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

Meeting notes

The Guangdong Provincial Office of the State Administration of Taxation and The Hong Kong Institute of Certified Public Accountants

2016

Foreword

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 Office of the State Administration of Taxation ("GPOSAT") on 6 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 GPOSAT 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.

<u>Meeting notes</u>

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5. VAT issues on centralized purchasing
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E. Integrated question

1. Compliance Guidance

Attendees include:

GPOSAT

Liu Li	Deputy Director, Department of International Tax Management
Chen Hui	Principal Staff Member, Department of Income Tax
Zhuang Bo	Principal Staff Member, Department of International Tax Management
Chen Weidi	Deputy Principal Staff Member, Department of Commodity and Service Tax
Chen Liexin	Deputy Principal Staff Member, Department of International Tax Management

HKICPA

Anthony Tam	Chairman, Taxation Faculty Executive Committee and Convenor, 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
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

Discussion items

A. Corporate Income Tax ("CIT")

1. SAT Public Notice [2015] No. 7 ("PN7")

a. Reasonable commercial purposes

There is no clear guideline on how to interpret "reasonable commercial purposes" in actual situations, such as the following:

- How do we determine "whether the main equity value of the overseas enterprise is derived directly or indirectly from Taxable Properties in China" in Article 3(1)? For example, should taxpayers provide relevant equity valuation reports to justify the equity value? Are there any other bases to determine "reasonable commercial purpose"?

- What are the specific criteria for determining "whether a majority of assets of the overseas enterprise is directly or indirectly comprised of investments in China, or whether a majority of its income is directly or indirectly derived from China" in Article 3(2)?

  Could the tax bureau share recent cases to help further explain the judging criterion of "reasonable commercial purposes" mentioned in PN7?

  With respect to the principal commercial substance ("PCS") mentioned in PN7, the principal activities of many Hong Kong intermediate holding companies are investment holding and financing. When a transfer transaction does not satisfy the safe habour rule on group internal reorganization, and the blacklist is not automatically applicable such that the transaction is subject to further analysis on confirming PCS of the intermediate holding company. In this particular example, will the tax authority estimate the value of the Chinese domestic company and demand CIT payment according to a calculated ratio?

GPOSAT: The tax authorities generally consider various factors in estimating enterprise equity values. They generally take the report provided by the enterprise as a major reference for valuation. However, the submission of the valuation report is not mandatory. As for "reasonable commercial purposes" judging criteria, the judgment will be based on the combination of functional risks and asset analysis of the enterprise, value chain analysis, etc. and will be done on a case by case basis.

b. Transfer pricing considerations to be used for tax calculation purposes

When calculating the gains derived in an indirect transfer under PN7, should that be computed based on the enterprise value on the date of the transfer or another basis?

If the transferor of an indirect equity transaction reported the case and made tax payments according to PN7, and the equity of the underlying Chinese entity is later transferred out under a direct transfer arrangement, can the value of the Chinese company used in the indirect transfer reported in the tax return be used as the base for the tax calculation of this subsequent transaction? (This question involves investment entity on different levels.)

- Example 1:

  No tax had been paid in accordance with the rules in PN7 in the first indirect transfer transaction (the reasons for which could be, e.g., that the first indirect transfer took place before 2008 or the parties involved had not reported the case). Subsequently, the buyer indirectly disposed the equity of overseas company. How should the gains on this subsequent disposal be calculated? Can the cost incurred in the first indirect transfer be treated as deductable expenses in calculating the subsequent gains? (The corresponding payment document and equity agreement proof are available).

- Example 2:

  An overseas company indirectly obtained equity of a Chinese enterprise via acquiring the intermediate overseas holding company (special-purpose vehicle ("SPV")). The SPV had been "looked through" and tax had been paid on the gains arising from this indirect transfer. Subsequently, the overseas company directly transferred out the equity of the Chinese enterprise. As the actual acquisition cost of the overseas company is the amount it paid to purchase the SPV, which had been "looked through" by the tax authority, can the cost for acquiring the SPV rather than the paid up capital of the Chinese enterprise be used in calculating the gains in the subsequent transfer?

GPOSAT: The tax bureau would in general not make any irrelevant adjustments on the transaction prices when the transaction is between unrelated parties. As for ascertaining the gains in share transfers of a domestic company, the paid up capital of the domestic company will be used as the cost base in the calculation, hence, the tax calculation will be based on the paid-up capital. The tax bureau may accept adjustments to the cost base if there are any unsettled obligations and/or liabilities from the overseas companies.

