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NEWSLETTER CHINA

BROADENING HORIZONS

Issue: October 2020

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→ Investment in China

New Opportunities for Investment in China

Due to the outbreak of the covid-19 Epidemic, the implementation of the Foreign Investment Law (effective on 1 January 2020) along with its implementation regulations and supporting rules had to be slowed down in the first quarter 2020. As the epidemic is coming under control, the Chinese government is proceeding with further opening-up with a series of measures to facilitate foreign investment, encourage foreign M&As and stimulate foreign investment growth.

On 18 June 2020, the Chinese Ministry of Commerce (MOFCOM) issued the Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies (Revised Draft for Comment) to seek public comments by 19 July 2020, which aims to attract foreign investors to enter the A-share market for extensive implementation of the Foreign Investment Law. The Revised Draft mainly lowers the investment threshold in the following aspects:

- For foreign investors as non-controlling shareholders, the threshold for the total assets is set to not less than USD 50 million or the total assets under management to not less than USD 300 million. For foreign investors as controlling shareholders, the total assets should be no less than USD 100 million or the total assets under management should be no less than USD 500 million;
- Qualified foreign natural persons are allowed to make strategic investments;
- The lock-up period for foreign investors are shortened from 3 years to 12 months;
- More investment types are allowed, including tender offer investment, agreement investment and private placement investment;
- The restriction on the foreign investor's shareholding ratio of not less than 10 per cent is cancelled. For tender offer investment and agreement investment, the shareholding ratio of foreign investors is set to no less than 5 percent;
- Foreign investors are allowed to make strategic investments in small and medium-sized companies listed in National Equities Exchange and Quotation (NEEQ);
- Terms for cross-border share swaps are loosened. Foreign investors are allowed to use their holding shares or new additionally issued shares of overseas non-listed companies for payment.

The above-mentioned Revised Draft was issued by MOFCOM in collaboration with the State-owned Assets Supervision and Administration Commission (SASAC), the State Taxation Administration (STA), the China Securities Regulatory Commission (CSRC), the State Administration for Market Regulation (SAMR) and the State Administration of Foreign Exchange (SAFE). Therefore, it is convincing that the feasibility in practice has already been fully examined by considering various aspects such as taxation, enterprise registration, foreign exchange management, overseas investment management and financial institution management etc.

The MOFCOM issued the new Negative List for Foreign Investment Access (2020 Edition) on 23 June 2020, which will be implemented from 23 July 2020. It is noteworthy that the new list removes access restrictions to the financial sector and further loosens the restrictions on the proportion of foreign shares in manufacturing and agriculture industries. Furthermore, it is stipulated by the above-mentioned Revised Draft for Comment that foreign investors are not allowed to invest in the areas mentioned in the Negative List.

The Chinese economy is now recovering slowly and steadily from covid-19. Even though the pace of globalization might be slackened due to the epidemic, the current initiatives of Chinese Government demonstrate its commitment to economic globalization and indicate that China will continue to open up to attract more foreign investments. Good news such as lowering restrictions on foreign investment and promoting investment liberalization will undoubtedly present an favorable opportunity for foreign investors who have confidence in China's economic development in the long run.

Contact

Vivian Yao
Tax Advisor (China)
+86 21 6163 5200
vivian.yao@roedl.com

→ Individual Income Tax

Travel restrictions in China – Tax risks for foreign expatriates

With the imposition of travel restriction in China in response to covid-19 pandemic since March 2020, a lot of foreign expatriates are still not allowed to re-enter China. Many of them keep an employment relationship with a Chinese company only, who is also their only source of salary income.

According to the current Chinese tax regulations, for foreign expatriates who hold a position with a Chinese employer only, the salary paid by the Chinese employer should anyway be fully subject to Chinese IIT, irrespective of how many days the expatriates stay in China or where the work related to this position is carried out.

Under normal circumstances, foreign expatriates carry out most of the employment related activities in China to contribute to the daily operation of the Chinese employer and to perform professional and management tasks on site. This means that usually such expatriates would not stay in their home country for more than 183 days either in a calendar year or a rolling year. As a result, their salaries should be regarded as China-sourced income, and the home country of the expatriates should give up the taxation right on these salaries, in accordance with most international tax treaties. Therefore, double taxation dispute would not arise.

