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Reference: Cai Shui [2016] No. 101 / Guo Fa [2016] No. 52 and No. 53 / Cai Shui [2016] No. 98
Issuance date: 5, 11, 20 September 2016
Effective date: 1 September 2016 (Circular 101), 1 January 2016 to 31 December 2018 (Circular 98)

Relevant industries: Banking, investment etc.
Relevant companies: Banks, VC enterprises, sci-tech parks etc.
Relevant taxes: BT / VAT / RET / UTLUT / CIT / IIT

Potential impacts on businesses:

- Restrictions on investments reduced
- Effective tax burden may be reduced
- Operational costs may be reduced

You may click the circular titles to access full content of the circulars.

New tax rules to boost innovation and start-ups

Recently, the State Council, the Ministry of Finance (MOF), the State Administration of Taxation (SAT) as well as other relevant authorities clarified the preferential policies for, inter alia, equity incentives, venture capital (VC) investment, and technology innovation hubs.

❑ MOF and SAT improve the income tax policies for stock incentives and contribution with technological results (Cai Shui [2016] No. 101, "Circular 101")

On 20 September 2016, the MOF and the SAT jointly issued Circular 101, in which the income tax policies for stock incentives and contribution with technology have been improved. Compared with the existing tax policies for stock incentives, Circular 101 made the following adjustments:

Deferred taxation policy for equity incentives from non-listed companies	• The current tax policy provides that, for stock option, restricted stock and equity awards that non-listed companies grant their employees, the employees shall pay Individual Income Tax (IIT) at tax rates ranging from 3%-45%. These are the applicable IIT rates for "income from wage and salary". Tax is payable at these rates when the stock option is exercised and the shares are acquired. The employees shall also pay IIT at 20%, the rate for "income from transfer of property", on the gains derived from disposing the equity when they finally sell this off • Circular 101 provides that the eligible stock option, equity option, restricted stock and equity awards that non-listed companies grant their employees are subject to the policy of deferred taxation. That is, employees are not required to pay taxes at the time of receiving their equity incentives. Neither receipt of the options nor exercise of the options would give rise to IIT, and receipt of share awards or restricted stock would not give rise to IIT either. Rather the employees will simply pay tax on the transfer the equity, and the tax rate 20% shall apply to the transfer. Of course, the base cost of the equity at time of disposal will be less than under the current regime (The base cost of the equity would be the actual acquiring cost of the equity, i.e., exercise price for share option, actual cash paid for restricted stocks and zero for share award). The tax burden, therefore, will be reduced by 10-20 percent, as well as the time deferral advantage

Deferred taxation policy for equity incentives from non-listed companies (Cont'd)	(For example, if there is a share award and the shares have a value of RMB20 when received, under the current system, IIT at 45% might be paid on the RMB20 at time of receiving the award (i.e., RMB9). When the shares are sold for RMB30, the tax applied is RMB2 (RMB (30-20)*20%). Total tax is RMB11. Under the new system, no tax applies at the time of the share award, but the full RMB30 will be taxed at the time of sale (i.e., no base cost). IIT is therefore RMB6 (RMB30 * 20%). This is much better than the RMB11 under the old system as well as a cash flow advantage as the tax is paid much later. For the share option case, the principle is generally the same except that exercise price of the share option would be adopted as base cost in both the old and the new system.) • Circular 101 also specifies the conditions that the equity incentives must meet for enjoyment of deferred taxation, covering 7 aspects: implementation party, examine and approval, object of incentive, target of incentive, holding period of equity incentive, time of exercise and industry restriction (i.e., negative list)
Tax payment for the equity incentive of the listed company extended	• For the stock options, restricted stock and equity awards that listed companies grant their employees, the employees may pay their IIT within 12 months after the date on which the stock option is exercised, the ban on the restricted stock is lifted or equity awards are received (within 6 months in the current policy) • The above-mentioned deferral and reduced tax rate policy for non-listed companies does not apply to listed companies
Preferential policy of deferred taxation may be adopted selectively for transferring rights in technology as capital contribution	• In addition to the current policy, enterprises or individuals transferring rights in technology to domestic resident enterprises as capital contribution, the enterprises or individuals may also select the deferred taxation policy as an optional choice ❖ Current policy: where an enterprise or an individual makes investment using their non-monetary assets (including technological results) for exchange of shares, the income from transfer of non-monetary assets shall be determined in accordance with the evaluated fair value, and the income tax can be made by instalment within five calendar years (Cai Shui [2014] No. 116) ❖ Deferred taxation policy: income taxes are not required to be paid when rights in technology are transferred for exchange of shares. The income taxes are allowed to be paid until transfer of such shares based on the balance of income derived from the share transfer after deducting original value of the technology and other reasonable taxes and expenses • Whether investors choose to the current policy or the deferred taxation policy, the evaluation value of the technology can be amortized and be deducted before tax by the investee enterprises

