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

2013

Preface

The Hong Kong Institute of Certified Public Accountants ("HKICPA") was pleased to be able to discuss with the Guangdong Provincial Office of the State Administration of Taxation ("GDOSAT") various tax topics on 11th November 2013 in Guangzhou.

The following is a translation of the meeting notes prepared, in Chinese, by the Institute. Please note that the meeting notes reflect the views of GDOSAT officals attending the meeting only and are not intended to be legally-binding or a definitive interpretation. Professional advice should be sought before applying the content of these notes to your particular situation. If there are differences in the interpretation between the English and Chinese versions, reference should be made to the Chinese version.

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Participants

GDOSAT

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Discussion items

A. Issues relating to VAT reform

A1. Application of VAT on the Tourism Industry

(a) Release timing of specific regulations and implementation rules

When will the detailed implementation rules of VAT, as well as the VAT rates, for the tourism industry be released?

(b) Preparation period

Based on the current VAT pilot experience, how long will the preparation period be from the announcement date of regulation to the implementation date?

(c) Seeking the opinion of parties and organizations in the affected industries?

Prior to implementation of the rules, will tax authorities seek any feedback and opinion from the tourism industry, tourism association or relevant agents?

(d) Tax declaration issues

Will the branches declare VAT on separate basis or on consolidated basis, i.e. consolidated filing with head office?

(e) Tax rate issues

After VAT reform, in the event that the VAT rate is higher than the current applicable BT rate, the taxpayer may not have sufficient input tax credit. In order to remain competitive in the tourism industry, taxpayers may need to bear the additional VAT burden. Under such circumstances, will tax authorities consider to grant favorable VAT rates to tourism industry?

(f) Input tax credit issues

For ticket agencies, will the cost of the tickets be allowed as input VAT credit?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting.

Updated reply of GDOSAT: According to the National "12th Five-Year" Plan, all industries subject to BT would be required to transition to VAT in "12th Five-Year" Plan period. To date, the transportation industry, part of modern service industry and the postal service industry transitioned to VAT. Other industries such as the telecommunications industry, might go through VAT reform in 2014.

Prior to implementation, the tax authorities below provincial level would conduct industry investigations and research on affected industries, arrange relevant trainings, handle queries from taxpayers and report the findings and recommendations to higher level tax authorities.

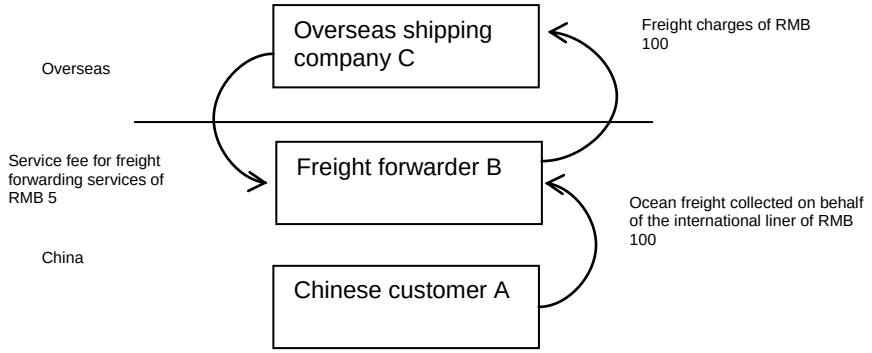
Generally speaking, VAT reform would reduce tax for taxpayers. Based on the current implementation, 97.44% of the taxpayers in the pilot industry reported a reduction in their tax costs; while a minority reported an increase in taxes. For taxpayers with an increased tax burden, GDOSAT was of the opinion that tax

costs would be reduced gradually as more and more industries transition to VAT and the VAT chain was improved.

A2. Issues relating to Caishui [2013] No. 37

I. Effects on international freight forwarding industry

On 24 May 2013, the Ministry of Finance ("MOF") and the State Administration of Taxation ("SAT") jointly issued Circular Caishui [2013] 37 ("Circular 37") setting out new regulations to implement the nationwide expansion of China's VAT pilot program on 1 August 2013. Circular 37 also replaces previous circulars relating to the pilot Business Tax to VAT reform program.



The above is a common business model for international freight forwarders. Chinese customer A engages an overseas shipping company C to provide international freight services through freight forwarder B. For example, Customer A will pay freight charges of RMB 100 to freight forwarder B, who will in turn pay the same amount to shipping company C. As the freight forwarder B has provided services (loading of goods, issuing bill of laden, collection of freight etc) for shipping company C, C will pay RMB 5 to B as a service fee for international freight forwarding services.

(a) VAT treatment on ocean freight charges collected on behalf of the international liner?

How should the ocean freight charges of RMB 100 received by B be treated for VAT purposes?

