2023 China macroeconomic and tax policy outlook

China Tax & Investment News

10 February 2023

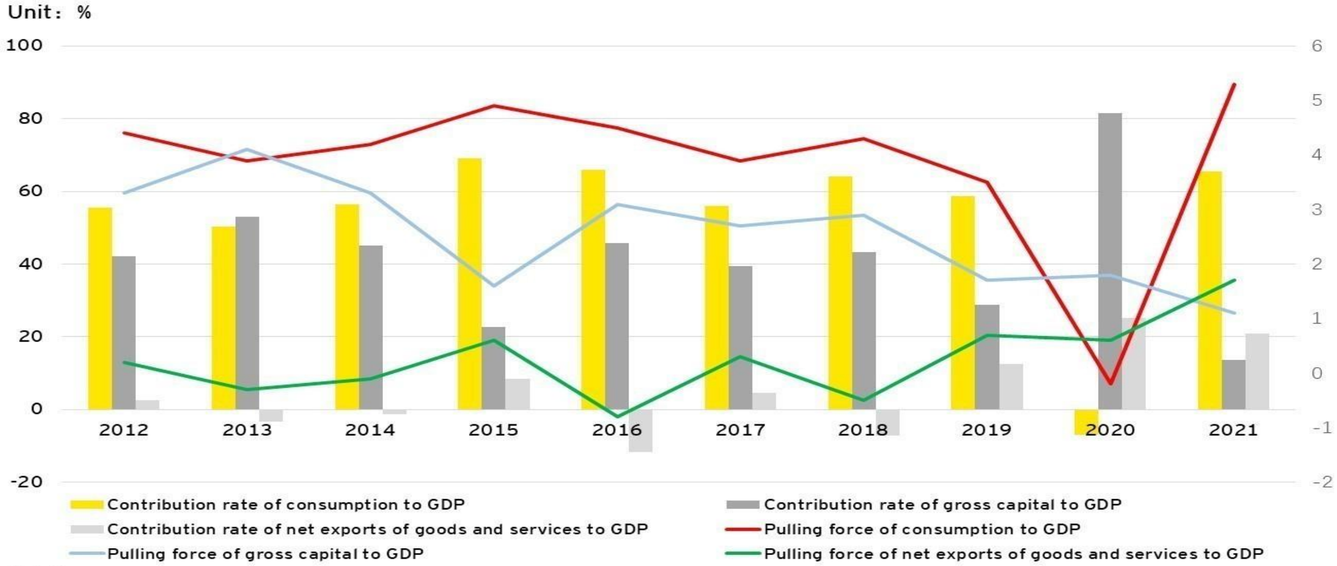
At the end of 2022, following the 20th CPC National Congress in October, China disclosed its priorities on economic policy for 2023 in a series of high-level meetings. A tone is set on China's upcoming focus on a gradual and steady economic recovery in 2023. Domestic consumption is expected to be the main force to boost economy rebound. On the other hand, certain tax policies are likely to be introduced to support the enhancement of overall economy. This newsletter summarizes the key points and shares with you our observations.

At the end of 2022, following the 20th CPC (the Communist Party of China) National Congress in October, China disclosed its priorities on economic policy for 2023 in a series of high-level meetings[1]. A tone is set on China's upcoming focus on a gradual and steady economic recovery in 2023. Domestic consumption is expected to be the main force to boost economy rebound. On the other hand, certain tax policies are likely to be introduced to support the enhancement of overall economy.

The Organization for Economic Cooperation and Development (OECD) forecasted in its latest report[2] a significant slowdown in global growth in 2023, which also matches China government's growth goal.

