Hong Kong Institute of
Certified Public Accountants
香港會計師公會

# Meeting notes

## Shenzhen Tax Service, State Taxation Administration

## and

## The Hong Kong Institute of Certified Public Accountants

2018

## Foreword

It is a great honor for the Hong Kong Institute of Certified Public Accountants ("Institute" or "HKICPA") to hold the meeting with the Shenzhen Tax Service, State Administration of Taxation ("SZSTA") on 13 December 2018 in Shenzhen. The meeting aims to discuss various taxation topics and to exchange opinions based on the discussion.

The following is a translation of the meeting notes prepared, in Chinese, by the Institute. Please note that the meeting notes merely represent the views of SZSTA officials who attended the meetings and are not intended to be legally-binding or a definitive interpretation. Professional advice should be sought before applying the content of these notes to your particular situation.

HKICPA wishes to thank the delegates from Grant Thornton for taking the meeting notes.

**Summary Note**

**Agenda items**

**A. Corporate Income Tax ("CIT")**

1. Equity transfer
2. Assignment of equities/assets
3. Caishui [2018] No. 55
4. Caishui [2009] No. 59 (“Circular 59”) – Can merger of entities under the same control apply for special tax treatment?
5. State Taxation Administration (“STA”) Public Notice [2018] No. 28
6. STA Public Notice [2015] No. 7

**B. Withholding Income Tax**

1. Determination of “Beneficial Owners”

**C. Individual Income Tax (“IIT”)/Social Security**

1. Resident identity
2. New IIT rate
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1. STA Public Notice [2018] No. 57 (“PN57”) & STA Public Notice [2018] No. 17 (“PN17”)

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1. Combination of local and state taxation bureaus
2. Improve business environment
3. Planning on the Greater Bay Area
4. Golden Tax Project Phase III

**Attendees:**

**SZSTA**

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| Lin Weiming | Deputy Director, SZSTA |
| Cheng Taiping | Associate Consultant, Human Resources Department |
| Lin Hanyi | Associate Consultant, Goods and Services Tax Department |
| Huang Liya | Deputy Director, Corporate Income Tax Department |
| Zhan Feng Ying | Associate Consultant, Individual Income Tax Department |
| Li Hong Wei | Deputy Director, Property and Behavior Tax Department |
| Wang Xinxing | Deputy Director, Social Insurance Department |
| Níngjìng | Deputy Director, Tax Payment Services Department |
| Zheng Nianhua | Deputy Director, Collection, Administration and IT Development Department |
| Liu Jia | Deputy Director, International Taxation Department |
| Chen Youlun | Deputy Director, International Taxation Department |
| Xiao Shu | Deputy Director, Division Four of SZSTA |

**HKICPA**

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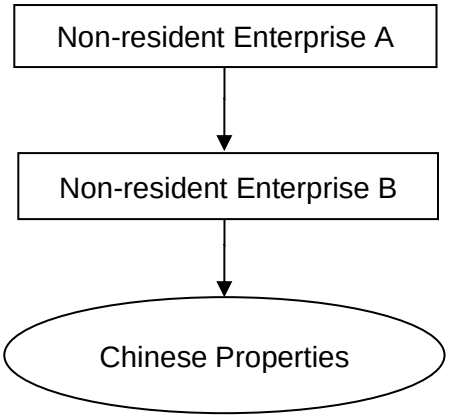
| William Chan | Convenor, China Taxation Subcommittee and Member, Taxation Faculty Executive Committee |
| George Lam | Member, Taxation Faculty Executive Committee and China Taxation Subcommittee |
| Cecilia Lee | Member, China Taxation Subcommittee |
| Travis Lee | Member, China Taxation Subcommittee |
| Mak Ho Sing | Member, China Taxation Subcommittee |
| Shanice Siu | Member, China Taxation Subcommittee |
| Leo Li | Member, China Taxation Subcommittee |
| Sunny Hua | Director, Grant Thornton China (Shenzhen) |
| Oscar Chow | Senior Manager, Tax Advisory Services, Mazars |
| Eric Chiang | Deputy Director, Advocacy and Practice Development |
| Wallace Wong | Associate Director, Advocacy and Practice Development |

**Agenda items**

## A. Corporate Income Tax ("CIT")

1. Equity transfer




Non-resident Enterprise A directly transfers the equity interest in another non-resident Enterprise B in which Enterprise B holds a real estate in China directly. Through receiving rent in China, Enterprise B would be deemed to have a permanent establishment in China. Tax bureaus expressed different views on the tax rate, should the applicable CIT rate be 10% or 25% for the above scenario?

