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China offices

Legal flash - Tax

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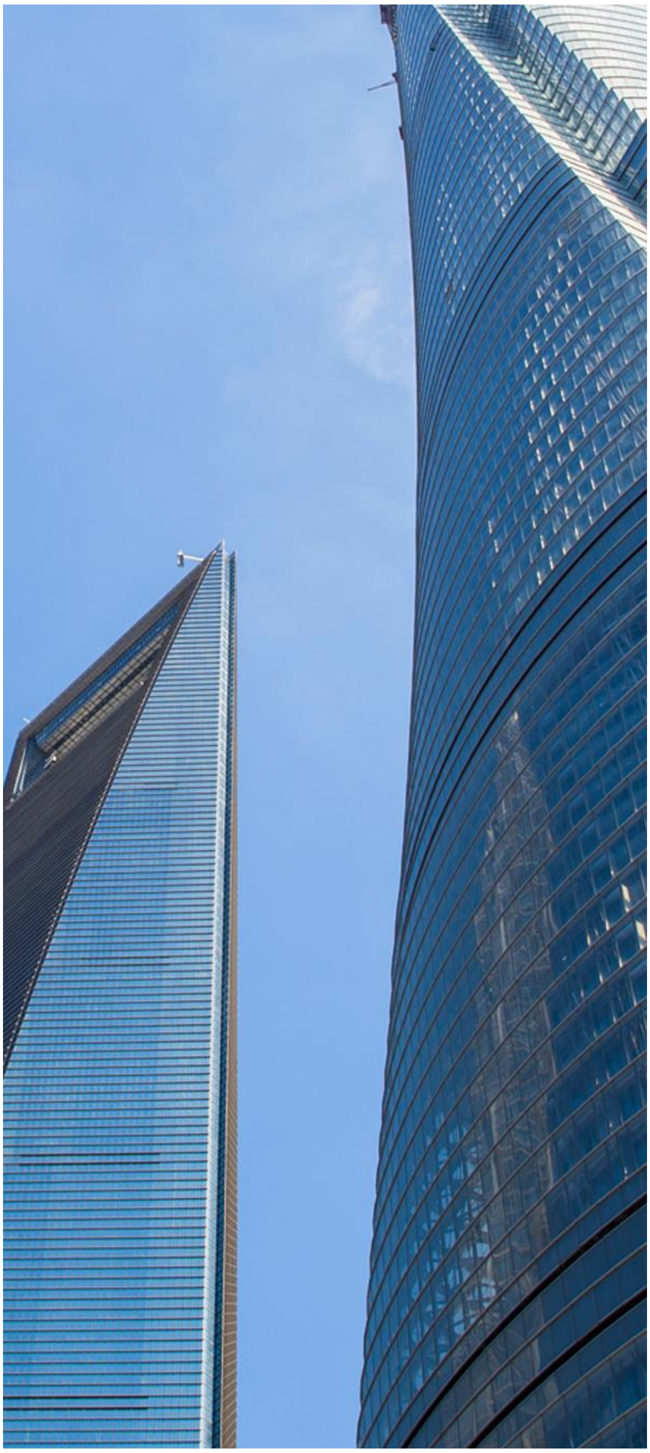

Content

New Deed Tax Law

On August 11, 2020, the 21st session of the Standing Committee of the 13th National People's Congress approved the new Deed Tax Law, which will take effect on September 1, 2021.

The new law inherits most of the stipulations under the current Provisional Regulation on Deed Tax and its Implementing Rules, and it is another step towards upgrading China's tax rules into law.

Main changes:

- **Scope of taxable activities**

  Deed tax applies to the transfer of ownership of land and real estate in China. The transferee pays the deed tax.

  Taxable activities include (i) the assignment of land use rights; (ii) the transfer of land use rights, including sale, donation and swap; and (iii) the sale, donation and swap of real estate.

  Regarding the assignment of land use rights, under the current regulations, it is limited to assigning state-owned land use rights. However, the new law extends it to include assigning rural collective land use rights.

  The reason behind this change is the amendment of the Land Administration Law in August 2019, allowing the use right of collective operational construction land to be assigned. Consequently, the new law introduces this transaction as a taxable activity.

  The new law also defines deemed taxable activities as transferring the ownership of land and real estate through investment (equity contribution), debt repayment, transfer, and reward, which are also subject to deed tax. This definition is borrowed from the current regulations, except for adding "transfer" to the scope, which need to be further defined.

- **Tax rate and preferential policies**

  a) The new law maintains the deed tax rate range (3% to 5%) under the current regulations.

