Legal Update

March 2022

2021 China Tax Update

Table of Content

1. Introduction

In this annual issue of China Tax Update, we will discuss the major China tax developments in 2021. By the time you read this report, a number of tax policies implemented in 2021 are expected to be modified in 2022. The 2022 Report of the Work of the Government ("**2022 Report**") proposes to continue to implement tax and fee cuts for small and medium enterprises (SMEs), expand the 100% R&D super deduction incentive to small and medium tech enterprises, refine the input VAT credit refund mechanism for SMEs and qualified enterprises in the specified manufacturing industries, and implement the accelerated depreciation policy for qualified enterprises.[1] These measures will be discussed in our March issue of China Tax Update, which we recommend that you read in conjunction with this report.

As in other jurisdictions, the COVID-19 pandemic continued to cause disruption and challenges for individuals and businesses in China throughout 2021. The Chinese government has been taking measures to strike a balance between reviving the economy and addressing the pandemic.

For multinational companies (MNCs) operating in China, an important China tax development is the introduction of a new simplified process for the administration of unilateral advance pricing arrangements (UAPA). The new process features fewer steps, specified timelines and one-off submission of application documents. Previously, MNCs were discouraged by the potential cost, time commitment and uncertainty involved in the process of concluding advance pricing arrangements (APA) with the Chinese tax authorities. The new process demonstrates that the Chinese tax authorities are more willing to improve MNCs' experience when they manage their transfer pricing matters in China. We believe the new process is a useful and practical tool for MNCs. MNCs that are interested in negotiating and concluding APAs with the Chinese tax authorities are recommended to discuss this with their tax advisers to evaluate whether they could take advantage of the new rules. The topic is discussed in section 2.

With respect to individual income tax (IIT), compliance is perhaps the theme of the year. By issuing Bulletin [2021] No. 69, the State Taxation Administration (STA) makes clear that it will be strengthening the administration of equity incentive plans in China and enforcing collection of IIT on income from participating in these plans. MNCs that have implemented equity incentive plans or are contemplating implementing any such plans should comply with the filing and reporting requirements under the new and existing rules. The topic is discussed in section 3.

Another trend we have observed over the recent years is the proliferation of regional free trade ports and modern service cooperation zones, and regional tax policies associated with the establishment of these special regions. At the top of the list are Hainan Free Trade Port, Qianhai Modern Service Zone (Shenzhen), Lin'gang New Area (Shanghai) and Henqing Guangdong-Macau Cooperation Zone. While these regions differ in how they position themselves strategically to attract domestic and foreign investment, they are similar in terms of formulating and providing tax incentive policies to attract investment. MNCs with a presence close to these regions may consider whether an investment in these 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 operations 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. Further, MNCs should be aware that detailed implementation guidance has yet to be released for some regions, meaning the local governmental authorities may have some flexibility to adjust details of the tax incentive policies and make them more competitive compared to other regions. MNCs that are interested in investing in the regions are advised to obtain assistance from their tax advisers when communicating and negotiating with the local governmental authorities. Finally, MNCs that have already established operations in the regions should ensure they continue to be eligible for the tax incentive policies by satisfying the business substance requirements and complying with the compliance and documentation requirements. The topic is discussed in section 4.

With respect to enterprise income tax (EIT), the tax policies implemented in 2021 reflect the Chinese government's policy priorities that emerged in recent years, including: (1) tax and fee cuts to support the development of real economy and vital market players, in particular, SMEs and sole proprietors in response to the pandemic; and (2) tax incentives to encourage scientific and technological innovation and enterprises in the manufacturing industry in response to the rapidly changing international landscape.[2] In addition, Bulletin [2021] No. 34 extends the tax exemption policy on bond interest earned by foreign institutional investors. The policies are discussed in section 5.

In section 6, we will discuss Bulletin [2021] No. 21 and Bulletin [2021] No. 17, which extends the deed tax (DT) and land value appreciation tax (LVAT) exemption treatment for qualified enterprise restructuring. Enterprises that contemplate restructuring involving real properties should evaluate whether they are eligible for the exemption and retain relevant documents for inspection.

In section 7, we will discuss the Stamp Duty Law of China ("**SD Law**"). The SD Law simplifies the tax items that should be subject to SD and reduce tax rates for certain items. The passage of the SD Law is another step that the Chinese government has taken to implement the principle of statutory taxation in China.

Last but not least, in section 8, we will discuss the China-Spain Double Taxation Agreement (DTA) that went into effect on 2 May 2021 and replaced the 1990 tax treaty between the two countries. Further, a new treaty was signed with Rwanda, which has yet to be ratified.

2. Transfer pricing

2.1 Simplified unilateral advance pricing arrangement process

In brief

The STA recently released Bulletin [2021] No. 24 ("**Bulletin 24**"),[3] introducing a new simplified process for the administration of UAPAs.

Key takeaways

- The Chinese tax authorities are increasingly willing to accelerate the APA process to confirm compliance with the arm's length principle in related-party transactions.
- Bulletin 24 introduces a new simplified process for UAPA with fewer steps, specified timelines and one-off submission of application documents to improve efficiency and tax certainty for MNCs.
- The simplified UAPA process could serve as a useful and practical tool for MNCs to manage their transfer pricing matters in China.
- The simplified process is not one-size-fits-all. We recommend that MNCs discuss this with their tax advisers to assess if they could take advantage of the new rules.

Background

An APA is an effective tool for MNCs to manage their transfer pricing matters. However, in recent years, the desirability of APAs has been undermined by the delay and lackluster commitment from the tax authorities. Lack of resources and diversion of APAs to other priorities daunt the APA programs of many countries. COVID-19 made it even worse: scheduling meetings between competent authorities and between tax authorities and taxpayers has become very challenging. MNCs expect a more efficient APA program to achieve their objectives.

---

[1] On 5 March 2022, Premier of the State Council Li Keqiang delivered the report on the work of the government at the opening meeting of the fifth session of the 13th National People's Congress. The report is available at http://www.gov.cn/zhuanti/2022lhzfgzbg/index.htm.

[2] See the 2021 Report on the Work of the Government available at http://www.gov.cn/zhuanti/2021lhzfgzbg/index.htm

[3] The Bulletin of the State Administration of Taxation on Issues Concerning the Application of the Simplified Process for Unilateral Advance Pricing Arrangements, Bulletin [2021] No. 24, dated 26 July 2021 and effective from 1 September 2021.

On 26 July 2021, the STA released Bulletin 24, which introduced a new simplified process for the administration of UAPA. Bulletin 24 built upon the existing framework set out in Bulletin [2016] No. 64 ("**Bulletin 64**").[4] Bulletin 24 now provides qualified MNCs with the option of a simplified process with a specific timeframe for UAPA.

Standard APA process daunted potential UAPA applications

Bulletin 64 provides the general framework for APA administration, including UAPAs. While Bulletin 64 is helpful in laying out the detailed process and scope of availability for APAs, the long process without a specified timeline may have delayed the process of concluding APAs and impeded its effectiveness. As a result, it is difficult for MNCs to obtain certainty on the expected timeline of the UAPA process. According to the latest statistics published by the STA on China APAs, from 2005 to 2020, China signed only around 7.25 UAPAs per year, while around 50% of UAPAs were concluded after a year or more. The average time spent to conclude UAPA is two years.

