

Rödl & Partner

NEWSLETTER CHINA

BROADENING HORIZONS

Issue:
February
2019

Latest news on law, tax and business in China

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China Continues the Trend of Tax and Fee Reduction

Recently, the State Council of China announced that it will implement a series of new tax incentives. The recent National Tax Work Conference also released a positive signal on tax cuts and fee reductions. Shortly afterwards, the State Administration of Taxation (SAT) officially announced the incentives, especially for small and micro enterprises (SME) with thin profits.

TAX BENEFITS FOR SMALL ENTERPRISES WITH THIN PROFITS

The latest tax policies for SMEs are summarized in the following table:

Issue	Old Regulation	New Regulation
Threshold for identification as SME	<p>Industrial enterprises:</p> <ul style="list-style-type: none"> - Total assets ≤ 30 million - Number of employees ≤ 100 - Annual taxable income ≤ 1 million <p>Other enterprises:</p> <ul style="list-style-type: none"> - Total assets ≤ 10 million - Number of employees ≤ 80 - Annual taxable income ≤ 1 million 	<p>All enterprises:</p> <ul style="list-style-type: none"> - Total assets ≤ 50 million - Number of employees ≤ 300 - Annual taxable income ≤ 3 million
Corporate Income Tax (CIT) preferences for SMEs	<ul style="list-style-type: none"> - If annual taxable income is no more than 1 million, SMEs are taxed on 50 percent of the taxable income at a reduced CIT rate of 20 percent. 	<ul style="list-style-type: none"> - SMEs are taxed on 25 percent of the taxable income part that is no more than 1 million at the reduced CIT rate of 20 percent. - SMEs are taxed on 50 percent of the taxable income part exceeding 1 million but no more than 3 million at the reduced CIT rate of 20 percent.
Threshold of VAT obligation for small-scale VAT payers	<ul style="list-style-type: none"> - No VAT obligation for small-scale VAT payers with monthly sales of less than 30,000 	<ul style="list-style-type: none"> - No VAT obligation for small-scale VAT payers with monthly sales of less than 100,000
Tax incentives for local taxes for small-scale VAT taxpayers	<ul style="list-style-type: none"> - No unified regulations 	<ul style="list-style-type: none"> - Local authorities are allowed to reduce tax rates for local taxes within a range of 50 percent, including resource tax, urban construction and maintenance tax, property tax, stamp duty, etc.

By comparing the regulations, it can be found that in addition to the measures to reduce the tax burden, the scope of the preferential policies has also been expanded through the new incentives. It is to note that the implementation period of the incentives is set at 3 years, which take effect from January 1, 2019 till to December 31, 2021.

OTHER TAX REDUCTION MEASURES

Besides publishing new regulations, recently the Chinese government has also indicated the orientation of China's tax reduction measures in 2019 through various channels. In addition to the above mentioned tax incentives for SMEs, it also includes the following three aspects:

- Continuation of the VAT reform;
- Full implementation of the new Individual Income Tax (IIT) law and the special additional deduction;
- Research on plans for reducing social insurance.

In addition to the new IIT law that has already been formally implemented, the issues of VAT reform and the reduction of social security have already been discussed for some time. The takeover of social security collection by tax authority, which was originally planned to be implemented in 2019, has also been suspended. Considering the current signals, it is believed that the

changes and adjustments of these regulations are already concretized but not yet published.

OUTLOOK

Since 2018, "tax and fee reduction" has gradually become a policy that the Chinese government has vigorously promoted. With a series of tax incentives are announced at the beginning of 2019, it shows that this trend will continue this year. It can be expected that the tax reduction measures will be mainly focused on SMEs, and the VAT and IIT reform will continue to deepen the reduction of burden on taxpayers to a greater extent. Whether there will be new changes regarding supporting measures such as tax declaration and collection will also be worthy of attention.

