中國稅務及投資顧問有限公司
China Tax & Investment Consultants Ltd

International Taxation in China (I)

Alfred Chan
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Part I

Case: Tax on Dividends

<Legal structure – I>

FDI to China

Comparing:

1. BVI Co.
2. Hong Kong Co.
3. Mauritius Co.
4. Singapore Co.
5. Canadian Co.

Domestic tax rules in host country

- Distribution of dividend by FIE / FICE in host country :

  Dividend is exempt from PRC Income Tax before 2008.1.1; dividend payment is taxable on 2008.1.1 and thereafter.

Domestic tax rules in home country - (I)

- Different tax implications in the home countries:

  (a) No liability for tax
  (b) Tax exemption（Unilateral or bilateral）
  (c) Tax on receipt basis
  (d) Tax on as-earned basis

Domestic tax rules in home country (II)

Dividend not taxable	BVI / Hong Kong	
Taxable	Singapore, Taiwan, Canada	Taxed upon receipt
	Canada	Taxed on as earned basis
Tax-exempt	Singapore, Canada	Exempt or spared under DTA

Singapore (domestic rules)

➢ In general, foreign source income is taxed if received in Singapore; [Section 10(1), SITA]

➢ Offshore dividend Income received in Singapore is taxable but it is specifically exempted under domestic Income Tax Act. [Section 13(8), SITA]

Singapore (Bilateral rules)

➢Direct credit: Tax credit for Chinese tax paid on income derived from China

➢ Indirect credit: If ownership in FIE =>10%, tax credit on dividend income shall include Chinese tax paid on profits, out of which dividend is paid.

Tax residents are eligible for tax credits.

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Tax policy of foreign dividends in Singapore

➢Difference between tax credit and tax exemption

➢ Tax exemption can reduce the taxable income of the Singapore holding co. (it can keep the tax loss bought forward). Tax credit cannot reduce the amount of taxable income of the holding company; dividend income will use up carried forward tax loss.

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(1) Foreign tax credit

	PRC Corporate Income Tax Return (extracts)	RMB	Reference
	Foreign Dividend Income	2000	Row 9
	Less: Expenses	-100	
	Taxable income	1900	
	Less: Loss brought forward from previous years	-1100	Row 24
	Taxable income after offsetting loss	800	Row 25
	Tax at 25%		
	Income tax payable	200	
	Less: foreign tax credit	-200	Row 32

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(2) Foreign income tax exemption

	PRC Corporate Income Tax Return (extracts)	RMB	Reference
	Foreign Dividend Income	2000	Row 9
	Less: Expenses	-100	
	Taxable income b/4 adjustment	1900	
	Less: Exempt income	-2000	Row 17
	Less: Loss brought forward from previous years		Row 24; N/A as Company incurs loss for current year
	Taxable income after offsetting loss, if any	-100	
	Tax at 25%		
	Income tax payable	0	
	Less: foreign tax credit	0	

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Mauritius

➢ GBL1 Company: Dividend taxed at 15%, but with a 80% unilateral tax credit (effectively taxed at 3%)

➢ GBL2 Company: not liable to tax (GBL2 Co not eligible for DTA benefits

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Canada (DTA)

- Dividend distributed by treaty country Co (FIE in China) is taxed at 10%, if Canadian tax residents own more than 10% equity in FIE. Indirect credit also available.

Canada (Domestic rules)

- Dividend distributed by Non-treaty country Co.

1. Taxed on receipt basis if foreign subsidiary earns active income

2. Taxed on as-earned basis if foreign subsidiary earns passive income

Hong Kong

- Excluded from profit tax: (i) Dividend distributed by HK Company; (ii) Profit derived from outside HK.

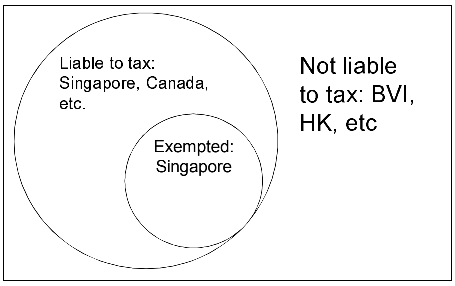
- HK tax system does not adopt residence principle, except for taxation on shipping and air service income.

BVI

- BVI law imposes no tax on income received outside BVI

- BVI Co. has no power to carry on business with BVI residents, and own any property situated in BVI, except for office used as legal address.

Dividends liable to tax and not liable to tax



Tip: Consult DTA or domestic rules to determine whether or not it is liable to tax, or exempt from tax.

The position of the PRC State Administration of Taxation (SAT)

- New DTA with Singapore concluded and came into effect on 2009.

- The interpretation of the China-Singapore DTA shall apply to interpretation of all DTA's China concludes with other countries. See SAT circular Guo Shui Fa (2010) No. 75.

Exemption of foreign source dividends in Singapore (I)

➢ The dividend is exempted from tax under domestic rules in host country, and given tax sparing credit under the DTA.

