



China Tax Weekly Update

ISSUE 17 | May 2018

Reference: N/A
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: All
Relevant taxes: CIT / IIT /
Stamp duty

Potential impacts on
businesses:

- Operational costs reduced

You may click [here](#) to access
full content of the circular.

China reduces taxes to support innovation

On 25 April 2018, [seven tax reduction measures](#) were outlined by Premier Li Keqiang at an executive meeting of the State Council. These measures aim to provide greater support to innovation and small enterprises.

Specifically, these measures include:

- From 1 January 2018 to 31 December 2020, equipment or machinery, newly purchased for research and development (R&D) activities, is eligible for a 100% immediate tax deduction for corporate income tax (CIT) purposes. This is on the condition that the unit price of each item of equipment or machinery is individually less than RMB5 million (previously RMB1 million under [SAT Announcement \[2014\] No. 64](#)).
- From 1 January 2018 to 31 December 2020, eligible small enterprises whose taxable income falls under RMB1 million, may qualify for a reduced 10% effective CIT rate. Under this incentive, 50% of their income is taxed at a rate of 20%. The threshold was previously RMB500,000 (it was previously increased from RMB300,000 under [Cai Shui \[2017\] No. 43](#) in 2017, see KPMG [China Tax Weekly Update \(Issue 24, June 2017\)](#) for details).
- Effective from 1 January 2018, a super deduction bonus, for payments to overseas service providers, will now be allowed. Under China's R&D super deduction incentive, a 150% deduction (i.e. a 50% bonus deduction) is available for eligible R&D expenses. This rises to a 175% deduction for science and technology SMEs. Up to now, however, the super deduction was disallowed for payments to overseas service providers for outsourced R&D work; such payments will no longer be disallowed.

A further consideration is that, under [Cai Shui \[2015\] No. 119](#) and [SAT Announcement \[2015\] No. 97](#) issued in 2015, Chinese enterprises outsourcing research work to domestic service providers have faced an 80% deduction cap. This applies to both the expense itself and the super deduction bonus (i.e. a payment of RMB100, which would otherwise bring with it an RMB50 bonus deduction, provides a tax deduction of just RMB120 following the application of the 80% cap) (see KPMG [China Tax Weekly Update \(Issue 1, January 2016\)](#) for details). As the 80% cap for payments to domestic service providers is still in place, this could mean that payments to overseas service providers might provide a greater tax deduction. However, it remains to be seen if this cap might, in practice, be extended to payments to overseas service providers, as well.

- From 1 January 2018, China's general restriction of a 5 year carry-forward period to tax losses is extended to 10 years for high and new technology enterprises (HNTEs) and science and technology small and medium sized enterprises.

- China applies a limitation to tax deductions for staff education expenses. The limit is set at 2.5% of the enterprise's salary bill, though a special 8% ceiling has applied for some time to advanced technology services enterprises (ATSEs) and HNTes. The 8% limitation is now being expanded to all enterprises nationwide. The new treatment is retroactively effective from January 1 2018.
- Currently, stamp duty is levied on the paid-in capital, entering the capital accounts of Chinese enterprises. It is levied at 0.05% of the total amount of paid-in capital and capital reserves. From 1 May 2018, stamp duty on these capital account injections will be levied at a reduced 0.025% rate. Stamp duty is also levied at fixed amounts (i.e. RMB5 per document) on certain types of documents (such as land use certificates, business licenses). This levy will now be scrapped.
- Pilot incentives for venture capital and business angel investment in innovative start-ups will go nationwide. The pilot program has been operated from January 2017 for CIT purposes, and from July 2017 for Individual Income Tax (IIT) purposes, in eight designated locations, including Beijing-Tianjin-Hebei, Shanghai, Guangdong, Anhui, Sichuan, Wuhan, Xian, Shenyang, as well as Suzhou Industrial Park. Under the relief, where investments are made in science and technology enterprises seeking capital or start-up stage support ('technology start-ups'), and where the investment is for a period of two years or more, then 70% of the investment amount can be offset against the taxable income of the investor (see KPMG [China Tax Weekly Update \(Issue 18, May 2017\)](#) for details).

