2023 China Tax Yearbook
WTS China

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About WTS China

WTS China is led by a formal Big 4 senior tax partner, and comprises experienced tax professions practising at a quality level comparable to Big 4 standard. It has been in China for 20 years, serving finance / tax services predominantly to MNCs. Its clients include multinational groups, national and international medium and small-sized companies, in various industries.

About WTS Global

With representation in over 100 countries, WTS Global has already grown to a leadership position as a global tax practice offering the full range of tax services and aspires to become the preeminent non-audit tax practice worldwide. WTS Global deliberately refrains from conducting annual audits in order to avoid any conflicts of interest and to be the long-term trusted advisor for its international clients. Clients of WTS Global include multinational companies, international m.id-size companies as well as private clients and family offices.

The member firms of WTS Global are carefully selected through stringent quality reviews. They are strong local players in their home market who are united by the ambition of building a truly global practice that develops the tax leaders of the future and anticipates the new digital tax world.

WTS Global effectively combines senior tax expertise from different cultures and backgrounds and offers world-class skills in advisory, in-house, regulatory and digital, coupled with the ability to think like experienced business people in a constantly changing world.

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Preface

07 February 2024

Dear readers,

In 2023, China has achieved a GDP growth of 5.2 percent, surpassing the official target of 5 percent. Look back to 2023, China's economy picked up a bumpy recovery. On one side, the normalization of travel and exchange after the pandemic has brought opportunities for business. On the other hand, China's economy has faced pressures from subdued global economic growth, tight financial conditions, weak demand, a downturn in the property market, etc. The Chinese government has announced a series of measures to boost the economy, including tax policies.

For a recap over 2023, we now offer a complimentary yearbook, a compilation of the tax topics ever reported by WTS China in 2023. They are worthy of another read for their long-term significance, to name but a few:

- Since the start of 2023 after a three-year combat against the COVID-19 pandemic, various tax and financial incentives and grants, varying in focus and magnitude, have been introduced by local governments around China to support the post-pandemic business recovery and expansion.

- Offshore trading was once handcuffed and is now being strategically boosted in some tier-one free trade zones (FTZs) in China with the green light from the State Council and central foreign exchange authority. And Chinese FTZ authorities are also offering financial and tax incentives via various programs to offshore traders. Offshore trading operators can benefit from running their business in an environment as tax-competitive and business-friendly.

- In order to invigorate the capital market and enhance the confidence of investors, the State Taxation Administration ("STA") has announced the extension of a series of tax incentive policies for the stock market and derivatives market.

- Last but not least, the Chinese government has been actively participating in and contributing to the design and development of the BEPS programs, such as the Multilateral BEPS Convention, Pillar One, Pillar Two, etc. So far, much effort has focused on stepping up public awareness and deliberation. It will take some time for the lawmakers to analyse the full implications of the program and make the necessary realignments to the current legislation.

Enjoy your reading. If you need any support, please do not hesitate to contact us.

Best regards

Maggie Han

Partner, WTS China

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No.01
Jan 2023

China optimizes entry/exit measures

In brief

» From 8 January 2023, following the downgrading of COVID-19 pandemic to Category B, China has optimized her entry/exit measures to promote international exchange, including the removal of on-arrival PCR test and quarantine, and resuming visa issuance, renewal and re-issuance for inbound travelers.

In detail

On 26 December 2022, the central epidemic control body under the State Council announced the "*Overall Policy Plan for COVID-19 under Category B Management*" to implement and coordinate the prevention and control of COVID-19 infections, and economic and social development.

From 8 January 2023, the COVID-19 pandemic has been downgraded from Category A to Category B and thus the entry control measures will be loosened accordingly. The details of the new policies are summarized below.

	After 8 January 2023	By 8 January 2023
Entry/exit measures changes	• Requiring inbound travelers to take a polymerase chain reaction (PCR) test 48 hours before the departure and only those with negative results can come to China.	• Removing the circuit breaker mechanism for inbound flights has been abolished from 11 November 2022. • Adjusting the two-PCR-test requirement 48 hours before boarding to one test.
	• Eliminating on-arrival PCR testing and quarantine. Admitting arrivals based on a normal health declaration. • Conducting antigen testing by the Customs on those inbound travelers showing fever symptom or submitting abnormal health declarations. • Suggesting self-isolation or self-care for travelers showing a positive test result and minor sickness but without serious disease with asymptomatic infection. • Suggesting clinic treatments for other cases.	• Requiring "5-day central quarantine + 3-day home quarantine" for all inbound travelers. • Requiring PCR testing on the 1st, 2nd, 3rd, and 5 days since the start of the central quarantine. • Requiring PCR testing on the 1st and 3rd since the start of the home quarantine.
	• Abolishing the red health coding practice for incoming personnel.	• Coding inbound traveling based on the results of PCR testing.
	• Lifting control measures for international passenger flights, including the "Five Ones" measures and seat limits. • Continuing the pre-boarding disease prevention measures and on-board face masking practice.	• Continuing the "Five Ones" measures, i.e. an airline is limited to one route per country and one flight per week.