According to Cai Shui [2011] No. 111, which was replaced by Circular 37, "for general VAT taxpayers on the pilot programme who provide international freight forwarding services and were subject to BT on net basis previously, the fees they pay to other pilot taxpayers are allowed to be deducted in calculating VAT liabilities". Hence, when freight forwarder B nets off the RMB 100 paid to shipping company C against the sea freight charges of RMB 100 received from customer A, the net sales amounts will be nil. As a result, no VAT will be payable.

After the issuance of Circular 37, however, the above net basis method is removed.

According to the general practice in Guangdong province and Guangzhou city, the question is whether the ocean freight charge of RMB 100 received by freight forwarder B is considered as being received on behalf of shipping company C, thus not subject to VAT, or is considered to be a service fee and

subject to 6% VAT?

(i) Is there any input tax credit for freight forwarding industry?

If VAT is applicable on the ocean freight charges of RMB100 received by the freight forwarder B, then B will not have any input tax credit (on the assumption that the jurisdiction in which shipping company C operates has signed a bilateral transportation agreement with China and the ocean freight charges of RMB 100 received by C are exempt from VAT).

(ii) Will the tax authority introduce special taxation policy to reduce the tax burden on freight forwarding industry?

As shipping company C is an overseas enterprise, it is not possible to issue a China VAT invoice to freight forwarder B to enable B to claim input VAT credit. Even if shipping company C is a China-incorporated company, as the service should qualify for zero VAT rate, Company C can only issue normal non-VAT invoice, such that no input VAT is claimable. Without the input tax credit and with the removal of the net basis method as well, when the freight forwarders then seek to charge on Chinese customers, a 6% VAT will be applied on the gross amount. This tax treatment will be a big concern for the freight forwarding industry and adversely affects their profits. In view of it, will the tax authorities introduce special policies as transitional measures to reduce the tax costs of companies in the freight forwarding industry?

(b) Can the income of international freight forwarding agencies be exempt from VAT?

According to Circular 37, provision of logistics support services to foreign parties can enjoy VAT exemption. Can the income derived by freight forwarder B from foreign shipping company C for the provision of international freight services, in the example, be exempted from VAT?

In practice, are there any business model suggestions that can be considered by such freight forwarders to reduce their tax burden?

II. Will the VAT reform affect tax-exemption application for export services?

A Chinese company provides service to an overseas entity. The contract is entered into with the overseas entity, and the invoice is issued to the overseas entity. The payment is made by the overseas entity. Nevertheless, the ultimate beneficiary of the service provided is another Chinese entity in China. For example, a Chinese company provides information technology services to an overseas entity. The resulting product will be used by other Chinese entities in China. Will this affect the application for tax-exempt export status?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting. Updated reply of GDOSAT: Subsequent to the cancellation of the net basis method under Circular 37, SAT and GDOSAT has carried out further studies on the international freight forward industry and subsequently made amendments in Caishui [2013] No. 106 ("Circular 106"):

In order to benefit from VAT exemption, all the international goods transportation agency services income and the freight charges paid to international transportation services providers must be settled through financial institutions. If requested, the international goods transportation agent should issue general VAT invoices to the engaging party. Cash settlements would not be eligible for VAT exemption.

Circular 106 further prescribed that agency services provided for international goods transportation, as well as transportation between mainland China and Hong Kong, Macau, and Taiwan, would be entitled to VAT exemption.

Importantly, this regulation was effective retrospectively, as from 1 August 2013. This meant that for services invoiced between 1 August 2013 and the date of issuance of Circular 106, if the taxpayer had issued special VAT invoices, they could benefit from the retrospective change in policy upon collection back of the special VAT invoices issued. This effectively ensured no mismatch between the (reduced) output VAT liability of the agents, under the policies in Circular 106, and the input VAT credit which might have originally been claimed.

Circular 106 effectively restored the 'net basis method' which had been in place until 1 August 2013. It provided that the sales amount of general VAT taxpayers providing international goods transportation agency services was the revenue received less the international freight charges paid for international transportation services.

Circular 106 further defined "international goods transportation agency services" very broadly. An agency service included the acceptance of the goods of the consignee, the consignor, their agents, or a transportation owner or lessee, where the service was either performed in the name of the principal or in the agent's own name. The agency services for which the net basis method applied encompassed all business activities associated with arranging the international transportation of goods (except the provision of the actual transportation service itself), including arranging pilotage, berthing, loading and unloading of cargo and related activities.

A3. VAT consolidated filing

According to Cai Shui [2012] No. 9, where the head office and the branches of a company are not located in the same county (or city) but in the same province (or district, city), the head office may, with the approval of finance or tax authorities at the provincial level, declare and pay VAT to the tax authority in charge of its location on a consolidated basis.

(a) Can head office and branches apply for VAT consolidated filing?

Can head office and branches in Guangdong province apply for VAT consolidated filing and the qualifying conditions?

