China offices

Legal flash

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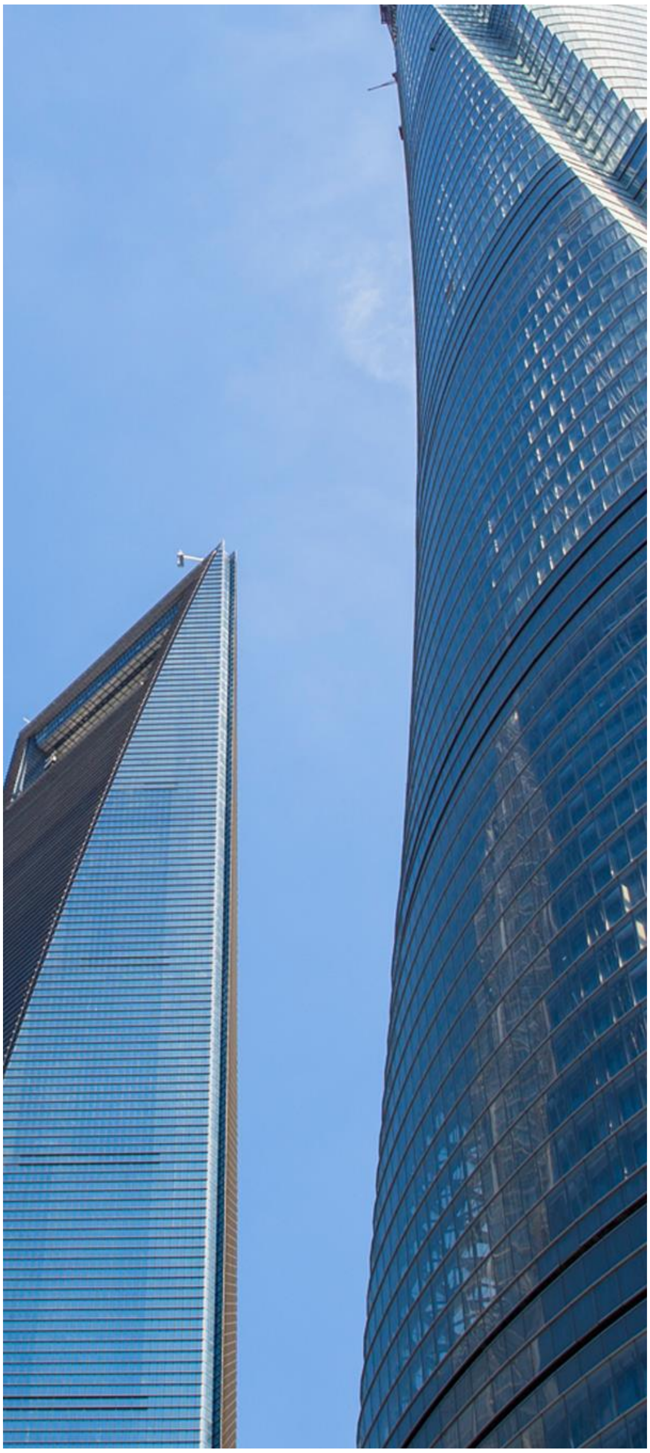

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Implementing Rules on the Individual Income Tax ("IIT") Law released (《个人所得税法实施条例》发布)

On December 18, 2018, the State Council published the Implementing Rules on the new IIT Law (the "Implementing Rules"), which is the final version of the Draft Implementing Rules (the "Draft Version") we analyzed in our Legal Flash of November 2018. To our surprise, the Implementing Rules introduce many changes to the Draft Version. Taking into account the current overall economic environment, the Implementing Rules reflect China's intent to take a moderate stance by eliminating some of the provisions that may be viewed as too radical. Several other regulations have been released at the same time, and there will be more in the near future. With the curtain of the reform gradually unfolding, we will soon see its impact on tax administration.

