

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2025

MODULE 2.02 – CHINA OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

ACO is a resident company in the Hong Kong and controlled by Mr Lin and BCO which is a Chinese resident company. ACO and BCO are related parties under the same family with common interest, therefore transactions between ACO and BCO can be regarded as affiliated transactions.

ACO's factory in Shanghai constitutes a PE in Chinese Mainland, thus the profits attributable to the factory shall be taxable in Chinese Mainland, according to Art. 5 and Art. 7 of the Tax Arrangement between Hong Kong and Chinese Mainland.

Under the technical support agreement, the business income represented by 20% of the contract revenue for providing technical support services earned by the factory and BCO shall be taxed in China, partially because of its effective connection with the factory in Shanghai, according to Art. 3(2) of the Chinese Enterprise Income Tax Law, partially because it is earned by a Chinese resident company according to Art. 3(1) of the Chinese Enterprise Income Tax Law.

Meanwhile, providing technical support services by BCO in the UK constitutes a PE of BCO and the profits attributable to the PE shall be taxed in the UK, according to Art. 5(3)(b) and Art. 7 of China-UK Tax Treaty. Therefore, BCO is entitled to foreign tax credit for the amount of income tax paid for providing technical support services in the UK, according to Art. 22(1) of China-UK Tax Treaty and Art. 23(1) of the Chinese Enterprise Income Tax Law. In addition, the factory in Shanghai is entitled to foreign tax credit for the amount of income tax paid for providing technical support services in the UK, according to Art. 23(2) of the Chinese Enterprise Income Tax Law.

However, the resident status of ACO is likely to be challenged and thus reidentified by Chinese tax authorities as a resident company in Chinese Mainland, based on its effective management completed in Chinese Mainland to large extent, according to Art. 7 of the Notice on Issues Relating to Identification of Foreign-Registered Enterprise Controlled by Chinese Capital as Resident Enterprise Pursuant to the Standard of Effective Management Place (Guoshuifa [2009] No. 82), and Art. 2 of the Announcement on Administrative Measures on Income Tax on Foreign-Registered Resident Enterprise Controlled by Chinese Capital (Announcement of the STA [2011] No. 45).

If ACO is identified by Chinese tax authority as a resident company in Chinese Mainland, all tax issues will be adjusted.

- First, all income inside and outside China will be taxed in China.
- Second, the selling branch in the UK will constitute a PE of ACO in the UK and thus the profits attributable to the PE will be taxed in the UK, according to Art. 5(1) and 5(2) and Art. 7 of China-UK Tax Treaty.
- Third, the technical support services provided by the factory in Shanghai in the UK constitute a PE of ACO in the UK and the profits attributable to the PE shall be taxed in the UK, according to Art. 5(3)(b) and Art. 7 of China-UK Tax Treaty.
- Fourth, the royalties represented by 80% of contract revenue for licensing the patent of making paramedical equipment and paid by FCO to ACO shall be taxed in China, and shall be subject to 10% of withholding tax at not more than 10% tax rate in the UK, according to Art. 12 of China-UK Tax Treaty.
- Fifth, ACO is entitled to foreign tax credit for the amount of income tax paid in the UK, according to Art. 22(1) of China-UK Tax Treaty and Art. 23(1) of the Chinese Enterprise Income Tax Law.
- Sixth, the dividends paid by ACO to BCO will be tax-exempt.

Question 2

According to Art. 3 of the Announcement on Several Issues Relating to Enterprise Income Tax on Indirect Transfer of Assets by Non-resident Enterprises (Gonggao [2015] No. 7), when a business purpose is determined as reasonable or not, all arrangements relating to the indirect transfer of Chinese taxable assets shall be taken into overall consideration, and the following relevant factors shall be comprehensively analysed in light of the actual circumstances:

- Whether the main value of the equities of an overseas enterprise directly or indirectly arises from Chinese taxable assets.
- Whether the assets of an overseas enterprise mainly consist of direct or indirect investment made within the territory of China, or whether the main income it obtains directly or indirectly arises from within the territory of China.
- Whether the functions actually fulfilled and risks assumed by an overseas enterprise or its affiliated enterprise directly or indirectly holding Chinese taxable assets are able to prove that the enterprise structure has the economic nature.
- The shareholders, business model and the duration of the relevant organisational structure of an overseas enterprise.
- The income tax payable abroad on the income from the indirect transfer of Chinese taxable assets.
- Whether the equity transferor's indirect investment in and indirect transfer of Chinese taxable assets may be substituted by the direct investment in and direct transfer of Chinese taxable assets.
- Tax convention or arrangement that is applicable in China to the income from the indirect transfer of Chinese taxable assets.
- Other relevant factors.

