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# ACHIEVING CLARITY

PR China: Tax review and outlook 2022



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# Turnover Tax

Currently turnover taxes in China mainly include Value Added Tax (“VAT”) and consumption tax. In 2021, the keynote of turnover tax in China is tax relief and optimization. Especially, Chinese tax authority has released a series of VAT related policies to support the small and low-profit enterprises (“SMEs”) in China. Statistics show that the cumulative VAT refunds are about 13.3 billion RMB to ease the liquidity pressure on manufacturing enterprises.

## I. THE APPLICABLE GROUP IN ADVANCED MANUFACTURING INDUSTRY FOR VAT CREDIT REFUNDING HAS BEEN EXPANDED

The regulation of VAT credit refunding is one of the substantial tax relief treatments which taxpayers truly benefit from. Compared to general industries, the threshold for enjoying this regulation in advanced manufacturing industries is lower and the incentives are more aggressive.

### The threshold for VAT credit refunding

Thresholds for general industries	Thresholds for advanced manufacturing industries
From April 2019, incremental VAT credit for six consecutive months is greater than zero, and the incremental VAT credit of the sixth month is not less than 500,000 RMB.	The incremental VAT credit after March 31, 2019 is greater than zero.
The refundable incremental VAT credit for general industries	The refundable incremental VAT credit for advanced manufacturing industries
Incremental VAT credit × Input tax composition ratio × 60 percent	Incremental VAT credit × Input tax composition ratio

*Note:* The input composition ratio refers to the proportion of the offset VAT amount indicated on the special VAT invoice (including the unified invoice of vehicle sales), the customs import special VAT payment certificate and the remitted VAT payment receipt to all offset input VAT for the same period from April 2019 to the previous taxation period prior to applying for a VAT refund.

In principle, the portion of incremental VAT credit that is covered by the input composition ratio can be fully refunded for advanced manufacturing industries. Input composition ratio is the proportion of input VAT based on VAT credit certificate, which covers almost all VAT credits for most enterprises.

### Scope of application for advanced manufacturing industries

Compared to 2019, the scope of application for the advanced manufacturing industries was further expanded in 2021. According to the “National Industries Classification”, taxpayers who produce and sell “non-metallic mineral products”, “general equipment”, “special equipment”, “computer, communication and other electronic equipment”, “pharmaceuticals”, “chemical fibers”, “railway, watercraft, aerospace and other transportation equipment”, “electrical machinery and equipment”, “instruments” with sales revenue accounting for more than 50 percent of their total revenues are the entitled enterprises.

But it does not mean that only those who produce and sell any single type of product mentioned above with a sales ratio exceeding 50 percent can apply to enjoy the VAT credit refund policy for the advanced manufacturing industries. As long as the total sales ratio of the above-mentioned 9 types of products exceeds 50 percent during the stipulated operation period, the threshold for advanced manufacturing industries for VAT credit refund is met.

### Hints for Taxpayers

In order to take advantage of this special tax incentive, there are several points to note in the daily tax compliance, VAT declaration, and Fapiao administration. An oversight in one aspect may affect the application of VAT credit refund.

First of all, it is about the tax credit and compliance management of the enterprise. Only taxpayers with a tax credit Grade A or B are eligible to apply for VAT credit refund. It is important to note that newly established enterprises, whose tax credit grade is normally M, are not eligible to apply for VAT credit refund. The tax credit grading is a comprehensive evaluation of an enterprise's tax compliance level (please refer to details of Administration on Taxation in China in Chapter V).

Moreover, enterprises with tax compliance risks are not eligible for VAT credit refund until the relevant risks are eliminated. For example, the VAT risks existing for suspicion of VAT compliance, unsettled tax investigations, or abnormal conditions in VAT invoice handling, etc.. Therefore, it requires enterprises to pay particular attention to their tax compliance risk management, and to set up a complete and effectively implemented tax risk control system. It can be seen that the tax administration in China has turned into a systematic evaluation. The administration of different categories of taxes no longer exists in isolation as it once did, but connects and affects each other. In addition, it should be noted that the input VAT related to tax-exempt business cannot participate in the application of VAT credit refund as it is not deductible in the first place.

Secondly, VAT credit refund is essentially the same as export VAT refund, which is a refund of input VAT arising from purchases. Therefore, it is particularly reminded that enterprises should avoid overlapping applications for VAT credit refund and export VAT refund for the same input VAT. In other words, the incremental VAT credit should be the result after the deduction of the export VAT refundable approved by the tax authority for the same period. Enterprises should avoid risks arising from the improper benefits gained from tax incentives.

*Note:* In April 2022, the above policy has been further extended from advanced manufacturing industries to SMEs (including individual entrepreneurs) and other economic sectors, e.g. sectors of “manufacturing industry”, “scientific research and technology services”, “electricity, heat, gas and water production and supply”, “software and information technology services”, “ecological protection and environmental governance” and “transportation, storage and postal services”. Taxpayers meeting certain conditions



can further apply for refund of existing VAT credits, not only incremental VAT credits. In July 2022, the scope of sectors eligible for the full refund of incremental VAT credits on a monthly basis and lump-sum refund of existing VAT credits is further expanded to:

- Wholesale and Retail
- Agriculture, Forestry, Cattle breeding and Fishery
- Accommodation and Catering
- Residential services, repairs and other services
- Education
- Health and Social work and
- Culture, Sports and Entertainment

## II. VAT REDUCTION FOR SMALL-SCALE VAT TAXPAYER

Effective from 1 April 2021 to 31 December 2022, small-scale VAT taxpayers with monthly sales below 150,000 RMB are exempted from VAT payments. Effective from 1 April 2021 to 31 December 2021, for small-scale VAT taxpayers, VAT are levied at a reduced rate of 1 percent on the taxable sales that are previously subject to a 3 percent levy rate. The above tax incentives support the development of SMEs to some extent.

Effective from 1 April 2022 to 31 December 2022, small-scale VAT taxpayers are exempt from VAT on taxable transactions subject to a 3 percent levy rate. Likewise, the VAT prepayment is suspended for VAT items subject to a 3 percent levy rate. It should be noted that small-scale VAT taxpayers who enjoy tax exemptions on sales income can issue VAT general invoices and are not allowed to issue VAT special invoices.

## III. IMPROVED VAT POLICY FOR COMPREHENSIVE UTILIZATION OF RESOURCES

At the end of year 2021, improved VAT policy for comprehensive utilization of resources has been released, which is a re-organization and replacement of former VAT preferential policies for comprehensive utilization of resources. The new policy is implemented from March 2022 and, compared to the previous policy, the following aspects should be paid particular attention by enterprises:

General VAT taxpayers engaged in the recycling of renewable resources can choose their own taxation method for the sales of recycled resources they have required, either by applying the simplified calculation method at a levy rate of 3 percent, or by applying the general calculation method for VAT payment.

According to the current prevailing policy, VAT taxpayers engaged in the sale of self-produced products and provision of services for the comprehensive utilization of resources may claim immediate VAT refund after payment. This policy is still valid while a new policy is released to set further requirements and conditions. For example, the management of Fapiaos and valid vouchers requires taxpayers to obtain VAT fapiaos for renewable resources acquired in the territory of China, or general VAT fapiaos if the tax exemption policy applies. If the renewable resources are purchased from entities or individuals engaged in small-income business operations who cannot issue fapiaos, it should be supported with the receipt voucher from the seller and the internal voucher of the acquirer, or fapiaos issued by the tax authority on-behalf of the seller. If no fapiaos or vouchers are obtained where they should have been, the sales income of the products corresponding to the renewable resources shall not be subject to the immediate VAT refund. Furthermore, ledgers of management should be set up for the acquisition of renewable resources for inspection.

In particular, the new policy has supplemented a review system for large VAT refunds. It is stipulated that for VAT refunds exceeding 5 Mio RMB in a single tax filing period, the competent tax authority should submit the VAT refund documents to the same-level department of finance for review within 30 working days after the completion of the VAT refunds. After the department of finance has reviewed the documents at each level, the provincial department of finance shall submit the documents to the local supervision bureau for final review opinion. The review shall be completed within 3 months after the VAT refund.

The new policy has supplemented more options for taxpayers and more certainty of the scope of application compared to the previous VAT preferential policy, but it has imposed higher requirements on

the completeness of documentation for further inspection, which requires taxpayers to pay more attention to the management of documentation in their daily operation activities, so as to fully enjoy the immediate VAT refund preferential policy.

#### IV. FURTHER RELIEF FOR SERVICE INDUSTRIES IN DIFFICULTY

Effective from 1 January 2022 to 31 December 2022, the VAT exemption is granted to public transportation services, and the VAT prepayment for branches of air and rail transportation enterprises is suspended. For VAT already levied and prepaid, the enterprises can apply for refund.

#### V. UPDATES OF CONSUMPTION TAX

Consumption tax is levied on specific consumer goods and also belongs to the category of turnover tax. Consumption tax is levied on selected consumer goods on top of VAT to regulate the product mix and guide the direction of consumption. The common consumption tax objects include tobacco, alcohol, cosmetics, refined oil products, cars, yachts, disposable wooden chopsticks, wooden flooring, jewelry, high-end watches, etc.



# Corporate Income Tax

*Looking back to 2021, the Chinese tax authority has released a series of tax regulations aiming to reduce the burden on taxpayers. Specifically, they are mainly reflected in the following areas.*

## I. STRENGTHENED POLICY FOR ADDITIONAL DEDUCTION OF RESEARCH & DEVELOPMENT EXPENSES

Research & Development (“R&D”) activities have been consistently supported and promoted by the Chinese government. In order to further motivate enterprises to increase R&D investment and support technological innovation, the State Administration of Taxation (“SAT”) has released a series of policies to strengthen the tax preferential treatment on R&D expenses. In March of 2021, SAT issued a tax circular to further increase the additional proportion of R&D expenses to be deducted, before Corporate Income Tax (“CIT”), from the current 75 to 100 percent. R&D expenses that form intangible assets will be amortized before CIT at 200 percent of the cost. This policy is for enterprises in manufacturing industries, who are with more than 50 percent of manufacturing business revenue. Furthermore, new instrument and equipment purchased by High New Technology Enterprises (“HNTE”) from 1 October 2022 to 31 December 2022 are permitted to be deducted in a one-off manner as costs and expenses with a 100 percent super-deduction in the current period. This is undoubtedly a great benefit to manufacturing enterprises that have spent much effort on R&D activities.

The following practical issues should be paid attention to while enjoying the tax preferential policy:

Enterprises should adopt the handling method of “actually incurring, making independent judgment, declaring for enjoyment and retaining the relevant materials for future reference” when enjoying the tax preferences. Tax authorities should implement follow-up administration, supervision and inspection on enterprises who have enjoyed the additional deduction of R&D expenses, and make verification on that after the annual CIT reconciliation period each year.

Therefore, the completeness of the documentation for inspection is a top priority in corporate compliance reviews. The following information is suggested for the sufficient documentation.

- R&D project plan and resolution for project establishment issued by the competent department of the enterprise. It should be noted that self-developed projects are subject to review and filing by the competent of the enterprise, such as the board of directors. In other words, such projects are not required for the review and filing procedures at the competent Science and Technology Administration and tax authorities. Entrusted R&D and cooperative R&D projects shall be registered by the competent Science and Technology Administration, and the contracts for entrusted and cooperative R&D projects should be archived.
- The constitution of the specialized project team undertaking the R&D activities and the list of R&D personnel.
- Subsidiary ledgers and the summary sheet for R&D expenditures  
In 2021, SAT supplemented a simplified format for subsidiary ledgers and the summary sheet for R&D expenditures, so as to reduce the workload of enterprises. The adjustments of taxation policies are also taken into consideration in this simplified format, including particular columns for overseas entrusted R&D projects and reflecting the adjusted calculation scheme of other relevant expense limits. Enterprises are allowed to design and use their own R&D expenditure subsidiary ledgers according to the actual situation of their management.

## II. FURTHER SPECIFIED ADMINISTRATIVE REQUIREMENTS AND IMPACT ON IMPLEMENTATION

In June 2021, SAT issued several implementation calibre in CIT administration, which are applicable for the 2021 annual CIT reconciliation and thereafter. The following key points are for reference.

### Timing of income recognition for government subsidies

Enterprises may obtain a variety of government subsidies in the course of their operations, and the timing of revenue recognition will vary under different circumstances.

