

Rödl & Partner

NEWSLETTER CHINA

BROADENING HORIZONS

Issue:
May
2020

Latest news on law, tax and business in China

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Foreign-Sourced Income Declaration in China

Right after the publication of the detailed guideline of the annual individual income tax (“IIT”) reconciliation, the State Administration of Taxation (“SAT”) of China published the Public Notice [2020] No. 3 (“Circular 3”), in order to provide specific guidance on declaration of foreign-sourced income during annual IIT reconciliation.

OBLIGATION OF DECLARATION

As a general rule, resident taxpayers in China are obliged to declare their foreign-sourced income to the Chinese tax authority.

While there is still a particular exemption rule for a special group of resident taxpayers:

- who are not domiciled in China; and
- who have not physically stayed in China for no less than 183 days for six consecutive years

The special group is exempted from paying Chinese IIT on their foreign-sourced income which is not paid or borne by a company or an individual in China.

DEFINITION OF FOREIGN-SOURCED INDIVIDUAL INCOME

Circular 3 has defined the foreign-sourced individual income according to the location of:

- activities carried out, e.g. income from labor services rendered outside China, for which time-apportionment method are usually used for quantification;
- payers, e.g. interest and dividend income paid or borne by an enterprise located outside China or a non-resident taxpayer of China;
- transaction targets, e.g. income from transfer of immovable property located outside China and from transfer of equity investment in enterprises located outside China.

IIT CALCULATION

In general, resident taxpayer should calculate their Chinese IIT on both the China-sourced and foreign-sourced income, and foreign income tax paid on their foreign-sourced income, if any, can be offset from the China IIT payable of the current period. The offset limit is the IIT calculated in accordance

with the Chinese IIT law on the foreign-sourced income. The portion in excess of the offset limit can be carried forward to the next five years.

It is particularly pointed out that only income tax imposed by foreign countries can be offset, which excludes foreign income tax which should not be imposed according to double tax treaty and interests, late payment surcharges or administrative penalties connected with foreign income tax, etc. In view of that, it is recommended that taxpayers should keep solid documentation to support the nature of the tax payments they made outside China, especially to separate the creditable foreign income tax from those uncreditable payment items.

ASSISTANCE DECLARATION OBLIGATIONS OF CHINESE ENTERPRISE

Circular 3 highlights the declaration assistance obligations of a Chinese enterprise who dispatches resident taxpayers to work outside China, where the relevant remuneration, i.e. the foreign-sourced individual income, is to be paid by a foreign enterprise. In such case, the dispatching Chinese enterprise could:

1. take over the IIT withholding obligation on the foreign-sourced income; or
2. report the details of the dispatched employees to the Chinese tax authority by the end of the following February.

The details to be reported include all personal information, income information and tax payment information.

If the dispatching enterprise takes over the withholding obligation, Circular 3 explained that the remuneration payer outside China could withhold the relevant Chinese IIT, pass the tax fund to the dispatching enterprise in China for them to declare and settle it with the Chinese tax authority.

Under such arrangement, cross-border tax fund remittance will be processed regularly so that support from the Chinese banks or SAFE will be necessary. In addition, taking the offsetting of foreign income tax payment into consideration, the calculation of the Chinese IIT to be withheld is also relatively complicated.

OUR RECOMMENDATION

In general, the declaration of foreign-sourced individual income in Chinese IIT filings demands relatively higher professional expertise, as it requires detailed assessment, and complicated calculation. We recommend concerned taxpayers, especially high net worth individuals who have diversified income categories derived in- and outside China, to seek for professional assistance where necessary, to mitigate their tax compliance risks in China.

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→ Transfer Pricing

New Challenges Ahead – Transfer Pricing Season in China Starts Again

Previously, it is not clear whether the deadline for transfer pricing documentation will be postponed due to the pandemic. Recently, we noticed that a lot of local tax authorities have announced the requirement of the completion of the FY 2019 Local File by 30 June, 2020.