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| SZSTA: If a non-resident enterprise transferred the equity interest in its overseas subsidiary and this overseas subsidiary directly holds a real estate located in China, the transfer is regarded as an indirect transfer of asset in China between non-resident enterprises. According to Article 1 of STA Public Notice [2015] No. 7, where a non-resident enterprise makes indirect transfer of assets without reasonable commercial reasons, the indirect transfer transaction shall be redefined as direct transfer of assets in China by virtue of Article 47 of the Corporate Income Tax Law. According to item 3 of Article 3 of the Corporate Income Tax Law, 10% withholding tax rate will apply. |

2. Assignment of equities/assets

According to Caishui [2014] No. 109 (“Circular 109”), special tax treatment on assignment of equities or assets applies if the requirement of equities or the original substantial business activities of the transferred equity or assets has not been changed within 12 consecutive months after the transfer.

According to item 7 of STA Public Notice [2015] No. 40 ("PN40"), in the event of change of manufacturing or business activities, nature of company, asset or equity structure etc. of the transferor or the transferee within 12 consecutive months from completion of the transfer of equity or assets, which render the transfer of equity or assets to be non-compliant with the special tax treatment criteria, the party triggers the change shall report this change to its tax authorities in charge within 30 days from occurrence of the change, and notify the other party

in writing simultaneously. The other party shall report to its tax authorities in charge of the relevant change within 30 days from receipt of notification.

a. For the above requirement of "substantive business activities" and " equity structure", is it implied that assigned equities cannot be transferred within 12 months?

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| SZSTA: For a change in asset or equity structure of the transferor or the transferee within 12 consecutive months after the completion of transfer, if transfer transaction did not satisfy special tax treatment criteria due to the change in asset or equity structure, the special tax treatment would not apply. (1) If transferred equity were transferred again within 12 months from the date of the original transaction, the two transfer will collectively be regarded as a single transaction and this would lead to the entire arrangement not satisfying the qualifying conditions for the special tax treatment. (2) "A change in equity structure" mentioned in PN40, means that within 12 consecutive months after the transfer, both transferor and transferee (includes 100% direct parent company, 100% directly controlled by the same or multiple parent companies) have changes in the equity structure such that it is no longer a 100% direct control relationship. |

b. If there is a capital injection from the third party within 12 months (original shareholder does not transfer the equities), would it be treated as a change in "equity structure"?

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| SZSTA: Please refer the previous question for the meaning of "a change in equity structure". Capital increase (injection) by a third party within 12 months (original shareholder does not assign/transfer out its equity interest) is not "a change in equity structure". |

c. A restructured enterprise has disposed part of the investment business within 12 consecutive months after the completion of transfer of equity or assets, but there was no change in the nature of main business, would it be treated as a change in "production and operations"?

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| SZSTA: There is no specific requirement in both PN40 and Circular 109 on how the production and operations of transferor or transferee could qualify for the special tax treatment. The Notices also do not specify what constitutes a change in "Production and Operations". If a change in "Production and Operations" of transferor or transferee would have impact on "where the transfer has a reasonable commercial objective and not mainly for the purpose of tax reduction or exemption or deferred tax payment", special tax treatment would not apply. |

3. Caishui [2018] No. 55 (“Circular 55”)

According to Circular 55, where a limited partnership venture capital enterprise (hereinafter referred to as the "partnership VC enterprise") invests directly, by way of equity investment, in a start-up technology enterprise for two years, the legal person partner and the individual partner may use 70% of the investment amount in the start-up technology company to offset

against its share of the proceeds from start-up technology company; the unutilized balance may be carried forward to subsequent tax year(s) for offsetting.

- Question 1: If a partnership VC enterprise A invested in another partnership VC enterprise B, and B invested in a start-up technology enterprise. Whether this offset policy applicable for A's legal person partners and individual partners?

SZSTA: Not applicable. According to the quote of Circular 55 above, "where a limited partnership VC enterprise (hereinafter referred to as "partnership VC enterprise") invests directly, by way of equity investment, in a start-up technology enterprise for two years, the legal person partner and the individual partner may use 70% of the investment amount in the start-up technology company to offset against its share of the proceeds from start-up technology company; the unutilized balance may be carried forward to subsequent tax year(s) for offsetting." It must fulfill the condition on "direct investment in the form of equity interest" to apply this offset policy. If a partnership VC enterprise A invested in another partnership VC enterprise B, leading to an indirect investment in a start-up technology enterprise, this offset policy is not applicable.

- Question 2: If same partner invested in several partnership VC enterprises, can mixed deduction be applied based on different investment projects? According to item 3 in STA Public Notice [2015] No. 81 ("PN81"), the legal person partners might go for mixed deduction, is it correct?

SZSTA: If a legal person partner invests in several partnership VC enterprises which can satisfy the qualifying conditions, the partner can calculate the deductible investment amount and the distributable taxable income amount on a consolidated basis.

4. Circular 59 – Can merger of entities under the same control apply for special tax treatment?

Is special tax treatment applicable for the merger between Chinese parent company and its subsidiary company (vertical) or the merger of two fellow subsidiary companies (under the same parent company)? Is there any requirement on the equity ratio on "common control"?

SZSTA: If the consideration in the form of equity payment is not less than 85% in a merger transaction, and the enterprise merges with entities under common control without consideration, special tax treatment applies.

