New tax policies fuel impetus for China's high-quality development

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Foreword

China’s economy is now at a critical stage of structural transformation and optimization. Despite numerous challenges, China’s overall growth outlook remains stable, with the International Monetary Fund (IMF) growth rate projected at 5% in 2024 and 4.5% in 2025[1]. Nevertheless, the economy will still be under pressure in the short-term. Data from the Ministry of Finance (MOF) shows that China’s cumulative general public budget revenue amounted to RMB16,305.9 billion[2], experiencing a 2.2% year-on-year decline from January to September 2024. After special factors’ adjustment, such as the inflated base due to deferred tax payments for small and medium-sized enterprises last year and the lagged effect of tax cuts implemented in the middle of last year, the comparable growth is approximately 1%.

Against this backdrop, the Political Bureau of the Communist Party of China (CPC) Central Committee held a meeting on 26 September 2024 to analyze the current economic situation and make further arrangements for the next step. On 12 October 2024, the State Council Information Office (SCIO) held a press[3] about intensifying countercyclical adjustment of fiscal policy to promote high-quality economic development. The Minister of Finance Lan Fo’an, along with Deputy Ministers Liao Min, Wang Dongwei and Guo Tingting, attended the press conference and answered questions from journalists, signaling a series of significant policy measures. During the press conference, several proactive fiscal measures were announced, including expanding the fiscal deficit, raising the limit on local government special debt and issuing ultra-long-term special treasury bonds, which all aiming at expanding the fiscal expenditure and providing stronger support for the economic development. Among these, tax policy, as a crucial component of fiscal policy, plays a vital role in achieving counter-cyclical adjustments and promoting high-quality development and is worthy of attention and analysis.

General approach to the new round of tax policy

The MOF has outlined the overarching strategy for the upcoming round of tax policy in the press conference, aiming to promote the economic structure optimization and foster high-quality development amid the downward pressure. The key areas of this strategy include:

Modification of tax policies related to real estate

In alignment with the directives from the Political Bureau of the CPC Central Committee meeting, the MOF is expediting the execution of established policies and planning a comprehensive package of targeted incremental policy measures to stabilize the growth, expand the domestic demand and mitigate the risks. Among these initiatives, the application of tax policy and other mechanisms to support the stabilization of the real estate market is recognized as a critical component.

In previous, China employs differentiated taxation policies for ordinary and non-ordinary residential properties concerning value-added tax (VAT) and land appreciation tax (LAT):

- Differentiated VAT policy (only applicable to Beijing, Shanghai, Guangzhou and Shenzhen) [4]

Applicable scenarios	Specific provisions
Individual sales of housing purchased for more than 2 years (including 2 years)	Ordinary residence: Tax exemption Non-ordinary residence[5]: Tax on net basis, applicable tax rate is 5%

- Differentiated LAT policy

Applicable scenarios	Specific provisions
Taxpayers who build residential houses for sale, with the value added not exceeding 20% of the amount of deductions	Ordinary residence: tax exemption Non-ordinary residence: fully taxable
Advance tax provisions in some areas may be linked to ordinary residence or non-ordinary residence standards	Guangzhou[6] as an example: ▸ Ordinary residence: 2% ▸ Other non-ordinary residence: 3% ▸ Villa: 4%
In some areas, the deemed tax rate may be linked to the standard of ordinary or non-ordinary residential units	Tianjin[7] as an example: ▸ Ordinary standard residence: 6% ▸ Non-ordinary standard residential and other types of real estate: 8% ▸ Unable to distinguish the type of real estate: 8%

In addition to the aforementioned policies, the classification of ordinary and non-ordinary residential standards has been intricately linked to several regulations, including the down payment ratios for home purchase loans and the deed tax, which will be progressively eliminated in the evolution of real estate policy adjustment.

On 12 November 2024, the MOF, the State Taxation Administration (STA) and the Ministry of Housing and Urban Rural Development jointly issued the *Public Announcement [2024] No. 16*[8], announcing the cancellation of the standard classifications for ordinary and non-ordinary residences and adjusting VAT and LAT preferential policies, effective 1 December 2024. Beijing, Shanghai, Guangzhou and Shenzhen have successively announced the implementation of this policy from 1 December 2024. Relevant stakeholders are generally optimistic regarding this policy and believe it will alleviate the burden of individual housing transactions and reduce the tax burdens for certain real estate developers, thus easing the financial strain on homebuyers. Moreover, the policy is expected to stimulate the potential demand in the real estate market and prop up gradual recovery of the sector.

Accelerating the reform of fiscal and taxation system

Based on the keynote of the press conference, increasing local fiscal revenue to reduce the pressure on local governments to dissolve debts is an important consideration. Minister Lan stated that “the launch of reform implementation plans is being accelerated and the adoption of reform measures is gaining pace.” He also stressed that “China plans to introduce a batch of mature and tangible reform measures this year and next.” This aligns with the *Resolution of the Central Committee of the Communist Party of China on Further Deepening Reform Comprehensively to Advance Chinese Modernization* (hereinafter referred to as “the Resolution”) adopted at the Third Plenary Session of the 20th Central Committee of the Communist Party of China (hereinafter referred to as “the Third Plenary Session”). The Resolution stated that “excise tax collection will be moved further down the production-to-consumption chain with the power of taxation being passed steadily to local governments and the ratio for taxes shared between the central and local governments will be optimized,” demonstrating China’s determination and confidence in accelerating the reform of fiscal and taxation system.