Some other entry/exit measures have also been optimized starting from 8 January 2023:

1. Resuming ordinary passport applications for Chinese citizens for overseas tourism and visiting friends and relatives, and also a business endorsement for tourism and business trips.

2. Resuming foreigners' applications for ordinary visa (extensions, renewals, re-issuance), for stayover documents (issuance, renewal and replacement), and for residence permits (issuance, extension, re-issuance and replacement).

3. Optimizing the arrangements and visas applications for foreigners to visit China for work resumption, business, study, and family visits; opening up gradually waterways and land ports for passengers' entry/exit.

4. Resuming visa issuance at ports; resuming the 24/72/144-hour visa-free transit policy and issuing temporary entry permits.

5. Resuming Chinese citizens' outbound tourism based on priority arrangements.

WTS China's observation

Following the downgrading of the COVID-19 pandemic to Category B, China's entry and exit measures have been gradually liberalized, which is conducive to the movement of corporate dispatchers and business visitors to China.

In brief, the changes have brought about the following convenience:

- No more quarantine and on-arrival PCR testing;
- No more red coding for new arrivals;
- More international flights to resume; and
- Resumption of visa services.

Companies' management is advised to monitor the new changes and adjust their personnel mobility schedules for projects in China.

No.02
Jan 2023

China has approved the Multilateral BEPS Convention

In brief

» China has submitted its instrument of approval for the “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting” (Multilateral BEPS Convention) to the OECD, which contains the list of reservations and notifications made by the Chinese government.

In detail

25 May 2022 saw China submit its instrument of approval for the “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting” (Multilateral BEPS Convention) to the OECD. The approval of the Multilateral BEPS Convention contains the list of reservations and notifications made by the Chinese government, which becomes effective from 1 September 2022.

Position of mainland China

According to the submitted instrument of approval, China has adopted two kinds of BEPS measures:

1) Minimum standards of BEPS measures (such as dual resident entities, principal purpose test for the prevention of treaty abuse, etc.);
2) Non-mandatory measures that China has already adopted in the double taxation agreements (“DTA”) signed in recent years.

Below is the summary of China’s position:

Convention Articles	China’s Position
Article 2 – Interpretation of terms	*Adopted and applied to 100 DTAs concluded by China as of 25 May 2022*
Article 3 – Transparent entities	*Not adopted*
Article 4 – Dual resident entities	*Adopted*
Article 5 – Application of methods for the elimination of double taxation	*Not adopted*
Article 6 – Purpose of a covered tax agreement	*Adopted*
Article 7 – Prevention of treaty abuse	*Adopted partially (principal purpose test has been adopted)*
Article 8 – Dividend transfer transactions	*Adopted*
Article 9 – Capital gains from alienation of shares or interests of entities deriving their value principally from immovable property	*Not adopted*
Article 10 – Anti-abuse rule for permanent establishments situated in third jurisdictions	*Not adopted*
Article 11 – Application of tax agreements to restrict a party’s right to tax its own residents	*Adopted*
Article 12 – Artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies	*Not adopted*
Article 13 – Artificial avoidance of permanent establishment status through the specific activity exemptions	*Not adopted*
Article 15 – Definition of a person closely related to an enterprise	*Not adopted*
Article 16 – Mutual agreement procedure	*Adopted (Article 16.1 has not been adopted.)*
Article 17 – Corresponding adjustments	*Adopted*
PART VI. ARBITRATION (Article 18 to Article 26)	*Not adopted*

Principal purpose test

China has adopted the principal purpose test articles stipulated in Article 7, namely the "Prevention of treaty abuse". The tax treaty benefit could be refused, if obtaining the tax treaty benefit was one of the principal purposes of any arrangement or transaction. It is therefore crucial for companies to check and review upfront whether an arrange- ment or transaction has reasonable commercial purpose and business substance.

Avoidance of permanent establishment status

China has not adopted all the articles regarding the avoidance of permanent establish- ment status (Article 12 to Article 15). The Chinese tax authorities will continue to apply the DTA articles and domestic rulings (such as Guoshuifa [2010] No. 75) for the perma- nent establishment assessment.

Effective date of the Multilateral BEPS Convention to double taxation agreements

The Multilateral BEPS Convention affects the DTAs depending, in terms of the latter, on when the tax treaty parties have enforced the Multilateral BEPS Convention. As of 30 June 2022, the enactment procedures for the Multilateral BEPS Convention have been completed for 47 DTAs out of 100 adopted DTAs.

No.03
Mar 2023

China continues incentives to spur business growth

In brief

» Various tax and financial incentives and grants, varying in focus and magnitude, are introduced by local governments around China to support the post-pandemic business recovery and expansion.

» Business analysis and incentive application should be planned ahead, especially those businesses seeking to expand or relocate.

In detail

Since the start of 2023 after a three-year combat against the COVID-19 pandemic, various provinces and municipalities in China have kept launching a flurry of initiatives to reinvigorate investments. Some are tax and financial supports while others are administrative facilitation measures. We have highlighted some examples below.

