



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**

2014

Preface

The Hong Kong Institute of Certified Public Accountants ("HKICPA") was pleased to be able to discuss with the Guangdong Provincial Local Taxation Bureau ("GPLTB") various tax topics on 19th December 2014 in Guangzhou.

The following is a translation of the meeting notes prepared, in Chinese, by the Institute. Please note that the meeting notes reflect the views of GPLTB officials attending the meeting only 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 differences in the interpretation between English and Chinese versions, reference should be made to the Chinese version.

HKICPA wishes to thank the delegate from EY for taking the meeting notes.

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Attendees

GPLTB

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| Zhan Liren | Director, Division of International Tax Administration |
| Meng Quanzhong | Deputy Director, the First Division of Tax Policy |
| Luo Cuiying | Deputy Director, Division of International Tax Administration |
| Chen Yunzhang | Deputy Director, Division of International Tax Administration |
| He Fan | Principal Staff Member, the Second Division of Tax Policy |
| Tang Dandan | Principal Staff Member, Division of International Tax Administration |
| Zhu Guoqiang | Principal Staff Member, Division of International Tax Administration |
| Yan Hao | Deputy Principal Staff Member, Division of International Tax Administration |
| Lin Weitao | Deputy Principal Staff Member, Division of International Tax Administration |

HKICPA

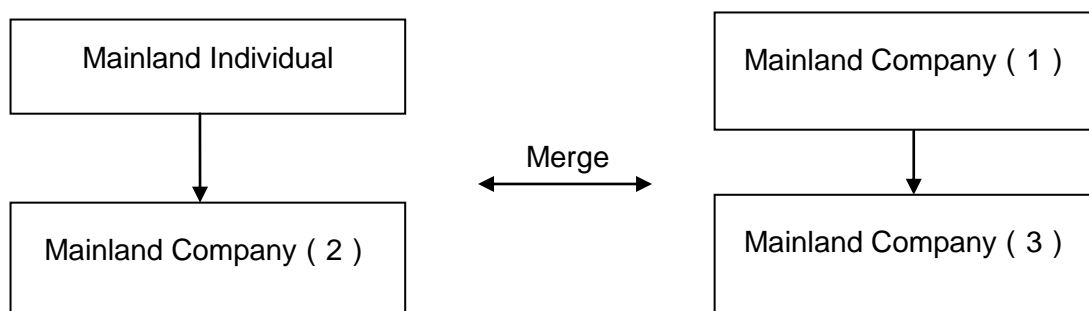
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|--------------|---|
| Anthony Tam | Deputy Chair, Taxation Faculty Executive Committee and Convener, Mainland Taxation Subcommittee |
| William Chan | Members, Taxation Faculty Executive Committee and Mainland Taxation Subcommittee |
| Daisy Kwun | Member, Mainland Taxation Subcommittee |
| Ho Sing Mak | Member, Mainland Taxation Subcommittee |
| Shanice Siu | Member, Mainland Taxation Subcommittee |
| Percy Wong | Members, Taxation Faculty Executive Committee and Mainland Taxation Subcommittee |
| Jessica Li | Manager, International Tax Service, Ernst & Young |
| Mary Lam | Director, Member Support |
| Wallace Wong | Manager, Advocacy and Practice Development |

Discussions

A. Individual Income Tax (“IIT”)

A1. The Special Tax Treatment Policy

Currently, the special tax treatment is applicable only for the corporate income tax (“CIT”) purposes on group restructurings (Caishui [2009] No.59 or “Circular 59”). Can the treatment be adopted for the IIT purposes on personal transfer of assets, such that the taxpayer’s IIT could be deferred? Please refer to the illustration below.



Mainland Individual and Mainland Company (1) are within the same group. The group decides to merge Mainland Company (2) and Mainland Company (3). Accordingly, Mainland Individual and Mainland Company (1) can obtain the merged company’s equity as consideration. Therefore, a profit would be derived by Mainland Individual from transferring the equity in Mainland Company (2). Will the tax authority introduce rules similar to Circular 59 such that Mainland Individual can enjoy the “special tax treatment”?

