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"Quick replies; efficient; combines in depth local knowledge with a hands on attitude; not afraid to take a position; good understanding of local culture; solid legal quality."

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'Maarten Roos is vastly experienced in advising European and American Companies on their China-bound investment and corporate activities.'

Partner Chen Yun Seconded to Vancouver and Chicago

R&P is the China member of Ally Law (www.ally-law.com), an international network of independent law firms that refer work and cooperate in other areas. As a new initiative, Vancouver member Kornfeld LLP (www.kornfeldllp.com) and Much Shelist PC (www.muchshelist.com) in Chicago agreed to host R&P partner Ms. Chen Yun for a month each, to foster understanding of and cooperation between our firms and to give Yun the opportunity to learn more of the North American business and legal environments.

The initiative was a great success. Yun continued to lead her team in Shanghai and support her clients in China; many clients never noticed that she was travelling. Meanwhile, this exchange program allowed Yun the opportunity to establish new relationships with lawyers in Canada and the United States, and to learn more about their approach to law as well as the needs of North American clients.

We take this opportunity to thank the lawyers of Kornfeld and Much Shelist for their support of the initiative, and for the warm welcome that they all gave Yun. We are very pleased to use innovative ways to contribute to the development of our lawyers, with always as end-objective to be able to provide superior legal services to international businesses in China.

New Efforts on Unfair Competition Enforcement

We are in the midst of an in-depth enforcement campaign related to unfair competition practices, by the newly founded State Administration for Market Regulation. This enforcement campaign is focusing particularly on the online and pharma industries. For further reading please refer to an article co-authored by **Robin Tabbers** and **Victoria Lei** at:

<http://www.rplawyers.com/articles/new-efforts-on-unfair-competition-enforcement/>

Please visit our website www.rplawyers.com if you are interested in our recent legal articles about:

- Differences between Chinese and international trademark application procedures
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R&P China Lawyers is a boutique Chinese law firm headquartered in Shanghai, providing high-end legal services to foreign businesses active in China.

R&P Legal Briefing is written to inform clients and friends of the latest developments in Chinese law and practices.

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Changes to Individual Income Tax Law Will Impact Companies Operating in China

By Simon Robertson & Gina Chen

In June 2018, the Standing Committee of the National People's Congress proposed major amendments to the *PRC Individual Income Tax Law* (IIT Law). These changes are expected to take effect in October 2018, with full implementation of the revised law planned for January 2019.

The reforms are some of the most important and comprehensive since the passing of the original IIT law in 1980, and will certainly impact the payroll/finance operations of every company in China. Key amendments are the introduction of tax deductible expenses for Chinese employees and a reduction for expatriates; a reshuffle of the tax brackets to alleviate the IIT burden on low and middle-income earners; and changes to the residency rules for foreigners.

One important aspect of Chinese IIT laws that the amendments do not touch, is that employers remain responsible for withholding IIT. So the burden remains on companies to get it right.

1. Introduction of Tax Deductible Expenses

Arguably the most important amendment to the IIT Law is the long overdue implementation of deductible expenses. Expatriates have long been allowed to deduct certain expenses from IIT;

under the revised law, all individuals (incl. expatriates) will be able to lower their monthly/yearly IIT payment by offsetting their income against "special additional deductions" including:

- Education expenses for children;
- Expenses for further self-education;
- Health care costs for serious illness;
- Housing loan interest; and
- Housing rent.

This means that individual employees must work closely with their employer's finance / HR departments to ensure these special deductions are taken into account every month, which can greatly increase a company's administrative burden. The amendments also expressly forbid employers from denying valid deductions produced by their employees.

It is also important to recognize that foreigners will be subject to the same rules. In effect this can mean a decrease of the deductibles and so an increase of the tax burden, e.g. with relation

to laundry, meal allowances, and home flight tickets, which are items that currently are deductible for foreigners but may not be in the future.

Finally, the law allows for tax returns to individuals to be paid out after the March 31st annual tax reconciliation, which means that if too much IIT has been paid due to under-reporting of deductions, these can be reported later. It remains to be seen how this will work in practice.

2. IIT Rate Changes and Statutory Deduction Increase

The statutory deduction (i.e. the first part of the salary that is not subject to IIT) will increase to CNY 5,000 (from CNY 3,500 for Chinese employees, and CNY 4,800 for foreigners). More important, is the shuffling/lowering of income tax rates for employees with taxable income of up to CNY 35,000; the new tax brackets are as below.

Current and Amended Tax Brackets for IIT on Monthly Taxable Income (after standard deduction and allowable deductions)		
Current Bracket	Amended Bracket	IIT rate (%)
up to 1,500	up to 3,000	3
1,501-4,500	3,001-12,000	10
4,501-9,000	12,001-25,000	20
9,001-35,000	25,001-35,000	25
35,001-55,000	35,001-55,000	30
55,001-80,000	55,001-80,000	35
> 80,000	> 80,000	45

As an example of the scope of these changes, a Chinese resident national with a taxable income of CNY 40,000 per month would have to pay CNY 8,195 in taxes; but under the amendments he will see his tax burden fall to CNY 6,090, and that is without even considering the new special deductions!