Highlights:

- From the Draft Version, we learned that China would keep the tax exemption policy applied to foreign-sourced income paid overseas to non-domiciled tax residents living in China for less than five consecutive years, or for five consecutive years with a single stay abroad of over 30 days during the period.

  The Implementing Rules go one-step further and extend these five years to six, which is good news for foreign expatriates working in China.

  The Implementing Rules also clarify that the single stay of over 30 days outside China to break the six-year continuous residency status must take place in one tax year.

- The Implementing Rules remove the income from author's remuneration and contingent income paid by Chinese companies and resident individuals from the scope of China-sourced income.

  This change is consistent with the general principle of China-sourced income, which depends on the location of business activities or assets. Therefore, defining author's remuneration and contingent income as China-sourced income merely because they are paid or borne by a Chinese party may be far-fetched.

- The Implementing Rules provide individuals that earn only business operational income without any comprehensive income access to the statutory deduction of RMB 60,000, special deductions, additional special deductions and other qualified deductions when calculating annual taxable incomes. Additional special deductions must be deducted during the annual declaration process.

- The Implementing Rules remove the provision that deemed property transfer transactions are subject to IIT. This provision was widely criticized and considered unreasonable. In practice, it was also impossible to implement it, except for certain properties subject to registration.

- The Implementing Rules remove all provisions on the anti-tax avoidance rules and the provision granting the Ministry of Finance (“MOF”) and the State Administration of Taxation (“SAT”) the power to formulate specific rules on anti-tax avoidance adjustment. This makes the anti-tax avoidance rules provided in the IIT Law merely a spearhead. Whether this means Chinese tax authorities will not focus on anti-tax avoidance investigations in the near future is yet to be seen.

- The Implementing Rules reduces the daily interest accrued on underpaid taxes resulting from an adjustment due to the anti-tax avoidance rules to the current benchmark RMB lending rate, without the additional 5% penalty interest previously provided in the Draft Version, even if the taxpayer is not cooperative.

- The Implementing Rules remove the figure of the “appointed withholding agent” introduced in the Draft Version, and therefore, the tax authorities cannot appoint companies as withholding agent in any situation.

Date of issue: December 18, 2018. Effective date: January 1, 2019

Regulations on special additional deductions released (专项附加扣除相关法规出台)

On December 13, 2018, the State Council released the Provisional Measures on Special Additional Deductions for IIT, followed by the SAT’s release of the Working Measures on Special Additional Deduction for IIT (trial) on December 21, 2018. The regulations provide detailed criteria and documentation requirements on special additional deductions and introduce several changes to the draft version of the Provisional Measures.

We summarize the updated deduction criteria:

Deduction	Limit	Scope	Deduction method
Child education expenses	RMB 1,000/month per child	Pre-school education after three years of age Degree education, including overseas degrees	Parents can deduct 50% each or one parent can deduct 100%
Continuous education expense	RMB 400/month	Domestic degrees For the same degree, deduction limited to 48 months. It can be applied with the deduction for professional qualifications but not to multiple degrees at the same time	Parents can deduct it as child education expenses (bachelor degree or lower) or the taxpayer as continuous education expenses
	RMB 3,600/year for professional qualifications	Professional qualifications included in the National Professional Qualification Catalogue published by the Ministry of Human Resources and Social Security It can be applied with the deduction for degree education but not to multiple qualifications at the same time	Only the taxpayer can deduct it
Medical expenses for serious illness	Up to RMB 80,000/year for amounts over RMB 15,000 paid by the taxpayer	Medical expenses registered in the social medical insurance administration information system, deducting the amount reimbursed by the basic medical insurance	The taxpayer or the spouse can deduct it Either parent can also deduct underage children's medical expenses
Mortgage interest expenses	RMB 1,000/month	The taxpayer or the spouse's mortgage interest on a commercial loan or housing fund loan for the first home (i.e., the mortgage with the loan interest rate applicable to the first home)	For a couple, either party can deduct it When a couple purchases a first home before getting married, they can choose one party to deduct 100% for one

