China Tax Weekly Update

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Reference: Cai Shui [2018] No. 54, No. 51 and No. 50
Issuance date: 7 May 2018 / 7 May 2018 / 3 May 2018
Effective date: from 1 January 2018 to 31 December 2020 / 1 January 2018 / 1 May 2018

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

Potential impacts on businesses:
- Operational costs reduced

You may click here to access full content of Circular 54, click here to access full content of Circular 51, and click here to access full content of Circular 50.

Tax reduction measures further clarified

As highlighted in KPMG *China Tax Weekly Update (Issue 17, May 2018)*, Premier Li Keqiang, at an 25 April 2018 executive meeting of the State Council, outlined seven tax reduction measures to provide greater support to innovation and small enterprises.

Following this, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT), issued additional guidance on the following three measures.

- *Notice on Preferential Corporate Income Tax (CIT) Treatment for Eligible Equipment or Machinery* (Cai Shui [2018] No. 54, "Circular 54")

  Circular 54 issued on 7 May 2018, clarified that, from 1 January 2018 to 31 December 2020, newly purchased equipment or machinery, is subject to the following CIT treatment:

  - A 100% immediate tax deduction for CIT purposes is allowed on the condition that the unit price of each item of equipment or machinery is individually less than RMB5 million. Depreciation for tax purposes is not required.
  - Where the unit price of an item exceeds RMB5 million, the existing accelerated depreciation rules set out in SAT Announcement [2014] No. 64 and Cai Shui [2015] No. 106 shall be applied. The current accelerated depreciation policy covers 10 industries including biopharmaceutical manufacturing, special equipment manufacturing, railway, vessel, aviation and aerospace and other transportation equipment manufacturing, computer, communications and other electronic equipment manufacturing, instruments manufacturing, information transmission, and software and information technology services, light manufacturing, textiles, machinery and automobiles.

- *Notice on Deduction of Staff Education Expenses for CIT Purposes* (Cai Shui [2018] No. 51, "Circular 51")

- Circular 51 issued on 7 May 2018, clarified that staff education expenses incurred after 1 January 2018, not exceeding 8% of the total amount of salary paid to staff, shall be deductible for CIT purposes. The excess amount can be carried forward to the following years. Prior to this change, China applied 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 High and New Technology Enterprises (HNTEs). The 8% limitation is now being expanded to all enterprises nationwide.

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- ❑ *Notice on Stamp Duty Relief on Capital Accounts* (Cai Shui [2018] No. 50, "Circular 50")

  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. Circular 50 issued on 3 May 2018 clarified that, from 1 May 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.

The detailed rules of the following four measures outlined by the State Council are still under development, and will be set out in future updates.

- 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 (specifically, 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 R&D service providers, will now be allowed. Previously, the super deduction was disallowed for payments to overseas parties.
- From 1 January 2018, China's general restriction of a 5 year carry-forward period to tax losses is extended to 10 years for HNTEs and science and technology small and medium sized enterprises.
- 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.

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Relevant industries: Financial sector
Relevant companies: Futures companies
Relevant taxes: N/A

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

You may click here to access full content of the circular.

China to ease limits on foreign investment in futures companies

At the 10 November 2017 China-US economic cooperation meeting, China committed that it will lift the ceiling on foreign equity ownership in securities, fund management and futures companies from 49% to 51%. China will eliminate all equity ownership limits once this initial relaxation to 51% has been in place for three years (i.e., where the relaxation to 51% is in place from 2018 to 2020, the full relaxation will take effect from 2021).

To fulfill the commitment, China Securities Regulatory Commission (CSRC) has relaxed the foreign investment limitation in securities companies in April 2018, setting out *Administrative Measures on Foreign-invested Securities Enterprises* under CSRC Order No. 140 (see KPMG *China Tax Weekly Update (Issue 18, May 2018)* for details).

Going further, to deal specifically with futures companies, CSRC on 4 May 2018 issued the draft *Administrative Measures on Foreign-invested Futures Companies* (the "2018 draft measures) to solicit public comments. Specially, the 2018 draft measures:

- **Defining foreign-invested futures companies.** Under the 2018 draft measures, a foreign-invested futures company refers to a futures company, whose foreign equity ownership exceeds 5%. The determination of the 5% takes into account investments made separately and collectively across several related foreign investors, and those made directly and indirectly.
- **Refining qualifying conditions for foreign investors.** Some of the qualifying conditions for the foreign investor include:
  - ➢ The foreign investor must be a financial institution and have been operating its business for five or more years;
  - ➢ The foreign investors must have a good international reputation and solid business performance; and
  - ➢ The foreign investors' business scale, revenue and profits must have been at the forefront of the world, and they must have had a highly-scored long-term credit rating, over the past three years.
- **Clarifying the requirements for indirect foreign investment.** Under the 2018 draft measures, where a foreign investor indirectly holds more than 5% of the equity of a Chinese futures company by way of an investment, agreement or other arrangements, they may be required to restructure this as a direct investment. Indirect foreign investment made by way of an investment in a domestic securities company, which in turn holds an interest in a futures company, is exempted from this requirement.
- **Clarifying the requirements for senior executives.** Under the 2018 draft measures, all senior executives of a foreign-invested futures company must actually perform their duties within China. The number of Chinese nationals as senior executives must not fall below one third of the total number of senior executives. This is a new requirement for foreign-invested futures companies.