In addition, some of the processes were originally designed for bilateral APAs but shoehorned to fit the UAPA applicants. The required information is also repetitive and in some cases redundant. This would undoubtedly lengthen the process and administrative burden of both the MNCs and tax authorities.

Overview of the simplified UAPA process

Bulletin 24 introduces a new simplified process for UAPA with fewer steps, a clear timeline, and one-off submission of the application documents to enhance efficiency and tax certainty for MNCs. Please see below for a comparison between the standard process for APA under Bulletin 64 and the simplified process for UAPA under Bulletin 24 for your reference:

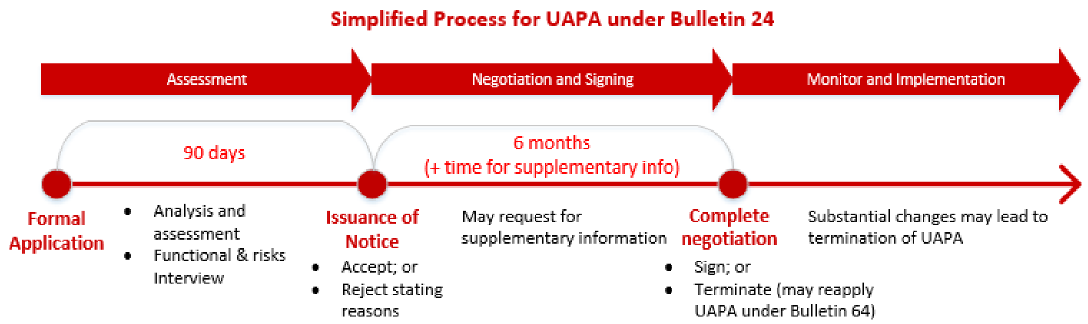
	Bulletin 64: APA standard process	Bulletin 24: UAPA simplified process
Process	The standard APA process under Bulletin 64 requires enterprises to go through the following six stages: (i) Pre-filing meeting (ii) Letter of intent to seek an APA (iii) Analysis and evaluation (iv) Formal application (v) Negotiation and execution (vi) Monitoring and implementation	The simplified UAPA process is streamlined into three stages only: (i) Submission of formal application for assessment (ii) Negotiation and execution (iii) Monitoring and implementation
Timeline	No specific timeline to complete negotiation and execution. Timeframe is dependent on various factors.	Bulletin 24 specifies the following timeframe for the simplified UAPA process. • **Within 90 days** upon receipt of the formal application, tax authorities must commence the process of assessment and functional and risk interviews, and report the results to the enterprise by issuing the 'Notice of Tax Matters.' The tax

[4] The Bulletin of the State Administration of Taxation on Issues Concerning the Improvement of the Administration of Advance Pricing Arrangements, STA Bulletin [2016] No. 64, dated 11 October 2016 and effective from 1 December 2016.

	authorities must state their reason if they refuse to accept the application. • **Within six months** from the issuance of the 'Notice of Tax Matters' accepting the application, the tax authorities should complete the negotiation and signing process. Negotiation should be based on whether the related-party transactions align with the arm's length principle. The six-month period excludes the time an enterprise spent on submitting supplementary information. If no consensus is reached, the UAPA will terminate, and the enterprise can choose to re-apply for a UAPA under the general process of Bulletin 64 without the need to resubmit information that has already been submitted.

Note, however, that even though Bulletin 24 provides for a six-month timeline for a UAPA to be negotiated and executed, the actual time spent on the simplified UAPA process remains to be seen. Tax authorities may well reject the initial filing if they believe that the submission package is incomplete and thus stop the clock from running in the first place. In addition, tax authorities may also suspend the clock from running by requesting enterprises to provide supplementary information as the six-month period specifically excludes the time enterprises spent on submitting supplementary information.

For your ease of reference, please refer to the diagram below for the simplified process for UAPA under Bulletin 24:



To be eligible for the simplified UAPA process, the MNC must satisfy the conditions set out in Bulletin 24 as summarized in the table below:

	Conditions
Eligibility criteria	1. Condition 1: The enterprise's yearly aggregate related-party transaction must reach amounts of RMB 40 million or above ("**Threshold**") in each of the past three tax years prior to the year in which the tax authorities issued the 'Notice of Tax Matters' to the enterprise accepting its UAPA application. 2. Condition 2: The enterprise must satisfy one of the following conditions: a. The enterprise has **already provided the tax authorities with contemporaneous transfer pricing documentation** (**TPD**) relating to the

	past three tax years prior to the submission of the UAPA application, and such documentation complies with the requirements stipulated under Bulletin 42.[5] b. The enterprise **executed an APA once** and is in compliance with the APA in the past 10 tax years prior to the submission of the UAPA application. c. The enterprise was **once subjected to special tax adjustments audit** that has already been concluded in the past 10 tax years prior to the submission of the UAPA application.
Grounds for rejection	The tax authorities may refuse to accept the enterprise's application to opt for the simplified UAPA process if any of the following circumstances is met: o The tax authorities already conducted **special tax adjustments audit or other related tax audit** on the enterprise but such tax audit has not been concluded. o The enterprise **failed to complete the "Annual Related Party Transaction Disclosure Forms"** in accordance with the applicable rules and did not make timely rectifications. o The enterprise failed to **prepare, store or provide TPD** in accordance with the applicable rules. o The enterprise **refused to cooperate** with tax authorities in respect of functional and risks interview.
Inapplicable	The UAPA simplified process will temporarily be **inapplicable to UAPAs involving two or more** different provinces, autonomous regions, municipalities or cities specifically listed in the state plan.

Our observations

In recent years, the Chinese government has been working hard to develop a more transparent, predictable and accessible business environment for MNCs. Against this backdrop, we have seen the Chinese tax authorities become increasingly open to accelerate the APA process to confirm compliance with the arm's length principle. The introduction of a simplified process for UAPA signals tax authorities' willingness to engage in a mutual negotiation process with MNCs over their transfer pricing matters, instead of relying heavily on confrontational TP audits.

The simplified process, if it works as planned, would enable taxpayers to obtain a 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. In addition, coupled with the recent relaxation of the foreign exchange control on cross-border transfer pricing adjustment, the simplified UAPA would make it possible for MNCs to make the transfer pricing adjustments (true-up or true-down) at the year-end without other complications.

[5] The Bulletin of the State Taxation Administration on Issues Relating to the Enhancement of the Declaration of Related Party Transactions and Administration of Contemporaneous Documentation, STA Bulletin [2016] No. 42, dated 29 June 2016, retroactively effective from 1 January 2016.

Who would typically benefit from the simplified UAPA process?

Besides the considerations for APA in general, UAPA can only obtain tax certainty in one jurisdiction, and therefore would not be able to relieve MNCs from potential double taxation. UAPAs, including those under the simplified process, are only suitable to taxpayers in transactions where double taxation is not a concern. For example, assuming that the double taxation risk is not a concern, MNCs that were subject to TP audits concluded in previous tax periods may be incentivized to apply for a UAPA under the simplified process. In such cases, MNCs may agree to continue to adopt the agreed existing TP methodologies and comparable methods as set out in the previous tax audit, while using the UAPA to agree on a reduced target operating margin reflecting the latest operating data for recent years. Since the simplified process is not one-size-fits-all, we would encourage MNCs to engage professional tax advisers to assess if they would be able to take advantage of the simplified UAPA process.

