HAN KUN LAW OFFICES

Legal Commentary

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Tax Law

Release of Tax Policy on QFIIs, RQFIIs and Shanghai-Hong Kong Stock Connect Program

James WANG | Bing XUE | Ying XIA

In a long-awaited move to provide clarity to the capital gains tax for QFIIs and RQFIIs, the PRC Ministry of Finance, State Administration of Taxation and China Securities Regulatory Commission jointly released the *Circular on Issues Relating to Temporary Exemption of Enterprise Income Tax*(“**EIT**”)*on Gains from Transfer of Equity Investment Assets Obtained within China by QFIIs and RQFIIs*(Caishui [2014] No. 79, “**Circular 79**”)[1]along with the *Circular on Issues Relating to the Tax Policy of the Pilot Inter-connected Mechanism for Trading on the Shanghai and Hong Kong Stock Markets* (Caishui [2014] No. 81, “**Circular 81**”)[2] on November 14, 2014.Circular 79 and Circular 81 will become effective on November 17, 2014 when the Inter-connected Mechanism for Trading on the Shanghai Stock Market and the Hong Kong Stock Market (“**Shanghai-Hong Kong Stock Connect Program**”) is officially launched.

1. Tax Policy for Income Tax on Capital Gains Derived by QFIIs and RQFIIs

Since the beginning of the PRC qualified foreign institutional investors (“**QFIIs**”) regime in 2002,the PRC tax policy relating to the taxation of income from the transfer of equity investment assets (“**Capital Gains**”) derived by QFIIs has been unclear. The capital gains tax for RMB Qualified Foreign Institutional Investors (“**RQFIIs**”) program launched at the end of 2011 has similarly remained uncertain.

Circular 79 clarified the tax policy relating to the income tax of Capital Gains derived by QFIIs and RQFIIs.

(1) Temporary exemption of EIT: EIT will be temporarily exempt on income from the transfer of equity investment assets derived by QFIIs and RQFIIs within China on or after November 17, 2014.

[1]For the full text of Circular 79, please refer to: http://www.chinatax.gov.cn/n810341/n810755/c1305363/content.html.
[2]For the full text of Circular 81, please refer to: http://www.chinatax.gov.cn/n810341/n810755/c1305421/content.html.

(2) Temporal application of aforementioned exemption: Capital Gains derived by QFIIs and RQFIIs prior to November 17, 2014 should pay EIT according to law.

(3) Scope of aforementioned exemption: Circular 79 explicitly provides that the scope of the exemption is limited to QFIIs and RQFIIs that do not have an establishment or office in China, or that have an establishment or office in China but whose income is not connected with such establishment or office.

Given that Circular 79 takes the segmentation approach on the temporary exemption of EIT, which may pose a challenge to the potential tax adjustment on the profits previously distributed to foreign investors by QFIIs and RQFIIs, we suggest that QFIIs and RQFIIs confirm with the competent tax authority as soon as possible.

2. General Analysis of Tax Policy of Shanghai-Hong Kong Stock Connect Program

Regarding the tax policy relating to investments in shares listed on the Stock Exchange of Hong Kong Limited ("**HKEX**")conducted by mainland investors through Shanghai-Hong Kong Stock Connect Program and the investments in A-shares listed on the Shanghai Stock Exchange ("**SSE**") conducted by Hong Kong investors through Shanghai-Hong Kong Stock Connect Program, Circular 81 has made a systematic stipulation.

(1) Comparison of income tax policy for Shanghai-Hong Kong Stock Connect Program

Investor	Type of Income	Income Tax Policy	Note
Mainland Personal	Income arising from price difference of the transfer of shares listed on the HKEX	Individual income tax ("**IIT**") is exempt from November 17, 2014 through November 16, 2017.	
	Dividends arising from investments in shares listed on the HKEX (including dividends arising from the investments in the shares listed on the HKEX by mainland securities investment funds through Shanghai-Hong Kong Stock Connect Program)	Dividends of H-shares: H-shares companies should be liable to the 20% withholding IIT. Dividends of non H-shares: China Securities Depository and Clearing Co., Ltd. ("**CSDCC**") should be liable to the 20% withholding IIT.	H-shares companies shall submit applications to CSDCC for the mainland individual investors' booklet provided by CSDCC. Where withholding tax has been paid overseas, the individual investors may apply for a tax credit to the competent tax authority of CSDCC on the strength of valid evidence of such withholding tax.

Mainland Enterprise	Income arising from price difference of the transfer of shares listed on the HKEX	Income shall be counted as part of total taxable income to which EIT shall be applied according to law.	
	Dividends arising from the investments in shares listed on the HKEX	Dividends shall be counted as part of total taxable income to which EIT shall be applied according to law.	Where the mainland resident enterprise holds the H-shares continuously for more than 12 months, dividends arising from H-shares are exempt from EIT. H-share companies should not be liable to the withholding income tax on dividends. Instead, the mainland enterprise shall pay the tax itself. Where the income tax on dividends has been withheld by non H-share companies listed on the HKEX, the mainland enterprise may apply fora tax credit in accordance with law.
Hong Kong Investors (including enterprise and personal)	Income arising from price difference of the transfer of A-shares listed on the SSE	Income tax is temporarily exempt.	
	Dividends arising from the investments in A-shares listed on the SSE	Before Hong Kong Securities Clearing Company Limited. (“**HKSCC**”) can provide the detailed information (such as the identity of the investor, the holding period, etc.) to CSDCC, the listed companies should be liable to the 10% withholding income tax and make the withholding declaration to the competent tax authority.	Where the Hong Kong investor is a tax resident of another country and the tax treaty entered into between such other country and China provides for an income tax rate on dividends lower than 10%, the enterprise or the individual may directly or through the withholding obligor to apply to the competent tax authority for treaty benefit. After the examination and approval of the competent tax authority, the difference between the amount of tax paid and the amount calculated on the rate provided in the tax treaty should be refunded.

(2) Tax policy of business tax on stock trading through Shanghai-Hong Kong Stock Connect Program

- Business tax is temporally exempt on income arising from the price difference of trading A-shares listed on the SSE derived by Hong Kong investors (including entity and individual) through the Shanghai-Hong Kong Stock Connect Program.
- Business tax is temporally exempt on income arising from the price difference of trading shares listed on the HKEX derived by mainland individual investors through the Shanghai-Hong Kong Stock Connect Program.
- Business tax is exempt on income arising from the price difference of trading shares listed on the HKEX derived by mainland entity investors through the Shanghai-Hong Kong Stock Connect Program.

(3) The tax policy of the stamp duty on stock trading through Shanghai-Hong Kong Stock Connect Program

CSDCC and HKSCC may collect stamp duty on stock trading for each other.

- Where Hong Kong investors trade, inherit and gift A-shares listed on the SSE through the Shanghai-Hong Kong Stock Connect Program, the stamp duty on security (stock) trading shall be paid according to currently effective mainland tax laws and regulations.
- Where mainland investors trade, inherit and gift shares listed on the HKEX through the Shanghai-Hong Kong Stock Connect Program, the stamp duty shall be paid according to currently effective Hong Kong tax laws and regulations.

The release and implementation of the tax policy on QFIIs, RQFIIs and the Shanghai-Hong Kong Stock Connect Program is a significant milestone for the opening-up of China's capital market. We will continue to closely observe and study issues during the implementation of the relevant rules and share with you our latest viewpoints in a timely manner.

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Important Announcement

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If you have any questions regarding this publication, please contact **James WANG** (**+86-10-8525 5553; james.wang@hankunlaw.com**) or **Bing XUE(+86-755-3680 6568; bing.xue@hankunlaw.com).**