1. Shanghai city
» Tax optimization
1) Simplifying cross-provincial enterprise relocation in the Yangtze River Delta region. Qualified enterprises can resume operation before a tax de-registration is done in the original location.
» Financial support
1) Subsidy up to CNY 100K for Shanghai-qualified new "specialized, refined, featured and new" small-and-medium-sized enterprises; 2) Subsidy up to CNY 300K for state-qualified new "little giant" enterprises; 3) Subsidy up to CNY 500K, or 5% of R&D expenses of the previous year, for four types of high-tech firms (large scale enterprises in manufacturing, construction, retailing, servicing, real estate); 4) Subsidy up to CNY 1 million for retailing enterprises leading industrial innovations or market growth; 5) Subsidy up to CNY 500K for catering enterprises leading industrial innovations or market growth.
2. Ningbo city
» Financial supports
1) Subsidy up to CNY 50 million for new foreign investments in promoted industries; 2) Subsidy up to CNY 5 million for new foreign investments in financial sector (e.g. banking, insurance, securities, QFLP);
3. Heilongjiang province
» Financial supports
1) Subsidy up to CNY 300K for qualified enterprises in wholesale, retail, accommodation, and catering. 2) Subsidy up to CNY 500K per quarter, or 1% of its quarterly incremental revenue, for enterprises achieving a quarterly revenue of CNY 10 million or above and a year-on-year growth of 10% or above, until 30 June 30 2023. 3) Subsidy up to CNY 2 million per year, or maximum 5% of its yearly incremental revenue volume, for online retailing e-commerce enterprises achieving an annual revenue of CNY 30 million or above and a year-on-year growth of 10% or above and pays tax in its registration location.
4. Henan province
» Financial supports
1) Subsidy up to CNY 5 million, or 30% of its investment in equipment and software, for state-qualified new “little giant” enterprises; 2) Subsidy for export insurances: › Full premium subsidy for enterprises with annual export under USD 3 million, insured by the government-authorized blanket insurance platform; › 80% premium subsidy for enterprise with annual export between USD 3 million and 6 million, insured by the government-authorized blanket insurance platform; › 50% premium subsidy for enterprises purchasing their own export credit insurances. 3) Subsidy up to CNY 5 million, or maximum 80% of legal expenses incurred by enterprises for their trade disputes which have reached adjudications. 4) Subsidy of CNY 1 million for talent incubation platforms in provincial cross-border e-commerce parks. 5) Subsidy up to CNY 5 million for province-qualified overseas warehousing enterprises; 6) Subsidy up to CNY 500K for province-qualified foreign trade comprehensive servicing enterprises; 7) Subsidy up to CNY 10 million, on a CNY 100K per USD 1 million paid-in capital basis, for new foreign investments including incremental investments.

WTS China's observation

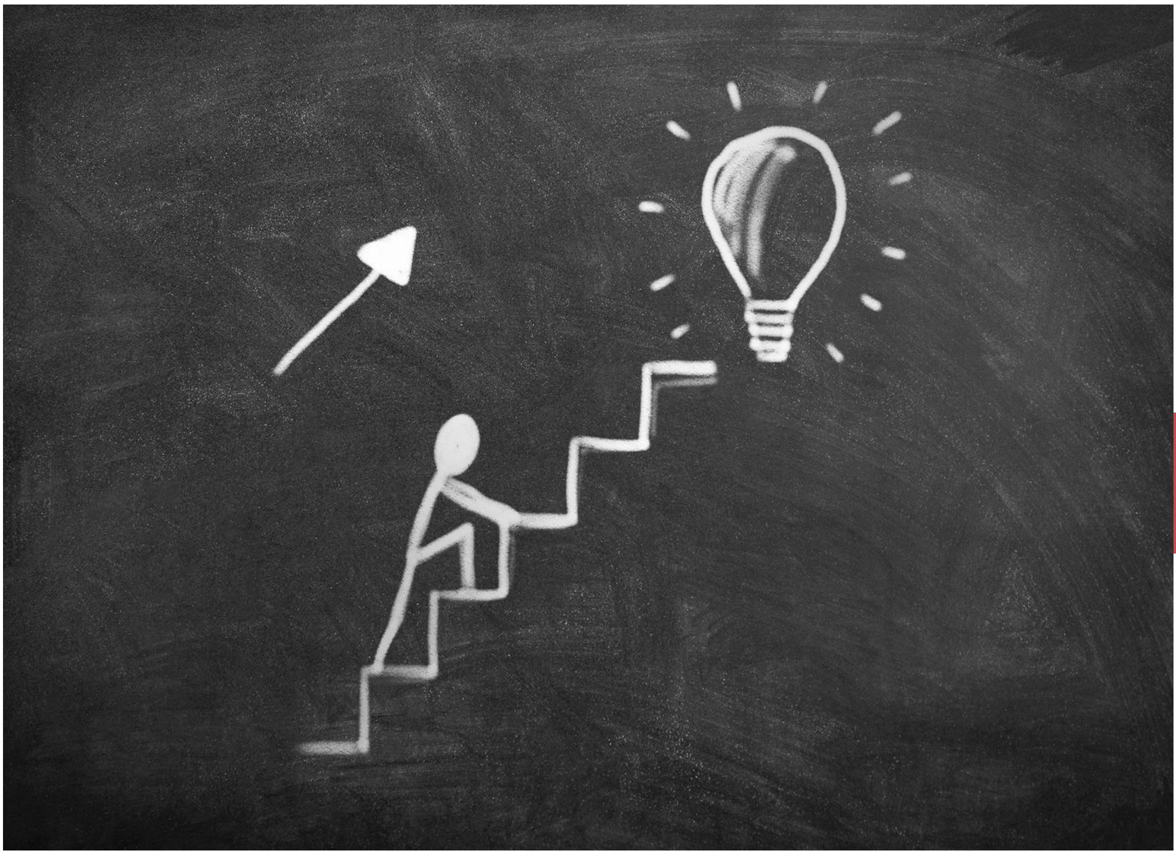
Post-pandemic business-supporting incentive programs abound in diverse formats and names. An incentive application will usually incur a rigorous collection of documentation proof, be based on contractual performance benchmarks and also subject to a deadline. The maximum benefits will go to the early birds. The management of companies is advised to consider the worthiness of assigning a business evaluation and an application for the benefits in the locality of their operation in China.

