



***Cross-border transactions,
profit repatriation and funding of SME's in China***

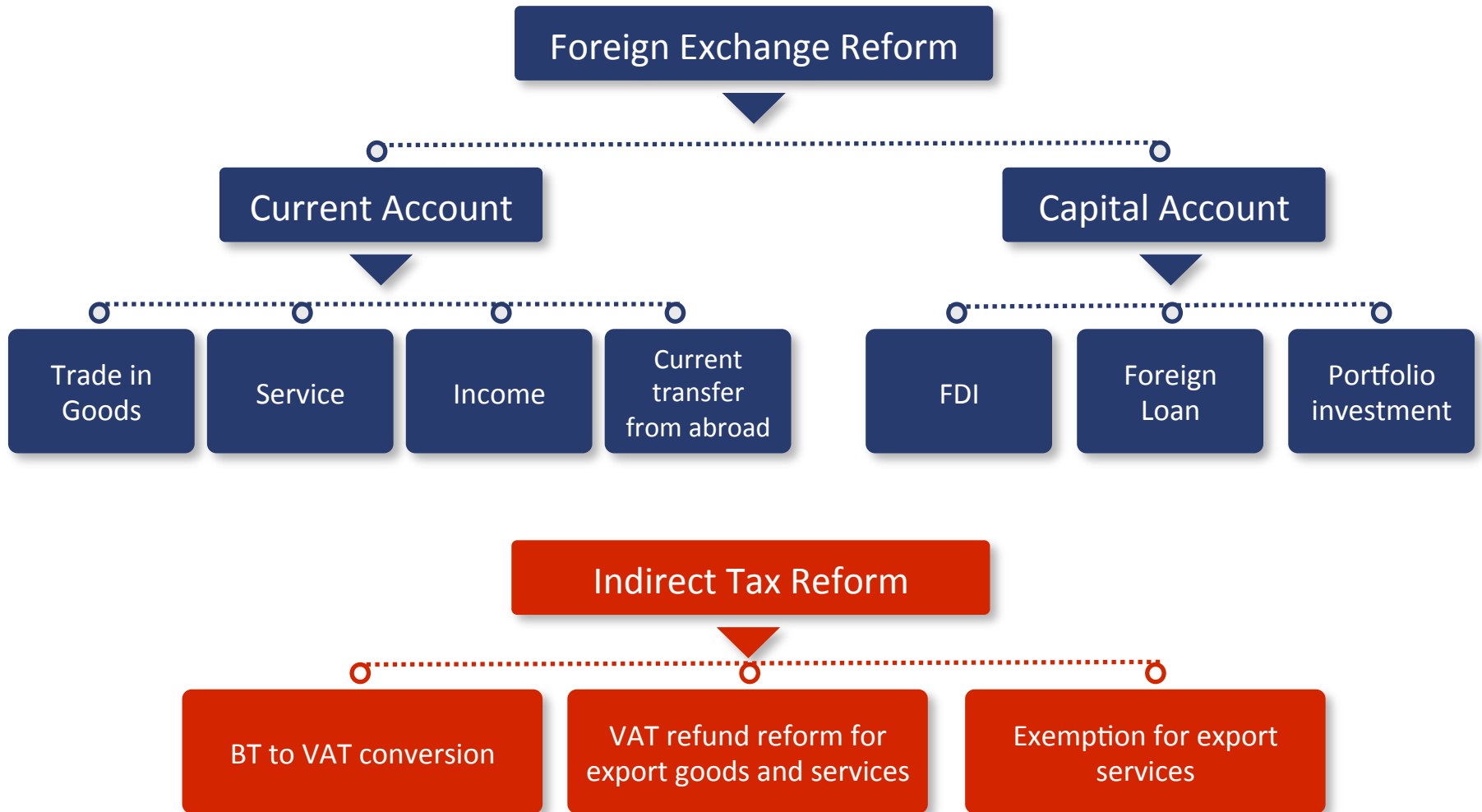
DEZAN SHIRA & ASSOCIATES

Corporate Establishment, Tax, Accounting & Payroll Throughout Asia

- Practical steps to overcome your biggest challenges

*Hannah Feng
11 January 2014*

Rapid Change – “The Name of the Game”



AGENDA



Case study I

How to manage the reimbursement and allocation of expenses between related entities to avoid unwanted tax bureau scrutiny

Case study II

How to repatriate or distribute profits and enjoy a lower withholding tax rate on dividends

Case study III

What are the new cross-border tax withholding rules without need of a Tax Clearance Certificate

AGENDA



Case study IV

How to apply for VAT exemption on cross-border services

Case study V

How the newly implemented foreign exchange rules affect SME import and export transaction

AGENDA



Case study I

How to manage the reimbursement and allocation of expenses between related entities to avoid unwanted tax bureau scrutiny

Reimbursement and Allocation of Expenses between Related Parties



Qualified Payment Items

- Reimbursement between related entities, such as pre-operating expenses, salaries, overseas insurances, etc.
- Allocation of expenses between related entities

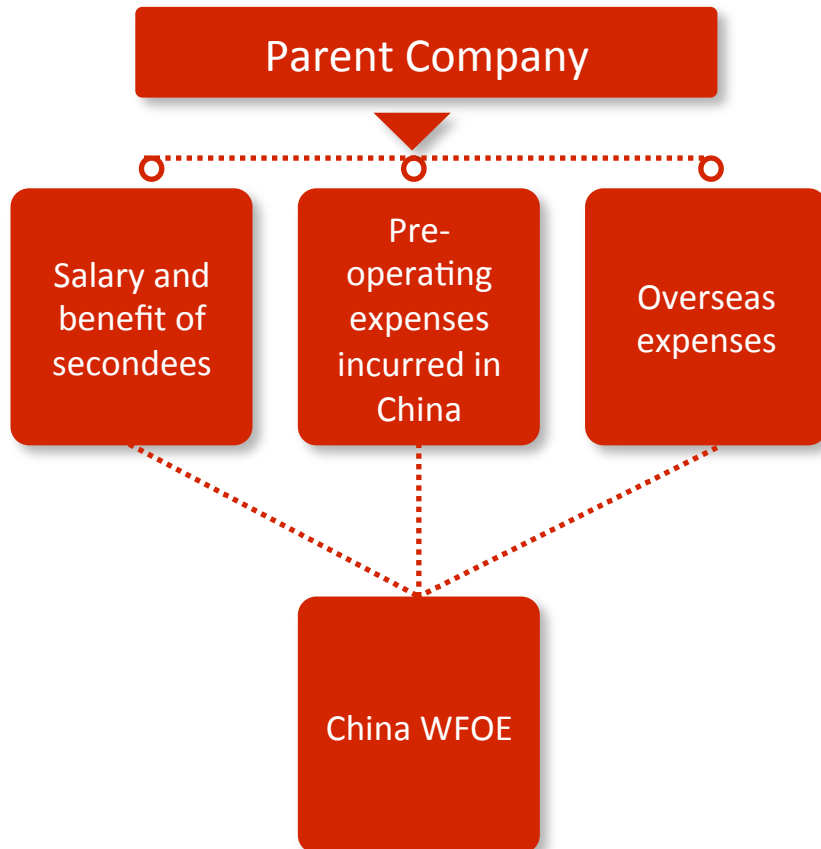
Document Required

- Original contracts between China entity and suppliers
- Reimbursement or cost allocation agreement between China entity and the overseas related entity
- Payment notice

Time Limit

- Within 12 months

Case Study I



Facts:

- The parent company would settle the salary and benefits to the secondees and expenditures in the initial setup phase in and outside of China
- The parent company seek to recover such costs from the WFOE in China

Issues:

1. Whether the payment for secondees is merely for cost reimbursement or in the nature of service fee?
2. Whether the WFOE signs the contract and obtain the official invoices from domestic suppliers?
3. Whether the WFOE is responsible to withhold taxes for overseas suppliers?

Case Study I



Parent Company

Salary and benefit
of secondees

China WFOE

Secondment vs Service:

- Main Principles:

- Responsibilities & risks of the secondees' work fully or partially borne by China WFOE
- Secondees' performance assessed by China WFOE

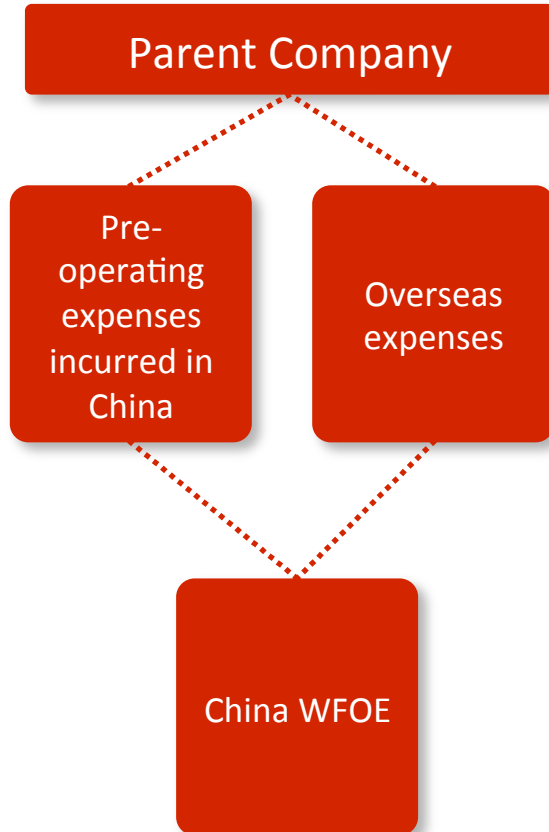
Double line reporting?

- Other factors:

- Parent company would not gain any financial benefits from the secondment arrangement
- Secondees would fully pay IIT on their income that is borne by China WFOE
- China WFOE determines the number, qualifications, salary and working location

Indirect management costs for secondees? No-reimbursement? IIT on time-apportionment?

