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Legal Update

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2022 China Tax Update

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1. Introduction

In this annual China Tax Update, we will discuss the major China tax developments in 2022. The year 2022 has witnessed the recurrence of Covid-19 pandemic, the intermittence of lock-down in certain regions and the outbreak of a large-scale pandemic at the year end. To deal with the disruption and challenges caused by Covid-19 pandemic for individuals and businesses in China throughout 2022, China's government has continued to implement a series of tax and fee cuts policies for market participants to reduce their operational cost and revive the macroeconomy.

In the field of transfer pricing (TP), the State Taxation Administration (STA) published 2021 Advance Pricing Arrangement (APA) Annual Report, describing the latest mechanism, procedures, and implementation of APA program in China, which is of meaningful reference value for multinational companies (MNCs) operating in China, especially the ones with any intention to enter into APAs with China's tax authorities. Meanwhile, Shenzhen customs and tax authority have established a coordination scheme to align the customs valuation and transfer pricing practices on a trial basis. Such action is a beneficial attempt to address the practical challenges the businesses have long faced in ensuring compliance with both customs and tax requirements. These topics are discussed in section 2.

In section 3, we will discuss China's depository of its instrument of approval for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**MLI**"). MNCs with cross-border transactions should keep the MLI in mind when evaluating their tax treaty positions. Furthermore, the Double Taxation Agreements (DTAs) between China and Congo, Angola and Rwanda have come into effect on 1 January 2023. The key terms thereof are also discussed in section 3.

In regards to value-added tax (VAT), the Ministry of Finance (MOF) and the STA issued a series of policies and implementation rules in 2022, allowing qualified enterprises to apply for the refund of excess input VAT to ease the cash burden on enterprises and promote the development of small and micro-size enterprises as well as the enterprises in key industries. More importantly, the draft of PRC VAT Law has been submitted to the Standing Committee of National People's Congress (NPC) for the first round deliberation. And it is expected to be officially promulgated in 2023 the earliest. These topics are discussed in section 4.

With respect to individual income tax (IIT), the preferential tax policy for equity incentive income has been unsurprisingly extended for one additional year and will expire by the end of 2023, as same as the preferential tax policies for annual bonus and expatriates' allowances. Meanwhile, to address the challenges brought by the nation's population aging issue, the government has initiated the private pensions regime as a supplement to the existing public pensions and annuity primarily sponsored by the state and employers. The tax authority has also released preferential tax policy in this regard to promote the implementation of private pensions. Additionally, the governmental authority has newly added the nursing expenses for children under 3 years old to the existing list of additional special deduction items for IIT purpose. Such move is also designed to encourage larger families to deal with the issue of population aging. These topics are discussed in section 5.

With respect to enterprise income tax (EIT), China's tax authorities have made efforts to promote the development of real estate investment trusts (REITs) in the infrastructure sector via preferential tax policies. In addition, the government has provided further tax incentives to enterprises investing in the basic research to encourage scientific and technological innovation, which is also consistent with the nation's strategy for scientific development in response to the rapidly changing international landscape. The details of those policies are discussed in section 6.

In the 2021 China Tax Update released last year,[1] we shared our observations and key takeaways from the existing regional preferential tax policies in some key areas, including Hainan, Qianhai, Lin'gang and Hengqin. In 2022, the local governments have further elaborated on the relevant criteria for certain tax incentive policies and published several implementation rules to regulate the local enforcement. In addition, the State Council released the development plan for Guangzhou Nansha in 2022, adding Guangzhou Nansha into the existing list of regions with local preferential tax policies. We have accordingly updated the summary of relevant tax policies in those regions and will discuss the details thereof in section 7.

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[1] Available at https://insightplus.bakermckenzie.com/bm/tax/asia-pacific-2021-china-tax-update.

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Last but not least, in section 8, we will discuss the implementation rules released by tax authorities, which clarified some practical issues to smoothen the implementation of the PRC Stamp Duty Law ("**SD Law**"). Some of the covered issues are particularly relevant to cross-border transactions. MNCs are advised to consider the relevant PRC SD implications in structuring their transactions.

2. Transfer pricing

2.1 China Advance Pricing Arrangement Annual Report (2021)

In brief

The STA released the China Advance Pricing Arrangement (APA) Annual Report (2021) ("**2021 APA Report**") in both Chinese and English versions on 21 November 2022. Such report is the 13th APA annual report released by the STA outlining the latest mechanism, procedures, and implementation of the APA program in China.

In detail

The 2021 APA Report provides data pertaining to the period from 1 January 2005 to 31 December 2021. As disclosed by the 2021 APA Report, as of 31 December 2021, a cumulative total of 226 APAs have been concluded by China's tax authorities, including 125 unilateral APAs and 101 bilateral APAs. In addition, 137 bilateral APAs and 14 unilateral APAs are in the pipeline (including in the intent phase and application phase).

Particularly in 2021, a total of 9 unilateral APAs and 11 bilateral APAs were signed. Among the 11 bilateral APAs, 8 were signed with Asian countries (regions), 2 were signed with North American countries, and the remaining 1 was signed with an European country. Most of the APAs signed in 2021 still involve manufacturing industry, which demonstrates the role of taxation on serving the real economy.[2] The key takeaways from the 2021 APA Report are set forth as follows.

a. Transaction type

The chart below illustrates the types of transactions involved in the concluded APAs from 2005 to 2021.[3]

Transaction Type	Number of APAs	Percentage
Transfer of the right to use or ownership of tangible assets	189	56.59%
Transfer of the right to use or ownership of intangibles	64	19.16%
Services	80	23.95%
Financing	1	0.30%
Transfer of financial assets	0	0
Total	**334**	**100.00%**

As a result of the service industry development in China, more service companies may wish to apply for APAs to secure tax certainty. Thus, an increasing number of APAs may involve transactions of service nature in future.

b. Time from application to conclusion

The chart below illustrates the time taken to conclude APAs in 2021.

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[2] See the 2021 APA report available at http://www.chinatax.gov.cn/chinatax/n810214/n810606/c5182942/content.html.

[3] As some APAs involve multiple transaction types, the total number of related party transactions is greater than the number of APAs.

Type	Time from Application to Conclusion (2021)		
	≤ 24 months	> 24 months	Total
Unilateral	7	2	**9**
Bilateral	2	9	**11**

The chart below illustrates the time taken to conclude APAs from 2005 to 2021.

Type	Time from Application to Conclusion (2005-2021)		
	≤ 24 months	> 24 months	Total
Unilateral	110	15	**125**
Bilateral	51	50	**101**

Most of China's unilateral APAs were concluded within 24 months, and only 12% of them took more than 24 months. While bilateral APAs generally took more time, 50.5% were concluded within 24 months, and the remaining 49.5% were concluded in more than 24 months.

The time required to complete the entire APA process depends on many factors including the type of APA requested (i.e., unilateral, bilateral, or multilateral), the complexity of transactions involved, the quality of the documents prepared by the taxpayer, the logistics of the review process performed by competent authorities. It is encouraged for MNCs to get their tax advisors involved at an early stage of the whole process to improve the efficiency and shorten the timeframe for APA conclusion.

c. Transfer pricing methods

The chart below shows the transfer pricing methods applied in the concluded APAs from 2005 to 2021.[4]

Transfer Pricing Method	Number of APAs	Percentage
Comparable uncontrolled price (CUP)	8	2.91%
Resale price	2	0.73%
Cost plus	21	7.64%
TNMM - Full cost mark up	141	51.27%
TNMM - EBIT operation margin	82	29.82%
TNMM - ROA	2	0.73%
TNMM - Berry Ratio	0	0
Profit split	12	4.36%
Other	7	2.55%
Total	**275**	**100.00%**

The data indicates that the transactional net margin method (TNMM) is the most commonly used transfer pricing method, being used 225 times and accounting for 81.82% of all the applied transfer pricing methods. The most commonly used profit level indicators are the full cost mark-up (used in 141 APAs) and EBIT operating margin (used

[4] Some APAs involve two or more types of transactions and multiple transfer pricing methods may be used.

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in 82 APAs). The second most popular transfer pricing method is the cost plus method, being used in 21 of the concluded APAs. The other transfer pricing methods tend to be applied less frequently in practice, as the CUP method requires a very high standard of comparability for application and the resale price method and profit split method require a heavy amount of information regarding the transaction and pricing. However, the STA and local tax administrations have been still exploring the use of such less commonly adopted methods where appropriate, such as the profit split method used for transactions where both parties to the transaction have made significant contributions to the value creation or where there exists the location specific advantages such as market premium or cost savings.

d. Industries covered by concluded APAs

The chart below illustrates the industries covered by the concluded APAs from 2005 to 2021. 78.76% of the APAs signed from 2005 to 2021 involve manufacturing industry.

Industry involved	Number	Percentage
Manufacturing	178	78.76%
Leasing and commercial services	9	3.98%
Wholesale trade and retail	25	11.06%
Transportation, warehousing, and postal services	5	2.21%
Scientific and technical services	3	1.33%
Information transmission, software and information technology services	3	1.33%
Electricity, thermo, gas and water generation and supply	1	0.44%
Construction	1	0.44%
Catering	1	0.44%
Total	**226**	**100.00%**

Our observations

In recent years, the Chinese government has been working hard to develop a more transparent, predictable and accessible business environment for MNCs. The steady growth of the number of concluded APAs reflects both the taxpayer's and the Chinese tax authorities' will to secure the tax certainty beforehand.

Against this backdrop, we have observed that:

- Chinese tax authorities become increasingly open to accelerate the APA process to confirm compliance with the arm's length principle. The STA released Bulletin [2021] No. 24[5] in 2021 to provide a new simplified process for the administration of unilateral APAs (UAPA), in order to optimize business environment and make the process of UAPA more efficient. The simplified process, if worked as planned, would enable taxpayers to obtain an UAPA within a year and achieve certainty on a fast track. This would increase the overall value of the UAPA and its usefulness to MNCs.