- If an enterprise sells goods or renders services at market prices and is paid in whole or in part by the government financial payment according to a certain percentage of the quantity or amount of the goods sold or services rendered by the enterprise, the accounting should recognize revenue when the subsidy is received following the Accounting Principle for Grants. Nevertheless, the CIT stipulates that revenue should be recognized following the accrual basis.
- If the income from government subsidy obtained by an enterprise is directly linked to its revenue or quantity from the sale of goods, services, intangible assets, or real estate, the subsidy actually forms part of the sales revenue. Consequently, the income of subsidy should be recognized following the Accounting Principle for Revenue. The CIT stipulates that revenue should be recognized following the accrual basis.

Except as noted above, CIT stipulates that income from various government financial payments, such as financial subsidies, grants, compensation, tax refunds, etc., obtained by an enterprise should be recognized upon the time of acquisition, i.e. following the cash basis.

#### Deduction of Expenses Related to Public Welfare Donations

Public welfare donations made by the enterprise's self-produced and purchased goods, together with related expenses incurred during the donation process, can be recorded as public welfare donation expenditures. The amount of the expenditure should be according to the public welfare donation note issued by State organs or the social organizations for the public welfare. It is stipulated that public welfare donation expenditures can be deducted before CIT, with the limit not exceeding the 12 percent of the current annual income before tax. The expenditures exceeding the limit are allowed to be carried forward to the next 3 years in the calculation of taxable income deduction.

Under the impact of the Covid pandemic, enterprises and individuals make public welfare donations through different channels. In 2021, based on the prevailing CIT law, SAT further specified the

eligibility of the social organizations for the public welfare for the donation expenditures deductible for CIT calculation. Firstly, the mass organizations shall be administrated directly by authorized establishment departments at the county level or above. Secondly, the income derived from donation acceptance and the spending of donation income shall be separately accounted for. The proportion of expenditure for public welfare charities in the recent 3 years shall be not less than 70 percent of the total income derived from donation acceptance. Most importantly, the qualification of the public welfare mass organizations, to whom the donation made can be deducted for CIT calculation, shall be approved through in stipulated procedures in the first place.

### III. OTHER IMPORTANT CIT POLICY UPDATES

#### CIT preferences for small and low-profit enterprises

In 2021, the Chinese government provided various and significant support to small and low-profit enterprises. From 1 January 2021 to 31 December 2021, for small and low-profit enterprises, the portion of the annual taxable income not exceeding CNY 1 million will be reduced to 12.5 percent for the calculation of taxable income and subject to a reduced tax rate of 20 percent, which results in an effective CIT rate of 2.5 percent. From 1 January 2022 to 31 December 2024, the portion of the annual taxable income over CNY 1 million but not exceeding CNY 3 million will be reduced to 25 percent for the calculation of taxable income and subject to a reduced tax rate of 20 percent, which results in an effective CIT rate of 5 percent.

The small and low-profit enterprise refers to an enterprise engaged in an industry not restricted or prohibited by the Chinese government. Moreover, the following three criteria should be met.

1. annual taxable income not exceeding CNY 3 million,
2. not more than 300 employees, and
3. total assets not exceeding CNY 50 million.

### Accelerated Depreciation of Fixed Assets for SMEs

For equipment newly purchased in 2022 with a unit cost over CNY 5 million, eligible SMEs may choose to apply special deduction for taxable income.

- Equipment with depreciation life of 3 years: a one-off deduction of cost for current year taxable income;
- Equipment with depreciation life of 4, 5 or 10 years: deduction of 50 percent cost for current year taxable income; deduction of remaining 50 percent cost by yearly depreciation in the useful life.

### Deduction of advertising and sales promotion expenses

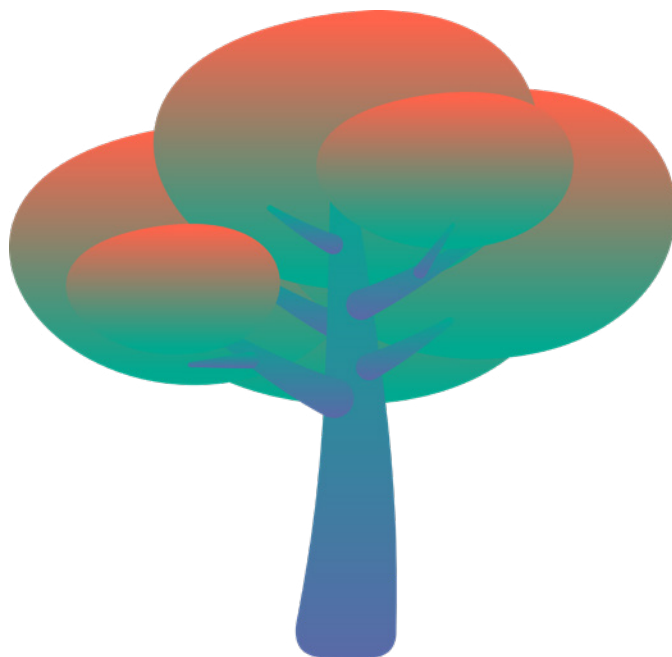
For advertising expenses and business promotion expenses incurred by enterprises engaged in manufacturing or selling cosmetics, pharmaceutical manufacturing, or manufacturing beverage (excluding liquor), there's a limit of pre-tax deduction not exceeding 30 percent of the current year sales. The part in excess of the limit is permitted to be carried forward for deduction till the end of 2025.

### CIT preferences for energy conservation and environmental protection industry

As a support to energy conservation and environmental protection industry, since the tax year in which the enterprises earn the first operation income, the taxable income of enterprises derived from environmental protection, energy and water-saving projects shall be exempted from CIT for the first 3 years, and then be 50 percent exempted from CIT for the second 3 years. Income derived from the production of products that are not restricted or prohibited by the Chinese government and satisfy the relevant national and industry standards, by using the resources specified in the Catalogue of Preferential Tax Treatments for Comprehensive Resource Utilization as the main raw materials, shall be reduced to 90 percent of the total taxable income.



The Announcement on Issuing the Catalogue of Environmental Protection, Energy Conservation and Water Saving Projects Eligible for Enterprise Income Tax Preference (2021 Edition) and the Enterprise Income Tax Preference Catalogue for Comprehensive Utilization of Resources (2021 Edition), which were published in 2021, have further expanded the preference catalogue, in order to promote the R&D and application of new technologies, devices and products in energy conservation and environmental protection, and strengthen the relevant industries.



# Individual Income Tax and Social Securities

*The year 2021 means a lot for individual income tax (“IIT”) and social securities in China. It is the first complete calendar year since the tax authority takes over social security collection in China. The collection efficiency the has drawn wide attention by taxpayers. At the same time, for foreign employees working in Shanghai, the stipulation supporting voluntary participation in Chinese social security’s lost effectiveness since August 2021, which once again caused attention to the compliance in social security participation by foreign employees and their companies. In addition, it is especially eye-catching that at the end of the year, the transitional IIT preferential policy was announced to be extended. In particular, the policy of IIT exempted allowances for foreign employees has become a big tax relief for foreign individuals working in China in the next years.*

## I. BIG DATA SUPPORT THE COLLECTION OF SOCIAL SECURITY CONTRIBUTIONS

By the end of 2020, the collection of Chinese mandatory social security contributions has been taken over by tax authority (“the collection handover”). It is stipulated that the social security contributions should be calculated according to contribution ratios and calculation base, which shall be determined by the employee’s actual salary income.

In China, social security underpayment is commonly seen in practice. The collection handover meant to support the comparison between social security calculation bases and the IIT taxation bases of salary income, so as to improve the efficiency of social security collection and administration.

In 2021, the expected trace on underpaid social security contributions by Bigdata comparison did not take place on a large scale. Nevertheless, compliance in social security contributions is a legal obligation by enterprise at any time. The collection handover is the measure by the government to strengthen the social security collection, which will increase the chance of exposure of incompliance practices.

## II. SHANGHAI: FOREIGN EMPLOYEES AND THE CHINESE SOCIAL SECURITY

Since 15 August 2021, the local regulation in Shanghai which allowed foreign employees to participate in Chinese social security on a voluntary basis lost efficacy. It is noticed that a lot of enterprises has taken the initiative to make social security registration for their foreign employees out of compliance consideration, and has paid contributions retroactively for a certain period. According to our observation, the retroactive payment may be required in the two scenarios: from the validation date of the current labor contract, or from the validation date of the current valid work permit, depending on the different local practices. So far no further strict collection measures are noticed to be implemented by the social security authority in Shanghai, e.g. making fully contribution of social security to be the pre-condition of work permit extension for foreign employees, etc.

For employees who still remain in the German social security system, it is not difficult to be exempted from paying Chinese pension and unemployment insurances by obtaining the particular social security participation certification to be issued by the German social security authority, from our current practical experiences. The first exemption period can be 60 months long and could be extended to 96 months upon confirmation.

Under the background of collection handover, we recommend the foreign employees and their employers in Shanghai should take the initiative to make social security registration and make contributions timely according to the relevant laws and regulations. It is also suggested to pay close attention to the local policy interpretation and practices in other cities where social security collection from foreign employees has not yet been implemented.

### III. TRANSITIONAL IIT PREFERENTIAL POLICY BEING EXTENDED UNTIL THE END OF 2023

In the last two days of 2021, the SAT provided IIT relief gifts one after another, including the extension of IIT preferential calculating method for annual bonus as well as the IIT exemption treatments on foreign employees' housing allowance, language training allowance and children's education allowance, until the end of 2023. These two IIT preferential policies were announced to be abolished at the end of 2021, which caused wide concerns by foreign individuals and multinational companies on the increased tax burden and consequently the impact on their foreign employees' assignment after 2022.

It is understood that the additional subsidies on housing, education and language are usually the pre-conditions for foreign employees to work in China. If the additional tax burden thereof triggered are required to be undertaken by the employers, the abolishment of the tax exemption policy would lead to the direct consequence that the labor costs in hiring foreign employees were increased. We are happy to see the current result, while at the same time would like to remind enterprises to pay attention to the compliance matters when enjoying the tax preferential policy.

Effective documentation is critical for enjoying the tax-exempt allowances. It is recommended to keep valid and consistent contracts and invoices for housing rentals. The children's education expenses should be incurred with registered educational institutions in China. The daily meal and laundry allowances are still tax-exempt while the provision should be in a reasonable amount. Furthermore, the tax-exempt allowances are required to be reported in detail during the monthly IIT filings by the employer as the withholding agent. Furthermore, foreign employees cannot enjoy the IIT exempted allowances and the special additional deduction in IIT taxable income at the same time. Even if the employers have paid the housing rents and children's education fee directly, the employees are regarded as having enjoyed the non-monetary benefits. If such non-monetary benefits have not been included into the IIT taxation bases, the employees shall not make the special additional deductions from their IIT taxable income following the above rule.

#### IV. SPECIAL DEDUCTION FOR IIT

For IIT calculation, individuals will be able to claim an additional special deduction of RMB 1,000 per month for each child under the age of 3 from 1 January 2022. Guardians who are not parents can also make the deduction according to the policy to reduce the family's burden.



# Other Taxes

*In addition to the value-added tax and corporate income tax, other current major taxes in China mainly include urban maintenance and construction tax (“UMCT”) based on turnover tax, deed tax and land appreciation tax related to land and real estate transfer, and the widely applicable stamp tax. In 2021, two important laws, the Urban Maintenance and Construction Tax Law and the Deed Tax Law, come into force at the same time, and the Stamp Tax Law is also formally legislated. The strength of tax relief on surtaxes is relative high in year 2021. In addition to the UMCT, preferential tax policies such as deed tax and land appreciation tax on enterprise restructuring are continued.*

## I. THE URBAN MAINTENANCE AND CONSTRUCTION TAX LAW IS EFFECTIVE

UMCT is a local tax based on the actual VAT and CT paid by taxpayers in accordance with the law.

The Urban Maintenance and Construction Tax Law (“the Law”) came into force on 1 September 2021. Under the Law, the tax rates are different depending on the location:

Taxpayers who are located in	Applicable tax rate
urban areas	7%
a county or town	5%
places other than a city, county or town	1%

The several notable changes of the Law from the old regulations could be observed:

### Introduction of the stipulations relating to the uncredited VAT

This optimization allows that the amount of period-end uncredited VAT could be deducted from the taxation base of urban maintenance and construction tax, which will further reduce the burden on the taxpayers who are eligible for the refund of period-end uncredited VAT.

