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Recent Developments in International Taxation

The People's Republic of China (the "PRC")

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I. Overview

From 2022 to the first half of 2023, under complex domestic and international environments, China actively expands international tax exchanges and cooperation, orderly takes domestic tax reform forward, fosters fiscal and taxation development, and makes great efforts in direction of tax modernization.

At the international level, China participates in the formulation of international tax rules and carries out bilateral and multilateral cooperation in international taxation, such as deeply involving in multilateral negotiations on the Two-Pillar Solution at the OECD/G20 Inclusive Framework to address the tax challenges arising from the digitalization of the economy, contributing Chinese wisdom to program 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 digitalization of electronic invoices, as well as the legislative process of the Value-added Tax ("**VAT**") Law and the Stamp Tax Law, while improving the preferential tax policies and implementing the principle of statutory taxation with equal emphasis on optimizing business environment.

II. International Dimension

(i) Active Participation in the BEPS Action Plan

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

The approval of the Convention is a significant step for China to implement 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 in tax treaties of China in recent years.

(ii) Promoting 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 constantly expressed that China will continue to proactively contribute to the discussion of rules for the Two-Pillar Solution and promote its implementation.

On January 18, 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 the International Financial Reporting Standards and make the revisions better meet China stakeholders' needs.

(iii) Expanding 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 (namely Congo, Angola and Rwanda) have come into effect respectively on July 6, June11, June 25.

III. Domestic Dimension

(i) Golden Tax Project Phase IV to be Completed

In September 2022, Mr. Jun WANG, Commissioner of China's State Taxation Administration, firstly mentioned at the third Belt and Road Initiative Tax Administration Cooperation Forum that Golden Tax Project Phase IV would be basically completed by the end of 2022. Golden Tax Project Phase IV focuses on constructing smart taxation, taking the 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, comprehensively advance the digital upgrading and intelligent transformation of tax collection and administration, and finally realizes "data-based tax governance".

Under this circumstance, China has been actively promoting the use of electronic invoices. The pilot program of issuing fully digitized electronic invoices ("**fully digitalized E-invoices**") has been conducted in Guangzhou, Foshan, Guangdong-Macao In-Depth Cooperation Zone in Hengqin, Shanghai and Hohhot since December

1, 2021, and extended to more regions such as Sichuan province and Xiamen as of November 2022.

(ii) Individual Income Tax ("IIT")

In 2022, China's IIT system is further improved with the key revisions which are as follows:

1. Since 2022, expenses related to taxpayer's care of infants or children under the age of 3 are deducted at the standard fixed amount of RMB 1,000 per month for each infant or child.

2. From October 1, 2022 to December 31, 2023, taxpayers who purchase a new house within one year after the sale of their current houses shall be given tax rebates for IIT that have been paid on sale of their current houses.

3. Since 2022, the preferential policy of deferred payment of taxes on private pensions shall apply. For example, the incomes from investments included in private pension fund accounts shall be temporarily exempted from IIT.

(iii) Enterprise Income Tax ("EIT")

China encourages enterprises to engage in innovation through different market-based mechanisms, such as various preferential tax policies with annual scale exceeding RMB 1 trillion, promotes enterprises' realization of depreciation for fixed assets, pre-tax deductions for research and development expenses ("**R&D Expenses**"), as well as deductions for investment in basic research.

1. **For Enterprises in All Industries**: if the unit price of the equipment or instruments (which means the fixed assets other than houses and buildings) newly purchased during the period from January 1, 2018 to December 31, 2023 by an enterprise is not more than RMB 5 million, such equipment or instruments expenses are allowed to be one-off deduction (instead of being depreciated annually).

2. **For Micro, Small and Medium-sized Enterprises**: this kind of enterprises may voluntarily choose to deduct the equipment and instruments expenses with a unit value of RMB 5 million or more which are newly purchased by it between

January 1, 2022 and December 31, 2022, before the payment of EIT at a certain percentage of the unit value.

