

News Flash

China Tax and Business Advisory

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With over 1,200 China tax professionals and 54 China tax partners in 12 cities in Mainland China, Hong Kong, Singapore, and Taiwan, our PwC China Tax and Business Service Team provides a full range of tax advisory and compliance services. Leveraging on a strong international network, our tax specialists are striving to offer technically robust, industry specific, pragmatic and seamless solutions to our clients on their tax and business issues locally. The Global Tax Monitor recognises PwC as having the strongest overall reputation for tax services in China, with a lead over the competition.

A Milestone in the Development of China's Double Tax Agreements

China has concluded double tax agreements ("DTA") with 95 countries / regions to date. The tax residents of these countries / regions ("treaty residents") may be eligible for the relevant treaty treatments with respect to their income from China. With the increasingly tightened administration on non-tax residents' taxation, the implementation of DTAs has also come under close scrutiny of the Chinese tax authorities in recent years.

On 26 July 2010¹, the State Administration of Taxation ("SAT") issued a Departmental Interpretation Notes ("DIN"), by way of Guoshuifa [2010] No.75 ("Cover Circular"), for the DTA concluded between China and Singapore which entered into force on 1 January 2008 ("China/Singapore DTA"). The DIN represents the SAT's effort for the first time to introduce a set of technical views, interpretation and practice guidelines for the implementation of a DTA in such a comprehensive manner. More importantly, this set of interpretation is also applicable to other DTAs concluded by China if the provisions of the relevant articles in those DTAs are the same as those in the China/Singapore DTA.

While further analysis on the DIN are to be covered in a series of our News Flash on different key topics, this News Flash specifically highlights our insights on the background, objectives, impact, application, etc. as well as the general provisions in the first four articles of the DIN.

Salient points

Salient points of the Cover Circular

The Cover Circular sets out the legal basis, application of the DIN, as well as roles and responsibilities of local-level tax bureaus.

- The DIN is prepared in accordance with the China/Singapore DTA, the <Vienna Convention on the Law of Treaties>, and relevant Chinese domestic tax laws, i.e. the Corporate Income Tax Law ("CIT Law") and Individual Income Tax Law and their respective Detailed Implementation Rules.
- The interpretation in this DIN should be applicable to other DTAs concluded by China if the provisions of the relevant articles in those DTAs are the same as those in the China/Singapore DTA.

¹ Though the issuance date is marked as 26 July 2010, the DIN was only released to the public on 2 September 2010.

- If the interpretation in this DIN is different from the interpretation in previous Chinese domestic tax circulars regarding the interpretation and implementation of DTAs, the interpretation in this DIN should prevail.
- The local-level tax bureaus are required to properly interpret and implement DTAs based on the DIN.

Salient points of general provisions of the DIN

The first four articles of the DIN as well as the China/Singapore DTA set out certain general provisions including persons and taxes covered, general definitions and the definition of “resident” in particular.

Article 1: Persons Covered

The DTA is applicable to “persons who are residents of one or both of the Contracting States”.

Article 2: Taxes Covered

The DTA should in principle only apply to the taxes listed therein, i.e. income taxes in nature. However, Business Tax of China should also be covered in respect of revenue derived from international transportation by Singaporean residents in accordance with Article 2 of the Protocol to the China/Singapore DTA.

Article 3: General Definitions

Article 3 of the DIN elaborates the definition and scope of some terms used in the DTA, such as “person”, “company”, “international transportation”, etc. The term “person” carries an extensive meaning. It refers to “an individual, a company and any other body of persons”. The meaning of “other body of persons” is broad. It includes a “Trust” if a “Trust” is considered to be a tax resident based on the domestic laws of the Contracting States.

However, to our disappointment, the term “other body of persons” is not defined to explicitly include “partnership”. In other words, the SAT does not give out a definitive position in the DIN as to whether the China/Singapore DTA is applicable to partnerships. We understand that the domestic tax laws of different countries/regions may vary with respect to the tax treatment for partnerships. Such disparity may cause administrative complexity and difficulties in applying DTA in relation to partnerships. This may be the reason why the SAT keeps silent on the topic of partnership in the DIN.

