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Recent Developments in International Taxation

The People's Republic of China

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Overview

From 2022 to the first half of 2023, under complex domestic and international environments, China actively expanded international tax exchanges and cooperation, took domestic tax reform forward in an orderly manner, fostered fiscal and taxation development, and made great efforts in the direction of tax modernisation.

At the international level, China participates in the formulation of international tax rules, and cooperates bilaterally and multilaterally in international taxation. For example, it was deeply involved in multilateral negotiations on the Two-Pillar Solution for the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework to address tax challenges arising from the digitalisation of the economy, contributing Chinese wisdom to programme design and continuously enhancing its international tax impact.

At the domestic level, China has continued to deepen the reform of tax collection and administration, promoting the construction of Golden Tax Project Phase IV and the full digitalisation of electronic invoices, as well as the legislative process of the Value-added Tax Law (the 'VAT Law') and the Stamp Tax Law, while improving preferential tax policies and implementing the principle of statutory taxation with equal emphasis on optimising the business environment.

International dimension

Active participation in the base erosion and profit shifting (BEPS) action plan

China participates in the ongoing discussion for the OECD/G20 Inclusive Framework to address tax challenges arising from the digitalisation of the economy. On 25 May 2022, China approved the Multilateral Convention to Implement Tax-treaty-related Measures to Prevent Base Erosion and Profit Shifting (the 'Convention'), which entered into force for China on 1 September 2022.

The approval of the Convention is a significant step towards China implementing the BEPS action plan. China has adopted two types of outcomes and recommendations in the Convention, including the BEPS minimum standard terms, and other outcomes and recommendations that have been incorporated into the tax treaties of China in recent years.

Promoting the domestic implementation of the Two-Pillar Solution

As of May 2023, China has not legislated for the Two-Pillar Solution. However, the Chinese Minister of Finance has constantly expressed that China will continue to proactively contribute to the discussion of rules for the Two-Pillar Solution and promote its implementation.

On 18 January 2023, the Accounting Department of the Ministry of Finance published a letter to seek public comments on drafts of the International Tax Reform – Pillar Two Model Rules issued by the International Accounting Standards Board in order to be deeply involved in the amendments of International Financial Reporting Standards and make the revisions better meet China stakeholders' needs.

Expanding the tax treaty network

China actively strengthens tax cooperation with other countries and expands its tax treaty network. In 2022, new tax treaties between China and three countries (Congo, Angola and Rwanda) came into effect on 6 July, 11 June and 25 June, respectively. On 14 September 2023, China and Austria made partial revisions to the tax agreement signed by the two governments in 1991. Subsequently, on 17 October of the same year, tax treaties were signed with the governments of Senegal and Cameroon. So far, China's tax treaty network extends to 114 countries and regions.

Domestic dimension

Golden Tax Project Phase IV to be completed

Golden Tax Project Phase IV focuses on constructing smart taxation, taking electronic invoice reform as a breakthrough and tax big data as the driving force to build a smart taxation system with high integration function, high safety performance and high application efficiency. It comprehensively advances the digital upgrading and intelligent transformation of tax collection and administration and will finally realise 'data-based tax governance'. The completion date for Golden Tax Project Phase IV has not yet been determined.

Under this circumstance, China has been actively promoting the use of electronic invoices. A pilot programme for issuing fully digitalised electronic invoices (e-invoices) has been conducted in Guangzhou, Foshan, Guangdong-Macao In-Depth Cooperation Zone in Hengqin, Shanghai and Hohhot since 1 December 2021, and extended to more regions, such as Sichuan province and Xiamen as of November 2022.

New Tariff Law

On 26 April 2024, the Tariff Law of the People's Republic of China was approved and is scheduled to be implemented from 1 December 2024. Overall, the Customs Law maintains the basic stability of the current tariff system and the overall level of tariff burden will remain unchanged after implementation. At the same time, the Tariff Law provides clear provisions regarding the adjustment authority for tariff items and rates at the elevated legal level, tax obligations under new business formats and trade models. It actively aligns with international high-standard economic and trade rules, enhances customs tariff collection and management systems.

