

## New Clarification on Income Tax Withholding Issues of Non-resident Enterprises

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On 17<sup>th</sup> October 2017, the State Administration of Taxation (SAT) promulgated "Notice about Income tax withholding issues of Non-resident enterprises (hereinafter the "Circular No.37")", which is considered to be an important revise regarding withholding tax issues since 2009, and will take effect from 1<sup>st</sup> December 2017.

### BACKGROUND

In 2009, "Interim Administrative Measures on the Collection of Withholding Income Tax on Non-resident Enterprises" (Guoshuifa [2009] No. 3 (Circular No.3)) and the "Notice on Strengthening the Administration of EIT for Income Derived by Non-resident Enterprises from Equity Transfers"(Guoshuihan [2009] No. 698 (Circular No.698)) were released one after another, as guidelines regarding income tax withholding issues in China.

However, in recent years with more and more frequent business transactions between overseas and domestic companies, some current regulations are found not practically appropriate, which may cause confusion in operation. For instance, in regard to dividend distribution, the tax-payment date was set the day on which distribution decision be made, which was deemed not favourable for tax-payers. Furthermore, in practical cases owing to multiple parties' involving, the duties and responsibilities of each tax authorities-in-charge requires to be clarified by a more distinct guidance.

Therefore, with an aim of easing burden on both non-resident enterprises and withholding agents as well as better facilitating withholding tax regime, Circular No.37 is released to streamline the procedures and provide a clear operational instruction to resolve quite a part of practical problems, to some extent enhancing the accessibility of tax rules.

### HIGHLIGHTS

#### I) Cancellation of Contract Filing by Withholding agents

- Contract filing within 30 days from the day of signing contract is cancelled. However, it is necessary for withholding agent to set up material file relating to contract and account books as a preparation for checking. And the tax authority is entitled to request materials related to tax payables such as contract.

#### II) Clarification of time to withheld in occasion of distributing dividend

- The withholding agent should withhold income tax on the day when payment is actually made instead of the day when the dividend distribution decision is made. Plus, the related income derived before 1st December 2017 but not yet paid is applicable to Circular No.37.
- The withholding agent should declare and pay withholding tax towards obligatory tax authority within 7 days after the day on which payment is actually made.

### III) Adjustment of Foreign exchange conversion rules regarding tax calculation

- In the case that non-resident enterprises carry out tax declaration, the payment should be converted into RMB if it is based on foreign currency, and subject to the reference rate released one day before the day on which the non-resident enterprises complete the tax declaration form.
- In the case that non-resident enterprises are requested by tax-authority to carry out tax declaration, the payment should be converted into RMB if it is based on foreign currency, and subject to the reference rate released one day before the day on which the tax authority made the decision of tax payment deadline.
- On the other hand, in case of asset transferring, the price or cost of transferring shares based on foreign currency should be converted into RMB for calculation. While the reference rate subject to the above two rules.

For example, a non-resident enterprise hold the share of Company A in AUD and sold to Company B in USD:

<u>Conversion under Circular No.698(Before)</u>	<u>Conversion under Circular No.37(Now &amp; After)</u>
① Cost of shares: AUD <sub>1</sub>	① Cost of shares: AUD→RMB <sub>1</sub>
② Share transfer price: USD→AUD <sub>2</sub>	② Share transfer price: USD→RMB <sub>2</sub>
③ Income in AUD : AUD <sub>2</sub> - AUD <sub>1</sub> =AUD <sub>3</sub>	③ Income in RMB: RMB <sub>2</sub> - RMB <sub>1</sub> =RMB <sub>3</sub>
④ Income in RMB: AUD <sub>3</sub> →RMB	

### IV) Clarification of responsibilities of related tax authorities over withholding tax

- In the occasion that withholding agent is to pay, tax declaration and payment should be carried out to tax authority in the place where the withholding agent is located
- In the occasion that non-resident enterprise is to pay, tax declaration and payment should be carried out to tax authority in the place where the income derived.

The obligatory tax authority is subject to the territorial source principle of taxation and set as below:

- In case of income derived from transferring real estate, the state tax bureau in the place where real estate is located;
- In case of income derived from transferring equity investment asset, the obligatory tax authority in charge of the invested company's income tax;
- In case of dividend, the obligatory tax authority in charge of the distributing enterprise's income tax;
- In case of interest, rents and royalties, the obligatory tax authority in charge of the income tax of the enterprise or individuals affords or pays relevant income.

### V) Classification between the behaviour of 'already withheld but not yet paid to tax authority ' and 'Neither declare nor withheld'

It would be considered as 'already withheld but not yet pay to tax authority' if meeting any one of the below situations:

- The withholding agent informed the non-resident enterprise that tax amount had been withheld;
- The tax payable amount is expressed separately in accounting statement;
- Having carried out separate deduction of tax payable amount or begins to separately amortize tax payable amount in the tax filing;
- Other evidences proving the tax-withholding.

Except the above, any situations that the withholding tax amount not be paid to SAT will be considered as 'Neither declared nor withheld'. Plus, the behaviour of 'already paid out but not yet withheld' is subject to penalty; while 'neither declared nor withheld' is subject to overdue payment.

## **VI) Others**

- When the asset that obtained by multiple investment or purchase is partly transferred, the calculation of purchase cost on transferred asset will be based on ratio of the amount of the shares transferred to the total amount of all shares by transferor before transfer.
- For the income derived from transferring asset by instalment payments, the tax calculation and withholding not be carried out until all investment cost is covered. Plus, the related income derived before 1st December 2017 but not yet paid is applicable.

## **COMMENTS**

Overall, SAT takes measures to ease the burden on withholding agents as well as optimize the business environment through No.37. For example, Circular No.37 streamlined the procedures of withholding tax declaration and put off the schedule of tax duty in regards of income derived from equity investment asset, which is positive changes to both non-resident enterprises and withholding agents.

However, due to the quite a lot revises brought by No.37, all parties who already finished related transactions but not yet carry out procedures over taxation are recommended to fully understand related tax rules. Besides, in order to protect themselves from potential risk as well as fulfil tax duty, all parties who are to carry out related transactions should clarify items such as tax return and tax payment by legal means so as to protect own rights and interest.

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