According to Article 21 of Public Notice of the STA [2010] No. 4 ("PN4"), “common control” means that the enterprises participate in the merger are ultimately controlled by the same party or parties before and after the merger, and the control is not temporary. The parties with ultimate control over the enterprises participating in the merger before and after the merger shall mean the group of investors which have control over decision-making on the financial and business policies of the enterprises participating in the merger pursuant to the provisions of the contract or agreement. Where the parties participating in the merger are controlled by the ultimate controlling party for 12 months or more before the merger of the

enterprise, the merged entity shall also be controlled by the ultimate controlling party for 12 consecutive months.

5. STA Public Notice [2018] No. 28 ("PN28")

According to PN28, an enterprise should but failed to obtain an invoice or external proof in a previous year and the corresponding expenditure was not pre-tax deducted in the said year, if the enterprise obtains in a subsequent year a pre-tax deduction proof which complies with the provisions, such expenditure may be allowed for pre-tax deduction retrospectively in the year in which the expenditure is incurred; however the period of retrospective deduction may not exceed five years.

How to implement in practice? Should the companies revise the relevant annual returns (maybe 5 years) and submit those returns? Is there any special form to fill in by the company or should the company conduct a calculation table by themselves?

SZSTA: Taxpayers should provide the tax authorities with the correct information in relation to the annual returns for previous years by filling in the “Special Declaration Form for Deductible Expenditures in Previous Years” with relevant explanation and supporting documents.

6. STA Public Notice [2015] No. 7 ("PN7")

According to PN7, income from indirect transfer of immovable/equity, which is subject to CIT pursuant to the provisions of this Notice, the organisation or individual that directly bears the payment obligation towards the transferor of equity pursuant to the relevant provisions of the law or the contractual agreement shall be the withholding agent. However, before PN7 was released, there was no regulation (including CIT law and Guoshuihan [2009] No. 698 (“Circular 698”)) to enforce the buyer from indirect transfer of equity to have a withholding obligation. When GDSTA handles indirect transfer of equity before PN7 was released, would it be treated as if the buyer bears withholding obligation?

SZSTA: According to Article 37 of Corporate Income Tax Law, "income tax on non-resident enterprise income pursuant to the provisions of the third paragraph of Article 3 shall be subject to withholding tax at source, where the payer shall act as the withholding agent". The regulation on withholding agents in PN7 are based on Corporate Income Tax Law. Thus, when the tax authority handles the indirect equity transfer before PN7 was released, e.g. if the overseas transferor is required to pay tax due to indirect property transfer, the buyer would be regarded as the withholding agent.

## B. Withholding Income Tax

1. Determination of “Beneficial Owners”

a. According to item 3 of STA Public Notice [2018] No. 9 ("PN9"), where a resident of the treaty counterparty who needs to enjoy the tax treaty benefits (hereinafter referred to as

the "applicant") receives dividend income in China, if the applicant does not satisfy the criteria for "beneficial owner" but the person who holds 100% of the applicant's shares directly or indirectly satisfies the criteria for "beneficial owner" and the circumstances falls under either of the following scenarios, the applicant shall be deemed as a "beneficial owner".

Also according to item 4 of PN9 (safe-harbour rule), when the following applicants receive dividend income from China, the applicants may be determined as a "beneficial owner":

(1) the government of the treaty counterparty;
(2) a resident of the treaty counterparty which is a listed company in the treaty counterparty;
(3) an individual who is a resident of the treaty counterparty; and
(4) 100% of the applicant's shares are held by one or several persons set out in item (1) to item (3), and the multi-tier holders holding the shares indirectly are China residents or residents of the treaty counterparty.

In practice, when the applicant does not satisfy the criteria for "beneficial owner", but the applicant owns more than one non-listed company of a resident of the treaty counterparty directly or indirectly, if these non-listed companies meet the conditions of “beneficiary owner”, would the Tax Bureau extend the idea of "more than one beneficial owner" from safe-harbour rule to item 3, and consider all beneficial owners, to accept the applicant as a "beneficial owner"?

SZSTA: Article 4 has relaxed the safe harbour rules, and expanded the scope of safe harbour. It also lists out the determining factors for carrying out comprehensive analysis for direct identification of "beneficial owner”. Comparing PN9 with the original PN30, the requirements are obviously relaxed. However, in order to prevent the abuse of tax treaties, it cannot be further relaxed. Therefore, the above conditions cannot be directly recognized as “beneficiary owners” in accordance under the safe harbour rules.

On the other hand, when some countries quote the regulation of "limitation on benefits" under the tax treaties, allowing the applicants to enjoy full or partial dividend tax treaty benefits even though they are not 100% jointly owned by the “beneficial owners” of residents of the treaty counterparty. For example, the U.S. and some European Union countries adapted derivative benefits test in tax treaties, if at least 95% of the applicant’s shareholders are directly or indirectly held by 7 or less equal beneficiaries, they may still enjoy tax treaty benefits. Also, some countries allow sharing the dividends of applicant based on the controlling proportion of the ultimate beneficial owners to the applicant in order to calculate the part that enjoys tax treaty benefit. Although items 3 and 4 of PN9 have mentioned the requirement of "100% holds controlling stake directly or indirectly", would GDSTA consider applying dividend tax treaty benefits to applicants who do not meet the requirement of beneficial owners themselves, but most of the shareholders (for example, more than 95%) are the beneficial owners under above conditions?

