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Tax Updates Impacting on Sino-Spanish Businesses

CASA ASIA

SPEAKERS

Brígida Galbete
Tax Counsel

brigida.galbete@cuatrecasas.com

Conchi Bargalló
Senior Tax Associate

conchi.bargallo@cuatrecasas.com

Grace Lin
Senior Tax Associate

grace.lin@cuatrecasas.com

Ana Jorge
Tax Associate

ana.jorge@cuatrecasas.com

INTRODUCTION TO THE NEW TAX TREATY

- Signed in Madrid in 2018, after three years of negotiations.
- It does not cover wealth tax, but only income taxes.
- At present, it has not been officially published in China.
- It rests on the principles of the OECD – will China continue applying its old interpretations to the new tax treaty?
- Important changes for investors of the two countries:
    - Permanent establishment
    - Dividends
    - Other capital income
    - Associated companies
    - Anti-abuse rules
    - …

PERMANENT ESTABLISHMENT (ARTICLE 5)

CHINESE PRACTICAL CONSIDERATIONS ON THE PERMANENT ESTABLISHMENT

PERMANENT ESTABLISHMENT – CONSTRUCTION, INSTALLATION AND ASSEMBLY WORKS (ARTICLE 5)

- Definition: when a company tax resident in one state has a construction site or carries out installation and assembly works or projects in the other state for a period exceeding **12 months**.
- It is a fixed place of business that with 2 additional features:
  - Specific activity.
  - Duration > 12 months.

⚠ ANTI-ABUSE RULES ALREADY IN PLACE IN CHINA: **AVOID THE SPLITTING OF THE OVERALL PROJECT INTO SMALLER PROJECTS WITH DIFFERENT ASSOCIATED COMPANIES.**

- Connected supervisory activities excluded from the new DTA?

PERMANENT ESTABLISHMENT – SERVICES (ARTICLE 5)

- Definition: when a company tax resident in one state has its own personnel or other hired personnel carrying out tasks in the other state for a period exceeding **183 days** within any period of twelve months in relation to the same project.

- It is a specific type of permanent establishment proposed under the UN Model Tax Convention for developing countries.

ANTI-ABUSE RULES ALREADY IN PLACE IN CHINA: **CONCEPT OF CONNECTED PROJECT.**

25/01/2021 – 10/03/2021

10/03/2021 – 25/03/2021

01/04/2021- 12/06/2021

06/07/2021– 03/10/2021

01/11/2021 – 15/11/2021

PERMANENT ESTABLISHMENT – DEPENDENT AGENT (ARTICLE 5)

- Definition: a person acts in the one state on behalf or in the interest of a company tax resident in the other state.
- 4 features: substance approach in line with the changes undergone by the OECD Model Tax Convention:
  - The person habitually concludes contracts **or plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise**.
  - The contracts are:
    - in the name of the nonresident company; or
    - **for the transfer of the ownership the right to use property owned by the nonresident company or that it has the right to use; or**
    - **for the provision of services by that enterprise**.
  - Exclusion of auxiliary and preparatory activities.
  - Exclusion of independent agents.

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PERMANENT ESTABLISHMENT – EXCEPTIONS (ARTICLE 5)

- List of exclusions based on the preparatory or auxiliary nature of the activities carried out in the other state:
  - Activities preceding the start of the real effective activity, with a specific and limited duration.
  - Ancillary and support activities to the real effective activity, of little relevance in terms of resources.

- **Cohesive business approach** – anti-fragmentation approach based on the substance and economic coherence of the business as a whole (analysis of the factual and functional concurring features and possible supplemental nature):
  - the same company or a closely related company carries on business activities at the same place or at another place in the same state, and that place or other place constitutes a permanent establishment for either; or
  - the same company or a closely related company carries on business activities at the same place or at another place in the same state, and the overall activity resulting from the combination of the activities lacks preparatory or auxiliary nature.