If tax had been paid properly in the first indirect transfer in the two examples above, the tax bureau would acknowledge the transactions and, therefore, the cost incurred by the buyer in the first indirect transfer could be used as cost base in calculating the gains in the subsequent disposals. A tax payment certificate in the first indirect transfer would required as supporting proof in these cases.

c. Interests and late payment surcharges issues mentioned in PN7

Article 13 of PN7 stipulates that when a does not pay sufficient tax in a timely manner, interest will be imposed on a daily basis, based on the prime RMB lending rate published by the People's Bank of China in the year to which the unpaid tax is attributed. If the transferor fails to submit the required documents, or has not paid tax on a timely basis, the calculation for the applicable interest rate will be based on the RMB prime lending rate plus another 5%. In practice, we have encountered scenarios in which tax authorities imposed a late payment surcharge on the entire tax amount. How would you handle similar cases?

GPOSAT: When taxpayers do not file their tax return for the indirect transfers in a timely manner, interest will be imposed by reference to the rules as stated in PN7. If the tax authority has ordered the taxpayer to remedy the situation within a certain time period and the taxpayer fails to comply, a late payment surcharge will be imposed.

d. Looking through approach

Many overseas listed enterprises apply for delisting and prepare to return to the A-share market. This generally involves a privatization (i.e. the major shareholders acquire the equities of the small shareholders) or merger among overseas holding companies. In this circumstance, as the original group holding company is the listed company, could the group company be treated as if it has certain functions and risks (e.g. investment and financing)? Also, in case there is a transfer of equity, could the transfer be considered to have a reasonable commercial purpose, and the group company not be "looked through" under Circular 698 or PN7?

GPOSAT: As stated in Article 5 of PN 7 the "white list" concept cannot be directly applied to the above transaction. The tax bureau would take the functions and risks borne by the listed company into account as to whether they would look through the transaction.

e. Variable Interest Entity ("VIE") structure

When a group is operating with a VIE structure in place, the group holds the equity interest of the wholly foreign-owned enterprise ("WFOE") and the group has entered into various agreements with the PRC domestic company. It is worth noting that a PRC individual (i.e. natural person) is still the legal owner of the domestic company under the VIE structure. Under the circumstances, should the WOFE or the VIE entity be the taxing entity when tax is required to be levied in an indirect transfer transaction? In other words, only the WFOE rather than the VIE will be considered as the company being indirectly transferred? The VIE is held by an individual in legal context and there is no shareholding relationship with the overseas group holding company. (The question involves source of tax and if the gains arising from the indirect transfer are required to be allocated between the WFOE and the VIE).

GPOSAT: These situations will be handled on case-by-case, based on the merits of each individual case.

2. Corporate reorganization

a. CIT implications for non-resident enterprises in cross-border reorganization arrangement

The cross-border reorganization transactions entitled to special tax treatments are limited to the following three scenarios, as stipulated in Article 7 of Circular 59:

(1) A non-resident entity transfers its shareholding in a Chinese company to its wholly-owned non-resident subsidiary, where the non-resident company directly holds the equity of the transferee company. Moreover, the share transfer does not lead to a change of the withholding tax burden in relation to the gains derived from the subsequent transfer of the shares of the resident company. And the transferor issues a written commitment to the in-charge tax bureau that it will not sell shares of the transferee company (i.e. the shares of the wholly-owned subsidiary of transferor) within the following 3 years.

(2) A non-resident enterprise transfers the shares of a resident subsidiary enterprise to its another 100% directly-owned resident subsidiary enterprise;

(3) A resident enterprise invests in its 100% directly-subsidiary non-resident enterprise in the form of assets or equity interests;

The nature of many reorganization exercises is actually similar to the above, but enterprises that are involved in the similar arrangements cannot enjoy the special tax treatment. As stipulated in Article 7(4) of Circular 59, the Ministry of Finance and the State Taxation Administration have the authority to approve other cross-border reorganizations. Is it possible to use this provision to approve special tax treatment applications in other reorganization arrangements? Are there any precedent cases in Guangzhou that we can make reference to?

