

China Tax Weekly Update

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Reference: Guo Yi Gai Ban Fa [2016] No. 4
 Issuance date: 9 January 2017
 Effective date: 26 December 2016

Relevant industries:
 Pharmaceutical sector
 Relevant companies:
 Enterprises engaged in manufacturing and sales of drugs as well as public medical service providers
 Relevant taxes: N/A

Potential impacts on businesses:

- Intermediate processes of drugs sales compressed
- Restructure in pharmaceutical industry facilitated

You may click [here](#) to access full content of the circular.

“Two invoices system” for pharmaceutical sector

On 26 December 2016, eight authorities including the Medical Reform Office of the State Council, the National Health and Family Planning Commission, and the State Administration of Taxation (SAT), jointly issued Guo Yi Gai Ban Fa [2016] No. 4 (“Circular 4”). This aims to implement the “two invoices system” for drugs procurement by public medical institutions, which will standardize drugs distribution processes, reduce intermediate steps, and hopefully lower high drug prices.

Definition of “two invoices system”	<ul style="list-style-type: none"> • The “two invoices system” refers to: (i). a first invoice from the manufacturer to the distributor; and (ii). a second invoice from the distributor to the medical service providers. (the multiple layers of agents, and numerous invoices with separate mark ups, currently adopted by many drugs manufacturers, will be eliminated with the roll out of the “two invoices system”) • The following companies are deemed as manufacturers: (i). a commercial enterprise (either wholly owned or controlled, and only one of which is allowed within China) set up by a manufacturing company or a group enterprise that sells the products of the company or group only; and (ii). master agent for China for imported drugs (only one master agent is allowed within China). • Encourage public hospitals to directly settle the drugs payment with drug manufacturers and encourage drug manufacturers to directly settle the drug logistics fees with distributors.
Rollout of “two invoices system”	<ul style="list-style-type: none"> • The “two invoices system” will be gradually introduced into the process of drug procurement by public hospitals, and this system will be encouraged to be rolled out for drug procurement by other medical service providers. • The “two invoices system” will be rolled out in comprehensive Healthcare Reform pilot provinces and Public Hospital Reform pilot cities, and it will be encouraged in other regions. Subsequently, the two invoices system may be rolled out nationwide in 2018. <p>* Comprehensive Healthcare Reform pilot province and Public Hospital Reform pilot cities include, inter alia, Fujian, Jiangsu, Anhui, Qinghai, Shaanxi, Shanghai, Zhejiang, Sichuan.</p>

Invoice management for drugs purchase and sale

- Drug manufacturers and drug distributors shall issue special VAT invoices or ordinary VAT invoices for sales of drugs. The names of the purchaser and seller stated on the invoice must be consistent with bills accompanying the drugs, with the flow of goods, and with the amount of the payment.
- Drug distributors shall demand invoice from drug manufacturers for purchase of drugs. The invoice must be issued by the drug manufacturers.
- When public medical institutions conduct acceptance checks on drugs, they shall verify the consistency between the bills, goods and accounts before putting the drugs in storage and putting them to use. The public medical institutions shall not only demand and verify the invoices from the drug distributors, but also request drug distributors to present the copies of invoices which were provided by drug manufacturers for purchase of drugs and the copies shall be affixed with the seal of the drug manufacturers. Information, such as the name of the drug distributor, batch number of drug etc. stated on the “two invoices” (i.e., invoice from the manufacturer to the distributor and invoice from the distributor to the medical service providers.), shall be cross-checked for consistency.
- Encourage electronic invoices to be used in the areas where the necessary conditions are satisfied, so as to enable the “two invoices” to be verified by way of information management.

* By adopting the “two invoices system”, the unnecessary invoice “pass through” within the value chain is expected to be eliminated, as well as increasing transparency over the pricing of drugs. This will also induce drug manufacturers to change their existing business model. With regard to the impact of the “two invoices system”, you may access the article *Challenges of the two invoices system for China’s pharmaceutical industry* in [China – Looking Ahead, 6th Edition](#), which is produced by KPMG in collaboration with the International Tax Review.



Reference: Cai Shui [2017] No. 2

Issuance date: 6 January 2017

Effective date: N/A

Relevant industries: All

Relevant companies: All

Relevant taxes: VAT

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

You may click [here](#) to access full content of the circular.

VAT on asset management further clarified

As highlighted in KPMG China Tax Weekly Update ([Issue 49, December 2016](#)), on 21 December 2016, the Ministry of Finance (MOF) and the SAT jointly issued Cai Shui [2016] No.140 ("Circular 140"). This sets out new Value Added Tax (VAT) rules applicable to those sectors which recently transitioned from Business Tax (BT) to VAT, being financial services, real estate and construction services, and lifestyle services, and clarifies a number of uncertainties which have arisen in practice.

Circular 140 clarifies that, in the asset management sector, the asset manager shall be the VAT taxpayer and it shall account for VAT on a consolidated basis in respect of all of the taxable activities occurring during the operating period for which asset management products are supplied. In this regard, the MOF and the SAT further issued Cai Shui [2017] No. 2 ("Circular 2") on 6 January 2017, granting a half-year transition period to asset managers. Details are as follows:

- For taxable activities occurring, on or after 1 July 2017, during the operating period for which asset management products are supplied, the asset manager shall be the VAT taxpayer and shall pay VAT pursuant to the current provisions.
- VAT which may have been considered to have accrued from taxable activities occurring before 1 July 2017, during the operating period for which asset management products are supplied, need not be paid; if the VAT has been paid, it shall be allowed to be credited against the relevant VAT payable thereafter.