(b) Coordination issue for tax bureaus

Notwithstanding that consolidated VAT filing in the same province may be feasible from a legal perspective, there are many practical issues and challenges in actual implementation. Will the tax bureaus coordinate and facilitate resolving any practical issues in the future?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting.

Updated reply of GDOSAT: According to VAT Provisional Regulation and its Implementation Rules, as well as Caishui [2012] No. 9, where the head office and the branches were not located in the same county (or city) but in the same province (or district, city), the head office might, with the approval of finance or tax authorities at the provincial level, declare and pay VAT to the tax authority in charge of its location, on a consolidated basis.

For pilot taxpayers under VAT reform, according to Circular 106, effective 1 January 2014, where the head office and the branches were not located in the same county (or city) but in the same province (or district, city), the head office might, with the approval of finance or tax authorities at the provincial level, declare and pay VAT to the tax authority in charge of its location, on a consolidated basis.

A4. VAT – entire transfer

According to SAT Announcement [2011] No. 13 on the VAT Issues Concerning Asset Restructuring of the Taxpayers ("Announcement 13"), certain forms of corporate restructuring, involving the transfer of tangible goods, will be regarded as falling outside the scope of VAT. The criteria for a qualified corporate restructuring are as follows:

The taxpayer transfers tangible goods in a corporate restructuring that takes the form of a merger, de-merger, sale, swap; and

The taxpayer transfers all or part of the tangible assets together with related debt claims, liabilities and work force to other units or individuals.

If the transfer of physical assets includes all inventories and equipment etc, but excludes properties and land rights, and includes other related claims, liabilities and workforce, will it fall under the above scenario where VAT is not applicable?

Response of GDOSAT: It should be noted that Announcement 13 was not a VAT-exempt scheme or concession. Instead, it clarified that the transfer of physical assets, or part thereof, and the related claims, liabilities and workforce together to another entity or individual, did not fall within the scope of VAT. Further, to apply Announcement No. 13, the transfer of debt claims, liabilities and workforce should be connected with the transfer of physical assets.

A5. Input VAT transfer-out for tax-exempt items

According to Article 26 and Article 27 of the Implementation Rules for the Provisional Regulations of the People's Republic of China on Value-added Tax, there are two methods to compute input VAT transfer-out:

- If the input VAT for taxable and tax-exempt items cannot be allocated accurately, the input VAT transfer-out shall be computed based on the sales volume i.e. sales of tax-exempt items in proportion to total sales. ("Transferred out by sales proportion").

- If the input VAT for taxable and tax-exempt items can be accurately identified and recorded, the input VAT transfer-out shall be computed on the actual basis

("Transferred out on actual basis").

Currently, there is no specific regulation regarding the criteria of “accurate allocation of input VAT for taxable or tax-exempt items” or “separate record of input VAT for taxable or tax-exempt items”.

If an enterprise wishes to apply for separate record of input VAT for taxable or tax-exempt items, what are the conditions that the enterprise would have to fulfil before doing so? For example, should a taxpayer independently account for tax-exempt items in each stage of its business transaction, such as purchase and storage, production and consumption, cost and sales etc? Will GDOSAT consider promulgating specific regulations to clarify this issue?

Reply of GDOSAT: There was no application requirement in place for an enterprise to independently account for input VAT on tax-exempt items. As many corporations calculated the usage of raw materials based on the sales volume, instead of actual usage volume, it was practically not feasible to calculate the amount of taxable and tax-exempt items used in the production process accurately. As long as the taxpayer was unable to accurately segregate taxable items and tax-exempt items for the purpose of computing the input VAT, it could follow the method prescribed by the VAT regulations to calculate the input VAT transfer-out.

A6. VAT reform – tax exemption

According to Caishui [2012] No. 86, prior to 31 December 2013, the corporations with the respective approvals obtained from the administrative department of radio, film and television (including central, provinces, cities and counties) which carried on film production, distribution and screening, are included in the pilot programme for VAT reform. The transfer of film rights can enjoy VAT exemption.

What are the conditions for the VAT exemption granted by Caishui [2012] No. 86?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting.

Updated reply of GDOSAT: According to Cai Shui [2012] No. 86, prior to 31 December 2013, the corporations with approvals obtained from the administrative department of radio, film and television (including central, provinces, cities and counties) which carried on film production, distribution and screening, were included in the pilot programme for VAT reform. The transfer of film rights could enjoy VAT exemption.

With the progress of the VAT reform, Caishui [2012] No. 86 was superseded by Circular 37, and the above rules have been included in Caishui [2013] No. 37. The above mentioned favourable treatment was effective only up to 31 December 2013.

To enjoy the favourable treatment under the original policy, the documents required and qualifying conditions included: Application Form for Tax Relief and documentary proof of approvals granted by the administrative department of radio, film and television. The tax authorities would review the documents and, if granted, the VAT exemption would apply with effect from the approval date.

