

China and Barbados Sign DTT Protocol Amendment

By David Yu and Clare Lu

Since the PRC government and the government of Barbados signed a Double Taxation Treaty, effective 27 October 2000, Barbados has been one of the most popular locations through which foreign investors make indirect investments into the People's Republic of China. This is particularly true where the target company is a real estate enterprise or its major assets are real property. Choosing to form an intermediate holding company (or a special purpose vehicle) in Barbados has served as a cross-border tax planning solution for investors.

Along with the issuance and implementation of the new corporate income tax (the CIT) law on 10 February 2010, the PRC government and the government of Barbados signed *the Protocol for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (the Sino-Barbados Protocol). The Sino-Barbados Protocol took effect from 9 June 2010 and shall be enforced from 1 January 2011.

Effective Management Place

The Sino-Barbados Protocol adopts the concept of 'effective management place' as one of the criteria to determine tax resident status.

This change makes the definition of tax residence in the Sino-Barbados DTT consistent with that stated in the new CIT Law. In practice, enterprise investors usually set up SPVs in tax havens (such as Barbados) that have DTTs with the PRC so as to enjoy preferential tax treatment. However, despite being incorporated under the laws of Barbados, if none of an SPV's residence, headquarters or place of effective management is located in Barbados, this SPV is still unqualified as a tax resident of Barbados under the Sino-Barbados DTT.

Given the introduction of the general anti-avoidance rules and provisions for information exchange under the Sino-Barbados Protocol, we understand the risk of being denied Barbados tax residence status is

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ever greater. Also noteworthy is that, according to the new CIT Law and DTTs, if the Chinese tax bureau deems the place of effective management of the SPV to be in the PRC, the foreign investor might become tax residents of both the PRC and its country of incorporation. The Sino-Barbados DTT and Sino-Barbados Protocol stipulated that if there is any dispute regarding the dual tax residents of both the PRC and Barbados, the case should be presented to the competent authorities of both countries and be resolved by the mutual agreement.

Limiting Withholding Tax Preferential Treatment

In accordance with the Sino-Barbados Protocol, a Barbados beneficial owner can enjoy the preferential 5% PRC withholding tax (WHT) rate on dividends derived from a Chinese company only if it directly owns at least 25% of the total equity interests. In addition, the PRC government has the right to levy WHT upon capital gains derived by a Barbados tax resident from the disposal of shares of a Chinese company, if (i) the Barbados tax resident, at any time during the 12-month period preceding the date of share disposal, had a participation, directly or indirectly, of at least 25% in the capital of the Chinese company; or (ii) more than 50% of the value of the Chinese target company's equity interest is derived, directly or indirectly, from immovable property situated in the PRC.

The Sino-Barbados Protocol substantially alters how WHT is levied upon dividends and capital gains. The Sino-Barbados Protocol makes the levy of WHT on dividends and capital gains consistent with that under some other DTTs between the PRC and other countries (regions). Stated differently, there is no obvious advantage for foreign investors looking to derive income through dividends and share disposal to choose Barbados for their SPVs over other tax havens after the enforcement of the Sino-Barbados Protocol.

In fact, there are DTTs between China and other countries that contain provisions regarding dividends and capital gains similar to those under the pre-amendment Sino-Barbados DTT. However, investors should keep in mind that Chinese tax bureaus have tightened tax administration on non-PRC resident enterprises in various ways by reinforcing filing requirements and implementing anti-tax-avoidance inspections. In the meantime, the State Administration of Taxation has also begun to re-assess DTTs that were entered into by the PRC. In this regard, foreign investors should give serious and comprehensive consideration to the abovementioned factors when structuring PRC investments through an SPV.

Anti-avoidance Rules

The Sino-Barbados Protocol adds an anti-avoidance rule that allows both contracting states to apply their domestic tax regimes.

Based on the foregoing rule, the Chinese tax bureau can apply to its domestic tax regimes for anti-tax-evasion and anti-tax-avoidance purposes so long as it does not conflict with the Sino-Barbados DTT. We understand this amendment allows Chinese tax bureaus to utilise PRC anti-avoidance rules provided under the CIT Law and *Implementation Measures of Special Tax Adjustments (Trial Version)*.

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