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Updates

In this edition of our APAC Newsletter, we have articles covering the development of the profession in China, reporting on the growth of Chinese CPAs and the reasons behind the recent shift in number from practising to non-practising members.

The Hong Kong article covers the recent release by the tax administration on tax issues arising from the COVID-19 pandemic. The tax administration heels the approach set out in the OECD's Guidance on this matter. The article would be a good piece of reference to readers wishing to have a quick understanding of the OECD's approach.

India has moved quickly on regulations regarding cryptocurrency. Bills have been introduced to the Companies Act to address disclosure in financial statements on cryptocurrency activities.

The article by Japan is on International Taxation in Digital Economy Updates, summarizing the recommendations of direction in the 32-page interim report by the Study Group released in August 2021. The study covers the potential implications on Japanese companies in home country as well as interaction and interfacing with international tax development on digital economy.

Lastly, but ahead of the game is Malaysia, which rolled out Digital Service Tax (DST) as early as 2020. We have a good summary on the DST coverage and application in this Newsletter.

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CHINA

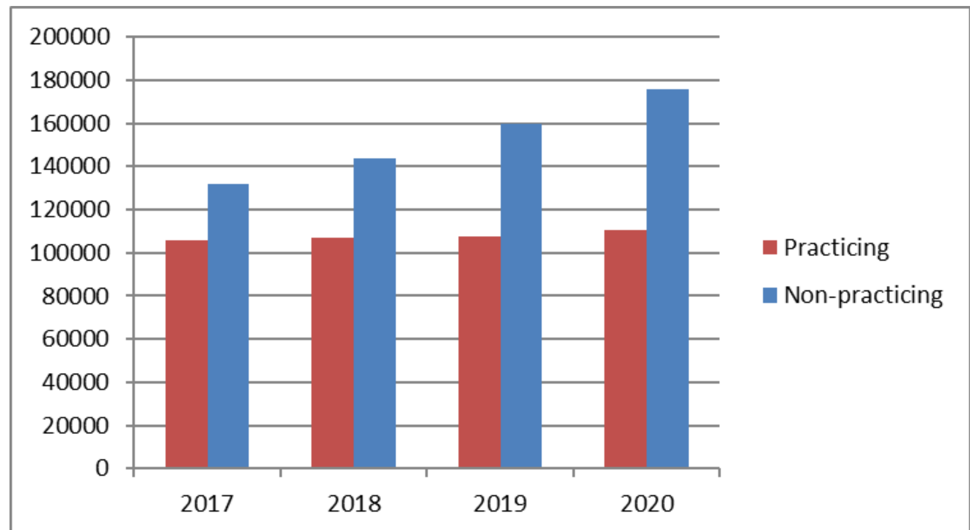
NUMBER OF CHINESE CPAS: UP AND DOWN

This year, we may witness great fluctuation in number of Chinese CPAs, practicing vs non-practicing. In China, CPAs practicing in name has been a special phenomenon existing for many years. The phenomenon refers to the situation in which a non-practicing CPA's certificate is affiliated with a CPA firm and the CPA becomes a nominal practicing CPA. In some cases, the CPA does this just for "renting out" the certificate, and in others, the firm needs the watered number of its CPAs just for fame.

