**China’s move to improve its international taxation policies by virtue of G20 tax reform**

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**In brief**

Earlier this month, at a seminar in Hong Kong sharing the latest international tax development in the Mainland and Hong Kong, the officials of the State Administration of Taxation (SAT) of China delivered keynote speeches on the topics of current international tax administration framework and achievements, G20 tax reform and focus of international taxation development, etc. In their speeches, they provided China’s responses to the G20 tax reform and outlook of international taxation development in China, and put forward China’s plan to upgrade its international taxation policies and advance the modernisation of international taxation to a new stage. This coincides with China’s international tax agenda for year 2015 and the near future, which was announced at the National International Taxation Conference held this February.

In this News Flash, we will highlight China’s strategic initiatives for the G20 tax reform, introduce the outlook of China’s international tax policy and important tax reforms, and share our observations. Taxpayers should closely monitor Chinese tax authority’s positions and work plans to come up with prompt actions in response to potential changes and developments in the future.

**In detail**

There are currently three key initiatives in the global collaboration in tax matters organised by the Organisation for Economic Co-operation and Development (OECD) under the G20 framework: (1) To address the OECD’s Action Plan on base erosion and profit shifting (BEPS) with the aim to transform current international tax rules and combat double non-taxation; (2) To promote administrative collaboration in tax matters among nations according to the Convention on Mutual Administrative Assistance in Tax Matters (the “Convention”); (3) To improve international tax transparency by implementing the Common Reporting Standard (CRS) for automatic exchange of financial account information, and resolve the information asymmetry in tax collection of cross-border transactions. At this seminar, the aforementioned initiatives, which are to reinforce international co-operation and to combat cross-border tax evasion and avoidance are defined collectively as “G20 tax reform” by the SAT officials. The SAT officials also introduced China’s strategic initiatives in participating in the G20 tax reform, as well as the current status and achievements in recent years on domestic tax administration:

**Active participation in studying international tax rules and improving global tax fairness**

As a G20 member, China has always expressed its support to collectively combat BEPS in the relevant G20’s statements, indicating its willingness to fully participate in the BEPS projects. The SAT experts have profoundly participated in the BEPS work streams. Immediately after the OECD released the first batch of seven BEPS deliverables in September 2014, the SAT hosted a conference reiterating the principle of the BEPS project, that is, “profits should be taxed in the jurisdiction where economic activities take place and value is created”, and announced China’s action plans to apply the BEPS deliverables. In the meantime, the SAT identified 15 unacceptable tax practices to reflect its determination to tackle BEPS issues in China². In the upcoming 2015 and 2016 G20 summits, the SAT will closely follow up on the remaining 8 BEPS projects, participate in other work streams of the G20 tax reform, and put forward China’s positions and proposals.
China’s in-depth participation in the BEPS reflects its increasing willingness to engage in global study on international tax rules over the past years. This is not only to protect China’s rights in tax collection as the “source state”, but also to prevent the future trend becoming unfavourable to China’s outbound investments. At the same time, by doing so, China can improve its international tax policies.

**Improving China’s domestic tax rules by virtue of the G20 tax reform**

The SAT’s determination to tackle tax avoidance was well reflected in various tax circulars issued recently concerning Non-Tax Resident Enterprises (Non-TREs) and treaty matters as early as before the BEPS project commenced, including the tax circulars on beneficial owner, procedural requirement for treaty benefit application, and guidance for overseas indirect transfer of equity in a Chinese company by Non-TREs, etc. Moreover, the drafting of the <Administrative Measures on the General Anti-Avoidance Rule (GAAR) (Trial)> issued in 2014 was actually started several years prior to its release. All these measures coincide with the objectives of the BEPS project. Certain provisions in the <Public Notice Regarding the CIT Treatment on Overseas Indirect Transfers of China Taxable Properties> released in March this year directly reflects what is said in the BEPS Action 8 report: Guidance on Transfer Pricing Aspects of Intangibles released in 2014. Obviously, the SAT is proactively learning from international experience and making efforts to build up China’s tax system against BEPS.

In addition, the SAT officials also shared the following plan to improve the domestic tax rules this year and in the future in response to the G20 tax reform:

- To amend the <Tax Collection and Administration Law>, <Individual Income Tax Law> in order to have anti-tax avoidance legislation covering various taxes by adding anti-tax avoidance provisions into these two laws.
- To amend the <Implementation Measures of Special Tax Adjustment>. We look forward to seeing the principles to be laid down in the articles of GAAR, Controlled Foreign Corporations (CFC) and thin capitalisation, etc. Turning to the area of transfer pricing, we believe the SAT will pay special focus on contemporaneous documentation, intra-group services, transfer pricing issues of intangibles as well as quantitative adjustment on cost savings and market premium, etc.

