DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

CASH REPATRIATION STRATEGIES – TAX, FOREIGN EXCHANGE AND REGULATORY ISSUES

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Agenda

- Dividend Distribution
- Service Fee & Royalty
- Cost Reimbursement
- Outbound Loan

Dividend Distribution

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Profit Repatriation - Regulatory

When The Profit Is Allowed To Be Repatriated?

- The WFOE's registered capital has been injected within the time limits as set out in the Article of Association;
- The WFOE's prior year's loss has been fully made up;
- The WFOE has drawn 10% of the rest after-tax profits as the company's statutory common reserve;
- The WFOE's relevant taxes have been fully paid up;
- The WFOE has sufficient cash for dividend distribution;
- The WFOE's board of directors approved the distribution through a board resolution.

Profit Repatriation - Foreign Exchange

Procedure for Repatriating Dividends from China

Step 1	Tax Clearance & Annual Audit
Step 2	Derive Tax Payment & Net Profit Figures
Step 3	Board of Directors/ Executive Director of WFOE Drafts Profit Distribution Plan with Shareholder's Approval
Step 4	Apply for Preferential Tax Rate according to DTA & Payment of Withholding Tax
Step 5	Apply for Foreign Exchange Approval with State Administration of Foreign Exchange
Step 6	Dividend Remittance

Procedures for Outward Payment on Overseas transactions

Procedure	Time
Contract Registration	3-5 working days
Tax Assessment	15-20 working days
Treaty Benefit Application*	15-20 working days
WHT filing and Payment	2-3 working days
Payment Registration*	3-5 working days

Profit Repatriation - Regulatory (Cont'd)

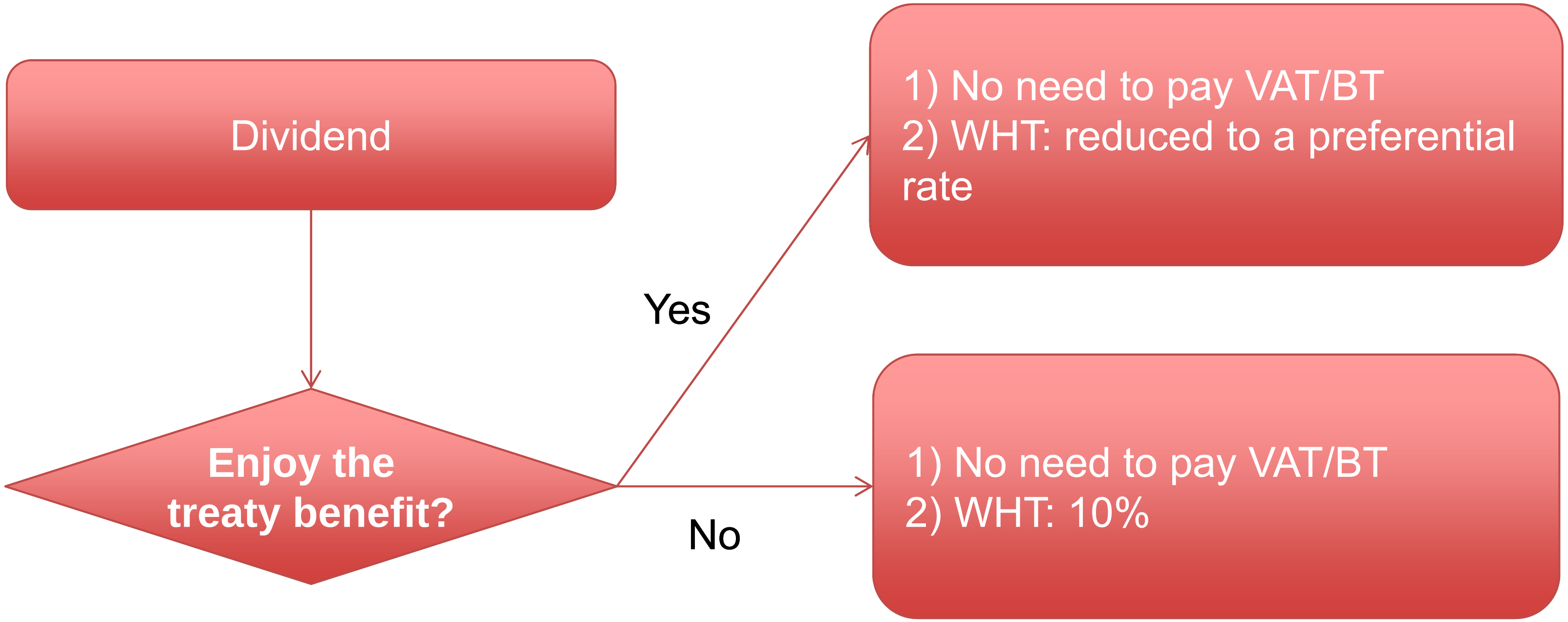
How Many Profit Is Allowed To Be Repatriated?