Special considerations could be given to the following cases:

i. Special tax treatments in relation to cross-border reorganization as mentioned in Circular 59

Article 7(2) of Circular 59 mentions a situation where a non-resident enterprise transfers shares of a resident enterprise to its 100% directly-owned resident enterprise. May we know which type of 100% direct holding relationship is eligible for special tax treatments for reorganization under this provision? Is it (1) a non-resident enterprise to its 100% directly-owned Chinese resident enterprise or/and (2) a Chinese resident enterprise to its 100% directly-owned non-resident enterprise?

GPOSAT: The special tax treatment mentioned in Article 7(2) is applicable to any 100% directly-owned structures. That includes the parent company transforming its subsidiary company from first-tier into second-tier or vice versa.

ii. Special tax treatment application on cross-border merger transactions

If two Chinese resident enterprises, which are held by an overseas non-resident enterprise, merge, is it considered as a cross-border reorganization so that the above conditions are required to be fulfilled before enjoying special tax treatments? If yes, it appears that special tax treatments are not applicable as none of the above conditions has been satisfied. In fact, there will not be any non-equity payments as a result of the merger transaction, especially in the merger of resident enterprises which are controlled by the same non-resident enterprise. Also, there is no inflow of any other economic interest in this merger exercise. It would seem unreasonable that, under these circumstances, CIT would be ascertained and be payable based on the general tax treatment.

GPOSAT: Further clarifications from SAT are needed on this issue.

iii. Issues in relation to non-resident enterprises strike off as a result of cross-border reorganizations

If the overseas parent company is stuck off, the shareholding structure of the domestic company would need to be changed as well. Although this type of situation is not mentioned in Circular 59 as being eligible for tax deferral treatment in a group reorganization, can the tax deferral treatment be applied to this kind of case?

GPOSAT: No.

iv. Issues in relation to where the business nature of the parent company changed

If an overseas parent company of a resident enterprise changes its business nature (e.g. from corporate to partnership), will the change trigger a deemed equity transfer of the resident enterprise?

GPOSAT: There is no clear guideline on this type of case. We need to seek clarification on the tax treatment from SAT

b. Implementations of Caishui [2014] Circular 109 and SAT Public Notice [2015] No. 40

Has the GPOSAT handled any cases in which enterprises are eligible for the special tax treatments under Circular 109 on their equity transfers? Is Circular 109 applicable to multinational companies but not for domestic entities on share transfer between their Chinese resident subsidiaries? Are the parties involved in the transaction required to inform the tax authorities in writing about the arrangements by reference to the requirements of Circular 59? (This does not seem to be a requirement in the Circular)

Hypothetical Case 1: Parent company A (a resident enterprise) transfers the equity of subsidiary company B (a resident enterprise) to its 100% wholly-owned subsidiary C (a resident enterprise), will C be forbidden from transferring equity of B within 12 months? (This does not seem to be a requirement in the Circular)

Furthermore, will A be forbidden to transfer equities of C again within 12 months? If B in the above case is a non-resident enterprise, is Circular 109 still applicable?

GPOSAT: As stated in Article 3 of Caishui [2014] Circular 109 for domestic intra-group equities and asset assignments between resident enterprises which have a 100% direct investment holding relationship, special tax treatment would be applicable as long as the requirements are fulfilled. On the other hand, Circular 109 would apply if the foreign invested enterprises are resident enterprises.

Article 5 of Public Notice 40 stipulates that both parties of the underlying transaction should submit the application of special tax treatment for assets (equity) transfer of the resident enterprise and relevant information (please see below for details) to the respective in-charge tax authorities when filing their CIT annual final settlement returns. Relevant information includes:

1. The description of the transfer arrangement, including the basic information, the transfer proposals, the underlying commercial purposes, etc.;
2. The transfer agreement (contract) arrangement signed by the parties to the transaction, and the relevant approval document if permission is required from the relevant (external and internal) parties;
3. The net asset value and the illustration of the tax calculation basis for the equities and assets being transferred;
4. The statements jointly issued by the transaction parties sharing the value of the transferred equities or assets on a net asset value basis (the corresponding accounting treatment information should be attached);
5. The statements of both parties to the transaction on unrecognized loss or gain in accounting (the corresponding accounting treatment information

should be attached);

6. The commitment letter confirming that the original principal activities of the Transferee Company or assets being transferred will not be changed within 12 months from the date of transfer.

