

Rödl & Partner

NEWSLETTER CHINA

BROADENING HORIZONS

Issue:
October
2018

Latest news on law, tax and business in China

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New Regulations on Super Deduction for R&D Expenses

According to the previous regulations, the Research and Development ("R&D") expenses are entitled to a 50 per cent super deduction for Chinese Corporate Income Tax ("CIT") purpose, while the small and medium-sized technology enterprises can enjoy a higher super deduction rate of 75 per cent. However, the two regulations for R&D expenses super deduction are not applicable to overseas R&D expenses. Recently, China has launched 2 new tax benefits for R&D expenses super deduction, which aim to promote R&D investment and technological innovation.

NEW TAX REDUCTIONS

At the executive meeting in July this year, the State Council proposed several tax reduction policies. Among them, the most concerned is that the scope of enterprises which can enjoy 75 per cent super deduction for R&D expenses is expanded from small and medium-sized technology enterprises to all enterprises. It is expected that this policy would only apply to enterprises that are eligible for R&D expenses super deduction, i.e. the 6+1 restricted industries such as the tobacco manufacturing industry would not be included. The policy is expected to be valid from 2018 till the end of 2020. According to preliminary estimates, the benefit will reduce the annual tax amounting to RMB 65 billion.

BACKGROUND AND EXPLANATIONS

Prior to 2018, overseas R&D expenses could not enjoy the super deduction. The Circular Caishui [2018] No. 64 issued in June this year broadens the super deduction to R&D expenses incurred overseas. The new regulation came into force with retroactive effect on January 1, 2018. It is stipulated in the Circular that for the R&D expenses arisen from overseas contract R&D activities, 80 per cent of the actual amount incurred could be booked as overseas R&D expenses for contract activities. The principal enterprise may superdeduct its overseas R&D expenses for contract activities before CIT to the extent that such expenses do not exceed two third of the enterprise's qualified domestic R&D expenses. It is worth noting that for the above-mentioned super deduction

for overseas R&D expenses, it's required that the principal should file the contract R&D agreement with the competent Science and Technology Administrative Department in advance. If the both contract parties are related parties, the trustee shall provide the principal with details of the expenses of the R&D projects. Therefore, if the group intends to apply for super deduction for intercompany R&D expenses, the following conditions must be met:

- The R&D results are attributed to the Chinese entity;
- The trustee shall disclose the details of R&D expenses to the Chinese tax authorities.

Considering the limit of super deduction for overseas R&D expenses, if a group hopes that its Chinese subsidiaries can fully enjoy the R&D super deduction policy, it may need to adjust the allocation of R&D functions within the group.

In addition, the regulation also clarify that R&D expenses paid to overseas parties should be determined in accordance with the arm's length principle. Taking the series of anti-tax avoidance regulations introduced by China in recent years into account, R&D expenses should be determined based on the benefit-received principle under the premise of fully considering the functions, risks and assets of all parties.

PROSPECTS

The above two measures not only increase the intensity of super deductions, but also provide the same tax preferential treatment to overseas and domestic R&D expenses. The measures are believed to be conducive to market vitality and investment in R&D activities, especially for enterprises with high R&D expenses or overseas R&D centers.

Contact for further information



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→ Tax II

China Strengthens Supervision on Social Insurance Payment

As part of the local and national tax administration system reform, from January 1, 2019, the social insurance of Chinese enterprises will be uniformly levied by the tax authorities. Since the tax authorities have access to employees' salary information and is more powerful in terms of tax collection and management, it is widely expected that the supervision on social security payment will become stricter in the future.

At present, some enterprises have already been investigated and even punished by tax authorities for outstanding social insurance payment. Recently, it was discovered by the tax authority that an enterprise in Jiangsu Province failed to pay a total of more than RMB 2 million in social security contributions in the last 10 years, and was sentenced to enforcement measures by the court. It can be seen from this incident that the tax authorities, with their data resources and law enforcement powers, have strong supervision capabilities in collection of social insurance. Therefore, it is increasingly difficult to escape justice if an enterprise owes or pays less social insurance. According to the provisions of relevant social insurance laws, if the employer fails to pay the social insurance in full amount and the outstanding payment is overdue, the administrative department has the right to enforce the fund transfer from the employer's bank account, charge the late payment fee. And the employer will be fined one to three times of the overdue amount. In addition, the person directly responsible for the incompliance will also be fined. Furthermore, if some enterprises do not pay social insurance for employees during trial period, or if they try to evade social insurance payment by

signing agreements on "voluntarily quitting social insurance contribution" with employees, huge risks will also arise regarding social insurance incompliance.

In fact, in many provinces such as Guangdong and Zhejiang, tax authorities have always been responsible for the collection of social insurance. The nationwide implementation of this policy would have little impact on these areas. However, for other regions, this measure might mean a substantial increase in the strength of collection and management of social security. Currently, local tax authorities are setting up specialized social insurance collection departments, indicating that the issue of social insurance will become the focus of the tax authorities.