Note:
1. http://www.gov.cn/xinwen/2022-12/16/content_5732408.htm
2. OECD (2022), *OECD Economic Outlook, Volume 2022 Issue 2: Preliminary version*, No. 112, OECD Publishing, Paris, https://doi.org/10.1787/f6da2159-en

Contribution and pulling force of consumption, investment and export over GDP growth in recent 10 years (percentage)



Note：
1. Contribution rate refers to the ratio of the three major demand increments to GDP by expenditure accounting method
2. Pulling force refers to the product of GDP growth rate and the contribution rate
Source： National Bureau of Statistics

The priorities of the macroeconomic policy mentioned are summarized as follows:

- Fiscal
  - More accurate and specific tax cuts for targeted industries or areas
  - Enhanced supports and investments toward key sectors including technology innovation, environment protection, basic livelihood and regional coordination
- Monetary
  - Promotion on technology innovation, green development, infrastructure construction, small and micro-sized businesses, etc.
  - Appropriate supports on reasonable financing demand of property developers
- Industry
  - Upgrade traditional industries with the focuses on securing the core technologies in supply chains and improving the weak links
  - Cultivate strategic emerging industries (i.e., new energy, artificial intelligence, biological manufacturing, green and low-carbon, quantum computing)
- Foreign investment
  - Further open-up for market access, especially the modern service industry
  - Enhance the protection of intellectual property rights and legitimate interests of foreign investors
  - Proactively participate in high-standard global economic and trade agreements
- Technology
  - Focus on developing fully self-sustained core technologies
  - Enhance support for attracting high-end talents
- Employment
  - Stabilizing youth employment is the top priority

Key tax policy trends

Tax policies to expand domestic demand

Expanding domestic demand and stabilizing employment are the key missions this year as mapped out by China's high-level meetings while tax policies in the following areas will likely be introduced:

- More precise tax policy to adjust the allocation of tax revenue source – reasonable expansion of middle-income group and adjustment of high-income group
  - Improve direct tax system
  - Optimize Individual Income Tax system
  - Enhance tax administration on high-income individual taxpayers
- Cultivate more advanced or duty-free consumption in selected areas
- Improve tax policies including Customs Duties to support foreign trade businesses
- Expand Double Taxation Agreement (DTA) network

China's fiscal and taxation policies will shift from reducing taxes and fees for businesses to direct stimulation of consumption while some preferential tax policies introduced during the epidemic may be subject to adjustment or extension.

On the other hand, Chinese tax authority has also been strengthening its tax enforcement on high income or high net-worth individuals. Relevant taxpayers should closely observe any changes in tax compliance requests.

Tax legislation

China currently has 18 types of taxes, six of which have yet to be legislated:

- Value-added Tax (VAT): The draft VAT law was submitted on 27 December 2022 to the Standing Committee of the National People's Congress (NPC) for deliberation for the first time[3]. Compared to the current VAT regulations, the overall tax framework and tax burden remain unchanged. The draft law stipulates the taxpayer, scope of charge, tax rate, tax incentives, tax collection and administration, etc.
- Consumption Tax (CT): Public comments on CT Law (Discussion Draft) closed on 2 January 2020[4].
- Land Appreciation Tax (LAT): Public comments on the LAT Law (Discussion draft) closed on 15 August 2019[5].
- Customs Duty (CD): China's 2022 Legislation Plan[6] mentioned to submit the draft CD law to the Standing Committee of the NPC for deliberation. So far, no progress is revealed.
- Real Estate Tax (RET): The "14th Five-year Plan" mentioned to promote the legislation of RET. No major progress is expected in 2023.
- Urban Land Use Tax: No official information is disclosed.

The public consultation on the revised discussion draft of *Law of the PRC on the Administration of Tax Collection* had been completed in 2015. However, whether there will be any progress in 2023 is still uncertain.

Note:
3. http://www.npc.gov.cn/npc/c30834/202212/7e9c45995dc9435fbbed6b36edf17f46.shtml
4. http://www.gov.cn/xinwen/2019-12/04/content_5458247.htm
5. http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5136578/content.html
6. http://www.gov.cn/zhengce/zhengceku/2022-07/14/content_5700974.htm

Development on BEPS 2.0 Pillar Two global minimum tax

As of the date of this newsletter, vast majority of the 141 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), including China, have reached an agreement that certain multinational enterprises (MNEs) will be subject to a minimum 15% tax rate[7]. On 2 February 2023, the OECD/G20 Inclusive Framework on BEPS released the *Agreed Administrative Guidance for the Pillar Two GloBE Rules*[8] to assist governments with implementation of the landmark reform to the international tax system.

