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CHAMBERS GLOBAL PRACTICE GUIDES

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# Corporate Tax 2026

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**China: Law and Practice & Trends and Developments**

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Han Kun Law Offices



# CHINA

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## Law and Practice

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**Han Kun Law Offices** is a leading full-service law firm in China with over 900 professionals located in Beijing, Shanghai, Shenzhen, Hong Kong, Haikou, Wuhan, Singapore, New York City and Silicon Valley. The firm's main practice areas include private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, compliance, banking and finance, aviation finance, foreign direct investment, antitrust/competition, data protection, private client/wealth

management, intellectual property, bankruptcy and restructuring, and dispute resolution. Han Kun provides a full range of legal services and business advice to Chinese companies and multinationals doing business in China. Over the years, Han Kun has been widely recognised as a leader in complex cross-border, domestic transactions and compliance matters that cover foreign investment access, industry compliance, labour and national security review, taxation, foreign exchange and intellectual property.

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## 1. Corporate Structures, Residence and Tax Treatment

### 1.1 Corporate Forms and Their Tax Treatment

Under the PRC Company Law, there are two corporate forms: the limited liability company and the company limited by shares. A limited liability company is established by shareholders, who contribute capital and are liable to the company to the extent of the amount of capital contributions they have made. This form is typically suitable for start-ups and small to medium-sized businesses. A company limited by shares divides its entire capital into equal shares, and its shareholders are liable to the company to the extent of the shares they have subscribed for. This form is typically applicable to larger businesses with plans for public offerings or those requiring capital raising from the public.

Under both corporate forms, the company is treated as an independent taxpayer and is subject to corporate income tax (CIT) on its taxable income (the amount derived from the company's annual operating profit after tax adjustments). When after-tax profits are distributed to shareholders, shareholders may also be subject to CIT or individual income tax (IIT) on dividends received; the applicable tax treatment and rates depend on the legal form of both the company and the shareholder, as well as the manner in which the shares are held.

In addition to corporate forms, other alternative structures exist in PRC:

- *Individual industrial and commercial household:* This is a form of business operation conducted by a natural person or a household, under which the operator bears unlimited liability.
- *Sole proprietorship:* This is an enterprise invested in by a single natural person, where the investor bears unlimited liability for the enterprise's debts.
- *Partnership:* This comprises two forms: general partnership and limited partnership. In practice, the limited partnership is the more common form. It is established by no fewer than two and no more than 50 partners, who contribute capital and operate the business jointly. There must be at least one general partner, who bears unlimited joint and several liability for the debts of the partnership.

The above-mentioned alternative forms of corporate structures are not regarded as independent taxable entities under PRC tax law. They are not required to pay CIT on their profits. Instead, profits are passed through and distributed to investors or partners, who are then taxed at their respective levels.

### 1.2 Use and Taxation of Transparent Business Structures

In PRC, the principal transparent entities are sole proprietorship, individual industrial and commercial household, and partnership. These three entities lack legal personality but may engage in civil activities in their own name. The registration procedures for sole proprietorship and individual industrial and commercial household are relatively straightforward, making them suitable for small-scale operations such as

individuals providing external services or establishing personal studios.

With great flexibility in governance and partner liability arrangements, a partnership combines elements of both capital and personal contribution. These advantages make partnership a widely used type of transparent entity, as seen in the typical partnership structure of law and accounting firms.

In particular, the limited partnership structure is widely adopted in the investment sector and serves as a common structure for private equity fund vehicles. The general partner assumes unlimited liability and is responsible for executing partnership affairs, while financial investors, as limited partners, are liable only to the extent of their capital contributions and do not participate in the operation of the partnership business. This structure enables efficient decision-making and flexible profit distribution. In tax practice, a partnership is not itself a taxable entity for CIT; rather, its investment income is passed through and directly allocated to the partners. This feature is particularly advantageous when constructing multi-layered or complex investment structures, as it helps mitigate the risks and effects of double taxation associated with corporate entities.

It should be noted, however, that a partnership is not an absolutely “transparent” entity. Although a partnership is treated as transparent for CIT, when such an entity appears within a multi-layered investment structure, it may alter the tax character of income or even block the application of certain tax benefits. This may increase the complexity of the investment structure, which requires proper interpretation.

### 1.3 Tests for Determining Tax Residence

For incorporated businesses, PRC tax law adopts a combination of a Registration Test and an Effective Management Function Test to determine tax residence.

Under the Registration Test, enterprises lawfully incorporated in PRC automatically become Chinese tax residents. Under the Effective Management Function Test, an enterprise lawfully incorporated pursuant to the laws of a foreign country (region) but where actual

management functions are conducted in PRC shall also be deemed Chinese tax residents.

The Effective Management Function Test follows the principle of “substance over form”, with comprehensive consideration given to factors such as the location where senior management performs its functions, the place where financial and personnel decisions are made, the location of principal assets and records, and the place of residence of directors with voting rights.

For transparent entities, given that they are not themselves treated as taxable entities, they do not in a strict sense have a “residence” for tax purposes equivalent to that of an incorporated enterprise (except where a transparent entity constitutes a permanent establishment (PE) in PRC of a non-resident enterprise and thereby becomes subject to CIT). Accordingly, transparent entities cannot apply for a Certificate of Residence in their own name.

A concept closely related to tax residence is “tax payment place”. Since the income of a transparent entity is passed through to the level of its investors or partners for taxation, the actual tax payment place depends on the identity and tax residence of those investors or partners. Using a limited partnership as an example: individual partners deriving business income from the partnership should file and pay IIT through the partnership to the competent tax bureau at the partnership’s place of actual management and operation; income allocated by the partnership to corporate partners should be included in the corporate partner’s taxable income and subject to CIT at the corporate partner’s place of registration.

### 1.4 Applicable Corporate and Individual Tax Rates

CIT is payable by a resident enterprise for income derived from or accruing in or outside PRC, at a standard rate of 25%. Lower rates may apply in specific circumstances prescribed by law; for example, qualified Small and Low-Profit Enterprises are subject to a reduced CIT rate of 20%, and State-Supported High and New Technology Enterprises are eligible for a reduced CIT rate of 15%. Additionally, PRC tax law offers incentive CIT rates for encouraged indus-

tries and specific regions. Non-resident enterprises, regardless of whether they are tax-transparent entities in their country, shall pay CIT at a rate of 10% on income derived from within PRC that is not attributable to PEs.

When a resident enterprise distributes after-tax profits to its individual shareholders in the form of dividends, those shareholders are subject to IIT at a rate of 20% on such dividend income. When a shareholder disposes of corporation shares, the resulting gain is likewise subject to IIT at a rate of 20%.

Where a natural person conducts business or indirectly holds equity in other enterprises through a transparent entity, the income derived is typically classified as business income and subject to the five-tier progressive IIT rate schedule ranging from 5% to 35%. Income in the form of dividends derived by a limited partnership from external investments and allocated to individual partners may be taxed separately at a flat rate of 20%, without being aggregated with business income. In particular, where a venture capital enterprise opts for single investment fund accounting (a special calculation method for taxable profit), the equity transfer income and dividend income distributable to its individual partners shall be subject to individual income tax calculated in accordance with the 20% tax rate.

## 2. Corporate Tax Regime

### 2.1 Taxable Profits

Taxable profits are calculated by taking accounting profits as the starting point and making adjustments in accordance with PRC tax law (commonly referred to as “tax adjustments”). Tax adjustments may result in either an upward or a downward adjustment to taxable income; the basic formula is: Taxable Profits = Accounting Profits + Upward Adjustments – Downward Adjustments.

Tax adjustments can be categorised into four types:

- Income adjustments, common examples of which include deemed sales, failure to recognise income on an accrual basis, gains and losses on changes

in fair value, non-taxable income and tax-exempt income.

- Deduction adjustments, such as entertainment expenses, advertising expenses and charitable donations. PRC tax law imposes caps on the deduction of certain items of expenditure; where the amount recognised in the accounts exceeds the prescribed deductible cap, the excess must be added back to taxable profit. Expenditure that is wholly non-deductible under PRC tax law, such as administrative fines and provisions not approved by the tax bureaus (eg, bad debt provisions), must be added back in full. Conversely, certain policies permit enhanced deductions beyond the accounting amount; for example, R&D expenses and salaries for disabled employees may qualify for super-deductions, resulting in a downward adjustment to taxable income.
- Asset adjustments, such as adjustments arising from the depreciation of fixed assets and asset impairment.
- Adjustments for special items, such as adjustments arising from related-party transactions and the carry-forward of prior-year losses.