A7. VAT issue on retailing enterprise

Nowadays, as many chain department stores have launched the sale of prepaid cards, they have received requests from customers to issue invoices upon the sales of such cards. However, as these prepaid cards may be eventually used by customers to buy products in other cities (for example, customers use the cards to purchase products from a store in Shanghai, even though the cards were originally purchased in Guangzhou), in which city should the VAT be paid (Guangzhou or Shanghai)? According to current VAT Provisional Regulations, VAT is payable upon the issuance of invoice, which implies that VAT in the above example should be payable in Guangzhou. If so, will the Shanghai tax bureau agree with this? Notwithstanding the above, VAT consolidated filing appears to be able to resolve the above problem. Will it then be easier for enterprises in Guangdong to apply and obtain approval for consolidated VAT filing?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting.

Updated reply of GDOSAT: According to Provisional Regulations of VAT and its Implementation Rules, VAT taxpayers should file VAT in the place where the organization was located. Therefore, when the prepaid cards were purchased and invoices were issued, the VAT should be paid in the place where the seller was located. As far as the GDOSAT knew, there had not been any cases of inter-provincial usage of such prepaid cards to date. According to Cai Shui [2012] No.9, where the head office and the branches were not located in the same county (or city) but in the same province (or district, city), the head office might, with the approval of finance or tax authorities at the provincial level, declare and pay VAT to the tax authorities in charge of its location, on a consolidated basis.

A8. Administrative Measures on Application for Tax Refund (Exemption) for VAT Zero-rated Taxable Services ("SAT Announcement [2013] No. 47")

(a) Issues regarding zero-rated export services

According to the newly released Administrative Measures on Application for Tax Refund (Exemption) for VAT Zero-rated Taxable Services ("Administrative Measures")[1], the basis for computing tax exemption and refund for zero-rated taxable services provided by a foreign enterprise is the amount for exported zero-rated taxable “services” purchased. Should the nature of the "services" be exactly the same as the exported zero-rated taxable services (For example, the "purchased service" of an exported design service must be also design service)? Can the basis of computing tax exemption and refund cover all the services purchased for zero-rated taxable services?

[1] Administrative Measures on Tax Refund (Exemption) for VAT Zero-rated Taxable Services (SAT Announcement [2013] No. 47) (Excerpt):

Article 5 Tax computation basis for VAT refund (exemption) for zero-rated taxable services

(2) Tax computation basis for tax exemption and refund for zero-rated taxable services provided by a foreign trade enterprise concurrently:

I. The amount stated on the special VAT invoice by the provider for exported zero-rated taxable services purchased from organizations or individuals in China.

II. The amount stated on the PRC tax payment receipt for exported zero-rated taxable services purchased from overseas organizations or individuals.

Article 7 Providers of zero-rated taxable services shall, prior to making declaration for tax refund (exemption) for zero-rated taxable services, provide the following materials to the tax authorities in charge to complete determination of export tax refund (exemption) status:

(5) In the case of provision of research and development, design services to overseas parties, the original copy and photocopy of the “Technology Export Contract Registration Certificate” shall be provided.

In addition, given that the enterprises engaging in zero-rated taxable services may purchase fixed assets, such as machinery and equipment, which can be credited as input VAT, can the computation base for VAT refund cover input VAT from machinery and equipment purchased instead of being limited to purchase of services?

(b) Application for tax refund without Registration Certificate or submitting Registration Certificate after obtaining tax refund

According to the Administrative Measures, for enterprises engaged in the provision of research and development, and design services to overseas parties, the original copy and photocopy of the "Technology Export Contract Registration Certificate" ("Registration Certificate") is required. Is the Registration Certificate essential for all enterprises that apply for zero-rated taxable services? In practice, the deadline for tax refund would be delayed due to the long application and communication process with the relevant authorities before obtaining such a Registration Certificate. Will the tax bureau consider processing the tax refund without Registration Certificate or allow enterprises to submit the Registration Certificate after the tax refund under exceptional circumstances?

Reply of GDOSAT: Under the current VAT reform policies, the zero-rate applied to the provision of international transportation services and transportation services within Hong Kong, Macau and Taiwan, as well as the provision of research and development, and design services to overseas entities. It was clearly stated in the Administrative Measures that zero-rated taxable services provided by foreign trade enterprises concurrently would be exempted from VAT, and the input tax corresponding to the externally procured taxable services would be refunded. Regardless of current policies or procedures of tax refund application, the nature of the zero-rated taxable services must be the same as zero-rated taxable services purchased. Correspondingly, the computation of VAT exemption or refund of zero-rated taxable services would not include input VAT arising from the purchase of machinery and equipment.

According to SAT Announcement [2013] No. 47, for enterprises engaged in the provision of research and development, and design services to overseas parties, the original copy and photocopy of the “Technology Export Contract Registration Certificate” (“Registration Certificate”) was required. Otherwise, the enterprise would not be able to apply for zero-rated taxable services. The tax authorities would not process tax refunds without Registration Certificate or permit the submission of Registration Certificate after refunding tax. It was also prohibited by legislation.