- As indicated in the 2021 APA Report, an APA request that presents innovative application of transfer pricing methods or high-quality quantitative analysis for intangibles, cost savings or market premiums will merit the STA's prioritized attention.

[5] The Notice of the STA on Matters regarding the Application of the Simplified Procedure for Unilateral Advance Pricing Arrangements, STA Bulletin [2021] No. 24, dated 26 July 2021 and effective from 1 September 2021.

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- In 2022, Shenzhen Tax Service and Shenzhen Customs jointly released Circular [2022] No. 62 ("**Circular 62**")[6] to explore the way of joint administration and synergetic law enforcement by both customs and tax departments for the imported goods from related parties. Circular 62 applies to companies in Shenzhen on a pilot basis, and it may ultimately be replicated elsewhere in China if proved successful. MNCs in China are encouraged to consider and evaluate the implication of, and how they may benefit from, the implementation of this policy. The details thereof are discussed in the section 2.2 below.

2.2 Aligned arrangement of customs valuation and transfer pricing

In brief

On 18 May 2022, Shenzhen Customs and Shenzhen Tax Service jointly issued Circular 62 which calls for better coordination and information exchange between customs valuation and transfer pricing administration.

In detail

The two sets of rules, respectively implemented by the tax authority and customs, currently lack alignment and apply in significantly different ways for the administration of intercompany pricing. In some respects, the tax authority and customs are in fact working toward competing objectives to maximize their respective tax/duty collection.

More importantly, under the existing customs valuation rules and practices, there is no official mechanism to allow for adjustments and retrospective amendments to customs declaration forms previously filed. For MNCs engaged in the import and trade of goods, this presents practical difficulties when making retrospective transfer pricing adjustments to the purchase prices of imported goods to meet the targeted profit level under their transfer pricing policy. Consequently, MNCs often try to avoid such adjustments and typically only accept such adjustments as a result of customs audits that require them to upwardly adjust their prices for the sole purpose of recovering "underpaid" import duties and taxes. In some cases, given the practical challenges in meeting transfer pricing requirements, MNCs may approach customs on an ad hoc basis to negotiate for practical solutions on a case-by-case basis. Even in those circumstances, MNCs may still not be allowed to amend their customs declaration forms or process foreign exchange payment in and out of China for the adjusted import price.

Given the above challenges, MNCs currently face considerable practical difficulties in making any retroactive transfer pricing adjustment, which is sometimes important to meet transfer pricing requirements.

The major breakthrough offered by Circular 62 is that it provides an aligned approach for customs and the tax authority to allow a company that has an APA with the tax authority to make retrospective adjustment to its import price of goods, most likely on a yearly basis, to ensure that the actual price meets the targeted income level, or more specifically, the median of the comparable range, set by the APA. Such adjustment, according to Circular 62, may either be upward or downward, depending on the actual financial performance (e.g., profit margin) of the company, as compared to the targeted income level.

To participate in the program, a company should simultaneously submit the required package, which consists of: (1) an application for customs advanced ruling; (2) an application for APA; and (3) an application for the "aligned arrangement" to both Shenzhen Customs and Shenzhen Tax Service to initiate the negotiation process with both authorities. The customs and tax authority will conduct a joint interview with the applicant and align on the agreed approach. That means the authorities are expected to communicate with each other and to reach an agreement on the key considerations, including the applicable transfer pricing method, benchmark, profit target and comparable range, etc. If the authorities cannot align on these key considerations, the application for the "aligned arrangement" should be rejected.

Once the customs and tax authority have aligned on these considerations, the customs, tax authority and the

[6] The Notice of Shenzhen Customs and Shenzhen Tax Service on Related Matters concerning the Coordinated Administration of Transfer Pricing of Imported Goods from Related Parties, Shen Guan Shui [2022] No. 62, dated and effective from 18 May 2022.

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company will enter into a tripartite memorandum to memorialize the key terms, such that they become formalized and enforceable amongst the parties. Once signed, the memorandum would be binding for a period of three calendar years, unless the key assumptions are no longer applicable or otherwise revoked by the company.

Our observation

The coordinated administration mechanism under Circular 62 is a meaningful attempt to address the long-standing conflicts and differences between the customs and tax authorities in the supervision of the prices of imported goods from related parties. In this regard, Circular 62 represents a significant step forward taken by the relevant authorities to resolve the challenges that businesses have long faced in ensuring compliance with both customs valuation and transfer pricing requirements. Meanwhile, further details on the implementation of Circular 62 are expected and there are still gaps to be bridged by the authorities in the practical implementation of the "aligned arrangement". For further details, please refer to the previous tax newsletter we released in August 2022.[7]

The implementation of Circular 62 also clearly underscores the benefits of putting an APA in place for MNCs with operations in China. From a customs perspective, Circular 62 provides an additional reason for MNCs to consider obtaining an APA as a viable long-term solution to ensure full compliance with the tax and customs rules. Before submitting such application, however, companies should at least carefully weigh the risk and implication in selecting certain benchmarks for its transfer pricing documentation against the resulting customs valuation implication and ensure that existing transfer pricing and customs approaches are anchored on a robust defense documentation in case they are subject to scrutiny during this process.

Although the scope of implementation for Circular 62 is currently limited to companies operating in Shenzhen, it is hoped that the regime can ultimately be implemented nationwide once it proves successful.

3. Tax treaty developments

3.1 China's depository of ratification instrument for BEPS MLI[8]

In brief

On 25 May 2022, China deposited its instrument of approval for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("**BEPS MLI**"), which entered into force on 1 September 2022 for China.

In detail

The MLI was developed under the 2013 BEPS Action Plan 15 as a mechanism to simultaneously update existing bilateral double tax agreements (DTAs) between relevant jurisdictions. The OECD released the MLI on 24 November 2016, and China was one of the jurisdictions that endorsed the MLI.

a. China's concluded DTAs to be covered by the MLI

China listed 100 out of its existing 112 DTAs as covered tax agreements (CTAs) for the MLI.[9] As of 30 June 2022, among the 100 CTAs, 47 counterparty jurisdictions have selected their DTAs with China to be covered by the MLI

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[7] See the China Tax Update issued in August 2022, available at https://insightplus.bakermckenzie.com/bm/tax/china-2022-q2-tax-update.

[8] The main content of this section was already covered in the China Tax Update issued in August 2022, available at https://insightplus.bakermckenzie.com/bm/tax/china-2022-q2-tax-update.

[9] The excluded DTAs include the treaties with Chile, India, New Zealand, Spain, Congo, Angola, Rwanda, Kenya (yet to be effective) and Argentina (yet to be effective) and the double taxation arrangements with Macau, Hong Kong and Taiwan, PRC.

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and have deposited their instrument of approval with the OECD, and the MLI will enter into force for the DTAs pursuant to Article 35 of the MLI.[10]

b. China's MLI positions

China's MLI positions in its instrument of approval are largely consistent with its positions at the time it signed the MLI in 2016.

- **Principal purpose test (PPT) to prevent treaty shopping activities:** Article 7 of the MLI proposes the PPT and limitation on benefits (LOB) rules to prevent treaty abuse activities. China has chosen to adopt the PPT, which denies treaty benefits if one of the principal purposes of an arrangement or transaction is to obtain treaty benefits.

  Compared to China's domestic general anti-avoidance rules, which target arrangements or transactions with the sole or main purpose of obtaining tax benefits, the PPT appears to have a broader scope and may potentially impact arrangements or transactions that have reasonable commercial purposes.

- **Holding period for dividend:** China has chosen to adopt the 365-day look-back period rule for the purpose of determining the minimum holding period for reduced withholding tax rate on dividend.[11] Since China already has a one year look-back period rule under its domestic tax law, the change should not impact MNCs' current treaty positions.

- **Capital gain from alienation of shares or interests of entities deriving value primarily from immovable properties:** China has chosen to update the treaty article relating to disposal of shares or interests in land-rich entities by expanding the scope of the article to cover disposal of interests in partnerships and trusts with immovable properties. Notably, China reserved on the 365-day look-back period rule for the purpose of determining whether an entity was land-rich at any point. This is because China already has a three-year look-back period rule under its domestic tax law.[12]

- **Hybrid mismatch (tax transparent entities):** China reserved on the article relating to tax-transparent entities.[13] One reason for the reservation is that China has not finalized domestic tax rules for tax-transparent entities and would prefer to negotiate such rules on a bilateral basis.

- **Dual resident entities:** China has chosen to adopt article 4 of the MLI, which provides that the tax residency of a dual resident entity should be determined by MAP rather than by defaulting to the place of effective management. In the absence of a mutual agreement between the competent tax authorities, the entity may not be entitled to treaty benefits unless the competent authorities agree otherwise.

- **Avoidance of PE status:** China has chosen not to update the PE articles and not to adopt the proposals to address commissionaire arrangement, specific activity exemption and contract-splitting scheme. However, China has been pushing out the OECD on the PE issue. Even before the BEPS project, China had developed its own interpretation of PE that aligns with the new principles under the MLI.[14]

- **MAP and arbitration:** China reserved on article 16 of the MLI that a taxpayer can present a MAP request to

[10] Article 35 of the MLI provides a different effective date for taxes withheld at source and other taxes levied by a contracting jurisdiction.

[11] Article 8(1) of the MLI.

[12] See the Notice of STA on Issues Concerning the Capital Gains Clause in Tax Treaties, STA Bulletin [2012] No. 59, dated and effective form 31 December 2012.

[13] Article 3 of the MLI.