Under PRC tax law, taxable profits are calculated on an accrual basis. Revenues and expenses are recognised in the taxable period to which they relate, regardless of whether the relevant payments have actually been received or made.

### 2.2 Technology Investments

PRC tax law contains a series of special incentives for technological investment.

#### CIT Incentives

State-Supported High and New Technology Enterprises are entitled to a preferential CIT rate of 15% during the incentive period. State-Supported Software Enterprises enjoy a “two-year exemption and three-year half-rate” CIT incentive from the first profitable year. Key Software Enterprises are entitled to a “five-year exemption” followed by a preferential rate of 10% for subsequent years. Integrated Circuit Enterprises are also entitled to time-limited tax reductions and exemptions, as well as an extended period for carrying forward losses. The above are nationally applicable incentives, certain regional policies additionally

provide support for specific technology industries. For example, the Western Development Policy designates encouraged industries within specific regions, including locally competitive and emerging technology sectors.

In addition to the above incentives that directly reduce a corporation's overall tax burden, further incentives exist specifically for R&D activities. For example, enterprises in industries not on the negative list that incur R&D expenses in the course of their R&D activities may deduct those expenses at 200% of the actual amount incurred against taxable profit. Where R&D activities result in the creation of an intangible asset, the asset may be amortised at 200% of its cost, which can be deducted for tax purposes. Integrated Circuit Enterprises are eligible for an even higher deduction ratio.

To reduce the tax cost of technology commercialisation, PRC tax law provides for an exemption and reduction on income derived from technology transfers. Resident enterprises are fully exempt from CIT on technology transfer income not exceeding CNY5 million; income exceeding CNY5 million is subject to CIT at half the applicable rate. Where the enterprise is established within a designated area of the Zhongguancun National Innovation Demonstration Zone, the exempt threshold may be increased to CNY20 million.

### Value-Added Tax (VAT) Incentives

VAT incentives are generally targeted at R&D-related activities. For example, resident enterprises providing technology transfer, technology development, and related technology consultancy and technology services are entitled to a VAT exemption. Enterprises selling self-developed software products are entitled to a refund-upon-collection policy, whereby VAT is levied at 13% but the portion of the actual VAT burden exceeding 3% is immediately refunded upon collection.

## 2.3 Special Incentives

In addition to the technology investment incentives described in 2.2 Technology Investments, the following special tax incentives are available in PRC for specific industries and transactions.

### Specific Industries Incentives

If an Eligible Energy Service Enterprise that carries out an energy performance contracting project meets the relevant provisions, it is entitled to exemption from CIT from the first year to the third year since the tax year in which the project had the first production and operation income, and it may enjoy tax reduction by half of the 25% statutory tax rate from the fourth year to the sixth year.

### Specific Transactions Incentives

- Income derived by enterprises from agricultural, forestry, husbandry and fishery projects may be exempt from or subject to a 50% reduction in CIT.
- Income derived by enterprises from investment in and operation of state-supported public infrastructure projects may enjoy a full CIT exemption in years one through three from the first year of revenue, and a 50% CIT reduction in years four through six.
- Income derived by enterprises from qualified environmental protection, energy conservation and water conservation projects may enjoy a full CIT exemption in years one through three from the first year of revenue, and a 50% CIT reduction in years four through six.
- Venture capital enterprises that make equity investments in start-up technology enterprises or unlisted small-to-medium-sized high-technology enterprises for a period of two years or more may deduct 70% of the investment amount from the venture capital enterprise's taxable income in the year in which the equity has been held for at least two years; any amount not deducted in that year may be carried forward to subsequent tax years.

## 2.4 Loss Relief

Losses incurred by an enterprise in a given tax year may be carried forward to offset taxable income in future years. For most enterprises, the carry-forward period is five years; for high-tech enterprises and high-tech small and medium-sized Enterprises, such period may be extended to ten years. In particular, for outbound investment enterprises, losses incurred by domestic establishments may be offset against income from overseas sources; however, losses incurred by overseas establishments may not be used to offset profits from domestic sources.

As a general principle, PRC tax law does not permit loss carry-back; that is, losses incurred in the current year may not be offset against profits of prior years so as to generate a tax refund.

The CIT Law generally makes no distinction between types of income. When offsetting losses, losses incurred by an enterprise may be set off against the total taxable profits of subsequent years, without distinguishing between income losses and capital losses.

## 2.5 Deduction of Interest

The rules of the deduction of interest vary depending on the nature of the lender:

- Interest on borrowings by non-financial enterprises from financial enterprises is generally deductible in full as actually incurred.
- Interest on borrowings by non-financial enterprises from other non-financial enterprises is deductible only up to the amount calculated at the benchmark lending rate applied by financial enterprises for loans of comparable type and term.
- To prevent tax base erosion, interest expenses attributable to the portion of debt investment received from related parties that exceeds the prescribed debt-to-equity ratio are not deductible; the applicable ratio is 5:1 for financial enterprises and 2:1 for other enterprises.
- Interest paid by an enterprise on borrowings from related natural persons is subject to the related-party debt-to-equity ratio restriction described above; interest paid on bona fide borrowings from unrelated natural persons under a loan agreement is deductible up to the amount calculated at the benchmark lending rate applied by financial enterprises for comparable loans.
- Interest on bonds issued with proper approval by an enterprise is deductible as actually incurred.

## 2.6 Consolidated Tax Grouping

Under PRC tax law, unless the State Council stipulates otherwise, enterprises shall not make combined payments of CIT. As a general rule, companies within a group are treated as independent legal entities for tax purposes, and losses incurred by one company may only be carried forward against that company's own future profits; they cannot be directly offset against

the profits of other companies at the group level. In particular, branches do not have independent legal personality and are treated as divisions of the same legal entity; CIT is therefore calculated on a consolidated basis for the company as a whole.

Given that consolidated tax grouping cannot be achieved directly, enterprise groups may, subject to regulatory compliance, pursue tax optimisation through measures such as flexibly establishing subsidiaries or branches, effecting intra-group mergers by absorption, and conducting reasonable intra-group transactions to rebalance profit distribution.

## 2.7 Capital Gains

PRC does not currently have a separate capital gains tax regime. Capital gains derived by resident enterprises are included in their income for the relevant year and subject to CIT in the ordinary course. Non-resident enterprises that directly dispose of assets located in PRC and derive capital gains therefrom are subject to CIT at a rate of 10%, unless an exemption may be claimed under an applicable tax treaty. In particular, PRC tax law has indirect transfer rules. If non-resident enterprises implement arrangements without a reasonable commercial purpose that result in the indirect transfer of assets such as equity in a PRC resident enterprise, such transfer will be deemed a direct transfer of PRC assets and become subject to PRC tax.

In addition to exemptions under tax treaties, certain entities may qualify for exemption from taxation on income of capital gains. For example, capital gains derived from the transfer of Chinese Depository Receipts (CDRs) of innovative enterprises by public securities investment funds, Qualified Foreign Institutional Investors (QFIIs) and Renminbi Qualified Foreign Institutional Investors (RQFIIs) are temporarily exempt from CIT. Meanwhile, income derived by securities investment funds from the securities market, including gains from the trading of stocks and bonds, is temporarily exempt from CIT.

## 2.8 Other Taxes on Transactions

Under the PRC tax system, in addition to CIT, an incorporated business is typically subject to the following major taxes.

## VAT

VAT is payable by enterprises on the sale of goods, services, intangible assets and immovable property within the territory of PRC, as well as on the importation of goods.

Enterprises with annual taxable sales exceeding CNY5 million are generally classified as General VAT Payers. They are subject to VAT rates of 13%, 9% and 6% on different taxable items, and the VAT payable is calculated as the difference between the output tax and the input tax for the period.

Enterprises with annual taxable sales not exceeding CNY5 million are classified as Small-Scale VAT Payers. They calculate and pay VAT based on a levy rate of 3%. Currently, a preferential policy applies, reducing the rate to 1%.

## Stamp Duty

Stamp duty is a tax levied on the execution of contracts, the transfer of property ownership, business account books and the conduct of securities transactions within PRC. The stamp duty rates range from 0.005% to 0.1%. Although the rates are very low, failure to pay stamp duty may result in penalties and late payment surcharges.