- Circular 101 takes effect from 1 September 2016. For the eligible equity incentives applying in Zhongguancun national innovation demonstration zone from 1 January 2016 to 31 August 2016 and the relevant taxes have yet to be paid, Circular 101 shall be applied.

❑ Measures to promote sustainable development of venture capital investment (Guo Fa [2016] No. 53, "Circular 53")

- The State Council issued Circular 53 on 20 September 2016 on promoting the sustainable development of VC investment, as an effort to advance mass entrepreneurship and innovation in China. Circular 53 applies to all kinds of VC investments including angel investment.

Improve tax policies for VC investment	• Tax incentive policies to encourage the VC enterprises and angel investors investing science and technology (sci-tech) enterprises at the stage of seed germination or start-up • Improve tax reduction policy for VC enterprises • Consider introduction of pilot individual income tax policy for angel investors
Optimize regulatory environment	• Supervision of VC enterprise (such as industry management, recordal filing etc.) shall be different from other PE funds. Liberalize the market access process and strengthen the in-process and post-process supervision over the venture capital industry
Optimize business environment	• No regions or departments are allowed to adopt policies or measures that hinder the market access and development of venture capital enterprises and venture capital management enterprises
Expand the opening up for foreign VC investment	• Liberalize market entry for foreign investment, streamline administration, encourage foreign investors to expand their VC investments and provide greater support for the enterprises at the stage of seed germination or start-up • Encourage overseas and domestic investors to use RMB in cross-border VC investments and other relevant investment • Foreign VC enterprises are allowed to transfer the RMB funds, which are converted based on their actual investment, to the invested enterprises' accounts

❑ CBRC pushes forward venture loan to be piloted in commercial banks

Based on news from the website of the China Banking Regulatory Commission (CBRC), Mr. Shang Fulin, Chairman of the CBRC, indicated at the 7th general meeting of China Banking Association held on 13 September 2016, that the banking sector shall push forward venture loan pilot programs (see below for details of the scheme):

- Venture loans are now being piloted by 10 banks and 5 National Independent Innovation Demonstration Zones (NIIDZ). They aim to develop the relevant mechanism to serve the scientific and technological innovation
- In the future, qualified banks may be allowed to set up subsidiaries to carry out equity investment in sci-tech innovation and start-ups. The banks will be permitted to calculate their profit and loss on a consolidated basis, so that the investment gains may be hedged against loan losses. (Group consolidation for tax purposes is generally not provided for under China CIT law.)

Prior to this, on 15 April 2016, the CBRC, the Ministry of Science and Technology, and the People's Bank of China jointly issued *Guidance on Strengthening Innovation of Banking Institutions and Conducting Pilots of Venture Loan for Scientific and Technological Innovation-based Enterprises* (Yin Jian Fa [2016] No. 14, "Circular 14"). According to Circular 14, 10 banks including China Development Bank, Bank of China, Hengfeng Bank, Bank of Beijing, Pudong Guigu Bank etc. as well as 5 NIIDZs that are located in Beijing, Wuhan, Shanghai, Tianjin and Xi'an, may carry out venture loan business. Circular 14 also clarifies the following:

- Venture loan is a financing mode that may provide sustained funding support to sci-tech innovation and start-ups, by way of "credit loan" and "equity investment", which is conjunctively carried out by financial institutions in the banking sector and their subsidiaries (with the function of investment) respectively. Under such arrangement, loan risks can be made up by investment gains, so as to achieve the matching
- Circular 14 may be applied to venture loans that being carried out by pilot financial institutions in banking sector to sci-tech innovation and start-ups (including eligible sci-tech small and medium enterprises with low profits) that are located in pilot areas
- Where pilot financial institutions have set up the subsidiaries (with the function of investment), the subsidiaries may carry out equity investment for venture loan purposes. Otherwise, subject to application and approval, pilot financial institutions may be allowed to set up the subsidiaries with investment function
- Pilot financial institutions, may set up financial service institutions as well as branches specialized for science and technology to serve the sci-tech innovation and start-ups, focus on offering credit loans which are relevant to equity investment for sci-tech innovation and start-ups. In addition to the loans, the financial service institutions and their branches may also provide sci-tech innovation and start-ups with one-stop and systematic financial services including settlement, financial advisor, foreign exchange etc.

❑ The State Council issues overall plan for making Beijing a national scientific and technological innovation hub (Guo Fa [2016] No. 52)

On 11 September 2016, the State Council issued an overall plan to promote the Beijing technology innovation hub drive. The plan puts forward three goals that will be phased in:

- By 2017, a primary innovation hub will be set up;
- by 2020, Beijing will see a complete sci-tech innovation system, leading the country's R&D efforts and being the booster for the Beijing-Tianjin-Hebei area's information drive; and
- by 2030, it will be an important force in the global innovation network

To achieve these goals, the plan requires Beijing to intensify efforts in 5 aspects. We outlined the main finance and tax related tasks as follows:

Improve business system to serve innovation	• Build up a convenient and efficient business system. Promote the reform of business registration, such as cluster registration (i.e., one address or premises of an institution can be used by several enterprises for business registration purposes) and "business license first, then permit", to reduce the threshold for start-ups

Accelerate the construction of national science and technology financial innovation centre	• Consider introduction of tax policies to support the investments made in innovation activities that are at the stage of seed germination or start-up (such as Angel investment) • Select eligible financial institutions in the banking sector to pilot provision of financing services (combining the equity and debt) to sci-tech innovation and start-ups in Zhongguancun National Innovation Demonstration Zone; Encourage eligible financial institutions in banking sector to carry out the venture loan with venture capital institutions and equity investment institutions to support the sci-tech innovative enterprises and start-ups, in the premise of compliance and risk controllable

* In January 2016, the SAT has issued 10 measures to support Shanghai scientific and technological innovation center. In April 2016, the State Council has issued the Plan on accelerating Shanghai's transformations into a world-class technical innovation center. With regard to the details of the above, you may click to access KPMG *China Weekly Update* Issue 4 and Issue 15 for more.

❑ MOF and SAT clarify the preferential tax policies for national university sci-tech parks (Cai Shui [2016] No. 98, "Circular 98")

On 5 September 2016, the MOF and the SAT jointly issued Circular 98 to clarify the tax incentives for the eligible national university sci-tech parks (hereinafter referred as "sci-tech parks").

- From 1 January 2016 to 31 December 2018, eligible sci-tech parks shall be exempted from real estate tax (RET) and urban and township land use tax (UTLUT) on properties or land for own use, and provided free or leased to incubated enterprises
- From 1 January 2016 to 30 April 2016, business tax (BT) shall be exempted for income derived by sci-tech parks from renting sites or buildings, and providing incubation services to incubated enterprises. Such incomes shall be subject to VAT exemption in the period of VAT reform

In addition to the above, Circular 98 sets out the requirements that the sci-tech parks and incubated enterprises shall be met, and this also clarifies the taxable items of "incubation services" subject to BT and VAT respectively.

* On 11 August 2016, the MOF and the SAT jointly issued Cai Shui [2016] No. 89 to clarify the tax incentives for the eligible science and technology enterprise incubators. you may access KPMG *China Tax Weekly Update (Issue 33, August 2016)* for more details.