SZSTA: Currently, the rule of "beneficial owner" in China is neither "limitation on benefits", nor “main purpose test”. Instead, it has made reference to the above two OECD methods at the same time. The 100% controlling ratio has been stated clearly. Therefore, SZSTA will strictly follow the relevant provisions in PN9.

b. Hong Kong Company B is the parent company of Chinese Company A, and Company B is held by Singapore listed Company C. The above controlling relationship is 100%. Suppose Company B has no commercial substance, but Company B and Company C obtained the Hong Kong and Singapore tax resident identity cards respectively. Can the Tax Bureau take into account Company C's listed company identity directly and determine Company B's beneficial owner status?

SZSTA: This structure does not comply with the safe harbour rules in PN9. However, Company B could be regarded as the "beneficial owner" under Article 3 of PN9.

## C. Individual Income Tax (“IIT”)/ Social Security

1. Resident identity

New IIT Law has given a new definition to tax residents. With the development of the Greater Bay Area (“GBA”), mainland and Hong Kong individuals are travelling more frequently between the two places (including working, holding properties, economic and family relations are closely linked in the two places, mainland residents immigrating to Hong Kong to become temporary or permanent Hong Kong resident etc.), which may lead to a problem that individuals may become tax residents in both the Mainland and Hong Kong.

- Question 1: Would GDSTA establish a set of mechanism to help these individuals determining the identity of tax residents under the framework of Chinese/Hong Kong tax arrangement. Please explain the views of two tax authorities by analyzing some examples.

SZSTA: With the release of the new IIT Law and also due the geographical factor of the GBA, Hong Kong and Macau people have been expressing concerns on these questions. SZSTA has also referred these questions to the relevant department of STA. STA is now studying the issues. However, as the Implementation Regulations for IIT Law and relevant document has not yet been released, we have no case study and mechanism to share with you at the moment.

- Question 2: Under the situation of "being tax residents in both two places at the same time", is there any simple mechanism for Hong Kong and China tax authorities to discuss the double taxation problems? If formal consultation procedures were proposed in every single case, it would be difficult for normal taxpayers to bear tax compliance issues due to the costs and uncertainties.

SZSTA: We will reflect the above requests to the STA proactively and work with them together to solve these problems.

2. New IIT rates

New IIT rate has been implemented since 1/10/2018, for wages and salaries, including severance payments and equity incentives income. If the income is obtained after 1/10/2018, would it be acceptable to use the new tax rates? Some tax bureaus require enterprises to use the old tax rates as this income was related to the past months/years activities. Seems that it is not aligning with the cash basis principle.

SZSTA: According to Caishui [2018] No. 98 ("Circular 98"), income from wages and salaries obtained by a taxpayer after 1 October 2018 (inclusive) will be taxed after deduction of RMB5,000/month, and the tax payable amount shall be computed according to Schedule 1 of Circular 98. Therefore, it is incorrect to calculate tax payable in relation to income received after 1 October 2018 based on the old tax rates.

3. Collection on social security

Starting from 1/1/2019, social security is collected by tax authorities.

- Question 1: Is there any work plan for the collection and management of social security in Guangzhou? Will it require companies to remedy for the underpayment over the past year's social security? If the companies want to make remedy and rectify the non-compliance in previous years proactively, would GDSTA accept and trace back to a few less retrospective years?

- Question 2: Does the system of Golden Tax Project Phase III cross-check the data of wages and salary and identify if there is any IIT/CIT deduction or social security problems?

SZSTA answered the above 2 questions collectively: According to 2018 SZSTA Public Notice No. 18, starting from 1 January 2019, social security contributions for government and public institution employees, urban and rural residents' basic endowment insurance premiums in Shenzhen (not including Shen-Shan Special Cooperation Zone) will be collected by tax authorities. Therefore, social insurance premium paid by the enterprise does not fall into to the scope of transfer of the social insurance premium collection and management duties, and it is still collected by the Human and Social Department.

## D. Transfer Pricing and Information Exchange

1. Information exchange

a. Passive attitude on foreign tax authorities

Although China and other countries/jurisdictions have entered a numbers of agreements for automatic exchange of tax information (for example the exchanges according to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCAA) and Country-by-Country reporting ("CbCR") exchange mechanism), some

countries/jurisdictions (such as Hong Kong) are still taking a passive attitude on information exchange (i.e. it would only exchange the information when it is under the mandatory automatic information exchange mechanism or when other tax authorities request the information according to tax treaties or other special arrangements).