Article 4: Resident

The term “resident” should be considered from the following aspects:

- A resident should be liable to comprehensive tax in a Contracting State; however, “liable to tax” is not the same as actually paying tax;
- The Chinese and Singaporean domestic tax laws should be adopted in assessing a resident of the respective State; and
- The China/Singapore DTA should apply to the permanent establishment of a Singaporean corporate resident located in a third tax jurisdiction.

Further clarifications are provided for the “tie-breaker rule” where an individual is considered as residents of both Contracting States. These clarifications are consistent with the Commentary of the Organization for Economic Co-operation and Development (“OECD”) Model Convention.

The assessment of resident status is important in the sense that only a qualified resident of a Contracting State would be able to enjoy the DTA benefits. Article 4 of the DIN elaborates the definition of a resident in great details which are basically in line with the OECD Commentary. Meanwhile, it is worth noting that the DIN only quotes the definition of “tax resident enterprise” as stipulated in the CIT Law, but unfortunately neither the DIN nor other domestic laws and regulations so far have provided further clarification on the term “place of effective management” used in the definition.

PwC observations

Background and objectives

Over the past decades, there have been different local interpretation and practices in respect of implementation of DTAs across the country. Such inconsistency, to a certain degree, may be caused by the insufficient technical knowledge and experience of the Chinese local-level tax bureaus in handling tax issues in relation to DTAs, and the lack of clear-cut guidelines at the State level in interpreting DTAs.

Though the SAT has from time to time issued guidelines regarding the interpretation of DTAs, most of these guidelines merely addressed certain clauses of a specific DTA that China concluded. In the past year 2009 we witnessed an unprecedented vigorous effort of the SAT to provide guidelines on some fundamental principles with respect to the implementation of DTAs, namely the interpretation of the Articles of Dividends and Royalties, the assessment of beneficial ownership in granting treaty benefits, and compliance requirements for claiming treaty benefits, etc.

Despite what it has achieved, the SAT has, since early 2009, started to prepare the DIN for China/Singapore DTA to illustrate the official positions on each Article of the DTA. The China/Singapore DTA was selected for this first DIN because it is one of the most recent DTAs concluded by China and the provisions therein are seen as a prototype for future DTAs to be concluded or re-negotiated by China. It is believed that the DIN for China/Singapore DTA can help the local-level tax bureaus to gain technical knowledge on DTAs in general, appreciate the SAT's technical positions and improve tax administration on treaty residents. In the meantime, the DIN also serves as guidance for the treaty residents to observe how the Chinese tax authorities apply DTAs.

Application of the DIN

- The above messages delivered in the Cover Circular indicate that the DIN should be applicable not only to the China/Singapore DTA but also other DTAs concluded by China as long as the provisions of those DTAs are the same as those in the China/Singapore DTA. Since all the DTAs concluded by China so far basically follow the OECD and/or United Nation Model Conventions, most of the provisions in all the DTAs are similar with merely some minor variations in certain articles, or even the same. In particular, it is imperative to note the new trends of the Chinese tax authorities in negotiating tax treaties by taking a look at the terms of some key articles, such as, permanent establishment, dividends, capital gains, anti-tax avoidance and so on, in those DTAs concluded or re-negotiated by China in recent years, such as China's DTAs with Singapore, Hong Kong, Macao, Mauritius, Barbados, Belgium, Finland, etc.. In addition, it is anticipated that DTAs to be concluded or re-negotiated by China in the foreseeable future are likely to follow such trends as well.
- However, the Cover Circular does not clarify what if there are existing interpretation and practice guidelines specifically issued for a DTA. Technically speaking, if there is a separate interpretation for a specific DTA, then that interpretation should prevail if it conflicts with the interpretation in general as those in the DIN on the China/Singapore DTA.
- In situations where the interpretation in the DIN is different from that in previous Chinese tax circulars, the interpretation in the DIN should prevail. This means, the DIN should override the previous tax circulars in respect of the relevant interpretations in conflict. We note that most of the interpretation in the DIN are consistent with previous Chinese tax circulars. However, there are still a few inconsistencies which should be revisited in light of the new interpretation in the DIN.

