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Draft Measures on Due Diligence of Non-resident Financial Account Information in relation to Tax Matters for Public Comments

The State Administration of Taxation ("SAT") released the "Draft Measure on Due Diligence of Non-Resident Financial Account Information in relation to Tax Matters for Public Comments" ("Draft Measure") on 14th October 2016 as an effort to apply the Standard for Automatic Exchange of Financial Information in Tax Matters ("AEOI") created by the Organization for Economic Cooperation and Development ("OECD"). The draft measure stipulates the principles and procedures for China financial institutions to follow in identifying non-resident accounts and collecting the related financial information. This new regulation is expected to become effective on 1st January 2017. Highlights of the Draft Measure are as below:

- Financial institutions established in China are required to identify financial accounts opened by non-resident individuals and entities through due diligence procedures. The financial institutions of interest consist of deposit-taking institutions, custodian institutions, investment institutions, specified insurance institutions and their Chinese branches;

- From 1st January 2017 onward, due diligence has to be conducted on new accounts of both individuals and entities;

- By 31st December 2017, due diligence has to be conducted on all existing individual high net worth accounts (i.e. aggregate balance of financial accounts with more than RMB 6 million as of 31st December 2016);

- By 31st December 2018, due diligence has to be conducted on all existing low net worth individual accounts and institutions/ entities accounts (i.e. aggregate balance of financial accounts with no more than RMB 6 million as of 31st December 2016);

- The account holders are required to declare their status of tax residency;

- Financial account information will be reported to SAT and exchanged with the relevant tax authorities after due diligence has been conducted. Continuous monitoring mechanism is also required to be implemented by financial institutions.

In addition, the Draft Measure stipulated a definition of passive non-financial entity ("passive NFE") to prevent non-residents from evading from compliance through setting up investment entities, trusts, funds, or similar arrangements without any business substance. Investment institutions with resident countries or regions where AEOI is not applicable are deemed as passive NFEs.

The Draft Measure may significantly affect both financial institutions and non-resident investors. Financial institutions may be faced with compliance challenges and non-resident investors may be confronted with the burden of disclosure of additional financial information which could result in unfavorable tax implications.

China Issues New Guidance on Administration of Advanced Transfer Pricing Agreements

On 11th October 2016, SAT issued Public Notice [2016] No. 64 on "Matters Regarding Enhancing the Administration of Advanced Pricing Arrangement ("Public Notice 64")" which became effective on 1st December 2016. Public Notice 64 aims at further improving the management of Advanced Pricing Arrangement ("APA") in China as part of the implementation of the Action Plan on Base Erosion and Profit Shifting ("BEPS") led by OECD. Highlights of Public Notice 64 are as follows:

- For an enterprise to be eligible for APA application, its related party transactions should amount to at least RMB40 million in each of the past 3 consecutive years. This requirement is more restrictive than the previous rule without the 3-year requirement. APA may be rolled back for up to 10 years;

- Negotiation and implementation process have been adjusted. The letter of intent was added as a separate procedure while the negotiation and signing stages were combined into one procedure. More requirements, such as field investigation and adjustment of draft application, have been set for the enterprise to cooperate with tax authorities at the analysis and evaluation stage;

- Location Specific Advantages ("LSAs") is one of the topics for discussion at the pre-filing meeting. Value chain and LSAs analyses are key aspects that SAT would be focusing on;

- If an APA adopts the interquartile range to determine the transfer price or profit level, the actual result would be adjusted to the median if it falls out of the quartile range. The tax authority may reject the enterprises' APA renewal if the weighted average operating results during APA period fall below and are not adjusted to the median;

- Unilateral APAs will be subject to information exchange under BEPS Action 5 which states that the related party transactions of local taxpayers who have been granted unilateral APAs will be submitted to other tax jurisdictions periodically.

Public Notice 64 clearly shows China's ambition of deep involvement and implementation of BEPS aiming to enhance international tax cooperation and transparency.

Launch of Shenzhen-Hong Kong Stock Connect

Following the launch of Shanghai-Hong Kong Stock Connect in 2014, Shenzhen-Hong Kong Stock Connect ("Stock Connect") was launched on 5th December 2016 as the second leg of the stock connect program between Mainland China and Hong Kong. To facilitate the implementation of the Stock Connect, China Securities Regulatory Commission ("CSRC") has worked with other governmental departments such as the People's Bank of China to release a series of provisions, rules and guidance.

With the implementation of Stock Connect, Shenzhen and Hong Kong stock markets are to a greater extent open to overseas stock investors and China investors. The highlights of the Stock Connect are as below:

- 417 and 881 stocks are eligible to trade on the Stock Exchange of Hong Kong and Shenzhen Stock Exchange respectively;

- Securities should generally be recorded in the accounts of the securities holders but not in accounts opened in the name of nominee holders except under exceptional circumstances;

- Overseas investors may enjoy the proprietary interest as shareholders through holding Connect Securities in the name of Hong Kong Securities Clearing Company Limited ("HKSCC");

- Overseas investors may exercise their rights of shareholders over Connect Securities through HKSCC;

- The disclosure of the top 10 shareholders in annual report may be based on the register of nominee holders;

- One overseas investor is allowed to hold a maximum of 10% shares of a single listed company.

In order to clarify the tax treatment for Shenzhen-Hong Kong stock connect transactions, the Ministry of Finance ("MOF"), SAT and CSRC jointly issued Caishui [2016] No.127 on 5th November 2016 which came into force on 5th December 2016. The followings are the highlights for Hong Kong market investors (both incorporations and individuals):

- Corporate Income Tax ("CIT")/ Individual Income Tax ("IIT")/ Value Added Tax ("VAT") are temporarily exempt for capital gains from transfer of A-shares;

- 10% withholding tax will be applied on dividends (or a lower tax treaty rate);

- Stamp duty will be charged on income from trading, inheritance and gift of A-share listed on the Shenzhen Stock Exchange through Shenzhen-Hong Kong Stock Connect.

The launch of Shenzhen-Hong Kong Stock Connect aims at giving overseas investors access to stocks in the tech-oriented Shenzhen market via the Hong Kong stock market. This is a positive move to the market where China is allowing overseas investors to access its fast growing technology sector.

SAT and SAFE Promote Information Sharing

The SAT and State Administration of Foreign Exchange ("SAFE") jointly signed a cooperative memorandum ("the Memorandum") in Beijing on 14th November 2016 to promote information sharing and implement joint supervision.

According to the Memorandum, in order to achieve information exchange and cross supervision between SAT and SAFE, the two authorities will jointly monitor and assess export tax refund, cross-border tax and foreign exchange inbound and outbound transactions under mechanism of resource sharing. Meanwhile, SAT and MOF will implement the joint incentive and disciplinary measures together for administration based on the shared enterprise classification management information. The move is expected to enhance efficiency and lessen the burden of companies.

Service Highlight

Sino-Bridge is greatly honoured to have grown with our clients and CBA readers for another year. All of our staff would like to take this opportunity to wish our clients and readers a very merry Christmas and prosperous year ahead! Our Marketing Executive, Ms Kimme Chan, would like to hear from you at +852 3579 8745 or kimmechan@sinobridge-consulting.com to learn of how we could assist you with your business.

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