Item	Formula	Amount
Gross profit	(1)	200.00
CIT	(2)=(1) x 25%	50.00
Net profit	(3)=(1)-(2)	150.00
Surplus reserves	(4)=(3)x 10%	15.00
Maximum dividend	(5)=(3)-(4)	135.00
Withholding CIT	(6)=(5)x 10%	13.50
Net payment	(7)=(5)-(6)	121.50

60.75%

If a DTA is available and the parent company qualifies as the beneficial owner, a preferential dividend withholding CIT rate of 5 percent may apply.

Profit Repatriation - Tax



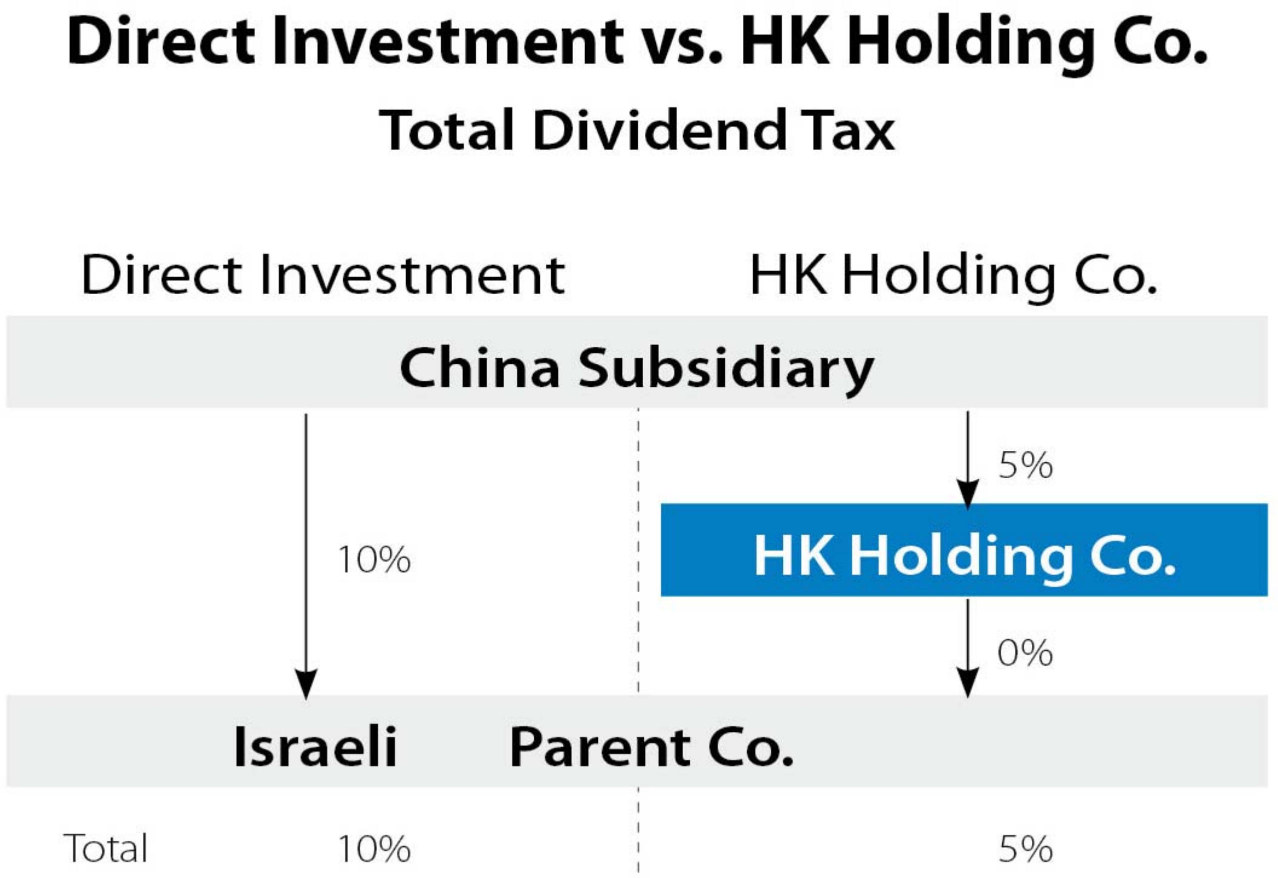
- Dividend tax rate: 10%
- China-Israel DTA: 10%
- China-HK, China-Singapore, etc.: 5%

CASE STUDY I

- How to repatriate or distribute profits and enjoy a lower withholding tax rate on dividends

Direct Investment vs. Hong Kong Holding Co.