For enterprises that employ foreign employees or have foreign expatriates under secondment, in addition to complying with the general social insurance provisions (such as sticking to actual salary for determining payment base, etc.), they should also pay attention to the relevant provisions on expatriates' social insurance payment in China. As for German employees, according to the Sino-German Social Insurance Agreement, eligible German employees can apply for exemption from paying statutory pension insurance and unemployment insurance in China, and only need to pay basic medical insurance, employment injury insurance and maternity insurance. However, in practice, various provinces and cities in China have different requirements on foreign employees' obligation of participating in Chinese social insurance. For example, in Shanghai, it is determined by mutual agreement between the enterprise and employee. However, in

Beijing City and Zhejiang Province, foreign individuals who work in China with a work visa are obliged to participate in Chinese social insurance scheme.

OUR OBSERVATION

After tax authorities' takeover of social insurance collection, the supervision on social insurance payment will become stricter and the requirements on compliance for enterprises will also increase. Nevertheless, due to the differences in the current collection methods, the impact of this policy on different regions is also different. Enterprises should assess their own compliance risks regarding social insurance contributions according to the actual situation in the region. For the foreign employees, enterprises should pay attention to the latest regulations on social insurance collection in order to avoid missing or wrong payment of social insurance.

As the new amendment to the individual income tax law and the new social insurance collection method have been finally approved and announced, the social security payment base and

individual income tax declaration base will be strictly unified. The increasing supervision on social insurance collection also means the rise of actual social insurance burden on the enterprises, which might adversely affect the operation and investment of enterprises. In response to this problem, the State Council has also made clear that it is considering lowering the social insurance contribution rates to ensure that the overall burden on enterprises will not be increased.

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→ Corporate Laws

China Further Simplifies the Establishment Process of Foreign Invested Enterprises

On May 17, 2018, the General Office of the State Council has issued Circular to Reduce the Enterprise Setup Time (hereinafter referred to as "Circular") to simplify the company setup process and to reduce more than half of the current company setup time line, from the current average registration time line of 20 working days in big cities to average 8.5 working days by the end of this year. Other cities shall also try to achieve this target in the first half year of 2019.

BACKGROUND

Before October, 2016, the establishment and changes of foreign invested enterprise shall mainly be subject to two essential procedures, namely approval and registration. During the approval process, the approval authority requested the submission of full set of application documents like application report, feasibility study, articles of association and relevant resolutions etc.; after receiving the approval certificate issued by the approval authority, the enterprise shall submit to

the competent registration authority a full set of different application documents for the issuance of new business license. These two steps of company setup will take at least 2-3 months.

As from October, 2016, Chinese government replaced the approval with record-filing administration for the establishment and change of foreign-invested enterprises that are not subject to special entry administration measures. The documents for record-filing are mainly submitted by online filing and the record-filing could be completed before or after the registration process. There are still two steps for company setup. However, after change from approval to record-filing, the time line for enterprise setup is reduced by roughly 1 month. Please kindly note that enterprises subject to special entry administration measures according to the Catalogue of Industries for Guiding Foreign Investment shall obtain the special approvals as required.

In February, 2018, the Ministry of Commerce and State Administration of Industry and Commerce (AIC) further issued notice to im-

plement “One Window, One Form” by the end of June, 2018, namely to complete the record-filing and registration with one window of the administration of industry and commerce.

MEASURES

The Circular of May 17, 2018 emphasizes the following measures to simplify the company setup process:

1. to implement “One Window and Parallel Registrations”, namely to obtain all necessary licenses and permits with one competent authority;
2. to implement the company online registration process and no enterprise name pre-registration is required except for special circumstances. The registration forms will be simplified and the company setup time line will be reduced to within 5 working days;
3. The company chop carving shall be integrated into “Integration of All Certificates” and the chop carving entity shall complete the chop carving within 1 working day and complete the filing with local public security bureau;
4. to improve the invoice application process and reduce the application time line. The application time for newly established enterprise shall be reduced to within 2 working days;

5. the social insurance registration certificate will be canceled and the administration based on the unified social credit code will be implemented.

CONCLUSION

According to our current experiences in company setup in various places in China, the above new policy has not been fully implemented yet.

The authorities in Shanghai and Jiangsu Province are still in transmission period and did not implement the one window and one application form yet. This new policy has been implemented in some cities like Shenzhen.

Due to the changes and uncertainty during the transition period, we suggest the enterprises to timely and closely communicate the competent bureau of commerce and administration of industry and commerce before filing of the company setup, to ensure to complete the filing process correctly and efficiently.

