China Tax Weekly Update

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Reference: N/A
Issuance date: 19 June 2018
Effective date: N/A

Relevant industries: All
Relevant companies: All
Relevant taxes: IIT

Potential impacts on businesses:
- Operational costs reduced

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

Details of China individual income tax reform released

As highlighted in KPMG *China Tax Weekly Update (Issue 25, June 2018)*, the proposed amendments to China's individual income tax (IIT) law ("draft IIT bill") were sent for deliberation at the third session of the 13th National People's Congress (NPC) on 19 June 2018. However, it has not yet been adopted by the NPC.

On 29 June 2018, NPC further published the full context of the draft IIT bill on its website to solicit public comments. The key amendments are in line with those previously outlined by Mr. Liu Kun, the Minister of Finance.

Public comments are sought by 28 July 2018, with reports that in excess of 100,000 comments have already been received. The changes to personal deductions and tax brackets would take effect in part from October 2018, and the rest of the changes from January 2019.

With regard to the detailed analysis of the draft bill, please read the following KPMG publications:

- *China Tax Alert: PRC Individual income tax reform – Release of the proposed amendments (Issue 14, June 2018)*
- *China Tax Alert: China seeks Public Consultation on Draft Amendments to the PRC IIT Law (Issue 16, July 2018)*

Reference: Cai Shui [2018] No. 70
Issuance date: 27 June 2018
Effective date: 27 June 2018

Relevant industries: Advanced manufacturing, modern services sector and electric grid
Relevant companies: Enterprises engaged in advanced manufacturing and R&D activities, as well as electrical grid operators
Relevant taxes: VAT

Potential impacts on businesses:
- Operational costs reduced

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

VAT support for innovative activities

In March 2018, China's State Council announced a one-off refund of accumulated excess input VAT credits for enterprises engaged in advanced manufacturing and research and development (R&D) activities, as well as electrical grid operators.

Access to refunds of excess input VAT credits has long been a source of challenge for businesses in China, particularly those at early stages of development. These normally have to carry forward excess input VAT credits for offset against output VAT, in order to utilize them. Excess VAT credit refunds have already been facilitated for certain industries, such as integrated circuits, aircraft production and certain fuel supply businesses, though have been restricted to certain regions such as Shandong. The expansion of such treatment was therefore welcomed.

The particulars of the new treatment were set out on 27 June 2018 in Cai Shui [2018] No. 70. It has been specified that the following taxpayers are covered:

- Enterprises in 10 key areas set out under the Made in China 2025 plan, including those engaged in manufacturing of new generation information technology, aerospace equipment, marine engineering equipment and high-tech marine vessels;
- High and new technology enterprises (HNTEs), advanced technology services enterprises (ATSEs) and science and technology SMEs; and
- All electrical grid companies with appropriate transmission or supply qualifications.

The refundable excess input VAT credits will be calculated as the taxpayer's excess input VAT amount at the end of the previous period, multiplied by the refundable proportion. The refundable amount is limited to the taxpayer's excess input VAT amount as at the end of 2017. It should be noted that the provincial taxation and finance authorities will determine lists of taxpayers eligible for the refund and the refundable amount for the taxpayers. The refunds will be processed by the end of September 2018.

Reference: Cai Shui [2018] No. 64
Issuance date: 25 June 2018
Effective date: 1 January 2018

Relevant industries: Sectors in relation to R&D activities
Relevant companies: Enterprises engaged in R&D activities
Relevant taxes: CIT

Potential impacts on businesses:
- Compliance costs due to regulatory uncertainties reduced

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

CIT super deduction for R&D outsourced overseas

At an executive meeting of China's State Council on 25 April 2018, Premier Li Keqiang announced that China would allow the R&D super deduction bonus for R&D payments made to overseas service providers. This is now in effect, retroactively from 1 January 2018.

Under the super deduction, a 150% deduction (i.e. a 50% bonus deduction) is available for eligible R&D expenses. This increases to a 175% deduction for science and technology SMEs. Up until recently, no super deduction was allowed in respect of R&D payments made to overseas service providers.

Under the new Cai Shui [2018] No. 64 ("Circular 64"), issued on 25 June 2018, 80% of the amount of such outbound payments can now qualify for the super deduction. This reflects the 80% cap which has already existed for payments to domestic outsourced R&D service providers. However, a further limitation also exists that the super deduction for outbound payments may only be enjoyed to the extent that they do not exceed two thirds of the total qualifying R&D expenses incurred in China.

