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

Corporate structure, fund repatriation & management relocation

2008 PRC CIT Law

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Agenda:

1.Legal and tax rules

2.Change in scope of resident enterprise;

3.Re-location of top management;

4.Repatriation of funds;

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Company vs. enterprise

■What are the similarities and differences in the legal definition?

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Development of relevant PRC law and regulations

1.PRC Company Law (Amended in 2005 and effective on 2006.1.1.);

2.PRC Accounting Standards (Effective 2007.1.1)

3.PRC CIT Law and Implementation Regulations (Effective 2008.1.1)

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International (regional) Agreements

1.The DTA between HKSAR government and the PRC Central government (New DTA) came into force on 1st January 2007;

2.The DTA between China and Singapore (New DTA) came into force on 1st January 2008;

3.OECD Model Treaty Convention

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Resident and non-resident enterprises

➢ Resident enterprises shall pay tax on worldwide income.

➢Non-resident enterprises shall pay tax on PRC-source income

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Change in income tax rate

1.FIE (resident taxpayer): at 25%.

2.Non-resident taxpayers that have PE in China will be taxed at 25% on PRC-source income.

3.Non-resident taxpayers that do not have PE in China will be taxed at 20% on PRC-source income (as reduced to 10% under art. 91 of Implementation Reg).

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Change in the scope of resident company

1.Previously, companies created outside China will not be treated as resident company.

2.New EIT law not only considers the place of incorporation, but also considers the place of the actual management.

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Legal rules	Old tax law	New tax Law
1. Country of incorporation 2. Place of actual management	Both rule 1 AND 2 must be met to become a resident enterprise	Either rule 1 OR rule 2 will suffice

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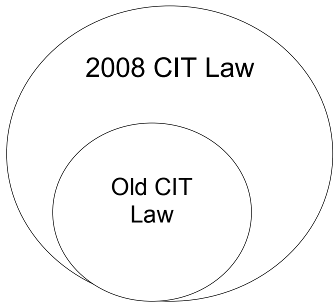
Scope of resident company



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Place of actual management?

■ Establishment that maintains overall control and management over production & business operation, personnel function, financial function, and properties of the Foreign Enterprises

* Article 4 of Implementation Regulations

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Possible examples of place of actual management

- Representative office

- Factory set up under export processing agreement

- Partnership (sole proprietorship) created outside China

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Scope of resident enterprise

- Including some non-legal person (partnerships, sole proprietorships) created outside China
- Excluding all non-legal persons created in China

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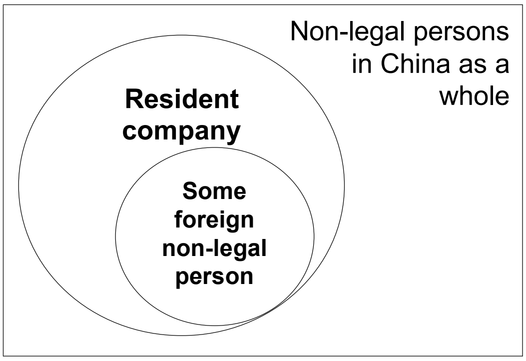

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Implications of being a resident enterprise

Obligations: taxation on worldwide income

Rights: Benefits under DTA including (i) tax credits; (ii) protection against discriminatory taxation; (iii) tax sparing credit

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Double taxation & non-taxation

	Country A	Country B
➢Place of incorporation	Y	
➢Place of actual management		Y

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International practices

- Residence jurisdiction: nexus between country and the person earning the income, irrespective of where the income is earned;
- Source jurisdiction: nexus between country and the activities generating the income, irrespective of the residence of the person

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Taxation on non-resident enterprises

- Foreign Co with PE (2 types)
- Foreign Co with no PE

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Tax on non-resident

Foreign Co with PE in China?	PRC source income	Foreign source income
1. Yes, if income is effectively connected with PE	Taxable	Taxable
2. Yes, if income is not e.c.w. PE	Taxable	Not
3. No PE	Taxable	Not

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"Effectively Connected"?

- Establishment owns equity interest or debt claim giving rise to income;
- Establishment owns, manages, controls properties giving rise to income.

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Permanent establishment

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What constitutes a PE?

- Establishment or place of business (机构、场所)
- Presence of employee (183 days)
- Agent appointed to conclude contract, or accept orders

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Establishment or place of biz

1. Management establishment, business establishment or an office;
2. Factory, farm, or place of extraction of natural resources;
3. Place where services are provided;
4. Place where a project of construction, installation, assembly, repair, exploration, etc is carried out;
5. Other establishments or places of business where production and business operations are carried out.

As per Art. 5 of Implementation Reg.

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Permanent establishment

- Taxable vs. non-taxable activities
- Domestic rules vs. treaty rules
- Computation methods

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	Permanent establishment (Domestic rules)	Exceptions: activities not constituting PE (Tax Treaty)
1.	Establishment or fixed place of business in China	The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery
2.	Presence of employee in China	Not exceeding 183 days continuously or cumulatively in any 12-month period
3.	Dependent agent in China	The agent's activities in the fixed place of business are confined to that of item 1 above

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Legal form and bases of computation

- FIE: tax on net income (resident enterprise)
- Foreign enterprise (with PE): tax on gross or net income
- Foreign enterprise (with no PE): tax on gross income

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Avoiding cross-border Double Taxation

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Reasons for double taxation

- Residence-residence conflict;
- Residence-source conflict;
- Source-source conflict

