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Relevant industries: All
Relevant companies: Foreign-invested enterprises
Relevant taxes: N/A

Potential impacts on businesses:
- Risks of being challenged due to non-compliance issues increased
- Compliance risks due to regulatory uncertainties reduced

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Adjustment to restrictions on foreign investment in China

As mentioned in KPMG *China Tax Weekly Update* *(Issue 35, September 2016)* and *(Issue 39, October 2016)*, China has been in the process of revising its inbound investment rules. Following various pilot programs in certain localities, a new nationwide system for the administration of foreign investment approvals is being rolled out. Whereas previously, all foreign investment into China needed pre-approval by the Ministry of Commerce (MOFCOM), the new system generally allows for simple recordals to be made for investments in industries where foreign investment is encouraged/permitted, with pre-approvals limited to industries where investment is restricted. This is the so-called "Negative List" system (under the "special administrative measures for foreign investment access") and it is effective from 1 October 2016. The Negative List is to set out the sectors which are prohibited/restricted, or for which pre-approvals may otherwise be needed (e.g. investments in the previous encouraged industrial sectors for which foreign investors are limited in terms of the percentage of equity they can hold in the Chinese investment entity, or in terms of a requirement for certain senior executives to be Chinese citizens).

To complement this, the Catalogue of Industries for Guiding Foreign Investment ("Catalogue on Foreign Investment"), which sets out the encouraged, restricted and prohibited industrial sectors, and which was last updated in 2015, is also evolving (permitted industries are those not listed). On 7 December 2016, the National Development and Reform Commission (NDRC) and MOFCOM issued a notice to solicit public opinions on a revised Catalogue, with the following main changes:

- The details from the 2015 Catalogue will be consolidated into the Negative List. This includes the list of prohibited/restricted industries and the various special requirements (e.g. equity percentages, executives) for certain encouraged industries.
- The number of overall limitations will be cut. At the moment there are 93 restrictive measures in the Catalogue;19 equities percentage requirements in the encouraged list, 38 restricted list items, and 36 prohibited list items. These are to be cut to 62.

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- Prohibitions/restrictions on investment in certain service sector segments are to be lessened, including highway passenger transportation, cargo handling, creditworthiness investigation and rating services. Limitations on investment in certain manufacturing sector segments are to be reduced, including road transportation equipment, automotive, electronics and batteries for new energy vehicles, motorcycle, edible oils, deep processing of corn, fuel ethanol. Limitations on investment in certain mining sector segments are to be reduced including unconventional oil and gas, precious metals and lithium ore etc. The abovementioned segments have been taken off the restricted/prohibited lists.
- Restrictions/prohibitions on 11 industrial sectors are now lifted in the revised Catalogue, and they are now no longer on the Negative List. But this does not mean that they are simply permitted. They will be subject to the same administration requirements as for Chinese-funded enterprises (i.e., subject to the approvals of relevant ministries or government agencies, e.g. Ministry of Education). Such sectors include construction and operation of large-scale theme parks, special educational institutions for military, police, politics and Party school, construction and operation of golf courses and villas, projects which endanger the security and efficiency of military facilities.
- No major changes are planned in the revised Catalogue in relation to the encouraged industries. The general policy is to continue to encourage foreign investment on modern agriculture, advanced manufacturing, high-tech, energy conservation and environmental protection, and modern services. It is hoped to encourage the transformation and upgrade of traditional industries and promote the utilisation of new technologies, new process, new material and new equipment.

Interested parties are invited send comments on the revised Catalogue by 6 January 2017 via the websites of *NDRC* and *MOFCOM*.

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

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

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

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China tightens restrictions on outbound investment

The global media have widely reported that the Chinese government is seeking to better control outbound capital flows from China. There had been indications in the media that the State Council had considered issuing guidance to tighten limitations on outbound investment. Specifically the indications were that outbound mergers and acquisitions (M&As) worth more than US$10bn, and purchases of more than US$1bn if the overseas targets are outside the core business of the investors, would not be approved by MOFCOM and other relevant authorities. In addition, per these reports, state-owned enterprises (SOEs) would not be allowed to invest more than US$1bn in a single overseas real estate transaction. There have also been media indications that State Administration of Foreign Exchange (SAFE) approval could be required for capital outflows valued at more than US$5m (including repayment of loans, payments of dividend, etc.) regardless of the currency used for the remittance.