Case Study I



Domestic Expenses:

- China WFOE should sign the contract with domestic suppliers;
- VAT/BT invoices must be issued in the title of China WFOE.

Overseas Expenses:

- China WFOE should withhold taxes for either overseas suppliers or the parent company



Case study II

How to repatriate or distribute profits and enjoy a lower withholding tax rate on dividends



When the profit is allowed to be repatriated?

- The WFOE's registered capital has been injected within the time limits as set out in the Article of Association;
- The WFOE's prior year's loss has been fully made up;
- The WFOE has drawn 10% of the rest after-tax profits as the company's statutory common reserve;
- The WFOE's relevant taxes have been fully paid;
- The WFOE has sufficient cash for dividend distribution;
- The WFOE's board of directors approved the distribution through a board resolution.

Profit Repatriation



What documents are required?

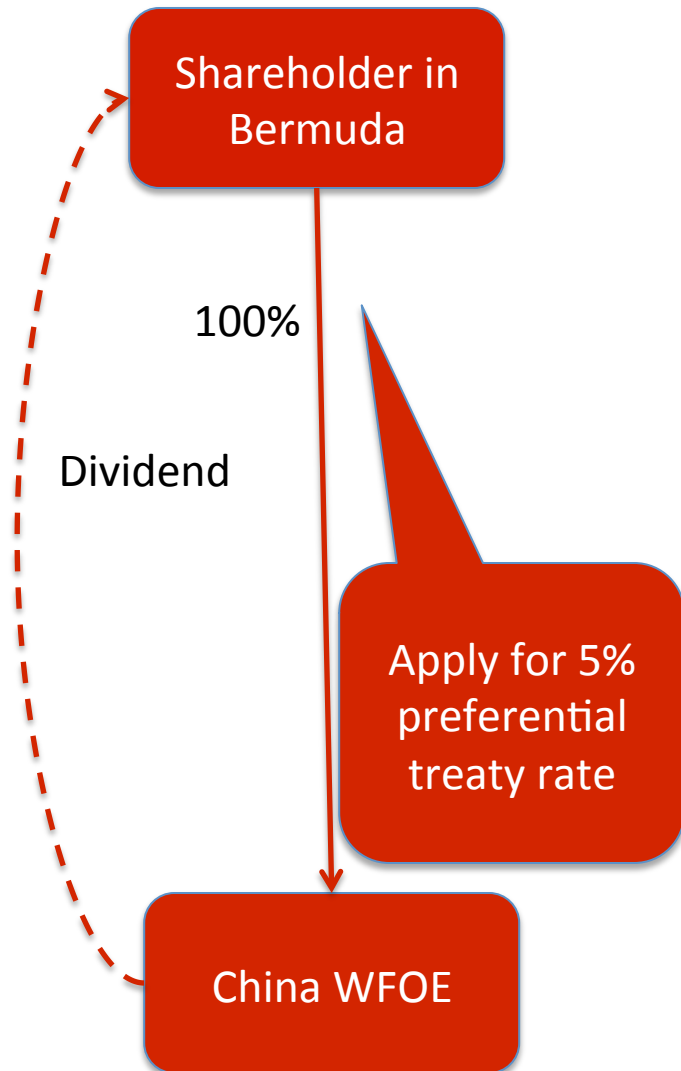
Document	Required by Banks	Required by Tax Authorities
Audit Report for Profit-making Years	✓	✓
Annual CIT Returns and quarter and annual tax receipts for profit-making years		✓
Financial Statement in the Year of Profit Distribution		✓
Capital Verification Report	✓	✓
Articles of Association of and All Amendments		✓
All Approval of Changing the WFOE's Company Name by AIC		✓
Board Resolution for Dividend Repatriation and Chinese translation	✓	✓



When the withholding obligation for dividend remittance arises?

Situation	Timing
Payment of dividend is after the declaration date	Withholding obligation arises on the day when the dividend is declared
Payment of dividend is before the declaration date	Withholding obligation arises on the day when the payment is made

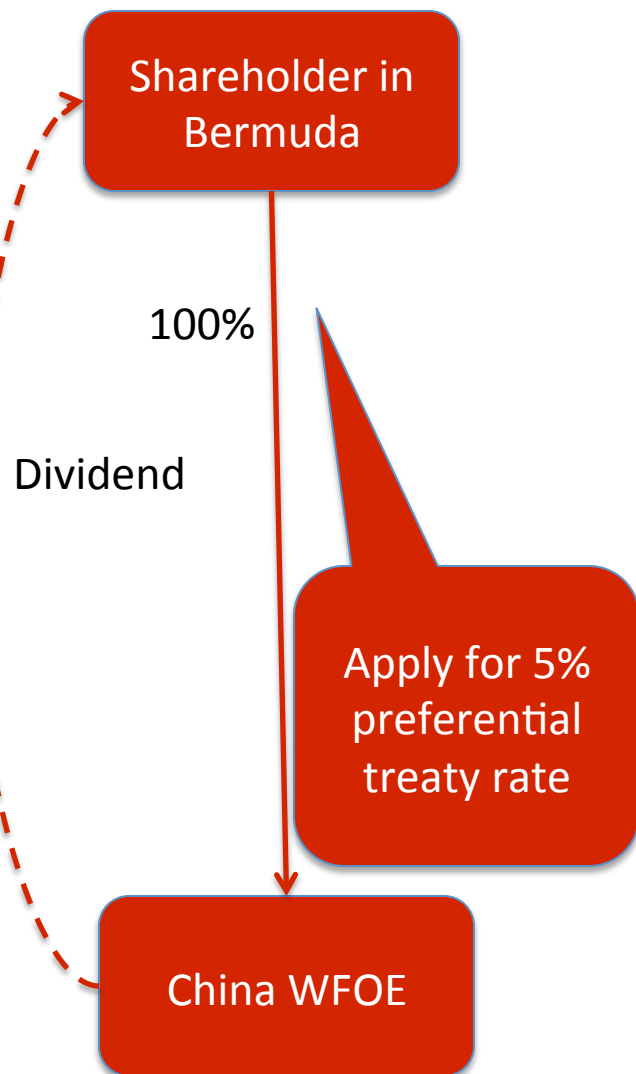
Case Study II



Facts:

- The Shareholder of China WFOE is registered in Bermuda but does not need to pay tax in Bermuda according to local tax law;
- The control and management of the shareholder is exercised in Singapore so that it is a tax resident in Singapore;
- The shareholder is a listed company in Singapore.
- It is an investment holding company holding and managing a large portfolio of investment in various countries.

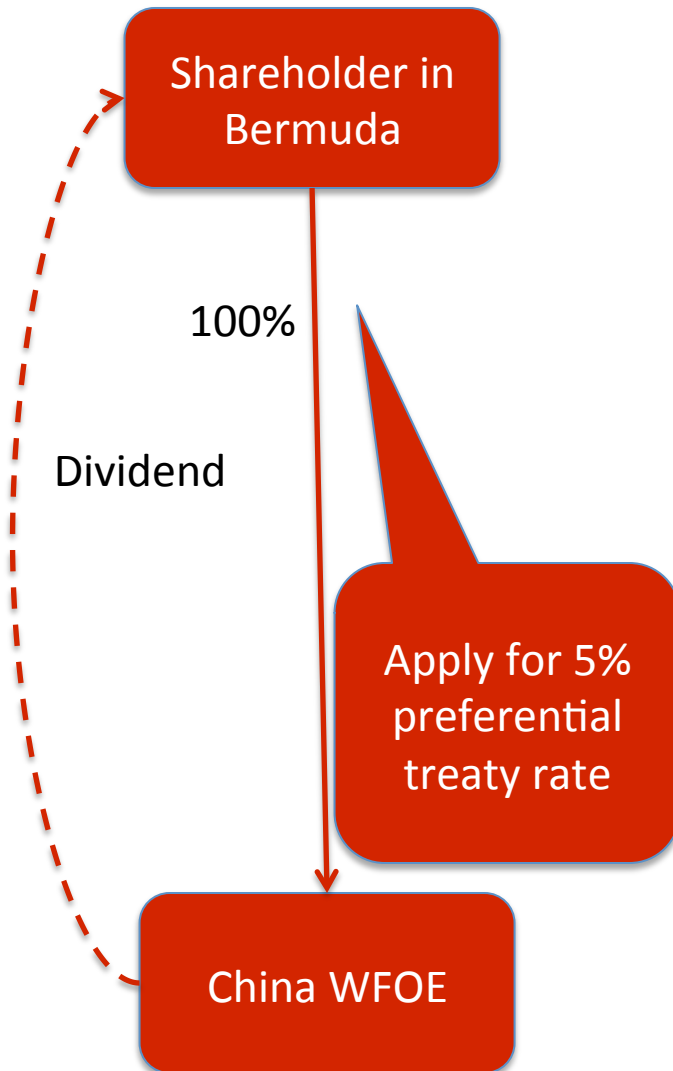
Case Study II



Analysis:

- The shareholder is a listed company in Singapore.
- It has address in Singapore and has significant amount of total assets.
- It has no staff but has directors who responsible for the portfolio of investment, strategic management, administrative and finance support functions.
- It holds more than one subsidiaries and has recent active merge and acquisitions.
- No tax paid in Singapore but it controls the dividend which would be used to finance the operations and investment activities.

