



Date: 24 September 2014

**New PRC Tax Bylaw on Non-Resident Owners or Charterers to Pay Enterprises
Income Tax Deprived from China-sourced Freight or Hire Payment**

Introduction

1. On 30 June 2014, PRC State Administration of Taxation (“SAT”) officially released the *Provisional Measures of Administration of Taxation on Non-resident Enterprises Engaging in International transport business* (the “**Measures**”), which came into force on 1 August 2014. As per the **Measures**, non-resident enterprises (“NRE”) are subject to enterprises income tax (“EIT”) on freight or charter hire payment deprived from International transport business (“ITB”) in mainland China unless EIT exemption on basis of bilateral tax treaty.
2. Before 1 Aug 2014, there are a number of mainland Chinese tax law or bylaws, which require owners or charterers incorporated outside mainland China to pay EIT and business tax deprived from freight or hire payment received from companies incorporated in mainland China. There are a number of judgments that NRE owners were required to pay EIT or business tax for freight or hire payment paid by China incorporated companies.
3. However, SAT has not strictly enforced the previous tax law or bylaws in respect of ITB that NRE engages in mainland China. Most NRE as owners or charterers were not aware of what taxes would be levied on them in accordance with the previous tax law or bylaws of mainland China. The recently published **Measures** imply that SAT intends to adopt stricter standards in levying EIT on NRE for freight or hire payment originating from mainland China. The **Measures** is only relevant with EIT and irrelevant with business tax (which was replaced by VAT) as far as transportation business is concerned in mainland China.
4. We summarize key features of the **Measures** and its possible impacts to non-resident owners or charterers and given guidance to non-resident owners or charterers how they may protect themselves from such impacts.

International transport business

5. International transport business (“ITB”) is defined as carriage of passengers, cargoes, mails or the likes into or out of mainland China by ships, airplanes, slots of ship or airplane owned or leased by an NRE, including transport related side business such as loading, unloading and warehousing. Voyage charter and time charter with transport service into and out of mainland China are deemed as ITB in the **Measures** while bareboat charter is not. The scope of ITB as defined in the **Measures** is much wider than transport services out of mainland China as defined in the previous bylaw numbered GuoShuiHan [2008] No. 952 (“**Circular 952**”). Circular 952 was replaced by the **Measures**.

6. It is a misunderstanding by some NRE that bareboat charterers are not required to declare and pay EIT in mainland China as per the **Measures**. If the bareboat charterers time charter or voyage charter out a vessel to a mainland Chinese company and receive time charter hire payment or freight from the Chinese company, they are required to declare and pay EIT as per the **Measures**. If an NRE owners bareboat charter out a vessel to a Chinese company and receive bareboat charter hire payment from the Chinese company, the NRE owners are required to declare and pay EIT for hire payment received in mainland China as per the *Provisional Measures on Administration of Withholding Chinese-Sourced Enterprise Income Tax on Non-Resident Enterprises* (GSF No. 3 [2009], “**SAT Circular 3 of 2009**”).

Non-residents enterprises

7. In mainland China, EIT is defined as tax levied on profit (earnings deducting costs) earned by a Chinese resident tax payer or a non-resident tax payer (“NRT”). A company incorporated outside mainland China an NRT if the company has not set up branches or premises in mainland China but it earns income originating from mainland china. Company incorporated in Hong Kong, Macau or Taiwan is not deemed NRE to mainland China.

Under what circumstance NRE owners or charterers shall register with PRC local tax authority and declare/pay EIT in mainland China?

8. As per the **Measures**, any NRE as owners or charterers (including bareboat charterer) shall declare and pay EIT in mainland China if the following requirements are satisfied.
 - a) The NRE engages in ITB in mainland China, and

- b) The NRE receives freight or time charter hire payment from a company incorporated in mainland China.
9. If an NRE receives freight or time charter hire or bareboat charter hire (defined as “rental hire”) payment from a Chinese company but the NRE does **NOT** engage in ITB in mainland China, the NRE was required to pay EIT for the freight or hire payment received from Chinese company and the Chinese company was required to withhold and pay certain percentage of freight or hire payment received as EIT on behalf of the NRE in accordance with **SAT Circular 3 of 2009** before 1 August 2014. We intend to take that **SAT Circular 3 of 2009** is valid and that the Measures does not stop NRE to pay EIT for freight or hire payment received from Chinese company even if the vessel does not call at Chinese port at all. It requires SAT’s clarification on this as the **Measures** is giving rise of confusion or uncertainty.
10. Please see more detailed information from the example given in the end of this summary.