In response to these media reports, on 6 December 2016, the SAFE along with other three authorities, including the NDRC, MOFCOM, and the People's Bank of China (PBOC) clarified the supervision issues for China's outbound investment. Responding to questions from reporters the relevant officials said:

- The government supports Chinese enterprises which possess the capabilities to carry out genuine outbound investment, especially when such investment promotes the transformation and upgrade of Chinese economy, and/or involves participation in "Belt and Road" initiatives and international industrial capacity cooperation projects.

- The regulators are paying close attention to "irrational" outbound investment in certain industries such as real estate, hotel, cinema, entertainment, sports clubs, etc.. Chinese outbound investing enterprises are being advised to "make decisions prudently" regarding investments in the following four categories that will now face particular regulatory attention: (i). Large investments unrelated to a company's core business; (ii). Outbound investments made by China-registered limited partnerships; (iii). Investments initiated and executed in a very short timeframe (i.e. presumed to be speculative); and (iv). financing/capitalization of large subsidiaries controlled by much-thinner-capitalized parent companies.

It is noted that, in the above response, the Chinese governments have not confirmed the specifics of the reports from the global media, detailed above. KPMG will continue to monitor for news updates on this matter.

It is also worth noting that at the same time as the Chinese authorities are tightening their control of capital account transactions, greater efforts are also being made to ensure that forex transactions on trading account are not being manipulated to aid capital flight from China. However, no official circular/announcement has yet been issued in this regard. We will continue to monitor for news updates on this matter.

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Reference: Cai Shui [2016] No.125
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: Enterprises put leverage reduction in place
Relevant taxes: CIT / VAT / LAT / DT / SD

Potential impacts on businesses:
- Effective tax burden reduced

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

Chinese government aims to reduce enterprise leverage - relevant existing tax rules highlighted

The State Council aims to reduce the high indebtedness of Chinese enterprises and issued a circular (Guo Fa [2016] No. 54) on 10 October 2016 and brought up with some guidance to reduce enterprises' leverage rations. Subsequently, on 22 November 2016, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued Cai Shui [2016] No.125 ("Circular 125"). The purpose of Circular 125 is to summarize and reiterate all existing tax preferential rules to local tax authorities and taxpayers in order to improve general awareness of the availability of these reliefs. All these rules are already in place for some time, which can facilitate enterprises to reduce leverage ratios.

- Debt restructuring may avail of special Corporate Income Tax (CIT) treatment. This relief can apply where the recognised taxable income arising from enterprise debt restructuring (e.g. from debt forgiveness) constitutes 50% or more of the taxable income of the enterprise in a given year. Tax on this amount may be deferred, with tax applied instead by averaging the income arising over the five tax years following the debt restructuring. (Reference: Cai Shui [2009] No. 59, Cai Shui [2014] No. 109)
- A tax relief exists for transactions in which China resident enterprises inject non-monetary assets into foreign entities. The CIT on the income deemed to arise on the transfer of these non-monetary assets can be deferred, with tax applied instead by averaging the income arising over the five tax years following the transfer of non-monetary assets (Reference: Cai Shui [2014] No. 116)
- Liquidation expenses, wages, social security expenses and statutory compensation of employees, arising from bankruptcy and liquidation de-registration of an enterprise, may be deducted for CIT purposes. (Reference: Cai Shui [2009] No. 60)
- The debt losses arising from the loans and guarantees provided by one enterprise to its affiliated enterprises are allowed for deduction for CIT purposes. (Reference: SAT Announcement [2011] No. 25)
- Loan loss reserves recorded by financial institutions shall be allowed as a tax deduction, provided that certain criteria are met. (Reference: Cai Shui [2015] No. 3, Cai Shui [2015] No. 9)
- Exclusions of asset restructurings from the scope of VAT. The transfer of all or part of the physical assets and associated, claims, liabilities and labour force by a taxpayer to other institutions or individuals during a asset restructuring process, by means of merger, separation, sale or replacement, is clarified to not fall within the scope of the VAT. (Reference: Cai Shui [2016] No. 36, SAT Announcement [2011] No. 13)
- Land Appreciation Tax (LAT), Deed Tax (DT), Stamp Duty (SD), incurred in restructuring of an enterprise that conforms to the regulations, may be subject to relevant preferential polices. (Reference: Cai Shui [2015] No. 5, Cai Shui [2015] No. 37, Cai Shui [2003] No. 183)
- Securitizations of credit assets that are in line with certain criteria, may be subject to relevant preferential policies. (Reference: Cai Shui [2006] No. 5)

Circular 125 also points out that the local tax and finance authorities shall keep abreast of problems encountered in the execution of the abovementioned policies, and offer suggestions to the SAT/MOF so as to further improve these tax policies.