		Deduction is limited to 240 months Each taxpayer can only benefit once from this deduction	home, or each party can deduct 50% for the home they own
House rental expenses	RMB 1,500/month	In directly controlled municipalities, provincial capital cities, municipalities with independent planning status, and other cities assigned by the State Council	When a couple works in the same city, only one party can deduct it Only the lessee in a leasing agreement can deduct it
	RMB 1,100/month	In medium-size cities with a population over one million	The taxpayer and the spouse cannot separately benefit from deducting mortgage interest expense and housing rental expense
	RMB 800/month	In small cities with a population below one million	
Elderly support expenses	1) RMB 2,000/month, when there is one child; 2) RMB 2,000/month: when there is more than one child, it is allocated among siblings	Applies to parents aged 60 or older and grandparents that qualify	The allocation method can be average allocation, appointed allocation or agreed-on allocation. Individuals must not be allocated more than RMB 1,000/month. When applying appointed allocation or agreed-on allocation, a written allocation agreement must be signed

Date of issue: December 13, 2018/ December 21, 2018. Effective date: January 1, 2019

Regulations on IIT withholding declaration method released (个人所得税扣缴申报方法出台)

On December 19, 2018, the SAT released Announcement [2018] No. 56 to provide IIT withholding methods on salary, service income, author's remuneration and royalties during a tax year, followed by the SAT's release of the Administrative Measures on the Administration of IIT Withholding Declaration (Announcement [2018] No. 61).

The regulations provide IIT withholding methods for withholding agents to declare IIT during a tax year for both resident and non-resident taxpayers.

Summary of updated deduction criteria:

Residency status	Income type	Withholding method
Resident taxpayers	Salary	Accumulative withholding method: IIT withheld for the current month = (accumulated taxable income x withholding tax rate – super deduction) – accumulated deductible tax amount – accumulated withheld tax in the previous periods Accumulated taxable income = accumulated income – accumulated exempt income – accumulated statutory deduction – accumulated special deduction – accumulated special additional deduction – accumulated other qualified deduction
	Service income	IIT withheld for each month or each income = taxable income x withholding tax rate – super deduction Taxable income = income – statutory deduction Statutory deduction: when income is no more than RMB 4,000, then RMB 800; when income is more than RMB 4,000, 20% of income.
	Author's remuneration and royalties	IIT withheld for each month or each income = taxable income x 20% Taxable income = income – statutory deduction Statutory deduction: when income is no more than RMB 4,000, then RMB 800; when income is more than RMB 4,000, 20% of income. For authors' remuneration, income is 70% of the remuneration.
Non-resident taxpayers	Salary	IIT withheld for each month = taxable income x withholding tax rate – super deduction Taxable income = income – statutory deduction of RMB 5,000

	Service income, author's remuneration and royalty	IIT withheld for each income = taxable income x withholding tax rate – super deduction Taxable income = income – statutory deduction of 20% of income For author's remuneration, income is 70% of the remuneration.

Tax rates applicable to IIT withholding calculation:

Withholding tax rates for resident taxpayers' salary

Bracket	Accumulated taxable income (RMB)	Tax rate (%)	Super deduction
1	Up to 36,000	3	0
2	Over 36,000 up to 144,000	10	2,520
3	Over 144,000 up to 300,000	20	16,920
4	Over 300,000 up to 420,000	25	31,920
5	Over 420,000 up to 660,000	30	52,920
6	Over 660,000 up to 960,000	35	85,920
7	Over 960,000	45	181,920

Withholding tax rate table for resident taxpayers' service income

Bracket	Accumulated taxable income (RMB)	Tax rate (%)	Super deduction
1	Up to 20,000	20	0
2	Over 20,000 up to 50,000	30	2,000
3	Over 50,000	40	7,000

Withholding tax rate table for non-resident taxpayers' salary, service income, author's remuneration and royalties

