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Grandfathering Tax Preferential Policies after the Amendment of Individual Income Tax ("IIT") Law

With the new IIT Law coming into effect from 1st January 2019, Ministry of Finance ("MOF") and State Administration of Taxation ("SAT") jointly released Caishui [2018] No.164 (the "Notice") on 27th December 2018 to clarity the grandfathering tax preferential policies after the amendment of IIT Law. We have summarized some major highlights below:

On or before 31st December 2021, individual residents who obtain a one-off annual bonus which meet the conditions stipulated in Guoshuifa [2005] No.9 have the option to exclude the bonus from calculating their consolidated income of the year and apply the old regulations using the applicable tax rates stipulated in the Notice to calculate their IIT payable. Similar treatment applies to deferred income and incentive bonus which meets the conditions stipulated in Guoshuifa [2007] No. 118.

On or before 31st December 2021, individual residents who obtain equity incentives which meet the conditions stipulated in Caishui [2005] No.35, Caishui [2009] No.5, section 4 of Caishui [2015] No.116 and section 4 clause 1 of Caishui [2016] No.101 can exclude the incentives from calculating their consolidated income of the year and apply the old regulations using the applicable tax rates stipulated in the Notice to calculate their IIT payable.

The portion of one-off compensation received by an individual from termination of labor relationships within 3 times of the annual average remuneration of the individual are exempted from IIT while the portion exceeding 3 times will be excluded from the consolidated income of the year and taxed using the applicable tax rates stipulated in the Notice.

On or before 31st December 2021, eligible foreign resident individuals can select either to enjoy the new special additional deductions or continue to enjoy the old preferential tax-exemption policies on subsidies for housing allowance, language training fee and education fee for children for calculating their IIT payable. Once selected, the foreign individual cannot change the basis within one tax year. From 1st January 2022, only the special additional deductions would be applicable.

In addition to the above highlighted policies, the Notice also clarified the polices on the followings:

- ✓ Commission income for insurance salespersons and securities brokers;
- ✓ Collection of enterprise annuities and occupational annuities by individuals;
- ✓ One-off compensation income for early retirement and internal retirement; and
- ✓ Selling apartments to employees at lower than purchase price/costs.

The policies is expected to have impact on most enterprises and individuals, including expatriates working in China. We recommend to study the policies careful to ensure proper compliance and tax effectiveness.

Release of Discussion Draft on Foreign Investment Law

On 26th December 2018, National People's Congress ("NPC") of the People's Republic of China ("PRC") released the Discussion Draft on Foreign Investment Law (the "Draft") to solicit opinions from the public. The new Law aims to unify the existing three laws on foreign investment (Law of PRC on Chinese-Foreign Equity Joint Ventures, Law of PRC on Foreign-funded Enterprises and Law of PRC on Chinese-foreign Cooperative Enterprises), strengthening the rule of law for promoting the opening up of China to foreign investors.

The key points of the Draft are as following:

- Definition and types of foreign investment
  - ✓ Foreign investment refers to the investment activities of foreign natural individuals, enterprises and other organizations (hereinafter referred to as foreign investors) directly or indirectly within China, including 1) foreign investors invest in new projects, establish enterprises and increase investments in China alone or jointly with other investors; 2) foreign investors obtain shares, equity, property shares or other similar rights and interests in Chinese domestic enterprises through mergers and acquisitions; and 3) foreign investors invest in China through other ways prescribed by the laws, administrative regulations or the State Council ("SC").
- Foreign Investment Promotion
  - ✓ Foreign investment is subject to same treatment as domestic investment ("national treatment") with restrictions imposed by negative list management system.
  - ✓ Except as otherwise provided in laws and administrative regulations, the state's policies supporting the development of enterprises are equally applicable to foreign-invested enterprises.
  - ✓ Foreign-invested enterprises can participate in standardization work and government procurement activities on an equal footing with other domestic enterprises. The mandatory standards set by the state are equally applicable to foreign-invested enterprises. Government procurement shall treat the products produced by foreign-invested enterprises in China equally as those produced by domestic enterprises.
  - ✓ Foreign-invested enterprises can obtain financing through public issue of stocks, corporate bonds and other securities and other means in accordance with the law.
  - ✓ Government authorities at all levels in China can formulate policies to promote foreign

investment within statutory jurisdiction.

