China Issued New Guidance on the Administration of Withholding Corporate Income Tax

On 17 October 2017, the China State Administration of Taxation (‘SAT’) issued Public Notice [2017] No. 37 - “Issues Regarding Withholding Corporate Income Tax (CIT) at Source for Non-Resident Enterprises” (“PN 37”). PN 37 revises and streamlines the rules governing the administration of withholding CIT on income derived by non-resident enterprises. It is accompanied by the SAT official interpretation and took effect from 1 December 2017.

In this Tax Flash, we will provide you the salient points of PN37.

1. Replaces Circulars

PN 37 repeals the following circulars:

- the remaining provisions on the calculation of disposal gains of Circular Guoshuihan [2009] No. 698 - “Notice of SAT on Strengthening the Administration of Corporate Income Tax on Gains derived by Non-resident Enterprises from Equity Transfers” ¹ (“Circular 698”);
- Art. 5 and Art. 6 of SAT Public Notice [2011] No. 24 - “Corporate Income Tax Administration of Non-resident Enterprises” (“PN 24”); and
- Relevant articles in some other circulars.

¹ The indirect transfer rules in Circular 698 was repealed by SAT PN 7 – “Several Issues Relating to Corporate Income Tax on Gains from Indirect Transfer of Assets by Non-resident Enterprises” in 2015
2. Abolition of Contract Registration Requirement

Under the repealed Circular 3, for an offshore transfer of a PRC enterprise, the transfer agreement should be submitted to the competent tax authority within 30 days from the date the agreement was signed or amended. Such requirement was abolished by PN 37.

Having that said, PN 37 expressly stipulated that (i) the competent tax authority still has the authority to ask for the contract and other information from the relevant parties (including the withholding agent and non-resident taxpayer); and (ii) withholding agent should properly maintain a file which contains the contract details, the records of tax withholding and payments and other relevant information.

Besides, non-resident enterprises should be aware that contract registration with tax authorities would still be required in some other occasions, e.g. application for tax treaty benefit, contracted projects for a PRC entity, outbound payments exceeding USD 50,000 etc.

3. Abolition of Withholding Agent’s Tax Clearance Requirement for Contract with Multiple Instalment Payments

PN 37 abolished the Circular 3 requirement of which the withholding agent of a contract with multiple instalment payments should complete the final tax clearance with the competent tax authority within 15 days before the last instalment payment.

4. Timing of Dividend Withholding Obligation

PN 37 stipulated that the dividend CIT withholding obligation arises on the day the dividend payment is made to the non-resident enterprise rather than on the day the resolution to declare the dividend was made.

<table>
<thead>
<tr>
<th>Art. 5 of PN 24 (repealed)</th>
<th>Art. 7 of PN 37</th>
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| ➢ Withholding obligation arises on the date the resolution to declare dividend was made (or actual payment date if it is before the date of resolution). | ➢ Withholding obligation arises on the date of dividend payment.  
➢ This provision retroactively applies to unpaid dividends where withholding tax has not been settled prior to the effective date of PN 37. |

5. Consideration paid in instalments – Recovery of Investment Cost

Where transfer consideration is to be paid in instalments, investment cost will first be recovered.

<table>
<thead>
<tr>
<th>Art. 6 of PN 24 (repealed)</th>
<th>Art. 7 of PN 37</th>
</tr>
</thead>
</table>
| ➢ For non-resident enterprise directly transfer the equity interest of a Chinese entity, if transfer consideration is to be paid in instalments, income recognition should take place after:  
- the related agreement takes effect; and  
- formalities for change in equity ownership are completed. | ➢ If transfer consideration is to be paid in instalments, the instalment payments will first be regarded as recovery of investment cost.  
➢ CIT should be calculated and withheld after all investment costs have been recovered.  
➢ This provision retroactively applies to contract where withholding tax has not been settled prior to the effective date of PN 37. |
6. **Conversion of Foreign Currency into RMB**

PN37 clarifies the exchange rate that should be used for converting payment denominated in foreign currency into RMB under the following three scenarios:

<table>
<thead>
<tr>
<th>Situation</th>
<th>Use of Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Tax is withheld by withholding agent</td>
<td>➢ The exchange rate on the date the withholding obligation arises (i.e. the date when payment is actually paid or become due)</td>
</tr>
<tr>
<td>➢ Non-resident taxpayer voluntarily reports and files tax return</td>
<td>➢ The exchange rate on the day before the issuance of tax payment certificates</td>
</tr>
<tr>
<td>➢ Tax authority order non-resident taxpayer to pay tax</td>
<td>➢ The exchange rate on the day before the tax authority makes the decision</td>
</tr>
</tbody>
</table>

PN 37 also revises the Circular 698 provision on how the income/costs (denominated in foreign currency) of equity transfer should be converted into RMB for tax calculation purposes:

<table>
<thead>
<tr>
<th>Art. 4 of Circular 698 (repealed)</th>
<th>Art. 5 of PN 37</th>
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<tbody>
<tr>
<td>➢ If the income/costs of equity transfer is in a currency other than RMB, they should first be converted to the currency used in the first capital injection (or purchased the equity) for tax calculation purpose.</td>
<td>➢ If the income/costs is in a currency other than RMB, they shall be converted into RMB first before calculating the gain.</td>
</tr>
<tr>
<td>➢ The exchange rate used should be on the day the income is obtained or initial investment is made.</td>
<td>➢ The exchange rate used should follow the three scenarios in the above table</td>
</tr>
</tbody>
</table>