[14] See the Circular on Issuing the Interpretations on the DTA and its Protocol between China and Singapore, Guo Shui Fa [2010] No. 75, dated and effective from 26 July 2010.

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either contracting state. China maintains its position that a taxpayer can only initiate a MAP request with the competent tax authority of the taxpayer's resident jurisdiction or state of nationality (for non-discrimination cases) and that the competent authority will implement a bilateral notification or consultation process. Meanwhile, China has opted out of the article on mandatory arbitration.

Our observation

As anticipated, China has chosen not to adopt many of the MLI articles that are not required under the minimum standard. However, this is not to say that MNCs can underestimate the implication of the MLI's implementation in China. MNCs with cross-border transactions should keep the MLI in mind when evaluating their treaty positions. As discussed above, one significant modification to China's DTAs is the PPT. Although the ultimate impact of the PPT remains unclear, MNCs that wish to claim treaty benefits should expect China tax authorities' treaty administration to be enhanced to accommodate the change brought by the MLI, thus creating additional burden and risk for MNCs.

Another trend we observed in recent years is that China tax authorities exchange information with their foreign counterparts more frequently. Therefore, MNCs should be mindful that information historically not available to China tax authorities may become more visible to China tax authorities in the context of MLI when assessing their treaty positions.

Although China has opted out of the relevant MLI articles, it has unilaterally developed its own interpretation of PE that aligns with the new principles under the MLI. Therefore, MNCs with cross-border transactions in China should continue to monitor their PE position in China.

3.2 DTAs with Congo, Angola and Rwanda

In brief

On 27 June 2022, the STA released Bulletin [2022] No. 13 ("**Bulletin 13**")[15] to announce the implementation of the DTAs between China and Congo, Angola, and Rwanda. All those DTAs will become effective from 1 January 2023.

In detail

The key terms of the above-mentioned DTAs are summarized as follows.

Key Terms	China-Congo DTA	China-Angola DTA	China-Rwanda DTA
Permanent Establishment			
Construction PE	A building site or construction or installation project constitutes a PE only if it lasts more than six months.	A building site, a construction, assembly or installation project or supervisory activities in connection therewith, constitutes a PE but only if they last more than 183 days.	A building site, a construction, assembly or installation project or any supervisory activity in connection therewith will constitute a PE but only if they last for more than 6 months in any 12-month period commencing or ending in the fiscal year concerned.

[15] The Notice of STA on the Entry-into-Force and Implementation of DTAs and Protocols between China and Congo, Angola, and Rwanda, STA Bulletin [2022] No. 13, dated and effective from 27 June 2022.

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Natural resource PE	N/A	An installation or structure used in the research or exploration for natural resources constitutes a PE provided that it continues for not less than 90 days.	Activities that consist of, or are connected with, the exploration for or exploitation of natural resources will constitute a PE if they are carried on for a period or periods aggregating more than 183 days within any 12-month period commencing or ending in the fiscal year concerned.
Withholding tax rates			
Dividends	Exempt - if the beneficial owner of the dividends is the government or political subdivisions, local authorities thereof, or the central bank, etc.; 5% - if the beneficial owner of the dividends is a company that holds directly at least 25% of the capital of the company paying the dividends; 10% - for all other cases.	Exempt - if the beneficial owner of the dividends is the government or political subdivisions, local authorities thereof, or the central bank, etc.; 5% - if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends throughout a 365-days period that includes the day of the dividend payment. 8% - for all other cases.	7.5%
Interest	Exempt - if the interest is paid to the government or political subdivisions, local authorities thereof, or the central bank, etc.; 10% - for all other cases.	Exempt - if the interest is paid to the government or political subdivisions, local authorities thereof, or the central bank, etc.; 8% - for all other cases.	Exempt- if the interest is paid to the government or political subdivisions, local authorities thereof, or the central bank, etc.; 8% - for all other cases.
Royalties	5%	8%	10%
Technical services[16]	N/A	5%	10%

[16] The fees for technical services refer to the payment in consideration for any service of a managerial, technical, or consultancy nature except for certain prescribed payments.

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Capital gains	China may tax a Congo tax resident on: (1) gains from the disposal of immovable property in China; (2) gains from the disposal of movable property forming part of the business property of a PE in China; (3) gains from the disposal of shares deriving more than 50% of their value directly or indirectly from immovable property in China.	China may tax an Angola tax resident on: (1) gains from the disposal of immovable property in China; (2) gains from the disposal of movable property forming part of the business property of a PE in China; (3) gains from the disposal of shares or comparable interests if, at any time during the 365 days preceding the alienation, the shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property in China.	China may tax a Rwanda tax resident on: (1) gains from the disposal of immovable property in China; (2) gains from the disposal of movable property forming part of the business property of a PE in China; (3) gains from the disposal of shares deriving more than 50% of their value directly or indirectly from immovable property in China; (4) gains from the disposal of shares if the alienator, at any time during the 365 days preceding the alienation, held directly or indirectly at least 25% of the capital of that company.

Our Observation

The China-Angola DTA and China-Rwanda DTA both include an uncommon article (i.e., fees for technical services). This article has only been included in a few DTAs entered into by China, e.g., the China-India DTA. MNCs are encouraged to refer to the full text of the relevant DTAs for further details and resort to tax advisors for assistance if they have business activities connected to both China and one of those countries.

4. Value-added tax

4.1 Excess input VAT refund policy for qualified enterprises

In brief

On 21 March and 22 March 2022, the MOF and the STA issued Bulletin [2022] No. 14 ("**Bulletin 14**")[17] and STA Bulletin [2022] No. 4 ("**Bulletin 4**")[18] implementing the excess input VAT refund policy proposed under the Government Work Report.[19] The new policy allows the small- and micro-size enterprises ("**SMEs**") and enterprises in specific industry sectors to apply for a one-off refund of outstanding input VAT credits and a monthly refund of incremental input VAT credits. On 7 June 2022, the MOF and the STA issued Bulletin [2022] No. 21 ("**Bulletin 21**")[20] to expand the scope of excess input VAT refund to companies in seven more industries, in addition to the ones

[17] The Notice of MOF and STA on Further Implementing the Excess Input VAT Refund Policy, Bulletin [2022] No. 14, dated 21 March 2022 and effective from 1 April 2022.

[18] The Bulletin of STA on Administrative Matters Related to Further Implementing the Excess Input VAT Refund Policy, STA Bulletin [2022] No. 4, dated 22 March 2022 and effective from 1 April 2022.

[19] On 5 March 2022, China's Premier Li Keqiang delivered a government work report at the opening meeting of the fifth session of the 13th National People's Congress, which highlights the government's tax policy priorities for 2022 including the refinement of the excess input VAT refund policy, available at http://www.gov.cn/zhuanti/2022lhzfgzbg/index.htm.

[20] The Notice of MOF and STA on Expanding the Scope of Industries Eligible for the Excess Input VAT Full Refund Policy, Cai Shui [2022] No. 21, dated 7 June 2022 and effective from 1 July 2022.

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already eligible. The new policy for excess input VAT refund is proposed in the face of growing pressure on China's economy, with the purpose of easing cash flow burden on small enterprises and the enterprises in key industries. Meanwhile, it also represents a significant step forward taken by the Chinese government to refine China's VAT regime and align it with the international common practice.

In detail

Previously, the taxpayers in most cases could not get the refund of their excess input VAT and were only allowed to carry them forward to offset the future output VAT. Such mechanism is distinct from the common practices in other jurisdictions and may even impose an undue cash burden on a few enterprises, in particular, those with large initial capital expenditure and timing mismatch of cost and revenue.

The excess input VAT refund policy was initially introduced under Bulletin [2019] No. 39 ("**Bulletin 39**") on a trial basis starting from 1 April 2019.[21] Prior to the introduction of such policy, enterprises were only allowed to carry forward their excess input VAT to offset their future output VAT. Bulletin 39 sets out the conditions and calculation methods of the VAT refund mechanism that are still relevant today. Pursuant to Bulletin 39, only 60% of the incremental excess input VAT arising on or after 1 April 2019 is allowed for refund.

Bulletin [2019] No. 84[22] and Bulletin [2021] No. 15 ("**Bulletin 15**")[23] slightly revised the conditions and calculation methods under Bulletin 39 for qualified enterprises in the specified advanced manufacturing industries. Among other changes, Bulletin 15 increases the incremental excess input VAT refund percentage from 60% to 100%. Whereas, the accumulated balance of excess input VAT prior to 1 April 2019 still remains nonrefundable.

Bulletin 14 expands the quantum of refundable excess input VAT to cover the accumulated balance of excess input VAT for SMEs and qualified enterprises in the designated industries, meaning SMEs and qualified enterprises would be able to apply for a 100% refund of their accumulated balance of excess input VAT.

For the details of eligibility scope, refund mechanism, conditions, and application timeline, etc., please refer to our tax newsletter issued in March 2022.[24]

Our observation

Bulletin 14 represents a significant step forward taken by the government in refining China's VAT system and benefits a wide spectrum of enterprises in different sizes and industries. As disclosed by the STA's senior officials in a press conference held on 31 January 2023, approximately RMB 2.46 trillion worth of VAT credits were refunded to taxpayers' accounts in 2022, which is larger than the accumulative sum of the refunded VAT credits of the preceding three years.

Meanwhile, under the pressure of large-scale refund of excess input VAT, tax authorities have strengthened their supervision, examination, and auditing on the refund applications as well. It's important to note that the defraud on the application for uncredited VAT refund is not an independent tax-related offense in most cases. Instead, it may associate with the actions such as concealing income or acquiring falsified invoices to artificially exaggerate input VAT. Therefore, in the cases related to excess input VAT refund, the tax authorities generally investigated the suspicious taxpayers retrospectively for the past three years as well as their upstream and downstream enterprises

[21] The Bulletin of MOF, STA and General Administration of Customs (GAC) on Relevant Policies Deepening the VAT Reform, Bulletin [2019] No. 39, dated 20 March 2019 and effective from 1 April 2019.

