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The US-China Trade War And Impacts on China Tax Policy and Practice

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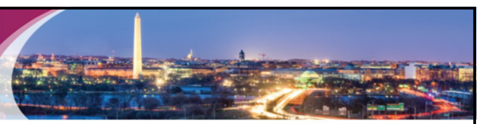


Today's Topics

- Overview of China Tax Regime – Carrots and Sticks
- Trends in Chinese Tax Audits and Practical Strategies
- China Tax Flashpoints: Royalties & Transfer Pricing
- Balance with Foreign Investment: Export VAT Rebate Strategy

Overview of China Tax Regime – Carrots and Sticks

- The primary categories of tax in China include:
  - Value-added tax 增值税
  - Enterprise income tax (“EIT”) 企业所得税
  - Individual income tax (“IIT”) 个人所得税等

- Other categories of tax in China include：
  - Stamp duty 印花税
  - Real estate property tax 房产税
  - Land use tax 土地使用税
  - Urban maintenance and construction tax 城市维护建设税

Overview of China Tax Regime – Carrots and Sticks

- VAT tax rebates and exemptions
  - For export of goods, a Chinese company can generally obtain an export tax rebate
  - For export of services, a Chinese company can generally obtain a tax exemption

- If a Chinese company pays royalties to a U.S. company, the Chinese company must pay VAT and withhold income tax on behalf of the U.S. company
  - Transfer pricing issues may come into play

- If a foreign enterprise assigns an expat employee to work at the Chinese company, beware of the application of the IIT and issues associated with permanent establishment/business nexus

Overview of China Tax Regime – Carrots and Sticks

- To counter the impacts of the trade war, China began reducing its taxes:
  - The VAT tax rate for goods was reduced；
  - The tax burden for small enterprises was reduced;
  - The deduction for R&D expenses was increased to reduce the EIT tax burden of high-tech companies;
  - The IIT tax rate was reduced as a part of the IIT reform.

Trends in Chinese Tax Audits and Practical Strategies

- Policy and enforcement adjustments in response to the trade war:
  - Tax authorities have been tasked to strictly implement the policy of tax reduction
  - On issues where tax laws may not be entirely clear and are subject to interpretation, such as transfer pricing, tax authorities tend to take a more conservative position
- Management of invoices (fapiao 发票) is a very important part of the strategy to manage China audits; China auditors rely heavily on invoice records
  - Many tax violation cases stem from fake invoices or real invoices that are incorrect or inaccurate

Trends in Chinese Tax Audits and Practical Strategies

- Chinese tax authorities are beginning to use data analytics to assist in its audits
  - Exchanging information with securities and stock registration agencies and real estate registration agencies
  - Requesting information from industry associations and statistical reporting organizations
  - Linking the various databases to create the necessary data analytics for comparison between companies of the same industry or other companies with similar risk profile

China Tax Flashpoints: Royalties & Transfer Pricing

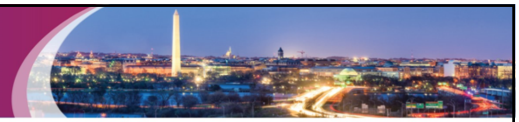
- China's transfer pricing system which is part of the China corporate tax law is similar to those of the US
- US invested enterprises have faced a large amount of EIT as a result of transfer pricing adjustments
- Chinese companies' payment of royalties to overseas affiliates may be seen as diversion of profits overseas, which can result in adjustments in transfer pricing
  - Transfer pricing issues can result from related-party transactions in both tangible and intangible assets, including transactions involving sales of stock

China Tax Flashpoints: Royalties & Transfer Pricing

- The strategy to managing transfer pricing risks is to ensure arm-length transactions and to prepare accurate and complete documentation
- Royalties are paid based on use of patents or other non-patent technologies, trademark or copyright; the use of such rights must objectively exist
- Royalties and service fees are often connected; however, it may be more beneficial to keep them separate if possible, rather than confusing the two

Balance with Foreign Investment: Export VAT Rebate Strategy

- To manage China export rebates, it is important to keep good records of the VAT invoice, especially the input VAT invoice, as the basis of export rebate claims
- The use of special customs zones can allow for early tax rebate; movement of goods to a special customs zone is considered export, even though the goods have not physically left China
- To avoid the hassle of dealing with export rebates, a company can conduct its processing in bonded zones



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