But currently a lot of expatriates are blocked outside China by the travel restriction since the first quarter of 2020. Although the Chinese government announced in mid-August that it would relax entry restrictions for foreign expatriates from various countries, the accurate timetable is still not clear. As a result, it is possible that the expat have to stay in their home countries for more than 183 days, which could make the tax consequences complicated and even undesirable.

When a foreign expatriate stays in his/her home country for more than 183 days in 2020, he/she may be in general not regarded as Chinese tax resident for 2020. In such case,

1. if he/she becomes a tax resident of the home country, he/she may refer to the double tax treaty between China and the home country and apply for avoidance of double taxation at his/her home country. Nevertheless, as mentioned above, China anyway imposes income tax on his/her full salaries according to Chinese domestic tax regulation, based on the understanding that the employment-related activities, wherever they are carried out, contribute fully to the Chinese employer who also fully bears the salary costs.
   However, such treatment might be interpreted as a violation of double tax treaty, considering that the activities are carried out outside China and should not be regarded as China-sourced income. Also, China, where the expatriate's tax residency does not belong to, may not have right of taxation on the salary income. From this point of view, the home country may possibly reject the tax exemption treatment/credit treatment on the salary income and ask the expatriate to apply for tax refund from China, which, based on our practical experiences, has rare chance of success.

2. if he/she would not become a tax resident of the home country even by staying there for more than 183 days, it could happen that the expatriate is tax resident of nowhere for the calendar year. In principal, no double tax treaty could be applied in such case, while the home country could claim for income taxation on salary income (borne by the Chinese employer) according to their domestic law based on the fact that he/she stays there to carry out employment-related activities for a certain period of time. As a result, double taxation could also be triggered if China also claims the full taxation right on the salary income.

Things could look better if the expatriate is considered as domiciled in China, e.g., in cases where he holds a Chinese green card, is settled down with family in China and all the economic interests are closely related to China, etc. In this circumstance, even if the expatriate stays in China for less than 183 days, he/she is still a Chinese tax resident and could claim for Chinese tax credit on his/her foreign income tax by referring to the double tax treaty between China and the foreign country. However, in such case, such a status change may lead to his/her worldwide income being subject to Chinese income tax on a long-term basis.

Covid-19 has certainly left the current taxation under cross-border employment or business arrangements in disarray. Due to lack of former similar experience, compounded by the diversification in tax laws as well as the discrepancy in understanding and interpretation on tax treaties in different countries, to solve and avoid double taxation is never an easy topic. It requires detailed case-by-case analysis, and a close cooperation between experienced tax advisors from all involved countries.

Contact

Monica Chen
Tax Advisor (China)
+86 21 6163 5297
monica.chen@roedl.com

→ Social Security

Labor Dispatch - Restricted Social Security Participation in Beijing

Recently, the notice regarding several issues on participation of Labor Dispatch Companies and Human Resource Service Companies in Social Insurance Scheme ("Notice"), issued by the Beijing Municipal Human Resource and Social Security Bureau on 30 June 2020 attracted wide attention.

With immediate effect of the Notice since 5 July 2020, companies without officially registered address in Beijing cannot pay social securities for their employees in Beijing via a third-party agent anymore, which has been a commonly adopted practice by many companies so far. To pay the social insurance in Beijing is in general interesting for employees, as the respective contribution bases of the social insurance in Beijing are comparatively high. Moreover, the social insurance in Beijing impacts employees in many other areas, e.g. an employee without a Beijing household registration cannot buy a house in Beijing unless a consecutive five-years social insurance has been paid. Apart from this, there are impacts on the purchase of a car in Beijing, the application for the Beijing household registration and many other areas.

The "trigger" for this restriction has been the local filing system of the Beijing social security. Under the upgraded online system, any third-party agent, such as Foreign Enterprises Service Corporation (FESCO) and China International Intellectech Group Co., Ltd. (CIIC), who wants to register a new employee to participate in the Beijing social security scheme, must now input the information of the company, for which the new employee actually works. If such company is not registered in Beijing, the system would not accept the registration of the new employee.

