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Tax Administration for VCEs in China: A Lifecycle Perspective

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Abstract: Tax administration, as a crucial component of the business environment, directly impacts the operational efficiency and investment vitality of venture capital enterprises (VCEs). Based on the lifecycle theory, this study segments VCEs into four stages: fundraising, investment, post-investment management, and exit. It then systematically analyzes the key challenges within China's tax administration at each stage. The research identifies several persistent challenges: inconsistent policy interpretation and enforcement across regions, complex and ambiguous criteria for qualifying start-up technology enterprises, inflexible mechanisms for carrying forward losses across periods, passive and lagging policy services, and uncertain exit tax liabilities coupled with inefficient refund processes. To address these issues, a systematic optimization of the tax administration system is proposed. This includes enhancing policy certainty, establishing a cross-cycle tax service mechanism, deepening targeted guidance and risk alerts, strengthening inter-departmental collaboration and co-governance, and leveraging digital technologies. These measures aim to provide theoretical support and practical references for advancing the tax administration of VCEs towards greater professionalism and refinement.

Keywords: Venture Capital; Tax Administration; Lifecycle; Tax Compliance

1. Introduction

In recent years, China has deepened its innovation-driven development strategy. As a vital link connecting technological innovation with capital markets, venture capital has continuously injected momentum into fostering technological innovation and stimulating market vitality. Data from the Asset Management Association of China shows that by July 2025, the number of active venture capital funds in China had reached 26,300, with assets under management totaling 3.46 trillion yuan. The industry as a whole exhibits a positive trajectory of standardized development, deep engagement in technology, and stable operations. However, compared to the rapid development of the venture capital market and its complex and dynamic operational models, the current tax administration system has yet to fully align with its inherent characteristics of high risk, long investment cycles, and high specialization. Issues such as inadequate policy adaptability, cumbersome tax collection procedures, and insufficiently targeted services have objectively increased the compliance costs and tax risks for VCEs, and to some extent, constrained the full release of capital efficiency.

Optimizing tax administration for VCEs fundamentally reflects the shift in tax governance philosophy from traditional control-oriented approaches to modern service-oriented models. This shift prioritizes enterprise tax needs, reduces compliance costs through service optimization, and enhances corporate tax compliance willingness. From a value perspective, tax administration for VC firms has dual attributes: On one hand, it reduces the cost of tax compliance through high-quality services, thereby incentivizing enterprises to proactively fulfill their tax obligations. On the other hand, it alleviates the tax burden through policy guidance and the implementation of tax incentives, enabling enterprises to allocate more resources to R&D and business expansion, and promoting sustainable development. This dual objective aligns with both the new demands for tax governance capabilities in high-quality economic development and the concept of building a service-oriented government. It contributes to fostering a law-based and convenient tax business environment.

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2. Literature Review

Optimizing tax administration for VCEs requires a systematic understanding of the theoretical foundations of tax policies, the stage-specific needs of VCEs, and existing proposals for improvement. Existing research can be categorized into three main streams. However, a comprehensive lifecycle perspective remains underdeveloped.

Most extant studies concur that the theoretical foundations of China's tax policies for VCEs contain inherent conflicts, leading to frequent disputes in practice. The conceptual positioning of partnership income tax is a focal point of controversy. Zhang Mujun [1] argues that the debate over whether individual partners' income from VCEs should be subject to a 20% rate essentially stems from the theoretical clash between the “aggregate” and “entity” concepts.

2.1 Theoretical Foundations and Controversial Issues in Venture Capital Tax Policy

Specifically, the application of the partnership income tax system presents practical challenges. Wei Lin [2] looked at nested partnerships used in equity deals and fund raising; he argues current regulations fail to accommodate evolving financial structures. Zhang Jinhong [3] focuses on how partnerships miss breaks aimed at small, low-profit companies and calls the setup unfair. Wei Xuemei [4] examines the application challenges of the “distribute first, tax later” principle for institutional investors in private equity funds, noting that current rules lack the flexibility required by market practices.