**Enhancing anti-tax avoidance administration and exchange of information to protect China’s tax base**

China’s tax revenue collected through anti-tax avoidance measures amounted to RMB 52.7 billion in 2014, increased by 113 times as compared with the amount collected of RMB 0.46 billion back in 2005. In 2005, the average tax amount per anti-tax avoidance investigation case was only RMB 1.27 million, and none of these cases was over RMB 100 million. In 2014, the average tax amount per case amounted to RMB 30.68 million, and there were 20 cases with tax amount exceeding RMB 100 million. We believe the considerable growth of the annual tax revenue from anti-avoidance investigation, and the increasing average tax amount per case is an indication of the improvement in China’s anti-tax avoidance system.

In order to improve and clarify its domestic anti-tax avoidance regime, as mentioned above, China released the <Administrative Measures on GAAR (Trial)> at the end of 2014, and now is revising the <Implementation Measures of Special Tax Adjustment> with the aim to crack down on aggressive tax planning, and enable various anti-tax avoidance measures to play a role in protecting tax fairness. We understand that China has several initiatives for anti-tax avoidance on the agenda, such as: setting up an administrative system for international tax information and improving the system to monitor the profits levels of multinational corporations (MNC) having operation in China; the purpose of which is to enable the tax authorities to deal with the associated international tax risks. Information transparency appears to be a key word in these initiatives. We can see China’s commitment to prevent base erosion and profit shifting in China by means of informationisation.

From an international angle, apart from the BEPS project, China has also proactively participated in the other two initiatives of the G20 tax reform. China signed the Convention in August last year with the aim to reinforce exchange of information between governments and improve global collaboration against tax avoidance. Signing the Convention was just the first step. It is believed the SAT would take further actions to prepare for the implementation of the Convention. For instance, China will devote more resources to improve the efficiency of various types of information exchange on tax matters, and provide domestic implementation guidance for the new forms of assistance, etc. In addition, in respect of the G20 leaders’ proposal to commence the automatic exchange of financial information among members by the end of 2015, China has also pledged to implement such CRS as soon as possible. After the new standard was released, the OECD is currently developing the commentary for the CRS which is expected to be released soon.

**Reinforcing administration and improving services for cross-border tax revenues**

In order to enhance the administration and improve services for cross-border tax revenues, it is necessary to establish a tax administration framework which can cater to both Non-TREs investing in China and domestic taxpayers going abroad.

1) Non-TREs

China has considerably improved the administration on tax revenues from Non-TREs during the recent years. According to statistics, China collected tax revenue of RMB 335.5 billion from Non-TREs in 2014, having achieved a year on year growth of 15.5%. The average growth per year for tax revenue from Non-TREs in China is 24% since the concept of Non-TRE was introduced in the new Corporate Income Tax (CIT) regime in 2008.

Over the past years, the SAT has released certain tax circulars relating to Non-TREs, including QFII and RQFII taxation, tax policy for Shanghai-Hong Kong Stock Connect, and SAT Public Notice [2015] No.7 (“Public Notice 7”), the circular which has attracted the most attention, on a set of new guidance for the tax treatment on overseas indirect transfers of China taxable properties. At this seminar, the SAT officials mentioned that formulating the...
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internal implementation guideline for Public Notice 7 is on their agenda. Furthermore, the SAT is also working on the <Administrative Measures on CIT Collection of Non-TRE on a Deemed Profit Basis> which would be released later.

The SAT officials also talked about optimizing the tax administration mechanism and procedures on Non-TREs. Streamlined administration and decentralised authority will be gradually achieved by removing or relaxing the administrative approval procedure. For instance, the Tax Clearance Certificate for outward remittance has been replaced by a record-filing system in 2013. This has made the administrative process for outward remittance more flexible and efficient, and facilitated cross-border cash movement by MNC’s. Nevertheless, the replacement of the approval system by the recording-filing system (it is possible that all pre-approval procedures may be removed in the future) does not mean that the Chinese tax authorities are relaxing the tax administration on outward remittance. On the contrary, the tax authorities would shift its focus to daily tax administration and post-remittance examinations.

The SAT puts forward a risk management-based approach for the future tax administration on Non-TREs. In other words, the SAT would formulate internal guidance for risk management and release external international tax risk reminders so that international tax risk management can be enforced at each and every angle. Today, many jurisdictions in the world have adopted a risk management-based approach in their tax administration so that more resources could be devoted to those enterprises with low compliance level but high tax risk. We notice that this kind of approach is becoming an international trend in tax administration. China has also accelerated its steps to move towards this trend. It therefore has placed higher standards in relation to the internal tax risk control of MNCs as well.