Some jurisdictions have made responses (please refer to some highlights below). Chinese Mainland has launched consultation on implementation of BEPS 2.0 Pillar Two on 18 January 2023, and the public comments will close on 17 February 2023[9].

Jurisdictions	Response
Chinese Mainland, New Zealand, Australia, Netherlands	Launched consultation on implementation of BEPS 2.0 Pillar Two
Korea	The domestic tax law on global minimum tax has been released and will take effect from 1 January 2024
Hong Kong SAR, Canada, Ireland	Mentioned in their budgets that BEPS 2.0 Pillar Two will be introduced
Singapore, Germany, Malaysia, France, United Kingdom, Switzerland	Confirmed or plan to implement BEPS 2.0 Pillar Two
United States	No major progress on implementation
European Union (EU)	Members have reached an agreement on implementing BEPS 2.0 Pillar Two global minimum tax in the form of an EU directive

Tax audit trend

China tax authorities have been conducting tax investigations on specific industries by observing economic cycles and industry development status, as well as specific issues with regards to particular industries or transactions. It can be observed that random tax audits may also be conducted more frequently by respective local tax authorities. The audit targets in past years have covered real estate, construction, automobile sales, pharmaceutical, trading, investment, technology. Up to now, there is no public information for any specified audit target list available.

It is also expected that China tax authorities will continue to carry out random tax inspections and strictly crack down on tax frauds particularly on invoice forging, falsifying invoices without valid transactions, defrauding export tax refunds, or fraudulent tax incentive claims[10].

For transfer pricing, China tax authorities are paying more attention to issues on low profitability of MNE subsidiaries in China, large amount of cross-border payments, outbound service fees, royalty fees and payments for ownership or use of IPs, continuous loss from significant inter-company transactions, etc.

For businesses enjoying tax incentives (such as High-and-New Technology Enterprises eligible for the reduced CIT rate of 15%), tax authorities are conducting robust and stringent reviews on these businesses by assessing whether the relevant conditions are genuinely met. Late payment surcharge and penalties could be imposed if any noncompliance is identified.

With the full launch of Golden Tax System (Phase IV), the digitalized tax administration in China is expected to move up to the new level. The State Tax Administration (STA) had clear indication that tax audit would also be further strengthened as empowered by the big data application. The selection of audit target would have closer link with those risk areas that Golden Tax System raises the red flag. Businesses are recommended to closely monitor the overall tax compliance status and internal control (e.g., tax filing, information declaration, and documentation management), in addition to keep track of the STA announcements of audit target list.

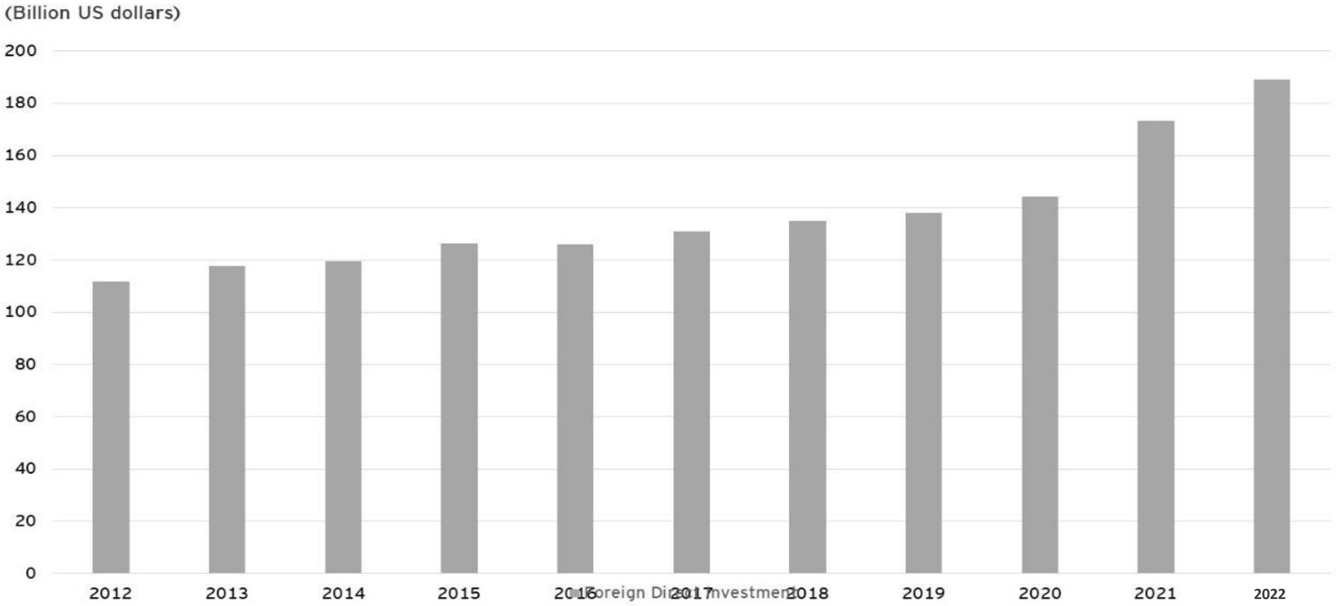
Note:
7. https://www.oecd.org/tax/beps/
8. https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf
9. https://www.casc.org.cn/2023/0119/237707.shtml
10. http://www.chinatax.gov.cn/chinatax/n810219/n810724/c5159465/content.html