### Clarifying that “the imported goods / services are not taxed”

The Law makes it clear that no urban maintenance and construction tax will be levied on the amount of VAT or consumption tax paid for imported goods, services or intangible assets which are provided by overseas entities or individuals to domestic customers.

### Definition the tax obligation occurrence time

The obligation of the urban maintenance and construction tax occurs at the same time when the tax liability of VAT and consumption tax arises. The tax payment shall be made together with VAT and consumption tax at one time.

### Tax benefits

From 1 January 2019 to 31 December 2021, the UMCT of all small-scale VAT taxpayers and small enterprises with low profit can be reduced within a 50 percent range. According to the latest regulation in 2022, this tax benefit will continue to 31 December 2024.

### Hints for Taxpayers

The enactment and implementation of the Urban Maintenance and Construction Tax relieves the tax burden of cross-border transactions on taxpayers. It is worth noting that the calculation base of education surcharge and local education surcharge shall be the same as the one of Urban Maintenance and Construction Tax. This means that from tax filing for September 2021 onwards, the relevant enterprises will be exempted from paying the urban maintenance and construction tax, while other additional taxes will also not be levied at the same time.

Previously, in practice, when domestic enterprises remit non-trading payments such as service fees and royalties to overseas enterprises, they were required to withhold and pay additional taxes such as UMCT when withholding and paying VAT. But the three additional taxes will no longer need to be withheld for common non-trade foreign exchange payments from 1 September 2021.

## II. THE DEED TAX LAW COMES INTO FORCE

Deed tax is a tax on transfer of ownership of land and housing based on the transaction price or market price for the transferee.

In parallel with the aforementioned UMCT, the Deed Tax Law (“the New Law”) became effective on 1 September 2021. Compared to the previous regulations, the Deed Tax Law appropriately expands tax incentives, simplifies tax returns, adds refund provisions, as well as consolidates tax filing and payment timelines. The details are as follows:

### Expanded Application Range

The New Law specifies that all transferee entities and individuals of any transfer of ownership of land (including state-owned and collective land) or housing within the territory of China shall be the taxpayers of deed tax. It is no longer limited to the transfer of “state-owned” land use right, which means that the transfer of collective land use right also triggers the tax obligation of deed tax. The Deed Tax Law has added the tax obligation of transferring land and housing ownership by means of valuation-based investment (equity contribution), debt repayment, transfer or reward.

### Statutory tax rate

The Deed Tax Law maintains the statutory tax rate from 3 percent to 5 percent, while authorizing provinces, autonomous regions and municipalities directly under the Central Government to determine differential tax rates for the transfer of ownership of housing with different subjects, in different regions and of different types.



## Tax Base

It is supplemented in the new deed tax law that the transaction price includes currency and in kind to be delivered as well as money paid corresponding to other economic benefits. In terms of gratuitous transfer, the price legally checked and ratified by the competent tax authority with reference to the market price for sale of the land use right or housing transaction shall be deemed as tax calculation base.

## Tax Benefits

The new law adds tax exemption for some non-profit organizations and also clarifies that deed tax shall be exempted when a husband and a wife alter the ownership of any land or housing between them during the existence of their marriage relationship, and when a legal heir inherits the ownership of any land or housing.

## Combination of Tax Declaration and Payment

The new law combines the tax declaration and payment. A taxpayer shall declare and pay deed tax at the same time prior to going through the formalities for registration of the ownership of land or housing, which facilitates the process for the taxpayers.

## Hints for Taxpayers

After the legislation of deed tax, the preferential treatment for individual house purchasing has not been adjusted, and the original preferential policies will continue to be implemented:

- For an individual purchasing a one-and-only residence for his or her family with the area of 90 square meters or less, deed tax shall be levied at a reduced rate of 1 percent; for residence with the area of more than 90 square meters, deed tax shall be levied at a reduced rate of 1.5 percent.

- For an individual purchasing a second residence for improving living conditions of his or her family (except for Shanghai, Beijing, Guangzhou and Shenzhen) with the area of 90 square meters or less, deed tax shall be levied at a reduced rate of 1 percent; for residence with the area of more than 90 square meters, deed tax shall be levied at a reduced rate of 2 percent. (For the second residence in Shanghai, Beijing, Guangzhou and Shenzhen, deed tax shall be levied at 3 percent.)

### III. CONTINUATION OF DEED TAX AND LAND APPRECIATION PREFERENTIAL TREATMENT IN RESTRUCTURING

All entities and individuals receiving income from transfer of real estate shall be the taxpayers of land appreciation tax, which is levied at progressive rate of 30 percent to 60 percent on the amount of increased value. The increased amount is an amount of surplus between the income received by the taxpayers from the transfer of real estate and the sum of the deductible items.

The Ministry of Finance and the State Administration of Taxation respectively announced in April and May 2021 the continuation and further update of the preferential policies on deed tax and land appreciation tax in relation to the restructuring and reorganization of enterprises, which implementation period had previously expired, and the new regulations are effective from 1 January 2021 to 31 December 2023.

#### Continuation of Deed Tax Treatment

The new regulation continues the deed tax exemption of succeeding the lands and housing ownership of the original enterprises / institutions in restructuring and reorganization transactions under nine circumstances, as summarized below:

1. Enterprise restructuring: for meeting 75 percent shareholding ratio, exemption
2. Institution restructuring to enterprise: for meeting 50 percent shareholding ratio, exemption
3. Enterprise merge: exemption
4. Enterprise division: exemption

5. Enterprise bankruptcy: for the creditors, exemption; for non-creditors, exemption or reduction by half when meeting certain preconditions;
6. Allocation of assets: for allocation of the people's governments at or above the county level, or for the transfer between internal enterprises with the same investment objects, or for the capital increase from parent company, exemption
7. Debts converting into equity: for the newly established companies after debts converted into equity with approval of the State Council, exemption
8. Transfer or investment of allocated lands: for succeeding allocated lands of the original reorganizing enterprises and institutions in way of transfer or the state investment valued as capital (shares), taxed
9. Share transfer of enterprise: when the lands and housing ownership of the enterprises do not change when succeeding shares, exemption

#### Tax Refund

The new regulations clarify that if eligible transactions occur after 1 January 2021 during transition period and taxes have been paid, enterprises can apply for tax refund.

#### Continuation of Land Appreciation Tax Treatment

If enterprise transfers or changes the real estate to a restructured / merged / split enterprise during restructuring, merge or division, or transfers or changes the real estate to an invested enterprise for investment with the real estate to acquire shares at the time of restructuring and reorganization, the transfer or change of such real estate will be temporarily exempted from land appreciation tax. But the preferential policy shall not apply when either party in the transfer or change is a real estate development enterprise.

#### Tax Basis for Retransfer

If the real estate is transferred after the restructuring and reorganization, at the time of declaring for land appreciation tax, the "amount paid for the acquisition of the land use rights" shall be determined according to:

- the land cost for obtaining the land use rights of the state-owned land before the restructuring and reorganization and relevant expenses paid as uniformly required by the State;
- the evaluated price approved by the competent natural resources administration at the time of contribution or investment, in case of contribution or investment to acquire shares by means of the state-owned land use rights upon approval;
- the house purchase invoice prior to the restructuring and reorganization, with a 5 percent super deduction each year from the year of purchase to the year of transfer, where the amount of deduction items is determined according to the house purchase invoice.

### Hints for Taxpayers

The third scenario above mentioned is the newly added deductible item in the preferential regulation of year 2021. In practice, the real estate transferee is required to obtain the original purchase invoice as proof of deduction, and otherwise the item may not be deducted and lead to an increase in the land appreciation tax burden. It is also noticed that although the new regulation simplifies the requirement to enjoy preferential treatment to “in accordance with the regulations of tax authorities”, it also requires enterprises to actively communicate with the competent tax authorities to obtain clear guidance.

As there is no clear regulation on refund of land appreciation tax compared to deed tax, it is recommended that enterprises shall communicate with tax authorities to seek refund possibility if eligible transactions occurred after 1 January 2021 and relevant taxes were paid.

## IV. LEGISLATION OF STAMP TAX

Stamp tax is levied on contracts, vouchers, business account books and licenses of rights and other documents signed and executed in China.

On 10 June 2021, the Stamp Tax Law was officially promulgated and is formally implemented from 1 July 2022.

With simplified and consolidated tax items and tax rates and reduced tax rates for some tax items.

The main contents are as follows:

Adjusted applicable tax rates and tax items

Tax Rates	Tax Items	
0.005%	contracts	loan contracts, financial leasing contracts
0.03%		purchase and sales contracts, contracts for hired work, contracts for construction projects, transport contracts, technology contracts
0.1%		rental contracts, deposit contracts, warehousing contracts, property insurance contracts
0.05%	documents for transfer of property rights	documents for granting of land use rights, documents for transfer of land use rights and housing, documents for transfer of equity
0.03%		documents for transfer of trademark, copyright, patent right and right to use proprietary technology
0.025%	business account books	
0.1%	securities transactions	

## Taxpayer and Withholding Agent

The Stamp Tax Law stipulates that all entities and individuals that execute taxable vouchers or conduct securities transaction within the territory of China are the taxpayers of stamp tax, which also applies to the scenario that the taxable vouchers are executed outside the territory of China for the use within the territory. Therefore, for taxable transactions of an overseas entity, the domestic agent shall be the withholding agent if the overseas taxpayer has an agent in China; if there is no agent in China, the overseas taxpayer shall declare and pay the stamp tax by itself.

## Tax Basis

According to the law, the taxation basis for a taxable contract shall be the amount listed in the contract, excluding the listed value-added tax, which resolved the previous dispute whether the VAT amount should be included in the tax basis or not. In the meanwhile, for business account book for which stamp tax has been paid, the stamp tax payable shall be calculated based on the increased amount of total paid-in capital and capital surplus.

## Tax Relief

The Law supplements and improves the specific circumstances of stamp tax reduction and exemption. For example, electronic orders entered into by and between individuals and e-commerce operators are exempted from stamp tax, the purchase and sales contracts on moveable property concluded by individuals with enterprises are exempted from stamp tax. Furthermore, tax reduction or exemption may be granted under some circumstances such as to meet the residents' housing demand or to support the development of small and micro enterprises.

## Inclusion of Securities Transaction in the Law

In the Stamp Tax Law, the entities and individuals conducting securities transactions are clearly defined as taxpayers, and securities transactions are accordingly classified as statutory tax items. The stamp tax is calculated based on transaction amount and charged in one direction, i.e. investors do not need to pay when buying securities, but only when selling.

## Hints for Taxpayers

Although stamp tax is a small tax, the taxpayers are required by tax authorities almost every year to make self-examination, which should be taken seriously by all enterprises. After the stamp tax legislation, enterprises should be more conscious of taxation awareness and pay attention to tax compliance. Enterprises should follow the requirements of the new law, such as: the amount of VAT should be separately presented and the amount should be separately stated for items with different tax rates on the same taxable voucher to ensure higher tax compliance. In practice, enterprises should pay attention to the selection of the stamp tax period when filing the tax and maintain a well-archived stamp tax ledger in order to cope with the tax bureau to extract the data of the corresponding period for comparison and verification.

## V. EXEMPTION FROM VEHICLE PURCHASE TAX ON NEW-ENERGY VEHICLES

Vehicle purchase tax shall be levied on purchase of automobile, tramcar, trailer, or motorcycle with a gas displacement of over 150 ccm in China.

In order to support the development of the new-energy vehicle industry and promote vehicle consumption, the Chinese State Tax Administration and other two departments jointly issued a new circular for exemption from vehicle purchase tax on new-energy vehicles from 1 January 2021 to 31 December 2022.

New-energy vehicles eligible for vehicle purchase tax exemption refer to blade electric vehicles, plug-in hybrid electric vehicles (including extended-range electric vehicles), and fuel cell vehicles. Furthermore, the new-energy vehicles already listed in the Catalog of New-energy Vehicle Models Exempt from Vehicle Purchase Tax before 31 December 2020 are still eligible for the tax exemption.