Bracket	Accumulated taxable income (RMB)	Tax rate (%)	Super deduction
1	Up to 3,000	3	0
2	Over 3,000 up to 12,000	10	210
3	Over 12,000 up to 25,000	20	1,410
4	Over 25,000 up to 35,000	25	2,660
5	Over 35,000 up to 55,000	30	4,410
6	Over 55,000 up to 80,000	35	7,160
7	Over 80,000	45	15,160

Date of issue: December 19, 2018/December 21, 2018. Effective date: January 1, 2019

Notice on applicability of several preferential tax polices after implementing the new IIT Law (关于个人所得税法修改后有关优惠政策衔接问题的通知)

On December 27, 2018, the MOF and the SAT jointly released tax circular Cai Shui [2018] No. 164 to clarify the continuous application of several important preferential tax policies after implementing the new IIT Law.

Highlights:

- Regarding annual bonuses received by resident taxpayers, they do not need to be added to resident taxpayers' comprehensive incomes and can continue to be treated separately by applying the previous preferential tax policy (i.e., divide annual bonus by 12 to determine the applicable tax rate) until December 31, 2021. Resident taxpayers can also choose to add the annual bonus to their comprehensive income.

  Starting January 1, 2022, resident taxpayers' annual bonus must be added to their comprehensive income to calculate IIT.

- Until December 31, 2021, the full amount of stock incentives of listed companies received by resident taxpayers will be treated separately, without being added to their comprehensive income, and the tax rate for comprehensive income will apply. The preferential calculation formula under the previous tax policies no longer applies.

  The policy from January 1, 2022, will be determined in the future.

- Regarding severance paid for termination of an employment contract, an amount equal to three times the local annual average salary for the last year continues to be exempt.

  Any excess amount will be treated separately, without being added to the comprehensive income, and the tax rate for comprehensive income will apply. The preferential calculation formula under the previous tax policies no longer applies.

- Regarding tax-exempt items for foreign expatriates working in China, from January 1, 2019, to December 31, 2021, foreign expatriates can choose to apply either the special additional deductions provided under the new IIT Law or the tax-exempt items under the previous tax policy. Once taxpayers make the choice, they cannot change it during the tax year.

  Starting January 1, 2022, like other Chinese nationals, foreign expatriates must apply the special additional deductions provided under the new IIT Law.

  Date of issue: December 27, 2018. Effective date: January 1, 2019

Draft Foreign Investment Law published for public comments (外商投资法《草案》征求意见)

The Standing Committee of the National People's Congress reviewed the Draft Foreign Investment Law and published it for public comments on December 26, 2018. The deadline for public comments is February 24, 2019. The Foreign Investment Law, which will replace existing laws on Sino-foreign equity joint ventures (EJVs), cooperative joint ventures (CJVs) and wholly foreign-owned enterprises (WFOEs), was first drafted by the Ministry of Commerce and published on January 19, 2015, for public comments. During these three years, the State Council introduced at least three documents promoting and expanding the use of foreign investment.

- The new draft significantly **reduces the number of clauses from 170 to 39**, deleting sections on national security review, information reporting, coordination of handling complaints, and supervision and inspection, replacing them with one simple clause each. The old version provoked a huge response from foreign investors, causing panic among them that the Chinese government might tighten polices on foreign investment.

- The new draft simplifies the **definition of foreign investment** to direct/indirect investment by foreign individuals/enterprises/other organizations in China, including new construction projects; and by establishing foreign-invested enterprises/capital increase; and by acquiring equity interests, shares, property shares or other rights of domestic enterprises; as well as other investments stipulated by laws and regulations. The definition eliminates from foreign investment the determination and criteria of "control" and "actual controller".

- The new draft emphasizes **granting national treatment** to foreign invested enterprises, so they can (i) equally participate in formulating standardization and government procurement, and (ii) finance enterprise by issuing public stock or enterprise bond.

- It also **removes the monetary fines** faced by foreign investors that invested in prohibited or restricted items on the Negative List of Foreign Investment (for an updated version, see our special edition of the Unified Negative List Regime for Foreign Investment in China July 2018).

- EJVs and CJVs established before the final Foreign Investment Law comes into force will be allowed to maintain their current **internal organizational structure**, with the board of directors as the highest authority, for five years.