B. Tax treaty benefits and overseas tax credits

1. Resident certificate and resident status confirmation

a. The tax treaty benefits

When a Hong Kong company claims any tax treaty benefits (e.g. preferential tax rate on dividends) under the tax arrangement between Hong Kong and China, the Hong Kong company is obliged to provide the in-charge Chinese tax authorities with a certificate of residence status issued by the Hong Kong Inland Revenue Department (IRD). According to SAT [2016] No. 25, the certificate is valid for 3 calendar years from the date of issue of the certificate. If the identity of the Hong Kong company changes during the stated 3 years, the certificate will become invalid.

We would like to share information regarding a few cases we have come across. For instance, a Hong Kong company applied for the tax treaty benefits from tax authority A in 2015 with its Hong Kong resident certificate for 2015 as a supporting document. The same company applied for similar tax treaty benefits from tax authority B for 2016 and was asked to provide its Hong Kong resident status certificate for 2016 to tax authority B. (It could be because tax authority B did not receive any copy of the certificate that was submitted to A, and authority B indicated that the company had to provide them with the 2016 certificate to substantiate that there was no change in its residence status). Are there any internal guidelines for the tax authorities such that the submission requirements of the residence certificate could be simplified, e.g. requesting the company to fill in a form to declare that there is no change (in these three years) in the residence status from the date of issue of the original certificate?

If the company in Hong Kong is a holding company or a listed company (investment holding is the only business activity of the company), can the investment holding of the company be treated as the actual business of the company? Or can its Hong Kong listing status be treated as the substance for recognizing the listed holding company as a Hong Kong resident company?

GPOSAT: According to SAT [2016] Circular 35, when a Hong Kong company receives its Hong Kong tax resident certificate from IRD in 2015, the certificate can be used as an identity proof from 2015 to 2017. This is an effective means in avoiding duplicate submissions of the certificate to the same tax authority.

Non-resident taxpayers and withholding agents can provide the copies of certificates or information to other tax authorities for proof of identity. However, the authority to which the original certificate was filed should be written on the copy of the certificate. The copy should also be stamped by an officer in-charge of the company. The taxpayer should also advise the tax authority receiving the copy that they may verify with the tax authority holding the original certificate.

A Hong Kong resident status certificate issued by the IRD is regarded as verification of a Hong Kong resident company's identity.

b. Permanent Establishments

For non-resident enterprises that have business operations in China, how would GPOSAT determine whether the operations constitute permanent establishments in China? According to the prevailing tax regulations, income derived by non-resident enterprises outside of China (e.g. Hong Kong) is not taxable for CIT proposes. Would you specifically review the tax status of these non-resident enterprises from the perspective of their residence, permanent establishment or based on transfer pricing?

GPOSAT: They are reviewing possible double non-taxation cases such as above-mentioned cases. Whether tax will be imposed is still dependent on whether their activities would lead to the creation of a permanent establishment in China.

2. CIT credits

a. How should the indirect tax credit be applied to partnerships/ tax transparency entities?

b. Difference in calculating the overseas tax credit in relation to CIT between direct and indirect tax credit set off for partnerships

"The guidelines on overseas tax credit on CIT calculations" provide guidance on how to calculate the direct tax credits and indirect tax credits. The calculation of direct tax credit is covered in the guidelines, including taxes for CIT incurred on overseas business profits, withholding taxes on overseas dividends, interest, rentals, royalties and transfer of assets. Indirect tax credits cover tax credits related to the tax paid on the pre-dividend payment, profit attributable to shareholding by the Chinese entities. However, taxpayers may find the illustrations difficult to comprehend. Could you provide further examples of, for instance, dividend distributions in which the calculation of the direct and/ or indirect tax credit is considered? You may wish to consider an example where a China-incorporated company holds a Cayman/ British Virgin Islands partnership which holds a U.S. limited company (supposedly the CIT rate is 35% /withholding tax rate for dividends is 30%) which in turn owns a U.S. partnership. The in-charge tax authorities may allow credit only for a part of overseas tax payments in the actual situation, e.g. the payments of the overseas withholding taxes. Do you have any comments on the above?