3. Changes to Residency Establishment Period

The amended IIT Law reduces the qualification of residency from 1 year to 183 days. This means that any foreign individual who has stayed in China for 183 days or longer in a calendar year will be considered a resident, with income sourced within or outside the country subject to IIT. It is unclear whether the current "5-year tax rule" (i.e. a foreigner's global income is only taxed if (s)he has stayed in China for five years without interruption) will be repealed, though clarification in implementing regulations is expected later this year.

4. New Measures to Combat Tax Evasion

Further emphasis is placed on combating tax evasion under the amended IIT Law. Among the key changes are income recapture for China residents' overseas company business activities and profit distribution. The amendments also give greater authority to tax officers to review any situation under which an individual seeks to reduce his IIT burden without justified business-related purpose. China residents, both foreign and domestic, should review their global income structure to avoid unnecessary and expensive individual income tax audits.

5. Closing Remarks

The 7th major revision to the *PRC Individual Income Tax Law* will begin to take effect later this year, and is arguably the largest amendment to the law yet, in terms of the scope and importance of the changes. Foreign companies will need to review their payroll and IIT declaration processes and communicate the changes with their expatriate and local employees to ensure a smooth transition. Chinese individuals will need to ensure their lease agreements, education agreements, and other supporting documents are up to date in order to enjoy the new tax benefits; while foreigners will need to be prepared or compensated for any decreases in deductibles.

Points of Interest

- New basic deduction mechanism of CNY 5,000 per month, applied from October 2018 onwards;
- Additional emphasis that "withholding agent" (i.e. employers) must provide full deduction and declaration for all taxpayers, and provide full information on individual income and withheld tax;
- Clarification on applicable tax and deduction mechanisms for labour remuneration, author's remunerations and royalties;
- Potential step back on tax deductible expenses for expatriates, as the article has been rewritten and the specific quota/standard for deductions will ultimately be determined in the IIT Law Implementing Regulations.



Reform of Social Insurance System to Impact Foreign Business

By Maarten Roos & Simon Robertson

With the *Regulations on the Reform of National Tax and Local Tax* (the “**Reform**”) adopted on 20 July 2018 (to become effective on 1 January 2019), the responsibility to collect social insurance premiums (i.e. for basic pension insurance, basic medical insurance, unemployment insurance, work-related injury insurance, and maternity insurance) will be transferred from the local social insurance bureau to the local tax bureau. This means that from 2019 onwards, the same bureau will be in charge of the collection of both individual income tax and social insurance premiums.

This could have huge implications on companies in China, as the local tax bureau will have direct information on whether:

- Social insurance premiums are being contributed on the full salary of employees.
- Social insurance premiums are being contributed in the location where the employer is established.

1. Under-Reporting of Social Insurance

The law (via the *Circular on Relevant Matters concerning the Standardization of the Social Insurance Contribution Base* [2006]) establishes very clearly that social insurance should be declared and withheld by the employer and paid on the full monthly salary of the employee. The only exceptions are:

- If the monthly salary is higher than

three times the average salary in such location, then this “cap” will be used as basis to calculate and pay premiums.

- The social insurance basis is normally adjusted once per year. Therefore, an increase of wages will not immediately lead to an increase in social insurance obligations; instead adjustments should be made around February every year (referring to the average monthly salary in the previous calendar year).

Under current practice, social insurance bases are reported to and premiums are collected by the local social insurance bureau, which does not have direct access to information on an employee’s actual salary; while the local tax bureau has the employee’s salary (to calculate individual income tax) but is not involved in social insurance premium collection. As these authorities have separate systems and generally do not share information, some companies get away with under-contribution of social insurance premiums.

The main objective of the Reform is to put an end to this practice. Once local tax bureaus combine the two information systems into one, any incongruences will be found out immediately. Penalties for non-compliance remain unchanged, and include late fees (0.05% per day) and a penalty of up to three times the outstanding amount.

2. Location of Social Insurance Declaration

The *Administrative Provisions on Declaration and Payment of Social Insurance Premiums* [2013] (Article 4) provide that social insurance premiums should be paid in the location where the company is located. In practice however, it is very common for a company to hire people directly in other locations. Some examples of common situations:

- A retailer who is selling in another city through a join-sales agreement with a department store (so no branch is needed), and is using its own staff to operate the consignment store in the name of the landlord;
- A manufacturer has sales people in locations all over China to reach customers, but manages these people from HQ.
- A sourcing company hires local quality control people to manage production processes at various factory locations.