No.04
Mar. 2023

Input VAT refunds beding scrutinised

In brief

» In light of an increasing number of fraudulent VAT refund claims, the Chinese tax authorities are performing a tiger scrutiny of input VAT credit refund applications.



In detail

In light of an increasing number of fraudulent VAT refund claims, the State Taxation Administration (STA) is announcing a more stringent screening of input VAT credit refund applications.

According to the input VAT credit refund regime, which became effective on 1 April 2019, taxpayers can claim a refund of non-utilised input VAT if they meet all of the following criteria at the time of an application:

- being a small and low-profit entity (in all sectors) or a medium- to large-sized enterprise in designated manufacturing, wholesale or retail sectors;
- scoring a grade of A or B in the tax credit rating system;
- never committed any VAT fraud in tax refunds or false invoicing in the past thirty-six months;
- never been charged twice for tax evasion in the past thirty-six months; and
- never made use of VAT refunds by means of the "refund-upon-payment" or the "refund-after-payment" methods since 1 April 2019.

Local tax authorities, while tasked with a quicker tax refund, are facing an increasing number of false claims. STA is appealing for rigorous scrutiny nationwide into cases involving duty dereliction and noncompliance on the part of tax officers.

STA has recently disclosed numerous fraudulent VAT claims (with two examples summarized below), drawing the public's attention to the risks of non-compliant practices and their consequences.

Case 1
A trading company is detected by big data analysis for committing VAT fraud by concealing revenue, collecting sales proceeds via a personal bank account, understating VAT liability and making false declarations to deceive a VAT refund of CNY 1.4 million. The company is charged with returning the illicit funds and faces a heavy penalty.

Case 2
A tax officer is found guilty of neglecting the discrepancy between the reported income and the data shown in the tax system, resulting in an excessive refund to a taxpayer. The local tax authority has managed to reclaim the tax refund but has held the tax officer personally accountable for the dereliction of duty.

In addition, STA has further reinforced the cross-department collaboration mechanism involving six government agencies to intensify scrutiny over the tax refund administration, risk control and accountability. As highlighted in the disclosed cases, technical tools such as tax big data are also commonly used to track the VAT deduction chain.

Companies are advised to maintain an effective internal review system, especially regarding VAT refund applications, as they could easily invite tax audits.

No.05
Mar 2023

IIT benefits continue for another year

In brief

» The adecade-long preferential individual income tax (IIT) treatments, which should have ended on 31 December 2022, will continue for another year.

In detail

The Chinese tax authority confirmed to the public, at short notice at the beginning of the new year, that the following decade-long preferential individual income tax (IIT) treatments, which should have ended on 31 December 2022, will continue for another year.

1. IIT benefits for stock-based rewards for employees

Under a special IIT filing policy, stock-based rewards are taxed separately from the consolidated income for IIT filing purposes, resulting in a lower IIT rate and burden. This policy has been renewed twice, from 2019 to 2022.

It was just announced that the stated preferential policy on stock rewards will continue for another year, until the end of 2023. Following the same treatment as before, stock-based rewards can be taxed independently from the consolidated income.

2. IIT benefits for the special programmes between the mainland and Hong Kong (HK)

Capital gains from the disposal of HK-listed stocks by individual investors in the Mainland under the Shanghai-HK Stock Connect or the Shenzhen-HK Stock Connect programmes, and the capital gains from the trading of HK fund units under the mutual recognition programme will still be IIT-exempt through 31 December 2023.

3. New IIT treatments on bonuses and perks at work

- Under the current policy, a bonus can be filed for IIT separately from the consolidated income, so as to enjoy a lower IIT rate and IIT burden. However, the policy is supposed to expire by the end of 2023.

  Thus, starting from 2024, if no further renewal is granted for the policy, all bonuses will be taxed together with wages on a consolidated basis, and will therefore be subject to a higher IIT rate.

- Moreover, the current IIT exemption treatment for expatriates' perks (i.e. rental, child education and meal allowances) is supposed to expire by the end of 2023.

The concern that the expatriates' IIT burden might surge after 2023 may revive again. Expatriate employees in China, uncertain if the policy would be granted another period of renewal, would be put on edge again. If a renewal does not take place, the mentioned perks would be taxed for IIT at a rate much higher than that under the current policy, even though some minor deductions are still allowed.