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Reference: Cai Shui [2016] No. 122
Issuance date: 10 November 2016
Effective date: 1 January 2016 to 31 December 2017

Relevant industries: service industry
Relevant companies: Advanced technology service enterprises in pilot service innovation development zones
Relevant taxes: CIT

Potential impacts on businesses:
- Effective tax burden reduced

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

Tax incentives for advanced technology service enterprises in pilot service innovation development zones

As mentioned in KPMG *China Tax Weekly Update (Issue 7, February 2016)*, on 25 February 2016, the State Council officially approved a pilot program of service trade innovation development zones in 10 provinces (cities), as well as 5 new zones. The 10 provinces (cities) are Tianjin, Shanghai, Hainan, Shenzhen, Hangzhou, Wuhan, Guangzhou, Chengdu, Suzhou and Weihai. The 5 new zones are Harbin, Jiangbei of Nanjing, Liangjiang of Chongqing, Gui'an of Guizhou and Xixian of Shaanxi.

Relevant tax incentive policies, set out in the pilot program include:

- Recognition scope of advanced technological service enterprises (ATSEs) will be expanded within the pilot areas, i.e., other services with high-tech and high value added, other than service outsourcing enterprises, will be recognized as ATSEs.
- Expand the preferential tax policies for the ATSEs in services outsourcing areas from the model cities, to which the ATSE scheme has applied since year 2016, to the pilot regions now covered under the new plan.

Following on from the State Council's instructions, on 10 November 2016, 5 authorities including the MOF and the SAT jointly issued Cai Shui [2016] No. 122 (Circular 122) offering the following preferential CIT treatment to ATSEs that are located in the abovementioned 15 pilot service innovation zones provided that certain requirements are met, apply from 1 January 2016 to 31 December 2017:

- Applicable CIT rate shall be reduced to 15%; and
- The expenditures on staff education not exceeding 8% of the total amount of salary shall be deductible for CIT purposes. The exceeding amount could be carried forward to the following years.

The above preferential CIT treatment is in line with that are entitled to the qualified ATSEs that are located in 31 service outsourcing cities*.

An ATSE is required to observe the relevant provisions of Cai Shui [2014] No. 59 when applying for the preferential CIT treatment, i.e., income derived from provision of technically advanced services shall account for more than 50% of the enterprise's total income for the year, income derived from offshore service outsourcing business shall not be less than 35% of the enterprise's total income for the year, and staff with college or above qualifications shall account for 50% of the total staff in the enterprises, etc.

Circular 122 provides that the services eligible for the incentive include computer and information services, research and development technical services, culture technical services, and medical services of traditional Chinese Medicine etc. A list of such services is attached to the notice. As mentioned above, this is an expansion from the current scope of ATSEs located in service outsourcing cities.

* With regard to the specific preferential CIT policy and scope for ATSEs that are located in service outsourcing cities, you may click KPMG *China Tax Weekly Update (Issue 44, November 2016)* for more.

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Reference: SAT Announcement [2016] No. 75
Issuance date: 1 December 2016
Effective date: 1 December 2016

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

Potential impacts on businesses:

- reformsCompliance risks due to regulatory uncertainties reduced

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Further VAT implementation rules

On 1 December 2016, the SAT issued Announcement [2016] No. 75 (Announcement 75). This clarifies issues in relation to claims for offset of carried forward excess input VAT credits against output VAT of later periods. It is effective from 1 December 2016.

Announcement 75 provides that carried forward excess input VAT credits, which were accumulated before the final stage of the VAT reform took effect in May 2016, can be offset against output VAT arising from activities which transitioned from business tax to VAT in the reform. Detailed reporting is provided for on the VAT filing forms to deal with such cases.

