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

Potential impacts on businesses:

- Operational costs reduced

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China to reduce non-tax charges on businesses

China has many types of local and provincial charges and fees alongside normal taxes. These add to the overall fiscal contribution of enterprises operating in China. Many complain that, even though China's Corporate Income Tax (CIT) rate at 25% is average among major economies, the fiscal burden (taxes and fees) is much heavier than it first appears due to all these fees.

Recently, Zong Qinghou, founder of China's largest beverage company, asserted that his beverage company Wahaha Group had paid more than 500 different types of fees to the government in 2016 (article "*Trump's pledge triggers debate in China over corporate tax*", in *Financial Times*, 6 February 2017). In a 18 January 2017 news item posting to the website of the National Development and Reform Commission (NDRC), it was disclosed that the Ministry of Finance (MOF) and the NDRC had conducted an investigation into this assertion, and the news item publicized the findings. At the same time MOF and NDRC set out details on plans to standardize enterprise-related fees in China, involving cancellation and suspension of, and relief for, a number of these charges.

The Wahaha case highlighted the high number of fees paid by big groups. While the authorities ultimately determined that the fees payable were less than Wahaha originally asserted, they were still very high.

In recognition of this fact, and with a view to encouraging the economy and making China more competitive, an effort will be undertaken to draw up a national inventory of all the fees imposed on businesses, and the circumstances in which they apply. This will help to alert enterprises of the existence of these charges and their conditions, and allow the authorities to standardise the fee criteria, as well as eliminating many of them.

On 8 February 2017, the Standing Committee of the State Council committed to further reduce and standardize business charges to lower corporate fiscal burdens:

- The State Council instructed government departments to eliminate unreasonable charges and subject continuing charges to greater oversight and audit. The use, by brokerage businesses and industry associations, of their relationships with officials and their official status to extract various charges from businesses needs to be subjected to particular scrutiny and review.
- The government must formulate a nationwide fee list by the end of 2017 setting out clearly the conditions under which fees are applied.

More detailed guidance is expected to be later forthcoming form lower level authorities.

Reference: Guo Ban Fa [2017] No. 13
Issuance date: 9 February 2017
Effective date: N/A

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
- Compliance risks increased

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Further guidance to pharmaceutical sector

China aims to reduce the proliferation of intermediaries in its pharmaceuticals market and expects to more than halve the number of intermediaries in the sector. As highlighted in KPMG *China Tax Weekly Update (Issue 3, January 2017)*, 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.

"Two invoices system" limits the number of invoices which can be issued in the supply chain as drugs move between drug makers to hospitals, to a maximum of two. It is already being piloted in 11 provinces. The number of drug distributors is expected to plummet as a result. The reform is likely to be more of a challenge for Chinese drug makers that typically distribute their products indirectly, through local intermediaries. If applied to the medical device market it could benefit overseas companies by reducing the need for complicated supply chains.

To complement this, on 9 February 2017, the State Council issued Guo Ban Fa [2017] No. 13 ("Circular 13"), introducing 17 specific measures to drive medical and health system reform, improve the quality of medicines, and better regulate the distribution system. Among the 17 specific measures, tax-related measures are set out as below:

- Drug distributors and medical service providers shall establish internal records for purchase and sales of drugs which documents and evidences the rigorous verification that there is no inconsistency in terms of the product being sold/purchased and the information recorded on the related documents, and "Accompanying Bill" (随货同行单) shall be attached with the products. (The type, specification and quantity of the procured pharmaceutical products shall be in accordance with those shown on the corresponding invoice and 'Accompanying Bill'. Otherwise, the delivery cannot be accepted).

- Drug manufacturers and drug distributors shall issue invoices or vouchers for sales of drugs as a mandatory and standard part of the sales process. They must ensure that they standardize invoice and documentation management (including use of electronic invoices and documentation) for purchase and sales of drugs.

