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CHINA MARKET ACCESS UPDATE: CHINESE TAX AUTHORITIES CLARIFY TAX TREATMENT

DERIVATIVES AND TRADING

Further to our note earlier this week on Shanghai-Hong Kong Stock Connect (Stock Connect), the Chinese tax authorities[1] today issued two tax circulars clarifying the tax treatment of Stock Connect, QFII and RQFII.

STOCK CONNECT

It has been clarified that:

- an exemption from business tax and income tax on capital gains (CGT) applies to trading on Stock Connect (this is stated to be a temporary exemption, but no expiry date is provided);
- normal Chinese stamp duty is payable; and
- a 10 per cent dividend withholding tax will be applied.

This is a welcome clarification ahead of Monday's commencement of trading on Stock Connect.

QFII AND RQFII

The circulars also give a corresponding exemption from CGT in relation to equity securities and other equity investments under QFII and RQFII, effective from 17 November 2014.

However, the circulars also state that CGT will be levied on capital gains made on investments under QFII and RQFII prior to 17 November 2014:

- this is the strongest indication to date that any net gains generated on underliers in QFII and RQFII (before 17 November 2014) will be subject to CGT and that the Chinese tax authorities will seek collection; and
- any funds with historical net gains generated through QFII and RQFII may wish to consider the impact of this clarification on any relevant tax provisions in their existing swap documentation.

We are discussing this development with Chinese counsel and would be happy to assist any clients who may have questions on this.

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[1] The Ministry of Finance, the State Administration of Taxation and the China Securities Regulatory Commission

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