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TAX NEWSLETTER

JANUARY/FEBRUARY 2016

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EDITORIAL NOTE

Welcome to the latest issue of our Tax Newsletter. In this issue, we have covered a number of developments and cases in the PRC and Hong Kong which could impose legal and tax implications to your business.

In the PRC, there has been an important development in the past few months - the VAT reform will be fully rolled out and take effect by May 1, 2016. This was announced by Premier Li Keqiang in the Annual Government Working Report to the National People's Congress. As you may see more details in the later article, this would significantly affect further industries/sectors including construction, real estate, finance and insurance, and lifestyle services industries. Premier Li also promised to ensure tax burden for all industries will not increase, and we certainly expect to see more tax circulars about the implementation details in the short future.

Further, with the aim to promote the technology development, China has provided more clarifications pertaining to the super deduction of R&D expenses as well as the updates on the qualification criteria for High & New Technology Enterprises.

We noted that the PRC government is working on upgrading its tax payment credit administration system for a more effective monitoring of taxpayers' behavior; and on the other hand, it is also trying to streamline the approval formality by updating the catalogue of the tax administrative approval items.

More interestingly, echoing to the upsurge discussion of information disclosure, the State Administration of Taxation ("SAT") has shed some lights on the extent of assistance that could be provided by the tax authorities to other contracting states.

In Hong Kong, the HKSAR Government has announced a set of concessionary tax measures in the 2016-17 Budget to (1) reduce profits tax and salaries tax, (2) raise allowances and deduction ceiling and (3) expand the scope of tax deduction.

In addition, under the new Mainland-Hong Kong Mutual Recognition of Funds scheme, sale and purchase or non-trade transfer of units of a recognized Hong Kong fund in Mainland are subject to stamp duty in Hong Kong.

In a recent case regarding double stamp duty, the Court of First Instance has held that tax refund is available for a series of property purchases and sales, so long as the Hong Kong resident homeowner ends up with only one residential property within the prescribed period. Besides, the Court of Final Appeal has held that Sheng Kung Hui did not have the intention and status of a trader in the surrender and re-grant of land and emphasized that there is no universal principle or definition of trade.

Finally, we have highlighted the new tax network with six Nordic jurisdictions and Russia and summarized three advance ruling cases reflecting the implementation of the new tax treatments regarding court free amalgamation.

We welcome your feedback and any question you may have about this issue of the Tax Newsletter.

HONG KONG

GOOD NEWS FOR TAXPAYERS: CONCESSIONARY TAX MEASURES PROPOSED IN 2016-17 BUDGET

The Financial Secretary proposed the following tax measures on 24 February 2016 for the 2016-17 Budget. The IRD anticipates that such measures will benefit 600,000 taxpayers and reduce tax revenue by $860 million a year.

(1) Reducing profits tax, salaries tax and tax under personal assessment for the year of assessment 2016/17

It is proposed that taxpayers are entitled to a one-off reduction of salaries tax, tax under personal assessment and profits tax for the year of assessment 2015/16 by 75%, subject to a ceiling of $20,000 per case. The reduction will be reflected in the taxpayers' final tax payable for 2015/16 (but not for the provisional tax of the same year) and taxpayers should file their profits tax returns and tax returns for individuals for the year of assessment 2015-16, to be issued in the coming April and May respectively, as usual. It is expected that excess tax paid will be refunded starting from late July 2016.

(2) Increasing allowances

The basic allowance and the single parent allowance are proposed to be increased from $120,000 to $132,000 and the married person's allowance from $240,000 to $264,000. Also, the dependent parent/grandparent allowance and the additional dependent parent/grandparent allowance for each eligible parent/grandparent are proposed to be increased from $40,000 to $46,000 (for aged 60 or above) and from $20,000 to $23,000 (for aged 55 or above but below 60).

(3) Raising the deduction ceiling for elderly residential care expenses

The deduction ceiling for elderly residential care expenses for each eligible parent/grandparent is proposed to be raised from $80,000 to $92,000.

