JONES DAY

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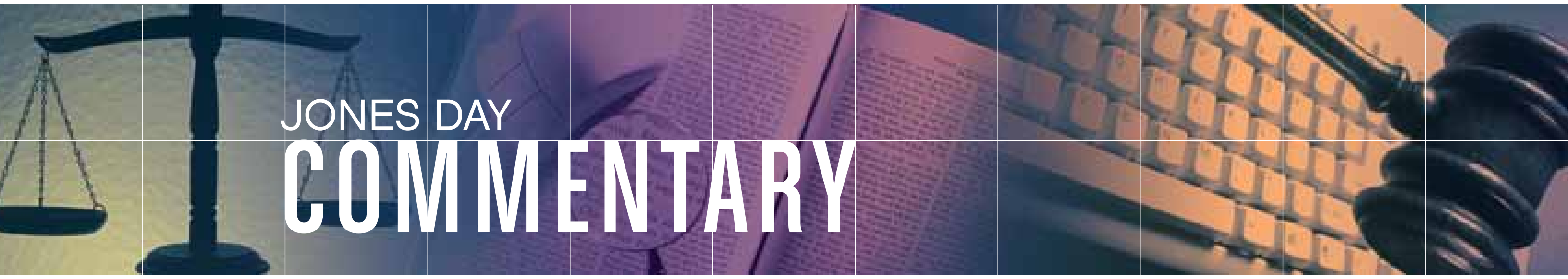

TOUGHER RULES FOR CLAIM FOR TAX TREATY BENEFITS IN CHINA

On August 24, 2009, the State Administration of Taxation issued Administrative Measures for Claims for Tax Treaty Benefits by Nonresidents (Trial Implementation), Guo Shui Fa [2009] No. 124 (the "Measures"). The Measures provide guidance for application, filing, and review procedures for claims for tax exemption or reduced tax rates under double taxation treaties between China and other countries and regions. The Measures apply to the tax liabilities incurred on or after October 1, 2009. They also apply to a tax liability incurred prior to October 1, 2009, and for which the claim for treaty benefits is made on or after October 1, 2009. The Measures govern the implementation of all tax treaty benefit claims except for those provided under international transportation provisions of tax treaties.

APPROVAL REQUIRED FOR CLAIMS FOR TREATY BENEFITS FOR DIVIDEND, INTEREST, ROYALTY, AND GAIN ON TRANSFER OF PROPERTIES

Application for Treaty Benefits. To enjoy a tax exemption or reduced tax rate under treaty provisions concerning dividends, interest, royalty, and gain on transfer of properties, a nonresident must apply to the relevant tax authorities for such benefits. A taxpayer must submit required application forms and a resident certificate issued by the competent authority of the treaty country or region. The resident certificate must be dated on or after January 1 of the year immediately prior to the year of application. The taxpayer also needs to submit documents that evidence its right to the payment, such as property ownership certificate, contract, agreement, payment voucher, or certificate issued by an intermediary or notary agent.

If a nonresident who is eligible for treaty benefits paid tax at the normal rate according to domestic law, the nonresident may apply for treaty benefits and claim a tax refund within three years from the date of tax payment.

Review and Approval. A nonresident should submit the application to the tax authority in charge, which in general is the district, county, or city tax bureau in charge of the payer. However, not all of those tax bureaus have the right to approve an application for treaty benefits. Tax bureaus at the provincial level can designate certain tax bureaus as approval authorities within their jurisdictions. If a tax bureau in charge is not an authorized bureau, it will forward the application to the authorized tax bureau. An authorized tax bureau should approve or reject the application within a prescribed review period. The review period is 20 working days if the approval authority is a tax bureau at the district and county level, 30 working days if the approval authority is a tax bureau at the prefecture and city level, and 40 working days if the approval authority is a tax bureau at the provincial level. If the tax authority cannot make a decision within the above review period, it can extend the review period by an additional 10 working days upon the approval of the tax bureau head and by delivering a written notice to the taxpayer. If the tax bureau has not issued a written notice to the taxpayer within the allowed review period, including the extension of time, the bureau is deemed to have approved the treaty benefit claim. If an authorized tax bureau is not able to determine whether the nonresident can enjoy a treaty benefit, it may notify the taxpayer in writing of temporarily not granting the treaty benefit and reasons therefor. In such situation, the tax bureau must report it to the higher level tax bureau and, if necessary, commence mutual agreement or information exchange procedures with the relevant treaty country or region.

