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Release of the Draft Implementation Rules and Draft Measures on Special Additional Tax Deductions of Updated Individual Income Tax Law

Following the promulgation of the new Individual Income Tax ("IIT") Law as amended on 31st August 2018, the Ministry of Finance ("MOF") and the State Administration of Taxation ("SAT") jointly released the Draft Implementation Rules and Draft Measures on Special Additional Tax Deductions for public consultation on 20th October 2018. The former is a policy interpretation of the implementation of the new IIT Law while the latter is a policy refinement of the special additional deductions which were introduced in the IIT reform. Both include important guidelines for implementation of the new IIT Law. The key points are as follows:

1. <u>The Draft Implementation Rules of the new IIT Law</u>

- Refine the definition of tax residents

  Based on the new IIT law, individuals who have domicile, or do not have domicile but reside in mainland China for 183 days or above within a tax year are considered as China Tax

Residents. And China Tax Residents are subject to IIT on their worldwide income.

The Draft Implementation Rules provided that a non-domiciled individual, being a China Tax Resident, may be exempt from China IIT on the non-China sourced income, when:

a. The tax resident stays in China for no more than five consecutive years, where a year is defined as a tax year when residing in China for more than 183 days; or
b. The tax resident stays in China for five consecutive years but had a leave from mainland China for more than 30 days in one trip during those five years.

Proper record filing in tax authorities should be done to be entitlement to exemption under b.

- Elaborate anti-avoidance rules

The new IIT law introduced an anti-tax avoidance clause, drawing from the experience in the implementation of the Corporate Income Tax Law, and introduced various provisions for anti-tax avoidance as below:

a. Define the concepts of related parties, related-party relationship, the principle of arm’s length transactions, controlled foreign enterprises, evident low actual tax burdens, reasonable business need, etc.;
b. Introduce the calculation method of interest surcharges resulting from tax remediation; and
c. Stipulate that the methods for tax adjustment to be determined by the finance and tax authorities under State Council.

2. <u>The Draft Measures on Special Additional Tax Deductions of the new IIT Law</u>

- The Draft Measures on Special Additional Tax Deductions introduce detailed standards for special additional tax deductions. They are summarized as below:

Special Additional Deductions	Standard Amount (RMB)	Scope of Application		Subject Entitle to Deductions	Time of Deduction
Children Education	12,000 per year (1,000 per month)	Preschool education	Aged 3 to primary school	50% per parent; or 100% by father or mother	Per year or per month
		Academic education	Compulsory education High school education Higher education		
Continued Education	4,800 per year (400 per month)	Academic education		Either parents or son or daughter	Per year or per month
	3,600 per year	Continued education	Continued education for skilled personnel/ professional and technical personnel	Taxpayer	Per year (in the year of the certificate is obtained)
Medical Expenses for Serious Illness	Personal expenses above 15,000, Deduction Capped at 60,000 (based on actual)	Recorded in the social medical insurance management information system		Taxpayer	Per year (together with annual reconciliation filing)
Housing Loan Interest	12,000 per year (1,000 per month)	The housing loan interest for the first residential property of taxpayer or spouse		Either husband or wife	Per year or per month

Housing Rent	14,400 per year (1,200 per month)	Big cities	Municipalities provincial capitals, planning unit cities, and other cities designated by the State Council	Either husband or wife within the same city; Deduct respectively in different cities when they work and lease two properties in two cities	Per year or per month
	12,000 per year (1,000 per month)	Medium cities	Over 1 million of registered population		
	9,600 per year (800 per month)	Small cities	No more than 1 million (inclusive) of registered population		
Caring for the Elderly	24,000 per year (2,000 per month)	Singleton	60 years old or above parents and other statutory grandparents	Taxpayer	Per year or per month
	Not exceed 12,000 per year (not exceed 1,000 per month)	Non-singleton	60 years old or above parents and other statutory grandparents	Averaged, Designated or Agreed	

- Tax deductions benefit for non-Chinese nationals

The Draft Measures provided that if non-Chinese nationals meets the special deduction conditions for children's education, continuing education, housing loan interest or housing rent, they may choose to deduct according to the above rules , or they may choose to continue to enjoy the current tax deductions for children's education fees, language training fees and housing subsidies, but the same expenditure items will only be entitled for deductions once.