Hong Kong and Singapore have DTAs with China that lower withholding tax to 5%. These jurisdictions do not impose withholding tax on dividends leaving the country, making these total withholding tax remitted with a holding company structure half of that if the profits were remitted directly from China.



Beneficial Owner

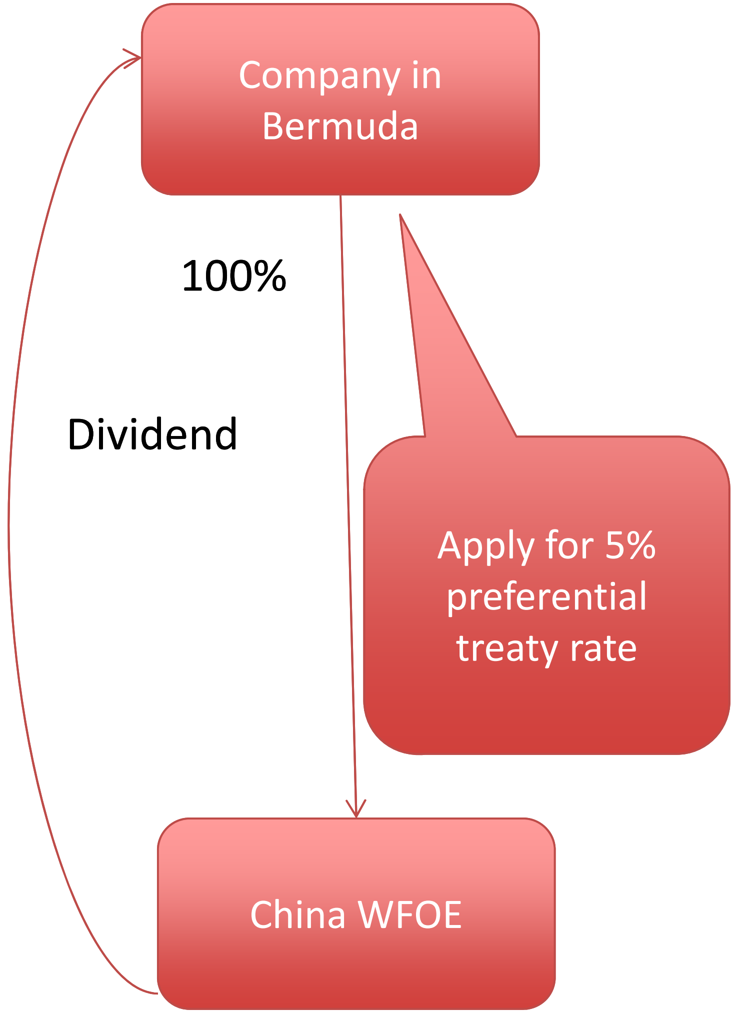
- **<u>Beneficial Owner Definition</u>**
  - A person that has the ownership and control over the income and rights or properties from which income is derived;
  - Can be an individual, company or any other organization;
  - Generally engage in substantive business activities (i.E. Manufacturing, trading and management activities);
  - Agents and conduit companies shall not fall under the scope of "beneficial owners".

- **<u>Unfavorable Factor Tests</u>**
  - The applicant is obligated to pay or distribute all or the majority of its income (e.G. 60% and above) to residents of a third country (region) within a stipulated period (e.G. Within 12 months from receipt of income);
  - Except for properties or rights from which income is derived, the applicant has little or no other business activities;
  - Where the applicant is a corporation, its assets, scale of operations and staffing of are relatively small (or lesser) and not commensurate with the amount of the income;
  - The applicant has little or no control or right of disposal over income or properties or rights from which income is derived, and bears no or little risk;
  - The counterparty country (region) of the tax agreement does not levy tax or exempts tax on the relevant income, or the actual levy rate is very low;
  - Except for loan contracts from which interest is derived and paid, there exist other loan or deposit contracts between the creditor and a third party which are similar in respect of amount, interest rate and date of execution, etc.; And
  - Except for transfer contracts for copyrights, patents, proprietary technologies and other use rights from which royalties are derived and paid, there exist transfer contracts between the applicant and a third party pertaining to copyrights, patents, proprietary technologies and other use rights or ownership.