2.2 Phased Characteristics of Tax Administration for VCEs

Some studies have begun to examine the tax service needs of VCEs as they move through their lifecycle. Still, an integrated framework is lacking. At the fundraising step, Li Zhuyun [5] points out that no direct tax bill shows up yet, fund managers must carefully select the fund's domicile because local perks or penalties can swing the final payout for the fund and its backers. That makes policy certainty a service worth paying for while the money is still being raised. When the cash is finally poured into start-ups, Xue Wei et al. [6] remind us that both corporate and partnership funds can use losses to eat later gains. Whatever is left can be carried forward for at least five years. However, a key issue arises: most funds wrap up within seven years, and the big write-offs usually surface near the end. There just is not enough runway to use them. The rule says five, the cycle says seven, and the gap quietly lifts the real tax cost. Policy certainty is again the thing investors ask for. Following the completion of an investment, Zhu Gongping and Xu Quan [7] notice that ad and promo deductions turn into a fight. The law lets you deduct a slice of revenue, but VC firms barely book revenue at all. The cap stays low, the spend stays high, and the unused part vanishes. Add fear of “abusing incentives” plus auditor pressure, and you get partners begging for clearer guidance and early warning tools. On the way out, Chen Aihua [8] watches partners sell their stakes. New buyers set their tax cost at what they actually paid. That number rarely matches the old partnership basis. Nobody spells out if the two bases should move in lockstep later. Each study identifies stage-specific difficulties, yet they remain isolated rather than integrated into a cohesive, lifecycle-spanning service framework.

2.3 Optimization Pathways for Tax Administration

Most papers try to address tax headaches for VCEs by tweaking policy, tech, or teamwork, yet they skip the firm’s own life-cycle. Fan and Zhou [9] say tax breaks should hand out lower rates the longer you stay invested; that trims the weird distortions. Ma Caichen [10] identifies the issue of double taxation: corporate funds pay both company and personal income tax. Their fix is simple—drop the dividend tax on unlisted firms or copy Singapore’s “tax-exempt resident investment enterprise” set-up. Ye Xiaojie [11] notices limited-partnership losses stay locked inside the fund; investors can’t use them. He wants partners to net those losses against other income and stretch the carry-forward to ten years, the same cushion high-tech outfits get. Switching to tech fixes, Zhang Xuechun [12] wants every fund share and cash flow parked on a blockchain so regulators can chase nominee shells and circular money in real time. Liu Xiaoling [13] pushes an equity-investment database; AI would then flag quick-flip trades that smell like short-term arbitrage. When it comes to getting different agencies or stakeholders in one room, Liu Jianghui [14] shows VC money pairs well with a single subsidy but replaces a whole bundle of them. His take: steer VC toward firms on lone subsidies and tighten oversight on the ones swimming in bundled perks. Zeng Zhuoqi [15] finds public tech finance sparks innovation by loosening the funding choke; market money barely moves the needle, so state capital needs a stronger lead. Finally, Zhang Xuechun [12] criticizes regional preferential policies for creating "policy havens"; he asks the State Taxation Administration to print one national “Venture Capital Tax Incentive Catalog” so every province plays the same game.

2.4 Limitations of Existing Research

In summary, existing research has laid a valuable foundation by sketching the main ideas behind venture capital tax rules, mapping the administrative needs of firms, and proposing potential solutions. However, three significant limitations persist. First, stage-specific characteristics are examined in a fragmented manner. Papers zoom in on isolated issues, such as the deduction formula used at the investment step or the applicable partnership tax rate. They never line up the different service needs across the whole journey. No one has yet pulled together the policy fights that pop up while fundraising, or the tax-burden guessing game that hits at exit. Second, the recommendations tend to be generic; while they identify the problem of uncertainty at each stage, they lack detailed designs for delivering clear and reliable services to firms. Third, researchers have identified the core mismatch between standard tax rules and the extended lifecycle of VCEs, yet they fail to design integrated service mechanisms that cover the entire "fund-invest-manage-exit" cycle. Consequently, the proposed systemic optimizations remain vague. These gaps open the door for the present paper: we will pin down the real key challenges at every life-cycle stage, then sketch a path that is both stage-appropriate and scale-differentiated.