## Surcharges

Urban Maintenance and Construction Tax, Education Surcharge and Local Education Surcharge are ancillary taxes levied on the basis of VAT and Consumption Tax liabilities. The tax base for these surcharges is the amount of VAT and Consumption Tax payable. The applicable rate for Urban Maintenance and Construction Tax ranges from 1% to 7%, the Education Surcharge is levied at a rate of 3%, and the Local Education Surcharge at a rate of 2%.

## 2.9 Other Notable Taxes

Incorporated businesses engaged in specific business activities and transactions may also be subject to the following additional taxes:

- Consumption Tax is payable by enterprises that manufacture, commission the processing of, or import specified consumer goods. It applies only to high-value or bulk goods within designated cat-

egories, including tobacco, alcohol and petroleum products.

- Customs Duty is payable by enterprises on the importation or exportation of goods.
- Land Appreciation Tax applies to the transfer of state-owned land use rights, buildings and attachments for consideration.
- Deed Tax applies to enterprises acquiring title through land use rights and real estate transactions.
- Property Tax generally applies to enterprises that own real estate.

## 3. Corporations and Non-Corporate Businesses

### 3.1 Form of Closely Held Local Businesses

PRC closely held businesses adopt a variety of organisational forms, typically selected in accordance with the enterprise's stage of development, scale of capital, and risk management requirements. In general, individual industrial and commercial households and corporations are the most commonly adopted forms.

In the consumer services, food and beverage, and retail sectors, private enterprises frequently adopt the individual industrial and commercial household form. This is particularly prevalent at the early stages of a business, as it offers ease of registration, swift decision-making, and straightforward financial and tax administration, making them well-suited for asset-light, small-scale projects operated by individuals or families. In terms of operational and decision-making flexibility, they have a clear advantage over corporate entities.

By contrast, in manufacturing and production industries, or at later stages of a business's development, private enterprises are more likely to adopt a corporate form, such as a limited liability company or company limited by shares, as their principal operating structure. The corporate form provides a regulated governance framework, achieves separation of the assets and liabilities of the entity from those of its shareholders, and is better suited to businesses with scaling ambitions, financing needs or higher risk profiles.

## 3.2 Individual and Corporate Rates

Individual professionals typically derive comprehensive income and business income, with top marginal IIT rates of 45% and 35% respectively. Where an individual professional establishes a corporate entity to conduct business, the corporate profits are subject to CIT at a rate of 25%. The dividend subsequently distributed to the individual is then subject to IIT at 20%, such that the overall tax burden is not reduced.

Where an individual conducts business through a Small and Low-Profit Enterprise or similar entity subject to a lower tax rate, the tax burden may be temporarily reduced. However, the scale of businesses may be subject to restrictions, and the arrangement may attract audits from the tax bureaus on grounds of intentional income-splitting or fraudulent claims for tax incentives. In addition, dividends received by the individual as a shareholder would equally be subject to IIT at 20%.

Where an individual uses a non-corporate entity to alter the character of income and the applicable tax rate, the tax bureaus may invoke general anti-avoidance rules to adjust arrangements that lack a genuine commercial purpose. In recent years, the tax bureaus have publicised a number of cases involving and adjustments in respect of IIT underpayments by entertainment celebrities and online streamers.

## 3.3 Restrictions on Retention of Earnings by Closely Held Corporations

The PRC Company Law does not contain any mandatory provisions prohibiting closely held corporations from retaining earnings for investment purposes. This legislative restraint is based on the legal principle of respecting corporate autonomy. However, where a majority shareholder abuses its position to withhold dividend distributions, the courts may override the principle of company autonomy and order the compulsory distribution of dividends even without a shareholders' resolution. This provision is not motivated by tax considerations but is designed to protect the interests of minority shareholders.

In particular, the IIT Law as amended in 2018 introduced individual Controlled Foreign Company (CFC) rules. Where a resident individual controls an enter-

prise established in a jurisdiction with a substantially lower effective tax burden and that enterprise fails to distribute or reduces the distribution of its profits without justifiable business reasons, the tax bureaus are entitled to make a tax adjustment.

## 3.4 Taxation of Individuals on Shares in Closely Held Corporations

Individuals receiving dividends from closely held corporations are subject to IIT at a flat rate of 20% on the full amount, withheld at source by the investee company.

Individuals disposing of equity in a closely held company are subject to IIT at a flat rate of 20% on the gain (being the disposal proceeds less the original cost of the equity and reasonable expenses), withheld by the purchaser. In particular, where an individual transfers equity at a price that is obviously low without justifiable reason, the tax bureaus are entitled to reassess the consideration.

## 3.5 Taxation of Individuals on Shares in Public Corporations

A differentiated IIT applies to dividends received by individuals in respect of shares in publicly traded corporations. The longer the holding period, the lower the effective tax burden, and dividends may even be fully exempt:

- Where the holding period does not exceed one month, dividends are subject to IIT in full at a rate of 20%.
- Where the holding period exceeds one month but does not exceed one year, dividends are subject to a provisional 50% tax deduction, with a 20% tax rate applied, resulting in an effective tax rate of 10%.
- Where the holding period exceeds one year, dividends are temporarily exempt from IIT. Where IIT on dividends is applicable, it is withheld at source by the listed company.

Capital gains derived by individuals from the transfer of shares in listed companies acquired through the public offering and trading market are temporarily exempt from IIT. In addition, the transfer of listed company shares by individuals, being a financial

commodities transaction, is exempt from VAT on the proceeds. However, individuals transferring listed company shares are subject to Securities Transaction Stamp Duty at a rate of 0.1%, which is withheld by the securities registration and settlement institution.

The above provisions also apply to dividends received by individuals and gains on share transfers in respect of shares listed on the National Equities Exchange and Quotations (NEEQ) system, which can be understood as a platform for corporate financing and stock trading that sits between private companies and public companies.

In respect of shares subject to lock-up restrictions, dividends received prior to the expiry of the lock-up period are included in taxable income at 50% and subject to IIT at a rate of 20%. Gains on the transfer of restricted shares prior to the expiry of the lock-up period are calculated by deducting the acquisition cost and reasonable taxes and fees from the disposal proceeds, with IIT applied at a rate of 20%.

## 4. Taxation of Inbound Investments

### 4.1 Application of Withholding Taxes

PRC generally levies a 10% withholding tax (WHT) on dividends, interest, and royalties derived by non-resident enterprises from sources within PRC. WHT is withheld at source by the domestic payer at the time of payment. In the absence of a bilateral tax treaty between PRC and the non-resident enterprise's country of residence, there is no general reduction or exemption from PRC WHT. However, qualifying foreign-invested enterprises may benefit from a temporary exemption on profits reinvested.

The administration of WHT on cross-border payments by PRC tax bureaus has become increasingly stringent, with a particular focus on transactions that present a risk of tax avoidance. For example, where cross-border enterprises characterise royalties as service fees and seek to apply preferential treaty provisions, the tax bureaus will rigorously scrutinise the substance of the underlying arrangements.

### 4.2 Key Treaty Jurisdictions for Inbound Investment

To date, PRC has concluded double tax agreements or arrangements with more than 100 countries and regions. Foreign investors commonly access the PRC market indirectly through intermediate holding companies established in Hong Kong and Singapore.

Under the bilateral tax arrangement between PRC and Hong Kong, the WHT on dividends may be reduced to 5% and that on royalties to 7%, where the requisite conditions are satisfied. In addition, Hong Kong, as an international financial centre, offers further advantages including a relatively relaxed foreign exchange regime, ease of financing and a straightforward local tax system.

Under the bilateral tax treaty between PRC and Singapore, the WHT on dividends may be reduced to 5% and that on royalties to 10%, where the requisite conditions are satisfied. Singapore similarly offers advantages including flexibility in capital management and a well-developed financial system.

### 4.3 Tax Authority Scrutiny of “Treaty Shopping” Practices

An applicant for treaty benefits must be a tax resident of contracting states (regions). In the case of entities from non-treaty jurisdictions seeking to apply for treaty benefits in PRC through the use of entities established in a treaty jurisdiction, the PRC tax bureaus will typically examine whether the applicant for treaty benefits is the genuine “beneficial owner” of the relevant income. A finding that the applicant entity is merely a conduit – for example, where a significant proportion of the income is contractually or practically required to be passed on to a third jurisdiction within 12 months, or where the entity lacks substantive business activities, pays little or no tax on the income in the source jurisdiction, or is involved in back-to-back arrangements in respect of interest and royalties – will be unfavourable to a determination of beneficial ownership. Where beneficial ownership is denied, the tax bureaus may find that there has been treaty abuse, and where the purpose of avoiding tax obligations through arrangements lacking genuine commercial purpose is established, the use of treaty benefits may be denied.