[22] The Bulletin of MOF and STA on Clarifying the Excess Input VAT Refund Policy for Certain Taxpayers in the Advanced Manufacturing Industry, Bulletin [2019] No. 84, dated and effective from 31 August 2019.

[23] The Bulletin of MOF and STA on Clarifying the Excess Input VAT Refund Policy for Taxpayers in the Advanced Manufacturing Industry, Bulletin [2021] No. 15, dated and effective from 23 April 2021.

[24] See the China Tax Update issued in March 2022, available at https://insightplus.bakermckenzie.com/bm/tax/china-tax-update_2. Please note that Bulletin 21 was not covered in the previous newsletter as it was not released yet as of the issuance date of that newsletter.

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along the invoice chain, and have sanctioned plenty of enterprises with historic compliance issues. By the end of 2022, the tax authorities have identified a total of 7,813 enterprises with fraudulently or illegally obtaining input VAT refunds, and made 716 typical cases public throughout the year.

Of note, the new refund policy may not be a one-time tax holiday for taxpayers. As discussed in the section 3.2 below, the recently released draft of PRC VAT Law provides that the VAT payers are allowed to either carry forward the excess input VAT to offset their future output VAT or get the excess input VAT refunded. Once the refund mechanism for the excess input VAT is enacted into the law through the VAT legislation, it will provide more tax certainty on the taxpayers and further guarantee the neutrality of VAT.

4.2 The draft of PRC VAT Law

In brief

The draft of the PRC VAT Law ("**Draft VAT Law**") has been submitted to the Standing Committee of the NPC for the first round deliberation on 27 December 2022. According to the PRC Legislation Law and prior tax legislation experience, it is possible that the VAT Law will be formally promulgated after two or three rounds of deliberation and approval of the NPC in 2023.

In detail

In comparison with the prevailing VAT rules, the Draft VAT Law contains some important changes which will have substantial implications on the taxpayers once officially enacted. The key takeaways from the Draft VAT Law are set forth below with our comments for taxpayers' consideration.

Items	Provisions in the Draft VAT Law	Comments
Scope of taxable activities	Taxable activities include sales of goods, services, intangible assets, immovable property and imports of goods within the territory of China.	"Processing, repairs, and replacement services" in the prevailing VAT rules has been covered by the wording of "services" and not separately listed anymore. Although the financial products are of different features compared to general services, it's still covered under the "services" category in the Draft.
Place of supply	"Within the territory of China" means: • Goods: the place of origin or the location of the goods is within China; • Services and intangible assets: they are consumed within China or the seller is a domestic entity or individual; • Immovable property and the right to use natural resources: immovable property or the natural resource is located within China; • Financial products: they are listed within China or the seller is a domestic entity or individual.	Considering the complexity of real life transactions, it is hoped that the lawmaker will further clarify on the determination of consumption place for the sales of services and intangible assets.
Deemed sales	The following scenarios shall be deemed as taxable transactions and subject to VAT: • Use of self-produced goods or goods processed on commission for welfare or individual consumption purposes;	Compared to the prevailing VAT rules, the Draft does not include consignment sales, inter-city transfers among branches, capital injection, distribution-in-kind to shareholders and the free-of-charge provision of services in the

	• Free-of-charge gifts; • Free-of-charge transfer of intangible assets, immovable property or financial products. • Any other circumstances to be stipulated by the MOF and the STA.	scope of deemed sales. Meanwhile, the Draft specifically addresses that free-of-charge provision of "financial products" is subject to deemed sales.
Non-taxable items	The following scenarios are not taxable transactions and not subject to VAT: • Services provided by employees to employers for wages and salaries; • Compensation for expropriation or requisition in accordance with the provisions of the law; • Collection of administrative fees and governmental funds; and • Receipt of interest income from deposits.	It's important to note that the Draft does not include a "catch-all" clause therein, meaning that the non-taxable items are limited to what's specified in the Draft.
Application of the levy rate under simplified taxation method	The levy rate for small-scale VAT taxpayers under the simplified taxation method is set at 3%.	The Draft does not mention the prevailing levy rate of 5% that applies to certain circumstances. It remains unclear whether the 5% levy rate would be abolished.
Withholding agent	Unless otherwise stipulated by the fiscal and tax departments of the State Council, the purchaser shall be the withholding agent for the overseas entities and individuals conducting taxable transactions within the territory of China.	The Draft does not require the determination of business establishment or domestic agent of the overseas entities or individuals under the prevailing VAT rules anymore. Such removal is conducive to the implementation of withholding mechanism in the field of VAT. However, it may be practically difficult for the purchaser to perform its withholding obligation under certain circumstances, such as cross-border E-commerce and securities trading. Ideally, the overseas entities and individuals should be allowed to register for VAT and perform the self-filings by themselves as a supplement to the withholding mechanism.
Non-creditable input VAT	Non-creditable input VAT includes: • Input VAT corresponding to items subject to the simplified taxation method; • Input VAT corresponding to VAT-exempt items; • Input VAT corresponding to items of abnormal losses; • Input VAT corresponding to purchased goods, services, intangible assets, and immovable property used for collective welfare or personal consumption purposes;	The Draft does not include input VAT related to loan services as the non-creditable input VAT, which is good news for taxpayers if finally endorsed by lawmakers.

	• Input VAT corresponding to catering services, daily services for residents, and entertainment services purchased for direct consumption; • Other input VAT to be prescribed by the State Council.	
Mixed sales	Where a taxable transaction conducted by the taxpayer involves supplies that are subject to two or more VAT rates or levy rates, the VAT rate or levy rate applicable to the principal business activity involved in such transaction should apply.	According to the Draft, the applicable VAT rate/levy rate of a "mixed sales" transaction should be determined according to the principal business activity of the particular transaction instead of the taxpayer's principal business as stipulated in the prevailing VAT rules.
Refund of excess input VAT	Where input VAT for the current period exceeds output VAT for the current period, the excess input VAT can be either carried forward to offset future output VAT, or refunded to the taxpayer.	The refund of excess input VAT permitted by the Draft is consistent with international practice and the pilot VAT refund programs in the past few years.

Our observation

- In general, the Draft VAT Law has basically maintained the prevailing VAT regime and kept the current level of tax burden unchanged, which is beneficial to the continuity of tax policies and consistent with market expectation.
- The enactment of VAT Law marks a significant step forward taken by China's government to further the implementation of the principle of "taxation according to the law". For the year 2021, the VAT revenue accounts for more than 1/3 of the total tax revenue in China. After the enactment of VAT Law, more than 80% of tax revenue will be collected according to the applicable tax laws.
- The Draft VAT Law has upgraded the current bifurcated VAT pilot program rules (applicable to services) and "Interim VAT Regulations" (applicable to goods) into a single substantive law with the incorporation of the VAT reform accomplishments in the recent years, such as the refund of excess input VAT for enterprises of particular scale and in specified industries. The proposed changes as reflected in the Draft VAT Law should make China's VAT regime more aligned with international common practice.
- MNCs should pay close attention to the legislative progress of the PRC VAT Law, and we will also share with the clients the legal updates and our observations in this regard in a timely manner.

5. Individual income tax

5.1 Extension of preferential tax policies for equity incentive

In brief

On 16 January 2023, the MOF and the STA jointly issued Bulletin [2023] No. 2 ("**Bulletin 2**")[25] to extend the preferential IIT treatment for equity incentive for one additional year with effect until 31 December 2023.

In detail

[25] The Bulletin of MOF and STA Relating to the Extension of Certain Preferential Individual Income Tax Policies, Bulletin [2023] No. 2, dated 16 January 2023 and retroactively effective from 1 January 2023.

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The prevailing preferential IIT policy for equity incentive income as provided under Bulletin [2018] No. 164 ("**Bulletin 164**")[26] was originally set to expire by the end of 2021. On 31 December 2021, the MOF and the STA jointly issued Bulletin [2021] No. 42 ("**Bulletin 42**")[27] which granted a one-year extension for the preferential IIT treatment for equity incentive income.

Furthermore, Bulletin 2 has extended the preferential IIT treatment for equity incentive income for one additional year. Pursuant to Bulletin 2, PRC tax resident employees can continue enjoying preferential IIT treatment on qualified equity incentive income for the period from 1 January 2023 to 31 December 2023.

It is not surprising to see the preferential IIT policy on equity incentive income was further extended. In fact, it is common for the Chinese government to first set a limited effective period for tax incentives and then grant extensions from time to time. This approach provides the Chinese government the flexibility on whether to continue granting the relevant tax incentives depending on the specific circumstances.

In addition to equity incentive income, the prevailing preferential IIT treatments for annual bonus and expatriates' allowances are also scheduled to expire by the end of 2023. It remains to be seen if these preferential IIT policies would be further extended after 2023.

Our observation

The extension of the IIT preferential treatment for equity incentive income is welcome news for taxpayers. Meanwhile, the fact that the policy is only extended for additional one year also indicates the government's plan to remove the preferential treatment at an appropriate time in the future, thereby achieving equal tax treatment among taxpayers, regardless of the composition of their employment income (i.e., equity incentive income versus ordinary salaries and wages).

Also, it is important to note that the Chinese tax authority has been strengthening the IIT compliance administration relating to equity incentive. During the past year, we have seen local tax bureaus actively enforcing the reporting requirements imposed under Shui Zong Zheng Ke Fa [2021] No. 69 ("**Notice 69**")[28] on equity incentive. In some cities, in addition to the grant and/or vesting filings in accordance with Cai Shui [2005] No. 35,[29] Notice 69 filings must be completed in order for the relevant employees to enjoy the preferential IIT treatment.