Case Study I

Facts

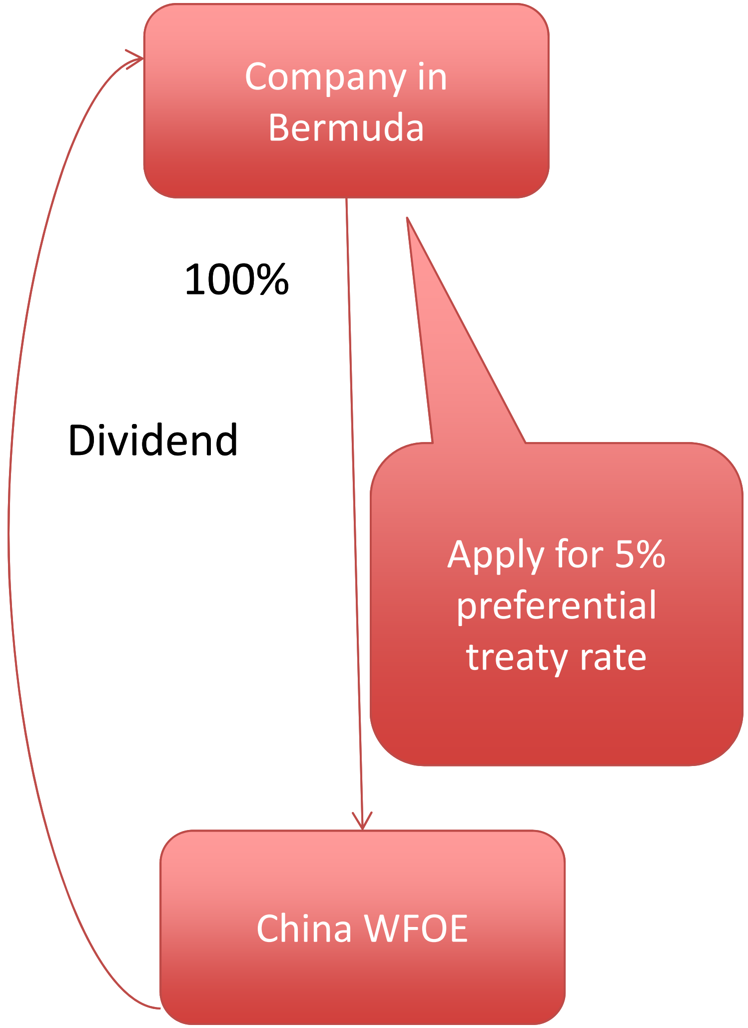
- The holding company of China WFOE is registered in Bermuda but does not need to pay tax in Bermuda according to local tax law;
- It is a tax resident in Singapore, as the control and management of the shareholder is exercised in Singapore.
- Very small registered capital;
- It is an investment holding company holding and managing a large investment portfolio in various countries but no other business activities;
- There is no staff;
- No tax paid in Singapore for dividends from China subsidiary.



Case Study II

<u>Analysis</u>

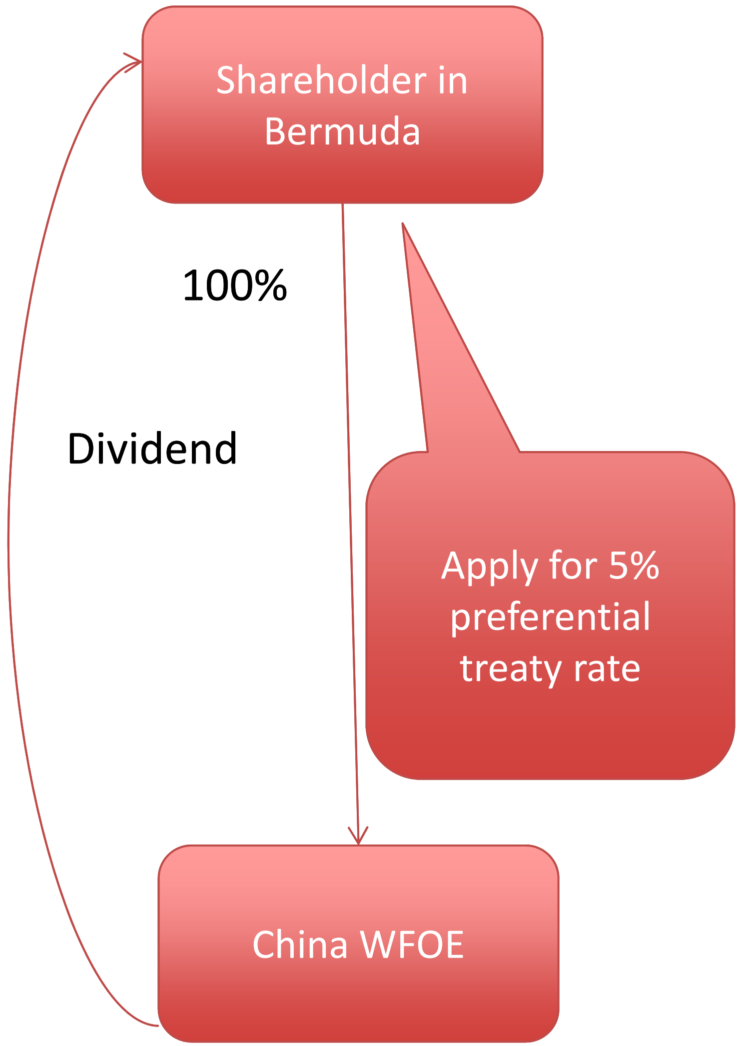
- It controls the dividend which would be used to finance the operations and investment activities.
- It has significant amount of total assets;
- It has no staff but has directors who responsible for the portfolio of investment, strategic management, administrative and finance support functions;
- It holds more than one subsidiaries and has recent active merge and acquisitions;
- <u>The company is listed in Singapore.</u>