GPLTB: There was currently no regulation stipulating that the special tax treatment in <Circular on the Issues Concerning Treatment of Enterprise Income Tax for Enterprise Restructuring> (Caishui [2009] No.59) could be referred to for IIT purposes. Taxpayers should adopt <Administrative Measures for IIT on Income Derived from the Alienation of Shares (Trial)> and relevant circulars to handle IIT matters.

A2. Administrative Penalty

If a non-resident enterprise constitutes a permanent establishment (“PE”) in Mainland China, the employer is required to withhold its expatriate employees’ IIT. In some cases, there may be a delay in withholding the IIT for these employees (e.g., it can be done only within 1 to 2 months after the statutory filing deadline, although before the tax authorities raise any enquires), due to practical difficulties in ascertaining the employees’ travel schedule. Some local tax authorities regard such situations as “Failure to withhold” and impose a penalty at 50% of the under-paid tax, in accordance with “Implementation Measures of the Guangdong Province Local Tax Bureau on Regulating Discretion for Tax Administrative Punishment” (“Tax Administrative Punishment Measures”), even if enterprises take the initiative to pay the under-paid tax. However, according to Tax Administrative Punishment Measures, if the non-compliance is not serious (such as an inadvertent mistake in tax calculation or incorrectly withholding of a tax payment) and the error is rectified on a timely basis, penalties should not be imposed. Could tax authorities take into consideration the taxpayers’ practical difficulties and not treat this as a “Failure to withhold” situation and impose penalties on the taxpayers?

GPLTB: According to Tax Administrative Punishment Measures, if an enterprise had any difficulties in timely reporting/ withholding of IIT for expatriate employees, it was allowed to apply for an extension with in-charge tax authorities before filing deadline. The enterprise should report and withhold IIT within the extension period, after obtaining the extension approval from tax authorities.

If there were any practical difficulties, such as expatriate employees' travel schedules not being available on a timely basis, the taxpayers were allowed to discuss with in-charge tax authorities and apply to extend the filing deadline for withholding IIT before the statutory IIT filing deadline, so as to mitigate the penalty risk for late tax filings. It should be noted that if the aforesaid tax filing extension was a regular monthly occurrence, the enterprise would be required to apply for an extension every month for withholding IIT, before the monthly filing deadline.

A3. Overseas Sourced Income

A company in the Mainland hires an expatriate employee, whose main responsibility is to represent the company to conduct business in overseas markets. Will the expatriate employee be allowed to calculate his/her IIT under the time apportionment method?

GPLTB: Generally speaking, IIT on salary income of expatriate employee could be calculated based on the time apportionment method. However, if the expatriate employee's remuneration had been deducted by the Mainland company in calculating its CIT, the expatriate employee's salary income would be fully subject to IIT in the Mainland.

HKICPA note: An individual who is not a resident in the Mainland should report IIT on his/her income sourced from the Mainland only. Mainland-sourced salary means remuneration paid to the individual for his/her work within Mainland China. Remuneration paid to the individual for his/her work within the Mainland is deemed to be income sourced from the Mainland, regardless of whether it is paid by a Mainland employer or an overseas employer, while remuneration paid to the individual for his/her overseas work is deemed to be income from overseas regardless of whether it is paid by a Mainland employer or an overseas employer.

A4. Dual employment

Does an enterprise in Mainland China have an obligation to withhold IIT for an employee on the salary paid by an overseas enterprise under dual employment arrangements?

GPLTB: Under dual employment arrangements, if an employee was resident in the Mainland, the Mainland enterprise should withhold IIT on the salary paid by overseas companies to the employee. If the employee was not resident in the Mainland, the company should withhold IIT based on the salary sourced from the Mainland, as well as any salary paid by the overseas company which was borne by the Mainland company.

In accordance with Circular Yuedishuihan [2005] No. 64, where a Mainland enterprise/institution paid or bore salaries and withheld the relevant IIT for an individual employee who did not have residence in Mainland China, it should request the individual or overseas employer to provide information of the employee's salary income paid or borne by the overseas employer. If the individual or overseas employer could not provide relevant information, due to confidentiality or other reasons, the withholding

enterprise/ institution could report the situation to the tax authority and have the individual perform IIT self-reporting or authorize an agent to file the IIT for the employee. Indeed, according to Article 3 of the “Notice issued by the State Administration of Taxation regarding Several Issues Concerning the Execution of Double Tax Arrangements and Individual Income Tax Law on Individuals Without Residence Within the Territory of China” (Guoshuifa [2004] No. 97), IIT would be calculated by combining the salary income sourced from the Mainland and overseas. .