(4) Waiving business registration fees for the period from 1 April 2016 to 31 March 2017

The proposed waiver only relates to the waiver of one year registration fees for the incorporation submissions made under the One-stop Registration within the waiver period or, in other cases, new certificates or renewal certificates with commencement date falling within the waiver period.

(5) Expanding the scope of tax deduction for capital expenditure on purchasing intellectual property rights

The total number of categories covered by the scope of profits tax deduction for capital expenditure incurred for the purchase of intellectual property rights is proposed to be increased from five categories to eight, with the addition of layout-design of integrated circuits, plant varieties and rights in performance. This measure aims to promote Hong Kong as an intellectual property trading hub in the region.

In relation to the first three proposed tax measures, the Inland Revenue (Amendment) (No. 2) Bill 2016 was gazetted on 4 March 2016 and introduced to the Legislative Council on 16 March 2016.

STAMP DUTY ON THE MAINLAND – HONG KONG MUTUAL RECOGNITION OF FUNDS

The Mainland-Hong Kong mutual recognition of funds ("MRF"), a joint initiative between the China Securities Regulatory Commission and the Securities and Futures Commission, is an important milestone in the mutual opening up of the Mainland and Hong Kong capital markets. We discussed in our November/December 2015 issue about the China tax rules regarding the MRF. Here, we set out the main transactions that are subject to stamp duty in Hong Kong under the MRF scheme, as well as those which are not subject to stamp duty.

(1) Transactions subject to stamp duty in Hong Kong under the MRF scheme

a. The sale and purchase in Mainland of units of a recognized Hong Kong fund (units under a unit trust scheme fall within the definition of 'stock')

b. Non-trade transfers of units of a recognized Hong Kong fund (This normally takes place in a succession; divorce; dissolution; liquidation or winding up of any company or corporation; donation to a charitable foundation; assistance in enforcing proceedings or action taken by any court, prosecutor or law enforcement agency; and any other transfers which may be permitted by the competent authorities.)

(2) Transactions not subject to stamp duty in Hong Kong under the MRF scheme

a. The sale and purchase of units of a recognized Mainland fund;

b. Allotment or redemption of units of a recognized Hong Kong fund.

Investors in units of a *recognized Hong Kong fund* will be required to execute contract notes and pay stamp duty for the relevant transfers in Hong Kong within the stipulated time limit. Documentary evidence showing the net asset value of the recognized Hong Kong fund (close to the date of transfers) will also need to be provided to the Stamp Office to adjudicate the amount of stamp duty payable.

DOUBLE STAMP DUTY – SILVER LINING FOR HOMEOWNERS WITH TWO FLATS?

In the midst of Hong Kong housing bubble, it is no surprise that the recent judicial review case, Ho Kwok Tai v Collector of Stamp Revenue (HCAL 49/2015), came into public spotlight.

You may recall that in February 2013, the Secretary for Financial Services and the Treasury ("Financial Secretary") introduced the double stamp duty rule to curb residential property speculation in Hong Kong. A higher scale of stamp duty applies retrospectively to conveyance on sale of a Hong Kong residential property executed on or after 23 February 2013, except for a residential property acquired by a Hong Kong permanent resident ("HKPR") who does not own any other residential property in Hong Kong at the time of acquisition.

Exceptions have been made for a HKPR homeowner who sells his/her existing residential property within six months from the purchase of the new residential property, in which case such homeowner may apply for a partial refund of the increased duty.

Ho Kwok Tai raises the issue as to whether double stamp duty refund should be available if a HKPR homeowner had more than one existing residential property (two, in the case of Ho Kwok Tai), all of which were sold within six months from the purchase of the new residential property.

The Collector of Stamp Revenue ("Collector") took the view that in such circumstances, refund should not be available as exemption to the double stamp duty rule (section 29DF of the Stamp Duty Ordinance Cap. 117) should only apply to HKPR homeowners who bought ***one*** and sold ***one*** residential property (being the original and only residential property in Hong Kong).