CONTACT FOR FURTHER INFORMATION



Kai KANG
kai.kang@roedl.com

→ Tax

New Details for the Implementation of the New IIT Law

The new IIT law in the PRC has taken another hurdle in the implementation process. Most recently, several tax circulars have been promulgated:

- Implementation Rules of PRC Individual Income Tax ("IIT") Law ("Implementation rules")
- SAT Public Notice on Transitional Matters concerning Tax Collection
- Administration for Full-scale Implementation of the new IIT Law ("Public Notice 56")
- Notice on Transitional Matters concerning Preferential Policies after the Amendment of IIT Law ("Circular 164") and others

The new regulations are aiming to serve the full-scale implementation of the new IIT Law since 2019.

FROM FIVE-EAR RULE TO SIX-YEAR RULE

Implementation rules has broadened the "Five-year rule" regarding world-wide income tax filing obligation in the old IIT Law, which has been modified as "Six-year rule", that is, for an individual who has no domicile in China but has resided in China for not more than six consecutive years in each of which he resided for 183 days or more accumulatively, among all their incomes derived outside China, the part paid or borne inside China is subject to Chinese IIT.

It is also easy to understand and realize the condition which breaks the "Six-year rule", that is, where an individual left China for more than 30 days on a single trip in any year during which he resided in China for 183 days or more accumulatively, the consecutive years in each of which he resided in China for 183 days or more accumulatively could be counted again from the beginning. Comparing to the previous draft regulation, in which the time condition of a single departure for more than 30 days was set as "within 5 years", the current condition is less flexible. Foreigners may not circumvent the world-wide income tax filing obligation by arranging a cross-year departure. However, we still have to remind that it is not a safe tax planning to avoid global tax filing obligations by deliberately breaking the Six-Year Rule.

IIT DECLARATION BY TAX WITHHOLDING AGENT AND SPECIAL ADDITIONAL DEDUCTIONS

According to Public Notice 56, when making payment for wage and salary income to tax resident individuals, withholding agents are required to add up the year-to-date taxable income for wage and salary, calculate the year-to-date IIT payable with the applicable annual progressive tax rates, deduct the cumulative IIT paid up to the last month, to get the IIT payable of the current month.

EXAMPLE - CALCULATION OF THE CHINESE IIT

Employee A has a monthly gross salary of RMB 201.666,75. The monthly deductible amount RMB 5.000, the monthly tax exempt amount RMB 10.000. The monthly calculation for the IIT based on the annual progressive tax rate:

Level	Annual taxable income (RMB)	Tax rate (%)	Deduction at source (RMB)
1	0 - 36,000	3	0
2	36,000 - 144,000	10	2,520
3	144,000 - 300,000	20	16,920
4	300,000 - 420,000	25	31,920
5	420,000 - 660,000	30	52,920
6	660,000 - 960,000	35	85,920
7	above 960,000	45	181,920

January:
Accumulated taxable income: =
201.666,75 - 10.000 - 5.000 = 186.666,75;
IIT January = annual accumulated IIT =
186.666,75 * 20% - 16.920 (deduction at source) =
20.413,35

February:
Accumulated taxable income: =
186.666,75 + 201.666,75 - 10.000 - 5.000 =
373.333,50; annual accumulated IIT = 373.333,50 *
25% - 31.920 = 61.413,38;
IIT February = annual accumulated IIT -
paid IIT in January = 61.413,38 - 20.413,35 =
41.000,03

March:
Accumulated taxable income: =
373.333,50 + 201.666,75 - 10.000 - 5.000 =

560.000,25; Accumulated IIT = 560.000,25 * 30%
- 52.920 = 115.080,08;
IIT March = Accumulated IIT - accumulated paid
IIT in January and February = 115.080,08 -
20.413,35 - 41.000,03 = 53.666,70

Furthermore, withholding agents should consider the additional special deductions for each taxpayer when withholding monthly IIT. It is assumed that the amount of information in need will expand, the data documentation will be more demanding, and the IIT calculation method will be much more complicated.

In the previous draft additional special deductions were made. Two facts had been finalized as follows:

Items of deduction	Deductible amount
Medical treatment of critical illnesses	Deduction based on actual amount for expense over 15,000 RMB that are borne by the taxpayer (co-paying in the range of Chinese medical insurance). Upper limit is 80,000 RMB* each year.
Rental expense	9,600 to 18,000 RMB** each year (varies in different cities)

* The upper limit in the previous draft regulation is RMB 60,000 per year.