Conclusion

We see Bulletin 24 as an improvement to the existing rules relating to UAPAs. The simplified UAPA process, coupled with the relaxation of foreign exchange control in cross-border transfer pricing adjustments, would allow certain MNCs more flexibility and agility in managing their TP risks.

3. Individual income tax

3.1 Individual income tax compliance on equity incentive plans

In brief

On 12 October 2021, the STA issued Notice [2021] No. 69 ("**Notice 69**"),[6] which introduces 15 measures relating to tax collection and administration. In particular, article 10 of Notice 69 tightens the reporting requirements on employee equity incentive plans by requiring applicable companies to file an Equity Incentive Plan Reporting Form with their in-charge tax authorities within a short time frame.

In detail

Notice 35 and Notice 101: Companies in China commonly use equity incentive plans to attract and retain talents. In the past, the STA has issued two important notices providing and clarifying the IIT treatment on equity incentive income, one being Cai Shui [2005] No. 35 ("**Notice 35**"),[7] which clarifies the IIT treatment for equity incentive plans implemented by public companies (domestic or foreign), and the other being Cai Shui [2016] No. 101 ("**Notice 101**"),[8] which clarifies the IIT treatment for qualified equity incentive plans implemented by private companies.

Notice 35 and Notice 101 should continue to apply for purposes of determining the IIT treatment of equity incentive income earned by employees. Under Notice 35, an employee should be taxed when stock options are exercised by the employee or restrictions on restricted stock are removed. The income should be taxed as "salary" at progressive tax rates up to 45%. Importantly, a preferential tax calculation method to separate the equity incentive income from the regular salary is provided under Notice 35.[9] Notice 35 only applies to public companies and their employees. As a result, prior to Notice 101, the preferential tax calculation method was not available to employees of private companies, meaning equity incentive income earned by employees of private companies should be added to the employees' regular salary and is often subject to tax at a higher rate.

Notice 101 extends the preferential tax calculation method under Notice 35 to employees of private companies.[10] Further, Notice 101 provides a tax deferral treatment for qualified equity incentive plans. Equity incentive income from qualified equity incentive plans is deferred until the disposal of relevant stock. The income would be taxed as a "transfer of property" at a rate of 20%. Notice 101 addresses the cash flow issue faced by employees of private companies and reduces the IIT burden on those employees by making the preferential tax calculation method available to them or allowing them to use the tax deferral treatment. Conditions under Notice 101 should be satisfied to be treated as a qualified equity incentive plan (e.g., the plan should be issued only to senior managers and core technical staff, holding period requirements and etc.).

Compliance: Under Notice 35 and Notice 101, there are already requirements to make filings for grant and vesting/exercise of equity awards, but local practice varies, with some tax authorities focusing more on the reporting of taxable events (e.g., exercise of stock options and vesting of restricted stock). Under Notice 69, going forward, all companies granting equity awards in China are required to file the Equity Incentive Plan Reporting Form within 15 days after the end of the month in which the equity awards are granted to employees in China. The requirements also apply to domestic companies that participate in equity incentive plans of their foreign related companies.

Our observation

Notice 69 makes clear that the STA intends to strengthen administration on equity incentive plans and enforce collection of IIT on income from participating in these plans. Companies that have implemented equity incentive plans or are contemplating implementing any plans should meet the reporting requirements in a timely manner, including filing the Equity Incentive Plan Reporting Form with their in-charge tax authorities for new plans and reporting grant and vesting/exercise events under the existing plans.

The Equity Incentive Plan Reporting Form collects comprehensive information, including the issuer company name and address, employer name and address, and employee names and ID numbers. For each equity award, the form also needs to specify the equity award type, grant date, vesting schedule, and the number of shares underlying the award. Companies should complete the form carefully and take the opportunity to review and ensure their filings with their in-charge tax authorities are compliant.

4. Regional tax policies

4.1 Executive summary

One trend we have observed in recent years is the establishment of regional free trade ports and modern service cooperation zone, and associated with the establishment of these special regions, preferential tax policies are usually provide as part of the policy packages. At the top of the list are Hainan Free Trade Port, Qianhai Modern Service Zone (Shenzhen), Lin'gang New Area (Shanghai) and Henqing Guangdong-Macau Cooperation Zone. In the table below, we compare the EIT and IIT incentive policies in each region. Our key takeaways are as follows:

- The Hainan Free Trade Port has the most comprehensive catalogue of encouraged industries. While there is some overlap of encouraged industries among the regions, Lin'gang New Area positions itself to attract investment in the high-end tech industries, while Qianhai (Shenzhen) Modern Service Zone and Henqing Guangdong-Macau Cooperation Zone position themselves to attract investment in both high-tech and modern service industries.

- All the regions provide a reduced EIT rate of 15% for qualified enterprises. Business substance is the key to the EIT incentive. Enterprises in the regions should evaluate whether they are eligible to meet the business substance requirements and should comply with the compliance and documentation requirements.

- MNCs with a presence close to these 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.

---

[6] The Bulletin of the State Taxation Administration Regarding Several Measures on Further Deepening the Reform of Tax Administration to Simplify and Streamline Tax Administration Process and Enhance Taxpayer Experience, with the Aim to Cultivate and Stimulate Market Vitality, Bulletin [2021] No. 69, dated 12 October 2021 and effective from 12 October 2021.

[7] The Notice of the Ministry of Finance and the State Taxation Administration on the Imposition of Individual Income Tax on Income from Stock Options, Cai Shui [2005] No. 35, dated 28 March 2005 and effective from 1 July 2005.

[8] Notice of the Ministry of Finance and the State Taxation Administration on Improving the Individual Income Tax Policies on Equity Incentive and Capital Contribution Using Technology, Cai Shui [2016] No. 101, dated 20 September 2016 and effective from 1 September 2016.

[9] See our China Tax Update February Issue, available on https://insightplus.bakermckenzie.com/bm/tax, for more detail.

[10] See article 4 of Notice 101.

- 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.

- Further, MNCs should be aware that detailed implementation guidance has yet to be released for some regions, meaning the local governmental authorities may have some flexibility to adjust details of the tax incentive policies to make them more competitive compared to other regions. MNCs that are interested in investing in the regions are advised to obtain assistance from their tax advisers when communicating and negotiating with the local governmental authorities.

	Hainai Free Trade Port	Qianhai (Shenzhen) Modern Service Zone	Lin'gang New Area (Shanghai)	Henqing Guangdong-Macau Cooperation Zone
Encouraged industries	Very broad[11]	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	New catalogue to be released. Under the previous catalogue and the Plan, encouraged industries are expected to include high and new technology, pharmaceuticals and healthcare, science and technology, education and R&D, cultural creativity, business and trade service, tourism, Macau branding industries (e.g., traditional Chinese medicine), cultural tourism, exhibition and trade and modern financial service.
EIT	15%	15%	15%	15%
IIT	Effective IIT burden capped at 15% for high-end and urgently needed foreign or domestic talent		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 and detailed guidance has yet to be released.	Effective IIT burden capped at 15% for high end and urgently needed foreign or domestic talent

[11] 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. Please refer to the main sections for the discussion.

Outbound regime	EIT exemption on income from new overseas direct investment for enterprises in the tourism, modern services and high-tech industries		EIT exemption on income from new overseas direct investment for enterprises in the tourism, modern services and high-tech industries. Detailed guidance has yet to be released.
Depreciation and amortization (D&A)	Immediate expensing for qualified capital expenditures, and accelerated D&A for others		Immediate expensing for qualified capital expenditures, and accelerated D&A for others. Detailed guidance has yet to be released.