7. **Relaxed Timeline for Non-Resident Taxpayer’s Self-Reporting**

In case the withholding agent fails to perform its withholding obligation, PN 37 provides a more reasonable timeline for non-resident taxpayer’s self-reporting:

<table>
<thead>
<tr>
<th>Under Circular 3 (repealed)</th>
<th>Under PN 37</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Non-resident taxpayer should, within 7 days of the original withholding obligation arises, file and settle the CIT with the in-charge tax authority at the location where the income is derived.</td>
<td>➢ Non-resident taxpayer can wait for tax authority’s instruction to file and settle the CIT.</td>
</tr>
<tr>
<td></td>
<td>➢ If non-resident taxpayer voluntarily reports and pays CIT before the deadline set by the tax authority, the tax payment would be regarded as being paid on time.</td>
</tr>
<tr>
<td></td>
<td>➢ This provision has retroactive effect.</td>
</tr>
</tbody>
</table>
8. Multi-Locations Tax filing

Under Circular 3, for non-resident enterprise with income from several locations within China, it may select one location to self report and settle the tax. PN 37 now supplements with a further requirement that the captioned income streams must be “income of same nature”.

PN 37 did not define “income of same nature”. However, the official interpretation of PN 37 has explicitly stipulated that for an indirect transfer of two or more Chinese entities (i.e. transferring an overseas co. with two or more Chinese entities), the gain derived from disposal of these Chinese entities will not be treated as “income of the same nature”. Separate filings will need to be made with all the relevant authorities in which the transferred Chinese entities are located.

9. Competent Tax Authorities and Withholding Agent

PN 37 also clarifies how to determine the competent tax authority and the withholding agent’s non-compliance liabilities:

- Withholding agent should report and settle the tax withheld with its in-charge tax authority.
- If withholding agent has made payment to the non-resident recipient but did not settle the tax with the tax authority within the prescribed timeline, the withholding agent will be considered as “tax withheld but not remit to the tax authority” in any one of the following circumstances:
  - Withholding agent informed the non-resident recipient that tax has been withheld;
  - Tax payable has been booked separately in the withholding agent’s accounting book;
  - Tax payable has been separately deducted/amortized in the withholding agent’s income tax returns; or
  - There is other evidence that the tax was actually withheld.

In such case, withholding agent’s competent tax authority should follow up with the withholding agent to recover tax withheld but not paid over. Withholding agent may also be pursued for late payment levies and penalties.

- In any other situations, the withholding agent would be considered as failing to withhold tax:
  - If the withholding agent’s competent tax authority confirmed that tax has not been withheld and paid by the withholding agent, the tax authority should notify the competent tax authorities in the place where the income is derived by sending a letter within five business days from the date of such confirmation.
  - The non-resident recipient should report and pay the tax to the competent authorities located in the place where the income is derived:

<table>
<thead>
<tr>
<th>Types of income</th>
<th>Competent Tax Authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income derived from the transfer of immovable property</td>
<td>the state tax bureau at the place where the property is located</td>
</tr>
<tr>
<td>Gains derived from a transfer of an equity investment</td>
<td>the tax authorities in charge of the invested enterprise’s income tax</td>
</tr>
<tr>
<td>Dividends</td>
<td>the tax authorities in charge of the distributing entity’s income tax</td>
</tr>
<tr>
<td>Interest, rents and royalties</td>
<td>the tax authorities in charge of the income tax of the enterprise or individual that bears or pays the relevant income</td>
</tr>
</tbody>
</table>
- If the location of a withholding agent is different from the place where the income is derived, and the competent tax authorities in the place where the income is derived are responsible for collecting the tax, those authorities will be responsible for verifying the relevant information with the withholding agent’s competent tax authority;
- The withholding agent’s competent tax authority will pursue the non-compliance liability of the withholding agent;
- The withholding agent or the non-resident recipient (or both) may be pursued for tax recovery (and levies/penalties).

**POINTS TO NOTE**

PN 37 provides clearer guidance on the administration of withholding CIT on income derived by non-resident enterprises. On one hand, new measures are introduced to reduce the administrative burden on withholding agents and non-resident payees. On the other, it continues and refines certain provisions in Circular 698, such as:

- The base cost of equity for calculating transfer gain/loss is the “Equity Net Value”.
- “Equity Net Value” is the amount of capital contributed (or consideration paid to the original owner for acquiring the equity interest), adjusted by value decrements/increments recognized for tax purposes during the holding period.
- Undistributed retained profit of the transferee (i.e. the Chinese entity) cannot be used to offset against the transfer consideration.
- Taxable income received by non-resident enterprise should be grossed-up if the withholding tax cost is borne by the withholding agent.

PN 37 makes a number of changes to the previous rules. Relevant parties (including the withholding agent and non-resident recipient) should have thorough understanding of this new guidance and pay close attention to their withholding obligations and the relevant legal liabilities.
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