Validity Period. An approval for a treaty benefit item is valid for three calendar years (*i.e.*, the remaining period of the current year plus the following two calendar years) for the same nonresident and same type of benefit under the same tax treaty. For example, if a foreign company receives an approval for a reduced withholding tax rate on a dividend payment made by a resident enterprise under a tax treaty, the foreign company can enjoy the reduced rate for subsequent dividend payments from the same resident enterprise within the valid period without additional application. However, the foreign company must separately apply for a reduced tax rate if it receives dividends from another resident enterprise. A similar situation applies if a foreign company obtains approval for a reduced tax rate on interest on a loan paid by a resident enterprise. The benefit approved only applies to the interest on the same loan within the valid period. The foreign company must separately apply for treaty benefit for interest income if it subsequently makes additional loans to the same resident enterprise. With regard to royalties, the approved benefit only applies to the royalty payments under the same licensing agreement. In addition to the initial application and approval, during the implementation of a treaty benefit approval, the taxpayer or withholding agent must file a form—Report of Implementation of Nonresident's Treatment Upon Approval under Double Taxation Agreement—to report the actual implementation status.

FILING REQUIRED FOR CLAIMS FOR OTHER TAX TREATY BENEFITS

To enjoy treaty benefits other than those for dividend, interest, royalty, and gain on transfer of properties, a nonresident does not need to obtain a specific approval. However, prior to a tax liability occurring or at the time of the tax filing, the nonresident or a withholding agent must file an information reporting form—Nonresident's Claim for Treatment under Double Taxation Agreement—together with a resident certificate issued by the competent authority of the treaty country or region and other documents that may be required by the tax authorities. The resident certificate must be dated on or after January 1 of the year immediately prior to the year of filing.

According to China tax treaties, the business profits of a foreign enterprise from a treaty country generally will not be taxable in China unless the foreign enterprise has a permanent establishment in China and the business profits are derived from the permanent establishment. A "permanent establishment" is a fixed place of business through which the business of an enterprise of a treaty country is wholly or partly carried on. For the provision of services by a foreign enterprise in China, the foreign enterprise will be considered to have permanent establishment in China if the services rendered by the foreign enterprise through employees or other personnel engaged by the foreign enterprise continue within China for a certain period of time. Most treaties provide for a period or periods aggregating more than six months within any 12-month period.

Many foreign companies from treaty countries provide services in China, which may include undertaking engineering or installation projects, performing technical service contracts, and providing various consulting services. According to the Measures, the claims for benefits under treaty provisions concerning business profits and permanent establishment do not require approval and are only required for filing of the above information with the tax authority in charge. However, a tax certificate is required for remittance of foreign exchange of more than US$30,000. If a foreign company files a claim for tax exemption because its activities do not constitute a permanent establishment in China, the tax authority in charge most likely will conduct a substantial review of filing documents for treaty benefit claim before issuing a tax clearance certificate. As it is not clear how to account for the six-month (or more number of months in some treaties) period under the current tax law and regulations, it may not be easy for the tax authorities to agree to the no-permanent-establishment position of the foreign company in some situations. Accordingly, it may be difficult to implement "merely filing for records" as provided in the Measures in those situations.

RECORD RETENTION AND TAX AUDIT

If a taxpayer has received tax treaty benefits, the taxpayer and withholding agent must maintain documents and records in relation to the treaty benefit claims for at least 10 years. The tax authorities may randomly select taxpayers (for both approved cases and information filing cases) for review and reconfirmation of eligibility of treaty benefits. If the tax authorities find that a taxpayer is not eligible for the treaty benefits, provides false information in the application or information filing, or cannot be determined for eligibility of treaty benefits, the tax authorities may withdraw the approval or require a reapplication for treaty benefits or other corrective actions. In some circumstances, the tax authorities may impose penalties on taxpayers and withholding agents.

CONCLUSION

China has strengthened administration of nonresident tax collections. In addition to the Measures, several other tax circulars concerning nonresidents were issued recently. In implementing the review procedures for claiming tax treatment under double taxation treaties, the tax authorities may apply anti-avoidance provisions as provided in the tax law, regulations, and other tax circulars and deny a claim for treaty benefits. To receive tax treaty benefits, multinational companies should not only make accurate and complete initial applications or filings but should also ensure proper information filings during the implementation of an approved treaty benefit claim.

LAWYER CONTACT

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