

## **Public Notice on Matters Regarding Refining the Administration of Advance Pricing Arrangements**

### **Public Notice of the State Administration of Taxation [2016] 64**

In accordance with “The Corporate Income Tax Law of the People’s Republic of China” (hereinafter referred to as “Corporate Income Tax Law”) and its Detailed Implementation Regulations, “The Law of the People’s Republic of China on Tax Collection and Administration” (hereinafter referred to as the “Tax Collection Law”) and its Detailed Regulations, and in order to enhance the administration of advance pricing arrangements and implementation of treaties between China and other countries on avoidance of double taxation (agreements or arrangements, hereinafter referred to as “Tax Treaties”), a public notice on related matters is hereby announced.

1. An enterprise may enter into advance pricing arrangements with tax authorities on the pricing principles and calculation methods for its related party transactions for future years.
2. The negotiation, signing and implementation of an advance pricing arrangement involve the following six stages: pre-filing meeting, letter of intent, analysis and evaluation, formal application, negotiation and signing, and execution and monitoring. Advance pricing arrangements include the following three categories: unilateral, bilateral and multilateral arrangements.
3. An advance pricing arrangement applies to related party transactions for 3 to 5 years starting from the year during which the in-charge tax authorities issue the “Notice of Tax Related Issues” to the enterprise.

If the related party transactions in the year of application and its preceding years are the same as or similar to those covered by the advance pricing arrangement, subject to the enterprise’s application, the transfer pricing methodology and calculation method specified in the advance pricing arrangement can be retrospectively applied to the evaluation and adjustment of the same related party transactions in prior years. The retrospective period can extend to 10 years.

Negotiation and signing of an advance pricing arrangement does not affect the special tax investigation and adjustments, or monitoring and administration performed by tax authorities on the enterprise’s related party transactions for any years which are not covered by the advance pricing arrangement or related party transactions which are not covered by the advance pricing arrangement.

4. An advance pricing arrangement generally applies to enterprises with the amount of annual related party transactions exceeding RMB 40 million for the past 3 consecutive years starting from the year during which the in-charge tax authorities issue the “Notice of Tax Related Issues” to the enterprise.
5. The enterprise with the intention to negotiate and sign an advance pricing arrangement shall make a written request for a pre-filing meeting. Tax authorities may hold pre-filing meeting(s) with the enterprise.
  - (1) The enterprise applying for a unilateral advance pricing arrangement shall make the request by submitting the “Application Letter for Advance Pricing Arrangement Pre-

filling Meeting” (see Appendix 1) to the in-charge tax authority. The pre-filing meeting with the enterprise shall be organized by the in-charge tax authority.

The enterprise applying for a bilateral or multilateral advance pricing arrangement shall make the request by submitting the “Application Letter for Advance Pricing Arrangement Pre-filing Meeting” to both the State Administration of Taxation and the in-charge tax authority. The pre-filing meeting with the enterprise shall be organized by the State Administration of Taxation.

- (2) During the pre-filing meeting stage, the enterprise shall provide brief descriptions of the following:
  - 1) Years to be covered under the advance pricing arrangement;
  - 2) Related parties involved and related party transactions to be covered under the advance pricing arrangement;
  - 3) Organisational and management structure of the enterprise and the group it belongs to;
  - 4) Business operations of the enterprise for the most recent 3 to 5 years, its contemporaneous transfer pricing documentation, etc.
  - 5) Allocation of functions and risks among related parties covered under the advance pricing arrangement, including the allocation bases used, such as entities involved, personnel, expenses, assets, etc.;
  - 6) Market conditions, including industry development trend and competitive environment;
  - 7) Whether there are location specific advantages such as location savings, market premium, etc.;
  - 8) Whether the advance pricing arrangement will be retroactive to prior years;
  - 9) Any other circumstances requiring explanation.

The enterprise applying for a bilateral or multilateral advance pricing arrangement shall also provide the following:

- 1) Applications for the advance pricing arrangement with relevant competent tax authorities of the other treaty country;
  - 2) Business operations of related parties involved in the advance pricing arrangement and their related party transactions for the most recent 3 to 5 years;
  - 3) Whether there are international double taxation issues and relevant explanations.
- (3) During the pre-filing meeting stage, the enterprise shall provide additional information upon request from tax authorities.
6. If the tax authorities and the enterprise can reach an agreement during the pre-filing meeting stage, the in-charge tax authorities shall issue a “Notice of Tax Related Issues” to the enterprise to inform the enterprise that it may submit a letter of intent for negotiation and signing of an advance pricing arrangement. The enterprise may submit a letter of intent for negotiation and signing of an advance pricing arrangement to the tax authorities after receiving the “Notice of Tax Related Issues”.
  - (1) The enterprise applying for a unilateral advance pricing arrangement shall submit a “Letter of Intent for Negotiation and Signing of an Advance Pricing Arrangement”

(Appendix 2) and the draft application package for a unilateral advance pricing arrangement to the in-charge tax authorities.

