



Hong Kong Institute of
Certified Public Accountants
香港会计师公会

Meeting notes

**The Guangdong Provincial Local Taxation Bureau
and
The Hong Kong Institute of Certified Public Accountants**

2016

Preface

It was a great pleasure for the Hong Kong Institute of Certified Public Accountants ("Institute" or "HKICPA") to hold a meeting with the Guangdong Provincial Local Taxation Bureau ("GPLTB") on 6th December 2016 in Guangzhou. The purpose of the meeting was to discuss various taxation topics and to exchange opinions based on the discussion.

The following is a translation of the meeting notes prepared, in Chinese, by the Institute. Please note that the meeting notes represent only the views of GPLTB officials who attended the meetings and are not intended to be a legally-binding or definitive interpretation. Professional advice should be sought before applying the content of these notes to your particular situation.

HKICPA wishes to thank the delegates from KPMG for taking the meeting notes.

Meeting notes

List of Discussion Topics

A. Individual Income Tax ("IIT")

1. Tax credit associated with overseas tax paid
2. Directors' fees
3. Questions in relation to equity transfers by individuals
4. Phantom stock incentive schemes
5. Individual non-monetary asset investment
6. Going abroad
7. Shareholding platform
8. Private placement
9. Withholding agents
10. Interns and temporary workers
11. IIT implications on the housing subsidy received by Chinese citizens when working overseas

B. Stamp duty

Attendees

GPLTB

Luo Cuiying	Deputy Director, Division of International Tax Administration
Tang Dandan	Principal Staff Member, Division of International Tax Administration
Zhu Guoqiang	Principal Staff Member, Division of International Tax Administration
Lin Weitao	Deputy Principal Staff Member, Division of International Tax Administration
Gao Zhan	Staff Member, Division of International Tax Administration
Yang Hao	Deputy Director, the First Division of Tax Policy
Sun Ting	Principal Staff Member, the Second Division of Tax Policy

HKICPA

Anthony Tam	Chairman, Taxation Faculty Executive Committee and Convener, Mainland Taxation Subcommittee
So Kwok Kay	Deputy Chairman, Taxation Faculty Executive Committee and Member, Mainland Taxation Subcommittee
Sarah Chan	Member, Taxation Faculty Executive Committee and Mainland Taxation Subcommittee
William Chan	Member, Taxation Faculty Executive Committee and Mainland Taxation Subcommittee
Daniel Hui	Member, Mainland Taxation Subcommittee
Li Wen Huan	Member, Mainland Taxation Subcommittee
Mak Ho Sing	Member, Mainland Taxation Subcommittee
Rebecca Wong	Member, Mainland Taxation Subcommittee
Luke Lu	Manager, China Tax, KPMG
Eric Chiang	Deputy Director, Advocacy and Practice Development
Serena Fong	Associate Officer, Advocacy and Practice Development

Summary of Discussion

A. Individual Income Tax ("IIT")

1. Tax credit associated with overseas tax paid

A Chinese company sent its employee to work overseas with multiple roles (e.g. acting as the general managers of the Hong Kong holding company and Indonesian project company). The individual received salaries from the group legal entities in China, Hong Kong and Indonesia respectively. When calculating the tax credits received from foreign tax payments for IIT purposes, should we only make reference to the principle of foreign tax paid in the respective countries rather than each income item of the individual? In other words, the tax credit should be computed based on the total relevant incomes derived from each country, but not the different individual income items. If the ratio of the salaries paid between the Hong Kong and Indonesian entities is disproportionate to the working hours of the individual in the two countries, should adjustments be made in calculating tax credits?

GPLTB: The principle of calculating tax credits for IIT and corporate income tax ("CIT") is the same. It is calculated according to the tax paid in both the respective countries and individual income items. The tax credit is the lesser of IIT computed as if the income were earned in China or the actual foreign tax paid in a particular country. The ratio of the wages and the working hours is not a consideration for the tax credit calculation. According to the Chinese tax law, Chinese citizens are obliged to report their overseas income to the tax authorities. As for the overseas income of the Chinese citizens, the tax authorities can check the reasonableness of the income amount from their database or through exchange of information with the overseas tax authorities (especially countries with many immigrants), and a tax adjustment may be made by reference to this additional information.

