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Relevant industries: Network operation
Relevant companies: Network operators
Relevant taxes: N/A

Potential impacts on businesses:

- Risk of non-compliance due to introduction of law increased

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New rules on cross-border data transmission

As highlighted in KPMG *China Tax Weekly Update (Issue 43, November 2016)*, a Cybersecurity Law was adopted by China's National People's Congress (NPC) in November 2016 and will come into effect from 1 June 2017.

The Cybersecurity Law provides various security obligations for network products/service providers and network operators. The law further strengthens the protection of personal information, sets up a system to protect the security of key information infrastructure facilities (KIIFs), and establishes rules for cross-border transfer of vital data held by KIIFs.

The new law provides that "*The personal information and key data collected and generated in China by the operators of KIIFs should be stored within China. Information which needs to be provided to overseas parties for business reasons shall be subject to security evaluation. The security evaluation shall be carried out based on the measures that are developed by the Cyberspace Administration of China and the State Council*".

Subsequently, the Cyberspace Administration of China on 11 April 2017 released the draft Measures for the Security Evaluation of Personal Information and Key Data to be Transferred out of China ("draft measures") to seek public comments. Comments shall be returned by 11 May 2017.

This indicates that foreign companies with business operations in China will be required to get permission to transfer data out of the country. The new rule would affect all network operators (a broadly defined term), a term that industry experts say likely encompasses technology companies, as well as potentially extending to various other enterprises that do business in China through computer networks. Among others, financial institutions, might be particularly affected.

The Cybersecurity Law itself solely provided that the personal information and key data collected and generated in China by the operations of KIIFs should be stored within China, and that security assessments on such data must be conducted. The draft measures further expand this provision to cover all network operators (broadly defined term), and at the same time, provide clarification on the definition of relevant terms, applicable scope, procedures as well as other key content as follows:

- "Network operators" refers to owners of, managers of and service providers to networks.
- "Data being transferred out of the country" means providing overseas institutions, organizations and individuals with the personal information and key data generated or collected by network operators in the course of their operations within China.

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- For the transmission of personal information out of the country, an explanation of and details on the purpose, scope, content and recipient (including their location) of the data to be transmitted must be given to the owner of the personal information. The transmission must be consented to by such owners.
- Prior to data being transferred out of the country, a network operator shall self-conduct a security assessment and be liable for the assessment results. The security assessment shall focus on the following:
  - ❖ Necessity for data to be transferred out of the country;
  - ❖ Where personal information is involved, an assessment shall be made on the quantity, scope, type and sensitivity of the personal information, as well as whether the owner of the personal information agrees to transfer his personal information out of the country;
  - ❖ Where important data is involved, an assessment shall be made on the quantity, scope, type and sensitivity of the important data;
  - ❖ Security protection measures, the ability and proficiency of the data recipient, as well as the network security environment of the country or region where the data recipient is located;
  - ❖ Risks of leakage, damage, alteration and abuse of data after being transferred out of the country and further transferred;
  - ❖ Risks to national security, social and public interests, and personal interests arising from the transfer the data out of the country and the gathering of such data abroad.
- In any of the following circumstances, a network operator shall apply to its industrial supervisory authority or regulator to conduct a security assessment:
  - ❖ The data to be transferred out of the country contains the personal information of more than 500,000 users;
  - ❖ The quantity of the data to be transferred out of the country is more than 1,000 gigabytes;
  - ❖ The data to be transferred out of the country contains data related to nuclear facilities, chemical biology, national defense and the military industry, population and health, as well as the data of large-scale project activities, the marine environment and sensitive geographic information;
  - ❖ The data to be transferred out of the country contains details on system vulnerabilities, security protection and other network security information of KIIFs;
  - ❖ A KIIF provides personal information and important data to overseas; or
  - ❖ Other data which may affect national security, and social and public interests, and are necessary for assessment as determined by the relevant industrial supervisory authority or regulator.
- Data shall not be transferred out of the country in any of the following circumstances:
  - ❖ The outbound transmission fails to be approved by the owner of the personal information, or may jeopardize personal interests;
  - ❖ The outbound transmission causes security risks to the nation's political system, economy, technology and defense, which may affect national security and jeopardize social and public interests;
  - ❖ Other data which are forbidden to be transferred out of the country as determined by the state cyberspace administration, public security authority, security authority and other relevant authorities.