Hainan Pilot Free Trade Zone Formally Approved for Establishment

The State Council released Guohan [2018] No.119 to approve the establishment of China (Hainan) Pilot Free Trade Zone ("FTZ") on 24th September 2018. Moreover, the "General Plan for the China (Hainan) Pilot Free Trade Zone" by Guofa [2018] No. 34 was released on 16th October 2018. The Hainan FTZ covers the whole Hainan Island.

The main contents included in the general plan are:

- Substantial liberalization of market access for foreign investments
  - ✓ Cancel the restriction on the selection of new varieties of vegetables and the ratio of foreign shares in seed production;
  - ✓ Allow foreign investors to invest in domestic internet virtual private network services (The foreign share proportion shall not exceed 50%);
  - ✓ Allow to set up a foreign-invested cultural performance group (majority control by Chinese party);
  - ✓ Relax the foreign ownership limit of foreign-invested personal insurance companies to 51%;
  - ✓ Remove foreign ownership limit for ship (including segmentation) and trunk line, branch line, general aircraft design, manufacturing and maintenance companies;
  - ✓ Remove foreign ownership limit for international maritime transportation companies and international shipping agencies; and
  - ✓ Remove restrictions on foreign investments in new energy vehicle manufacturing.
- Improvement of trade facilitation: Accelerate the setup of "One-stop Service" for international trade and upgrade the service to an international and advanced level.

- Promote the development of modern service industry: Professionals in the fields of finance, construction, planning, patent agency, etc., which are qualified to practice in Hong Kong and Macao, are allowed to provide professional services to enterprises in the Hainan FTZ after filing.

Shanghai Pilot Free Trade Zone Launches Negative List of Cross-Border Service Trade

Shanghai released "Measures for Implementation of Negative List Management Model for Cross-border Service Trade in the China (Shanghai) Pilot Free Trade Zone" and "Special Management Measures for Cross-border Trade in Services in China (Shanghai) Pilot Free Trade Zone (Negative List)" on 9th October 2018, which have been implemented from 1st November 2018.

The negative list model focuses on cross-border delivery, overseas consumption, and movement of natural persons:

- Services provided to entities in Shanghai FTZ by overseas service providers outside of China are considered as cross-border delivery;
- Services provided outside of China to entities coming from Shanghai FTZ are considered as overseas consumption; and
- Services provided by natural persons employed by overseas service providers in Shanghai FTZ to entities in Shanghai FTZ are considered as movement of natural persons.

The objectives for introducing these measures is to promote the reform and openness of FTZ, introduce stress testing to the reform and openness. The management model and measures is expected to enhance China's abilities in tackling the changes in international economic framework, merging into the global value chain and promote the international competitive abilities of the service providers in China.

159 special management measures involving 13 categories and 31 industry categories were listed in the negative list of service trade, and there are 31 items in the negative list involving the financial industry, accounting for about 19%. 31 items on monetary and financial services, capital market services, insurance, and other financial industries, which may help the financial industry to have access to international practices and become more transparent and effective.

Besides, according to the negative list, some services provided by overseas service providers are with restrictions, such as:

- Illegal sales of overseas insurance products are prohibited;
- Credit rating business in the securities market must be a Chinese legal person; and
- The overseas service providers cannot establish a special financial network in the territory.

Services within the negative list will be managed by the respective authorities according to the relevant applicable regulations in China. For services outside the negative list, overseas services and service providers will be managed on same basis as domestic services and service providers.

Service Highlight

From many new and updated polices released, it is evident that the Chinese government has been putting in strenuous effort into improving the investment environment of China. We are more than pleased to discuss with you on how to make the most out of these reforms to enhance the competitiveness of your business. Our Marketing Executive, Ms. Rika Wong, looks forward to hearing from you at (852) 3579 8745 or rikawong@sinobridge-consulting.com for any assistance and support we could provide you with.

Our China Investment Business Advisory Team

Hong Kong
Room 2301-02, 23/F, Prosperity Center,
25 Chong Yip Street, Kwun Tong, Kowloon, Hong Kong

Guangzhou
Room 16A02, 16/F, Vili International, 167 Linhexi Road, Tianhe District, Guangzhou, 510620, PRC

Shanghai
Room 30A, 30/F, World Plaza, No.855, South Pudong Road, Pudong New Area, Shanghai, PRC 200120

Lyon Odiceo
115 Boulevard Stalingrad – BP52038,
69616 Villeurbanne Cedex, France

Website: www.sinobridge-consulting.com
E-mail: info@sinobridge-consulting.com
Telephone: (852) 3579 8745