It is still difficult for the Chinese tax authorities to investigate tax evasions engaged by some international companies (example: Hong Kong company has constituted a permanent establishment in China but it may not be detected, which lead to problems such as deduction of extra costs among domestic related parties and the profit sourced in China cannot be taxed by the Hong Kong Tax Authority. At the same time, as the company does not meet the requirement for preparing the CbCR, STA cannot obtain information on the profit of permanent establishments under the arrangement of mandatory information exchange). In response to the foreign tax authorities with passive attitude, will GDSTA require them to provide information automatically (for example, requiring tax authorities to provide the information automatically on all foreign income derived by taxpayers that are not taxed)?

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| SZSTA: Currently, information exchange (including automatic and spontaneous exchanges) by SZSTA are carried out based on the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and tax treaties (arrangements), etc. SZSTA only exchanges information under the agreed scopes of the above-mentioned international treaties. |

b. Common Reporting Standard ("CRS")

We understand that government has exchanged the financial account information with relevant countries and regions (including Hong Kong) according to CRS on 09/2018. What is the next step of the government after receiving the data? How frequent the data is exchange in the practice of SZSTA and foreign tax authorities?

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| SZSTA: SZSTA will follow the STA's instruction and carry out the relevant works in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. We currently cannot disclose how the data and information collected will be used. |

2. Monitoring cross-border profit levels

Recently, STA emphasized that the general principle of China's anti-tax avoidance work in the near future is to seek improvement while ensuring stability, and focus on cross-border profit level monitoring. The STA also disclosed the work plan for future anti-tax avoidance work at the relevant tax policy meeting:, including to establish a "globally-integrated" profit level monitoring system for multinational enterprises with a unified statistics standard and risk evaluation system; to conduct deep scanning and risk testing on single enterprises from the global, national and provincial levels to understand the overall operation profile of multinational groups; to rank them by risk level and compliance willingness; to develop

transfer pricing risk and compliance files for each enterprise; and to carry out risk assessment from the dimensions of nationality, industry, fiscal year, transaction type and taxpayer so as to achieve a comprehensive upgrade of the transfer pricing management level of multinational enterprises. With the above requirements, we hope to have a deeper understanding on how to monitor cross-border profit level locally in the future. In terms of information collection, what should taxpayers do? In addition, what aspects and risk indicators will the tax authorities assess the tax compliance of taxpayers?

SZSTA: In order to implement the complete opening up strategy promulgated in the 19th National Congress of the CPC and the reform promulgated by the State Council, the fourth bureau follows the idea and implements investigation focus management strategy + new services. The new management focus will promote tax compliance and make use of new services to optimize the business environment. The information collection duties of Profit Level Monitoring of Cross-Border Related Party Transactions will be carried out according to the STA's overall strategies.

In terms of information collection, the STA tends not to increase taxpayers' burden. However, STA requires taxpayers to prepare contemporaneous information documents and related declarations based on STA Public Notice [2016] No. 42 ("PN42") and STA Public Notice [2017] No. 6. STA will assess the level of tax compliance of taxpayers based on the arm's length principle and whether the profit can match with the economic activities and value creation.

3. Contemporaneous documentation

Since STA Public Notice [2016] No. 42 ("PN42") was released, companies have submitted contemporaneous information documents (including master files, local files, special issue files) and related declarations (22 related declaration forms) for two years (including 2016 and 2017). After receiving the above documents and declaration forms, what statistical and analytical works GDSTA has carried out, or are there any rating and review results on the quality of the declaration and contemporaneous information? What are the requirements, suggestions or feedbacks for taxpayers to prepare for the above-mentioned contemporaneous documents and related declarations in the future? If the quality of the declaration and preparation do not meet the expected standards, what further actions or warnings would STA do?

SZSTA: After STA collects contemporaneous information documents and related declarations, STA will conduct screening based on risk indicators in order to classify the enterprises into different categories: for low-risk enterprises, system will automatically generate risk category message to the enterprise, and the enterprise can carry out self-assessment for tax compliance; for medium-risk enterprises, International Tax Offices from each STA office in various districts will carry out the risk assessment; for high-risk enterprises, the fourth taxation bureau will take charge of the cases directly.

The next step is to separate the contemporaneous documents and related declarations according to their quality and to make them as an indicator of level of tax compliance. If

taxpayers prepare contemporaneous documents and related declarations without following the requirements, STA will closely monitor and ensure that they comply with the relevant regulations. If the quality of contemporaneous documents and related declarations still do not meet with the requirements after counseling, taxpayers may face the following consequences: (i) a fine; (ii) to be classified as high tax risks; (iii) application of advance pricing arrangement ("APA") will not be entertained; or (iv) when implementing special tax investigation and levy tax retrospectively, the taxpayer shall accrue interest pursuant to the provisions of Article 122 of the Implementation Regulations for Corporate Income Tax Law, interest will be calculated based on the Renminbi loan based interest rate for the same period as retrospective tax payment period, announced by the People's Bank of China in the tax year for which the tax is related.