The enterprise applying for a bilateral or multilateral advance pricing arrangement shall submit a "Letter of Intent for Negotiation and Signing of an Advance Pricing Arrangement" and the draft application package for a bilateral or multilateral advance pricing arrangement to both the State Administration of Taxation and the in-charge tax authorities.

- (2) The draft application package for a unilateral advance pricing arrangement shall include the following:
- 1) Years to be covered under the advance pricing arrangement;
  - 2) Related parties involved and related party transactions to be covered under the advance pricing arrangement;
  - 3) Organisational and management structure of the enterprise and the group it belongs to;
  - 4) Business operations of the enterprise for the most recent 3 to 5 years, financial and accounting reports, audit reports, contemporaneous transfer pricing documentation, etc.;
  - 5) Allocation of functions and risks among related parties covered under the advance pricing arrangement, including the allocation bases used, such as entities involved, personnel, expenses, assets, etc.;
  - 6) Proposed pricing methodology and calculation method under the advance pricing arrangement, and the functional and risk analysis, comparability analysis and assumptions used for supporting such methodology and method;
  - 7) Value chain or supply chain analysis, and consideration of location specific advantages including location savings, market premium, etc.;
  - 8) Market conditions, including industry development trend and competitive environment;
  - 9) Annual information on business scale, business result forecasts and business plans for the applicable period covered under the advance pricing arrangement;
  - 10) Whether the arrangement will be retroactive to prior years;
  - 11) Relevant domestic and international laws and rules in the industry that have impact on the advance pricing arrangement;
  - 12) Explanation that none of the circumstances listed in (3) of this article exists;
  - 13) Any other circumstances requiring explanation.

The draft application package for a bilateral or multilateral advance pricing arrangement shall also include the following:

- 1) Applications for the advance pricing arrangement submitted to the relevant competent tax authority or authorities;
  - 2) Business operations of related parties involved in the advance pricing arrangement and their related party transactions for the most recent 3 to 5 years;
  - 3) Whether there are international double taxation issues and relevant explanations.
- (3) The tax authority can decline the submission of the letter of intent for negotiation and signing of an advance pricing arrangement under the following circumstances:

- 1) The enterprise is under special tax investigation or other tax related investigations by tax authorities which are not closed yet;
  - 2) The enterprise fails to file the annual reporting forms for related party dealings of enterprises as required by relevant regulations;
  - 3) The enterprise fails to prepare, maintain and provide the contemporaneous transfer pricing documentation as required by relevant regulations;
  - 4) Tax authorities and the enterprise cannot reach an agreement at the pre-filing meeting stage.
7. Tax authorities shall conduct an analysis of the draft application package of the advance pricing arrangement after receiving the letter of intent from the enterprise, and evaluate whether it is consistent with the arm's length principle. Tax authorities may request additional information from the enterprise based on the findings of their analysis and evaluation.

The analysis and evaluation conducted by tax authorities shall cover the following:

- (1) Functional and risk profile – analysis and evaluation of the functions performed and contribution made in supply, production, logistics, sales, and research and development of intangibles, and risks such as inventory risk, credit risk, foreign exchange risk and market risk borne by the enterprise and its related parties;
  - (2) Information on comparable transactions – analysis and evaluation of information on comparable transactions provided by the enterprise, and adjustments on substantive comparability differences.
  - (3) Financial information on related party transactions – analysis and evaluation on whether the revenue, cost, expenses and profit associated with the related party transactions covered under the advance pricing arrangement are actually accounted for or determined based on reasonable allocation keys;
  - (4) Pricing methodology and calculation method – analysis and evaluation of the selected pricing methodology and calculation method under the arrangement. Relevant explanation shall be provided if the method will be retroactive to prior years.
  - (5) Value chain analysis and contribution analysis – evaluation on whether the analysis of the value chain or the supply chain is complete and clear; whether adequate considerations have been given to location specific advantages including location savings, market premium, etc.; and whether adequate considerations have been given to the local enterprise's contribution to value creation.
  - (6) Transaction price or profit level – Determination of the arm's length price or profit level based on the above analysis and evaluation .
  - (7) Assumptions – analysis and evaluation of the factors that influence the profit level of the industry and the operation of the enterprise and their relevant impact, and determination of appropriate assumptions for the advance pricing arrangement.
8. During the analysis and evaluation stage, tax authorities shall have discussions with the enterprise regarding the draft application of the advance pricing arrangement, and conduct on-site functional interviews. If tax authorities determine that the draft application package of the advance pricing arrangement does not conform to the arm's length principle, the enterprise shall negotiate with tax authorities and make adjustments accordingly. If tax authorities determine that the draft application package of the advance pricing arrangement conforms to the arm's length principle, the in-charge tax authorities shall issue the "Notice of Tax Related Issues" to the enterprise informing the enterprise their consent for the enterprise to submit a formal application of the advance pricing

