Tax Newsflash

China

Deloitte Tohmatsu Tax Co.

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SAT Clarifies New Rules on Tax Treaty Benefit Claims

China's State Administration of Taxation ("SAT") issued guidance (Circular 128) on 29 October 2015 that clarifies the responsibilities of the tax authorities at all levels of the government when they assess whether a nonresident is entitled to benefits under China's tax treaties. Circular 128 supplements guidance released in August 2015 (Bulletin 60)1 that eliminated the advance approval and registration requirement for nonresidents to obtain treaty benefits and introduced a new self-assessment procedure. Both sets of guidance applied as from 1 November 2015.

(1) Highlights of Circular 128

Bulletin 60 relaxes the procedures for nonresident enterprises and individuals to obtain benefits under China's tax treaties by allowing treaty benefits to be enjoyed based on assessments made by the nonresident recipient of China-source income or the Chinese withholding agent and the submission of certain documentation.2 The tax authorities can subsequently review the documentation and request additional information from the nonresident or the withholding agent, and if the authorities conclude that a nonresident improperly obtained benefits under a treaty, they may require the nonresident to pay the relevant tax.

Circular 128 requires the local tax authorities to carry out periodic assessments of a certain percentage of nonresidents claiming treaty benefits. These examinations specifically will target nonresidents located in jurisdictions that have low effective tax rates, those claiming significant tax benefits and nonresidents with poor credit ratings.

The tax authorities are directed to carry out "sample" examinations of nonresidents that claim tax benefits under the dividends, interest, royalties and capital gains provisions within three months after the end of each quarter. For each of these four articles, the authorities must examine at least 30% of the total number of nonresidents claiming treaty benefits based on the same article during the relevant quarter. Additionally, for other treaty articles, the authorities must, within six months of the end of each quarter, examine at least 10% of the total number of nonresidents claiming benefits based on the same article during the relevant quarter.

The examinations will focus on the following issues:

- Whether the nonresident's tax residence certificate meets the requirements under Chinese law and whether the nonresident was a dual resident for tax purposes;

- Whether the income concerned was correctly categorized for purposes of obtaining the relevant treaty benefits, whether the correct treaty provision was applied and whether the nonresident was eligible to obtain the benefits;
- Whether the tax payable was calculated correctly; and
- Whether any tax treaty abuse was present.

If the local tax authorities discover that a nonresident recipient of China-source income does not qualify for benefits under a relevant treaty and the authorities require the taxpayer to pay back at least RMB 5 million in taxes, the local tax authorities must prepare a Tax Adjustment Case Summary of Ineligibility for Tax Treaty Benefits ("Summary") and submit the Summaries to the next level of tax authorities. These Summaries will ultimately be submitted to the SAT, which will circulate the consolidated Summaries to tax authorities throughout the country. For cases that expose high tax risks and/or inconsistencies in practice, the SAT will set up expert panel reviews.

The provincial level tax authorities must maintain credit files that contain information on nonresidents that have inappropriately claimed treaty benefits and must complete a Poor Credit List of Nonresident Taxpayers Claiming Tax Treaty Benefits. Such information will ultimately be submitted to the SAT and circulated by the SAT to other tax authorities regularly. Nonresidents with poor credit ratings will be targeted for further examinations by tax authorities at all levels.

(2) Deloitte's comments

Bulletin 60 relaxes the procedure for nonresidents to obtain benefits under China's tax treaties and shifts from an advance approval/registration system to a system based on follow-up administration by the tax authorities. Circular 128 provides guidance to the local tax authorities on how they should conduct and strengthen the subsequent administration.

It should be noted that Bulletin 60 does not make changes to the substantive requirements (such as beneficial ownership, satisfying the purpose test, etc.) that must be met for a nonresident to be entitled to treaty benefits. Further, the frequency and proportion of sample examinations by the tax authorities as required under Circular 128 are not low. Therefore, when making self-assessments for tax treaty benefit purposes, both the nonresident recipient of income and the Chinese withholding agent should ensure that the claims are valid and accurate.

Notes:

1 See Bulletin to Issue Administrative Measures for Nonresident Taxpayers to Enjoy Tax Treaty Benefits (Bulletin of the State Administration of Taxation [2015] No. 60) (Chinese version)

2 See Deloitte Tax Analysis on Bulletin 60 (Tax Analysis:September 21, 2015)

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Contacts

Vicky Wang, Partner vicwang@deloitte.com.cn

Issued by

Deloitte Tohmatsu Tax Co.

Tokyo Office

Shin-Tokyo Building 5F, 3-3-1 Marunouchi, Chiyoda-ku, Tokyo 100-8305, Japan

T e l: +81 3 6213 3800

email: tax.cs@tohmatsu.co.jp

Corporate Info.: www.deloitte.com/jp/en/tax

Tax Services: www.deloitte.com/jp/tax/s/en

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