Case Study II

<u>Conclusion</u>

Beneficial Owner is approved by Tax Authorities!



Service Fee & Royalty

Parent Company

Provide services and charge service fees to FIE

FIE

Remit service fees to parent company

Parent Company

Charge FIE royalty fees for transfer of trademark, patent copyrights, and proprietary technology

FIE

Remit royalty fees to parent company

Service Fee & Royalty - Foreign Exchange

- No SAFE approval on outward service payments;
- No transaction related documents is required for the payment no more than US$ 50,000;
- A tax record-filing form is required for the payment more than US$ 50,000;
- For some payments, tax record-filing form is not required, such as overseas travel expenses, import & export insurance, commissions, international transportation, etc.
- Tax withholding is required no matter the payment is more than US$ 50,000 or not !!!

Service Fee & Royalty - Tax

- Value Added Tax (VAT) or Business Tax (BT) and its surcharges
- Withholding Tax (WHT)
- Corporate Income Tax (CIT)
- Individual Income Tax (IIT)
- If no specification on payment terms, normally foreign company shall bear the tax burden

Service Fee - Tax

- A non-resident enterprise (NRE) with an establishment or place of business in china shall pay corporate income tax on its china-sourced income derived by such establishment or place of business.

- An establishment or place of business includes but are not limited to:
  - *A management establishment, a business establishment or an office*
  - *A factory, farm, or place of extraction of natural resources*
  - *A place where services are provided*
  - *A place where a project of construction, installation, assembly, repair, exploration, etc, is carried out*
  - *Other establishments or places of business where production and business operations are carried out*

- An establishment or place of business is equivalent to the concept of a permanent establishment (PE) in tax treaties.

PE Test

- **China-Israel DTA: "**For a period or periods aggregating more than 12 months within any 24-months period" relevant to service PE

- 6-month Threshold Counting Method *Guoshuihan [2007] No.403*

  – from the first month arrived until the last month of service
  – do not necessarily have to be six full months, one day in a month could be also counted
  – if no expatriate in China for performing service within consecutive 30 days, one month is deducted

- 183-day Threshold Counting Method *Guoshuifa [2010] No.75*

  – from the first day arrived until the last day of service
  – more than one employee is counted as one day

How are PEs Taxed – Deemed Taxation

- Scope of profits taxable in source country: only profits of an NRE attributable to its PE in China are taxable in China.

- If A PE does not keep separate accounts and profit apportioning is not customarily used, profits of A PE will be determined on A deemed basis.

