China Tax Alert

Issue 5, February 2020

Coronavirus epidemic - Weathering the tax challenges and policy options

Regulations discussed in this issue:

- Announcement on Tax-free Policy on Supplies Imported for Prevention and Control of Pneumonia Epidemic of New Coronavirus Infection, MOF Announcement [2020] No. 6, (Announcement 6, released by MOF, GAC and STA on February 1, 2020)
- Notice on Optimizing Tax Payment Services to Support Prevention and Control of Pneumonia Epidemic of New Coronavirus Infection, Shui Zong Han [2020] No. 19, (Circular 19, released by STA on January 30, 2020)

Background

A pneumonia epidemic, caused by a novel coronavirus, has spread rapidly across China since the beginning of 2020. At present, the epidemic has spread to 31 provinces (including autonomous regions and municipalities) as well as to Hong Kong SAR, Macao SAR and Taiwan region. More impactful than the SARS epidemic back in 2003, a greater number of cities and industries have been affected by the novel coronavirus epidemic. Affected industries especially include service sectors, such as hotel catering, tourism, education and training. In view of the severe situation, the Chinese government extended the Chinese New Year holidays with a view to containing the outbreak. While this has inevitably resulted in disruption to normal enterprise operations, many are actively donating money and goods to support front-line medical workers. In parallel, enterprises engaged in special fields, such as logistics, agriculture, genetics, and bio-pharmaceuticals, are persisting in their efforts to tackle the outbreak.

China's tax and finance authorities reacted quickly to the epidemic. On February 1, 2020, the Ministry of Finance (MOF), General Administration of Customs (GAC) and State Taxation Administration (STA) jointly issued Announcement 6. In parallel, STA on January 30 issued Circular 19. These set out preferential measures to support enterprises and citizens to fight against the outbreak.

Main content

Announcement 6: Announcement 6 clarifies that imported supplies, donated by domestic and foreign donors and used for prevention and control of the epidemic, can be exempted from import duties, import value-added tax (VAT), and import consumption tax. This is valid from January 1 to March 31, 2020. The key points of Announcement 6 include:

i. Imported medical supplies, subject to tax-free import treatment, include reagents, disinfection equipment, protective supplies, ambulances, and vehicles used for epidemic prevention purposes, disinfection purposes, and emergency command roles.

Regulations discussed in this issue:

- Circular on Further Strengthening Financial Support to Prevent and Control the Pneumonia Caused by the New Coronavirus (Yin Fa [2020] No. 29, released by PBOC, MOF, CBIRC, CRSC and SAFE on February 1, 2020)
- Circular on Subsidy Arrangement for Prevention and Control of New Coronavirus Pneumonia (Cai She [2020] No. 2, released by MOF and NHC on January 25, 2020)

ii. Import tax exemption applies to supplies imported from overseas or special customs supervision zones and directly donated by (i) Chinese government bodies, enterprises, social organizations and individuals; or (ii) foreign nationals travelling to/residing in China. Supplies donated by Chinese processing trade enterprises are also covered.

iii. The scope of donees covers, among others, provincial civil affairs administrations (such as the Hubei Provincial Civil Affairs Administration) and their designated enterprises. The enterprise list shall be reported to the customs offices where the enterprises are located and to tax authorities at the provincial level.

In addition, the preferential treatment also applies to supplies imported by the health administration for the outbreak, even though the supplies are not donated. Tax refunds can be obtained for qualified supplies for which taxes have already been paid.

Circular 19: Circular 19 extends February's statutory tax filing deadline to February 24, 2020. This can be further extended by local tax authorities where the outbreak is serious (such as in Hubei). Affected taxpayers and withholding agents can apply for further extension. Circular 19 also encourages local tax authorities and taxpayers to deal with tax matters online or via mobile application.

Additional guidance: In Circular 29, issued on February 1, government authorities including the People's Bank of China (PBOC), MOF, China Banking Insurance and Regulatory Commission (CBIRC), China Securities Regulatory Commission (CSRC), and State Administration of Foreign Exchange (SAFE) jointly set out 30 financial measures to support the prevention and control of the coronavirus outbreak. This covers credit and financial support, security of financial infrastructure, forex, and cross-border RMB business.

Prior to this, MOF and the National Health Commission (NHC) on January 25 also issued a circular clarifying that the government will provide subsidies for treatment expenses, medical and epidemic prevention workers, medical institution expenditure on purchased special equipment, and rapid diagnostic reagents for prevention of the outbreak.

