

## First Chinese Customs and Tax Collaborative Transfer Pricing Management Mechanism

Related-party transactions are routine practices of Multinational Enterprises (MNEs) but sometimes present a recurrent headache due to the dilemma that a tax authority often holds a viewpoint opposite to that of a customs authority when it comes to assessing an import price.

- The customs authority focuses on assessing whether the import price is lower than the arm's length price; if yes, it would suspect an underpayment of import duty and VAT.
- The tax authority focuses on assessing whether the import price is higher than the arm's length price; if yes, it would suspect an erosion of the taxation base.

In practice, there is little room for MNEs to reconcile the sometimes conflicting opinions of the two authorities. Inevitably, they might have to accept the destiny of double taxation if a price adjustment is enforced by either authority.

Now there is an opportunity for reconciliation. On 18 May 2022, China's customs and tax authorities in Shenzhen jointly issued a circular named "*Implementation Measures for Collaborative Administration of Transfer Pricing of Related-Party Imports*", introducing a pilot mechanism to address the double taxation issue via cross-departmental cooperation.

The circular has advocated the mutual recognition of the advance rulings issued by each other. Enterprises are permitted to apply for collaborative administration on Transfer Pricing matters, if they satisfy all the following criteria:

- 1) Being registered at a customs authority and handling import/export dealings; and
- 2) Having related-party transactions over RMB 40 million/year in the last three years.

Upon receiving an application, Shenzhen's Customs and Tax Bureau would jointly assess the import price concerned, carry out negotiations, reach a consensus, conclude a memorandum with the applicant and thereafter issue a customs advance ruling and an advance pricing agreement. The rulings will be valid for three years and renewable by an application within 90 days before its expiry date

The collaborative arrangement between the customs and the tax authorities has established a long-awaited mechanism to address the double taxation issues in tax and customs regimes. It is aimed that cross-departmental collaborative administration will help reduce compliance costs, improve the level of certainty, and enhance administrative efficiency.

Currently, the said collaborative arrangement is only applicable to enterprises registered in Shenzhen. It is assumed that the practice may expand to other regions in the future, allowing more taxpayers to benefit from the administrative breakthrough.