EBNER
STOLZ

Published by Financier Worldwide Ltd

ANNUAL REVIEW **Reprint** April 2020

Global tax

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in global tax.

China

GERALD NEUMANN
Ebner Stolz China
Partner
+86 21 6330 9962 807
gerald.neumann@
cn.ebnerstolz.com

Dr Gerald Neumann is a partner at Ebner Stolz and a fully qualified lawyer specialising in tax and controlling. He has been engaged in the financial services sector in China for more than 11 years and has an excellent understanding of corporate structuring and financing. His practice focuses on tax advisory and financial controlling, corporate structuring, risk management, due diligence and business audits. Prior to his work in China, he worked at Deutsche Bank.

Q. Could you outline what you consider to be the key developments relating to tax regulations that you have seen in China over the last 12-18 months?

NEUMANN: In the past 12 to 18 months, the most important tax regulations development was the implementation of the revised PRC Individual Income Tax (IIT) Law, under which tax burdens can be reduced as more deductions can be claimed. For foreign expats, the new IIT Law, as well as a series of additional tax regulations, implies that significant allowances, such as housing and education, for expats will be abolished from 2022. In terms of VAT, standard VAT rates have been gradually reduced from 17 percent to 13 percent, especially for sales and the import of goods, with further incentives for VAT refunds also introduced. Additionally, from 1 January 2019 to 31 December 2021, enterprises that generate small profits can enjoy preferential corporate income tax rates between 5 and 10 percent.

Q. What factors are driving the political agenda on tax-related decisions? Does there seem to be a motivation to get tougher on tax enforcement, for example?

NEUMANN: China intends to push domestic companies into more tax-compliant behaviour. Therefore, tax rates have been lowered, but, at the same time, Chinese tax authorities are executing tax laws more strictly. For foreign investors, this is good news. Previously, foreign companies that strictly observed local rules were often at a disadvantage compared to domestic companies, especially in the midcap size, which do not have such strict internal compliance regulations. Furthermore, since the Chinese economy does not enjoy the growth rates of previous years, the effective execution of tax laws guarantees sufficient tax income for state and local governments.

Q. To what extent is transfer pricing a key challenge for multinational enterprises? Are too many companies underestimating the importance of compliance and risk management in this area?

NEUMANN: Chinese tax authorities are quite active in the administration of transfer pricing (TP). They observe base erosion and profit shifting (BEPS) developments, and tax regulations in China reflect BEPS results. We note that more multinational enterprises with subsidiaries in China deal with TP issues proactively. However, there are still many enterprises that do not take Chinese TP rules into account at a global level, and their approach is being challenged by Chinese tax authorities. Since the authorities usually have their own requirements, it is necessary for multinationals to consider TP rules as early as possible.

Q. How would you describe the tax laws in China as they relate to foreign entities? Has there been an effort to tighten laws and crack down on issues such as offshore tax jurisdictions?

NEUMANN: Foreign investors can pursue double tax agreements (DTAs) for tax relief or protection from double taxation. As of December 2018, China had concluded DTAs with around 110 countries and regions. China is also making efforts to revise longstanding DTAs that were concluded with counterparties years before, to bring treaties into line with the most recent version of the OECD model. On the one hand, updated DTAs generally provide favourable tax relief for foreign investors regarding capital gains, dividends and the assessment of service

permanent establishment. On the other hand, China has made continuous efforts to crack down on cross-border tax avoidance. For example, China promulgated the General Anti-Avoidance Rules (GAAR) in 2014. In 2017, China stipulated the administrative measures on special tax investigation, adjustment and mutual agreement procedure. Newly signed or amended DTAs have also included anti-avoidance articles. In recent years, China has strengthened its exchange of tax-related information with other countries or jurisdictions, such as the British Virgin Islands (BVI), Cayman and Bermuda, by entering into bilateral or multilateral information exchange agreements. All these measures make global tax planning more challenging.

Q. Have you seen an increase in tax disputes in China? What lessons can companies learn from their outcome?

NEUMANN: Tax disputes in China have increased over the last five years and are becoming more complex and diverse. Alongside an economic slowdown and a structural tax reduction in China, local tax authorities have been under pressure to generate revenue and have tended to be cautious with post-declaration review and tax investigations. In addition, the development of tax laws and tax collection methods are making tax non-compliance more visible to the tax authority. On the other hand, the concept of rule-of-law and taxpayers' awareness of their legal rights are constantly increasing, therefore taxpayers are increasingly willing to argue with the tax authority in the case of a dispute. The successful settlement of tax disputes is critical to business operations and a company's development. In China, companies can resolve tax disputes by negotiating with the tax authority, through administrative review or litigation, if necessary. In terms of litigation, the tax authority's success rate is 68 percent, compared to 8 percent for taxpayers, with a withdrawal rate of 28 percent. After weighing up the costs of tax litigation and the likelihood of success, most taxpayers still prefer an efficient and favourable negotiation with the tax authority to resolve the tax disputes. It is helpful to seek advice from tax advisers regarding tax defence strategies that can facilitate subsequent negotiations.

Q. If a company does find itself the subject of a tax-related audit, investigation or enquiry, what steps should it take to manage its relationship with tax authorities?

NEUMANN: Proper communication is always important during a tax audit. In recent years, Chinese tax authorities have started to use databases to select companies to audit. When a company is selected, tax officials should have already analysed the finances and chosen focus areas. Therefore, it is important for a company to help tax officials understand business models and any unique aspects which might cause financial irregularities. Besides, a company should demonstrate a willingness to cooperate with tax officials by preparing documents for review. Staff members involved in an audit should answer questions from tax officials in a fact-based fashion.

> *“The tax environment in China is in a state of flux. Serious inconsistencies exist in the interpretation, application and enforcement of Chinese legal and tax rules.”*

Q. What general advice would you give to companies on effective tax planning? How important is it to create tax efficient structures and improve internal functions and processes across the organisation?

NEUMANN: The tax environment in China is in a state of flux. Serious inconsistencies exist in the interpretation, application and enforcement of Chinese legal and tax rules. In recent years, the tax authority has dismissed ‘pre-approval’ requests on certain tax matters. Instead, the tax authority permits taxpayers to claim tax benefits based on the self-assessment of their eligibility for corresponding tax reliefs. The tax authority focuses more on post-declaration review, which places greater demands on taxpayer compliance and the quality of documentation. Indeed, when questioned, companies should be able to justify their tax treatment by presenting proper documentation. It may be necessary to seek professional tax advice in relation to proposed tax planning ideas, to foresee not only tax advantages but also potential risks. Moreover, companies may consider tailoring their internal functions and processes to the size of the business and the complexity of the tax matter, as well as regularly reviewing risk management systems so that they align with any regulatory changes. ■

www.cn.ebnerstolz.com

EBNER STOLZ

Ebner Stolz is a leading audit and tax firm in Germany providing audit, accounting and tax services. In China, the firm has two offices, in Shanghai and Beijing, and mainly supports investors from overseas seeking transparency and full compliance with tax and accounting regulations in China. All services come with a commitment to building lasting client relationships and the desire to help clients build, control and develop their investment in China.

GERALD NEUMANN
Partner
+86 21 6330 9962 807
gerald.neumann@cn.ebnerstolz.com

EILEEN WU
Partner
+86 21 6330 9962 808
eileen.wu@cn.ebnerstolz.com