** The deductible amount in the previous draft regulation is maximal RMB 14,400 per year.

As for the taxpayer, since the withholding IIT is calculated based on the annual progressive tax rates, the marginal tax rate for wages and salaries may increase by month from the beginning of calendar year, which may result in the increase of general effective tax rate, and the taxpayer's monthly net salaries may decrease by month accordingly.

TAX PREFERENTIAL POLICIES TRANSITION

Circular 164 has given the green light to the IIT related preferential policies after the implementation of the New IIT Law. At the same time, a 3-year transition period is set out, i.e., from 1 January 2019 to 31 December 2021, during which period a stable continuation of the preferential policies will be basically guaranteed.

When a resident individual receives annual performance-related bonus during the transition period, the former preferential tax calculation method is still optional, or he/she may choose to tax it on a combined basis with the other comprehensive income of the year. After the transition period, the former calculation method will not be adoptable. It is noticed that Circular 164 has not mentioned the above treatment applies to non-resident individuals, which may imply that since 2019, the preferential tax calculation method for annual bonus will not be applicable to non-resident individuals any more.

Similarly, a foreign individual, who fulfills the requirements of tax residents, can choose to enjoy the ongoing tax-exempted allowances, i.e., housing allowance, Chinese language training fee, children's education fee, meal and laundry expense, home-trip expense and relocation fee, during the transition period. Alternatively, they can choose to enjoy the additional special deduction in

fixed amounts and give up the tax-exemption treatments. After the transition period, only the special additional deduction is adoptable.

In addition, Circular 164 basically continues the tax preferential treatments for severance payments, share based incentives and other income with slight amendments, which also helps to guarantee a stable transition for the new IIT Law.

SUMMARY

Generally speaking, a foreign individual who fulfills the requirements of tax residents, i.e., physically staying in China for more than 183 days cumulatively during a calendar year, will not be affected by the New IIT Law significantly. Whereas, foreign individuals who does not fulfill the requirements of tax residents may have higher tax burden due to the abolishment of certain relevant tax preferential policies. Therefore, tax planning and pre-arrangements are always meaningful to foreign individuals from both tax efficiency and compliance perspectives.

CONTACT FOR FURTHER INFORMATION



Kai KANG
kai.kang@roedl.com

→ Tax

New IIT Law – Existing Ambiguities for Foreign Taxpayers

Confusion still exists in China - The new Individual Income Tax (“IIT”) Law has fully come into force. However, quite a few tax treatments that apply to foreign taxpayers are still not clearly stipulated, especially to those who do not fulfil the requirements as a Chinese resident taxpayer and also to the withholding agents who are responsible for preparing tax declarations.

TAX TREATMENTS FOR TAXPAYERS WITH DUAL POSITIONS WITHIN AND OUTSIDE CHINA

In practice, taxpayers may hold dual positions simultaneously within and outside China, and obtain salary income from both domestic and overseas companies. Taxpayers need to travel frequently entering and leaving China, in order to fulfil the dual responsibilities. According to the implementation rules of the IIT Law, income derived from activities outside China due to employment should be defined as foreign-sourced income. Furthermore, foreign-sourced income derived by non-resident taxpayers and resident taxpayers who fulfil certain conditions are exempted from Chinese IIT to varying degrees.

According to former IIT related regulations, tax exemption treatment on foreign-sourced income functioned by reducing the final IIT payment, i.e., calculating the total IIT amount on both China- and foreign-sourced income as the taxation base, then reducing the IIT payment that attributed to the foreign-sourced income in proportion.

According to the so-far released regulations related to the new IIT Law, the tax exemption treatment on foreign-sourced income is still not clear. It could continue the IIT payment reduction treatment as before, or as an alternative, it could reduce the taxable income directly by making exemption on the taxation base. A guidance from future tax regulations is still required.