3. Basis for Aligning Lifecycle Theory with Tax Administration

The introduction of lifecycle theory into the tax administration framework for VCEs is well justified. This alignment is grounded in three dimensions: theoretical logic, practical necessity, and policy orientation. Lifecycle theory delineates organizational evolution, which closely mirrors the development trajectory of VCEs. It delineates four stages: startup, growth, maturity, and transition/exit. Each stage is characterized by its own goals, its own way of spending money, and its own flavour of risk. The operations of VCEs are deeply integrated with the lifecycle of their portfolio companies. Early on they hustle for funds and pick deals. Mid-game they coach founders and push value up. Near the end they hunt for exits and carve up the gains. Cash flow, profit recipe, and danger list keep shape-shifting the whole way. Old-school tax rules that treat everyone the same can’t keep pace. Policy lands late, services feel off. Integrating the lifecycle perspective into tax administration transforms the approach from a static, one-size-fits-all model into a dynamic and targeted one. This ensures resources are allocated where they are most needed and improves the overall efficiency of tax operations.

Venture capital firms don’t all want the same tax treatment. Their needs shift as they move through the lifecycle. At the start, when they raise money and set up shop, they hunt for a structure that keeps taxes see-through and neutral. They seek to minimize setup costs, so they weigh a corporation against a partnership and opt for the more tax-efficient structure. Later, once cash is flowing into deals, the game changes. Teams now claw for every venture capital tax credit on the books and try to keep the “look-through” rules in layered partnerships from turning into a maze. They need clear guidance that actually works on the ground. The exit phase presents distinct challenges. Founders and backers stare at the capital-gains clock. They map IPOs, secondaries, straight equity sales—each path carries its own tax bite. A big slice of the final pie is the carry; calling it income or capital gain can swing the return. One label can eat a fifth of the profit. Thus, a traditional, uniform approach to tax service is ineffective. A living, stage-by-stage tax engine has to tag along the whole ride.

On the policy side, we first need a tax system that tracks venture capital firms from birth to exit. That’s the only way to keep up with the

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push for modern tax governance and give firms help that actually hits the mark. Venture capital is the money engine behind the innovation-driven growth plan. If we smooth its tax path, the slogan "invest early, invest small, invest in tech" stops being a slogan and starts showing up in real numbers. It also feeds straight into building the national innovation system. Furthermore, as the "streamline administration, delegate power, and improve services" reform (often abbreviated as "Fang Guan Fu") reform digs deeper, tax offices are dropping the old cop mindset and picking up a service one. A lifecycle approach is the sweet spot where tight oversight and gentle service meet. This involves designing differentiated risk assessment rules for each stage and allocating administrative resources more strategically to high-priority areas. At birth, we lead with policy guidance and clear tax direction. While the firm is running, we tidy up the incentive-filing steps and tighten the after-care rules. At exit, we zero in on anti-avoidance tricks. This back-and-forth lifts compliance, gives companies a rules-based yet easy ride, and lets the tax crew spend their hours where the real fires are. It also shuts down the risk that some policy obtains misread or shows up too late.

Theoretical alignment, practical demands, and policy direction now meet in one place. Together they give venture capital firms a sturdy starting point for tuning tax administration across the whole lifecycle. Moreover, this mix also hands us a clear thread. We can pick out today's key challenges step by step and sketch future-ready fixes without jumping hoops.

4. Tax Administration Challenges across Different Lifecycle Stages

4.1 Fundraising Stage

This stage mainly sets up the fund and pumps in the money. Most venture capital funds in China now pick the limited partnership setup. There is inconsistency in the interpretation and enforcement of tax rules across regions.

First, the rule says "distribution-first, taxation-later," yet no one reads it the same way. Policies spell out that a partnership enterprise should follow this order. Still, local offices argue over when the investor actually owes the tax. Some want the bill the moment cash leaves the fund; others wait until the books close in December. This ambiguity forces fund managers to adopt conservative and often uncertain tax positions. Second, every city labels the cash that flows to an individual LP a little differently. One clerk calls it a dividend; the next aisle over it turns into business income. Pick the first box and you hand over 20%. Stay silent and the slide rule runs from 5% all the way to 35%. A venture capital outfit can lock the 20% slot, but only if it signs up for single-fund accounting. That choice sounds neat until you notice management fees can't hop across years; they simply vanish. The real headache is geography. A fund parked in City A watches the tax team dump its gain into the business bucket. Drive two hours to City B and the same gain slips into property transfer, still 20%. Consequently, the tax liability is determined more by geographical location than by a uniform interpretation of the rules. This undermines tax fairness.