No.06
Mar 2023

China boosting offshore trading business

In brief

» Offshore trading is now being strategically boosted in some tier-one free trade zones (FTZs) in China with the green light from the State Council and central foreign exchange authority. Financial and tax incentives are offered by FTZ authorities to offshore traders.

In detail

Once an ugly duckling and now Cinderella, which is what offshore trading has experienced – a business niche once handcuffed and now being strategically boosted in some tier-one free trade zones (FTZs) in China with the green light from the State Council and central foreign exchange authority.

Offshore trading refers to an offshore purchase-and-sale transaction conducted by a Chinese trading entity with the shipment transported directly from an overseas customs point to another overseas customs point, without arriving in China.

Offshore trading was somehow handicapped by the bureaucratic difficulties in verifying the delivery and fund flow. Traditionally, China's foreign exchange and tax regulations for imports/exports have been blatantly based on customs declarations – which are typically absent in offshore trading, resulting in some feasibility issues: the banks were hesitant in processing funds for imports/exports without actual flow of goods across the border; the tax authorities tended to cast doubt on the exports when assessing VAT refunds, and foreign exchange authorities were uncertain about the identity of offshore suppliers and final customers.

To drive China's service economy further, the central government now sees the time ripe to encourage and support offshore trading, especially in top-ranking FTZs. Thanks to the endorsement from the central government and the cross-function data exchange mechanism, local FTZ authorities can now collaborate with each other to make the business feasible and verifiable. One practical means is to deploy e-platforms to capture and share offshore trading data, making them accessible to the banks, the authorities, and the traders for an efficient and a reliable verification.

In addition, it is observed that some FTZ authorities are also offering financial and tax incentives via various programs to offshore traders on a negotiation basis (WTS China has helped in some of the negotiations). On the whole, offshore trading operators can benefit from running the business in an environment as tax-competitive and business-friendly as in some other jurisdictions (see a short comparison between Shanghai's FTZ and Hong Kong).

	Shanghai (China)	Hong Kong (HK)
Government policy	**Yes.** State Council supports and promotes offshore trading. The FTZ government has also teamed up with local finance and tax bureau, and banks to ensure offshore trading can work smoothly, efficiently and economically.	**No.** HK government cannot instruct the banks to support any transactions. It is up to the banks to decide.
Tax rate	**16%** (reduced from the headline rate at 25% after tax incentives and subsidies).	**16.5%** (could be exempted. However, it could be even higher as the profit could be taxed at investor's level due to the place of effective management).
Free from Customs tariff	**Yes.** Offshore trading is outside China customs regime and not subject to China customs tariff and control.	**Yes.** HK has no customs tariff and control on international trading in general.

Many other FTZs in China (e.g. Beijing, Xiamen, Hainan, and Guangzhou, etc.) have launched their local policies to promote offshore trading.

WTS China has been working in an integrated approach with the local government bureau, banks, and landlords to offer investors a one-stop solution for offshore trading, from entity incorporation, renting office venues, negotiating for tax incentives and grants, opening bank accounts, employments, bookkeeping to tax filings. It allows the operators to conduct offshore trading while enjoying strong financial and logistics supports.

No.07
May 2023

Capital gain taxability of an indirect transfer by a foreign individual

In brief

» An indirect share transfer by a foreign individual could trigger capital gain taxability in China. The foreign individual's tax liabilities in China depend on whether the capital gain derived should be treated as an income source from China.

In detail

The China State Taxation Administration issued Announcement [2015] No.7 to guide the assessment of capital gain tax risk for the indirect transfer of shares in a Chinese company resulting from a share deal. However, this regulation pertains exclusively to corporate income tax obligations and does not apply directly to foreign individuals selling shares.

An indirect transfer of shares in a Chinese company may occur when a German individual sells shares in a German company that owns 100% of a Chinese company's shares. In this scenario, the individual will be liable to pay Chinese personal income tax (PIT) on any income derived from China. We need to assess whether the capital gain from the share deal in Germany should be considered income sourced from China, based on the following elements:

1) Income sourced from China
Article 1.7 of Announcement [2020] No.3 states that income from the transfer of equity in a non-Chinese company is sourced outside China, except where more than 50% of the fair value of the invested enterprise's assets is sourced directly or indirectly from immovables in China across 36 consecutive calendar months before the equity transfer. If the foreign company passes the immovable asset test, the capital gain from the share transfer is deemed to be income derived outside of China and is not subject to PIT in China. Otherwise, if the fair value of the company's assets sourced from immovables in China is over 50%, PIT applies to the capital gain at a rate of 20%.

2) Anti-tax avoidance clause
The Chinese tax authority may make an adjustment if an individual makes arrangements without a reasonable business purpose and obtains improper tax benefits. Therefore, even if the foreign company passes the immovable asset test, the Chinese tax authority may treat the capital gain as income derived from China if it deems the share transfer lacks commercial substance and serves only for tax minimisation purposes.

If the foreign company has commercial substance and holds no valuable real estate, the capital gain tax risk of the individual seller is low. Otherwise, if the foreign company fails the examination, the individual seller will have a PIT obligation in China for the share deal and the buyer will have withholding obligations.