arrangement. Upon receipt of the Notice, the enterprise shall submit the "Formal Application Letter for Advance Pricing Arrangement" (Appendix 3) together with the formal application package of the advance pricing arrangement to tax authorities.

- (1) The enterprise applying for a unilateral advance pricing arrangements shall submit the above mentioned documents to the in-charge tax authorities. The enterprise applying for a bilateral or multilateral advance pricing arrangements shall submit the above mentioned documents to both the State Administration of Taxation and the in-charge tax authorities, and shall apply to initiate the Mutual Agreement Procedure process for special tax adjustments according to relevant regulations.
  - (2) The tax authority may reject the formal application for an advance pricing arrangement from the enterprise if one of the following circumstances applies:
    - 1) The proposed pricing methodology and calculation method in the draft application of the advance pricing arrangement are not reasonable and the enterprise refuses to negotiate and make adjustments;
    - 2) The enterprise fails to provide related information, or information provided does not meet the tax authority's requirement and the enterprise fails to timely provide supplement or revised information;
    - 3) The enterprise fails to cooperate with tax authorities on the on-site function and risk interviews;
    - 4) Any other circumstances that are not appropriate for negotiation and signing of an advance pricing arrangement.
9. Tax authorities shall form negotiation positions based on their analysis and evaluation, and arrange negotiations accordingly.
- (1) For unilateral advance pricing arrangements, the in-charge tax authorities shall negotiate with the enterprise and, upon reaching an agreement, draft the unilateral advance pricing arrangement (Appendix 4).

For bilateral or multilateral advance pricing arrangements, the State Administration of Taxation shall arrange negotiations with relevant competent authorities of the other treaty country(ies) and, upon reaching an agreement, draft the bilateral or multilateral advance pricing arrangement.

- (2) An advance pricing arrangement shall include the following:
  - 1) Basic information of the enterprise and its related parties such as the names and addresses;
  - 2) Related party transactions and the years covered under the advance pricing arrangement;
  - 3) Selected transfer pricing methodology and calculation method, comparable prices or profit levels, etc.;
  - 4) Definition of technical terms in relation to the application of transfer pricing method and calculation basis;
  - 5) Assumptions and notification obligation of changes to the assumptions;
  - 6) The enterprise's annual reporting obligations;
  - 7) Legal force of the advance pricing arrangement;

- 8) Renewal of the advance pricing arrangement;
  - 9) Effectiveness, revisions and termination of the advance pricing arrangement;
  - 10) Dispute resolutions;
  - 11) Obligations to keep confidentiality of documents and information;
  - 12) Information exchange on unilateral advance pricing arrangement;
  - 13) Appendices.
- (3) Legal representatives or representatives authorised by the legal representatives of both in-charge tax authorities and the enterprise shall sign the unilateral advance pricing arrangement upon reaching an agreement on the text of the unilateral advance pricing arrangement.

Representatives authorised by the State Administration of Taxation and relevant competent tax authorities of the other tax treaty party(ies) shall sign the bilateral or multilateral advance pricing arrangement upon reaching an agreement on the text of the bilateral or multilateral advance pricing arrangement. The State Administration of Taxation shall forward the advance pricing arrangement to the in-charge tax authorities, who shall issue a "Notice of Tax Related Issues" to the enterprise together with the advance pricing arrangement, and implement the arrangement accordingly.

- (4) If an advance pricing arrangement involves additional tax payments or tax refunds for the covered period or the retrospective period, tax authorities shall calculate the amounts of tax payable or tax refund on a yearly basis and issue a "Special Tax Investigation Adjustment Notice" (Appendix 5) to the enterprise.

10. Tax authorities shall monitor the implementation of advance pricing arrangements.

- (1) During the term of the advance pricing arrangement, the enterprise shall maintain a complete record of relevant documents and information (including accounting records and other relevant records), which shall not be lost, destroyed or transferred.