PART B

Question 3

XCO is a resident company in the UK. YCO is a Chinese resident company which is controlled by XCO. YCO is a subsidiary of XCO, therefore, the transactions between XCO and YCO are related transactions, pricing of which shall be line with the arm's length principle.

In the actual business operation, the contracts with Chinese clients concluded by XCO are substantially negotiated by YCO on XCO's behalf, and XCO just approve the contracts routinely without any material modification. Based on these facts, it can be regarded that XCO plays a principal role leading to the conclusion of the contracts.

In addition, YCO independently carries out its business activities at its normal course, but activities it carries out are devoted wholly on behalf of XCO. Meanwhile, the commercial and financial relations between YCO and XCO are different from those which would have been between independent enterprises, because of their affiliated relation.

According to Art. 5 of the Notice on the Issuance of the Interpretation of the Articles of the Agreement and Protocol between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of tax Evasion (Guoshuifa [2015] No.75), the term "conclude contracts" not only refers to the act of concluding a contract itself but also includes engaging in contract negotiations and the agreement of contract terms.

Based on the above, Chinese tax authority may determine that the YCO constitutes an agent PE of XCO in China, according to Art. 5(5) of the China-UK Tax Treaty. The profits of XCO attributable to activities carried out by YCO on XCO's behalf shall be taxed in China, according to Art. 7 of the China-UK Tax Treaty.

In addition, as a subsidiary, business income earned by YCO in respect of its own activities shall be taxed in China separately, according to Art. 3(1) of the Chinese Enterprise Income Tax Law.

Question 4

Linda is a resident individual in the UK. RCO is a Chinese resident company.

Linda is a singer, who performs her personal activities as such in a concert in China. Thus, payment with amount of RMB 2 million received by Linda shall be taxed in China, according to Art.17(1) of the China-UK Tax Treaty.

Under the agreement between Linda and RCO, the legal copyright of recorded video of the concert belongs to RCO and Linda is paid a one-time fixed payment with amount of RMB 1 million, without any further legal and economic interest in the recorded video of the concert. The facts can be regarded as a transfer of legal copyright of recorded video of the concert to RCO by Linda in exchange for a consideration of RMB 1 million. According to Art. 13(6) of the China-UK Tax Treaty, the payment shall only be taxed in the UK, which means that such payment may not be taxed in China.

Under the agreement between Linda and RCO, Linda is entitled to share with RCO the derivative products revenue, even if the legal copyright of the derivative products of the concert belongs to RCO. Linda grants RCO the use of her image in the concert during selling the derivative products. Substantially, Linda enjoys the economic interest in the copyright of the derivative products of the concert.

Based on the facts, payments received by Linda in respect of the selling derivative products can be regarded as royalties, thus shall be taxed in China, according to Art. 12 of the China-UK Tax Treaty.

PART C

Question 5

According to Art.4(2) of the China-UK Tax Treaty, Ms Zhang is a resident in the UK.

Ms Zhang exercised her part of employment aboard aircraft operated in international traffic by a Chinese airline company, therefore, according to Art. 15(3) of the China-UK Tax Treaty, her salary obtained in respect of her such employment shall be taxed in China.

According to Art. 1(1) of the Announcement on Relevant Individual Income Tax Policies Regarding Non-Resident Individuals and Resident Individuals Who Are Not Domiciled in China (Gonggao [2019] No. 35), if an individual who is not domiciled in China holds posts both inside and outside China in the current period, the amount of his/her income from wages and salaries derived from inside/outside China shall be calculated and determined according to the proportion of the number of days of his or her working inside/outside China, during which wages and salaries are generated to the number of Gregorian calendar days in the current period. The number of days of working outside China shall be the number of Gregorian calendar days in the current period less the number of days of working inside China in the current period.