What is EIT rate applied?

11. The default EIT rate is 25% on profit that an NRE earned.
12. If NRE fails to calculate profit earned from ITB based on accurate and complete accounting books and records, SAT will apply a 2010-published tax bylaw to determine a figure not less than 15% as deemed profit rate. EIT that an NRE shall pay would be the amount of income x deemed profit rate (15% or over) x 25% (EIT rate).
13. Nevertheless, in accordance with SAT circular No. 95 (previously applied tax bylaw), the profit rate is deemed 5% if the NRE fails to provide accurate and complete accounting books and records to prove otherwise. Under such a circumstance, EIT that an NRE shall pay would be the amount of income x deemed profit rate (5%) x 25% (EIT rate), which is much lower than that determined in accordance with the **Measures**.

The procedures: How does an NRE declare and pay EIT?

14. If an NRE engages ITB and receives freight or hire payment from Chinese company, the NRE shall directly or indirectly apply for registration of taxation before a local SAT within 30 days from contract is signed or approved. After that, the NRE shall declare and pay EIT to a local SAT at the port where ITB is engaged by the NRE.

15. If an NRE fails to register itself before a local SAT or fails to declare and pay EIT, the Chinese company, who is supposed to pay freight or charter hire, is obliged to act as withholding agent and to deduct EIT from the freight or charter hire on behalf of the NRE.

Double tax exemption

16. Mainland China entered bilateral treaty on double tax exemption with over 100 countries or areas (please see Attachment 1 for detailed information) like Britain, Greece, Japan, Cyprus, Chile and Hong Kong. Before any EIT may incur, NRE from these countries or areas, which entered bilateral treaty with China, may enjoy double EIT exemption after filing application to SAT for approval.
17. An NRE's registration with SAT for enjoying double tax exemption has effect of retrospection to any extra enterprise income tax paid for the past three years.
18. For purpose of enjoying double tax exemption, where a vessel, which is engaged in ITB in mainland China, is commercially operated or managed and the domicile of the company, which contracts with Chinese company and receives hire or freight determine whether an NRE can enjoy double tax exemption. Where the vessel is technically managed is not relevant.
19. In brief, the key for an NRE owners or charterers to enjoy double tax exemption is to show Chinese tax authority that the NRE owners/charterers contract with Chinese charterers and receive Chinese sourced hire payment or freight and are required to pay EIT in the country, where the NRE is commercially operated and managed and that this country entered a double tax treaty with mainland China.

Impact on NRE

20. As per the **Measures**, NRE shall have itself registered with local Chinese tax authority, declare and pay EIT when it engages in ITB and earns Chinese-sourced hire or freight.
21. If the NRE fails to follow the **Measures**, Chinese counter party (charterer) will withhold a certain percentage of the freight or hire payment as EIT to be paid on behalf of the NRE owners or NRE charterers no matter whether or not the NRE has profit or deficit.

22. NRE shall apply to Chinese tax authority for enjoying double tax exemption if a double tax treaty is entered between mainland China and the country where the NRE is domiciled.

Comment

23. In case of ITB related time charter, it is not easy for NRE or Chinese charterer to determine when NRE shall declare and pay EIT as per the **Measures** and when the Chinese charters act as withholding agent to deduct hire payment and pay EIT on behalf of the NRE and it is also impractical for NRE to determine what amount of hire payment is the **Measures** related and what amount of hire payment is **SAT Circular No. 3 of 2009** related if a vessel calls at a Chinese port only once in a long time charter.

24. We estimate that SAT's levying EIT on time charter hire payment will face great difficulty if a vessel calls at a Chinese port only once in a long time charter.

How shall NREs react to protect themselves?

25. NRE shall properly draft contract or charter to the effect:-

- a) NRE ensures to receive the agreed amount of freight or hire without deduction of tax;
- b) The charterer accounts to SAT for EIT levied;
- c) Such clause shall not be deemed as tax evasion;
- d) NRE has the benefit of an indemnity from the charterer in case of any dispute in this respect.

26. Sample of charter clause are provided for NRE's rough reference.

Quote

- a) The agreed hire/freight payable to Owners under this Charter is an amount net of any taxes including but not limited to Chinese enterprise income taxes.
- b) Charterers shall bear and pay all taxes, including but not limited to enterprise income tax, VAT or any other taxes, if so levied by Chinese government on the freight or charter hire payment sourced from China under this Charter Party and ensure the

agreed hire/freight to be paid in full and net of any taxes to the owners' bank account.