The enterprise shall also file an annual compliance report in relation to implementation of the advance pricing arrangement in both printed copy and electronic version to the in-charge tax authorities within 6 months after the end of each tax year. The in-charge tax authorities shall provide the electronic version of the annual compliance report to the State Administration of Taxation. For bilateral or multilateral advance pricing arrangements, the enterprise shall file the printed copy and electronic version of the annual compliance report to the in-charge tax authorities and shall also file the electronic version of the annual compliance report to the State Administration of Taxation.

The annual compliance report shall document the business operations and the implementation of the advance pricing arrangement during the reported period. The enterprise shall also explain in the annual compliance report if there is a need to amend or terminate the arrangement, or if there are any unsettled issues or any issues expected to occur.

- (2) During the term of the advance pricing arrangement, the in-charge tax authorities shall monitor the enterprise's implementation status on a yearly basis. Major areas for monitoring include: whether the enterprise complies with the provisions and requirements in the advance pricing arrangement; whether the information provided

in the annual compliance report reflects the actual operations of the enterprise; whether the assumptions in the advance pricing arrangement are still valid, etc.;

- (3) During the term of the advance pricing arrangement, if there are substantial changes that have affected the advance pricing arrangement, the enterprise shall report these changes to the in-charge tax authorities in writing within 30 days, with detailed explanations of the impact of these changes on implementation of the advance pricing arrangement and all relevant information. If the enterprise cannot report such changes within the specified time frame due to non-subjective reasons, an extension of up to 30 days is allowed.

Tax authorities shall analyse the substantial change that have affected the advance pricing arrangement after receiving the written report from the enterprise, and amend or even terminate the arrangement depending on the impact of the changes on the implementation of the advance pricing arrangement. If the original advance pricing arrangement is terminated, tax authorities and the enterprise may re-negotiate and sign a new advance pricing arrangement in accordance with the provisions of this public notice.

- (4) If an advance pricing arrangements is signed by both the state and local tax bureaus with the enterprise, the enterprise shall, during the implementation of the advance pricing arrangement, file the annual compliance report and report any substantial changes to both the state and local tax bureaus. The state and local tax bureaus shall conduct joint monitoring the enterprise's compliance status.
11. An advance pricing arrangements will become invalid automatically upon its expiration. If the enterprise intends to renew the advance pricing arrangement, it shall file a renewal application within 90 days prior to the expiration of the advance pricing arrangement to the tax authorities. The enterprise shall submit an "Advance Pricing Arrangement Renewal Application" (Appendix 6) along with a report specifying the implementation status of the current advance pricing arrangement, and documents explaining whether there are any substantial changes to the facts in the existing advance pricing arrangement and the operational environment, and the forecast for the years covered by the renewal advance pricing arrangement, etc.

12. If the interquartile range is adopted to determine the price or profit level for an advance pricing arrangement, and the actual operating results of the enterprise fall outside of the interquartile range during the implementation of the advance pricing arrangement, tax authorities shall adjust the actual operating results to the median. Upon expiration of the advance pricing arrangement, if the weighted average operating result of the enterprise during the term of the advance pricing arrangement falls below the median and is not adjusted to the median, tax authorities shall not accept the renewal application.

In case of a bilateral or multilateral advance pricing arrangement, the in-charge tax authorities shall timely report the above mentioned situations to the State Administration of Taxation.

13. In case of any dispute between the in-charge tax authorities and the enterprise during the implementation of an advance pricing arrangement, both parties shall try to resolve the dispute through negotiations. If the dispute is still not resolved after negotiations, it can be reported to the tax authorities at the next higher level for mediation. Disputes involving bilateral or multilateral advance pricing arrangements must be submitted to the State Administration of Taxation for mediation. The tax authorities shall implement the

determination of the tax authorities at the next higher level or the State Administration of Taxation. However, if it is still not acceptable to the enterprise, the advance pricing arrangement shall be terminated.

