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RECENT DEVELOPMENT ON FOREIGN EXCHANGE ADMINISTRATION IN THE PRC

The PRC's foreign exchange reserves experienced a continuous drop during the second half of 2016 and hit the psychological level of US\$3 trillion for the first time since February 2011. The regulators recently promulgated Circular YinFa [2016] No. 306 - “Notice on Further Clarification of Issues Concerning Overseas RMB Lending by Enterprises in China” 《关于进一步明确境内企业人民币境外放款业务有关事项的通知》, PBOC Order [2016] No.3 “Administrative Measures for the Reporting for Large-Value Transactions and Suspicious Transactions by Financial Institutions” 《金融机构大额交易和可疑交易报告管理办法》 and Circular Huifa [2017] No.3 – “Notice on Further Advancing the Reform of Forex Administration and Improving the Review for Authenticity and Compliance” 《关于进一步推进外汇管理改革完善真实合规性审核的通知》.

In this Tax Flash, we aim to provide you the salient points of these Circulars.

1. CIRCULAR YINFA [2016] NO. 306

Circular Yinfa [2016] No. 306 was issued by the People’s Bank of China (“PBOC”) on 29 November 2016. It sets forth new requirements when a PRC enterprise lends RMB loan to overseas borrower.

Salient points of Circular Yinfa [2016] No. 306 include:

- The PRC lender should be legally incorporated for more than 1 year;
- The PRC lender and the overseas borrower should have shareholding relationship;
- The PRC lender should perform pre-registration of overseas RMB loans with the local in-charge State Administration of Foreign Exchange (“SAFE”);
- The PRC lender’s overseas lending quota is capped at 30% of its owner equity in its last year’s audited financial statements;
- The PRC lender should not fund its overseas loan through debt financing or with investment from individuals;
- The loan interest rate should be commercially justifiable (interest-free loan is not allowed);

- The loan term should be between 6 months and 5 years. For loan term more than 5 years, record-filing with the local PBOC branch is required;
- The overseas RMB loan should only be extended once;
- The size of the loan should commensurate with the overseas borrower's scale of operations;
- The actual usage of the overseas RMB loan will be examined; and
- Return of loan principal is mandated. If the loan repayment is overdue and the lender fails to provide reasonable explanation regarding the delay in repayment, registration process of new transaction will be suspended.

The Circular aims to strengthen the regulation of overseas RMB lending by PRC enterprises.

2. PBOC ORDER [2016] No.3

On 30 December 2016, PBOC issued Order [2016] No. 3 which applies to the following financial institutions incorporated in the PRC:

- Policy banks, commercial banks, rural cooperative banks, rural credit cooperatives, rural banks;
- Securities companies, futures broker companies and fund management companies;
- Insurance companies, insurance asset management companies, insurance agency companies and insurance brokerage companies;
- Trust companies, financial asset management companies, group finance companies, financial leasing companies, automobile finance companies, consumer finance companies, currency brokerage companies and mortgage companies; and
- Other financial institutions as prescribed and named by the PBOC.

PBOC Order [2016] No. 3 requires the above financial institutions to report large-value transactions and suspicious transactions to the PRC Anti-Money Laundering Monitoring Centre within 5 working days¹.

The large-value transactions reporting thresholds are as follows:

Types of Transaction	Reporting Thresholds ²	
	Non-natural Person	Natural Person
Cash Transactions ³ (single or cumulative) on a single day	RMB50,000 ⁴ or above; or USD10,000 equivalent or above in foreign currencies	
Domestic Fund Transfers (single or cumulative) on a single day	RMB2,000,000 or above; or USD200,000 equivalent or above in foreign currencies	RMB500,000 or more, or USD100,000 equivalent or above in foreign currencies
Cross-border Fund Transfers (single or cumulative) on a single day		RMB200,000 or more, or USD10,000 equivalent or above in foreign currencies

¹ The responsibility of reporting large-value transactions and suspicious transactions will be assumed by the financial institutions. No documentations or approval procedures required for companies or individuals.

² The cumulative amounts are calculated and reported on a unilateral transaction basis by a single customer according to receipts or payments of funds, unless otherwise stipulated by the PBOC.

³ Include cash deposit and withdrawal, cash settlement of foreign exchange verification and cancellation, cash exchange, cash remittance, cashier's check payment and other cash transactions.

⁴ The reporting threshold was RMB 200,000 before the promulgation of PBOC Order [2016] No.3.

For suspicious transactions, if a financial institution discovers (or with “reasonable suspicion” to believe) its customers, customers’ funds/assets or transactions, or their intended transactions relate to criminal activities (e.g. money laundering and/or terrorist financing), it should report the same to the authority regardless of the amount or value of funds involved.

