DEZAN SHIRA & ASSOCIATES
Your Partner for Growth in Asia

How to Repatriate Profits from China

Practical Methods & Strategy Development

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Today’s Speakers

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Agenda

Section 1:
Overview: General methods for profit repatriation

- Presented by Amber Liu

Section 2: **Tax implication and compliance procedures for profit repatriation**

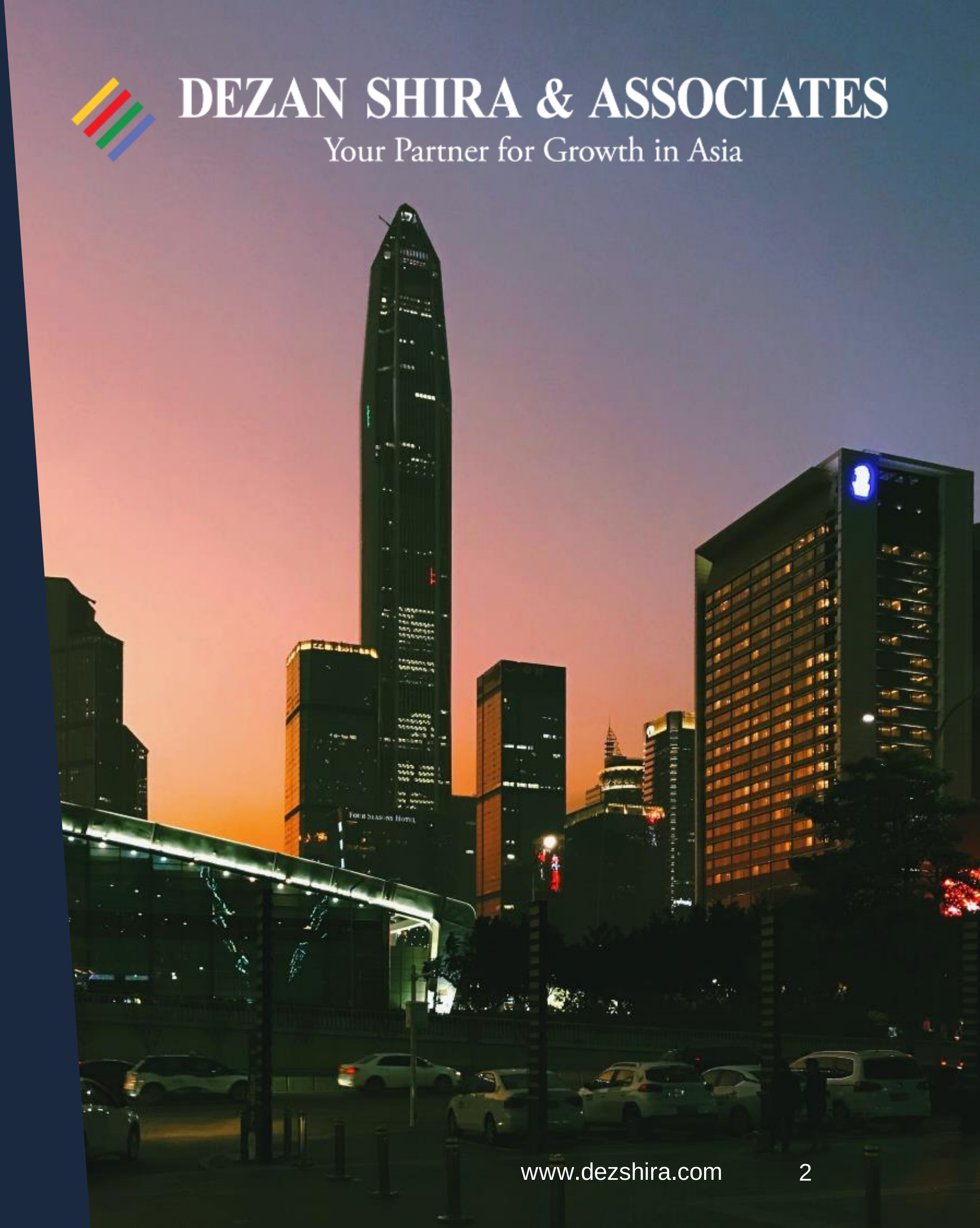
- Presented by Judy Chao

Section 3: **Leverage Double Taxation Avoidance Agreements to maximize take-home profits**

- Presented by Lynn Shen

Section 4: **Summary**

- Presented by Amber Liu



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Section 1:

General methods for profit repatriation

01 General methods for profit repatriation

Dividends	WFOE's after tax profit
Inter-company Service fees	Professional services and activities, including: • IT service fee; • Designing fee; • Training fee; • Consultancy, etc.
Inter-company Royalties	• Patent licensing; • know-how licensing; • Trademark, copyright and other rights licensing; • Rentals for equipment (for some countries), etc.