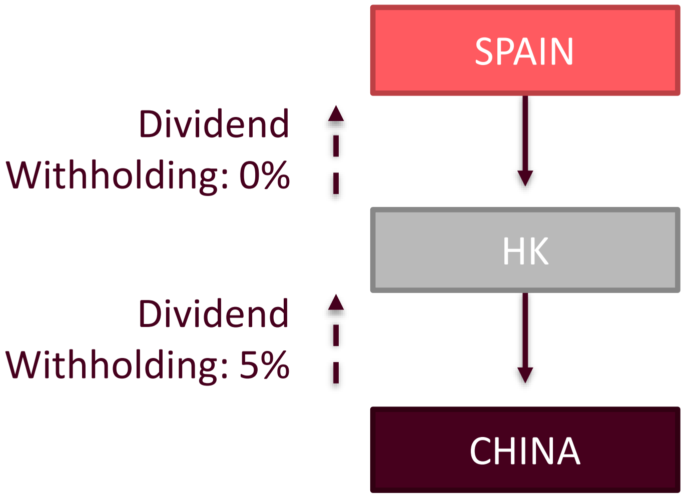
- Independent agent – **exclusions**:
  - If he or she acts exclusively or almost exclusively on behalf of one or more nonresident companies to which it is closely related.
  - Closely related concept liked to control (possession, directly or indirectly, of more than 50 per cent of the beneficial interest in the other).

DIVIDENDS (ARTICLE 10)

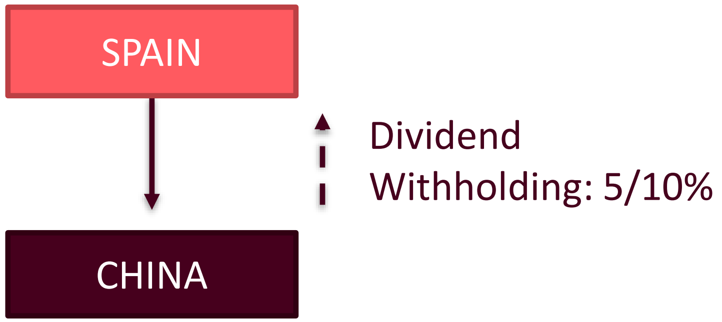
- Withholding tax on the dividend distribution has been reduced from 10% to 5% when:
  - The dividend recipient holds at least 25% of the company paying the dividends, for at least, 365 days prior to the dividend distribution; and
  - The dividend recipient is the "beneficial owner" of such dividends.

CHINESE CONCEPT OF "BENEFICIAL OWNER" – LIST OF NEGATIVE FACTORS
– SAFE HARBOR RULES
– "SAME COUNTRY" AND "SAME DTT" RULE

DIVIDENDS (ARTICLE 10)



Vs



Dividend “distributed” by the Chinese company	**EUR 1,000**
Dividend received by the HK company	EUR 950
Dividend received by the Spanish Company	EUR 950

Dividend “distributed” by the Chinese company	**EUR 1,000**
Dividend received by the Spanish Company	EUR 900 // 950

INTEREST (ARTICLE 11)

- As a rule, maximum taxation at source is capped to 10%.
- Interest paid in connection with the sale of commercial or scientific equipment on credit is exempt.

ROYALTIES (ARTICLE 12)

- As a rule, maximum taxation at source is capped to 10%.
- “Royalties” do no include any longer fees for the rental of industrial, commercial or scientific equipment.

PROTOCOL

- Limitation on withholding tax rates applies directly, and not by means of the procedure of collection and subsequent reimbursement.

THIS PROVISION IS NOT INCOMPATIBLE WITH THE ADMINISTRATIVE PROCEDURES IN CHINA FOR THE APPLICATION OF THE BENEFITS IN THE TAX TREATY.

