Deloitte. 德勤

Tax
Issue P353/2022 – 19 May 2022

Tax Analysis

Shenzhen customs and tax authorities announce transfer pricing collaboration

On 18 May 2022, the city of Shenzhen in the Guangdong Province of Mainland China announced a collaboration between Shenzhen's customs and tax authorities on transfer pricing administration. The program, which became effective upon announcement, allows qualifying businesses in Shenzhen to have their transfer pricing arrangements for the importation of goods from related parties agreed to by both Shenzhen customs and tax authorities.

It has long been difficult for multinational groups to manage their transfer pricing on related party imports from both customs and income tax perspectives. The customs authorities normally are concerned as to whether the import price declared by an importer is lower than the arm's length range, which would result in lower customs duty and other import taxes. On the contrary, the tax authorities normally are concerned as to whether such import price is higher than the arm's length range, which would erode the taxable profits of the importer. The lack of coordination between the customs and tax authorities makes it cumbersome for businesses to obtain agreement from both authorities simultaneously on such import prices. The launch of the Shenzhen program marks the first time for the customs and tax authorities in China to formally collaborate on transfer pricing administration to address this lack of coordination.

The Shenzhen program essentially consolidates two existing procedures, i.e., advance rulings on customs pricing and advance pricing arrangements (APAs). A qualifying business that participates in the program must meet the requirements of both procedures.

Authors:

Customs and Global Trade
Janet Zhang
Partner
Tel: +86 20 2831 1212
Email: jazhang@deloitte.com.cn

Dolly Zhang
Partner
Tel: +86 21 6141 1113
Email: dozhang@deloitte.com.cn

Shelly Ma
Director
Tel: +86 755 3353 8751
Email: shelma@deloitte.com.cn

Transfer Pricing
Edison Zuo
Partner
Tel: +86 20 2831 1309
Email: ezuo@deloitte.com.cn

Martin Que
Partner
Tel: +86 755 3353 8139
Email: mque@deloitte.com.cn

Xiao Xiao Mo
Senior Manager
Tel: +86 755 3637 6814
Email: smo@deloitte.com.cn

Application

To initiate the program, an applicant must meet the following conditions:

Customs advance ruling	APA
• The applicant must be engaged in a foreign trading business and registered with the Shenzhen customs office; and • The application generally should be submitted at least three months before the date of the proposed import.	• The applicant must be registered with Shenzhen tax office; • The amount of related party transactions of the applicant must reach CNY 40 million in each of the three calendar years prior to the year in which the Shenzhen tax office sends the notice to the applicant accepting the letter of intent for an APA; and • The applicant must have good compliance records on transfer pricing without situations that are listed in the APA rules where an APA application may be rejected by the tax authorities (e.g., an applicant fails to prepare transfer pricing documentation according to the enterprise income tax law or a transfer pricing investigation is already initiated against the applicant).

An applicant must submit the following to the Shenzhen customs office and the Shenzhen tax office respectively:

Customs advance ruling	APA
• An application form to initiate the program; • An application letter for a customs advance ruling; and • Other materials to explain the relationship between the foreign seller and domestic importer and whether such relationship impacts the import price, e.g., relevant entity's audited financial statements, explanations on transfer pricing arrangement, etc.	• An application form to initiate the program; • An application letter to initiate an APA pre-filing meeting; and • Other materials about the transfer pricing arrangement, e.g., contemporaneous transfer pricing documentation, annual reporting forms of related party transactions, audited financial statements, etc.

For more information, please contact:

Tax and Business Advisory
Transfer Pricing
National Leader
Liantang He
Partner
Tel：+86 10 8520 7666
Email：lhe@deloitte.com.cn

Northern China
Sophie Wei
Partner
Tel：+86 10 8520 7622
Email：swei@deloitte.com.cn

Eastern China
Jerry Wang
Partner
Tel：+86 512 6289 1308
Email：jerrywang@deloitte.com.cn

Southern China
Edison Zuo
Partner
Tel：+86 20 2831 1309
Email：ezuo@deloitte.com.cn

Western China
Frank Tang
Partner
Tel：+86 23 8823 1208
Email：ftang@deloitte.com.cn

Within 10 days after receiving the application materials, the Shenzhen customs and tax offices will jointly determine whether to accept the application to initiate the program. They would each issue an acceptance letter to the applicant if they agree to accept the application.

Evaluation and negotiation

After the application is accepted, the Shenzhen customs and tax offices will jointly start the evaluation and negotiations within 15 days.

After the Shenzhen customs and tax offices and the applicant have reached a consensus on the pricing arrangement of the imports of goods, the three parties will sign a memorandum accordingly. Based on the memorandum, the Shenzhen customs office will issue a customs advance ruling to the applicant, and the Shenzhen tax office will conclude an APA with the applicant. If the three parties cannot reach a consensus, the Shenzhen customs and tax offices may terminate the program by notifying the applicant in writing.

Execution and monitoring

Pricing adjustments

For each calendar year during the term of the memorandum, the applicant must make pricing adjustments according to the median of the relevant financial indicator's arm's length range, if the applicant's actual financial indicator deviates from the median. The applicant then must report the adjustments to the Shenzhen customs and tax offices.

Annual reporting

For each calendar year during the term of the memorandum, the applicant must prepare and submit an annual report (in both paper and electronic form) to the Shenzhen customs and tax offices within six months after the end of the calendar year. The applicant must disclose the operating information and the implementation status of the memorandum in the annual report.

Amendment and termination

The Shenzhen customs and tax offices may initiate discussions with the applicant to amend or terminate the memorandum in the following situations:

- The applicant did not implement the memorandum;
- There were substantial changes so that the memorandum cannot be implemented (e.g., changes to key assumptions); or
- The applicant proposed to amend or terminate the memorandum.

