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FINANCIAL ACCOUNTS OF NON-RESIDENTS: UNDER STRICT SUPERVISION OF THE SAT

On May 19, 2017, the State Administration of Taxation (“SAT”), the Ministry of Finance, the People’s Bank of China, the China Banking Regulatory Commission, the China Securities Regulatory Commission, as well as the China Insurance Regulatory Commission issued an announcement on the Administrative Measures of Tax Information Due Diligence for Financial Accounts of Non-residents (“Announcement 14”) to implement the information exchange (“IE”) of financial accounts between China and other participated countries or jurisdictions¹. The following sections provide a nutshell of Announcement 14 and the potential tax impact on non-residents that have financial accounts in China.

1. PURPOSE OF ANNOUNCEMENT 14

Announcement 14 provides legal basis and guidance for Chinese financial institutions to conduct the tax information due diligence (“TDD”) on the financial accounts of non-residents. It aims to improve the transparency of tax information by enhancing the cooperation among tax authorities in different countries or jurisdictions and oppose to the tax avoidances by sharing the information of non-residents’ offshore accounts. In order to achieve this aim, Announcement 14 specifies the target (i.e. non-resident explained in section 2), the assessor (i.e. financial institutions explained in section 3), the scope (i.e. financial accounts explained in section 4) and the implementation (i.e. TDD and reporting explained in section 5).

2. DEFINITION AND ASSESSMENT OF NON-RESIDENT

According to Announcement 14, the assessment of the resident status of the account holder is the key process of the TDD, which directly determines whether Announcement 14 would have an impact on the account holder. A non-resident refers to an individual or an enterprise (including other organizations) that is not a Chinese tax resident².

However, the abovementioned non-resident does not include government authorities, international organizations, central banks, financial institutions, listed companies or affiliates of listed companies.

Financial institutions, as the assessor of non-resident, would apply a ‘Factor Test’ by referring to one or more than one of the criteria listed below for the identification of non-residents on their own discretion:

- The account holder has an overseas identity document(s) (e.g. passport);
- The account holder has an overseas residential address or mailing address;
- The account holder has an overseas telephone number and does not have any Chinese telephone number;
- There are regular instructions of transfers from the inbound account (excluding deposit accounts) to overseas accounts;
- The account agent or authorized signatory has an overseas address; and
- The account only has an overseas notification address.

Based on the above, individuals and institutions could perform self-review on the account information provided to financial institutions so as to assess whether they have fallen or will fall into the scope of non-resident under Announcement 14.

¹ The Chinese government has signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and the Multilateral Agreement on Automatic Exchange of Tax Information Involved in the Financial Accounts. At present, there are over 100 countries and jurisdictions have committed to the said Convention and Agreement.

² A Chinese tax resident refers to a Chinese tax resident enterprise or a Chinese tax resident individual according to the definitions under tax laws in China.

3. FINANCIAL INSTITUTIONS FOR TDDS

With reference to Announcement 14, not all financial institutions are obliged to conduct TDD. The following table demonstrates the financial institutions that are obliged to conduct a TDD, and those who are not.

Financial institutions obliged to conduct TDD (“TDD Institutions”)	Financial institutions not obliged to conduct TDD
<ul style="list-style-type: none"> • Commercial banks, rural credit cooperatives, policy banks and other financial institutions taking public deposits; • Securities companies; • Futures companies; • Securities investment fund management companies; • Private equity fund management companies; • Partnerships engaging in private equity fund management; • Insurance companies; • Insurance asset management companies carrying out insurance or annuity business with cash value; and • Trust companies. 	<ul style="list-style-type: none"> • Financial asset management companies; • Finance companies; • Financial leasing companies; • Automobile financing companies; • Consumer financing companies; • Currency brokerage companies; and • Securities registration and settlement organizations

Hence, a non-resident that has a financial account in the TDD Institutions would be monitored and reported if the financial account met other specified requirements explained in the below sections.

4. FINANCIAL ACCOUNTS FOR TDD

Announcement 14 specifies that individual’s financial accounts will be subject to TDD regardless of the account balance, whereas financial accounts of institutions have to show a balance exceeding USD 250,000 to be subject to conduct TDD. In the case that a non-resident directly (or indirectly) owns (or controls) several financial accounts in the same TDD Institution (including the affiliates of the TDD Institution), the account balance shall be the total value of these accounts.

