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

Meeting notes

Guangdong Provincial Tax Service, State Taxation Administration

and

The Hong Kong Institute of Certified Public Accountants

2019

Foreword

It is a great honor for the Hong Kong Institute of Certified Public Accountants ("Institute" or "HKICPA") to hold the meeting with the Guangdong Provincial Tax Service, State Taxation Administration ("GDSTA") on 13 December 2019 in Guangdong. 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 GDSTA officials who attended the meeting and are not intended to be legally-binding or a definitive interpretation. Professional advice should be sought before applying the contents 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

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3. VAT issues facing commercial factoring companies
4. VAT deduction for real estates

B. Corporate Restructuring

1. Indirect equity transfer between non-resident enterprises settled by instalments
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C. Determination of beneficial owner

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1. The Greater Bay Area ("GBA")
2. IIT subsidy policies in the GBA
3. General IIT issues

E. Others

1. Asset restructuring and reorganization
2. Caishui [2019] No.8: Income tax issues on individual partners of venture capital enterprises

Attendees:

GDSTA

Liu Li	Director, Department of International Tax Management
Li Zuguang	Consultant, Department of International Tax Management
Tang Dandan	Principal Staff Member, Department of International Tax Management
Zhu Guoqiang	Principal Staff Member, Department of International Tax Management
Chen Liexin	Deputy Principal Staff Member, Department of International Tax Management
Chen Hui	Principal Staff Member, Corporate Income Tax Department
Liang Bin	Principal Staff Member, Individual Income Tax Department
Tian Liangchang	Principal Staff Member, Property and Behavior Tax Department
Chen Weidi	Deputy Principal Staff Member, Department of Commodity and Service Tax

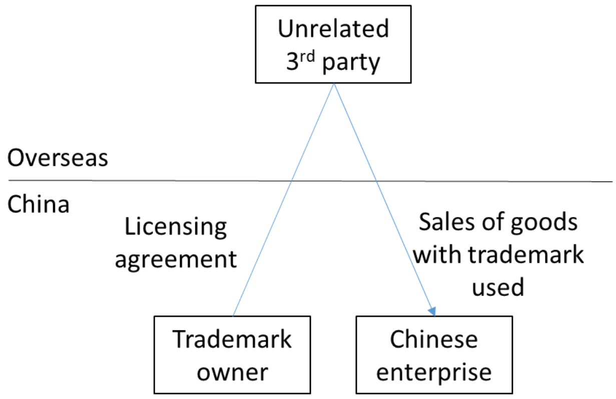
HKICPA

William Chan	Convenor, China Taxation Subcommittee and Member, Taxation Faculty Executive Committee
KK So	Chairman, Taxation Faculty Executive Committee and Member, China Taxation Subcommittee
Anthony Tam	Member, China Taxation Subcommittee
Lorraine Cheung	Member, China Taxation Subcommittee
George Lam	Member, Taxation Faculty Executive Committee and China Taxation Subcommittee
Travis Lee	Member, China Taxation Subcommittee
Leo Li	Member, China Taxation Subcommittee
Shanice Siu	Member, China Taxation Subcommittee
Gloria Chan	Partner, China Tax Service, PwC
Sunny Hua	Director, Grant Thornton China (Shenzhen)
Eric Chiang	Deputy Director, Advocacy and Practice Development
Wallace Wong	Associate Director, Advocacy and Practice Development

Agenda items

A. Value-added tax ("VAT")

1. Trademark used overseas



A Chinese enterprise licenses its trademark to an overseas third party enterprise. Products of the overseas enterprise will be printed with the trademark and sold globally (including China). The overseas enterprise will pay royalties to the Chinese enterprise based on the sales amount.

According to Appendix 4 of Caishui [2016] No.36 ("Circular 36"), VAT exemption is available for intangible assets, which are fully consumed overseas, provided by Chinese enterprises to overseas enterprises. "Fully consumed overseas" means that the intangible assets are entirely used outside China and unrelated to any goods and immovables in China.

We understand that the use of the trademark is related to the goods sold in China. Therefore, the VAT exemption shall not be applicable. However, if the overseas enterprise could allocate the sales amount and royalties paid which are attributable to the products sold in China (i.e. to divide the products into two types: (i) products entirely sold to overseas; and (ii) products sold in China only), could the royalties related to the products sold overseas be regarded as " intangible assets fully consumed overseas " and subject to the VAT exemption?

GDSTA: "Intangible assets fully consumed overseas" in Circular 36 limits to the intangible assets that are used completely overseas and unrelated to any goods and immovables in China. If the intangible asset has been used in both China and overseas at the same time, it should not be regarded as fully consumed overseas and thus the VAT exemption does not apply. The concepts of trademark used in both China and overseas at the same time and trademark completely used overseas are entirely different. We need to study on a

case-by-case basis in order to determine whether it is reasonable to apportion the sales amount and royalties.

