



Hong Kong Institute of  
**Certified Public Accountants**  
香港会计师公会

# Meeting notes

**The Guangdong Provincial Local Taxation Bureau  
and  
The Hong Kong Institute of Certified Public Accountants**

2015

*This is the brief translation of the Chinese version of the report for members' reference. In the event of any inconsistencies between this translation and the Chinese version of the report, members should refer to the original Chinese version of the report. The Institute is not responsible for the accuracy of this translation.*

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## **Preface**

The Hong Kong Institute of Certified Public Accountants (“HKICPA” or “the Institute”) was pleased to hold a meeting on 11<sup>th</sup> December 2015 with the Guangdong Provincial Local Taxation Bureau (“GPLTB”) to discuss on various tax topics in Guangzhou.

The following is a translation of the meeting notes prepared, in Chinese, by the Institute. Please note that this meeting notes merely represented the views of GPLTB officials who attended the meeting 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 any differences in the interpretation between the English and Chinese versions, references should be made to the Chinese version. It should also be noted that the Mainland tax authorities have issued a number of new circulars since the meeting took place. Members may therefore wish to refer to the websites of the relevant tax authorities for the most updated tax circulars.

HKICPA wishes to thank the delegates from Ernst & Young for taking the meeting notes.

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## **Attendees**

### **GPLTB**

Li Huadong	Deputy Director
Luo Cuiying	Deputy Director, Division of International Tax Administration
He Fan	Deputy Director, the First Division of Tax Policy
Tang Dandan	Principal Staff Member, Division of International Tax Administration
Zhu Guoqiang	Principal Staff Member, Division of International Tax Administration
Sun Ting	Principal Staff Member, the Second Division of Tax Policy
Yan Hao	Deputy Principal Staff Member, Division of International Tax Administration
Lin Weitao	Deputy Principal Staff Member, Division of International Tax Administration

### **HKICPA**

Anthony Tam	Deputy Chair, Taxation Faculty Executive Committee and Convener, Mainland Taxation Subcommittee
Ho Sing Mak	Member, Mainland Taxation Subcommittee
Shanice Siu	Member, Mainland Taxation Subcommittee
Raymond Chan	Director, Tax, PricewaterhouseCoopers China
Jessica Li	Manager, International Tax Service, Ernst & Young (China) Advisory Limited
Wallace Wong	Manager, Advocacy and Practice Development

## Discussions

### **A. Individual Income Tax ("IIT")**

#### **1. Indirect transfer of shares**

The State Administration of Taxation ("SAT") is committed to cracking down on abuses by means of various arrangements by non-Chinese resident enterprise investors that lack commercial substance and which aim to avoid paying China enterprise income tax ("EIT") on indirect transfers of shares in Chinese resident enterprises.

SAT's determination to address abuses is demonstrated by the introduction of new rules on tax administration over the years. The major relevant tax circulars are:-

<u>Year of issuance</u>	<u>Subject matter</u>
2009	Guoshuihan [2009] No. 698 – Clarification on tax administration matters on share transfers by non-Chinese resident enterprise investors
2014	Administrative Measures for the General Anti-avoidance Rule (Trial)
2015	SAT [2015] Announcement 7 – Clarifications on enterprise income tax implications on indirect transfer of China assets by non-Chinese resident enterprise investors

#### **(a) Essence of Announcement 7**

When non-Chinese resident individuals effected indirect transfers of Chinese assets by means of share transfers of offshore holding vehicles and such transactions have little commercial justification, will the tax authority apply the spirit of Announcement 7 in attacking the transactions and levy IIT on these individuals?

There is a case in 2011 where the Shenzhen tax authority imposed IIT on a non-Chinese resident individual on his gain on an indirect transfer of Chinese assets via share transfer of an offshore holding vehicle. There is a similar case in 2015 where the Beijing Haidian tax authority imposed IIT on

a non-Chinese resident individual on his gain on an indirect transfer of China immovable assets.

If we take a closer look on the IIT legislation, there is no general anti-avoidance provision in the legislation. Guoshuihan [2011] No. 14, "Reply on policy in relation to non-Chinese resident share transfer", provides that "The general anti-avoidance provisions in the EIT law is not applicable on share transfer transactions if the shareholders of company C are Hong Kong residents."

GPLTB: Announcement 7 was issued based on the EIT law and its implementation rules; and the Tax Collection and Administration Law. Announcement 7 is applicable only on indirect transfers of Chinese assets by non-Chinese resident corporations, but not individuals.