Reference: N/A
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: Multinational enterprises
Relevant taxes: All

Potential impacts on businesses:

- Risks of being challenged due to cross-border tax anti-avoidance arrangements increased

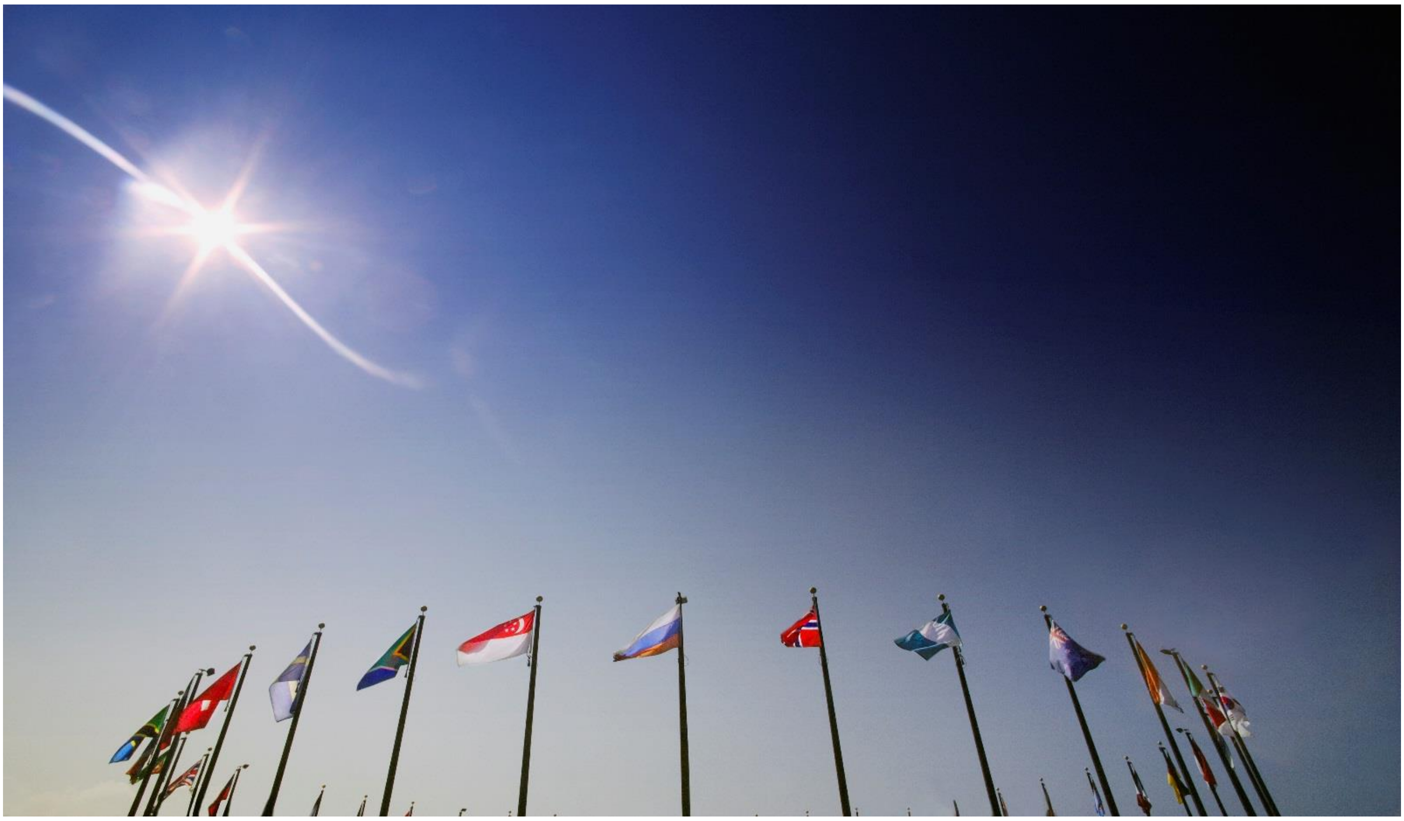
You may click the circular titles to access full content of the circulars.

OECD publishes the comments received for certain BEPS discussion drafts

As mentioned in KPMG *China Tax Weekly Update (Issue 26, July 2016)*, the OECD, in July 2016, released a series of discussion drafts on the continuity BEPS work to call for public opinions. Recently, on 8 and 15 September 2016, the OECD published the comments received on its official website.