HKICPA note: According to GuoShuiFa [1999] No. 24, the salary or wages of an employee who works for a foreign investment enterprise (“FIE”) within the Mainland should be paid by the FIE. Where a FIE has a related party relationship with an overseas enterprise and part or all of an employee's salary or wages that should have been paid by the FIE is paid by the overseas enterprise, the FIE shall be responsible for collecting the relevant information and withholding the IIT, in accordance with the IIT Law. As such, the FIE should be responsible for withholding IIT on employees' salaries and wages paid by its foreign affiliates, in accordance with the above provisions.

A5. Tax Treatment under Double Tax Arrangement (“DTA”)

An American employee comes to Mainland China and works for an enterprise there for two years. During this period, the employee does not stay in the Mainland for more than 183 day in either the calendar year when he/she arrives in the Mainland or the calendar year when he/she leaves the Mainland, and his/her salary is not borne by the Mainland enterprise. The employee is an American tax resident, and the enterprise that bears the employee's salary does not have a PE in China. In this situation, which of the following IIT treatments would apply to the employee's salary for the years when he/she arrived in/ left China?

- Tax exemption treatment under the China-US DTA could be applied but the taxpayer would be required to register with the in-charge tax bureau to enjoy the tax exemption according to GuoShuiFa [2009] No. 124 (in practice such registration is rarely done); or
- Since the employee works in the Mainland enterprise, it would be the employer in substance. The tax authorities will consider that the employee's salary is borne by the Mainland enterprise. As such, the tax exemption under China-US DTA would not be applicable and the relevant salary would be subject to IIT.

GPLTB: According to China-US DTA, the above situation would fulfil the criteria for treaty relief. After lodging an registration with the in-charge tax bureau for the treaty relief, based on GuoShuiFa [2009] No. 124, the employee would not be subject to IIT.

A6. Employee Secondment

For business reasons, an individual employed by a Guangzhou company is assigned to work in a related company located in Shanghai under a secondment arrangement. As the employee is employed by the Guangzhou company, the employee's salary is paid by the Guangzhou company. When performing IIT filing for this employee, with which tax authority, i.e., Guangzhou or Shanghai, should the employee perform IIT filing?

GPLTB: Since the employee was employed by and his/her salary was paid by the Guangzhou company, it had the obligation to withhold IIT for him/her.

HKICPA: If the Guangzhou company had withheld IIT for the employee, was it necessary to provide explanations to the Shanghai tax authority that the employee's IIT had been withheld in Guangzhou? GPLTB indicated that the company could explain this situation to the Shanghai tax bureau, which might require the Shanghai company to provide the IIT payment receipt of this employee as evidence.

HKICPA: If the employee planned to purchase a house/apartment in Shanghai, the IIT payment receipt (issued by the Shanghai tax bureau) would be required by Shanghai government authorities. However, since Guangzhou company withheld IIT for the employee, the IIT payment receipt would be provided by the Guangzhou in-charge tax bureau. How to address this situation? GPLTB explained that the management might consider arranging for the Shanghai company to pay the employee's salary, then the Shanghai company would withhold the IIT for this employee.

A7. Overseas Chinese

In addition to a tax deduction of RMB4,800 for IIT purposes, are the other tax exemptions for foreign nationals also applicable to overseas Chinese who are working in China?

In accordance with the provisions issued by the Overseas Chinese Affairs Office of the State Council on Defining the Identity of Overseas Chinese, Expatriate Chinese and their Family Members Who Return to China (GuoQiaoFa [2009] No.5), overseas Chinese refers to Chinese citizens who reside abroad. The specific definition is as follows:

- "Reside" shall mean a Chinese citizen who has obtained the long-term or permanent right to live in the state of his/her overseas residence, and has lived consecutively in such state for two years and no less than 18 months accumulatively.
- A Chinese citizen who has not obtained the long-term or permanent right to live in the state of his/her overseas residence, but has obtained the lawful right to reside in such state consecutively for more than 5 years (inclusive), and live in such state for not less than 30 months accumulatively within the 5-year period, shall be deemed as an overseas Chinese.