(b) Guoshuihan [2011] No. 14

"China sourced income", referred to in Article 4 of the IIT implementation rule, is further elaborated in Guoshuihan [2011] No. 14 ("Circular 14") to include income derived from indirect transfers of China immovable property via share transfer of a China-incorporated company which holds the immovable property(ies). Will the tax authority issue any tax circular similar to Circular 698 to clarify the application scope of Circular 14 before applying the "by-passing" tax treatment and levy IIT on individuals? We would like to clarify with GPLTB if the by-passing tax treatment is applicable only to share transfers of China-incorporated companies which hold immovable properties in China.

GPLTB: The interpretation of "China sourced income" under Circular 14 should be in line with the "China sourced income" concept stated in the IIT law. The principle of substance over form applies.

(c) Application of Circular 698 and Announcement 7

We are of the view that application of circular 698 and Announcement 7 should be limited to enterprises. There seems to be a lack of legal authority to apply the same principles to individuals. It makes more sense for SAT to

first introduce general anti-avoidance provisions in the IIT law before applying the same principles on individuals. To this end, what is the progress of the relevant legislation and the expected completion date of the revised IIT law.

GPLTB: We are not aware that SAT will introduce general anti-avoidance provisions in the IIT law.

- (d) Indirect transfer of shares in Chinese resident enterprises by non-resident individuals

Under what circumstances will the tax authority treat an indirect transfer of shares of a Chinese enterprise as a direct transfer, such that the non-Chinese resident individual shareholder will be subject to IIT? Will the tax authority issue any tax circular in future to clarify what is the appropriate tax treatment on indirect share transfers of Chinese enterprises by non-resident individual shareholders? Under the prevailing tax rules and regulations, how should a taxpayer estimate his IIT liability in the above-mentioned situation?

GPLTB: There is no clear guideline on the IIT treatment on indirect share transfers of Chinese enterprises by non-Chinese resident individuals. Therefore, we should consolidate the facts, analyse the details and conclude the IIT liabilities of the non-Chinese resident individuals on a case-by-case basis.

- (e) SAT [2014] Announcement No. 67 ("Announcement 67")

If a non-Chinese resident individual effected an indirect transfer of shares of a Chinese enterprise and the tax authority applied the by-passing tax treatment in disregarding the intermediate offshore holding company and treated the case as a direct transfer of shares of a Chinese resident enterprise, should the non-Chinese resident individual follow the guidelines in Announcement 67 (Tax administrative measures on gains on share transfers by individuals) in estimating his IIT liabilities?



GPLTB: Announcement 67 is the correct reference for the said individual in estimating his IIT liabilities.

(f) Implications of Announcement 7 on individuals

On the assumption that the provisions of Announcement 7 are also applicable to individuals, how do we apply the said provisions on individuals? Should the transferor submit the transfer details to the tax authority? Does the overseas transferee have any withholding obligations?

GPLTB: As mentioned previously, Announcement 7 is applicable only on indirect share transfers of Chinese resident companies effected by a non-Chinese resident company for EIT purposes. Announcement 7 is not relevant to the IIT liabilities of non-Chinese resident individuals who effect indirect share transfers of Chinese resident companies.

## 2. Tax treaty benefit entitlement information submission for non-residents

According to Clause 1, Article 8 of SAT [2015] Announcement 60 (Administrative Measures on non-resident individual tax treaty benefit entitlement), the benefit entitlement information of the non-resident individual should be submitted to the tax authority when the individual "first receives income and performs tax filing", if the individual is not an independent contractor; or the withholding agent first withholds tax and files the relevant withholding tax return.

Should "first receives income and performs tax filing" be taken to mean "the first month after 90/183 days have lapsed", or "the first month when the individual receives his salary after his arrival in China"?

GPLTB: Caishuiwaizi [1998] No. 59 (Clarifications jointly issued by the Ministry of Finance and SAT on using the date of physical presence of the temporary visitors in calculating their IIT liabilities) would shed some light on this question. Article 4 of Circular 59 allows temporary visitors to use two different bases in reporting their IIT liabilities. Firstly, if a temporary visitor foresees that he will stay in China for more than 90 days, he can file IIT return and pay IIT based on the ordinary monthly filing due date. If, however, the temporary visitor does not live in China for more than 90 days by the end of his stay in

China, he can apply for a tax refund. Alternatively, if a temporary visitor initially does not foresee that his stay in China will be longer than 90 days, he can file tax return and pay tax when he becomes aware that his stay will exceed 90 days, or when his stay first actually exceeds 90 days. If the temporary visitor files his tax return when his actual stay first exceed 90 days, he should file the tax return within 7 days after his stay has exceeded 90 days. If the filing due date is a public holiday in China, the filing due date can be extended to the next working day.