- c) In case Owners are requested by Chinese taxation authority to pay enterprises income taxes or the likes directly, Charterers shall reimburse to Owners any taxes, interests, fines, or any other amounts levied by mainland Chinese tax authorities on any mainland China-sourced amounts under this Charter Party. Charterers shall indemnify Owners and hold Owners harmless from any expenses arising therefrom, including legal fees, accounting fees, tax registration and declaration costs.
- d) Any clauses above shall not be deemed as tax evasion by the Owners.

Unquote

27. We estimate that Chinese charterers will insert one clause requesting NRE owners or charterers to ensure themselves to apply and enjoy double tax exempt as per any applicable bilateral tax treaties and requesting for documents of tax exemption so that they can be relieved from withholding any EIT for NRE owners or charterers.
28. NRE shall have itself registered with a local SAT at a port most convenient, which vessels of the NRE will call at most frequently, declare and pay EIT as per the **Measures** and its forthcoming implementing regulations. NRE can apply to local SAT for double EIT exemption on basis of bilateral treaty entered, if any.

Example 1:

- A (NRE, owners)→B (Chinese bareboat charterer) →C(NRE, Greek time charterer)→D(Chinese time charterer)→E(NRE time charterer)→F(Chinese voyage charterer)→G(NRE voyage charterer)→H(NRE voyage charterer)→I(Chinese shipper as voyage charterer).
 - In one voyage, the load port is Shanghai and the discharge port is Rotterdam.
- a) A is not required to declare or pay EIT by itself for hire received as per the **Measures** as it receives bareboat charter hire. Bareboat charter is not ITB as defined in the **Measures**. B is required to act as withholding agent to deduct EIT from the hire payment and pay EIT to local SAT on behalf of A as per **SAT Circular 3 of 2009**.
- b) C shall declare and pay EIT in mainland China as per the **Measures** as it receives time

- charter hire from Chinese company D but C can be exempted from paying EIT in mainland China as Greece entered bilateral tax exemption treaty with mainland China.
- c) E shall declare and pay EIT in mainland China as per the **Measures** as it receives freight from Chinese company F.
 - d) G is not obliged to declare or pay EIT in mainland China as it does not receive freight or hire payment from company incorporated in China although G engages in ITB. .
 - e) H shall declare and pay EIT in mainland China as per the **Measures** as it receives freight from company incorporated in China.
 - f) The others are not required to declare or pay EIT in mainland China for any hire payment or freight received.

Example 2:

- A(NRE owners)→ B(Chinese bareboat charterer)→C(NRE time charterer)→D(Chinese voyage charterer)→E(NRE voyage charterer)→F(Chinese shipper as voyage charterer).
 - Nevertheless, the vessel does not call at Chinese port(s) during the time charter or the voyage charter.
- a) A is not required to declare or pay EIT on bareboat charter hire payment received from B as per the **Measures** as bareboat charter service does not fall within ITB as defined in the **Measures**. B is required to act withholding agent to deduct from hire payment and pay EIT on behalf of A as per **SAT Circular No. 3 of 2009**.
 - b) B is not required to declare or pay EIT on hire payment received as B receives hire payment from an NRE rather than from a Chinese company.
 - c) C is not required to declare or pay EIT for hire received as per the **Measures**. D is likely required to act withholding agent to deduct from hire payment and pay EIT on behalf of C as per **SAT Circular No. 3 of 2009** as this business is not Chinese related.
 - d) E may have some goods, mails or others shipped at a port outside mainland China under this scenario. E is not required to declare and pay EIT for freight received from a Chinese company F as per the **Measures** but F is likely required to act withholding agent to deduct from hire payment and pay EIT on behalf of E as per **SAT Circular No. 3 of 2009** as this business is not Chinese ITB related.

The above is very preliminary opinion and formal legal and tax advice shall be sought before taking any steps appropriate to prevailing circumstances.