4. Transfer pricing in Shenzhen

We found that SZSTA has recently established the fourth bureau and it will mainly focus on transfer pricing in Shenzhen. Can SZSTA briefly describe the work plans and priorities of the fourth bureau after the establishment? What is the difference in the job duties of transfer pricing compared with before (including contemporaneous data collection, cases investigation, and the arrangement for the review and interview process etc.)?

SZSTA: To formulate and implement the work plan for anti-tax avoidance according to SZSTA International Taxation Tactics Planning and Annual Plan; to coordinate the investigation and implementation of results and feedback of special tax adjustment cases; to be responsible for implementing unilateral APA; to assist STA in bilateral APA and mutual negotiation and implementation for relevant adjustments in transfer pricing adjustment cases; to be responsible for the implementation of monitoring and management of multinational enterprises; to coordinate the review of contemporaneous documents and related declarations.

Since the formation of the bureau, it has mainly focused on large-scale business training, and improvement of the file selection and review mechanisms. It has carried out special inspection on external payments; assisted STA to complete mutual negotiation for relevant adjustments in transfer pricing adjustment cases in order to eliminate double taxation of RMB70 million for two enterprises.

In order to create a good business environment for enterprises, the fourth bureau is now more open-minded and more receptive to new ideas in transfer pricing management; particularly in contemporaneous documents management. It has strengthened the review in contemporaneous documents and examination quality of the documents. It also monitors those information documents to compile a risky list. In respect of pricing arrangement, it mainly helps increase the efficiency in assisting STA on mutual negotiation. For tax investigation in transfer pricing, it mainly aims to combat intentional tax evasion, increase the quality of investigation, and improve the work process of internal department including file selection, allocation, investigation and handling, etc.

## E. Value-added Tax ("VAT")

1. Confirmation of VAT on Fund management Products

   a. How to understand Capital-guaranteed in Fund management Products

      According to Caishui [2016] No. 140 ("Circular 140"), capital-guaranteed refers to "investment returns undertaken in the contract for principal that is fully recoverable". In practice, is there a need for determining capital-guaranteed return based on the business substance?

      i. For the business such as loans, credit assets, and sales and leaseback, is it necessary to determine the conditions of capital-guaranteed according to its business substance or to pay tax directly based on the loan services?

      ii. For investment without clear commitment as capital-guaranteed, but with some credit enhancement measures (such as agreement to repurchase or redeem at a certain time with a fixed price) or terms regarding the compensation on the differences in return (for example, when the income of preferred shareholders is less as agreed, the other shareholders have to compensate the preferred shareholders) in order to ensure the product is capital-guaranteed, is it required to determine the capital-guaranteed return based on the business substance?

      SZSTA: According to Caishui [2016] No. 36, item 1 of Article 1(5), "capital-preserved returns, remuneration, fund occupancy fee, compensation etc." refer to investment returns undertaken in the contract for principal that is fully recoverable. "Capital-guaranteed" shall means delegation rather than the ability for repaying principal. We should refer to the contract in determining if the underlying investment is capital-guaranteed.

   b. When convertible bonds and exchangeable bonds are converted into bonds, is VAT levied according to the transfer of financial products?

      Convertible bonds mean that the bondholder can convert them into a company's common stock at agreed issuing price. Exchangeable bonds mean that bondholder can use bonds as the exchange for the pledged equity of the listed company according to the agreed condition when bonds are issued in a certain period of time in the future. Since the original bond has been written off at the time of debt-for-equity swap, should this change be regarded as holding the bond until maturity payment, and not regarded as a financial commodity transfer?

      SZSTA: Interest income (capital-guaranteed returns, remuneration, fund occupancy fee, compensation etc.) accrued during the holding period (including maturity date) should be taxed by loan services. The aforesaid non-capital guaranteed gains obtained during the holding period of the financial products, are not dividend or interest income

and shall not be subject to VAT. We are still waiting for the STA to confirm if debt-for-equity swap should be regarded as a financial commodity transfer.

## F. Property Tax and Act Tax

1. PN57 & PN17

PN57: "Where two or more enterprises are merged into an enterprise pursuant to the provisions of the laws or contractual agreement, and the investment entity of the original enterprises subsist, the transfer of real estate from the original enterprises to the merged enterprise shall not be subject to land appreciation tax temporarily."

PN17: "Where two or more companies are merged into one pursuant to the provisions of laws or a contractual agreement, and the former investors survive, deed tax will be exempted for the land and building title of the former parties succeeded by the merged company."

- Question 1: Is there any specific requirement in the form of "merger" for these two restructuring tax incentives? Are they applicable to the merger between Chinese parent company and subsidiary (vertical) or two associate companies (under the same parent company)? Is there any specific shareholding requirement?

  The merger is regulated under the company law.