2. Director's fees

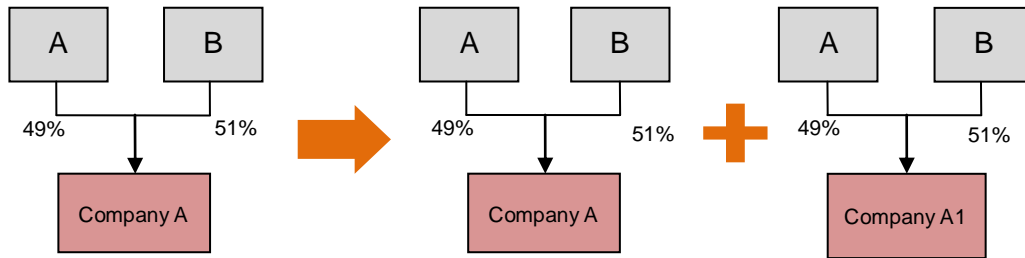
A tax Circular issued by State Administration of Taxation ("SAT"), Guoshuifa [2009] Circular 121, clarifies certain IIT issues such that if an individual is an employee and also a director of a company (or a related company), the director's fees received by the individual should be consolidated with his/her salary for computing the IIT liability of the individual.

For example, a foreign individual is both a director of an overseas listed company and he also holds a senior managerial position of a group company in China and he receives a director's fee from the listed entity and salary from the group company in China. There is a reasonable commercial reason for him to act as the director of the company. Should the director's fee be included as salary for IIT calculation purposes according to Circular 121? Or can the director's fee which he earned from the overseas company be excluded in the IIT calculation as long as he resides in China for less than 5 years?

GPLTB: The case should be dealt with in two steps. Firstly, we need to determine if the taxpayer would have IIT liability under the ground rules of Circular 121 e.g. whether there is a reasonable commercial reason for the payment, if the relevant fees are borne by the Chinese domestic enterprises; and whether an associated company is involved in the transaction. Secondly, if the individual is liable to pay IIT based on the first analysis, other factors would be taken into account in determining if the director's fee would be deemed as salary for IIT calculation. If the two companies involved are related parties, rules in Circular 121 would prevail in determining whether the director's fee should be combined with salary for IIT calculation. For example, if a non-resident individual resides in China for less than five years, the director's fee is paid to him with a reasonable commercial justification and is not borne by a Chinese domestic enterprise, in principle; the individual should not be liable to pay IIT in respect of the director's fee that he received. However, if

a resident individual receives director's fee from an overseas entity and the overseas entity is an associate of a Chinese company, the director's fees should be combined with salary in calculating the IIT liability.

3. Questions in relation to equity transfers by individuals



- a. A and B are individuals who own Company A in the proportions shown in the above diagram. If Company A is spun off into a new Company A and Company A1, what are the IIT implications to the individuals? Should we make reference to Caishui [2009] Circular 59 and SAT [2015] Circular 48 about the special CIT treatment on restructuring and deferring IIT payment, if there is any?
- b. If A and B are relatives, would the transfer of shares be regarded as having legitimate reasons as per Article 13 of SAT [2014] Circular 67?

GPLTB: Based on the information provided, the individuals remain the shareholders and the shareholding ratio of the spun off entities remain the same as the original entity. Hence, it can be concluded that there was no change in shareholding. Despite this, we should find out the reasons for the restructuring exercise. If the shareholders have changed from natural persons to corporations, gains derived from the restructuring exercise by the above individuals should be deemed to be equity transfers.

If there are capital changes (not the changes of the corresponding amounts arising from creation of an independent company via the sale or distribution of new shares of an existing business or division of a parent company) in the registrations of either the newly-established company or the continuing enterprise, gains derived from the exercise by the above individuals should be [considered to be] deemed as dividends.

