

CHINA TAX ALERT

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Tax clearance procedure for certain outbound remittances overhauled

Regulations discussed in this issue:

- The 2013 Notice of State Administration of Foreign Exchange and State Administration of Taxation on Issues relating to Tax Recordal Filing for Payments to Foreign Parties under Service Trade, etc. (Announcement 40)
- The 2008 Notice of State Administration of Foreign Exchange and State Administration of Taxation on Issues relating to Provision of Tax Certificate for Payments to Foreign Parties under Service Trade, etc. (Circular 64)

On 9 July 2013, the State Administration of Taxation (SAT) and the State Administration of Foreign Exchange (SAFE) jointly issued Announcement 40 to prescribe a new tax registration requirement for Chinese residents making certain payments overseas, effective from 1 September 2013. The scope of the new circular covers cross-border service fees as well as other current account and capital account items under China's foreign exchange regulations.

Announcement 40 is a welcome development for multinational companies (MNCs) doing business in China. It eliminates the existing requirement that tax clearance must be secured before outbound remittance can be carried out; it will also significantly expedite cash transfers from China to overseas for items covered by the circular. However, with the new tax recordal filing system, taxpayers may face greater penalty risks if they are unable to demonstrate that Chinese taxes in connection with the remittance have been adequately settled.

Background

China has maintained a strict foreign exchange control system that regulates funds flowing in and out of China. Historically, a Chinese payor needs to obtain various tax clearance documents before a remittance application can be accepted by a bank in China. In 2008, the SAFE and the SAT jointly issued Circular 64 to streamline the process of obtaining tax certificates for remitting abroad service fees, earnings, current transfers and some capital account items. The tax certificate requirement is waived for a payment that does not exceed USD 30,000 on per remittance basis. In addition, Circular 64 stipulates several instances of outbound remittance where the Chinese payor does not need to obtain tax clearance in advance (the carve-out).

The tax clearance system formalised by Circular 64 has played an important role in ensuring the collection of Chinese taxes on international transactions that are accompanied by cross-border movement of foreign currency. However, the system also creates inefficiency in commercial arrangements and slows down legitimate business transactions, especially in the cross-border service sector. In the past, due to various reasons, the application process to obtain tax certificate on transactions such as service fee payment and expense reimbursement may have taken months or even years to complete. Until the tax certificate was issued, a taxpayer was unable to remit the associated cross-border payment.

Many MNCs have voiced concerns over the negative implications of the tax clearance system on business operations, especially its effect on impeding the development of cross-border provision of services.

Announcement 40

Announcement 40 comes as a government response to address these concerns and to promote international service flows. The circular is consistent with the general trend to gradually relax China's foreign exchange system over recent years. In essence, Announcement 40 prescribes a new tax recordal filing system to replace the existing advance tax certificate system. For each covered remittance that exceeds USD 50,000, the Chinese payor needs to perform a tax recordal filing with its in-charge state tax bureau (ISTB), unless the remittance falls into an exemption list. The reporting package submitted by the Chinese payor for the initial remittance includes the executed contract or other legal documents evidencing the relevant transaction, and the 'tax recordal filing form', which contains basic information on the initial outbound remittance. For any subsequent remittance related to the same transaction, the taxpayer only needs to provide an updated tax recordal filing form reflecting that particular remittance.

The Chinese payor can obtain the tax recordal filing form from the ISTB office or its government homepage. Three copies of the form need to be filled out and submitted to the ISTB. During the recordal filing, the ISTB will assign a serial number to the forms for tracking purposes and will stamp them with the official chop. The ISTB will return one copy to the Chinese payor, retain one copy for their own record, and will send one copy to the local tax bureau in charge. The Chinese payor will bring the stamped tax recordal filing form to a designated bank in China to carry out the remittance.