Case Study II



Conclusion:

**Beneficial Owner
is approved by Tax
Authorities!**



Case study III

What are the new cross-border tax withholding rules without need of a Tax Clearance Certificate

New WHT Procedures





Contract Registration

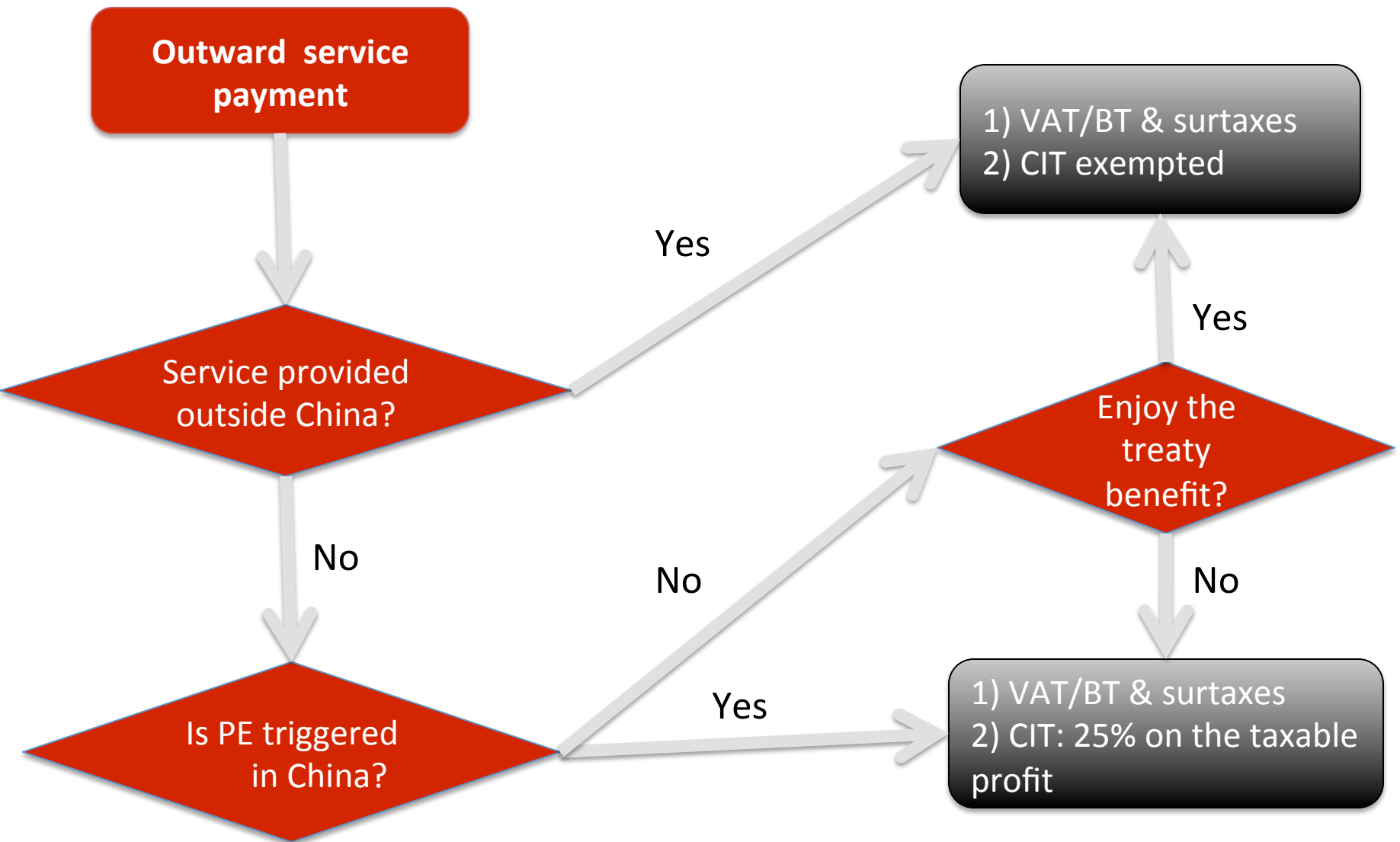
Within 30 days after conclusion of the contract
Service fee vs. Passive Income (royalty, dividend, capital gain, etc.)



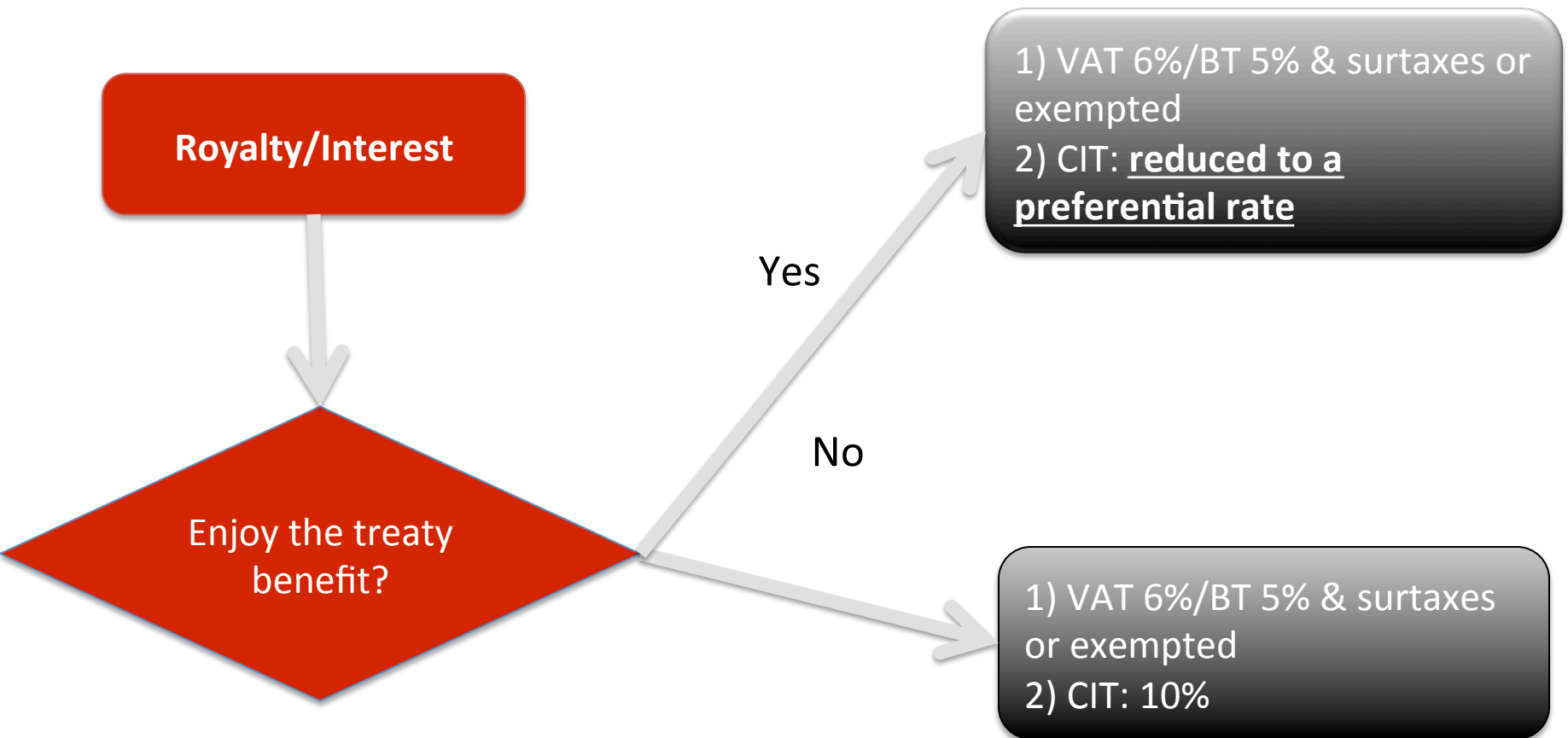
Tax Assessment

- Offshore Service – CIT exemption
- Onshore service – PE assessment

Tax Assessment – Outward Service Payment



Tax Assessment – Royalty/ Interest



Tax Assessment – Dividend



Dividend

Enjoy the
treaty benefit?

Yes

No

1) Not applicable to VAT/
BT
2) CIT: reduced to a
preferential rate

1) Not applicable to VAT/
BT
2) CIT: 10%



Treaty Benefit Application

- Onshore service but service period not exceeding 6 months or 183 days
- Connected projects

New WHT Procedures



WHT Payment

- Should be filed and paid within the tax filing period
- Late payment surcharge may be imposed by LTB



Payment Registration

- Applicable to a single remittance of amount exceeding US\$ 50,000
- For some payments, payment registration not required, such as overseas travel expenses, import & export insurance, commissions, international transportation ,etc.

Case Study III



Sub-contractor
in Malaysia

Subcontract

China WFOE

Main Contract

China
Customer 1

China
Customer 2

China
Customer 3

China
Customer 4

Facts:

- China WFOE provided technical services for China customers;
- The subcontractor is the WFOE's affiliated company in Malaysia who provides majority of services for WFOE's customers;
- China WFOE signed subcontracts with the Malaysian company for each project separately.
- The Malaysia company arranged personnel to assist the WFOE in providing labor services in China for less than 183 days for each project, but accumulatively more than 183 days.

