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

2015

This is the brief translation of the Chinese version of the report for members' reference. In the event of any inconsistencies between this translation and the Chinese version of the report, members should refer to the original Chinese version of the report. The Institute is not responsible for the accuracy of this translation.

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Preface

The Hong Kong Institute of Certified Public Accountants ("HKICPA" or the Institute) was pleased to hold a meeting with the Guangdong Provincial Office, SAT ("GPOSAT") on 11th December 2015 to discuss various tax issues relevant to Guangzhou.

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

If there are any differences in the interpretation between the English and Chinese versions, reference should be made to the Chinese version. It should also be noted that the Mainland tax authorities have issued a number of new circulars since the meeting took place. Members may therefore wish to refer to the websites of the relevant tax authorities for the most updated tax circulars.

HKICPA would like to thank to Ernst & Young for arranging for notes to be taken of the meeting.

Meeting notes

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Attendance

GPOSAT

Wen Chunhong	Deputy Director, Department of International Tax Management
Liu Li	Deputy Director, Department of International Tax Management
Liang Jingru	Deputy Director, Department of Commodity and Service Tax
Yang Peiling	Associate Consultant, Department of Income Tax
Chen Hui	Principal Staff Member, Department of Income Tax
Zhuang Bo	Principal Staff Member, Department of International Tax Management
Huang Rui	Principal Staff Member, Department of International Tax Management
Lin Min	Principal Staff Member, Department of International Tax Management
Deng Ke	Principal Staff Member, Department of International Tax Management
Chen Weidi	Staff Member, Department of Commodity and Service Tax

HKIPCA

Anthony Tam	Deputy Chair, Taxation Faculty Executive Committee and Convener, Mainland Taxation Subcommittee
Ho Sing Mak	Member, Mainland Taxation Subcommittee
Shanice Siu	Member, Mainland Taxation Subcommittee
Raymond Chan	Director, Tax, PricewaterhouseCoopers China
Jessica Li	Manager, International Tax Service, Ernst & Young
Wallace Wong	Manager, Advocacy and Practice Development

Discussions

A. Value Added Tax ("VAT") reform

VAT reform is yet to be implemented in a number of industries, such as financial services and insurance, construction and installation, hotel and other consumer businesses.

1. Implementation timeline

What is the implementation timeline for VAT reform in relation to the above-mentioned industries?

> GPOSAT: It is our understanding that the relevant policies and regulations regarding VAT reform for the above-mentioned industries are still being formulated. They will be submitted to the State Council for approval after completion. The government originally planned to implement VAT reform in these industries in 2015, but implementation was suspended for various reasons. The State Administration of Taxation ("SAT") has included implementation of VAT reform covering all industries yet to be covered, in its 2016 work plan. Therefore, VAT reform in the above-mentioned industries should be take effect in 2016.

2. Preparation time for enterprises

How long will enterprises be allowed to prepare for the changes after release of the policies?

> GPOSAT: It is our understanding that the SAT will allow sufficient time for enterprises to prepare for the changes after the policies have been announced.

3. Preferential policies on VAT reform

If an enterprise's tax burden increases significantly as a result of implementation of the VAT reform, will there be any preferential policies for them? The VAT reform may significantly impact companies in some industries, especially for companies in the real estate and finance industries. For example, interest paid by companies in the finance industry may not be recognized for input VAT credit purposes.

Business Tax ("BT") is levied on certain industries on a "net basis". If an enterprise still has deductible costs for BT purposes on its account when VAT is implemented, what treatment will be given to such deductible costs?

GPOSAT: Some special supporting policies will be introduced for industries facing an increased tax burden as a result of the implementation of VAT reform. In the Guangdong Province, there are more than 400,000 new VAT payers as a result of the implementation of VAT reform. Based on the statistical information that we have on hand, the tax burden of 98% of the new VAT payers will remain the same or decrease slightly. Hence, only 2% of the new VAT payers have an increased tax burden. Therefore, taxpayers in the above-mentioned industries need not worry too much about the increase in tax burden when VAT reform is fully rolled out. For industries where BT is levied on a "net basis", if an enterprise still has deductible costs in its account after VAT has been implemented, such costs will not be allowed to be deducted after. However, taxpayers may apply for tax refund at the competent local taxation bureau.