In light of this practical environment, companies are recommended to take measures to ensure the compliance with their IIT withholding and/or reporting obligations and address historic non-compliances (if any).

5.2 Private pensions

In brief

On 21 April 2022, China's State Council released the Opinions on Promoting the Development of Personal Pensions ("**Opinions**"),[30] deciding to promote the private pension scheme as the third pillar of the existing pensions regime.[31]

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[26] The Notice of MOF and STA on the Transition of Relevant Preferential Tax Policies after the Amendment of the Individual Income Tax Law, Cai Shui [2018] No. 164, dated 27 December 2018 and effective from 1 January 2019.

[27] The Bulletin of MOF and STA on the Extension of the Preferential Individual Income Tax Policies including the Policy for One-off Annual Bonus, Bulletin [2021] No. 42, dated and effective from 31 December 2021.

[28] The Notice of STA on Certain Measures to Deepen the "Fang Guan Fu" Reform in the Tax Area and to Foster and Stimulate the Vitality of Market Players, Shui Zong Zheng Ke Fa [2021] No. 69, dated and effective from 12 October 2021.

[29] The Notice of MOF and STA Relating to the Collection of Individual Income Tax on Stock Option Income, Cai Shui [2005] No. 35, dated 28 March 2005 and effective from 1 July 2005.

[30] The Opinions of the General Office of the State Council on Promoting the Development of Personal Pensions, Guo Ban Fa [2022] No. 7, dated and effective from 8 April 2022.

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Subsequently, five central departments of the State Council launched the Implementation Measures for Personal Pensions ("**Implementation Measures**")[32] outlining the plans to develop a multitiered and sustainable social security system. Additionally, the MOF and the STA jointly released Bulletin [2022] No. 34 ("**Bulletin 34**")[33] on 3 November 2022 to specify the IIT policies on private pensions.

In detail

Bulletin 34 provides the tax-deferral policies for private pensions, which is in substance an exemption-exemption-taxation (EET) regime, similar to the US 401K scheme. The tax treatments at different stages are set forth below.

- Premium contributions to eligible private pensions products:[34] the contributions of up to RMB 12,000 can be deducted from the taxpayer's comprehensive income/business income for IIT purpose for each person per year. For wages and salaries, the contributions can be deducted at either the provisional IIT filing or the annual IIT filing; for labor services, author's remuneration, royalty or business income, the contributions can be deducted at the annual IIT filing.

- Investment: investment income accruing to an individual's personal account of private pensions is not subject to IIT for the time being.

- Withdrawal of pensions: withdrawals will not be included in the comprehensive income and instead be taxed separately as the salaries and wages at a flat rate of 3%. IIT should be withheld by the commercial banks at the cities where the taxpayer's personal accounts of private pensions were opened.

Bulletin 34 took retroactive effect from 1 January 2022 and is now applicable in 36 pilot cities and regions, including Shanghai, Fujian and Suzhou Industrial Park which had been under the pilot program of commercial pension insurance scheme.[35]

Our observation

Arising from the acceleration of the nation's population aging, the state pension fund is under increasing pressure. Against this backdrop, China's government decided to promote private pensions as a supplement to the current public pensions and annuities provided by the state and employers. Bulletin 34 provides a generous EET regime with the withdrawal tax rate at 3%, the lowest IIT rate for the taxpayer's comprehensive income. However, the upper limit of the deductible contributions for each person per year is quite low and thus may not be attractive enough for individuals with spare funds for investment in private pensions. It remains to be seen if the government would increase such limit in future.

5.3 Additional special deduction for nursing expenses

In brief

On 19 March 2022, the State Council issued Guo Fa [2022] No. 8 ("**Circular 8**"),[36] which adds nursing expenses for

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[31] The other two pillars of the existing pension regime are the public pensions (Pillar one) and annuities (Pillar two).

[32] The Circular of the Ministry of Human Resources and Social Security, the MOF, the STA, the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission on Issuing the Measures for the Implementation of Personal Pensions, Ren She Bu Fa [2022] No. 70, dated and effective from 26 October 2022.

[33] The Bulletin on Individual Income Tax Policies for Personal Pensions, MOF and STA Bulletin [2022] No. 34, dated 3 November 2022 and retroactively effective from 1 January 2022.

[34] According to the Implementation Measures, eligible financial products may include saving deposits, wealth management products, commercial pension insurance, and public funds.

[35] Such IIT deferral scheme with the similar EET regime had been operated on a trial basis in Shanghai, Fuzhou and Suzhou from 2018, but with a withdrawal tax rate of 7.5%, which has been conformed to 3% now.

children under 3 years old to the existing list of additional special deduction items for IIT purpose.[37] Shortly after the issuance of Circular 8, the STA issued Bulletin [2022] No. 7 ("**Bulletin 7**")[38] to amend the Operational Measures for Special Additional Deductions for Individual Income Tax (for Trial Implementation) to accommodate the updates provided under Circular 8.

In detail

The deduction of the nursing expenses for children under 3 years old shall be implemented from 1 January 2022. Per Circular 8, parents (guardians) can divide a monthly standard deduction of RMB 1,000 for each child on their respective income tax return or one of them can take the full deduction. Taxpayers can enjoy the deduction from the month the baby is born until the month before the baby turns 3 years old officially. The official Q&As has clarified that parents (guardians) of children under 3 years old are eligible for the deduction regardless of whether the children are born in China or abroad.

Our observation

The new policy is an integral part of a series of measures to encourage larger families to address the urgency of the nation's population aging issue. Human resources departments of MNCs should ensure that they comply with the administrative guidance under Bulletin 7 when withholding IIT for their employees.

6. Enterprise income tax

6.1 Tax treatment for infrastructure REITs

In brief

On 26 January 2022, the MOF and the STA jointly issued Bulletin [2022] No. 3 ("**Bulletin 3**"),[39] which clarifies the EIT treatment for the restructuring, establishment and operation of real estate investment trusts (REITs) in the infrastructure sector. Bulletin 3 makes it easier for companies to be eligible for the EIT deferral treatment, i.e., special tax treatment, under China tax laws and regulations.

In detail

The REITs under Bulletin 3 are investment trusts that own and operate income-generating infrastructure assets. For the public offering of REITs in China, a project company, an asset-backed security plan (ABS) and an investment trust should be organized/established under China law. The diagram below depicts a simplified REITs structure.

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[36] The Circular of State Council on Establishing the Individual Income Tax Special additional Deduction for Nursing Expenses for Infants and Toddlers, Guo Fa [2022] No. 8, dated 19 March 2022 and effective from 1 January 2022.

[37] The prior existing additional special deduction items include: (1) children's education; (2) continuing education expenses; (3) healthcare costs for serious illness; (4) housing mortgage interest; (5) expenses for supporting the elderly; and (6) housing rent.

[38] The Bulletin of STA on Revising and Issuing the Operational Measures for Special Additional Deductions for Individual Income Tax, STA Bulletin [2022] No. 7, dated 25 March 2022 and effective from 1 January 2022.

[39] The Bulletin of MOF and STA on Tax Policies for the Pilot Program of Real Estate Investment Trusts in the Infrastructure Sector, MOF and STA Bulletin [2022] No. 3, dated 26 January 2022 and retroactively effective from 1 January 2021.

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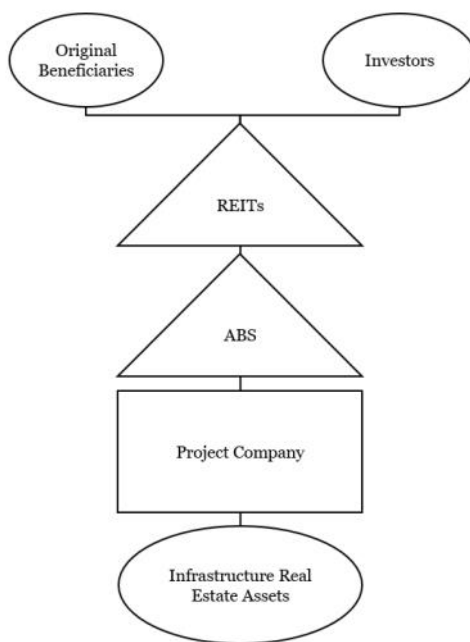

Prior to the public offering, the original beneficiaries of the infrastructure assets are expected to transfer such assets to the project company in exchange for the equity interest of the project company ("**Restructuring Phase**"). The project company will then be acquired by the ABS ("**REITs Establishment Phase**").

Bulletin 3 confirms that the asset transfer in exchange for the equity interest of the project company is eligible for the special tax treatment, specifically, the built-in gain in the infrastructure assets is eligible for the tax deferral treatment and the tax basis in the infrastructure assets could be carried over to the project company. For the original beneficiaries obtaining equity interest of the project company, the tax basis of the acquired equity interest would be the same as the original tax basis in the infrastructure assets before the transfer. Prior to the release of Bulletin 3, companies that consider a REITs offering may find difficulties in meeting the prevailing special tax treatment requirements under Cai Shui [2009] No. 59,[40] Cai Shui [2014] No. 109[41] and STA Bulletin [2015] No. 40,[42] such as the requirements on the continuity of business and continuity of ownership interest.

At the REITs Establishment Phase, the original beneficiaries are expected to transfer the equity interest of the project company to the ABS. Similar to the Restructuring Phase, the parties involved may not be able to meet one or more of the requirements for special tax treatment under the existing regulations. As a result, the equity transfer of the project company would be treated as a taxable event and the original beneficiaries would therefore be subject to tax on the capital gain derived thereof. Bulletin 3 defers the relevant tax obligation until the completion of the REITs offering and the receipt of the offering proceeds by the original beneficiaries. Furthermore, to the extent that the original beneficiaries retain any interest in the REITs, the built-in gain in the equity interest of the project company attributable to the retained interest will be further deferred until the actual transfer of the REITs interest.