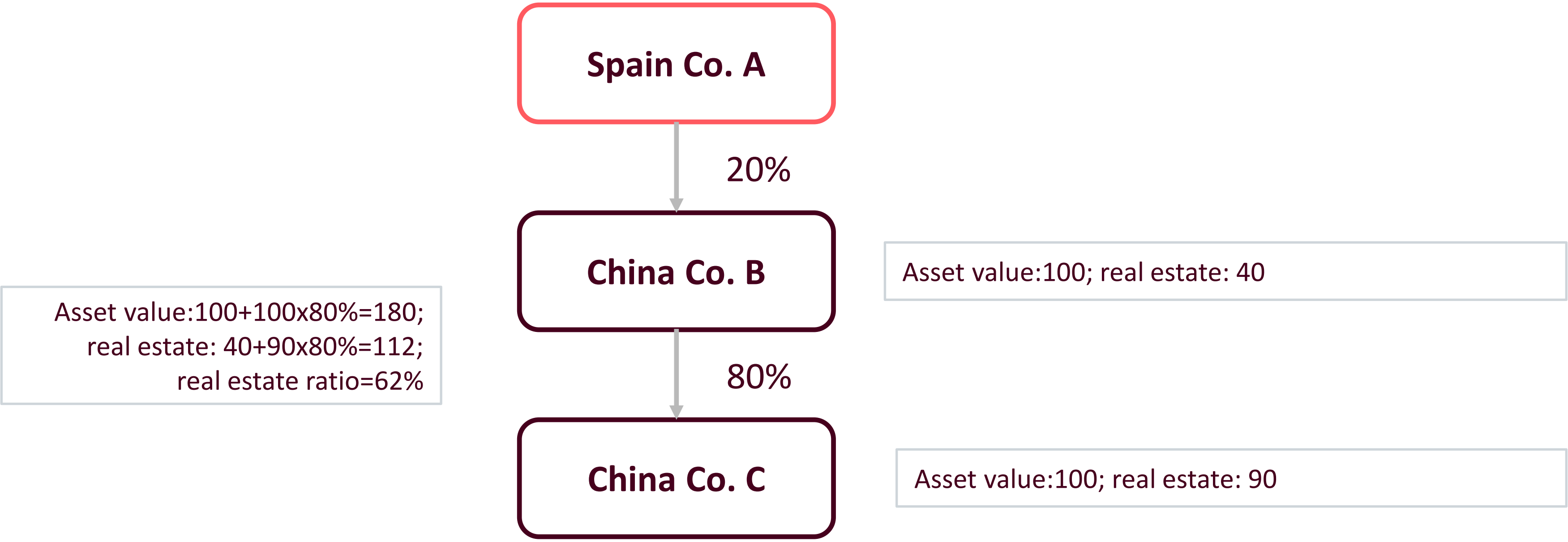
CAPITAL GAINS (ARTICLE 13)

- Transfer of real estate entities continue being taxed by the State where the properties are located.
    - Real estate entities are entities deriving more than 50% if their value directly or indirectly from immovable property situated in the other Contracting State (i.e. regardless of the percentage of stake that is being transferred and the tax residency of the real estate entity).
    - Immovable property used by a company for exercising its business will not be taken into account for the computation of the 50%.
- Transfer of substantial shareholdings (at least 25% stake, directly or indirectly) continue being taxed by the State of residence of the entity.
    - Inclusion of timeframe of the 365 days before the transfer and exclusion for listed entities in certain cases.

