

New PRC tax rules to impact on private equity funds

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China's recent commitment to joining the Common Reporting Standard (CRS) – an agreement developed by the OECD to share information between jurisdictions on residents' assets and income – will likely have a notable impact on Chinese private equity funds ('PE funds') and their managers in the PRC. Meanwhile, recent announcements regarding value-added tax (VAT) and business tax (BT) should also be taken on board.

The PRC government intends to implement the CRS from 1 January 2017. A public consultation paper released on 14 October 2016 by China's State Administration of Taxation (SAT) indicated PE funds would be deemed as financial institutions (FIs) and must meet CRS reporting obligations.

The systematic exchange of FI information with other participating jurisdictions on an annual basis under CRS is modeled to some degree on the US's FATCA (Foreign Account Tax Compliance Act), which sets out which financial institutions must report (typically depository institutions, custodial institutions, investment entities and some insurance companies) and the types of accounts and taxpayers covered, as well as the due diligence (DD) procedures to be conducted and the financial account information to be exchanged.

The classification of PE funds as FIs means PE funds would need to verify the tax residency of their investors. PE funds would be obliged to perform DD for the new fund investors, whom would be viewed as account holders or holding partnership interests in the fund from 1 January 2017, while DD for all the remaining pre-existing accounts would need to be completed gradually before 31 December 2018 (for high-net worth accounts, before 31 December 2017).

For accounts identified as non-resident, PE funds would need to report key data to SAT such as:

- name, jurisdiction, tax identification number, etc.
- account number/ID
- account balance at year end (including income breakdown – interest, dividend, trading gains, etc.)

Given the tight timeline of CRS implementation in China, PE funds should be factoring in the complex and varied nature of the information to be collected. Unlike banks, PE funds generally have no existing institutionalized customer on-boarding procedures;

timely and comprehensive planning would therefore be needed. Other considerations include:

- concerns on personal information collection/disclosure
- increased compliance costs
- implementation/upgrade of systems/databases
- attention to local CRS compliance in respective jurisdictions regarding offshore fund management (currently over 100 countries are CRS signatories)

It should be noted that the Cayman Islands, a popular jurisdiction for offshore fund establishment, implemented the CRS with effect from 1 January 2016.

Besides the above, SAT also recently issued SAT Announcement [2016] No.53 ('Circular 53'), which clarifies treatment of VAT on IPO restricted shares and BT on historical transactions. For VAT treatment on sales of restricted shares, where the tax payer transfers the restricted shares after the restricted sales period expires, Circular 53 states the cost for VAT purposes will be decided as follows:

- For restricted shares obtained from the non-tradable share reform of the listed company, the cost of shares for VAT purpose shall be the share's opening price at first trading day post reform.
- For the restricted shares attained pre-IPO, the cost of shares shall be listing price of the IPO.
- For restricted shares attained via restructuring of the listed company, the cost of shares for VAT purpose shall be closing price of the last trading day before the suspension of the stock trading.

Further, Circular 53 stipulates that the transfer of restricted shares before 1 May 2016 should be subject to BT (via the above methodology). It does not stipulate when and how the tax payers pay BT for the historical transactions. Therefore PE fund managers should closely monitor the local tax authority's imposition and collection of BT in this regard.

Overall, while Circular 53 is a welcoming development for PE funds – which have generally been waiting for clarification on how Chinese tax authorities would impose indirect (turnover) tax on pre-IPO shares/equities obtained before listing – we would urge PE funds to not delay in planning for a pending CRS implementation.

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