## 4.4 Transfer Pricing Issues for Inbound Investors

Inbound investors operating through a local corporation may attract the tax bureaus' attention in respect of transfer pricing issues in the following circumstances.

### Related-Party Transaction Risks

- *Large volume or multiple types of related-party transactions:* Tax bureaus will focus their review on high-value or frequent related-party transactions to assess whether such transactions erode the tax base.
- *Prolonged losses, low profitability or fluctuating profits:* If a domestic entity incurs abnormal profit performance, tax bureaus may suspect the existence of intra-group profit shifting.
- *Profitability below industry average:* Where a PRC company's profits are significantly lower than the industry average, tax bureaus may require an explanation for the low profitability.
- *Mismatch between profit level and functions/risks assumed, or between returns shared and costs borne:* If a PRC company undertakes high-value functions and significant risks but receives low returns, while foreign affiliates enjoy high profits, tax bureaus may require that the PRC company be entitled to a greater share of profits commensurate with its functions and risks.
- *Related-party transactions with affiliates in low-tax jurisdictions:* Related-party transactions between PRC companies and affiliates in low-tax jurisdictions such as the BVI and the Cayman Islands are more likely to attract scrutiny.

### Documentation Requirements

Enterprises are obliged to prepare contemporaneous documentation and provide it as required. Where an enterprise has failed to comply with related-party filing requirements or to prepare contemporaneous documentation, it will still bear the burden of proof if the tax bureaus initiate a transfer pricing audit.

## 4.5 Challenges to Related-Party Limited Risk Distribution Arrangements

If an enterprise and its related parties allocate costs incurred jointly without adhering to the arm's length principle, tax bureaus may challenge the arrangement

and require adjustments to be made using reasonable methods.

In particular, PRC tax law provides for the rules of cost-sharing arrangements. The costs borne by related parties should be consistent with the amount that independent parties would pay under comparable conditions to obtain the same beneficial interests. During the term of a cost-sharing arrangement, if there is a mismatch between the benefits actually shared by the participants and the costs allocated to them, compensation adjustments will be made based on the actual circumstances.

## 4.6 Local Transfer Pricing Rules and OECD Standards

Overall, the transfer pricing rules of PRC are broadly aligned with the OECD standards on core principles, such as adherence to the arm's length principle and the requirements for master files, local files and country-by-country reporting. However, PRC has also made adaptations based on its domestic circumstances in areas such as specific implementation details and the treatment of particular types of transactions.

## 4.7 Transfer Pricing Disputes and Mutual Agreement Procedures

To resolve international tax disputes, PRC issued policy documents in 2013 and 2017 setting out rules governing tax treaty Mutual Agreement Procedures (MAPs) and transfer pricing MAPs respectively. Regarding tax treaty MAPs, PRC has specified their applicable scope, subject matter and qualifying conditions, and the principal rights and obligations of the competent authorities of each contracting party. Regarding transfer pricing MAPs, PRC has clarified the procedures relating to the initiation, suspension or termination, and conclusion of the MAP process.

In practice, due to differences between PRC and other countries in the reference rules for the MAP and other factors, the overall resolution rate for MAP cases is relatively low and the average time to resolution is comparatively long. At the same time, given that the MAP has a narrow audience, requires specialist expertise and involves significant costs, cross-border enterprises have shown limited proactivity in initiating MAP proceedings.

## 5. Taxation of Non-Local Corporations

### 5.1 Compensating Adjustments

Where an enterprise receives a risk notification in respect of a special tax adjustment to transfer pricing or identifies transfer pricing risks of its own accord, it may make a self-initiated adjustment and pay additional tax. Following such a self-initiated adjustment and additional payment, the tax bureaus may still carry out a special tax audit or adjustment.

### 5.2 Local Branches and Local Subsidiaries

Branches and subsidiaries differ in their legal status: a branch does not have independent legal personality, whereas a subsidiary is an independent legal entity. Accordingly, different tax administration rules apply to local branches and local subsidiaries of non-local corporations.

For CIT purposes, the two differ in the scope of their taxable income. Where a foreign company establishes a branch in PRC, that branch is subject to CIT only on income sourced within PRC and on income arising outside PRC but effectively connected with the local branch. Where a foreign company establishes a subsidiary in PRC, the subsidiary is a resident enterprise and is subject to CIT on both domestic and overseas income. In practice, the collection method may also differ. Foreign companies' branches in PRC are typically unable to maintain adequate records and are therefore subject to a deemed-profit method of assessment, under which the tax bureaus will assess a deemed profit margin and the resulting taxable profit is multiplied by the standard 25% rate to arrive at the tax liability. Foreign subsidiaries are typically assessed on an actual-profit basis.

It should be noted that a foreign enterprise may be regarded as having a PE in PRC if it maintains a place of business or establishment in PRC for the purpose of carrying on productive or commercial activities, habitually sends its employees into PRC to perform services or, under certain circumstances, carries on activities in PRC through an agent. In such cases, the taxation rules applicable to branches, as set forth above, shall apply.

For VAT purposes, both are independent VAT taxpayers and are required to pay VAT on the full amount of income derived from taxable transactions conducted within PRC.

### 5.3 Capital Gains of Non-Residents

Where a non-resident enterprise directly transfers equity interests in a resident enterprise, the capital gains derived therefrom are treated as income sourced in PRC and will be subject to CIT. Nevertheless, if the jurisdiction of residence of such non-resident enterprise has concluded a tax treaty with PRC and the conditions for exemption under the said treaty are satisfied, an application for tax exemption may be made.

Furthermore, non-resident enterprises are subject to VAT on the transfer of shares in listed companies. The VAT base is determined as the selling price of the shares minus the purchase price (or, where shares were held prior to listing and sold post-listing, minus the IPO price), with VAT applicable at the rate of 6%.

Where a non-resident enterprise indirectly transfers equity in a resident enterprise by transferring the shares of an offshore enterprise that directly or indirectly holds PRC taxable property, it is necessary to determine whether tax is payable in PRC in accordance with a series of rules under "Bulletin No. 7" of PRC tax law. If the transaction is deemed to lack a reasonable commercial purpose and to circumvent PRC's tax obligations, it will be regarded as a direct transfer of equity in a resident enterprise and subject to tax in PRC. In the case of an indirect transfer, a tax treaty exemption may still be applied for if the relevant conditions are met.

### 5.4 Tax Implications of Change of Control

Under the current tax system, there are no specific charging provisions triggered by a change of control. In PRC, specific assets (such as equity in companies, fixed assets and real property) and imports or exports of goods are subject to well-defined tax rules. The tax liability for income tax purposes generally arises only upon the transfer of ownership together with all associated risks and benefits. Unless otherwise provided by law (for example, the indirect transfer rules in Bulletin No. 7 discussed below), local tax bureaus rarely impose tax solely on the basis of a transfer of "control"

where no transfer of ownership has occurred. Whether a contractual arrangement giving effect to a change in control over an asset or goods falls within the scope of taxation will depend on the assessment made by the competent tax bureau of the actual nature of the relevant income. In the case of an equity transfer, the applicable tax rules are clear: only the transfer of ownership gives rise to a taxable event; nominee holding or unwinding arrangements that have legal effect at the commercial level are often not recognised in the context of tax administration. This does not, however, mean that the tax bureaus have no right to tax the transfer of “economic rights” associated with equity interests; in practice, individual tax bureaus retain a degree of discretion in respect of specific cases.

As discussed in **5.3 Capital Gains of Non-Residents**, where a non-resident enterprise indirectly transfers equity in a resident enterprise by disposing of an overseas holding entity within the group, whether such transfer is taxable in PRC must be determined in accordance with the rules of Bulletin No. 7. Where the transaction is found to lack genuine commercial purpose and to be designed to avoid tax obligations, it will be recharacterised as a direct transfer of equity in a resident enterprise and taxed accordingly.

## 5.5 Formula-Based Income Attribution

Foreign-owned local affiliates in PRC are required to maintain accounting books and calculate taxable profits on an accrual basis, and to file and pay CIT accordingly.