The detailed rules in respect of these measures are expected soon, we will keep you informed of any developments.

Reference: SAT Announcement [2018] No. 17, No. 18 and No. 20
 Issuance date: 19, 20 and 22 April 2018
 Effective date: 1 June 2018 / 1 May 2018 / 1 May 2018

Relevant industries: All
 Relevant companies: All
 Relevant taxes: VAT

Potential impacts on businesses:

- Compliance costs due to regulatory uncertainties reduced
- Operational costs reduced

You may click [here](#) to access full content of Announcement 17, click [here](#) to access full content of Announcement 18, and click [here](#) to access full content of Announcement 20.

Guidance on VAT rate reductions

China's VAT rates and its VAT registration thresholds have been adjusted with effect from 1 May 2018 under [Cai Shui \[2018\] No. 32](#) ("Circular 32") and [Cai Shui \[2018\] No. 33](#) ("Circular 33"), which were jointly issued by the Ministry of Finance (MOF) and State Administration of Taxation (SAT) on 4 April 2018 (see KPMG [China Tax Weekly Update \(Issue 14, April 2018\)](#) for details).

To implement these new rules, three guidance notes were issued by SAT in succession from 19 to 22 April 2018. In particular, these guidance notes clarify updated arrangements for VAT filing and collection, and for issuance of VAT invoices:

- [SAT Announcement \[2018\] No. 17](#) ("Announcement 17"), which applies from 1 June 2018, makes revisions to the VAT filing forms to reflect the VAT rate reduction changes.
- [SAT Announcement \[2018\] No. 18](#) ("Announcement 18"), applies from 1 May 2018, and clarifies the following:
 - Where there is a (part) cancellation of a previous VAT charge then a red-letter VAT invoice needs to be issued by the VAT general taxpayer. It is now clarified that where a VAT general taxpayer issued a VAT invoice at the old VAT rates (i.e. 17% or 11%), and the following reversing transactions occur after 1 May, then the red letter VAT invoice needs to be issued at the old VAT rates:
 - sales allowance;
 - taxable services are suspended;
 - goods are returned; or
 - there is an error in the invoice.

- ❑ For taxable services that were rendered before 1 May, but for which the VAT invoices have yet to be issued, a VAT general taxpayer must issue the VAT invoices at the old VAT rates.
- ❑ For VAT general taxpayers who choose to convert back to being small-scale taxpayers, Announcement 18 also clarifies the conditions, procedures, VAT calculation method in the transition period, treatment of excess input VAT credits, issuance of VAT invoices. A number of enterprises may choose to do this as the VAT registration thresholds have been raised from RMB500,000 (for industrial companies)/RMB800,000 (for trading companies) to RMB5 million.
- [SAT Announcement \[2018\] No. 20](#) (“Announcement 20”), applies from 1 May 2018, clarifying the tax refund (exemption) policy for exports for VAT general taxpayers converting into small-scale taxpayers.

On 27 April 2018, an SAT tax official held a [webcast](#) which explained these new Circulars in detail. In respect of excess input VAT credits, the tax official indicated that businesses engaged in advanced manufacturing, qualified modern service companies such as those carrying out R&D services, and companies operating electrical grids will be entitled to a one-off refund of excess input VAT credits accumulated over a specific period of time. This has been approved by the State Council, and the implementation rules are under discussion. These should provide further clarity on questions such as the look-back period to which the excess input VAT credit refund may relate.

For details of the VAT rate reductions and other changes, please see the following KPMG publication:

- ❑ [China Tax Alert: State Council announces reduction to VAT rates and other significant VAT changes \(Issue 9, March 2018\)](#)

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Treaty beneficial ownership and partnership guidance

On 3 February 2018, SAT issued [Announcement 9](#). This refines the interpretation of the beneficial ownership (BO) requirement in the dividends, interest and royalty articles of Chinese double tax agreements (DTAs).

Following this, SAT issued [Announcement 11](#) on 9 February 2018, providing clarifications on the DTA treatment of foreign partnerships, as well as the service permanent establishment (PE) time threshold calculation. Guidance on the China DTA transport and entertainer articles was also set out.

