

Interpreting the taxation breakthrough in 2024: Shanghai piloting advance tax rulings to enhance tax certainty

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In brief

On 29 December 2023, Shanghai Municipal Tax Service of the State Taxation Administration issued the *Administrative Measures for Advance Tax Rulings by the Shanghai Municipal Tax Service (Trial)*¹ (HuShuiBanFa [2023] No. 33, hereinafter referred to as the “Measures”). As the first set of formal advance ruling procedures released by a provincial or equivalent tax authority in China, it is a landmark in tax administration services. Starting now, enterprise taxpayers in Shanghai can request for advance rulings regarding the application of tax laws and regulations to proposed complex tax matters. The advance tax ruling regime will provide taxpayers, particularly enterprises involved in mergers and acquisitions (M&A), and those expanding into emerging markets, with greater tax certainty. Advance tax rulings will assist these enterprises in better evaluating tax costs and making informed business decisions.

In detail

Background

An advance tax ruling seeks to promote tax certainty and reduce tax disputes. Although there is no national advance tax ruling system in place, local tax authorities have in recent years sought to provide advance rulings as a customised service for large enterprises. In 2021, the State Council issued the *Opinions on Further Deepening the Reform of Tax Collection and Administration*, which urges efforts to “explore the implementation of advance tax rulings for large enterprises and establish a comprehensive system.” At the local government level, in 2020, the Nansha District of Guangzhou released the *Interim Measures for Advance Tax Rulings on Complex Tax Matters (Trial)*. In 2021, Guangzhou and Shenzhen issued the *Interim Measures for Joint Advance Rulings on International Tax Matters (Trial)*. In 2022, Zhuhai, Zhongshan and Hengqin jointly released the *Memorandum of Cross-Regional Coordination in International Tax Services*, and in the Yangtze River Delta region, the coordination of advance tax rulings for large enterprises has been piloted. For more details of local efforts in advance tax rulings, please refer to *China Tax/Business News Flash Issue 20*² of 2022. The release of the Measures by the Shanghai Municipal Tax Service marks the first extensive implementation of advance rulings by a tax authority at provincial and municipal levels in China. This move is expected to help foster a friendly tax and business environment and set a benchmark for high-standard tax services.

Scope of application of the Measures

According to the Measures, “advance tax rulings” refer to a service provided by tax authorities to enterprises, based on the principle of mutual trust, to clarify in writing the application of tax laws and regulations to specific complex tax matters that may arise. We summarise the scope of application as follows:

Taxpayers: The Measures is applicable to enterprise taxpayers based in Shanghai. In other words, it does not apply to natural person taxpayers. Additionally, although the competent department for advance rulings is responsible for large enterprise administration, the Measures is not limited to large enterprise taxpayers. Non-Shanghai based taxpayers are not covered by this Measures. Therefore, in case of a transaction involving cross-provincial matters or taxpayers from both Shanghai and other provinces/cities, such as the merger of a Shanghai-based enterprise into a Guangdong-based enterprise, it may not be possible to apply for an advance ruling from the Shanghai Municipal Tax Service. Even if a ruling can be obtained for the Shanghai-based enterprise, it may not be applicable in Guangdong. However, the Measures mentions that the Large Enterprise Administration Department (LEAD) under the Shanghai Municipal Tax Service will actively promote cross-provincial cooperation, and facilitate the integrated development of advance tax rulings for large enterprises in the Yangtze River Delta region. Therefore, it is possible to resolve cross-provincial tax matters in the Yangtze River Delta using the regional advance ruling system.

Tax types: The Measures does not explicitly limit the applicable tax types. Therefore, common types of taxes, such as Corporate Income Tax (CIT), Value-added Tax (VAT), Consumption Tax and Stamp Duty, can be ruled on in respect of how they are applied to the specific circumstances. Additionally, while natural person taxpayers are not covered by the Measures, enterprises, acting as tax withholding agents, often encounter uncertainties when dealing with Individual Income Tax (IIT). The Measures does not literally exclude the possibility of enterprises applying for advance tax rulings on IIT treatment. However, as tax authorities are not responsible for taxes on imports and exports such as tariffs and import VAT that are collected and administered by Customs, such types of tax should not be applicable under the Measures.