Chinese employers, as withholding agents, should take the total salary amount paid from China as taxation base, calculate and withhold IIT in the monthly declaration for prepayment purpose. Adjustments for IIT liabilities on China- and foreign-sourced salary income can be made via annual IIT settlement, following future tax regulations to be released.

TAX TREATMENT ON ANNUAL-PERFORMANCE RELATED BONUS FOR NON-RESIDENT TAXPAYERS

It is stipulated by current tax regulation that resident taxpayers may continue to use the former tax preferential treatment on annual-performance related bonus, i.e., dividing the bonus amount by 12, determining applicable monthly tax rate and calculating the IIT payable separately, during the 3 years' transition period. While the tax treatment for non-resident taxpayers' annual bonus is not mentioned. According to our consultation with local tax authority, it is very likely that non-resident taxpayers would not be applied to the former tax preferential tax treatment on annual-performance related bonus any more. The China-sourced bonus will be fully combined with the regular monthly salary for tax calculation, or alternatively, be treated as bonus for several months, and taxed with the tax rate to be determined separately.

FEASIBILITY OF CURRENT IIT-EXEMPTED ALLOWANCES ON NON-RESIDENT TAXPAYERS

As is known, non-resident taxpayers may not be applied to the additional special deductions under the new IIT Law, while it is not clear if non-resident taxpayer, could continue to enjoy the current IIT-exempted allowances, i.e., housing allowance, Chinese language training fee, children's education fee, meal and laundry expense, home-trip expense and relocation fee. We have noticed that relevant explanations vary among different tax officers, which has brought challenges in IIT filing practices for non-resident taxpayers.

In view that non-resident taxpayers normally stays in China for less than 183 days in a calendar year, if the withholding agents continue to apply the IIT-exempted allowances to them, they may take the risk of not being able to trace the underpaid IIT liabilities after the taxpayers leave China.

On the other hand, if the withholding agents cancel the IIT-exempted allowances for non-resident taxpayers, which however proves to be applicable afterwards, the tax refund application might also be difficult in practice after the taxpayers leave China.

CONCLUSION

The above matters need to be clarified by the tax authority in the near future. It is recommended that taxpayers and withholding agents pay close attention to relevant future tax regulations.

CONTACT FOR FURTHER INFORMATION



Monica CHEN
monica.chen@roedl.com

→ Tax

Major Tax Reforms in China – Introduction of Anti-tax Avoidance Clause in IIT

Since 2009, China has promulgated a series of anti-tax avoidance regulations. However, these regulations only aim at anti-tax avoidance issues at corporate level, and there is no clear anti-tax avoidance regulation for individuals, partnership and sole proprietorship enterprises. In China, the collection and management of the overdue tax as a result of anti-individual income tax ("IIT") avoidance has been in a difficult situation for a long time due to flaws in legislation.

The new IIT Law in China passed on August 31, 2018 formally introduced a comprehensive anti-IIT avoidance clause covering the following commonly seen IIT avoidance situations:

- Shift profits to overseas through related party transactions that do not comply with the arm's length principle between individuals and affiliated parties;
- Use personal consumption expenditures incurred through offshore companies established in tax havens or countries with low tax rates to avoid distributing profits to domestic individuals or retain profits abroad for a long time to evade individual taxes;
- Individuals avoid IIT through other arrangements without reasonable commercial purposes, such as indirect transfer of Chinese assets.

In practice, arrangements through the establishment of enterprises in the low tax areas, the use of local taxation policies to convert profits into legal individual income, or deliberate arrangement of related party transactions to shift profits

and deliberate avoidance of dividends to individuals under certain conditions, may be subject to the anti-tax avoidance investigation of the Chinese tax authorities.

The new Implementing Regulations of the IIT Law (draft for discussion) further clarify the definition of related parties, the determination of "control" and "obviously low effective tax burden" in the controlled foreign companies clauses, the definition of unreasonable business purposes, and the detailed calculation standard of interest on overdue tax payment. The above clauses refer to the current anti-tax avoidance provisions for enterprises in China to ensure the consistency of anti-tax avoidance clauses at individual and corporate income tax levels.