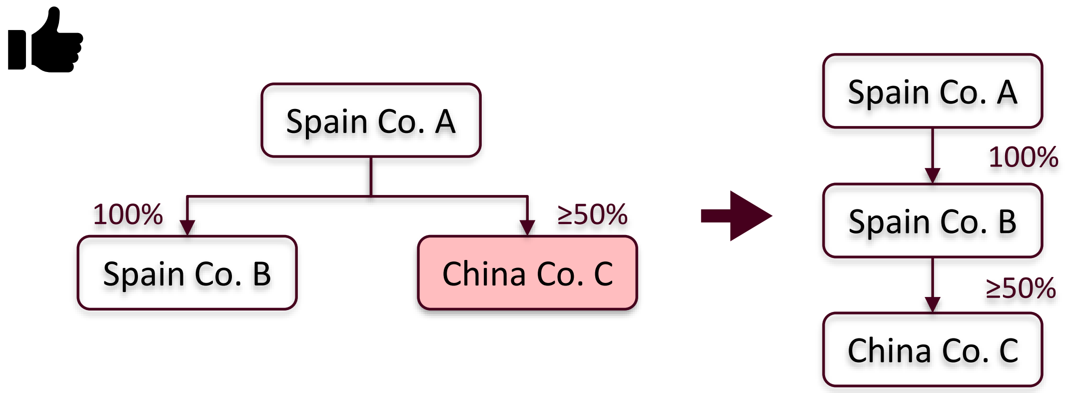
TAX DEFERRAL REGIMES IN CHINA AND SPAIN ON CROSSBORDER RESTRUCTURINGS

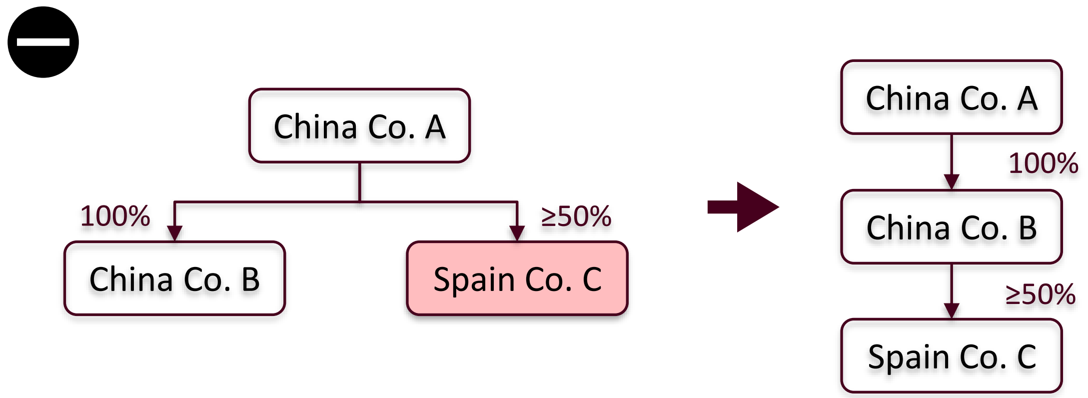
CAPITAL GAINS (ARTICLE 13)

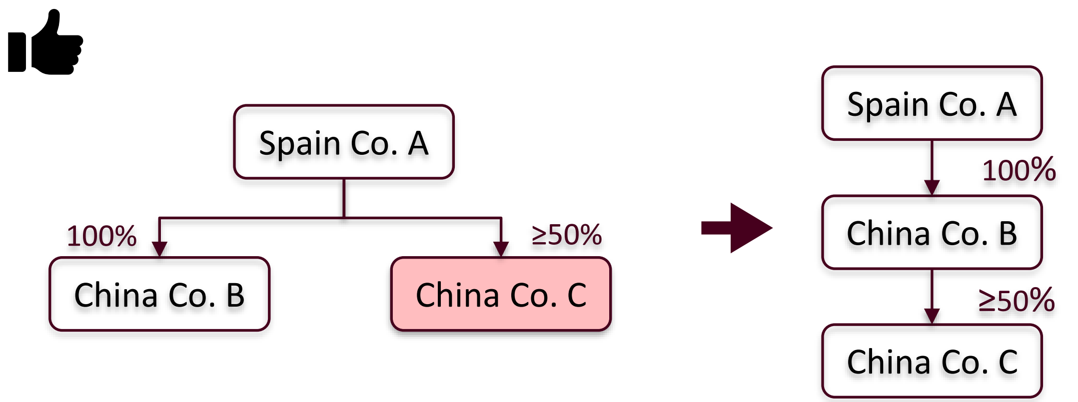
Chinese interpretation on the computation of the indirect holding

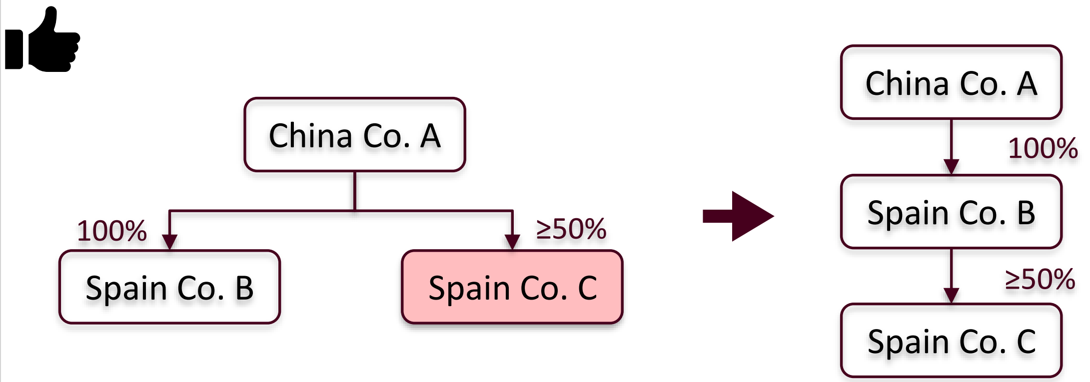


CAPITAL GAINS (ARTICLE 13) – Domestic special tax deferral regimes









ASSOCIATED ENTERPRISES (ARTICLE 9)