Issues:

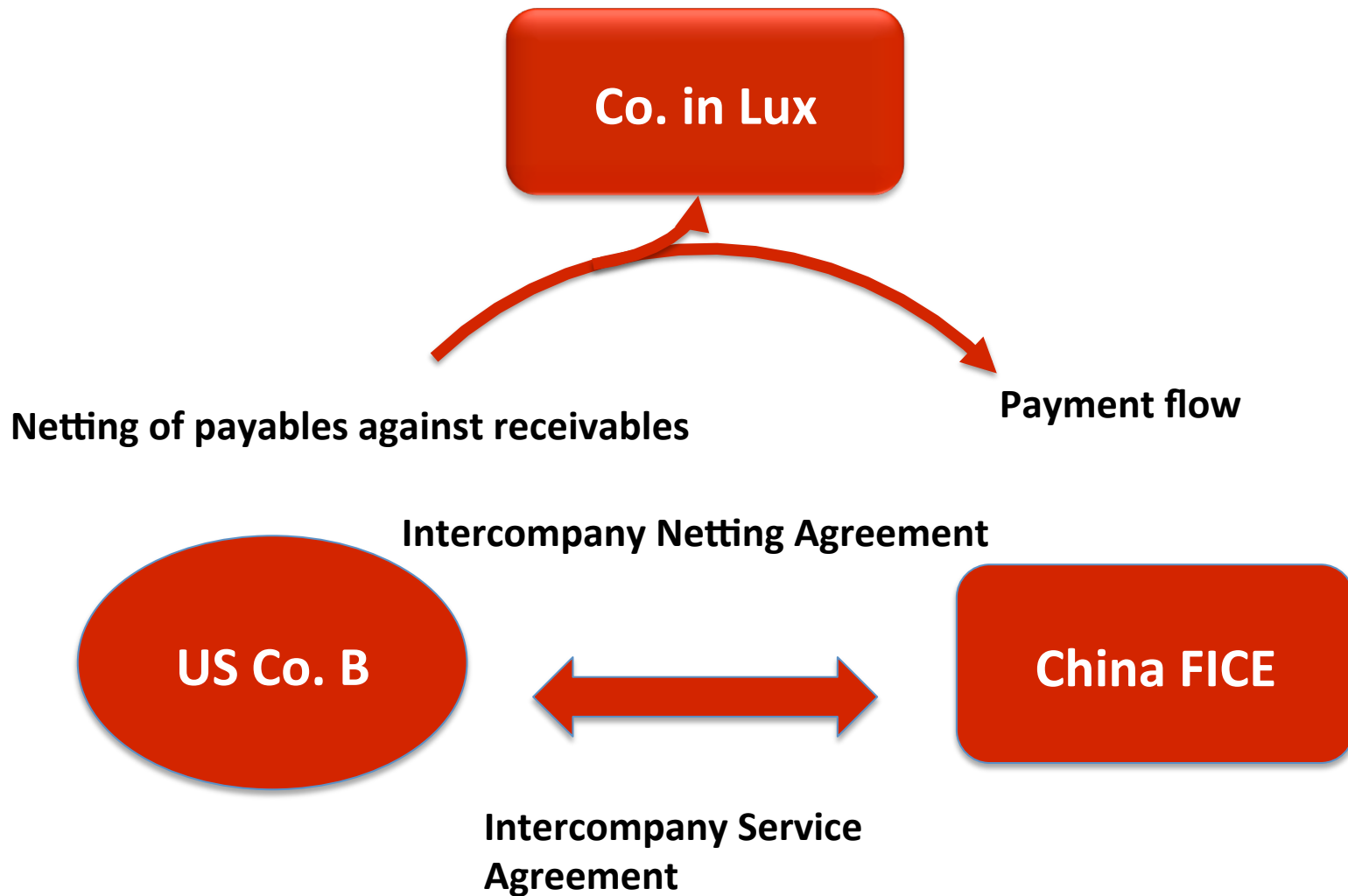
These projects was assessed as connected projects and the Malaysian company was considered to have a PE in China.



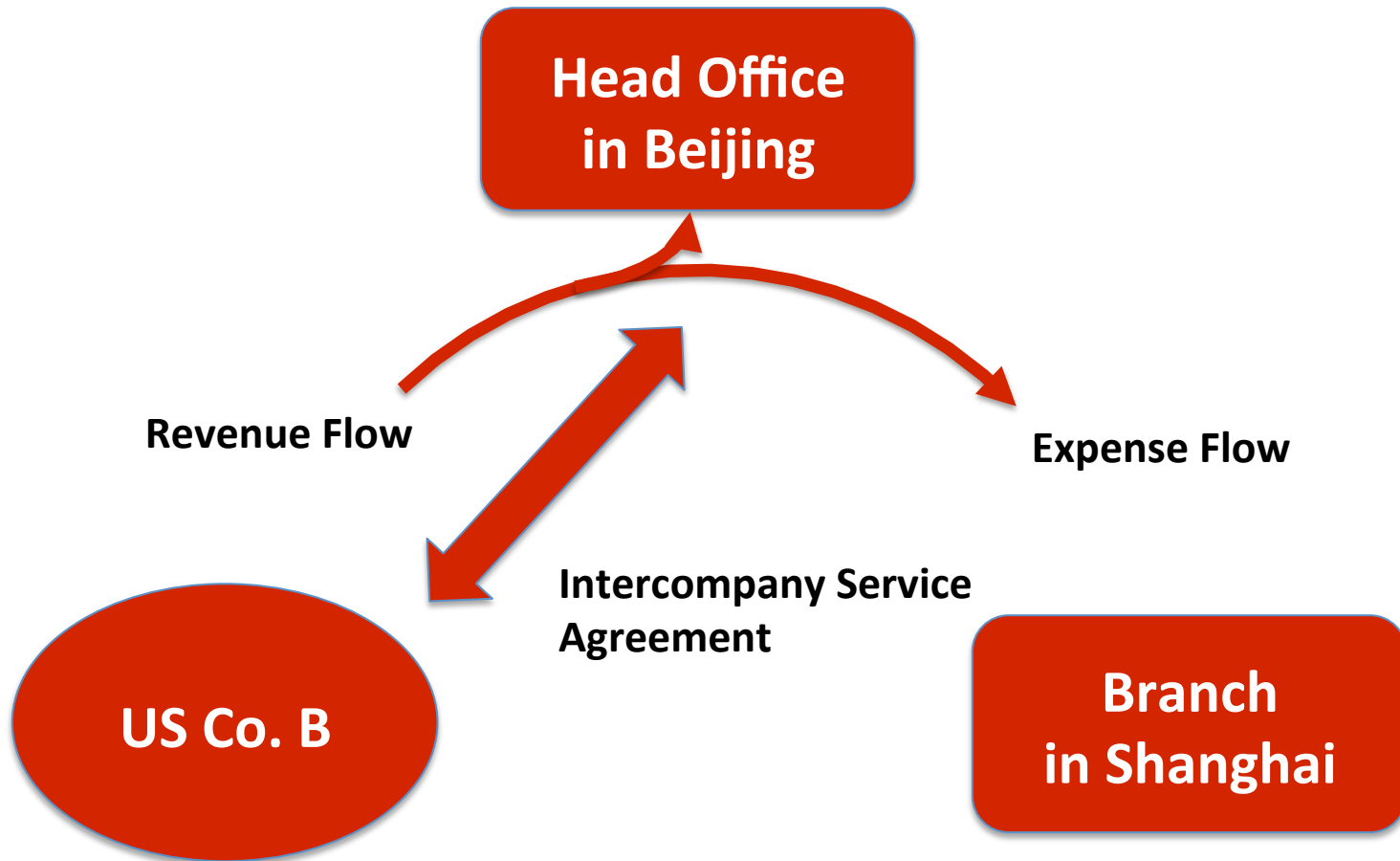
Case study IV

How to apply for VAT exemption on cross-border services

Case Study IV



Case Study IV



VAT Exemption on Cross-border Service



- China Nationwide

SAT Public Notice [2013] No. 52

- Identifies cross-border or ‘exported’ services exempted retroactively exempted to August 1, 2013 from VAT (Must make application for exemption)
- May apply to recover VAT paid for services if paid since the launch of VAT Pilot Program to August 1, 2013

Caishui [2013] No. 106

VAT Exemption on Cross-border Service



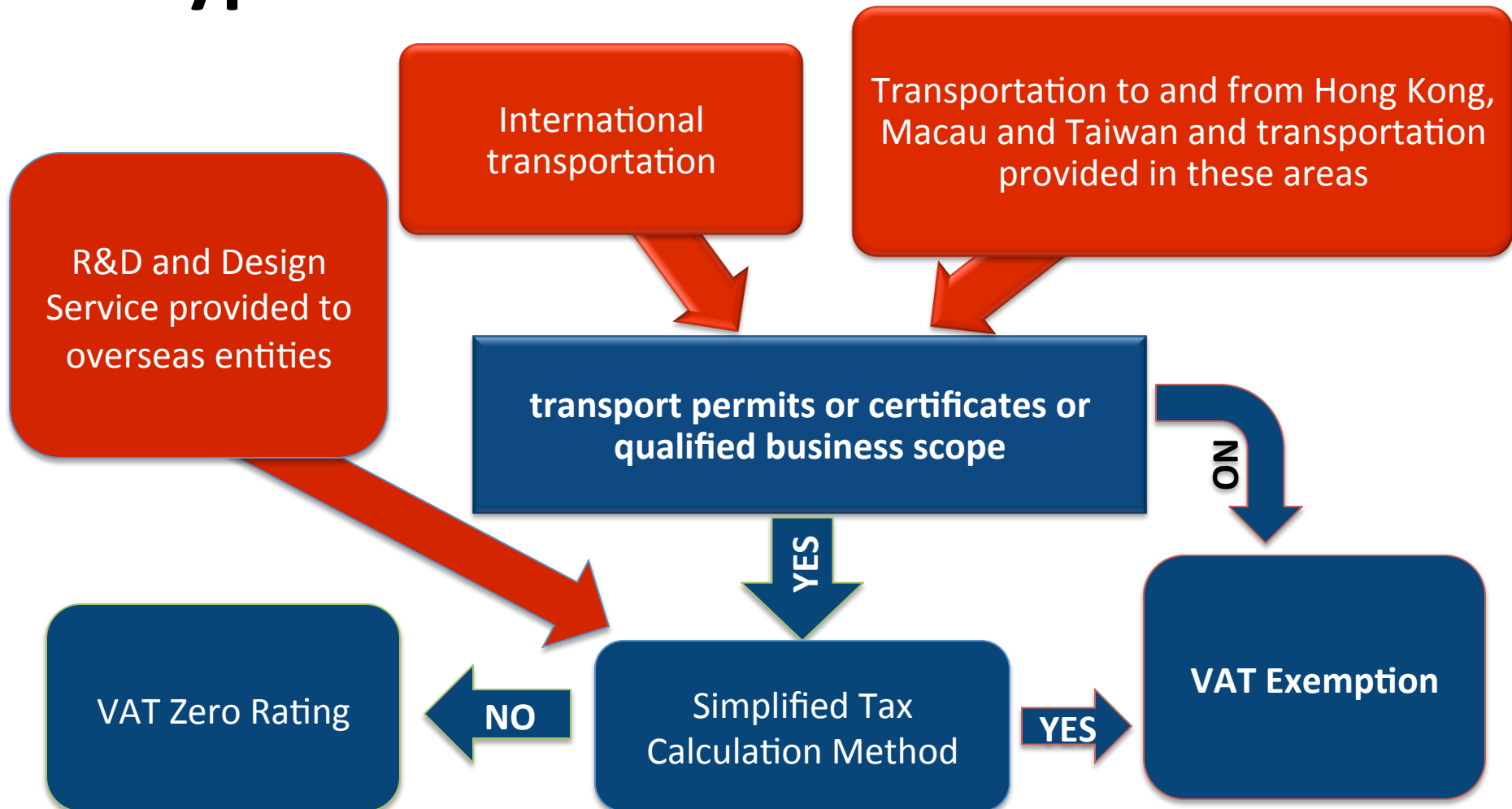
• **Type I: Location of Services and Properties!**