01 Government departments/ third parties involved

- Tax authorities
- State Administration of Foreign Exchange
- Banks
- Auditors
- Customs
- Ministry of Commerce or its local branches

Section 2:

Tax implication and compliance procedures for profit repatriation

General rules and procedures

- Document registration/ filing with authorities—Tax bureau, local commerce bureau, trademark office
- Withholding tax filing and payment-- Chinese domestic payers of profits bear the legal liability of tax withholding
- Banking payment—with supporting materials

Tax implication and compliance procedures for profit repatriation - Dividends

Prerequisites

The registered capital has been injected as set out in the AOA per requirements from certain bank

WFOE shall complete the annual audit and annual tax clearance—25% Corporate Income Tax should be paid before profit to be distributed

Accumulated losses from previous year have been made up and 10% after-tax profits as mandatory surplus reserve fund

A profit distribution resolution should be prepared

A special audit is required for repatriation of accumulated profits in previous years per requirements from certain bank

Tax implication and compliance procedures for profit repatriation - Dividends

Procedures

10% withholding Corporate Income Tax

preferential CIT rate may apply if DTA is available and parent company qualified as the beneficial owner

Record-filing with tax bureau in charge if the profit amount is over US$50,000

02

Tax implication and compliance procedures for profit repatriation - Dividends

Item	Formula	Amount (example)
Gross profit of the WFOE	a.	100.00
CIT	b=a*25%	25.00
Net profit	c=a-b	75.00
Mandatory surplus reserves	d=c*10%	7.50
Dividend can be repatriated	e=c-d	67.50
Withholding CIT	f=e*10%	6.75
Net payment	g=e-f	60.75

- *Assume there is no accumulated losses*
- *Assume there is no other reserves fund set out in AOA*
- *Assume DTA benefit is not applicable*

Tax preference

Caishui [2018] No. 102

Qualified non-resident enterprises can defer income tax as long as they re-invest those dividends derived from resident enterprises directly into projects not prohibited by the country

Tax implication and compliance procedures for profit repatriation - Dividends

Bank payment– Required materials

- Application form for profit remittance
- Profit distribution resolution
- Financial audit reports
- Register capital of the WFOE has been well paid as set out in AOA per particular bank require

02 Tax implication and compliance procedures for profit repatriation - Intercompany Service Fees

Procedures

Contract registration with tax bureau in charge

- **Withholding tax filing—VAT and surcharges, 6.72% in total**

25% withholding CIT—if the foreign enterprise is deemed to constitute a permanent establishment (PE)

- **deemed profit rate of 15% to 50%owner**

- **Record-filing with tax bureau in charge if the profit amount is over US$50,000**

02

Tax implication and compliance procedures for profit repatriation - Intercompany Service Fees

Item	Formula	Amount (example)
Service fee	a	100.00
VAT	B=a/(1+6%)*6%	5.66
VAT surcharges	C=b*12%	0.68
Withholding CIT	D=a/(1+6%)*30%*25%	7.08
Net payment	E=a-b-c-d	86.58

- Assume the service provider bear the tax
- Assume the service activities constitute a permanent establishment (PE)
- Assume the deemed profit rate is 30%
- Assume the WFOE is located in urban areas

Bank payment– Required materials

Per guidance issued by State Administration of Foreign Exchange (SAFE)

- Service contract
- Invoice or payment notice issued by service provider
- Other documents can prove the rationality and authenticity of the transaction

Tax implication and compliance procedures for profit repatriation - Royalties

Procedures

Contract registration with tax bureau in charge

- Contract registration with local commerce bureau or trademark office as required

Withholding tax filing—VAT and surcharges, 6.72% in total

- Withholding CIT—10% CIT, a lower preferential tax rate may apply if there is a valid DTA applicable

- Record-filing with tax bureau in charge if the profit amount is over US$50,000

02

Tax implication and compliance procedures for profit repatriation - Royalties

Item	Formula	Amount (example)
Royalties	a	100.00
VAT	B=a/(1+6%)*6%	5.66
VAT surcharges	C=b*12%	0.68
Withholding CIT	D=a/(1+6%)*10%	9.43
Net payment	E=a-b-c-d	84.23