Will the Notice issued by the State Administration of Taxation on Imposing and Exempting Individual Income Tax on Qualified Allowance Granted to Foreign Individuals (GuoShuiFa [1997] No. 54) apply to an overseas Chinese citizen who is working in the Mainland (and who fulfils the above definition of overseas Chinese). That is, will housing allowance, meal allowance, laundry fee, travel allowance, home trip allowance, children's education expenses, language training fee, etc., which are reasonable and paid to foreign individuals in the form of non-cash or reimbursement upon receipt, be exempt from IIT?

GPLTB: According to Article 30 of the Implementing Regulations of the Individual Income Tax Law of the People's Republic of China, Overseas Chinese, Hong Kong, Macau and Taiwan compatriots should be treated by reference to Articles 27, 28 and 29 hereof. Therefore, GuoShuiFa [1997] No.54 would apply to overseas Chinese (i.e., those fulfilling the definition of overseas Chinese) who were working in the Mainland.

A8. Travel Allowance

According to the IIT Law, travel allowances for domestic and overseas business trips by foreign individuals, which are in line with reasonable standards are exempt from IIT. However, there is no specific test of “reasonable”. What tax treatment should be applied to travel allowances given in cash (which are not a reimbursement of the travel cost actually incurred but a fixed amount of daily cash)?

- Whether such allowances can be exempted from IIT, in accordance with the provisions on business trips and meal allowances stipulated in YueCaihang [2014] No. 67 and CaiHang [2013] No. 516; or
- IIT exemption can be applied where the company can provide the standard for calculating travel allowances for domestic and overseas business trips and business trip arrangements and lodge these with the in-charge tax bureau.

GPLTB: YueCaiHang [2014] No. 67 applied only to travelling expenses of staff in the direct departments and the institutions of Guangdong Province Government for business trips to the areas outside of residence, including the expenses incurred on travelling among cities, accomodation and interurban transportation, but did not include expenses for overseas business trips. Caihang [2013] No. 516 applied only to travel expenses incurred for the officers at or below the provincial level (including provincial) on overseas business trips which were organized by all levels of the government authorities, such as the Party, the government, the National People’s Congress, the Chinese People’s Political Consultative Conference, the Courts, the Prosecutors, the Democratic Parties, and the Public Organizsations. Therefore, the above two circulars were not applicable to foreign individuals regarding IIT treatment of domestic and/or overseas business trip allowances.

IIT law was silent on what was a “reasonable standard” of domestic or overseas business trip allowances paid to foreign individuals. According to Guo Shui Fa [1997] No. 54, reasonable travel allowances paid to foreign individuals for domestic and overseas trips were exempt from IIT. The taxpayers should provide the copies of receipts of business trip transportation, accomodation, or business trip plans to the tax authorities in order to apply for IIT exemption. Therefore, foreign individuals should submit the relevant supporting documents, together with IIT filing, so as to enjoy the relevant tax exemption benefits.

A9. Asset Transfer

When an individual acquires a company (investee company)'s equity by injecting into the company his/ her non-monetary assets, if the value of the assets is shown to have increased upon evaluation, the corresponding portion of the equity value over and above the original value of the assets should be subject to IIT, as income from "transfer of property". Such IIT should be withheld by the investee company when the individual obtained the equity. However, as no cash flow is generated in the transaction, how could the investee company withhold the IIT? How should the tax reporting be conducted in practice?

GPLTB: The investee company was the statutory withholding agent, and whether additional cash flow existed or not would not affect the withholding obligation. If the investee company failed to fulfil the withholding obligation, the taxpayer would be required to report and pay the IIT to the tax authorities by themselves.

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

B1. RET's Pilot Policy on Individual Owned Property

Recently, there has been news about a pilot policy on RET on housing property owned by individuals. Will the pilot policy be implemented in Guangdong and, if so, when will the policy to be initiated?

GPLTB: The legislative power in relation to RET was the responsibility of national authority. So far, GPLTB had not received any notification that the RET pilot policy on housing property owned by individuals would be implemented in Guangdong.