VAT Exemption on Cross-border Service

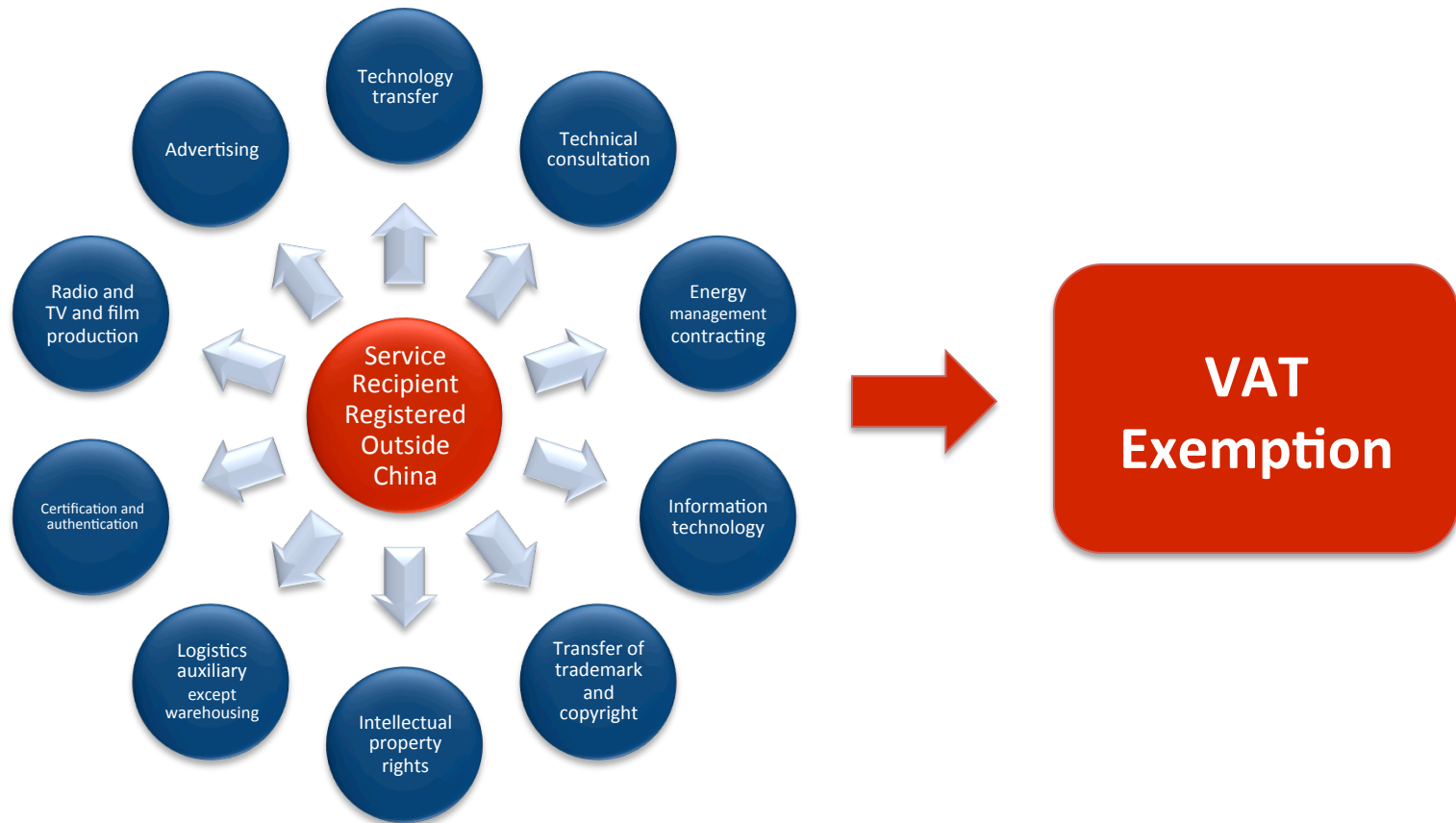


- **Type II: Permit!**





• Type III: Service Receiver Outside China!





- How to qualify for VAT exemption?
- Prepare a written cross-border services contract

Tip 1

Must include contracting parties and the companies' addresses, service object, service location, service fee amount and pricing method, payment terms, payment method, responsibility for breach of contract, etc.;

Tip 2

A master or framework contract is NOT suggested!!

VAT Exemption on Cross-border Service



- How to qualify for VAT exemption?
- Account for exported services separately and compute the non-creditable input VAT accurately

Tip 3

Set up sub accounts under the general ledger accounts

5101	主营业务收入/Revenue from main operations
5101.01	销售/Sales
5101.01.01	国内销售收入/Domestic sales income
5101.01.02	国际销售收入/International sales income
5101.01.03	退回/Return
5101.01.04	折让/Discount
5101.01.99	其他/Others
5101.02	服务收入/Services
5101.02.01	国内服务收入/Domestic service income
5101.02.02	国际服务收入/International service income
5101.02.99	其他/Others
5101.03	转移定价收入/Transfer Pricing Revenue
5101.99	其他/Others
5102	其他业务收入/Revenue from other operations
5102.99	其他/Others

2171.01	应交增值税/VAT payable
2171.01.01	进项税额/Input VAT
2171.01.02	已交税金/Taxes paid
2171.01.03	转出未交增值税/Transfer-out of unpaid VAT
2171.01.04	减免税款/VAT deductions and exemptions
2171.01.05	销项税额/Output VAT
2171.01.06	出口退税/Refund of export duty
2171.01.07	进项税额转出/Transfer-out of input VAT
2171.01.08	出口抵减内销产品应纳税额/Export duty deductible from taxes payable on domes sale
2171.01.09	转出多交增值税/Transfer-out of overpaid VAT
2171.02	未交增值税/Unpaid VAT



- How to qualify for VAT exemption?
 - Account for exported services separately and compute the non-creditable input VAT accurately

Tip 4

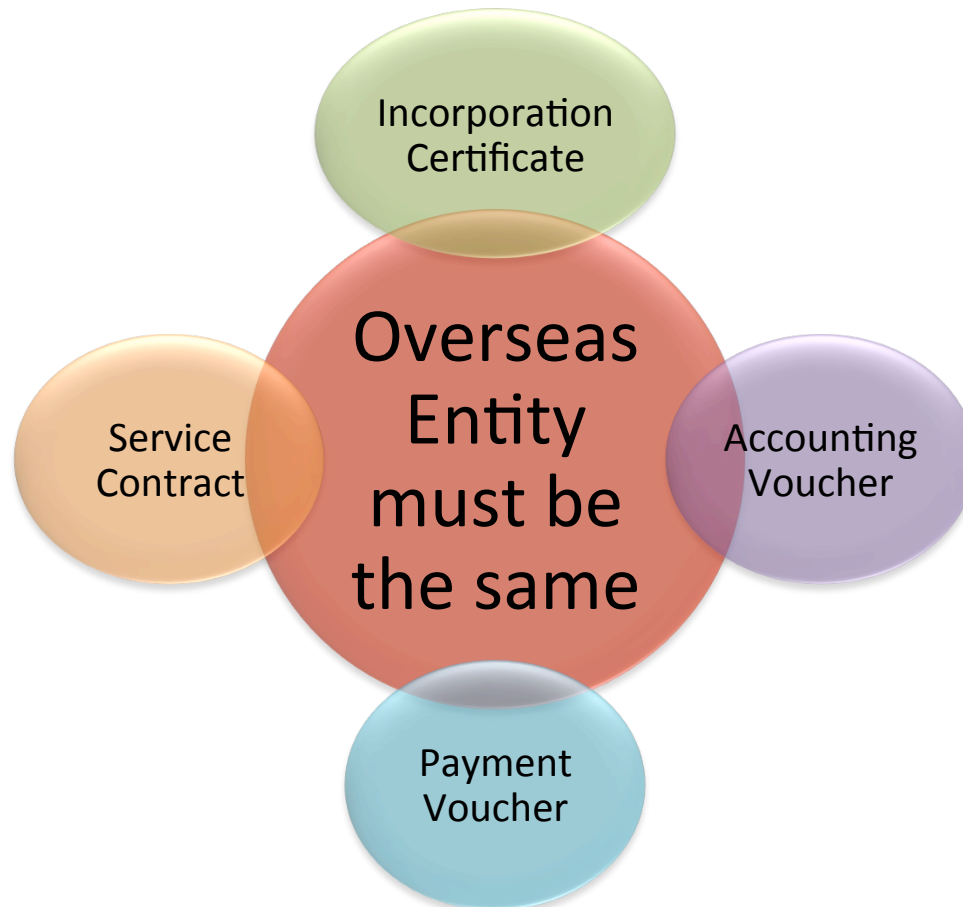
Apportionment of input VAT may be more beneficial than tracking the relevant input VAT credits separately, as the proportion of non-creditable input VAT should be calculated on a turnover basis

