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

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 Shenzhen Tax Service, State Taxation Administration ("SZSTA") on 13 December 2019 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 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

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A. Value-added tax ("VAT")

1. Trademark used overseas
2. Impact of the new accounting standards on VAT
3. VAT issues facing commercial factoring companies

B. Corporate Restructuring

1. Indirect equity transfer between non-resident enterprises settled by instalments
2. Whether the special tax treatment for corporate restructuring applies to capital reduction
3. Corporate separation
4. Questions on STA Public Notice [2015] No.7 ("PN7")

C. Determination of beneficial ownership

1. Determination of "beneficial owner" status of treaty benefit applicants

D. Individual Income tax ("IIT")

1. General IIT issues

E. Others

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

Attendees:

SZSTA

Lin Weiming	Deputy Director, SZSTA
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
Yao Ning	Director, International Taxation Department
Liu Jia	Deputy Director, International Taxation Department

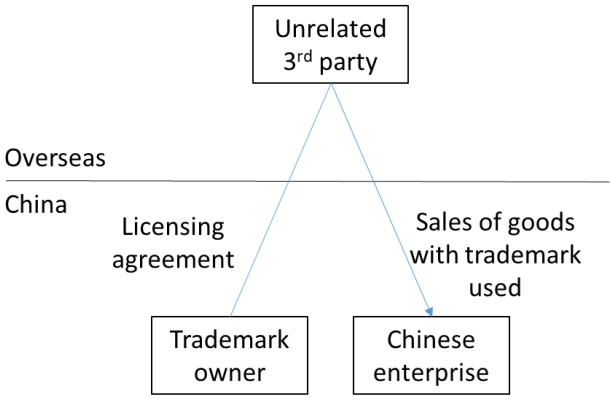
HKICPA

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
Cynthia Lam	Senior Manager, 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?

SZSTA: Based on the features of intangible assets, we understand that trademark should be a sign used to identify goods or services. It should be attached to the goods or services and cannot be separated. If the intangible asset concerned is regarded as a trademark, the corresponding products should be subject to the same tax treatment. If the products sold overseas are different from those sold in China and the corresponding intangible assets is not related to any goods and immovables in China, it should be regarded as fully consumed overseas and subject to the VAT exemption.

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?

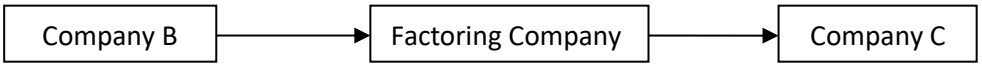
SZSTA: The revenue recognition principle and the timing of tax obligation for VAT have all along been clear. Before the amendments made to the accounting standards, taxpayers should pay VAT based on the income recognition principle and the timing of tax obligation. After the release of the New Accounting Standards, we note that the VAT treatment may be affected. However, as long as the taxpayers pay VAT according to the relevant rules, it will not cause inconsistent VAT filing. We will also follow up the situation with the STA.

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:



Selling accounts receivable at RMB 0.9 million

Selling accounts receivable at RMB 0.95 million

Please advise the following based on Circular 36 and the aforesaid business arrangement:

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

SZSTA: No, accounts receivable are not classified as financial products.

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)?

SZSTA: The factoring company should recognize the loan interest income based on the nature of the interest. In this case, the factoring company should pay tax for the interest income derived from the accounts receivable. The same applies to Company C.

B. Corporate Restructuring

1. Indirect equity transfer between non-resident enterprises settled 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.

SZSTA: The treatment of asset transfer by way of instalments under PN37 applies to both direct and indirect transfer of assets by non-resident enterprises, i.e. the instalments may first be treated as the recovery of previous investment costs; upon recovery of all the costs, the taxable amount should then be computed and withheld. In practice, when the enterprise received an upfront payment to offset the investment cost, it should submit a nil return if no taxable income is derived.