- Foreign Investment Protection
  - ✓ Confiscation shall not be imposed on foreign investment; if it is necessary, it shall proceed in accordance with legal procedures with fair and reasonable compensation. The foreign investor's capital contribution, profits, capital gains, intellectual property rights, or compensation obtained according to the law in China etc., may be freely transferred out in RMB or foreign currencies in accordance with the law.
  - ✓ Intellectual property rights of foreign investors and foreign-invested enterprises are protected in accordance with the law and technical cooperation is encouraged based on voluntary principles and commercial rules.
  - ✓ Government authorities at all levels shall not illegally derogate the legitimate rights and interests of foreign-invested enterprises or increase their obligations, shall not illegally set up market access and exit limitations, and shall not illegally intervene or influence the normal production and operation activities of foreign-invested enterprises.
  - ✓ Governments authorities at all levels shall strictly comply with policy commitments made and adhere to contracts concluded according to law.
  - ✓ A complaint and legal rights safeguard mechanism for foreign-invested enterprises will be established.

- Foreign Investment Administration
  - ✓ Implement national treatment and negative list management system.
  - ✓ Approval, filing and licensing of foreign-invested projects, registration, taxation, accounting, foreign exchange and other matters of foreign-invested enterprises shall be carried out in accordance with relevant regulations of the state.
  - ✓ Establish a centralized foreign investment information reporting system to avoid duplicate submission of same information to different authorities.
  - ✓ Conduct security review of foreign investment that affects or may affect national security.

Although the law is only in discussion draft stage, it shows the determination and direction of the central government in promoting foreign investment.

Updating of Guide Catalogue on Key Development Areas for Service Outsourcing Industry

In order to promote the development and growth of service outsourcing industry in China, Ministry of Commerce ("MOC"), MOF and General Administration of Customs ("GAC") jointly released Announcement [2018] No.105 - Guide Catalogue on Key Development Areas for Service Outsourcing Industry (Version 2018), to update and replace the one issued in 2016.

The new catalogue covers 23 key development areas, including software research & development ("R&D") services, cloud computing services, artificial intelligence ("AI") services, information technology operating and maintenance services, big data services, cultural and creative services, pharmaceutical and biotechnology R&D services, etc. 8 areas are under the category of Information Technology Outsourcing ("ITO"), 6 and 9 areas pertain to Business Process Outsourcing ("BPO") and Knowledge Process Outsourcing ("KPO") respectively.

With the expansion in definition, scope, type of business and application field for software R&D services, IT solutions services, pharmaceutical and biotechnology R&D services, the new catalogue cater for the emerging trends and requirements in growing industries and enhance competitiveness of enterprises in the international arena.

The new catalogue has added several new areas including network and information security services, AI services, financial back-office services, big data services, repair and maintenance services for encouraging more enterprises to undertake international subcontracting business and fostering further growth in the service outsourcing industry.

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Policies will be introduced to promote industries in the catalogue, including but not limited to encouraging government and non-government entities to outsource work to professional service providers, introducing grants and subsidies for research and development, design and integration and consolidated solutions, supporting universities and high schools in cooperation with these service providers in promoting developments in these industries.

Service Highlight

China has been incurring continuous effort to create a more relaxed and modernized business environment for enterprises by reducing tax burdens and simplifying the administrative processes. More positive changes in policies and regulations are expected to follow. Sino-Bridge is always well prepared and pleased to help investors to exploit the full potential of their business. Our Marketing Executive, Ms. Rika Wong, would like to hear from you at (852) 3579 8745 or Rikawong@sinobridge-consulting.com to learn of how we could assist you with your business.

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