4. Policies for projects in progress/on sale

What kind of policies will be applied to projects in progress/on sale in the real estate industry? Will the input VAT on land cost be deductible? Will there be any transitional policies for projects in progress/on sale?

GPOSAT: As regards the VAT reform in the real estate industry, there will be transitional policies for projects in progress/on sale. There is no further details are available for the time being.

B. Non-resident tax issues

1. Indirect transfer of shares

According to Announcement 7, withholding agents will be liable for penalties if they fail to withhold tax on indirect transfers of Chinese taxable assets by foreign non-resident enterprises. The liability, however, may be reduced or waived if the withholding agent submits documentation in respect of the share transfer within 30 days after signing of the share transfer agreement according to Article 9 of Announcement 7.

Besides, by virtue of Article 7 of SAT Notice on the Implementation Rules (Trial) for Enterprise Income Tax on Indirect Transfer of Assets by Non-Resident Enterprises (Shuizongfa [2015] No. 68) ("Circular 68"), the competent tax authority should prepare a report for record keeping purposes if it concludes, after analysis and verification, that a transfer is not a direct transfer of assets of Chinese resident enterprises.

According to Circular 68, if tax authorities conclude after their review that a transaction does not involve any direct transfer of shares and other assets of Chinese resident enterprises, they just need to keep the information for internal records.

We would like to clarify if the seller, as the withholding agent, considers that there is no direct transfer of assets of Chinese enterprises, or the safe harbour rules apply in an indirect transfer transaction and the seller reports the indirect transfer transaction as per the requirement of Announcement 7, will the tax authority inform the seller of the result of their analysis within a prescribed timeline.

GPOSAT: According to Article 7 of Circular 68, the competent tax authority should prepare a report for record keeping purposes. If it concludes, after analysis and verification, that the transfer is not a direct transfer of assets of Chinese resident enterprises. If the related tax authority considers that the relevant indirect transfer transaction does not involve direct transfer of assets of Chinese resident enterprises or is in compliance with safe harbour conditions, the related tax authority will not inform the withholding agent of the results in writing. If the related tax authority believes that an investigation is needed after reviewing the transaction, the related tax authority will submit the case to SAT for investigation accordingly.

2. Public Announcement 7 ("Announcement 7")

According to Article 6 of Announcement 7, in indirect transfers of shares, Chinese taxable assets satisfying all of the following conditions will be deemed to have bona fide commercial reasons for the transfers (i.e., will meet the safe harbour conditions):

(1) The shareholding relationship between the parties of the transaction satisfies one of the following criteria:

1. The transferor directly or indirectly owns 80% or more of the shares of the transferee;
2. The transferee directly or indirectly owns 80% or more of the shares of the transferor; or
3. 80% or more of the shares of the transferor and transferee are directly or indirectly owned by the same one or more parties.

