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

PRC Corporate Income Tax Law

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Agenda:

I. Update on development of legal and tax rules in China
II. Change in scope of PRC Corporate Income Tax Law; including residence rule, P.E. provision and double taxation
III. Other changes in the PRC CIT Law
IV. Tax on PRC source income

Part I

Update on development of PRC law and regulations for foreign investor

Update 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 Securities Law, revised on 2005.10. 27;
4. Revised M&A Rules, 8th Sept 2006 jointly by 6 PRC Ministries and Institutions directly under the PRC State Council

Update of PRC Law and Regulations

5. Enterprise Bankruptcy Law, 1st June 2007
6. PRC CIT Law and Implementation Regulations (Effective 2008.1.1)
7. PRC VAT Tentative Regulations, and PRC BT Tentative Regulations (Revised and Effective 2009.1.1)
8. PRC Business Tax Reform (Effective 2011)

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. China-ASEAN Free Trade Agreement 2010

Part II

Change in Scope of the PRC Corporate Income Tax Law

Effective 2008.1.1

Residence rules in the Corporate Income Tax Law

Resident and non-resident enterprises

- Resident enterprises shall pay tax on worldwide income.
- Non-resident enterprises shall pay tax on PRC-source income

Corporate income tax rate since 2008

1.FIE (resident taxpayer): on net basis at 25%.

2.Non-resident taxpayers that have PE in China will be taxed at 25% on net basis for 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).

Change in the scope of resident company

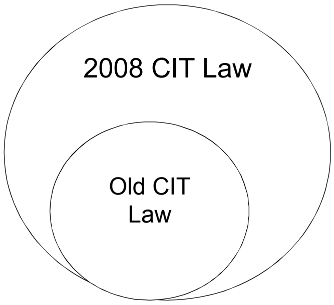
1.Previously, companies created outside China will not be treated as resident company.

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

Compare between the new one and old one:

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

Scope of resident company



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

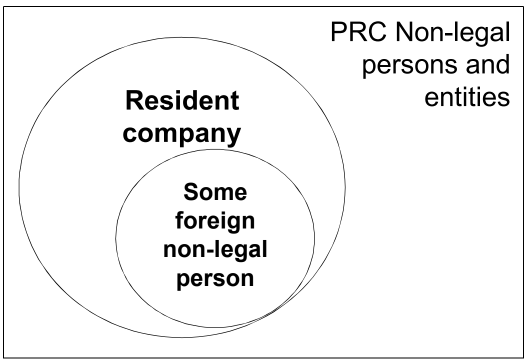
* Article 4 of Implementation Regulations

Possible examples of place of actual management

- Representative office
- Factory set up under export processing agreement (Lai Liao Jia Gong)
- Partnership (sole proprietorship) created outside China

Scope of resident enterprise

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



Implications of being a resident enterprise

Obligations: taxation on worldwide income

Rights: Benefits under DTA including tax credits; protection against discriminatory taxation; and tax sparing credit

PRC CIT Law follows international fiscal practices

- **Residence jurisdiction**: Tax imposed because of a nexus between country and the person earning the income, irrespective of where the income is earned;
- **Source jurisdiction**: Tax imposed because of a 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: non-legal person CJV, RO, employees / agent in China, etc
- 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
- Presence of employee (183 days)
- Agent appointed to conclude contract, or accept orders

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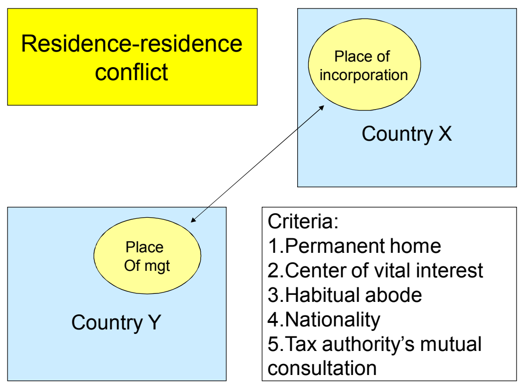
What constitutes a PE?