In addition, the new IIT Law has also changed the judgment condition for resident taxpayers from "one year" to the internationally conventional "183 days" to expand the applicable object of CRS tax information exchange. According to the new CRS regulations, the first batch of information on the overseas financial assets accounts of the Chinese individuals and their controlled companies was exchanged to China in September this year. This information will help the Chinese tax authorities to conduct risk assessments in order to make comprehensive judgments whether there is avoidance of tax collection and management in China, and take follow-up actions.

Therefore, it is recommendable that investors should carefully assess the tax risks with regard to the design and set up of transaction structure in which they individually participate.

They should also pay close attention to the commercial rationality and economic substance of the transaction arrangements, and adjust the business plan in a timely manner to minimize potential IIT risks.

CONTACT FOR FURTHER INFORMATION



Judy ZHU
judy.zhu@roedl.com

→ E-Commerce

China's New E-Commerce Law

Since January 1, 2019 new regulations for online retailing apply in China. The "E-Commerce Law" (the "Law") passed by the National People's Congress introduces comprehensive changes in the areas of retailer liability and consumer protection. The Law primarily affects Chinese companies, but also strengthens the position of (foreign) right holders, among other things.

One of the most important new regulations is the extension of the liability of retailers. Since this year not only the individual online retailer, but also the operator of the trading platform (such as Alibaba or Tmall) is jointly and severally responsible for violations of the laws. If in the past the platform operator could still claim that he is not the actual seller of the goods - and therefore should not be responsible - this is no longer possible. If, for example, the platform operator remains inactive while counterfeit goods are being sold on his platform or incorrect product ratings are being posted, he can be fined by the authorities with immediate effect. The Law provides for fines of between 50,000 and 2,000,000 RMB (6,500 to 260,000 EUR). Such administrative proceedings may also be initiated by the foreign right holder. But beware: If the right holder's accusations are made maliciously, "into the blue", or if the right holder is ultimately unable to prove his legal position (under Chinese law), he himself risks a fine.

The other major change concerns mainly small and micro entrepreneurs. According

to the new Law, retailers who do not sell their goods through their own shop but in direct customer contact via social media channels (such as WeChat) are now also legally classified as retailers. The classification as a retailer and not as a "private seller" closes a legal gap that is often exploited in practice and means that the seller is now subject to the above-mentioned rules of retailer liability, is obliged to make a company registration, issue invoices and tax the sales. Due to the unclear wording of the Law, however, it is still unclear from when one qualifies as a "retailer" and under what conditions the business activity can still be regarded as a private sale. It remains to be seen how this change will affect business practice.

CONTACT FOR FURTHER INFORMATION



Sebastian Wiendieck
sebastian.wiendieck@roedl.com

→ Environmental Protection

Law against Soil Pollution Entered into Force

In China, the Law on Prevention and Control of Soil Pollution (Soil Pollution Act) became effective on 1 January 2019. In particular, the Soil Pollution Act contains liability regulations in connection with the prevention, reduction and remediation of soil contamination.

In particular manufacturing companies are now obliged to take effective measures to prevent or reduce soil contamination and are liable for any contamination caused by them, whereby fines may be imposed for violations of the Soil Pollution Act and in certain cases penalties (including imprisonment) may be imposed on the responsible managers.

As a rule, the polluter is responsible for removing the pollution and remediating the soil. If the polluter cannot (or no longer) be identified, the holder of the land use right is responsible (but a provision for identifying the polluter in such cases will be formulated).

In the event of contamination, a risk assessment shall be carried out according to the degree of pollution. The competent authority then decides whether the land is subject to risk management, control and remediation. In this case, the polluter must take appropriate measures to control the risks of pollution. If soil remediation becomes necessary, the polluter must remove the contamination. The remedial measures as well as the other

measures related to risk management and ongoing monitoring shall be assessed by an independent expert.

Companies should therefore review and, where appropriate, adapt their soil pollution prevention measures. In addition, internal rules on soil pollution should be adjusted. In particular, this may include a corresponding emergency plan.