c. The appropriate tax credit for partnership

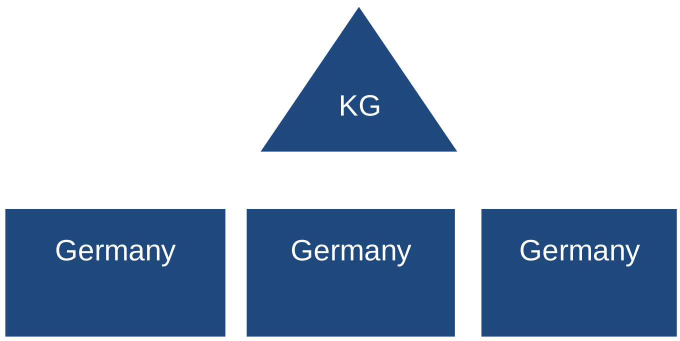
When a Chinese partnership has overseas investments, is the underlying tax credit computed based on the entity or the number of partners? (We think that the latter should be used as the partnership is not a tax paying unit).

d. The appropriate tax credit for an overseas partnership

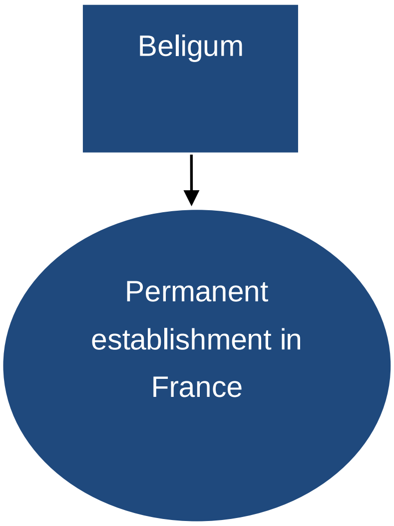
Should the overseas partnership/tax transparent entities be deemed as a separate tier in calculating overseas indirect tax credit with reference of the "three-tier" scheme?

Similarly, will the partnership or the consolidated tax group/ tax entity or permanent establishment be deemed as a tier or having multiple tiers? The current prevailing laws and regulations are not clear on this issue. It is understood that the new regulations on foreign tax credits will soon be released; will the provisions on indirect tax credits, which are currently limited to three tiers of overseas subsidiaries, be relaxed?

Case 1: A German group company uses KG structure for consolidated tax filing basis (Note: KG-Kommanditgesellschaft is the German name for a limited partnership and is used in the German, Austrian and some other European legal systems).



Case 2: A Belgian company has a permanent establishment in France. Will the permanent establishment in France be considered as a tier? In this case, the permanent establishment is not an independent legal entity and is unlikely to distribute dividends to its parent company.



e. Consolidated tax filing

In many overseas jurisdictions, different group companies may be allowed to file their consolidated tax returns under foreign tax rules. For example, Chinese Company controls Hong Kong Co. 1 which controls Hong Kong Co. 2 that owns U.S. C-corp. which finally holds U.S. LLC. As U.S. LLC is a transparent entity in U.S., its revenue and expenditure will be consolidated into the business of U.S. C-corp for the purposes of tax filing; only one single tax payment receipt will be received after the payment. Will U.S. LLC be deemed as a tier-four entity or a tier-three company, i.e. combining U.S. C-corp. and U.S. LLC?

GPOSAT: The tax bureau needs to further study the issues before coming to a conclusion.

3. Chinese resident enterprises and foreign-controlled enterprises

It is common for a Chinese enterprise to set up a holding company in Hong Kong as an overseas investment platform. What is the risk of the Hong Kong company being considered a Chinese resident enterprise and/ or a foreign-controlled enterprise? Also, the in-charge tax authorities seldom approve applications for Chinese resident enterprise status certificates (especially when taxpayers take the initiative to apply for China resident status) and foreign-controlled enterprises. Could you explain the actual situation and advise the proper ways to deal with the tax risk and planning (especially for Chinese enterprises that set up companies in Hong Kong)?

In respect of foreign-controlled enterprises, what are your focus areas for review?

GPOSAT: The tax bureau will pay attention to the above situation, but this does not mean that the tax authority will have any special tax treatment on the above.