B. Taxation of non-residents and transfer pricing issues

B1. Transfer pricing issues relating to royalty and consultancy service fee payments to non-residents

We understand from news reports that a retail commercial enterprise in Guangzhou was investigated for tax avoidance due to payments of trademark royalties and consulting service fee to an overseas parent company (Please refer to the Appendix. (N.B. only a Chinese version is available)). From the information disclosed, we understand that the enterprise attracted the tax authorities’ attention as its operating profits had been hovering at a low level despite its sales increasing every year. The tax authorities eventually carried out anti-tax avoidance investigation on the enterprise.

From a commercial perspective, compared with ordinary single-function enterprises, retail commercial enterprises are more vulnerable to changes in the domestic economy, market competition and other economic factors. Therefore, retail commercial enterprises have to manage higher business and operation risks. It is also normal for retail commercial enterprises to rely on overseas headquarters' management support services in their operations. Such services include trademark rights and group-shared services (for example, finance, personnel, IT consulting services). However, does this imply that trademark fee and IT consulting fee paid to overseas headquarters will not be tax deductible when the enterprises are deriving low operating profits or are loss making, due to other economic factors? How will the tax bureau determine the reasonableness of payments made to overseas related parties?

Reply of GDOSAT: When the tax bureau was considering whether to conduct a transfer pricing investigation, revenue and profits were key considerations, but were not the only factors considered. The tax bureau would consider the company's overall operating performance and compare it against that of other comparable competitors under similar economic conditions. According to Guo Shui Han [2007] No. 236, in line with international transfer pricing principles, single-function enterprises typically were able to maintain a certain profitability level and, therefore, in principle, such enterprises should not be in loss positions. However, the local tax bureau, agencies and taxpayers might have different interpretations of the document. Therefore, the tax bureau was willing to communicate with the parties involved and listen to their views to improve the regulatory policies and specific implementation measures. Notwithstanding the above, in the absence of new regulations or documents, the tax bureau would continue making reference to Guo Shui Han [2007] No. 236 in its implementation process.

B2. Tax treatment of cross-border taxpayers as beneficial owners

The tax treatment of cross-border issues indicated in SAT Announcement [2011] No. 24[2], (which requires application to higher tax authorities only) appears to be simpler as compared with that in SAT Announcement [2012] No. 30[3], and Shui Zong Han [2013] No. 165[4]. In practice, can taxpayers apply for the status of beneficial owners with reference to share transfer?

Reply of GDOSAT: An application for the status of beneficial owner, with reference to that for share transfer, can be lodged at the local tax bureau of a Chinese resident enterprise.

B3. Tax and transfer pricing issues arising from corporate restructuring

According to Article 5 in Cai Shui [2009] No. 59, the special tax treatment will apply if a corporate restructuring meets the following criteria:

[2] According to SAT Announcement [2011] No.24, where foreign investors simultaneously transfer their equity in two or more domestic resident enterprises which are located in different provinces (municipalities), such investors may, in line with Article 5 of the Circular, submit relevant materials to the competent tax authority at the place where one of the domestic resident enterprise is located, and the provincial or municipal tax bureau of above such competent tax authority shall discuss with its counterparts in other provinces (municipalities) and then decide whether or not to impose a tax, and report the same to SAT; if a tax collection decision is made, the overseas investors shall pay tax respectively to the competent tax authorities at the places where relevant domestic resident enterprises are located.

[3] According to SAT Announcement [2012] No. 30, where a taxpayer is required to apply to different tax authorities for recognition of benefical owner status and tax treaty entitlement under similar circumstances, the taxpayer shall explain to relevant tax authorities. The relevant tax authorities shall negotiate and reach a consensus; where the relevant tax authorities are unable to reach a consensus, the case shall be escalated to their common higher-level tax authorities for handling, and the negotiation outcome shall be explained.

[4] According to Shui Zong Han [2013] No. 165, where a case involves the situation that the income of the same taxpayer from the investment activities of the same kind is handled by different local tax authorities, such local tax authorities shall uniformly handle the related tax issues for such income.

(1) There are bona fide commercial objectives for the restructuring, and the main objective is not for the reduction, exemption or delay of tax payments.

(2) The ratio of acquired, merged or divided assets or equity complies with the ratio stipulated in this Notice.

(3) The original substantive business activities of the restructured assets will not be changed during the 12 months following the enterprise restructuring.

(4) The payment amount for equity involved in the consideration for a restructuring transaction complies with the ratio stipulated in this Notice.

(5) The original key shareholders obtaining the equity in an enterprise restructuring must not transfer the equity obtained during the 12 months following the restructuring.