The Court of First Instance ("CFI") however held that such refund was available as section 29DF is intended to apply to situations even where the HKPR homeowner owns more than one original residential property. In support of such argument, Deputy High Court Judge Brian Keith in his judgment referred to the Financial Secretary's Chinese blog, which states that "*as long as they intend to only own one residential property – regardless of whether it was a first time property or change of properties – they do not need to pay the 'Double Stamp Duty' and they only need to pay the stamp duty at the original rates. As for the persons who 'Buy-First-Sell-Later', as long as the original property could be sold within 6 months after the acquisition of the new property, they can also apply for refund of extra stamp duty paid*".

Deputy High Court Judge Brian Keith viewed that so long as the HKPR homeowner ended up with only one residential property at the end of the process, he or she would be entitled to partial refund even if he or she owns more than one original residential property.

It all seems like rather good news to some HKPR homeowners but having said that, the position is yet to be set in stone. On February 29, the Collector decided to lodge an appeal against the CFI's judgment. Let's wait and see.

IN THE MEANWHILE – INTERIM MEASURES IN RELATION TO FAIR VALUE ACCOUNTING

As you may recall, the Commissioner of Inland Revenue lost its appeal to the Court of Final Appeal in *Nice Cheer Investment Limited v CIR* back in 2013. The Court of Final Appeal held that although changes in value of trading stock shall be recognized in the financial statements of taxpayers in accordance with the international accounting standards, unrealized gains in respect of shares held for trading are not subject to profits tax.

The IRD is still reviewing its practice in light of the judgment of the *Nice Cheer* case. Therefore, the IRD has extended its interim administrative measure to accept assessable profits calculated on a fair value basis in profits tax returns for year 2015/16. The IRD also agrees, if the taxpayers subsequently adopts the realization basis, to re-compute the 2015/16 assessable profits calculated on a fair value basis. However, any request for re-computation should be made within the time limits laid down in the Inland Revenue Ordinance.

BETTER INTERNATIONAL TAX NETWORK

(a) Tax Information Exchange Agreements ("TIEAs") with six Nordic jurisdictions

As mentioned in our Sept/Oct 2015 issue, Hong Kong entered into TIEAs with six Nordic jurisdictions (i.e. Denmark, the Faroes, Greenland, Iceland, Norway and Sweden). Following the completion of ratification procedures in Hong Kong and the relevant Nordic jurisdictions, all six TIEAs have now come into force.

	Effective Date
Agreements with Denmark, the Faroes, Iceland and Norway	December 4, 2015
Agreement with Sweden	January 16, 2016
Agreement with Greenland	February 17, 2016

The TIEAs shall be effective for the taxable periods beginning on or after the respective dates on which the TIEAs entered into force, or, where there is no taxable period, for all charges to tax arising on or after the respective dates on which the respective TIEAs entered into force.

(b) Comprehensive Double Taxation Agreement ("DTA") with Russia

On January 18 2016, Hong Kong has concluded a DTA with Russia, expanding Hong Kong's DTA network to 34 jurisdictions.

Under the DTA, there is a reduction in withholding tax rates on dividends, interest and royalties derived from Russia by a Hong Kong resident as beneficial owner:

	Russia Withholding Tax Rate	Reduced Rate under DTA
Dividends	15%	5%*/10%
Interest	20%	0%
Royalties	20%	3%

*applicable if the beneficial owner is a company (other than a partnership) which holds directly at least 15% of the capital of the company paying the dividends.

The DTA will come into force after the completion of ratification procedures in Hong Kong and Russia. Hopefully this new DTA will create incentives for more Russian companies to invest in Hong Kong in near future.

SHENG KUNG HUI DID NOT BECOME A TRADER BY ENHANCING THE VALUE OF ITS LAND

The case of Church Body of the Hong Kong Sheng Kung Hui & Hong Kong Sheng Kung Hui v CIR (FACV 16/2015) circled around whether property enhancement inferred an intention to trade and therefore the imposition of profits tax on the resulting profits. It has caught the attention of many partly because a lot of people in Hong Kong hold properties, and partly because guidance on the definition of "trade" is much wanted.