## VI. RELIEF ON “SIX TAXES AND TWO FEES” FOR SMES

From 1 January 2022 to 31 December 2024, small-scale VAT payers, self-employed entrepreneurs and qualified SMEs can enjoy a tax reduction in the scope up to 50 percent on resource tax, urban maintenance and construction tax, real estate tax, urban land use tax, stamp duty (excluding stamp duty on securities transactions), agricultural land occupation tax and education surcharge and local education surcharge.





*In recent years, the Chinese tax authorities have been enhancing the administration on taxation by applying and upgrading digitalization in the field of tax supervision. In 2021, China has gradually established an e-invoice platform and meanwhile strengthened tax supervision of specific sectors, exposing a number of well-known cases of tax evasion.*

## I. ADMINISTRATION ON TAX EVASION

In 2021, the SAT issued a notice to further strengthen the daily tax management of artists in the cultural & entertainment sector, requiring that local tax authorities conduct regular tax inspections. After making comprehensive and in-depth tax audits, the tax authorities exposed a number of cases of tax evasion by artists and web hosts, which sparked widespread social concern.

Under the current tax law, for taxpayers who evade taxes, the tax authorities will seek the payment of the unpaid or underpaid taxes and late payment penalty (usually 0.05 percent per day of tax), and concurrently impose a fine not less than 50 percent of and not more than five times the amount of taxes unpaid or underpaid. For cases that constitute crimes, criminal liabilities shall be investigated according to the law. If the enterprise constitutes the crime of tax evasion in the criminal law, in addition to the enterprise to bear the fine, the directly responsible person in charge and directly responsible personnel are punished by referring to the above provisions. In most cases, these personnel may involve the general manager, chief financial officer or manager, and the handling finance accountant.

It is worth noting that although the tax obligation of tax evasion lies in the taxpayer, both the tax law and the criminal law currently will punish the withholding agents according to above provisions, who have intentional omission or participation in tax evasion.

In addition, the Chinese Tax Law stipulates that the direct person in charge will not be investigated for criminal liability if the person is able to pay the tax, late fees and fines in a timely manner after the tax authorities issuing the notice of recovery. For example, in the case of tax evasion by the actress, although it is a huge amount of tax, the criminal responsibility was not investigated after the payable taxes, late fees and fines were paid within in a certain period after the recovery notice was issued. It is remarkable that although criminal liability may be waived in the case of first-time tax evasion, the tax bureau can directly enforce the penalty according to the maximum 5 times of the fine for the huge amount of tax evasion, depending on the nature of the amount involved.

The Chinese tax law also has clear provisions on the time limit for retroactive tax returns. For underpaid taxes due to the responsibility of the tax authority, the tax authority may require the overdue payment within three years but shall not impose a late fee. If a taxpayer intentionally fails to pay tax, the tax authority may recover the tax payment and overdue fine within three years (which can be extended to five years). To the subjective and intentional evasion of taxes can be pursued indefinitely. In addition, for transfer pricing adjustments and other general anti-avoidance matters, the tax authorities will be able to recover taxes and impose penalty interest for 10 years.

### Compliance Tips

Businesses and individual taxpayers should have a thorough understanding of the compliance requirements of Chinese tax law and conduct tax returns in a faithful and prudent way. In daily operation, taxpayers often pay less taxes because they are not familiar with the provisions of the tax law and financial system, or they are careless. These cases have essential difference to tax evasion as mentioned above, as without subjective intent or malicious. For this type of underpaid taxes, companies usually only have to pay the taxes and late fees. However, in practice, repeated non-subjective tax underpayment may also cause the alarm of the golden tax system and the attention of the tax bureau, and increase the possibility of tax inspection. Therefore, the compliance of tax declaration by the financial and tax departments must be kept on the front burner. In particular, we would like to draw attention to a special situation: if the management or internal financial and tax personnel of an enterprise

discover a tax evasion caused by historical reasons (by previous management or personnel, system errors, etc.) and there is evidence proving that the personnel fail to correct it in time due to negligence, such case may be regarded as subjective and intentional tax evasion.

Taxpayers should be aware that the Chinese tax authorities has cracked down hard the tax evasion behavior. No matter by what means, such as setting up shell companies, accepting false invoices, cashing out by booking more costs and less income, itemizing false personnel expenses. Tax may be indefinitely pursued for these tax evasion due to subjective intent, and will bring huge risks to the business operating and responsible person.

## II. TAX AUDITS AND PENALTIES

On 1 April 2021, the List of “Exempted First Offenses” from Tax Administrative Penalties was officially implemented. On 15 July 2021, the Amended Law on Administrative Penalties came into force. In addition, the Provisions on the Case Handling Procedures for Tax Inspection have been brought into effect since 11 August 2021.

### “Exempted First Offenses” from Tax Administrative Penalties

Any of the listed items of offenses committed for the first time whose harmful consequences are minor and which is corrected voluntarily before being discovered by the tax authorities or corrected within the time limit prescribed by tax authorities shall not incur administrative penalties. The offenses by a taxpayer listed here mainly include:

- failure to report the information on all of its bank accounts to the tax authorities;
- failure to establish account books or keep accounting vouchers;
- failure to make tax returns within the prescribed period;
- failure to submit invoicing data to the tax authorities as required, provided that there are no illegal proceeds;
- failure to turn over the issued invoices for cancellation, provided that there are no illegal proceeds;
- failure by a withholding agent to establish account books or retain accounting vouchers on the taxes withheld and paid;

- failure by a withholding agent to issue a tax receipt; and
- failure by a domestic institution or individual who contracts out any engineering works or labor services to a non-resident to report any related matter to the tax authorities.

### The Newly Amended Law on Administrative Penalties

The new revision of Law of the People's Republic of China on Administrative Penalties (2021) gives those taxpayers who can prove no subjective fault the means to plead for a non-penalty, and also introduces the provisions of “shall not be subject to administrative penalty” and “may not be subject to administrative penalty” by adhering to the principle of combining punishment and education. Meanwhile, five types of administrative penalties have been added, which include: notification of criticism, reduction of qualification level, restriction on production and operation activities, order to close down, and restriction on practice. Compared to the previous version of the law, the amendment this time makes it more humane as well as reasonable in terms of enforcement.

### Provisions on the Case Handling Procedures for Tax Inspection

The protection of personal privacy and personal information was introduced in the new provisions. The legitimation and compliance for executing tax inspection is to be further ensured by requiring the entire process of case handling to be recorded and refining the procedure of retrieving electronic data. In addition, the new provisions stipulate that the party concerned in a tax inspection case shall have the “right to know” and the “right of statement and defense” and the evidence shall be incorporated into the content of the decision of tax treatment. A series of relevant handling procedures are also clearly defined.

### Compliance Tips

“No penalty if there is no subjective fault” requires companies to keep appropriate records in their daily compliance management, such as: internal documentation for code of corporate conducts, policy enquiry and consultation records, etc.

### III. TAXPAYER CREDIT RATING AND RESTORATION

As China vigorously promotes the construction of social credit system, tax credit also increasingly affects the daily operation of enterprises. Since 2014, the SAT has issued several circulars to establish and regulate the taxpayer credit rating system in China, covering essential practical aspects such as information collection and evaluation, credit rating determination, release and application, dispute handling, credit repair etc. In 2021, a circular was issued to clarify that starting from the tax credit evaluation in 2021, if the tax authorities do not impose administrative penalties on taxpayers in accordance with the relevant provisions of the “first violation of impunity”, the relevant records will not be included in the tax credit evaluation, which will effectively connect with the Administrative Penalties Law.

#### Taxpayer Credit Rating Types and Relevant Administrative Measures

Taxpayer credit rating includes four levels: A, B, C and D:

- For taxpayer with level A, tax authority will grant credit-keeping incentives;
- For taxpayer with level B, tax authority will implement normal administration measures, provide timely guidance on tax policies and regulations and selectively grant incentives based on the trend of the taxpayer’s credit rating status;
- For taxpayer with level C, tax authority will take strict administration adhering to law and selectively adopt disciplinary measures based on the trend of the taxpayer’s credit rating status;
- For taxpayer with level D, tax authority and other relevant authorities will take punitive measures and the daily operation will be under intensified control and restrict.

#### Evaluation and Restoration Mechanism

The tax authority will evaluate taxpayers based on various sources of credit information, among which the internal taxation information is particularly important. As the taxpayer credit rating is under dynamic management, it can be recovered under certain conditions.

### Compliance Tips

Credit rating management for taxpayers is one of the most important administration regulations implemented by Chinese tax authorities in recent years. Corporate taxpayers should learn about the mechanism and basic rules of the tax credit rating system in China, keep track of to their tax credit rating status and maintain a high-level compliance with the operational requirements related to tax credit rating.

## IV. RANDOM INSPECTIONS ON HIGH AND NEW TECHNOLOGY ENTERPRISE

On 15 September 2021, the Ministry of Science and Technology issued a circular to launch a nationwide inspection of the administration of high and new-tech enterprises (“HNTE”) recognition, mainly requiring self-inspection activities on the accreditation, supervision as well as utilization of tax incentives of the HNTEs to be conducted.

The self-inspection calls for a certain number of HNTEs to conduct material sampling, while field inspection is demanded for some other HNTEs.

### Compliance Tips

HNTEs can enjoy the preferential corporate income tax rate of 15 percent. However, it should be reminded that the basis for benefiting from such incentives is that the enterprises must genuinely carry out the relevant R&D activities and meet the application requirements for HNTE accreditation (e.g., the ratio of R&D expenses to sales revenue, the ratio of revenue from high-tech products to total revenue, the ratio of R&D personnel to total employees, etc.). In addition, another condition for enjoying such tax incentives for HNTEs is that the above requirements need to be met throughout the validity period of the accreditation. Otherwise, the enterprise will not only be revoked of the HNTE title, have to repay all tax benefits claimed and pay a late payment fee, but will also be subject to the corresponding administrative penalties.

Relevant enterprises should review the latest application documents for HNTe as soon as possible, including the breakdown of R&D expenses, the list of R&D personnel and the breakdown and reasonableness of the revenue from high-tech products during the validity period. If the breakdown of R&D expenses includes R&D assistance from related parties, we also recommend that the enterprises communicate with their overseas related parties as soon as possible and prepare a specific description and breakdown of such R&D assistance to prepare for possible random checks.

## V. TAX DEFERRAL FOR MANUFACTURING SMES FOR Q4 2021

The SAT and the Ministry of Finance (“MOF”) have jointly issued a notice to allow the deferral of some taxes for medium, small and micro manufacturing enterprises for Q4 2021, which implementing from 1 November 2021. After tax declaration, the qualified medium-sized manufacturing enterprises (with annual sales turnover more than RMB 20 Million less than RMB 400 Million) may defer 50 percent, while the qualified small and micro manufacturing enterprises (with annual sales turnover less than RMB 20 Million) may fully defer all relevant taxes. The deferral period will be three months. The relevant taxes include corporate income tax, individual income tax (excluding withholding tax), domestic value added tax, domestic consumption and the supplementary urban maintenance and construction tax, education surcharge and local education surcharge for October to December 2021.

In March 2022, the two state departments issued another notice extending the tax deferral period to six months for the fourth quarter of 2021, while clarifying that the same tax deferral policy would apply for the first and second quarters of 2022, allowing for a six-month deferral period.

## VI. UPDATES FOR OTHER IMPORTANT TAX POLICIES

### Optimization and Integration of Information Systems for Export Tax Refund

On 16 June 2021, the SAT issued an announcement aimed at optimizing and integrating the information system for export tax refund, which mainly involves cancelling several declaration items for export tax refund, simplifying the materials submitted for export tax refund application, streamlining the procedures for handling export tax refund and issuing export tax refund certificate. Among others, the announcement specifies that, when a taxpayer applies for record-filing for export tax refund, the following three documents are no longer required to be submitted: Record-filing and Registration Form for Foreign Trade Operators, Approval Certificate for the Establishment of a Foreign Invested Enterprise in the People's Republic of China and Certificate of the Customs of the People's Republic of China on the Registration of Customs Declaration Entities. Moreover, when applying for changes to the record-filing of export tax refund in the future, taxpayers will only need to fill in the changes in the record-filing form.