Bulletin 3 does not provide any special rules for the operation of and distribution from REITs, meaning tax matters involved in the operation of and distribution from REITs should still be governed by prevailing laws and regulations.

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[40] The Notice of MOF and STA on Issues Relating to Enterprise Income Tax in Corporate Restructuring, Cai Shui [2009] No. 59, dated 30 April 2009 and effective from 1 January 2008.

[41] The Notice of MOF and STA on Issues Relating to Enterprise Income Tax for the Promotion of Corporate Restructuring, Cai Shui [2014] No. 109, dated 25 December 2014 and effective from 1 January 2014.

[42] The Bulletin of STA on the Levy and Administration of Enterprise Income Tax on Asset and Equity Transfer, STA Bulletin [2015] No. 40, dated and effective from 27 May 2015.

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Our observation

Prior to the release of Bulletin 3, companies that consider a REITs offering may not be able to meet the special tax treatment requirements and thus be discouraged by the potential tax cost to be incurred in the REITs offering process. Bulletin 3 provides more clarity and certainty on the application for the special tax treatment by significantly simplifying the requirements. It is anticipated that the issuance of Bulletin 3 should further promote the development of infrastructure REITs as a result of the lower threshold for tax deferral treatment and the consequent relief of the cash flow burden on original beneficiaries.

It should be noted that Bulletin 3 only addresses the EIT treatment for a REITs offering. Other types of taxes, including land value appreciation tax (LVAT) and VAT should also be considered. LVAT may be incurred in an asset restructuring unless exempted.[43] With respect to VAT, STA Bulletin [2011] No. 13 generally provides that an asset transfer may not be subject to VAT, provided liabilities and labor force related to the asset are also transferred.[44] During the operation of REITs, it should be noted that both the REITs and the ABS are taxable entities for VAT purposes and subject to 3% VAT. The asset manager as the VAT taxpayer should be responsible for the tax filing and settlement.[45]

6.2 Preferential tax policy for investment in basic research

In brief

To encourage enterprises to increase their investment in technology innovation and the development of basic research in China, the MOF and the STA jointly released Bulletin [2022] No. 32 ("**Bulletin 32**")[46] on 30 September 2022 to provide tax incentives for enterprises with qualified contributions made into basic research.

In detail

Pursuant to Bulletin 32, from 1 January 2022, enterprises may claim a 200% super deduction on their contributions to qualifying non-profit scientific research institutions, universities, and governmental natural science funds for conducting basic research. On the other side, the funds received by non-profit scientific research institutions and universities from enterprises, individuals, and other organizations for basic research will be exempted from enterprise income tax.

Bulletin 32 specifies the definitions of qualifying non-profit scientific research institutions, universities, and governmental natural science funds as well as the scope of basic research. It is important to note that the aforesaid basic research does not include the research carried out overseas, or the research in social sciences, arts, or humanities.

Enterprises investing in basic research shall sign relevant agreements or contracts with the recipients, which shall explicitly state that the funds will be used in the field of basic research. The relevant enterprises, non-profit scientific research institutions, universities or governmental natural science funds should also maintain the relevant supporting documents for future reference, such as investment agreements/contracts and relevant receipts, that indicate the contributors, recipients, the intended use of contributions, and contribution amounts, etc.

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[43] A qualified reorganization may be exempted from LVAT under Cai Shui [2018] No. 57, i.e., the Notice on Continuing the Land Value Added Tax Policies Relating to Corporate Restructuring and Reorganization, dated 16 May 2018 and retroactively effective from 1 January 2018. It should be noted that such policy does not apply to real estate development companies.

[44] The Bulletin of STA on Relevant Issues Concerning VAT for Asset Restructuring, STA Bulletin [2011] No. 13, dated 18 February 2011 and effective from 1 March 2011.

[45] The Notice on the VAT Policies for Financial, Real Estate Development, Education Ancillary Services and Other Sectors, Cai Shui [2016] No. 140, dated 21 December 2016 and retroactively effective from 1 May 2016, and the Notice on the Relevant Issues Concerning VAT Levied on Asset Management Products, Cai Shui [2017] No. 56, dated 30 June 2017 and effective from 1 January 2018.

[46] The Notice of MOF and STA on the Preferential Tax Policy for Enterprises' Investment in Basic Research, MOF and STA Bulletin [2022] No. 32, dated 30 September 2022 and retroactively effective from 1 January 2022.

Our observation

Bulletin 32 does not further elaborate on the definition and means of "contribution". In practice, there are various means of cooperation between enterprises and research institutions. In some cases, the contributions may not be made to the research institutions directly in the name of the enterprise that intends to claim the tax deduction. It remains uncertain whether such "indirect contribution" would be qualified for the super deduction provided by Bulletin 32. The enterprises are encouraged to consult with tax advisors to confirm if the particular contributions are eligible for super deduction. If in doubt, it is also advised to contact their in-charge tax authorities to get aligned before they leverage the tax incentives offered by Bulletin 32.

7. Regional tax policies

7.1 Executive summary

To promote comprehensive cooperation among Guangdong, Hong Kong and Macao in Guangzhou Nansha, the State Council released the development plan for Guangzhou Nansha in 2022, adding Nansha into the existing list of regions with local preferential tax policies. Meanwhile, the local governments at other well-known regions have also issued a series of implementation rules or guidance to further regulate the enforcement of their preferential tax policies.

In the table below, we compare the EIT and IIT incentive policies in the key regions at the top of the list, including Hainan Free Trade Port ("**Hainan FTP**"), Shenzhen Qianhai Modern Service Zone ("**Qianhai**"), Shanghai Lin'gang New Area ("**Lin'gang**"), Hengqin Guangdong-Macau Cooperation Zone ("**Hengqin**") and Guangzhou Nansha. The key takeaways from the regional preferential tax policies are as follows:

- All the in-scope regions provide a reduced EIT rate of 15% for qualified enterprises. Substantive operation is the key to be qualified for the EIT incentive. Enterprises in the regions should evaluate whether they are eligible to meet the substantive operation criteria and should strictly follow the compliance and documentation requirements.

- The IIT burden is generally capped at 15% for qualified domestic individual taxpayers working in those regions. Due to the close connection with Hong Kong/Macao, those regions within Guangdong province also provide for Hong Kong/Macao residents the exemption of the portion of IIT that exceeds the tax burden which would have been arisen in Hong Kong/Macao, to attract Hong Kong/Macao residents to work there.

- MNCs with a presence close to the listed regions may consider whether an investment in the regions makes sense from a strategic perspective. In the decision making process, considerations should be given to the geographic location, supply chain, cost of establishing operation in the regions, etc. in addition to the potential tax saving.

- Transfer pricing policies should be planned and implemented commensurate with the function and risk profile of the enterprises in the regions to justify the reasonableness of the overall transfer pricing arrangement.

- The tax preferential policies and related implementation rules are scattering and not easy to comprehend. MNCs that are interested in investing in the in-scope regions are advised to obtain assistance from their tax advisers when conducting the feasibility study and communicating with the local governmental authorities.

- Finally, MNCs that have already established operations in the in-scope regions should ensure they continue to be eligible for the tax incentive policies by satisfying the substantive operation criteria and complying with the compliance and documentation requirements.

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Items	Hainai FTP	Qianhai	Lin'gang	Henqing	Nansha
Encouraged industries	Very broad.[47]	Limited to modern logistics, information service, scientific and technological service, cultural creativity and commercial service.	Limited to integrated circuits, artificial intelligence, biopharma and civil aviation.	High and new technology, education and R&D, traditional Chinese medicine, pharmaceuticals and healthcare, Macau branding industries, cultural exhibition, business and trade service, tourism, modern services, and modern financial services	High and new technology key industries, information technology, advanced manufacturing, biopharma, new resources and new materials, shipping and logistics, modern services, and finance.
EIT rate	15%	15%	15%	15%	15%
IIT rate	Effective IIT burden capped at 15% for high-end and urgently needed foreign or domestic talent.	Local governments of the nine cities in Greater Bay Area (including Shenzhen) provide financial subsidies to cover the portion of IIT paid that exceeds 15% of taxable income of the overseas high-end talents and urgently needed talents who work in Greater Bay Area.	Potential financial subsidy may be granted to foreign talent to offset IIT burden differences between mainland China and other regions. This policy is briefly mentioned in the overall design plan of the Lin'gang New Area. The implementation details are not crystal clear yet.	Effective IIT burden capped at 15% for high-end and urgently needed foreign or domestic talents. Same IIT burden with the one that would have been arisen in Macao for Macao residents working in Hengqin.	Same IIT burden with the one that would have been arisen in Hong Kong/Macao for Hong Kong/Macao residents working in Nansha.
Outbound investment	EIT exemption on income from new overseas direct investment for enterprises in the tourism, modern services and high-tech industries	N/A	N/A	EIT exemption on income from new overseas direct investment for enterprises in the tourism, modern services and high-tech industries.	N/A

[47] In addition to the encouraged industries under the Catalogue of Industrial Structure Adjustment and the Catalogue of Encouraged Industries for Foreign Investment, a broad list of encouraged industries is provided under the Catalogue of Encouraged Industries for the Hainan Free Trade Port.

Depreciation and amortization (D&A)	Immediate expensing for qualified capital expenditures, and accelerated D&A for others	N/A	N/A	Immediate expensing for qualified capital expenditures, and accelerated D&A for others.	N/A
Extension of tax loss carry-forward period	N/A	N/A	N/A	N/A	Allow qualified HNTE or TSME (defined in section 6.4) to carry forward its unutilized tax losses incurred within eight preceding years before it being recognized as a HNTE or TSME, for a period up to 13 years.