In summary, when the seller in a deal (that results in an indirect share transfer of a Chinese company) is an individual, the seller's tax liability should be assessed from the Chinese PIT aspect. The following factors could be relevant for assessment:

- The tax residency of the individual seller.
- Any properties/investments in China involved in the deal.
- The commercial substance of the foreign company in other countries.

No.08
Aug. 2023

Lingang adds economic substance rules

In brief

» Lingang Special Area in Shanghai has instituted specific economic substance requirements for its tax incentive program - in line with the practices of other low-tax regions in China.

In detail

On 13 June 2023, Lingang Special Area (a state-approved high-profile sub-zone within Shanghai Free Trade Zone) issued its economic substance requirements governing the manufacturing or R&D companies operating in Lingang, seeking to enjoy the 15%-rated corporate income tax (CIT) incentives granted by the zone.

The said rules are never a pioneer since similar requirements have been issued by six other economic zones in China. Lingang's practice still draws extensive attention due to its prominent status and enviable accomplishment in its short (four-year) history – its GDP has grown at an average annual rate of 21.2%, surpassing Shanghai's 4%. It is also the home to Tesla's first super-plant and R&D hub in China.

The new announcement, taking effect retroactively from 1 January 2023, is a sequel to a previous announcement dated 2020. It is issued jointly by four major Shanghai authorities (namely Shanghai Municipal Tax Service, Shanghai Municipal Finance Bureau, Shanghai Municipal Commission of Economic and Information, and the Management Committee of Lingang Special Area).

Lingang's requirements

Lingang sets out the following criteria for economic substance, <u>all</u> of which are mandatory to a tax incentive applicant:

1. The applicant must be a company registered in Lingang and has filed CIT in the zone;
2. The applicant must have maintained a <u>physical</u> presence in the zone, signified by the following evidence:

   - **Fixed business place:** The applicant should prove its in-the-zone presence by maintaining a fixed and equipped business venue or property in Lingang with <u>actual</u> manufacturing or R&D process. It should have concluded contracts in its own name and transacted via its bank accounts in Lingang. In addition, its accounting books should be kept in Lingang;
   - **On-site staff:** The applicant should have hired a number of staff sufficient for its business need. It should pay their wages via its bank account in Lingang; it should have enrolled 50% of its staff in the social security (SS) program of Lingang; *and*
   - **On-site infrastructure:** The applicant should have owned or used hardware or software facilities installed within the zone, which are compatible with its business need.
3. On the contrary, an applicant is considered as <u>failing</u> the substance test in either of the two situations:

   - A company, even though Lingang-registered, has <u>one</u> kind of its assets (i.e. business venue, staffing, and hardware/software facilities) located outside the zone; or

   - A company has transformed its business into a new operation other than production or R&D.

In practice, to facilitate a faster tax incentive application, the announcement has innovated a self-assessment mechanism, allowing an applicant to assess itself and confirm whether it can meet the said substance requirements, based on which its application for CIT incentives can be processed without delay.

Overview

So far, a total of seven economic zones in China, including Lingang, have issued similar substance requirements for their preferential tax regime, being:

1. Lingang : Lingang Special Area, China (Shanghai) Pilot Free Trade Zone
2. Hainan : Hainan Free Trade Port
3. Hengqin : Guangdong-Macao In-Depth Cooperation Zone in Hengqin
4. Nansha : Guangzhou Nansha Pilot Free Trade Zone
5. Pingtan : Pingtan Comprehensive Experimental Zone
6. Qianhai : Shenzhen Qianhai Cooperation Zone
7. Xinjiang : Xinjiang Difficult Area and Two Concurrent Zones

The said zones have all offered to specific or encouraged businesses a preferential CIT rate at 15%, except Xinjiang which offers a five-year tax holiday based on 25%. The following table presents a snapshot of the economic substance requirements of the seven zones:

Physical presence insider the zone										
Zones	Business			Staffing				Finance		
	Property	Facilities	Contracts	Headcount	Wages	SS funds	Stay days	Files	Capital A/C	Current A/C
Lingang	✓	✓	✓		✓	✓		✓	✓	✓
Hainan	✓	✓	✓	✓	✓		✓	✓	✓	✓
Hengqin	✓	✓	✓	✓	✓	✓		✓	✓	✓
Nansha	✓	✓	✓	✓	✓	✓		✓	✓	✓
Pingtan	✓	✓	✓	✓	✓	✓		✓	✓	✓
Qianhai	✓	✓	✓	✓	✓	✓		✓	✓	✓
Xinjiang	✓	✓		✓	✓	✓		✓	✓	✓

WTS China's observation

Lingang's economic substance requirements for the most part have aligned with the general trend in China but offer slightly more flexibility – without demanding within the zone a minimum headcount, a mandatory payment of social security (SS) fund by all staff or a minimum residence days for the employees.

The new practice on the whole is in line with the global trend to combat harmful tax practices (OECD's BEPS Action 5, 2015). As of June 2023, per OECD's review results regarding harmful tax practices, over 100 tax regimes globally under a stringent review have ended up in abolishment or amendment (by introducing substance requirements). Corporate management should recognize that the days of dodging taxes by using "tax haven" places are already gone, especially with the ubiquitous enforcement of substance requirements.