The taxpayers in this case are charities. They owned agricultural and restricted building lands in Tai Po ("Old Lots") since 1930s and had used them for an orphanage. The New Territories had since gone through substantial urbanization. The Old Lots turned out to be ideal for residential developments.

In 1970s, the taxpayers began to explore possibilities of developing the Old Lots. In 1989, serious considerations were made on redeveloping the Old Lots. From 1990 to 1993, the taxpayers went through the process of surrendering of the Old Lots in exchange for a new grant which allowed for residential use ("New Lots").

In 1993, the taxpayers invited tender offers to either purchase the New Lots outright or to enter a joint venture agreement for redevelopment. The Cheung Kong Group tendered offers on both options. Subsequently, the taxpayers entered into a joint venture agreement with Cheung Kong to develop the New Lots into a luxury residential project. Under the agreement, the taxpayers were rewarded some units and parking spaces. Substantial profits were made from subsequent sale of these units and parking spaces.

The heart of the disagreement between the Commissioner and the taxpayers was – when did the taxpayers change their intention to hold the Old Lots/New Lots for trade?

The Commissioner contended that the change of intention occurred, and therefore the accrual of profits tax began, in 1989 (when the taxpayers made serious considerations for redeveloping the Old Lots) or 1990 the latest (when the taxpayers decided on the exchange for new grant). These findings, in the eyes of the CFA, lacked the required precision for change of intention.

Whether the taxpayers' activities amounted to trade or business is in essence a question of fact and degree. The so-called badges of trade, a non-exhaustive list, provide useful guidance on how that question should be answered. The CFA considered one of the badges of trade to be of critical importance in this case, namely, whether the taxpayer has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class.

The CFA held that there was no change of intention in 1989 or 1990 during which the taxpayers' enhancement work was necessary for finding out the potential of the property and ascertaining the maximum value. These activities did not go beyond what might be expected of a non-trader under similar circumstances. The CFA even took the view that the taxpayers' invitation for tender in 1993 did not mark the change of intention. The CFA therefore dismissed the CIR's appeal and confirmed the COA's order to remit the case to the Board to ascertain when that change of intention occurred.

The CFA reiterated that there is no universal principal of law that defines trade, nor what may be expected of a non-trader. The answer to these questions still lie in the particular facts of each case.

RECENT ADVANCE RULING CASES – TREATMENT OF TAX LOSSES

It is not uncommon in the commercial world for two or more companies to amalgamate into a single company through business restructuring, generally for purposes of maximizing profits and achieving cost savings, operational efficiency or market diversification, etc. You may recall that Hong Kong's new Companies Ordinance introduced the court-free amalgamation regime in 2014 and that the IRD issued guidelines on 30 December 2015 clarifying the current profits tax treatment of such court-free amalgamation (Please refer to our November/December 2015 issue).

The general position on the treatment of pre-amalgamation tax losses is that (a) tax losses cannot be transferred to other group companies, and (b) group loss relief and deduction for acquired losses through the court-free amalgamation procedure are not allowed. The IRD guidelines have specifically provided that tax losses can only be set off against profits of the amalgamated company on the following conditions:

- tax losses are incurred after the amalgamating company and the amalgamated company have become wholly owned subsidiaries of the same group;
- tax losses are carried forward by the amalgamating or amalgamated company in a trade or business, which continues until amalgamation;
  - tax losses if brought forward in the amalgamated company, the amalgamated company has adequate financial resources (excluding intra-group loans) to purchase the trade or business if not via amalgamation;
  - tax losses brought forward from the amalgamating company can only be used to set off against the profits of the amalgamated company derived from the same trade or business succeeded from the amalgamating company.

Three recent Advance Ruling Cases No. 55, 56 and 57 relating to amalgamation were published by the IRD on 18 January 2016. Regarding the amalgamations in Advance Ruling Cases No. 56 (relating to treatment of fixed assets) and 57 (relating to tax losses), the IRD ruled that Sections 61A and 61B of the Inland Revenue Ordinance ("IRO") (i.e., the anti-avoidance provisions) will not be applied, because the Commissioner is satisfied in both cases that there is genuine need for an amalgamation to achieve operational efficiency and cost savings.

