MOVE TOWARDS A CHINESE FATCA?

Enhanced Reporting Requirements for PRC Residents on Foreign Assets and Transactions

On 9 November 2013, the PRC State Council released the revised reporting requirements for 'PRC residents'[1] in relation to their cross-border receipts and payments as well as foreign assets and liabilities (*Order of the PRC State Council No. 642 outlining the "Decision of the State Council on Amending the Measures for Reporting of Statistics on International Receipts and Payments"*, hereinafter referred to as "**Circular 642**"), effective from 1 January 2014. Circular 642 revises the *Measures for Reporting of Statistics on International Receipts and Payments* first published by the State Administration for Foreign Exchange ("**SAFE**") in 1995[2] ("**1995 Measures**"). The revised 1995 Measures, hereinafter referred to as "**2014 Measures**", expands the group of persons subject to the reporting requirements as well as the reportable events.

REPORTING LIABILITY - *ON WHOM?*

The reporting requirements under Circular 642 are imposed on 'PRC Residents', as well as 'non-PRC residents carrying out economic activities within the PRC'.

For purposes of Circular 642 the definition of 'PRC Residents' includes:

- Individuals residing in the PRC for one year or more;[3]

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[1] For purposes of the revised reporting requirements under Circular 642 a broad definition of 'PRC Residents' is adopted.

[2] Under the 1995 Measures, PRC residents who are individuals were only required to report their economic transactions with non- PRC residents (either directly or through a financial institution) whereas more extensive reporting requirements applied to non-individual PRC residents (e.g. financial institutions within China were required to provide information about their proprietary foreign operations, including their foreign assets and liabilities and the change therein, as well as facilitate PRC residents' reporting obligations as far as they relate to the statistics of the international receipts and payments).

[3] Under the 1995 Measures, PRC residents who are individuals were only required to report their economic transactions with non- PRC residents (either directly or through a financial institution) whereas more extensive reporting requirements applied to non-individual PRC residents (e.g. financial institutions within China were

- PRC nationals staying abroad for a period of less than one year;[4]

- PRC incorporated enterprises (including foreign-invested enterprises and foreign-invested financial institutions);

- Representative offices and branches of foreign legal persons (excluding the offices of international organizations, Embassies and Consulates); *and*

- PRC state authorities (including PRC Embassies and Consulates abroad), PRC organizations and garrisons of the PRC.

With respect to financial institutions, Circular 642 extends the reporting requirement to institutions performing registration, clearing and custodial services in the PRC[5]. Same as under the old reporting requirements, dealers in securities, futures and options as well as various other financial institutions would remain subject to the reporting requirements.

As for 'non-PRC residents carrying out economic activities within the PRC', this seems to be a broad category and may for instance include overseas residents buying property in the PRC, overseas residents making an investment in a PRC business, or overseas residents merely performing consulting services for a PRC enterprise. This term is not yet defined and we keenly await further guidance in order to better assess the impact of the revised reporting requirements for non- PRC residents.

REPORTING EVENTS- *WHAT?*

- **Economic transactions between PRC residents and non-PRC residents**

  - Previously, PRC residents (as outlined above) are required to report their economic transactions with non- PRC residents. The term 'economic transactions' is not defined but under the Implementation Rules[6], economic transactions which have to be reported[7] include: the receipt of and remittances of money overseas; foreign

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required to provide information about their proprietary foreign operations, including their foreign assets and liabilities and the change therein, as well as facilitate PRC residents' reporting obligations as far as they relate to the statistics of the international receipts and payments).

[4] PRC Embassy and Consular employees and their family members as well as persons who are absent from the PRC for study or medical purposes remain liable to report regardless of the period of absence.

[5] Article 9 of the 2014 Measures.

[6] *Rules for the Implementation of Measures on Reporting of Statistics on International Receipts and Payments.*

[7] Articles 3, 4, 8 and 9 of the Implementation Rules.

exchange transactions; transactions in foreign securities, options and futures etc. Circular 642 does not alter this obligation for PRC residents.