### Administrative Measures for Information Disclosure of the Parties with Seriously Tax-related Dishonest Acts

In December 2021, the SAT issued administrative measures (“Measures”) to comprehensively regulate the enforcement procedures related to the work of determining blacklisted parties, punishing dishonest acts and stopping the publication of blacklist information in advance. The Measures also clarify the responsibilities and obligations of tax authorities at all levels and refine the workflow of identification of dishonest parties, information disclosure and credit repair, effective from 1 February 2022.



The Measures clarify the 11 situations of major tax violation which will lead to the blacklisting of the offending subject, which include:

- forging, altering, concealing or destroying account books or bookkeeping vouchers without authorization;
- overstating expenses or not listing or under-stating income; refusing to declare or making false tax declarations after being notified by the tax authorities, where the underpaid tax amount is significant;
- owing significant amount of tax payable and attempting to transfer or conceal property obstructing the tax authorities in recovering the taxes;
- fraudulently obtaining export tax refunds; serious cases of issuing false general VAT invoices, etc.



# Cross-border Transactions

*In 2021, China has improved the application processes for non-trading outbound remittance, tax reduction and exemption for goods import and export as well as several administrative measures.*

## I. FURTHER SIMPLIFIED TAX RECORD-FILING PROCEDURE FOR OUTBOUND REMITTANCE

When Chinese companies make non-trading outbound payments, such as service fee, license fee, dividends, interests, etc., if a single remittance exceeds USD 50,000 equivalent, a tax record-filing needs to be proceeded.

On 29 June 2021, the SAT and the SAFE jointly released circular to promote a series of simplified procedures in tax record-filing for outbound payments, which took effect since publication. The simplified procedures include:

### One Record-filing for Repeated Outbound Payments

When repeated outbound payments are needed under one contract, tax record-filing should be proceeded only when the first payment is made, while previously tax record-filing is required for each payment. This is a significant relief for companies. For contracts with former payment which has been proceeded tax record-filing, no more record-filing is needed for future payments under the same contracts.

### Expanded Scope for Payments Exempted from Tax Record-filing

China-sourced profit to be re-invested in China would concern tax authority, foreign exchange authority and banks. The tax record-filing is now exempted for re-investment by foreign investors in China with legal income derived from direct investment in China.

### More Application Channels

The circular has specified online tax record-filing channels and processes for outbound payments. It is not necessary for companies to proceed on-site at the tax bureau. At the same time, the former procedure by paper document submission is also retained to provide more options to companies.

### Simplified Amendment and Repeal Procedure

Under the new procedure, when the tax record-filing is completed, companies can make outbound remittance at local banks with the serial number and verification code of the record-filing form, according to the relevant stipulation by SAFE. The digitalization has realized information sharing between tax authority and banks.

For tax record-filing without payment, companies can modify or cancel the filing directly online. While filings with payment made already cannot be cancelled by can be modified.

### Compliance Tips

Although the new procedures has simplified the tax record-filing, the tax payment obligations of companies remain unaffected. Regardless of the payment amounts, companies should fulfill their tax payment obligations in accordance with the relevant tax regulations for non-trading outbound payments.

## II. SIMPLIFIED TAX REDUCTION AND EXEMPTION APPLICATION FOR GOODS IMPORT AND EXPORT

On 1 March 2021, the updated Administrative Measures of the Customs of the People's Republic of China for the Reduction and Exemption of Import and Export Taxes was formally implemented with simplified administrative measures.

### Record-filing and approval (two steps) simplified as review and confirmation (one step)

The new measures has cancelled the former record-filing and approval measures (two steps) for tax reduction and exemption for goods import and export, and simplified them to be review and confirmation procedure (one step).

## Goods supervision and follow-up administration

The new circular has extended the annual reporting period on the use of goods entitled to tax reduction or exemption from the 1st quarter to the 2nd quarter. While at the same time, companies who fail to fulfill the reporting obligations will be included in the directory of abnormal credit information, in accordance with relevant provisions.

## Compliance Tips

Although the relevant procedures have been simplified for tax reduction and exemption application, higher requirements have been raised in application materials. Companies should submit complete and valid application materials filled out in a standardized manner as required, and assume corresponding legal liability for the authenticity, accuracy, completeness and standardization thereof. In addition, the follow-up administration is connected with companies' credit information, which should be paid attention by companies, to avoid negative impact from credit downgrading resulted from incompliance practices.

## III. MORE TRANSPARENT CUSTOMS ADMINISTRATIVE PENALTY PROCEDURES

On 15 July 2021, the revised Provisions of the Customs on the Procedures for Handling administrative Penalty Cases were officially implemented. Compared with the previous provisions, the new provisions have two particularly noticeable updates.

### The principle of non-penalty for first-time violation

Based the newly amended administrative penalty law, a principle of non-penalty for first-time violation was introduced, as specified below:

- Whoever commits a minor illegal act and makes corrections in a timely manner without causing any harmful consequences shall be exempt from an administrative penalty;
- Whoever violates the law for the first time, resulting in a minor harmful consequences, and makes timely corrections may be exempt from administrative penalty;

- Whoever takes the initiative to eliminate or mitigate the harmful consequences of violations, or takes the initiative to confess to violations not yet in the possession of the Customs, or cooperates with the Customs in the investigating of violations with meritorious performance shall be subject to a lighter or mitigated administrative penalty;
- Whoever proactively cooperates with the Customs in an investigation, admits the fault and accepts the penalty, or commits an illegal act with minor harmful consequences may be imposed a lighter or mitigated penalty.

It should be noted that Customs' specific penalty measures for companies violations are closely related to the attitude of the parties involved and the timeliness of the relief, and that the Customs has a certain discretion on this basis.

It is noteworthy that the matters which are applicable to "non-penalty for first-time violation" has not been published or implemented. In addition, the determination of matters which "violate the law for the first time resulting in a minor harmful consequences" might remain controversial, which deserves attention to whether subsequent detailed rules would be released by the customs for further clarification.

#### Reduction of enterprises' compliance cost in customs issues

The new provisions stipulated the followings:

- The new provisions set a time limit within which the Customs shall, in general, make a decision on administrative penalties within six months from the filing date of the administrative penalty case;
- Under certain conditions, the new provisions provide a new way of handling administrative penalty cases where the facts are clear, the party concerned applies in writing, voluntarily admits the faults and accepts the penalty, and has other evidence to prove, the Customs can handle the case expeditiously by simplifying the process of evidence collection, review and approval;
- The party concerned who has sufficient evidence to prove that there is no subjective fault shall be exempted from administrative penalty.

The new provisions encourage the independent proof of enterprises. In the case of enterprises fully discharge the responsibilities of proof, the Customs has a variety of favorable measures, not only can save the processing time of the case, improve efficiency, and even exempt the enterprise from administrative penalties.

### Update on Customs Active Disclosure of Tax-related Violations

On 30 June 2022, the General Administration of Customs a further Notice to provide for the update of the applicable criteria for the non-administrative penalties with active disclosure of tax-related violations from 1 July 2022 to 31 December 2023, including:

- The time interval between the occurrence of a violation and active disclosure is extended from 3 months to 6 months;
- For active disclosure after six months within 1 year, the limitation of the ratio of the unpaid or underpaid taxes to the taxes payable is increased from 10 percent to 30 percent and the amount of the unpaid or underpaid taxes is increased from RMB 0.5 million to RMB 1 million.

### Compliance Tips

It is recommended that enterprises should establish daily records of customs operations. On the one hand enterprises can carry out regular self-inspection and evaluation on customs compliance, which helps to notice compliance mistakes in time and eliminate or mitigate the harmful consequences to the biggest extent, thus to mitigate the negative consequences which should be borne due to the administrative penalties; On the other hand, enterprises may easily conclude the historic experiences, thus to make continuous improvements in the daily management of customs practices and benefit the internal control improvements and internal work handover. At the same time, complete records of daily work can provide strong and traceable support in self-defending by enterprises when necessary.

So far in proving the absence of subjective fault, the regulations do not provide more clear guidelines. However, from an enterprise's operational point of view, it is suggested that enterprises should record all inquiries and communication records related to the customs policies and operations, including website inquiry results,

12360 customs hotline records, customs on-site consultation records, and telephone records, so that if an enterprise has done all possible obligations to achieve compliance and noncompliance still occurs, these records will become valid subjective no-fault proof to support the enterprise's application for exemption from the processing of administrative penalties.

#### IV. IMPROVEMENT IN CREDIT MANAGEMENT SYSTEM BY THE CUSTOMS

With the development of social credit management system in China, the continuous upgrading of the system has put forth higher requirements on corporate compliance in operation. Customs credit management, as a part of the credit construction, has experienced continuous improvement and upgrading in the recent years. The Measures for Credit Management of Enterprises Registered and Filed with the Customs which started to be implemented since 1 November 2021 has the following main changes, comparing to the former Measures for Corporate Credit Management by Customs:

##### Optimizing Credit Management Grades

Under the new measures, the credit grades at the Customs are simplified from 4 grades to 3 grades. The former high-grade authorized enterprises and dishonest enterprises are kept. The former generally authorized enterprises and generally credit enterprises are combined to one grade, as "other enterprises". Under the 3-grade system, the Customs would implement more transparent management measures, which provides facilitation measures to high-grade authorized enterprises, intensify the management of dishonest enterprises, and implement regular management to other enterprises.

##### Introducing credit cultivating system

As the newly introduced clause, the new measures specified that the Customs would provide credit cultivation services to enterprises, in order to strengthen enterprise's sense of credit and compliance, improve their honest operation. This means more companies meeting the requirements can become high-grade authorized enterprises via Customs' coaching, so that more policy facilitation can be enjoyed.

### Extending reviewing period for high-grade authorized enterprises

For high-grade authorized enterprises, the reviewing period has been adjusted from former 3 years to 5 years, which mitigates the burden of companies to a certain extent. While at the same time, the Customs may carry out non-scheduled review on enterprises in whose credit status irregularity occurs.

### Professional conclusion from agents being taken as reference

The new measures has specified that the Customs or enterprises may involve agent in the recognition or review of high-grade authorized enterprises, and present professional conclusion as a reference taken by the Customs. The involvement of agents can help enterprises to better execute the required procedures by the Customs, and communicate with the Customs effectively.

### More accurate determination of dishonest enterprises

The new measures has provided more details in the determination standards of dishonest enterprises, which gives more specific and quantified measurements for dishonest behavior and amounts. For example, default on tax and penalty payment is classified into “over 3 months” and “over 6 months and 10 thousand yuan”, which gives more accurate basis for the Customs determination and implementation in practice.

### Name list of companies who has serious dishonest behavior

Two newly-added serious dishonest behavior are closely relevant to food safety and live health. The relevant penalties include:

- Violating the management rules for imported and exported food safety, imported and exported cosmetics, smuggling physical scraps which lead to criminal obligations;
- Illegal importing physical scrap which lead to administration penalty by Customs over 2.5 Mio RMB.



### Management measures for high-grade authorized enterprises

Comparing to the former management measures, for the high-grade authorized enterprises as the authorized economic operator (“AEO”), the new measures has added 3 more facilitation measures, to further encourage the enterprises with good credit:

- The average sampling percentage for country of origin investigation on exported goods would be below 20 percent of the average sampling percentage;
- Priority in customs declaration related procedures for goods import and export;
- Priority in registration for agricultural products and food export enterprise recommended to other countries / regions.

### Compliance Tips

For high-grade authorized enterprises, it is recommended that companies should fully understand the standards and requirements, with reference from agents, prepare for the relevant documents from daily management, so as to respond to the Customs’ authorization or review. For other companies, it is recommended a regular self-inspection in Customs practices should be carried out, so as to find incompliant behavior and disclose timely, to avoid being listed as dishonest enterprises and being restricted in daily operations.

## V. OTHER IMPORTANT UPDATES IN CUSTOMS REGULATIONS

### Management measures for customs administrative permission

The management measures came into force on 1 February 2021. The definition of administrative permission was adjusted according to the ongoing administrative permission items. The measures have specified the situations which are not included in the term of administrative permissions. Products sampling inspection, examination and testing stipulations as well as handling measures for

cheating and robbery are added in. As for administrative permission approved by the Customs, non-discriminatory and confidential principle are added in, to protect the rights of the applicants. The procedures in administrative permission are also offered in different channels, online procedures in customs administrative permission are promoted.