- Discussion Draft on the Attribution of Profits to Permanent Establishments, which deals with work in relation to Action 7 ("Preventing the Artificial Avoidance of Permanent Establishment Status") of the BEPS Action Plan. Public comments on this discussion draft are divided into two parts, you may click Part I and Part II for more details
- Discussion Draft on the Revised Guidance on Profit Splits, which deals with work in relation to Actions 8-10 ("Assure that transfer pricing outcomes are in line with value creation") of the BEPS Action Plan. Public comments on this discussion draft are divided into two parts, you may click Part I and Part II for more details
- Discussion Draft on the Approaches to Address Interest in the Banking and Insurance Sectors, which deals with work in relation to Action 4 (Limiting Base Erosion Involving Interest Deductions and Other Financial Payments) of the BEPS Action Plan. You may click here for the public comments on this discussion draft

A public consultation on the first two discussion drafts will be held on 11-12 October 2016 at the OECD Conference Centre in Paris. Speakers and other participants at the public consultation will be selected from among those providing timely written comments on the Discussion Drafts. Details on how to attend the public consultation will be available on the OECD website in due course.



Reference: N/A
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: FIEs are located in central and western regions
Relevant taxes: N/A

Potential impacts on businesses:
- Restriction on Investment reduced

You may click here to access full content of the circular.

Foreign investment in central and western China is further encouraged

On 18 September 2016, the National Development and Reform Commission (NDRC) invited public to comment the revised *Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions ("the revised Catalogue")*. In the revised catalogue, the encouraged foreign investments in central and western regions are further expanded. Public are invited to send comments on the revised catalogue by 19 October 2016.

* The Catalogue was originally introduced on 16 June 2000, then which has been revised in 2004, 2008 and 2013 and this is now the fourth revision. According to *Regulations on Foreign Investment Guidelines (State Council Order No. 346)*, those projects that are listed in the Catalogue may enjoy the preferential policies for foreign investment projects of the encouraged category.

** According to *Notice on Tax Policies Applied to the Implementation of the Western Development Strategy (Cai Shui [2011] No. 58)*, self-used equipment, imported within the total amount of investment and for projects falling in the Catalogue shall be exempted from the duties to the extent permitted by policies.

Reference: Guo Fa [2016] No. 51
Issuance date: 19 September 2016
Effective date: 19 September 2016

Relevant industries: All
Relevant companies: All
Relevant taxes: N/A

Potential impacts on businesses:
- Operation costs reduced

You may click here to access full content of the circular.

The State Council regulates the sharing of government information

On 19 September 2016, The State Council issued Guo Fa [2016] No. 51 regarding the sharing of government information and public data to enhance administrative efficiency and improve services. The Circular mainly clarifies the following:

Classification of government information resources	Government information is classified in three categories: • Information for which sharing is not limited, i.e., information that can be accessed by all the government authorities • Information for which sharing is conditional, i.e., information that can be accessed by the relevant government authorities or certain information that can be accessed by all the government authorities • Information that cannot be shared, i.e., information that is inappropriate to be accessed by other government authorities. For certain information that cannot be shared, related authorities should provide legal or political basis
Provision of shared information	• Government authorities shall not request the natural person, legal person or other organisations to provide the information again if such information that are available on the sharing platform

Reference: Shui Zong Fa [2016] No. 111
Issuance date: 19 July 2016
Effective date: N/A

Relevant industries: All
Relevant companies: All
Relevant taxes: N/A

Potential impacts on businesses:
- Compliance costs increased

You may click here to access full content of the circular.

SAT further regulates the transparency on identity of tax handlers

As mentioned in KPMG *China Tax Weekly Update (Issue 27, September 2016)*, Guangdong State Tax Bureau issued an announcement on 8 July 2016, which determines that the tax administration under real name shall be launched in Guangdong state tax bureaus (excluding Shenzhen) starting from 8 August 2016. Tax administration under real name means that the tax authorities shall provide tax services upon receipt and verification of ID information of tax handlers of enterprises (including tax agents). The SAT, on 19 July 2016, issued Shui Zong Fa [2016] No.111, clarifying the purposes, implementation points and work requirements of carrying out the tax administration under real name basis.