4. Phantom stock incentive schemes

It is not specified in the existing laws and regulations that the tax formula used for calculating IIT for stock option gains is also applicable to the gain from phantom stocks. However, according to the nature of the phantom stock incentive scheme, this is also a kind of share incentive scheme deployed by companies to motivate staff. As a separate note, State Administration of Foreign Exchange also requires information on Chinese individuals' participation in phantom stock schemes to be reported in the declaration forms. This implies that phantom stock schemes are one of the popular share incentive schemes used in China. Would the above mentioned concessionary tax treatment be extended to cover the gains derived by the phantom stock schemes?

GPLTB: The scenario does not satisfy the requirements for concessionary tax treatment set out in Caishui [2016] Circular 101. Detailed requirements for the concessionary treatment can be found in the relevant circulars issued in 1998. The document outlining Alibaba's bonuses has been abolished, thus there is no reference value now. It is more reasonable to treat the gains derived from the phantom stock schemes as salary for IIT calculation purposes.

5. Individual non-monetary asset investment

In respect of settling IIT payments by instalments within five calendar years (Caishui [2015] Circular 41), we should be grateful if the tax bureau would share some actual cases of the instalment applications lodged by the individuals.

For instance, should the payments be made in equal instalments, or could taxpayers pay less in the earlier instalment payments and more in the later instalments? How frequent should the repayments be made, quarterly, half-yearly? What are the general requirements and areas of attention for taxpayers when making applications?

GPLTB: It is mentioned in Caishui [2015] Circular 41 and SAT Announcement [2015] Circular 20 that, a taxpayer can lodge an application with the in-charge tax authority for making tax payments by instalments if he has difficulties paying all taxes at once. However the instalment plan has to be reasonable and not longer than 5 calendar year period from the date of occurrence of the taxable event. The cash premium received from the transaction shall all be used for tax payments. The remaining outstanding tax payment could be settled by instalments. The "Personal tax instalment from non-monetary assets" form, proof of taxpayer identity, investment agreement, and other evidence that can substantiate the value of the non-monetary assets should be submitted, as supporting documents for the applications. The taxpayers are obliged to prepare and submit an instalment payment proposal to the tax authority together with the above mentioned supporting documents.

6. Going abroad

As the number of "going aboard" Chinese residents has been increasing and more taxpayers are aware of their tax reporting obligations, more Chinese nationals residing overseas are going back to China for filing IIT final settlement returns at the end of the year. It appears that there are no clear guidelines for these Chinese nationals for filing their final settlement returns; especially after implementation of the "Jinshan" system - a tax system for people to complete their tax filings online. We understand the GPLTB has internal guidelines on IIT final settlement for "going aboard" individuals. Could you provide us the internal guidelines for reference?

GPLTB: The GPLTB has not released any formal guidelines on IIT final settlement return filing for "going aboard" individuals. However the subject matter will be taken care of by SAT. Also, it will become one of the highlighted projects for SAT next year.

7. Shareholding platform

If there is a gain on transfer of shares in a partnership enterprise, will the tax rates of 20% and 5%-35% levied on the limited partners and general partners respectively, in Guangdong? If an asset management scheme acts as a shareholding platform, should the securities company or the company itself be the taxpayer? Will the Guangdong government consider publishing relevant guidelines for partnership enterprises?

GPLTB: SAT has a clear written guideline for the above issues. The guidance from SAT does not differentiate limited partners and general partners. Rather, all income other than interests, dividends and bonuses earned by partnership should be dealt with in the same way as individual merchants, i.e. based on the IIT tax rate from 5% to 35%.

8. Private placement

Under the current policy, private placements may not be offered to the public. Listed companies may issue stocks to their staff members through private placement. Should the dividend differentiation IIT policy be applied to private placement arrangements?

GPLTB: According to Caishui [2015] Circular 101, IIT policy of dividend differentiation is applicable to the stocks of listed companies. Thus, if the stock from private placement had been registered at National Equities Exchange and Quotations or China Securities Depository and Clearing Corporation Limited, the dividend differentiation IIT policy would be applicable. The holders of unregistered stocks cannot enjoy the above beneficial tax treatment.