Where it is not possible to determine taxable profits on the basis of actual accounts due to inadequate or incomplete books and records, the tax bureaus will apply a formula to calculate taxable income:

- *Assessment of taxable income amount based on the total income amount:* This is applicable for a non-resident enterprise whose income can be accurately accounted or total income amount can be deduced by a reasonable method but whose costs and expenses cannot be accurately accounted. The formula shall be as follows: taxable income amount = total income amount × profit margin assessed by the tax bureaus.

- *Assessment of taxable income amount based on costs and expenses:* This is applicable for a non-resident enterprise whose costs and expenses can be accurately accounted but whose total income amount cannot be accurately accounted. The formula shall be as follows: taxable income amount = total amount of costs and expenses / (1 – assessed profit margin) × assessed profit margin.
- *Assessment of taxable income amount based on conversion of income in accordance with expenditure:* This is applicable for a non-resident enterprise whose total amount of expenditure can be accurately accounted but whose total income amount and costs and expenses cannot be accurately accounted. The formula shall be as follows: taxable income amount = expenses incurred in the current period / (1 – assessed profit margin) × assessed profit margin.

In particular, where a non-resident enterprise has entered into a sale contract for machinery and equipment or goods, and concurrently provides labour services such as installation of equipment, assembly, technical training, guidance, supervision services, etc, and the sale of goods contract does not list the fee amount for the aforesaid labour services or the pricing is unreasonable, the tax bureaus in charge may assess the income from provision of labour services based on the actual circumstances and with reference to the pricing standards for identical or similar business. Where there are no reference standards, the non-resident enterprise’s income from provision of labour services shall be determined in accordance with the principle of not less than 10% of the total price in the sale of goods contract. In the case of a non-resident enterprise whose income is derived from provision of labour services for customers in PRC, and all the services are provided in PRC, the non-resident enterprise shall declare and pay CIT for the full income amount in PRC. Where the services are provided in and outside PRC concurrently, domestic and overseas income shall be separated in accordance with the principle of the place of provision of labour services, and the enterprise shall declare and pay CIT for income from provision of labour services derived in PRC.

## 5.6 Deductibility of Intra-Group Management and Administrative Charges

Under PRC tax law, management fees charged by a parent company to a subsidiary are not deductible before CIT. This rule also applies to cross-border group arrangements.

PRC tax law on intra-group related-party service transactions incorporates the relevant OECD principles, requiring compliance with both the benefit test and the arm's length principle:

- The benefit test requires that the service brings direct or indirect economic benefit to the recipient, and that an unrelated party in the same or similar circumstances would be willing to purchase the service or to perform it itself.
- The arm's length principle requires that related-party transactions be priced in accordance with normal business practices and fair market prices applicable between unrelated parties in the same or similar circumstances.

In addition, where the service fees charged by a cross-border related party are calculated by reference to an allocation formula rather than based on actual costs incurred, such arrangements are likely to be challenged by the tax bureaus.

## 5.7 Restraints on Related-Party Borrowing

Related-party borrowing by foreign-owned local affiliates paid to non-local affiliates are generally subject to foreign exchange controls and must be registered as external debt. For tax purposes, where a foreign-invested enterprise or a local branch of a foreign enterprise acts as the lender, it is required to pay VAT and CIT on the interest income.

Where an interest-free loan arrangement is implemented, as the new VAT law does not treat the provision of services without consideration as a deemed sale, such interest-free lending is ordinarily not within the scope of VAT. Nonetheless, the potential application of the general anti-avoidance rule by the tax bureaus to impose adjustments remains a possibility. Furthermore, an interest-free loan diminishes the lender's CIT base and may consequently trigger tax bureau scrutiny and corresponding adjustments.

The rules governing the pre-tax deductibility of interest paid on borrowings where the borrower is a tax resident are discussed in **2.5 Deduction of Interest**.

## 6. Taxation of Foreign Income of Local Corporations

### 6.1 Foreign Income Exemptions

Resident enterprises of PRC are subject to CIT on their worldwide income; accordingly, the foreign income of a local corporations is generally not exempt from CIT. Certain regional incentives in PRC also provide an exemption on income from foreign direct investment (see **6.3 Dividends From Foreign Subsidiaries**).

To avoid double taxation, a resident corporation may credit foreign enterprise income taxes directly paid and indirectly borne in respect of its foreign income against the corresponding CIT liability of PRC. The credit is capped at the amount of CIT that would be payable on that foreign income. Where a resident corporation derives income from different countries, it may elect to calculate the credit limit separately for each country or to aggregate all foreign income into a single overall credit limit; once made, this election cannot be changed for five years. When crediting indirectly borne foreign income taxes, the credit should be calculated upwards from the lowest-tier foreign enterprise, covering up to five tiers of foreign enterprises, with each tier requiring a direct or indirect shareholding of at least 20%.

### 6.2 Non-Deductible Local Expenses

As noted above, PRC does not currently have a general exemption policy for foreign income. In PRC, the deductibility of expenditure actually incurred by an enterprise in connection with the derivation of income is not contingent on the place in which the expenditure is incurred or on whether the relevant income is exempt from tax. Costs and expenses corresponding to various items of exempt income received by an enterprise may, unless otherwise specifically provided, be deducted in calculating the enterprise's taxable profits.

## 6.3 Dividends From Foreign Subsidiaries

Dividends received by a local corporation from foreign subsidiaries are generally required to be included in taxable profits and subject to CIT. However, the credit mechanism is available to eliminate international double taxation.

In particular, under the regional incentives of PRC, income derived from incremental foreign direct investments by enterprises in tourism, modern services, or high-technology industries established in the Hainan Free Trade Port, the Hengqin Guangdong-Macao In-Depth Cooperation Zone and similar regions, is exempt from CIT.

## 6.4 Taxation of Intangibles Developed by Local Corporations

Where a local corporation develops an intangible asset and licenses it to a non-resident subsidiary for use, this constitutes a transfer of the right to use the intangible asset. Royalty income received by the local corporation in connection therewith is subject to CIT at 25%, and the foreign tax credit may be available. The price for the transfer of the right to use an intangible asset between related parties must comply with the arm's length principle. Where the price is clearly unreasonable and lacks genuine commercial purpose, the tax bureaus may make a special tax adjustment.

From a procedural standpoint, the local parent company is obliged to report details of its related-party transactions as part of its annual CIT reconciliation filing.

## 6.5 Controlled Foreign Corporation-Type Rules

In PRC, CFCs established in low-tax jurisdictions that fail to distribute or reduce their distribution of profits without justifiable business reasons are subject to the CFC rules. The tax bureaus will deem the CFC to have distributed dividends, and the portion of its profits attributable to the resident enterprise shareholders will be included in the current income of those shareholders and subject to CIT.

A foreign enterprise that simultaneously satisfies all of the following conditions falls within CFC rules:

- The foreign enterprise is controlled by resident enterprises, resident individuals, or a combination of both (each individually holding 10% or more of the voting shares, with combined holdings of more than 50%). The condition is satisfied if met on any single day within a tax year.
- The foreign enterprise bears an effective tax burden of less than 12.5%. The low-tax jurisdiction determination is based on the effective tax rate rather than the statutory rate. Foreign companies established in 12 designated non-low-tax countries or territories, including the United States, the United Kingdom, France, Germany and Japan, are exempt from this test.
- The profits of the foreign enterprise are undistributed without any genuine commercial reason. Foreign enterprises whose income derives primarily from active business activities may be exempt from the CFC test.

In addition, where a foreign enterprise's total annual profits are less than CNY5 million, it may be exempt from the CFC test.

A non-local branch is legally an extension of the head company in a jurisdiction outside PRC, rather than an independent legal entity. Accordingly, the CFC rules do not apply to non-local branches of local corporations. Under PRC tax law, the income of a non-local branch is treated directly as part of the head company's income, consolidated with the head company's income and subject to CIT. Any foreign taxes paid by the non-local branch may be credited to avoid double taxation.

## 6.6 The Substance of Non-Local Affiliates

PRC tax law does not currently apply substance requirements to non-local affiliates.

## 6.7 The Sale of Shares in Non-Local Affiliates

Gains derived from the disposal of shares in non-local affiliates are equally subject to CIT. The gain derived from a transfer of equity interests shall be the amount of the transfer proceeds less the cost of acquiring such equity interests. Tax is payable at the rate of 25% (or such reduced rate as may apply to the local corporation under applicable preferential regimes). In cases where the gain has suffered tax outside PRC,

a credit may be claimed for the foreign tax paid (see 6.1 Foreign Income Exemptions).