A low headline tax rate is no longer key to the selection of a business place; one should recognize that the economic substance requirements will call for the restructuring of supply chain and functions. Cautious consideration and strategy setting is advised.

China extends multiple personal tax benefits to 2027

In brief

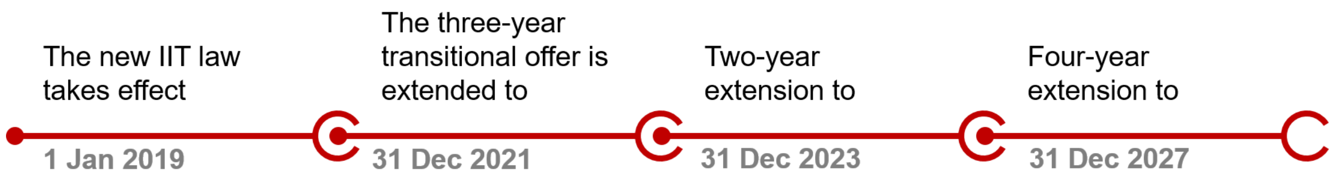
» State Taxation Administration (STA) has won praise from individuals at work, foreign and Chinese, by announcing in one breathe a four-year extension to three set of soon-expiring employee-favored individual income tax (IIT) policies, postponing their expiry date to the end of 2027.

In detail

The tax incentives revitalized by STA are those concerning employee stock ownership plan (ESOP) and annual bonuses for employees of all nationality, and living subsidies for expatriate staff in particular, as outlined below.

Income with IIT incentive	STA Notice	Expiry date	New expiry date
A. ESOP	No. 25 of 2023	31 Dec 2023	31 Dec 2027
B. Annual bonus	No. 30 of 2023	31 Dec 2023	31 Dec 2027
C. Living subsidies	No. 29 of 2023	31 Dec 2023	31 Dec 2027

These IIT incentive policies have been renewed several times, for two or three years each time, depending on the ebb and flow of the economy. A straight four-year extension is considered unusual but is warmly welcomed by individual taxpayers.



A. ESOP's tax incentive

Employees, no matter what nationality, if categorized as Chinese tax residents in IIT filing, can continue to treat their ESOP income as a separate income, instead of as part of the comprehensive income. The rules of the policy remain unchanged as follows:

- ESOP covers stock options, stock appreciation rights, restricted stocks and equity rewards, etc.;
- ESOP income received more than once within a year should be aggregated and taxed together.

B. Annual bonus's tax incentive

All employees' annual bonus received within a calendar year can continue to adopt a preferential IIT filing method, i.e. the bonus can be taxed as a standalone income, separate from the monthly salaries - there is a chance that it may hit a lower IIT rate resulting in a lower tax liability. As it has always been, this benefit can only be used once per year even though an employee may receive several bonuses within a year.

C. Living subsidies' tax incentive

The living overheads of expatriate employees, when covered by their employers, can continue to be exempted from China IIT, which include the following:

- Relocation allowance due to employment adjustment;
- Housing allowance;
- Home leave allowance (two trips a year between China and an overseas hometown);
- Child education allowance;
- Language training allowance for an employee himself or herself; and
- Meals and laundry allowance.

WTS China observation

STA's above generous move conveys that a message that talent recruitment and equity investment will continue to be a core part of the economy stimulation strategy. Yet it remains to be seen how the said policies be dealt with beyond 2027 – the agenda keeps getting on employees' nerves whenever they are due to expire.

No.10
Oct. 2023

Tax incentives rolled out to boost capital investments

In brief

» To invigorate the capital market and enhance the confidence of investors, the State Taxation Administration ("STA") has announced the extension of a series of tax incentive policies.

In detail

To invigorate the capital market and enhance the confidence of investors, the State Taxation Administration ("STA") has announced the extension of a series of tax incentive policies.

Booster to stock market

- Stamp Duty ("SD") on securities transactions is reduced by half from August 28, 2023 (Originally 0.1%, halved to 0.05%).
- Until December 31, 2027, individual income tax ("IIT") exemption continues to be applied to the investment made by Chinese individual on the HK-listed stocks via two special channels the Shanghai-Hong Kong Stock Connect or the Shenzhen-Hong Kong Stock Connect and investment gains from the trading of Hong Kong fund units under the Mutual Recognition of Funds program.

Booster to derivatives market

- Until December 31, 2027, IIT is temporarily exempted to the income earned by overseas individual investors from their investments in commodity options such as crude oil in China approved by the State Council for opening up to foreign investors.
- Until December 31, 2027, VAT is temporarily exempted to the bonded delivery of futures varieties approved by the State Council for opening up to the foreign investors.

To further support entrepreneurship and innovation, the STA has unveiled further tax incentives to support Venture Capital Enterprises.

- Venture capital enterprises and angel investors who have invested directly in start-up science and technology enterprises by way of equity investment for two years can offset their taxable income by 70% of the investment amount in the year in which the equity is held for two years; if there is insufficient offset in that year, it can be carried forward for offset in the following tax years. This incentive shall remain in force until December 31, 2027.
- The tax policies for investing in the Chinese Depository Receipts ("CDRs") of innovation-oriented enterprises at the pilot stage are summarized below.