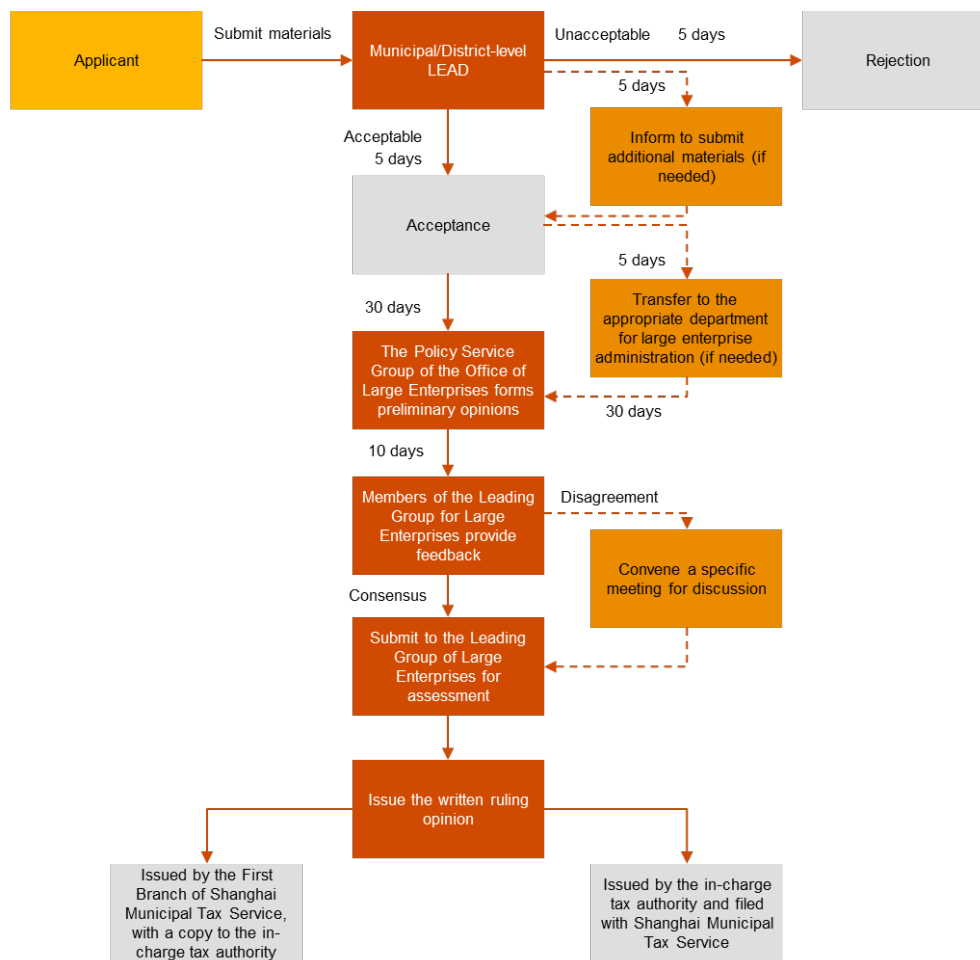
Matters: Advance rulings apply to complex tax matters that are “expected to take place in the future” for enterprises, and do not apply to past matters, project plans that are not seriously considered, or matters that will not occur within the next two years. This means that enterprises can apply for advance rulings on proposed transactions that are expected to be conducted within two years to clarify the tax treatment. In addition, advance rulings are not applicable in cases where there are already clear provisions in existing tax laws and regulations that can be directly applied. For example, advance rulings on VAT rate are not applicable when an enterprise plans to sell a new product for which the VAT rate of 13% is clearly stated in the tax regulations. However, if an enterprise intends to pursue a new business model that the existing tax laws cannot be directly applied and requires analysis and judgment based on the actual situation, it can request clarification by means of advance rulings on how the tax laws shall be applied. The Measures also stipulates that advance rulings shall not be applied to matters that have no reasonable commercial purpose or that are prohibited by national laws and regulations. Therefore, advance rulings are not applicable where the purpose of an enterprise’s proposed transaction is to avoid paying tax. The Measures does not apply when it comes to Advance Pricing Arrangements as they are covered under another procedure. As the Measures does not set an amount threshold, we believe that there is no limit on the transaction amount on advance rulings by the Shanghai Municipal Tax Service.