Circular 64 also clarifies the following:

- Outsourcing R&D activities conducted by overseas individuals do not qualify for the super deduction.
- The technical contracts entered into for outsourcing R&D activities must be registered with local science and technology administration where the domestic enterprise, which outsources the services, is located.
- The enterprise can claim the CIT benefits in accordance with the simplified procedures set out under SAT Announcement 23 (see KPMG *China Tax Weekly Update (Issue 18, May 2018)* for details).

For more information about the R&D "super deduction" policy, you may access the following KPMG publications:

- ❑ *China Tax Weekly Update (Issue 46, November 2017)*
- ❑ *China Tax Alert: Notice of the State Administration of Taxation on Further Implementation of the R&D Expenses Super Deduction Policy (Issue 6, February 2017)*
- ❑ *China Tax Alert: 150% Super Deduction Regulation Update (Issue 3, January 2016)*
- ❑ *China Tax Alert: R&D Super Deduction Regulation Update (Issue 31, November 2015)*

Reference: NDRC and MOFCOM Order [2018] No. 18 / No. 19
Issuance date: 28/30 June 2018
Effective date: 28 and 30 July 2018 respectively

Relevant industries: Services, manufacturing sectors etc.
Relevant companies: FIEs
Relevant taxes: N/A

Potential impacts on businesses:
- Restriction on foreign investment may be lowered

You may click here to access full content of Order 18 and here to access full content of Order 19.

New nationwide and free trade zone negative lists for foreign investment

On 28 and 30 June 2018, China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) issued NDRC/MOFCOM Order No. 18 and No. 19 in tandem, setting out the revised 'negative lists' for foreign investment nationwide ("2018 nationwide list") and in pilot free trade zones ("2018 FTZ list"). The revisions in the two lists are in line with the direction of the revision that have been set out by the NDRC in April 2018 (see KPMG *China Tax Weekly Update (Issue 15, April 2018)* and *(Issue 16, April 2018)* for details).

The 2018 nationwide list will apply from 28 July 2018, replacing the existing 2017 nationwide list set out under the Catalogue of Industries for Guiding Foreign Investment (2017 revisions) (see KPMG *China Tax Weekly Update (Issue 26, July 2017)* for details). The economic sectors for which foreign investors face limitations are reduced to 48 in the 2018 nationwide list, from 63 in the 2017 nationwide list. Specific timeframes and route maps for opening up of the financial and automotive sectors are also set out. Key developments include:

Services sector	• Financial sector: (i) removal of the foreign equity ownership holding limitation in the banking sector; (ii) lift the ceiling on foreign equity ownership in securities, fund management, futures, and life insurance companies to 51% (currently 49% for the first three sectors, and 50% for life insurance companies). China will eliminate foreign equity ownership limits in the financial sector entirely by 2021. • Infrastructure sector: removal of the restrictions on foreign investment in the trunk railway network and power grid sectors. • Transportation sector: removal of the restrictions on foreign investment in railway passenger transportation companies, international sea transportation and international shipping agencies. • Commerce and trade sector: removal of the restrictions on foreign investment in gas stations, grain purchasing and wholesale activities. • Culture sector: allow foreign investors to make investments in internet services.
Manufacturing sector	• Automotive sector: remove the foreign equity ownership limits (currently 50%) for special vehicles and new energy vehicles in 2018, commercial vehicles in 2020 and passenger vehicles in 2022. Also in 2022, the limitation on a foreign investor, whereby it may only set up two joint venture entities (JV) for passenger vehicles and two JVs for commercial vehicles, will be eliminated. • Shipbuilding sector: foreign equity ownership limits (currently 49%) for the shipbuilding sector will be eliminated. This would apply to enterprises engaged in ship design, manufacturing or repair.

Manufacturing sector (cont'd)	• Aviation sector: foreign equity ownership limits for the aviation sector will be eliminated. The types include: trunk airliner, regional aircraft, general-purpose plane, helicopter, unmanned aerial vehicle and aerostatics. Currently, the aviation sector is either subject to 49% foreign equity holding requirements or enterprises must be set up in the form of an equity joint venture or cooperative joint venture.
Agriculture, energy and resource sectors	• Agriculture sector: remove the restrictions that foreign investments cannot be made in crop (excluding wheat and corn) production. • Energy sector: remove the restrictions that foreign investments cannot be made in rare coal mining. • Resource sector: remove the restrictions that foreign investments cannot be made in graphite mining, rare earth smelting and splitting, wolfram smelting.