Indirect Tax
National Leader
Lily Li
Partner
Tel： +86 21 6141 1099
Email： lilyxcli@deloitte.com.cn

Deputy National Leader
Shu Tian
Partner
Tel： +86 10 8534 2338
Email： shutian@deloitte.com.cn

Customs and Global Trade
National Leader / Northern China
Yi Zhou
Partner
Tel： +86 10 8520 7512
Email： jchow@deloitte.com.cn

Eastern China
Li Qun Gao
Partner
Tel： +86 21 6141 1053
Email： ligao@deloitte.com.cn

Southern China
Janet Zhang
Partner
Tel： +86 20 2831 1212
Email： jazhang@deloitte.com.cn

Western China
Frank Tang
Partner
Tel： +86 23 8823 1208
Email： ftang@deloitte.com.cn

According to the memorandum sample jointly issued by the Shenzhen customs and tax offices, key assumptions for the memorandum include that there are no substantial changes to the applicant's business activities, business models, function/risk allocation and asset deployment, financial accounting rules being applied, or tax and customs regulatory environment, there are no significant legal disputes emerging, etc. An applicant is required to report to the Shenzhen customs and tax offices, respectively, within 30 days if there are changes to the key assumptions.

Term and renewal

The memorandum is valid for three years and terminates upon expiration. The applicant may apply for renewal of the memorandum by submitting renewal applications to the offices, respectively, at least 90 days before the expiration date.

Comments

Businesses and tax practitioners likely will welcome the introduction of the Shenzhen program, which should provide a useful tool for businesses to increase the certainty and predictability of the application of the transfer pricing rules from both customs and tax perspectives. The program may save businesses' efforts to separately negotiate with customs and tax authorities on future imports. The joint evaluation mechanism provided by the program can make it easier for businesses to reach agreements simultaneously with the two government authorities.

More collaboration between customs and tax authorities in transfer pricing administration seems to be a global trend, as the World Customs Organization has published documents and cases discussing how to leverage transfer pricing documentation for customs administration purposes. We expect more local Chinese customs and tax authorities to consider the introduction of similar programs aiming to improve their local business environment.

Although the Shenzhen program basically consolidates the existing rules of customs advance ruling and APAs, it is worth noting that the two set of rules still have different features (see below for a few examples). It is left to be seen how these differences would be reconciled in practice. In addition, how the program would be implemented in certain more complex cases (e.g., if a bilateral or multilateral APA is involved) is still unclarified.

- *Customs advance ruling* – A customs advance ruling is valid for three years and can be applied nationwide. The ruling only can be applied to future imports and may not be applied to goods that have been imported before a ruling is issued. When reviewing the pricing arrangement, customs may tend to put more emphasis on the import transaction itself.

- *APA* – An APA can be applied to related party transactions in the following three to five years after the tax authorities notify the applicant of the receipt of the APA letter of intent. Upon separate application, an APA also may be retroactively applied for a maximum of 10 years. Unlike the customs authorities' focus on the transaction itself, tax authorities may review more about the overall impact of the related party transactions on taxable profits.

In considering the program, businesses should:

Evaluate the impact of the program – Groups with Shenzhen businesses importing goods from foreign related parties should evaluate the program impact and analyze the feasibility and pros and cons to determine whether to apply for the program to improve the efficiency of their transfer pricing management.

Start to prepare the application package – For businesses that have decided to apply for the program, it is advisable to start the relevant preparation work as soon as possible. The relevant work may include preparation or review of the transfer pricing analysis to support the proposed pricing arrangement, etc.

Monitor the practice and regulatory development – Businesses in other regions that want to apply for such a program should continue dialogues with customs and tax authorities, closely monitor whether any similar local programs will be introduced, and start the relevant application work once such program is announced.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Country Leader of Tax and Business Advisory services, Deloitte China
Victor Li
Partner
Tel: +86 755 3353 8113
Fax: +86 755 8246 3222
Email: vicli@deloitte.com.cn

Northern China
Xiaoli Huang
Partner
Tel: +86 10 8520 7707
Fax: +86 10 6508 8781
Email: xiaolihuang@deloitte.com.cn

Eastern China
Maria Liang
Partner
Tel: +86 21 6141 1059
Fax: +86 21 6335 0003
Email: mliang@deloitte.com.cn

Southern China
Jennifer Zhang
Partner
Tel: +86 20 2885 8608
Fax: +86 20 3888 0115
Email: jenzhang@deloitte.com.cn

Western China
Frank Tang
Partner
Tel: +86 23 8823 1208
Fax: +86 23 8857 0978
Email: ftang@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre ("NTC") was established in 2006 to continuously improve the quality of Deloitte China's tax services and help Deloitte China's tax team better serve the clients. The Deloitte China NTC issues "Tax Analysis" which are commentaries on newly issued tax laws, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre
Email: ntc@deloitte.com.cn

National Leader/Northern China
Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 6508 8781
Email: juliezhang@deloitte.com.cn

Eastern China
Kevin Zhu
Partner
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

Western China
Tony Zhang
Partner
Tel: +86 28 6789 8008
Fax: +86 28 6317 3500
Email: tonzhang@deloitte.com.cn

Southern China (Mainland)
German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0115
Email: gercheung@deloitte.com.cn

Southern China (Hong Kong)
Doris Chik
Director
Tel: +852 2852 6608
Fax: +852 2543 4647
Email: dchik@deloitte.com.hk

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify national marketing team of Deloitte China by email at cimchina@deloitte.com.hk.

About Deloitte