9. Withholding agents

When a non-resident enterprise purchases shares of a Chinese domestic enterprise from a non-resident individual, does the non-resident enterprise have obligation to withhold IIT from the payment made to the non-resident individual?

GPLTB: It is stipulated in Article 8 of SAT Announcement [2015] Circular 7 that non-resident enterprises are the withholding agents of the sellers in the indirect shareholding transfer. However, this requirement is for CIT rather than IIT. The tax bureau understands that it might be difficult for the non-resident enterprise to exercise the withholding obligations in practice. The tax bureau also considered that the current IIT regulation on tax withholding is behind that of CIT, and there is no clear regulation for the share transfers conducted by the non-resident individuals. However, the tax bureau will handle the cases in accordance with actual situation, the tax administration law and IIT law. In other words, the buyers and the sellers will be checked if they have fulfilled their tax obligations according to information provided in the tax returns. Tax bureaus may take actions against the taxpayers and withholding agents.

10. Interns and temporary workers

According to the notice regarding certain CIT policies for the taxable income (SAT Announcement [2012] Circular 15), the expenses of employing seasonal and temporary workers, interns, re-employed retirees and labourers should be divided into wages and salaries expense and employee benefits expenses, based on the nature of the expenses. These expenses (e.g., salaries and wages, and employee welfare expenses) are deductible for CIT purposes. The wages and salaries expenses should be included as the total remunerations of the enterprises to calculate the deductible amount of relevant expenses for CIT purposes.

Based on the above regulations, should we infer that interns and temporary workers should pay IIT based on the IIT rate for salary? Or do we need to refer to the nature of the payments made to the individuals before we determine what tax rate should be used for calculating their IIT, i.e. salaries or service income? What are the factors that the tax bureau would consider in determining what tax rates should be used?

GPLTB: The way of handling CIT and IIT is the same. If the interns or temporary workers are employed under normal payment staff terms of employment, they should be subject to IIT as if they were receiving salary; otherwise, they should be subject to IIT as if they were receiving service income. The IIT is then paid based on the salaries received or the income from the services rendered.

11. IIT implications on the housing subsidy received by Chinese citizens when working overseas

Many Chinese domestic companies send their employees from the Chinese parent companies to overseas subsidiaries; the employees working at the overseas subsidiaries have housing subsidy benefits. According to Caishui [2004] Circular 29, non-cash subsidies for accommodation, meals, laundry and relocation, etc., or reimbursement of actual payment, received by foreigners (excluding Hong Kong and Macau residents) employed by enterprises in China and living in Hong Kong or Macau, , are non-taxable

items for IIT. However, it is our understanding that this provision does not apply to the Chinese domestic employees. If the housing subsidy is given to the Chinese domestic employees in cash, the subsidy will be considered as part of salary income and be subject to IIT. When a Chinese domestic employee resides in staff quarters provided by the company during his/her overseas assignments (i.e., the Chinese domestic employee does not receive cash benefits from housing subsidy), will the housing subsidies be taxable items for IIT purposes? If yes, how should the benefits received by a Chinese domestic employee on the housing subsidies be quantified?

GPLTB: The view is that housing subsidy should be included in salary for calculating IIT. Staff quarters (in non-cash form) should be quantified according to the contract terms and be included in salary for calculating IIT. The difficulties in implementation in practice will be reflected to SAT.

B. Stamp duty

According to the Notice on stamp duty policy to the process of enterprise reformation (Caishui [2003] Circular 183), if an enterprise transferred its property as a result of enterprise reformation, enterprises are exempt from paying stamp duty on documents in relation to the property transfer. Would entities undergoing mergers and spin offs also be able to get stamp duty exemptions on their asset transfers, according to Caishui [2003] Circular 183? Meanwhile, do both parties in the transaction have to pay stamp duty for the transfers of equity and assets, according to Caishui [2014] Circular 109?

GPLTB: The view is that transfers of assets during mergers and spin offs will not affect the stamp duty exemption status, as long as the requirements of Caishui [2003] Circular 183 are fulfilled. Both parties in the transaction have to pay stamp duty on the transfer of equity and assets as per Caishui [2014] Circular 109.