With these revisions, we believe the new draft will be passed in 2019 or during the first few months of 2020, and we assume that the EJVs and CJVs will be ready to change their current structure, as well as their articles of association and internal rules.

Date of issue: December 26, 2018. Deadline for comments: February 24, 2019

Administrative Provisions on Investment in the Automobile Industry promulgated (国家发改委颁布《汽车产业投资管理规定》)

On December 10, 2018, the National Reform and Development Commission ("NDRC") issued the Administrative Provisions on Investment in the Automobile Industry ("Investment Provisions"), which became effective January 10, 2019. Although the final version of the Investment Provisions does not stipulate that they will replace the Policy on the Development of the Automotive Industry of 2004 (revised in 2009), the Administrative Provisions on Newly Established Pure Electric Passenger Vehicle Enterprises of 2015 and the Opinions on Improving the Management of Automobile Investment Projects of 2017, the NDRC has confirmed in a press conference that these regulations will be amended or abolished .

The Investment Provisions, which aim to develop pure electric vehicles ("BEVs"), plug-in hybrid electric vehicle ("PHEVs") and fuel cell vehicles ("FCVs"), were published for public comments on May 17 (limited to professionals and authorities only) and July 4, 2018. All investment projects are divided into whole vehicle projects and other projects (e.g., engine, power batteries, fuel cells, recycling of power batteries, special purpose vehicles and trailers); the whole vehicle projects are further divided into fuel vehicle projects powered by engines (traditional fuel vehicles, alternative fuel vehicles, hybrid electric vehicles and PHEVs) and BEV projects powered by electric motors (BEVs, extended range electric vehicles and FCVs).

Main changes:

- All investment projects will only have to file record with the provincial reform and development commission (whole vehicle projects) or the local commission (other projects), including newly-built Sino-foreign joint-venture car manufacturer projects previously seeking State Council's approval, the step-by-step liberation of foreign shareholding ratio in the automotive sector started from 2018 (please refer to our special edition of July 2018 on the unified negative list regime for foreign investment in China), the newly-built pure electric passenger vehicle manufacturer projects (including the existing vehicle manufacturer switch to purely electric passenger vehicles, previously seeking NDRC's approval) and other projects will be subject to the approval of provincial governments.

- Investment projects relating to fuel vehicles
  - Newly added prohibited investment projects: i) overall relocation across provinces not listed in the state-level regional development planning; and ii) investment in a shell company other than by its current shareholder(s) or acquisition by existing whole vehicle manufacturer(s). Projects whose products will not be sold in China are excluded from existing and new prohibitions.
  - Newly added pre-conditions to expand production capacity of existing fuel vehicle manufacturers, to have the utilization ratio of existing production capacity of the province where the project is located exceed the average of the same category (either passenger or commercial vehicles) for the past two years and no shell company without a manufacturing operation in the province announced by the relevant authority. These pre-conditions can be lifted for PHEV projects, as well as the pre-condition that production ratio of new energy vehicles must be higher than the industry average in the past two years.
  - Cross-provincial fuel passenger vehicle expansion projects must have a production scale of at least 150,000 vehicles, and the enterprise must have a total production volume of at least 300,000 vehicles.
- BEV projects
  - Province where the new project (including cross-category project) is located must have a utilization ratio of existing production capacity of the province where the project is located that exceeds the average of the same category (either passenger or commercial vehicles) in the past two years; have the existing BEV project(s) of the same category (either passenger or commercial vehicles) complete and reach the production scale.
  - Shareholder(s) must not withdraw shares before the project completes and reaches the production scale; main shareholder(s) must have a shareholding ratio of more than one-third. If the main shareholder is a whole vehicle manufacturer, automobile component manufacturer, R&D enterprise or foreign investor, it must meet the corresponding requirements.

- Production scale for new projects and expansion of production capacity through cross-provincial investment of existing enterprises in the same category must be at least 100,000 passenger vehicles or 5,000 commercial vehicles.