4.2 Hainan Free Trade Port

In brief

On 23 June 2020, the MOF and the STA jointly issued Cai Shui [2020] No. 31 ("**Notice 31**"),[12] which provides the tax incentive policies for the Hainan Free Trade Port ("**Hainan FTP**"). Specifically, three preferential EIT policies are provided, including: (1) a reduced EIT rate of 15% for enterprises that operate in encouraged industries and have substantive operations in the region; (2) an EIT exemption policy on foreign income from new overseas direct investment earned by enterprises that operate in the tourism, modern services and high-tech industries; and (3) an immediate tax deduction or accelerated tax depreciation or amortization policy for qualified capital expenditure. To implement the preferential EIT policies, the local governmental bodies of Hainan Province issued various notices, which are discussed below.

In more detail

Qualified industries: Only enterprises that primarily operate in the encouraged industries and have substantive operation in the region are entitled to the reduced EIT rate. Enterprises should derive more than 60% of their annual revenue from the encouraged industries.

Encouraged industries are industries covered under three catalogues, including the Catalogue of Industrial Structure Adjustment (产业结构调整指导目录), the Catalogue of Encouraged Industries for Foreign Investment (鼓励外商投资产业目录) and the Catalogue of Encouraged Industries for the Hainan FTP.[13] The Catalogue of Encouraged Industries for the Hainan FTP is comprehensive and contains 143 items under 12 industries, including: (1) agriculture, forestry, animal husbandry and fishery; (2) manufacturing; (3) construction; (4) wholesale and retail; (5) transportation, storage and mail; (6) accommodation and catering; (7) telecommunication, software and information technology services; (8) financial services; (9) leasing and business services; (10) scientific research and

[12] The Notice of the Ministry of Finance and the State Taxation Administration on Preferential Enterprise Income Tax Policies for the Hainan Free Trade Port, Cai Shui [2020] No. 31, dated 23 June 2020 and effective from 1 January 2020.

[13] The Notice of the National Development and Reform Commission, the Ministry of Finance and the State Taxation Administration on the Catalogue of Encouraged Industries for Hainan Free Trade Port (2020 Version), Fa Gai Di Qu Gui [2021] No. 120, dated 27 January 2021 and effective from 1 January 2021.

technological services; (11) public infrastructure management services; (12) education; (13) health and social work; and (14) culture, sports and entertainment.

Substantive operation: 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, assets, etc. should be considered as having substantive operation. On 5 March 2021, the Hainan Provincial Taxation Administration, the Hainan Provincial Department of Finance and the Hainan Provincial Administration for Market Regulation jointly issued Hainan Notice [2021] No. 1 ("**Hainan Notice 1**"),[14] which adds more color to the definition of substantive operation. In the table below, we summarize the specific requirements for different scenarios.

Scenario	Substantive operation requirements
Resident enterprise established in the Hainan FTP with no branches outside the Hainan FTP	Production and operation, people function, finance and accounting, and asset ("**Four Elements**") should be in the Hainan FTP.
Resident enterprise established in the Hainan FTP with branches outside the Hainan FTP	The enterprise should be able to exercise effective control and management over the Four Elements of the branches outside the Hainan FTP.
Resident enterprise established outside the Hainan FTP with branches in the Hainan FTP	The branches should have operating income, employee compensation and total asset in the Hainan FTP commensurate with their production and operation functions
Nonresident enterprise with an establishment/place of business in the Hainan FTP	Same as above.

Hainan Notice 1 is accompanied by an official interpretation, which provides more detailed requirements of the Four Elements.[15]

Element	Interpretation
Production and operation	The enterprise should have fixed production and operation premises in the FTP and its major production and operation premises should be in the FTP, or it can exercise substantial and comprehensive management and control over the institutions in the FTP.

[14] The Notice of the Hainan Provincial Taxation Administration, the Hainan Provincial Department of Finance and the Hainan Provincial Administration for Market Regulation 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 effective from 1 January 2020.

[15] Available at http://hainan.chinatax.gov.cn/xxgk_6_3/05132524.html

People function	The enterprise should have employees working in the FTP for its production and operation. Employment agreements should been signed with the enterprise in the FTP for more than one year.
Finance and accounting	The enterprise should store its finance and accounting documents in the FTP and its primary bank account should be opened in the FTP.
Asset	The enterprise should own or have the right to use the production and operation assets in the FTP.

EIT exemption on income from new overseas direct investment: Notice 13 provides an EIT exemption policy on foreign income earned by enterprises established in the region that operate in the qualified industries. To enjoy the EIT exemption policy, enterprises should satisfy the industry requirement (i.e., tourism, modern services and high-tech industries); the ownership requirement (i.e., enterprises should own more than 20% equity interest in foreign subsidiaries); and the statutory EIT rate requirement (i.e., the statutory EIT rate of the jurisdiction where the investment is made should not be less than 5%). With respect to the industry requirement, Notice [2021] No. 14[16] was jointly issued by the MOF and the STA on 18 March 2021, which provides the specific items under the three qualified industries.

Immediate expensing or accelerated depreciation or amortization: For newly purchased fixed assets (excluding real estate assets) and intangible assets with a unit value of no more than RMB 5 million, enterprises established in the region would be able to take an immediate tax deduction. For assets with a unit value of more than RMB 5 million, enterprises would be entitled to an accelerated tax depreciation or amortization policy.

IIT policy: As part of the policy packages, an IIT incentive policy is also provided to attract domestic and foreign talent. Cai Shui [2020] No. 32 ("**Notice 32**")[17] provides the fundamental policy for individual taxpayers, which is implemented by Qiong Cai Shui [2020] No. 1019. Under Notice 32, high-end and urgently needed talent working in the region would be entitled to a partial IIT exemption policy on the portion of IIT that exceeds 15% of their respective taxable income. To be eligible for the IIT incentive, relevant individuals should work in the region and satisfy other requirements (e.g., employment agreements with enterprises established in the region).

Our observation

The establishment and development of the Hainan FTP is one of the priorities of the Chinese government. China's top legislator passed the Hainan Free Trade Port Law in 2021, which demonstrates the Chinese government's ambitious plan to transform Hainan into an influential free trade port. With respect to fiscal and tax policies, in addition to the income tax incentive policies discussed above, it is noted in the Hainan Free Trade Port Law that VAT, consumption tax, vehicle purchase tax, urban maintenance and construction tax, etc. will be consolidated and sales tax will be imposed on the retail sale of goods and services.

[16] The Notice of the Ministry of Finance and the State Taxation Administration on Issuing the Catalogue of Tourism, Modern Service and High-Tech Industries for the Preferential Enterprise Income Tax Policy in the Hainan Free Trade Port, Cai Shui [2021] No. 14, dated 28 March 2021 and effective from 1 January 2021.

[17] The Notice of the Ministry of Finance and the State Taxation Administration on Preferential Individual Income Tax Policies for the Hainan Free Trade Port, Cai Shui [2020] No. 32, dated 30 June 2020 and effective from 1 January 2020.

With respect to the preferential EIT policies, substantive operation is the key. Enterprises established in the region or that contemplate making an investment in the region should evaluate whether they can satisfy the specific substantive operation requirements, and adhere to the compliance and documentation requirements.