Best regards,
Green Zhu / Yuchao Zhang
Hightime Law Office Shanghai



Complete List of Jurisdictions Entering Bi-Lateral Tax Treaties with Mainland China¹

No.	Jurisdiction	Signed on	Effective from	Applicable since	Note
1	JAPAN	1983.9.6	1984.6.26	1985.1.1	
2	U.S.A.	1984.4.30	1986.11.21	1987.1.1	
3	FRANCE	1984.5.30	1985.2.21	1986.1.1	
4	U.K.	1984.7.26	1984.12.23	1985.1.1	
5	BELGIUM	1985.4.18	1987.9.11	1988.1.1	
6	GERMANY	1985.6.10	1986.5.14	1985.1.1/7.1	
7	MALAYSIA	1985.11.23	1986.9.14	1987.1.1	50% EIT Exemption
8	NORWAY	1986.2.25	1986.12.21	1987.1.1	
9	DENMARK	1986.3.26	1986.10.22	1987.1.1	
10	SINGAPORE	1986.4.18	1986.12.11	1987.1.1	
11	CANADA	1986.5.12	1986.12.29	1987.1.1	
12	FINLAND	1986.5.12	1987.12.18	1988.1.1	
13	SWEDEN	1986.5.16	1987.1.3	1987.1.1	
14	NEW ZEALAND	1986.9.16	1986.12.17	1987.1.1	
15	THAILAND	1986.10.27	1986.12.29	1987.1.1	50% EIT Exemption
16	ITALY	1986.10.31	1989.11.14	1990.1.1	
17	THE NETHERLANDS	1987.5.13	1988.3.5	1989.1.1	
18	CZECHOSLOVAKIA	1987.6.11	1987.12.23	1988.1.1	
19	POLAND	1988.6.7	1989.1.7	1990.1.1	
20	AUSTRALIA	1988.11.17	1990.12.28	1991.1.1	
21	YUGOSLAVIA (BOSNIA AND HERZEGOVINA)	1988.12.2	1989.12.16	1990.1.1	
22	BULGARIA	1989.11.6	1990.5.25	1991.1.1	
23	PAKISTAN	1989.11.15	1989.12.27	1989.1.1/7.1	
24	KUWAIT	1989.12.25	1990.7.20	1989.1.1	
25	SWITZERLAND	1990.7.6	1991.9.27	1990.1.1	
26	CYPRUS	1990.10.25	1991.10.5	1992.1.1	
27	SPAIN	1990.11.22	1992.5.20	1993.1.1	
28	ROMANIA	1991.1.16	1992.3.5	1993.1.1	
29	AUSTRIA	1991.4.10	1992.11.1	1993.1.1	
30	BRAZIL	1991.8.5	1993.1.6	1994.1.1	

¹ Data from Official Website of China State Administration of Taxation
<http://www.chinatax.gov.cn/n8136506/n8136593/n8137537/n8687294/8688432.html>

No.	Jurisdiction	Signed on	Effective from	Applicable since	Note
31	MONGOLIA	1991.8.26	1992.6.23	1993.1.1	
32	HUNGARY	1992.6.17	1994.12.31	1995.1.1	
33	MALTA	1993.2.2	1994.3.20	1995.1.1	
34	UNITED ARAB EMIRATES	1993.7.1	1994.7.14	1995.1.1	
35	LUXEMBOURG	1994.3.12	1995.7.28	1996.1.1	
36	KOREA	1994.3.28	1994.9.27	1995.1.1	
37	RUSSIA	1994.5.27	1997.4.10	1998.1.1	
38	PAPUA NEW GUI NEA	1994.7.14	1995.8.16	1996.1.1	
39	INDIA	1994.7.18	1994.11.19	1995.1.1	
40	MAURITIUS	1994.8.1	1995.5.4	1996.1.1	
41	CROATIA	1995.1.9	2001.5.18	2002.1.1	
42	BELARUS	1995.1.17	1996.10.3	1997.1.1	
43	SLOVENIA	1995.2.13	1995.12.27	1996.1.1	
44	ISRAEL	1995.4.8	1995.12.22	1996.1.1	
45	VIET NAM	1995.5.17	1996.10.18	1997.1.1	
46	TURKEY	1995.5.23	1997.1.20	1998.1.1	
47	UKRAINE	1995.12.4	1996.10.18	1997.1.1	
48	ARMENIA	1996.5.5	1996.11.28	1997.1.1	
49	JAMAICA	1996.6.3	1997.3.15	1998.1.1	
50	ICELAND	1996.6.3	1997.2.5	1998.1.1	
51	LITHUANIA	1996.6.3	1996.10.18	1997.1.1	
52	LATVIA	1996.6.7	1997.1.27	1998.1.1	
53	UZBEKISTAN	1996.7.3	1996.7.3	1997.1.1	
54	BANGLADESH	1996.9.12	1997.4.10	1998.1.1	50% EIT Exemption
55	YUGOSLAVIA(SE RBIA AND MONTENEGRO)	1997.3.21	1998.1.1	1998.1.1	
56	SUDAN	1997.5.30	1999.2.9	2000.1.1	
57	MACEDONIA	1997.6.9	1997.11.29	1998.1.1	
58	EGYPT	1997.8.13	1999.3.24	2000.1.1	
59	PORTUGAL	1998.4.21	2000.6.7	2001.1.1	
60	ESTONIA	1998.5.12	1999.1.8	2000.1.1	
61	LAOS	1999.1.25	1999.6.22	2000.1.1	
62	SEYCHELLES	1999.8.26	1999.12.17	2000.1.1	
63	PHILIPPINES	1999.11.18	2001.3.23	2002.1.1	EIT Rate shall not exceed 1.5% of total