#### Classification management in imported / exported goods

The stipulation came into effect on 1 November 2021. The newly-added highlighted points are as follows:

1. National standards and industry standards concerning imported and exported goods can be used as a reference for classification.
2. The customs offices may conduct laboratory tests and inspections, when necessary, on the attributes, ingredients, content, composition, quality, and specifications of imported and exported goods, according to the Tariff Schedule for Imports and Exports, national standards, and industry standards, as well as customs testing methods, and use the results of laboratory tests and inspections as the basis for classification.

#### Management Rules on Record-filing of Customs Declaration Entities

The rules came into effect on 1 January 2022, with the main points as follows:

1. Customs declaration entities and goods recipients or delivers of import and export are unified to record-filing procedure;
2. The record-filing for customs declaration personnel is cancelled. The management of customs declaration personnel are handed over to enterprises for self-filling-in.
3. The obligation of enterprises in different areas for making record-filing of foreign trade operators are differentiated;
4. It is the first time to stipulated in regulation that the record-filing of customs declaration entities are valid without term limitation.

## Implementation of the RCEP specified by the Customs

The Regional Comprehensive Economic Partnership (“RCEP”) takes effect since January 2022. In order to guarantee the smooth implementation, the Customs has released administrative measures of the Origin of Imports and Exports under RCEP, which stipulated that goods wholly obtained or produced in a member country shall be treated as originating goods under the RCEP and have originating status under the RCEP. Imports with originating status may be subject to the corresponding tax rates under the RCEP based on the country (region) of origin.



*In 2021, the United Nations released the third edition of the “Practical Manual on Transfer Pricing for Developing Countries”, which contains significant additions and updates on the development of transfer pricing in China. It includes an overview of the development of anti-tax avoidance regulation in China in recent years, examples of the difficulties and hot issues in the implementation and application of arm’s length principle in practice, and a discussion of the use of geographical factors in transfer pricing practice with Chinese characteristics and the functional positioning of Chinese companies in the value chain.*

## I. UNILATERAL APA PROCEDURES AND PRACTICES

For enterprises with good tax compliance, signing Advanced Pricing Arrangement (“APA”) with the Chinese tax authorities may help multinational enterprises to reduce their transfer pricing risks proactively. However, in practice, the existing APA procedure generally suffers from cumbersome negotiation and long processing and reviewing time. The simplified procedures to APA released in 2021 gives many taxpayers the opportunity to get on the fast track to the simplified APA and gain tax certainty.

### Simplified Procedures

The negotiation and implementation of the simplified procedure will be shortened to three stages: Application & Assessment, Negotiation & Signing, and Implementation & Monitoring. In addition, the new procedures will help to improve the cumbersome process and long review time in previous APA applications by specifying the processing time of Negotiation & Signing.

Application & Assessment	Negotiation & Signing	Implementation & Monitoring
<ol style="list-style-type: none"> <li>1. Analysis and assessment as well as on-site functional risk review</li> <li>2. Issuance of a Notice of Tax Matters (“Notice”) the within 90 days to the enterprise: <ul style="list-style-type: none"> <li>- Accepted: Delivery of Notice;</li> <li>- Not accepted: Delivery of Notice and explanation of reasons.</li> </ul> </li> </ol>	<ol style="list-style-type: none"> <li>1. Negotiation between the tax authority and enterprise</li> <li>2. Completion of negotiation within 6 months starting from the delivery of an “Accepted” Notice to the enterprise <ul style="list-style-type: none"> <li>- Consensus: Signing of APA;</li> <li>- Disagreement: Delivery of Notice and termination of the simplified APA procedure</li> </ul> </li> </ol>	<p>Submit the Annual Reporting for review / adjustment</p>

<p>Deadline: (3 months) + 90 days</p>	<p>Deadline: 6 months + Time for enterprises to submit supplementary information</p>	<p>Deadline: 3-5 years starting from the tax year when the "Accepted" Notice is delivered to the enterprise. Also, the enterprise can choose the retroactive application of previous years when submitting the application.</p>
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### Application Conditions

As to the application conditions, enterprise, which has incurred related-party transactions of more than RMB 40 million in each of the three years preceding the tax year when the Notice was issued by the tax authority in charge, and meets one of the following three conditions, may apply for the simplified APA procedure:

- It has provided the tax authority with the local file for the recent three tax years (If it meets the conditions for preparing the master file, the master file shall further be provided). Enterprises that do not meet the contemporaneous TP Documentation criteria but have voluntarily supplemented the last three years' TP Documentation are also eligible to apply for the Simplified Unilateral APA;
- It has implemented APAs in the recent ten tax years, and the implementation results meet the arrangement requirements; or
- It has been subjected to special tax investigation and adjustment by the tax authority in the recent ten tax years, and the case has been closed.

It should be noted that the New Procedures indicate the circumstances under which the tax authorities may reject an application, with particular reference to the compliance requirement for contemporaneous documentation and the annual related-party transactions forms, and in the meantime also provide a second chance for the Simplified Unilateral APA application to taxpayers who

have not completed the annual TP filings or have made errors in their annual TP filings in the past three years will be given provided that they are able to correct their annual TP filings prior to the application.

### Hints

The introduction of the simplified Unilateral APAs, which significantly reduces the application time, helps to obtain tax certainty for the taxpayers' cross-border investments and also decreases the administrative burden of the Chinese tax authority in the future for these enterprises and further encourages foreign investments in China. This will then be a “win-win” situation for both parties.

In times of economic uncertainty, the implementation of the simplified unilateral APA procedure will also bring convenience to transfer pricing year-end adjustments for enterprises. According to the “Q&As on the Administration Policy of Transfer Pricing Adjustment of Foreign Exchange Business” recently released by the State Administration of Foreign Exchange (“SAFE”), when processing “foreign exchange business of profit compensation by enterprises from transfer pricing perspective”, the bank is required to review the following documents: “relevant written documents issued by tax authority or Customs, profit adjustment agreement, invoices”, etc. Therefore, if an enterprise can quickly reach a unilateral APA with the competent tax authority through a simplified procedure, it can provide a copy of the APA to help the bank to quickly complete the review of the “profit compensation business from transfer pricing perspective”, which will also facilitate year-end transfer pricing adjustments for enterprises operating in China. This could be helpful to solve the long-time headaches of multinational groups in this aspect, i.e. the difficulties of implementing group unified TP policies in China which include a year-end adjustment.

In order to ensure a successful application, it is recommended that enterprises shall adequately review their own situation for quality improvement of the transfer pricing compliance documentation to ensure the completeness and accuracy of the information disclosure and comply with the application requirements. Enterprises may also consider communicating with the tax authorities in advance to assess the possibility of acceptance and related risks before making a formal application. On the other hand, given that the unilateral APA

is only an agreement between the enterprise and the Chinese tax authorities, and that the unilateral APA application report requires a detailed analysis of the enterprise's value chain/supply chain as well as examination of geographically specific advantages such as cost saving and market price premium, enterprises should also communicate with their related parties accordingly prior to formal application to ensure that the general understanding agreed with the Chinese tax authorities can also be acknowledged by the competent tax authorities of the related parties, so that the double taxation risk could be alleviated.

## II. TRANSFER PRICING ADMINISTRATION IN TIMES OF COVID-19

On 30 September 2021, the Chinese State Administration of Taxation (“SAT”) responded the daily concerns of enterprises about transfer pricing (“TP”) during the Covid-19 period. The responses from Chinese tax authority provide official guidance on how enterprises shall deal with TP investigations under the epidemic. The main points are as follows:

### TP investigations by the tax authorities - Are pandemic effects taken into account?

The tax authority has emphasized in the answers that the pandemic has a very different impact on businesses in different industries. In some industries, the impact on companies is greater, while in other industries, new development opportunities arise. In addition to industry affiliation, the market positioning of the company under study or even its role in (global) supply chains also plays a crucial role. Companies should therefore specifically analyze potential VP risks with regard to the pandemic and its impact on the company, rather than making sweeping generalizations.

Therefore, when conducting TP investigations, the tax authorities will take into account the epidemic impact on related party transactions on a case-by-case analysis, while complying with the arm's length principle.



### How do tax authorities take into account losses caused by the epidemic?

The tax authority mentioned that in the investigation the epidemic impact would be considered in the context of functions and risks of the enterprises, related party transaction characteristics, industry features, comparable enterprise conditions and other factors. In the comparability analysis, the difference of costs and expenses would be adjusted with reference to the situation of independent third parties.

The tax authority clearly stipulates that enterprises engaged in simple production activities such as toll manufacturing or contract manufacturing, simple distribution or contract Research & Development activities for overseas related parties, should maintain a reasonable profit level in principle. However, according to “OECD Covid-19 Transfer Pricing Guidelines”, it is still possible for such entities to incur losses in the short term due to the epidemic. Therefore, it is recommended that enterprises engaged in simple production, limited risk distribution and contract R&D activities should prepare sufficient documents to prove that independent third parties do bear the same risks or additional costs under comparable conditions to avoid potential TP risks in this regard.

### Profit fluctuation: How can enterprises prepare the local file for TP -documentation?

The tax authority requires enterprises to specify the specific impact of the epidemic on related party transactions and value chains when preparing local file, and focus on comparable object information for the same year, region, industry, product and functions and risks when conducting comparability analysis to reflect the impact of the epidemic on profit level in the industry.

Considering that financial data for comparable companies in the public database for the relevant year may not be available at the time of preparation of the local file, the following methods could be taken into consideration when preparing the local file to reflect the impact of the epidemic to the profit level of the industry:

- Adopting multi-year data from the tested company instead of the current year data during the epidemic for validation
- Adopting but-for-analysis for specific factor adjustment
- Adopting interim financial data (quarterly / semi-annual data) of the relevant year for comparison, if possible

In addition, when required by tax authority to submit local files, enterprises could check again whether the financial data of comparable enterprises for the year under review has been updated in the public database and make corresponding supplements to better reflect the impact of the epidemic on the profit level of the industry engaged in.

#### Do government assistance affects price adjustment for related party transactions?

During the epidemic, the Chinese government introduced a series of assistance policies in areas of rent, taxes and financing. The tax authority clarifies that if enterprises believe that government assistance has an impact on TP arrangements, they should provide relevant information in the TP documentation to support the analysis, while the tax authority will identify the comparable factors to ensure the fairness and consistency of the results of the comparability analysis.

The above response indicates that the Chinese tax authority will consider the government subsidies as a special geographical specific factor during epidemic and therefore simply taking the relevant subsidies into account in the TP arrangement (e.g. reducing costs when adopting cost plus method or reducing marketing expenses when adopting resale price method) may lead to potential TP risks.

In addition, it is also recommended that enterprises search for comparable companies in China to perform comparability analysis during the epidemic to reduce tax authority's requirement to adjust for relevant location specific factors (such as government assistance and market differences).

## How to execute APA under epidemic impact

The tax authority points out that if enterprises do experience material changes affecting the implementation of Advance Pricing Arrangement (APA) due to the epidemic, they may report to competent tax authorities in written form with relevant information to explain the epidemic impact on implementing APA in details. The competent tax authority will analyze and assess the situation to revise or terminate the unilateral arrangement or the SAT to negotiate with the parties to the agreement to settle the bilateral arrangement.

## Hints

Most enterprises have submitted their first TP local file under Covid-19 to tax authorities. The responses from tax authority indicates that the Chinese tax authorities will recognize the impact of the epidemic on enterprises when reviewing the documentation for TP investigations. However, in view of the loss and profit fluctuation caused by the epidemic, enterprises should perform a quantitative analysis based on various factors proposed by the tax authority, and retain relevant supporting documents that independent third parties would suffer similar losses under the same circumstances, so as to reduce the TP risks of their Chinese subsidiaries. In addition, the tax authority also emphasizes the difference of the impact on enterprises in different industries in the response, which also indicates that tax authorities may adopt more detailed industry analysis in the future TP administration to evaluate the reasonableness of the TP policies implemented by different enterprises.

At the same time, the Covid-19 continues to have an impact on the global economy in 2021. In practice, many multinational enterprises adopt regular tracking on group transfer pricing implementation to make timely adjustment on deviations such as year-end adjustments, which requires full consideration of compliance and practicality on Chinese tax and foreign exchange administration.