4.3 Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone

In brief

On 27 May 2021, the MOF and the STA jointly issued Cai Shui [2021] No. 30 ("**Notice 30**"),[18] which extends the preferential EIT rate of 15% for enterprises established in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone ("**Qianhai Modern Service Zone**"). Further, a 2021 version of the Catalogue of Encouraged Industries for the Qianhai Modern Service Zone ("**Qianhai 2021 Catalogue**") was issued as part of Notice 30. Both are effective from 1 January 2021 to 31 December 2025. To implement the preferential EIT policy under Notice 30, Shenzhen Tax Bureau subsequently issued a local guideline specifying the procedure and filing method for relevant enterprises.[19]

In more detail

Notice 30 provides that enterprises established in the Qianhai Modern Service Zone would be entitled to a reduced 15% EIT rate if their main business falls within one or more encouraged industries under the Qianhai 2021 Catalogue and the enterprises derive more than 60% of their total revenue from the encouraged industries. The predecessor of Notice 30 (i.e., Cai Shui [2014] No. 26) specifies that 70% should be from the encouraged industries.[20] By lowering the revenue percentage threshold, more enterprises are expected to be eligible for the preferential EIT policy. Where an enterprise has its headquarters in the Qianhai Modern Service Zone and has branches outside the region, or vice versa, only the income attributable to the headquarters or branches in the Qianhai Modern Service Zone is eligible for the preferential EIT policy.

Qualified industries: The Qianhai 2021 Catalogue contains 30 items under five industries: (1) modern logistics, (2) information services, (3) scientific and technological services, (4) cultural creativity and (5) commercial services.

Procedure: The local guidance provides that enterprises enjoying the preferential EIT policy should make a self-assessment as to whether they meet the encouraged industry and revenue requirements, and retain documents for inspection.

Our observation

For enterprises that have been enjoying the preferential EIT policy, the extension of the policy is good news. They should ensure that they continue to meet the requirements and retain documents for inspection. For enterprises in the modern service industries that are interested in making an investment in the region, they should evaluate whether they are eligible for the policy and perform a cost-benefit study.

---

[18] The Notice of the Ministry of Finance and the State Taxation Administration on Extending the Preferential Enterprise Income Tax Policy for Enterprises Established in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone, Cai Shui [2021] No. 30, dated 27 May 2021 and effective from 1 January 2021.

[19] Guidelines on the Preferential Enterprise Income Tax Policies for Enterprises Established in Qianhai. Available at http://qh.sz.gov.cn/tzqh/yhzc/qysdsyh/content/post_9025432.html.

[20] The Notice of the Ministry of Finance and the State Administration of Taxation on the Preferential Enterprise Income Tax Policies and Catalogue for Hengqin New Area of Guangdong Province, Pingtan Comprehensive Experimental Area of Fujian Province and Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone, Cai Shui [2014] No. 26, dated 25 March 2014 and effective from 1 January 2014.

4.4 Lin'gang New Area

In brief

Back in August 2019, the State Council issued the General Plan for the Lin'gang New Area of Shanghai Pudong Free Trade Zone ("**Lin'gang New Area**") as the guiding principle for the local government to create an internationally competitive free trade zone.[21] To implement the plan, on 13 July 2020, the MOF and the STA jointly issued Notice [2020] No. 38 ("**Notice 38**"), which provides a reduced EIT rate of 15% for enterprises established in the region that operate in the qualified high-tech industries within five years from the date of establishment.

In more detail

Qualified industries: Enterprises should engage in the core process of manufacturing and R&D in the key industries such as integrated circuit, artificial intelligence, biopharma and civil aviation to be eligible for the reduced EIT rate.

Specific requirements: Notice 38 sets out the specific requirements to be eligible for the preferential EIT policy as follows:

- Enterprises should be legally established in the Lin'gang New Area and carry out "substantial manufacturing or R&D activities" in the qualified industries. Substantial manufacturing or R&D activities mean that an enterprise should have a fixed place of business, employ regular staff, and have hardware and software for the manufacturing or R&D activities.
- Enterprises should have at least one core product (technology) embedded in its R&D activities or products manufactured and sold. A core product (technology) is a product (technology) that plays critical roles or is indispensable in the relevant industry.
- Requirements on investors: The investors should have leading international market influence in the industry, and their technological strength should be ranked among the best in the industry or the investors should have a leading position in the domestic market segment, and have cutting-edge technologies in the industry.
- Enterprises should satisfy one of the manufacturing and R&D conditions specified under Notice 38, which are primarily related to the manufacturing and R&D strength of the enterprises (e.g., core technology in the industry).

Our observation

Lin'gang New Area limits its preferential EIT policy to enterprises in the key industries such as integrated circuits, artificial intelligence, biopharma and civil aviation. Enterprises operating in the qualified industries that intend to invest in the region should evaluate whether they could satisfy the requirements and carry out a cost-benefit analysis. Further, as noted in the General Plan for the Lin'gang New Area, the State Council urged the local government to explore a preferential IIT policy for high-end foreign talent, a VAT policy for export of services, a tax policy for investment and financing activities, etc. Enterprises are recommended to closely monitor the tax developments in the region.

Further, on 23 April 2021, the China's Central Committee and the State Council jointly released the Opinion on Supporting the High-level Reform and Opening-up in the Pudong New Area and Transforming it into a Pioneer Area for Socialist Moderation. which proposes to replicate the preferential EIT policy in other areas of Pudong. Relevant MNCs are recommended to closely monitor the policy developments.

4.5 Henqing Guangdong-Macau Cooperation Zone

In brief

On 5 September 2021, China's Central Committee and the State Council jointly released the Plan ("**Plan**")[22] for Building a Guangdong-Macau Cooperation Zone in Hengqin ("**Henqing Guangdong-Macau Cooperation Zone**").

The Plan aims to further encourage economic development in the region and cooperation between Guangzhou and Macau. The Plan also proposes various preferential EIT and IIT tax policies.

In more detail

Qualified industries: The Plan proposes a preferential EIT rate of 15% for enterprises that operate in the encouraged industries. A new catalogue of encouraged industries has yet to be released. The previous 2019 catalogue under Cai Shui [2019] No. 63[23] contained six industries: (1) high and new technology; (2) pharmaceuticals and healthcare; (3) science and technology, education and R&D; (4) cultural creativity; (5) business and trade services; and (6) tourism. The 2019 catalogue and Cai Shui [2019] No. 63 both expired on 31 December 2020. Further, as noted in the plan, the following industries are expected to be included in the new catalogue: (1) science and technology, R&D and advanced manufacturing; (2) Macau branding, such as traditional Chinese medicine; (3) cultural tourism; exhibition and trade; and (4) modern financial services.

Other preferential EIT policies: The Plan also proposed two EIT policies similar to the Hainan FTP. For qualified capital expenditures, enterprises established in the region would be able to take an immediate tax deduction or accelerated tax depreciation or amortization. Further, for enterprises established in the region that are engaged in the high and new technology, tourism and modern services industries, an EIT exemption would apply to foreign income derived from new direct foreign investment.

IIT policy: Similar to the IIT policy in the Hainan FTP, the Plan proposes a partial IIT exemption policy that would be available to high-end and urgently needed talent working in the region to achieve a 15% effective tax rate.[24] Further, for Macau residents working in the region, the difference between IIT paid in China and the tax that would be payable on the same income in Macau would be exempt from IIT.

Our observation

Enterprises established in the region or are contemplating making an investment in the region should be mindful of the upcoming implementing guidelines, assess their eligibility for the preferential EIT and IIT policies, and carry out a cost-benefit analysis.