The following table provides the types of financial accounts that are subject to or are exempted from TDD:

Financial accounts subject to TDD	Financial accounts exempted from TDD
<ul style="list-style-type: none"> • Deposit accounts; • Hosting accounts³; • Insurance contracts with cash value or annuity contracts; and 	<ul style="list-style-type: none"> • Pension accounts which meet specific requirements; • Social security accounts which meet specific requirements; • Life insurance contracts which meet specific requirements; • Accounts which are opened for court orders or judgments;

³ A hosting account refers to an account which is established for holding financial assets on behalf of clients, including purchasing and selling financial assets as an agent, as well as managing entrusted assets on behalf of clients.

Financial accounts subject to TDD	Financial accounts exempted from TDD
<ul style="list-style-type: none"> Equity interests (or creditors' rights) of investment institutions, including interests in private equity funds and beneficial right of trust. 	<ul style="list-style-type: none"> Accounts which are opened for the sale, trading or lease of immovable properties or movable properties; Accounts with certain amounts of remaining balance for tax and insurance payments in relation to the immovable properties for mortgage loans; Tax payment accounts; Deposit accounts as a result of excessive repayments of credit cards or other repayments; Deposit accounts whose holder is not allowed to make an excessive repayment of more than USD 50,000, or the excessive repayment of more than USD 50,000 will be returned to the account holder within 60 days; Dormant accounts⁴ with a remaining balance of no more than USD1,000 in the last calendar year (excluding annuity contract); Accounts held by a government authorities, public institutions, armies, armed police forces, resident committees, village committees, community committees, social organizations etc. in mainland China; Accounts held by soldiers (armed police) who hold military identity documents; Accounts held by policy banks for executing a government decision; and Compensation reinsurance contracts among insurance companies.

5. TDD AND REPORTING

The procedures of TDD depend on the types of financial accounts (i.e. individual's financial accounts or institution's financial accounts), as well as the opening date of financial accounts. The financial accounts have been further divided into 4 groups, including new individual's financial accounts, existing individual's financial accounts, new institution's financial accounts and existing institution's financial accounts.

Individual's financial accounts

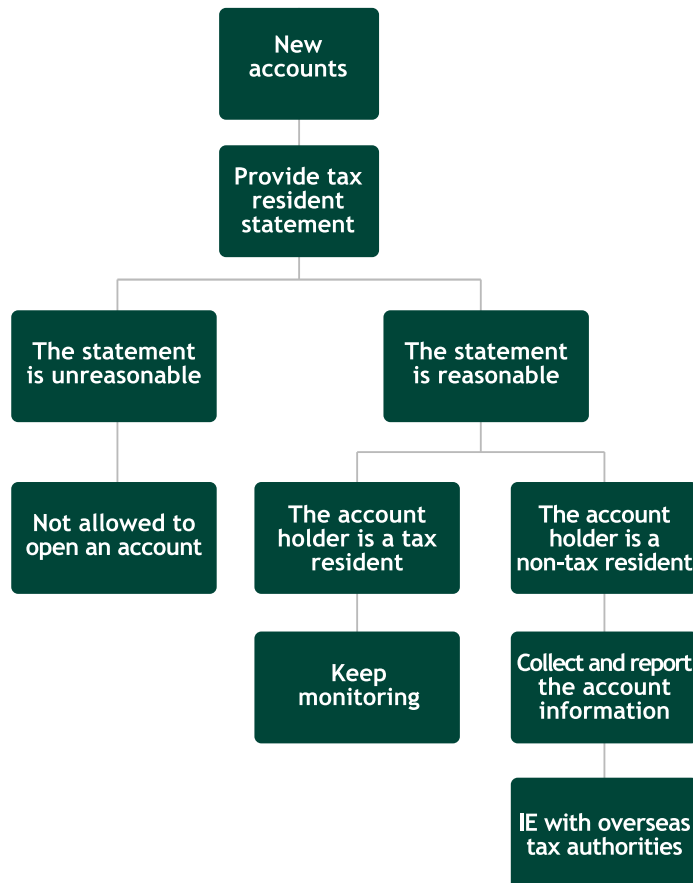
- New individual's financial accounts

A financial account opened on or after July 1, 2017 may be regarded as a new financial account. In the case that the account holder has already had an existing financial account in the same financial institution but opens a new financial account on or after July 1, 2017, the later account would not be treated as a new financial account.

