Annual International Bar Association Conference 2020

Recent developments in international taxation – China

Mark Rufeng Gao

Zhong Lun Law Firm, Shanghai

markgao@zhonglun.com

Tax reforms to be continued

The year 2019 has seen many amendments to the Chinese tax system, including the full enforcement of the new PRC Individual Income Tax (IIT) Law and further improvements to the VAT system. According to the National People's Congress' Plan, China will accelerate all-round tax legislation in 2020, meaning that the pace of China tax reform will continue.

In addition, in response to the reforms to 'streamline administration, delegate power, strengthen regulation and improve services', the China tax authorities have taken steps to improve tax services, and to support the business operation in the Chinese market. The changes in the mode of tax collection and administration have helped enterprises to save 'time to comply'.

Further clarifications on PRC individual income tax rules on non-domiciled individuals

Since the full implementation of the new IIT Law, a new taxation system for non-domiciled individuals has been established to attract and encourage overseas individuals (including individuals from Hong Kong, Macao and Taiwan) to work in mainland China.

New guidance on tax residence rule:

Under the PRC IIT Law, individuals who are PRC tax residents are subject to PRC IIT on their worldwide income. For individuals who are not considered PRC tax residents, only the income derived from the PRC is subject to PRC IIT. Specifically, the term 'resident' for purposes of the PRC IIT Law includes: 1. individuals domiciled in the PRC (ie, the 'domicile test'); and 2. individuals having foreign citizenship or residence status with no domicile in the PRC but residing in the PRC for more than 183 days (ie, the 'significant presence test').

According to the guidance issued by the Ministry of Finance ('MOF') and the State Taxation Administration ('STA') in March 2019, the term 'domicile' under

the first test is broadly defined as having a habitual residence in the PRC due to domiciliary registration (or household registration), family ties or economic interests in the PRC, rather than a physical dwelling. In addition, the 'significant presence test' of the PRC tax resident has been changed from 'ordinarily residing in the PRC for a full year (ie, 365 days)' to 'ordinarily residing in the PRC for more than 183 days in a calendar year'. Under this new rule, if one person has stayed in the PRC for more than 183 days in one calendar year, notwithstanding if he is temporarily absent from the PRC for more than 30 days at one time or for more than 90 days in total in multiple trips within a year, he would clearly be considered as a PRC tax resident. In addition, if a non-domiciled person stays in the PRC for the entire 24 hours in one calendar day, that day would be counted as one day for the purposes of calculating the 183-day period.

The five-year rule becomes the six-year rule:

Under the new IIT Law, the previous five-year safe harbour rule has been upgraded to the six-year rule. Specifically, if a non-domiciled individual has been residing in the PRC for more than 183 days in a calendar year for six years consecutively but has temporarily been absent from the PRC for more than 30 days at one time in any of these six years, such non-domiciled person, after the necessary filings have been made, would only be taxed on his/her PRC-sourced income as well as his/her foreign-sourced income paid by PRC enterprises, organisations, or individuals. A non-domiciled individual that has resided in the PRC for more than six full consecutive years is subject to PRC IIT on his worldwide income starting from the seventh year of full-year residence in the PRC.

That stated, in practice, it would be at the discretion of the local tax authority in charge, if a non-domiciled individual who is subject to PRC IIT on worldwide income taxation can claim foreign tax credit as a PRC tax resident.

Innovation and changes to facilitate tax services

In recent years, Chinese tax authorities have replaced several administrative approval requirements with easier administrative processes. For example, in the past, taxpayers needed to obtain tax authorities' approval before they could enjoy certain kinds of tax exemption or reduction, but now they can evaluate their eligibility for such preferential treatments at their own discretion and then file those treatments with tax authorities. It is observed that Chinese tax authorities are gradually moving from an upfront approval approach to a follow-up management approach.