5. Enterprise income tax

5.1 Tax reduction policies for small and micro enterprises

Tax reduction policies for SMEs continue to be one of the Chinese government's priority policies this year.

On 17 January 2019, the MOF and the STA jointly issued Cai Shui [2019] No. 13, which provides reduced progressive EIT rates for SMEs.[25] Specifically, where the annual taxable income of an SME is less than RMB 1 million, its taxable income would be reduced by 75% and subject to EIT at 20% (i.e., an effective tax rate at 5%), and

---

[21] The Notice of the State Council on Issuing the Overall Plan for the Lingang New Area of Shanghai Free Trade Zone, Guo Fa [2019] No. 15, dated 27 July 2019 and effective from 27 July 2019.

[22] The Plan for Building a Guangdong-Macau Cooperation Zone in Hengqin Jointly Issued by China's Central Committee and the State Council, dated 5 September 2021 and effective from 5 September 2021.

[23] The Notice of the Ministry of Finance and the State Taxation Administration on the Inclusion of the Tourism Industry into the Catalogue of Encouraged Industries Eligible for the Preferential Enterprise Income Tax Policy in Henqing New Area, Cai Shui [2019] No. 63, dated 2 August 2019 and effective from 1 January 2019.

[24] The IIT policy proposed in the Plan is implemented by the Notice of the Ministry of Finance and the State Taxation Administration on the Preferential Individual Income Tax Policy for Henqing New Area, Cai Shui [2022] No. 3 and effective from 1 January 2021.

[25] The Notice of the Ministry of Finance and the State Taxation Administration on Implementing the Tax Reduction and Exemption Policies for Small and Micro Enterprises, Cai Shui [2019] No. 13, dated 17 January 2019 and effective from 1 January 2019.

where the annual taxable income of an SME is between RMB 1 million and RMB 3 million, its taxable income that exceeds RMB 1 million would be reduced by 50% and subject to EIT at 20% (i.e., an effective EIT rate at 10%).[26] Enterprises should satisfy the total asset, number of employees and taxable income requirements to be eligible for the reduced EIT rates, i.e., taxable income of not more than RMB 3 million, a workforce of not more than 300 employees, and total assets of not more than RMB 50 million.[27]

To implement the tax proposal noted in the Report, the MOF and the STA jointly issued Bulletin [2021] No. 8[28] and Bulletin [2021] No. 12,[29] which further reduced the effective EIT rate from 5% to 2.5% on the first RMB 1 million taxable income of SMEs, i.e., the taxable income would be reduced by 87.5% and subject to EIT at 20%. The policy is in force until 31 December 2022.

Our observation

The EIT reduction policy for SMEs is partly in response to the disruption caused by the COVID-19 pandemic and partly in response to the Chinese government's initiative to support the development of the private economy. While the policy is effective until 31 December 2022, it may be extended given that the disruption and pressure exerted on the private economy by the COVID-19 pandemic may not end any time soon.

The EIT reduction policy is part of the policy packages supporting SMEs. The Chinese government has introduced other notable measures, including lowering the VAT rate for VAT small-scale taxpayers. For instance, a reduced VAT rate of 1% is granted to VAT small-scale taxpayers under Bulletin [2020] No. 13.[30] Further, VAT small-scale taxpayers with monthly turnover of no more than RMB 150,000 are entitled to VAT exemption.[31]

5.2 R&D expense super deduction

In brief

In March 2021, the MOF and the STA jointly issued Bulletin [2021] No. 6 ("**Bulletin 6**")[32] and Bulletin [2021] No. 13 ("**Bulletin 13**").[33] Bulletin 6 extends the 75% R&D expense super deduction incentive until 31 December 2023, and Bulletin 13 increases the R&D expense super deduction ratio from 75% to 100% for manufacturing enterprises.

---

[26] Also see Cai Shui [2019] No. 13.

[27] Also see Cai Shui [2019] No. 13.

[28] The Bulletin of the State Taxation Administration on Implementing the Preferential Income Tax Policies to Support Small and Micro Enterprises and Sole Proprietors, Bulletin [2021] No. 8, dated 7 April 2021 and effective from 1 January 2021.

[29] The Bulletin of the Ministry of Finance and the State Taxation Administration on Implementing the Preferential Income Tax Policies to Support Small and Micro Enterprises and Sole Proprietors, Bulletin [2021] No. 12, dated 2 April 2021 and effective from 1 January 2021.

[30] The Bulletin of the Ministry of Finance and the State Taxation Administration on VAT Policy to Support VAT Small-Scale Taxpayers in Resuming Production and Operation, Bulletin [2020] No. 13, dated 28 Feb 2020 and effective from 28 Feb 2020.

[31] The Bulletin of the Ministry of Finance and the State Taxation Administration on Clarifying the VAT Exemption Policy for Small-Scale Taxpayers, Bulletin [2021] No. 11, dated 31 March 2021 and effective from 31 March 2021.

[32] The Bulletin of the Ministry of Finance and the State Taxation Administration on Extending the Implementation Period for Some Tax Preferential Policies, Bulletin [2021] No. 6, dated 15 March 2021 and effective from 15 March 2021.

[33] The Bulletin of the Ministry of Finance and the State Taxation Administration on Further Improving the R&D Expense Super Deduction Incentive, Bulletin [2021] No. 13, dated 31 March 2021 and effective from 1 January 2021.

In more detail

The R&D expense super deduction incentive has existed since 2008.[34] In recent years, access to the incentive has been progressively expanded to cover most industries. Those excluded from the incentive are enterprises in the tobacco manufacturing, hotel and catering, wholesale and retail, real estate, leasing and business services, and entertainment industries.[35] Further, the super deduction ratio was increased from 50% to 75%.[36] The incentive works in such a way that enterprises incurring qualified R&D expenses should be entitled to an additional 75% deduction for EIT purposes. To the extent the qualified R&D expense is capitalized as an intangible asset, the enterprise should be entitled to amortize the intangible asset based on 175% of the qualified R&D expense incurred.[37] The incentive was set to expire on 31 December 2020 and was extended by Bulletin 6 until 31 December 2023.

Therefore, enterprises that intend to enjoy the benefit should consider whether they are eligible for the 75% deduction, which applies to all enterprises except those excluded from the incentive and those in the manufacturing industry, which may be eligible for the 100% super deduction.

100% R&D expense super deduction: As mentioned at the beginning, Bulletin 13 increases the super deduction ratio from 75% to 100% for enterprises in the manufacturing industry. The adjustment is in response to a tax proposal noted in the Report to encourage enterprises in the manufacturing industry to engage in more R&D activities and upgrade their manufacturing processes using new technologies and innovative solutions. An enterprise should primarily engage in the manufacturing industry, which is determined under the National Economic Industry Category (GB/T 4574-2017) and should derive more than 50% of its annual operating income from the manufacturing industry to be eligible for the 100% super deduction.

Advanced deduction: Enterprises are allowed to pre-claim the R&D expense super deduction for the first half of a tax year, during their quarterly or monthly filing in September.

Our observation

The R&D expense super deduction incentive is an important part of the policy packages provided by the Chinese government to support scientific and technological innovation and upgrade the manufacturing industry. While enterprises with material R&D activities may benefit from the incentive, the rules are complicated. The gating issue is determining whether any expense incurred is eligible R&D expense, which should be determined under Cai Shui [2015] No. 119 and Bulletin [2015] No. 97.[38] While Cai Shui [2015] No. 119 provides a broad scope of eligible R&D expenses and a negative list of ineligible expenses,[39] tax professionals may not find the determination straightforward. Tax professionals should expect to coordinate with other departments within their respective organizations to make the determination.