Since additional information is required for the Local File and Master File in China as compared to BEPS Action 13, companies have to identify the gap between group documentation template and Chinese documentation requirements and prepare the additional information to bridge the gap. Timely negotiation is therefore recommended for all Chinese subsidiaries of multinational groups. However, due to the outbreak of the pandemic in overseas countries, the information exchange with the group HQ might take more time than before. Therefore, the process of information exchange is suggested to be started earlier compared to previous years so as to ensure that the information could be collected in time.

Another key issue to be aware of this year for the Local File preparation is the increasing challenges from the Customs Authority. Besides the royalty arrangements which have been a hot audit target for several years, customs authorities begin to focus on directly examining the reasonableness of the inter-company transfer price for goods imported from overseas related parties. More and more companies have been required by the Customs Authority to also submit the Local File for review during a customs audit. In practice, there have already been cases in which enterprises were requested by the Customs Authorities to adjust the transfer prices for related party transactions according to the interquartile range of profit margin achieved by comparable companies based on the benchmarking study in Local File.

It is therefore becoming increasingly important to also consider the possible customs risks in the Local File preparation, e.g. to perform additional gross margin analysis or to adjust the functional and risk profile of the Chinese enterprise to support the deviation in the profit margin observed.

Due to the impact of COVID-19, it is expected that enterprises may face more challenges in the preparation of transfer pricing documentation next year as many enterprises are expected to have significant profitability fluctuations or even losses in 2020. Especially for Chinese subsidiaries performing routine functions, if they incur losses due to insufficient productivity and slack market demand resulting from the pandemic as force majeure, they shall consider how to distinguish or quantify the losses that should be borne by the routine company and the principal company.

In this case, enterprises are recommended to start to collect the relevant information on special factors which cause the losses this year which could then be used for conducting special factor analysis in the 2020 Local File to justify the unfavorable financial performance of the Chinese subsidiaries.

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→ Covid-19

OECD Guideline on Determination of Permanent Establishment and Tax Resident Status

Recently, the World Organization for Economic Co-operation and Development (OECD) released the report on "Tax Treaties and the Impact of the Covid-19". The analysis report aims to provide guidance on possible cross-border tax issues in the circumstance of the current global epidemic in accordance with relevant international tax agreements. The relevant key issues are summarized below:

PERMANENT ESTABLISHMENT ("PE") DETERMINATION

An enterprise should not be considered to have created a new PE if its employees are temporarily home-based or unable to work in their regular workplace and tax jurisdictions due to the crisis.

An employee or agent abroad who temporarily works from home and signs a contract on behalf of his non-resident employer or principal in the tax jurisdictions where he resides should not be regarded as "regularly exercising the duty to sign contracts under the name of the enterprise", nor should the enterprise be regarded as creating a PE of agents in that tax jurisdictions.

In the determination of whether a construction project created a PE, the time of suspension of work for reasons such as shortage of materials or labor is generally included in the duration of construction of the construction project. Therefore, temporary downtime due to pandemic should also be included.

DETERMINATION OF TAX RESIDENT STATUS OF ENTERPRISE

In accordance with the tax treaty, the determination of tax resident status (or the location of the actual management) of an enterprise should not be changed if the enterprise's management is temporarily relocated as a result of the pandemic. Under most current tax treaties, when an enterprise is a resident of both tax jurisdictions, it is deemed to be a resident of the country in which the "actual management" is located.

DETERMINATION OF TAX RESIDENT STATUS OF INDIVIDUAL

If an individual is temporarily residing in a foreign country affected by the epidemic, his or her tax resident status will generally not be changed.

OUR UNDERSTANDING

According to the OECD version of the tax treaty, the determination of PE of all types requires that the activities meet a certain level of permanence and sustainability. The situation of being held in a place or unable to work across the border under normal circumstances due to the epidemic is a sudden, temporary situation that is not controlled by the subjective intent of the enterprise concerned. Such a stay would be inconsistent with the spirit of the OECD's official interpretation of the provisions of tax agreements if it would lead to the formation of permanent establishments and result in additional tax burdens and tax compliance burdens for companies.

