China Tax Alert

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Foreign Banks and Insurers Granted Greater China Market Access

Regulations discussed in this issue:

- Regulations of the People's Republic of China on Administration of Foreign Funded Insurance Companies (State Council Order No. 336, latest amended by State Council Order No. 720, hereinafter referred to as the "New Foreign Insurance Companies Regulation").
- Regulations of the People's Republic of China on Administration of Foreign Funded Banks (State Council Order No. 478, latest amended by State Council Order No. 720, hereinafter referred to as the "New Foreign Banks Regulation").

Background

To further expand the Opening-up of financial industry, the State Council issued the Amendment of the Regulations of the People's Republic of China on Administration of Foreign Funded Insurance Companies and Foreign Funded Banks (State Council Order No. 720) on 30 September 2019. It has become effective since.

KPMG summarized the major changes mentioned in New Foreign Insurance Companies Regulation and New Foreign Banks Regulation in this alert, as well as explored the potential tax issues faced by foreign investors when entering the Chinese banking and insurance markets.

Main Contents

Highlights of changes on New Foreign Insurance Companies Regulation:

1. Set-up and investment of insurance companies in China by foreign insurance group is permitted. Previously, the foreign insurance institutions in China are all set up by insurance subsidiaries of a foreign insurance group.
2. The requirement of "applicant of foreign insurance companies having more than 30 years' experience in insurance business, with representative office set up in China at least 2 years ago prior to the submission of the application" has been removed.
3. Overseas financial institutions investing in foreign insurance companies as shareholders are allowed.

Highlights of changes on New Foreign Banks Regulation:

1. Removing the total asset requirement of US$ 20 billion as of the previous year end prior to application for the sole or controlling shareholder to establish a wholly foreign-owned bank, for the sole or major foreign shareholder to establish a Sino-foreign joint venture bank, and for a foreign bank to set up a branch in China.
2. For foreign banks, set-up and operation of foreign bank branches and WFOE bank/JV bank in parallel are permitted.

3. Business scope of WFOE bank/JV bank/foreign bank branches has been expanded to include “issuance, redemption and underwriting of government bonds” as well as “acting as payment agent”.
4. The threshold for deposit taking by foreign bank branches from Chinese citizens within the territory of China has been reduced to RMB 500,000 from RMB 1,000,000 for each transaction.
5. RMB license approval has been removed and foreign banks should still be subject to the prudential requirements stipulated by the banking regulatory department of the State Council.
6. The interest-bearing asset percentage of 30% of the working capital has been removed while the exact percentage should be subject to further confirmation from the regulator.
7. The restrictions are relaxed on the proportion of RMB capital to RMB risk assets for foreign bank branches in China, as long as those branches’ capital adequacy ratio continues to meet relevant domestic and overseas regulatory requirements.

KPMG observations

The Amendment focused on market access, business scope (including operation requirements) and regulatory procedures of foreign banks and insurance companies. It removed restrictions upon shareholder’s total asset, type, overseas operation experience, etc., expanded business scope of foreign banks, and greatly accelerated the opening-up of banking and insurance industry, all of which aimed to attract more foreign financial institutions to invest in China.

However, the regulatory and tax environment remains complicated during the opening-up. From regulatory perspective, RMB license approval has been removed but foreign banks should still comply with the prudential requirements stipulated by the banking regulatory department of the State Council. Meanwhile, interest-bearing asset percentage of foreign bank branches is still subject to further confirmation from the regulator. In this regard, the market entry level for foreign financial institutions is lower whilst foreign financial institutions may face a stricter regulatory environment during the business operation in China.

From tax perspective, areas of complications and uncertainties still exist, we list a few tax considerations here:

- Pricing of related party transactions. How to make reasonable pricing policies to determine the fee charged among related parties of the same group, so as to reduce the risk of being challenged by the tax bureau due to the violation of the arm’s length rule. In particular, with respect to the China tax implications on head office cost allocation, the typical issue for foreign insurance company branches and foreign bank branches and their head offices, considerations should be taken on the cost allocation proportion; the conditions for Corporate Income Tax (“CIT”) deduction; withholding taxes and remittance registrations filing (for service fee or royalty), etc. should be subject to the detailed analysis in practice.
- The applicability of VAT to certain financial products. For example, banks often offer a type of bank deposit product that generates a higher yield than regular term-deposits. This is done by embedding certain financial derivatives (e.g. futures, swap, or options) into the product, in order to mimic similar investment returns of other