Accordingly, we can follow the principle of Circular 59 in inferring the meaning of "first receives income and performs tax filing". Tax treaty benefit entitlement information should be submitted to the tax authority together with the first IIT filing.

As per the spirit of Caishuiwaizi [1998] No. 59, no late payment surcharge or penalty should be levied no matter which basis the taxpayer follows in the tax filing.

### **3. Social security paid for expatriates**

Can an expatriate taxpayer group the social security payments (in relation to the annual bonus) made by the employer into bonus and apply the preferential IIT calculation basis on the consolidated sum?

GBLTB: Social security payments do not fall within the scope of the preferential basis for calculating IIT on bonuses.

### **4. PRC resident employees assigned to work at overseas related companies outside the PRC**

If a Chinese resident employee is assigned to work in overseas subsidiary (the "host entity") of a Chinese entity ("home entity") and the host entity bears the employee's actual rental expenses (e.g., the host entity reimburses the employee his actual rental expenses), should the employee's overseas housing benefits be tax exempted for IIT purposes? For the sake of argument, the reimbursement of actual rental expenses is IIT-exempted income in the hands of expatriate employees working in China.

If the Chinese resident employee is put under a tax equalisation programme during his overseas assignment period (i.e., the home entity will bear the overseas individual income tax of the employee and the employee will be subject to a hypothetical tax deduction by the home entity), the overseas individual income tax liability will be treated as additional income in the hands of the employee. On the assumption that the individual income tax is computed on an annual basis in the overseas jurisdiction, should the taxpayer spread the tax payments into 12 instalments and allocate them to the respective month for IIT filing purposes? (If the tax paid in the overseas jurisdiction is treated as an income item for a particular month, the marginal tax rate of the employee for that month would become very high.)

GPLTB: Under the prevailing China IIT law and regulations, rental reimbursement to the expatriate employees working in China is an IIT exempted item in the hands of the expatriate employees. However, this preferential tax treatment is open only to expatriate employees working in China. Therefore, reimbursements of overseas rental expenses to the Chinese-resident employees cannot be treated as IIT exempted items.

According to the prevailing China IIT law and regulations, employers should exercise their withholding obligation on salaries paid to the employees on a monthly basis. In the case mentioned above, the overseas individual tax paid by the home entity should not in principle be allowed to be divided into 12 instalments and allocated to the respective months.

## **B. Real Estate Tax (“RET”) and Land Appreciation Tax (“LAT”)**

### **1. Validity of laws and regulations**

We understand that SAT has empowered the governments at provincial, autonomous regional, municipal level or local tax authorities to formulate some specific regulations on LAT, such as determining the standards for pre-tax and new and old houses, and standards for ordinary residential houses, etc. If some cities formulate certain standards for pre-tax deductions of LAT, while similar regulations have not been set out by the provincial local tax bureaus or authorised by provincial authorities, are these regulations legally binding?

According to Guoshuifa [2006] No.187 (SAT circular on the issues in relation to the liquidation and administration of LAT on real estate developers), the local tax authority can make reference to the benchmark figures issued by the local construction cost authority in the LAT clearance process, if the local tax authority finds that information (including pre-construction costs, construction and installation fees, costs incurred on building up infrastructure, and indirect costs in the construction process) provided by the developers in the LAT clearance process does not fulfil the LAT clearance requirement or is fictitious. The local tax authority can analyse the benchmark figures, structure of the building, usage purposes and location of the building, in coming up with a deemed unit cost for the four areas mentioned above.

The specific methods will be determined by the provincial tax authorities. GPLTB has recently clarified that municipal local tax authorities will assign the administrative department for construction costs in Guangdong Province to formulate relevant standards for construction price benchmarks. Tax authorities will rely on the applicable construction price benchmarks in reviewing the deductible items submitted by enterprises for LAT purposes. If the costs submitted by enterprises are relatively higher, tax authorities will refer to the construction cost standard in assessing the cost of real estate projects, in order to adjust deductible items for LAT purpose and make corresponding calculations.