



Further clarification on tax residency status of China-controlled foreign enterprises

Regulation discussed in this issue:

- Announcement on Trial Corporate Income Tax administration measures on China-controlled overseas-registered resident enterprises, SAT Announcement [2011] No. 45 (Announcement 45), issued by the State Administration of Taxation on 27 July 2011, effective from 1 September 2011

Background

The State Administration of Taxation (SAT) issued the announcement [2011] No. 45 (Announcement 45) on 27 July 2011 to deal with various issues concerning China-controlled overseas-registered resident enterprises, such as the tax residency identification and Corporate Income Tax (CIT) administration matters. Announcement 45 sets out implementation details of the existing regulations. Announcement 45 will take effect from 1 September 2011. The announcement shall be applied to China-controlled foreign enterprises that have been identified as resident enterprise according to Guo Shui Fa [2009] No. 82 (Circular 82) as well.

The salient points of Announcement 45 and our comments on them are set out below:

1. What are China-controlled foreign enterprise and China-controlled overseas registered resident enterprise?

Announcement 45 defines China-controlled foreign enterprise (CCFE) as enterprise incorporated in a country or region (including Hong Kong, Macau and Taiwan) other than the China mainland but whose main controlling investor is a Chinese enterprise or group in the mainland.

China-controlled overseas-registered resident enterprise (hereinafter referred to as “non-domestically-registered resident enterprise” (NDRRE)) is defined as a CCFE that is identified as a Chinese resident enterprise due to the fact that its place of effective management is in China.

2. How to identify NDRREs?

Announcement 45 sets out two methods for the identification of resident status of CCFEs. A CCFE may apply to the relevant tax authority to be certified as a resident status of its own accord. Alternatively, the tax authority may certify a CCFE as a resident enterprise upon discovery as a result of its investigation.

Application of its own accord

A CCFE shall assess whether its place of effective management is in China or not based on the actual circumstances of its business operations and management according to relevant provisions of Circular 82. Where the criteria are satisfied, the enterprise shall apply to its tax authority in charge for the resident status and provide following documents:

- Documents supporting the legal identity of the enterprise
- Information of the group's organisational structure and business operations
- The notarised audit report of the enterprise for the previous tax year
- Supporting document of the place where the senior management in charge of the enterprise's production / business operations executes its responsibilities
- Records of the residence of the directors and senior management staff in China for the current year and previous year
- Board resolution and meeting minutes on important matters of the current year and previous year
- Other documents.

Certification as resident enterprise upon discovery by tax authority

Where the tax authority in charge discovers that a CCFE meet the criteria set out in Circular 82 but has not applied for a resident status, the tax authority can carry out investigation in respect of the place of effective management of the enterprise. The tax authority in charge has the right to require the CCFE and its Chinese (domestic) investors to provide the relevant documents.

The tax authority in charge will examine the relevant documents, make a preliminary assessment based on those documents and report the case tier by tier to the SAT for final determination.

Once a CCFE is identified as a resident enterprise, it will receive a certificate of resident status, and the tax authorities in charge of the CCFE's domestic investors and investees will receive a written notice as well.

If SAT terminates the residency status of a NDRRE on grounds that the circumstances of the enterprise have changed significantly, and the enterprise no longer satisfies the certification criteria, SAT will send the written notice of this outcome to the tax authorities in charge of the enterprise's domestic investor(s) and investee(s).

3. What are the obligations of a NDRRE under the CIT Law?

Ongoing tax filing and settlement

A NDRRE shall be subject to CIT as a resident enterprise and enjoy the relevant preferential CIT treatment available to a resident enterprise from the year in which it is certified as a resident enterprise. Moreover, a NDRRE shall withhold CIT in accordance with relevant provisions when it pays China-sourced income as stipulated in CIT law (such as dividends, interest) to non-resident enterprises.

The NDRRE shall settle its CIT liability in advance on a quarterly basis and file its annual CIT return with the tax authority for annual reconciliation and settlement. The CIT liability shall be calculated in RMB.

Reporting on change of circumstances

Where one of the following changes occurs, a NDRRE shall report to its tax authority in charge within 15 days from the day of the change. The tax authority in charge of the NDRRE will report tier by tier to SAT on the latter to decide whether the resident status of the enterprise shall be terminated or not:

- Whether the place of effective management of the enterprise has moved out of China
- Whether the controlling position of the Chinese shareholder(s) has changed due to the disposal of the equity interests.

Where the NDRRE status of an enterprise has changed, it may stop paying CIT as a resident enterprise and acting as a withholding agent from the date on which it receives a written notice from its tax authority in charge on the cancellation of its resident status; at the same time, it is no longer eligible for the CIT preferential treatment available to resident enterprises. The enterprise shall perform reconciliation and settlement of its CIT liability for the current period within 60 days from the date of the cancellation of the resident status. The follow-up administration procedure will be carried out by the tax authority in charge according to the relevant regulations, such as the claw-back of the CIT exemption / deduction.