The liberalization of rules on foreign investment in futures companies is in line with a keynote speech made by Chinese President Xi Jinping at the opening ceremony of the Boao Forum for Asia (BFA) Annual Conference on 10 April 2018. A "four-point plan" for the further liberalization of rules governing foreign investment in, and trade with, China was announced.

Following on President Xi's speech, on 11 April, Mr. Yi Gang, governor of the People's Bank of China ("PBOC") announced a string of opening up measures for the financial sector and a timetable for the opening up. He set out the measures that will be implemented in the coming months.

(see KPMG *China Tax Weekly Update (Issue 15, April 2018)* for details).

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Relevant industries: Financial sector
Relevant companies: Insurance companies
Relevant taxes: N/A

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

You may click here to access full content of the circular.

Insurance regulator increases scrutiny of related party transactions

In order to intensify the regulatory oversight of related party transactions in the insurance sector, on 3 May 2018, China Insurance Regulatory Commission (CIRC) released *Draft Measures on Related Party Transactions Conducted by Insurance Companies* (the "2018 Draft Measures") to solicit public comments. Once it is finalized, this will supersede the five existing rules regulating related party transactions for the insurance sector, that were issued in the period from 2007 to 2017. CIRC may use information, reported to them, on related party transactions to investigate inappropriate arrangements. However, this is separate from tax-related investigations of related party transactions (e.g. transfer pricing).

In addition to the matters detailed below, the 2018 Draft Measures set out detailed rules for the internal control, reporting and disclosure, supervision and administration of related party transactions. The CIRC may use the information generated and reported for supervision purposes. The 2018 Draft Measures are to take effect from 1 June 2018, and notable matters clarified include the following:

- **Define related party.** A related party of an insurance company is defined as natural person, legal person or other organization who controls (or is controlled by) the insurance company, or where there is a relationship which involves significant influence of one party over the other.
- **Define related party transaction.** Related party transactions refer to resource/obligation transfers occurring between an insurance company and its related parties. These transactions are divided into the following types:
  - Equity investments (such as a related party investing in the insurance company);
  - Application of funds (such as making investments in financial products issued by the related party);
  - Insurance business (such as insurance brokerage, reinsurance outward and inward businesses);
  - Interest transfer (such as transfer of rights);
  - Service delivery (such as asset valuation); and
  - Other transactions that are determined to have occurred, by CIRC, on the basis of 'substance over form'.
- **Classify related party transactions as "significant" or "general" related party transactions".** A significant related party transaction refers to a case where the transactions occurring between an insurance company (including its subsidiaries) and a related party, account for 1% or more of the net assets of the insurance company of the end of the preceding accounting year. This covers both individual transactions, as well as the total transactions of a year. To be a significant transaction, the amount must exceed RMB30 million. Other transactions are regarded as 'general'.
- **Clarify the determination of the transaction amount.** In principle, the transaction amount shall be determined as the consideration provided. The 2018 Draft Measures elaborate the calculation methods for each related party transaction amount.

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- Operational costs reduced

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China-Japan social security agreement signed

A news posting to the website of Ministry of Human Resources and Social Security (MOHRSS) on 10 May 2018 indicated that China has recently signed an Agreement on Social Security with Japan ("China-Japan social security agreement").

According to the China-Japan social security agreement, where a Chinese enterprise assigns employees to work in Japan, an exemption may be obtained from payment of social security contributions in Japan, such as welfare pension, national pension (these are equivalent of the so-called "basic pension insurance" in China). These would otherwise be mandatory for the assigned employees and the Chinese enterprise. Persons eligible for the exemption include assigned employees, seafarers, aircraft crew, civil servants, members of diplomatic missions and consular posts.

The same exemption applies for Japanese companies and assigned employees in China.

China's Social Insurance Law requires employers and their employees to contribute towards social insurance schemes, including pensions, medical, unemployment, maternity insurance and work-related injury insurance. Since 15 October 2011, expatriate employees working in China are also required to contribute. To mitigate the burden of double contributions in two countries by cross-border employees, China has been rapidly building up its network of bilateral social security agreements and has so far signed them with 10 countries, including Germany, South Korea, Denmark, Finland, Canada, Switzerland, Netherland, France, Spain and Luxembourg. These have all entered into force, except for the China-France and China-Luxembourg agreements**.** China is also negotiating agreements with further countries, including Belgium, Serbia and Romania.

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Other recent regulatory and tax circulars:

- China-Cambodia DTA comes into force (SAT Announcement [2018] No. 22, issued on 27 April 2018)

- MOF and SAT's notice on tax policies for insurance guarantee fund (Cai Shui [2018] No. 41, issued on 27 April 2018)

- CSRC to solicit public comments on *Draft Measures for Securities Companies and Securities Investment Fund Management Companies Setting up, Acquiring and Participating Institutions Abroad* (issued on 4 May 2018)

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