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China updates BO rules on dividends, interest and royalty

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In brief

- China State Administration of Taxation ("SAT") issued an announcement to refine its beneficial ownership (BO) rule for the implementation of its tax treaties, effective from 1 April 2018.
- This announcement is another BEPS- [1] related action to improve the clarity in BO assessment and allow more non-abusing cases to enjoy tax treaty benefits.

Feedback

1. "Base erosion and profit shifting" (BEPS)

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In detail

Anyone expecting dividends, interests and royalty from China should examine closely China's new beneficiary ownership (BO) requirements, effective from 1 April 2018, per SAT Announcement [2018] No. 9 ("Rule 9").

Rule 9 represents the third milestone amendment to BO requirements, repealing the last two rules:

- Rule 610 (*ref. Guo Shui Han [2009] No.601*)
- Rule 30 (*ref. SAT Announcement [2012] No. 30*)

The latest amendments offer clarity to some technical issues, and improve BO assessment.

1. Rule 9

Rule 9 has brought about some major changes in seven areas:

a) Expanding the safe harbor scope, including governments and individuals as eligible BO for dividends;
b) Accepting non-qualified applicants as BOs, if fulfilling some conditions;
c) Adding a 12-month stock holding condition for applicants held 100% by qualified BOs;
d) Reducing seven negative factors to five;
e) Clarifying further what a collection agent means;
f) Clarifying that a residence certificate must be provided for income-related current year (or a year before)
g) Keeping province-level SAT informed of any voluntary disqualification initiated by applicants.

Major changes are summarized in the table below.

2. Major changes comparison

Rule 601 or 30 (old)	Rule 9 (new)	Remarks by WTS
1) Reducing negative factors, and refining the definitions		
a) " Those applicants who have the obligation to pay or distribute all or the majority of its income (e.g. 60% and above) to residents of a third country (region) within a stipulated period (e.g. within 12 months from receipt of income)" *b) " Those applicants who have little or no other business activity, except properties or rights of the income"* *c) " Those applicants in a company format but their assets, scale and staffing are small (or minor), incomparable to their income"*	*a) "…. to pay 50% or more "* *b) "The term 'obligation' shall include agreed obligations and de facto payment even though there is no agreed obligation"* *c) " The business activity undertaken by the applicant do not constitute substantive business activities. Substantive business activities shall include manufacturing, sales and marketing and management activities of a substantive nature. Determination of whether the business activities undertaken by the applicant are of a substantive nature shall be based on the functions actually performed and the risks borne"*	a) It has tightened the income pass-through rate, from 60% to 50%; b) It re-defines "obligation" in a more pragmatic manner. E.g. Receivables / payables offsetting between the parent and a subsidiary can be viewed as de facto payments too. It offers a more explicit and broader definition on "*substantive business activity*", which include sales, marketing, management and investment holding management (the last one in particular was widely doubted if recognizable under the old rules). c) It rules that "*other business activity*" cannot be accepted as "substantive", if their income is too low – but does not offer exact measurement.

Rule 601 or 30 (old)	Rule 9 (new)	Remarks by WTS
d) *" Those applicants who have little or no control or right of disposal over income or properties or rights from which income is derived, and bears no or little risk"*	d) *" Investment holding management activities of a substantive nature undertaken by the applicant may constitute substantive business activities; where the applicant undertakes investment holding management activities which do not constitute substantive business activities and simultaneously undertakes other business activities, if such other business activity are not significant enough, the applicant's business activities shall not constitute substantive business activities"*	d) It gives a practical interpretation on "investment holding management" and expects it to handle practical tasks, e.g. investment-related research, analysis, decision, implementation, follow-up management, capital allocation and financing, etc.
2) Broadening safe harbor definition for dividends		
- Circular 30 can accept an applicant as an automatic BO (without the need for BO assessment), if it is a resident of the treaty counterparty and also a listed company in the treaty counterparty (or it is 100% held by the listed company which is a resident of the treaty counterparty)	Circular 9 admits expanded the scope of automatic BO admission: a) The government of a treaty counterparty; b) A listed company (and a resident) of a treaty counterparty; c) An individual (and a resident) of a treaty counterparty; d) Those 100% held by the above directly or indirectly, and all shareholders in between are either a resident of China or of a treaty counterparty.	- It has expanded the scope of "safe harbor" rule. It now includes also the government and individuals, apart from listed companies.
3) Allowing more situations to qualify as BO		
- Under Rule 601 and 30, an applicant - if not meeting BO criteria and held under a multi-layer shareholding structure - can hardly enjoy a BO status for China dividends.	Rule 9 adds that if an applicant cannot meet BO criteria but falls into one of the following, it can still be a BO: • It is 100% owned by a shareholder satisfying the BO criteria and also a resident of the same country (region) as the applicant's; • Its shareholder and mid-holding entities can all meet BO criteria - though its shareholder is not a resident of the country (region) of the applicant; Rule 9 adds that General Anti-Avoidance Rule (GAAR) can be applied to revoke a BO status.	- Rule 9 offers a breakthrough in approving certain multi-layer shareholding structures. - Rule 9 clarifies that a person who satisfies the BO criteria can enjoy a treaty treatment identical to or more favorable than the one enjoyed by the applicant for dividends. - Rule 9 also empowers the tax authority to overturn a BO status using GAAR.

WTS observation

Non-residents, if failing to meet the BO requirements, will lose their tax treaty treatments for dividends, interests or royalty. Therefore, BO definitions are crucial in assessing the eligibility for tax treaty benefits.

Rule 9 brings some good news but also imposes some stricter requirements. MNCs are advised to re-visit their investment structure and business models, and assess how they are affected by Rule 9.

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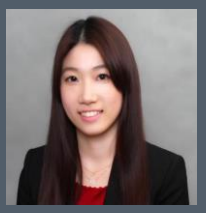

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