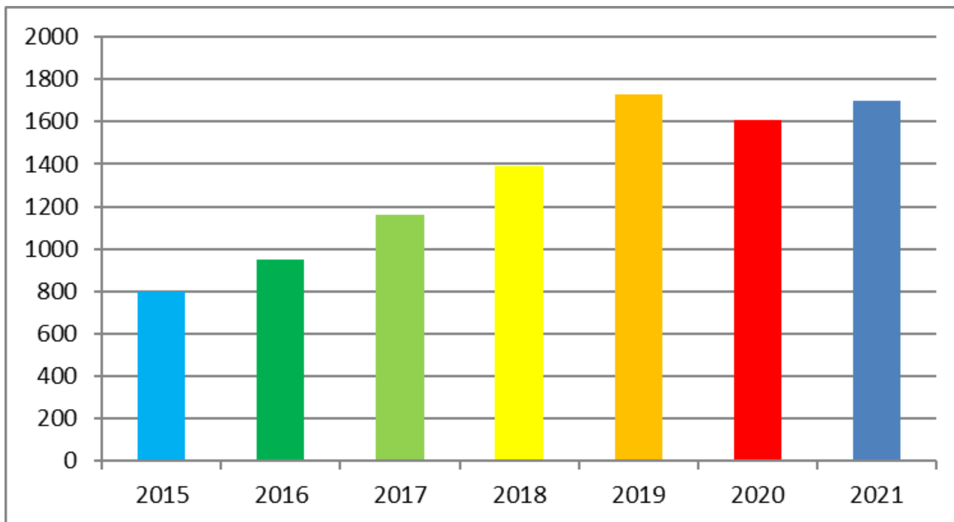
"...increase in number of non-practicing CPAs is faster than that of practicing CPAs, meaning that the attraction of CPA firms has been diminishing. "

On 13 August 2021, the General Office of the State Council published "Opinions on Further Standardising the Order of Financial Audit and Promoting the Healthy Development of CPA Industry". Before this, the Ministry of Finance and the Ministry of Human Resources and Social Security released in June 2021 "Circular on Carrying Out the Rectification of Nominal Practicing CPAs". In July, the Beijing Municipal Bureau of Finance released "Notice on Carrying Out Special Rectification Work on the Behaviours of Accounting Firms Such as CPAs Practicing in Name, Online Sales of Audit Report, CPAs Practicing Beyond Their Competence, and Operating Without License". Up to the date of this article, around 30 percent of nominal practicing CPAs in Beijing only (total number of practicing CPAs was around 13,000 on 30 July 2020) were ferreted out and transferred to non-practicing CPAs. The number for the whole country is not yet known at the moment, but calculated according to proportion of Beijing number of practicing CPAs in China's and other factors, around 30,000 practicing CPAs may be transferred to non-practicing CPAs at the end of the rectification.

The total number of Chinese CPAs has been increasing. According to the Ministry of Finance, by the end of July 2021, there were 111,000 practicing CPAs (before the rectification) and 8782 accounting firms in China. The chart below shows the growth in number of CPAs:



It can be seen that the increase in number of non-practicing CPAs is faster than that of practicing CPAs, meaning that the attraction of CPA firms has been diminishing. Although the number of applicants for CPA examination had been rising before 2020 (as shown in the chart below, people in thousand), the proportion of those passed exam and are willing to work in CPA firms is declining.



CHINA

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"...the proportion of those passed exam and are willing to work in CPA firms is declining. "

The situation is being worsened by COVID-19 epidemic since 2020, the numbers for 2020 and 2021 declined. The CPA examination was cancelled in Beijing and Xinjiang in 2020; and in 2021 it was postponed in certain areas including Beijing, Jiangsu, Hubei, Henan and Shaanxi.

HONG KONG GUIDANCE - TAX ISSUES ARISING FROM COVID-19

HONG KONG

In the March 2021 edition of APAC Newsletter, we reported the OECD Guidance of issues arising from COVID-19 on the interpretation of permanent establishment (PE) and tax residence (TR). In July 2021, the Hong Kong Inland Revenue Department (IRD) released a Hong Kong guidance setting out guidelines that are by large similar to those of the OECD. In brief, the IRD's view is as follows:

<u>Tax residence & permanent establishment</u>

TR of companies – a temporary change in the locations where senior management hold their meetings or conduct the business of a company due to the pandemic would not change the TR status of the company. In determining the company's TR status, the IRD will consider all relevant facts and circumstances. For situation of dual residency, the place of residence under the tie-breaker rules shall not be affected by the fact that management cannot travel due to public health measures.