### III. OECD RELEASED NEW TRANSFER PRICING GUIDELINES

On 20 January 2022, the OECD released the 2022 edition of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The new TP Guidelines has mainly combined the following aspects which has been published by OECD in the BEPS framework in the past couple of years:

- The revised guidance on the application of the transactional profit split method
- Guidance on the application of the approach to Hard-to-Value Intangibles
- Transfer pricing guidance on financial transactions

#### Application of Profit Split Method (“PSM”)

The new Transfer Pricing Guidelines clarify and expand on when the PSM may be the most appropriate Transfer Pricing method, as well as to provide further cases for reference by tax authorities and enterprises when applying the PSM.

OECD recognizes that the PSM should be considered as an appropriate Transfer Pricing method in the following scenarios:

- Each party to the transaction makes a unique and valuable contribution (a unique and valuable contribution includes not only the assets used, such as intangible assets, but also the functions performed);
- The business operations are highly integrated, i.e. there is an interconnection of the functions, risks and assets used undertaken by the parties to the transaction, so that the contribution of each party cannot be reliably measured separately;
- The parties to the transaction share significant economic risks or each party bears closely related risks separately.

On the other hand, it also emphasizes that the application of the PSM may lead to increased compliance burden of the taxpayer since it requires a lot of qualitative analysis (such as whether the contribution is unique and highly integrated and whether third parties would be willing to disclose their own internal data for applying such

a PSM) as well as a lot of quantitative analysis (such as the accuracy of actual and forecast financial data of related parties as well as the consistency of accounting standards).

It should be observed that the Chinese tax authorities have increasingly advocated the application of PSM for the assessment of related-party transactions in Transfer Pricing audits or APA applications in recent years. Therefore, multinationals may consider to use PSM at least as a testing method to verify whether the related party transactions entered is in line with the arm's-length principle if they have comparatively complicated operations in China.

### Approaches to Hard-to-Value Intangibles Assets

The new Transfer Pricing Guidelines provide guidance for tax authorities on the application of the approaches to Hard-to-Value Intangibles (HTVI). In practice, there are often potential information asymmetries between the taxpayer and the tax authorities in relation to HTVI.

According to the new Transfer Pricing Guidelines, the tax authorities may use the ex-post results as presumptive evidence to evaluate the reasonableness of the ex-ante Transfer Pricing arrangement. If the revised valuation result indicates that the ex-ante transfer price set is significantly lower or higher than the arm's-length price, the tax authorities may apply Transfer Pricing adjustments in accordance with the revised valuation result. From this point of view, intangible asset transactions between related parties, license fee transactions relating to intangible assets as well as cost-sharing agreements ("CSA") relating to intangible assets will be subject to a higher potential Transfer Pricing risk. Please note that this has been in line with the relevant provisions for the license fee charge and CSA in the Chinese Transfer Pricing regulations.

### Guidance on Financial Transactions

The new Transfer Pricing Guidelines provide further guidance on cross-border intra-group financing transactions (e.g. fund lending, cash pooling arrangements), guarantees, etc. The determination

of whether a financing arrangement is characterized as debt or capital becomes a key focus of international tax and Transfer Pricing analysis, and only interest arising from a debt-based financing arrangement is eligible for pre-tax deduction. In practice, many multinational companies provide funds for equity or debt investments to their overseas subsidiaries in the form of non-interest bearing transactions. However, under the new Transfer Pricing Guidelines, these non-interest-bearing arrangements may be characterized as debt arrangements by the tax authorities and thus lead to potential tax risks. In this regard, we suggest that enterprises should conduct a comprehensive analysis of the economic substance of the financing arrangement as well as the functions and risks performed by the parties.

# Overview of the Prevailing Regional Preferential Tax Benefits

*As the Chinese economy has transformed from fast increasing phase to high quality development phase. Therefore the preferential policy has also gradually transferred the focus to the industry and project which has the priority support and is encouraged for development by the Chinese government. At the same time, there are new requirements for regional development in a harmonized way. As motivated by various policies in 2021, regional economic development has shown strong power and tenacity.*

## I. TAX PREFERENTIAL POLICY IN HAINAN FREE TRADE PORT (HAINAN FTP)

On 10 June 2021, the Law of the People's Republic of China on the Hainan Free Trade Port takes effect.

### Corporate Income Tax

For the period from 1 January 2020 to 31 December 2024, enterprises in the encouraged industries that are registered and have substantial operations in the Hainan Free Trade Port ("FTP"), may pay Corporate Income Tax at a reduced rate of 15 percent.

In addition, for enterprises in the tourism, modern service and high-tech industries that are established in the Hainan FTP, meeting the following conditions simultaneously, the income obtained from newly increased overseas direct investment will be exempt from CIT ("tax exemption on overseas investment"):

- the operational profit from the newly established overseas branches; or dividends distributed from overseas subsidiary with more than 20 percent shareholding;
- the statutory CIT rate of the invested country (region) is no less than 5 percent.

In March 2021, the Ministry of Finance and the State Taxation Administration released the Catalogue of CIT Preferences for Tourism Industry, Modern Service Industry and High-tech Industry in Hainan FTP.

Herein it is noteworthy that in order to enjoy the foregoing CIT preferences, enterprises should be registered with substantial operations in Hainan FTP. The main operating business should fall into the catalogue of encouraged industries, from which the main operating income shall account for over 60 percent of the company's total revenue. The substantial operation includes four circumstances and the detailed qualification conditions as follows:

	Circumstance	Qualification Conditions
A	Resident enterprise is registered in the FTP and does not establish branches outside the FTP.	Production and operation, personnel, accounts, assets, etc. are all located in the FTP.
B	Resident enterprise is registered in the FTP and establishes branches outside the FTP.	The head office in the FTP implements substantial overall management and control over the production and operation, personnel, accounts and assets of each branch.
C	Resident enterprise is registered outside the FTP and establishes branches in the FTP.	The branches or premises established in the FTP shall have production and business functions and have matched business income, employee remuneration and total assets with the functions.
D	Non-resident enterprise establishes institutions and premises in the FTP.	



## Taxation for Import and Export

Since March 2021, self-use production equipment in Hainan FTP applies to zero tariff policy. Enterprises registered in the Hainan FTP with independent legal personality shall, when importing self-use production equipment other than goods not entitled to tax exemption as explicitly prescribed in laws, regulations or relevant provisions, goods prohibited from import under state regulations, and the equipment set out in the “negative list of Hainan FTP self-use production equipment with zero tariff”, be exempt from import tariffs, import value-added tax (“VAT”) and consumption tax.

It should be particularly noticed, that those import goods which are formerly not exempted from tariff, i.e., those equipment listed in “the Catalog of Imported Key Technical Equipment and Products Not Entitled to Duty Exemption”, “Catalogue of Imported Merchandises under Foreign-Invested Projects Not Entitled to Duty Exemption” and “the Catalogue of Import Commodities Not Entitled to Duty Exemption for Domestic Investment Projects”, can also apply to the “zero tariff” policy for self-use production equipment in Hainan FTP. For enterprises meeting the conditions, importing equipment listed in the foregoing catalogues can also be exempt from import tariffs, import VAT and consumption tax.

Besides, raw and auxiliary materials imported by enterprises registered in the Hainan FTP and with independent legal person status for self-use in production activities, or consumed in production and processing activities or in the process of service trade, which adopt the model of “putting the supply of raw materials and the marketing of products on the world market”, will be exempted from import tariffs, import VAT and consumption tax.

Since January 2021, policy of tax refund at ports of shipment started to be implemented in Hainan FTP. In normal circumstances, enterprises who export goods should apply for tax refund with tax authorities after the goods are delivered to the exit port and customs clearances are settled. Under the policy of tax refund at ports of shipment, as long as the goods are shipped at the stipulated ports of shipment and exit the Chinese territory at Hainan Yangpu Port, the goods would be deemed as exported after going through the permission for leaving formalities, and apply for tax refund at tax authorities.

### Individual Income Tax (“IIT”)

For the period from 1 January 2020 to 31 December 2024, high-level talents and urgently-needed talents that work in the Hainan FTP will be exempted from the portion of their actual IIT burdens that exceed 15 percent.

It is noteworthy that the high-level talents and urgently-needed talents who enjoy IIT preferences shall work in Hainan FTP, continuously pay social insurances including basic pension in Hainan FTP for no less than 6 months in a calendar year, have employment relationship over 1 year with enterprises or entities registered with substantial operations in Hainan FTP, and shall meet the following thresholds:

high-level talents	urgently-needed talents
Authorized by the various levels of talent administration department of Hainan; or Income derived in Hainan FTP within 1 calendar year exceeds 300 TRMB (can be adjusted according to development of social economy).	In the catalogue of urgently-needed talents in industries in Hainan FTP, which is adjusted annually.

Overseas high-level talents and urgently-needed talents who may not pay Chinese social insurances, in principle should provide evidence documents such as labor contracts to support the employment relationship of over 1 year with the enterprises or entities registered with substantial operations in Hainan FTP only.

## II. TAX PREFERENTIAL POLICY IN THE GREATER BAY AREA

Guangdong-Hong Kong-Macao Greater Bay Area (“Greater Bay Area”) is composed of Hong Kong special administrative region, Macao special administrative region, and Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen, Zhaoqing (“Nine Pearl River Delta Cities”).

### IIT in Greater Bay Area

For overseas high-level talents and urgently-needed talents working in Greater Bay Area, the portion of their individual income tax paid in the nine Pearl River Delta cities in excess of 15 percent of their taxable income will be provided by the government of the nine Pearl River Delta Cities as subsidies, and such subsidies are exempt from individual income tax. Criteria for qualified talents and measures for subsidy granting may be determined by the nine Pearl River Delta Cities independently.

### CIT in Qianhai Zone (Shenzhen)

The qualified enterprises set up in Qianhai Zone (The Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone), whose main business falls in the scope of the industries stipulated in the Preferential CIT Catalogue of Qianhai Zone, and whose income from the main business accounts for no less than 60 percent of the enterprise’s total income, are subject to 15 percent of corporate income tax.

The Catalogue of 2021 version stipulated industries including modern logistics industry, information service industry, technical service industry, cultural innovation industry and business service industry.

### IIT in Qianhai

The recognition measures of high-level talents and urgently-needed talents working in Greater Bay Area are in general updated on an annual basis. According to the latest recognition standards, foreign expatriates holding foreigner’s work permits in China (A type, B type) can reach the threshold of applying for individual income tax subsidies.

### CIT in Hengqin (Zhuhai)

In September 2021, the State Council released “Overall Plan for Building the Guangdong-Macao In-depth Cooperation Zone in Hengqin” (“Cooperation Zone”), which requires improvements in corporate income tax preferential policies. Eligible industrial enterprises in the Cooperation Zone are subject to the corporate income tax at a reduced tax rate of 15 percent, and all the industries that are conducive to Macao’s appropriate economic diversification shall be included in the scope of the policy. Eligible capital expenditures of enterprises can be subject to one-off deduction before tax or accelerated depreciation and amortization in the current period when the expenditures occur. Corporate income tax shall be exempted on the income obtained from new overseas direct investment of tourism, modern services, and high-tech industrial enterprises established in the Cooperation Zone.

### IIT in Hengqin

In January 2022, the MOF and the SAT released IIT preferential policy for domestic and foreign high-level talents and urgently-needed talents working in the Cooperation Zone, which stipulated that during the period from 1 January 2021 to 31 December 2025, the IIT burden in excess of 15 percent are exempted. For Macao residents working in the Cooperation Zone, the IIT burden in excess of that of Macao are exempted. The above mentioned IIT preferential policy can be enjoyed when proceeding the annual tax reconciliation in the Cooperation Zone.

### Taxation for Import and Export in Hengqin

According to “Overall Plan for Building the Guangdong-Macao In-depth Cooperation Zone in Hengqin”, releasing the goods within the “first line” and controlling those within the “second line” are required for the Cooperation Zone.

The “first line” refers to the national border line, which means that it shall continue to implement record-filing administration for goods entering and leaving the Cooperation Zone and Macao via the “first line”, and further simplify the declaration procedures. Except for certain special goods, other goods entering the Cooperation Zone are tax-free (bonded).

The “second line” refers to the middle line between the customs special supervision area and the mainland, which means that duty-free (bonded) goods entering the mainland from the Cooperation Zone via the “second-line” shall be subject to customs procedures in accordance with the relevant provisions on imported goods, and customs duties and import-related taxes. For goods that are produced by enterprises in the Cooperation Zone and do not contain imported materials or that contain imported materials and appreciate in value by 30 percent or more after being processed in the Cooperation Zone, import duties will be exempted when such goods enter the mainland via the “second line”.