4.2 Investment Stage

This is when firms sift through projects and decide where to put their money. They mostly ask if they can squeeze every drop out of perks like investment deductions.

First, the criteria for recognizing start-up technology enterprises are complex. To qualify for the policy allowing a 70% deduction of investment amounts from taxable income, the invested enterprise must be recognized as a start-up technology enterprise. This recognition involves multiple criteria, including years of operation, number of employees, total assets, and proportion of R&D expenses. Fund managers often struggle to accurately assess these factors during pre-investment due diligence. Furthermore, discrepancies in interpretation between tax authorities and enterprises regarding recognition standards may create risks for subsequent application of the incentives. Second, the loss carryforward mechanism lacks flexibility. Venture capital funds typically have extended investment cycles of 7-10 years, generating only management fees with high expenses during the early phase, resulting in significant book losses. Profits are concentrated in the later exit phase. Current tax laws provide unclear and inflexible provisions for loss carryforward in partnership funds, making it difficult to effectively offset later profits with earlier losses and thereby increasing the overall tax burden.

4.3 Post-Investment Management Phase

In this phase, which is characterized by passive and lagging tax policy services, VCEs also grapple with issues such as calculating performance-based compensation (carried interest) for their management teams. That math creates information gaps and slows down new rules from actually landing.

First, tax policy services stay passive and lag behind. Authorities mostly wait for filings after the fact. They rarely give early tips or risk alerts on tricky post-investment tasks, like spotting “equity disguised as debt,” handling share-based pay, or using tax treaties for cross-border deals. Moreover, the policy chain is just too long. A fresh national rule crawls from the State Taxation Administration down to provincial, municipal, district, and county offices, then to the frontline tax officer, and only then reaches the firm. Each hop adds delay and blurs the message. As a result, VCEs must independently monitor regulatory changes. It costs them time to figure things out, and they can still miss the window or read it wrong.

4.4 Exit Phase

Exit marks the moment when investors finally turn paper gains into cash. It also brings a thicket of tax bills and paperwork. Most fights between tax offices and taxpayers flare up right here. No one knows the exact tax liability in advance, and the admin steps tangle everyone.

First, tax burdens vary significantly across different exit methods. Exit pathways like IPOs, M&A, non-listed equity transfers, and buybacks involve complex transaction structures that may trigger multiple taxes (e.g., income tax, VAT), with intricate rules governing tax bases and payment timelines. Policy ambiguities exist in areas such as VAT treatment for restricted share transfers by listed companies or determining tax bases for indirect equity transfers via partnerships by individual investors. Second, tax administration processes are cumbersome, and refund efficiency is low. When applying for tax incentive refunds (e.g., investment credit benefits) or settling prepaid taxes, enterprises must submit extensive supporting documentation. The lengthy review process with multiple stages results in slow refund disbursement, tying up substantial corporate capital and time resources while impairing capital reinvestment efficiency. For instance, a fund investing in multiple early-stage technology startups applied for investment tax credit benefits upon exiting certain projects. However, the process proved arduous because the fund had to provide proof for each portfolio company meeting the "early-stage technology enterprise" criteria to tax authorities. Since some early stage companies had already deregistered or lost documentation, the credit verification process became difficult, and the tax benefits were not realized in a timely manner.

5. Tax Administration Optimization Strategies

To address the aforementioned challenges, a lifecycle-based approach should be adopted to shift tax administration from a passive, reactive mode to a proactive and anticipatory one. The goal is to construct a comprehensive tax administration system that accurately meets the needs of VCEs throughout their entire lifecycle. The following optimization strategies are proposed:

5.1 Making Tax Policy Less of a Moving Target

For larger, well-established VCEs, tax authorities could offer advance tax rulings. They could submit the proposed transaction details for prior review. In return, they would receive a binding ruling. A proactive approach would involve the State Taxation Administration systematically addressing these recurrent disputes. These include issues such as whether distributions to individual LPs constitute business income or capital gains, when exactly does the “distribute-first, tax-later” clock start, and can a partnership push old losses forward. The administration should bundle these issues into one national “Tax Administration and Service Guide for the Venture Capital Industry.” Same answers from Beijing to Guangzhou, thereby minimizing discretion and inconsistency in local enforcement.

