TAX NEWS CHINA

2025 (No.10 issue)
September 2025

TAR practice blossoming in China

In brief

» While tax authorities across China are stepping up efforts to enforce Tax Advance Ruling (TAR) practices, more rulings are being publicly showcased. This phenomenon highlights encouraging progress in the experimental field of TAR and marks a much-needed improvement in tax certainty.

» This article examines two thought-provoking TAR cases in Shanghai, delving into their unique aspects.

Feedback

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In detail

Tax certainty has long been a sought-after element in China. Various means exist to achieve it, ranging from softer approaches (e.g., informal inquiries, negotiations, or post-event adjustments) to more confrontational methods (e.g., administrative appeals or judicial adjudication). However, these are often seen as less effective, sometimes punitive, and generally unpleasant.

Tax Advance Ruling (TAR) has emerged to bridge this gap, gaining popularity for its efficiency and customization. Among the cities that have formally adopted TAR practices, Shanghai stands out as a frontrunner, as evidenced by its recent initiatives: the introduction of Shanghai TAR policies on 29 December 2023 and the publication in July 2025 of three TAR cases — covering a merger, a service transaction, and a land use right transfer.

Examining these cases reveals their query, reasoning and typicality: each ruling is delivered as a standardized one-to-one letter in an abstracted and anonymized format, clarifying the applicable tax regulations and issuing binding verdicts for the relevant district-level tax authorities in Shanghai.

Two cases in focus

This article provides an in-depth analysis of two specific cases: one concerning business classification under the VAT regime and another addressing tax exemption assessment under the corporate income tax (CIT) regime, as summarized below.

AR cases	Case 1: VAT assessment	Case 2: CIT exemption assessment
Business plan	A Shanghai entity plans to add intelligent cleaning equipment to its estate cleaning service.	A Shanghai entity plans to merge its two 100% owned subsidiaries.
Query	It enquires if its new service should be still classified as "*enterprise management*" (VAT rate at 6%) or others.	It enquires if its merger can enjoy a special CIT exemption treatment (i.e. merger at par value without capital gain).
Verdict	SMTS rules that "*enterprise management*" can prevail, subject to VAT at 6%.	SMTS upholds CIT exemption.
Tax rules	Cai Shui [2016] No. 36	• Cai Shui [2009] No. 59 (art. 5 and 6) • STA Notice [2010] No. 4; and • STA Notice [2015] No. 48
TAR date	May 2025	May 2025

Analysis

Reflecting on the original legislative intent behind TAR regulations — whether at national or local level — TAR applications are only admissible when the proposed matters satisfy the following fundamental criteria:

1. Matters must involve plans for implementation within two years, be commercially justified, and legitimate;
2. Matters must not yet be explicitly covered by existing tax laws and require official clarification; and
3. Matters must not involve transfer pricing arrangements.

We now examine the distinctive aspects of these cases that warranted a TAR ruling.

- **Case 1**

  The business migration plan could have created classification confusion. At first glance, all property cleaning services should fall under the "*enterprise management*" category, subject to a 6% VAT rate. However, without details of the transaction, one might hazard a supposition that the applicant either: (1) entered a new business, or (2) provided services under a different VAT rate (e.g., the 9% rate for "*property maintenance*"). Ultimately, SMTS ruled that the 6% rate for "*enterprise management*" should apply.

  Notably, this ruling was issued after the implementation of the new VAT Law in December 2024. The new law stipulates that when a transaction involves multiple VAT rates, the rate applicable to the "*principal*" service shall govern the entire transaction. This decision not only aligns with the new legislation but also provides valuable guidance for achieving tax certainty during periods of regulatory change.

- **Case 2**

  This case similarly raises questions about why a straightforward merger between two wholly-owned subsidiaries would warrant a TAR.

  At first glance, the transaction appears clearly addressed by existing tax legislation, particularly *Caishui [2009] No. 59*, which explicitly grants CIT exemption for absorption mergers between subsidiaries under common parent company control.

  The likely rationale for TAR admission could be that the merger might involve unique circumstances (though undisclosed) that created ambiguity regarding its CIT exemption eligibility. Drawing on our extensive experience working with SMTS - the supreme authority overseeing Shanghai's 16 district-level tax bureaus - we speculate that this case may have involved an unconventional merger structure not yet covered under the current M&A tax regulations. Finally, SMTS rules that the merger under consideration can enjoy CIT exemption (deferral) treatment.

WTS China's observation

These TAR cases underscore the growing demand for tax certainty amid business innovation and industry convergence. They also effectively address concerns regarding the protection of proprietary commercial information.

Ultimately, one should recognize that TARs are case specific, and are <u>not</u> establishing precedents for general application. The minimalist nature of TAR letters deserves commendation - they effectively provide tax certainty to the applicants while maintaining strict confidentiality and preventing copycats in the public.

With the expanding nationwide adoption of TAR practices — already implemented in Beijing, Shanghai, Hainan, Guangzhou, Nanjing, and Heilongjiang — the TAR mechanism has undeniably emerged as an increasingly essential and practical tool for enhancing tax predictability.

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