2) Taxpayers “going abroad”

The SAT has set forth the principle to improve the services and tax administration on Chinese enterprises and individuals “going abroad” in the circular entitled <Guidance on the Administrative Mechanism for International Taxation> in 2012, that is, “understanding taxpayers’ tax profile, improving tax policies, optimizing services and strengthening administration”.

• Understanding taxpayers’ tax profile:

In recent years, the Chinese tax authorities have started to build up a tax profile of taxpayers “going abroad” by collecting comprehensive information of enterprises and individuals “going abroad” with regard to their outbound investment and operation, overseas income and foreign tax payments. The circular entitled <Public Notice Regarding Information Disclosure by TRE on Outbound Investment and Overseas Income> was issued last year to strengthen the collection of information relating to Chinese TRE’s outbound investment.

• Improving tax policies:

The SAT is contemplating to build up a comprehensive mechanism for overseas tax services and administration to better serve the opening up strategies including “One Belt, One Road”. Apart from providing supportive policies for the outbound investment projects encouraged by the State (e.g. issuing the <Work Plan to Promote “One Belt, One Road” through Innovative Tax Services and Administration>), the SAT will further study the CFC rules and improve the foreign tax credit rules to facilitate and provide tax certainty to enterprises “going abroad” from a tax policy perspective.

• Optimizing services:

We understand from the seminar that the SAT is expanding the scale of National Tax Information Centre, with double tax treaties as a backdrop, to enable enterprises and individuals “going abroad” to have a better understanding of the tax regimes of the investee countries. In order to provide legal protection and tax services for enterprise and individuals “going abroad”, the SAT will select those provinces with more outbound investments, and designate their local-level tax authorities to collect, collate and study the tax regimes of the foreign investee countries. Meanwhile, with more and more international tax disputes, enterprises facing investigation by foreign tax authorities are encouraged to timely and efficiently resolve the foreign tax disputes through channels such as mutual agreement.

• Strengthening administration:

As far as we know, the International Taxation Department of SAT has established a new division, Overseas Taxation Division, to optimize the tax administration on outbound investments for both enterprises and individuals. The set-up of the Overseas Taxation Division shows the SAT’s focus and efforts on the “going abroad” tax policies. We believe this new division will not only standardise and unify the administration in practice, but will also play an important role in improving the “going abroad” related tax policies, and coming up with new tax rules, for instance, CFC rules as soon as possible.

Helping taxpayers to comply with the tax law, avoid or mitigate negative impact on business

The G20 tax reform is giving rise to significant changes in China in terms of domestic tax regulations and tax administrative environment and which may also have an impact to taxpayers. We are pleased to see that the SAT officials commit to making any new tax laws and regulations more transparent, providing more clarification on taxpayer’s rights and obligations with emphasis on protecting taxpayer’s interests and rights. Meanwhile, the tax authority would also help taxpayers to better comply with the tax law and minimize their compliance cost arising from the G20 tax reform. The SAT will carefully study how to carry out the G20 tax reform under China’s domestic environment, solicit public opinions, fully consider its impact on business, and make every effort to minimise its negative effect on businesses.

The takeaway

With the continual and profound development of economic globalisation, there are increasing competitions among jurisdictions surrounding internationalisation of tax sources and the protection of their taxing rights. Looking at the current international and domestic economic
environment and the stringent international tax administrative stringent environment, China is facing bigger challenges from both “inbound” and “outbound” investment perspective. It places new requirements on international tax administration. The Chinese tax authority’s statements on various occasions indicate China’s willingness to deeply participate in the G20 tax reform, and upgrade its global taxation policies by participating in international collaboration in tax matters.

The proposed amendments on international tax standards and domestic tax rules under G20 tax reform will bring substantial changes to the tax environment in China. Against this backdrop, taxpayers will be facing more uncertainties in formulating tax related strategies and administering their tax matters. The further simplification on tax administration and approval procedures would reduce business’ administrative cost and improve their operation efficiency, however, enterprises should at the same time improve its tax risk control capabilities. We recommend enterprises to adopt a more proactive approach rather than taking a “wait-and-see” attitude, prepare for the possible changes in tax administration, closely monitor the global and domestic development of G20 tax reform, identify any transaction or arrangement that would likely be investigated by tax authority, take steps to improve their internal tax risk control mechanism, and prepare for any potential challenges in the future.

Endnote

1. For more details of the BEPS project, Convention, and CRS, please refer to our News Flash 2014 Issue 21, 2013 Issue 22, and 2014 Issue 12 respectively.

2. For more details of the “15 unacceptable tax practices identified”, please refer to our News Flash 2014 Issue 23.


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Let’s talk

For a deeper discussion of how this issue might affect your business, please contact a member of PwC’s China Tax and Business:

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