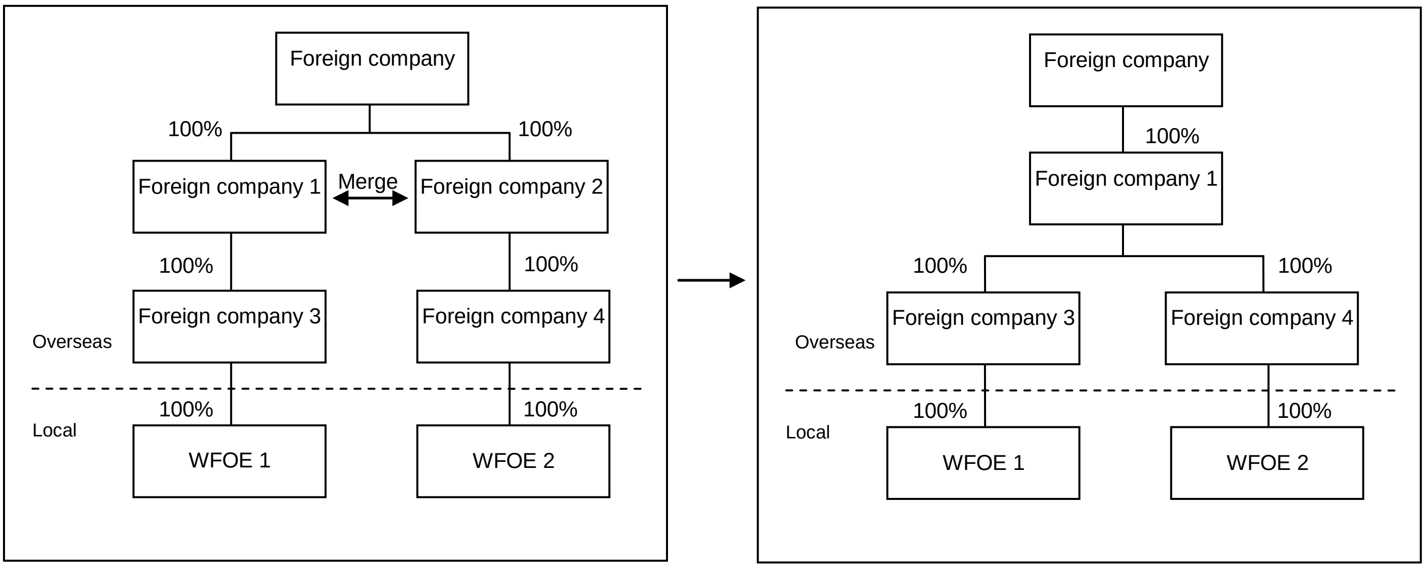
If more than 50% (i.e., not including 50%) of the value of the non-resident enterprises is directly or indirectly made up of immovable properties located in China, the shareholding percentage requirement stated above will be revised upwards to 100%.

(2) When compared with the situation where the group restructuring had not occurred, the burden of corporate income tax in China on any subsequent indirect transfer would not be decreased.

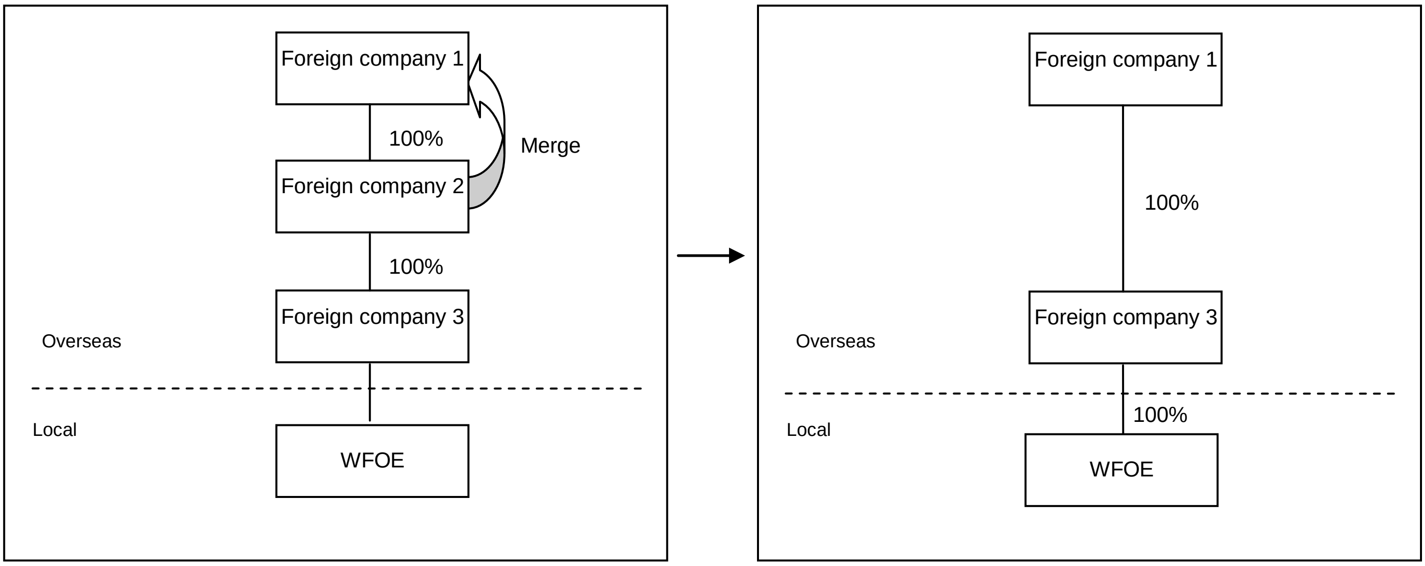
(3) All the consideration paid by the transferee in respect of the share transfer must consist of its own shares, or shares of a related enterprise(s) in which the transferee has a controlling interest (however the equities of listed company cannot be used).