As a result, employees who are dispatched or outsourced to work in a company which is not registered in Beijing cannot participate in Beijing social security anymore, even if via a third-party agent.

In fact, legally speaking such practice, which is now restricted by the Notice, has always been a grey area. In 2014, the Ministry of Human Resources and Social Security (MOHRSS) released the "Interim Provisions on Labor Dispatch" ("Interim Provisions"), which stipulates that cross-city dispatched employees should pay social security at the place where the labor using company is located, instead of where the dispatching company is located. Also, according to the PRC Social Insurance Law, a company shall provide social insurance contributions for employees at the place where the company is registered regardless of the actual work places or home addresses of employees. The current restriction set out in the Notice is therefore only an implementation of the abovementioned Interim Provisions.

It seems that the restriction is now merely set for employees, who are newly registered in the filing system, which would also apply to already existing employees, who's social insurance shall be transferred to Beijing, as they would have to be newly inserted into the filing system of Beijing as well. If existing employees are also covered by the Notice, cannot be said with certainty at present. Nevertheless, it is likely that the Beijing social security authority may also "clear" the abovementioned existing employee step by step.

For affected companies, the following options may be taken into consideration:

- Set up a branch in Beijing and transfer the employees to such branch (As a matter of fact, this results in certain additional costs and administrative expenses.);
- If setting up a branch in Beijing is not suitable or practicable based on the actual circumstances, try to discuss with the current employees proactively for possible solutions in terms of transferring the social security to the location where the employer is registered.

Although the Notice has been in effect since 5 July 2020, we have been informed that based on official notices from the government, some big HR agencies in Beijing are required to provide the above-mentioned information of the existing employees only by 30 September 2020. Thus, it seems currently not quite clear to what extent the Notice at this time has and will in the near future have direct consequences for affected employees and companies. We will continue to observe the development of this issue and keep you informed.

In any case, it is advisable that affected companies act now and communicate with the respective employees in order to find a suitable solution, as a break in the social security of the employees in question should be avoided.

For now, only the local Beijing government issued the above restriction. However, other local governments might follow this restriction in the future. We will also keep you up to date with any news on this topic.

Contact

Christina Gigler
Legal Counsel
+86 10 8573 1300
christina.gigler@roedl.com

Kathy Chen
Chinese CPA
+86 10 8573 1300
kathy.chen@roedl.com

Monica Chen
Tax Advisor (China)
+86 21 6163 5297
monica.chen@roedl.com

→ Business Environment

Better Business Environment: Growing Your Business in Shanghai

On 10 April 10 2020, the Shanghai Municipal Government issued the Regulations on Optimizing the Business Environment (the "Regulations"), which aim to continuously optimize the business conditions and to stimulate the market vitality (effective from 10 April 2020). This article combines our professional insights with a selection of the policies from the Regulations that are closely related to your business.

Facilitate Reasonable Cross-district Relocation of Enterprises in Shanghai

The Regulations state that enterprises may freely choose the location of their main office within the city and register it as their domicile in accordance with the law. All districts and authorities shall facilitate enterprises' cross-district relocation of domiciles, and shall not place obstacles during the change of domiciles. Matters relating to the cross-district relocation of enterprises that are difficult to coordinate and resolve at the district level shall be coordinated and resolved by the relevant departments, who shall also promote their implementation.

Enterprises often make the decision to relocate within the city to meet their own development needs. In practice, the local tax authorities often set up obstacles to the tax deregistration of enterprises moving across districts for fear of losing tax sources, resulting in difficult and time-consuming administrative approval processes for cross-district relocation of enterprises.

Back in 2009, Shanghai had already issued regulations to standardize the order of tax collection and administration on matters relating to the cross-district relocation of enterprises and to protect the legitimate interests of enterprises relocating across districts. The Regulations are a further clarification on this requirement and take into account the issues that occur in practice to facilitate implementation.