B2. RET's Pilot Policy on Enterprise Owned Property

Will the current RET on enterprises' real estate be reformed?

GPLTB: To date, GPLTB had not received any notification from the central government to change the current RET policy on enterprises.

B3. RET Issue on Outdoor Car Park (without shelter)

According to Caishuidizi [1987] No.3, Article 1 indicates that "real estate" is a property in the form of a house, which means that there is a roof and building structure (with walls or columns on both sides) that can be a shelter from wind and rain. It is a place where people can produce, work, study, entertain, reside or store materials. The RET on real estate related to the operation of an enterprise is levied on the rent or the residual value of the real estate.

Regarding an open area on the top floor of a mall, this seems not to meet the definition of "real estate". Where the open area on the top floor of the mall is used as a car park and parking fees are charged by hour, will RET be levied? If the answer is yes, which RET calculation method should be adopted? If the RET is levied based on the residual value, then how should the residual value of the top floor of a mall be determined?

GPLTB: If the open area on the top floor of a mall did not meet the definition of the "real estate" in the Interpretation and Provision of Ministry of Finance and SAT on several practical problems of RET and Vehicle and Vessel Usage Tax (Caishuidizi [1987] No.3), no RET would be levied on.

B4. RET Calculation of Property without Legal Ownership

A Mainland company purchased a ten-storey commercial unit from a real estate developer in Guangzhou. In return, the developer presented ten parking lots to the company. However, the developer clarified that all of the parking lots came without certificates of property rights. However, the company rents out half of the parking lots and keeps the other half for its own use. How should the RET payable be calculated?

GPLTB: Regarding real estate without property rights, if the company rented out the real estate and received rental income, the RET would be levied based on rental income. If the real estate without property rights was used by the owner itself, the RET would be levied based on the residual value. If the company was not able to prove to

the tax authority the original value of similar real estate with adequate information, the tax authority could refer to the value of similar real estate to determine the original value of the real estate without property rights certificates, and calculate the RET based on the deemed original value. Presently, GPLTB has started to set up a real estate information database, which could be a reference for determining the original value of the real estate.

B5. LAT Issues on Demerger of Enterprises

According to Caishuizi [1995] No. 48, in a merger, where the merged enterprise transfers its land and buildings to the merging enterprise, the merged enterprise is temporarily exempted from LAT. However, the current regulations on LAT have not clearly stipulated whether LAT will be imposed on the transfer of land and building during demerger.

Some local tax authorities consider that the transfer of land and building during a demerger is not subject to LAT. For instance, according to Article 18 of the Notice of Qingdao Local Tax Bureau on the Issuance of "the Answer of Practical Problems on Clearing LAT in Real Estate Development Projects (Qingdishuihan [2009] No. 47), in the situation where a real estate development company was demerged into two or more companies, in accordance with the law or based on contract, the demerging party or the new party which takes up the original company's real estate would be exempt from LAT.

Since Qingdishuihan [2009] No.47 is valid only in Qingdao city, Shandong Province, what is the opinion of GPLTB on whether or not LAT should be imposed in demergers? Would GPLTB refer to the Qingdao Local Tax Bureau's practice?

GPLTB: The higher level tax authority was currently in the process of discussing and clarifying issues regarding LAT in enterprise demergers.

B6. Unfinished Buildings

A taxpayer purchased an entire unfinished building project (final acceptance to be done) via the court auction. The Sales Confirmation states that the taxpayer needs to pay for tax associated with ownership transfer, including business taxes and surcharges and LAT. Having acquired the unfinished building project, the buyer also needs to pay unsettled land transaction fees, complete the administrative procedures and fully construct and decorate the building before it can be sold.

- Will the taxes paid by the buyer be considered as part of the costs of acquiring the land and building and, therefore, be deducted for the purpose of calculating the LAT?
- Will the follow-up construction and sale be considered as real estate development and so be eligible for 20% super deduction on LAT? If so, is there any additional condition that needs to be met?

GPLTB: When a taxpayer purchased the unfinished building project via court auction (final acceptance to be done), the taxes that were required to be paid by the buyer could be deducted. Whether the costs associated with follow-up construction and sales could be eligible for 20% additional deduction for LAT purposes would need to be determined on a case-by-case basis.

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