Binding force of the DIN

From an international perspective, the DIN is the unilateral interpretation provided by the Competent Authority of China (i.e. the SAT) on their implementation of the China/Singapore DTA. We do not see that its counterpart in Singapore, i.e. the Inland Revenue Authority of Singapore ("IRAS"), has expressed any official views on this DIN. It is possible that the IRAS would revert to the SAT in future where questions or disputes arise from the implementation of the China/Singapore DTA in accordance with this DIN on the China side.

Locally, there may be concerns as to what extent the local-level tax bureaus could digest the principles laid in the DIN and apply them properly in the course of implementation, given the depth and complexity of the DIN.

Effective date of the DIN

The Cover Circular does not specify an effective date for the DIN. Technically there may be two possible implications. Firstly, the DIN is not seen as a new policy but an interpretation of the existing DTAs. In this sense, it may retrospectively apply to the existing DTAs as long as the relevant provisions are same as those in the China/Singapore DTA. On the other hand, there may be an argument that the DIN must be effective on a prospective basis. According to a new policy issued by the SAT regarding the formulation and application of tax circulars which took effect from 1 July 2010, all tax circulars generally should not take retrospective effect unless the relevant provisions are beneficial to the taxpayers.

With such uncertainty, the local-level tax bureaus may have different interpretations and practices until there is further clarification from the SAT. So it is not impossible that the local-level tax bureaus may re-open previous cases and apply the interpretation in the DIN to come up with a new conclusion.

Impacts on treaty residents and suggestions

- It is clear that the impact of this DIN is not just on Singaporean tax residents, but on other treaty residents as well. Particularly for tax residents of Hong Kong, Macao, Mauritius, Barbados, Belgium, Finland, etc., the DIN has a direct impact as the relevant provisions in the DTAs between China and these countries/regions are the same or similar as those in the China/Singapore DTA in certain key articles. On the other hand, with more and more DTAs to be concluded and re-negotiated by China which bear same or similar provisions as those in the China/Singapore DTA, the DIN is likely to have an even wider impact going forward.
- It is of great interest to the relevant treaty residents to obtain benefit from relevant treaty treatments such as restricted tax rate on passive income, allocation of taxing rights on capital gains, protection from constituting a permanent establishment, etc. The DIN obviously provides a good guidance for the treaty residents to appreciate the Chinese tax authorities' positions in granting treaty benefits.
- The DIN is basically in line with the OECD Commentary. However, there are still certain interpretations that deviate from the OECD Commentary. The relevant treaty residents are recommended to assess the impact of the DIN, particularly in respect of key topics such as permanent establishment, passive income, capital gains, which are more relevant to their investment structures, operation models, etc. Where necessary, they may also consider revisiting their investment structures, operation models in order to mitigate any potential negative impact brought about by the DIN.
- It is likely that this DIN would improve the technical knowledge of the local-level tax bureaus in the interpretation of DTAs, or at least escalate their awareness and urge them to pay sufficient attention to the implementation of DTAs. It is possible that, after being educated by the DIN, the local-level tax bureaus are going to tighten its administration on treaty residents. It is advisable for the relevant treaty residents to keep regular dialogues with their in-charge tax bureaus and observe the trend in implementation of DTAs at local levels.

Conclusion

This is the first time that the Chinese tax authority states its official positions on the interpretation of a DTA with such width and depth. It serves as a good guidance for both the local-level tax bureaus and treaty residents (taxpayers) to appreciate the SAT's latest technical positions, interpretation and practice guidelines for the implementation of DTAs. It marks a milestone in the development of Chinese tax authorities' interpretation on DTAs. We believe this DIN will arouse a lot of interest and attention in the international tax arena, not only the tax practitioners, but a lot of multi-national companies as well.

Coming up next, we will walk you through various key topics under the DIN including permanent establishment, business profits and associated enterprises, passive income, capital gains, personal income, mutual agreement procedures, exchange of information, anti-tax avoidance, etc., in the upcoming issues of our News Flash.

In the context of this News Flash, China or the PRC refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PricewaterhouseCoopers client service team or your other tax advisers. The materials contained in this publication were assembled on 9 September 2010 and were based on the law enforceable and information available at that time.

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