⁴ A dormant account refers to an account, which can meet one of the following conditions:

- The account holder has not initiated any transaction, which is related to the account, with the financial institution in the last 3 calendar years;
- The account holder has not communicated with the financial institution on any matter, which is related to the account, in the last 6 calendar years; or
- For insurance contract with cash value, the account holder has not communicated with the financial institution on any matter, which is related to the account, in the last 6 calendar years.

Holders of individual’s financial accounts shall sign a statement regarding their tax resident status before opening individual accounts since July 1, 2017. The TDD Institutions will check the reasonableness of the statements. If a statement is suspected as unreasonable, the TDD Institution may ask the individual to submit additional supporting documents to further verify the authenticity of the statements or to give explanations. In the case that the additional supporting documents are still considered as unreasonable, the TDD Institution would deny the application for opening a new account.



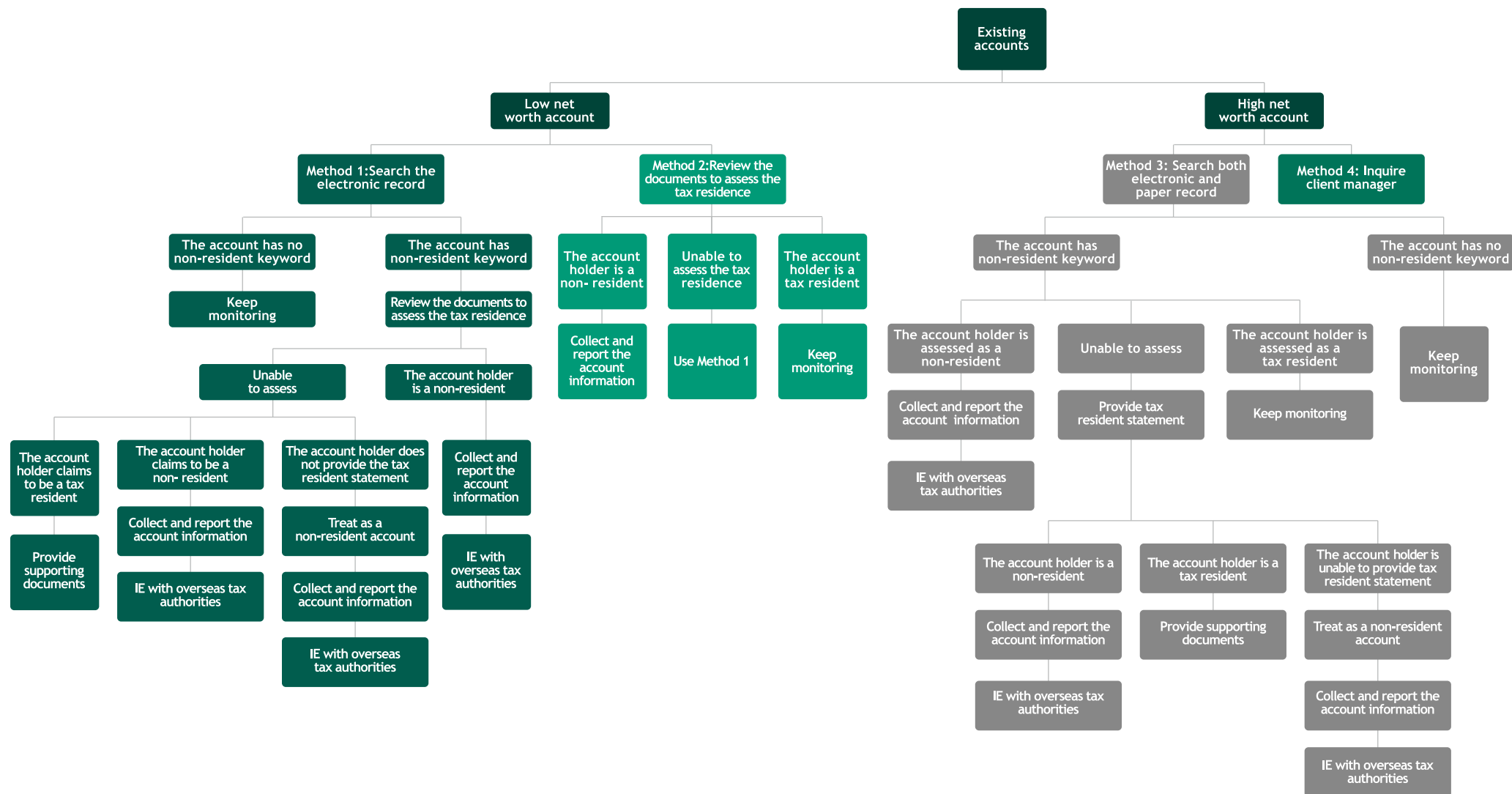
When the new individual’s financial account is ready to use, it shall be regarded as an existing individual’s financial account. The TDD and reporting rules for existing individual’s financial accounts will be applied.