However, it increases the level of authorization to determine the specific rate from the current local provincial-level government to the standing committee of the provincial-level people's congress. The decision must also be filed with the National People's Congress and the State Council instead of the Ministry of Finance and the State Administration of Taxation under the current regulations. This requirement is consistent with the principle of statutory taxation, so that local governments will not be able to easily change the tax rate.

b) The new law consolidates tax-exempt items established in the current regulations, and tax-exempt items such as change of ownership of land and real estate between spouses during marriage and inheritance of ownership of land and real estate through statutory succession are now stipulated into law.

The new law also mentions that, according to the nation's economic and social development, the State Council can provide deed tax exemption and reduction policies for meeting residential housing demand, corporate restructuring and post-disaster reconstruction, which needs to be filed with the Standing Committee of the National People's Congress.

Under tax circular Caishui [2016] No. 23, except for Beijing, Shanghai, Guangzhou and Shenzhen, the following preferential policies are applied:

- ✓ For any individual purchasing the family's only housing (family members include the purchaser, the spouse and underage children), if it is up to 90 square meters, 1% deed tax applies; otherwise, 1.5% deed tax applies.

- ✓ For any individual purchasing the family's second housing, if it is up to 90 square meters, 1% deed tax applies; otherwise, 2% deed tax applies.

Tax circular [2018] No. 17 also provides tax preferential policies applied to corporate restructuring, which will expire December 31, 2020.

Therefore, if these tax preferential policies are to be renewed after the date the new law becomes effective, they will need to be enacted by the State Council and filed with the Standing Committee of the National People's Congress.

Timing of tax obligation and tax refund claim

The new law maintains that the deed tax obligation occurs on the date a taxpayer signs the ownership transfer contract for land and real estate or obtains a similar document corresponding to the transfer contract. The taxpayer must make the tax declaration before the ownership registration process for land and real estate.

However, the new law removes the requirement to make the tax declaration within 10 days from the date the contract is signed. Therefore, provided the taxpayer makes the tax declaration before the registration process, there is no late payment surcharge or penalty for not declaring the deed tax.

Also, before the registration process, if the contract or similar document is ineffective, invalid, rescinded, or terminated, the taxpayer can claim a tax refund from the tax authorities.

Under tax circular Guoshuihan [2008] No. 438, a tax refund also applies to the situation where the court rules a transfer to be invalid and revokes the ownership certificate. This interpretation is expected to continue being applied after the date the new law becomes effective.

New City Maintenance and Construction Tax

On August 11, 2020, the 21st session of the Standing Committee of the 13th National People's Congress approved the new City Maintenance and Construction Tax ("CMCT") Law, which will take effect on September 1, 2021.

CMCT is a simple and small tax in China. The new CMCT Law inherits the three-tier tax rates of 7% in city area, 5% in the town area and 1% in other areas under the current Provisional Regulation on CMCT.

Definition on taxpayer and tax basis

Given the abolishment of business tax after the value-added tax ("VAT") reform in China, the new law establishes that taxpayers of CMCT are those who pay VAT and consumption tax in China; the tax basis of CMCT is the actual VAT and consumption tax payable amount.

Also, to accommodate the refund policy for the uncredited input VAT, the tax basis of CMCT should deduct the VAT refund amount at the end of each period.

As CMCT applies to the actual VAT and consumption tax payable amount, and the new VAT Law and the new Consumption Tax Law are being legislated, paying attention to the changes introduced in both laws is important.

- **Exception situation**

The new law excludes CMCT from applying to the VAT and consumption tax amount arising from imported goods and services provided and intangible assets sold by an overseas supplier to a Chinese recipient.

The exclusion of imported services and intangible assets from the CMCT scope is a new rule, which is welcomed. We expect a similar rule to be introduced soon for education surcharge and local education surcharge, which are always levied together with CMCT.

However, the exclusion does not cover (i) real estate in China to be sold/leased by an overseas supplier, and (ii) the use right of natural resources in China to be transferred by an overseas supplier to an overseas recipient, which are taxable activities under the VAT scope.

- **Timing of tax obligation and withholding obligation**

The new law establishes that the CMCT obligation occurs at the same time as VAT and consumption tax, and taxpayers of VAT and consumption tax have the withholding obligation and should withhold CMCT when paying their VAT and consumption tax. These are all consistent with the current practice.

Hainan Free Trade Port Tax Policies

On June 1, 2020, China released its Master Plan for the Construction of the Hainan Free Trade Port (the “Master Plan”), dedicated to building the Hainan Free Trade Port (“FTP”) into a crucial port that will lead China’s opening-up to the world in a new era. The scope of the implementation of the FTP will cover the entire island of Hainan.