KPMG Observations

Actions for enterprises

The introduction of Announcement 6 and Circular 19 in a very short time illustrates the determination of China's tax and finance authorities to deal with this public emergency. Looking back at the financial and tax circulars issued at the time of the SARS epidemic, we expect more tax relief measures for the coronavirus outbreak in due course.

Suggestions may be made for enterprises from a tax perspective:

- **Cashflow management and planning**. Enterprise cash flows may come under pressure both during and following the outbreak period. As cash inflows may fall, enterprises will need to actively manage their cash outflows. This could include, for example, (i) applying for tax filing and payment extensions where the enterprise runs into financial difficulties; (ii) speedily process tax refunds; and (iii) ensure that tax deductible losses are calculated accurately.

- **Keep abreast of tax policies on donations**. As noted above, Announcement 6 gives Chinese domestic enterprises two tax-free donation options. They can either import, tax-free, overseas-purchased supplies for donation, or they can make direct donations out of tax-deferred supplies stored in special customs supervision zones. As Announcement 6 covers a wide range of qualified donees, enterprises can make direct donations to medical institutions in need in a timely and tax efficient manner. Going further, bonded goods, produced under processing trade arrangements by Chinese domestic enterprises, can also be used for tax-free donation.

- **Use of tax incentives**. Biotech companies engaged in scientific research can enjoy R&D tax incentives, such as the R&D expense super deduction, and the VAT refund for equipment purchased by scientific institutions. Enterprises and their employees can also enjoy preferential tax treatment on their donations. Enterprises should keep abreast of further new incentives introduced during the outbreak, to make best use of them.

- **Utilization of tax technology**. To limit the risk of spread of the epidemic, the tax authorities are now encouraging taxpayers to deal with tax matters remotely, such as by way of e-tax bureau and mobile application. Enterprises could consider developing tax management tools to conduct business operations in an orderly manner, while protecting the health of employees. More generally, enterprises could embed technology into the entire tax management process, facilitating remote operations in real time:

  - Establish a platform to integrate tax and accounting functions, facilitating tax invoice issuance and verification, tax credit calculation and filing.

  - For tax compliance, use technologies such as robotic process automation (RPA), and have enterprise systems seamlessly-connected to e-tax bureaus. This can serve as technical preparation for wider connectivity with the e-tax bureaus of various tax authorities.

  - Leverage tax informatization solutions, such as invoice management systems and vendor management platforms, to authenticate and manage special VAT invoices in a digitalized manner, reducing use of paper invoices.

  - Encourage employees to use electronic invoices to make reimbursement claims, and build authenticity checks for invoices into the system. This can reduce employee contact during the reimbursement process.

- **Maintain engagement with tax authorities**: Proactively seek the tax authority's support when confronted with a dilemma, e.g. applying for tax payment extension, tax relief in view of business difficulties.

Potential supportive tax policies

The crucial role of biotech enterprises, producers of protective apparatus, and medical and scientific professionals in combatting the outbreak is well recognized. We expect future tax and financial policies to provide additional support, and set out policy suggestions below.

Disaster relief measures

- Introduce tax relief measures to help affected industries pull through. Industries which are deeply affected by the outbreak (e.g. logistics, transportation, hotel, lodging and catering, tourism) are firstly advised to utilize existing tax relief measures, e.g. preferential tax policies for small enterprises. If these policies are insufficient to alleviate industry difficulties, policymakers could be called upon to develop temporary tax relief measures for affected enterprises. Given the much broader and deeper impact of the coronavirus outbreak, relative to SARS, we would expect government authorities to restore and enhance the incentives previously rolled out in the context of the SARS epidemic.

- Expand and improve tax incentives for charitable donations for the coronavirus outbreak, and encourage enterprises to meet their social responsibilities.

  For example, (i) perhaps it would be possible to grant businesses a 100% tax deduction for coronavirus-related donations (ii) perhaps the qualified donees could be expanded to cover designated hospitals (referencing designated public welfare institutions), (iii) perhaps for donations made by individuals, the deductible ratio could be raised (currently, charitable donations made by an individual, are deductible up to 30% of the individual's taxable income), (iv) perhaps coronavirus donations made with self-produced property could be VAT exempt (this is currently the case for donations for poverty alleviation purposes), (v) perhaps coronavirus donations made with purchased supplies could be regarded as public welfare, and consequently not treated as a "deemed sale" for VAT purposes.

- Perhaps qualified medical and scientific staff, working at the frontline, could be granted individual income tax (IIT) relief, e.g. increased personal deductions or a special itemized deduction.