Policies to support foreign investment

Further relax market access for foreign investors

China has been consistently opening up its market and foreign investments have been a key driver for economic growth. Based on China's official statistics, foreign direct investment (FDI)[11] inflows to Chinese Mainland revealed a steady growth in the past decade, and reached a record high of RMB1.15 trillion in 2021, i.e., up by 14.9% compared to the year before. In USD terms, the FDI inflows hit USD173.48 billion, surged by 20.2% on a year-to-year basis[12]. In 2022, FDI inflows to Chinese Mainland was RMB1,232.68 billion, an increase of 6.3% year-on-year. The figure expanded by 8% in USD dollar terms, i.e., USD189.13 billion[13].

China's FDI (2012 – 2022)



Source: Official websites of the Ministry of Commerce and National Development and Reform Commission

In 2023, China will further open market access to the modern service industry and shorten the negative list of foreign investment. Education, medical care and elderly care are expected to be the few sectors to further open-up[14]. In addition, as specified in the "14th Five-year Plan", China will gradually relax entry restriction of foreign capital into telecommunication, internet and culture sectors. It is expected that relevant rules will be piloted in the free trade zones first and then rolled out nationwide.

Further, China has launched comprehensive pilot program for expanding the open-up of service industry in Beijing, Tianjin, Shanghai, Hainan and Chongqing and will expand to six more cities including Shenyang, Nanjing, Hangzhou, Wuhan, Guangzhou and Chengdu[15]. On 10 January 2023, the Ministry of Commerce introduced the detailed implementation plans for these six cities.

Note:

11. excluding banking, securities and insurance, the same below
12. http://www.mofcom.gov.cn/article/xwfb/xwsjfzr/202201/20220103236797.shtml
13. http://de.mofcom.gov.cn/article/ywzx/202301/20230103379884.shtml
14. http://www.gov.cn/xinwen/2022-12/19/content_5732626.htm
15. http://www.gov.cn/zhengce/content/2022-12/20/content_5732723.htm

Simplified procedures for foreign investment tax incentive claim

- Deferred taxation for foreign reinvestment

  At present, foreign investors who reinvest in non-prohibited projects and derived dividends from resident enterprises in China are allowed to claim for withholding income tax deferral[16]. To be eligible, foreign investors shall meet the prescribed conditions and submit supporting documentation in accordance with the regulations. And under certain circumstances, the enterprise in China has the responsibility to ensure the information is complete and correct.

  To encourage foreign reinvestment, China has indicated in a recent Circular Fagaiwaizi [2022] No. 1586 ("Circular 1586")[17] that it will further optimize the procedures to facilitate foreign investors to enjoy the incentive. Detailed measures are yet to be announced.

