

China Tax Weekly Update

ISSUE 3 | January 2017

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
 Issuance date: 6 January 2017
 Effective date: N/A

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.

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho
Head of Tax,
KPMG China
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Beijing/Shenyang
David Ling
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Tianjin
Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Qingdao
Vincent Pang
Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Shanghai/Nanjing
Lewis Lu
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Chengdu
Anthony Chau
Tel. +86 (28) 8673 3916
anthony.chau@kpmg.com

Hangzhou
John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou
Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen
Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen
Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong
Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China
David Ling
Head of Tax,
Northern Region
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Andy Chen
Tel. +86 (10) 8508 7025
andy.m.chen@kpmg.com

Yali Chen
Tel. +86 (10) 8508 7571
yali.chen@kpmg.com

Conrad TURLEY
Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Milano Fang
Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng
Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

John Gu
Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan
Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han
Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong
Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Josephine Jiang
Tel. +86 (10) 8508 7511
josephine.jiang@kpmg.com

Henry Kim
Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

Li Li
Tel. +86 (10) 8508 7537
li.li@kpmg.com

Lisa Li
Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Thomas Li
Tel. +86 (10) 8508 7574
thomas.li@kpmg.com

Simon Liu
Tel. +86 (10) 8508 7565
simon.liu@kpmg.com

Alan O'Connor
Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Vincent Pang
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Naoko Hirasawa
Tel. +86 (10) 8508 7054
naoko.hirasawa@kpmg.com

Shirley Shen
Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam
Tel. +86 (10) 8508 7605
laiyiu.tam@kpmg.com

Joyce Tan
Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Jessica Xie
Tel. +86 (10) 8508 7540
jessica.xie@kpmg.com

Cynthia Xie
Tel. +86 (10) 8508 7543
cynthia.py.xie@kpmg.com

Christopher Xing
Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Irene Yan
Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Jessie Zhang
Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang
Tel. +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tiansheng Zhang
Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Tracy Zhang
Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Central China
Lewis Lu
Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Alan Garcia
Tel. +86 (21) 2212 3509
alan.garcia@kpmg.com

Cheng Chi
Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Yasuhiko Otani
Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Johnny Deng
Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong
Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Marianne Dong
Tel. +86 (21) 2212 3436
marianne.dong@kpmg.com

Chris Ge
Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong
Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang
Tel. +86 (21) 2212 3527
jason.jt.jiang@kpmg.com

Flame Jin
Tel. +86 (21) 2212 3420
flame.jin@kpmg.com

Sunny Leung
Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li
Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin
Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Christopher Mak
Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Henry Ngai
Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Ruqiang Pan
Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao
Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan
Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang
Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao
Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang
Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang
Tel. +86 (21) 2212 3438
john.wang@kpmg.com

Mimi Wang
Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng
Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie
Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu
Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu
Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu
Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Yang Yang
Tel. +86 (21) 2212 3372
yang.yang@kpmg.com

William Zhang
Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Dylan Jeng
Tel. +86 (21) 2212 3080
dylan.jeng@kpmg.com

Hanson Zhou
Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Michelle Zhou
Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Southern China

Lilly Li
Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Penny Chen
Tel. +1 (408) 367 6086
penny.chen@kpmg.com

Vivian Chen
Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Sam Fan
Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Joe Fu
Tel. +86 (755) 2547 1138
joe.fu@kpmg.com

Ricky Gu
Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He
Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Angie Ho
Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Aileen Jiang
Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li
Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li
Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li
Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li
Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao
Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu
Tel. +86 (755) 2547 1187
patrick.c.lu@kpmg.com

Grace Luo
Tel. +86 (20) 3813 8609
grace.lu@kpmg.com

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Michelle Sun
Tel. +86 (20) 3813 8615
michelle.sun@kpmg.com

Bin Yang
Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Lixin Zeng
Tel. +86 (20) 3813 8812
lixin.zeng@kpmg.com

Hong Kong
Ayesha M. Lau
Head of Tax, Hong Kong
Tel. +852 2826 7165
ayasha.lau@kpmg.com

Chris Abbiss
Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern
Tel. +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Tel. +852 2847 5108
yvette.chan@kpmg.com

Lu Chen
Tel. +852 2143 8777
lu.l.chen@kpmg.com

Rebecca Chin
Tel. +852 2978 8987
rebecca.chin@kpmg.com

Wade Wagatsuma
Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Natalie To
Tel. +852 2143 8509
natalie.to@kpmg.com

Matthew Fenwick
Tel. +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Tel. +852 2143 8821
sandy.fung@kpmg.com

Charles Kinsley
Tel. +852 2826 8070
charles.kinsley@kpmg.com

Stanley Ho
Tel. +852 2826 7296
stanley.ho@kpmg.com

Becky Wong
Tel. +852 2978 8271
becky.wong@kpmg.com

Barbara Forrest
Tel. +852 2978 8941
barbara.forrest@kpmg.com

John Kondos
Tel. +852 2685 7457
john.kondos@kpmg.com

Kate Lai
Tel. +852 2978 8942
kate.lai@kpmg.com

Travis Lee
Tel. +852 2143 8524
travis.lee@kpmg.com

Irene Lee
Tel. +852 2685 7372
irene.lee@kpmg.com

Alice Leung
Tel. +852 2143 8711
alice.leung@kpmg.com

Jocelyn Lam
Tel. +852 2685 7605
jocelyn.lam@kpmg.com

Ivor Morris
Tel. +852 2847 5092
ivor.morris@kpmg.com

Benjamin Pong
Tel. +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Tel. +852 2684 7472
malcolm.j.prebble@kpmg.com

David Siew
Tel. +852 2143 8785
david.siew@kpmg.com

Murray Sarelus
Tel. +852 3927 5671
murray.sarelus@kpmg.com

John Timpany
Tel. +852 2143 8790
john.timpany@kpmg.com

Lachlan Wolfers
Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Steve Man
Tel. +852 2978 8976
steve.man@kpmg.com

Curtis Ng
Tel. +852 2143 8709
curtis.ng@kpmg.com

Daniel Hui
Tel. +852 2685 7815
daniel.hui@kpmg.com