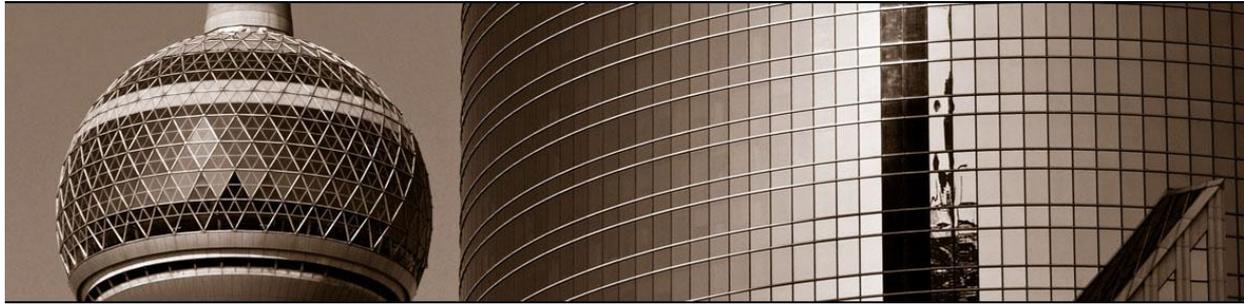


# CUATRECASAS, GONÇALVES PEREIRA



## LEGAL FLASH | SHANGHAI OFFICE

SPECIAL EDITION 2014

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## UPDATE ON TAX REGULATIONS 2014

In 2014, China continued to develop its taxation system affecting domestic and crossborder transactions. This "Legal Flash – Special Edition 2014" highlights the most significant tax updates of the year. Please see our monthly legal flashes for more information and analysis [here](#).

Taking a **step-forward on anti-avoidance provisions**, the State Administration of Taxation ("SAT") released Decree No. 32 to introduce the Administrative Measures on the General Anti-Avoidance Rule ("GAAR") (Trial). Before this, China only had general principles for the application of GAAR, which left the procedures and standards related to GAAR cases to the discretion of local tax authorities. The measures, based on the substance-over-form principle, give detailed guidelines for applying the GAAR in China, specifying the scope, characteristics, adjustment methods and investigation procedures; it comes into force on February 1, 2015.

This is a positive response from the Chinese government to the OECD/G20's Base Erosion and Profit Shifting ("BEPS") Action Plan. It has announced that the measures do not focus on domestic transactions, so we expect the Chinese tax authorities will take a more active stance on combating international tax evasion in the near future.

Regarding the international framework, in the past few years China has been working with other countries on **amending double taxation treaties** ("DTT") to facilitate international transactions and investment, especially the DTT signed with developed countries in the 1980s. The remarkable milestones for 2014 in this area are as follows:

- The amended China-UK DTT became effective on December 13, 2013, and applies to income generated in China since January 1, 2014.
- The amended China-Belgium DTT became effective on December 29, 2013, and applies to income generated in China since January 1, 2014.
- The amended China-Netherlands DTT became effective on August 31, 2014, and applies to income generated in China since January 1, 2015.
- The amended China-Switzerland DTT became effective on November 15, 2014, and applies to income generated in China since January 1, 2015.
- The amended China-France DTT became effective on December 28, 2014, and applies to income generated in China since January 1, 2015.
- The amended China-Germany DTT was signed on March 28, 2014, but is not yet effective.

- The amended China-Russia DTT was signed on October 13, 2014, but is not yet effective.
- The new China-Ecuador DTT became effective on March 6, 2014, and applies to income generated in China since January 1, 2015.
- China and Liechtenstein signed an agreement for the exchange of information relating to taxes on January 27, 2014, which is not yet effective.

A significant change in all the amended DTT reduces the withholding tax rate on dividends from 10% to 5%, if the beneficial owner is a company holding directly at least 25% of the capital of the company distributing them. The Chinese government is expected to gradually amend its DTT network in the near future and introduce a similar provision in all DTT. This change reduces significantly the advantages of indirect investment in China through Hong Kong or Singapore. Foreign countries, especially developed countries, may need to reassess the pros and cons of indirect investment through Hong Kong or Singapore when determining their corporate structure.