Are the safe harbour conditions in Announcement 7 applicable to the following group internal reorganizations (where companies involved in such reorganizations are all 100% owned by the group and no cash transactions take place)?

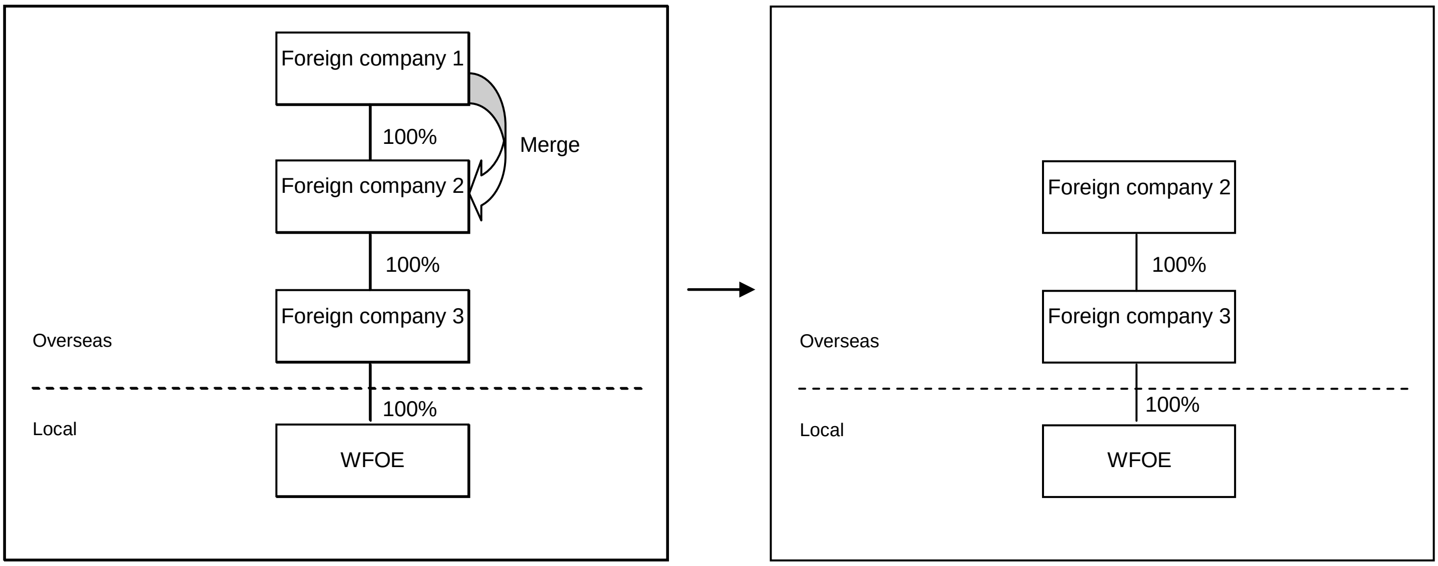
- Merger of two related fellow subsidiary companies which are 100% controlled by the same party(-ies), and these fellow subsidiary companies each hold a wholly foreign-owned enterprise ("WFOE") in China as shown in the following diagrams:



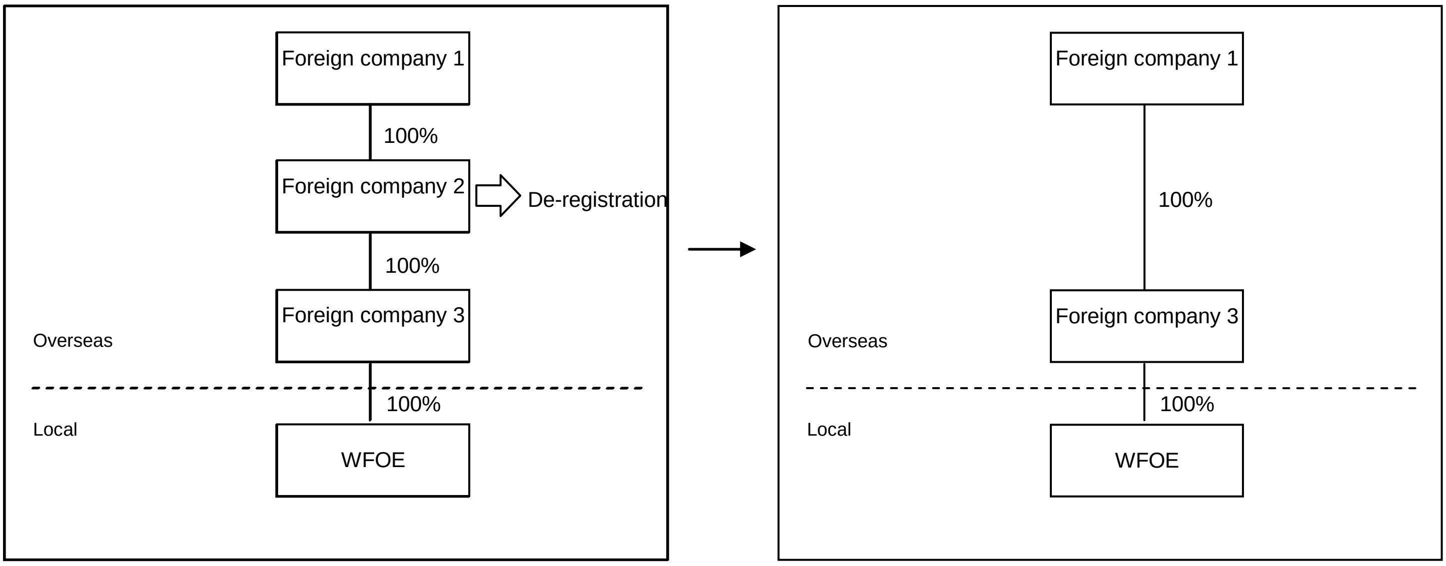
- Vertical merger between a parent company and its 100% owned subsidiary, where the parent company takes over assets of the subsidiary (and the subsidiary is de-registered) as shown in the following diagrams:



- Vertical merger between a parent company and its 100% owned subsidiary where the subsidiary takes over assets of the parent company (and the parent company is de-registered) as shown in the following diagrams:



- De-registration of the overseas holding company as shown in the following diagrams:



GPOSAT: As stipulated in the safe harbour conditions in Announcement 7, a transaction will be deemed to have a bona fide commercial purpose only if all the above three conditions are satisfied. The above examples all concern the reorganization of enterprises within the same group. Shares are not used as consideration in the above transactions and it is not clear whether the tax burdens of the group in China would be reduced in subsequent transfer transactions, if any. Therefore, these four scenarios do not fulfil all the safe harbour conditions. Hence, it would not matter even if we were to assume that the transactions satisfied condition (1) of the safe harbour conditions.

3. Administration Measures on the tax treaty treatment for Non-resident taxpayers ("Announcement 60")

(a) Penalties for withholding agents

By virtue of Announcement 60, non-resident taxpayers and withholding agents are no longer required to go through the pre-approval and pre-registration procedures before applying the tax treaty provisions in tax filing. They will only need to do a self assessment on their eligibility on the tax treaty benefits. If, however, the tax authorities subsequently disagree with the self-assessment result and demand additional tax payments, will the tax authorities impose penalties on the withholding agents?