Tip 5

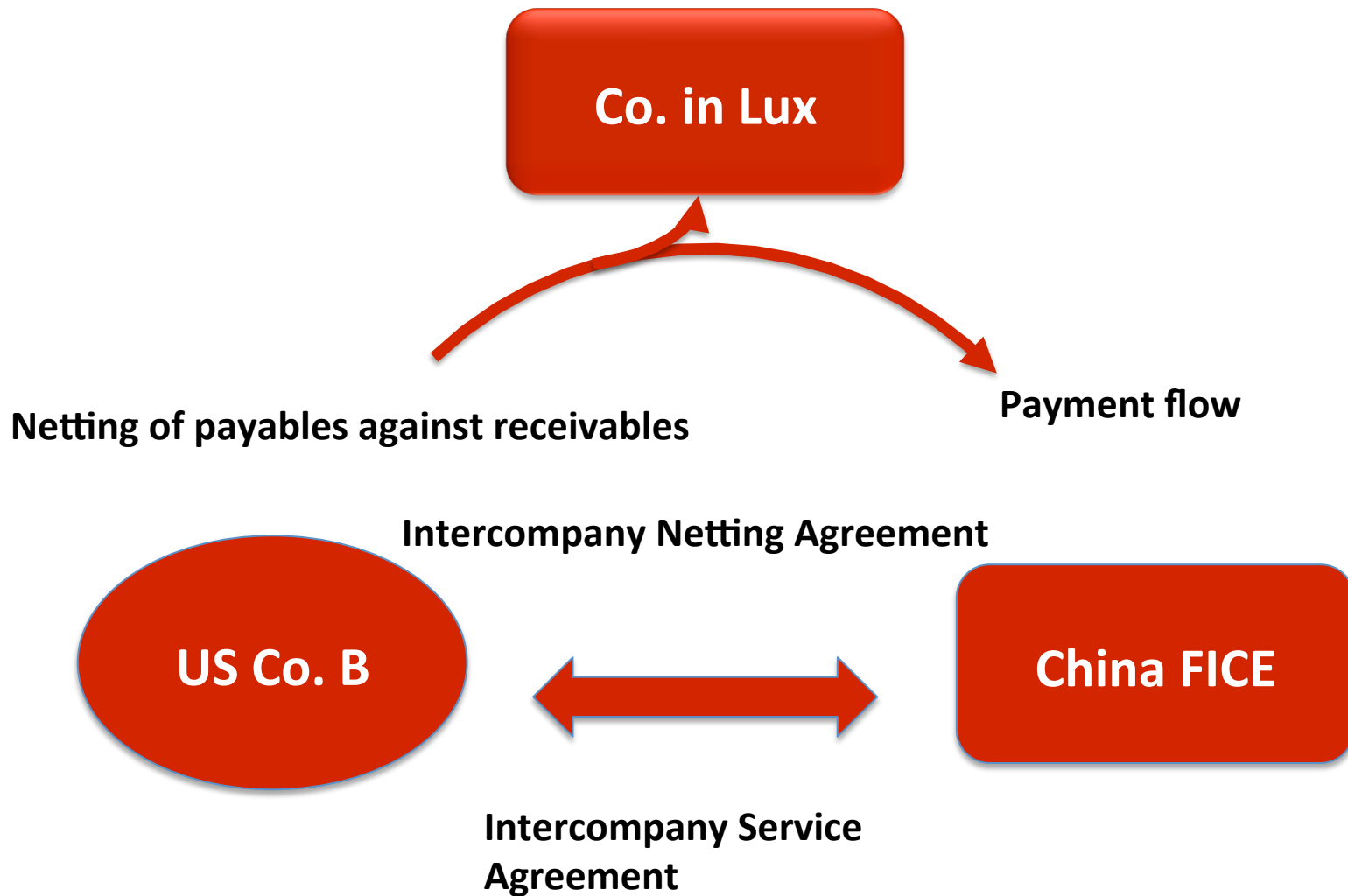
Manage the timing of input VAT verification

VAT Exemption on Cross-border Service

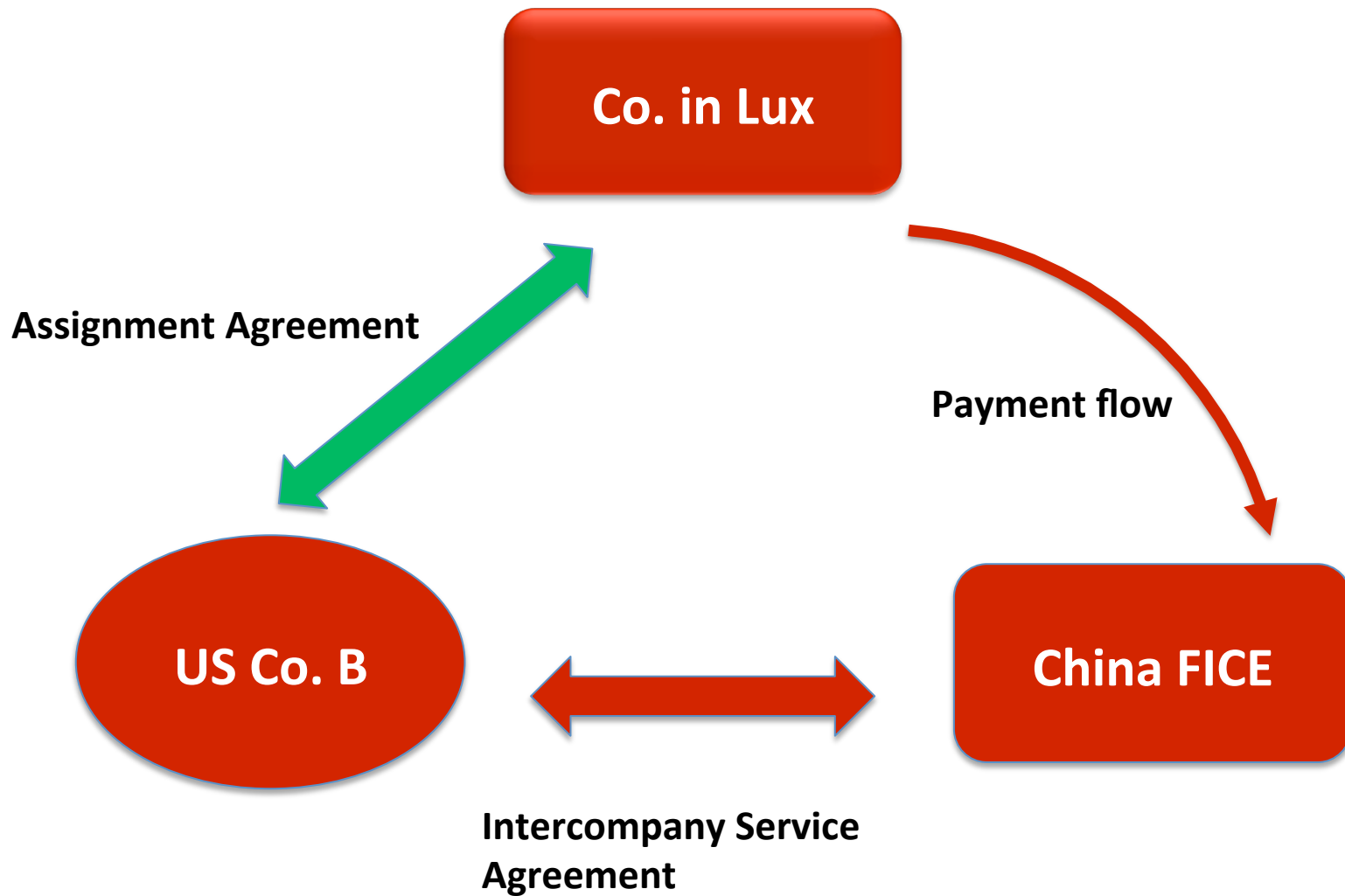
- How to qualify for VAT exemption?
 - Proof service recipient located overseas



