

China Tax Alert

Issue 5, February 2018

China clarifies tax treaty application for partnerships, service PE and international transportation

Regulations discussed in this issue:

- Announcement on Clarification on Certain DTA Implementation Issues (Announcement [2018] No. 11, "Announcement 11"), issued by SAT on 9 February 2018.
- Notice on Interpreting Articles set out in China-Singapore DTA and its Protocol (Guo Shui Fa [2010] No. 75, "Circular 75"), issued by SAT on 26 July 2010.

On 9 February 2018, the State Administration of Taxation (SAT) issued Announcement 11 to supplement the earlier double tax agreement (DTA) guidance provided in Circular 75. This provides notable clarifications concerning the DTA treatment of foreign partnerships and the service permanent establishment (PE) timeframe calculations. There is also supplementary guidance on DTA transport and entertainer articles. The guidance applies from 1 April 2018.

Announcement 11 main changes

Circular 75 is the most substantive piece of China DTA guidance and draws heavily on the commentary on the OECD Model Tax Convention (MTC). While it formally applies to the interpretation of the China-Singapore DTA, it is stated to be relevant to interpretation of treaties with provisions matching those in the China-Singapore DTA.

The Announcement 11 foreign partnership clarifications, however, diverge from the OECD approach. It is provided that, unless there are specific provisions in a given DTA dealing with partnership 'transparency' (e.g. under the China-France DTA), then foreign partnerships themselves must qualify for DTA benefits, for any relief to be available. This means that the foreign partnerships need to show that they possess tax residency certificates issued by foreign tax authorities, and have tax payment obligations as residents therein. It appears that one cannot just look through to the underlying partners and show that the partners paid tax, and then be able to claim DTA benefits on this basis. This differs from the approach, in the OECD MTC Commentary, that the source country should look at how the residence country taxes the partnership/partners, and follow this to determine the appropriate DTA relief claimant. By contrast, foreign partners in Chinese partnerships may claim DTA benefits, under the DTA between their country and China, as long as that country taxes them as residents.

The other significant clarification is that older China DTAs, whose service PE articles set a six month (rather than 183 day) threshold, should be interpreted as setting a 183 day test.

Apart from this, other clarifications include:

- Unincorporated Sino-foreign educational institutes are clarified to constitute a PE in China for foreign partners.
- The guidance in Circular 75 on the shipping and air transport article (Article 17) is replaced. This provides, in particular, greater guidance on which activities are considered 'ancillary' to the operation of ships or aircraft in international traffic through the provision of a 'three-pronged test', and thus only taxable in the country of the transport enterprise. This can include, inter alia, certain deposit interest income, and lodging/local transport supplies to transit passengers.
- The guidance in Circular 75 on the entertainers and sportspersons article (Article 8) is replaced. This delivers greater clarity on the activities subject to source taxation under this article, those for which the fixed base threshold is applied under the independent services article, those for which employment treatment under the dependent services article are relevant, and those subject to withholding tax (WHT) under the royalty article.

KPMG observations

The partnership clarifications are potentially challenging for foreign businesses. At present, solely the China-France DTA has special provisions allowing for foreign partnership look-through. In practice, for other DTAs, taxpayers have, in the past, had case-by-case discussions with local tax authorities to agree foreign partnership look-through to access DTA relief. The new guidance would seem to close the door on this approach.

Given that, in commercial practice (and particularly for investment funds), many partnerships are set up as flow-through entities, and the partnerships themselves are not registered as tax residents, this could create extensive China DTA relief complications. While China could, potentially, look to add new protocols to its DTAs to provide for look-through, this would not assist with the many Cayman and BVI partnerships, used for China investment, given the lack of relevant China DTAs.

By contrast, the Service PE clarifications are helpful. This addresses the problem of aggressive local tax authorities asserting, for older DTAs with a six month threshold, that foreign company staff presence in China for one day in a month constitutes presence for a full month. This is of assistance in relation to the US, Canada, Australia, Spain, Norway, Malaysia, and South Korea DTAs, among others.

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho

Head of Tax,
KPMG Asia Pacific
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Lewis Lu

Head of Tax,
KPMG China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Beijing/Shenyang/Qingdao Vincent Pang

Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Tianjin

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Shanghai/Nanjing/Chengdu

Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Hangzhou

John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou

Lily Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

Vincent Pang

Head of Tax,
Northern Region
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Cheng Chi

Tel. +86 (10) 8508 7606
cheng.chi@kpmg.com

Conrad TURLEY

Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Milano Fang

Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng

Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

Flora Fan

Tel. +86 (10) 8508 7611
flora.fan@kpmg.com

John Gu

Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan

Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han

Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong

Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Josephine Jiang

Tel. +86 (10) 8508 7511
josephine.jiang@kpmg.com

Henry Kim

Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

David Ling

Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Li Li

Tel. +86 (10) 8508 7537
li.li@kpmg.com

Lisa Li

Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Thomas Li

Tel. +86 (10) 8508 7574
thomas.li@kpmg.com

Larry Li

Tel. +86 (10) 8508 7658
larry.y.li@kpmg.com

Lucia Liu

Tel. +86 (10) 8508 7570
lucia.j.liu@kpmg.com

Alan O'Connor

Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Shirley Shen

Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam

Tel. +86 (10) 8508 7605
laiyi.tam@kpmg.com

Joyce Tan

Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Cynthia Xie

Tel. +86 (10) 8508 7543
cynthia.py.xie@kpmg.com

Christopher Xing

Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Irene Yan

Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Adams Yuan

Tel. +86 (10) 8508 7596
adams.yuan@kpmg.com

Jessie Zhang

Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang

Tel. +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tiansheng Zhang

Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Tracy Zhang

Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou

Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Vivian Zhou

Tel. +86 (10) 8508 3360
v.zhou@kpmg.com

Central China

Anthony Chau

Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Yasuhiko Otani

Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Johnny Deng

Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong

Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Chris Ge

Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho

Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong

Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang

Tel. +86 (21) 2212 3527
jason.tj.jiang@kpmg.com

Sunny Leung

Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li

Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin

Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Benjamin Lu

Tel. +86 (21) 2212 3462
benjamin.lu@kpmg.com

Christopher Mak

Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Naoko Hirasawa

Tel. +86 (21) 2212 3098
naoko.hirasawa@kpmg.com

Ruqiang Pan

Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao

Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan

Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang

Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao

Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang

Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang

Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Mimi Wang

Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng

Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie

Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu

Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu

Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu

Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Jason Yu

Tel. +86 (21) 2212 3316
jim.yu@kpmg.com

William Zhang

Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Hanson Zhou

Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Michelle Zhou

Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Eric Zhang

Tel. +86 (21) 2212 3398
eric.z.zhang@kpmg.com

Kevin Zhu

Tel. +86 (21) 2212 3346
kevin.x.zhu@kpmg.com

Southern China

Lily Li

Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Vivian Chen

Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Nicole Cao

Tel. +86 (20) 3813 8619
nicole.cao@kpmg.com

Sam Fan

Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Joe Fu

Tel. +86 (755) 2547 1138
joe.fu@kpmg.com

Ricky Gu

Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He

Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Angie Ho

Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Aileen Jiang

Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li

Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li

Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li

Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li

Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao

Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu

Tel. +86 (755) 2547 1187
patrick.c.lu@kpmg.com

Grace Luo

Tel. +86 (20) 3813 8609
grace.luo@kpmg.com

Ling Lin

Tel. +86 (755) 2547 1170
ling.lin@kpmg.com

Maria Mei

Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Chris Xiao

Tel. +86 (755) 3813 8630