Industry support policies

- Perhaps supplies for epidemic prevention control could be treated as VAT exempt. Perhaps the VAT "refund-upon-collection" policy could be applied to domestic enterprises engaged in producing such supplies.
- Perhaps the government could expand the tax incentives for key scientific research projects. For example, they could (i) raise the R&D super deduction ratio to a higher level for scientific work on the coronavirus (ii) expand the scope of qualifying R&D expenses, (iii) perhaps the VAT refund incentive could be expanded to cover China-made or imported equipment purchased by R&D institutions for use in coronavirus research (iv) perhaps the rules for the 100% expensing tax deduction for purchased equipment could be relaxed to cover more China-made or imported equipment purchased for coronavirus research (under existing rules, this covers purchased equipment with a unit value less than RMB 5 million).
- The government could consider more universal tax incentives for affected enterprises, e.g. VAT rate reductions for certain industries; lowered threshold to qualify as small enterprise with low VAT rate.
- Given the importance of the bio-pharmaceutical industry, the government could consider granting tax and finance support.
- As noted above, Circular 29 sets out 30 stimulus measures for the financial services industry, helping it to play a key role in economic recovery efforts. Further support could be considered, such as VAT exempting interest income from loans made by financial institutions to coronavirus-affected enterprise
- The government could consider reducing the social security contribution rate or adjusting social security contribution categories, to compensate enterprises for costs incurred from delayed resumption of work due to the outbreak.

More tax relief is expected by affected enterprises to help them endure the current difficulties and help them with recovery once the outbreak is under control. We earnestly hope that the government will consider these suggestions, and that all sectors of the community will work together to seek solutions.

KPMG is eager to work with enterprises to tackle the challenges from the coronavirus outbreak, studying possible policies and response measures, and sharing our insights on weathering the tax challenges.

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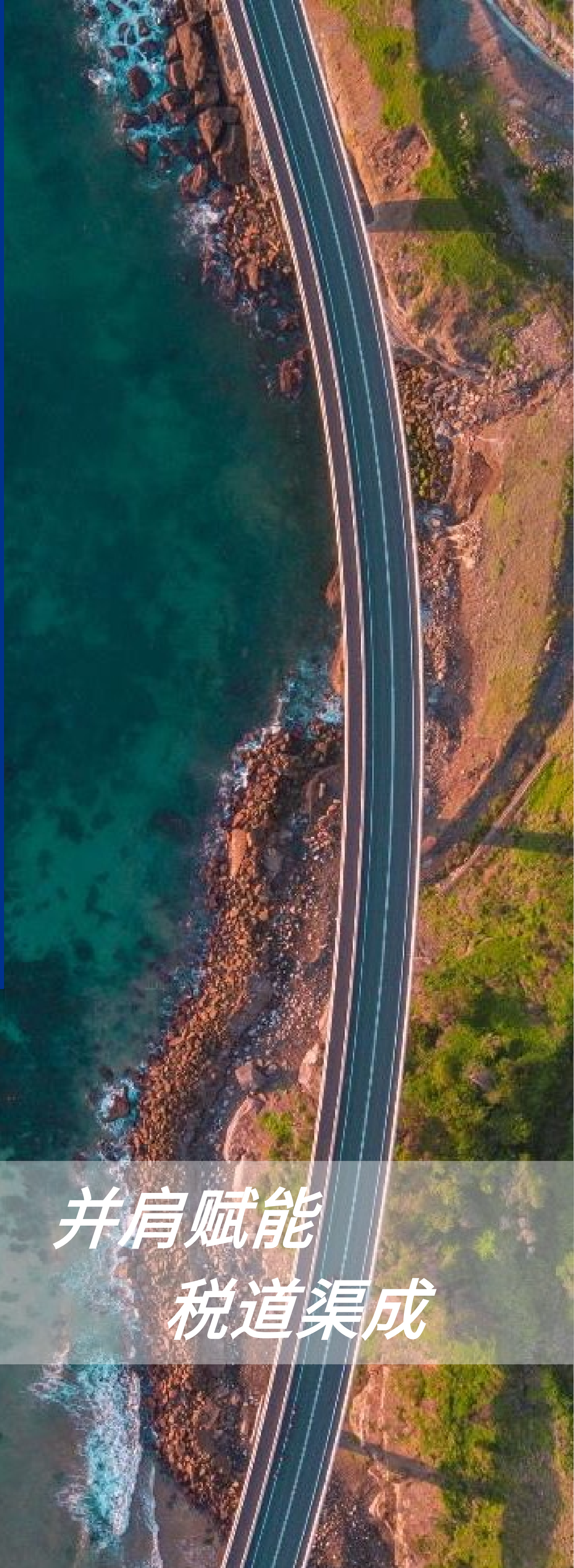

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