4. Reimbursement of expenses paid by overseas enterprises

The Guidance for Foreign Exchange Management for Service Trade of Detailed Implementation Rules ("IDR") (SAFE [2013] Circular 30) states in Article 6(9) that domestic enterprises can apply to "reimbursement of expenses and cost sharing with domestic or foreign related companies." Also, SAT/SAFE Announcement of Issues concerning "Taxation Recording for Foreign Payments under Service Trade and Other Items" (SAT/SAFE [2013] Circular 40) expresses in Article 3 that domestic enterprises or individuals are not required to maintain(?) tax records and submit the Record Form when attributing following foreign exchange funds payments: (1) travel, conference, product exhibition, and other expenses incurred overseas by domestic enterprises, (2) office expenses incurred by the overseas representative offices of domestic enterprises, and project payments for projects contracted overseas by domestic enterprises. However, there are practical difficulties when enterprises are implementing above rules. Could the tax bureau advise us the procedures for domestic enterprises to reimburse overseas related companies for the expenses paid on their behalf? Are there any specific rules explaining the types of reimbursable expenses such as wages or travelling expenses? Does the tax bureau have unified internal processes when handling advanced expenses incurred by taxpayers; and what supporting documents that the taxpayers are required to submit?

GPOSAT: The requirements for reimbursement for overseas expenses are dealt with in Circular 40. The tax authorities do not have any additional requirements for making reimbursement payments to overseas related companies.

If third party receipts can be provided to prove that the reimbursement is indeed only dollar to dollar matching, would the tax bureau agree the overseas related company should be exempt from paying Chinese tax on this reimbursement of expenses?

GPOSAT: Taxpayers can submit relevant proofs and information to the tax bureau and the tax bureau will determine if the overseas related company should be exempt on the transaction, based on the information provided.

C. Value-added taxes ("VAT")

1. VAT liabilities on permanent representative offices of foreign enterprises

Representative offices of foreign enterprises are subject to CIT based on their operating expenses. How would VAT be imposed on them? Currently the in-charge tax authorities of some provinces and cities are inclined to impose VAT based on deemed income. However, the concerned taxpayers do not actually provide any of the services mentioned in Circular 36. How should the VAT liability be quantified, having regard to the service types, tax rates, tax credits, and general or small-scale taxpayers? A handful of representative offices are treated as the small-scale taxpayers who pay tax at 3%, while others pay tax at 6% as general taxpayers, without taking tax credit into account. Will you issue a guideline in this respect?

GPOSAT: Representative offices of foreign enterprises are taxpayers in China. Whether a representative office needs to pay VAT will be determined by reference to its business model. If the business engages in taxable activities within the scope of VAT, it will be liable for VAT. Unlike business tax, those paying CIT are not necessarily subject to VAT. The tax bureau has not yet issued any VAT-related documents similar to the provisional measures for the administration of tax collection on representative offices of foreign enterprises (Guoshuifa [2010] Circular 18). The tax bureau has consulted SAT but no responses has been received as yet. There is no legal basis for imposing VAT on representative offices on a basis similar to the previous business tax calculation.

2. VAT implications on cross-border activities offer business tax to value-added tax ("B2V") reform

a. Circular 36

Circular 36 stipulates that VAT liability arises when either the service seller or buyer, is located in the Mainland China. This is a typical people oriented tax administration basis. There are two special but ambiguous regulations on cross-border activities, namely:

- Appendix 1 stipulates that if foreign entities or individuals provide services that are performed completely outside China to domestic entities or individuals, the former parties are not subject to VAT. How would you interpret services that are performed outside China? This was originally defined in Circular 106 as services that are consumed completely overseas. What is the difference between "performed", as stated in the new regulation, and "consumed" in Circular 106? How should we infer these requirements in real life situations?

b. Article 1 of SAT Public Notice [2016] No. 53

Article 1 of SAT Public Notice [2016] No. 53 stipulates that the following activities are not treated as provision of services nor sales of intangible assets in China by overseas entities or individuals:

- Postal, collections and delivery services provided for outbound mails and parcels
- Construction and project supervision services performed on overseas construction sites where domestic entities or individuals are located
- Engineering reconnaissance and exploration services provided for overseas mineral resources where domestic entities or individuals are engaged

- Conference and exhibition services provided for overseas conferences and exhibitions where domestic entities or individuals are engaged

Since the above four activities are not subject to VAT, does it mean that foreign entities or individuals providing domestic entities or individuals with other relevant services would be liable to pay VAT on the services provided?

In addition, Appendix 4 stipulates that where domestic entities or individuals provide foreign entities or individuals with services that are consumed completely overseas, VAT is exempted. Consumption occurring completely overseas means the service recipients have to be located outside of China and there is no association with any commodities and immovable properties within China. How should the phrase "no relation to domestic commodities and immovable properties" be interpreted?