According to Art. 1(1) of the Announcement on Relevant Individual Income Tax Policies Regarding Non-Resident Individuals and Resident Individuals Who Are Not Domiciled in China (Gonggao [2019] No. 35), the number of days of his/ her working inside China, including his /her actual working days inside China, the public holidays, personal leaves, and training days he/she may enjoy both at home and abroad during the period of his/her working within China.

Based on the above, Ms Zhang's whole salary shall be split in accordance with the proportion of the number of days of her working inside/outside China. Only the part of salary which can be allocated to the period of working days inside China shall be taxed only in China.

Question 6

Before 2024, Ms Liu was a Chinese tax resident, but in 2024 she became a tax resident in the UK because of her emigration with her family, according to Art. 4 of the China-UK tax treaty.

The severance payment she received is based on her employment in China, thus shall be taxable in China according to Art. 15(1) of the China-UK tax treaty.

According to Art. 5(1) of the Notice on Issues Concerning the Connection of Preference Policies after the Individual Income Tax is Amended (Caishui [2018] No. 164), where any employee obtains one-off compensation income (including economic compensation, living allowances and other subsidies granted by an employer) from the employer's termination of employment relationship with him/her, the part of the income which is not more than three times the amount of average wages of employees in the local area in the previous year shall be exempt from individual income tax; and the part in excess of three times the said amount shall not be included in the comprehensive income of the current year, and the tax payable on such part shall be calculated separately based on the relevant Comprehensive Income Tax Rate Schedule.

Therefore, Ms Liu is entitled to relevant tax preference with respect to the severance payment received from LCo, the amount of tax payable on the severance payment is RMB 10,480, which is computed as follows:

- The tax-exempt amount of severance payment: $50,000 \times 3 = 150,000$
- The taxable amount of severance payment: $280,000 - 150,000 = 130,000$
- The amount of tax payable: $130,000 \times 10\% - 2,520 = 10,480$

Question 7

ICO is a resident in the UK. According to Art. 5 of the Implementing Regulations for the Chinese Enterprise Income Tax Law, the service center can be considered as a “establishment and/or place” owned by ICO in China.

In general, the service center does not only collect information from prospective clients but also provides after-sale technical services to clients. Therefore, the business activities carried on by ICO at its service center are not limited to the activities listed by Art. 5(4) of China-UK Tax Treaty, accordingly, the service center shall be considered as a PE of ICO in China according to the wording of Art. 5 of China-UK Tax Treaty.

According to Art. 4(2) of the Notice on Issuing the Administrative Measures for the Assessment and Levy of Enterprise Income Tax on Non-resident Enterprises (Guoshuifa [2010] No.19), where a non-resident enterprise is unable to accurately compute and faithfully file tax returns about the income taxes payable because it is difficult to check the account as a result of incomplete account books and references or for any other reason, the tax authority shall have the power to assess its taxes payable on the basis of costs and expenses if the costs and expenses can be correctly computed according to its accounting book.

Meanwhile, according to Art. 5(3) of the Notice on Issuing the Administrative Measures for the Assessment and Levy of Enterprise Income Tax on Non-resident Enterprises (Guoshuifa [2010] No.19), when the tax authority assess the taxes payable of a non-resident enterprise engaging in other services than contracting the construction and design, consultation, as well as management, it may adopt the profit ratio of not less than 15%.

Question 8

MCO is a resident in the UK, and NCO is a resident in China.

The guarantee fees derived by MCO in China shall be considered as taxable interest, according to Art. 2 of the Announcement on Several Issues Concerning the Administration of Enterprise Income Tax on Non-resident Enterprises (Gonggao [2011] No. 24).

The guarantee fees received from NCO is subject to tax in China, but tax charged shall not exceed 10 percent of the gross amount of the interest, according to Art. 11(2) of the China-UK Tax Treaty.

MCO does not have any business establishment and/or place in China, the guarantee fees derived by MCO shall be withhold by NCO, according to Art. 37 of the Chinese Enterprise Income Tax Law.