



## China Tax Newsletter

November 2017

Our tax newsletter for this month covers:

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## **1. Announcement of the State Administration of Taxation on Matters concerning the Collection Scope of Research and Development Expenses for the Purpose of Super Pre-tax Deduction**

On November 8<sup>th</sup>, 2017, the State Administration of Taxation issued Announcement of the State Administration of Taxation on Matters concerning the Collection Scope of Research and Development Expenses for the Purpose of Super Pre-tax Deduction (Announcement of the State Administration of Taxation [2017] No.40, hereinafter referred to as “**Announcement No.40**”).

Announcement No.40 further specifies the collection of research and development expenses, such as labor costs of researchers and developers, costs of direct input, depreciation expenses, amortization expenses of intangible assets, and other relevant expenses, etc. based on the Notice of the Ministry of Finance, the State Administration of Taxation and the Ministry of Science and Technology on Improving the Policy on Super Pre-tax Deduction of Research and Development Expenses (Cai Shui [2015] No.119) and the Announcement of the State Administration of Taxation on Issues Concerning the Super Pre-tax Deduction Policy for Corporate Research and Development Expenses (Announcement of the State Administration of Taxation [2015] No.97, hereinafter referred to as “**Announcement No.97**”).

Announcement No.40 applies to the annual final settlement of enterprise income tax of FY2017 and the years subsequent thereto.

### **(1) Appropriately broaden the scope of external research and development personnel**

Based on Announcement No.97, Announcement No.40 further specifies as follows: in addition to the wages and salaries which are paid directly to employees, labor costs paid by an enterprise to a labor dispatching enterprise per the agreement (contract) signed for the payment of wages and salaries to external researchers and developers are included in the scope of Super Pre-tax Deduction.

### **(2) Apply the super pre-tax deduction to the expenditure of equity incentives for researchers and developers**

Wages and salaries in line with the provisions of the Announcement of the State Administration of Taxation on Issues Relating to Handling of Enterprise Income Tax for Equity Incentive Plans Implemented by Resident Enterprises in China (Announcement of the State Administration of Taxation [2012] No.18) shall include the expenditure of equity incentives for researchers and developers which can be deducted before tax according to the provisions.

### **(3) Material costs of research and development products can directly offset the research and development expenses in the year of sales**

Announcement No.97 stipulates that where the products or the components, which are formed directly in the research and development activities of an enterprise, are sold outwards, the costs of materials corresponding to the research and development expenses shall not be allowed for super pre-tax deduction.

However, in actual implementation, the sale of the products and the occurrence of corresponding material costs are usually in different tax years, as a result of which correction of the annual tax declaration of the previous years would be required when the products are sold. Announcement No.40 specifies that where the sale of the products and the occurrence of corresponding material costs are in different tax years and the material

costs have been included in research and development expenses, the corresponding material costs can directly offset the research and development expenses in the year of sales; if the amount is insufficient for offsetting, the costs can be carried forward to subsequent years for offsetting.

#### **(4) Pre-tax deducted accelerated depreciation (or amortization) expenses are allowed for super pre-tax deduction**

Announcement No.97 made it clear that the principle of accelerated depreciation expenses eligible to the policy of super pre-tax deduction is that the depreciation and expenses which have been accounted for shall not exceed the amounts computed pursuant to the provisions of the tax law.

Announcement No.40 simplifies collection of accelerated depreciation expenses as following:

When calculating the research and development expenses allowed for super pre-tax deduction, it is not required to compare the amounts that have been accounted for with amounts pursuant to the provisions of the tax law with regard to super pre-tax deduction, and the amounts eligible for super pre-tax deduction are not required to be adjusted according to the changes in accounting depreciation periods. For intangible assets allowed for a shortened amortization period, their depreciation expenses apply to the same collection method with that of fixed assets, i.e. pre-tax deducted part of amortization shall be super-deducted.

#### **(5) Broaden the scope of other relevant expenses**

Other than the relevant expenses listed in Cai Shui [2015] No.119, Announcement No.40 stipulates that other relevant expenses include employee benefits, supplementary pension insurance premiums and supplementary medical insurance premiums.

#### **(6) The rights and interests for super pre-tax deduction of the principal shall not be transferred to the agent**

According to Announcement No.40, no matter whether the principal is eligible to the policies on super pre-tax deduction of research and development expenses, the agent is not allow to super-deduct the research and development expenses.

## **2. Effective of the Agreement between the People's Republic of China and Romania for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance**

The People's Republic of China and Romania comprehensively revised the Agreement between the Government of the People's Republic of China and the Government of Romania for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income which was signed on January 16<sup>th</sup>, 1991, and signed the Agreement between the People's Republic of China and Romania for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Evasion and Avoidance (hereinafter referred to as the "AGREEMENT") in Bucharest on the 4<sup>th</sup> day of July, 2016. The main changes between the old agreement and AGREEMENT are as follows:

### **(1) Article on permanent establishment**

For furnishing of services by an enterprise through employees or other personnel engaged by

the enterprise for such purpose, to constitute a permanent establishment, the activities of the enterprise shall continue for "a period or periods aggregating more than six months within any twelve-month period" according to the old agreement; but it is revised to "a period or periods aggregating more than 183 days within any twelve month period commencing or ending in the fiscal year concerned" in the AGREEMENT.