Where a NDRRE terminates its business operations, it shall perform reconciliation and settlement of its CIT liability for the current period within 60 days from the date of termination.

Where a NDRRE carries out tax deregistration with its tax authority in charge, it shall file its CIT return with, and make the tax payment to, its tax authority in charge on its liquidation income, prior to deregistration.

4. What are the tax authorities in charge of NDRREs?

The location of effective management of a NDRRE may not be the same as that of the NDRRE's main domestic controlling investor. Hence, the tax authority in charge of a NDRRE shall be determined as follows:

- If these two locations are same, the tax authority in charge of the NDRRE shall be in charge of the main domestic controlling investor
- If these two locations are different, the tax authority in charge of the NDRRE shall generally be the state tax bureau in the location where the effective management of the NDRRE is located. However, a NDRRE can choose the tax authority in charge of its main domestic controlling investor as its tax authority in charge upon the approval of the common higher-level tax authority
- If a NDRRE has more than one place of effective management, the tax authority in charge of the enterprise shall be determined by the common higher-level tax authority.

Once the tax authority in charge of NDRRE is determined, it shall not be arbitrarily changed. If the change of the tax authority in charge is necessary, the change shall be reported tier by tier to SAT for approval.

5. How should a NDRRE carry out tax registration?

A NDRRE shall submit the following documents to its tax authority in charge for tax registration within 30 days from the date on which it receives the

certificate of resident status:

- Certificate of the residence status
- Certificate of incorporation
- Other documents.

The tax authority in charge will issue a provisional tax registration certificate to the enterprise. A NDRRE shall carry out a tax withholding registration with its tax authority in charge within 30 days from the date on which its withholding obligation arises.

A NDRRE whose resident status is terminated by SAT shall carry out tax deregistration with its tax authority in charge within 15 days from the date on which it receives the written notice on the termination from its tax authority in charge.

6. How should a NDRRE keep its accounting records?

A NDRRE shall produce its financial statements in accordance with the relevant Chinese laws and regulations. It shall report its accounting methods and relevant documents to the tax authority in charge for record purposes within 15 days from the date of obtaining its tax registration certificate.

Where a NDRRE acts as a withholding agent, it shall set up a file record for the ledger and contract information, accurately recording the situation in respect of the withholding of CIT.

The accounting ledgers kept by a NDRRE in China and other documents required by the domestic tax authorities shall be in Chinese.

Where transactions occur between NDRREs and domestic enterprises, invoices shall be used in accordance with the relevant regulations, and the invoice stubs shall be kept in China.

7. What if a NDRRE receives dividends from a resident enterprise in China?

Where a NDRRE receives China-sourced income of an investment nature such as dividends and shared profits, as well as interest, rentals, royalties, capital gains and other income, it shall provide the copy of its certificate of resident status to the payer. With such copy, the payer does not need to withhold the relevant CIT.

8. What if a non-resident enterprise derives capital gains from disposal of a NDRRE?

Such income shall be recognised as China-sourced income and subject to CIT in China. The NDRRE shall report to its tax authority in charge and provide the tax authority with the equity transfer contract and relevant documents within 30 days from the date of signing of the equity transfer agreement.

9. Must a NDRRE prepare transfer pricing documentation reports?

A NDRRE shall report its related party transactions and prepare contemporaneous documents in accordance with the CIT law, its implementation rules and the circular, Guo Shui Fa [2009] No. 2.

10. What if a NDRRE is also treated as a tax resident in the country or territory in which it is registered?

The resident status of an enterprise shall be determined in accordance with the provisions of the treaty entered into between China and the country (territory) where the enterprise is incorporated.

If a NDRRE is identified as a Chinese resident, the treaty entered into between China and the other countries (territories) can be applied. The NDRRE can apply to its tax authority in charge for a certificate of Chinese tax resident when the supporting of its Chinese resident status is required. If the foreign tax authorities refuse to grant the NDRRE the treaty relief or seek to treat the NDRRE as a tax resident of the country (territory) where it is incorporated, the NDRRE can apply to initiate a mutual agreement procedure (MAP) according to the relevant provisions.

KPMG observations

The concept of “the place of effective management” has been introduced in the new CIT law. According to the relevant provisions, an enterprise whose place of effective management is in China shall be recognised as a Chinese resident enterprise even if it is incorporated overseas. Subsequently, Circular 82 was issued to set out the criteria for identifying the place of effective management of a CCFE and clarifies the related CIT implications of such status, based on the CIT law and its implementation rules (please refer to [China alert 2009 issue 36](#)). Certain CCFEs have been identified as Chinese resident enterprises in accordance with Circular 82, such as certain foreign entities within the group of China Unicom, China Power, Sinotruk and CNOOC. However, Circular 82 does not cover many administration details. Thus, practical implementation issues have arisen with more CCFEs being recognised as Chinese resident enterprises. Announcement 45 provides some guidance on the treatment of such issues, facilitating the compliance of the enterprises with the relevant provisions.

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