Similarly, the factors that determine the enterprise and individual tax resident status are still based on normal circumstances. Temporary changes in work and place of residence due to the pandemic generally will not affect the determination of tax residence status. From our current experience, only when individuals employed across the border have to stay in their home country due to the pandemic and are unable to work and live in the country of employment (e.g. for Germans employed by a Chinese employer are unable to work in China), their tax resident status for the year may belong to the home country rather than the country of employment, especially when their permanent residence in the home country is retained.

Due to the complexity of cross-border activities, a comprehensive consideration of local and domestic law and the provisions of tax treaty shall be made in order to reach a reasonable assessment to meet tax compliance requirements.

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→ Business Environment

Optimization of the Business Environment in Beijing – An Update

On 27 March 2020, the Standing Committee of Beijing Municipal People's Congress issued the "Regulations on Improving the Business Environment in Beijing" (the "Regulations"), which are effective since 28 April 2020.

In the following we will provide you with a short overview of the main changes and updates as mentioned in the Regulations:

METROPOLITAN REGION BEIJING-TIANJIN-HEBEI – JING-JIN-JI

Already since 2014 (and even a few years earlier) Beijing, Tianjin and Hebei have been working on a joint development plan known as "Jing-Jin-Ji". The name for the metropolitan region is composed of the names BeiJING, TianJIN and the abbreviated provincial name Ji of Hebei Province.

With Art. 8 of the new Regulations the gradual unification of government service standards, mutual recognition of qualifications, and regional coordination between Beijing, Tianjin and Hebei Province shall be promoted.

With the inclusion of the municipality of Tianjin and Hebei province in a grand project centered around the economic powerhouse Beijing the region's overall competitiveness shall be improved.

For instance, the latest opening of the Daxing International Airport located between Beijing and Langfang (Hebei Province) in autumn 2019 is just one piece of the jigsaw in further internationalizing and integrating the overall "Jing-Jin-Ji" region.

SIMPLIFICATION AND STANDARDIZATION OF REGISTRATION PROCEDURES

Art. 12 of the Regulations mentions diverse novelties that are intended to simplify various procedures. Where, in the case of certain registration procedures, the applicant undertakes that the materials submitted are complete, true, lawful and effective, the Administration for Market Regulation ("AMR") shall conduct a formal examination of the submitted materials, whereas an examination in terms of content is not expressly mentioned.

However, the downside of such a procedure is that where a person makes a false promise, the decision shall be revoked directly and the

relevant activities shall be investigated for corresponding legal liabilities. The respective information is therefore incorporated into the municipal credit information platform (Social Credit System), which, under certain circumstances, can have an impact on the corporate credit ranking.

Also new is that multiple market entities now may use the same address as their registered domicile. Later on, they may announce the address of the actual place of production and operation via the National Enterprise Credit Information Publicity System.

Also, when an enterprise establishes a branch, it may apply to indicate the domicile of the branch on its business license, instead of separately applying for a business license for the branch.

Moreover, a unified municipal government affairs service item catalogue and guidelines shall be published. The guidelines shall, inter alia, specify the handling conditions and procedures for each government affairs service item, the required materials, the handling procedures, the handling links and time limits, the charging standards, the contact information and the channels for complaints. This is intended to make it easier for the applicant to prepare for the registration procedure and gain an overview of the necessary steps and documents.

CANCELLATION OF REGISTRATION

Besides the listed provisions as mentioned in Art. 180 "Company Law of the People's Republic of China" and Art. 20 "Administrative Regulations of the People's Republic of China on Registration of Enterprise Legal Persons" the Regulations state a new possibility to liquidate an enterprise. Pursuant to Art. 26 of the Regulations, the AMR shall cancel the registration of an enterprise, which fails to carry out production and business operations or has no creditor's rights or debts after obtaining the business license, if the enterprise has no objection to the announcement of the proposed cancellation on the National Enterprise Credit Information Publicity System for twenty days.