- *Assume the payee bear the tax*
- *Assume the WFOE is located in urban area*
- *Assume there is no DAT benefit applicable*

Bank payment– Required materials

Per guidance issued by State Administration of Foreign Exchange (SAFE)

- Service contract
- Invoice or payment notice issued by service provider
- Other documents can prove the rationality and authenticity of the transaction

Section 3:

Leverage Double Taxation Avoidance Agreements to maximize take-home profits

03 DTA tax rates on dividends

Country	Dividend		
	General Rate	Exeption Rate	Exeption Scope
Italy	10%		
Switzerland	10%	5%	benefit owner is a corporate, directly own at least 25% of the capital of the payer
United Kingdom	10%	5%	benefit owner is a corporate, directly own at least 25% of the capital of the payer
		15%	related to investment vehicle and investments in real estate
USA	10%		
Austria	10%	7%	the beneficial owner is a company, has directly owned at least 25% voting rights share of the company paying the dividend
Germany	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% of the capital of the company paying the dividend
		15%	related to investment vehicle and investments in real estate
Ireland	10%	5%	the beneficial owner is a company, has directly owned at least 25% voting share of the company paying the dividend
Israel	10%		
Russia	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend which is also not less than euro 80,000(or other currencies equivalent)
Hongkong	10%	5%	the beneficial owner is a company, has directly owned at least 25% of the capital of the company paying the dividend
Denmark	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend
Singapore	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend
Czech Republic	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend
Finland	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend
Belgium	10%	5%	the beneficial owner is a company (except partnerships), has directly owned at least 25% capital of the company paying the dividend for at least 12 consecutive months prior to the payment of the dividend

03 DTA tax rates on royalties

Country	Royalty		
	General Rate	Exeption Rate	Exeption Scope
Italy	10%	7%	payments for the use of or the right to use industrial, commercial or scientific equipment
Switzerland	9%		
United Kingdom	10%	6%	payments for the use of or the right to use industrial, commercial or scientific equipment
USA	10%	7%	payments for the use of or the right to use industrial, commercial or scientific equipment
Austria	10%	6%	payments for the use of or the right to use industrial, commercial or scientific equipment
Germany	10%	6%	payments for the use of or the right to use industrial, commercial or scientific equipment
Ireland	10%	6%	payments for the use of or the right to use industrial, commercial or scientific equipment
Israel	10%	7%	payments for the use of or the right to use industrial, commercial or scientific equipment
Russia	6%		
Hongkong	7%		
Denmark	10%	7%	payments for the use of or the right to use industrial, commercial or scientific equipment
Singapore	10%		
Czech Republic	10%		
Finland	10%		
Belgium	7%		

03 DTA benefits on service fee

For services provided by the oversea related party in Mainland China through its employees or personnel, if there is a DTA in place and applicable

whether a permanent establishment (PE) is constituted

If the service activities (for the same or related project) continue for a continuous or cumulative period such as over 183 days within any 12-month period (depending on the specific DTA), a PE will be constituted

YES

DTA benefits of CIT exemption will not apply, the service income attributable to the PE will be subject to 25% CIT on the deemed profit rate of 15% to 50%

NO

CIT exempted

Definition of "Beneficial Owner"

"Beneficial owner" refers to an individual, company, or any other group having the ownership and right of control over the income or the right or property that the income derived from.

Regulation on "Beneficial Owner" determination

SAT Announcement [2018] No.9

Announcement of State Administration of Taxation (SAT) on Issues Relating to Beneficial Owner in Tax Treaties"

Beneficial Owner

Some rules on determination of “Beneficial Owner”

- Safe Harbor Rule
- Unfavorable Factors
- Same Jurisdiction and Same Treaty Benefit Rule

Safe Harbor Rule

If the applicant in the treaty counterparty is:

- 1

The government

- 2

A listed resident company

- 3

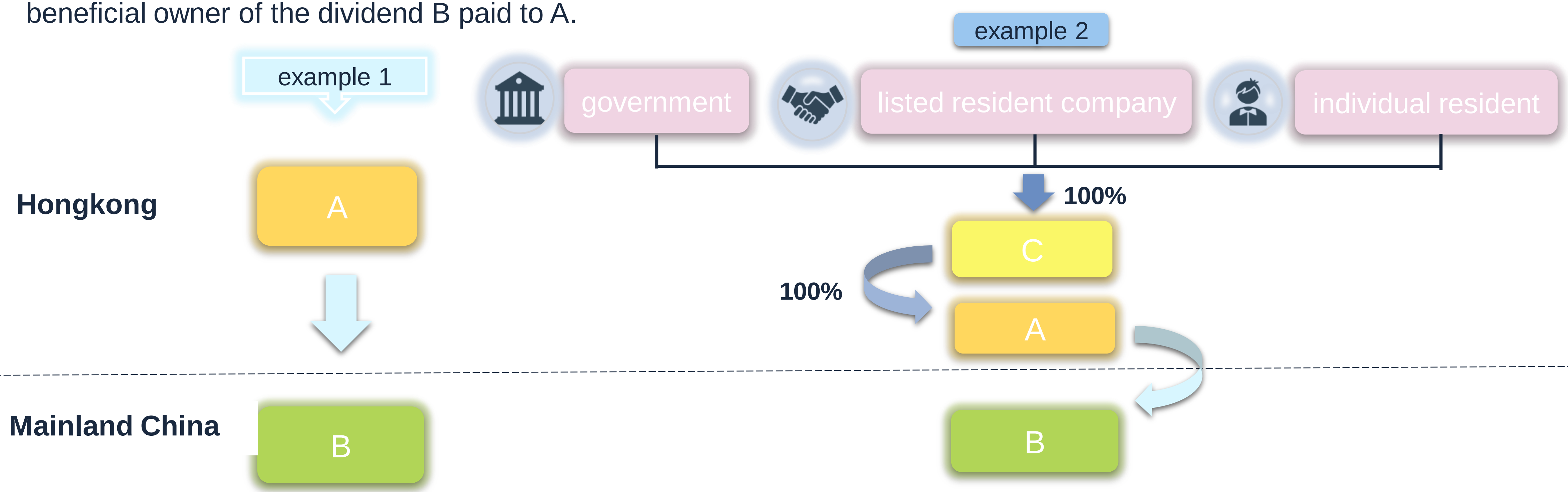
An individual resident

- 4

directly or indirectly held 100% of its shares by one or several persons set out in item 1 to item 3, and in indirect shareholding scenario, the multi-tier holders are either China residents or residents of the treaty counterparty

Safe Harbor Rule - dividend

Example1: a HK resident A invested a Mainland China resident B, if A is HK government or a HK listed resident company or a HK individual resident, A could be directly deemed as the beneficial owner of the dividend B paid to A.
Example2: a HK resident A invested a Mainland China resident B, if A is 100% hold by HK resident C, and C is 100% hold by HK government, HK listed resident company and HK individual resident, A could be directly deemed as the beneficial owner of the dividend B paid to A.



Unfavorable Factors for BO Status Determination

- *The applicant is obligated to pay 50% or more of the income to a resident of a third country (region) within 12 months from receipt of the income ("Obligated" shall include agreed obligations and de facto payment even though there is no agreed obligation)*
- *The business activities undertaken by the applicant do not constitute substantive business activities*
- *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;*
- *Aside from contracts for the transfer of copyrights, patents, proprietary technologies, and other usage rights based upon which royalties are derived and paid, there exist contracts between the applicant and a third party pertaining to the transfer of copyrights, patents, proprietary technologies, and other usage rights or ownership.*
- *In addition to the loan contract upon which interest is derived and paid, there is/are other loan or deposit contract(s) between the creditor and the third party where the amount, interest rate and date of execution etc. are similar*

Additional Opportunities for Applying BO Status - Dividend

the person who directly or indirectly holds 100% of the applicant's shares satisfies the criteria for "beneficial owner" and falls into either of the following circumstances