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

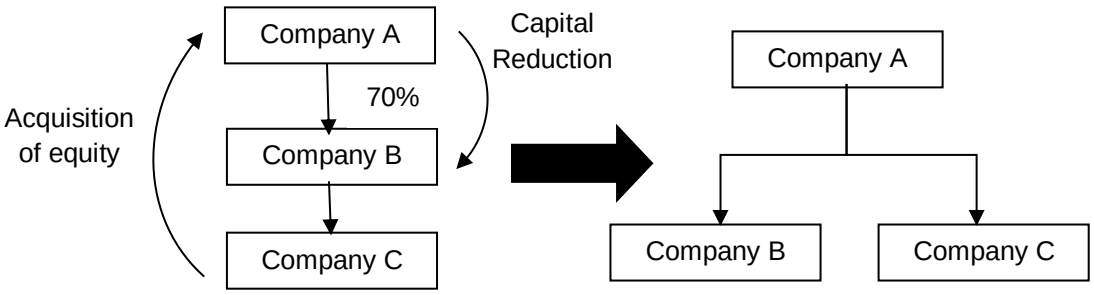
According to Caishui [2009] No. 59 ("Circular 59"), the provisions on special tax treatment shall apply if the corporate restructuring could satisfy the following criteria:

(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?



SZSTA: According to the requirements under Circular 59, the taxpayer can enjoy the special tax treatment on an acquisition only if the acquisition can satisfy the "equity payment" ratio requirement. For the above case in which Company A acquires Company C's equity, although the ratio of equity acquisition is satisfied, the requirement of equity payment ratio is not met, therefore the special tax treatment cannot be applied.

The tax treatment of "capital reduction" for enterprises should follow Article 5 of STA [2011] Public Notice 34: in the event of divestment or reduced investment in an investee enterprise, the assets obtained by the investor enterprise which equal to the initial capital contribution shall be recognized as the investment recovered; the assets obtained by the investor enterprise which 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 transfer of investment assets.

3. Corporate separation

Circular 59

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")

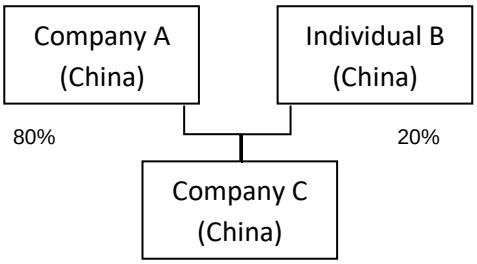
5. Tax treatment for divestment or reduced investment

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.**

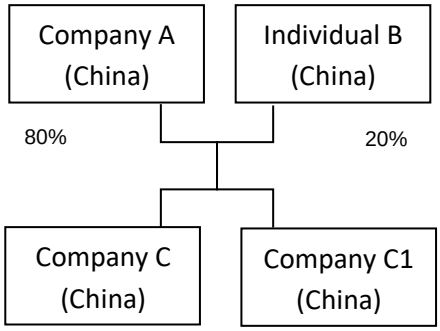
Example

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)

SZSTA: Under the general tax treatment, the enterprise being spun-off shall recognize the gain or loss from the transfer based on the fair market value of the assets spun-off; the spin-off enterprise shall determine the tax base of the assets received according to their fair market value; the consideration received

by the shareholders of the enterprise being spun-off shall be deemed as the distribution from the enterprise being spun-off. The tax base of Company A's equity in Company C shall be: original investment tax base – investment recovered = RMB 60 million – RMB 60 million*(2/3) = RMB 20 million. The original equity value held by Individual B in the enterprise being spun-off (Company C1) was RMB 2 million.

b. In the above example, how to determine the consideration obtained by Company A and Individual B as the 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)

SZSTA: The consideration received by the shareholders of the enterprise being spun-off shall be the corresponding value from the fair value of the enterprise being spun-off, 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?

SZSTA: 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, which is referring to the distribution from capital reduction. According to PN34, 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 transfer of investment assets. In case if the costs cannot be recovered, the irrecoverable amount shall be regarded as investment loss.

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?