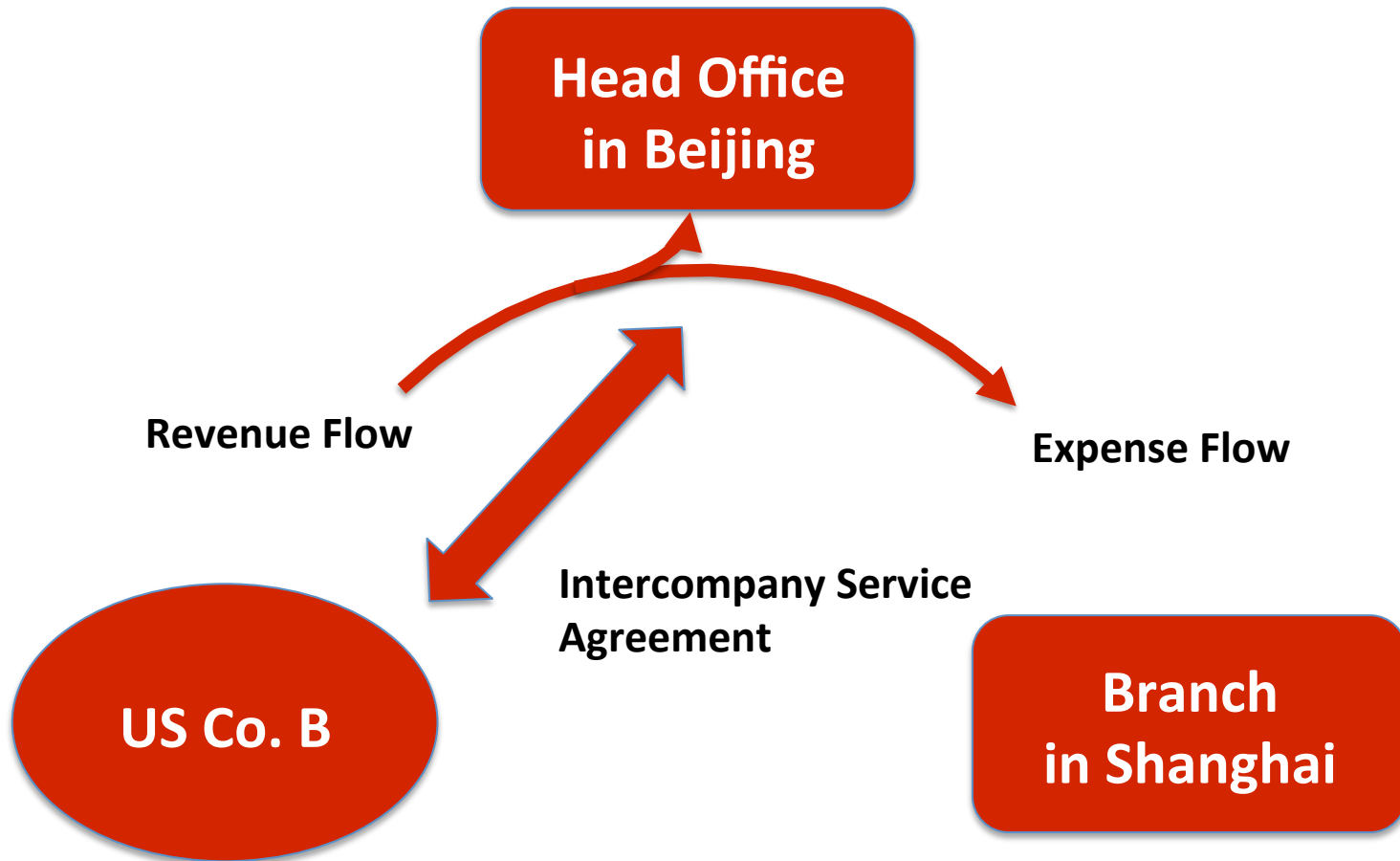
Case Study IV



Case Study IV



Case Study IV



Case Study IV



**Head Office
in Beijing**

US Co. B

**Branch
in Shanghai**



**Intercompany Service
Agreement**

VAT Exemption on Cross-border Service



- Beijing:
“BJSTB Public Notice [2013] No. 22”
 - ✓ Some tax offices started the VAT exemption application;
 - ✓ VAT refund/credit hasn't started yet;
 - ✓ A training will be held by tax authorities early next year.
- Shanghai:
“SHSTB Public Notice [2013] No. 3”
 - ✓ Submission of application documents for VAT exemption and VAT refund/credit must be completed by 31 Dec 2013;
 - ✓ SH tax authorities will complete the VAT refund assessment by 28 Jan 2014;
 - ✓ File VAT exemption on a monthly basis;
- Shenzhen
VAT exemption on Type III services are not allowed.



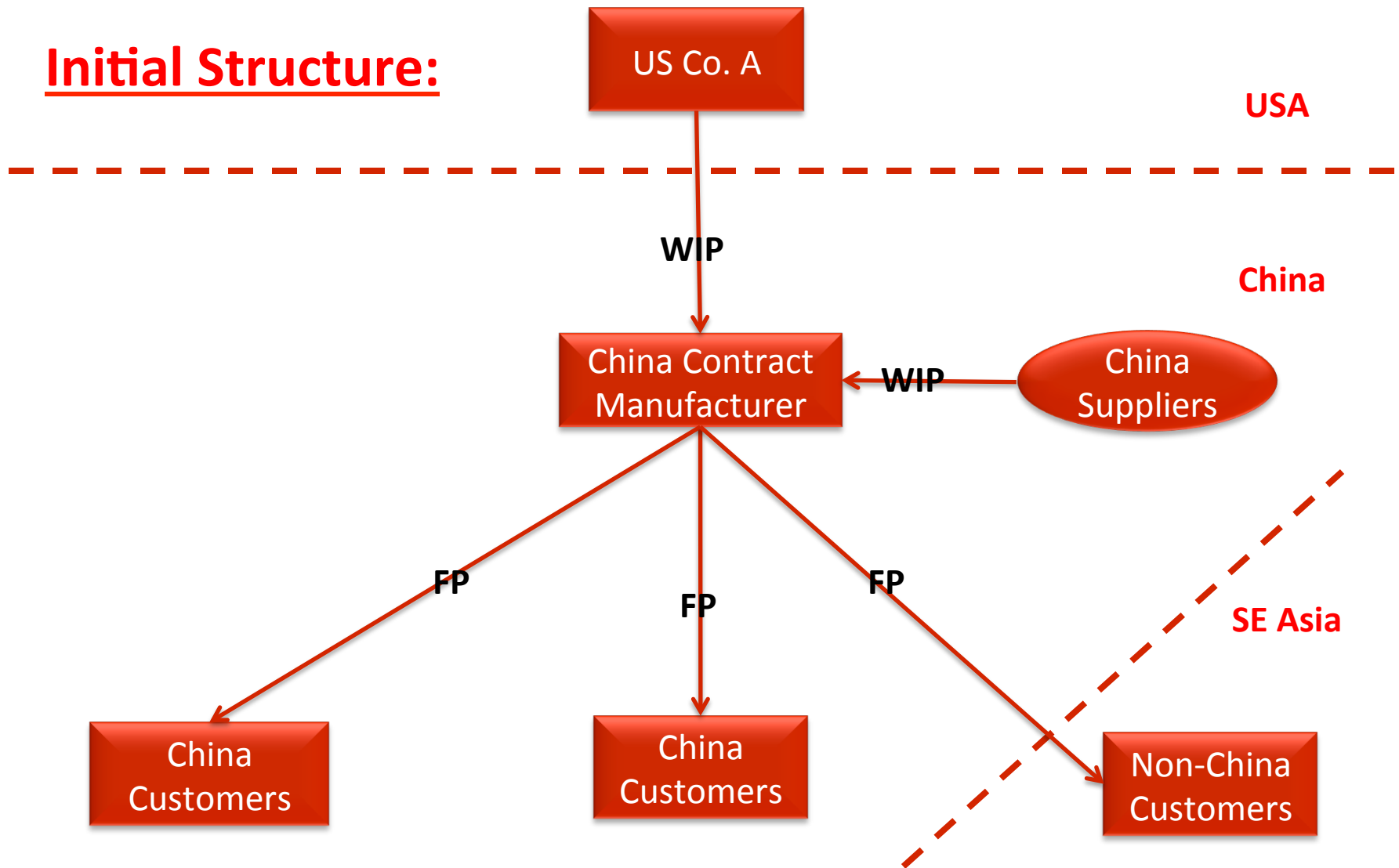
Case study V

How the newly implemented foreign exchange rules affect SME import and export transactions

Case Study V



Initial Structure:



Case Study V



Facts:

- A US Co. A purchases parts for resale to its Chinese customers;
- Such goods are mostly sourced in China;
- Chinese third party contract manager makes up assemblies which US Co. purchases and which are then shipped to its Chinese customers.

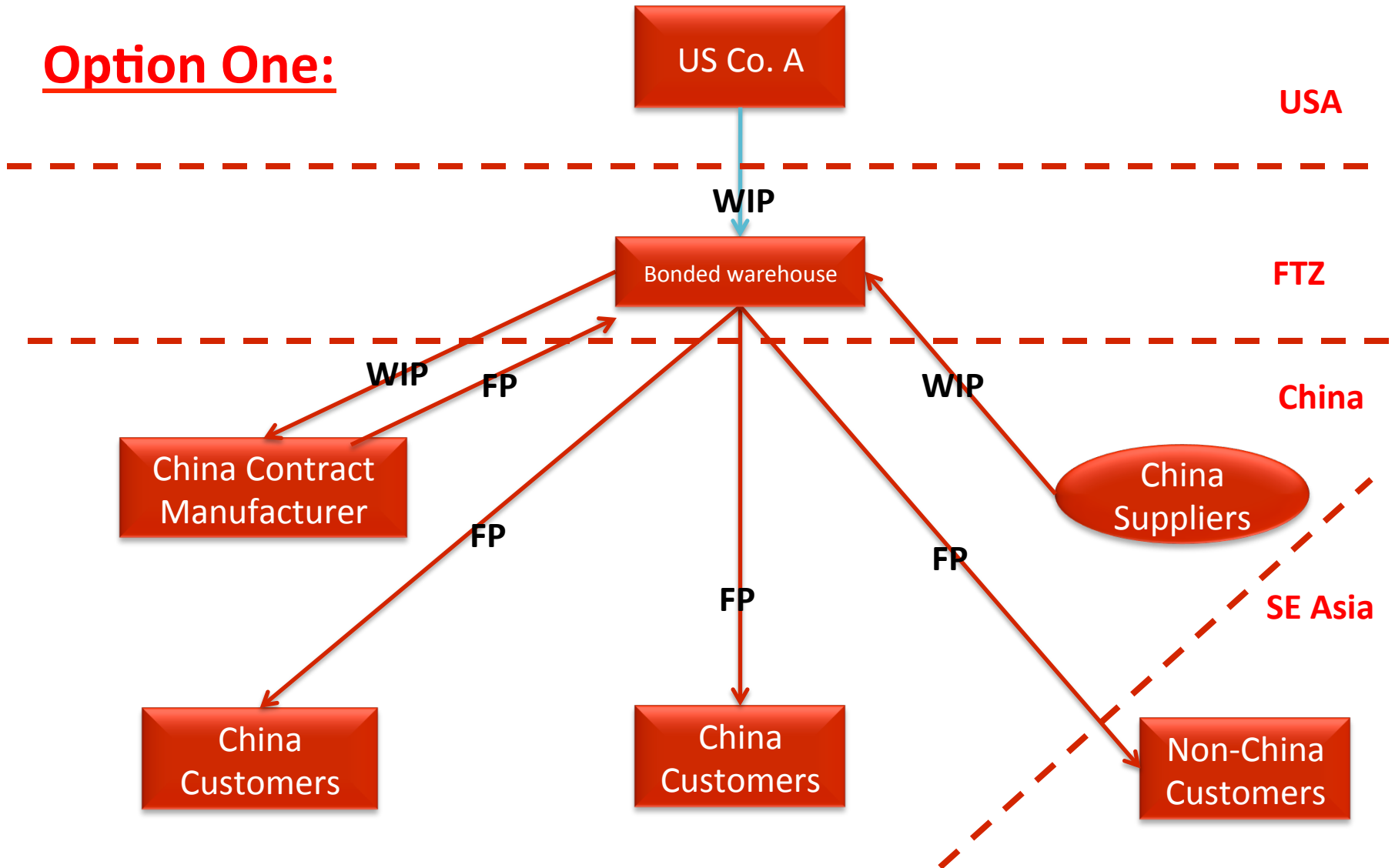
Issues:

The Chinese customers would not be able to pay the foreign currency proceeds to the US Co. !