Contact for further information



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→ Law in Internet

Implementation of the VPN Ban Suspended

A major focus of China's increasing efforts to regulate access to the Internet is currently on the so-called Virtual Private Networks (VPN). In this regard it was actually expected that VPN connections which are not approved by the Chinese Ministry of Industry and Information Technology (MIIT) would be blocked from March this year. This ban would not only affect VPN tunnels of commercial VPN providers, but also company-owned VPN tunnels between Chinese subsidiaries and foreign parent companies. It seems though, the technical requirements and necessary measures for the implementation of the ban seem to be more complex and extensive than expected as the ban has not been fully enforced yet. Due to

the complexity MIIT has extended the planned shutdown of irregular VPNs by March 2018 until March 2019 and has instructed its subordinate China Academy of Information and Communications Technology (CAICT) in a “Notice on Further Advancing the Clean-up of the Internet Access Market in China” to accompany and investigate the planned restrictions through appropriate analyses. An alliance founded with the leading Chinese telecommunications providers with the aim of self-regulation and control by the industry shall also serve this purpose.

POSSIBLE CONSEQUENCES FOR THE USE VPNs

In addition to established laws and regulations, China has further expanded its regulatory framework on data protection in particular by passing the relatively new Cyber Security Law and corresponding implementation rules, which will have a considerable influence on the (continued) use of VPNs. The current framework is expected to affect almost every foreign subsidiary that has a computer network and communicates via the internet with its parent company, customers and other third parties.

In the future, a security assessment will be mandatory for cross-border data traffic in China. As things stand at present, most foreign companies in China are likely to carry out this security assessment themselves due to their size and the nature of the data to be transferred. However, precise information must be provided on the method of cross-border data transmission, i.e. if a VPN tunnel is to be used. If the authority checks the corresponding security audit report or orders such a report itself, the illegal use of the VPN would become obvious.

The Cyber Security Law as well as other implementation rules also partly contain substantial sanctions for violations. These can range from fines to custody for responsible persons, as well as fines, suspension of business or even withdrawal of the business license for companies.

POSSIBLE ALTERNATIVES

The further use of VPNs, which transmit data abroad via the public internet, is likely to become very difficult, if not impossible, in the future. It is questionable whether company-internal VPNs will continue to be tolerated. According to the relevant regulations, there is no distinction between VPN tunnels of commercial providers, such as Astrill, which is very popular in China, and the company's own VPN tunnel, even if it is a closed company network. On the other hand, China is probably aware that VPN tunnels are very important for companies and thus also for China's economy and further development.

A (currently) legal alternative in this regard might be the use of a Multi-Protocol Label Switching (MPLS), which enables internal company data transmission without access to or use of the public internet.

In summary, it can be concluded that data transmission between parent companies and their Chinese subsidiaries will encounter further obstacles and become more difficult in the future. This is particularly likely to be the case for smaller companies, for which a MPLS solution might not be a suitable alternative due to the rather high costs associated therewith.

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→ Highlights

Recent Important Regulation Highlight

WITHHOLDING TAX DEFERRAL ON PROFITS USED BY OVERSEAS INVESTORS FOR DIRECT INVESTMENT

After the Circular “Caishui No. 88” in 2017, four authorities including the Ministry of Finance and the State Administration of Taxation has recently jointly issued a new Circular to expand the scope of the deferral of withholding tax liabilities on profits used by overseas investors for further direct investment in China from “encouraged investment projects” to “all not prohibited projects”. According to the new regulation, more foreign investors can enjoy the tax deferral policy.

China starts the first CRS Information Exchange

In September 2018, the Chinese State Administration of Taxation starts the first round of CRS (“Common Reporting Standard”) information exchange with other countries and regions. As a result, the Chinese tax authority can receive financial information of Chinese tax resident overseas.

EXPORT TAX REFUND RATE WILL BE IN- CREASED

The State Council recently announced that from November 1, 2018, Chinese export tax refund will be increased to lower enterprise cost and encourage exports. The administration and application procedure for tax refund will also be simplified.

→ 1st China Forum Shanghai

November 22, 2018, Shanghai

We would like to invite you to our 1st China Forum in Shanghai on November 22, 2018. Today, there is no way getting around China! We can read in the daily business news, how, for example, the American president rings the bell for the next round in the trade dispute and how long it will take China to answer. But the Middle Kingdom is significantly more than political power games.

For you as an internationally operating company, there are still excellent opportunities in this environment to conquer or further expand the Chinese market. At our first China Forum Shanghai we would like to show you how you can position yourself in the challenging market with our colorful program. We will explain what you should be aware of today and tomorrow, be it legal pitfalls such as manager liability, pros and cons on M&A transactions or tax tricks, so you can best control your subsidiary in China. In addition, we look at topics of the future such as digitization, the automotive market and “Made in China 2025”.

We have planned a whole day of lectures and panel discussions for you. Our experts and top-class guest speakers are looking forward

to stimulating discussions and exchange with you.

You may find the detailed program as well as all further information and the registration form under: [Event Calendar](#).

For further question, please feel free to contact our colleagues, Teresa Bauer and Beate Kürstner-Heß.

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Imprint

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