5.2 Establishing a Cross-Cycle Tax Administration Mechanism

Set up separate ledgers just for venture capital tax perks. Push, or even order, venture capital firms to keep an electronic tax-incentive ledger. They record key portfolio company details, how much went in, and the clock-start date right after the deal closes. Plug these ledgers into the tax office system. One click later, an exit report pops out, so the deduction claim moves fast and the minimizes paperwork. In practice, this could enable a shift from an "application-based" to a "confirmation-based" or even "automatic enjoyment" model for eligible incentives. The system spots the trigger, checks the boxes, and the money lands. A company clicks yes online and the break occurs at once; the benefit lands sooner. For the loss carryforward piece, spell out that partnership-style VCEs can roll yearly losses forward, say five to eight years, and use them later against income from the very same fund project. That move lines the tax rule up with the long-cycle reality these funds live in.

5.3 Deepening Targeted Guidance and Risk Alerts

Implement tax health check services. During the post-investment management phase, tax authorities can leverage tax big data to regularly provide voluntary VCEs with tax health check reports. This proactively identifies potential tax risks in areas such as share-based payments, related-party transactions, and cross border payments within portfolio companies, offering targeted alerts and guidance to advance service delivery. Establish industry expert service teams. Provincial and municipal tax bureaus may form venture capital industry tax service expert teams comprising tax professionals, accountants, lawyers, and other third-party experts. Through regular policy briefings, thematic salons, and online Q&A sessions, these teams provide specialized, customized tax policy consultations to venture capital firms. This reduces the risk of misinterpretation when companies interpret policies independently and ensures precise policy implementation.

5.4 Strengthening Cross-Departmental Collaboration and Co-Governance

Advance data sharing with securities, industry and commerce, and other departments. Promote data exchange and interoperability between the tax system and entities such as the China Securities Regulatory Commission (CSRC), securities depositories, and market supervision bureaus. Share transaction information on initial public offerings (IPOs), mergers and acquisitions (M&As), and equity transfers to help tax authorities accurately track exit dynamics while verifying the authenticity of enterprise filings and enhancing tax administration efficiency. Establish a joint certification mechanism for qualifying startups, high-tech enterprises, and similar entities. Create a system where tax, science and technology, and industry and information technology departments jointly certify and mutually recognize information. This enables enterprises to apply through a single platform, with multiple departments coordinating processing and sharing results, thereby reducing the burden of duplicate submissions.

5.5 Promoting Digital Technology Empowerment

Build a digital service platform for tax administration of VCEs. It pulls together policy dissemination, intelligent consultation, risk pre-warning, preferential calculation, and online processing in one screen. Add an investment deduction calculator. Firms input basic data, and the tool calculates the deductible amount. Furthermore, enable proactive policy update alerts so companies get a heads-up on fresh changes without asking. When the exit stage shows up, think about dropping blockchain into the mix. The chain would log every step from first money in to final transfer. Cost, transfer price, timing—each bit gets locked in. Because nothing can be altered later, tax officers land on a rock-solid base for the numbers. Exit paperwork shrinks, arguments fade.

6. Conclusion

Venture capital firms count as a vital capital force that keeps tech innovation moving. Their healthy growth leans heavily on tax admin services that actually work. Currently, China's tax administration services for VCEs face significant obstacles. The core issue lies in the misalignment between the service model and the operational reality of VCEs. They move fast, shift shapes, and the administrative procedures are ill-suited to their operational models. So the fix has to start with better tax admin services. First, ensure consistent policy interpretation and enforcement nationwide, eliminating regional disparities. Second, streamline procedures for claiming tax incentives; one portal, one upload, done. Third, enhance precision through targeted service: send the right reminder to the right CFO at the right time. Speed also matters; if an answer takes months, money's already flown. To get there, officials need to speak the same language on rules, slash the "prove-you're-worthy" forms, and show up before the headache starts. Departments have to talk—finance, tax, tech, commerce—in one room, not through stamped letters. Digital tools can integrate these functions within a unified platform: a dashboard that tracks a fund from first close to final exit. Build that cradle-to-grave service loop: fundraising, investing, managing, exiting, all covered. Do it right and compliance costs drop, audit scares fade. The tax perks finally do what they promised: lure more money into labs and prototypes. Innovation gets the fuel it needs, thereby providing the essential fuel for innovation and propelling the wider economy toward sustained, high-quality growth.

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