All the amended DTT extend the period for creating a construction permanent establishment ("PE") from more than 6 months to more than 12 months (except the amended China-Russia DTT, which keeps the period of more than 18 months) and change the period for creating a service PE from more than 6 months in any 12-month period (and more than 18 months in the China-Russia DTT) to more than 183 days in any 12-month period. This last change is more favorable with regard to PE exposure for residents in those countries providing services in China, as the Chinese authorities interpreted this threshold restrictively under the former DTT wording, considering one day of presence the same as a full month.

The amended China-Russia DTT and the new China-Ecuador DTT also introduce a limitation of benefits clause.

Regarding **transfer pricing practices**, the SAT released Announcement [2014] No. 54 concerning Issues related to Monitoring and Administration of Special Tax Adjustments, effective August 29, 2014.

Under this announcement, multinational companies should (i) examine and review their transfer pricing policies to avoid being identified as a target for self-adjustments by the tax authorities through their monitoring and administration methods, and (ii) keep up to date documentation and other transfer pricing related documents ready for tax authorities' requests, to avoid a 5% mark-up on the interest charged on taxes resulting from self-adjustments.

On December 5, 2014, the SAT also issued the China Advance Pricing Agreement Annual Report for 2013, which covers the statistics on China's advance pricing agreements ("APA") for January 1, 2005, to December 31, 2013. This is the fifth year that the SAT

has issued the APA Annual Report to introduce the China APA system, procedures and implementation. An analysis of the statistics show taxpayers' increasing inclination to use APA as a way to reduce double taxation risks in the case of tax reassessment.

China has also adopted several measures relating to **enterprise income tax ("EIT") administration**, affecting both resident and non-resident enterprises.

Regarding resident enterprises, the SAT released Announcement [2014] No. 38 on Reporting Overseas Investment and Income by Resident Enterprises, effective September 1, 2014. Resident enterprises are now required to report to the tax authorities direct or indirect equity holdings of 10% or more in foreign enterprises, as well as any change that causes the holding percentage to go above or below the 10% threshold. The report must be filed with the EIT prepayment declaration during the period in which the transaction occurs. The announcement aims to further regulate the information (form and content) resident enterprises must provide on overseas investments and income, so the Chinese tax authorities can access complete and systematic information to help them administer and collect EIT.

The SAT also released Caishui [2014] No. 75 and Announcement [2014] No. 64 concerning EIT policies on accelerated depreciation of fixed assets, effective retroactively to January 1, 2014.

It also issued the 2014 version of the EIT Annual Declaration Form, to be used by resident enterprises for their EIT annual declaration and settlement for tax year 2014.

Regarding non-resident enterprises, the SAT issued Announcement [2014] No. 24 on determining beneficial owner status under entrusted investment structures (i.e., investment in China by hiring services of a foreign individual or organization that formally invests on behalf of the non-resident).

The SAT also released Caishui [2014] No.79, under which, starting November 17, 2014, EIT exemption applies to qualified investors generating capital gains from domestic share transfers.

In addition, the SAT released Provisional Measures on Tax Administration on Non-Resident Enterprises Engaging in International Transportation Services (Announcement [2014] No.37), addressing EIT administration only. These international transportation services include transport of passengers, goods and mail into and out of Chinese domestic ports, using self-owned or rented ships, aircrafts and containers, as well as ancillary services, such as loading and unloading, and warehousing. Non-resident enterprises operating bareboat charter and dry-leasing aircrafts or renting containers fall outside the scope of these services. In addition to addressing tax registration issues, the measures also clarify that non-resident enterprises can benefit from the DTT related to their international transportation services' income, if applicable.

Regarding **individual income tax administration**, on December 7, 2014, the SAT released Announcement [2014] No. 67 on the Administrative Measures for Individual Income Tax on Capital Gains from Equity Transfer, effective January 1, 2015. The measures provide more comprehensive and clearer guidelines on capital gain tax relating to individuals transferring non-listed equity of entities established in China.