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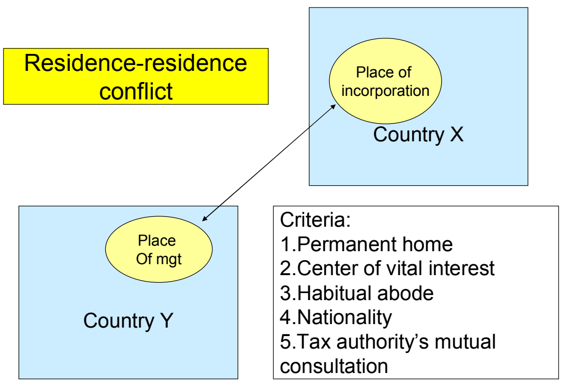

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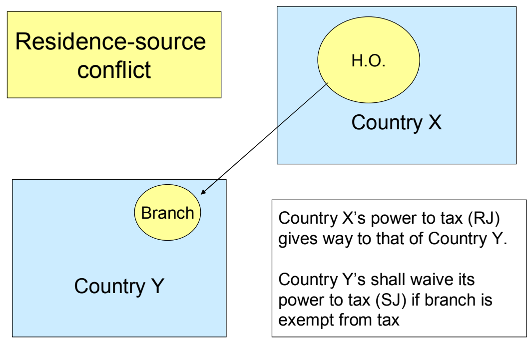

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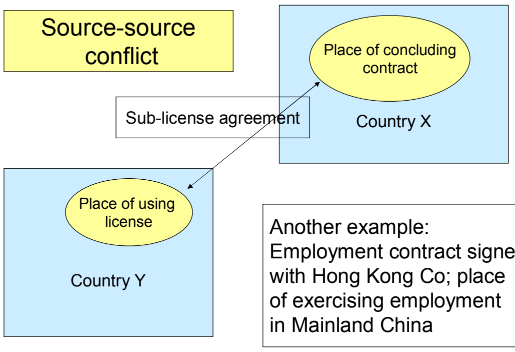

Another example: Employment contract signed with Hong Kong Co; place of exercising employment in Mainland China

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Case 1 International Assignment

- Hong Kong Co assigns a general manager to work in China under a 3-year secondment contract. The employee is a US national who owns a house, with wife and kids all working and living in Canada.
- How the following tax jurisdictions exercise their respective taxing rights? HK, Mainland China, US and Canada?
- Where he should pay taxes?
- Corporate income tax?

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Fund Repatriations

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What is PRC-source income?

Dividend, interest, royalty, rental income (immovable property and chattel), service income, gain from disposal of properties in China

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- **Dividend, interest and royalty distributed to the foreign investors situated outside China**
  - Tax base: taxed on a gross basis
- **Gain on disposal of property**
  - Tax base: taxed on net basis.

Tax is withheld at source at the time of payment.

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Tax rate on dividend income

1. Resident of non-PRC tax treaty country: 20% (reduced to 10% under Imp. Reg.)
2. Resident of PRC tax treaty country: 10% (HK/Singapore Co: 5%, subject to legal ownership in FIE being no less than 25%).

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Dividend Income

Accounting rules

- Accrual basis or receipt basis
- At group or company level

Tax rules

- Tax-exempt or taxable
- If dividend is taxable, on accrual basis or as-earned basis.

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Domestic tax rules in home country / jurisdiction

- Possible tax treatments in home country if FIE pays a dividend
  - (a) No liability for tax
  - (b) Tax exemption
  - (c) Tax on receipt basis
  - (d) Tax on as-earned basis

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Withholding income tax rates

The applicable tax rate for H K holding Co to receive payments from subsidiary in China:

	Item of Payment	WIT	BT
1.	Dividend	5% / 10%	N/A
2.	Interest	7%	5%
3.	Royalty	7%	5%
4.	Rental income	10%	5%
5	Service charges	10%	5%

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Withholding income tax rates

Comparison between HK Co and Singapore Co:

	Item of Payment	HK	Singapore
1.	Dividend	5% / 10%	5% / 10%
2.	Interest	7%	7% *
3.	Royalty	7%	10%
4.	Rental income	10%	10%
5	Service charges	10%	10%

* Interest paid on loans from non-financial institutions will be taxed at 10%

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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 – 5) x 10% = 9.5

Total tax will be = (BT + IT) = 5 + 9.5 = 14.5

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IP Transactions

- Transfer technology to China;
- Providing technical services in China;

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Transfer of technology

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

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PRC VAT and BT rules

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

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Royalties paid for imported goods are taxable?

- Royalties paid for the sale of imported goods are subject to duty and VAT;
- Royalties paid for the importation of goods on the list of national high-tech products are <u>not</u> subject to duty and VAT

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Transfer structured under sale agreement

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

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Import duty & VAT Exemption

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

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Import duty and VAT

- 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 of General Administration of Customs (2006) 148

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Transfer structured under royalty agreement

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

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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

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Case 3 - Service charges

- Delivered outside China: 0% IT & 0%BT
- Delivered inside China: 10% IT & 5% BT (0% IT if activities constitute no PE)
- Delivered inside and outside: income apportioned between onshore & offshore activities

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Service charges

- Technical services or licensing?
- business profits and royalties implications: (I) tax on net income or tax on gross income; (ii) Tax implication with PE or with no PE?

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Gain on disposal of properties

- Income tax computation on net basis
- Type of deductible taxes & expenses
- Computation of land appreciation tax
- Exemption of capital gain by companies who are residents of PRC treaty countries.

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Thank You

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