



ICEbreakers: Unlocking China



Hot topics

- **Beneficial ownership rules for tax treaty benefits:** New guidance issued by the State Administration of Taxation (SAT) that applies as from April 1, 2018 updates and revises the rules on the determination of the beneficial owner (BO) of income for purposes of claiming reduced withholding tax rates on dividends, interest and royalties under China's tax treaties. The guidance replaces older rules and replaces the seven "negative factors" with five factors as the general test for determining BO status. A "derivative benefits" rule and a "safe harbor" rule are introduced for determining a BO with respect to dividends, which should increase the chances for foreign companies to claim treaty benefits on dividends from China.
- **Eligibility of foreign partnership for tax treaty benefits:** Guidance that applies as from April 1, 2018 clarifies the interpretation of certain articles in China's tax treaties. According to the guidance, income of a Chinese partnership is treated as flowing through to the foreign partners, so a partner should be subject to Chinese enterprise income tax (EIT) on its share of partnership income. Further, if the partner is a tax resident of the other contracting state, the foreign partner will be entitled to treaty benefits provided such income is treated as the income of the partner in its jurisdiction of residence. However, a foreign partnership (i.e. a partnership that is not formed and effectively managed in China) is considered a nonresident enterprise (i.e. a taxpayer) for China EIT purposes. A foreign partnership will be denied tax treaty benefits if it is not a tax resident in the other contracting state and the partners of a foreign partnership may not claim tax treaty benefit unless the treaty specifically contains provisions that allow the partners to claim such benefits.
- **Deferral of withholding tax on dividends:** On December 28, 2017, four government agencies jointly issued new rules (Circular 88) that defer the imposition of withholding tax (10% under domestic law) on dividends distributed by Chinese enterprises to foreign investors, provided the funds are used to invest in domestic projects encouraged by China, and certain other requirements are met. The SAT issued implementation guidance on the deferral rules on January 8, 2018. Investments qualifying for deferral include establishing new Chinese companies, increasing the capital (or capital surplus) of existing Chinese companies and acquiring Chinese companies from unrelated parties (excluding investments in publicly listed companies). There are requirements relating to the form of the investment, the source and routing of the funds and the scope of the reinvestment. Circular 88 applies retroactively to dividend distributions made on or after January 1, 2017. Qualifying foreign investors may request a refund of dividend withholding tax paid on such distributions.
- **EIT withholding on China-source income derived by nonresident entities (NREs):** The rules governing the administration of withholding tax on China-source income derived by NREs were revised as from December 1, 2017. Changes include the following: (i) elimination of the requirement that NREs submit contracts to the SAT within 30 days after the contract was signed or amended; (ii) clarification that EIT on dividend payments may be withheld on the actual payment date rather than the date the distribution decision was made by the board of directors; (iii) stipulation of the date an NRE is required to report and pay tax on its own; and (iv) identification of situations where a withholding agent will be deemed to have withheld tax but not paid the tax to the tax authorities.

Legislative updates

- **VAT rates:** The 17% and 11% VAT rates will be reduced to 16% and 11%, respectively, as from May 1, 2018 as part of a package of planned tax cuts.
- **VAT credit refund:** One time refund of excessive input VAT credit may be claimed by certain qualified enterprises (e.g. equipment manufacturing and certain advanced manufacturing enterprises, R&D and modern services enterprises). Further guidance is expected from the SAT.

Tax treaties

- **OECD multilateral instrument (MLI):** China was one of the countries that signed the MLI on June 7, 2017, and it is expected that the first modification of covered tax agreements will become effective in 2018. China has opted for the "principal purpose test only" minimum standard in the MLI, but has decided not to make the proposed changes to the permanent establishment (PE) threshold, so there will not be any changes to the PE provisions in China's treaties (China will continue to determine PE status of a foreign company under its domestic tax law).

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