- General principle: arm's length conditions must govern dealings between associated companies.
- Practical effects:
  - upwards adjustments to profits are allowed; while
  - **correlated bilateral adjustments may be applicable on agreement between Spain and China**.

METHODS TO CORRECT DOUBLE TAXATION (ARTICLE 23)

› The exemption with progression method, as a mean of eliminating doble taxation for labor income, is replace by the ordinary credit method.

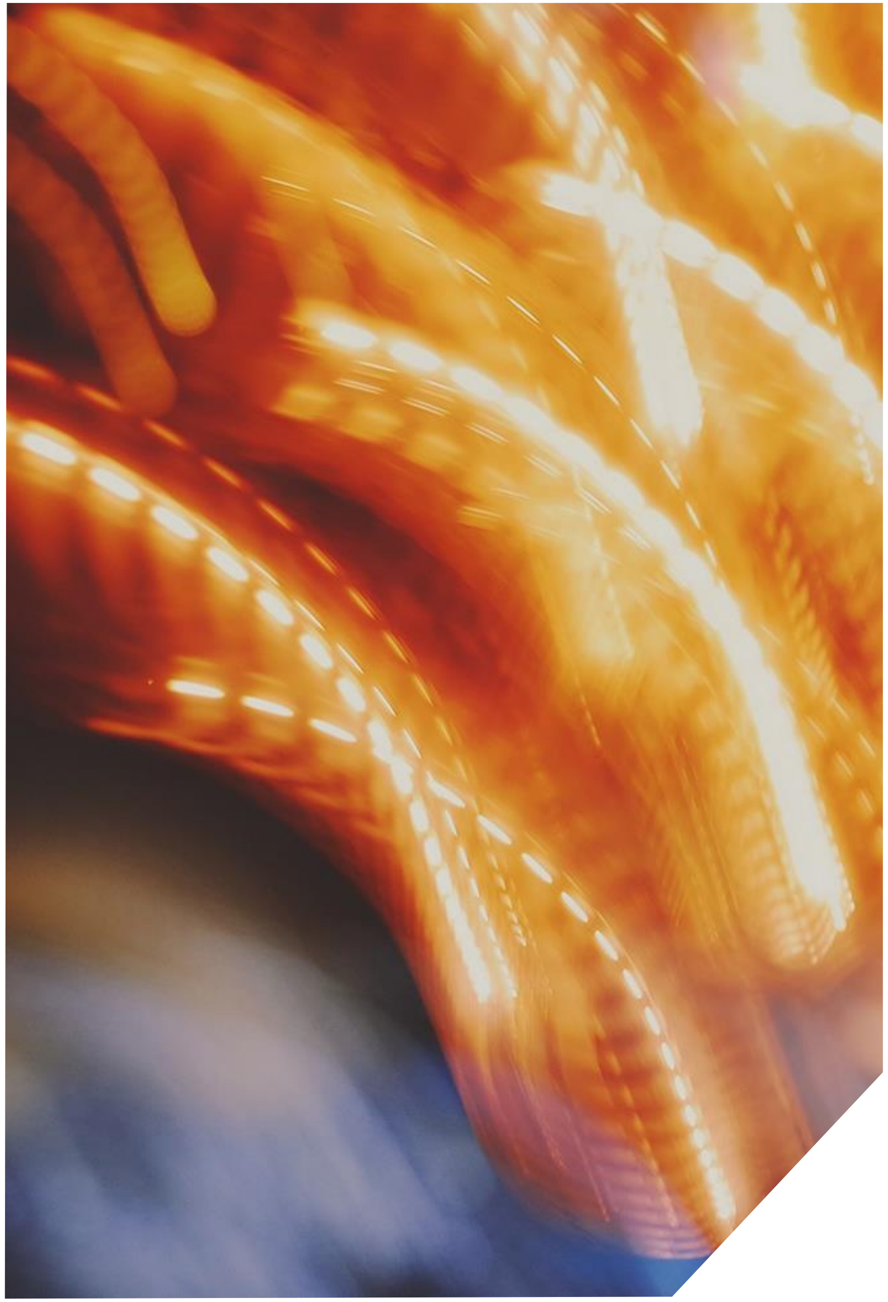
Progressive exemption	Limited tax credit
BEFORE	**CURRENTLY**
• The Chinese-sourced income that a Spanish tax resident obtains is subject to but exempt from taxation when the referred income was subject to taxation in China. • However, the overall income was considered in order to determine the applicable tax rate.	• Chinese taxes on Chinese-sourced income that a Spanish tax resident obtains may be credited against his/her Spanish tax liability by the lower of: i. The tax paid in China. ii. The Spanish income tax attributable to the Chinese-sourced income

