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Remittance of Cost Reimbursement Items

(Shanghai Hui Fa [2010] 192)

Introduction

Further to the circular Hui Fa [2010] 43 issued by State Administration of Foreign Exchange ("SAFE"), Shanghai-SAFE has recently issued a local circular Shanghai Hui Fa [2010] 192 ("Circular 192').

Accordingly to the above circulars, normal foreign investment enterprises ("FIEs") that do not have the "Multinational Corporation Status" ("MCS") are now allowed to remit cost reimbursement/cost allocation items to their overseas affiliates.

Key Points of the Circular

According to Circular 192:-

- FIEs that have MCS can remit cost reimbursement/cost allocation items through their banks directly based on:-
    - The MCS approval issued by SAFE
    - The supporting documents regarding the cost reimbursement/cost allocation items
- Certain types of FIEs that do not have MCS can also remit cost reimbursement/cost allocation items through their banks, including:-
    - FIEs that have the Regional Headquarter status
    - FIEs that are recognized R&D centers
    - FIEs that are approved as "2010 Key FIEs in Shanghai"
    - Recognized key enterprises in the areas of service outsourcing and service trade
- Normal FIEs that do not meet the conditions of the above two categories can remit cost reimbursement/cost allocation items as follows:-

- For each of their such invoice whose amount is no higher than USD 100,000 (or the amount in other currencies that is equivalent to USD 100,000), the remittance can be processed by the banks directly.

- For each of their such invoice whose amount is higher than USD 100,000 (or the amount in other currencies that is equivalent to USD 100,000), the approval issued by Shanghai-SAFE should be provided so that the remittance can be processed by the banks.

Possible Impact on Your Group and Our Suggested Approach

Historically, normal FIEs (except those under the first two categories mentioned above) were not allowed to remit any cost reimbursement/cost allocation items to any overseas parties under the China foreign exchange regulations. However, in economic reality, overseas affiliates of FIEs do need to pay certain expenses on behalf of the FIEs first and then re-charge to the FIEs in China. For example, certain expatriates of a US company are sent to China and work for a consulting subsidiary (in Shanghai) of that US company for a certain period. Due to the employees' request or other considerations, their salaries are paid by the US company first and then the US company recharges the salary costs to the Shanghai company. From the Shanghai company's perspective, it should bear the salary costs of its employees (the expatriates mentioned above) and should reimburse such costs to the US company. In the past, such cost reimbursement items may have to be taxed as "service fee", so that the China tax clearance documents can be obtained for the remittance purpose. In other words, the cost imbursement items are remitted in the name of "service fee". This used to be the common practice adopted by many FIEs in China due to the hurdle on the remittance. However, such arrangement has the following risks or disadvantages:-

- Strictly speaking, it was bypassing the foreign exchange control on the remittance of cost reimbursement items.

- The "service fee" nature declared to the China tax authorities (and the banks/SAFE) did not reflect the genuine nature of the items.

- The China taxes levied on the "service fee" should not be paid, if judging from the tax technical perspective. In other words, it is a tax inefficient approach.

Now under Circular 192, normal FIEs can remit cost reimbursement/cost allocation items legitimately. Definitely this is a good news for those normal FIEs that must have cost imbursement items. However, the following issues should be noted:-

- The cost reimbursement/cost allocation items can only be remitted to the overseas affiliates of the FIEs.

- The cost reimbursement item should not include any markup. Otherwise, the "cost reimbursement" nature of the entire invoice amount may be jeopardized.

- Comparing with cost reimbursement items, there are still tax exposures on the remittance of cost allocation items.

- Breakdowns and supporting documents should be provided to the banks to process the remittance of cost reimbursement items. For example, employment contracts and China Individual Income Tax certificates should be provided for salary items, while hotel invoices/air tickets should be provided for such cost reimbursement items.

- For any single invoice whose amount is above USD 100,000, the approval of Shanghai-SAFE is required. Thus, to the extent possible, it should be avoided that any single invoice is amounted above USD 100,000.

- The detailed requirements of different banks may vary slightly. Certain banks may even be not aware of such new regulation.

- The practices in other Chinese cities may also vary.

What Texel Consulting Can Help?

Regarding the issues discussed in this Issuance of our China Tax and Business Newsflash, Texel Consulting can help your company on the following aspects:-

- Reviewing the background information and documents of the cost reimbursement/cost allocation items and suggesting the appropriate approach to handle.

- Assisting to compile the supporting document packages for the remittance of cost reimbursement items.

- Coordination with your banks for the processing of the cost reimbursement items.

Your Strategic Partner to Success

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