## 7. Anti-Avoidance Provisions

### 7.1 Overarching Provisions

In recent years, anti-avoidance rules have developed rapidly in PRC, expanding from a primary focus on enterprises to comprehensive coverage of IIT and VAT, strengthening provisions targeting arrangements that are technically compliant with PRC tax law but lack genuine commercial purpose and are designed primarily to obtain a tax advantage.

#### Anti-Avoidance Provisions

- *CIT*: The tax bureaus have the power to adjust arrangements implemented by enterprises that lack genuine commercial purpose and result in a reduction of taxable profits.
- *IIT*: The tax bureaus may make adjustments in cases where an individual's tax liability is reduced as a result of a transaction not conducted on an arm's length basis, where a CFC fails to distribute or reduces its distribution of profits without justifiable business reasons, or where an individual obtains an improper tax advantage through an arrangement lacking genuine commercial purpose.
- *VAT*: The VAT Law, which took effect on 1 January 2026, introduced a new anti-avoidance provision. Tax bureaus now have the authority to make tax adjustments in respect of transaction arrangements that lack a reasonable commercial purpose and are primarily designed to circumvent VAT.

#### Special Tax Adjustments

More detailed rules are provided under PRC tax law in relation to specific anti-avoidance arrangements such as transfer pricing, thin capitalisation and tax haven avoidance, as well as the associated related-party filing and contemporaneous documentation requirements.

#### General Anti-Avoidance Administrative Rules

These rules govern arrangements that are formally lawful but whose sole or primary purpose is to obtain a tax advantage, and that lack genuine commercial purpose; they apply in the field of CIT.

## 8. Audit Cycles

### 8.1 Regular Routine Audit Cycle

PRC does not have a regular audit cycle that applies to all taxpayers on an annual basis; tax audits are typically initiated based on the exposure of case-specific risks. Common triggers for a tax audit include random selections by the tax bureaus identifying tax risks, leads arising from named or anonymous tip-offs, anomalies in tax-related information identified through big data analysis, and tax issues connected with other cases under investigation.

In addition, tax supervision is becoming increasingly sophisticated through the use of big data. While this might not necessarily trigger a formal tax audit, the tax bureau's system may generate alerts in response to anomalies in a company's daily operational data.

In most cases, the limitation period for recovery by tax bureaus of unpaid or underpaid tax is three years. In special circumstances, this may be extended to five years. In cases involving tax evasion, anti-taxation measures or tax fraud, recovery may be pursued without any time limit.

## 9. BEPS

### 9.1 Adoption of BEPS Recommendations

As an active participant in the BEPS Framework, PRC was among the first 67 countries to jointly sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting in June 2017, with a view to applying the outcomes of the BEPS project to more than 3,000 bilateral tax treaties worldwide.

PRC has now incorporated a series of BEPS recommendations into its domestic legislation and tax administration practice. PRC has adopted all four minimum standards: countering harmful tax practices, preventing treaty abuse, implementing country-by-country reporting and improving dispute resolution mechanisms. Meanwhile, PRC has introduced a number of BEPS Actions, including rules regarding hybrid mismatch arrangements, CFCs, thin capitalisa-

tion, intangible assets, risk and capital, and mandatory disclosure.

## 9.2 Government Policy and Objectives Approach

As an OECD participant country, PRC is deeply engaged in the BEPS project and has played a constructive and positive role in building international consensus, with the aim of establishing a fairer and more appropriate international tax framework consistent with the demands of globalisation.

Within the BEPS Framework, PRC pursues a dual strategic objective. On the one hand, PRC aims to strengthen international co-operation, draw on international experience, and optimise its domestic tax system to effectively safeguard the security of its national tax base and the legitimate interests of cross-border taxpayers. On the other hand, it seeks to enhance its voice in international tax governance and demonstrate the responsibilities of a major economy through active participation in research, discussions and the translation of outcomes.

The implementation of Pillar One and Pillar Two remains at a stage of dynamic development. PRC will take into account the international regulatory trajectory, actual domestic economic requirements and the operational realities of enterprises, and will proceed prudently and steadily with the implementation of the relevant rules. If those relevant rules are implemented in PRC, it is anticipated to have a significant impact on the digital economy sector, large multinational enterprises, and enterprises investing overseas.

### 9.3 International Tax

PRC pays close attention to the development of international tax rules and the evolution of the global tax order, particularly with respect to topics that affect enterprises going global:

- *Economic substance requirements:* As the BEPS project continues to advance, traditional tax havens and low-tax jurisdictions are increasingly requiring demonstration of economic substance. The Hong Kong Foreign-Sourced Income Exemption regime took effect in 2023 and has attracted considerable attention from multinational enterpris-

es operating under red-chip structures and foreign-invested enterprises.

- *Pillar One:* The global implementation of Pillar One remains uncertain. PRC, as a major market jurisdiction and significant residence jurisdiction, is closely monitoring developments relating to Pillar One.
- *Pillar Two:* As Pillar Two moves into practice, enterprises investing overseas continue to monitor its impact on the effectiveness of overseas tax incentives and the cost of tax compliance.

### 9.4 Competitive Tax Policy Objectives

To balance domestic economic development with global tax competition, PRC has in recent years moved away from a strategy of tax competition based on fiscal rebates, instead seeking to enhance the attractiveness of the market by standardising tax incentives and improving business environment.

In actively responding to BEPS, combating harmful tax practices and preventing base erosion and profit shifting, PRC has undertaken a systematic optimisation and upgrade of the domestic tax incentives management framework, strengthening oversight of the conditions for the application of tax incentives. This is designed to ensure that tax incentives genuinely benefit the real economy, rather than serving as a vehicle for cross-border enterprises to avoid tax obligations.

### 9.5 The Competitive Tax System

PRC's competitive tax system does not currently have features that are notably more vulnerable than other areas of the tax regime, and there are no state aid or similar constraints applicable.

### 9.6 Hybrid Instruments and BEPS Implementation

In 2013, the State Administration of Taxation issued the Announcement on Issues Concerning Enterprise Income Tax Treatment of Hybrid Investment Businesses of Enterprises, which established that hybrid investments satisfying specified conditions are to be uniformly characterised as debt investments for tax purposes. Since then, no new policies have been issued in PRC specifically addressing the tax treatment of hybrid instruments, and the impact of the BEPS project on neutralising hybrid mismatch arrangements in PRC has been relatively limited. As

cross-border economic activity increases and tax reform progresses in PRC, subsequent administrative rules warrant continued attention.

## 9.7 Interest Deductibility and Territorial Tax Regime

As PRC does not apply a purely territorial tax jurisdiction, there are no interest deductibility restrictions specifically designed to accompany a territorial regime. However, PRC tax law does contain interest deductibility limitation rules that serve to prevent the use of thin capitalisation and related-party borrowing to circumvent tax obligations (see 2.5 Deduction of Interest).

## 9.8 Controlled Foreign Corporation Reform

PRC adopts a tax system that combines both a residence regime and a territorial regime. Currently, PRC has implemented the CFC rules under BEPS Action 3. These rules, in effect, “pierce the veil” of CFCs by treating a portion of their profits as constructively distributed, thereby effectively curbing tax avoidance structures that utilise entities in low-tax jurisdictions to defer or escape Chinese tax obligations. For the CFC rules, see 6.5 Controlled Foreign Corporation-Type Rules.

## 9.9 Anti-Avoidance Rules

The limitations on tax treaty benefits and anti-avoidance rules in PRC are not more stringent than those of other major jurisdictions.

## 9.10 Transfer Pricing and IP Taxation

The BEPS transfer pricing rules have significantly influenced PRC’s treatment of intangible property in related-party transactions. BEPS emphasises the importance of aligning value creation with profit attribution for intangible assets by reference to economic substance. Incorporating this principle, PRC’s transfer pricing regulations mandate a functional analysis of the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangibles. This ensures that returns attributable to intangibles are allocated to the parties within the group that perform the core functions and assume the associated risks, as opposed to merely following legal title. During transfer pricing examinations, tax bureaus are increasingly scrutinising the valuation methodologies applied to

intangibles and their reasonableness. Taxpayers must adduce robust documentation substantiating that the pricing adopted for the transfer or use of intangibles adheres to the arm’s length standard, thereby forestalling the erosion of the tax base through artificial pricing arrangements.