TR of individuals – an individual would generally not be regarded as a TR of the host jurisdiction where he/she temporarily remains due to travel restrictions under the COVID-19 pandemic.

PE – The exceptional and temporary change of work location of employees (e.g., work from home) due to the COVID-19 pandemic should not result in new PEs for the employers. Similarly, conclusion of contracts in the home of the employees or agents

(Continued)

because of the pandemic should not result in new PEs for the enterprises. However, if the work from home continues after removal of the public health measures, the IRD will examine the facts and circumstances further to determine whether a PE exists.

Income from employment – where a tax treaty is applicable, for the purpose of the 183-day test, the additional days spent in Hong Kong shall not be counted if a non-Hong Kong TR was stranded in Hong Kong due to the pandemic. This non-counting concession shall not apply for non-treaty situation. In other words, TR of non-treaty jurisdiction cannot rely on the travel restriction to exclude days in Hong Kong when considering his/her eligibility to the 60-day exemption rule.

"…a temporary change in the locations where senior management hold their meetings or conduct the business of a company due to the pandemic would not change the TR status of the company. "

Transfer pricing (TP)

The IRD will generally follow the OECD's COVID-19 TP Guidance. Accordingly, the arm's length principle remains the applicable standard for the purpose of evaluating the TP of controlled transactions in the face of the pandemic.

That said, due regard shall be given to the impact of the pandemic that affects the outcomes of the economically significant risks controlled by the parties to the transactions. For this reason, in comparable analysis, it may be appropriate to (i) have separate testing periods for the duration of the pandemic and / or (ii) include loss-making comparables. Also, a limited-risk entity could be accepted to have incurred losses if the losses are found to be incurred at arm's length. The analysis should also take account of government assistance or subsidies as they may affect the price of a controlled transaction.

The IRD will uphold existing advance pricing arrangements (APAs), unless a condition leading to the revocation, cancellation or revision of the APA has occurred. Where material changes in economic conditions lead to the breach of the critical assumptions, taxpayers should notify the IRD not later than one month after the breach occurs.

Practical approach to address information deficiencies

As the economic circumstances caused by the pandemic are continuing and evolving over time, taxpayers may encounter difficulties in determining arm's length pricing due to time lag between the occurrence of a controlled transaction and the availability of information of contemporaneous uncontrolled transactions. The OECD's COVID-19 TP Guidance suggests that:

- Taxpayers and tax administrations are encouraged to use reasonable commercial judgement supplemented by contemporaneous information to set the TP. Taxpayers should document the best available market evidence currently available, covering the effects of COVID-19 on the level of demand for goods and services, and on production and supply chains in the relevant economic sectors. Tax administrations should be mindful of the complexities due to the fast-changing conditions and consider whether the documentation support provided by the taxpayers does demonstrate reasonable effort and due care have been taken to comply with the arm's length principle.

- Tax administration may consider, on a temporary basis during the pandemic, to use the outcome-testing approach incorporating information available after the close of the tax year (as opposed to the price-setting approach which is based on historic data prior to the transaction) to determine the arm's length conditions and results reported in the tax return.

HONG KONG

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- Under the specific circumstances of the pandemic, more than one TP method may be used to corroborate the arm's length price of a controlled transaction. This contrasted with the normal situation which does not require the application of more than one TP method.

- Separate testing periods may be used for the duration of the pandemic or for the period when certain material effects of the pandemic were most evident. Care should be taken to ensure that the data from independent comparables is measured over a similar period. In addition, when government invention in a market has a material effect on economic performance, the controlled transaction shall be accurately delineated to carve out the distortion effect of the invention.

- Tax administration may consider allowing price adjustment in a year through adjusted invoicing or intercompany payments effected in a subsequent period (e.g., TP for a transaction in FY2020 adjusted in FY2021) when more accurate information to establish arm's length pricing becomes available.