### III. CIT FOR VENTURE CAPITAL ENTERPRISES IN CERTAIN AREAS OF PUDONG NEW AREA IN SHANGHAI

Since 1 January 2021, for venture capital enterprises in the certain areas of Pudong New Area in Shanghai, i.e. the Pilot Area of Free Trade Zone of Shanghai China, Lingang New Areas in Pudong of the Pilot Area of Free Trade Zone of Shanghai China and Zhangjiang Science City, the income derived from transfer of shares held for more than 3 years accounting for over 50 percent of the annual share transfer income, are exempted from CIT by 50 percent according to the shareholding percentage by individual shareholders at the year-end; the income derived from transfer of shares held for more than 5 years accounting for over 50 percent of the annual share transfer income, are fully exempted from CIT according to the shareholding percentage by individual shareholders at the year-end.

#### IV. PREFERENTIAL CIT IN WESTERN AREA EXTENDED FOR 10 YEARS FURTHER

For the period from 1 January 2021 and 31 December 2021, enterprises in encouraged industries set up in western areas can be applied to 15 percent CIT rate. The income derived from encourage industries shall account for no less than 60 percent of corporate income. The preferential policy has announced to be extended until 31 December 2030.

*Tax reduction and relief will continue to be the theme of China's tax reform, which provides relief for small, medium and micro enterprises (SMEs) and actively encourages technological innovation. Meanwhile, the rapid development of the digital economy in recent years has challenged the traditional tax system in many ways, and the outbreak of the Covid-19 in 2020 and international tax developments have prompted China's tax authorities to accelerate digital transformation. According to the OECD's two-pillar program schedule, member countries will complete their domestic legislation in 2022 to cope with the new international tax rules. It is foreseeable that China, as a large country with a fast-growing digital economy, will also start to strengthen its supervision on the tax compliance of digital economy practitioners and fully examine how the existing tax laws can better adapt to the development of the digital economy. At the domestic level, in the implementation of Golden Tax Phase IV, China will enter the era of big data tax collection and management, and the tax regulation of personal income tax for high net worth income earners and equity incentives will also be strengthened.*

## I. TAX REDUCTIONS

Tax reduction will continue to be China's primary means to support SMEs and to encourage technological innovation.

On the one hand, many phased tax benefits are renewed in 2022, including:

- General VAT payers providing manufacturing and lifestyle services can continue to receive an additional input tax deduction of 10 percent and 15 percent respectively until the end of 2022;
- The deferring tax payment for manufacturing SMEs for the first and second quarters of 2022;
- The preferential IIT treatment for annual lump-sum bonuses and tax-free allowances for foreign individuals.

On the other hand, affected by the epidemic, tax reduction strength will be continuously increased to cope with the negative impact of the epidemic on taxpayers. The latest tax reduction and fee reduction policies announced are specified as follows:

- Strengthen Refund of Remaining Input Tax Credits (please refer to details of Turnover Tax in Chapter I)
- VAT-Exemption for Small-scale VAT Payers (please refer to details of Turnover Tax in Chapter I)
- Further Relief for Service Industries in Difficulty (please refer to details of Turnover Tax in Chapter I)
- Strengthen the Super Deduction of R&D Costs (please refer to details of Corporate Income Tax in Chapter II)
- General CIT and IIT Relief for SMEs and Self-employed Entrepreneurs (please refer to details of Corporate Income Tax in Chapter II)
- Accelerated Depreciation of Fixed Assets for SMEs (please refer to details of Corporate Income Tax in Chapter II)
- IIT Benefit for Expatriates Continues to the End of 2023 (please refer to details of Individual Income Tax in Chapter III)
- Special Deduction for IIT for child under the age of 3 (please refer to details of Individual Income Tax in Chapter III)
- Relief on “Six Taxes and Two Fees” for SMEs (please refer to details of Other Taxes in Chapter IV)

## II. TAX LEGISLATION AND REFORM

With the Stamp Duty Law formally takes effect on 1 July 2022, China has made great progress in the tax legislation process. In addition, the Land Appreciation Tax Law, the Value Added Tax Law and the Consumption Tax Law have also been released to the public for comments and are expected to complete the relevant legislation in the next phase, while customs duties, real estate tax and urban land use tax will eventually be included in the relevant legislative process.

Real estate tax reform has undoubtedly become a focus of tax reform in the next stage. However, the Ministry of Finance recently said that the conditions for expanding the pilot cities of real estate tax reform are not available in 2022, so it remains to be seen when the real estate



tax reform pilot will be landed. At present, Shanghai and Chongqing are still the only two cities in the whole China to implement the real estate tax pilot.

### III. ELECTRONIC VAT INVOICE AND GOLDEN TAX PHASE IV

With the pilot of “all-electric invoice” and the promotion of “Golden Tax IV”, China’s tax collection and administration has ushered in the era of big data and intelligent supervision.

#### Electronic VAT-Invoice

From December 2021, the pilot project of fully digitalized electronic invoices starts in Shanghai, Guangdong Province and Inner Mongolia. After the implementation of “all-electric invoice”, on the one hand, it can facilitate taxpayers to issue invoices, handle all matters related to invoices through the digital platform, reduce operation costs, and flexibly handle business operations, especially under the epidemic. On the other hand, the use of “all-electric invoice” also provides more available data for tax authorities to supervise the daily operation of enterprises, and also enables the sharing of taxpayers’ tax information among various departments and regions, so that tax authorities can conduct more accurate big data analysis.

It is worth noting that “false VAT invoicing” is still the focus of strict supervision by the tax authorities in the next phase. Relying on electronic invoices, it will be easier for tax authorities to detect illegal acts, which leads to higher requirements for taxpayers’ daily compliance.

#### Golden Tax IV

In 2022, Golden Tax IV will be fully implemented. Under Golden Tax IV, the “non-tax” business will be more comprehensively monitored, and bank information will be shared to conduct inspections on the cell phone numbers, tax status and registration information of the relevant personnel of enterprises.

Under Golden Tax IV, the first and foremost is the information shared by banks for tax purposes, so that the use of private accounts to conceal corporate income will be revealed. For high-net-worth individuals, their personal assets will be more transparent, which will facilitate the tax authorities' IIT collection and administration. Secondly, after the inclusion of "non-tax" business, the tax authorities have comprehensive data about the business processes of enterprises, which makes enterprises more transparent in front of the tax authorities and enables the tax authorities to carry out all-round supervision of enterprises.

Golden Tax IV also puts forward high requirements for enterprises' financial and tax compliance. Enterprises should pay great attention to the use of their invoices, abnormal tax burden rate, tax and social security declaration and the compliance of the use of existing tax incentives.

#### IV. ENHANCED IIT SUPERVISION

In recent years, Chinese tax authorities have increasingly focused on the personal income and tax returns of high net worth individuals. Especially in the global environment of combating cross-border tax evasion, the exchange of bank account information among countries is being implemented in an orderly manner, and China has joined CRS and exchanged account information with nearly 100 countries (regions). For high net worth individuals, global tax identity planning is a common means for them to plan their tax liabilities. However, it should be noted that acquiring foreign nationality is not usually the same as becoming a full tax resident of that country, let alone being able to completely avoid the tax obligation of IIT in China.

In addition, starting from 2022, the income of individual sole proprietorships and partnerships holding equity investments, such as equity shares, stocks and partnership property shares, will be subject to IIT on actual profit. Prior to this, it was a common practice for companies to use individual partnerships to build employee shareholding platforms to implement equity incentives, and partnerships were often able to apply for taxation on deemed profit at a lower rate, which was often much lower than the maximum 35 percent tax rate applied to operating income under actual basis. The

implementation of this policy in 2022 will have a significant impact on companies and employees who implement equity incentives, given the high equity-based income generated under the equity incentive.

## V. REGIONAL BENEFITS TO SHANGHAI PUDONG NEW AREA

According to the policy issued by the State Council in April 2021, China will strongly support the development of Shanghai Pudong New Area, mainly including:

1. For supporting the key technology research and development: the import tax exemption for drugs used in clinical research will be studied; R&D institutions recognized by Pudong can enjoy import tax exemption for imported equipment for their own use and tax refund for purchasing domestic equipment for their own use.
2. For creating world-class innovation industry clusters: based on the implementation experience of Pilot Free Trade Zone and Lingang New Area, the CIT reduction at a rate of 15 percent for five years from the date of establishment for qualified enterprises engaged in the production and R&D of core aspects in key areas such as integrated circuits, artificial intelligence, biomedicine and civil aviation in specific areas of Pudong will be studied.
3. Promote the Pilot Free Trade Zone and Lingang New Area:
  - The construction of special customs supervision areas will be promoted;
  - In areas with conditions in Pudong, tax policies to adapt to the development of overseas investment and offshore business will be studied and explored;
  - On the premise of risk control, the VAT policy to support the export of services for enterprises in Pudong will be studied and explored;
  - On the premise of information sharing among supervisory departments and controlled risks, key enterprises outside the special customs supervision area to perform specific maintenance business will be promoted;
  - On the premise that the tax base will not be eroded and profit will not be shifted, pilot tax arrangement for free trade accounts will be explored.

## VI. TWO-PILLAR PROGRAM COMING SOON

In 2021, the OECD reached consensus with 136 countries (regions) on a major reform of the international tax system and issued a “Statement on the Two-Pillar Program to Address the Tax Challenges of Economic Digitalization”. In the two-pillar program, Pillar One redistributes the taxation rights of global profits of large multinational enterprises to balance the pattern of international tax equity distribution in the context of economic digitalization and address the tax challenges brought by economic digitalization; Pillar Two ensures that multinational enterprises bear no less than a certain level of tax burden in each jurisdiction by implementing a global minimum tax, discourages multinational enterprises from tax evasion and sets a bottom line for tax competition among countries.

### Application of Pillar 1

For multinational companies with global revenues over EUR 20 billion and pre-tax margins of 10 percent or more, profits in excess of 10 percent of revenues will be defined as “residual profits” and 25 percent of the residual profits will be allocated to the market jurisdictions, in which the revenues are used as the allocation factor. For countries with low regulatory capacity, the basic marketing and distribution activities will be simplified and optimized by application of the arm’s length principle.

### Application of Pillar 2

Pillar 2 includes a global minimum taxation of all multinational groups with annual sales of at least EUR 750 million. If this is not ensured by national taxation, an “additional tax” is levied within the group. The aim of the implementation is to limit international tax competition and create more tax justice.

Implementation as early as 2022 with effect from 2023, as originally envisaged by the OECD, is becoming increasingly unlikely. It is to be considered that the implementation from 2024 onwards is realistic. It is expected that China will amend its domestic law accordingly in the near future for proper connection, and multinational groups should pay attention to the corresponding changes and prepare accordingly for the eventual dual-pillar implementation.

## VII. RCEP FORMALLY ENTERED INTO FORCE

On 15 November 2020, the Regional Comprehensive Economic Partnership (“RCEP”) was officially signed and enters into force on 1 January 2022. The members of RCEP include 10 ASEAN countries as well as China, Japan, South Korea, Australia and New Zealand.

The formal entry-into-force of RCEP is still pending and waiting for the domestic legal approval process of each member country. It is foreseeable that the landing of RCEP will have a profound impact on China’s economic environment. Whether for domestic enterprises, foreign companies in China or foreign companies interested in entering the Chinese market, it will form a pattern of both opportunities and challenges.

## VIII. CHINA-EU COMPREHENSIVE AGREEMENT ON INVESTMENT

After seven years’ negotiation, China and the European Commission announced on 30 December 2020 the completion of negotiations on a “Comprehensive Agreement on Investment” (“CAI”). The core elements of the Chinese side are rules against forced technology transfer, commitments on the conduct of state-owned enterprises, comprehensive and transparent rules on subsidies and commitments on sustainable development, as well as further and new market access openings and commitments, such as the removal of quantitative restrictions, equity caps or joint venture requirements in some sectors.

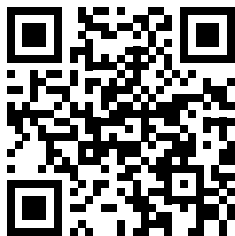


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