

China Tax News

Further clarification about application of tax treaties with regard to “beneficial ownership”

Key points

- Further direction regarding beneficial ownership in China
- New regulation in force as of June 29th, 2012
- Guidance on how to understand and recognize beneficial owner
- Totality of criteria crucial

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1) Background

A considerable number of companies have setup legal structures with the goal to access certain tax treaty benefits. In some cases, intermediate companies that have been setup do not undertake any business activities nor do they have employees, an office or functions. Companies that have the mere purpose to gain a tax advantageous tax treaty (so-called “treaty shopping”) are not regarded as beneficial owners of – for example - dividends. Anti-treaty shopping rules have been established in China since 2008 and are now commonly applied in China as in many other countries, e.g. Germany.

Back in 2009, the State Administration of Taxation (“SAT”) issued Guoshuihan [2009] No. 601 (“Circular 601”). Circular 601 addressed several issues on beneficial ownership with regard to Double Tax Agreements (“DTA”) entered into between China and another contracting state, e.g. Germany. According to Circular 601, a non-Chinese recipient of certain income from China must be the beneficial owner of the relevant income in order to enjoy the relief granted under the respective DTA. However, Circular 601 created several uncertainties. Therefore, SAT issued the “Announcement of the State Administration of Taxation [2012] No. 30” (“Circular 30”) on June 29th, 2012.

2) Salient Points of Circular 30

Circular 30 addresses a number of issues relating to the determination of the “beneficial owner” of income under China’s DTAs. Circular 30 aims to simplify the determination of “beneficial owner” for claiming/granting benefits under DTAs in respect of dividends, interest and royalty. Circular 30 is effective as of the date of issuance, i.e. June 29th, 2012.

The salient points of Circular 30 are set out as follows:

- **Overall objectives and principles**

Circular 30 regulates clearly that, when determining whether a company shall be the beneficial owner of income, ALL the relevant factors as mentioned in Circular 601 have to be taken into consideration equally. The determination shall not be made based on simply one of the factors as listed or just because the purpose of evading or reducing tax or transferring or accumulating profits does not exist.

- **Listed company safe harbor**

For dividend income, if the immediate recipient is a resident company of a DTA contracting state and is a listed company, it will automatically be treated as the beneficial owner of the dividends distributed from a Chinese company. The same treatment shall be applied, if the subsidiary, which receives the dividends, is 100% directly or indirectly owned by the listed parent company and is located in the same jurisdiction as the listed company (provided the subsidiary is not indirectly held through a third jurisdiction).

- **Agent**

Where income is received through an agent or nominee (a person who is designated to receive the amount of income), the determination of the true beneficial owner shall still be conducted by applying the general principles. As a precondition of the true beneficial owner to use the benefits in DTAs, the agent in question shall make a

corresponding declaration with the tax authorities stipulating that he is not the beneficial owner. If the tax authorities determine through information exchange in DTAs or further information exchange agreements that such declaration shall be wrong and the agent should have been considered as the true beneficial owner, late payment penalties will be levied.

- **Further clarification on administrative procedures**

Circular 30 grants the right to the in charge tax authority to temporarily refuse the application of DTA benefits, in case it is difficult to determine whether the recipient of income is the beneficial owner and such decision can not be made within the specified period. In case the recipient is ultimately recognized as the beneficial owner indeed, a corresponding tax refund on the overpaid tax shall be granted to the taxpayer.

In addition, Circular 30 stipulates that in case a tax authority decides to reject an application for DTA benefits on the grounds that the applicant is not the beneficial owner of the income, the tax authority in charge must obtain the approval of the provincial level tax authorities. In addition, the decision has to be reported to the SAT's International Tax Department for record.

3) Conclusion

Circular 30 further clarifies certain issues which have not been covered sufficiently in Circular 601. Particularly, it guides tax offices to apply the beneficial ownership test more in a way that is in line with international standards.

Especially the explanations with regard to the determination of the true beneficial owner in an agent-principal situation provide increased legal certainty.

However, we still see some issues which are not sufficiently clear at this moment, e.g. whether Circular 30 can be applied retroactively to cases that were still open as of June 29th, 2012 etc. As such, we recommend taxpayers to communicate with the tax authority in charge upfront in order to understand the local practice and interpretations.

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