ANTI-ABUSE RULES (ARTICLES 24 AND 25)

- Two supplementary measures to avoid treaty shopping and tax avoidance:
  - Denying **access to DTA benefits** for transactions carried out, primarily, to obtain such benefits.
  - Ensuring Spain's and China's right to apply their **domestic legislation** in preventing and assessing tax avoidance.

⚠ CHINESE ANTI-AVOIDANCE RULE OF THE INDIRECT TRANSFER OF ASSETS (SHARES) IN CHINA

CHINESE ANTI-AVOIDANCE RULES FOR INDIVIDUAL INCOME TAX



CHINA TAX UPDATES

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- **R&D expenses super deduction**
  - **Original policy:**
    - Companies' qualifying R&D expenses actually incurred during R&D activities are entitled to an additional 50% deduction before tax. If the R&D expenses are capitalized, the tax base for amortization of the resulting intangible assets is 150% of their cost.
    - **Negative list:** this policy does not apply to certain industries and activities.
  - **Update:**
    1. Until December 31, 2023, this percentage increases to 75% (or 175% for the amortization of intangible assets) for all qualifying companies.
    2. From January 1, 2021, this percentage increases to 100% (or 200% for the amortization of intangible assets) for **all manufacturing enterprises.**

- CONSISTENCY WITH TRANSFER PRICING POLICIES?

CHINA TAX UPDATES

› **VAT refund for advanced manufacturing industries**

- **Original policy:**

  i. From April 1, 2019, a VAT refund regime for domestic transactions was introduced, and taxpayers can claim a refund of un-deducted input VAT credits at 60%, provided they:

  - have incremental VAT credits above zero for six consecutive months (or for two consecutive quarters, if they declare VAT on a quarterly basis), and the incremental VAT credits in the sixth-month period is at least RMB 500,000;
  - have an A or B tax credit rating;
  - did not commit VAT fraud in the 36 months before the application;
  - were not penalized twice or more times for tax evasion in the 36 months before the application; and
  - have not benefitted from other VAT collection and refund policies since April 1, 2019.

CHINA TAX UPDATES

› **VAT refund for advanced manufacturing industries**

- **Original policy:**

   ii. From June 1, 2019, taxpayers in certain advanced manufacturing industries can benefit from the VAT refund policy without meeting the first condition mentioned above; also 60% was increased to 100%.

   iii. **Advanced manufacturing industries**: non-metallic mineral products, general equipment, special equipment, computers, communication devices, and other electronic equipment.

- **Update:**

   From April 1, 2021, **expanded scope** includes pharmaceutical, chemical fiber, railway, ships, aerospace and other transportation equipment, electrical machinery and equipment, and instruments.

CHINA TAX UPDATES

› **Cancellation of export VAT refund for iron and steel products**

- **Update:**

  i. From May 1, 2021, **146 types** of iron and steel products are cancelled of export VAT refund.

  ii. The affected products were granted with VAT refund rates of **13% and 10%.**

  iii. Following the cancellation, these exported iron and steel products will be treated as **domestic sales** by applying a 13% VAT rate.

  iv. This may be a **long-term policy**.

  v. Chinese exporters: renegotiate the export price.

  vi. Foreign buyers: take on the price increase or bear the VAT cost.

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Thank you!

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