In all the above examples, the employee will want to benefit from social insurance premiums paid in the location where he/she works, but the employer is registered at a different location and prefers to avoid the set-up of a separate registered branch office in each location that it has staff. The normal way around the above restrictions is to hire a national-level, certified human resources agency (i.e. a staffing firm) such as FESCO or CIIC to assist: the employment relationship remains with the company and so individual income taxes are withheld and paid at the location where the company is registered; while the agency assists to pay social insurance premiums in the other location under a separate service agreement.

While we cannot stress enough how common this practice is, it is technically non-compliant. And when the collection systems for IIT and social insurance premiums are combined, then any inconsistency will immediately become clear to the tax authorities.

The Reform does not seem to be primarily targeted at this practice, and it would be a huge effort on the part of tax bureaus to force companies to change their practices. It is also a main part of the business of State-owned staffing firms such as FESCO and CIIC which would lose much of their relevance if the practice is disallowed. At the same time, unless the current practice is somehow legalized, there remains a risk that a tax bureau will start addressing this issue sooner or later – for example by refusing payment of social insurance premiums if no IIT has been paid in the same location, or pursuing companies that try.

If a tax bureau raises concerns, and for companies that want to get ahead of the issue, we see the following options:

- Pay social insurance premiums in the location where the company is located, even if the employee is based elsewhere and cannot then fully benefit from the social insurance system. This would increase the challenge of competing for the best talent.
- Establish a branch in every city where fulltime employees are located, so that social insurance premiums and salary can be paid by the branch. This would significantly increase an employer’s administration and costs.
- Have a staffing firm hire the employee directly and dispatch her to the company. However, dispatch services are only permitted for temporary,

auxiliary and alternative positions, and should represent no more than 10% of the total work service.

Moreover, dispatch will reduce control over the employment relationship, and can increase costs.

3. Conclusion

Companies should review their practices to ensure that social insurance premiums are based on the full salary of their employees. While the risk of incompliances being discovered has been relatively low in the past, it

will become very high starting 1 January 2019 and with high penalties, it is important to get ahead of the problem as soon as possible.

As regards the practice of paying social insurance premiums in a different location from where the employee is established, it remains to be seen how big this risk will be. Companies have a number of alternative approaches but none are ideal. Companies that wish to minimize risk should consider acting now; in any case, an affected business should be ready to take action immediately if its local tax bureau raises the issue.



Maarten Roos to Attend Executive Course at Harvard Law School

“Leadership in Law Firms” is an executive education program offered at and by Harvard Law School (HSL), for senior law firm leaders as an “intensive study of a cross-section of professional service firms to help participants develop the perspectives and skills necessary to be effective law firm leaders.” After leading R&P for over 8 years of fast growth and development, founder and managing director Maarten Roos will attend this program in September 2018, with the aim of taking R&P to the next level.

On Maarten’s expectations: “As R&P’s managing director, I mainly split my time between clients and administering the firm – and this has worked really well. While R&P’s long-term strategy is always in the back of my mind, it rarely gets the attention it deserves. Attending HSL’s Leadership in Law Firms program will be an opportunity to learn from the experiences of other law firms; and to focus and think about how to continue developing R&P in an ever-changing environment.”

Rogier Van Bijnen Presented at Dutch Chamber of Commerce

On 11 September 2018, R&P Director Rogier Van Bijnen was invited to present at the Dutch Chamber of Commerce on ensuring payment from customers in China. The presentation included:

1. Doing your homework: a few simple due diligence steps every business should always take in China;
2. Prevent not getting paid: maintaining sufficient leverage over the Chinese counterpart throughout the transaction;
3. When things go wrong: how can foreign businesses use the Chinese court system to their advantage?

R&P’s Maarten Roos Re-appointed as SHIAC Arbitrator

The Selection and Disciplinary Committee of the recently re-appointed R&P founder and managing director Maarten Roos to its panel for another three years (till 2021), citing his “*qualification, professional expertise, social influence and handling expertise*”.

Roos: “*I am very proud to continue my position on the arbitration panel, and look forward to adjudicating more cases in the coming years. Working on arbitration cases is challenging but always interesting, but most of all it is rewarding to be able to help companies resolve their disputes.*”

SHIAC is the most important arbitration institution in Shanghai, and one of the most important in China, and R&P is very proud to have one of its own on the panel.



INDIVIDUAL RECOGNITIONS ASIALAW LEADING LAWYERS 2018



WE ARE THRILLED TO ANNOUNCE THAT ONCE AGAIN, FIVE OF R&P’S PROFESSIONALS ARE LISTED IN THE LATEST, 2018 EDITION OF ASIALAW LEADING LAWYERS – THE GUIDE TO ASIA-PACIFIC’S LEADING LAWYERS IN PRIVATE PRACTICE AT NATIONAL AND REGIONAL LAW FIRMS:

MAARTEN ROOS

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