

China withholding tax clarified

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In brief

- » China's tax authority issued a new rule (Announcement 37) to clarify a number of issues concerning withholding tax (WHT) related to dividends and asset sale (including share transfer).
 - WHT on dividend is not due at the time of declaration until actually paid;
 - WHT can be settled in phases for asset sale involving multiple payments, and WHT is not due until the cost is fully recovered;
 - Exchange rate is now determined by three different situations of WHT filing for income in a foreign currency.
- » The new rule will take effect from 1 December 2017.

Feedback

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In detail

China State Administration of Taxation (“SAT”) has issued Announcement 37, effective from 1 December 2017, addressing some particular issues concerning withholding taxes (“WHT”). The new measures aims at removing WHT filing bureaucracy and clarifying certain technical issues in WHT filings. The new rule applies only to passive income, but not active income like service fees from an on-shore projects.

1. Proportioned cost of equity

- » It is clarified that the cost of the equity should be proportioned in the situation that an equity (held via a series of investment or acquisition) is partially transferred. In other words, the cost of the equity will be determined by “total cost of equity x percentage of the transferred portion”.

2. Clarified exchange rate adoption

- » It is clarified that if a payment made by a Chinese party to an overseas party is denominated in a foreign currency, it should be converted into RMB using the exchange rate of the day specified as below:

WHT filing scenario		Day of exchange rate
1	If WHT agent does the filing	The day when WHT obligation is due
2	If the non-resident does the filing	One day preceeding to the filing date
3	If the non-resident is served by a tax payment notice from a tax authority to do the filing	One day preceeding to the deadline specified by the notice

This is an improvement to the previous regulation (the exchange rate of the day when the WHT agent submitted the WHT filing should be adopted) - which could hardly be practised if a WHT agent failed to perform its WHT obligation.

3. Clarified WHT timing for asset transfer

- » It is clarified that the WHT timing for an asset transfer with a multiple payment terms should not occur until its cost is recovered. This issue was not addressed in the previous tax regulations. The new rule offers a sympathetic consideration that WHT should not occur until a gain has started to realise.

As shown in the following example, Company A (*non-resident*) sells its shares in B to C (*both residents*) for RMB 1,000,000, receivable in three payments. The cost of the shares is RMB 500,000. Per the new rule, the WHT obligation will occur in two occasions, being:

- 2 February 2018 (when the cost, RMB 500,000, is recovered by the RMB 700,000 payment)
- 3 March 2018 (when the last payment is made, having RMB 300,000 as the residual gain)

Date of payment	Actual payment	Accumulative payment	WHT ?
1 January 2018	300,000	300,000	Not yet
2 February 2018	400,000	700,000	Yes
3 March 2018	300,000	1,000,000	Yes

4. Simplified WHT procedures

- » Announcement 37 has cancelled the previous requirements on contract registration (for cases of receiving passive income from China) and final tax clearance (for cases with multiple payment terms) to avoid bureaucracy and repetitive data submission. Focus now is put on timely WHT settlement rather than paperwork.

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5. Amended WHT timing for dividends

- » SAT has revoked the previous rule that WHT occurred when the dividends were declared as distributable. Instead, the new rule agrees to the view that WHT should not occur until dividends are actually paid. It offers a relief to the dividend payors who always face the risk of penalty for late WHT filing after declaring dividend distribution by a board decision.

6. Relaxed WHT collection rules

- » SAT has offered some relaxation and leniency in WHT collection in some special circumstances:
 - *If a WHT agent has failed in its WHT obligation, and the tax bureau pursue the tax with the non-resident enterprise, would the tax filing by the non-resident enterprise be considered as late?*

No. If the non-resident taxpayer (China-sourced income recipient) can pay its taxes before a tax payemnt notice is served or before a deadline specified by a Chinese tax bureau, its tax obligation is sitll regarded as timely fulfilled.

- *If a non-resident receives an income from multiple locations in China, how should it handle its filing?*

It can select a location to declare and pay the WHT. It will be the obligation of the tax authority selected to notify other tax authorities concerned within 5 days. In fact, this requirement is mentioned in the previous rules, except the format of the notification.

WTS observation

The new rule offers a WHT deference to companies planning a dividend distribution. The cancellation of the contract registration system is also a relief to companies which have quite a number of contracts for outbound payments involving WHT liability (e.g. royalty, rental, interest or property sales). It also offers practical solution to particular cases in the determination of exchange rate and the cost of equity. It has also urged that non-resident taxpayers should take the initiative in tax filing if their Chinese WHT agent has failed to do so.

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