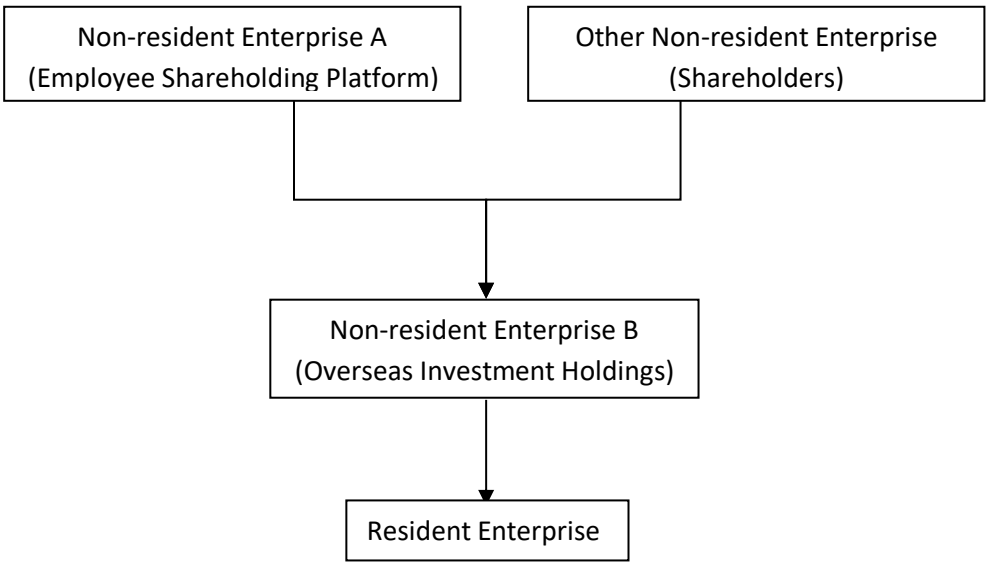
SZSTA: Under the provisions of general tax treatment, Company A recovers its asset through distribution from capital reduction, amounting to RMB 40 million*80% = RMB 32 million. The corresponding investment cost is RMB 60 million*2/3 = RMB 40 million, the irrecoverable part of investment costs of RMB 8 million (RMB 40 million – RMB 32 million = RMB 8 million) can be regarded as investment loss.

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%)?

SZSTA: Article 5 of PN34 clarifies the CIT issues in relation to divestment or reduced investment of invested enterprises. PN34 does not cover IIT.

6. 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?

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?

SZSTA: If Enterprise A transfers the equity of Chinese resident enterprise through the transfer of an intermediate holding company, it should be, in substance, regarded as a transfer of equity of Chinese resident enterprises according to PN7. Although Enterprise A had not obtained any income based on the relevant share transfer agreement, we should determine the value of shares transferred by Enterprise A based on the fair market value and calculate the equity transfer income for Enterprise A to pay the non-resident CIT.

C. Determination of beneficial ownership

1. Determination of “beneficial owner” status of treaty benefit applicants

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 months	g=d/b	80%	g is greater than 50%, exceeding the thresholds

SZSTA: "The applicant has the obligation to pay more than 50% of the income within 12 months of receiving the income to a third jurisdiction resident" is one of the unfavourable factors in determining the "beneficial owner". The ratio of dividend redistributed therein should be calculated based on the actual payment, by proportion of the agreed amount and actual payment amount to the amount received by the applicant.

D. Individual Income Tax ("IIT")

1. 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)?

SZSTA: According to Article 1 of Caishui [2018] No. 164, annual one-off bonus obtained by a resident individual before 31 December 2021 in compliance with Guoshuifa [2005] No. 9 shall not be included in his/her comprehensive income for the year; tax shall be computed separately by dividing the amount of the annual one-off bonus by 12 months, and applying the applicable tax rate determined in accordance with the tax rate table. The formula should be: Tax payable amount = Annual one-off bonus income x applicable tax rate.

If the taxpayer's annual one-off bonus is taxed separately from his/her comprehensive income, the taxpayer may include the bonus in his/her comprehensive income for final IIT assessment purpose. However, if the annual one-off bonus has been combined with the comprehensive income at the time when the tax is withheld, the taxpayer cannot elect to compute the bonus separately from his/her comprehensive income during the final IIT assessment.

E. Others

1. VAT deduction

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?

SZSTA: Compensation in the form of a house is not deductible. When the property developer paid the relocated household with a house, it should be deemed as sales and the turnover amount will be the construction cost plus 10%.

2. 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.

SZSTA: Circular 57 is not only applicable to state-owned enterprises, it should be applicable to all enterprises that can satisfy the requirement specified in Article 4.

3. 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.

   SZSTA: The aim of the circular was to provide further support to the development of venture capital ("VC") enterprises. It allows qualified VC enterprises to select whether to use the income derived by individual investment fund or the annual overall income of the VC enterprise for IIT calculation according to their actual situation. We have already raised the questions to STA on the deduction issues for VC enterprises selecting individual investment fund method. If there are any subsequent amendments to improve the regulations, we will announce the update and perform the tax services work accordingly.