In 2014, **progress was made on the VAT pilot reform**, which was one of the most significant tax updates for 2012 and 2013. As part of the main new developments, Caishui [2014] No. 43 included telecommunication services under the scope of the VAT pilot reform effective June 1, 2014, classifying them into two categories: basic telecommunication services, subject to 11% VAT, and value-added telecommunication services, subject to 6% VAT. In addition, under Announcement [2014] No. 42 concerning several VAT issues related to international freight forwarding services, forwarders indirectly providing these services are eligible for VAT exemption. Due to the change in the scope of the VAT pilot reform in the past two years, the SAT issued Bulletin [2014] No. 11 on Administrative Measures for Applying the Tax Refund (exemption) for Taxable Services Subject to Zero VAT Rate and Announcement [2014] No. 49 on Administrative Measures for VAT Exemption on Crossborder Taxable Services; these replace the former measures.

Finally, on November 17, 2014, China initiated a **pilot program linking the Shanghai and Hong Kong stock exchanges**, providing many preferential tax treatments under Caishui [2014] No. 81.

## UPDATE ON LEGAL REGULATIONS 2014

In 2014, Chinese lawmakers enacted and amended a series of laws, regulations and rules in many areas, covering issues such as company registration, foreign direct investment, outbound investment, foreign exchange, IP and labor. This special edition briefly highlights the most noteworthy of these. Please see our monthly legal flashes for more information and analysis [here](#).

One of the most significant changes in 2014, from a corporate perspective, was the **Amendment to the Company Law of the People's Republic of China** by the Standing Committee of the National People's Congress approved on December 28, 2013 (the "Company Law Amendment"), effective March 1, 2014. The Company Law Amendment abolishes the requirements on minimum registered capital, unless established otherwise under laws regulating certain specific industries, and minimum ratio of cash contribution, as well as the statutory timeframe for capital contributions. This implies a reduction of financial burden on investors, who may now freely decide these issues by covering them in the articles of association. Given the trend of relaxing government supervision of corporate governance, companies are expecting more regulatory reforms in the coming year.

A series of other regulations were adapted last year and brought into line with the Company Law Amendment, mainly affecting the regime for company registration in China:

- The State Council amended a series of administrative regulations, including the Regulations of the People's Republic of China on Registration Administration of Companies and the Regulations on the Administration of Enterprise Legal Person Registration of the People's Republic of China, to reflect the major changes introduced by the Company Law Amendment. As the requirement for registering the paid-in capital is lifted, the capital verification report is no longer compulsory except in specific cases.
- The State Administration for Industry and Commerce ("SAIC") enacted the Administrative Provisions on the Registration of Enterprise Registered Capital, also effective March 1, 2014, removing the requirements for registering companies' paid-in capital, but requiring companies to specify the timeframe for capital contribution in their articles of association.
- As these changes also affect foreign-invested enterprises, other regulations, such as the Detailed Rules for the Implementation of the Law on Wholly Foreign-Owned Enterprises, the Detailed Rules for the Implementation of the Law on Equity Joint Ventures and the Detailed Rules for the Implementation of the Law on Cooperative Joint Ventures, have been partially amended. However, the ratio of registered capital to total investment applicable to foreign-invested enterprises is not affected by these law amendments.

Along with the Company Law Amendment, the annual check system for enterprises has been replaced with an online public annual report system, as established in the Provisional Regulations on Enterprise Information Disclosure issued by SAIC on August 7, 2014, and effective October 1, 2014. Enterprises must now submit their annual reports by June 30 of the following year and report, within 20 days, any major activities, including capital contribution, change in shareholding, receiving or modifying administrative licenses, and any administrative sanctions imposed.

On November 4, 2014, the National Development and Reform Commission ("NDRC") issued the **draft Amendment of the Foreign Investment Industrial Guidance Catalogue** ("Draft Catalogue"), introducing a series of amendments to one of the most important regulations in China's legal framework of foreign direct investment. The Draft Catalogue keeps its basic structure of dividing the industrial sectors for foreign investment into three categories: encouraged sectors, restricted sectors and prohibited sectors, and it also relaxes foreign investment restrictions in some areas:

- It includes new encouraged sectors, which are subject to approval and may benefit from special tax policies.

- It greatly reduces the restricted sectors and lifts the restriction on the foreign shareholding proportion of many of them, giving foreigners easier access to the service and manufacturing industries. For example, manufacturing of several chemical raw materials and chemical products are removed from the restricted sectors, so after the Draft Catalogue comes into force foreign investors will be able to run businesses in these sectors by setting up wholly foreign-owned enterprises.
- It reduces prohibited sectors, opening to foreign investment sectors that have long been closed, such as the processing of green tea and other special tea with traditional Chinese techniques.