GPOSAT: Under Announcement 60, a non-resident taxpayer should conduct a self assessment on his tax obligations and the withholding agent should withhold taxes according to the self assessment result. Should the tax authorities subsequently disagree with the self assessment and the withholding agent fully co-operate with the tax authorities on the follow up investigation and tax management, no penalty will be levied on the withholding agent.

(b) Implementation timeline of Announcement 60

What is the implementation timeline of Announcement 60 in Guangzhou? In addition, for service fee payments to non-resident persons, is it necessary for the non-resident enterprise taxpayers to complete "Non-resident self assessment on tax treaty benefit entitlement report" (Enterprise Income Tax Form B, i.e., tax form for tax treaty benefit status declaration for permanent establishment and; business profits) on each payment?

GPOSAT: Announcement 60 was implemented on 1st November 2015. For service fee payments to non-resident persons, the non-resident person is not required to make the declaration to the same tax authority for three calendar years from the submission date of the declaration report and supporting information, on the condition that the non-resident fulfilled the conditions for tax treaty benefits when the declaration was first made and there is no change in the circumstance in the said three years.

4. Reporting deadline and documentation requirements

Announcement 72 – The Special Reorganization Tax Treatment of Share Transfers by a Non-resident Enterprise (“Announcement 72”) and Announcement 48 – Issues Relating to the Collection and Administration of Enterprise Income Tax on Enterprise Reorganizations (“Announcement 48”) issued by the SAT in 2013 and 2015, respectively are both related to the election for special tax treatment on group restructuring. Though both Announcements set out the deadline for reporting the special tax treatment election, there are slight differences in the requirements under the two Announcements. Under Announcement 72, non-resident enterprises electing for special reorganization tax treatment for share transfers should report their application within 30 days of the effective date of the relevant share transfer contract or agreement and completion of change in the PRC business registration. However, Announcement 48 requires the parties involved in the reorganization to submit relevant documents, together with the annual enterprise income tax return submission, in the year of completion of thereorganization.

In addition, there is a slight difference in the supporting documents required for tax filing under the two Announcements. For example, taxpayers are required under Announcement 72 to submit "the historical retained profit position of the transferee company up till the date of transfer". However, there is no such a requirement under Announcement 48.

Since Announcement 72 is a specific document issued in respect of the “non-resident enterprises electing for special reorganization tax treatment for share transfers”, while Announcement 48 is for enterprises electing for special tax treatment for enterprise reorganizations, in practice, will the tax authorities issue guidance to standardize the reporting deadlines and documentation requirements for non-resident enterprises that elect for special reorganization tax treatment for share transfers?

GPOSAT: Non-resident enterprises that elect for special reorganization tax treatment for share transfers follow the requirements in Announcement 72 for reporting the case and submitting the required supporting documents.

5. Beneficial owners

Regarding the article of capital gains set out in tax treaties, will the tax authorities consider whether the residents of the other contracting state are “beneficial owners”? Will the tax authorities reject the tax treaty benefit application of residents of the other contracting state that do not have business operations? We are not aware of such provision in the tax treaties or enterprise income tax law and regulations. However, in practice, tax authorities in some districts reject applications for tax treaty benefits on the above-mentioned grounds. Does this mean that the Chinese tax authorities mayapply the general anti-avoidance rules to reject the residence status of enterprises in the other contracting state if necessary?

GPOSAT: Tax treaties normally contain provisions preventing treaty abuse. The tax authorities will apply the relevant treaty provisions to reject treaty applicants' residence status in the other contracting state, if necessary.

6. Red chip enterprise moves their listing status back to the China markets

Red-chip enterprises which are preparing to list in the China market will first buy back their shares in the relevant overseas market. They will first price the share, then obtain approvals and make an offer to buy back the shares according to the local listing rules and regulations.