GPOSAT: In response to question (a), there is no difference between the terms "performed" and "consumed". The tax bureau will consider the nature of services, whether the services occurred in China and whether the services are related to domestic immovable properties to determine if the concerned entities are subject to VAT.

3. Issues on import VAT credits

Recently, many enterprises have reported that their import VAT tax credits have been taken by other companies. As the system only acknowledges the underlying codes rather than the taxpayer names, the codes could easily be sold for illegal purposes. Under the circumstances, should the affected taxpayers inform the in-charge tax authorities of the details of the individual cases, letting the in-charge authorities to investigate the cases with the relevant tax authorities, and to deal with the parties that obtained tax credits? The number of such cases has been increasing significantly; hence, it is advisable for the tax authorities to give more attention to this issue in order to assist taxpayers to file their tax returns correctly.

GPOSAT: The tax bureau has noted the issue since 2015 and the significant increase of relevant cases; however, they have not announced any concrete solutions to this issue yet. The taxpayers are advised to report the cases to the in-charge tax authorities immediately.

4. Inquiries on whether VAT should be imposed for transfer of shares listed in National Equities Exchange and Quotations ("NEEQ")

Public Notice 53 issued in late August 2016 stipulates that publicly traded shares are within the scope of VAT, and lays down rules for determining the purchase prices of three restricted share types. However, the Public Notice does not clarify whether transfers of shares listed in NEEQ should be subject to VAT and how tax should be levied. There are two schools of thoughts. Some people consider profit from trading of shares listed in NEEQ should be subject to VAT as the underlying shares, it could be argued, are publicly traded, even though there are differences between NEEQ and the main board. Others consider that the trading gains should be non-taxable as the entities listed in NEEQ are not listed companies under the definition of the relevant regulations issued by China Securities Regulatory Commission on provisional measures for the administration of NEEQ. Local tax authorities are reluctant to give a direct answer to this question. What is your opinion on the above?

GPOSAT: The tax authorities do not have any specific regulations on this matter. According to the relevant requirements, VAT is imposed on the differences of the purchase and the sales prices of the underlying shares in the public stock market. The tax bureau believed that the shares in NEEQ are akin to those in the public stock market, thus the shares should be taxable. The tax bureau also hopes that SAT could further elaborate the taxing rules on this.

5. VAT issues on centralized purchasing

Centralized procurement by a group company, e.g. purchase of materials, assets or services, is an effective means for overall cost reduction for the group. Under a group procurement arrangement, a group company signs a procurement agreement with the suppliers and shares its purchased materials, assets and services with other group companies. For example, a bank acquires a membership of an inter-organization lending platform, a securities company pays transaction fees for its various group companies, and a group company purchases the right to use software, etc.

GPOSAT: The tax bureau thinks that if a group of companies adopts centralized procurement, the corresponding invoices should be issued to the concerned subsidiaries in charge of the centralized procurement to balance the input and output VAT.

As the suppliers may have strong bargaining power in the market, they can request an entity of a group of companies to sign a supply agreement and the VAT invoices will be issued to this group entity. The purchased assets/ services are in fact used by different group companies, thus the procurement cost will be shared among the group companies according to the underlying benefits they receive from an accounting perspective. Could the group company which is responsible for the group procurement issue VAT invoices to other group companies based on their allocated procurement expenses? Will there be any risk that the above group company could be accused of issuing fake VAT invoices?

GPOSAT: VAT and related invoices are managed by local tax bureaus. We do not consider that the group company in charge of group procurement would be issuing fake VAT invoices in the above example.

6. **Issue on tax paying entities (VAT implications for foreign enterprises having permanent establishment in China)**

As a result of sending its staff to China to provide services to related/ unrelated clients, a non-resident enterprise may have established a permanent establishment in China. Should the non-resident enterprise pay VAT for the income it derives from services provided in China (i.e. because the non-resident enterprise is considered a domestic service provider)?

> GPOSAT: The permanent establishment concept is not relevant to VAT; instead, the locality of service matters. When a foreign entity or an individual performs taxable business activities in China and it does not have a place of business in China, the service purchaser should be the VAT withholding agent.

7. **Are dividends from fund or wealth products (i.e. non-fixed income) taxable items for VAT?**

> GPOSAT: Fixed income received by an investor is considered as interests on loans and is subject to VAT in the hands of the recipient. However, variable income, such as dividends on funds or other financial products, should be excluded from the charge for VAT.