- Circular 642 imposes personal liability on 'non-PRC residents who carry out economic activities within the PRC' to report their 'economic transactions' with PRC residents[8].

- **The status of foreign financial assets and liabilities**

  - Again, the term 'foreign assets and liabilities' is not defined. Under the 1995 Measures[9], this is a reporting event for PRC entities including various financial institutions. This obligation remains except in relation to the type of assets to be reported: now limited to 'foreign *financial* assets and liabilities'[10].

  - The term 'foreign *financial* assets and liabilities' is also not defined in the 2014 Measures. The change may potentially limit the scope of the types of assets and liabilities to be reported (e.g. real property may be excluded).

  - Circular 642 expanded the reporting of 'foreign financial assets and liabilities' to PRC residents who are individuals, such that they are supposed to declare all foreign financial assets and liabilities they own[11]. This may have far reaching implications as the ownership of any foreign financial assets and liabilities by PRC residents individuals even before the promulgation of the 2014 Measures may have to be declared and reported.

The combined effect of the revised rules under the 2014 Measures seems to be that any transfer of foreign assets by PRC residents to non-PRC residents will also trigger an incidence for reporting, including for example when PRC individuals transfer their foreign financial assets to an offshore trustee as part of their wealth planning.

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[8] Under the Implementation Rules made under the old regime, Articles 3 and 4 require money received from and remitted abroad through a domestic financial institution by non-PRC residents to be reported, but the obligation is on the domestic financial institution. Article 7 of the 2014 Measures extended this obligation on the non-PRC residents themselves.

[9] Articles 11 and 13 of the 1995 Measures.

[10] Articles 2, 10, 12 and 13 of the 2014 Measures.

[11] However, the wording of Article 13 of the 2014 Measures does not extend this obligation to non-PRC residents.

PENALTIES

Failure to comply with the above described reporting obligations may result in a fine of up to RMB 300,000 (approx. USD 50,000) for corporations, and RMB 50,000 (approx. USD 8,500) for individuals.[12]

CONFIDENTIALITY

Circular 642 also expands and strengthens provisions on confidentiality and data protection.[13] From those provisions, it appears that the (to be) collected data will merely serve the purpose of enabling SAFE to perform an analysis of, and maintain, statistical data of international receipts and payments for the benefit of the state. SAFE and its personnel (including its (personnel of) local branches), as well as financial services providers (e.g., banks and security dealers) and their personnel, are required to keep data confidential. A confidentiality breach may result in the imposition of a penalty and an investigation of legal liability.

OBSERVATIONS- *HOW?*

The further expansion and strengthening of reporting obligations to SAFE in relation to cross-border transactions and foreign assets, is in line with the anti-tax abuse campaign run by the State Administration of Taxation ("**SAT**") which started in 2008 with the introduction of general anti-avoidance rules in China's corporate income tax law. Even though Circular 642 contains expanded and enhanced confidentiality and data protection clauses, it remains to be seen whether the collected data will not eventually be disclosed to other governmental bodies such as the SAT.

At the moment, there is no procedural framework in place for reporting the broadened scope of reportable events under the 2014 Measures (e.g. there is not yet a mechanism for the PRC residents who are individuals to declare their foreign financial assets and liabilities; and for non-PRC residents who carry on economic activities within the PRC to declare their economic transactions with PRC residents.) From an enquiry with the local SAFE authorities we learned that it is unlikely that any implementation rules will be promulgated in the first half year of 2014. Even though parties affected are currently off the hook, it may well be expected that the to-be-issued further guidance will be effective retroactively.

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[12] Article 17 of the 2014 Measures juncto Article 48 of the Administrative Regulations of the People's Republic of China on Foreign Exchange.

[13] Article 16 and 18 of the 2014 Measures.

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