In contrast, Advance Ruling Case 55 received a "negative" ruling, in which the IRD ruled that Section 61A of IRO may be invoked and consequently tax losses of the amalgamating company sustained prior to the amalgamation will not be allowed for setting off against the assessable profits of the amalgamated company. The distinguishing fact of this case is that immediately prior to the amalgamation, the amalgamating company had no business or assets as its business was previously transferred to a third party in a group restructuring exercise, and hence was in a net liability position. The facts also revealed that directors of the amalgamating company had planned to put it into liquidation. There was apparently no commercial justification for the amalgamation, since it was merely an attempt to obtain tax benefits through the utilization of the unabsorbed losses sustained by the amalgamating company to reduce the tax liability of the amalgamated company.

We note from these advance rulings that the IRD has put much emphasis on anti-avoidance measures. It is therefore essential that, in addition to the above conditions for the set off of tax losses, taxpayers must have commercial justification for amalgamations when planning for group restructuring exercises.

PRC

CHINA EXPANDS VAT REFORM TO CONSTRUCTION, REAL ESTATE, FINANCE & INSURANCE AND LIFESTYLE SERVICES[1]

China's Premier Li Keqiang has announced, in the Annual Government Working Report to the National People's Congress, that China will further expand the application scope of value added tax ("VAT") on 1 May 2016, replacing the current Business Tax ("BT") in the four key business sectors of construction, real estate, finance and insurance, and lifestyle services.

China started the VAT reform in 2012 with the goal of reducing enterprise taxpayers' turnover tax burden by replacing the BT with VAT. This VAT reform was firstly tested in some trial cities and then expanded to the whole nation, initially covering transportation, industrial oriented services, telecommunication and postal services. According to the State Administration of Taxation ("SAT"), by mid-2015, the VAT reform has brought over a total turnover tax reduction of RMB484.8 billion.

Until this announcement in March this year, construction, real estate, finance and insurance, and lifestyle services (including mainly catering, hoteling, entertaining and healthcare services) were the four business sectors left outside of the VAT reform. But the economic work of those sectors is not insignificant. Based on the data released by the Ministry of Finance, BT revenue derived from these four sectors approximated 15% of the nation's overall 2015 tax revenue.

The last segment of China's VAT reform has finally arrived. Once VAT is applied to the four business sectors, the BT will be completely retiring from China's tax system. According to the SAT, this last step of VAT reform is expected to introduce an additional tax reduction of about RMB400 billion in the next few years. Beyond question, this will be a major incentive to China's economy and to most of the taxpayers in the four business sectors. As specifically expressed by the Premier, "reduction of tax burden is ensured for all business sectors involved."

The date of implementation

According to the Working Report, VAT will apply to the four business sectors **starting from 1 May 2016**, and this change will be nationwide. Although there have been a lot of discussions and explorations on the application of VAT on these sectors in the past few years, it is nonetheless a very heavy task for the SAT to accomplish within the next two months. Considering the complexity of China's VAT administration system, there is the possibility that the SAT may use a phased approach, instead of trying to cover all taxpayers at once.

The transition and implementation rules

Given the limited lead time, it is generally expected that the SAT will soon release a set of transition and implementation rules for taxpayers in the four affected business sectors. As observed in the previous VAT Reform practice, local tax authorities will undertake to provide training and instructions to taxpayers based on the transition and implementation rules.

The VAT rates

While the transition and implementation rules are still not available, the VAT rates applicable to the four business sectors are generally expected to be as follows:

- Construction: 11%
- Real Estate: 11%
- Finance and Insurance: 6%
- Lifestyle Services: 6%

[1] The new VAT policy ("Circular 36") has been issued on 23 March 2016 at the time of publication of this article. We have a separate client alert covering this.

