Chapter 7

China Tax Treaty and Policy: Development and Updates

Tianlong Hu and Na Li

7.1. Introduction

China has risen as a key global economic development engine and player over the past three decades. One outgrowth of its great economic advances is China’s gradually escalating move from being a passive norm taker to being a driver of the discourse in various international arenas, such as China’s continual efforts in reforming its international tax policies and outreach. Since China concluded its first two tax treaties with Japan (1983) and the United States (1984), its tax treaty network has expanded to include 99 tax treaties (as of 30 June 2013), and two arrangements with its own special administrative regions, Hong Kong and Macau.

The Third Plenary Session of the Chinese Communist Party’s 18th Congress, held in November 2013, made fiscal and tax reforms a major focus of the country’s efforts to modernize its economy and construct a “rule of law” system. For instance China’s tax treaty framework is heavily coloured by different stages of development and various considerations of the Chinese economy. For the most part, China’s growth-friendly and revenue-oriented tax treaties serve to eliminate double taxation, redistribute tax revenues and guarantee economic benefits from the stance of a net capital importer state. Given the fiscal reform, international trade surplus and foreign direct investment (inbound and outbound) to and within China, the evolution of Chinese tax treaties over the past three decades reflects a few notable patterns.

First, Chinese tax treaties are characterized and inspired by the hybrid influence of the UN Model and Commentary thereon, the OECD Model and Commentary thereon and China’s indigenous features in terms of economic and political orientations. On one hand, China has concluded different specific tax treaty provisions with developed (typically OECD members) and developing countries (South American, African and Southeast Asian states). Even for different OECD member countries, China either designed

1. Sections 7.1 to 7.3.3 have been written by Tianlong Hu, while sections 7.3.4 to 7.5.2 have been written by Na Li.
or reserved certain provisions and adopted various approaches, especially in recent renegotiations; for example a resident of Mexico may not qualify for limitation on benefits-related treaty relief, while residents of other OECD member countries may. On the other hand, such hybrid influence goes beyond mere incorporation of model provisions. Many principles, guidelines and concepts borrowed therefrom have been embedded in treaty negotiation and practice.

Second, there emerges a general re-evaluation of China’s treaty position, given its emergence as a growing capital exporter rather than a mere capital receiver or importer. One driver of this change is China’s weighty foreign exchange reserves, which invites the use of conduits for Chinese capital to be reinvested in China via overseas investments. Another force is that enterprises controlled by Chinese capital go abroad to invest in a myriad of enticing acquisitions and profitable businesses, putting China at the front of international tax policy negotiations. In this regard, the majority of recent treaty renegotiations have removed the tax sparing clause and reduced the withholding tax rate on direct dividends, and this trend likely will continue.

Third, with China’s continuous reform in its system of tax law since 1994 – especially after China became a WTO member country in 2001 – and the enactment of the Enterprise Income Tax Law (EIT Law) in 2007, its tax treaties concluded thereafter exhibit striking differences from those agreed in the 1980s and 1990s. For example general anti-abuse rules; CFC rules; the abolition or removal of certain tax incentives; and tax holidays were all directly raised in recent tax treaty negotiations and implementations.

Fourth but not least, the evolution of tax treaties between OECD member countries and China witnesses a broader scope of source taxation, especially comparing those with non-OECD developing countries or countries with

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5. For example the recently concluded China-Netherlands tax treaty (effective as from 31 August 2014) incorporates relevant consideration into clauses on permanent establishments, dividends, interests and royalties, and capital gains on shares, which makes the Netherlands one of the most favourable holding jurisdictions for investments from and into China. Agreement between China and Netherlands on Avoidance of Double Taxation and Prevention of Fiscal Evasion With Respect to Taxes on Income (2013), Treaties IBFD.