➢Upon receipt of dividends in Singapore, the tax obligation arising (foreign income) is specifically exempted under S13(8), SITA. [taxed and exempted)

Foreign dividends: Singapore & HK (1)

➢ Singapore imposes income tax on foreign income. PRC tax authority will not challenge its claim for benefit under DTA

➢ However, SAT circular [2009] 698 imposes additional filing requirement for jurisdictions that does not tax foreign income. (i.e.HK)

Foreign dividends: Singapore & HK (2)

➢Hong Kong Companies Ordinance does not impose residence requirements for directors.

➢It is different from that under Singapore Company Act.

Exemption of foreign source dividends in other tax jurisdictions

➢Mauritius adopts similar tax policies as Singapore in respect of foreign dividend income.

Classification of Tax Jurisdictions

I.	Tax heaven Co.	Cannot sign DTA	BVI, Seychelles
II.	Semi-tax heaven Co.	Can sign DTA (in part)	HK *, Mauritius (GBL2 Co)
III.	Non-tax heaven Co.	Can sign CDTA	Singapore, Canada, Mauritius

* HK is signing CDTA in recent years. But the substance for CDTA is absent.

Comparison: tax heaven Co and non-tax heaven Co

	Tax heaven Co.	Semi-tax heaven Co.	Non-tax heaven Co.
Residence jurisdiction	No	No (with exception)	Yes
Source jurisdiction	Yes / No (Some impose no tax)	Yes	Yes
CDTA	No	Yes (in part)	Yes

Case: Profit repatriation

- How it arises?
- What is the solution?

Balance Sheet

Year 1	Fixed asset	100	Capital	100
Year 10	Fixed Asset	100	Capital	**100**
	Cash	**100**	Profit	100
	Cum. Depr'n	-100	Profit	-100

Balance Sheet

10 Years ago	Fixed Asset	100	Capital	100
Now	Cash	100	Capital	100

Possible Solutions

1. Winding up the FIE
2. Capital reduction
3. Foreign investor's right to get back investment from before-tax profit in CJV; Condition: transfer ownership of contributed assets upon the expiry of CJV agreement <Article 21, CJV Law>

Part II
Taxation on royalty
<Legal structure – II>

Case 2 - Computations

Suppose that the WFOE in Shanghai is to pay a license fee of 100 to US Company, the computation of WIT and business tax will be as follows (IT & BT rate is 10% and 5% respectively):

Business Tax : 100 x 5% = 5

Withholding Income Tax : 100 x 10% = 10

Total tax will be = (BT + IT) = 5 + 10 = 15

IP Transactions

- Transfer technology to China, and / or licensing technology to China;
- Providing technical services in China;

Transfer of technology

- Scope of technology?
- Business profit or royalty: tax on activities vs. properties?
- IT, VAT, BT and customs duty implications

PRC VAT and BT rules

	VAT	BT
Sale of goods in China	Yes, except …	
Importation of goods to China	Yes	
Transfer of intangible assets		Yes
Provision of taxable services		Yes, except…

Transfer under sale agreement

1. No tax on outward payment (Given seller has no PE in China)
2. Import duty and VAT

Royalties paid for imported goods are taxable?

- Royalties paid for the sale of imported goods are subject to duty and VAT;

Exemption:

- Royalties paid for the importation of goods on the list of national high-tech products are not subject to duty and VAT [See Caishuizi (1999) 273]

Import duty & VAT Exemption (continued)

- FIE imports equipment and technology to make goods on <list of national hi-tech products> Caishuizi (1999) 273
- Recognized software enterprise importing equipment and software for own use. Guofa (2000) 18

Import duty and VAT liability

- Software for data process: excluded from dutiable value if priced and used separately from imported goods;
- Software licensing: included in dutiable value if related to imported goods, or as a condition for sales in China;

See order (2006) 148, General Administration of Customs

Transfer under royalty agreement

- 7% (HK Co) WIT on payment, (10% for residents of other treaty countries)
- 5% BT

Exempted from BT?

- Royalties received by FE for the transfer of patent and non-patent technology (not for trademark) are exempted from BT.
- Exemption includes technical consulting and services fee if they are provided in technology transfer contract and billed on same invoices as technology transfer.
- See Cai Shui Zi (1999) 273

- Technical services or licensing?
- business profits and royalties implications: (I) tax on net income or tax on gross income; (ii) foreign service provider (recipient) has PE or no PE in China?

Part III

Tax on Capital Gains

<Legal structure – III>

Gain on disposal of properties

- Income tax computation on net basis
- Type of deductible taxes & expenses
- Stamp tax
- Land appreciation tax
- Exemption of capital gain under DTA: conditions?

China - Singapore DTA

Gain on disposal of shares in PRC Co

- Jurisdiction: Who imposes the tax?
- 2 tests are adopted: land-rich test and percentage of foreign equity test.
- Computation: How do they do it?
- Taxed on net basis

China - Singapore DTA

Jurisdiction to tax capital gains:

1. Gain from disposal of shares in Chinese resident company, if recipient holds >25% equity during the 12-month period preceding the alienation, may also be taxed in China; Or
2. Gain from disposal of shares(equity interest) in company that derives >50% of their value from immovable property situated in China, may be taxed in China.

Comparison

	Dividend taxed in host country	Capital gain taxed in host country
Foreign ownership over 25%	at reduced rate	Taxed
Foreign ownership =< 25%	at higher rate	Exempt *

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The End

alfred@china-tax.net