Although these VAT rates appear to be higher than the current BT rates (normally either 5 % or 3%), taxpayers would be allowed to claim input VAT credits based on their purchase of VATable goods and services. In particular, taxpayers in the construction and real estate sectors normally would have significant input VAT credits from purchase of VATable materials and services, which can bring down their VAT payable to a level lower than that under the BT rates. On the other hand, taxpayers in the sectors of Finance and Insurance and Lifestyle Services may not have significant input VAT credits, but the 6% VAT rate is close to the current BT rate of 5%. In this regard, although individual taxpayers' actual VAT burden will depend on the level of input VAT credits derived from their business operation, most taxpayers may expect to have the same or lower turnover tax burden.

What is next for taxpayers

For taxpayers in the four affected business sectors, this is high time to seriously review business operations from a VAT application and compliance point of view. It may be necessary to review from different angles, such as:

- the readiness of accounting information;
- the sufficiency of tax compliance personnel;
- the flexibility of the IT system;
- the impact on on-going business contracts and transactions;
- the impact on the budget and financial forecast; and
- any potential difficulties and issues during the transition.

Naturally, taxpayers in the four business sectors should also look out for the issuance of the implementation rules, and it is also important for taxpayers to maintain timely communication with their supervising tax authorities and understand the schedule and deadlines at the local level.

Taxpayers should take a further step to consider the possibility of optimizing their business or financial models with the goal of improving tax efficiency under the VAT regime, or to streamline their internal VAT compliance procedures.

FURTHER GUIDELINE FOR SUPER DEDUCTION OF R&D EXPENSES

Further to Circular 119 regarding the super deduction of R&D expenses, the State Administration of Taxation ("SAT") released *Notice on Several Issues Concerning R&D Expenses Super Deduction Policy* ("Circular 97") which sheds more lights on the interpretation and implementation of the super deduction policy.

The Circular 97 clarifies the following major issues:

(1) Unqualified Enterprises

An enterprise will not be qualified for super deduction if (1) its main business involve unqualified industry and activity as stipulated in Circular 119, and (2) its annual income derived from such main business is less than 50% of the total income (non-taxable income and investment return excluded).

(2) Qualified R&D personnel

Qualified R&D personnel can include research, technical and supporting employees. Research personnel could be either self-employed or part-time.

(3) R&D expenses

- If R&D personnel or equipment, intangible assets are used for multiple projects including non-R&D projects, necessary records are required to be made and the relevant costs should be allocated reasonably (e.g. taking a time-apportionment approach).

- "Other related expenses" should be collected on a project basis. Circular 97 also provides a specific formula to calculate the cap of "other related expenses".
- In calculating deductible R&D expenses, special income derived from leftover, defective products and prototypes shall be deducted from the total R&D expenses.
- For sale of products directly made from R&D activities and their components, corresponding material expenses are not entitled for super deduction.
- It is emphasized that taxpayers are required to present legitimate proof to the tax authority in order to support super deduction where R&D activities are sub-contracted to independent contractors.

(4) Recordal and reporting requirements to claim super deduction

In order to claim the super deduction benefits, taxpayers are required to complete tax recordal prior to declaring the annual income tax filings. Documents, such as the name list of R&D personnel, relevant contracts, expenses allocation statements, etc., should be retained for any further tax authority's inspection.

CHINA UPDATES HIGH & NEW TECHNOLOGY ENTERPRISE RULES

The Income tax reduction for High & New Technology Enterprises ("HNTE") is a key tax incentive available under current China tax laws, and plays an important role in encouraging investment in high-tech and R&D areas. On January 29, 2016, the Ministry of Finance, the State Administration of Taxation, and the Ministry of Science and Technology jointly issued a new *Administrative Measures for Certification of High & New Technology Enterprises* ("Circular 32"), which has significantly changed the HNTE certification rules and been in effect since January 1, 2016. Generally, Circular 32 has lowered the criteria for qualifying as a HNTE, but at the same time enhanced the requirements on intellectual property ownership and compliance requirements.

(1) Ownership of Core Intellectual Property ("IP")

A qualified HNTE shall have the ownership of the technological IPs that are essential to the enterprise's production of products or provision of services. Such ownership may be derived from proprietary R&D, purchase, donation, acquisition or other means, but IP made available to an enterprise through an exclusive licensing arrangement would no longer qualify.

