

# Overview of the preferential tax policies in 2022 facing...COVID



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Starting from 2020 when Wuhan was firstly hit by COVID-19, China has continuously been fighting the pandemic. By 2022, the COVID-19 variants have swept the world and started to hit the country, the enterprises, especially the small-sized ones, have suffered continuous business decline and uncertainty.

To support the businesses financially, in the past two years, the Chinese government issued a series of tax preferential policies covering various types of tax, such as enterprise income tax, VAT, local taxes, etc. In 2022, the government continues to make such efforts, by not only maintaining or updating the existing preferential policies, but also rolling out some additional preferential measures. The overall tax refunds and deductions granted under the new measures are expected to reach 2.5 trillion RMB for the year 2022, compared to 1.1 trillion RMB last year.

In this article, we will summarize the main tax cuts put in place in 2022 aiming at relieving enterprises from their difficulties due to the pandemic.

## **1. EXPANSION OF THE REGIME OF VAT CREDITS REFUND**

The implementation of so-called «large-scale VAT credits refund» was first proposed by Premier Minister LI when he delivered his speech on the «Government Work Report» at the National Congress held on March 5, 2022, then officially introduced by the State Administration of Taxation («SAT») in late March and effective from April 1, 2022.

As a reminder, before April 2019, the excess or unutilized input VAT owned by an enterprise were not refundable and could only be carried forward to the subsequent taxation periods for deduction. Starting from April 2019 and as a part of Chinese VAT reform, qualified taxpayers were allowed to apply for the refund of incremental VAT credits (meaning the ones newly added after March 31st, 2019) subject to certain conditions and an amount limit (i.e. 60%). The manufacturing enterprises could however get the full refund without amount limit (hereinafter «Full Refund Regime»).

As from April 1, 2022, the Full Refund Regime is expanded from manufacturing industries to all small and micro enterprises («SMEs»), as well enterprises operating in some other key sectors to be supported (such as scientific research and technological services, software and IT services, environmental protection services, etc. («Key Sectors»)). In short, the qualified enterprises can now apply for the **full refund of incremental VAT credits on a monthly basis**.

In addition to the refund of incremental VAT credits, as a quite welcome incentive, the above-mentioned enterprises can also obtain a **one-shot refund of their historical unutilized VAT credits** (i.e. the excess input VAT generated before April 1, 2019) following the below timetable:

- Micro enterprises: application starts in April 2022
- Small enterprises: application starts in May 2022
- Medium enterprises in the Key Sectors: application starts in July 2022
- Large enterprises in the Key Sectors: application starts in October 2022

No time limit has been imposed so far for the submission of the application.

The SMEs eligible for the regime shall refer to the <Classification Standards for Medium and Small sized-Enterprises> issued by the Ministry of Industry and Information Technology (Regulation [2011] No.30) using criteria in terms of business revenues, number of employees, total assets or a combination of these. The criteria in the Classification Standards vary largely depending on the industry in which the enterprise operates.

Finally, a taxpayer must meet the following general conditions in order to enjoy VAT credits refund:

- i) The taxpayer has a tax compliance rating of A or B;
- ii) There are no records of tax fraud or non-compliance related to VAT for the 36-month period before the application;
- iii) There are no records of being punished two or more times by the tax authorities due to the tax evasion for the 36-month period before the application;
- iv) The taxpayer has not enjoyed certain VAT preferential treatments since April 1, 2019.

The new policies will help to relieve significantly the cash flow pressure of the enterprises during this difficult period. According to a rough estimation, the overall VAT credits refunds at national level would be 1.5 trillion RMB for the year 2022.

## **2. FURTHER ENTERPRISE INCOME TAX (“EIT”) REDUCTION FOR SMALL LOW-PROFIT ENTERPRISE**

On March 14, 2022, the Ministry of Finance (“MOF”) and the SAT made a joint announcement to further reduce the effective EIT rate of Small low-profit enterprise (“SLPEs”).

An enterprise shall meet all the following requirements to be considered as a SLPE:

- i) enterprise is engaged in business activities not restricted or prohibited by the government,
- ii) annual taxable income is no more than RMB 3 million,
- iii) employees are no more than 300, and
- iv) total assets amount is no more than RMB 50 million.