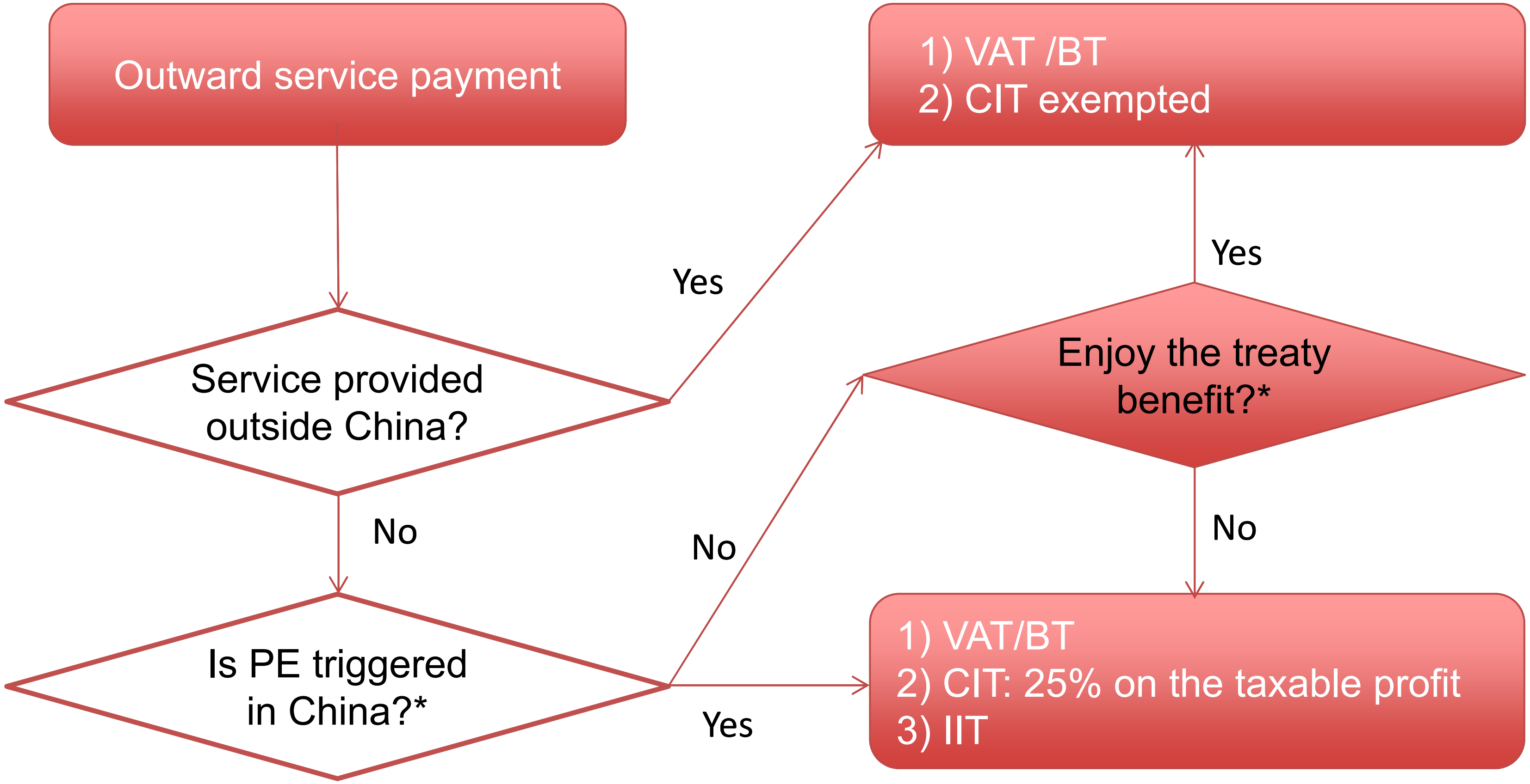
  Taxable Income = Gross Revenue X Deemed Profit Rate (DPR)

- DPR range

15%-30%	Project engineering, designing and consulting services
30%-50%	Management services
≥ 15%	Other services