According to Article 7 in Cai Shui [2009] No. 59, the special tax treatment shall apply to the acquisition of equity and assets involving a domestic party and an overseas party (including Hong Kong, Macau and Taiwan), if the transaction meets the criteria stipulated in Article 5 of this Notice, as well as the following criteria:

(1) The transfer of the equity of a resident enterprise held by a non-resident enterprise to another non-resident enterprise, in which the non-resident enterprise holds 100% direct controlling shares, will not result in a subsequent change in withholding tax burden on the income derived from the transfer of such equity; and the transferor of the non-resident enterprise has provided a written undertaking to the tax authorities in charge that it will not transfer the equity of the transferee of the non-resident enterprise owned by it within three years;

(2) The transfer of the equity of a resident enterprise by a non-resident enterprise to another resident enterprise in which the non-resident enterprise holds 100% direct controlling shares;

(3) The investment by a resident enterprise with assets or equity it owns in a non-resident enterprise in which the resident enterprise holds 100% direct controlling shares.

(a) Has GDOSAT handled any cases of such cross-border restructuring?

(b) Can GDOSAT share some relevant experience (such as incorporation of non-resident transferor and the transferee, and the share transfer reasons)?

As a result of recent changes in national tax policies, the updated reply below was provided by GDOSAT subsequent to the meeting. Updated reply of GDOSAT: At present, application for special tax treatment could be approved by tax authorities in charge if the respective criteria were met. GDOSAT advised that enterprises should not focus too much on the special tax treatment, as it merely delayed the tax obligation, instead of granting tax exemption. For the special tax treatment to apply in corporate restructuring, the restructurings would be analyzed on a case-by-case basis, with reference to Cai Shui [2009] No. 59, SAT Announcement [2010] No.4 and SAT Announcement [2013] No.72.

B4. SAT and SAFE Announcement [2013] No.40 /Hui Fa [2013] No. 30

According to SAT and SAFE Announcement [2013] No.40, the existing requirement for outbound remittance that tax clearance must be secured prior to the outbound remittance has been replaced with a new tax registration requirement. Announcement No.40 took effect from 1 September 2013.

(a) Is the income from share transfer considered to be one of the current account items of service trade?

According to Announcement No. 40, income from equity transfer is included as one of the items which requires tax registration. However, in Hui Fa [2013] No.30, it is not clear whether such income is included as an current account item. How will tax authorities and SAFE coordinate this issue with each other?

(b) Does salary reimbursement by foreign institutions fall under the above scope?

(c) Implementation rules or intructions for Announcement No. 40

Will GDOSAT release implementation rules or intructions for Announcement No. 40? If so, when will they be released? In the absence of relevant rules and instructions, taxpayers or tax withholding agents will encounter difficulties in practice.

Reply of GDOSAT: The existing requirement for outbound remittance was simplified with a new tax registration requirement, as announced in Announcement No. 40. GDOSAT understood that tax authorities maintained good communication with SAFE regarding the implementation of Announcement No. 40. There was no situation in which SAFE did not agree to the tax recordal forms approved by tax authorities.

Whether the salary reimbursement from foreign institutions fell within the scope should strictly follow the Article of Announcement No. 40. For example, Announcement No. 40 clarified that remitance of travel, meetings, commodity sales promotion expenses of domestic institution incurred overseas did not require filing registration.

The conversion from the advanced tax clearance system to the tax recordal filing system was a significant reform. However, as Announcement No. 40 was newly introduced, there might be some problems in the actual implementation process (e.g. if tax certificates issued prior to 1 September were still valid after that date?). The tax bureau, SAFE, companies and banks would need to communicate with one another to resolve these transitional issues. SAT was also working on improving the current measures.

B5. Shui Zong Han [2013] No. 165

On 12 April 2013, SAT released the Opinion Letter on the determination of beneficial ownership cases under the dividend article of the PRC-HK double tax arrangement, (Shui Zong Han [2013] No. 165) ("Circular 165") addressing to the state tax bureaus of Liaoning, Shandong, Henan, Jiangsu, Hubei and Hainan. It focuses on the issue on whether certain Hong Kong companies are considered the beneficial owners of dividends and would therefore qualify for tax treaty benefits, which was covered in Arrangements between the Mainland China and the Hong Kong Special Administrative Region on Avoiding Double Taxation.