## 9.11 Country-by-Country Reporting and Transparency Provisions

To enhance the tax transparency of cross-border enterprise groups, PRC has incorporated the country-by-country (CbC) reporting regime into domestic law. CbC reporting covers the global distribution of all member entities of a group’s income, taxes and business activities by country. The ultimate controlling enterprise of a cross-border enterprise group whose combined revenues in the preceding financial year as reported in its consolidated financial statements exceed CNY5.5 billion is required to file a CbC report. Resident enterprises designated by the cross-border enterprise group as the reporting entity are also subject to this filing obligation. CbC reports form part of the related-party reporting obligations and must be filed together with the annual CIT reconciliation return by 31 May each year.

## 9.12 Digital Economy Businesses

Although PRC has not yet formulated specific tax collection and administration policies targeting digital economy businesses operating largely from outside PRC, such businesses are nonetheless subject to the VAT and WHT regimes. As PRC’s participation in international tax governance deepens, further policy developments warrant close attention.

## 9.13 Approach to Digital Services Taxation

PRC has not yet introduced a digital services tax, nor has a domestic legislative proposal for a digital tax been published.

As a member of the BEPS Framework, PRC participated in the publication of the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy in 2021, and continues to push for alignment between the BEPS and the two-pillar solution and domestic law. At the same time, PRC has formally designated data as a factor of production, has established accounting rules

for corporate data assets, and is strengthening the application of big data tax administration technology, in preparation for adapting to the tax governance demands of the digital economy.

## 9.14 Offshore IP Provisions

Where offshore intellectual property is used within PRC, this constitutes a transfer of the right to use such assets by a non-resident enterprise to an organisation or individual within PRC. The non-resident enterprise is subject to WHT at 10% and VAT at 6% on income derived from within PRC (royalties). In most cases, such taxes are collected through a withholding mechanism, whereby the domestic payer of the royalties (typically also the domestic user of the intellectual property) is required to withhold and remit the tax.

PRC tax law follows the “substance over form” principle in allocating income derived from intellectual property. An enterprise that holds legal ownership of intangible assets but does not contribute to their

value should not participate in the income allocation from such intangibles. Where an enterprise provides only funding during the development and utilisation of intangibles, without actually performing the relevant functions or assuming the corresponding risks, it should only receive a return reflecting a reasonable cost of funding. The treatment of royalties does not differ based on the tax residency status of the owner, except where a bilateral tax treaty is applicable, in which case the provisions of the relevant treaty shall prevail. In practice, with respect to owners of intellectual property located in low-tax countries or territories, the tax bureaus may intensify the application of the general anti-avoidance rule. In particular, when assessing the applicability of tax treaties, they may conduct more rigorous scrutiny of the substance of owners registered in tax havens that lack economic substance, thereby reducing the likelihood of treaty abuse arrangements. In cases involving related-party transactions, the review of relevant transfer pricing arrangements may also be more stringent.

## Trends and Developments

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**Han Kun Law Offices** is a leading full-service law firm in China with over 900 professionals located in Beijing, Shanghai, Shenzhen, Hong Kong, Haikou, Wuhan, Singapore, New York City and Silicon Valley. The firm's main practice areas include private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, compliance, banking and finance, aviation finance, foreign direct investment, antitrust/competition, data protection, private client/wealth

management, intellectual property, bankruptcy and restructuring, and dispute resolution. Han Kun provides a full range of legal services and business advice to Chinese companies and multinationals doing business in China. Over the years, Han Kun has been widely recognised as a leader in complex cross-border, domestic transactions and compliance matters that cover foreign investment access, industry compliance, labour and national security review, taxation, foreign exchange and intellectual property.

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In the recently concluded year of 2025, China's tax landscape witnessed numerous significant changes, with significant developments spanning from tax legislation to tax law implementation. These developments will exert a far-reaching influence on China's tax cycle in 2026 and beyond. Below, we will focus on some of the key developments and trends.

### 1. Implementation of Value-Added Tax (VAT) Legislative Framework

For many years, the Chinese government has been consistently working to improve tax legislation. Among all major taxes, the VAT Law was the last to be finalised. In 2024, the Chinese government passed the VAT Law and decided to formally implement it in 2026.

In this context, throughout 2025, Chinese government branches – particularly the Ministry of Finance and the State Taxation Administration – were tasked with discussing, introducing and refining supporting policies such as the implementing regulations for VAT. From the fourth quarter of 2025 to early 2026, these regulations and policies have been rolled out at an exceptionally rapid pace. These measures will further solidify and refine China's VAT legal framework.

According to Han Kun's observations, the recently implemented VAT policies have the following core focuses:

- First, they are more detailed and explicit. For instance, the new VAT policies provide very clear definitions of "taxable transactions" and their core elements and limitations, thereby preventing

discrepancies in enforcement standards caused by inconsistent interpretations among local tax bureaus.

- Second, they are more scientifically grounded and aligned with tax logic.
- Third, they address deficiencies and loopholes in previous tax policies.

Additionally, as VAT legislation continues to evolve, attention should be paid to several supplementary tax policies and mechanisms:

- Adjusting the rules for defining taxable transactions, clarifying the criteria for determining the taxability of cross-border sales of services and intangible assets, as well as sales of financial products.
- Streamlining the scope of deemed sales, particularly ensuring that the provision of services without charge is generally no longer treated as a taxable deemed sale.
- Refining input tax credit rules, clarifying that input tax corresponding to non-taxable sales amounts is not deductible, and introducing new deduction rules for long-term assets with mixed-use purposes.
- Establishing a VAT withholding system for natural persons, requiring domestic paying entities to withhold VAT on taxable transactions involving natural persons.
- Strengthening the administration of small-scale taxpayers by clarifying that taxpayers whose annual taxable sales exceed CNY5 million shall change their taxpayer status in the same month.

- Introducing a general anti-avoidance provision, granting tax bureaus the power to make tax adjustments for transaction arrangements that lack reasonable commercial purposes and are primarily aimed at avoiding VAT.

Currently, the implementation of the VAT Law is in its early stages, and uncertainties remain regarding the practical application of the new regulations. Further clarification is urgently needed in the following areas:

- For cross-border services, additional guidance and criteria are needed to determine what constitutes “services consumed on site overseas” and “directly related to domestic goods, immovables, or natural resources”.
- Following adjustments to the input tax deduction rules, it is necessary to clarify the definition and scope of “business activities” in non-taxable transactions that are ineligible for input tax credits, as well as the practical implementation criteria for input tax credits on mixed-use long-term assets.
- The specific scope and operational procedures for withholding tax on taxable transactions involving natural persons remain unclear. In particular, it is uncertain whether taxes withheld from payments to natural persons can serve as a basis for the payer to obtain legally valid vouchers for input tax credit purposes.
- The boundary of application for general anti-avoidance rules remains unclear, and it is uncertain to what extent common arrangements, such as the provision of services without charge, will be required to be adjusted. In this connection, it is recommended that relevant entities closely monitor tax law policy developments and guiding cases, dynamically adjusting transaction arrangements and tax strategies to ensure tax compliance.

## 2. Discussions and Changes Regarding QFLP Tax Administration

“QFLP” refers to Qualified Foreign Limited Partnership. Over the past decade, the QFLP form has served as an effective channel for foreign investors to access Chinese businesses and assets. However, due to the ongoing evolution of China’s tax regime for limited partnerships, many fundamental principles have yet to be established, and given the unique characteristics

of cross-border limited partnership investments, the tax position of QFLPs has remained unclear.

For a considerable period, the tax practice of QFLP operations has been conducted in reference to foreign direct investment (FDI). Specifically, most local tax bureaus in various regions uniformly levy a 10% tax on QFLP-generated income (including capital gains, interest, dividends and similar distributions) only upon remittance. However, they rarely permit QFLP-related overseas investors to apply for tax treaty benefits. Nevertheless, QFLP foreign investors largely enjoyed a more favourable tax position than traditional FDI investors. This stemmed from the opportunity for foreign investors to declare taxable income based on the actual amount of profits remitted (generally aligning with the net profit framework of domestic limited partnerships). In other words, when filing income tax returns for QFLP investments (reflected as withholding tax deducted by the domestic limited partnership on behalf of the overseas investor), all costs and expenses at the partnership level are deducted before taxation, and profits and losses across projects can be offset. In contrast, traditional FDI projects can only file separate tax returns for each specific project and cannot deduct costs or expenses unrelated to the project’s investment costs or losses from other projects. Of course, given the relatively limited number of investors, scale and profitability of QFLP investments, to our knowledge, there have been no instances of systematic, large-scale tax avoidance through QFLPs.