- Effective CIT rate of 3.75% to 12.5% on gross service fee

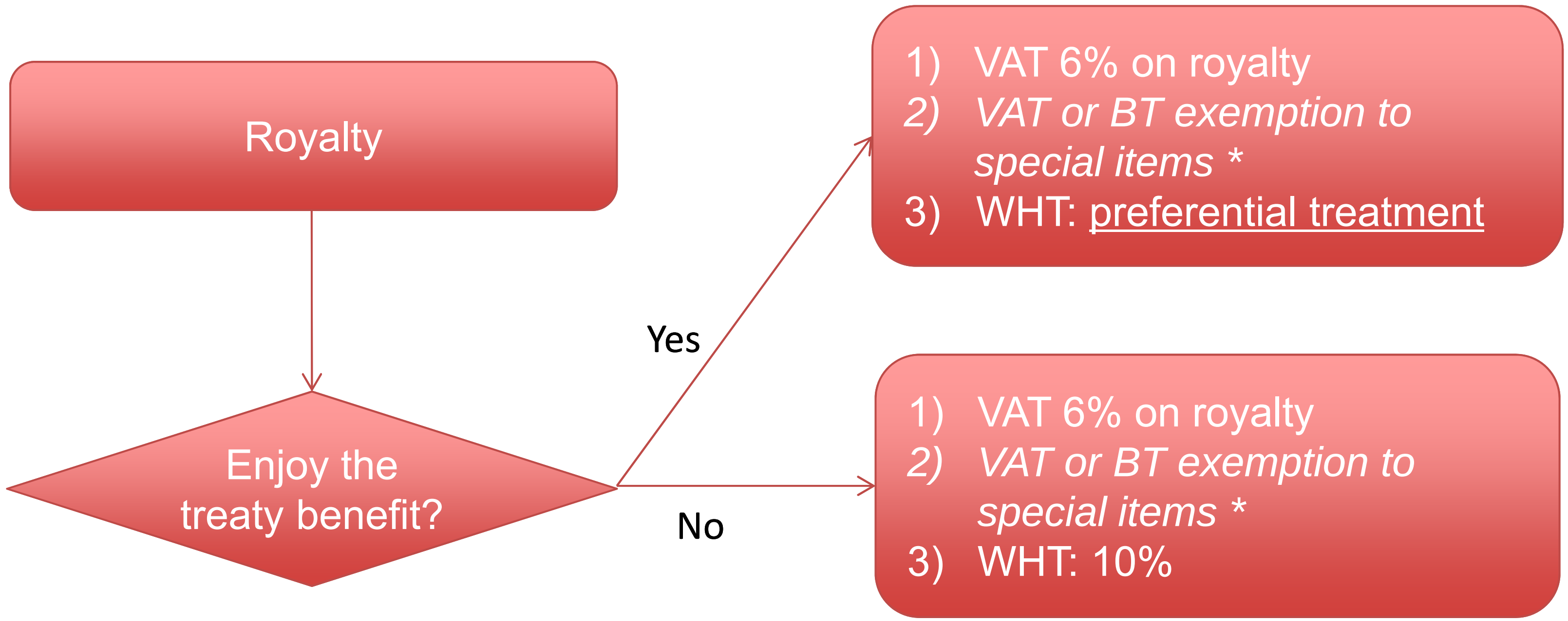
Service Fee - Tax



*Note *: Treaty benefit needs special approval.*

China-Israel DTA: Service PE - 12 months within any 24-month period

Royalty - Tax

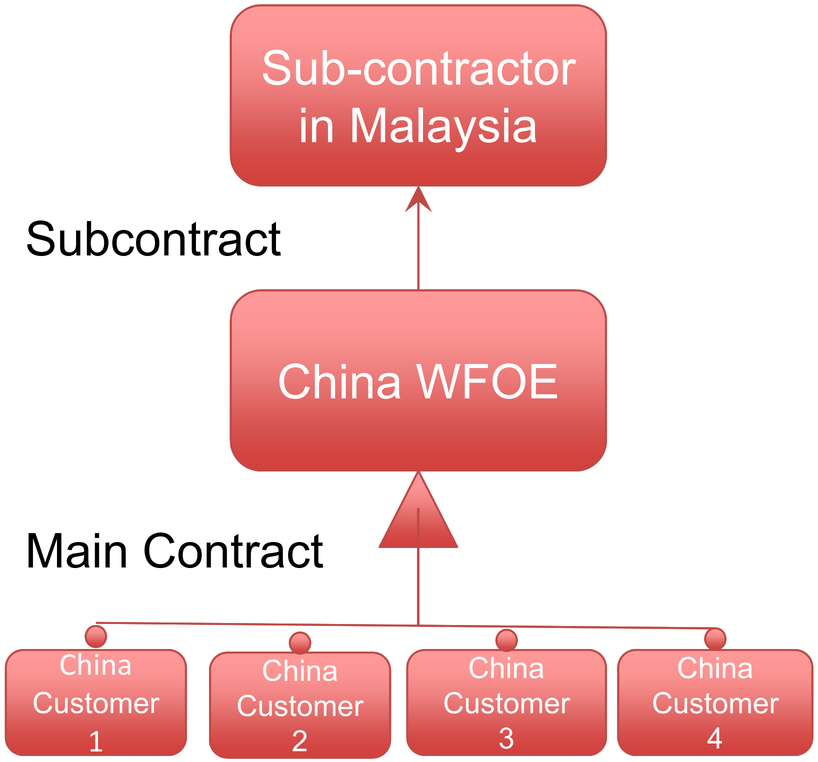


*Note *: VAT and BT exemption needs special approval.*
China-Israel DTA: a lower WHT rate 7% is applied to royalties paid for the use of , or the right to use, any industrial, commercial or scientific equipment.

CASE STUDY II

- What are the new cross-border tax withholding rules without need of a Tax Clearance Certificate

Case Study II



Facts:

- China WFOE provided technical services for China customers;
- The subcontractor is the WFOE's affiliated company in Malaysia who provides majority of services for WFOE's customers;
- China WFOE signed subcontracts with the Malaysian company for each project separately.
- The Malaysia company arranged personnel to assist the WFOE in providing labor services in China for less than 183 days for each project, but accumulatively more than 183 days.

Issues:

These projects was assessed as connected projects and the Malaysian company was considered to have a PE in China.

Case Study II

- Factors to be considered comprehensively in assessing "connected projects" for the purpose of Service PE:
  - Whether the projects are contained in a general contract;
  - Whether entered into by the same person or any connected person;
  - Whether one project is the necessary conditions for any latter project;
  - Whether those projects are the same in nature;
  - Whether those projects are implemented by the same personnel.