- Supply of invoices will not be interrupted by the relocation. During the liquidation period of an enterprise in the tax authority of the current domicile, the tax authority shall continue to provide the invoices required for production and operation; and the enterprise may at the same time apply for tax registration for business opening and other relevant procedures in the tax authority of the new domicile, After the liquidation and relocation procedures are completed in the tax authority of the current domicile, the enterprise is able to purchase invoices from the tax authority of the new domicile.
- If a VAT general taxpayer relocates across districts, its status as a VAT general taxpayer will be retained after it has completed deregistration in the current domicile and finished tax registration in the new domicile The input VAT not yet deducted before tax deregistration is allowed to continue to be deducted.
- Enterprises relocating across districts are not required to settle CIT, but are required to settle taxes payable, excessive tax refunds (exemptions), as well as interests and penalties. The losses from previous years that can be carried forward in accordance with the regulations are allowed to continue to be utilized after verification. Existing tax benefits are generally continue to be applicable, except for those that become invalid due to the change of domicile.
- Enterprises that encounter obstacles in the implementation of their reasonable requests for cross-district relocation can submit their requests online through the "Shanghai Enterprise Service Cloud". However, applications from enterprises that purposefully strive for investment promotion policies or have failed to complete the agreement with the relevant district will not be accepted (for example, applications from enterprises that have received financial support from the government of the current domicile but have not completed the agreement or commitments may be considered as unreasonable). If an enterprise has benefited from financial preferences in the current domicile and has made a written commitment to operate in the location for a certain number of years, it is recommended that it pay attention and communicate with the relevant authorities in the current domicile before relocation.

As for the inter-provincial relocation, it is currently not feasible to fully refer to of Shanghai's practice. It is recommended to communicate with the tax authorities of both cities. At present, enterprises with tax credit ratings of A and B in the Yangtze River Delta region (i.e. Shanghai, Jiangsu Province, Zhejiang Province, Anhui Province and Ningbo City, the same below) can retain their tax credit ratings and other qualifications, as well as the non-deducted input VAT at the end of the period after cross-provincial relocation. But for the time being, there are no explicit preferential provisions for enterprises moving across other provinces.

The Negative Foreign Investment Access List is Being Streamlined Again

The Regulations state that industries outside of the negative list for foreign investment access will be administered in accordance with the principle of consistency between domestic and foreign investment, aiming to create a fair business environment for foreign-invested enterprises. We find out that the new negative list in 2020 has been further reduced compared to the 2019 one, especially in the manufacturing sector, where the restriction of no more than 50% foreign equity in commercial vehicle manufacturers has been removed. In addition, from 2022 onwards, the restriction that the foreign shareholding in passenger car manufacturers should not exceed 50% will be cancelled, and one foreign company will be allowed to establish two or more joint ventures in China to produce the same kind of vehicle products.

For further changes in service sector, please refer to the article "Shanghai New Regulation to Foreign Investment ".

In addition, the Regulations provide concrete benefits to enterprises in terms of government services and regulatory enforcement:

- Shanghai will include all business licensing matters into the scope of the "separation of licenses" reform, integrating multiple licenses related to industry access into one industry comprehensive license.
- Shanghai will promote the standardization of government services and develop a guidebook

for government services, specifying the conditions for processing matters, materials, workflows, and application upon late document submission. The authorities shall not require enterprises to provide application materials other than those specified in the guidebook.
- Shanghai participates in the integrated regional tax administration system of the Yangtze River Delta, which facilitates cross-province relocation and tax-related reporting within the region. It also participates in advancing the unification of tax policy implementation standards and the system of tax administration lists within the region.

Our Observation

In recent years, there have been numerous positive policies for attracting and retaining foreign investment in China, including temporary exemption from withholding tax on foreign reinvestment with distributed profits in areas other than those on the negative list, flexibility in the selection of foreign debt quota (investment - registered capital difference or macro and prudent administrative policies for full-caliber cross-border financing), and the continued streamlining of the negative list of access for foreign investment. Meanwhile, various areas have also introduced a number of policies to optimize the business environment (for more details in Beijing).