In practice, we tend to view that intangible assets are not separable, especially for trademark (due to its distinctive character). Under this situation, VAT exemption will not be applicable.

2. Impact of the new accounting standards on VAT

On 5 July 2017, the Ministry of Finance published "Accounting Standards for Enterprises No.14 - Revenue" ("New Accounting Standards"). It has made significant amendments on the principle of revenue recognition by introducing the concepts of contract liability and variable consideration. The Ministry of Finance required companies that are listed on both overseas and Chinese markets to implement the New Accounting Standards starting from 1 January 2018. Other listed companies shall start the implementation from 1 January 2020. According to the New Accounting Standards, enterprises are required to accrue contract liability for the foreseeable commercial discount. However, the VAT invoices are issued based on the full income amount, therefore the amount of income recognized according to New Accounting Standards may be different from the amount stated on the VAT invoices.

For example, Company A sells goods to Company B at $100. As Company A expects that the sales volume would be higher this year, it would offer a 5% discount to Company B if the sales volume could attain to a certain level. Under the previous accounting standards, the full amount of $100 would be recognized as income and the discount amount would be reversed when it occurs. However, under the New Accounting Standards, Company A shall recognize $95 as income and $5 as contract liability. Nevertheless, a VAT invoice of $100 would be issued.

Subsequent to the amendments made to the accounting standards, will the difference between the sales amount recognized and the amount stated in the VAT invoice lead to inconsistent VAT filling under Public Notice [2017] No. 124? If the enterprises are required to keep the details of each transaction and explain the relevant difference to the tax bureaus, it may lead to huge administrative burdens on the enterprises. Will the tax bureaus adopt a relatively lenient approach in handling these cases?

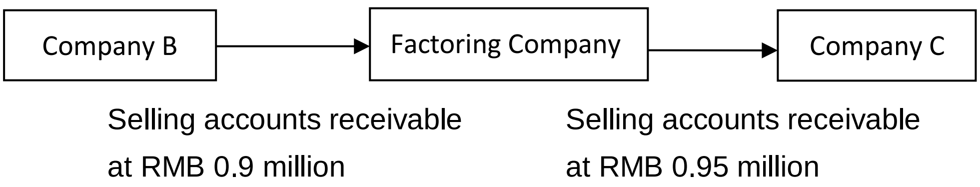
GDSTA: We think that the revenue recognition principle is a more reasonable way to determine the income. The discount will be written off when it occurs. In this way, there will not be any inconsistent VAT filing but only a temporary difference will result.

3. VAT issues facing commercial factoring companies

According to Caisui [2016] No.36 ("Circular 36"), transfer of financial products refers to the business activities of transferring ownership of foreign currencies, securities, non-commodity futures and other financial products. Transfer of other financial products shall include transfer of various asset management products and various financial derivatives such as funds, trusts and wealth management products.

The sales revenue of transfer of financial products shall be the balance of sales price less purchase price, where there are positive or negative balances, the total sales revenue of the tax filing period should be the balance after offsetting the losses against profits for that period. If there is a negative balance after offsetting, the balance can be carried forward to the subsequent tax filing period; however, a year-end negative balance cannot be carried forward to the next fiscal year. VAT invoices shall not be issued for the transfer of financial products.

Commercial factoring companies generally purchase accounts receivable from its clients and resell them to third party companies. The typical business arrangement is shown below:



a) If the main business of a company is the buying and selling of accounts receivables, will it be regarded as transfer of financial products?

GDSTA: Buying and selling accounts receivable does not fall into the scope of transferring financial products, so it is exempted from VAT. However, if the accounts receivable are not direct buying and selling of accounts receivable but being packaged into other trust products or financial products, it will be regarded as a transfer of financial products and thus subject to VAT.

b) Under the above transaction, the factoring company buys the accounts receivable at RMB 0.9 million and resells them at RMB 0.95 million, should the company be subject to VAT? If yes, should it be collected based on the profit margin (i.e. RMB 0.05 million) or the full amount (i.e. RMB 0.95 million)?

GDSTA: The arrangement is not subject to VAT.

4. VAT deduction for real estates

According to Caishui [2016] No.36 Article 1 Section 3(10), when property developers sell their projects (excluding those who have opted to be taxed under the simplified method on old projects), the turnover for the VAT calculation of the property developers should be the gross receipts (consideration and other fees) minus the land cost paid to the government when they acquire the land. In addition, according to Article 7 of Caishui [2016] No. 140, the relocation compensation paid to other organizations or individuals shall also be allowed as deduction in computing the turnover amount.