Previous article: [Third Plenum marks milestone in further reform to promote tax modernization]

For industries and enterprises with excise tax obligations, moving the tax collection to consumption level may lead to a significant adjustment to both tax filing process and business process. Regarding the information from the MOF that "multiple factors will be taken into account, including moving excise tax collection further down the production-to-consumption chain with the power of taxation being passed steadily to local governments, optimizing the ratio of taxes shared by the central and local governments and enhancing tax administration capacity; the implementation will be carried out step by step in terms of categories," market players focus more on what will be the first items to be implemented in the reform, whether there will be an adjustment to the excise tax rates and how to ensure smooth transition.

Considering the cost of implementation and the practical difficulty in tax collection and administration, market players would suggest the policy makers to initiate pilot programs with consumption tax (CT) taxable items that have smaller revenue base, limited impact scope and lower administrative complexity. For CT taxable items with larger revenue base and more fragmented distribution channels, the downstream shift of collection phase would entail higher administrative costs and implementation challenges, thus suggesting a later phase implementation in the reform timeline.

Optimizing preferential tax policies

The MOF stressed to continue implementing the established policy package for tax cut and fee reduction, including

- Super deduction of research and development expenses
- Super input VAT credit policy for advanced manufacturing enterprises
- Tax exemption and deduction on commercialization of scientific and technological achievements

This also aligns with the requirements put forward in the Resolution adopted by the Third Plenary Session. The Resolution stated that "new industrialization will be advanced at a quicker pace, advanced manufacturing clusters will be fostered and built up to make traditional industries higher-end, smarter and more eco-friendly." Additionally, the MOF proposed at the press conference to "improve the preferential tax policies for technology transformation of manufacturers," implementing the strategy from the Resolution further.

Currently, China's tax incentives for technology transformation of manufacturers have played a crucial role in boosting innovation and technology upgrading. According to the Circular No. 9 of 2024 issued by MOF and STA[9], new preferential tax measures will be introduced for input in digitalization and intelligent transformation of special equipment in 2024-2027. Specifically, for the input in the transformation of special equipment which does not exceed 50% of the initial tax base calculated at the time of purchase, enterprises can deduct 10% of such input from the tax payable in the year incurred. Any unused deduction can be carried forward within 5 years.

The above policy is expected to further optimize tax incentives, better support the technology transformation of manufacturers and facilitate the fostering and building up of advanced manufacturing clusters. We will keep an eye on the latest progress and share more details regarding this.

Optimizing tax-based business environment

In July, Hu Jinglin, director of the STA, stated in the article titled *Promoting Chinese-Style Modernized Tax Practices with High Quality* that "taxes and fees shall be collected in accordance with laws and regulations, holding the bottom line of no excessive taxation." Furthermore, the MOF restated at the Press Conference that "fiscal revenue shall be raised in accordance with laws and regulations without excessive taxation to safeguard rights and interests of business entities."

It is obvious that both fiscal and taxation authorities are now paying attention to the potential excessive taxation issues in practice and taking it as an important direction to optimize tax-based business environment. However, several issues need to be further clarified including how to define "excessive taxation" and how to raise fiscal revenue while safeguarding rights and interests of business entities. As such, businesses need to stay informed of forthcoming implementation measures. Moreover, the statement reiterated that "supportive fiscal and taxation policies are expected to be improved to promote coordinated regional development and regional development strategy will be firmly implemented, particularly the coordinated development of the Beijing-Tianjin-Hebei region, the development of the Yangtze River Economic Belt and the integrated development of the Yangtze River Delta." This may provide a signal about giving greater support and guidance for fiscal and taxation policies on coordinated regional development while advancing fiscal and taxation reform. It is expected that more targeted and differentiated measures on tax incentives and transfer payments will be rolled out to support regions in leveraging their comparative advantages to foster new drivers of regional economic growth and promote balanced development.

Conclusion

The press conference conveys a clear message about proactive fiscal policy with greater intensity and effectiveness. The Minister Lan stated that "China's fiscal system is resilient enough to achieve a balance between revenue and expenditure and to meet the annual budget target by taking comprehensive measures," demonstrating the determination and confidence of fiscal authorities to ensure the stability in economic growth.

Apart from the enhancement of VAT and LAT that are aligned with the cancellation of the standards for ordinary and non-ordinary residential housing, implementation details for other taxation policies have not yet been rolled out. We will stay a close look on this matter and help companies seizing opportunities amid challenges.

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1. IMF, https://www.elibrary.imf.org/configurable/content/book$002f9798400278525$002f9798400278525.xml?t:ac=book%24002f9798400278525%24002f9798400278525.xml
2. MOF, https://gks.mof.gov.cn/tongjishuju/202410/t20241025_3946291.htm
3. https://www.gov.cn/yaowen/tupian/202410/content_6979529.htm
4. Individuals selling residential properties outside Beijing, Shanghai, Guangzhou and Shenzhen shall pay a 5% VAT if the property was acquired less than two years. Properties purchased over two years are exempt from VAT, with no distinction between ordinary and non-ordinary residence.
5. The criteria for non-ordinary residence differ across various locations. In general terms, non-ordinary residence pertains to a dwelling that satisfies the requirements of having a greater floor area and a reduced plot ratio.
6. Guangzhou Provincial Tax Service, Notice No. 7 of 2017, https://guangdong.chinatax.gov.cn/gdsw/sffggzs/201706/26/content_9f1ce4c38b1e48fc9b8f5edc35d9dc92.shtml
7. Tianjin Provincial Tax Service, https://tianjin.chinatax.gov.cn/11200000000/0300/030004/03000408/20181121172901091.shtml
8. https://fgk.chinatax.gov.cn/zcfgk/c102416/c5235817/content.html
9. https://fgk.chinatax.gov.cn/zcfgk/c102416/c5232952/content.html

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