THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 2.02 – CHINA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

ACo is a UK resident company and BCo is a Hong Kong intermediary company for the purposes of Chinese business arrangement made by ACo. DCo is a Chinese resident company and an independent party of transactions with ACo and BCo. FCo is a Chinese resident company and a related enterprise of ACo and BCo in China.

The royalties of pharmaceutical manufacturing equipment by ACo to DCo would be taxed in China, but the tax so charged shall not exceed 10 percent of the adjusted amount that is equal to 60 percent of the gross amount of the payment received by ACo, according to Art. 12(2) of China-UK Tax Treaty.

The dividend paid by FCo to ACo would be taxed in China, but tax so charged shall not exceed 5 percent of the gross amount of such dividend, according to Art. 10 of China-UK Tax Treaty.

The royalties of licensing the patent of the medicine product paid by DCo to BCo would be taxed in China, but the tax so charged shall not exceed 7 percent of the gross amount of the consideration received by BCo, according to Art. 12(2) of the double taxation arrangement between Hong Kong and Chinese mainland.

However, the establishment of BCo would be challenged by Chinese tax authorities as a conduit company inserted into transactions between ACo and DCo for the purposes of reducing Chinese tax burden of ACo.

According to Art. 12(2)(i) of China-UK Tax Treaty, the royalties of licensing the patent of the medicine product paid directly by DCo to ACo would be taxed in China at a withholding rate of not exceed 10 percent, which is higher than that mentioned in Art. 12(2) of the double taxation arrangement between Hong Kong and Chinese mainland.

According to Art. 10 of Hong Kong-UK Tax Treaty, dividend paid by BCo to ACo would enjoy tax exemption.

Base the above-mentioned, transactions among ACo, BCo and DCo would be regarded by Chinese tax authorities as a treaty shopping arrangement and tax benefits enjoyed by BCo would be denied based on Art. 25 of the double taxation arrangement between Hong Kong and Chinese mainland.

The relevant royalties would be reconsidered to be received directly by ACo and would be taxed according to Art. 12(2)(i) of China-UK Tax Treaty.

ACo would not be regarded to have service PE in China because of its two employees stay in China no more than 183 days, however payments received by them would be taxed in China according to Chinese Individual Income Tax Law and Art. 15 of China-UK Tax Treaty.

Question 2

The legal framework

Article 43 of the Enterprise Income Tax Law, Article 114 of the Implementing Regulation on the Enterprise Income Tax Law, and Art. 15 of *Gonggao* [2017] No. 6 issued by the SAT.

Comparability Factors:

Characteristics of the assets or services transacted

- For tangible assets, the physical attributes of the assets, quality and quantity of the assets.
- For intangibles, the type of the intangibles, nature of the transaction, protection level and protected period, and anticipated benefits derived from the intangibles.
- For services, the nature and description of the services.
- For financial assets, the nature and characteristics of the assets, risk management, etc.

Functions performed, risks assumed and assets used by each party to the transaction

Functions include research and development, design, purchase, processing, assembly, manufacture, repair, distribution, marketing, advertising, inventory management, logistics, warehousing, financing, general administration, financial and accounting services, legal and human resource management, etc.

Risks include investment risk, research and development risks, procurement risks, production risks, market risks, management and financial risks, etc.

Assets include tangible assets, intangible assets, financial assets, etc.

Contractual terms

Including the goods/service transacted, quantity and prices of the goods/service, the forms and terms of payment, the terms of delivery, the scope and terms of after-sale services, conditions for provision of additional services, rights related to modifying or amending contractual terms, duration of the contract, and the right to terminate or renew the contract, etc.

The analysis of contractual terms should focus on the ability and behavior of the enterprises to perform the contract as well as the reliability of contract terms concluded by related parties.

Economic environment

Including industry overview, geographic location, market scale, market level, market share, degree of market competition, consumer purchasing power, substitutability of the goods/services, price of production factors, transportation costs, governmental regulations and location specific factors such as cost saving, market premium, etc.

Business strategies

Related to innovation and development, business diversification, synergy, risk aversion, and market penetration, etc.

PART B

Question 3

Joan was a work contractor who provided her independent personal services in China, using China HS's office as her fixed base, thus she would be taxed in China on her remuneration for her work from UK HS, according to Art. 14 of China-UK Tax Treaty.

When UK HS did its own business in China, China HS was an agent for entering in the business agreement with the high school and provided with work place, thus it would be deemed that UK HS had a PE in China, according to Art. 5(1), (2) and (5) of China-UK Tax Treaty.

According to Art. 7 and 12 of China-UK Tax Treaty, UK HS is subject to tax in China on the payment received from the high school in Xiamen for the development of intelligent teaching software and the use of the related supporting software owned by UK HS.

China HS needs to pay for training its personnel to UK HS. Such payment would also be taxed in China according to Art. 7 of China-UK Tax Treaty.

The dividend paid by Happy Study Co to UK HS would be taxed in China, but tax so charged shall not exceed 5 percent of the gross amount of such dividend, according to Art. 10 of China-UK Tax Treaty.

PART C

Question 4

Part 1

Art. 1(2) of Chinese Individual Income Tax Law.

Part 2

Art. 4 and 5 of Implementing Provisions on Individual Income Tax Law of China.

Question 5

Part 1

Art. 4 of China-UK Tax Treaty, XCo Ltd would be regarded as having its place of effective management in the UK and a UK resident company, even if it was incorporated in China.

Part 2

According to Chinese company law, a company incorporated in China shall have a head office in China as its domicile. Such office would be regarded as a fixed place of business according to Art. 5 of China-UK Tax Treaty, therefore XCo would be regarded as having a PE in China.

Part 3

According to Art. 7, 10, 11 and 13 of China-UK Tax Treaty, all income attributed to or effectively connected with the PE in China, and gains from the alienation of movable business property of PE would be taxed in China, thus all income listed mentioned in the question should be taxed in China.

Question 6

Part 1

According to Art. 1 of Chinese Individual Income Tax Law and Art. 2 of Implementing Provisions on Individual Income Tax Law of China, Mr Li has a domicile in China and is a Chinese resident before he accepts the offer and works in London, therefore is subject to Chinese individual income tax on his global income.

Part 2

According to Art. 1 of Chinese Individual Income Tax Law and Art 4 of China-UK Tax Treaty, Mr Li will become a non-resident in China after he works in London and his family move to London with him, even if they retain their house in China and spend holidays there, because his centre of vital interests locates in the UK and his stay in China is not more than 183 days.

Part 3

During his employment, his remuneration from the university in China would be taxed and withheld by the university, according to Art. 1 and 11 of Chinese Individual Income Tax Law and Art. 14 of China-UK Tax Treaty.

Question 7

Part 1

In China-UK Tax Treaty, there is no special provisions with respective to the business income of the insurance enterprise, thus all tax issues in this case are to be dealt with according to Art. 7 and Art. 5 of the Tax Treaty.

Part 2

For its current business related to its Chinese clients, RCo does not have a PE in China and therefore is not subject to Chinese tax for such business income, because according to Art.5 of China-UK Tax Treaty, (1) risks insuring related to Chinese clients or within China is not deemed to have a fix place of business therein; (2) Mr Yang is not in line with requirements of being a dependent agent.

Part 3

However, according to Art.5(1), (2) and (3) and Art. 7 of China-UK Tax Treaty, RCo could be have a PE in China and be taxed on its business profit attributed to the PE in China if its business plan in the next step comes true.