- As there is no overriding rule on the inclusion or exclusion of loss-making comparables in the OECD TP Guidelines for MNE and Tax Administrations (2017 edition), loss-making comparables should not be rejected on the sole basis that they suffer losses in periods affected by the pandemic.

"…more than one TP method may be used to corroborate the arm's length price of a controlled transaction. "

INDIA

UPDATES ON THE COMPANIES ACT, 2013, CRYPTOCURRENCIES AND MORE

Sharp & Tannan

Chartered Accountants

The Indian government has made several changes in the Companies Act, 2013, cryptocurrencies, and other matters. In this issue, we have outlined the changes/proposed changes in the Companies Act, 2013 [see (A) below] and in cryptocurrencies [see (B) below].

(A) Revised schedule III of the Companies Act, 2013

In India, the preparation and presentation of companies' financial statements are governed by schedule III to the Companies Act, 2013. Schedule III gives general instructions regarding the disclosures and presentation of financial statements and specifies:

1. Format of the balance sheet and disclosures under each head;

2. Various items to be disclosed in the statement of profit and loss along with certain other information, e.g., earnings in foreign currency etc.; and

3. Both (1) and (2) above shall also apply to consolidated financial statements of a company to the extent applicable.

Recently, schedule III was revised, and companies are now required to present their financial statements (FY 2021-22 onwards) and previous years' comparatives (2020-21) as per the revised requirements.

The following are the major areas of changes to the disclosure requirements from FY 2021-22 onwards.

1. Trade receivables and trade payables

a. The ageing of trade receivables and trade payables need to be disclosed separately, i.e., less than six months, six months - one year, one - two years, two - three years and over three years.

b. For trade receivables, whether they are disputed/undisputed needs to be disclosed. Unbilled revenues shall be disclosed separately.

c. Trade payables due to MSME (micro, small and medium enterprises) and due to others is required to be disclosed separately.

2. Capital-work-in-progress (CWIP) and intangible assets under development (IAUD)

The ageing of CWIP and IAUD into less than one year, one to two years, two to three years and over three years, the expected completion schedule of projects in progress, and projects temporarily suspended are required to be separately disclosed. Before this amendment, there were no disclosure requirements for CWIP and IAUD other than presenting the same as line items on the face of the balance sheet.

The new disclosures on ageing are likely to influence the management to either capitalize the asset without any delay or provide for impairment for CWIP and IAUD, which were not capitalized for a significant period. The amendment also brings additional disclosures on expected completion time and capitalization concerning projects that have exceeded budgeted time (over-due) or costs (over-run) compared to its original plan.

"…to either capitalize the asset without any delay or provide for impairment for CWIP and IAUD, which were not capitalized for a significant period."

3. Details of investing/trading in crypto/virtual currencies

Where the company has traded/invested in crypto/virtual currency during the year, the profit or loss on transactions involving crypto/virtual currency, amount of currency held as at the reporting date and deposits or advances received from any person for trading or investing in crypto/ virtual currency, shall be disclosed.

The new disclosure requirements may significantly impact the consolidated financial statements of a group having foreign subsidiaries dealing in cryptos. The upcoming cryptocurrency Bill in India and the further announcements in various laws will be crucial in deciding the treatment of crypto currencies.

4. Disclosures related to Companies Act provisions, viz.:

a. Details of charges or satisfaction yet to be registered with the registrar of companies (ROC) beyond the due date and the details of such charges.

b. Non-compliance with the number of layers of companies, name and company identification number ('CIN') of the companies beyond the specified layers and the relationship/extent of holding of the company in such downstream companies.

c. Transactions with struck-off companies such as investments in securities, receivables, payables, shares held by struck off company and other outstanding balances.

d. Regrouping and revision in disclosures, such as changes in equity, lease

liabilities, borrowings, current maturities of long-term debts as short-term borrowings, etc.