14. Both tax authorities and the enterprise can suspend or terminate the advance pricing arrangement process at any time before signing the advance pricing arrangement. If tax authorities discover that the enterprise or its related parties intentionally refuse to provide necessary information in relation to the negotiation and signing of an advance pricing arrangement, provide false or incomplete information, or there are other circumstances under which the enterprise refuse to cooperate and hence hinder the advance pricing arrangement process, tax authorities may suspend or terminate the advance pricing arrangement process. For bilateral or multilateral advance pricing arrangements, the advance pricing arrangements process can be suspended or terminated after consultation with relevant competent authorities. When the advance pricing arrangement process is suspended or terminated by tax authorities, tax authorities shall issue a "Notice of Tax Related Issues" to the enterprise along with the explanation for reasons. When the advance pricing arrangement process is suspended or terminated by the enterprise, the enterprise shall submit an explanation to the tax authorities.
15. If the enterprise fails to sign the arrangement according to authorisation and procedures in the provisions, or if tax authorities discover that the enterprise conceals facts, tax authorities shall consider the advance pricing arrangement to be invalid from the beginning of the term of the advance pricing arrangement and shall inform the enterprise by issuing a "Notice of Tax Related Issues" and explain the reason. If tax authorities discover that the enterprise refuses to execute the advance pricing arrangement or has other violation of the arrangement, they shall, depending on the circumstances, handle the violation until the termination of the advance pricing arrangement.
16. The tax authority shall prioritise the acceptance of the application from enterprises that meet one of the following conditions:
  - (1) Enterprises's annual reporting forms for related party dealings and contemporaneous transfer pricing documentation are complete and reasonable, with adequate disclosure;
  - (2) Enterprises with tax credit rating of A level;
  - (3) A special tax investigation has been conducted on the enterprise by the tax authorities and the case has been closed;
  - (4) Renewal applications for which the advance pricing arrangement has expired , and there is no substantial change to the facts in the original advance pricing arrangement and the operational environment of the enterprise;
  - (5) Information and documents submitted by the enterprise are complete and adequate; value chain analysis and supply chain analysis are clear and thorough; location specific factors including location savings and market premium, etc. have been given adequate considerations; and the proposed transfer pricing method and the calculation method are reasonable;
  - (6) The enterprise actively cooperates with the tax authorities in the negotiation and signing of the advance pricing arrangement;
  - (7) For bilateral or multilateral advance pricing arrangement applications, the relevant competent authority or authorities have a strong intention, and give a high degree of attention to the application;
  - (8) Any other factors that will benefit the negotiation and signing of the advance pricing arrangement.



17. For advance pricing arrangements involving two or more provinces, autonomous regions, municipalities or cities with independent planning, or involving both the state and local tax bureaus, the State Administration of Taxation shall organise and coordinate.

The enterprise applying for such a unilateral advance pricing arrangement mentioned above shall submit an application of negotiation and signing of the advance pricing arrangement to both the State Administration of Taxation and its designated tax authority. The State Administration of Taxation or its designated tax authority may sign a unified unilateral advance pricing arrangement with the enterprise, or the relevant tax authorities may sign the unilateral advance pricing arrangements with the enterprise respectively.

18. For unilateral advance pricing arrangements involving two or more in-charge tax authorities in one provinces, autonomous regions, municipalities or cities, or involving only the state tax bureau or the local tax bureau, the respective tax authority of the provinces, autonomous regions, municipalities or cities shall organise and coordinate.
19. Both the tax authorities and the enterprise have the duty to keep confidential all information obtained during the process of the negotiation and signing of the advance pricing arrangement. Despite the provision of information to the relevant departments according to the regulation, the tax authorities shall not disclose the information in relation to the advance pricing arrangements in any way without the consent of the taxpayers.

In case the tax authorities and the enterprise fail to reach an agreement for an advance pricing arrangement, the non-factual information of the enterprise such as various suggestions, inferences, concepts and judgements obtained by the tax authorities during negotiations shall not be used in future special tax investigations of the transactions covered under the proposed advance pricing arrangement.

20. Unless information involves national security, the State Administration of Taxation can exchange unilateral advance pricing arrangement signed after 1 April, 2016 with relevant competent authorities of other countries (regions) according to the international conventions, treaties, agreements and other regulations between China and other countries. The enterprise shall provide a list of countries (regions) of its ultimate holding company, its direct holding company of higher level and overseas related parties covered under the unilateral advance pricing arrangement.
21. The in-charge tax authorities mentioned in this public notice refer to the tax authorities which are responsible for the special tax adjustment issues.
22. This Public Notice shall become effective from 1 December 2016. Chapter 6 of the "Implementation Measures of Special Tax Adjustments (Trial Version)" (Guo Shui Fa [2009] No.2) shall be annulled as of the same date. Enterprises whose formal applications of advance pricing arrangements have not been accepted by the tax authorities before the effective date of this public notice shall follow the provisions in this public notice.

Appendix:

- (1) Application Letter for Advance Pricing Arrangement Pre-filling Meeting
- (2) Letter of Intent for Negotiation and Signing of an Advance Pricing Arrangement
- (3) Formal Application Letter for Advance Pricing Arrangement

- (4) Unilateral Advance Pricing Arrangement (content for reference)
- (5) Advance Pricing Arrangement Tax Payment (Refund) Notice
- (6) Advance Pricing Arrangement Renewal Application

Sate Administration of Taxation  
11 October 2016