This means that newly established enterprises now have to be specifically careful to start doing business right after their registration,

as otherwise there might be a risk that the enterprise will be liquidated by the AMR within a short period of time.

UNIFIED BIG DATA PLATFORM

Noteworthy is also, although not new, that Art. 35 of the Regulations emphasizes that a unified big data management platform and information sharing mechanism for the whole city of Beijing shall be established to promote the sharing of government information. Relevant government departments shall collect government information to the big data management platform accurately, timely and completely according to their duties.

This goes hand in hand with the gradual transition to online registration systems and the acceptance of electronic signatures and electronic chops.

On the one hand, these measures are intended to facilitate and speed up various procedures, but on the other hand it cannot be denied that this means the central collection of a wide range of comprehensive data, which in turn can serve as a data

source for the Social Credit System. How these measures will affect enterprises in detail must be analyzed from an individual point of view.

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→ Highlights

Recent Important Regulation Highlight

TAX BENEFITS FOR THE DEVELOPMENT OF WESTERN CHINA WILL CONTINUE

Recently, the SAT and other related departments jointly issued a notice to continue the tax benefits for the development of western China. From 1 January 2021 to 31 December 2030, enterprises set up in the western China region and mainly engaged in encouraged industries will be subject to a reduced corporate income tax rate of 15 percent. According to the new notice, the required ratio of main business income from encouraged industries to the total income is reduced from 70 percent to 60 percent.

VAT BENEFIT FOR SME IS FURTHER EXTENDED

Recently, the SAT issued a notice to extend the period of tax benefits for small-scale VAT taxpayers. From 1 March to 31 December 2020, small-scale taxpayers in Hubei Province will be exempted from VAT and VAT rate of small-scale taxpayers in other regions will be reduced to 1 percent.

NEW APPLICATION REGULATION FOR CHINESE "GREEN CARD"

China has released the Draft Regulations on Administration of Permanent Residence of Foreigners (2020) for collecting public opinion. According to the new regulation, foreigners can apply for the Chinese green card, if they:

- have worked in China for four consecutive years, during which the accumulated residence in China is no less than two years, with the annual salary income of no less than six times of the average local wages of the previous year (approximately RMB 460,000 in Guangzhou, RMB 600,000 in Shanghai and RMB 570,000 in Beijing for 2020) and have corresponding tax filing records, or;
- have worked in China for eight consecutive years, during which the accumulated residence in China is no less than four years, with the annual salary income of no less than three times of the local average wages of the previous year (approximately RMB 230,000 in Guangzhou, RMB

- 300,000 in Shanghai and RMB 285,000 in Beijing for 2020) and have corresponding tax filing records, or;
- have a spouse who is a Chinese citizen or a foreigner holding Chinese green card and have lived with the spouse in China for five years after marriage, and has accumulated residence of no less than nine months each year in China.

CHINA ADOPTS THE CIVIL CODE

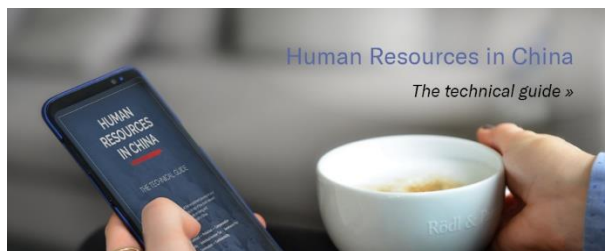
On 28 May 2020, the Chinese Civil Code was passed at the third session of the 13th National People's Congress, which will take effect on 1 January 2021.

→ More Information

ARTICLE SERIES - COVID-19 SPECIAL ASIA



BOOK INTRODUCTION - HR IN CHINA



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