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Tax Newsflash

China

Deloitte Tohmatsu Tax Co.

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State Council Calls for Changes to Local Preferential Policies

China's State Council issued a notice (Guofa [2014] No. 62) on 9 December 2014 that requires the ministries of the State Council and local governments to "clean up" and regulate preferential policies (e.g. tax incentives). Specifically, existing local incentives that violate state laws will have to be abolished; incentives that are not in violation of state laws and that are deemed to be essential to the regional/local government will have to be approved by the State Council. Local governments are required to take appropriate actions by 31 March 2015.

(1) Background

In recent years, some local government authorities have introduced preferential policies to promote regional economic development. Notice No. 62 acknowledges that these policies have been instrumental in boosting local investment and industrial growth, but points out that certain policies have distorted market competition and even given rise to international trade disputes. As a result, the State Council has decided to launch an initiative to cut back on preferential policies (in particular, those issued by local governments) in order to create a level playing field for all investors and enterprises.

(2) Regulation of preferential policies

1) Authority to issue tax incentives

Notice No. 62 provides that local governments may not introduce their own tax incentives unless so empowered by specific laws (for example, the local governments of the autonomous regions have discretion to provide some tax reductions or exemptions within a range prescribed by the Law of Regional Autonomy for Ethnic Minorities). The ministries may not formulate preferential policies when drafting laws, regulations and other policy documents without the approval of the State Council.

2) Administration of non-tax government income

The notice specifies that the following activities are not permitted:

- The reduction, waiver or deferred collection of government charges, or the assignment of land use rights for no consideration (or a consideration lower than market price) that is in violation of state laws;
- The transfer of state-owned assets, shares of state-owned enterprises or state-owned resources for a consideration lower than market price; or

- The reduction, waiver or deferred collection of social security charges that is in violation of state laws, or the granting of a lower contribution rate to enterprises without the approval of the State Council.

3) Administration of government expenditure

Notice No. 62 calls for the abolition of preferential policies which are in violation of state laws and in which the amount of an incentive granted is linked to the amount of tax (or non-tax) revenue contributed by the enterprise and/or its investor (or the relevant management) to the local government. According to the notice, such policies may take various forms, such as "collect, then refund," financial awards or subsidies, government subsidies for the purchase of land, etc.

The notice also calls for further regulation, although not the immediate abolition, of certain other preferential policies, such as the government paying certain business expenses on behalf of an enterprise, granting favorable rates for utilities, company relocation awards, etc.

(3) Cleaning up of existing preferential policies

According to Notice No. 62, relevant ministries and all local governments are required to carry out an investigation of their existing preferential policies, including those granted and documented in agreements, memorandum or meeting minutes with relevant enterprises. Policies that are in conflict or inconsistent with state laws must be formally abolished. Preferential policies that are deemed to be essential by the relevant ministries or local governments will have to be reviewed by the Ministry of Finance and reported to the State Council for approval. Detailed reports of the investigations must be submitted to the Ministry of Finance by the end of March 2015.

(4) Deloitte comments

Notice No. 62 has generated considerable concern among businesses about the sustainability of various incentives (in particular, financial subsidies) granted by local governments. Although it remains to be seen whether the notice will be strictly enforced, it appears that some local governments seemed inclined to take a wait-and-see approach, meaning that the granting and negotiating of preferential policies will not be effectively deterred at this stage. Some local officials seem cautiously optimistic about the probability of being able to continue to offer certain preferential policies in the future.

Since the local governments need to take action before 31 March 2015, the next few months will be critical. Affected businesses should proactively communicate with the local authorities, closely monitor developments and take appropriate steps to address the uncertainties and potential negative financial impact of Notice No. 62. We will maintain close contact with various local governments and share any updates as they occur.

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