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China Issues New Anti-Treaty Shopping Guidance

July 17, 2012

A widely anticipated supplementary circular, *Announcement of the State Administration of Taxation (“SAT”) regarding Recognition of “Beneficiary Owner” under Tax Treaties* (“Announcement No. 30”) was issued by the PRC tax authorities on June 29, 2012 to clarify various issues related to the *Notice of the SAT Regarding Understanding and Recognition of “Beneficial Owner” under Tax Treaties* (“Circular 601”) and beneficial ownership concepts in the tax treaty context. A link to a bilingual version of Announcement No. 30 is available at the end of this article.

Beneficial Ownership Concepts under Prior Guidance

The beneficial ownership concept was first formally introduced by the SAT in Circular 601 on October 27, 2009. According to Circular 601, the beneficial owner entitled to benefits under an income tax treaty is defined as any person who owns or has control and dominion over the income or the rights or assets that may give rise to such income. A beneficial owner must also be engaged in “substantive” business activities (for example, manufacturing, distribution, or management) in the form of “individuals, cooperation, or other forms.” Circular 601 states that a pure conduit, or shell company formed merely to fulfill legal registration obligations in a foreign jurisdiction, does not qualify for treaty benefits as a beneficial owner. Conduit companies are defined as those incorporated for the purposes of the “evasion or reduction of tax, the transfer, or the

accumulation of income.”

Highlights of Announcement No. 30

Safe Harbor for Public Companies Only for Dividend Income

One of the most significant aspects of Announcement No. 30 is that it provides a safe harbor on treaty qualification for public companies. It states that, for dividend income, if the treaty benefit applicant is a public company, or it is 100% directly or indirectly owned by a public company which is a tax resident of the contracting country, then the beneficial ownership status of the applicant can be confirmed automatically without further verification by the PRC tax authorities. However, a parenthetical in the circular literally says that indirect ownership through a third country enterprise which is not a tax resident in China or of the contracting country does not qualify.

Beneficial Ownership Concepts for Treatment of Agents

The other significant development provided by Announcement No. 30 is that it allows another party (other than the original income recipient) to qualify as the beneficial owner. As long as the original income recipient is acting as a collection agent and claims that it is not the beneficial owner of the income, the applicant could apply for beneficial owner status. It is further provided that the agent's tax residency will not affect the recognition of beneficial owner status of the applicant. A sample form of the agent's declaration for this purpose is provided by the SAT as an attachment to Announcement No. 30.

Retroactive Enforcement Matters

Announcement No. 30 allows for retroactive enforcement on non-qualified applicants by the tax authorities. If benefits are originally granted, but afterwards through any tax treaty or information exchange the tax authority discovers the agent is in fact the beneficial owner, the tax authority may alter its previous decision and impose applicable taxes and a late payment surcharge on the former beneficial owner. Similarly, if the tax authority is unable to make a decision due to the difficulty in identification of the beneficial owner within the prescribed timeline as provided by the *Notice of the SAT on Printing and Distribution of the Measures for the Administration of Tax Treaty Benefits for Non-resident Enterprises (Trial)* (Guo Shui Fa [2009] No.124), it may not grant treaty benefits temporarily. However, if after further examination the tax authority decides to grant treaty benefits, the taxes previously paid may be refunded by the tax authority.

Allocation of Power to Deny Benefits

Announcement No. 30 also introduces an unique power allocation mechanism between the tax authorities. According to Announcement No. 30, the applicant can only be denied by the local in-charge tax authorities

after obtaining consent from provincial level tax authorities, while Announcement No. 30 does not require such approval from provincial level tax authority for granting of tax treaty benefits. In addition, denied applications should be reported by the tax authority at provincial level to the SAT for the record.

History of the Drafting Process

Announcement No. 30 had been in the drafting process for quite some time. As far as we know, the last two drafts (i.e., Revision No. 8 and No. 9) have been circulating for comments since July 2011. Comparing different revisions and the final version, it is notable that certain key issues have been added or deleted during the deliberation process which may be instructive. For example, while Revision No. 8 was drafted to literally interpret various determination factors mentioned in Circular 601 and should generally be applicable to dividend, interest, and royalty income, the latest draft in circulation earlier this year limited its application to tax treaty benefit applications for dividend income only. The final Announcement No. 30 instead seems to extend its scope to all types of income with the exception of the public company safe harbor as discussed above which only applies to dividends. On the other hand, Revision No. 8 had specifically expressed that the beneficial owner test does not apply to capital gains arising from the alienation of property which is consistent with the SAT's prior oral interpretations. However, this clarification was dropped from the draft and has not been included into the final Announcement No. 30.

Announcement No. 30 is effective as of the date of its issuance of June 29, 2012. While the supplemental guidance is helpful more guidance will clearly be required to address numerous unanswered points.

[Click here to read the bilingual version of Announcement No. 30](#)

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