More details on the regional policies and implementation rules issued in 2022 are discussed in the following subsections. For the observations on the other local preferential tax policies issued previously, please refer to our tax newsletter released in March 2022 for further details.[48]

7.2 Hainan Free Trade Port

In brief

On 23 June 2020, the MOF and the STA jointly issued Cai Shui [2020] No. 31 ("**Notice 31**"),[49] stipulating that enterprises that operate in encouraged industries and have substantive operations in Hainan FTP are entitled to a reduced EIT rate of 15%. Under Notice 31, an enterprise with an effective management in the region that exercises substantive management and control over the enterprise's production and operation, people function, finance and accounting, and assets, etc. should be considered as having substantive operations.

On 5 March 2021 and 27 September 2022 respectively, Hainan governmental authorities jointly issued Bulletin [2021] No. 1 ("**Bulletin 1**")[50] and Bulletin [2022] No. 5 ("**Bulletin 5**")[51] to further elaborate the key factors for the determination of "substantial operation" and other relevant requirements.

In detail

Bulletin 1 provides the key elements for the determination of "substantial operation" in Hainan FTP, i.e., the enterprise taxpayer's production and operation, people function, finance and accounting, and assets ("**Four Elements**") should be in Hannan FTP. The official interpretation on Bulletin 1 as well as Bulletin 5 and its official

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[48] Available at https://insightplus.bakermckenzie.com/bm/tax/asia-pacific-2021-china-tax-update.

[49] The Notice of MOF and STA on Preferential Enterprise Income Tax Policies for the Hainan Free Trade Port, Cai Shui [2020] No. 31, dated 23 June 2020 and retroactively effective from 1 January 2020.

[50] The Notice Regarding the Substantive Operation of Enterprises that Operate in the Encouraged Industries in the Hainan Free Trade Port, Hainan Notice [2021] No. 1, dated 5 March 2021 and retroactively effective from 1 January 2020.

[51] The Notice Regarding the Supplementary Announcement on Issues Relating to the Substantive Operation of Enterprises in the Encouraged Industries of Hainan Free Trade Port, Hainan Notice [2022] No. 5, dated 27 September 2022 and effective from 1 January 2023.

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interpretation provide more detailed requirements with respect to the Four Elements.

Element	Detailed illustration
Production and operation	The enterprise will be deemed as having "production and operation in the FTP" if the relevant contract is concluded in the name of the enterprise and it satisfies either one of the following standards: (1) Business operation standard: the enterprise has fixed production and operation premises as well as necessary equipment and facilities, etc. in the Hainan FTP, and the primary production and operation location is in the Hainan FTP; or (2) Managerial standard: the institution, that implements substantial overall management and control over production and operation, is in the Hainan FTP. That means it is the institution located in the Hainan FTP that makes or implements (a) production/operational decisions (such as formulating plans, controls, review, and evaluations); (b) financial decisions (such as borrowing/granting loans, financing, and management of financial risks); (c) human resources related decisions (such as staff hiring/dismissal, compensation plans).
People function	The enterprise should have employees working in the Hainan FTP for its production and operation. Employment agreements should be signed with the enterprise in the Hainan FTP for more than one year. The salary of the employees should be paid through the bank account opened by the enterprise in the Hainan FTP. Depending on the scale of the enterprise and the employees, at least 3 (inclusive) to 30 (inclusive) employees must reside in the Hainan FTP for a total of 183 days or more cumulatively in a tax year.
Finance and accounting	Ledgers, accounting books and financial statements of the enterprise should be kept in the Hainan FTP, and the basic deposit account and bank accounts for the settlement of major business activities should be opened in the Hainan FTP.
Assets	A qualifying enterprise should have necessary assets in the Hainan FTP for production and operation purpose. However, certain assets under the title of the enterprise are not required to be physically situated in the Hainan FTP due to industry/asset characteristics, such as vehicles/vessels of transportation enterprises and intangible assets like patents.

Pursuant to Bulletin 5, any enterprises that fall into either of the following situations shall be determined as disqualified for substantial operation:

- An enterprise without production and operational functions but only undertakes financial settlement, tax filings, invoicing functions for the inland businesses; or
- An enterprise's registered address is inconsistent with its actual business address and its contact person cannot be reached or failed to provide its actual business address after accessed by the regulatory authorities.

It's important to note that the aforementioned requirements also apply to the determination of substantive operation for the entitlement to the IIT preferential policy as prescribed in Qiong Fu [2022] No. 31 ("**Circular 31**").[52]

Our observation

[52] The Provisional Administrative Measures on the List of High-end Talents and Urgently Needed Talents Eligible for IIT Preferential Policies in Hainan FTP, Qiong Fu [2022] No. 31, dated 15 September 2022 and effective from 1 January 2023.

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With respect to the preferential EIT policies, substantive operation is the key for enterprise taxpayers wishing for the entitlement to such benefit. It is important to note that the EIT preferential treatment claimed and received by the taxpayer shall be subject to ex-post verification. Accordingly, enterprises established in the Hainan FTP or that contemplate making an investment in that region should evaluate whether they can satisfy the specific substantive operation criteria, and strictly adhere to the compliance and documentation requirements.

7.3 Hengqin Guangdong-Macau Cooperation Zone

In brief

On 5 September 2021, China's Central Committee and the State Council jointly released the Plan for Building a Guangdong-Macau Cooperation Zone in Hengqin ("**Overall Plan**"). The Overall Plan aims to further encourage economic development in the region and cooperation between Guangdong and Macau. The Overall Plan also proposes preferential IIT and EIT policies. Further to the Overall Plan, the MOF and the STA jointly issued several implementation guidance regarding the preferential IIT and EIT policies in Hengqin.

In detail

a. IIT policies

The MOF and the STA jointly issued Cai Shui [2022] No. 3 ("**Circular 3**")[53] on 10 January 2022, reiterating the following preferential IIT policies announced in the Overall Plan.

- For domestic and overseas high-end or urgently needed talents working in Henqqin, the part of their IIT burden exceeding 15% shall be exempted.
- IIT imposed on Macao residents working in Hengqin that exceeds the tax burden that would have been arisen in Macao shall be exempted.

The above IIT exemption applies to the individual's income derived from Hengqin, including comprehensive income (i.e., salaries and wages, remuneration for labor services, authors' remuneration and royalties); business income; and talent related subsidy income recognized by the local government authorities.

b. EIT policies

The MOF and the STA jointly released Cai Shui [2022] No. 19 ("**Circular 19**")[54] on 25 May 2022 to elaborate on the preferential EIT policies proposed in the Overall Plan, of which the details are set forth below.

1. Preferential EIT rate of 15%

Enterprises engaging in qualified industries in Hengqin will be eligible for a reduced EIT rate of 15%. To enjoy the reduced EIT rate, an enterprise shall meet the following conditions:

- Its primary business falls within the scope as specified in the "Catalogue of Industries Eligible for the Preferential EIT Treatments for the Hengqin Cooperation Zone (version 2021)" ("**Catalogue**"), and its primary business income accounts for more than 60% of the total income.
- Conduction of substantial operation. The enterprise's effective management institution shall be located in Hengqin and implement substantial and comprehensive management and control over the production and

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[53] The Notice of MOF and STA on the Preferential Individual Income Tax Policy for Hengqin Cooperation Zone, Cai Shui [2022] No. 3, dated 10 January 2022 and effective from 1 January 2021 to 31 December 2025.

[54] The Notice of MOF and STA on the Preferential Enterprise Income Tax Policy for Hengqin Cooperation Zone, Cai Shui [2022] No. 19, dated 25 May 2022 and effective from 1 January 2021.

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operation, personnel, accounts, property, etc. of the enterprise.

It is important to note that, where an enterprise has its head office established in Hengqin, the reduced EIT rate of 15% is only applicable to the income of the head office and the branches established in Hengqin that meet the conditions as specified above. Where an enterprise has its head office established outside Hengqin, the reduced EIT rate of 15% shall only be applicable to the income of the branches established in Hengqin that meet the conditions as specified above.

2. EIT exemption

For the enterprises engaging in tourism, modern service or high and new technology industries in Hengqin, the income derived from their incremental outbound direct investments ("**ODI**") shall be exempted from EIT. The qualified income derived from incremental ODI shall meet the following conditions:

- The income should be either the operating profits from newly established overseas branches, or dividend income corresponding to incremental ODI derived from overseas subsidiaries with a shareholding percentage of not less than 20%;
- The statutory EIT rate of the invested country (region) shall not be lower than 5%.

3. Purchase of fixed assets and intangible assets

Enterprises established in Hengqin that purchase (including self-built and self-developed) fixed assets or intangible assets other than houses and buildings with unit value not exceeding RMB 5 million are allowed to claim one-off deduction for the calculation of taxable income; where the unit value exceeds RMB 5 million, the depreciation and amortization are allowed to be accelerated.

Our observation

The preferential tax policies in Hengqin are quite similar to what's provided by Hainan FTP. Enterprises established in Hengqin or are contemplating making an investment in that region should be mindful of the criteria for the preferential EIT and IIT policies, assess their eligibility, and carry out a cost-benefit analysis in advance.

7.4 Guangzhou Nansha

In brief

The State Council released the "Overall Plan for Promoting Comprehensive Cooperation Among Guangdong, Hong Kong and Macao by Further Deepening the Open-up of Nansha district in Guangzhou" ("**Overall Plan**") on 6 June 2022. Further to the Overall Plan, the MOF and the STA jointly released Cai Shui [2022] No. 29 ("**Circular 29**")[55] on 21 July 2022 to specify the preferential IIT policies, which would be effective from 1 January 2022 to 31 December 2026.