The 2018 FTZ list will apply from 30 July 2018, replacing the existing 2017 FTZ list (see KPMG *China Tax Weekly Update (Issue 25, June 2017)* for details). The 2018 FTZ list will cover all the existing 12 FTZs, including Shanghai, Guangdong, Tianjin, Fujian, Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan, Shaanxi and Hainan. The economic sectors for which foreign investors face limitations are reduced to 45 in the 2018 FTZ list, from 95 in the 2017 FTZ list. In addition to the reductions in the limitations on foreign investors made to the nationwide list, the reductions under the new FTZ negative list go even further. In particular, the new list:

- Lifts the foreign equity ownership limits on enterprises engaged in crop production (excluding wheat and corn) to 66% (currently 49%);
- Eliminates the restrictions that petroleum/natural gas exploitation activity must be carried out by foreign businesses through JVs or joint cooperation arrangements together with Chinese partners;
- Eliminates the restrictions providing that foreign investment cannot be made in radioactive mineral smelting and processing, as well as production of nuclear fuel;
- Eliminates the foreign equity ownership limits applying to performers' agencies;
- Allows foreign investors to make investments in Chinese performing group, but the controlling stakes must be held by a Chinese party;
- Extends the liberalization of foreign investment in value-added telecommunication services, which was originally piloted in the Shanghai FTZ, to cover all FTZs. The pilot measures eliminated the previously existing 50% foreign equity limits for enterprises operating data storage, call centres, domestic telecom services, internet access services and domestic internet virtual private network services.

Other recent regulatory and tax circulars:

- GAC's announcement on implementation rules of tonnage dues law (GAC Announcement [2018] No. 77, issued on 28 June 2018)
- China to combat tax evasion in firm and television industry (released on 27 June 2018)

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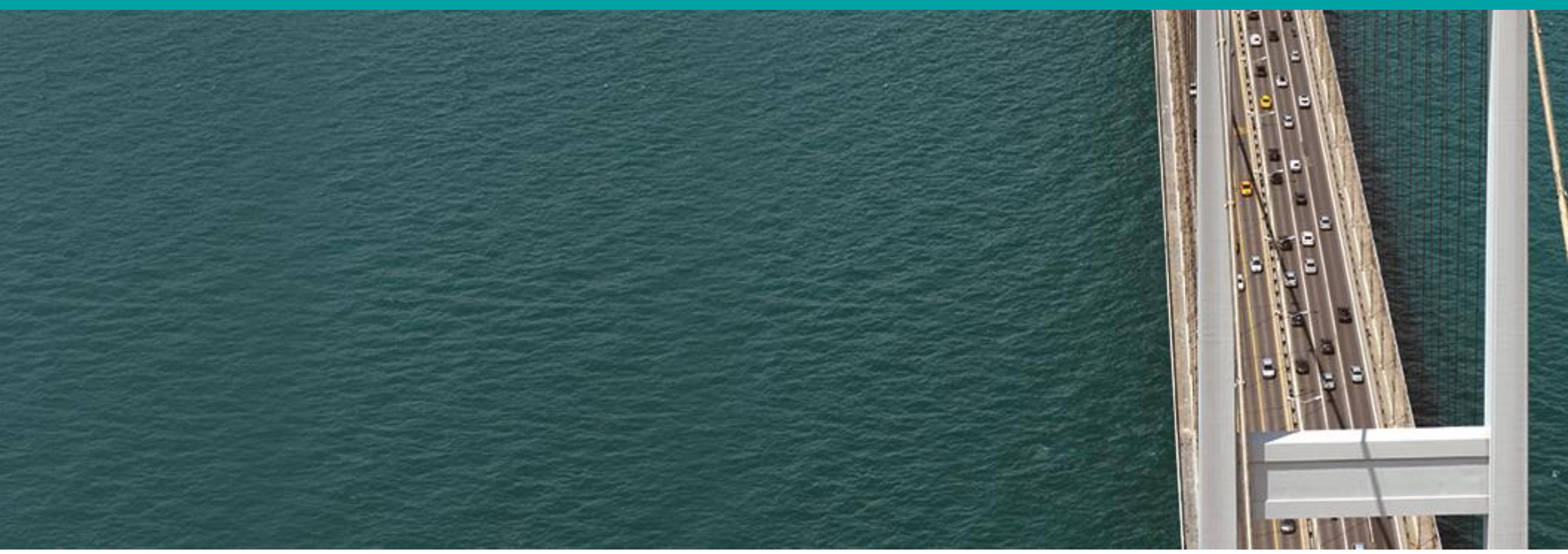

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