PBOC Order [2016] No.3 also stipulates that the financial institutions should:

- establish enhanced monitoring systems for large-value transactions and suspicious transactions in order to satisfy the data requirements; and
- formulate their internal transaction monitoring standards (guidelines will be released by PBOC in future) for the reporting of large-value transactions and suspicious transactions.

PBOC Order [2016] No.3 will be effective 1 July 2017 and the old administrative measures (i.e. PBOC Order [2006] No. 2 and PBOC Order [2007] No. 1) will be superseded.

3. CIRCULAR HUIFA [2017] NO.3

Circular Huifa [2017] No. 3 was promulgated by the SAFE on 26 January 2017 to advance the reform of foreign exchange administration in the PRC. Salient points include:

(a) Expand the scope of settlement for domestic foreign currency loan

PRC enterprises can now settle their domestic foreign currency loans with foreign exchange proceeds from exported goods. Settlement through foreign exchange purchase, however, is still restricted.

(b) Allow to transfer the funds of overseas loans under domestic guarantees back to the PRC for domestic use

This can be done through lending to PRC enterprises, equity investment, etc.

(c) Further enhance the centralized management of foreign exchange of multinational corporations

- The percentage of deposits retained by the PRC banks’ international foreign exchange master account that is allowed to be used in the PRC is increased from 50% of the daily average balance of deposits over the last 6 months to 100%.
- The above funds used in the PRC will not take up the quota for outstanding short term external debt of banks.

(d) Allow non-PRC enterprises in the pilot free trade zones to have foreign exchange settlement through their non-resident foreign exchange account.

In case the funds are for domestic use in the PRC after foreign exchange settlement, the bank should examine the supporting documentation of the PRC enterprises and individuals concerned in accordance with the relevant regulations.

(e) Further strengthen the foreign exchange administration for trade-in-goods

PRC enterprises should follow the principle of “exporters/importers should match with the corresponding foreign exchange receipts/payments” when performing the trade-in-goods foreign exchange settlement.

(f) Improving the statistics of foreign exchange revenue under current account deposited overseas

For those PRC enterprises which have deposited their export revenues from trade-in-goods or trade-in-services overseas but failed to perform the relevant formalities in accordance with Circular Huifa [2012] No.38 and Circular Huifa [2013] No.30, they should report the relevant information to the local authority within one month after the release of this Circular.

(g) Continue to implement and refine the administrative measures for outbound remittance of dividends

- When processing a PRC enterprise's outbound remittance of profits/dividends of more than an equivalent amount of USD 50,000, banks should review the authenticity of the resolutions of the board of directors on profit distribution, the original tax record filing forms (and stamp on the original tax record filing forms indicating the amount and date of the remittance) as well as the related audited financial statements.
- A PRC enterprise should make up for the losses incurred in previous years before remitting profits overseas.

(h) Enhance the authenticity and compliance review for "Outbound Direct Investment"

When a PRC enterprise performs the "Outbound Direct Investment" registration and outbound remittance, besides the documents as prescribed under the regulations, the following should also be provided to the designated bank for authenticity and compliance review:

- the sources and the usage of the investment funds;
- resolutions of the board of directors; and
- contracts and other documents to demonstrate authenticity.

(i) Supervision of overseas RMB and foreign currency loan

The sum of a PRC enterprise's overseas loan in RMB and foreign currencies should not exceed 30% of its owners' equity in its last year's audited financial statements.

4. POINTS TO NOTE

In response to news that the PRC government will tighten its regulatory practice with respect to outbound fund flows, at a press conference held in December 2016, officials from the National Development and Reform Commission, Ministry of Commerce, the PBOC and the SAFE jointly reiterated that:

- there is no change in government policies to encourage businesses to go global;
- the current recordal system for administering overseas investment will be maintained;
- the government will strengthen the supervision on overseas direct investment in the current investment environment, including but not limited to:
 - "irrational" investment such as real estate, hotels, film, entertainment and sports clubs, etc.;
 - large non-core business investments;
 - investment through limited partnerships;
 - small parent companies with large subsidiaries; and
 - enterprises established hastily or rushing to go global, etc.

Going forward, enhancing supervision on cross-border capital flow and protecting the foreign exchange reserve are the major tasks for foreign exchange administration reform in the PRC. Investors should be more cautious and ensure that they are up to date with the new rules and new procedures implemented by the SAFE and the financial institutions.

RSM Tax Advisory (Hong Kong) Limited

RSM Hong Kong's dedicated and experienced tax specialists can:

- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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