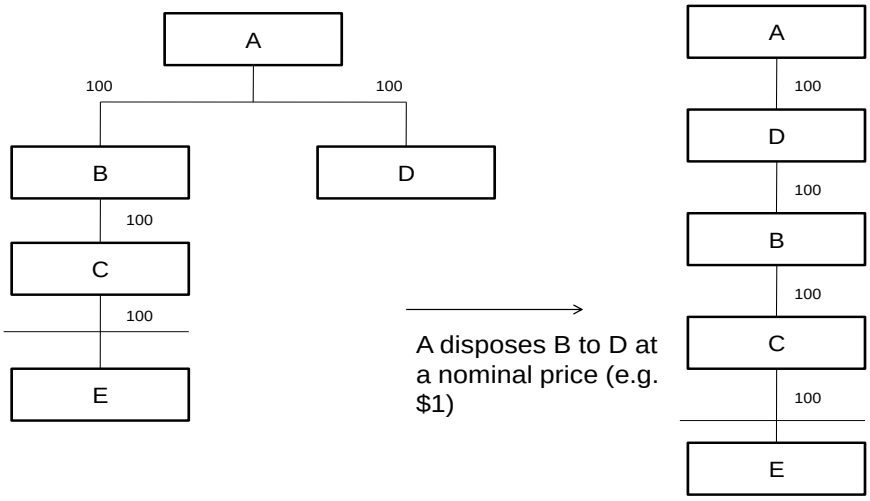
(a) Will GDOSAT and other state tax bureaus within Guangdong take reference to the guideline in Circular 165 when implementing the tax treaties?

(b) Will the guideline in Circular 165 be applied by GDOSAT in the assessement of China's tax treaties with other countries?

Reply of GDOSAT: Circular 165 was SAT's official reply to an individual case and was merely addressed to some provinces like Liaoning etc. SAT had not yet given a clear indication if the other provinces in China could apply the guidelines in Circular 165. If there were similar cases in Guangdong, GDOSAT suggested that the corporations concerned should bring such cases to their attention and they would feedback and seek the opinion of SAT.

B6. Re-assess the price of share transfer by foreign enterprise

Under a group restructuring, an offshore holding company disposes its shares in an offsore intermediate holding company at a nominal price to another related-party offshore company within the group. In doing so, there was an indirect equity transfer in a PRC entity, which was held by the intermediate holding company. Under such circumstances, will GDOSAT re-assess the transfer price of the foreign share transfer and require the non-resident company to pay PRC Corporate Income Tax on the transaction?



Per GDOSAT, the following factors shall be considered in the above transaction:

- How to understand the reasonableness of share transfer price?

  The reasonableness of share transfer price should be considered with reference to the factors such as net assets of the entity transferred and the equity ratio held by the transferor. If the transfer involved intellectual property and land use rights, the incremental value of such assets should be considered as well. In addition, please note that a valuation report was also required for this purpose.

- How to understand the fair market value of the share transfer?

  For a non-related party transaction, the contractual transfer price was typically at

market value, which was regarded as a relatively fair price. However, if the transaction was undertaken by related parties, the following factors should be considered in order to assess if the transfer is at fair value:

- Was the price in accordance with the government's pricing principles?
- Did the government have guidelines for the price range?
- What was the fair market value?
- What was the net asset value in the book?

- How to understand the commercial purposes? In determining if a restructuring was carried out for reasonable commercial purposes, the following factors should be considered:

  - Did the restructuring make commercial sense?
  - How did the restructuring affect the company's tax costs?
  - During the restructuring, were the related party transactions with affiliated entities in China in accordance with anti-tax avoidance regulations?

B7. SAT Announcement [2013] No. 19

On 19 April 2013, SAT issued an announcement to address the Corporate Income Tax implications of secondment arrangements of non-resident enterprises, effective from 1 June 2013.

If a non-resident enterprise dispatches its employee to a Chinese entity and is deemed as constituting a permanent establishment in China, can the taxable services provided by the employee to the non-resident enterprise be separated from the non-taxable services, i.e. the stewardship functions performed by the employee (rendering investment advice to the non-resident enterprise with respect to the Chinese entity, and participating in board meetings of the Chinese entity on behalf of the non-resident enterprise, etc) in the computation of taxable income?

Reply of GDOSAT: If the seconded employee provided taxable services and non-taxable services (i.e. stewardship functions) to the non-resident enterprise at the same time, the remuneration relating to the taxable and non-taxable services shall be recorded separately. Otherwise, both the taxable and non-taxable services shall be subject to CIT. Even if the taxable and non-taxable services could be recorded separately, the taxpayer would need to substantiate to the tax authorities that the method used to separately account for such non-taxable services was reasonable.

In addition, whether the secondment arrangement would constitute a permanent establishment in China should be assessed from the perspectives of the whole project and the whole contract.

Hong Kong Institute of Certified Public Accountants

November 2013

Appendix to Question B1

广东查处全国首例滥用商誉避税案件

日期：2013-01-04 来源：广东省国家税务局 作者：刘丽、李穗红

经过两年多的调查，广东省国税局完成了对广州某大型零售商业企业的反避税调整，调增应纳税所得额1.98亿元，补缴企业所得税6000多万元，并使未来5个年度直接增加入库税款超过3000万元。这是全国首例对滥用商誉和关联商标、劳务交易综合避税行为进行查处的案件。

企业计提大额关联费用引警觉

2009年，广州市国税局发现广州A公司经营规模不断扩大，销售收入逐年增加，但利润却没有相应增长，利润率一直徘徊在较低的水平。该公司2004年－2008年期间，向境外公司计提的特许权使用费和咨询服务费合计达2亿多元。