3. **For High-tech Enterprises**: [Expired] equipment and instruments purchased by high-tech enterprises from October 1, 2022 to December 31, 2022 may be qualified for a full deduction in a lump sum for the year in the calculation of taxable income and for a 100% pre-tax additional deduction.

4. **Pre-EIT Deduction of R&D Expenses**: With respect to the R&D Expenses actually incurred by an enterprise, an extra 100% 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 January 1, 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 amortized at the rate of 200% of the costs of the intangible assets before tax payment as of January 1, 2023.

5. **Pre-EIT Deduction for the Investment in Basic Research**: Since January 1, 2022, the expenditures of funds contributed by an enterprise to a not-for-profit scientific and technological research and development 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% of the amount of such expenditures may be deducted before tax payment. The income from basic research funds received by not-for-profit Scientific Research Institutions and institutions of higher education from enterprises, individuals and other organizations shall be exempt from enterprise income tax.

(iv) VAT

China reviewed drafts of the PRC VAT Law ("**Draft**") in late 2022 and sought public comments on the Draft on December 30, 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:

1. **Taxable Transactions**: "labor services of processing, repairment or replacement" are no longer be listed separately as taxable "labor services", but be included in taxable "services".

2. **New Non-taxable Transactions**: namely (i) compensation for expropriation and requisition; and (ii) services provided by employees to their employers for wages and salaries.

3. **Withholding Agents**: where the overseas entities and individuals engage in taxable transactions within China, the 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".

4. **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 3%.

5. **Preferential Tax Policies**: the Draft expands the scope of VAT exemptions (such as 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 the taxpayers.

6. **New Connection with Golden Tax Project Phase IV**: the Draft requires that tax authorities, bank, customs, foreign exchange management, market regulation and other departments shall establish the VAT information sharing and work cooperation mechanisms to strengthen the administration of VAT collection.

(v) Stamp Tax

The PRC Stamp Tax Law has come into force since July 1, 2022, which mainly has the following revisions in taxable items, tax rates, etc., replacing the old PRC Interim Regulation on Stamp Tax:

1. **Reduced Rate**: The tax rate for some taxable items such as work contracts, construction project contracts, transportation contracts, etc. is reduced from 0.5% to 0.3%, while the tax rate for business account book is set at 0.25% of the total amount of paid-up capital (capital stock) and capital reserve.

2. **Four New Tax-exempt Vouchers**: namely (i) the taxable vouchers concluded by embassies or consulates in China of foreign countries or representative offices in China of international organizations, which shall be exempt from taxes in accordance with the provisions of laws, for acquirement of premises; (ii) the taxable vouchers concluded by the Chinese People's Liberation Army and the Chinese People's Armed Police Force; (iii) the sales contracts concluded by non-profit medical institutions for the procurement of medicines or sanitary materials; and (iv) electronic orders formed between individuals and e-commerce businesses.

3. **New Provisions on the Withholding Agent**: if a taxpayer is an overseas entity or individual, and has an agent inside China, its or his/her 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 or his/her own initiative.

4. The provision of round-off difference has been removed and the amount of taxes payable shall be determined based on the actually calculated amount.

5. 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.

(vi) Regional Preferential Tax Policies

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

1. **IIT**: The high-end or urgently-needed talents working in these three areas shall be exempted from the portion of their IIT that exceeds 15%. The Macao residents working in the Guangdong-Australia Deep Cooperation Zone in Hengqin will be exempted from the portion of their IIT that exceeds the Macao tax burden.

2. **EIT**: The EIT on the eligible industrial enterprises located in the Guangdong-Macao In-Depth Cooperation Zone in Hengqin shall be levied at a reduced tax rate of 15%; the EIT on the enterprises in encouraged industries registered in the

Hainan Free Trade Port and operated substantially shall be levied at a reduced tax rate of 15%; the income obtained by enterprises in tourism, modern service industry, and high-tech industries established in Hainan Free Trade Port from their new overseas direct investments shall be exempt from EIT.