However, a complication arises from conflicting guidance. According to Appendix 3 of Cai Shui [2016] No. 36 (Circular 36), issued in March 2016, VAT general taxpayers who were recognized before the final stage of the VAT reform took effect in May 2016, engaging in sale of services, intangible assets or immovables (VAT reform businesses) concurrently after May 2016, may not be able to offset carried forward excess input VAT credits, when such input VAT is generated by non-VAT reform businesses before May 2016. Specifically, for such enterprises, carried forward excess input VAT credits as at the May 2016 transition under the VAT reform, may not be deducted from the output VAT arising in relation to services, intangible assets or immovables sold (VAT reform businesses). In other words, such carried forward excess input VAT can only be offset against output VAT incurred in relation to activities which were already subjected to VAT before the VAT reform.

It is noted that the treatment of carried forward excess input VAT provided for in Announcement 75 and Circular 36 is contradictory. But so far, the SAT has not issued further notice to abolish the relevant provisions stated in Circular 36. We will report any further developments on this matter.

Reference: SAT Announcement [2016] No. 76
Issuance date: 1 December 2016
Effective date: 1 December 2016

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

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.

Rules for abnormal VAT invoices clarified

On 1 December 2016, the SAT issued Announcement [2016] No. 76, clarifying the treatment applied to special VAT invoices issued by enterprises who cannot be contacted by the tax authorities ("Out-of-contact enterprises"). The announcement is effective from the date of issuance.

- An out-of-contact enterprise means an enterprise that fails to fulfil tax compliance obligations and does not submit to effective supervision by the tax authorities. These include cases where:
  - ❖ The tax authorities cannot locate the enterprise and relevant officers of the enterprise by means of on-site investigation, phone call, examination of tax matters as well as other methods for tax collection and administration.
  - ❖ The bookkeeping agent of the enterprise or personnel who undertake tax filing matters can be contacted, but they are have no information relevant to the tax evasion problems identified by the tax authorities and are unable to contact the actual controllers of the enterprise.
- Special VAT invoices issued by the out-of-contact enterprise during the out-of-contact period shall be deemed as abnormal deduction vouchers for VAT purposes ("abnormal vouchers"). If other general VAT taxpayers who have obtained abnormal vouchers, they shall note the following:
  - ❖ General VAT taxpayers, who have not yet applied for tax credit or tax refund for exports, are temporarily not allowed to proceed with tax credit and tax refund;
  - ❖ For those who have already applied for claim input VAT credits, the input VAT credited shall be clawed back;

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- If a tax refund for exports has already been processed, tax authorities can suspend proceeding with other approved refundable tax of this enterprise according to the amount involved by the abnormal vouchers. If the enterprise has no refundable tax or the refundable tax is less than the involved refund amount, the export enterprise should be required to provide guarantee for the difference in amount. (The announcement is not clear whether the taxpayers have to give back tax already refunded.)

Reference: SAT Announcement [2016] No. 77
Issuance date: 29 November 2016
Effective date: 1 January 2017

Relevant industries: All
Relevant companies: All
Relevant taxes: Stamp duty

Potential impacts on businesses:

- Risks of being challenged due to non-compliance issues increased
- Compliance risks due to regulatory uncertainties reduced

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

SAT standardizes administration for stamp duty

On 29 November 2016, the SAT issued the trial *Administrative Procedures on Stamp Duty* (SAT Announcement [2016] No. 77, "the Procedures"), which standardizes procedures and guidance for tax administration, tax collection, tax relief, tax refund and risk management of stamp duty, effective from 1 January 2017. Stamp duty, arising from all business activities, except for stock exchange, shall be subject to the Procedures; the latter continue to be governed by existing procedures.

In addition to the clarifications provided on existing stamp duty policies, guidance is set out on tax risk management for stamp duty. Tax authorities will identify the risk points by means of comparison between tax related information on file with filing or tax relief information provided by taxpayers.

- Tax authorities may compare the filing information provided by taxpayers with their corresponding taxable documents (In China, the payable stamp duty shall be calculated based on the nature of the taxable documents, including business books of account, documentation of rights or licenses, taxable contracts, etc.). By doing this, under collection of stamp duty for such taxable documents may be on guard.
- Tax authorities may compare the payable stamp duty collected on a deemed basis with taxpayers' main business incomes. By doing this, underpayment of such stamp duty may be on guard.