Based on the EIT Law, the EIT rate for SLPEs is 20% instead of 25% (standard EIT rate). However, since years, only a part of taxable income needs to be taxed according to a series of incentive policies, which leads to even lower effective EIT rates. Now, effective from January 1, 2022, the EIT taxable basis is further reduced for the portion of taxable income between RMB 1 million and 3 million. The current situation is summarized below:

| Annual taxable income of SLPE                             | Effective EIT rate                                     |                                     |
|---|--|-------------------------------------|
|   | Jan 1, 2022 – Dec 31, 2022                             | Jan 1, 2023 – Dec 31, 2024          |
| The portion of amount no more than RMB 1 million          | <b>2.5%</b><br>(i.e. 12.5% annual taxable income *20%) | No more than 5%, but not yet issued |
| The portion of amount between RMB 1 million and 3 million | <b>5%</b><br>(i.e. 25% annual taxable income * 20%)    |                                     |

## **3. VAT EXEMPTION FOR SMALL-SCALE TAXPAYERS**

On March 24, 2022, the MOF and the STA released a new announcement clarifying issues related to VAT exemption for small-scale VAT taxpayers.

The small scale VAT taxpayers mainly refers to taxpayers whose annual taxable sales value is less than RMB 5,000,000.

According to announcement, from April 1, 2022 to December 31, 2022, small-scale VAT taxpayers that are subject to a VAT levy rate of 3% will be exempted from VAT collection or pre-collection. Small-scale VAT taxpayer who is exempt from VAT issues VAT ordinary invoice, while Small-scale VAT taxpayer who gives up VAT exemption should issue VAT special invoice mentioning 3% VAT rate.

#### **4. INCREASED RATIOS FOR SUPER TAX DEDUCTION OF R&D EXPENSES**

Since 2018, when an enterprise incurs R&D expenses that do not form intangible assets and are included in the current profits and losses, in addition to the actual deduction, an additional 75% of such R&D expenses could be deducted for the purpose of EIT calculation. If R&D expenses have formed intangible assets, they can be amortized for EIT purpose at 175% of the actual cost of intangible assets.

In 2021, the two ratios have been increased to **100%** and **200%** respectively for enterprises in the manufacturing sector. As a move to further help small enterprises facing the continuous pandemic, starting from January 1, 2022, the application of increased ratios have been expanded to all small and medium-sized technology enterprises ("**SMTEs**"). In short, R&D expenses could be deducted by double from the taxable income of SMTEs.

The SMTE under this regime is defined by the *<Measures of Assessment for SMTEs>* (Guokefazheng [2017] No.115) and shall meet the following size-related criteria:

- The number of employees is no more than 500; and
- The annual sales revenue is no more than RMB 200 million; and
- The amount of total assets does not exceed RMB 200 million.

Furthermore, the products and services provided by the enterprise shall not be the ones prohibited, restricted or obsoleted by the State.

The scope of R&D expenses is stipulated by Circular Caishui [2015] No. 119 and SAT Bulletin [2017] No. 40.

#### **5. EXPANSION OF ONE-SHOT TAX DEDUCTION FOR NEW EQUIPMENT PURCHASES FOR MEDIUM, SMALL AND MICRO-SIZED ENTERPRISES ("MSMES")**

Since 2018, the purchase expenses of new machines, equipment and appliances (i.e. fixed assets other than real estate properties (the "**Equipment**")) with unit value exceeding RMB 5 million are allowed to be deducted for EIT purpose in one-shot in the year of acquisition. For the Equipment costing less than RMB 5 million, however, the purchase expenses had to be capitalized if the Equipment's useful life exceeds 12 months, then depreciated and deducted for EIT purpose over the depreciation years.

Following an announcement issued by the MOF and SAT on March 4, 2022, **MSMEs** may voluntarily opt for the one-shot tax deduction at a certain percentage for the Equipment newly purchased during the period from January 1, 2022 to December 31, 2022 **with a unit value of RMB 5 million or above**. In concrete terms:

- i) For the Equipment with a minimum depreciation period of 3 years as per tax law, **100%** of the unit value can be deducted on a one-off basis for the EIT calculation of the current year; and
- ii) For the Equipment with a minimum depreciation period of 4, 5 or 10 years, **50%** of the unit value can be so deducted, and the remaining 50% may be depreciated in the remaining years.

The MSMEs here refer to enterprises engaging in industries not restricted or prohibited by the government satisfying the following criteria:

- For enterprises in the construction, information transmission, leasing and commercial service industries: the number of employees shall be less than 2,000, or the business revenue shall be less than RMB 1 billion or the amount of total assets shall be less than RMB 1.2 billion;
- For enterprises in real estate development industry: the business revenue shall be less than RMB 2 billion or the amount of total assets shall be less than RMB 100 million; and
- For enterprises in other industries: the number of employees shall be less than 1,000 or business revenue shall be less than RMB 400 million.