The period for gathering public opinions on the Draft Catalogue is over. Whether it will be enacted in its current draft form remains to be seen.

Regulations were approved in 2014 to facilitate **overseas trade and investment** and relax current policies. The Administrative Measures for Verifying and Registering Outbound Investment Projects, which took effect on May 8, 2014, remove the requirement to secure NDRC approval and verification for most outbound investment projects, except for (i) major projects with a Chinese investment exceeding USD 1 billion and (ii) sensitive projects involving sensitive countries, regions and industries. Outbound investment projects that do not fall within these two categories are now only subject to a record-filing process with the applicable authorities. Effective October 6, 2014, the updated Administrative Measures for Outbound Investment set out the approval and record-filing procedures and applicable authorities for outbound investment projects, further defining the sensitive countries and industries subject to approval and simplifying the formalities of approval procedures in comparison with the former rules issued in 2009.

The State Administration of Foreign Exchange ("SAFE") issued the Notice on Relevant Issues Concerning Foreign Exchange Administration for Offshore Investment, Financing and Round-Trip Investment Undertaken by Domestic Residents via Special Purpose Vehicles ("SPV"), known as Circular 37, on July 14, 2014. Circular 37 updates SAFE's 2005 Circular 75 and broadens the definition of SPV to include the use of Chinese residents' domestic and overseas assets and interests to receive financing and carry out investments overseas. Circular 37 also simplifies the formalities for registering SPVs with SAFE branches.

In 2014, SAFE also enacted key **Provisions on Administering Foreign Exchange for Crossborder Guarantees**, effective June 1, 2014. These provisions establish a comprehensive legal framework and, for the first time, divide the crossborder transactions relating to crossborder guarantees into three categories: (1) overseas loans with domestic guarantees; (2) domestic loans with overseas guarantees; and (3) other forms of crossborder guarantees. They establish the filing and registration obligations of the different parties in the crossborder guarantees (lender, borrower and guarantor) at

different stages of the transaction; for example, when the parties enter the loan agreement with a guarantee or when the guarantor performs the guarantee obligation. Domestic institutions giving or accepting other forms of crossborder guarantees not identified as overseas loans with domestic guarantees or domestic loans with overseas guarantees can enter into guarantee contracts at their discretion, without going through formalities with governmental authorities.

The Standing Committee of Shanghai Municipal People's Congress enacted the **Provisions of China (Shanghai) Free Trade Zone ("FTZ")** on July 25, 2014, effective August 1, 2014, covering aspects such as the management system, investment opening-up, trade facilitation, financial services, taxation administration, comprehensive regulation, and the legal environment of FTZ, which are mostly introduced by the General Plan on FTZ issued by the State Council on September 27, 2013.

Aiming to regulate extensively China's booming **electronic commerce**, on January 26, 2014, SAIC published the Administrative Measures for Online Trading, effective March 15, 2014. The measures establish the operators' obligations to register with AIC and obtain business licenses to be displayed on their websites. They also limit unfair practices and ensure online consumers' rights to return purchases within seven days of receipt without giving a reason, in line with the new Law on the Protection of Consumer Rights published in 2013, and online consumers' rights to data protection. The measures also establish the supervising roles and obligations of third-party operators of online trading platforms, such as Taobao, Tmall and Amazon, as well as their non-compliance liabilities.

On November 4, 2014, China's International Economic and Trade Arbitration Commission ("CIETAC") issued its **new arbitration rules**, effective January 1, 2015. This is the first significant development since CIETAC's former Shanghai and Shenzhen sub-commissions declared their independence. In addition to reducing any ambiguities on the choice of arbitration institution following the split, their main update is the adoption of an emergency arbitrator procedure mechanism to keep in pace with other leading worldwide international arbitration institutions.

Finally, from a labor perspective, and as analyzed in our "Legal Flash - Special Edition 2013," the **first comprehensive rules standardizing labor dispatch activities in China** came into force on March 1, 2014. Other labor developments include the Supreme People's Court provisions on several issues concerning hearing administrative cases of work related injury insurance, which clarify several applicable concepts.

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