Reference: GAC Announcement [2016] No. 75
Issuance date: 5 December 2016
Effective date: 1 December 2016

Relevant industries: Cross-border B2C e-commerce
Relevant companies: Enterprises engaged in cross-border B2C e-commerce business
Relevant taxes: N/A

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

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

GAC strengthens supervision on cross-border B2C e-commerce

As mentioned in KPMG *China Tax Weekly Update* *(Issue 12, April 2016)*, *(Issue 14, April 2016)*, *(Issue 15, April 2016)*, *(Issue 20, May 2016)* *and* *(Issue 44, November 2016)*, the government authorities introduced the new import tax policy to cross-border B2C e-commerce business, taking effect from 8 April 2016. Later, certain regulatory requirements were delayed in implementation until end of 2017.

In a bid to facilitate the new policy to be carried out smoothly, and to allow the Customs authorities to oversee products imported in cross-border e-commerce transactions through special customs supervision zones and bonded logistics centres, new guidance has been issued. To facilitate the preparation of usable statistics, the General Administration of Customs (GAC) on 5 December 2016, issued Announcement [2016] No. 75 to add a supervision method code "1239" in its system.

Cross-border B2C e-commerce transaction in Tianjin, Shanghai, Hangzhou, Ningbo, Fuzhou Pingtan, Zhengzhou, Guangzhou, Shenzhen and Chongqing shall temporarily not be subject to this supervision method. The Announcement will take effect from 1 December 2016.

* Regarding the details of the new import tax policy and its impact to cross-border B2C e-commerce, you may access the following KPMG publications for more:

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- [ ] China Tax Alert: China's New Import Tax Polices for Cross-border E-commerce worth the attention of the whole industry (Issue 14, March 2016)
- [ ] China Tax Alert: New Policies to Regulate Cross-Border E-Commerce Retail Import Business and the Imported Articles (Issue 15, April 2016)

Reference: Guo Fa [2016] No. 65
Issuance date: 5 December 2016
Effective date: From 1 January 2016 to 31 December 2020

Relevant industries: All
Relevant companies: All
Relevant taxes: Environmental protection tax / Resource tax

Potential impacts on businesses:

- Effective tax burden reduced

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

China's environmental strategy 2016-2020 outlined

China will strengthen efforts to improve environmental quality and enhance environmental governance during the 13th Five-Year Plan (FYP) period (2016-2020), according to a plan issued by the State Council on 5 December 2016. The measures in relation to finance and tax set out in the plan are as follows:

- Implement an emission permits system, including:
  - Establish a system for the initial allocation and transaction of emission permits. Improve the existing pilot paid-use and transaction of emission permits. Construction of a platform for emission permits transactions;
  - Encourage transactions in the pollutant emission permits for new construction projects. The idea is that there should not be an increase the total pollutant emission for the region where the new project is located;
  - Roll out a system to control the use of energy, and a pilot program of paid-use and transaction of permits for use of energy.
- Fiscal and tax policies are to play a guiding role in environmental protection. For instance:
  - A new environmental protection tax will start to be collected during the 13th FYP period.
  - Comprehensive reform of resource tax. According to the plan, resource tax will be gradually expanded to cover various types of natural ecological spaces.
  - Preferential tax measures will be implemented to promote environmental protection, ecological building, and new energy development and utilization.

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Vehicle purchase tax exemption for special vehicles

On 16 November 2016, the MOF and the SAT jointly issued Cai Shui [2016] No. 123. This clarifies that, pursuant to Cai Shui [2001] No. 39, 24 vehicles specially used in flood prevention in 2016 are exempted from vehicle purchase tax. The deadline for the exemption will be 30 June 2017.

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

Tax policies for imported seeds & seed sources during the 13th Five-Year Planning Period clarified

On 29 April 2016, the MOF, the GAC and the SAT jointly issued Cai Guan Shui [2016] No. 64, clarifying that the importation of certain seeds & seed sources could continue to enjoy an import VAT exemption from 1 January 2016 to 31 December 2020. At the same time, Circular 64 also clarifies the application scope, application conditions, operation procedures of the tax exemption policies.

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