Request, assessment and decision on advance rulings

Processes: Enterprises can apply for an advance tax ruling to the LEAD at either the municipal or district level, which then decides at its own discretion the responsible department for accepting the request and forwards it to the appropriate department. The Leading Group for the Taxation of Large Enterprises (hereinafter referred to as the “Leading Group for Large Enterprises”) is responsible for the overall advance tax rulings. Specifically, the accepted request will be forwarded to the Office of the Leading Group of Large Enterprises (hereinafter referred to as “the Office of Large Enterprises”) which coordinates the overall efforts. The Policy Service Group of the Office of Large Enterprises will formulate the preliminary opinions and solicit feedback from members of the Leading Group of Large Enterprises. Alternatively, the Office of Large Enterprises will convene a specific meeting to discuss the matters. After a consensus is reached, the request will be submitted to the Leading Group of Large Enterprises for assessment. Then, the Shanghai Municipal Tax Service or the in-charge tax authority will issue a stamped written *Advance Tax Ruling Opinion* to the applicant. The Measures does not clarify the respective administrative authorities of the municipal and district-level departments. For example, whether the geographical location, the complexity or taxable amount of transactions will be used in determining the scope of authority. In practice, it is critical to know which level of tax authorities enterprises need to communicate with on the rulings. Enterprises should communicate with the tax authorities in this regard before filing an application.

Documents: The applicant should submit the following materials, including the *Application Form for Advance Tax Rulings*, the *Notice of Consent on Advance Tax Rulings*, necessary documents of approval or ruling by relevant authorities (if any), relevant supporting materials such as contracts, agreements, meeting minutes or feasibility study reports, and other materials required by the tax authorities. It should be noted that in the *Application Form for Advance Tax Rulings*, the applicant must specify the matters, opinions, impacts on operation and taxation, the information of member enterprises and other enterprises involved, the taxation period involved and the policy basis. In other words, it requires the applicant to have a relatively clear tax analysis of the matter, so that the tax authorities can make the tax decision more efficiently. The ruling obtained may also be revoked if the application materials are not legitimate, authentic, accurate or complete.

Timetable: The Measures clearly lists the timetable for accepting and turning over the request, forming preliminary opinions and soliciting feedback, making the whole process quite efficient. If all goes well, the applicant may obtain the advance tax ruling within 3 months. Tax can sometimes be the deciding factor on whether a transaction can go ahead. Efficient advance tax rulings help applicants to assess the tax costs of the whole transaction. The diagram below provides a reference for enterprises to understand the application process and timetable for the ruling:



Enforcement and follow-up administration of advance rulings

The Measures does not mention whether the advance rulings are legally binding on the tax authorities and taxpayers. Under the current tax system, advance rulings are “customised tax service initiatives” for enterprises, not “administrative actions” that materially affect the rights and obligations of enterprises, and are therefore not subject to reconsideration or litigation. However, the Measures stipulates that advance rulings can be applied if the application materials are legitimate, authentic, accurate and complete and the matter ruled on is consistent with the actual tax matters of the applicant, provided that the basis for the ruling has not changed. This means that the advance rulings decision can be relied on and allows enterprises an option to apply them when appropriate.

It must be noted that advance rulings are issued on a case-by-case basis. The ruling applies only to the transaction applied by the applicant. Even if other taxpayers have similar transaction or the same taxpayer has other unruléd transactions, the ruling cannot be directly applied. In addition, the matters subject to the ruling and the tax policies on which the ruling is based may change over time. If such changes have any material impact on the ruling, the applicant shall notify the in-charge tax authorities within 30 days from the date of such changes, or considers re-applying for another advance rulings if necessary. The in-charge tax authorities will follow up on the advance ruling and the actual business activities of the applicant, and can request to terminate or revoke the rulings when there are substantial changes identified.

The takeaway

The Measures released by Shanghai Municipal Tax Service has a broad application scope, a clear timetable and well-defined scope of responsibilities. It will greatly enhance tax certainty and reduce tax risks for enterprises. This is particularly helpful for enterprises with frequent M&A transactions, seeking IPOs or planning to venture into new markets.

The advance tax ruling regime is new to the market and is still in a trial phase. Moreover, matters to be ruled are generally complicated, for example, involving restructurings, overseas indirect equity transfers, significant assets loss deductions, equity incentives, the partnership tax system, and special business models, which requires tax authorities to devote considerable resources for assessment. Therefore, it is important for enterprises to conduct a pre-application in-depth analysis and communication with the tax authorities at the initial phase. Enterprises seeking for such rulings should take early actions. We also hope that, with the Shanghai experience, this advance ruling regime can be extended beyond Shanghai to other regions in China to provide greater certainty and consistency in tax matters across the country.

Endnote

1. *Circular on Issuing the Administrative Measures for Advance Tax Rulings by Shanghai Municipal Tax Service (Trial)*
<https://shanghai.chinatax.gov.cn/zcfw/zcfgk/zhsszc/202312/t469904.html>
2. *China Tax/Business News Flash Issue 20 of 2022: Exploring cross-regional tax advance rulings to better support the national strategy for coordinated regional development*
<https://www.pwccn.com/zh/china-tax-news/2022q3/chinatax-news-aug2022-20.pdf>

Let's talk

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