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Relevant industries: All
Relevant companies: MNEs
Relevant taxes: N/A

Potential impacts on businesses:

- Risks of being challenged due to non-compliance issues increased

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2017 UN TP manual and UN model tax treaty updates

2017 UN Transfer Pricing Manual released

The United Nations (UN) Committee of Experts on International Cooperation in Tax Matters (UN Committee) released its revised and updated 2017 United Nations Practical Manual on Transfer Pricing for Developing Countries (2017 UN TP Manual), organised into four parts, as follows:

(i). TP in a global environment;

(ii). Guidance on TP rule design principles and policy considerations;

(iii). Practical implementation of a TP regime in developing countries; and

(iv). Country specific practices, including practices in India, Brazil, China, South Africa, and Mexico.

The 2017 UN TP Manual adds new chapters on intragroup services, intangibles, cost sharing agreements, and business restructuring. The new intangible chapter is aligned with OECD/G20 base erosion profit shifting (BEPS) plan TP work. The 2017 UN TP Manual also includes updated guidance on TP documentation, including a discussion of country-by-country (CBC) reporting.

The China Country Practice chapter of the 2017 UN TP Manual adds supplementary guidance on "market premium" (paras. D.2.4.4.10 to D.2.4.4.12). This is defined as "the additional profit derived by an MNE by operating in a jurisdiction with unique qualities impacting on the sale and demand of a service or product." By this definition, market premium is the amount of additional profit that accrues from the ability to charge higher prices in a location as compared to elsewhere in the world (e.g., EU-made luxury leather products in China). The SAT had briefly mentioned market premium in the original 2013 China Country Practice chapter, and the 2017 update explains this further. In addition to the luxury goods sector, the SAT identified the pharmaceuticals and automotive industries as sectors that may potentially give rise to market premiums.

The concept of market premium may be distinguished from that of marketing intangibles. Even if the Chinese subsidiary has not contributed to the creation of China-specific marketing intangibles, a pure market premium concept could, in principle, be used to justify the attribution of additional profits to the Chinese subsidiary. This would be due to the willingness of Chinese consumers to pay higher prices for goods. This could, conceptually speaking, apply even when the brand image built up through investments in the home country.

This being said, the examples on market premium set out in the China Country Practice chapter provide illustrative cases where the Chinese subsidiary was "involved in heavy marketing and sales activities to build the brand image among Chinese consumers" or has "undertaken significant promotion activities to educate Chinese customers who had known nothing about the brands before." These examples appear to envisage China market premium arising in cases where a BEPS-style DEMPE (development, enhancement, maintenance, protection, exploitation) analysis might also view intangible value being created in China. As such, the SAT's updated 2017 China Country Practice chapter guidance might be more readily linked to the global TP developments at a concepts level. However, this does not necessarily make TP disputes between countries easier to resolve, as there may still be differing views on the relative value contribution of the activities carried out in China.

Among the new developments, the China Country Practice chapter also suggests that Chinese subsidiaries who have helped build brand value among Chinese consumers should be attributed additional revenues and profits if Chinese consumers choose to buy the products outside of China due to the high prices in Chinese stores.

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UN Model Tax Treaty updated

The UN Committee also reached agreement on several items for a planned 2017 update to the United Nations Model Double Taxation Convention between developed and developing countries (UN model tax treaty). The items agreed during the April 3-6 session in New York, include, inter alia:

- A new article allowing withholding tax on payments for technical services;
- New text to address tax treaty abuse, combining a detailed limitation on benefits (LOB) provision (based on the US model) with a principal purpose test (PPT). The UN committee goes further than the OECD dues, in its multilateral instrument (MLI) to implement BEPS tax treaty provisions, as the OECD proposes that the PPT could be used alone or in combination with a simplified LOB, with a detailed LOB (by itself) as an alternative.
- Further work on the Commentary to the UN model tax treaty concerning how the royalty article relates to the use of machinery;
- Revised UN model tax treaty article on international transport (bringing the article in line with OECD provisions;
- A provision on indirect transfer of land-rich companies; and
- A revised Guide to MAP (G-MAP).