Based on the above regulations, there is no dispute that monetary compensation can be deducted from the turnover amount for VAT purpose. However, if the compensation paid by the property developers is in the form of a house (i.e. compensation in-kind), can it also be deducted when calculating the turnover amount? If yes, should we use the construction cost or the fair market value of the house as the deduction amount?

GDSTA: The view of different tax bureaus within the country should be consistent that only monetary compensation can be deducted from the sales amount for VAT purpose. In practice, monetary compensation is the most common form of transaction. Therefore, we follow the STA's regulations that only monetary compensation can be deducted in calculating the sales amount.

B. Corporate Restructuring

1. Indirect equity transfer between non-resident enterprises by instalments

According to Article 7 of STA [2017] Public Notice No. 37 ("PN37"), where the asset transfer income which is subject to withholding tax at source is derived by a non-resident enterprise by way of instalments, the instalments may first be treated as recovery of the previous investment costs; upon recovery of all costs, the tax amount shall then be computed and withheld. If the non-resident enterprise transfer equities indirectly by way of instalments, will it be treated according to Article 7 of PN37 as mentioned above?

If it takes a longer period to recover the costs, can the taxpayer confirm the calculation method of the asset transfer income with the tax bureaus in advance in order to obtain certainty on the tax reporting and subsequent tax management?

- For example, non-resident Enterprise A (the seller) and non-resident Enterprise B (the buyer) signed an equity transfer agreement on 1 September 2019 to transfer 100% equity of a Chinese Enterprise C indirectly. In the transaction, the registered capital of Enterprise C was RMB 2 million and the consideration was RMB 5 million. According to the agreement, Enterprise B had paid RMB 1.5 million on 1 September 2019 as a down payment and would pay the remaining RMB 3.5 million on 1 September 2022 (after 3 years).

- According to Article 7 of PN37, as Enterprise A only received RMB 1.5 million out of the RMB 2 million equity transfer cost on 1 September 2019, it is not required to calculate and pay tax temporarily. On 1 September 2022, the outstanding balance of RMB 0.5 million will be recovered, and the remaining amount of RMB 3 million should be treated as equity transfer income for tax purpose.

- In practice, when Enterprise A did the tax filing under PN7 in 2019, could it make an agreement with the tax authorities and obtain a written confirmation on the calculation basis of the indirect transfer income? Or could Enterprise A report in 2019 that both the consideration and the cost for the transfer are RMB 1.5 million, thus the transfer income is zero; and subsequently, report RMB 3.5 million as the consideration and RMB 0.5 million as the cost in 2022, resulting in a transfer income of RMB 3 million? In this way, the historical data would be reflected in the reporting system, facilitating the management of the tax authorities.

GDSTA: Your question reveals that both the enterprises and the tax authorities wish to have a more complete picture with evidence to substantiate the calculation basis of cost deduction and taxable amount for transactions under payment by instalment arrangements. The above example is consistent with our usual practice. We also recommend that fund collected in the initial instalments should be set off against the cost first in the tax reporting such that there would not be any taxable profit, hence no tax payable before the taxpayers start to realize profit.

2. Whether the special tax treatment for corporate restructuring applies to capital reduction

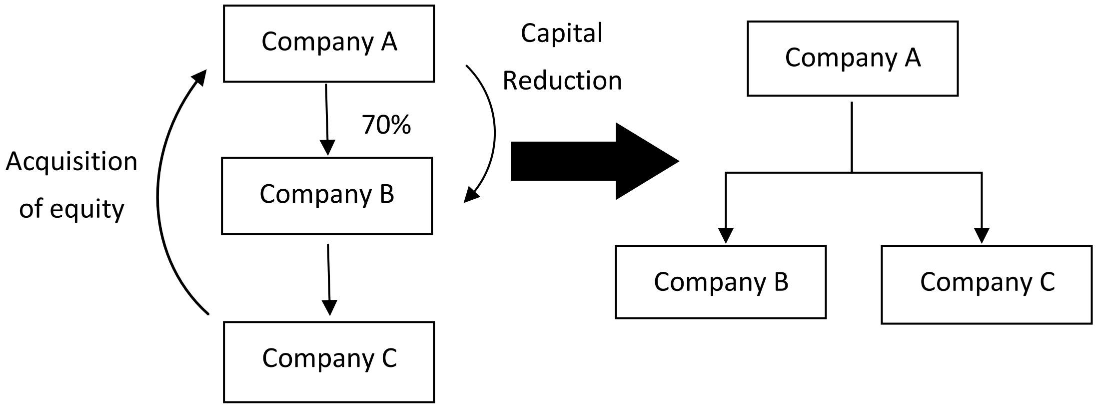
According to Caishui [2009] No. 59 ("Circular 59"), the provisions on special tax treatment shall apply if the corporate restructuring could satisfy the following criteria:

(1) There are reasonable commercial purposes; and reduction, exemption or postponement of tax payment shall not be the main purpose.
(2) The ratio of assets or equity being acquired, merged or divided shall comply with the ratio stipulated in Circular 59.
(3) The original substantive business activities of the restructured assets shall not be changed within 12 consecutive months following the corporate restructuring.
(4) The amount of equity payment involved in the consideration of a restructuring transaction shall comply with the ratio stipulated in Circular 59.
(5) The original substantial shareholders who obtain the equity payment in a corporate restructuring shall not transfer the equity obtained within 12 consecutive months following the restructuring.

As shown in the diagram below, within a group, Company A would like to acquire Company C's equity which is held by Company B, but Company A is unable to pay Company B with its own equity. In order to enjoy the special tax treatment, Company

A chooses to reduce its investment in Company B as the consideration (i.e. paying Company B the equity of Company B held by A to exchange for Company C's equity).

As Company A only holds 70% equity of Company B before the acquisition, Company A is not eligible for the special tax treatment on equity transfer under Caishui [2014] No. 109 and STA [2015] No. 40. Under the aforesaid situation, can Company A enjoy the special tax treatment according to Circular 59?



GDSTA: We believe that Circular 59 has provided clear guidance on equity payments. Equity payment refers to situation where equity of a company or its holding company is used as a mean to settle the consideration. However, capital reduction is not an equity payment and not eligible for the special tax treatment of corporate restructuring. Also, it is difficult to calculate the ratio of equity payment in a capital reduction arrangement.

We have guidelines on indirect transfer to determine whether a merger through consideration by deregistration of an overseas holding company or its intermediate company in Guangdong constitutes an equity payment. However, the guidelines do not state that all capital reduction can be regarded as equity payment. We generally accept that the capital reduction under merger through absorption can be regarded as equity payment, but we need to consider on a case-by-case basis under merger by deregistration or capital reduction. As the guidelines have not provided an exhaustive list on what should be regarded as an equity payment, we may not be able to apply our current practice on indirect transfer to the cases directly.

3. Corporate separation

<u>Circular 59</u>

Provisions on general tax treatment:

According to paragraph 4(5), "The parties concerned in a spin-off shall be dealt with pursuant to the following provisions:

a. The enterprise being spun-off shall recognize the gain or loss from the transfer based on the fair market value of the assets being spun-off.

b. The enterprise being spun-off shall determine the tax base of the assets received according to their fair market value.
c. When the enterprise being spun-off continues to exist, the consideration received by its shareholders shall be deemed as a distribution from the enterprise being spun-off.
d. ... ”

Provisions on special tax treatment:

According to paragraph 6(5), "In a spin-off, …, taxpayers may select the treatment as below:

d. If the shareholders of the enterprise being spun-off surrender part or all of equity interest in the enterprise being spun-off (hereinafter referred to as the "old shares") in exchange for an equity interest in the spin-off enterprise (hereinafter referred to as the "new shares"), the tax base of the new shares shall be determined according to the tax base of the old shares surrendered. If the shareholders of the enterprise being spun-off are not required to surrender the old shares, there are two options available to determine the tax base of the new shares: (i) setting the tax base of the new shares as zero directly; or (ii) reducing the tax base of the old shares by proportion of the net assets spun-off to the total net assets of the enterprise being spun-off and then allocate the remaining tax base evenly to the new shares."

STA Public Notice [2011] No. 34 ("PN34")

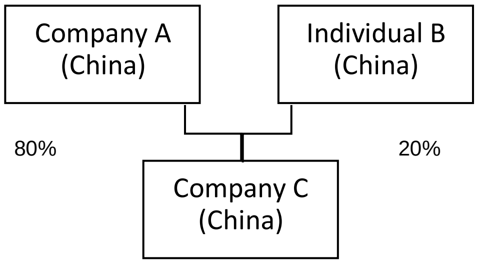
5. Tax treatment for divestment or reduced investment

In the event of divestment or reduced investment in an investee enterprise, the assets obtained by the investor enterprise, which is equal to the initial capital contribution, shall be recognized as investment recovered; the assets obtained by the investor enterprise, which is equal to the cumulative undistributed profits and cumulative surplus reserve of the investee enterprise computed in accordance with the percentage of reduced paid-up capital shall be recognized as dividend income; the remaining assets obtained by the investor enterprise shall be recognized as income derived from the transfer of investment assets.