Management measures for advance tax rulings

On 29 December 2023, the Shanghai Municipal Tax Service Office issued 'Management Measures for Advance Tax Rulings of the Shanghai Municipal Tax Service (Trial)'. This marks the first set of advance ruling regulations issued by a provincial-level tax authority in China, introducing a new framework for tax management services. Subsequently, on 7 May 2024, Beijing announced similar advance tax rulings, further promoting the implementation of the advance ruling system. Both Shanghai and Beijing taxpayers now have the opportunity to seek advance rulings on complex tax matters, enhancing tax certainty and aiding businesses in assessing their tax costs.

Individual income tax (IIT)

In 2022, China's IIT system was further improved with the following key revisions:

- since 2022, expenses related to taxpayer's care of infants or children under the age of three have been deducted at the standard fixed amount of RMB 1,000 per month for each infant or child;
- since 2022, the preferential policy of the deferred payment of taxes on private pensions has applied. For example, income from investment included in private pension fund accounts was temporarily exempt from IIT; and

- on 26 April 2024, for domestic listed companies, stock options, restricted stocks and equity incentives granted to individuals, on filing with the competent tax authority, will be subject to IIT payments within a period not exceeding 36 months from the date of exercising the stock options, lifting restrictions on restricted stocks or acquiring equity incentives. If taxpayers leave the company during this period, they must settle all tax payments before departure.

Enterprise income tax (EIT)

China encourages enterprises to engage in innovation through different market-based mechanisms, such as various preferential tax policies with an annual scale exceeding RMB 1tn; and promotes enterprises' realisation of depreciation for fixed assets, pre-tax deductions for R&D expenses and deductions for investment in basic research.

FOR ENTERPRISES IN ALL INDUSTRIES

If the unit price of equipment or instruments (which means fixed assets other than houses and buildings) newly purchased during the period from 1 January 2018 to 31 December 2027 by an enterprise is not more than RMB 5m, such equipment or instrument expenses are allowed to be a one-off deduction (instead of being depreciated annually).

FOR MICRO, SMALL AND MEDIUM-SIZED ENTERPRISES

These kinds of enterprises may voluntarily choose to deduct equipment and instrument expenses with a unit value of RMB 5m or more that were newly purchased by between 1 January 2022 and 31 December 2022 before the payment of EIT at a certain percentage of the unit value.

PRE-EIT DEDUCTION OF R&D EXPENSES

With respect to the R&D expenses actually incurred by an enterprise, an extra 100 per cent of the amount of R&D expenses actually incurred shall be deducted before tax payment, in addition to the deduction of actual expenses as prescribed, from 1 January 2023, provided that the said expenses are not converted into intangible assets and included in the current profits and losses. If the said expenses have been converted into intangible assets, such expenses may be amortised at the rate of 200 per cent of the costs of the intangible assets before tax payment as of 1 January 2023. For integrated circuit and industrial host machine enterprises, during the period from 1 January 2023 to 31 December 2027, enterprises are eligible for an additional deduction of 120 per cent on actual R&D expenses incurred. If the said expenses have been converted into intangible assets, such expenses may be amortised at the rate of 220 per cent of the cost of the intangible assets.

PRE-EIT DEDUCTION FOR INVESTMENT IN BASIC RESEARCH

Since 1 January 2022, the expenditure of funds contributed by an enterprise to a not-for-profit scientific and technological R&D institution ('Scientific Research Institutions'), institution of higher education or government-managed natural science fund for basic research may be deducted before tax payment to the extent of the amount actually incurred in the calculation of the amount of taxable income, and an extra 100 per cent of the amount of such expenditure may be deducted before tax payment. Income from basic research funds received by not-for-profit Scientific Research Institutions and institutions of higher education from enterprises, individuals and other organisations shall be exempt from enterprise income tax.