* For detail analysis of Circular 140 and its impacts on businesses, please refer to the following KPMG China Tax Alert:

- [China Tax Alert: Significant retrospective changes introduced to clarify VAT reform policies \(Issue 38, December 2016\)](#)

Reference: N/A
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Relevant industries: All
 Relevant companies: Multinational enterprises
 Relevant taxes: N/A

Potential impacts on businesses:

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

You may click [here](#) to access full content of the circular.

OECD BEPS continuity work on treaty relief

As highlighted in KPMG *China Tax Weekly Update* ([Issue 25, July 2016](#)), ([Issue 26, July 2016](#)), ([Issue 33, August 2016](#)), ([Issue 37, September 2016](#)), ([Issue 41, November 2016](#)), ([Issue 45, December 2016](#)), ([Issue 48, December 2016](#)) and ([Issue 1, January 2017](#)), the Organisation for Economic Cooperation and Development (OECD) has continued to release new policy documents for the continuity of BEPS work subsequent to the issuance of the October 2015 BEPS Deliverables.

On 6 January 2017, the OECD released a [discussion draft](#) document which includes draft examples, to be included in an updated Commentary to the OECD Model Tax Convention (MTC), for public comment. The examples relate to the tax treaty entitlements of non-collective investment vehicles (non-CIV) funds in light of the BEPS Action 6 proposed principal purposes test (PPT) rule. Non-CIV funds include a wide variety of different arrangements, including sovereign wealth funds, pension funds, private equity funds, real estate investment trusts (REITs), securitization vehicles, and others.

❑ [Interaction between the tax treaty provisions of the report on BEPS Action 6 and the treaty entitlement of non-CIV funds](#)

- As part of the follow-up work on the [BEPS report on Action 6](#) (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), on 24 March 2016 the OECD published a [consultation document on the treaty entitlement of non-CIV funds](#). This sought to address concerns on how the Action 6 treaty anti-abuse rules (i.e. PPT and the Limitation on Benefits (LOB) rule) could affect the treaty entitlement of non-CIV funds. The [comments received](#) were published on the OECD website on 22 April 2016.
- The new [discussion draft](#) makes the following observations:
 - The November 2016 released Action 15 multilateral instrument (MLI) does not set out specified wording for a detailed LOB. As such, if two countries wish to include a detailed LOB in their bilateral tax treaty then they can tailor the LOB to the circumstances of non-CIVs in the two countries in question. Consequently the OECD did not see a need to set out detailed solutions to granting treaty access for non-CIVs where a detailed LOB is in point.
 - The simplified LOB, which is included as an option in the MLI, allows for an unlimited number of equivalent beneficiaries to be taken into account in determining whether treaty relief is available – this is seen to limit the risks of treaty relief denial for non-CIVs.
 - For treaties updated by the MLI to include the PPT, the OECD seeks to clarify that many types of genuine investment arrangement involving non-CIVs should not be denied treaty benefits. Three examples, for inclusion in the OECD MTC Commentary, are set out, covering a regional investment platform, a securitization vehicle and a REIT. The examples point to commercial aspects of the arrangement which support the applicability of relief.
- Comments should be sent by 3 February 2017.

Reference: Cai Guan Shui [2016] No. 68 / No. 69
 Issuance date: 29 December 2016

Effective date: From 1 January 2016 to 31 December 2020

Relevant industries: Energy industry

Relevant companies: Enterprises engaged in exploitation and sales of oil and nature gas

Relevant taxes: Import Duty / VAT

Potential impacts on businesses:

- Effective tax burden reduced

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

Oil and gas industry tax incentives for imports of goods and equipment

On 29 December 2016, the Ministry of Finance (MOF), the General Administration of Customs (GAC) and the State Administration of Taxation (SAT) jointly issued two circulars. These clarify that imports of goods and equipment directly used for marine and land exploration/exploitation of oil and gas will, in the 13th Five-Year-Plan period (i.e., from 1 January 2016 to 31 December 2020), continue to be entitled to enjoy relevant tax incentives.

- ❑ [Notice on import tax exemption for imported materials used for exploitation of oil and nature gas in specific areas on land in China during the 13th Five-Year-Plan \(FYP\) period](#) (Cai Guan Shui [2016] No. 68, "Circular 68")
 - One incentive relates to certain Chinese-run oil/gas exploitation projects in Chinese desert and wilderness areas, as well as Sino-foreign cooperative projects for oil/gas exploitation in designated areas. For these enterprises, imported materials such as equipment, instruments, spare parts and special tools that fall under a special [list of exempt goods or equipment](#) shall be exempted from import duties and VAT (import duties exemption only for the said Chinese-run oil/gas exploitation projects). This is provided that such goods or equipment cannot be produced in China or where the equivalents produced in China do not meet the specifications of business.
- ❑ [Notice on import tax exemption for imported materials used for exploitation of oil and nature gas in the oceans of China during the 13th FYP period](#) (Cai Guan Shui [2016] No. 69, "Circular 69")
 - The second incentive applies to projects for exploitation of oil/gas in the oceans of China. For these projects, imported materials such as equipment, instruments, spare parts and special tools that fall under a special [list of exempt goods or equipment](#) are exempt from import duties and import VAT. This is provided that such goods or equipment cannot be produced in China or where the equivalents produced in China do not meet the specifications of business.

In addition, Circular 68 and Circular 69 also clarify the administrative procedures for application of the exemption for imported materials.

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