- Tax authorities at each regions shall issue the list to clarify the scope of tax handlers, setting up the thresholds are not allowed
- Where the ID information of tax handlers have been verified, tax authorities shall not request the tax handlers to offer the tax registration certificate, copy of ID cards, etc.
- Tax authorities at state and local level shall explore to build up a database containing the ID information of tax handlers, which can be shared among the state and local tax authorities. Deal with tax issues online under real name basis is under discussion

Reference: Gong Shang Qi Jian Zi [2016] No. 185
Issuance date: 14 September 2016
Effective date: N/A

Relevant industries: All
Relevant companies: All
Relevant taxes: N/A

Potential impacts on businesses:
- Risks of being challenged due to non-compliance issues increased

You may click here to access full content of the circular.

SAIC supervision method innovation

On 14 September 2016, the State Administration for Industry and Commerce (SAIC) issued Gong Shang Qi Jian Zi [2016] No. 185 ("Circular 185"). This clarifies that industry and commerce authorities shall examine the market players on random basis in two aspects other than on discretionary basis. For the cases of complaint, monitoring of big data as well as the cases being transferred or assigned, random inspection shall not be applied.

Circular 185 also clarifies the guiding idea, basic principle, specific measures and implementation issues for pushing the reform and innovation of the supervision methods. The main innovation measures are as follows:

Implementation of inspection on random and open basis	• Generate the list for random inspection matters. The matters that are subject to random inspection shall be 70% of matters that are subject to supervision and law enforcement by industry and commerce authorities at each level in 2016, and be 100% in 2017 • Set up name-list database of inspection objects and inspection officers database • Develop the working rules for random inspection * "On random and open basis" means that industry and commerce authorities shall select inspection objects and inspection officers on random basis, and the findings shall be released on timely basis.

Supervision are supported by big data	• Provincial industrial and commercial authorities shall speed up the construction of integrated collaborative supervision platform. All information, such as registration, trademark registration, supervision and law enforcement of the market players will be gathered in the platform, which can be shared by industry and commerce authorities at different level as well as their internal departments
Carry out the supervision based on risks' classification	• Market players with high risk, which will be identified as key objects, and be subject to targeted inspection on random basis in two aspects, ratio and frequency of random inspection will also be increased • Market players with general risks, in addition to be subject to non-targeted random inspection, which will mainly be inspected if the following conditions occur: (i) Complaint; (ii). Being transferred or assigned by other authorities

Reference:
Issuance date:
Effective date:

Relevant industries: All
Relevant companies: All
Relevant taxes: VAT

Potential impacts on businesses:
- Compliance risks due to regulatory uncertainties reduced

You may click the circular titles to access full content of the circulars.

Updates on the VAT reform

In order to help better implement the new VAT rules Measures for Implementation of the Pilot Program of VAT Reform (Cai Shui [2016] No. 36, "Circular 36"). The SAT, in the recent internal meeting, made an arrangement for further work for the reform.

❑ SAT sets out further work arrangement for the VAT reform

- On 18 September 2016, Mr. Wang Jun, Director of the SAT, spoke at the nationwide working conference for the VAT reform and set out the further work arrangement for the reform
- In the further work, SAT shall focus on solving the problems raised by the local tax bureaus and the local tax bureaus shall focus on solving the problems raised by the taxpayers. Mr. Wang also clarified that the problems will be improved by stages and put forward the corresponding responses

Meanwhile, local tax bureaus and relevant departments also issued several interpretation notes to further clarify implementation issues for the VAT reform, mainly including the following:

❑ Q&A on hot issues for the VAT reform by Shandong State Tax Bureau (STB)

❑ Q&A on hot issues for the VAT reform by Xiamen STB (Issue 13)

The State Council, the Ministry of Finance (MOF) and the SAT have recently issued many circulars for the implementation of Circular 36. You may click KPMG *China Tax Weekly Update* *Issue 13*, *Issue 14*, *Issue 15*, *Issue 16*, *Issue 17*, *Issue 18*, *Issue 19*, *Issue 20*, *Issue 21*, *Issue 22*, *Issue 23*, *Issue 24*, *Issue 25* , *Issue 26* , *Issue 27* , *Issue 28* ,*Issue 29*, *Issue 30*, *Issue 31* , *Issue 32*, *Issue 33* , *Issue 34*, *Issue 35* and *Issue 36* to understand the details.