Circumstance 1 -- Same Jurisdiction

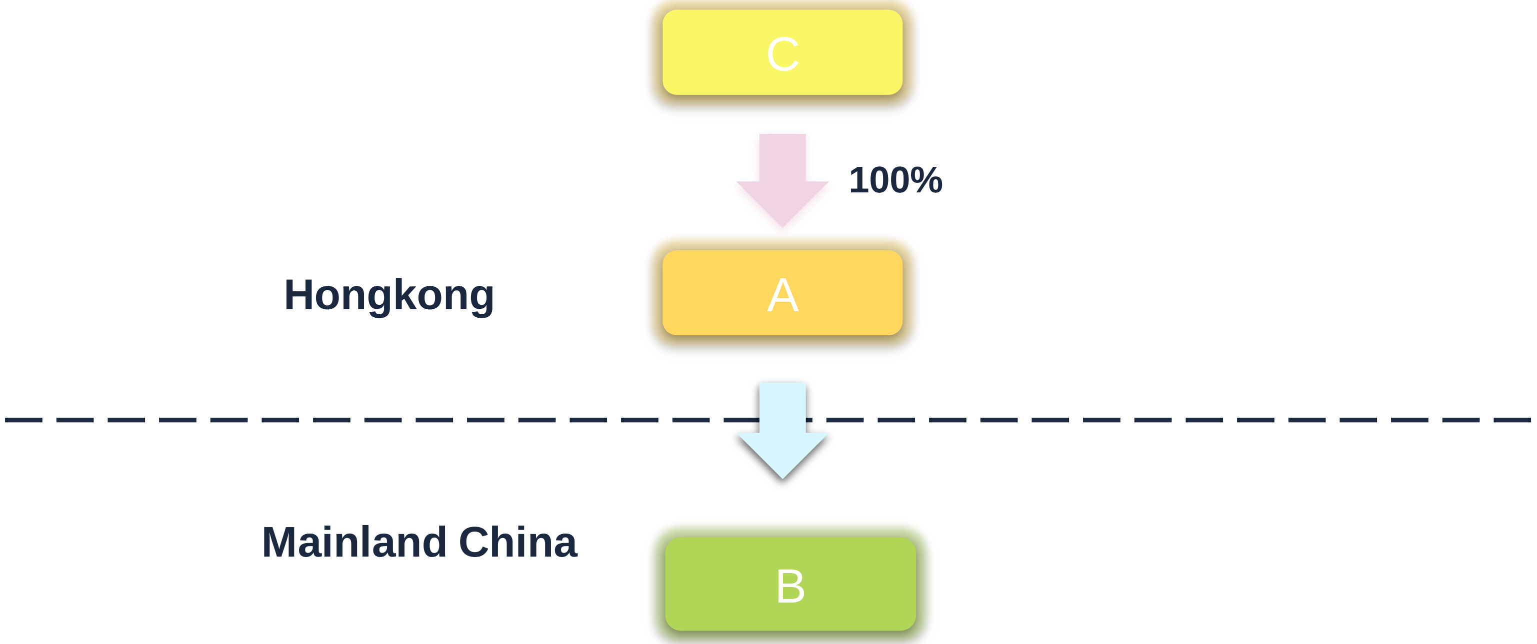
- *the aforesaid person who satisfies the criteria for "beneficial owner" is a resident of the country (region) where the applicant is a resident*

Circumstance 2 -- Same Treaty Benefit

- *although the aforesaid person who satisfies the criteria for "beneficial owner" is not a resident of the country (region) where the applicant is a resident, but the said person and the multi-tier holders (if any) are persons whose resident countries have an identical or more favorable tax treaty treatment on dividend derived from China mainland than the tax treaty treatment enjoyed by the applicant*

