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China's evolving tax treaty network

In brief

- China has recently accelerated its tax treaty development by concluding four new treaties — two new ones with Argentina and Gabon and two amendments on the existing treaties with Austria and Italy.
- This article examines key provisions and unique aspects of these treaties, highlighting their potential implications for cross-border taxation and investment.

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In detail

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Recent tax treaties with four countries

In recent months, China has expanded its tax treaty network with four significant developments: the conclusion of two new tax treaties (with Argentina and Gabon), the amendment of an existing treaty (with Austria), and the replacement of a prior treaty (with Italy). Their status, the date of effectiveness and the date governing the affected income are outlined below.

Nations	New treaty	Amendment	Replacement	Effective / affected income
Argentina	•			26 Nov. 24 / 1 Jan. 25
Gabon	•			13 Oct. 24 / 1 Jan. 25
Austria		•		19 Nov. 24 / 1 Jan. 25
Italy			•	19 Feb. 25 / 1 Jan. 26

This article examines the key features of these updates, highlighting special clauses and noteworthy changes that may impact cross-border taxation and investment. Notably, these treaties reflect China's tailored approach to bilateral economic relationships, incorporating provisions that address unique trade and investment dynamics. The table below summarizes some distinctive provisions under these treaties.

Treaty nation	Key features
Argentina	• **Residence:** The "*Persons Covered*" article in this treaty explicitly includes fiscally transparent entities or arrangements, demonstrating China's alignment with international standards as reflected in the OECD Model Tax Convention (2017) and the BEPS Action Plan recommendations. This provision also appears consistently in China's recent treaty updates, particularly in the amended treaty with Austria and the replaced treaty with Italy (see further comments next page). • **Permanent establishment (PE):** The treaty adopts a distinctive approach to construction PEs that combines both leniency and stringency: Its PE scope is much narrower – covering "*a building site, or construction or installation projects*" but notably excludes "*assembly or supervisory activities*" which are commonly targeted in most tax treaties. Yet this leniency is met with a shorter PE threshold, six months (vs. the more common twelve months). • **Dividends | royalties | capital gain:** It provides multiple tax rates for dividends (5% / 10% / 15%), royalties (3% / 5% / 7% / 10%) and capital gain (5% / 10% / 15%). Interestingly, its "*Royalties*" article covers only the usage of containers but not as general as "*equipment*". Such a practice is getting uncommon nowadays. • **Interests:** It offers a broad exemption scope (interests owed to commercial debt, long-term loans, or the government, central bank, or state-owned entities).
Gabon	• **Dividends:** It provides a specific withholding tax (WHT) exemption to dividends paid to China-Africa Development Fund; otherwise 5% WHT applies to other cases. • **Interests:** It provides tax exemption on loan interests paid to the government, central bank, or state-owned financial institutions, and interests due to loans guaranteed or insured by these entities; otherwise, the 10% rate applies. • **Royalties:** The treaty establishes a bifurcated approach to royalties taxation with two WHT rates. The 7.5% rate is for conventional proprietary assets such as copyrights, patents, trademarks and information, etc. However, it has a 5% rate for an atypical inclusion of payments related to "*studies, technical, financial, accounting, or tax support*", which normally constitute service fees rather than royalties. • **Capital gain:** It has excluded capital gain tax – unless the shares in concern are property-based, i.e. their major value derives from immovable property.

Treaty nation	Key features
Austria *(amended)*	This is an amendment to the tax treaty concluded in 1991 and has introduced the following changes: • **Residents:** Similar to the China-Argentina tax treaty, its "*Covered Persons*" article covers also fiscally transparent entities and arrangements. • **PE:** It has raised the PE threshold for building and construction projects from six (6) months to twelve (12) months. • **Dividends:** It has lowered the WHT rates for dividends from 7% to 5% for dividends paid to government bodies or major shareholders. • **Interests:** It adds WHT exemption for interest on government loans and specific credit sales.
Italy *(replaced)*	The new version will replace the tax treaty concluded in 1986, effective from 1 January 2026, fostering a more robust and equitable tax relationship, and adherence to the latest global tax principles. • **Residents:** Similar to the China-Argentina tax treaty, its "*Covered Persons*" article covers also fiscally transparent entities and arrangements. • **PE:** It has raised the PE threshold for building, construction, assembly and installation projects to twelve (12) months, and to 183 days for services. • **Interests:** It provides three WHT rates (0%, 8% and 10%). In particular, exemption applies to interest payable by the government or authorities to the other state's government, authorities, central bank, public institutions, or wholly state-owned entities, and bonds issued by specific Italian financial institutions to Chinese residents. • **Royalties:** It introduced the "*adjusted amount*" mechanism when applying the 10% WTH rate on the usage of industrial, commercial and scientific equipment, being 50% of the royalties - this effectively brings the WTH rate down to 5%. • **Anti-treaty abuse:** It includes a principal purpose test (PPT) - if obtaining treaty benefits is one of the main purposes, the tax benefits can be denied.