Meanwhile, tax authorities would expect to see enterprises adopt a systematic approach when conducting R&D activities, record expenses in an accurate manner and maintain supporting documents and evidence for inspection. Therefore, enterprises that intend to apply for the incentive should consider establishing a good internal control and documentation process over the conduct of R&D activities.

5.3 Tax exemption on bond interest derived by foreign institutional investors

In brief

On 22 November 2021, the MOF and the STA jointly issued Bulletin [2021] No. 34 ("**Bulletin 34**"),[40] which extended the EIT and VAT exemption policy for foreign institutional investors on bond interest derived from China's bond market for the period from 7 November 2021 to 31 December 2025.

In more detail

The EIT and VAT exemption policy was originally provided under Cai Shui [2018] No. 108, which expired on 6 November 2021.[41] Bulletin 34 extends the policy until 31 December 2025. It should be noted that the EIT exemption applies to foreign institutional investors that do not have an establishment in China, or, if there is an establishment, the bond interest is not effectively connected with the establishment.

Our observation

The extension of the EIT and VAT exemption policy is good news for foreign institutional investors. However, Bulletin 34 only provides the EIT exemption on bond interest and guidance should be provided on whether such exemption also applies to capital gain realized from the disposal of the bond.[42] Foreign institutional investors should closely monitor any future developments in this area.

6. Deed tax and land value appreciation tax exemption for qualified enterprise restructuring

6.1 Deed tax exemption policy for enterprises restructuring extended

In brief

On 26 April 2021, the MOF and the STA jointly released Bulletin [2021] No. 17 ("**Bulletin 17**"),[43] which extends the deed tax (DT) exemption policy for qualified enterprise restructuring until 31 December 2023.

In more detail

DT is levied on the transferees or assignees on the purchase, gift or exchange of ownership of land use rights or real properties, with the tax rates generally ranging from 3% to 5%. Under the predecessor of Bulletin 17, i.e., Notice [2018] No. 17,[44] qualified enterprise restructurings are exempted from DT. Cai Shui [2018] No. 17, which expired on 31 December 2021.

Bulletin 17 maintains the substance under Notice [2018] No. 17. It provides nine types of qualified restructuring that are exempted from DT, including restructuring of enterprises, restructuring of public institutions, merger, split, bankruptcy, asset transfer (资产划转), debt-to-equity conversion, grant or investment (出让或出资) and share transfer. For each type of restructuring, the conditions under Bulletin 17 should be satisfied. For instance, for a

---

[34] See article 30 of the Enterprise Income Tax Law of China.

[35] The Notice of the Ministry of Finance and the State Taxation Administration on Improving the R&D Expense Super Deduction Incentive, Cai Shui [2015] No. 119, dated 2 November 2015 and effective from 1 January 2016.

[36] The Notice of the Ministry of Finance, the State Taxation Administration and the Ministry of Science and Technology on Increasing the R&D Super Deduction Ratio, Cai Shui [2018] No. 99, dated 20 September 2018 and effective from 20 September 2018.

[37] Also see Cai Shui [2018] No. 99.

[38] The Bulletin of the State Administration Taxation on Relevant Issues Relating to R&D Expense Super Deduction, Bulletin [2015] No. 97, dated 29 December 2015 and effective from 29 December 2015.

[39] See article 1 of Cai Shui [2015] No. 119.

[40] The Bulletin of the Ministry of Finance and the State Taxation Administration on Extending the Enterprise Income Tax and Value Added Tax Policies for Overseas Institutions Investing in the Domestic Bond Market, Bulletin [2021] No. 34, dated 22 November 2021 and effective from 22 November 2021.

[41] The Notice of the Ministry of Finance and the State Taxation Administration on the Enterprise Income Tax and Value Added Tax Policies for Overseas Institutions Investing in the Domestic Bond Market, Cai Shui [2018] No. 108, dated 7 November 2018 and effective from 7 November 2018.

[42] See the Notice of the Ministry of Finance and the State Taxation Administration on Income from Transfer of Stocks and other Equity Investment by QFIIs and RQFIIs, Cai Shui [2014] No. 79, dated on 31 October 2014 and effective from 31 October 2014, which has a limited scope for equity investment.

[43] The Bulletin of the Ministry of Finance and the State Taxation Administration on Extending the Deed Tax Exemption Policy for Certain Restructuring of Enterprises and Public Institutions, Bulletin [2021] No. 17, dated 26 April 2021 and effective from 1 January 2021.

[44] The Notice of the Ministry of Finance and the State Taxation Administration on Relevant Deed Tax Policies Supporting Restructuring of Enterprises and Public Institutions, Notice [2018] No. 17, dated 2 March 2021 and effective from 1 January 2018.

merger or split to be eligible for the DT exemption, the original investors should satisfy the continuity of ownership interest requirement by retaining their interests in the surviving enterprise or new enterprise(s). For an asset transfer to be eligible for the DT exemption, the 100% shareholding ownership should be satisfied.

6.2 Land value appreciation tax exemption policy for enterprise restructuring extended

In brief

On 31 May 2021, the MOF and the STA jointly issued Bulletin [2021] No. 21 ("Bulletin 21"),[45] which extends the land value appreciation tax (LVAT) exemption policy for qualified enterprise restructuring until 31 December 2023.

In more detail

LVAT is levied on gains realized from real property transactions at progressive rates ranging from 30% to 60%. Under the predecessor of Bulletin 21, i.e., Notice [2015] No. 5,[46] qualified enterprise restructurings are exempted from LVAT. Notice [2015] No. 5 was extended by Notice [2018] No. 57,[47] which became invalid on 1 January 2021.

Bulletin 21 provides four types of qualified restructuring that are exempted from LVAT, including entire restructuring (整体改制), merger, split and investment using real properties. Further, Bulletin 21 provides the specific requirements for each type of restructuring.

For an entire restructuring (e.g., conversion of a non-corporate enterprise into a limited liability company), the transfer of real properties should be exempted from LVAT provided the restructuring should not result in "a change of investors of the original enterprise," whose rights and obligations are inherited by the post-restructuring enterprise. It is further clarified that "a change of investors" means that the restructuring enterprise should be owned by the same group of investors before and after the restructuring. However, their respective ownership interest in the restructuring enterprise may be adjusted to reflect the economics of the restructuring. For a merger or split, the original investors should satisfy the continuity of ownership interest requirement by retaining their interests in the surviving enterprise or new enterprise(s). Similar to the entire restructuring, the original investors may adjust their respective ownership interest in the surviving enterprise or new enterprise(s) according to the economics of the merger or split. Last but not least, the contribution of real properties to another enterprise as an investment and as part of the restructuring should also be exempted from LVAT. Importantly, as an exemption to the general rules, the LVAT exemption treatment should not apply if one party in the restructuring is a real estate development enterprise.

Our observation

Bulletin 21 and Bulletin 17 are good news for taxpayers that contemplate restructuring involving real properties. Neither Bulletin 21 nor Bulletin 17 provides a list of documents to be submitted to the tax authorities for purposes of applying the exemption. Thus, relevant taxpayers should evaluate whether they are eligible for the exemption and should retain relevant documents for inspection. If there is any uncertainty with respect to the application of the rules, we would recommend that taxpayers consult with their tax advisers.

