



International Tax

China Tax Alert

21 July 2014

New reporting requirements for foreign investments/income introduced

Contacts

Vicky Wang
vicwang@deloitte.com.cn

Friedman Ji
fenji@deloitte.com.cn

Mei Wu
mewu@deloitte.com.cn

The Chinese State Administration of Taxation (SAT) issued a notice on 30 June 2014 (Bulletin 38) that will require Chinese resident enterprises to report holdings in foreign enterprises, as well as other information relating to foreign-source income. The new rules will apply as from 1 September 2014.

Information on foreign investments

According to Bulletin 38, a resident enterprise will be required to report a holding of 10% or more in a foreign enterprise on a specific form ("Information Reporting for Participation of a Resident Enterprise in a Foreign Enterprise"). The form will have to be completed for each foreign enterprise if:

- 1) On 1 September 2014, the resident enterprise holds, directly or indirectly, 10% or more of the foreign enterprise;
- 2) After 1 September 2014, the direct or indirect holding of the resident enterprise in the foreign enterprise increases from less than 10% to 10% or more; or
- 3) After 1 September 2014, the direct or indirect holding of the resident enterprise in the foreign enterprise decreases from 10% or more to less than 10%.

Chinese accounting rules will have to be followed in determining whether a filing obligation arises. The interpretation notes that accompany Bulletin 38 clarify that the indirect participation percentage is to be calculated by multiplying the shareholding percentage at each tier of the ownership chain (if an intermediary shareholder holds more than 50% of the shares of a lower-tier entity, its shareholding percentage will be considered to be 100% for calculation purposes).

The form will be required to be submitted quarterly or monthly with the prepayment of enterprise income tax (EIT). Since the prepayment of EIT normally is due on a quarterly basis, the bulletin seems to suggest that the form will have to be filed with the prepayment due immediately after a filing obligation arises. In other words, a resident enterprise falling under situation 1) above likely will have to file the form no later than 15 October, at the time the third-quarter prepayment of EIT is made.

Information will have to be provided on the foreign-invested enterprise, other shareholders with a holding of 10% or more, any Chinese resident individuals that are part of the senior management of the invested enterprise, changes to the participation percentage, etc.

Information on controlled foreign corporations (CFCs)

Bulletin 38 imposes an obligation on a resident enterprise to submit certain documents at the time it files its annual EIT return with regard to a CFC. A CFC generally refers to a foreign enterprise that is more than 50% collectively owned by Chinese resident enterprises (or by Chinese resident enterprises and resident individuals), where each such Chinese resident owns, directly or indirectly, more than 10% of the voting shares and the effective tax rate of the foreign enterprise is lower than 12.5%. Note that even if the ownership percentage requirements are not satisfied, a foreign enterprise that is substantively controlled by Chinese residents in terms of its ownership, capital, operations, buy and sell relations, etc., still may be considered a CFC if its effective tax rate is lower than 12.5%.

The following documents are required to be submitted:

- A "CFC Information Reporting Form" for each CFC, regardless of whether the CFC is subject to the "deemed dividend distribution" (under which the undistributed profits derived by a CFC may be taxed in China as a deemed distribution to the Chinese parent);
- China GAAP financial statements for each CFC that is subject to the deemed dividend distribution; and
- China GAAP financial statements for each foreign enterprise whose income tax paid in relation to the foreign-source dividends is eligible to provide an indirect foreign tax credit (FTC) to the Chinese resident enterprise.

Information on foreign-source income

Bulletin 38 allows the Chinese tax authorities to request necessary information relating to foreign-source income during the course of a tax inspection (e.g. tax audit, transfer pricing review, etc.).

Miscellaneous

A resident enterprise may request an extension if there are valid reasons for a delay in submitting or reporting information. However, Bulletin 38 specifies that "valid reasons" do not include a situation in which foreign legislation or business contracts prohibit the enterprise from providing such information.

The reporting requirements also may apply to establishments of a nonresident enterprise in mainland China if the enterprise derives foreign income that is effectively connected with the establishment.

Comments

Given the rapid increase in outbound investments from China, as well as the evolution of the global and domestic anti-avoidance initiatives, foreign-source income clearly will become an area of focus by the Chinese tax authorities. Bulletin 38 signals the tax authorities' intent to strengthen administration in this

area. Affected taxpayers' compliance costs likely will increase, along with the tax risks in certain circumstances. For example, the requirement to submit China GAAP financial statements for certain CFCs or foreign entities generating FTCs may significantly increase a group's compliance costs, as those foreign entities otherwise may not have the obligation to prepare China GAAP financial statements (especially those entities that are not consolidated with the Chinese parent for financial reporting purposes). For those Chinese resident enterprises that have CFCs, it also would be prudent to carefully review the tax position under the deemed dividend distribution rule (if this has not already been done), since the risk of detection of nontaxed deemed distributions will increase under the Bulletin 38 reporting obligations.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte’s more than 200,000 professionals are committed to becoming the standard of excellence.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte network”) is, by means of this communication, rendering professional advice or services. No entity in the Deloitte network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2014. For information, contact Deloitte Touche Tohmatsu Limited.