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Relevant industries: All
Relevant companies: All
Relevant taxes: N/A

Potential impacts on businesses:

- Operational cost reduced
- Tax certainty increased

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China-Portugal tax treaty interest WHT relief enhanced

China's State Administration of Taxation (SAT) on 7 April 2017 signed an agreement with Portugal to clarify and enhance the interest WHT exemption provisions under the China-Portugal tax treaty.

The modifications are intended to reduce the tax burden on financing costs paid cross-border and should support greater bilateral investment and trade. Chinese enterprises have, in recent years, made extensive investments in Portugal's financial services sector and the treaty enhancements would be expected to further support this.

The full text of the agreement are yet to be released by the relevant authorities and we will publish this once available.

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Reference: Cai Shui [2017] No. 23
Issuance date: 21 March 2017
Effective date: 1 January 2016 to 31 December 2020

Relevant industries: Financial industry
Relevant companies: Securities and futures institutions
Relevant taxes: CIT

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

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CIT deductions for reserve contributions made by securities companies

On 21 March 2017, the Ministry of Finance (MOF) and the SAT jointly issued Cai Shui [2017] No. 23 ("Circular 23"). This clarifies the tax deduction position for contributions to reserves, made by enterprises in the securities industry, for Corporate Income Tax (CIT) purposes. The circular is effective from 1 January 2016 to 31 December 2020.

In 2012, the MOF and the SAT had issued Cai Shui [2012] No. 11 ("Circular 11"), which previously clarified the tax deduction rules for reserve contributions by securities industry companies. Circular 11 was due to expire on 31 December 2015.

Circular 23 continues the tax deduction rules as set forth in Circular 11. The reserve contributions made by institutions engaged in securities or futures business shall be allowed as a tax deduction, provided they are accrued based on the mandated ratios and/or do not exceed the limits at stated in the circular.

The types of reserves in scope include, for the securities industry, stock exchange risk funds, securities settlement risk funds and securities investor protection funds. For futures business the in-scope reserves include risk provisions made by futures exchanges, risk provisions made by futures companies and futures investor protection funds.

Reference: Cai Shui [2017] No. 22
Issuance date: 21 March 2017
Effective date: 1 January 2016 to 31 December 2020

Relevant industries: Financial industry
Relevant companies: Financing (credit) guarantee organisations for SMEs
Relevant taxes: CIT

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

You may click here to access full content of the circular.

CIT deduction for reserve contributions made by credit guarantee organisations for SMEs

On 21 March 2017, the MOF and the SAT jointly issued Cai Shui [2017] No. 22 ("Circular 22"). This clarifies the CIT deduction position for reserve contributions made by organisations engaged in providing financing (credit) guarantee services to small and medium-sized enterprises (SMEs). The circular is effective from 1 January 2016 to 31 December 2020.

In 2012, the MOF and the SAT had issued Cai Shui [2012] No.25 ("Circular 25"), which previously clarified the tax deduction rules for reserve contributions by the aforesaid organisations. Circular 25 was due to expire on 31 December 2015.

Circular 22 continues the tax deduction rules as set forth in Circular 25, i.e., eligible organisations engaged in providing financing (credit) guarantee services to SMEs are allowed to deduct the following contributions to reserves when calculating CIT:

(i). Contributions to guarantee compensation reserves in an amount not exceeding 1% of the year-end guarantee liability balance; and

(ii). Contributions to unearned premium reserves in an amount not exceeding 50% of the guarantee fee income of the year.

Organisations engaged in providing financing (credit) guarantee services to SMEs must meet certain requirements to enjoy the tax deduction rules. This remains unchanged from Circular 25, as do the application procedures.

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