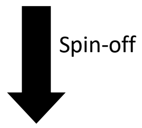
Example

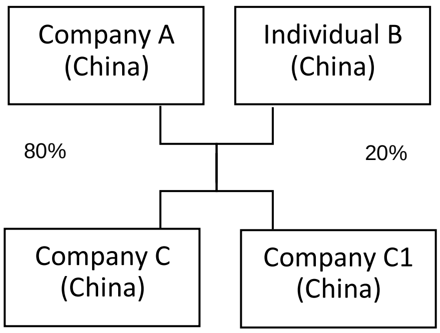
The net asset of Company C before the spin-off is shown in the table below and it is assumed that the fair value of the net asset is same as its book value.

Company A purchased 80% equity of Company C from a third party in 2018, the consideration was RMB 60 million. Individual B holds 20% equity of Company C and invested RMB 3 million when Company C was set up.



Company C	Net Asset (RMB million)
Paid-up Capital	15
Capital Reserve – Others	4
Surplus Reserve	1
Undistributed profit	40
Total net asset	60





After spin-off	Company C	Company C1
	Net Asset (RMB million)	
Paid-up Capital	5	10
Capital Reserve	1	30
Surplus Reserve	1	0
Undistributed profit	13	0
Total net asset	20	40

a. Under the provisions of general tax treatment, how should Company A and Individual B determine the respective tax base of their equity in Company C?

Shall we take reference from the special tax treatment and use the ratio of net asset spun-off and the total net asset of the enterprise being spun-off to reduce the tax base of the old shares?

i.e. A= RMB 60 million*(RMB 40 million/ RMB 60 million) = RMB 40 million; B = RMB 3 million*(RMB 40 million/ RMB 60 million) = RMB 2 million
(If we use the ratio of actual capital received and equity as the calculation basis: i.e. A=RMB 10 million*80% = RMB 8 million; B= RMB 10 million*20% = RMB 2 million)

b. In the above example, how to determine the consideration obtained by Company A and Individual B as shareholders (the consideration received by the shareholders = Company C's net asset)?

Is it determined by the equity ratio? (i.e. A= RMB 40 million*80%= RMB 32 million; B= RMB 40 million*20%= RMB 8 million)

c. How to interpret "deemed as a distribution from the enterprise being spun-off"? Shall we refer to PN34, which states that if the asset obtained by shareholders are equal to the initial capital contributed, it should be recognized as investment recovered; it should be recognized as dividend income if the asset obtained by the shareholders are equal to the cumulative undistributed profit and cumulative surplus reserve of the investee enterprise computed in accordance with the percentage of reduced paid-up capital. The remaining part should be recognized as income derived from transfer of investment assets? Is pre-tax deduction allowed for the loss incurred from the equity transfer?

Referring to PN34:

d. Company A recovers its investment from the assets obtained = RMB 40 million (investment recovered is not subject to tax), dividend income = (RMB 40 million – RMB 13 million)*80% = RMB 21.6 million (dividend derived by resident enterprise is exempted from tax), remaining part = RMB 32 million – RMB 40 million – RMB 21.6 million = RMB 29.6 million (negative), can RMB 29.6 million (negative) be treated as equity transfer loss and allowed for deduction when computing Company A's taxable income for Corporate Income Tax ("CIT") purpose?

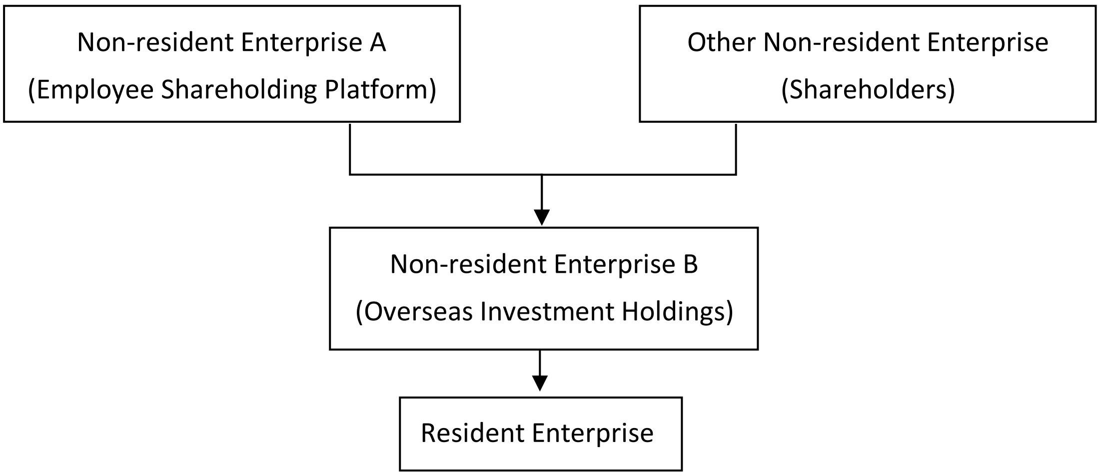
e. The amount of investment cost recovered by Individual B = RMB 2 million, dividend income = (RMB 40 million – RMB 13 million)*20% = RMB 5.4 million (subject to IIT of 20%), the remaining amount = RMB 8 million – RMB 2 million – RMB 5.4 million = RMB 0.6 million (equity transfer income subject to IIT of 20%)?