(2) R&D Personnel Requirement

The requirement of the minimum percentage of R&D personnel is now lowered to 10% of an enterprise's total employees, as in comparison with the previous 30%. At the same time, it is no longer required that each qualified R&D personnel shall hold a college diploma.

(3) R&D Expense Requirement

R&D expense ratio requirement is lowered from 6% to 5% for small and medium sized enterprises with an annual sales revenue of less than RMB 50 million. The R&D expense ratio for enterprises with an annual sales revenue between RMB 50 million and RMB 200 million, and enterprise with an annual sales revenue of or above RMB 200 million remain unchanged as 4% and 3% respectively.

(4) Application Documents

The application documents required remain similar to the previous rules, except that certain income tax filing records for the latest three years are additionally required under Circular 32.

(5) Strengthened Compliance Requirement

Under Circular 32, certified HNTEs are now required to conduct an annual recordal with the tax authorities to report information including IP, R&D personnel, R&D expenses, sales revenue and other related information of the year concerned. Where an HNTE fails to meet the prescribed criteria in a particular year, or where an HNTE fails to conduct the annual recordal for two years, the HNTE qualification will be revoked, such that the income tax benefits already enjoyed in the relevant years may be clawed back. Circular 32 also requires the tax authorities to conduct random reviews and investigations on certified HNTEs.

Apart from the above, Circular 32 provides that the administrative guidelines for the HNTE certification will be updated for implementation of the new rules. It is generally expected that the above changes will be further elaborated in the updated guidelines, and the eight business areas currently eligible to apply for the HNTE benefits might also be further expanded.

ADMINISTRATION OF EXPORT VAT REFUND (EXEMPTION) SIMPLIFIED – A STEP TO IMPROVE TAX COLLECTION AND ADMINISTRATION EFFICIENCY

To echo the *Plan for Further Reforming the State and Local Tax Collection and Administration System* issued by the General Office of the State Council and the Central Committee of China's People Congress ("Reform"), the State Administration of Taxation ("SAT") has been improving its system to establish a modern tax collection and administration system. As part of the reforms, the SAT issued the *Announcement on Issues concerning Further Strengthening the Interim and Ex-Post Administration of Export Tax Rebates (Exemption)* ("SAT Announcement [2016] No. 1").

With this announcement issued, the application documentary requirements for the export VAT refund (exemption) are simplified so that taxpayers are no longer required to provide documents that are considered replicative or that are already accessible to the tax authority. For instance, a group of companies that previously purchased products made by the manufacturing enterprises within the group should apply for treating the products as self-made for export VAT refund (exemption) purposes by submitting the export VAT recordal forms of all the participating group enterprises. After the issuance of this SAT announcement, such recordal forms are no longer required to be provided.

For trading companies exporting goods that were previously purchased and imported, this SAT Announcement [2016] No. 1 also waives the trading companies from providing the relevant import customs declaration forms of the import goods, this is because all other application documents should have provided sufficient grounds for the tax authority to approve the VAT refund (exemption) application.

This SAT announcement also provides guidance to export enterprises that have withdrawn the export VAT refund (exemption) recordal due to different reasons (such as corporate reorganization) but have not yet completed the tax clearance with the tax authority on the VAT refund amount.

This SAT announcement about simplifying the VAT refund administration is one of the many actions that are to be taken by the SAT in the next five years. In our view, those actions should be well received by both taxpayers and tax authorities.

CHINA TAX AUTHORITIES TO REFORM ON TAX ADMINISTRATIVE APPROVAL

On February 28, 2016, the State Administration of Taxation ("SAT") released the *Announcement on the Several Issues Related to Tax Administrative Approval* (the "Announcement 11") which will take effect on April 1, 2016. The SAT has been moving toward on a gradual removal of certain tax-related administrative approval items for the last two years to respond to the State Council's mandate to streamline and simplify the entire administrative approval system in China. Announcement 11 is viewed as a milestone to the administrative approval system reform of the tax authorities with an ultimate goal to abolish *the Circular of the SAT on the Several Issues Related to Implementing the Tax Administrative Approvals* ("Circular 73") issued around twelve years ago.