- Import and export tax incentives for foreign-invested R&D Centers

  Currently, eligible foreign-invested R&D centers importing products for science and technology development are exempt from import-level tariffs, VAT and CT.[18]

  Although the specific procedures for enjoying the incentives may vary at the local level, in general, the following process shall be undertaken:

  1. Enterprise declaration
  2. Preliminary review by local commercial authorities
  3. Joint review by provincial-level commercial, finance and taxation as well as the local Customs, and a name list will be formally publicized

  For qualified foreign-funded R&D centers, follow-up re-assessment will generally happen once every two years.

  At present, the frequency and duration of the recognition of foreign-invested R&D centers vary among regions. For example, Xiamen generally launches recognition twice a year, and each takes about two months from the declaration to the release of the list of qualified centers[19]; in Shanghai, it happens once a year and relevant departments review the application materials within 45 working days[20].

  Circular 1586 proposed to simplify and optimize the recognition procedures of foreign-invested R&D centers. Whether there will be regulations standardizing the frequency and time of approval on a national basis is yet to be revealed.

Other supporting polices

China will further deepen its reform to streamline administration processes and improve the business environment. Local governments are also encouraged to introduce preferential policies within their authority to attract foreign investment or reinvestment. Recently, some regions have announced incentives including financial subsidies, such as Suzhou granting up to RMB10 million to eligible foreign reinvestment projects[21]. More regions are expected to introduce supportive policies.

Note:
16. Circular Caishui [2018] No. 102, STA PN [2018] No. 53
17. http://www.mofcom.gov.cn/article/zcfb/zcwgtz/202210/20221003360524.shtml
18. Circular Caiguanshui [2021] No. 23
19. Circular Xiashangwugui [2021] No. 4
20. Circular Hushangcujin [2021] No. 187
21. http://www.jiangsu.gov.cn/art/2022/10/25/art_33718_10642796.html

Conclusion

China will step up efforts to invigorate domestic demand and further boost consumptions in 2023. It has been consistently broadcasting and acting on a strong commitment to an advanced-level open-up strategy. With the continuous improvement in business environment and the implementation of robust supporting policies, China's huge market remains attractive to foreign capital.

It is expected that new measures and policies will be announced and implemented soon. We will keep you posted.

Contact us

For more information, please contact your usual EY contact or one of the following EY's China tax leaders.

Greater China Tax Leader
Vickie Tan
+86 21 2228 2648
vickie.tan@cn.ey.com

Our tax leaders by service segment

Andrew Choy
International Tax and Transaction Services
+86 10 5815 3230
andrew.choy@cn.ey.com

Becky Lai
Tax Policy
+852 2629 3188
becky.lai@hk.ey.com

Alan Lan
Global Compliance and Reporting
+86 10 5815 3389
alan.lan@cn.ey.com

Jesse Lv
ITTS – Transaction Tax
+86 21 2228 2798
jesse.lv@cn.ey.com

Travis Qiu
ITTS – Transfer Pricing
+86 21 2228 2941
travis.qiu@cn.ey.com

Chuan Shi
Tax Technology and Transformation
+86 21 2228 4306
chuan.shi@cn.ey.com

Carrie Tang
Business Tax Services
+86 21 2228 2116
carrie.tang@cn.ey.com

Bryan Tang
Indirect Tax – Global Trade
+86 21 2228 2294
bryan.tang@cn.ey.com

Paul Wen
People Advisory Services
+852 2629 3876
paul.wen@hk.ey.com

Kevin Zhou
Indirect Tax – VAT
+86 21 2228 2178
kevin.zhou@cn.ey.com

Our tax leaders by service areas

Andrew Choy (China North)
+86 10 5815 3230
andrew.choy@cn.ey.com

Ho Sing Mak (China South)
+86 755 2502 8289
ho-sing.mak@cn.ey.com

Wilson Cheng (Hong Kong SAR/Macau SAR)
+852 2846 9066
wilson.cheng@hk.ey.com

Heidi Liu (Taiwan)
+886 2 2757 8888
heidi.liu@tw.ey.com

Author – China Tax Center
Jane Hui
+852 2629 3836
jane.hui@hk.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

APAC no. 03016604
ED None.

ey.com/china

Follow us on WeChat

Scan the QR code and stay up-to-date with the latest EY news.