5. Reporting of ratios

The following ratios are to be disclosed, along with the composition of the ratios. In case of variation of more than 25% as compared to the preceding year, an explanation shall be provided:

i. Current ratio
ii. Debt-equity ratio
iii. Debt service coverage ratio
iv. Return on equity
v. Inventory turnover ratio
vi. Trade receivables turnover ratio
vii. Trade payables turnover ratio
viii. Net capital turnover ratio
ix. Net profit ratio
x. Return on capital employed
xi. Return on investment

6. For non-banking financial companies (NBFCs)

The revised reporting requires NBFCs to disclose the following four ratios:

i. Capital to risk-weighted assets ratio,
ii. Tier I capital adequacy ratio (CRAR),
iii. Tier II CRAR,
iv. Liquidity coverage ratio.

(B) Cryptocurrency bill in India

Introduction:

Cryptocurrencies are privately exchanged currencies between parties, virtual in nature, and secured by cryptography. They take form of crypto assets based on a huge, distributed network of computers. The asset is encrypted among the parties and those outside the network have no control over the encryption. Hence, cryptocurrencies are not issued as a legal tender by any government/central bank and fall outside the purview of the regulators.

"…cryptocurrencies are not issued as a legal tender by any government/central bank and fall outside the purview of the regulators."

Today, thousands of cryptocurrencies are floated world-wide, with India investing about USD 6.6 billion in cryptocurrencies.

Indian regulators like the Reserve Bank of India ('RBI'), the Finance Ministry, the Institute of Chartered Accountants of India ('ICAI') are studying the various alternatives to bring the cryptocurrencies under the regulatory framework. Though the intention is not to make it a legal tender, the government intends to apply stringent controls over these digital assets.

The much-awaited cryptocurrency bill will be soon tabled in the Parliament by the Indian Government.

Features of the draft Bill to be tabled in the Parliament

The draft bill proposes to:

1. Define the cryptocurrency to bring it under the regulatory powers. Defining the term 'cryptocurrency' mean a huge impact on the entire crypto environment.

2. The cryptocurrency will be defined as an asset and not as 'money.'

3. Allow the use of only the 'government-regulated' crypto currencies in India.

INDIA

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4. The government intends to define the cryptocurrencies depending upon their end-use, though they are categorized as per the technology they use.

5. Propose a taxation treatment of cryptocurrency as 'digital assets'

6. Propose the method of bringing cryptocurrencies to the books of account.

7. Cryptocurrencies will be strictly outside the scope of payments and settlements systems of the RBI.

JAPAN

INTERNATIONAL TAXATION IN THE DIGITAL ECONOMY UPDATE

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I. Outline

In the March 2021's issue of APAC News, it was mentioned that the Ministry of Economy, Trade and Industry (METI) informed below; "METI inaugurates a "Study Group on International Taxation in the Digital Economy" (Study Group) to hold discussions on ideal approaches to fair international taxation that contributes to enhancement of Japanese companies' competitiveness and vitalization of the Japanese economy amid the acceleration of economic digitalization. The group held its first meeting on 1 March, 2021."

Website https://www.meti.go.j p/english/press/2021/0 301_001.html

After the meeting and further discussions, on August 19, the METI released a 32-page interim report titled "International Taxation in the Digital Economy" prepared by the Study Group. The contents were summarized into the following three main parts:

- Competitive situation and basic concept of Japanese companies
- Background and direction of international discussions
- Direction of future response

"…the monopoly and oligopoly of foreign companies are progressing."

The summary for each part is shown below:

II. Contents (overview)

1. Competitive situation and basic concept of Japanese companies

- In domestic and overseas markets, there are problems in price competitiveness and product development capabilities when compared to foreign companies.
- In the Japanese digital market, the monopoly and oligopoly of foreign companies are progressing.
- There is a significant tax burden gap when compared to no branch office/digital companies that transferred intangible assets to low-tax rate countries to avoid taxes.