In case a MSME does not choose to enjoy the one-shot tax deduction policy for Equipment purchase in the current year, it shall not change to enjoy the policies in the subsequent years.

## **6. EXTENSION OF THE TAX PAYMENT DEFERMENT FOR QUALIFIED MANUFACTURING COMPANIES**

A notice issued by the SAT in November 2021 allowed the MSMEs in the manufacturing industry to choose to defer the payment of some taxes and surcharges pertaining to the fourth quarter (Q4) of 2021, for 3 months. Medium-sized enterprises could defer 50% of taxes and surcharges, and small and micro sized enterprises could defer 100%.

Given the continuous pandemic situation, the SAT has decided, through a new announcement, to extend the deferral period for another 6 months for 2021 Q4 taxes. In addition, taxes and surcharges in terms of Q1/Q2 of 2022 can also enjoy the deferred payment up to 6 months.

The MSMEs eligible for this regime are enterprises that:

- engage in the manufacturing sector as per the national industry classification standard;
- have annual sales revenues of less than RMB 400 million (among which the small and micro enterprises are those whose annual sales are less than RMB 200 million).

Different from the criteria of MSMEs for the policy of one-shot tax deduction of equipment purchases (cf. Section 5), there is no requirement regarding the number of employees.

Finally, in case a manufacturing MSME already paid the deferrable taxes of 2021 Q4 and/or that of January 2022 before the announcement is issued in February, the enterprise can apply for the refund of taxes and surcharges paid and defer their payment according to the new relief measure.

The taxes and surcharges eligible for deferred payment include EIT, individual income tax, domestic consumption tax and domestic VAT plus surcharges, but exclude the withholding taxes and taxes paid when the tax authorities issue invoices upon the request and on behalf of enterprises.

## **7. EXPANSION OF THE SCOPE OF «SIX TAXES AND TWO SURCHARGES» REDUCTION**

The preferential regime regarding «six taxes and two surcharges», which previously only applicable to the small-scale VAT taxpayers, is now expanded to all SLPEs (even if they are not small-scale VAT taxpayers) and self-employed individuals and which application is extended to December 31<sup>st</sup>, 2024.

This regime allows local governments to reduce the «six taxes and two surcharges» within the limit of 50% cut.

The taxes and surcharges concerned are:

- Resources tax
- Urban maintenance and construction tax
- Real estate tax
- Urban land use tax
- Stamp duty
- Farmland occupation tax
- Education VAT surcharges
- Local education surcharges

Taxpayers who meet the conditions but fail to claim the reduction in time can either ask to offset the relevant tax amounts against future tax payments or apply for an immediate refund.

- **THINGS TO BE KEPT IN MIND:**

### **CRITERIA OF «SMALL» BUSINESSES ARE DIFFERENT UNDER DIFFERENT REGIMES**

We note that the relief measures presented mainly target small businesses and use various different terms to define the «small businesses» eligible for each given regime, such as SME, SLPE, Small-scale VAT taxpayer, SMTE, MSME and Manufacturing MSME.

It might be very confusing due to the fact that the Chinese expression of these terms is quite similar, while the criteria of each may largely differ.

Therefore, the enterprises need to look into carefully the size-related criteria in order to judge whether they can in fact enjoy a given preferential policy.

### **LOCAL TAX AUTHORITIES MAY HAVE THEIR OWN IMPLEMENTATION RULES**

As China adopts a «nationwide unified tax legislation» system, most of the tax measures and policies (except for certain local taxes) in China are issued at the national level and apply across the country in the same way. This being said, local tax authorities are sometimes allowed to introduce particular measures for the implementation according to the situation of each region.

Taking the example of Shanghai, the Shanghai government has set specific deadlines for the one-off refund of historical unutilized VAT credits (see Section 1) applied by local taxpayers, per which Shanghai tax authorities are required to complete the refund before the end of this June for SMEs, and before the end of the year for enterprises in some key industries (manufacturing, scientific research and technological services, software and IT services, environmental protection services, etc.).

### **PURE LOCAL TAX INCENTIVES TO BE FOLLOWED UP AS WELL**

In addition to the above national-level preferential policies, we can also see that several cities such as Shanghai, Shenzhen and some other regions hit by the COVID-19 this year have issued their local relief measures to help enterprises, especially the exemption of some real estate-related taxes under conditions, extension of time limit for tax filing, possible tax payment deferment in case of cash flow shortage etc.

Enterprises are hence suggested to also keep a close eye on the local incentives proposed during this special period.



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