to provide certainty for both the tax authorities and tax payers in regards to transfer pricing issues which is beneficial to both parties. On one hand, APA reduces the compliance costs for tax payer by mitigating the transfer pricing audit risks, avoiding the double taxation risks under bilateral / multilateral APA, providing higher assurance to the cross border operations. On the other hand, APA help to save administration costs for tax authorities in respect of transfer pricing issues, providing expectation of stable revenue.

This Report clearly demonstrates that SAT supports APA developments in China. More effort and resources shall be expected from SAT for improving the related APA administration in China, moving towards the international standard and practice, building up a transparent system, adopting the technically advanced APA approach.

Meanwhile, we also observed that SAT becomes more and more selective in accepting the APA applications. The reason behind is believed as that SAT aims to set precedents for transfer pricing for the same industries for the whole country through APA exercise. As a result, for certain industries the acceptance rate of the application may be affected.

The APA mechanism has been proved a useful tool for resolving transfer pricing issues, it is an important risk management tools for multinational enterprises (MNEs), those MNEs shall be aware of the new trend and practice developments in China so as to assess the risk and opportunities in a dynamic regulatory environment.

## Recent e-Newsletters

- Important stipulations in New Regulations
- New Regulations on Administration of Housing Provident Fund in Shenzhen
- Regulation of Foreign Representative Offices Further Tightened - But Procedural Certainty Improving
- New Regulation on Administration of Representative Offices of Foreign Enterprises
- New social insurance law updated
- New tax levies - Urban Construction & Maintenance Tax and Education Surcharge for foreign-related companies and individuals
- The General Office of the Ministry of Commerce (MOFCOM) released the Circular on Issues Concerning Examination and Approval of Foreign-invested Projects of Selling Goods via Internet and Automat
- Hong Kong signs Double Taxation Agreement with the United Kingdom
- PRC Government Removes Export Refunds on 406 Items
- New Administrative Measures for VAT General Taxpayer Recognition
- State Administration of Taxation Clarifies Several Implementation Issues Regarding Corporate Income Tax
- New Taxation Rules for Representative Offices of Foreign Enterprises in China
- New Regulation on Tax for Non-resident Enterprises
- New Requirement for 2009 Annual Corporate Income Tax Reconciliation