(a) Safe harbour rules

Overseas investors may have acquired shares when the enterprises were first listed in the initial public offering and disposed of the shares when the relevant enterprises changed their listing location. Is the safe harbour rule –regarding “acquiring and selling on a public market” under Announcement 7 applicable to these situations?

GPOSAT: The safe harbour rules under Announcement 7 are applicable only to non-resident enterprises that derived income from indirect transfers of Chinese taxable assets, by buying and selling the shares in an enterprise listed in the overseas market. The key factor to determine whether the relevant transactions satisfy the safe harbour rules is whether the counterparties and share prices are free from manipulation.

(b) Withholding obligations

If the relevant safe harbour rules are not applicable (e.g., because all of the arrangements including pricing, are pre-determined), will the red chip enterprises need to withhold tax and submit the relevant documents in relation to the transactions? In practice, the red chip enterprises would not be able to obtain the original share acquisition cost of each investor in order to calculate the withholding tax amount.

GPOSAT: As the return of red chip enterprises to the China market is still a new development in the taxation field, there is no precedent case in this area. The tax authorities will conduct detailed analysis on a case-by case-basis. If the tax authorities are of the view that the gains on disposal are taxable, the returning enterprises should withhold tax from the original shareholders.

7. Tax credits

There is an increasing number of Chinese enterprises making foreign direct investments (FDI). They have encountered practical difficulties in applying the income tax paid by the overseas group entities for tax credits set off in their enterprise income tax filing. For example, where an overseas branch office has filed an income tax return in the overseas jurisdiction and receives a tax payment demand note few months afterwards, , the Chinese enterprise may already have filed its enterprise income tax final settlement return for the same tax year. How would the tax authority handle such foreign tax credit applications? Should the enterprises pay tax in China first and apply for tax refund afterwards?

GPOSAT: According to SAT Announcement [2010] No. 1, enterprises should submit the tax payment receipts or tax payment certificates related to foreign profits to their competent tax authorities when applying for foreign income tax credits. If a Chinese enterprise receives the foreign tax payment certificate after the enterprise income tax final settlement filing due date, the enterprise can submit revised tax computation and apply for tax refund within three years after the original enterprise income tax final settlement filing due date. However, if transfer pricing adjustments on Chinese enterprises are involved, the relevant tax refund should be subject to the approval by the Chinese tax authority.

C. Transfer pricing

1. Implementation Measures for Special Tax Adjustment (Draft for Public Consultation) (the "Draft")

Article 50 under Chapter 5 of the Draft states that “this regulation does not apply to transactions carried out between related parties within China”.

Does it mean that tax authorities pay less attention to transactions between related parties within China? However, there could be tax rate differences between related parties within China, such as the tax rate difference between high and new technology enterprises and general enterprises. If transfer pricing arrangements between enterprises within China are not justifiable, what would be the legal authority for the tax authorities in conducting investigations and putting through adjustments?

GPOSAT: If the tax burdens of the related parties within China are the same, the provisions of the Draft are not applicable. If the transfer pricing arrangements between related parties within China result in less tax revenue being collected overall by the treasury (e.g., due to tax rate differences), the tax authority in the place where the entity with higher tax rate is located has the right to initiate tax investigations and put through transfer pricing adjustments, if necessary.

This issue will be discussed again in the second round of the discussion meeting on the Draft. Although cross border related party transactions are the focus of the tax authorities, the tax authorities will also watch out for transfer pricing issues between related parties within China.

2. Enforcement date of special tax adjustment

The enforcement date of the revised regulations has not been specified in the Draft. If the regulation is officially issued in late 2015 or early 2016, will related party transactions in 2015 be within the scope of the revised regulations, on a retrospective basis?

GPOSAT: Enforcement of the revised regulations will follow the general principle that "follow the old rules if the subject matter is in relation to substantive tax issues; and follow the new rules if the subject matter is in relation to procedural matters". As Implementation Measures for Special Tax Adjustments are regarded as laws on procedures, the revised regulations will apply to related party transactions conducted over the previous ten years, once they come into force.