

Notice on Interpretation and Determination of The Concept of "Beneficial Owner" for The Application of Tax Treaties

October 27, 2009

The State Administration of Taxation issued the "Notice on Interpretation and Determination of Beneficial Owner under Tax Treaties" (the "Notice").

The Notice intends to regulate the acts of foreign companies preventing them from taking advantage of the "double taxation arrangements" signed by China.

The following are the main contents of the Notice:

1. According to the Notice, a "beneficial owner" is a person who has owned and controlled the income or the rights and assets which generate the income. A beneficial owner can be an individual or a company, and is basically the one who carries out the substantial business.
An agent or a conduit company is not a beneficial owner. The "conduit company" is set up for the purpose of avoidance or reduction of tax, the transfer or accumulation of profit.
2. The Notice also lists seven factors, which may lead to determine the existence of a "conduit company". The following factors deserve especial mention:
 - a. The applicant has no or almost no business activities other than holding the rights or assets which generate the income;
 - b. If the applicant is a company, which assets, business scope, and personnel are small, and does not match the amount of income;
 - c. The applicant has no or almost no right to control or dispose of the income or the rights and assets which generate the income, and also assumes no or little risk.

The promulgation of the Notice indicates that Chinese government has taken actions to crack down on treaty shopping by nonresident enterprises. This Notice makes more difficult for multinational companies to enjoy the benefits established in the tax treaties between China and other countries and regions.

In any case, it must be noticed that theoretically the other parties of the tax treaties should also agree with the Notice and the relevant regulations for them to become fully applicable to the relevant parties.