

# China Business Advisory

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### 2. Service Highlight

## New Compliance Requirements for China Transfer Pricing

After releasing the discussion draft of the Implementation Measure of Special Tax Adjustment for public comment (please see details in “China Business Advisory 2015 Issue 10”), State Administration of Taxation (“SAT”) issued Announcement [2016] No.42 (“Announcement 42”) on 29<sup>th</sup> June 2016 to improve and revise the current relevant regulations in Guoshuifa [2009] No.2. In addition, Announcement

42, taking effect from 2016, also updated the relevant reporting forms stipulated in Guoshuifa [2008] No.114. The following areas have the most significant changes that will affect multinational corporations (“MNCs”):

- Related party relationships
- Related party transactions
- Contemporaneous documentation
- Related party transaction forms

Although comprehensive updated regulations for transfer pricing have not yet been released, China has improved some relevant regulations in a very short time following Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting) of Organisation for Economic Co-operation and Development (“OECD”)’s Base Erosion and Profit Shifting (“BEPS”) Action Plan. Announcement 42 as one of the most important ones would significantly affect MNCs with more stringent transfer pricing compliance.

## **Implementing New DTA between China and Germany**

SAT issued Announcement [2016] No. 37 on 16<sup>th</sup> June 2016, stating that the new “Agreement between the People’s Republic of China and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Tax Evasion with Respect to Taxes on Income and on Capital” (“DTA”) mutually signed on 28<sup>th</sup> March 2014 has come into force on 6<sup>th</sup> April 2016 and will be fully implemented from 1<sup>st</sup> January 2017. Comparing with the previous DTA mutually signed on 10<sup>th</sup> June 1985 and taken effect on 14<sup>th</sup> May 1986, the new DTA has been updated in several aspects. The key changes are summarized as below:

1. The definition of residence includes two more categories namely “place of incorporation” and “place of effective management” and excludes the category “place of head office”.
2. In terms of Permanent Establishment
  - Extend the period for a building site, construction, installation or assembly project or any supervising activities connected therewith from 6 months to 12 months;
  - Replace “6 months” by “183 days” in any consecutive 12 months for furnishing of services;
  - Add clause in relation to dependent agent;

3. Withholding tax on eligible dividends is reduced to 5%;
4. Effective withholding tax on certain royalties could be as low as 6%;
5. For Independent Personal Services and Income from Employment, the “aggregate 183 days in the calendar year” in the previous DTA is replaced by “aggregate 183 days in any twelve-month period”.

Multinational enterprises in China and Germany should study this new DTA and assess its impact to their business operations and plan for implementation of appropriate adjustments to their investment structure and operations accordingly.

## **Updated Working Guide for the Qualification and Administration of High- and New-Technology Enterprises**

In order to supplement and support the new administrative measures on qualification of high- and new-technology enterprises in terms of execution (please refer to “China Business Advisory 2016 Issue 2”), SAT, Ministry of Science and Technology (“MOST”) and Ministry of Finance (“MOF”) jointly issued Guokefahuo [2016] No.195 on 22<sup>nd</sup> June 2016 to replace the previous working guide of qualification of high- and new-technology enterprises, Guokefahuo [2008] No.362. This updated circular has lifted requirements on application, refined the valuation system, clarified the terms and reinforced the inspection system. Some of the highlights are summarized below:

- Determine only one owner to apply and extend the qualification when the ownership is shared by more than one person;
- Add corporate income tax (“CIT”) annual return filings for last three years into required list of documents;
- Apart from valuating the number of intellectual properties (“IPs”), implement three more indicators to assess the innovation ability, namely the level of technological advancement, the core effect of main product (service) on technology and the way of acquisition;

- Increase the percentage of other expense in R&D expense from 10% to 20%;
- Require at least one financial expert to be included in the expert group to evaluate financial statements, reports and filings; and
- Require at least 60% of the members in expert group being expert technicians.

In conclusion, it is obvious that China has paid more attention to technology advancement and therefore, has upgraded the requirements on the application to ensure that qualified high- and new-technology enterprises which enjoy CIT treatment are those who really make contribution to technology advancement. In addition, China has reinforced the inspection system to monitor qualified high- and new-technology enterprises and prevent abuse and misuse of the system. Enterprises which plan to apply for the qualification are now facing more stringent rules and requirements.

## **Expanding on China's VAT Exemptions for Financial Services Industry through a New Supplemental Circular**

MOF and SAT jointly issued Caishui [2016] No.70 on 30<sup>th</sup> June 2016 in order to supplement Caishui [2016] No.36 and expand on the categories of Value Added Tax ("VAT") exemption in the field of financial services industry and further clarify some commercial activities in this field. Caishui [2016] No.70 has taken retrospective effect from 1<sup>st</sup> May 2016. The key highlights include:

1. List of inter-financial institution transactions where the interests derived are exempted from VAT; and
2. Clarification of classification of other activities which are subject to VAT exemption.

Since the circular, Caishui [2016] No.70 has taken effect from 1<sup>st</sup> May 2016 retrospectively before the first VAT return date (20<sup>th</sup> July 2016) after the expansion of VAT Reform to the whole nation, financial institutions, especially those with international businesses, should pay particular attention to this new regulation which may reduce their VAT burden with the newly defined exemptions available to them.

## Service Highlight

It is obvious that China has not only kept improving and refining the domestic regulations towards international practices, but also kept building co-operative relationships with other countries via mutually beneficial agreements. With the continuous economic growths, China provides an increasingly desirable commercial environment for foreign investors. Sino-Bridge is always well prepared and pleased to help investors to exploit their full potentials from their business presence in China. Our Marketing Executive, Ms. Kimme Chan, would like to hear from you at (852) 3579 8745 or [kimmechan@sinobridge-consulting.com](mailto:kimmechan@sinobridge-consulting.com) to learn of what we could assist you on your plan.

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