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Tax Treatment of Investors Who Invest Through the Shanghai Hong Kong Stock Connect, QFIIs, and RQFIIs Clarified

The Ministry of Finance (MOF), State Administration of Taxation (SAT), and China Securities Regulatory Commission (CSRC) have jointly issued two circulars *Caishui (2014) No.81* and *Caishui (2014) No.79* clarifying the tax treatment of investors who invest through the Shanghai Hong Kong Stock Connect, qualified foreign institutional investors (QFIIs), and renminbi qualified foreign institutional investors (RQFIIs). Although the two circulars are dated October 31, 2014, they were published at the MOF's website only on November 14, the last working day before the official launch of Shanghai Hong Kong Stock Connect on November 17, 2014.

The Shanghai Hong Kong Stock Connect allows foreign investors to invest in A shares which are listed on the Shanghai Stock Exchange (SSE) via the Hong Kong Stock Exchange (HKSE), and Mainland investors to invest in Hong Kong (HK) shares via the SSE. Previously, foreign investors could invest in such A shares only through QFIIs and RQFIIs.

Circular 81 stipulates the People's Republic of China tax implications on Stock Connect

A. Tax implication for foreign investors who trade A-Shares listed on the SSE

	Dividends and bonus share issues	**Gains on disposal**
Foreign investors (both individuals and enterprises)	• 10 percent income tax will be withheld by the payer. Qualifying investors may apply for tax refunds.	• Gains derived from November 17, 2014 "temporarily exempted" from applicable taxes, being enterprise income tax, individual income tax and business tax

B. Tax implication for Mainland investors who invest in HK shares via the HKSE

	Dividends and bonus share issues	Gains on disposal
Mainland individual investors	• 20 percent (see note) income tax, with foreign tax credit (if any) allowed	• Gains derived during the period from November 17, 2014 to November 16, 2017 "temporarily exempted" from individual income tax • Business tax is temporarily exempted
Mainland enterprise investors	• No special tax treatment	

Note: 20 percent income tax will be withheld by H-share companies (which are Mainland-incorporated with shares listed in Hong Kong) for H-share dividends; and by China Securities Depository and Clearing Corporation Limited (CSDC) for non-H-share dividends. The 20 percent dividend tax implications and withholding requirements shall also apply to the Mainland's securities investment funds.

Both Chinese and Hong Kong stamp duty continues to be payable in accordance with the then applicable rules.

Circular 79 stipulates the income tax for QFIIs and RQFIIs on the income derived from the transfer of "equity interest"

	Gains on disposal
QFIIs / RQFIIs (no PE in Mainland China)	• Gains derived during the period from November 17, 2014 "temporarily exempted" from enterprise income tax

Deloitte observation

The above clarification of the tax treatment of investors who invest through the Shanghai Hong Kong Stock Connect, QFIIs, and RQFIIs was eagerly anticipated and is very welcome. Of note, whether or not the Mainland Chinese company is "land rich" is not a relevant consideration in relation to the "temporary exemption". However, the following significant matters remain outstanding:

- Gains derived by QFIIs and RQFIIs before November 17 remain subject to enterprise income tax. Our understanding is that the relevant authorities are still considering the period for which and the basis on which applicable taxes are to be collected. We also await details on how tax treaty claims by qualifying investors will be handled.

- The circulars specifically cover transfers of A shares, but is silent concerning transfers of other securities. Clarification concerning the tax treatment of gains derived from the transfers of such other securities remains outstanding.

Our expectation is that no late payment penalties or surcharges should be applied to gains that are subject to tax.

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