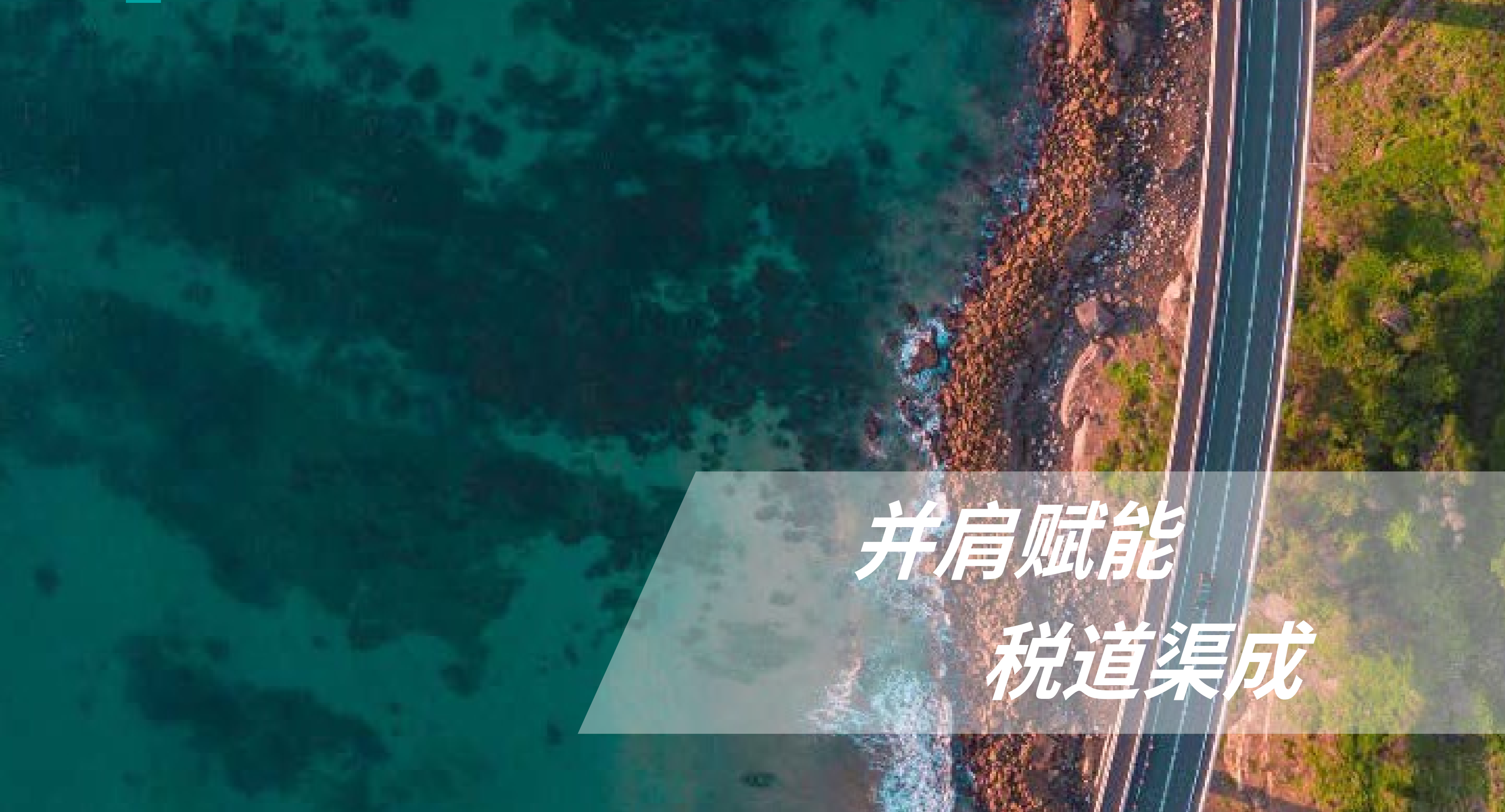
higher-risk financial instruments. At the same time the bank provides a guarantee for the repayment of the principal, just like under regular deposit arrangements. The question therefore arises whether such a structured-deposit note should be viewed (on the basis of its 'form') as a bank deposit – in this case the VAT rules provide that the deposit interest income will be VAT exempt. By contrast, the investment return might be treated instead as 'interest on a loan' – in such a case it would be subject to VAT on the basis that it is, 'in substance' a product providing a 'guaranteed return or capable of generating fixed income'. Recent notice announced by China Banking and Insurance Regulatory Commission with respect to requirement to account the structured-deposit in Bank's balance sheet may make the issue more complex.

- VAT exemption on reinsurance. Considering the possible VAT exemption on reinsurance provided to overseas insurance companies, in practice it is crucial for domestic insurance institutions to arrange the re-insurance contract properly to enjoy such tax benefits.

KPMG Services

With an overall deepening of reform and opening-up, and in light of the ever-changing domestic and international economy, China is exerting even more effort to facilitate its opening-up. Meanwhile, KPMG will continue to pay close attention to relevant policies and assist foreign financial institutions in investing and expanding business in China. We are well-positioned with our global network to aid foreign-invested enterprises. We can provide the following services:

- Domestic financial market research;
- Mergers and Acquisitions;
- One-stop shop of financial institution set-up advisory and implementation assistance;
- Strategic Transformation, risk management consulting;
- Transfer pricing advisory (including pricing policy-making and arrangement suggestions regarding related party transactions);
- China tax advisory and compliance.



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