GDSTA: In determining the income derived and cost incurred by the original shareholders and the new shareholders of the enterprise being spun-off, the transaction should generally be classified as disinvestment or external investment. For disinvestment, the investment gain refers to the difference between the investment income and the investment cost. Specifically, whether the transactions involve profit distribution will be consideration. If it is the case, the profit distributed between qualified resident enterprises will be exempted from tax. Under other situations, if the value of assets transferred exceeds the investment cost, the investment cost should be determined based on the market value of the equity of the enterprise being spun-off.

Regarding the IIT issues on the investment recovered by individuals, STA Announcement [2014] No. 67 ("PN67") has specified that IIT should be paid based on the asset transfer income derived from the disposal of equity; monetary transactions by use of equity for external investment; and other equity transfer activities. In addition, deduction on the initial value of the equity and the reasonable expenses incurred for the transfer will be allowed. There is another important fundamental principle in PN67 that the transfer of equity should be carried out based on the arm's length principle. As the relevant treatments could be complicated for different industries, detailed analysis may be required on a case-by-case basis.

4. Questions on STA Public Notice [2015] No.7 ("PN7")

Indirect transfer transaction – CIT obligation of non-resident enterprise acting as employee shareholding platform



In practice, it is common to set up overseas employee shareholding platforms. As shown in the above diagram, non-resident Enterprise A is an employee shareholding platform. It holds the shares of non-resident Enterprise B without any actual capital contribution. That part of shares is held on behalf of the shareholders and will be used as equity incentives for employees. Equity incentives are issued to employees in the form of stock options, granting the right to purchase the shares of Enterprise B.

In an indirect equity transfer transaction, the original shareholders (Enterprise A and other non-resident enterprise shareholders) sells the equity of Enterprise B to a third party (Enterprise C). Enterprise A will not receive any consideration and will cancel all the stock options previously issued. For employees who had obtained stock options previously, they may (i) get cash compensation based on the considerations paid by the other non-resident enterprise shareholders for the equity transactions, or (ii) obtain equivalent stock options from the new shareholder (i.e. Enterprise C).

Below are the questions regarding the tax obligation of Enterprise A:

a. Enterprise A is in substance an employee shareholding platform and it has not obtained any profit in the transaction. How shall we determine Enterprise A's CIT obligation?

GDSTA: We have also been doing research on this issue recently, but it is still unclear how the issue should be handled. We cannot give you a definitive answer on the nature of employee shareholding platform as the actual duties of the employees would affect the conclusion. From a legal perspective, the platform could be regarded as: (i) the legal owner of the equity, so that the legal person of the platform may be regarded as a taxpayer; or (ii) an agency arrangement where the platform is the agent of the employee. To this, we are uncertain if the agency

agreement would have actual tax consequence to the shareholders. Therefore, we cannot give a definitive answer.

b. If Enterprise A is required to consider its CIT obligation based on PN7, how shall we determine the amount of its equity transfer income? Should it be determined based on the cash compensation amount received on behalf of the employees or should we make reference to the share transfer price of other shareholders?

GDSTA: If the employee shareholding platform is subject to tax, there are two possible means to determine its equity transfer income: (i) computing the income based on the considerations paid by the other shareholders for the equity transactions; and (ii) taking reference to the value of the equity of the new shareholders.

We recommend to use the fair value for the time being. If both the employee shareholding platform and other shareholders transfer the shares to external parties at the same time, the transfer price of the other shareholders can be treated as the fair value.

C. Determination of beneficial ownership

1. According to Article 2 of STA Public Notice [2018] No.9 ("PN9"), the following factors are not favourable for the determination of "beneficial owner" status of a treaty benefit applicant:

   (1) the applicant has the obligation to pay more than 50% of the income within 12 months of receiving the income to a third jurisdiction tax resident. “Obligation” shall include contractual obligation and any factual payment even though the applicant has no contractual obligation to pay.

   In practice, should we use accrual basis or cash basis to determine whether the ratio of dividend redistributed has exceeded 50%?