- Existing individual’s financial accounts

For existing individual’s financial accounts (“EIFAs”), the requirements for TDD differ based on whether the account is a high-net-worth account or a low-net-worth account⁵. The TDD institutions would further assess the EIFAs by adopting the following methods:

- (i) Searching the electronic records in the existing information system or assessing the available information of an existing account holder by applying the ‘Factor Test’ as mentioned in section 2. If the holders of the EIFAs are assessed as non-residents, the information of their financial accounts will be reported to the Chinese tax authorities. If TDD Institutions cannot assess the resident status of an account holder based on the existing information, the account holder will be required to provide a statement regarding their tax resident status. A failure in providing such documents would be considered as a non-resident; and
- (ii) Investigating the client manager (for high-net-worth accounts only).

⁵ A low-net-worth account for existing individual’s financial account refers to an account, the total balance of which does not exceed USD 1,000,000, while a high-net-worth account refers to an account, the total balance of which exceeds USD 1,000,000. If the balance of a low-net-worth account exceeds USD 1,000,000 at the end of any calendar year after June 30, 2017, the financial institution shall regard the account as a high-net-worth account in the following year.



The first TDD for existing non-resident individual accounts with high net worth and low net worth shall be finished by December 31, 2017 and December 31, 2018 respectively. After determining the non-resident individual accounts for the reporting to the Chinese tax authorities, the first IE will take place in September 2018. The account balances of EIFAs with low net worth that exceed USD 1,000,000 at the end of any calendar year after June 30, 2017 shall be treated as high-net-worth accounts. The corresponding ongoing TDDs shall be finished by December 31 of the following year. Accordingly, the second IE will be held in September 2019.

Institution's financial accounts

TDD Institutions perform the TDD procedures by assessing the resident status of the account holder, determining whether the account holder is a passive non-financial institution⁶, as well as examining the control⁷ status of the account holder.

- New institution's financial accounts

The new institution accounts, which are opened on or after July 1, 2017, are classified into 6 groups by applying different TDD procedures accordingly.

No.	Type of account holders			TDD procedure
	Resident status	Is the account holder a passive non-financial institution?	Is the account holder controlled by a non-resident?	
1	Non-resident	No	Not applicable	The institution information shall be collected, recorded and reported to Chinese tax authorities.
2	Non-resident	Yes	No	
3	Non-resident	Yes	Yes	The information of both the institution and the controller shall be collected and recorded.
4	Resident	Yes	Yes	Both the information of institution and controller shall be collected and recorded.
5	Resident	Yes	No	No further actions are required.
6	Resident	No	Not applicable	

- Existing institution's financial accounts

Regarding existing institution's financial accounts, TDD Institutions will conduct the assessments to specify the resident status of the account holder, whether the account holder is a passive non-financial institution and whether the account is controlled by a non-resident in order to determine the TDD and reporting policies.

⁶ A passive non-financial institution refers to an institution which meets one of the following conditions:

- The passive operating income (i.e. dividends, interests, rents, royalties, etc.), as well as the income derives from the transfer of the financial assets which produce the passive operating income, account for more than 50% of the total income or assets;
- The institution is a tax resident of a country (or jurisdiction), which does not implement the standardization of IE for financial accounts.