- Food and drug regulatory authorities shall take the lead in establishing a platform for sharing drug price information with other authorities, especially with the tax authorities. Where an enterprise is found to fraudulently report the price of raw materials and ex-factory price of drugs, it will be subject to investigation and sanctions as a result, such as pursuit of underpaid taxes, and investigation of the liability of the persons concerned, by the relevant authorities.

A KPMG publication, titled as *Challenges of the 'two invoices' system for China's pharmaceutical industry,* highlights and analyses the salient points of Circular 4 and implications on pharmaceutical industry, as well as providing our thoughts on the tax implication of the "two invoices" system to pharmaceutical companies in China. You may click the following link to understand more details:

❑ *Challenges of the "two invoices" system for China's pharmaceutical industry (February 2017)*

Reference: Hu Fu Fa [2017] No. 9
Issuance date: 27 January 2017
Effective date: 1 February 2017

Relevant industries: All
Relevant companies: MNEs setting up regional headquarters and centralized function in Shanghai
Relevant taxes: N/A

Potential impacts on businesses:

- Operational costs reduced
- Facilitate MNEs to set up regional headquarters in Shanghai

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Incentives for MNE regional headquarters in Shanghai

The Shanghai government is seeking to encourage multinational enterprises (MNEs) to set up regional headquarters and centralized functions in Shanghai to transform the city into an economic and technological innovator. To this end the Shanghai government issued Hu Fu Fa [2017] No. 9 ("Circular 9"). Circular 9 builds on Circular 98, which was issued in 2011, making particular improvements:

- Setup of centralized functions in Shanghai is encouraged. Centralized functions refers to the activities of a wholly foreign owned enterprise (WFOE) (including a branch office of the WFOE, say a Shanghai branch office a Beijing WFOE) which, while not constituting the global headquarters functions of an MNE, involve the conduct of management decision-making, funds management, procurement, sales, logistics, settlement, R&D, and training in the geographic region (i.e. covering several Asian countries).
- The requirements for a WFOE/branch to qualify as a regional headquarters/ centralized functions centre have been amended. Where an enterprise in the service sector sets up a regional headquarters in Shanghai, the minimum capital requirement that its parent company must fulfil has been reduced to US$300 million (regional headquarters of non-service enterprises must still meet the US$400 million threshold set under Circular 98).
- Where a WFOE with the status of an independent legal entity (or its branch office) applies for recognition as a centralized functions centre in Shanghai, in order to qualify the capital of its parent company must be no less than US$200 million (versus US$400/300 million for the regional headquarters status), and the parent company must have established no less than two foreign-invested enterprises in China, at least one of which is registered in Shanghai.
- Abolition of the specific scope requirements for the business of the regional headquarters, as set out in Circular 98.
- Companies recognized as headquarters/centralized functions centres are eligible for financial support in operations, and are facilitated in the conduct of cross-border money management, entry-exit procedures, recruitment of talented personnel and are granted faster customs clearance.

Circular 9 comes into force on 1 February 2017 and will be valid until 31 January 2022.

R&D "super deduction" for 2016 CIT annual filing

On 23 January 2017, the Income Tax Department of the State Administration of Taxation (SAT) issued Shui Zong Suo Bian Han [2017] No. 5 to guide taxpayers on how to fill in the relevant filing forms for enterprises enjoying research & development (R&D) expense "super deduction" when performing CIT annual filing for year 2016.

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

* For more information about R&D "super deduction" policy, you may access the following KPMG publications:

- *China Tax Weekly Update (Issue 1, January 2016)* & *(Issue 1, January 2017)*
- *China Tax Alert: 150% Super Deduction Regulation Update (Issue 3, January 2016)*

Promotion of cross-border e-commerce in Hangzhou

A news item on Hangzhou economic cooperation website said that, on 23 December 2016, *Promotion Regulations on Cross-border E-commerce in Hangzhou*, was approved and the regulations will be come into force on 1 March 2017. The promotion regulations specify the administrative system for Hangzhou Cross-Border E-Commerce Comprehensive Pilot Zones, the development plan of cross-border e-commerce, promotion measures, etc.

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

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