   For example:

   Company A (incorporated in China) is wholly-owned by Company B (incorporated in Hong Kong) and Company B is wholly-owned by Company C (incorporated in the United States). In February 2019, Company A paid a dividend of RMB 0.5 million to Company B; Company B's balance of undistributed profit after receiving the dividend was RMB 2.5 million (including the undistributed profit of RMB 2 million at the beginning of the period and the additional undistributed profit of RMB 0.5 million, being the dividend received from Company A). Company B paid dividend of RMB 0.4 million to Company C in March 2019.

The ratios of dividend redistributed are different under accrual basis and cash basis. The detailed calculation is shown in the table below. Please advise which calculation method is more appropriate.

2019	Formula	RMB (million)	Description
Beginning balance of Company B’s undistributed profit	a	2	This amount does not include dividend income from A within 12 months
February 2019 Company A paid dividend to Company B	b	0.5	Withholding income tax is not considered for simplicity
Company B's balance of undistributed profit after receiving the dividend	c =a+b	2.5	Assuming all dividend are undistributed profits, no other impact is considered for simplicity
March 2019 B paid dividend to C	d	0.4	The timing is within 12 months of receiving A’s dividend
Accrual basis			
Company B's distributed dividend which is related to the dividend received in the current period	e =b/c*d	0.08	
Ratio of dividend distributed within 12 months	f=e/b	16%	f is less than 50%, not exceeding the thresholds
Cash basis			
Ratio of dividend distributed within 12	g=d/b	80%	g is greater than 50%, exceeding the thresholds

GDSTA: STA had not provided us with a definitive means to calculate the gain. Currently, we will agree to a basis that is in the favor of the taxpayer. We will accept the taxpayer's approach as long as they could justify the basis.

As for the payment by instalments, if collection of the instalment payment become doubtful but the contract could not be modified to reflect the position, the bad debt would not affect the tax position of the enterprise as it should be a matter of the enterprise’s fund and account management. As a matter of fact, timing and amount for revenue recognition should be based on the contract. If a taxpayer fails to collect an amount that had become due, we are open for discussion on what is the appropriate timing for revenue recognition. If, however, parties in the agreement agree to revise the payment terms on quantum and timing when the contract is in force, the taxpayer can submit the revised contract to the tax authorities and perform the remaining reporting obligation based on the revised contract terms.

D. Income tax

1. The Greater Bay Area (“GBA”)

   a. The latest development on IIT incentives

   In March 2019, MoF and STA issued Caishui [2019] No. 31 to introduce the IIT incentives for the GBA. Subsidies will be granted for overseas (including Hong Kong, Macau and Taiwan) high-end talents and talents in short working in the GBA based on the difference of IIT tax rates between the mainland China and Hong Kong. Such subsidies shall be exempted from IIT to support the construction of the GBA and attract overseas talents to work in the GBA. Since then, Guangdong Province also issued Yuecaishui [2019] No. 2 ("Circular 2") to provide further details on the application procedures and qualifying talent recognition criteria.

   - The new policy has been implemented for more than half a year, could you please share with us the effectiveness of the incentives in attracting talents and the progress in the policy implementation in the GBA?

GDSTA: The IIT subsidy measures have been officially published online in eight cities in the GBA. Most measures will be enacted after the assessment of next year, that is, during the period from 1 July to 15 August. For taxpayers who have not submitted the application in 2019, local governments have also formulated local measures for the cases to be handled in 2020. In addition, Shenzhen may introduce the local measures separately, but it is not expected to deviate much.

   - Since 1 January 2019, Circular 2 has been implemented on a trial basis for one year, will there be any expected changes in the IIT subsidy policies for the next year?

GDSTA: This is the first year of the IIT reform. We will need to deal with many complicated issues when we handle the final reconciliation of tax filing next year. For example, problems may arise on the calculations and qualifying talent recognition criteria. The filing procedures will be subject to continuous refinement based on the experience accumulated over time.

   b. Tax measures to boost the economy

   Affected by the trade war between China and the United States and other factors, the international community generally believes that the global economy would experience a deep recession. From the development of the GBA, will GDSTA consider to introduce the tax incentives to attract foreign investment, demonstrate the competitive advantages of GBA and boost the economic development of the GBA?

GDSTA: With the efforts of GDSTA this year, we have already implemented various preferential policies, including the IIT and CIT incentives in the GBA, and the 183-day criteria in determining the residency of individuals, etc. We are also seeking comments from taxpayers and the intermediaries while exchanging opinions with the Big 4 accounting firms in Hong Kong. Recently, we have been formulating some policies preliminarily on improving the flow of people, logistics and capital and have submitted to the STA in order to further promote the GBA.