SZSTA: According to Articles 2 & 8 of PN57, where two or more enterprises are merged and the original investment entity is the surviving entity, the transfer of real estate from the original enterprise to the merged enterprise shall not be subject to land VAT temporarily. "The investment entity subsist" means that the capital contributing entity of the original enterprise remains a surviving entity in the group structure after the transformation and restructuring. Changes in the capital contribution ratio is acceptable. The above guidance would be used to determine if the enterprise can enjoy preferential tax treatment in relation to the merger transaction.

- Question 2: According to PN57, "the aforesaid land appreciation tax policies relating to transformation and restructuring shall not apply when the transferor or the transferee of the real estate is a real estate developer". However, there is no similar restriction on real estate developers in PN17.

- Base on Article 5 of PN57, can the situations below apply for the land VAT preferential policies?

  a. A company that has been engaged in long-term investment in real estate for rent collection, but not in real estate development.
  b. If Company A is originally a real estate development company, but after the completion of a real estate development project, Company A has transformed into a real estate leasing and management company, using part of the property for long-

term investment and rental. Now, Company A plans to carry out restructuring and transfer some of the real estates to the restructured company.

SZSTA: According to Article 5 of PN57, the land VAT policies relating to transformation and restructuring are not applicable when the transferor or the transferee of real estate is a real estate developer. A real estate developer should obtain a certificate of qualification for real estate development enterprises according to the provisions on the Administration of the Qualifications of Real Estate Development Enterprises and Other Departmental Rules. When the enterprise ceases to be a developer, it should go to the original qualification management department to cancel the qualification certificate within 15 days after cancelling the business license from the Industry & Commerce Administrations. The business license and the certificate of qualification of the enterprise is an indication whether the enterprise is a real estate developer. The enterprise cannot enjoy the tax preferential policies under PN57 if it is a real estate developer.

## G. Others

1. Combination of local and state taxation bureaus

Can GDSTA introduce the current structure and division of labor of the departments?

SZSTA: SZSTA has become the official operating authority on 15 June 2018. The merger of Shenzhen Local Taxation Bureau and Shenzhen Municipal Office of the STA was based on "Decision of the CPC Central Committee on Deepening the Reform of the Party and State Institutions" and "Plan for Deepening the Institutional Reform of the Party and State" which deliberated and adopted at the Third Plenary Session of the 19th Central Committee of the Communist Party of China, also with the "State Council Institutional Reform Proposal" which adopted and approved at the First Session of the 13th National People's Congress. The new bureau will undertake most of the tax duties, social insurance premiums and collection and management of non-tax revenue. It helps to reduce the cost of tax collection, make clear the job duties and increase the efficiency of collection and management. It also provides services with higher efficiency and quality to taxpayers.

SZSTA will mainly focus on the tax duties, social insurance premiums and collection and management of non-tax revenue in Shenzhen.

Currently, the Municipal Bureau has set up 25 internal and external departments, 8 agencies, 4 institutions and 13 district tax bureaus.

The 25 internal and external departments are: Tax Service Office, Policy and Regulation Department, Goods and Services Tax Office, Corporate Income Tax Office, Individual Income Tax Office, Property and Behavior Tax Office, Resource and Environmental Tax Office, Social Insurance Office, Non-tax Revenue Department, Income Planning and Accounting Office, Taxation Service, Management and Technology Development Division, International Tax Administration Office, Taxation Economic Analysis Division, Tax Big Data

and Risk Administration, Financial Management Office (Equipment and Procurement Division), Inspector Internal Audit Office , Personnel Office, Assessment and Evaluation Office, Education Department, Party Committee, Bureau of Retired Veteran Cadres, Discipline Inspection Team, System Party Construction Office, Inspection Office.

The 8 agencies are: First Taxation Branch (Large Enterprise Tax Service and Authority), Second Taxation Branch (Export Tax Refund Service and Authority), Third Taxation Branch (Offshore Oil Taxation Authority), and Fourth Taxation Branch (Anti-tax avoidance investigation bureau), Municipal Bureau of Inspection, First Inspection Bureau, Second Inspection Bureau, and Third Inspection Bureau.

The 4 institutions are: Tax Service Center (Tax Promotion Center), Information Center, Agency Service Center, and Taxation Science Research Institute.

The 13 affiliated institutions are: Luohu District Tax Bureau, Futian District Tax Bureau, Nanshan District Tax Bureau, Shekou Tax Bureau, Yantian District Tax Bureau, Baoan District Tax Bureau, Longgang District Tax Bureau, Longhua District Tax Bureau, Pingshan District Tax Bureau, Guangming District Tax Bureau, Dapeng New District Tax Bureau, Qianhai Tax Bureau, and Shen-Shan Special Cooperation Zone Tax Bureau.

2. Improve business environment

Can GDSTA introduce the measures implemented in 2018 and work plan for 2019?

SZSTA: We first introduced policy on improving taxation business environment in 2018. Starting from August, SZSTA has introduced 108 action items on improving taxation business environment for 3 years from 2018. In which, 42 action items are expected to be completed in 2018. These action items are briefly summarized below:

1. Electronic Invoice Deployment of block chain technology: On 10 August, the first electronic block chain invoice was issued in China, achieving full block chain technology coverage from ticketing, billing, circulation, reimbursement to tax filing. Block chain technology deployment was selected by the Ministry of Industry and Information Technology "Ten Application Cases of 2018 Trusted Block Chain Summit".