D. <u>Taxation of financial business</u>

1. **Tax implications on non-performing loan/non-performing asset acquisition**

a. VAT Issues

i. According to the latest trial implementation rules of B2V pilot scheme, taxpayers are liable to pay VAT on income derived from trading of financial products. We understand that financial products include transfer of foreign exchange, securities, non-commodities futures and other financial products on equities. Transfer of other financial products includes transfer of funds, trusts, wealth products, and all kinds of asset management products and various financial derivatives. Non-performing loans/ non-performing assets are not included in the definition. Does it mean that transfer of non-performing loans/ non-performing assets is not subject to VAT?

ii. Having acquired non-performing loans/ assets, taxpayers may dispose of them at a price higher than the acquisition costs but below their carrying amounts. Will the underlying profit be treated as interest on loans and be subject to VAT?

iii. In case an enterprise transfers its shares through NEEQ, will it be defined as a transfer of financial products and be subject to VAT?

b. CIT issues

An enterprise acquires a portfolio of non-performing loans/ assets. From a CIT calculation perspective, should the enterprise assign the investment costs to each of the non-performing loans and calculate the profit of each disposal in the years concerned? Alternatively, could the underlying profit be taxed in a year in which the total disposal value of the portfolio was higher than its total original cost?

GPOSAT: There are no designated rules dealing with non-performing assets as a separate type under the current law.

2. Transfer of financial products

VAT issues on cross-border financial products transfers

VAT regulations on cross-border transfer of financial products in Caishui [2016] (Circular 36) stated:

- Transfer of financial products includes transfer of foreign exchange, securities, non-commodities futures and ownership of other financial products
- Transfer of other financial products includes funds, trusts, wealth products, all types of asset management products and various financial derivatives
- The transfer revenue of the financial products is the net balance between the selling price and purchase price
- Where there is profit or loss on the transfers of financial products, the revenue should be the net balance after offsetting profit or loss. If a loss results after offsetting, it can be carried forward to profit in the subsequent tax filing. However, an unrealized loss on the year-end revaluations cannot be carried forward to the next fiscal year.
- The purchase prices can be calculated based on weighted average method or moving weighted average method; however, once the computation method has been selected, such method shall not be changed within the following 36 months.

When overseas enterprises and domestic enterprises sign contracts, are the provisions of Circular 36 applicable? Should the domestic enterprise withhold and remit the tax after offsetting the loss against profit in the same tax filing period? Should the losses be carried forward to subsequent tax filing period? It is indeed difficult to implement the requirements in actual situations. Can the same treatment be given to both domestic and overseas enterprises?

GPOSAT: The tax bureau does not understand the difficulties in practice as the tax should be withheld and remitted by domestic enterprises.

3. VAT for interest receivables by non-financial enterprises

For the financial companies that are not mentioned in Caishui [2016] Circular 36 (e.g. insurance companies), in case they derive interest from receivables, should they pay VAT during the contract period or when interest is received?

We understand that the interest income computed in accordance with the relevant contract is subject to VAT. When income is accrued, the income is also subject to VAT even if the amount is due over 90 days or above.

Caishui [2003] Circular 16 stipulates that where an insurance company has paid business tax on its premium receivable, the receivable can be deducted from its business revenue if it is not received during the accounting period.

GPOSAT: The view of the tax bureau is consistent with the Institute.

4. Deemed sales of capital non-interest bearing loan and VAT implications for bank wealth products

There is a deemed sales concept in the VAT legislation. For example, where a group company with excess cash provides other group companies with interest-free short-term loans, would this lending activity be treated as deemed sales and therefore subject to VAT? If yes, what are the prevailing policies or implementation guidelines on the deemed interest income (including frequency, period, interest rate, etc.)? Besides, how should the nature of loans and deposits be differentiated from the perspective of deriving guaranteed/ fixed incomes on financial products? What should be the VAT treatments?

GPOSAT: The guaranteed/ fixed incomes on financial products should be treated as interest on loans and subject to VAT.

E. <u>Integrated question</u>

1. Compliance guidance

Will Guangdong Province follow Jiangsu and Zhejiang issuing international tax compliance guidance for the taxpayer's reference?

GPOSAT: The tax bureau will consider issuing the guidance, and it will be included in their work plan as well. However, the focus should be on BEPS. Taxpayers may wish to refer to other documents issued by other provincial tax bureaus; the contents of these documents should be similar.