* On the occurrence of Circular 36 announcement, KPMG immediately issued a series of China Tax Alerts to provide an overview of the high level policies and general impacts across all industries. Focusing on construction, real estate, finance and lifestyle services, at the same time, we also issued specific alerts for each of the three major industries affected by these changes. You may click the following links to read:

❑ *China Tax Alert: China's new VAT rates & rules –high level policies and general impacts across all industries (Issue 9, March 2016)*

❑ *China Tax Alert: China's new VAT rates & rules –Financial Services impacts (Issue 10, March 2016)*

❑ *China Tax Alert: China's new VAT rates & rules –Lifestyle Services impacts (Issue 11, March 2016)*

❑ *China Tax Alert: China's new VAT rates & rules -Real Estate & Construction industry impacts (Issue 12, March 2016)*

** In addition, the MOF and SAT issued Circular 68 to further clarify VAT treatment of services in regard of reinsurance arrangements, lease of immovable properties and non-academic education. Also, Circular 70 was issued to further clarify the VAT reform policies on financial industry. KPMG has issued two China Tax Alerts to detail the tax impact to reinsurance, insurance and financial services, you may click the following links to read:

❑ *China Tax Alert: New Circular clarifies China's VAT treatment of reinsurance arrangements (Issue 17, June 2016)*

❑ *China Tax Alert: New Circular expands upon China's VAT exemptions for financial services industry (Issue 20, July 2016)*

Continuance of existing VAT exemption for domestic anti-HIV drugs

On 1 September 2016, The Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued Cai Shui [2016] No. 97 ("Circular 97"). This clarifies the VAT policy for the domestic anti-HIV drugs as follows:

- From 1 January 2016 to 31 December 2018, domestic anti-HIV drugs shall continue to be exempted from VAT during the production and circulation
- Manufacturing enterprises and circulation enterprises of anti-HIV drugs shall calculate tax-free drugs and taxable drugs respectively. Otherwise, they cannot enjoy the VAT exemption policy

You may click here to access full content of the circular.

The State Council and the GAC adjust MFN tax rates for certain imported IT products

As mentioned in KPMG *China Tax Weekly Update (Issue 35, September 2016)*, on 3 September 2016, the 22nd meeting of the 12th NPC Standing Committee passed a bill to ratify an amendment to a tariff concession schedule of the World Trade Organization (WTO) access protocol ("Amendment"). Under the amendment, China will gradually cut and eventually eliminate customs duties on 201 IT products imported from WTO members.

Further to implement the Amendment, Tariff Committee of the State Council issued Shui Wei Hui [2016] No. 24 ("Circular 24") on 9 September 2016. This clarifies that China will slash down the MFN tax rates for the imported IT products listed in the schedule annexed to the Amendment to the tariff concession schedule of the WTO access protocol for the first time, effective from 15 September 2016.

On 14 September 2016, the General Administration of Customs (GAC) issued Announcement [2016] No. 50 ("Announcement 50"). This adjusts the HS code and Catalogue of Standardized Declaration of certain IT products. In the meanwhile, the consignees of imports are not requested to submit declaration form for usage of imported products that are eligible for ITA tax rates while the customs will no longer issue the certificate to confirm this.

You may click here to access full content of Circular 24 and here to access full content of Announcement 50.

Beijing relaxes documentation requirement for foreign investment projects

In order to implement the State Council's requirements on screening and regulating intermediary services involved in the administration approval process, on 7 September 2016, Beijing Development and Reform Commission (BDRC) issued Jing Fa Gai [2016] No. 1534. This abolishes Article 2 of BDRC Forwarding NDRC's Notice on Relevant Issues concerning the Handling of the Letter of Confirmation on Domestic or Foreign Investment Projects Encouraged to Develop by the State for Foreign Investment Projects (Jing Fa Gai [2006] No.1020) which was issued in 2006, i.e., where a foreign investment project with foreign exchange quota for the imported equipment exceeding USD 1 million, the application report for the project will not be required to be prepared by the qualified consulting agencies.

You may click here to access full content of the circular.

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