2. Implemented intelligent taxation services: By consolidating the digital services of the original STA and LTB, more than 90% of business could go paperless. Support multi-channel tax payment such as “Tripartite Agreement”, “WeChat Scan Code”, “Bank Mobile App” and “Cross-Border Electronic Check”. Settlement of tax payment by “Cross-Border Electronic Check” is a pioneer in China. Compared with the traditional tax payment method, it is more convenient and faster and no transaction fee will be charged.

3. Interface between corporate ERP and tax reporting portal. This project would integrate tax reporting into the taxpayers’ month end account closing exercises.

4. Held Tax Forum as and when required. To collect feedback from the stakeholders via tax forum between STA, agents and taxpayers. Thereafter, issued "Tax Administration Express" for sharing knowledge of tax revenue policies.

5. Uses friendly enquiry platform: SZSTA provided a "taxation platform" which supports enquiries in English, Russian, French and Japanese. It provides reference materials for taxpayers via the online self-learning platform such that taxpayers can learn about the tax updates according to their schedules.

6. Provide support to small and micro enterprises and trustworthy taxpayers: SZSTA developed a taxation information platform, introduced "financial supermarket", and signed a strategic cooperation agreement of "Bank-Tax link" with more than 20 financial institutions. In this year, the platform provided a credit line of RMB1.584 billion and accumulated loans for a total of RMB2.324 billion for more than 3100 enterprises and individuals.

SZSTA will focus on further improving the tax business environment from the following five aspects next year:

1. Simplify tax filing to make it more time efficient. Further simplify the taxation filing process, simplify the form of the certificate; reduce the submission of required information, improve the efficiency of tax refund; promote tax invoice system reform and try to eliminate the need for VAT invoice verification.

2. Efficient implementation of preferential tax treatments to reduce tax burden of taxpayers. Also implement measures in relation to the IIT reform, release the benefit from the reform, and ensure a smooth transition in social security fees and non-tax revenue tasks. Provide an efficient and convenient payment services for tax payers.

3. Further improve the function of e-tax bureau, encouraging more business using one network office and construct an AI tax service center for full-tax services.

4. Continue to improve tax credit system construction: expand the coverage of tax credit evaluation, implement joint encouragement of trustworthiness and joint disciplinary action, and strengthen the construction of information sharing exchange platform.

5. Strengthen the supervision and guidance of tax-related professional services. Implement a real-name taxation system, carry out the "black listed intermediary" rectification work, and leverage the tax-related professional service agencies.

3. Planning on the GBA

Can GDSTA introduce the tax policy and work plan in GBA?

SZSTA: The Outline Development Plan for the Guangdong-Hong Kong-Macao GBA has not yet been released. We are still waiting for the State Council to announce the GBA related preferential tax policies. For now, the CIT and IIT benefits applies to Qianhai, Hengqin and Nansha.

Before the release of relevant tax policies, SZSTA mainly focuses on the following duties in the area of taxation management service for the GBA: (i) to fully establish the existing tax preferential policies in the GBA, including Qianhai Tax Preferential Policies and Tax Incentives for High-tech Enterprises in order to support enterprises development; (ii) to provide outstanding services for the enterprises in the GBA in order to help enterprises manage tax risks and promote compliance; and (iii) to contribute ideas and suggestions to the STA for development of more favorable tax policies for the GBA.

4. Golden Tax Project Phase III

Many taxpayers report that, under Golden Tax Project Phase III system, taxpayers are required to explain to the tax authorities or make a tax adjustment when there is variance between the taxpayer's tax rate and the indicator in the system. Otherwise, the taxpayer would be classified as abnormal or their VAT invoice system may even be locked. Some taxpayers think that the variance has commercial reasons and they do not intend to pay less tax although the tax rate is different from the indicators set by the Golden Tax Project Phase III system. However, many local tax authorities may not accept the taxpayers' explanations, and require them to adjust the tax even after the tax is paid. After the adjustment, the status of the enterprise can be changed back to normal. In this regard, taxpayers have a bad perception on the tax business environment. In practice, the tax authorities only verbally require taxpayers to adjust their tax. They are informed as abnormal without a written notice, and the tax authorities may not explain which tax law has been violated.

Does GDSTA have any mechanism to deal with taxpayers' explanations or complaints on this problem? How to protect the taxpayer's rights and interests while allowing the tax authorities to act on a legal and reasonable basis?

SZSTA: When the effective tax rate is abnormal, taxpayers with reasonable reasons can submit application after getting the approval from the administrator through "One-stop-shop" service counter. If taxpayers have not applied for "One-stop-shop" service and lead to late filling, the system may generate abnormal alert message. Should this be the case, taxpayers can contact taxation resources management department directly, or dial 12366 for assistance.