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# Tax Newsflash

**China**

**Deloitte Tohmatsu Tax Co.**

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## State Council Suspends "Clean-up" of Preferential Policies

China's State Council issued a notice (Guofa [2015] No. 25, Notice 25) on 11 May 2015 that suspends the "clean-up" of preferential policies initiated in the year-end of 2014. The clean-up (set out in Notice 62) required local governments to review and abolish any local incentives that violated central government policies/law, and required State Council approval of incentives that did not violate central government policies/law but that were considered essential to the local/regional government. Local governments were required to report the status of these policies to the Ministry of Finance by the end of March 2015.

Notice 25 now suspends the clean-up initiative indefinitely, but indicates that it will be re-instituted at a future date. The notice also clarifies the following with respect to preferential policies:

- Policies that were granted by local governments and various departments of the State Council for a specific term will remain in effect for that term; the relevant governments/departments should establish a transitional period properly for policies that were granted without a termination date and need to be abolished, and such policies will remain in effect for the transitional period.
- Policies granted under contracts or agreements with local governments will continue to be valid, and any benefits that already have been granted will not be clawed back.
- If a local government/department wishes to introduce a new preferential tax policy, the policy must be approved by the State Council, unless otherwise stipulated by law or regulations. Where approval from the State Council is not required (e.g. certain nontax preferential policies), a preferential policy generally may not be in the form of a government subsidy linked to tax or nontax revenue contributed by enterprises.

### Observations and comments

The purpose of the clean-up was to create a level playing field for investors and enterprises, by mandating that local governments eliminate preferential policies that were identified as being in conflict with or inconsistent with central government policy/law. It was designed to dissuade local governments from engaging in what effectively amounted to "bidding wars" to compete for foreign or local investment.

Notice 62 gave rise to considerable concern and confusion on the part of businesses about the sustainability and future of various incentives (in particular, financial subsidies) granted by local governments; this intensified when some governments discontinued preferential treatment or put them on hold.

Local governments were concerned about the potential negative impact of Notice 62 on investment and how it would affect the government’s credibility. A lack of standards and consistent interpretations made it difficult to determine whether a specific policy conflicted with central government policy, which resulted in some disputes.

Notice 25 is the central government's response to the concerns articulated by the business community and local governments. The notice is particularly welcomed by businesses because it confirms the validity of contractually agreed upon policies and commits to a "no-claw back" rule for previously granted benefits.

Although the clean-up of preferential policies is suspended, Notice 25 indicates that the regulation of preferential policies will continue, albeit in a more benign manner. Based on Notice 25 and our communications with certain government officials, it appears that local governments still have some discretion to grant financial subsidies to certain encouraged businesses, provided the amount of the subsidy is not linked to the tax or nontax revenue contributed by the business (e.g. one-time fixed amount subsidies) and, therefore, these policies are likely to continue.

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