

Beijing Municipal Office, SAT Clarifies the Work of Levying the Income Tax of QFIIs and RQFIIs

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The Ministry of Finance, the State Administration of Taxation and the China Securities Regulatory Commission promulgated <Notice on Temporarily Waiving Enterprise Income Tax on the Incomes Obtained by QFIIs and RQFIIs from Transferring Stocks and Other Equity Investment Assets within Mainland China > (Cai Shui [2014] No. 79) (the “No.79 Document”) on 31 October 2014, which stated that qualified foreign institutional investors (the “QFII”) and RMB qualified foreign institutional investors (the “RQFII”) shall be temporarily exempted from enterprise income tax on the incomes derived from transferring stocks and other equity investment assets within Mainland China from 17 November 2014. Such incomes obtained by QFIIs and RQFIIs before 17 November 2014 shall be subject to enterprise income tax in accordance with the law. The Beijing Municipal Office, SAT mapped out the details of the work plan (the “Special Levy Program”) for the work of levying the income tax of QFIIs and RQFIIs on the related conference (the “Beijing Conference”) held by Asset Management Association of China in February 2015. The contents of the conference include: the scope of the levy work of the income tax, the time requirement, the computation of the tax payable, the levy on the overdue fine, the preparation of the materials, the application for the treatment under tax treaties and the work plan arrangement of the competent tax bureau and authority, etc.

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The Introduction of the Basic Information of the Levy on QFIIs and RQFIIs Income Tax

The Law of the People’s Republic of China on Enterprise Income Tax classifies the payers of enterprise income tax into resident enterprises and non-resident enterprises.¹ In general, QFIIs and RQFIIs shall be clarified as non-resident enterprises which have not established agencies or offices in Mainland China under the Law of the People’s Republic of China on Enterprise Income Tax, which is due to the limitations set by the relevant laws and regulations that restrict the investment scope

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of QFIIs and RQFIIs to the investments in the securities secondary market in mainland China. Therefore, in practice, QFIIs and RQFIIs do not have to establish offices to do businesses, they can entrust relevant domestic custodian banks as the asset trustees as well as domestic securities firms to handle the domestic securities transaction in accordance to the law. For custodian banks and securities firms, being entrusted as the asset trustees and the agency to handle the domestic securities transaction is part of their usual business. Therefore, custodian banks and securities firms shall not be deemed as the dependent agents of QFIIs and foreign investors.

In addition, it is worth noting that No.79 Document directly clarifies that the exemption only applies to QFIIs and RQFIIs that have not set up any agencies, offices in Mainland China, or that only have agencies or offices in Mainland China which are not in effective relation to the aforesaid incomes obtained.

➤ The basis for the computation of QFIIs and RQFIIs income tax

The incomes of QFIIs and RQFIIs mainly include incomes on equity investment (generally as dividends and bonuses) and capital gains. For the income tax on the dividends and bonuses of QFIIs and RQFIIs, the Notice of the State Administration of Taxation on Relevant Issues Regarding the Withholding of Enterprise Income Tax on Dividends, Bonuses and Interests Paid by Chinese Resident Enterprises to QFII (Guo Shui Han [2009] No.47) further clarifies that incomes such as dividends, bonuses and interests obtained by QFII that are sourced from Mainland China shall pay the enterprise income tax at a rate of 10% in accordance with The Law of the People's Republic of China on Enterprise Income Tax. For the capital gains, since the relevant tax regulations and policies are ambiguous before the promulgation of the No.79 Document and launch of this Special Levy Program, QFIIs and RQFIIs have not been levied on capital gains tax in practice.²

➤ The application of tax treaties preferences

QFIIs and RQFIIs, as non-resident enterprises, can enjoy treatment under tax treaties according to Measures for the Administration of Non-Residents' Claim for Treat under the Tax Treaties (Trial) promulgated by the State Administration of Taxation. Furthermore, the Notice of the State Administration of Taxation on Relevant Issues Regarding the Withholding of Enterprise Income Tax on Dividends, Bonuses and Interests Paid by Chinese Resident Enterprises to QFII also states that any QFII obtaining incomes such as dividends, bonuses and interests that needs to enjoy the treatment under tax treaties may file an application to the competent tax bureau, the competent tax bureau shall implement the arrangement in accordance with the provisions of the tax treaties upon examining and verifying the application to be valid; the competent tax bureau shall promptly handle it if tax rebates are required.

The Introduction of this Special Levy Program

As stated on the Beijing Conference, the time range for the levy of the tax is from 17 November 2009, to 16 November 2014. The authorities that in charge of this Special Levy Program related to QFIIs and RQFIIs are municipal offices in Beijing, Shanghai and Shenzhen, SAT. For relevant QFIIs and RQFIIs, the competent tax bureaus are the district local SAT where their domestic custodian banks are located.

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➤ The scope of the levy work

The scope of this Special Levy Program covers the dividends and interests, the enterprise income tax of which have not been withheld, and gains derived from transferring of equity investment assets (mainly include A/B share stock (stock equity), fund, warrant, stock index futures, etc.). It is worth noting that the transfer of pure-debt investment assets (including the transfer of bonds and units of the securities investment funds that invest in bonds) is not within the scope of the levy work, and for the transfer of convertible bonds, only the shares after the conversion shall be deemed as equity investment assets. QFIIs and RQFIIs that have already been liquidated or nullified are not within the scope of the levy work.

➤ The way of the levy work

- Overdue fine: with regard to the dividends and interests, the enterprise income tax of which has not been withheld, overdue fine will be applied. With regard to tax payable derived from the transfer of equity investment assets, overdue fine will not be applied.
- Computation of the tax payable: dividends and interests and incomes derived from transferring of equity investment assets shall not be subject to the deduction of costs. With regard to incomes derived from transferring of equity investment assets, taxable income shall be deemed as earnings from each transaction, with the tax rates of 10%, and profits and losses in one transaction cannot be offset with those in another transaction.
- Tax treaties: this Beijing Conference further clarifies the subject that can enjoy treatment under tax treaties. With regard to income derived from equity investment, the place where QFIIs and RQFIIs are registered (not where their fund managers are located) shall be considered to judge whether the relevant tax treaties can be enjoyed or not. If QFIIs and RQFIIs apply to enjoy treatment under tax treaties, they shall finish filing and approval procedures in accordance with Measures for the Administration of Non-Residents' Claim for Treat under the Tax Treaties (Trial) and other regulations.

It is worth noting that, according to the conference, the Beijing Municipal Office, SAT will not separately promulgate other documents in terms of this Special Levy Program. The scope of the levy work, the retroactive period of the tax payable, overdue fine, the computation of the tax payable and treatment under tax treaties have been reached a consensus with the State Administration of Taxation. However, for the specific requirements of the filing procedures and other problems in practical operation, it is advisable for QFIIs and RQFIIs and other institutions to contact their competent local tax bureaus promptly.

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1. “Non-resident” include: 1) enterprises which are established according to the law of a foreign country (region) and whose actual management body is not in Mainland China, but which have established agencies or offices in Mainland China, or 2) enterprises which have not established agencies or offices in Mainland China but have income earned in Mainland China.
2. The only example published is that when Lehman Brother withdraw capital from Mainland in late 2010, Beijing Municipal Office, SAT levied on its capital gains. More details can be found from the website of http://www.ctaxnews.net.cn/html/2011-01/07/nw.D340100zgswb_20110107_4-02.htm.

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