- Detailed legal rules about P.E. are dealt with in Part III under "International Taxation in China"

Forms of Double Taxation

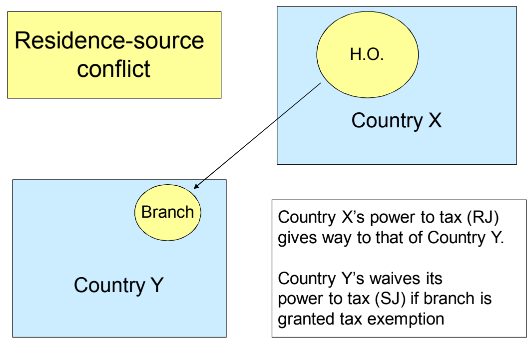
Reasons for double taxation

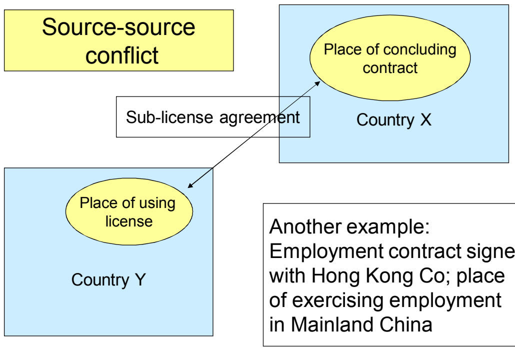
- Residence-residence conflict;
- Residence-source conflict;
- Source-source conflict



Double taxation & non-taxation?

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





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

Part III
Other major changes in the new PRC CIT Law

Change in scope of CIT law

	Special Tax Adjustments	
I	Direct and Indirect credit	Article 24
II	Related party transactions	Article 41 to Article 44
III	Control foreign corporation	Article 45
IV	Thin capitalization rules	Article 46
V	General provision for anti-tax evasion	Article 47

Article 41
Related party transactions

Where the transactions entered into between associated entities, which are not fixed at arm's length and result in a reduction of the taxable income of the enterprise or the associated entities, the tax authority shall make adjustments to those transactions using reasonable methods.

Article 45 Control Foreign Corporation

Where the companies, which is set up by and under the control of a corporate or individual resident, in a country (region) with an effective tax rate obviously below 25%, and which do not pay dividends or pay dividends at a reduced level without a reasonable commercial justification, the profits that belong to that resident enterprise shall be included in taxable income.

The country with effective tax rate equal to ½ of 25% (Article 118, IR)

Article 46, CIT Law
Thin capitalization rules

The portion of interest expenses paid to related parties for money advanced in excess of the standard as per prescribed debt/equity ratio, shall not be deductible from taxable income.

Article 47
General provision for anti-tax evasion

The tax authority shall have the power to make adjustments to the taxable income where the enterprise enters into arrangements to reduce taxable income without a reasonable commercial motive.

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What new contents the PRC corporation income tax law includes?

- Residence concept;
- Indirect credit;
- Control foreign corporation;
- Investment credit;
- Cost sharing agreement;
- Thin capitalization rules;

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What the PRC CIT law does away with?

- Two plus three tax holidays to FIE;
- Tax concession for export oriented enterprise;
- Tax reduction for re-invested profits;
- Low tax rate for specified locations

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Tax concessions and preferences under new PRC CIT law

- Income tax incentive has changed from preference to foreign investment to preference to industry sectors, from preference to coastal regions to the Central and Western region.

See information of tax concessions and preferences on separate sheets.

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Part IV
Taxation on PRC source income

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What is PRC-source income?

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

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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.

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%).

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 receipt basis or as-earned basis.

Withholding income tax rates

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

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

* FE with no PE in China

Withholding income tax rates: Comparison between Malaysian Co and Singapore Co:

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

* FE with no PE in China

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Thank You

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