- Existing BEV enterprise can only expand its production capacity of the same category, cross provincial or not, after its production capacity reaches the production scale.

- Existing non-BEV enterprise can only expand its production capacity of the same category, cross provincial or not, after its production capacity reaches the industry average for the past two years.

› For approved or verified investment projects, changes to production content, main shareholder(s) or others must be reported to the original approval or verification authority.

The Investment Provisions stipulate detailed and stricter requirements to allow new investment and expansion projects, to fight overcapacity in the automobile industry, although the record-filing regime will simplify their application. We will keep an eye on the implementation of the Investment Provisions.

Date of issue: December 10, 2018. Effective date: January 10, 2019

Administrative Measures for Market Access Permission for Road Motor Vehicle Manufacturers and Products issued (工业和信息化部发布《道路机动车辆生产企业及产品准入管理办法》)

On November 27, 2018, the Ministry of Industry and Information Technology ("MIIT") issued the Administrative Measures for Market Access Permission for Road Motor Vehicle Manufacturers and Products ("Measures for Access"), which will enter into force on June 1, 2019. The Measures for Access stipulate the procedures, requirements and application documents for vehicle manufacturing enterprises ("Enterprises") and products. To manufacture their vehicle products for use in China, they have to be published by MIIT as an Enterprise qualified for manufacturing vehicle products .

Similar to the administration of new energy vehicles, which announces the Enterprises suspending production activities for more than 12 months, from the supervision perspective, the Measures for Access provide details for Enterprises, announcing that they are unable to maintain normal production operation: two consecutive years with annual average production below 2,000 passenger vehicles, 1,000 trucks, 1,000 buses, 5,000 motorcycles or 100 trailers. MIIT will adjust these conditions from time to time.

The Measures for Access also encourage Enterprises to adopt new technology, new processes and new materials. For those for which the Enterprise will not fulfill the requirements, they can apply for the corresponding exemption. However, MIIT will decide at its discretion and set the restricted validity and implementation area.

The Measures for Access will also encourage Enterprises to cooperate on R&D and production capacity, allow qualified Enterprises "to entrust" manufacturing; encourage vehicle R&D and design enterprises to cooperate with the Enterprises, and allow qualified ones to use the Enterprises' production capacity to apply for qualification as enterprises manufacturing products and for their products. This new provision is interpreted as legitimating the current scenario of "entrust manufacturing" by R&D and design enterprises such as NEO-JAC, Xiaopeng-Haima, Dearcc-Southeast Motor, Singulato-BAIC BJEV. However, MIIT needs to define the qualification in the above two scenarios to put it into practice.

The examination requirements for access of the Enterprises and the products, such as the supporting documentation, have completed the period for public comments and will be published soon.

Date of issue: November 27, 2018. Effective date: June 1, 2019

Notice on Implementing the Management of Record-filing of Imported Non-Special Purpose Cosmetic Products Nationwide released (国家药监局发布《关于在全国范围实施进口非特殊用途化妆品备案管理有关事宜的公告》)

On January 10, 2017, China's Food and Drug Administration ("CFDA", currently the National Medical Products Administration, "NMPA") and the General Administration of Quality Supervision, Inspection and Quarantine (now merged into State Administration for Market

Regulation) jointly decided to temporarily lift the obligation to register imported non-special purpose cosmetic products, and to simplify it through a record-filing procedure from March 1, 2017, to December 21, 2018.

On March 8, 2018, China's Food and Drug Administration extended the implementation to all Pilot Free Trade Zones ("PFTZs") until December 21, 2018, and NMPA finally issued the Notice on Implementing the Management of Record-filing of Imported Non-Special Purpose Cosmetic Products Nationwide on November 7, 2018.

Starting November 10, 2018, NMPA is not accepting applications for approval of imported non-special purpose cosmetic products. Foreign manufacturers of those products are required to appoint and authorize a Chinese entity responsible for doing this (unlike the traditional unit responsible for application in China, which was only responsible for the application for approval of those products on their behalf, and one foreign manufacturer can only appoint one unit for all its products). The unit is responsible for

- record filing of the relevant products;
- importation of these products;
- operation of these products, including the whole process after importation; and
- product quality and safety liability.