The table below provides a snapshot of the tax rates under the four tax treaties for the passive income:

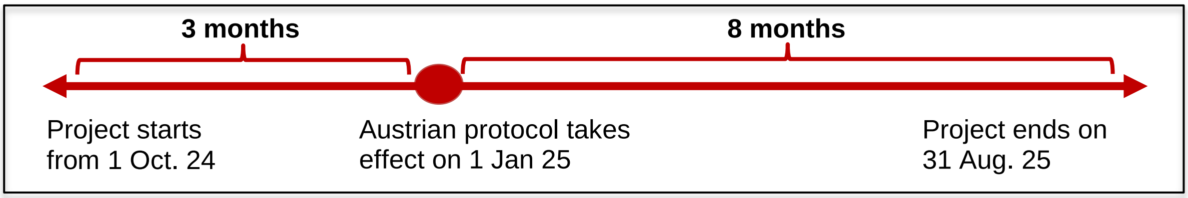
Treaty nation	Dividends	Interests	Royalties	Capital gain
Argentina	5% | 10% | 15%	0% | 12%	3% | 5% | 7% | 10%	5% | 10% | 15% or local rate for immovable property-based shares
Gabon	0% | 5%	0% | 10%	5% | 7.5%	0% (except immovable property-based shares)
Austria *(amended)*	5% (reduced from 7%) | 10%	10% (no change) | Exemption scope expanded	10% (no change)	No changes
Italy *(replaced)*	5% | 10% (10% previously)	0% | 8% | 10% (0% & 10% previously)	10% (equipment at 50% value)	Exclude exemption for transfer of immovable property-based shares

2 Impact of extended PE threshold

The amended China-Austria tax treaty and the replaced China-Italy tax treaty have extended the construction PE threshold from six months to twelve months for projects. However, this relaxation does not automatically benefit all projects, particularly those already underway. Below are two illustrative scenarios demonstrating how the amended China-Austria tax treaty may impact whether a PE is triggered.

a) No PE constituted

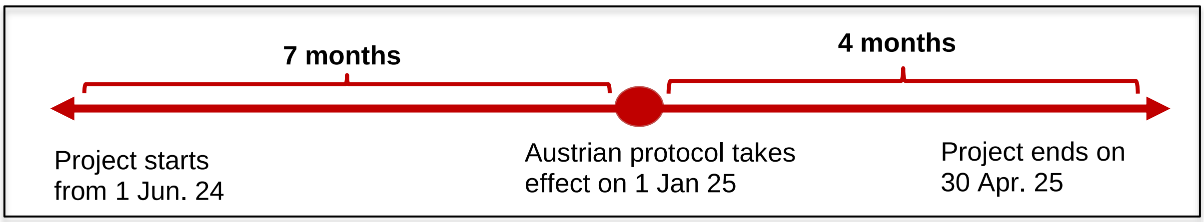
One scenario could be that no PE is triggered if benefiting from the amended version of the China-Austrian tax treaty. As shown in the following time chart, an Austrian company runs a construction site in China for eleven months, from 1 October 2024 to 31 August 2025.



Given the fact that the whole project lasts for eleven months, it should have constituted a PE under the rule (six-month PE threshold). However, based on the new PE threshold (twelve-month), it still has not constituted a PE as its entire duration is under the twelve-month PE threshold. China's typical treaty practice favors the newer standard for projects continuing after amendment

b) PE constituted

However, in another scenario, a PE could still be constituted under the revised treaty. Like the example below, an Austrian company operates a construction project in China for eleven months, running from 1 June 2024 to 31 April 2025.



Even though the project's duration has fallen below twelve months, the pre-2025 work period has exceeded six months before the new rule is in force. The Chinese tax authorities may reasonably assert that a PE was established during the pre-2025 period.

WTS China's observation

China's recent tax treaties with Argentina, Gabon, Austria and Italy reflect a strategic approach to strengthening international tax relations, enhancing cross-border investments, and promoting global tax compliance. Each treaty is tailored to the specific economic and bilateral needs of the contracting states, while also aligning with the latest global standards, such as the OECD's BEPS framework.

These agreements not only aim to resolve existing tax challenges but also set the stage for more dynamic, tax-efficient cross-border relationships between China and the respective countries, fostering trade, investment, and long-term cooperation.

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