No.	Jurisdiction	Signed on	Effective from	Applicable since	Note
					income
64	IRELAND	2000.4.19	2000.12.29	2001.1.1	
65	SOUTH AFRICA	2000.4.25	2001.1.7	2002.1.1	
66	BARBADOS	2000.5.15	2000.10.27	2001.1.1	
67	MOLDOVA	2000.6.7	2001.5.26	2002.1.1	
68	KATAR	2001.4.2	2008.10.21	2009.1.1	
69	CUBA	2001.4.13	2003.10.17	2004.1.1	
70	VENEZUELA	2001.4.17	2004.12.23	2005.1.1	
71	NEPAL	2001.5.14	2010.12.31	2011.1.1	
72	KAZAKHSTAN	2001.9.12	2003.7.27	2004.1.1	
73	INDONESIA	2001.11.7	2003.8.25	2004.1.1	50% EIT Exemption
74	OMAN	2002.3.25	2002.7.20	2003.1.1	
75	NIGERIA	2002.4.15	2009.3.21	2010.1.1	
76	TUNIS	2002.4.16	2003.9.23	2004.1.1	
77	IRAN	2002.4.20	2003.8.14	2004.1.1	
78	BAHRAIN	2002.5.16	2002.8.8	2003.1.1	
79	GREECE	2002.6.3	2005.11.1	2006.1.1	
80	KYRGYZSTAN	2002.6.24	2003.3.29	2004.1.1	
81	MOROCCO	2002.8.27	2006.8.16	2007.1.1	
82	SRILANKA	2003.8.11	2005.5.22	2006.1.1	50% EIT Exemption
83	TRINIDAD AND TOBAGO	2003.9.18	2005.5.22	2005.6.1/200 6.1.1	
84	ALBANIA	2004.9.13	2005.7.28	2006.1.1	
85	BRUNEI	2004.9.21	2006.12.29	2007.1.1	
86	AZERBAIJAN	2005.3.17	2005.8.17	2006.1.1	
87	GEORGIA	2005.6.22	2005.11.10	2006.1.1	
88	MEXICO	2005.9.12	2006.3.1	2007.1.1	
89	SAUDI ARABIA	2006.1.23	2006.9.1	2007.1.1	
90	ALGERIA	2006.11.6	2007.7.27	2008.1.1	
91	TAJKISTAN	2008.8.27	2009.3.28	2010.1.1	
92	ETHIOPIA	2009.5.14	2012.12.25	2013.1.1	
93	TURKMENISTAN	2009.12.13	2010.5.30	2011.1.1	
94	CZECH	2009.8.28	2011.5.4	2012.1.1	
95	ZAMBIA	2010.7.26	2011.6.30	2012.1.1	
96	SYRIA	2010.10.31	2011.9.1	2012.1.1	
97	UGANDA	2012.1.11	Not Effective Yet		

No.	Jurisdiction	Signed on	Effective from	Applicable since	Note
98	BOTSWANA	2012.4.11	Not Effective Yet		
99	ECUADOR	2013.1.21	2014.3.6	2015.1.1	
100	CHILE	1984.10.19	1984.10.19	1984.10.19	
101	KOREA (DPRK)	2002.6.14	2002.6.14	2002.6.14	
102	LENANON	1995.6.12	1995.6.12	1995.6.12	
103	ARGENTINA	1978.5.30	1980.12.19	1980.12.19	
104	HONG KONG SAR	2006.8.21	2006.12.8	2007.1.1	
105	MACAU SAR	2003.12.27	2003.12.30	2004.1.1	