Obviously, in response to the impact of the epidemic on foreign investment in China, the Chinese government's preferential policies to stabilize and attract foreign investment are accelerating and advancing on all fronts.

Contact

Monica Chen
Tax Advisor (China)
+86 21 6163 5297
monica.chen@roedl.com

→ Business Enviornment II

Shanghai's New Regulation on Foreign Investment

The new Foreign Investment Law entered into force on 1 January 2020. Since its adoption, it has already been expected that there should be positive changes for investments by foreign investors and foreign-invested companies. On 25 September 2020, the Standing Committee of the Shanghai People's Congress issued a new regulation on foreign investment ("the Regulation"). The Regulation will enter into force on 1 November 2020.

The Regulation is the first one of its kind on foreign investment in China at provincial level since the adoption of the new Foreign Investment Law, and has therefore received much attention. The Regulation consists of 51 articles in total, of which the following aspects deserve special attention:

Opening of the Service Sector (Article 9)

In line with the opening policy of the state, the city of Shanghai is promoting the opening of the service sector. First of all, the financial sector, such as banking, securities, insurance, futures, trust and investment transactions, asset management, creditworthiness, etc. is to be opened up. Secondly, the opening up of telecommunications, Internet, medical care, transport, culture, education, etc. will also be encouraged. Initiatives will be taken, in order to implement other measures to further opening up of the service sector.

The National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) have published two negative lists (one for the whole country and one for Free Trade Zones). The negative lists are regularly updated and specify which industries are prohibited or restricted for foreign investors. NDRC and MOFCOM have also published a catalogue listing industries promoted for foreign investment. If other industries beyond the scope of these lists are to be opened to foreign investment in Shanghai, a special regime should be introduced for Shanghai.

Unification in the Yangtze Delta Region (Article 12)

Together with the other regions of the Yangtze Delta, the city of Shanghai intends to unify the opening up policy in this region. In this respect, the construction of the Eco-Green Integrated Development Demonstration Zone should be mentioned in particular. It is planned to adopt an unified list of investment projects subject to approval by the government in this region. The standards for company registration of foreign-invested companies should also be unified.

The Yangtze Delta region (mainly Shanghai, Zhejiang and Jiangsu) has received a large amount of foreign investment. If the governmental working procedures in this region are unified, this will bring much convenience, in particular for those investors who have several subsidiaries in the region.

Service Platform(Article 16)

A multilingual service platform for the promotion of foreign investment will be set up. The platform will for example provide access to laws and regulations regarding foreign investment, but also to industry trends and information on promoted investment projects.

The platform has already been established: http://www.investsh.org.cn/. Especially new investors can use this platform to obtain general information about investment policies and approval procedures.

Preferential Policy and Commitments of Government Agencies

The investment in promoted industries under the national Catalogue of Industries for the Promotion of Foreign Investment will be encouraged through various support measures (Article 20). In addition, the establishment of headquarters and functional organizational bases of multinational companies (Article 21) and R&D centers (Article 22) will be supported by the government. Also, reinvestment will be encouraged through various preferential treatments (Article 24).

Governments' commitments towards foreign investors and foreign-invested enterprises must be strictly adhered to, especially in case of organic (e.g. administrative division) or personnel discontinuity. The relevant government agencies are held legally responsible for those commitments that are ineffective or unenforceable.

Under the national treatment principle, China has hardly any substantial preferential policy for foreign investment. The focus of the Regulation is to offer better service and facilitation measures through the government.

In order to attract foreign investment, government agencies often make various commitments. Investors shall always make sure that these commitments are in conformity with the law. Article 25 of the Foreign Investment Law already stipulates that government agencies must fulfil its commitments in accordance with the law. The Regulation goes a step further and stipulates a liability for government agencies if their commitments are ineffective or unenforceable.

Foreign Exchange (Article 28)

Capital contributions, profits, capital gains, proceeds from the sale of assets, intellectual property royalties, compensation received under the law and proceeds from liquidation may be freely transferred abroad or to China in RMB or foreign currency. In this regard, no entity or individual may unlawfully impose restrictions on the currency, amount and frequency of incoming and outgoing transfers.

