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China concludes tax agreement with Taiwan

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In brief

- » On 25th August 2015, the “Agreement between Mainland China and Taiwan for the Avoidance of Double Taxation and Enhanced Collaboration in Tax Matters” (“Agreement”) has been signed and will come into effect after relating ratification procedures are completed by both parties.
- » In principle, the Agreement bases on the OECD Model Convention. However, it provides more favorable treatments than other tax treaties signed by mainland China.



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In detail

1. Applicability of the Agreement to a third jurisdiction

Considering the stereotyped and popular indirect shareholding model adopted for investments between mainland China and Taiwan, the Agreement particularly provides that where the place of effective management of a third-jurisdiction incorporated company is situated in one of the contracting parties, it can be recognized as tax resident of that party.

To determine the place of effective management, the Agreement considers the following factors: where the business strategy decision is made, where certain documents are made and stored and where major business activities are performed.

2. Favorable treatments on withholding tax (“WHT”)

- Capital gains: The Agreement offers tax exemption to gains derived by a resident of a concluding party from the other party if no more than 50% value of the transferred company is derived directly or indirectly from immovable properties situated in the source jurisdiction.

Compared with other tax treaties signed by mainland China, this is the most favorable benefit provided.

- Dividends: A 5% preferential WHT rate applies where the beneficial owner is a company which holds at least 25% of the capital of the company paying the dividends.
- Interests: A 7% preferential WHT rate applies to the beneficial owner. Meanwhile, interests received by certain governmental institutions and interests on certain recognized loans to promote exports can be exempt from WHT.
- Royalties: A preferential WHT rate of 7% applies to the beneficial owner.

3. Restricted Exchange of Information (Eol)

In view of the special political relationship between the two agreement parties, the Agreement largely restricts the scope of Eol. For instance, no retrospective Eol for information obtained before the effective date, no automatic Eol or spontaneous Eol, and no application of Eol in criminal cases.

WTS observation

- » The Agreement makes a milestone improvement of tax legislation across the strait. For Taiwan enterprises investing directly or indirectly in mainland China, we suggest a review on the shareholding structure for better tax efficiency.

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