2. Background and direction of international discussions

(1) Allocation of taxing rights to user/market jurisdiction (Pillar One)

There is a problem that tax cannot be levied in user/market countries because there is no physical presence such as a branch. As a counter measure against these, it is conceivable to allocate a part of the profits of large-scale and high-profit multinational corporations to market countries. Countries like the United Kingdom, France, India and have already imposed digital sales tax (DST). To achieve globally unified responses, countries that already adopt DST need to make adjustments such as abolishing DST.

(2) Global minimum tax rate taxation (Pillar Two)

At present, there are some problems that intangible assets, which are the source of income, have been transferred to subsidiaries located in low-level tax rate countries.

It also leads to competition to reduce the corporate tax rate. As a counter measure against these, it is conceivable to set a minimum corporate tax rate (15% or more) so that the shortfall of overseas subsidiaries can be additionally taxed in their jurisdiction.

3. Direction of future response

(1) International agreement (Pillar One)

We wish that the international agreement come into effect early. However, we think that the remaining issues, the following items should be considered.

(a) Appropriate consumption tax for cross-border transactions (online games, etc.) by foreign companies

(b) Strengthen tax avoidance measures by Japanese subsidiaries of foreign companies as necessary

(c) In the unlikely event that the entry into force of Pillar One is delayed, Japan has been keeping pace with OECD member countries, but it is necessary to consider measures unique to Japan in the future.

"To achieve globally unified responses, countries that already adopt DST need to make adjustments such as abolishing DST."

(2) Global minimum tax rate taxation (Pillar Two)

If introduced by major countries, it will contribute to fair competition globally. In the final agreement and future implementation, it is necessary to consider the following matters:

(a) When introducing the minimum tax rate, we should consider the relationship with significant competitors (Europe, the United States, China, and South Korea, etc.)

(b) Consideration for tax burdens of local businesses, such as manufacturing industries

(c) Arrangement and simplification of the relationship with the existing Controlled Foreign Company (CFC) tax system

(d) Facilitation of overseas business activities such as overseas M & A

(e) The tax system that promotes the formation and use of intangible assets in Japan

With the above awareness of the issues, the Study Group states that discussions will proceed.

MALAYSIA

DIGITAL SERVICE TAX

Malaysia widened its scope of service tax to include digital service providers from 1 January 2020. As a result of this, a foreign service provider ("FSP") providing digital services that has no physical presence in Malaysia is liable to register for Digital Service Tax ("DST") in Malaysia and charge 6% service tax on digital services provided to both individual and business consumers in Malaysia. Since then, companies like Netflix, Spotify, Airbnb, Google, to name a few, have registered for this DST.

"Digital service" means any service that is delivered or subscribed over the internet or other electronic network and which cannot be obtained without the use of information technology and where delivery of the service is essentially automated. For clarity purposes, the following table provides a non-exhaustive list of services that are viewed to be digital services:

"…digital services that has no physical presence in Malaysia is liable to register for DST in Malaysia and charge 6% service tax …"

Types of services	Examples of digital service
Software, application and video games	Downloading of online software, updates and add-ons website filters, firewalls, provision of mobile applications, online gaming
Music, e-book and film	Provision of music, streaming services, including subscription-based media or membership
Advertisement and online platform	Offering online advertising space on intangible media platforms to trade products or services
Search engines and social networks	Customised search engine services
Database and hosting	Website hosting, online data warehousing, file sharing and cloud storage services
Internet based telecommunication	Cloud-PABX, VOIP phone
Online training	Provision of distance learning, e-learning, online courses, pre-recorded webinar
Others	Provision of digital content like images, text, information the delivery of which does not require human intervention and payment processing services

A FSP is either a business or individual outside Malaysia who provides any digital service directly or who sell the digital service on behalf of its principal through an online platform to consumers in Malaysia.

There is a threshold for registration where, if the value of digital services sold to customers in Malaysia exceeds RM500,000 for a period of 12 months, the FSP is required to register to collect and remit service tax on such sales.

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