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CHINA TAX ALERT

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China joined global efforts to combat tax avoidance and evasion

Regulations discussed in this issue:

- The Multilateral Convention on Mutual Administrative Assistance in Tax Matters issued on 25 January 1988
- The Protocol amending the Convention on Mutual Administrative Assistance in Tax Matters entered into force on 1 June 2011

On 27 August 2013, China became the 56th signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ('the Convention') at the headquarters of the OECD in Paris. Through information exchange and joint tax examinations with other member countries, China is raising its efforts to combat aggressive tax planning and evasion to a new level.

The Convention allows China to automatically or spontaneously exchange information with other signatories and conduct simultaneous tax examinations on a multinational company (MNC) both within and outside China. This easy access to a MNC's tax-related information from another foreign jurisdiction creates a new deterrent for any tax arrangement whose feasibility depends on its lack of full visibility to Chinese tax authorities.

Background

The Convention was originally developed by the Council of Europe and the OECD and opened for signature by the member states of both organisations on 25 January 1988 as a mechanism to facilitate tax information exchange and tax audits among the respective member states. Unlike the bilateral income tax treaties, the Convention is multilateral in nature and provides a single legal platform for co-operation among multiple tax jurisdictions. All the original members of the 1988 Convention enjoyed developed economies and had extensive income tax treaty networks already in place.

Since the onset of the 2008-2009 Global Financial Crisis (GFC), international tax avoidance and evasion has been widely recognised as a serious problem for tax administrators worldwide. In April 2009, the G20 called for action "to make it easier for developing countries to secure the benefits of the new co-operative tax environment, including a multilateral approach for the exchange of information". In 2011, the OECD and the Council of Europe developed a Protocol

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amending the 1988 Convention and opened its access to all countries. Subsequently, a number of developing countries have joined the Convention. With the latest entry of China into the membership, all G20 members have signed up to the Convention.

Contents of the amended Convention

The Convention facilitates international co-operation for a better operation of domestic tax laws. It prescribes various forms of administrative co-operation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion.

Some key provisions of the Convention are summarised below:

Administrative assistance covered

a. **Exchange of information (EoI)**: this includes EoI on request, automatic EoI, and spontaneous EoI among the signatory states.

b. **Tax examinations**: this includes concurrent tax examinations in multiple jurisdictions on the tax affairs of a party in which the member countries have a common or related interest (simultaneous examinations). In addition, one jurisdiction can also request to participate in the tax examination conducted abroad by another jurisdiction (tax examinations abroad).

c. **Tax recovery**: the Convention may allow one country to request assistance from another country in recovering unpaid taxes.

d. **Service of documents**: one country can request another country to deliver legal documents to a taxpayer in the latter jurisdiction. These legal documents may include judicial decisions that were issued in the requesting country and related to a tax covered by the Convention.

Taxes covered

The scope of the Convention is broad. In particular, all forms of compulsory payments to the government except for customs duties are covered. Unlike income tax treaties, the Convention also applies to local taxes, compulsory social security contributions, estate, inheritance or gift taxes, and even administrative fines, in addition to income taxes. Individual countries are allowed to make certain reservations on the types of payments to be covered.

Co-ordinating body

A co-ordinating body composed of representatives of the competent authorities of the countries is formed to monitor the implementation and development of the Convention. The body also serves as a forum for the study of new methods and procedures to increase international co-operation in tax matters.

Secrecy

Any information obtained by a country under the Convention shall be treated as secret and protected in the same manner as information obtained under the domestic law of that country.

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The information received under the Convention may also be used for other purposes besides those related to tax co-operation, for example to counter financial crimes, money laundering or corruptions with the authorisation of the state supplying the information.

KPMG observations

As of today, China has signed close to 100 income tax treaties and about 10 tax information exchange agreements (TIEAs). However, the scope of the Convention goes way beyond the existing treaties and agreements. The Convention allows China to exchange information with other signatories more easily and conduct simultaneous tax examinations on a MNC both within and outside China. China is about to possess a new tool to tackle a range of international tax issues with a global vision.

In addition, the Convention allows China to seek foreign assistance in recovering delinquent taxes. Previously, Chinese tax authorities mainly targeted Chinese withholding agents when trying to collect income taxes that were underpaid by non-residents. Under the Convention, China can potentially recover taxes of a foreign company by seeking assistance from the signatory state where the foreign company resides, if it chooses to participate in the tax recovery program.

In the short-term, Chinese tax authorities may face some constraints in meeting requests from other signatories and may make certain reservations on obligations under the Convention. In the longer term, China's capacity to carry out information exchange is expected to improve with the introduction of new domestic regulations and realignment of resources.

In summary, Chinese tax authorities can now leverage upon wider domestic and abroad resources to fight against tax evasion and adhere to higher international standards of administration and co-operation in the tax field. Both foreign companies operating in China and Chinese companies investing overseas will need to take this capacity into account when conducting cross-border tax planning. MNCs should review existing structures as soon as possible to identify exposure areas and take measure to mitigate their tax risks.

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