The potential issue of soil contamination should therefore also be taken into account in future contracts such as transfer of land use rights, share or asset deals as well as rental or lease agreements.

CONTACT FOR FURTHER INFORMATION



Sebastian Wiendieck
sebastian.wiendieck@roedl.com

→ Highlights

Recent Important Regulation Highlight

ANOTHER VAT RATE REDUCTION ON CHINESE COMPANIES!

The second conference of the 13th National People's Congress of China has just announced that the current VAT rate of 16 percent, which is applicable to industries including manufacturing, will be decreased to 13 percent. Meanwhile the rate of 10 percent, which is applicable to industries including transportation and construction, will be decreased to 9 percent, and the rate of 6 percent, which is applicable to industries including modern service, will remain unchanged.

31 PROVINCES, AUTONOMOUS REGIONS AND MUNICIPALITIES REDUCE LOCAL TAXES BY 50 PERCENT

Recently, 31 provinces, autonomous regions and municipalities including Shanghai have officially announced that six local taxes and two fees including resource tax, urban construction and maintenance tax, property tax, stamp duty etc. for small-scale VAT taxpayers are reduced by 50 percent from January 1, 2019 to December 31, 2021.

THE FOREIGN INVESTMENT LAW (DRAFT) IS COMING!

On March 8, the draft of the high-profile foreign investment law was submitted to the second conference of the 13th National People's Congress of China for deliberation. As the basic law in the field of foreign investment in China, the draft establishes the basic framework of a new type of legal system for foreign investment in China and provides unified provisions on access, promotion, protection and administration of foreign investment.

→ Event

Latest Developments: International Tax Law Practice

We would like to invite you to our event in Germany, "Latest Developments: International Tax Law Practice" on March 28, 2019 in Berlin. You may find the detailed program as well as all further information and the registration form under: [Event Calendar](#).

For further question, please feel free to contact our colleague, Ms. [Andrea Karacic](#).

OUR TAX TEAM CONTACT

Vivian Yao
Partner
Tax Advisor (China)
vivian.yao@roedl.com

SPECIAL CONSULTANT FOR INTERNATIONAL TAXATION

Dr. Hans R. Weggenmann
Managing Partner
Certified Tax Consultant
hans.weggenmann@roedl.com

OUR CONTACT IN GERMANY

Dr. Thilo Ketterer
Partner
German Public Auditor
thilo.ketterer@roedl.com

Mathias Müller
Partner
Certified Tax Consultant, MBA, CPA
mathias.mueller@roedl.com

OUR LEGAL TEAM CONTACT IN CHINA

Sebastian Wiendieck
Partner
Attorney-at-Law
sebastian.wiendieck@roedl.com

Dr. Martin Seybold
Partner
Attorney-at-Law
martin.seybold@roedl.com

Florian von Ortenberg
Partner, Attorney-at-Law
Registered Foreign Lawyer (HK)
florian.vonOrtenberg@roedl.com

Our Offices in China

Shanghai Office 31/F LJZ Plaza 1600 Century Avenue Pudong District Shanghai shanghai@roedl.com T +86 21 6163 5200 F +86 21 6163 5310	Beijing Office Suite 2200 Sunflower Tower 37 Maizidian Street Chaoyang District, Beijing peking@roedl.com T +86 10 8573 1300 F +86 10 8573 1399	Guangzhou Office 45/F, Metro Plaza 183 Tian He North Road Guangzhou kanton@roedl.com T +86 20 2264 6388 F +86 20 2264 6390	Taicang Office 16/F Dong Ting Building Middle Zheng He Road 319 215400 Taicang taicang@roedl.com T +86 5125 3203 171
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Imprint

Publisher:

Rödl & Partner China
31/F LJZ Plaza
1600 Century Avenue
Pudong District, Shanghai
T +86 21 6163 5200
www.roedl.de
www.roedl.com

Responsible for the content:

Vivian Yao
vivian.yao@roedl.com

Layout/Type:

Elisa Guo
elisa.guo@roedl.com

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