Simplifying the procedures to claim for China tax treaty benefits:

To further optimise the tax environment, the STA issued tax circular Announcement [2019] No.35 ('Announcement 35') and changed the post-filing supervision mechanism to the documents retained for inspection for claiming tax treaty benefits in October 2019, which has been in effect since 1 January 2020. Accordingly, the previous examination and approval procedure no longer apply. Instead, under Announcement 35, non-PRC resident taxpayers and their withholding agents may directly apply the reduced tax rate on the self-assessment basis that the taxpayer has met all the criteria and collect and retain the relevant supporting documents for post-filing inspection by the tax authorities.

New online electronic tax information filing for outbound payments:

In China, pursuant to the tax circular STA Notice [2013] No. 40, the PRC tax resident enterprise must make a tax information filing with and obtain a tax record form from the tax authority in charge, to make a single outbound payment of over USD50,000. Previously, the tax authorities may have required the enterprises to declare and pay taxes first before the tax record form is released. To address this situation, since 1 January 2020, China has allowed enterprises to make online electronic tax information filing for outbound payments so that the taxpayers can obtain the tax record form by providing prescribed documents in a more convenient and efficient way.

Tax relief measures to combat Covid-19

Since the Covid-19 outbreak in early 2020, the Chinese government has issued a number of targeted incentives to support the prevention and control of the epidemic and promote economic development, including supporting prevention, control and treatment of the disease, ensuring material supplies, encouraging public donations, and clearing the way for the resumption of work and production.

Reducing the enterprise income tax (EIT) burden of enterprises:

Losses incurred in 2020 by taxpayers who were hard hit by the Covid-19 outbreak may be carried forward for eight years (as opposed to the regular five-year carry-forward limitation). Taxpayers who made cash and/or in-kind donations for fighting Covid-19 will be allowed to deduct the entire amount of donations before income tax.

Waiving employers' payments to various social insurances and cutting IIT:

Starting from February 2020, each provincial/municipal government may exempt small and low-profit enterprises from employer contributions to the employee pension fund, unemployment fund and industrial injury fund, provided that such exemption shall be granted for a maximum period of five months. Where enterprises still experience financial difficulty after the five-months' exemption, the enterprises may apply for approval to delay contributions to these three funds. In addition, the temporary allowance and bonus received by medical workers in fighting Covid-19 shall be exempted from IIT.

Relieving the burden on foreign trade businesses:

Customs duty, VAT and consumption tax in respect of importation of donated goods for use in fighting Covid-19 shall be exempted. China customs authorities have implemented a fast customs-clearance channel (24–48 hours)

for importation of donated goods to be used in fighting Covid-19 which shall be exempted.

Implementing the ‘non-contact service’:

The Chinese tax authority has developed and put in use online tax reporting and payment apps, to minimise unnecessary risks of infection which may result from in-person meetings/contacts.

Hainan Free Trade port: a high-level free trade port

On 1 June 2020, China rolled out the Overall Plan for the Construction of Hainan Free Trade Port (FTP) and subsequently, the MOF and STA issued detailed EIT and IIT preferential policies for Hainan FTP on 30 June 2020; namely, tax circular Caishui [2020] No. 31 and Caishui [2020] No. 32, which are effective from 1 January 2020 to 31 December 2024.

Reduced 15 per cent EIT rate:

Enterprises may enjoy a favourable 15 per cent EIT rate (as opposed to the statutory 25 per cent EIT rate) if they are: 1. registered in Hainan FTP; 2. engaged in substantive business operations; and 3. in encouraged industries. In addition, EIT is exempted on a Hainan FTP enterprise’s income derived from newly increased overseas direct investment if the enterprise is in the tourism, modern services and high-tech industries.

Preferential IIT policies:

According to tax circular Caishui [2020] No.32, for high-end talents and talents with urgently needed skills who are working in Hainan FTP, the maximum effective IIT rate on their comprehensive income, operating income and Hainan government subsidies would be 15 per cent. Eligible talents can apply for a tax refund after the formalities for annual IIT filing is completed.