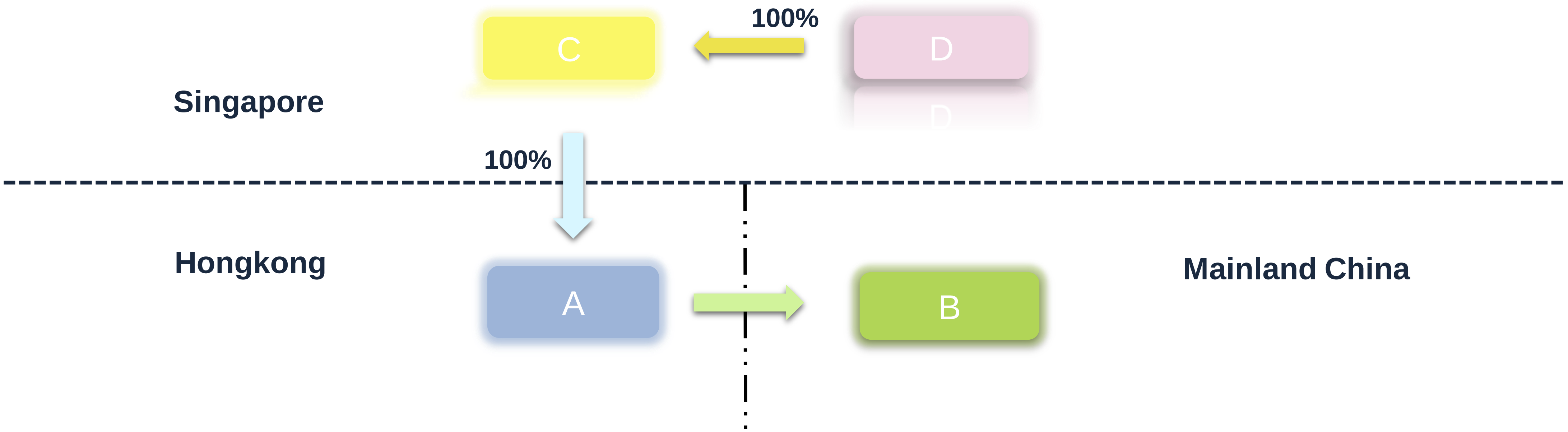
Same Jurisdiction

Example: a HK resident A invested a Mainland China resident B and got dividend from B, if A can't pass the "beneficial owner" assessment, but HK resident C who holds 100% of shares of A satisfies the criteria for "beneficial owner", A could be deemed as "beneficial owner" for the dividend deriving from B.



Same Treaty Benefit

Example: a HK resident A invested a Mainland China resident B and got dividend from B, a Singapore resident D indirectly hold 100% shares of A via a Singapore resident C. If A can't pass the "beneficial owner" assessment, but the Singapore resident D satisfies the criteria for "beneficial owner", A could be deemed as "beneficial owner" for the dividend derived from B as Singapore has identical DTA treatment to Hongkong on dividend.



Retained Documents for the Enjoyment of DTA Treatment per Regulations

.Tax Resident Identification Certificate that could prove the tax resident status of the year or previous year in which the income was obtained

a. the applicant itself meets the conditions of “beneficial owner”	b. the applicant has the status of "beneficial owner" in accordance with “same jurisdiction or same treaty benefit rule”	c. the applicant has the status of "beneficial owner" in accordance with “safe harbor rule”
—— tax resident identification certificate of the applicant	—— tax resident identification corticate of the applicant —— tax resident identification of the person who meets the conditions of “beneficial owner” and the tax resident identification certificates of the other qualified person (the multi-tier holders)	—— tax resident identification corticate of the applicant —— the tax resident identification certificates of the person directly or indirectly holding 100% of the shares of the applicant and the multi-tiers

Retained Documents for the Enjoyment of DTA Treatment per Regulations

- Documents that could prove the ownership relating to the acquisition of the relevant income, like contracts, agreements, resolutions of the board of directors or shareholders' meetings, certificates of payment, etc
- Relevant documents certifying the identity of the "beneficial owner" for the enjoyment of the DTA treatment regarding dividends, interest or royalties
- Other documents that could prove the applicant is qualified to enjoy the DTA treatment.

Section 4:

Summary

04 Summary- comparison

	Dividends	Inter-company Service fees	Inter-company Royalties
Tax implication	-- no VAT and surcharges	-- 6.72% VAT and surcharges	-- 6.72% VAT and surcharges; -- Import taxes (tariff and import VAT) when it is related the imported good
	-- CIT should be paid before profit distribution; -- 10% withholding CIT upon distribution	--25% CIT on the deemed profits in case the provision of service constitutes a PE (generally ranging from 3.75% to 12.5% on the gross service fee)	-- 10% withholding CIT
Prerequisites	-- Register capital has been paid within the time limits as set out in the Article of Association	Sufficient commercial substance to prove the beneficial nature and arm's length of the payments	Sufficient commercial substance to prove the beneficial nature and arm's length of the payments
	-- Accumulated losses have been made up		
	-- At least 10 percent of the after tax profits should be put into a mandatory reserve fund - --board of directors approved the distribution through a board resolution		
	--- board of directors approved the distribution through a board resolution		
Pros	The most obvious and legit channel for profits repatriation	Tax efficiency	Tax efficiency
Cons	Subject to various prerequisites; Not all profits can be repatriated.	Subject to high transfer pricing risks and high document requirements	Subject to high transfer pricing risks and high document requirements

04

What DSA can do?

DSA Services

Strategy review and advisory

Transfer pricing review and consulting

Contract draft/review

Implementation, including application, tax compliance, etc.

Update of policies

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