Announcement 11 updated the catalogue of the tax administrative approval items in accordance with the *Administrative Approval Law* and the relevant administrative regulations. Only two administrative approval items in the catalogue under the Circular 73 in 2004 ("2004 Catalogue") are kept, namely, approval of printing invoices by enterprises and approval of the upper limit of the invoicing amount of VAT special invoices. Announcement 11 explicitly confirmed another five approval items that have been implemented over the years in practice as follows:

- Taxpayer's delay in tax payment;
- Taxpayer's delay in tax declaration;
- Taxpayer's change of the tax payment assessed by the tax authority;
- Verification on an enterprise income tax prepayment method apart from tax prepayment based on actual income;
- Non-resident enterprise's consolidation and payment of enterprise income tax under its principal site and establishment.

The above items are subject to approval by the competent tax authority pursuant to Announcement 11.

Announcement 11 also clarified and detailed the procedures for application for tax administrative approval in respect of required conditions, major steps, filing and approval timelines, documentary requirements and filing methods, etc.

It is also noted in Announcement 11 that the tax authorities are strengthening supervision on certain tax administration matters. Specifically, the tax authorities will examine applicants' credibility through the use of data technology and centralized online credit and information platform when they process the application. The tax authorities will also establish a joint punishment system to punish those taxpayers who have low credibility levels.

FURTHER CLARIFICATIONS ON TAX PAYMENT CREDIT ADMINISTRATION

In July 2014, the State Administration for Taxation ("SAT") initially published the *Measures for Tax Payment Credit Administration (Trial Version)* for purposes of collection, evaluation, determination, release and application of tax payment credit information of taxpayers conducted by tax authorities. Taxpayers with a better credit would enjoy much convenience in term of invoice purchase, faster tax filing process, import and export applications and so forth. Ever since, the SAT has promulgated several supplementary circulars to provide clarifications to local tax authorities on the relevant tax payment credit evaluation. On February 16, 2016, the SAT released the *Announcement of the State Administration of Taxation on Perfecting Matters relating to Tax Payment Credit Administration* ("Circular 9") to provide more information on the matter.

Circular 9 mainly covers three matters:

(1) First, as a result of the recent system upgrade, the tax authorities can perform a dynamic adjustment on the tax payment credit evaluation process.

(2) With the new system, the tax authorities would publish a list of enterprises that are under A-rating. Taxpayers with credit ratings of B, C and D would need to perform separate checking with the tax authorities.

(3) More importantly, Circular 9 provides clarification on the "point deduction" mechanism to deal with non-compliance behaviors.

Circular 9 takes effect from March 1, 2016.

MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

Starting from February 1, 2016, the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* ("Convention") has come into force in China. The Convention was signed by the PRC government on August 27, 2013 and was approved by the legislation body on July 1, 2015. The actual implementation date of the Convention in China is January 1, 2017.

On January 18, 2016, the State Administration of Taxation ("SAT") released the *Announcement of the State Administration of Taxation on Enforcement of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters* ("SAT Announcement [2016] No. 4"), which sets forth the general principles for implementation of the Convention within the territory of China (Hong Kong and Macau are expressly excluded).

The Convention applies to all taxes collected and monitored by the tax authorities. In other words, other types of taxes or levies which are collected by other government bodies (such as Customs duty collected by Customs authorities) are excluded from the scope of this Convention, and the Chinese government will not provide any form of assistance in relation to such taxes under this Convention.

The form of "administrative assistance" to be provided by the Chinese government to other contracting states is merely restricted to exchange of information. The Chinese government will not assist other contracting states in collection of tax payment or preservation of the taxpayers' properties. Nor will the Chinese government provide any assistance in terms of document service, and other contracting states are not allowed to service the legal documents in China by post. According to the instrument of ratification of the Convention (submitted by the Chinese government to OECD in October 2015), the abovementioned areas are reserved by the Chinese government and not subject to the Convention.

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