Similar rules exist already. Nevertheless, in the practice companies often encounter the difficulty that capital cannot be transferred abroad freely. It is to be observed whether the Regulation will lead to an improvement in this regard.

Protection of Intellectual Property Rights (Article 29)

Courts at all levels in the city are expected to swiftly accept and examine applications for preservation of evidence and injunctions in relation to intellectual property rights of foreign investors and foreign-invested companies. The courts should also take decisions in accordance with the law and enforce them without delay. Punitive damages and other punitive measures will be applied in accordance with the law in cases of repeated or malicious infringements and other serious violations.

Effective protection of intellectual property rights depends to a large extent on an efficient judicial system. If the courts can examine and decide more quickly on applications for preservation of evidence and injunctions, the chances of successfully enforcing intellectual property rights will improve.

The Regulation sends a positive and open signal for foreign investment. However, it should be noted that the provisions in the Regulation are rather abstract. Whether the Regulation will have a positive impact depends on how the rules are ultimately implemented in practice.

It will also be necessary to follow up whether other provinces will adopt similar regulations to attract foreign investment. New developments in this respect should be kept under review.

Contact

Jiawei Wang
Attorney-at-Law (China)
+49 711 7819 1443 2
jiawei.wang@roedl.com

→ Civil Code

Article Series: New Chinese Civil Code

On 28 May 2020, the National People's Congress of China adopted the new Civil Code (CC), which will enter into force on 1 January 2021. With the adoption of the CC, a new era in China with regard to civil law begins.

The new Civil Code contains more than 1,200 articles, making it the most comprehensive law ever passed in China. It initially combines a number of existing single laws into one law, but also contains a number of new provisions.

The CC is divided into seven books:

- Book I contains General Provisions »
- Book II regulates Property Law »
- Book III regulates contracts »
- Book IV has personality rights » as an object
- Book V contains regulations on marriage, family and adoption »
- Book VI sums up regulations on succession »
- Book VII codifies tortious liability

Contact

Sebastian Wiendieck
Attorney-at-Law
+86 21 6163 5300
sebastian.wiendieck@roedl.cc

→ Highlights

Recent Important Regulation Highlight

Preferential Corporate Income Tax Regulation for Hainan Free Trade Port Clarified

Recently, the Chinese Ministry of Finance (MOF) and the State Administration of Taxation (SAT) have jointly issued a circular to clarify the preferential regulation on Corporate Income Tax (CIT) for enterprises established in the Hainan Free Trade Port (FTP), which is retrospectively effective from 1 January 2020 to 31 December 2024.

The details are as follows:

1. Enterprises in the encouraged industries with substantial operations are subject to CIT at a reduced rate of 15 percent;
2. For enterprises in the tourism, modern service and high-tech industries, the income obtained from newly increased overseas direct investment is exempt from CIT;
3. Newly purchased fixed assets or intangible assets with unit price lower than RMB 5 million could be one-off deducted from the taxable income as costs and expenses; for that with unit price exceeding RMB 5 million, the fixed assets or intangible assets could be depreciated over a shortened period or according to the accelerated depreciation method.

Extension of Social Security Fund Reliefs due to Covid-19 Pandemic

In early March 2020, the Chinese government granted several reductions and exemptions from social security contributions in order to reduce the economic impact of the coronavirus pandemic. Now the Ministry of Human Resources and Social Security (MOHRSS), the Ministry of Finance and the State Administration of Taxation issued a joint statement to further reduce the social security burden of organizations, especially extended the relief for small and medium sized enterprises (SMEs) to the end of December 2020.

Preferential Corporate Income Tax Regulation in Shanghai Free Trade Zone Lingang New Area

Recently, the Shanghai Finance Bureau and the Shanghai Taxation Bureau jointly released preferential policies on corporate income tax for key industries in the Lingang New Area of the Shanghai Free Trade Zone. The notice clarifies that from 1 January 2020 enterprises engaged in key fields such as integrated circuits, artificial intelligence, biomedicine, civil aviation, etc., and conducting substantial production or R&D activities in the Lingang New Area will be subject to a reduced CIT rate of 15 percent for five years from the date of establishment.