In detail

a. IIT policies

For Hong Kong and Macau residents who work in Guangzhou Nansha, the IIT burden exceeding their IIT burden that would have been arisen in Hong Kong or Macau shall be exempt. The above IIT exemption applies to the individual's income derived from Nansha, including comprehensive income (i.e., salaries and wages, remuneration for labor services, authors' remuneration and royalties); business income; and talent related subsidy income

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[55] The Notice of MOF and STA on the Preferential IIT Policies in Guangzhou Nansha, Cai Shui [2022] No. 29, dated 21 July 2022 and retroactively effective from 1 January 2022.

recognized by the local government authorities.

On 4 November 2022, Guangzhou Municipal Finance Bureau and Guangzhou Municipal Tax Service jointly released the Implementation Measures on the Preferential IIT Policies for Guangzhou Nansha (Sui Cai Gui Zi [2022] No. 1), which further clarified the criteria for the preferential IIT treatment as follows:

- The taxpayer should be a resident of Hong Kong or Macau;[56]
- The taxpayer should be employed by an enterprise that is registered in Nansha with substantive operation, or provide independent labor services, or engage in business activities in Nansha, and pays IIT in Nansha according to law;
- The taxpayer should obey laws and regulations and has no record of tax violations in the preceding three years prior to the enjoyment of such preferential IIT policy.

It's important to note that in the same tax year, taxpayers cannot enjoy both the preferential IIT policy for Nansha and that for overseas high-end or urgently needed talents who work in the Greater Bay Area.[57]

b. EIT policies

In regards to EIT, on 25 September 2022, the MOF and the STA jointly released Cai Shui [2022] No. 40 ("**Circular 40**") to specify the preferential EIT policies for Nansha, which would be effective from 1 January 2022 to 31 December 2026. The details thereof are set forth below.

1. Preferential EIT rate of 15%

The enterprises registered in start-up areas of Nansha[58] and engaged in substantial business in encouraged industries shall be subject to a reduced EIT rate of 15%. To enjoy the preferential policy, an enterprise shall meet the following conditions:

- The enterprise should be engaged in encouraged industries prescribed in the 2022 Catalogue of EIT Preferential Treatments for Enterprises of Nansha ("**2022 Nansha Catalogue**") and its revenue derived from the encouraged industries should account for 60% or above of its total revenue;
- Conduction of substantive operation. The effective management of the enterprise should be physically located in the start-up areas of Nansha and exercises substantial and overall management and control over production and operation, personnel, finance and accounting, and assets, etc. of the enterprise.

It is important to note that, where an enterprise has its head office established in Nansha, the reduced EIT rate of 15% is only applicable to the income of the head office and the branches established in Nansha that meet the conditions as specified above. Where an enterprise has its head office established outside Nansha, the reduced EIT rate of 15% shall only be applicable to the income of the branches established in Nansha that meet the conditions as specified above.

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[56] On 10 November 2022, Guangzhou Nansha Tax Service released the Guidelines for declaration of preferential IIT policies in Nansha for year 2022, which specified that the qualified Hong Kong/Macau residents include both permanent residents and non-permanent residents.

[57] According to Yue Cai Shui [2020] No. 29 ("**Circular 29**", i.e., the Notice regarding extending the implementation of preferential IIT policies in the Guangdong-Hong Kong-Macao Greater Bay Area), local governments of the nine cities (i.e., municipalities of Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing in Guangdong Province) of the Greater Bay Area shall provide financial subsidies to cover the portion of IIT paid that exceeds 15% of taxable income of the overseas high-end talents and urgently needed talents who work in Greater Bay Area. The subsidies paid to the individuals shall also be exempt from IIT.

[58] The start-up areas refer to Nansha Bay, Qingsheng Hub Cluster and Nansha Hub Cluster in the Nansha area of China (Guangdong) Pilot Free Trade Zone, with a total area of approximately 23 square kilometers.

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2. Extension of tax loss carry-forward period

Starting from 1 January 2022, where an eligible enterprise registered in Nansha is recognized as a High-and-new Technology Enterprise (HNTE) or a Technology-based Small and Medium-sized Enterprise (TSME), it is allowed to carry forward its unutilized tax losses incurred within eight preceding years before it being recognized as a HNTE or TSME, for a period up to 13 years. To be qualified for such extension, the eligible HNTEs or TSMEs should be engaging in key industries of high-and-new technology listed in the 2022 Nansha Catalogue and their revenue derived from such industries should account for 60% or above of its total revenue.

Our observation

The preferential tax policies provided by Nansha are quite similar to what's provided by Hainan FTP and Hengqin Cooperation Zone. Enterprises established in Nansha or are contemplating making an investment in such region should be mindful of the criteria for the preferential EIT and IIT policies, assess their eligibility, and carry out a cost-benefit analysis in advance.

8. Stamp Duty

8.1 Implementation guidance on certain stamp duty policies

In brief

The PRC Stamp Duty Law ("**SD Law**") officially became effective from 1 July 2022 and replaced the previous SD Provisional Regulations. The SD Law contains 20 articles that cover the definition of taxpayer, tax item, tax rate, tax base and preferential SD treatment. While the SD Law generally inherits the prevailing SD system, the tax item and applicable tax rate have been further simplified or reduced. As the full text of SD Law was introduced in 2021, we have comprehensively discussed it in the 2021 China Tax Update.[59] Anyone interested in that topic is encouraged to read the newsletter for further details.

Accompanying the enactment of the SD Law, the MOF and the STA jointly issued Bulletin [2022] No. 22 ("**Bulletin 22**")[60] on 12 June 2022, which further clarified certain SD issues to smoothen the implementation of the SD Law.[61]

In detail

Notably, bulletin 22 clarifies the following:

- **SD taxpayers:** The SD law provides that entities and individuals who conclude taxable documents within the PRC, or who conclude taxable documents outside the PRC but for use within the PRC, should be liable for SD. Bulletin 22 further clarifies that SD taxpayers should be entities or individuals who are legally responsible or liable for taxable documents.

- **Taxable documents concluded outside the PRC but for use within the PRC:** The SD law generally provides that taxable documents concluded outside the PRC but for use within the PRC should be subject to SD. In clarifying the meaning of "use within the PRC", Bulletin 22 provides the following scenarios where SD should be levied.

[59] Available at https://insightplus.bakermckenzie.com/bm/tax/asia-pacific-2021-china-tax-update.

[60] The Notice of MOF and STA on the Implementation Standards for Relevant Matters and Policies Concerning Stamp Duty, MOF and STA Bulletin [2022] No. 22, dated 12 June 2022 and effective from 1 July 2022.

[61] For detailed SD collection and administrative arrangements, taxpayers may refer to STA Bulletin [2022] No. 14 (i.e., the Notice Regarding Matters Related to Implementing the PRC SD Law) released by the STA on 28 June 2022.

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Subject matter of taxable documents	Use within the PRC
Real property	Real property is physically located in the PRC
Equity interest	Equity interest of a PRC resident company
Movable asset or trademark, copyright, patent and know-how	Either the seller or buyer is within the PRC, except if the subject matter is completely used outside the PRC
Service	Either the service provider or recipient is within the PRC, except if the service is completely provided outside the PRC

- **SD administration:** Bulletin 22 provides the following scenarios where SD taxpayers can re-determine the SD:

  1. The original amount in the taxable document is different from the actual settlement amount and the original amount on the taxable document is adjusted; and

  2. The SD is overpaid or underpaid due to the miscalculation of value-added tax.

- **Non-taxable scenarios:** Bulletin 22 also sets forth the situations where SD should not be levied (e.g., effective legal documents by the people's courts, etc.) or eligible for an exemption (e.g., E-commerce businesses as prescribed in the PRC Ecommerce law, etc.).

Our observation

Bulletin 22 addresses a number of practical questions that are particularly relevant to cross-border transactions. Multinational companies (MNCs) should consider the SD implications in structuring their transactions.

- **Equity transfer:** Bulletin 22 confirms that provided the subject matter is the equity interest of a PRC resident company, the transferor and transferee (domestic or foreign) should be subject to SD. Foreign transferors or transferees can report and pay SD by themselves, or appoint a domestic agent for the reporting and payment of SD. Technically speaking, an indirect transfer agreement that is concluded outside the PRC should not be subject to SD as the subject matter is not the equity interest of a PRC resident company.

- **Sale of tangible asset, license of intangible asset and service:** Bulletin 22 leverages the principles under VAT regulations in determining whether a taxable document is used within the PRC by reference to the location of the seller/service provider and buyer/service recipient. Under Bulletin 22, if the seller/service provider or buyer/service recipient is within the PRC, the taxable document for the sale of tangible asset, license of intangible asset and service could be subject to SD. For example, a foreign company that sells goods or provides a license to a company within the PRC could be subject to SD. We have seen some cases in practice where the foreign companies are required by PRC-based counterparties to fulfil their SD obligation while the tax authorities have not escalated the scrutiny and supervision on the same matter in a large scale. MNCs are advised to monitor the local practice and check whether their existing agreements specify which party should bear SD.

  Similar to the treatment under VAT regulations, Bulletin 22 includes the following exceptions to the general rule: (1) complete foreign use of asset; and (2) complete foreign performance of service. Bulletin 22 does not provide detailed guidance on how to determine the foreign use of asset and performance of service. The application of the exceptions should be analyzed for each case.

- **Administrative burden:** Under the SD law, MNCs can either report and pay SD by themselves or appoint a domestic agent in China to fulfil their SD obligation. However, in practice, the self-reporting method may not always be straightforward, and MNCs may need to work with tax authorities and other parties (e.g. banks) to figure out a practical solution. For MNCs with a large number of taxable documents, the administration burden should not be underestimated.

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