经分析，该公司的毛利率一直维持在较为平稳的水平然而管理费用却出现了大幅增长。2003年以前，管理费用占销售收入的比重不到1%，之后大幅增长到5%以上，主要原因就是从2004年度起，该公司分别按照销售收入净额的1%向境外关联公司计提特许权使用费和咨询服务费，以及每年在管理费用中列支商誉2000多万元。初步确认广州A公司存在明显的避税嫌疑后，经税务总局批复同意，广东省国税局对广州A公司进行反避税立案调查。

费用计提“低比例”隐藏大玄机

以往调整的大多是生产销售企业，其特许权使用费、技术服务费等计提比例一般比较高，而广州A公司属于零售企业，以营业额为计提基数。尽管这个计提比例貌似不高，但是由于计费基数巨大，增加1%的计提金额都会导致管理费用的计提金额增加2000万元。

反避税人员针对1%的商标特许权使用费和咨询服务费的计提比例，以及企业对外支付这项费用随意性较大等问题提出了质疑。

对此，企业财务人员辩称计提比例是根据境外总公司拥有丰富的品牌维护、推广经验以及便于集团管理等原因而设定的，符合企业实际情况。

反避税人员从外部数据入手，查证同行业特许权使用费的计提情况。结果显示，广州地区同行业企业计提特许权使用费的仅为少数，且计提的费率较低，一般在0.5%以下。且广州A公司在经营活动中在一定程度上对商标的维护也做出了贡献。因此广州A公司按照年净销售额的1%向境外公司支付特许权使用费是不合理的。

大量调查显示，企业通过加大计提比例和采用对自己有利的计提方法，将应在境内体现的利润转移到境外，避税的目的昭然若揭。

亏损企业商誉价值2亿元？

此外，反避税人员对企业2003年受让的一笔整体资产转让事项产生了怀疑。深圳B公司是广州A公司的关联企业，具有与广州A公司类似的经营范围和职能，截至2003年底，深圳B公司累计亏损超过3亿元。2003年12月31日，广州A公司与深圳B公司签订了整体资产转让合同，参照第三方出具的评估报告结果，深圳B公司的商誉作价2亿元连同其他资产整体转让给广州A公司，广州A公司在会计账上从2004年度起分10年进行摊销，截至2008年度已摊销金额为1亿元。同时该商誉收益在2003年度作为深圳B公司的营业外收入，全部用于弥补以前年度亏损。

通过调查分析，反避税人员发现了一个重要疑点：深圳B公司2003年12月31日转让整体资产，且委托广州A公司经营管理。接着，仅仅过了不到两个月，广州A公司与深圳B公司又签订合并合同。这种短期内发生的重大交易事项并不符合正常的商业行为。相比较而言，合并只是两家公司资产负债、所有者权益的简单相加，理论上不会影响两家公司股东的既得利益。而整体资产转让价格的确定，对两家公司的股东利益影响更大，卖高了会导致买入方利益的减少，卖低了则会导致卖出方利益的减少。

反避税人员经过缜密的分析，发现了其中的秘密：从提出合并申请，到经国家商务部批准需要一段比较长的时间。根据税法规定，年度应税所得可以弥补5年以内的亏损。换句话说，企业在2003年12月31日所作的整体资产转让，就是为了虚增深圳B公司当年度的营业外收入，用以弥补其以前年度的亏损，使即将超过5年期限的亏损在2003年得以弥补，达到避税的目的。同时也虚增了广州A公司的成本，减少了广州A公司的利润。2亿元的商誉，就是用于弥补亏损和抵消利润的重要内容。

艰苦谈判攻克层层难关

经过大量的调查、分析，案件进入了最为核心、也是最为艰难的谈判阶段。企业对该案件非常重视，专门派出境外母公司的税务经理全程跟进，并分别向四大会计师事务所进行咨询，最终确定由某会计师事务所代理该案件。税务人员始终保持顽强的意志，据理力争、以理服人。

在大量的证据面前，企业避税的思路及方式清晰地呈现出来，企业的心理防线一步步被突破。经过数十轮艰苦的谈判，企业最终认同了税务机关提出的方案，根据企业功能风险与利润相匹配的转让定价原则，该企业向避税港关联方已支付的1亿元商誉全部不予税前列支。反避税人员还根据有关规定，将企业巧立费用名目向关联公司转移利润的行为采用交易净利润法进行了统一调整。该案最终调增应纳税所得额近2亿元，补征税款6000多万

元，且杜绝了企业原计划在未来5年继续摊销列支余下的1亿元商誉的避税行为。经对广州A公司转让定价调整后的数据进行还原测算，本次调整共调减广州A公司关联交易额近60%，调整后企业利润水平较调整前大幅提高。目前税款已全部入库。

编辑：阿美