Cost Reimbursement

Cost Reimbursement - Foreign Exchange

Qualified Payment Items

- Reimbursement between related entities, such as pre-operating expenses, salaries, overseas insurances, etc.
- Allocation of expenses between related entities

Document Required

- Original contracts between China entity and suppliers
- Reimbursement or cost allocation agreement between China entity and the overseas related entity
- Payment notice

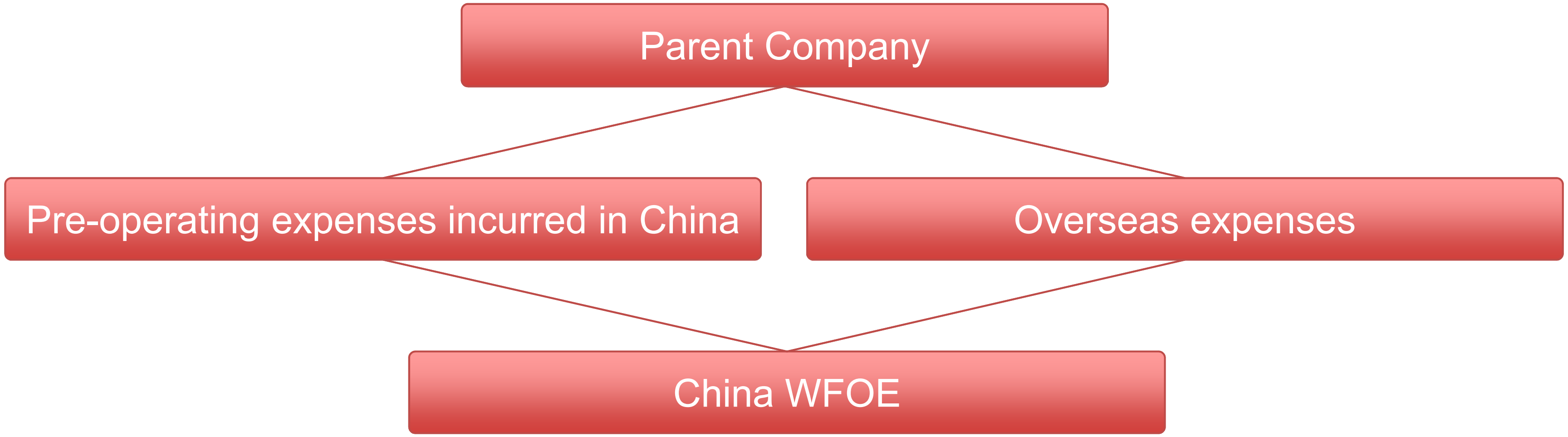
Time Limit

- Within 12 months

CASE STUDY III

- How to manage the reimbursement and allocation of expenses between related parties to avoid unwanted tax bureau scrutiny

Case Study III



<u>Domestic Expenses</u>

- China WFOE should sign the contract with domestic suppliers;
- VAT/BT tax invoices must be issued in the title of China WFOE.

<u>Overseas Expenses</u>

- China WFOE should withhold taxes for either overseas suppliers or the parent company

Taxes Involved with Cross-border Transactions

Tax	Service Fees		Royalty	Dividend	Cost Reimbursement
	PE	Non-PE			
VAT / BT & surcharges	Y	Y	Y	-	-
25% CIT (Based on DPR)	Y	Exempt	-	-	-
10% or less WHT	-	-	Y	Y	-
IIT	Y	-	-	-	Y

Outbound Loan

Parent Company

Borrow the money from FIE

FIE

Charge an interest to parent company

Outbound Loan

Currency	Foreign Currency	CNY
Regulator	SAFE	PBOC
Scope of Borrower	Offshore companies having an equity relationship with the FIE	Related companies in the same group
Source of Fund	• Self-owned foreign exchange of the FIE; • Foreign exchange purchased by the FIE using RMB; • Foreign exchange from a foreign currency cash pool as approved by SAFE; • Foreign exchange loans obtained by the FIE	Self-owned CNY
Loan Quota	30% of the FIE's equity of owners in the latest audited report unless otherwise approved by SAFE	No quota - FIE may prove to retain sufficient cash for its operations
Registration/ approval	Registration at SAFE, approval is required when exceeding the quota	Bank approval only
Tax	5% business tax plus surcharges and 25% CIT on interest income	

SUMMARY OF KEY TAKEAWAYS

- Corporate profits may be repatriated as dividends under limited circumstances and business decision making will be affected.
- Intra-group outbound services payments and royalty fee payments deserve special attention and possibly subject to Special Tax Adjustment Investigation;
- Although cost reimbursement may be available from foreign exchange perspective, a careful tax assessment beforehand will lower the risk of mistakes and future penalties.
- Outbound loan is still not a common transaction type, so make sure to check with bank at an early stage what the exact local requirements are.

For inquiries:

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