2. IIT subsidy policies in the GBA

   a. Can taxpayers apply for the IIT subsidies if the relevant Guangzhou company has already been deregistered or the taxpayer has already departed China at the time of application (provided that the taxpayer can satisfy the relevant criteria and requirements in the application year)?

   GDSTA: Yes, the measures introduced generally encourage the withholding agents to complete the subsidy application process. As long as the taxpayer can satisfy the application requirements, they can still apply for the subsidies even if the Guangzhou company has been deregistered.

   b. It is possible that the individual taxpayer may have already left the company, returned to his/ her country and cancelled the bank account in China when he/she is applying/obtaining the subsidies, is it possible to disburse the subsidies to another bank account of a designated group company, or an overseas personal accounts?

   GDSTA: No, for individual who left the company, returned to his/her country and cancelled his/her bank account in China, there will be a mismatch in the bank settlement as the subsidies will be paid to the company under individual application. As this would involve tax assessment and bank settlement issues, we do not recommend paying the subsidies to other companies. At the same time, there are foreign exchange control rules and it may give rise to practical difficulties in transferring the subsidies to an oversea personal account, therefore we do not support this method at the moment.

3. General IIT issues

   Can Chinese resident select to include or exclude the annual bonus in the comprehensive income for IIT assessment (i.e. whether the preferential tax treatment of bonus is allowed in the final IIT assessment, such as combining the bonus with the comprehensive income or making adjustment based on the preferential tax treatment of annual bonus)?

GDSTA: Some STA leaders have expressed views on this issue. They considered that individuals who have received the annual one-off bonus and are taxed separately from their comprehensive income can elect to include the bonus in their comprehensive income in the final reconciliation of IIT filing. However, the relevant policy has not yet been announced officially, we believe that this should be the general treatment. It should be clear that the annual one-off bonus treated separately may combine with the comprehensive income in the final assessment. Basically, we think that the bonus combined with the comprehensive income is unlikely to be separated subsequently.

E. Others

1. Asset restructuring and reorganization

According to Caishui [2018] No. 57 ("Circular 57"), where an enterprise or an individual uses real estates as the consideration for equity investment at the time of corporate restructuring and reorganization, the transfer of real estates to the invested enterprise is exempted from Land Value-added Tax ("LVAT") temporarily (for non-real estate enterprise only).

According to Caishuizi [1995] No. 48, in relation to real estates which are used as investment or in a joint venture, if the investor uses land (real estates) as the investment cost, the transfer of real estates to the invested enterprise is exempted from LVAT temporarily. To encourage corporate restructuring and improve the market environment continually, the State Council also stated in Guofa [2014] No. 14 that the LVAT policy should be enhanced by extending the scope of special tax treatment.

In practice, different tax bureaus interpret differently on whether companies within a corporate group can be exempted from LVAT when using immovable assets as capital injection. We understand that there are views that the LVAT treatments on corporate restructuring are only applicable to state-owned enterprises.

However, corporate restructuring were not mentioned in the above regulation which was issued in 1995 (over 20 years ago). Recently, China has further encouraged group restructuring to improve the market environment. Therefore, we believe that the LVAT provisional exemption for capital injection with immovable assets mentioned in Circular 57 should also be applicable to the restructuring of all corporate groups and not only limited to state-owned enterprises. Please advise if our understanding above is correct.

GDSTA: Circular 57 on corporate restructuring is not only applicable to state-owned enterprises. Private enterprises and foreign-owned enterprises can also apply for the exemption by providing the relevant information according to the regulations.

2. Caishui [2019] No.8: Income tax issues on individual partners of venture capital ("VC") enterprises

   According to the regulations, other expenses incurred by individual investment fund, (including the fund management fee and performance fee paid to fund managers) are not deductible from the taxable income of the fund. Such expenses will be treated as taxable profits of each individual partner. At the same time, the fund manager will also be subject to tax when they receive the management fee / performance fee. Please advise whether the double taxation imposed is reasonable.

   GDSTA: PN8 stipulates that a VC enterprise may select to use the income derived by individual investment fund or the annual overall income of the VC enterprise to calculate the IIT payable of its individual partners. Strictly speaking, the other expenses incurred by an individual investment fund, including the fund management fee and performance fee, cannot be deducted from the taxable income of the fund. Originally, individual businesses should be subject to income tax at progressive rates (with the top rate of 30%). As VC enterprises can elect to use individual investment fund method, the equity transfer income and dividend received by the individual partners will be subject to IIT at 20%, which is in fact a tax benefit offered to the partners. The 20% tax rate has already taken into the deduction of fund management fee and performance fee, therefore the current collection method is more reasonable. We will further reflect to the STA on the comments received during the execution process.