Case Study V



Option One:





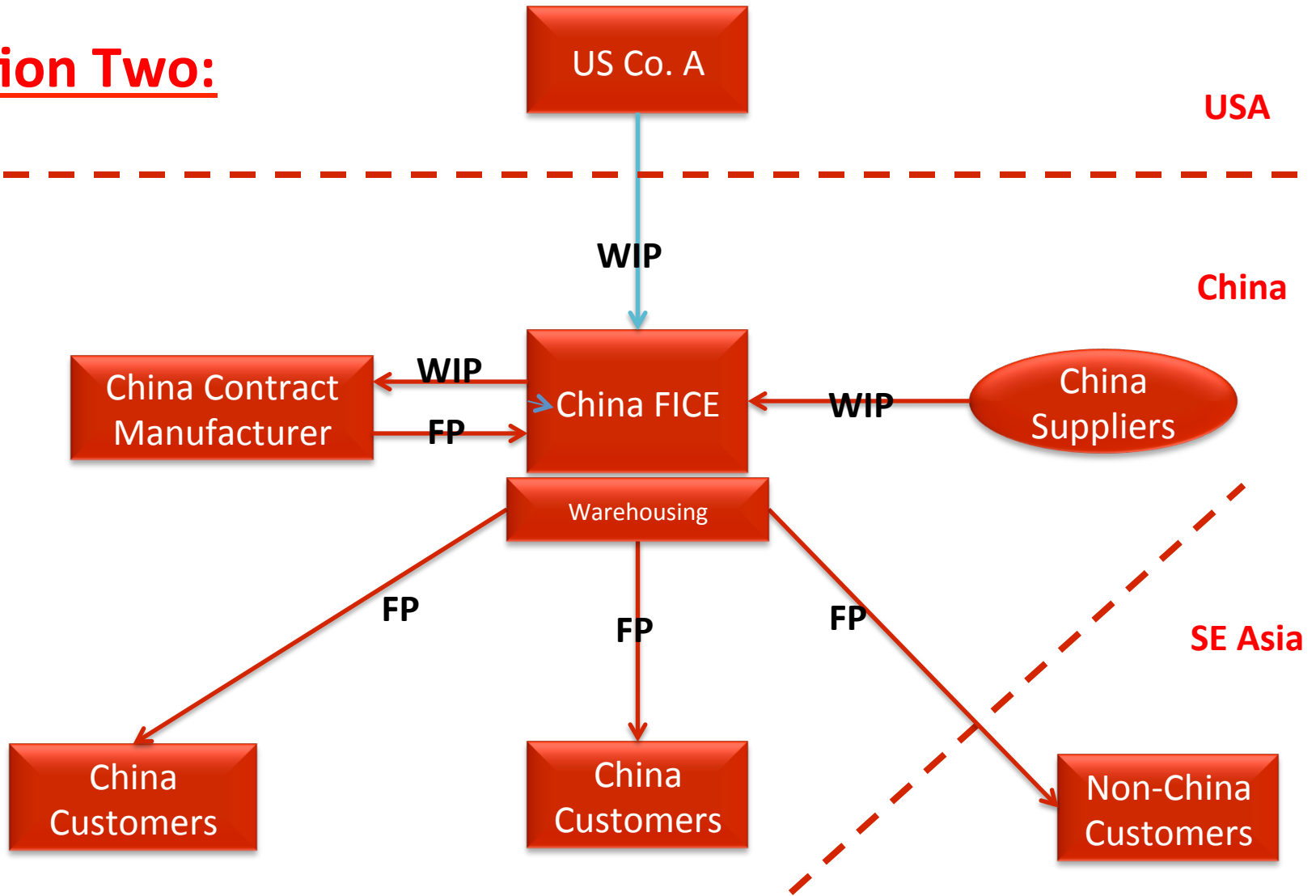
Factors to be considered:

- Cost of operation including storage fees, agent fees for Customs record-filing, etc
- Logistics including cost and lead time
- Different Tariff rate and VAT rate between spare parts and finished goods

Case Study V



Option Two:

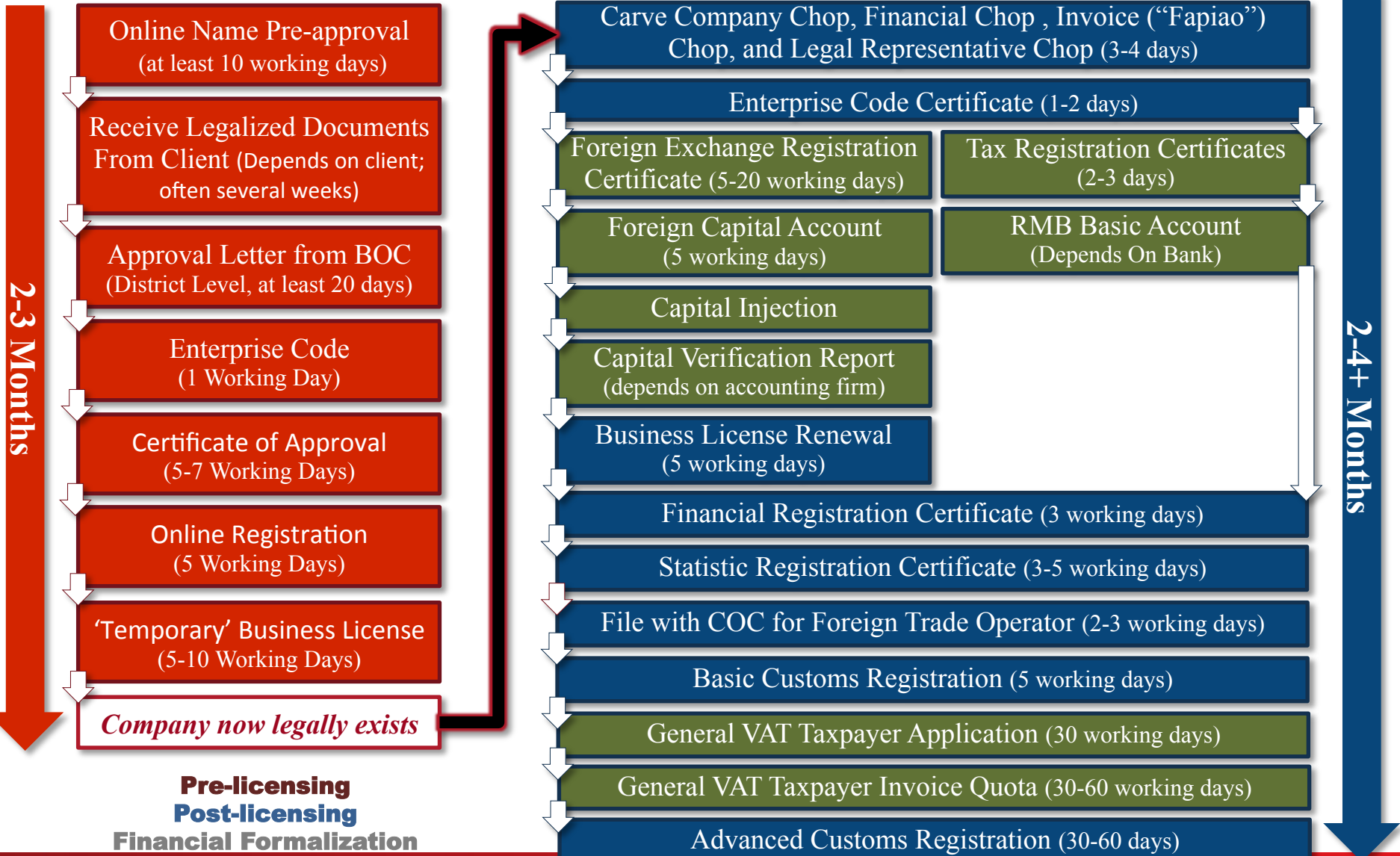




Factors to be considered:

- Time required to set up a FIE (a standard FICE – 6-8 months; a manufacturing WFOE 8-12 months) ;
- Subject to VAT and duties when receiving the WIP into China
- May not make advance payment to the US Co. from capital account
- Easy for customers to pay in RMB

Beijing WFOE or FICE Establishment Procedure



Pre-licensing
Post-licensing
Financial Formalization

Summary of Key Takeaways



1. Cross-border FX reimbursement and allocation of expenses among related entities must be completed within twelve months.
2. Corporate profits may be repatriated as dividends under limited circumstances and business decision making will be affected.
3. Although cross-border transactions may be made and withholding taxes paid later, a careful tax assessment beforehand will lower the risk of mistakes and future penalties.
4. To ensure VAT exemption during the provision of cross-border services, taxpayers should maintain a qualifying services contract and supporting documentation.
5. Because FX controls can severely restrict cross-border trading, structure transactions so FX inflows and outflows correlate closely to appropriate import and export records.



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