Additional importing ports and consignees can be added for cosmetic products already registered, if imported through ports other than the one(s) on record.

Non-special purpose cosmetic products already approved by the CFDA and granted paper certificates can be imported by presenting valid certificates. When the certificates expire, record must be filed for such products before importation. The same applies if there is a need to change the existing approval.

Based on the experience in Pudong New Area, Shanghai and PFTZs, the procedural burden for these products is reduced from three months to approximately five business days. This allows the enterprise to launch simultaneously new products in China, and due to *ex post* supervision and the introduction of units responsible for such products in China it does not affect the product quality and safety.

Date of issue: November 7, 2018. Effective date: November 10, 2018

Negative List for Market Access (Edition 2018) Officially Announced (市场准入负面清单（2018 年版）正式发布)

On December 25, 2018, the NDRC and the Ministry of Commerce ("MOFCOM") announced jointly the final version of the Negative List for Market Access (2018 Edition) applicable to all investors. The items on the Negative List are categorized as prohibited items and items requiring authorization, e.g., the laws and regulations, State Council's decisions, local regulations and temporary measures established by provincial government's rules and regulations. For example, in Shanghai, a permit is required to carry out the wholesale or retail business of liquor products.

It adopts the following measures:

- It strictly forbids prohibited items: no entity is allowed to carry out these activities, and the authorities will not examine or approve these projects.
- Items requiring a permit: entities must apply to the relevant authority, which will decide whether to grant the permit.
- Items that are not prohibited or do not require a permit are only subject to registration or record filing.

Date of issue: December 25, 2018. Effective date: January 1, 2019

Six Authorities Jointly Published Notice to Optimize the Supervision of Crossborder E-Commerce Retail Imports (六部门发文完善跨境电子商务零售进口监管有关工作)

Following the revised list of crossborder e-commerce retail imports issued on November 20, 2018, on November 28, 2018, MOFCOM, NDRC, the Ministry of Finance, the General Administration of Customs, the State Administration of Taxation, and the State Administration for Market jointly published the Circular on Improving the Regulation of Crossborder E-Commerce Retail Imports (the "Circular"), which became effective January 1, 2019. The Circular continues to lift the requirements for permits, registration and record filing for certain products on the list, which means the grace period will be further extended.

The Circular includes the following:

- Foreign companies selling goods from abroad to consumers in China will be responsible for the following:

  - Product quality and safety: it must entrust a company registered in China to register with customs and make a correct declaration and bear joint and several liability.

  - Consumer protection.

    Risk notification to consumers on the goods' ordering page or other visible position, stating that:

    - the goods meet the standards of their country or region of origin, but those standards may differ from China's standards, and the consumers bear the risks;
    - consumers can view the electronic product label in Chinese language online, if the products are directly purchased abroad and do not have a Chinese label; and
    - the goods are for the consumer's personal use and must not be resold.

  - Risk prevention and control mechanism.

  - Quality traceability system covering information on the logistics trajectory from the overseas place of departure to the domestic consumers.

  - Real-time electronic data of crossborder e-commerce retail import trading with the enterprise or its agent's electronic signature.

- Online purchases of bonded imported goods will not be allowed to be picked up in an offline store outside the customs special supervision zones.

- The enterprises involved in the crossborder e-commerce retail import, including crossborder e-commerce enterprises, will be given different credit ratings. Those recognized as good faith enterprises will be granted easier customs clearance and those recognized as discreditable enterprises will be under stricter supervision measures.

The Circular will apply in 37 cities, and the direct-purchase import business in non-pilot cities will be regulated by reference to the Circular. We expect the Circular to have a great impact on crossborder e-commerce business in China, and we welcome questions on the formalities required to comply with it.

Date of issue: November 28, 2018. Effective date: January 1, 2019

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