Both Announcements 9 and 11 take effect from 1 April 2018 (see KPMG [China Tax Weekly Update \(Issue 7, February 2018\)](#) for details).

On 27 April 2018, the SAT held a [webcast](#) which provided further clarifications on Announcements 9 and 11:

For Announcement 9:

- Announcement 9 extends the ‘safe harbor’ rule in respect of dividends, which existed since 2012 for listed companies and their same country subsidiaries, to also include entities 100% controlled by government bodies or by individuals, where these are tax resident in the same country as the latter. The tax official clarified that, if a treaty relief claimant is collectively 100% owned by several listed companies, or the claimant is collectively 100% owned by several individuals and listed companies, the claimant would satisfy the ‘safe harbor’ rule and qualify for treaty relief.

- Announcement 9 introduces a form of derivative benefits test for multi-tier holding structures. This allows treaty relief claimants to 'draw on' the substance at parent company level in support of a claim. Specifically, a treaty relief claimant that does not meet the BO criteria in their own right (e.g. due to insufficient commercial substance) may still potentially be considered a BO and eligible for treaty benefits on China-sourced dividends. The tax official noted how this test differs from the 'safe harbor' rule as the claimant will not automatically be determined to be a beneficial owner based on the tax residence of its controlling parties. The tax authorities will examine whether there is a person, who directly or indirectly owns 100% of the DTA relief claimant company, which satisfies the BO assessment based on the 'negative factors' set out in Announcement 9.

For Announcement 11:

- Announcement 11 clarifies that the service PE provisions in older China DTAs, which set a six month (rather than 183 day) threshold, should be interpreted as setting a 183 day test. The tax official confirmed that this is aimed at tackling the disputes that arose due to certain tax authorities still referring to the threshold calculation guidance in the (since abolished) Circular 403. This had been issued in 2007 and abolished in 2011.
- The tax official also set out an example, involving an older treaty with the 6 month wording, to illustrate the timing of the implementation of the '183 day' test. For example, where a foreigner has come to China to provide services starting from 1 February 2018, the '183 day' test will still be applied in place of the 6 month test. This is even though Announcement 11 comes into effect from 1 April 2018.
- In respect of DTA application for partnership, the tax official noted that, as per Announcement 11, for a partnership established outside of China to claim DTA benefits for its taxable income from China, it must be a tax resident of its foreign jurisdiction of establishment, and that jurisdiction must have a treaty with China. If the partnership is not a tax resident of its jurisdiction of establishment, it cannot claim DTA benefits even though its constituent partners may be tax residents of a foreign jurisdiction with a China DTA. This is in line with the wording of Announcement 11 and its guidance.

With regard to the detailed analysis and impacts of Announcement 9 and 11, please read the following KPMG publications:

- ❑ [*China Tax Alert: China clarifies beneficial ownership tax treaty requirements \(Issue 4, February 2018\)*](#)
- ❑ [*China Tax Alert: China clarifies tax treaty application for partnerships, service PE and international transportation \(Issue 5, February 2018\)*](#)



Other recent regulatory and tax circulars:

- ❑ [MOF, GAC, SAT and China Drug Administration's notice on VAT policy for anti-cancer drugs](#) (Cai Shui [2018] No. 47, issued on 27 April 2018)
- ❑ [SAT's announcement on tax refund \(exemption\) for exports](#) (SAT Announcement [2018] No. 16, issued on 19 April 2018)
- ❑ [SAT's announcement on VAT administration for iron ore futures bonded delivery in Dalian Commodity Exchange](#) (SAT Announcement [2018] No. 19, issued on 20 April 2018)
- ❑ [PBOC, CBIRC, CSRC and SAFE's guidance on regulating assets management businesses carried out by financial institutions](#) (Yin Fa [2018] No. 106, issued on 27 April 2018)
- ❑ [CBIRC's notice on further easing market access for foreign-invested banks](#) (Yin Bao Jian Ban Fa [2018] No. 16, issued on 27 April 2018)
- ❑ [CBIRC's notice on opening-up of business scope of foreign-invested insurance companies](#) (Yin Bao Jian Fa [2018] No. 19, issued on 27 April 2018)

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