According to Announcement 40, the ISTB will not review the tax position associated with the remittance during the recordal filing. The purpose of the filing is not to report the Chinese tax position on the remittance, but to notify the ISTB regarding the underlying transaction. As a result, the form does not include any tax information on the remittance. However, this will not diminish the taxpayer's obligation to settle Chinese taxes in compliance with the laws. Within 15 days ensuing the issuance of the stamped tax recordal filing form, the ISTB will examine the reporting package submitted by the Chinese payor as part of the recordal filing and may request additional supporting documents. The focus of this subsequent examination is to check:

- i. Whether the information reported on the form is consistent with the actual transaction
- ii. Whether all Chinese taxes have been fully paid according to the relevant regulations
- iii. Whether the transaction is really entitled to preferential tax treatment under a Chinese income tax treaty where such a treaty claim has been made.

In the post-filing examination, if the ISTB discovers that the Chinese taxes have not been properly paid, it will issue a notice of tax deficiency to the taxpayer or the withholding agent, and may impose a penalty as well as late payment surcharges according to Chinese tax law.

The types of remittances that fall within the scope of Announcement 40 are fairly broad. They include: income derived by non-residents from services (e.g., transportation, tourism, telecommunications, construction, installation, insurance, finance, information technology, and entertainment), intangible licensing, finance lease, real estate transfer, equity transfer, equity investment (e.g., dividend), foreign loan (e.g., interest), guarantee, and various current transfer items, among other things. China-sourced salary income earned by foreign individuals is included. Reinvestment of China-sourced earnings by a foreign investor within China is subject to the provisions in Announcement 40 as well.

The tax recordal filing requirement of Announcement 40 applies to the aforementioned payments only if the amount of a single remittance exceeds USD 50,000. In addition, Announcement 40 prescribes a number of instances where no tax recordal filing is necessary to affect a remittance from China to overseas. The list of exemptions in Announcement 40 is similar to the carve-out in Circular 64 in nature, but it is more comprehensive in scope.

KPMG observations

Announcement 40 represents a measure by the Chinese tax authorities to improve taxpayer services for non-residents, and delivers generally positive news for MNCs seeking to make remittance out of China. The conversion from the advance tax clearance system to the tax recordal filing system could significantly accelerate the outbound remittance process. Under the existing system, it is imperative that the designated Chinese bank sees a tax certificate in order to approve a remittance request. Meanwhile, tax officials reviewing the Chinese tax positions of the transactional parties are pressured to request that all taxes should be collected and all tax controversies are resolved before the tax clearance can be issued. This often causes delay in the remittance process, especially if the tax authorities and the taxpayer are locked in a tax dispute. Under the new system, remittance is de-linked from tax clearance. Tax officials do not need to determine whether adequate taxes have been settled at the time of registering the remittance transaction, and the remittance can take place right after the Chinese payor obtains the stamped tax recordal filing form. The ISTB will examine the transaction after the remittance and assess the MNC's tax positions, but this examination will not hold up the remittance process.

However, the new system in Announcement 40 places higher tax administration standards on the ISTB and creates greater urgency for taxpayers on document preparation. Announcement 40 suggests that the ITSB should proactively examine MNCs' tax positions in cross-border transactions rather than relying on foreign exchange control as an automatic check-point, given that advance tax clearance requirement is no longer a prerequisite for remittance in the future. MNCs should ensure that their tax positions have strong technical merits and are well supported by relevant documentation. If MNCs are imposed with additional tax assessments during the post-remittance examination, they could face penalty and late payment surcharges.

Announcement 40 is scheduled to take effect on 1 September 2013. The SAT has informally indicated that if a taxpayer has obtained a tax certificate, but has not completed remittance before the effective date of Announcement 40, the unutilised tax certificate will cease to be effective on 1 September 2013 and the tax recordal filing system will kick in. With a month to go before the implementation of Announcement 40, MNCs are encouraged to plan the timing of their impending remittances, proactively communicate with their ISTBs to understand any local practices, prepare tax computations according to the facts and the law, and gather documents to support their tax positions.

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