VAT

China reviewed drafts of the PRC VAT Law (the 'Draft') in late 2022 and sought public comments on the Draft on 30 December 2022. The Draft integrates substantive and procedural VAT systems in China, and achieves the following amendments and highlights on the basis of maintaining the current VAT framework and tax burden:

- taxable transactions: labour services of processing, repair or replacement are no longer listed separately as taxable 'labour services', but included in taxable 'services';
- new non-taxable transactions: (1) compensation for expropriation and requisition; and (2) services provided by employees to their employers for wages and salaries;
- withholding agents: where overseas entities and individuals engage in taxable transactions within China, purchasers shall be withholding agents; this conclusion is no longer subject to the prerequisite that '(the overseas entity or individual) has no business institution within China';

- tax rates: the Draft specifies that the applicable tax rates for exported goods (except as otherwise provided by the State Council), services and intangible assets within the regulated scope of the State Council are zero, as well as the VAT levy rate of three per cent;
- preferential tax policies: the Draft expands the scope of VAT exemptions (eg, medical services provided by hospitals, clinics and other medical institutions, as well as educational services provided by schools and other educational institutions) and provides the option right of accepting or waiving the exemptions to taxpayers; and
- new connection with the Golden Tax Project Phase IV: the Draft requires that tax authorities, bank, customs, foreign exchange management, market regulation and other departments shall establish VAT information sharing and work cooperation mechanisms to strengthen the administration of VAT collection.

Stamp tax

The PRC Stamp Tax Law came into force on 1 July 2022 and mainly has the following revisions in taxable items, tax rates and so on, replacing the old PRC Interim Regulation on Stamp Tax:

- reduced rate: the tax rate for some taxable items, such as work contracts, construction project contracts and transportation contracts, is reduced from 0.5 per cent to 0.3 per cent, while the tax rate for the business account book is set at 0.25 per cent of the total amount of paid-up capital (capital stock) and capital reserve;
- four new tax-exempt vouchers: (1) taxable vouchers concluded by embassies or consulates in China of foreign countries or representative offices in China of international organisations, which shall be exempt from taxes in accordance with the provisions of law, for the acquisition of premises; (2) taxable vouchers concluded by the Chinese People's Liberation Army and Chinese People's Armed Police Force; (3) sales contracts concluded by non-profit medical institutions for the procurement of medicines or sanitary materials; and (4) electronic orders formed between individuals and e-commerce businesses;

- new provisions on the withholding agent: if a taxpayer is an overseas entity or individual and has an agent inside China, the domestic agent shall be the withholding agent; and if the taxpayer has no agent inside China, the taxpayer shall file a return of stamp tax on its/his/her own initiative;
- the provision of round-off difference has been removed and the amount of tax payable shall be determined based on the actually calculated amount; and
- the practices of 'light taxation, heavy penalties' have been abolished and the collection of stamp tax shall be administered by tax authorities in accordance with the provisions of this law and the PRC Tax Collection Administration Law.

Regional preferential tax policies

To leverage regional economic advantages and promote the establishment of a new open economic system, China established the Hainan Free Trade Port, Guangdong-Hong Kong-Macao Greater Bay Area and Guangdong-Macao In-Depth Cooperation Zone in Hengqin, and formulated regional preferential tax policies. The main tax preferences are summarised below:

- IIT: High-end or urgently needed talents working in these three areas shall be exempt from the portion of their IIT that exceeds 15 per cent. Macao residents working in the Guangdong-Australia Deep Cooperation Zone in Hengqin will be exempt from the portion of their IIT that exceeds the Macao tax burden;
- EIT: The EIT on eligible industrial enterprises located in the Guangdong-Macao In-Depth Cooperation Zone in Hengqin shall be levied at a reduced tax rate of 15 per cent. The EIT on enterprises in encouraged industries registered in the Hainan Free Trade Port that operate substantially shall be levied at a reduced tax rate of 15 per cent. Income obtained from their new overseas direct investments by enterprises in tourism, the modern service industry and high-tech industries established in the Hainan Free Trade Port shall be exempt from EIT; and
- stamp duty: During the period from 1 April 2024 to 31 March 2025, no stamp duty shall be levied on offshore transfer transactions of sale contracts

concluded by enterprises registered in the Shanghai Free Trade Zone and Lin-gang Special Area.