7. The Stamp Duty Law of China

In brief

---

[45] The Bulletin of the Ministry of Finance and the State Taxation Administration on Extending the Land Value Appreciation Tax Policy for Certain Restructuring of Enterprises, Bulletin [2021] No. 21, dated 31 May 2021 and effective from 1 January 2021.

[46] The Notice of the Ministry of Finance and the State Taxation Administration on Land Value Appreciation Tax Policy for Certain Restructuring of Enterprises, Notice [2015] No. 5, dated 2 February 2015 and effective from 1 January 2015.

[47] The Notice of the Ministry of Finance and the State Taxation Administration on Extending the Land Value Appreciation Tax Policy for Certain Restructuring of Enterprises, Notice [2018] No. 57, dated 16 May 2018 and effective from 1 January 2018.

On 10 June 2021, the Standing Committee of the 13th NPC officially announced the Stamp Duty Law of China ("**SD Law**"), which will become effective from 1 July 2022 and replace the prevailing SD Provisional Regulations.[48] 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 maintains the current SD system, the tax item is simplified and the tax rate is reduced for some items.

In more detail

Enterprise or individual taxpayers that conclude certain contracts, receive certain documents ("**Taxable Documents**") or enter into securities transactions should pay stamp duty on such documents or transactions. Taxable Documents that are concluded outside China but used in China should also be subject to stamp duty.

In the table below, we summarize the tax item and tax rate under the SD Law. Notably, the tax rate for process contracting contracts, transportation contracts, reconnaissance and design contracts (under construction project contracts) and documents of transfer of exclusive right of trademark, patent right and proprietary technology usage right is reduced from 0.05% to 0.03%.

Tax item	Tax rate
Lease contract, custody contract, storage contract, property insurance contract, and securities transactions	0.1%
Documents of grant or transfer of land use right, ownership of buildings and structures or equity	0.05%
Purchase and sale contract, process contracting contract, construction contract, transportation contract, technology contract, documents of transfer of exclusive right to use trademark, copyright, patent right and proprietary technology usage right	0.03%
Business account books	0.025%
Loan contract and financial leasing contract	0.005%

Further, the SD Law clarifies the following issues:

- The tax base for stamp duty should exclude the listed VAT amount. The definition of listed VAT amount is not provided. Therefore, taxpayers are advised to separate the VAT amount when drafting contracts or documents.
- The withholding agent is specified for Taxable Documents that are concluded outside China but used in China. Where the foreign taxpayer has a domestic agent in China, the domestic agent should be the withholding agent. If there is no domestic agent, the foreign taxpayer should report and pay the stamp duty by itself.
- Tax collection and administration: The SD Law provides that stamp duty should be levied quarterly, annually or on a transactional basis. The location of the tax payment is also specified for enterprise taxpayers, individual taxpayers or real estate transfers.
- Securities transactions: The SD Law confirms that securities transactions and depositary receipts should be subject to stamp duty at a tax rate of 0.1%. The transferor of the securities transactions should be liable and pay the stamp duty on a weekly basis. The securities registration and settlement institutions as the withholding agents should declare and remit the stamp duty and the interest within five days after the end of each week.

[48] The Provisional Regulations of the People's Republic of China on Stamp Duty (revised in 2011) by the State Council.

- Electronic orders: The SD Law provides an exemption for electronic orders between e-commerce businesses and individual buyers. The exemption is not available to electronic orders between e-commerce businesses and non-individual buyers.

Our observation

The simplification of tax items and reduction of tax rates are welcome news for taxpayers. Further, the enforcement of the SD Law will provide taxpayers with more certainty. The legislation of the SD Law is another step taken by the Chinese government to promote the implementation of the statutory taxation principle in China. In accordance with the government's legislative work plan, the draft VAT Law, the draft Consumption Law and the draft Customs Duty Law are expected to be submitted to the Standing Committee of the NPC for deliberation.

8. Tax treaty developments

8.1 China-Spain tax treaty

On 2 May 2021, the China-Spain Double Taxation Agreement (DTA) entered into force. The new DTA, signed on 28 November 2019, replaced the 1990 tax treaty between the two countries.

Service permanent establishment: The new DTA modifies the service permanent establishment threshold by replacing six months by 183 days.

Withholding tax: Withholding tax on dividend is reduced to 5% if the beneficial owner is a company that has directly held at least 25% of the paying company's capital throughout a 365-day period that includes the day of the payment. Withholding tax on interest is 10%. Further, interest paid to the other contracting state, central bank or entities wholly owned by the other contracting state; and interest paid in connection with the sale of commercial or scientific equipment on credit are exempted from withholding tax. Withholding tax on royalty is 10%.

Nonresident capital gain: The capital gain article is modified to cover four scenarios where China may tax a Spain tax resident: (1) gain from the disposal of immovable property in China; (2) gain from the disposal of movable property forming part of the business property of a permanent establishment in China; (3) gain from the disposal of shares or comparable interests deriving more than 50% of their value directly or indirectly from immovable property in China (excluding immovable property used by a company for exercising its business); and (4) gain from the disposal of shares, other than the above, of a company that is a resident of the other state if the transferor, at any time during the 365 days preceding the alienation, directly or indirectly held at least 25% of the capital of that company, with an exemption for shares substantially and regularly traded on a recognized stock exchange, provided that the total shares disposed of during the fiscal year does not exceed 3% of the total shares of the company.

8.2 China-Rwanda tax treaty

The DTA between China and Rwanda was signed on 7 December 2021. The DTA has yet to be ratified.

Natural resource permanent establishment: The DTA specifically includes the provision that if an enterprise carries on activities in a contracting state that consist of, or are connected with, the exploration for or exploitation of natural resources situated in that state, if the activities are carried on for a period or periods aggregating more than 183 days within any 12-month period, the enterprise should be considered as having a permanent establishment in that state.

Withholding tax: The withholding tax on dividend is reduced to 7.5%. Withholding tax on interest is reduced to 8%. Further, interest paid to the other contracting state, central bank or entities wholly owned by the other contracting state is exempted from withholding tax. Withholding tax on royalty and technical services is 10%.

Nonresident capital gain: The capital gain article is drafted to cover four scenarios where China may tax a Rwanda tax resident: (1) gain from the disposal of immovable property in China; (2) gain from the disposal of movable property forming part of the business property of a permanent establishment in China; (3) gain from the disposal of shares or comparable interests deriving more than 50% of their value directly or indirectly from immovable property in China; and (4) gain from the disposal of shares, other than the above, of a company that is a resident of the other state if the transferor, at any time during the 365 days preceding the alienation, directly or indirectly held at least 25% of the capital of that company.

Baker McKenzie.

Contact Us

Jinghua Liu
Beijing
jinghua.liu@bakermckenziefenxun.com

Abe Zhao
Beijing
abe.zhao@bakermckenziefenxun.com

Jason Wen
Beijing
jason.wen@bakermckenziefenxun.com

Brendan Kelly
Shanghai
brendan.kelly@bakermckenzie.com

Nancy Lai
Shanghai
nancy.lai@bakermckenzie.com

Amy Ling
Hong Kong
amy.ling@bakermckenzie.com

Jon Eichelberger
San Francisco
jon.eichelberger@bakermckenzie.com

Shanwu Yuan
New York
shanwu.yuan@bakermckenzie.com