On the Spot

Double tax trouble

Global Times | 2012-8-8 17:30:04
By Cong Mu

Dickson Leung, a senior partner at Beijing-based LehmanBrown International Accountants, said his firm has run into difficulties when reclaiming dividend tax for its overseas clients.

One of his clients was a Hong Kong-based importer of cosmetics and clothes, which sold the imported goods to department stores in the mainland through its local subsidiaries.

But Leung, 46, from Hong Kong, said no matter how many documents they provided, they could not convince the mainland tax authorities that it was a genuine trading company, partially because it was less than one year old.

"Every city has a different local tax bureau and a different officer. Every officer has his or her own judgment and interpretation" on whether an overseas company is a true "beneficial owner" - or the actual owner, even if the title is different - of the taxable dividends derived from the mainland, Leung told the Global Times Friday.

"Sometimes some people [tax officers] are more … reasonable, sometimes very bureaucratic, and some are not experienced," he said.

Announcement 30

To address problems such as those Leung has encountered, the State Administration of Taxation (SAT) issued an announcement (Announcement 30) on June 29 and an interpretation on July 16 to set clearer guidelines for determining the beneficial ownership status of an overseas entity.

Qualifying for ownership status allows some overseas companies to reclaim part of the dividend tax they pay, according to the bilateral treaties between the mainland and 98 countries and regions to avoid double taxation and tax evasion.

The determination involves a beneficial ownership test, but the test has given rise to "uncertainties" in terms of how it is carried out, US auditor KPMG said in a briefing in July.

Non-resident enterprises were exempt from paying dividend tax until January 1, 2008, when China began to apply the same corporate income tax law for Chinese and foreign companies, Khoonming Ho, a tax partner of KPMG China in Hong Kong, told the Global Times Thursday.

"Because the rules are still being developed, inevitably there are some variations from city to city (in the mainland) in terms of the interpretation of the rules," Ho said. "This is understandable."

Announcement 30 has made an exception, known as "safe harbor" for listed companies. It states that a company that is a tax resident of a double tax agreement partner country or region and is listed in that jurisdiction will automatically be regarded as the beneficial owner of the dividends derived from the mainland.

Wholly owned subsidiaries of the listed parent in the same jurisdiction are also automatically qualified.

While tax advisors and foreign trade bodies lauded the safe harbor move as a step toward clearer rules, they are calling for more such measures to reassure foreign investors at a time of great economic uncertainty.

Foreign investments

A number of EU companies that are not publicly listed are wondering whether they can also enjoy the dividend tax benefits, as they are not covered by the safe harbor exception in Announcement 30, Simon Tan, chairman of the EU Chamber of Commerce's Shanghai Finance and Taxation Working Group, told the Global Times Friday.

Without tax relief, foreign companies usually pay 10 percent dividend tax. So, in addition to business tax, their total effective tax burden can reach 32.5 percent, which Tan said is higher than in many EU countries.

The tax burden is a particularly big concern for financial investors such as private equity funds, Tan said.

"When China could offer the investors (huge) profits, they wouldn't care about paying more taxes. But now … it's not easy to earn a windfall in China any more," and they will think twice before investing their money here, he noted.

The total value of venture capital investments in Chinese companies was $1.9 billion in the first six months of 2012, down 43 percent year-on-year, and the number of deals declined by 38 percent to 103, according to Dow Jones VentureSource Thursday. The decline was sharper than in the US and Europe.

China recorded net capital outflows of $71.5 billion in the second quarter, resulting in the first quarterly deficit in the country's capital and financial account since 1998, the US credit rating agency Fitch said in a press release Friday, citing data released by the State Administration of Foreign Exchange on July 31.

Announcement 30 does not provide additional tax benefits to foreign investors, except for those who are

eligible for the "same country exemption" in the case of overseas listed companies under specific holding structures, Andrew Choy, a tax partner at Ernst & Young, told the Global Times.

But foreign investors will still have confidence in China, Choy believes.

He said that 15 years ago, foreign companies would compare the tax rates in different countries before making an investment, but now "even if the tax burden is lower in some other countries they will not go there, because the market is in China."

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Block treaty shopping

"The reason why we stipulate beneficial ownership (in double tax treaties) is because … we want to give the tax benefits to the real investors, not to the in-between conduit companies," Zhu Qing, a tax professor at Beijing-based Renmin University of China, told the Global Times.

According to the double tax treaties, a British or US company has to pay a 10 percent dividend tax in China, but it may opt to set up a conduit company to pass on payments via Hong Kong, whose tax arrangement with the mainland allows the company to pay only a 5 percent tax, Zhu said. This is called "treaty shopping" or abuse of the system.

"We support the SAT's … beneficial ownership test, or else the double tax treaties can be abused," Tan of the EU chamber said.

Tan suggested that China could lower the dividend tax rate to 5 percent when renegotiating double tax treaties with EU countries, so that his chamber's members, listed or not, can all enjoy the tax safe harbor.

A new China-UK double taxation agreement - signed in June 2011, but not yet implemented - will conditionally reduce the dividend tax rate to 5 percent for British investors.

Because of the declining trend of foreign direct investment in China, Leung, who runs his accounting firm with a British partner, expects that the new treaty will soon enter into force and potentially attract more investors from the UK.

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