IIT incentive (from 21 September, 2023 to 31 December, 2025)	Capital gain			Tax Exempt
	Income from dividends and bonuses	Period to hold CDRs	Less than one month (including one month)	Full taxable income amount
			One month up to one year (including one year)	50% to taxable income amount
			More than one year	Tax Exempt
CIT incentive	Corporate investors			Exemption of CIT on capital gain and dividends income
	Public securities investment funds			
	QFIIs and RQFIIs			
VAT incentive	Individual investors			Exemption of VAT on income from sales gain
	Institutional investors			
	QFIIs and RQFIIs			
	Managers of publicly offered securities invest-ment funds			
SD incentive	The transferor shall pay SD on the trading of securities at 0.5 ‰ of the actual transaction amount.			

- A venture capital enterprise may opt for either single investment fund accounting or its annual income overall accounting, to compute the IIT payable amount of its individual partners for income sourced from the venture capital enterprise. The single investment fund accounting shall be subject to IIT computed at a tax rate of 20%. The annual income accounting shall be subject to IIT computed under the item of “operating income” at progressive tax rates from 5% to 35%.

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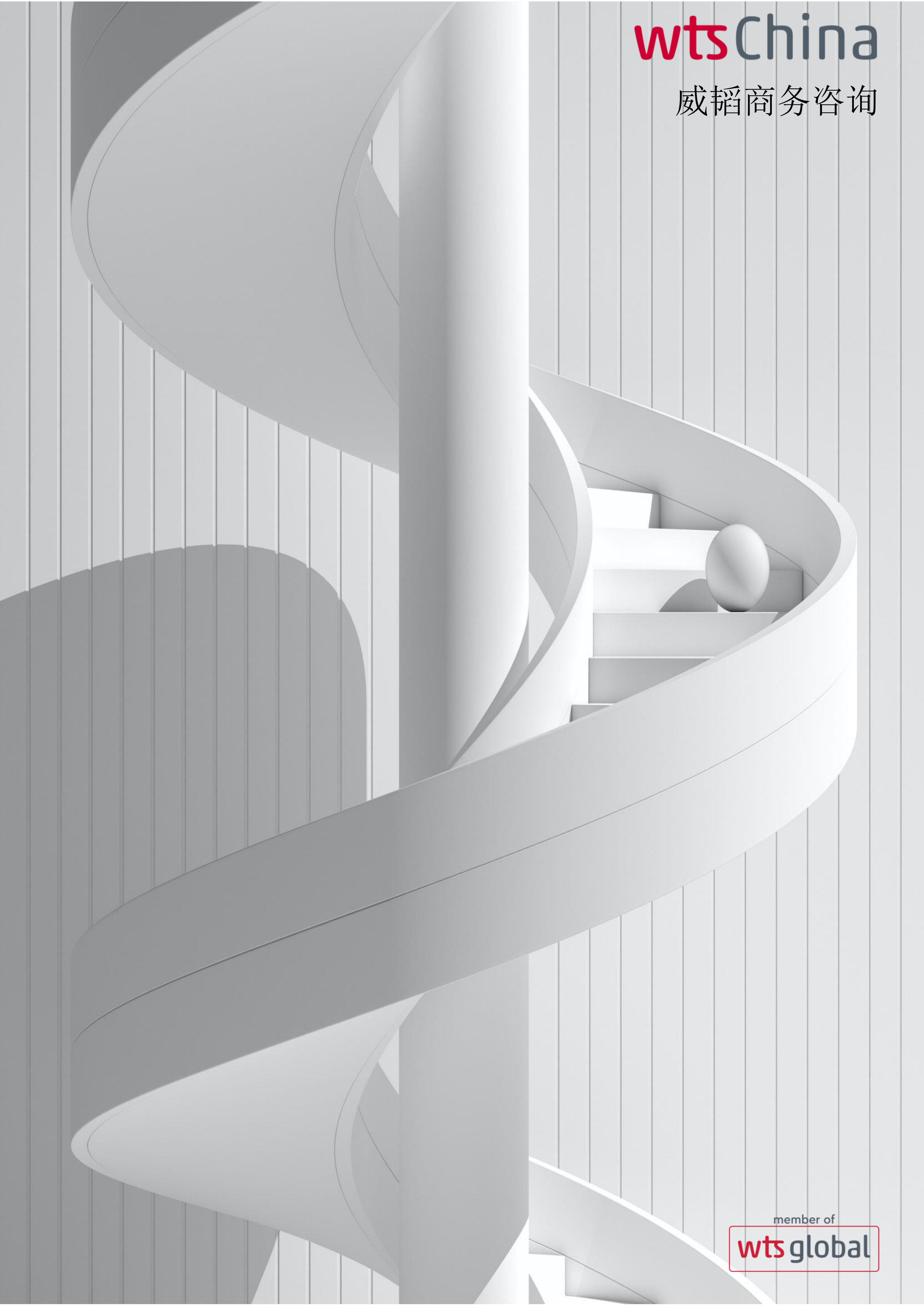
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