The Master Plan aims to (i) offer freedom and convenience in trade, investment, crossborder flow of capital, access for people, transportation, and the secure and orderly flow of data; (ii) develop a modern industrial system by focusing on tourism,

modern services and high-tech industries; and (iii) establish sound tax, social governance, legal and risk control systems.
The Master Plan establishes several tax policies, including zero tariff and low tax rates for (i) qualified companies effectively operating in the FTP, and (ii) qualified individuals, which is expected to be rolled out in two stages: (i) before 2025, and (ii) before 2035.

Main tasks of each stage:

CATEGORY	BEFORE 2025	BEFORE 2035
Customs tariff	The FTP will implement the bonded area for the whole island in due time. Before that, the FTP will administrate the imported goods with positive/negative "zero tariff" catalogues, applying an exemption on customs tariff, import VAT and consumption tax to goods listed in the catalogues. After that, the FTP will apply the following program: ✓ Zero customs tariff will apply to all goods entering the FTP from overseas, except for those listed in the Catalogue of Import Taxable Commodities. ✓ When imported goods enter mainland China from the FTP, in principle, the customs tariff and import taxes will be applied as usual. ✓ However, for companies active in the encouraged industries, zero tariff will be applied to their goods entering mainland China, provided the	

	goods are produced without imported materials, or processed in the FTP with imported materials by adding value of at least 30%. Before being extended to the whole island, this program will first be implemented in certain pilot areas of the FTP (e.g., Yangpu Bonded Port). Moreover, the annual duty-free shopping limit for travelers is also increased to RMB 100,000 per person.	
Enterprise Income Tax ("EIT")	A reduced tax rate of 15% applies to companies registered and effectively operating in the FTP and engaging in the encouraged industries: ✓ Companies engaging in the encouraged industries are those whose main business falls within the scope of the catalogues of the FTP's encouraged industries, and over 60% of the total revenue of the companies comes from their main business activities. ✓ "Effectively operating in the FTP" means the effective management body is situated in the FTP, which exerts overall management and control over the company's operation, employees, accounting and properties. ✓ Catalogues of encouraged industry include the Guidance	A reduced tax rate of 15% applies to all companies registered and effectively operating in the FTP, except for those engaging in the negative list industries.

	Catalogue of Industrial Restructuring (2019), Industry Catalogue of Encouraged Foreign Investment (2019) and Catalogue of Encouraged Industries in the FTP (2020, call for public comments by October 15, 2020). ✓ Qualified companies include an establishment/a fixed place of business set up in the FTP by a nonresident company. ✓ For companies with their headquarters set up in the FTP, 15% applies only to the income of the headquarters and branches in the FTP; for companies with their headquarters outside the FTP, 15% applies to the income of the qualified branches in the FTP. ✓ The reduced rate of 15% can be applied at EIT prepayment during the year; i.e., there is no need to wait until the annual declaration to benefit from it.	
	The EIT exemption applies to the income arising from new overseas direct investments by companies registered in the FTP and engaging in the tourism, modern services and high-tech industries: ✓ Income from new overseas direct investment must qualify for the conditions of (i) profits from a newly established branch overseas, or the corresponding dividends	

	distributed by an overseas subsidiary with at least 20% shareholdings, and (ii) the statutory EIT rate in the invested country is at least 5%. ✓ Companies can benefit from the exemption at annual declaration.	
	For fixed and intangible assets newly purchased (including self-constructed and developed) by companies registered in the FTP, if the unit value does not exceed RMB 5 million, the purchase cost can be deducted before tax in one lump sum; if the unit value is above RMB 5 million, the purchase cost can be depreciated/amortized by applying the shortened period or accelerated depreciation/amortization methods: ✓ Fixed assets exclude real estate and buildings. ✓ The benefit can be applied at EIT prepayment during the year. ✓ The benefit is accessible to the secondary branches operating with actual accounting and the establishment/fixed place of business of a nonresident company in the FTP.	
Individual Income Tax (“IIT”)	IIT burden over 15% is exempt for the top-level and urgently needed talents working in the FTP:	For individuals staying in the FTP for 183 cumulative days or more in a tax year, the

	✓ This policy applies to comprehensive income, operational income and subsidies recognized by Hainan Province. ✓ Individuals can apply this benefit at the annual declaration, meaning it will involve applying for a tax refund.	comprehensive income and operational income arising from the FTP will be applied with three-tire progressive tax rates of 3%, 10% and 15%.
Sales Tax	When the FTP fully implements the bonded area for the whole island, it will simplify the tax system and consolidate VAT, consumption tax, vehicle purchase tax, CMCT, and education surcharges into a unified sales tax, applying at the retail stage for goods and services.	

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