## **(2) Article on dividends**

The withholding income tax rate of dividend was 10 per cent in the old agreement. In the AGREEMENT, it is stipulated that if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed 3 per cent of the gross amount of the dividends; however, dividends arising in a Contracting State and paid to the other Contracting State or a political subdivision, local authority or administrative-territorial unit thereof, or dividends arising from any entity wholly or over 50 per cent owned by the other Contracting State, shall be exempt from tax in the first-mentioned State.

## **(3) Article on interest**

The withholding income tax rate of interest was 10 per cent in the old agreement. In the AGREEMENT, it is stipulated that if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 3 per cent of the gross amount of the interest; however, interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State to the extent that such interest is paid: a) in respect of indebtedness arising as a consequence of the sale on credit of any equipment, merchandise or services; or b) on any loan of whatever kind granted by a financial institution of that other State; or c) to that other State or a political subdivision, local authority or administrative-territorial unit thereof, or in respect of the interest arising from any entity wholly or over 50 per cent owned by that other State.

## **(4) Article on royalties**

The withholding income tax rate of royalties was 10 per cent in the old agreement. In the AGREEMENT, the withholding income tax rate of royalties is reduced to 3 per cent.

## **(5) Article on capital gains**

With regard to taxes on capital gains, the old agreement stipulates that the Contracting State which is the source of the tax revenue has the taxing power under the following scenarios: a) the alienated property consists directly or indirectly principally of immovable property or movable property situated in the Contracting State; b) before alienation of shares, the shareholding percentage of the resident is not less than 25 per cent in a company.

In the AGREEMENT, it is stipulated that the Contracting State which is the source of the tax revenue has the taxing power under the following scenarios: a) the alienated property consists directly and principally of immovable property or movable property situated in the Contracting State; b) more than 50 per cent of the value of the majority of shares or comparable interests derives directly or indirectly from immovable property situated in the Contracting State.

The AGREEMENT is effective from June 17<sup>th</sup>, 2017 and will be implemented from January 1, 2018.

### **3. Notice on Extending the Enterprise Income Tax Policies for Advanced Technology Service Enterprises for Nationwide Implementation**

For the purpose of guiding more foreign investment to the high-tech and high value-added service industries, the Ministry of Finance, the State Administration of Taxation, the Ministry of Commerce, the Ministry of Science and Technology and the National Development and Reform Commission issue the circular on the preferential enterprise income tax policies for advanced technology service enterprises. As of January 1, 2017, in addition to the 31 Chinese service outsourcing demonstration cities such as Beijing, Shanghai, Chongqing, Dalian, Shenzhen and Guangzhou, the whole nation will be eligible to the following preferential enterprise income tax policies:

(1) For the advanced technology service enterprises recognized, the enterprise income tax is levied at a lower tax rate of 15%.

(2) The part of employee education expenses of the advanced technology service enterprises recognized not exceeding 8% of total wages and salaries are allowed to be deducted during the calculation of taxable income; and the part exceeding 8% is allowed to be carried forward and deducted in subsequent tax years.

### **4. Continuous Implementation of Individual Income Tax Exemption for Gains Derived from the Transfer Price Difference from Investment Made by Mainland Individual Investors in Stocks Listed on the Stock Exchange of Hong Kong via the Shanghai-Hong Kong Stock Connect**

On November 1<sup>st</sup>, 2017, the Ministry of Finance, the State Administration of Taxation and the China Securities Regulatory Commission launched the Notice on Continuing to Implement Individual Income Tax Policies for the Connectivity Mechanism for Transactions in the Shanghai and Hong Kong Stock Markets which focuses on individual income tax policy on connectivity mechanism for transactions in Shanghai and Hong Kong stock markets (hereinafter referred to as the "Shanghai-Hong Kong Stock Connect"). According to the circular, the individual income tax shall be continued to be exempted from November 17<sup>th</sup>, 2017 to December 4<sup>th</sup>, 2019 concerning the gains derived from the transfer price difference from investment made by mainland individual investors in stocks listed on the Stock Exchange of Hong Kong (HKEX) via the Shanghai-Hong Kong Stock Connect.

#### **Tips from BDO China**

The circular is a continuation of the Notice on Tax Policies Relating to the Pilot Program of Shanghai-Hong Kong Stock Connect (Cai Shui [2014] No.81). Income tax exemption conditions of the involved parties are listed as follows:

Investors		Investment Target	Nature of Income	Exempted or Not	Note
Areas	Legal Entity				
Mainland	Individual	Stocks listed on the HKEX	Gains as a result of the transfer price difference	Temporarily exempted	Effective until December 4 <sup>th</sup> 2019.
			Dividends from investments	Not exempted	For withholding tax that has been paid by individual investors at abroad, the individual investors may apply to the competent tax authorities of China Securities Depository and

Investors		Investment Target	Nature of Income	Exempted or Not	Note
Areas	Legal Entity				
					Clearing Corporation Limited for a tax credit by presenting valid tax credit documents.
Mainland	Enterprise	Stocks listed on the HKEX	Gains as a result of the transfer price difference	Not exempted	
			Dividends from investments	Not exempted	Among that, dividends of mainland resident enterprises that hold H shares for over 12 consecutive months are exempted from enterprise income tax in accordance with the law.
Hong Kong	Enterprise an Individual	A Shares Listed on the Shanghai Stock Exchange	Gains as a result of the transfer price difference	Temporarily exempted	
			Dividends from investments	Not exempted	Not subject to the differentiation tax policies based on the shareholding period for the time being

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