China Allows Re-entry for Foreigners with Valid Residence Permits

Recently, the Chinese Ministry of Foreign Affairs and the National Immigration Administration jointly issued a notice that, starting from 28 September 2020, foreigners with valid residence permits for work, private affairs and reunion will be allowed to re-enter the country.

Urban Construction Tax Law and Deed Tax Law are Officially Released

Recently, the Urban Construction Tax Law and the Deed Tax Law have been officially issued, which will be implemented from 1 September 2021. This indicates that the previous temporary regulations of urban construction tax and deed tax are officially legitimated as laws.

Updates to Housing Fund In Beijing

In September the Beijing Housing Fund Management Center announced a new notice which comes into effect on 9th of October 2020. With the new notice acts in violation of the provisions of “Regulations on Management of Housing Provident Fund” will be punished. There are three grades of penalty: A, B and C. The corresponding fines are RMB 10,000 (A), RMB 10,000-30,000 (B) and RMB 30,000-50,000 (C).

Unlawful acts mainly include the following:

A. Where failing to do so at the expiration of the time limit, a fine of RMB 10,000 shall be imposed:
(1) Failing to undertake registration of payment and deposit of housing provident fund less than a year;
(2) Failing to set up accounts of housing provident fund for staff and workers less than 5 people.

B. Where failing to do so at the expiration of the time limit, a fine of RMB 10,000-30,000 shall be imposed:
(1) Failing to undertake registration of payment and deposit of housing provident fund less than 2 years;
(2) Failing to set up accounts of housing provident fund for staff and workers less than 10 people.

C. Where failing to do so at the expiration of the time limit, a fine of RMB 30,000-50,000 shall be imposed:
(1) Failing to undertake registration of payment and deposit of housing provident fund more than 2 years;
(2) Failing to set up accounts of housing provident fund for staff and workers more than 10 people.
(3) Again within 2 years, in violation of the provisions of “Regulations on Management of Housing Provident Fund”.

Contact for Tax in China

Vivian Yao
Partner
Tax Advisor (China)
+86 21 6163 5200
vivian.yao@roedl.com

Contact for Legal in China

Sebastian Wiendieck
Partner
Attorney-at-Law
+86 21 6163 5329
sebastian.wiendieck@roedl.com

Contact for Business Process Outsourcing and Audit in China

Qing Cheng
Partner
+86 21 6163 5266
qing.cheng@roedl.com

Roger Haynaly
Partner
German Public Auditor
+86 21 6163 5305
roger.haynaly@roedl.com

Our Contact in Germany

Dr. Thilo Ketterer
Partner
German Public Auditor
+49 911 9193 9003
thilo.ketterer@roedl.com

Mathias Müller
Partner
German Tax Advisor
+49 89 9287 8021 0
mathias.mueller@roedl.com

Jiawei Wang (Victor)
Partner
Attorney-at-Law (China)
+49 711 7819 1443 2
jiawei.wang@roedl.com

Our Offices in China			
Shanghai Office 31/F LJZ Plaza 1600 Century Avenue Pudong District Shanghai shanghai@roedl.com T +86 21 6163 5200 F +86 21 6163 5310	Beijing Office Suite 2200 Sunflower Tower 37 Maizidian Street Chaoyang District, Beijing peking@roedl.com T +86 10 8573 1300 F +86 10 8573 1399	Guangzhou Office 45/F, Metro Plaza 183 Tian He North Road Guangzhou kanton@roedl.com T +86 20 2264 6388 F +86 20 2264 6390	Taicang Office 16/F Dong Ting Building Middle Zheng He Road 319 215400 Taicang taicang@roedl.com T +86 5125 3203 171

Imprint

Publisher
Rödl & Partner China
31/F LJZ Plaza
1600 Century Avenue
Pudong District, Shanghai
T +86 21 6163 5200
www.roedl.de
www.roedl.com

Responsible for the content
Vivian Yao
vivian.yao@roedl.com

Layout/Type
Elisa Guo