Meanwhile, Chinese tax bureaus have consistently maintained a particular focus on QFLPs. Some tax officials argue that QFLPs (domestically registered limited partnerships) constitute permanent establishments formed by foreign entities within China. Consequently, income derived by foreign entities from domestic sources should be taxed at the resident enterprise rate of 25%, with no room for applying any treaty benefits. In practice, despite these uncertainties, the tax treatment of QFLPs has remained relatively stable in most regions over the long term. This stability is also linked to local governments’ fiscal pressures and the need to attract foreign investment.

It was not until the fourth quarter of 2025 that tax bureaus began implementing systematic adjust-

ments to tax administration. Although formal regulations have yet to be issued, tax bureaus in QFLP pilot regions have already started proactively contacting local QFLP entities and requiring them to adjust their tax filing mechanisms. Specifically, non-resident enterprises are being required to register for tax purposes and switch to filing using the tax return form designated for non-resident enterprises forming a permanent establishment within China. Changing the tax return form is far from a mere procedural adjustment; while QFLPs may retain their previous taxable income calculation methodology, the actual tax payment timing will advance (requiring periodic filings rather than triggering upon actual overseas payments), and the applicable tax rate for relevant overseas investors will sharply increase from 10% to 25%. Additionally, attention should be paid to tax bureaus' requests for QFLP overseas investors to provide extensive information on their offshore structures. It cannot be ruled out that tax bureaus seek to understand and control such information for potential future taxation purposes (such as broadening the tax base for direct investors or extending tax administration to their upper-tier investors). Relevant investment institutions must be prepared. For existing or prospective QFLP investors, we recommend restructuring or adjusting investment plans based on factors including the institution's own structure and the profitability of investment projects to address potential tax uncertainties.

### 3. Administration of Overseas Income for Tax-Resident Individuals

In 2018, China revised its Individual Income Tax Law (effective from 2019), systematically introducing a relatively comprehensive and enforceable mechanism for tax administration of overseas income earned by tax-resident individuals. That same year, China formally adopted the Common Reporting Standard and has since participated in periodic information exchanges. Despite the support of these policies and mechanisms, it was not until 2025 that Chinese tax bureaus fully initiated compliance inspections and recovery actions concerning the overseas income of individual tax residents.

In 2025, nationwide tax bureaus contacted relevant tax-resident individuals via text messages, phone calls, and other means, requiring them to fulfil their tax

filing obligations for overseas income. Among those contacted, a relatively large number were individuals trading US stocks via certain apps; others receiving notifications had earned income overseas without paying taxes. Due to the lack of tax knowledge among these individuals and the ambiguity of certain tax filing guidelines, the initial stages of the tax filing process were relatively inefficient. However, with the active participation of tax bureaus at all levels and the sharing of online experiences, tax filing outcomes in the final months of 2025 became relatively satisfactory. For income earned during historical periods (eg, 2022), late payment penalties were incurred when filing back taxes, but no cases of substantial fines have been reported so far.

Regarding the administration of overseas income for the years following 2026, Han Kun shares the following observations:

- First, a broader range of individuals will be affected. Those who were not previously contacted to file back taxes (such as individual tax residents who have worked or are currently working overseas) will also be included in the scope of tax filing obligations.
- Second, a broader range of overseas income will fall under tax administration. This includes active income and other passive income earned by relevant tax-resident individuals abroad, which may be subject to tax filing requirements in China.
- Third, unresolved matters – such as arrangements involving shareholdings through BVI companies or offshore trusts – will gradually be clarified through precedent-setting cases and required to comply.

Given these developments, we recommend that relevant tax-resident individuals undertake tax planning and adjustments after fully considering the tax implications of their overseas income, thereby managing tax risks and potential vulnerabilities.

### 4. Other Noteworthy Changes in Tax Administration

First, regarding tax legislation, in 2025 the Chinese government introduced a reinvestment tax credit policy to attract and stabilise foreign investment, while a revised version of the Tax Collection and Adminis-

tration Law may be enacted in 2026. As the fundamental law governing tax authority enforcement and taxpayer reporting, the new Tax Collection and Administration Law carries significant expectations. Based on the current draft for public comment, the revised law may introduce new mechanisms and reforms in areas such as tax administrative reconsideration, tax late payment penalties and taxpayer co-operation mechanisms.

Second, over the past few months, tax bureaus have intensified their focus on key areas such as the platform economy, tax incentives and tax audits, continually enhancing tax collection and administration efficiency:

- In the platform economy sector, China implemented regulations requiring internet platform enterprises to report tax-related information. Internet platform companies, including online merchandise sales platforms and live-streaming platforms, are required to submit tax-related information. Reporting obligation content encompasses the basic information of platform operators, as well as the identity and income details of both platform operators and their employees. It also includes tax-related information pertaining to live streamers and their partners or collaborators. This reporting mandate has significantly enhanced tax transparency in the platform economy, effectively reducing opportunities for high net worth individuals, such as top-tier streamers, to evade taxes by concealing income. Simultaneously, these requirements have heightened compliance standards for platform operators, compelling them to optimise their business models and income structures in order to adapt to an increasingly transparent regulatory environment.
- Regarding tax incentives, China's tax policies now emphasise standardisation and precision. On one hand, tax incentives have shifted from region-specific tax breaks and fiscal subsidies aimed at attracting investors towards a framework oriented towards a unified national market, thereby promoting law-based taxation and uniform enforcement. On the other hand, regional tax policies targeting key sectors and distinctive industries continue to play a role. Regions such as the Guangdong–Hong

Kong–Macao Greater Bay Area, Western China and Hainan Province are updating their industrial catalogues to adapt to new circumstances. Concurrently, tax bureaus are intensifying audits on businesses that misrepresent themselves as operating in supported industries in order to evade taxes.

- Regarding tax audits, tax bureaus have intensified scrutiny in recent years over R&D expense deductions, fraudulent tax benefit claims and tax intermediary services. With the deep application of big data and artificial intelligence, coupled with increasingly robust cross-regional joint oversight mechanisms, tax audits will see significantly enhanced coverage and precision. As a result, complex tax avoidance schemes face heightened exposure risks, compelling relevant parties to prioritise tax compliance constraints in commercial arrangements.

Han Kun predicts that in 2026, tax bureaus will increase audits targeting listed companies, the utilisation of tax incentives, and cross-regional and cross-tax joint inspections.

Additionally, tax administration reforms concerning limited partnership taxation systems and tax compliance requirements for restructuring of pre-IPO companies (including equity incentives) represent noteworthy tax developments.

In recent years, limited partnerships (LPs) have emerged as a key focus of tax administration. In practice, potential flaws in various tax treatments – such as the applicable tax rate for natural person LPs in specific investment projects, and the confirmation of income and recovery of investment costs for corporate LPs under the “look-through” mechanism – may all attract challenges from tax authorities. Furthermore, obstacles remain in applying tax incentives when limited partnerships engage in corporate reorganisations and other routine tax matters. While some successful cases of preferential treatment have emerged in practice, significant uncertainty remains overall. Given the widespread adoption of limited partnerships in the current economic conditions, particularly their irreplaceable advantages in sectors such as investment funds, we anticipate that tax bureaus will further clarify and unify tax administration rules

and preferential treatment standards relating to limited partnerships. This would enhance the certainty and transparency of policy implementation.

At the preparation stage of IPOs, Chinese enterprises often engage in complex capital operations, including capital reductions, equity structure adjustments, and restructuring or dismantling of the red-chip structure. Pre-IPO companies may involve multiple transactions such as share reductions, structural adjustments and employee stock ownership plans. During structural adjustments, potential tax risks may include unpaid taxes on original shareholder equity transfers, improper tax treatment of consideration received in share conversions, and indirect transfers of domestic companies. In addition, operational restructurings may fail to meet the requirements for special tax treatment under reorganisation rules. The restructuring or dismantling of red-chip structures may generate taxable gains, increasing the tax burden and potentially leading to base erosion. If a company listed on the National Equities Exchange and Quotations (NEEQ, a platform for corporate financing and stock trading that sits between listed and unlisted companies) becomes a publicly traded company, the applicability of relevant tax policies and the feasibility of tax planning arrangements also draws attention.

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