The below non-financial institutions do not belong to passive non-financial institutions:

Listed companies and their subsidiaries, government authorities (or institutions) performing public service functions, holding companies established only for holding the equities of non-financial institutions or providing them with financing and services, companies that have been established for less than 24 months and have not started to conduct business, Companies which are in the process of liquidation or reorganization, companies carrying out financing or hedging transactions only with subsidiaries in the group (all institutions in the group are non-financial institutions), as well as non-profit organizations.

⁷ As specified in Announcement 14, the word 'control' means an individual who:

- holds more than 25% of the company's equities or voting rights directly (or indirectly);
- controls the company by the means of personnel or finance;
- is a senior executive of the company;
- holds more than 25% of the interests in partnership;
- is a trustor, trustee or the beneficiary of the trust or any other individual who exercises the ultimate effective control over the trust; or
- owns more than 25% of the interests in the fund or controls the fund.

No.	Type of account holders			TDD procedure
	Resident status	Is the account holder a passive non-financial institution?	Is the account holder controlled by a non-resident?	
1	Non-resident	Not applicable	Not applicable	The institution information shall be reported.
2	Resident	Yes	Yes	The information of institution and controller shall be collected.
3	Resident	Yes	Unable to determine	The information of the institution shall be collected and recorded, while the information of the controller is voluntary to collect.
4	Resident	No	Not applicable	No further actions are required.
5	Resident	Yes	No	

6. CONCLUSIONS

In summary, the below timetable demonstrates the deadlines for different types of financial accounts in correspondence with the first time and ongoing TDDs and IEs:

Date	Purpose	Account Type	Remark
December 31, 2017	TDD	Individual accounts • high net worth as at June 30, 2017	First TDD
September 2018	IE	Individual accounts • high net worth as at June 30, 2017	First IE
December 31, 2018	TDD	Individual accounts • low net worth as at June 30, 2017 Institution accounts • balance exceeds USD 250,000 as at June 30, 2017	First TDD
December 31, 2018	TDD	Individual accounts • high net worth as at December 31, 2017	Second TDD

Date	Purpose	Account Type	Remark
December 31, 2018	TDD	Institution accounts <ul style="list-style-type: none"> balance exceeds USD 250,000 as at December 31, 2017 	Second TDD
September 2019	IE	Individual accounts <ul style="list-style-type: none"> low net worth as at June 30, 2017; and high net worth as at December 31, 2017. Institution accounts <ul style="list-style-type: none"> balance exceeds USD 250,000 as at June 30, 2017; and balance exceeds USD 250,000 as at December 31, 2017. 	Second IE
December 31, 2019	TDD	Individual accounts <ul style="list-style-type: none"> high net worth as at December 31, 2018 Institution accounts <ul style="list-style-type: none"> balance exceeds USD 250,000 as at December 31, 2018 	Third TDD

Financial accounts of non-PRC tax residents, which have satisfied certain conditions, will be reported by Chinese tax authorities to the tax authority located in the home country of an individual or an institution which participate in the IE. On one hand, PRC Individual Income Tax (“IIT”) Law is applicable to the assessment of non- PRC tax resident for individuals, which requires that non-Chinese individuals are subject to Chinese IIT either (a) when they qualify as a tax resident in China, which will depend on the staying days in China or (b) when they derive income from sources inside China. On the other hand, PRC Enterprise Income Tax (“EIT”) Law shall be applied in assessing the non- PRC tax resident for enterprises, which are subject to the registered location and the management location of the enterprise. It is recommended that the account holders (or controllers) of the financial accounts, which are affected by Announcement 14, shall pay special attention on the global tax compliance status to avoid tax disputes.

Furthermore, the account information of a PRC tax resident that holds overseas financial accounts opened in a country or a jurisdiction engaged in the IE will be reported to Chinese tax authorities, provided that it meets the requirements of IE in the respective country or jurisdiction. According to PRC EIT and IIT Laws, worldwide income of a PRC tax resident shall be taxable in China. Chinese tax authorities could check if there is any missing tax filing or underpaid tax based on the tax information exchanged by tax authorities in other countries or jurisdictions. Any non-compliance tax issue would be subject to higher tax risks due to the increasing transparency.

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