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Key Tax and Structuring Issues in Outbound Investment in China, India and Russia

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Key Tax and Structuring Issues in Outbound Investment in China, India and Russia

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Abstract

This paper discusses some of the common structures Canadian multinationals establish when investing in China, India and Russia. The paper provides an overview of these countries' tax treatment of these foreign investments as well as the Canadian tax implications. An Appendix provides a key to selected taxes in China.

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Acronym

BRIC	Brazil, Russia, India and China
China-HK DTA	Agreement between the mainland of China and the Hong Kong Special Administration Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income
China-Luxembourg Treaty	Agreement between the Government of the People's Republic of China and the Government of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income
Circular 59	SAT Circular 2009 No. 59
Circular 698	Tax Circular 2009 No. 698
CIT	Corporate Income Tax
CJV	Co-operative Joint Venture
DDT	Dividend Distribution Tax
DTC	Direct Taxes Code
EJV	Equity Joint Venture
ES	Exempt surplus
FAPI	Foreign Accrual Property Income
FIE	Foreign investment enterprise
MOF	Ministry of Finance
OECD	Organisation for Economic Co-operation and Development
OIDCE	Overseas Incorporated Domestically Controlled Enterprise
PE	Permanent establishment
PRC	People's Republic of China
RO	Representative office
SAT	State Administration of Taxation
SEZ	Special economic zones
TIEA	Tax information exchange agreement
TIEA FA	A company resident in a TIEA country which has a TIEA with Canada in force
TS	Taxable surplus
UMCT	Urban Maintenance & Construction Tax
VAT	Value-Added Tax
WFOE	Wholly Foreign Owned Enterprise
WHT	Withholding tax

I. Introduction



China and India will lead global growth this year, at between 8.4 percent and 8.7 percent, respectively, while the US and the European Union lag behind at 2.8 percent and 1.4 percent, according to the *World Bank 2011 Economic Prospects* report. Nine countries—the BRIC (Brazil-Russia-India-China) group, and Indonesia, Malaysia, Thailand, Turkey, and South Africa—grew at an astounding rate of 8.4 percent in 2010. These countries received the bulk of capital inflows in 2010, with net international equity and bond flows rising by 42 percent and 30 percent, respectively, while foreign direct investment stood at a modest 40 percent, the report notes.

Fortune 500 companies and multinationals have steadily increased their investments in the BRIC regions and the developed countries. These countries, with their large supply of skilled labour and resources and the improving purchasing power of their populations, have emerged as the centres of global economic activities.

Investing in the emerging nations presents both opportunities and challenges for Canadian multinationals. The tax and regulatory systems in these countries are still in the development stage, in deep contrast with those of the developed nations. Canadian investors will need to navigate through the cultural, language and business practice differences in these nations. In this paper, we discuss some of the common structures Canadian multinationals establish when investing in China, India and Russia and the Canadian income tax implications. We also provide a high-level discussion of some of the key local tax and regulatory issues companies face when establishing businesses in these countries.

II. Investment in China



A. Tax and Regulatory Overview for Foreign Investors

Over the last decade, China announced a series of structural changes to its foreign direct investment regime, the centerpiece of which is the Catalogue for Guiding Foreign Investment in Industries, promulgated in 2004 and subsequently revised in 2007. The Catalogue essentially divides China's economy, for foreign investment purposes, into four categories: prohibited, restricted, allowed, and encouraged. Foreign investments are subject to up-front examination and approval by the competent government authorities, such as the Ministry of Commerce, against such categories.

The most common form of foreign investment vehicles in China is the foreign investment enterprise (FIE). Typically, the direct foreign ownership in an FIE should be no less than 25 percent. The FIE then is able to carry out manufacturing, processing, trading and/or service activities in accordance with its approved business scope. Among the FIEs, three primary legal forms are observed: Equity Joint Venture (EJV)², Co-operative Joint Venture (CJV)³ and Wholly Foreign Owned Enterprise (WFOE)⁴. Foreign investors in certain industries, such as insurance and banking, may set up branches in China. Another corporate form, the foreign invested partnerships, has come into the spotlight but is yet to gain popularity due to the lack of specific regulatory guidance in this regard.

² EJVs are legal entities incorporated under the China-foreign Equity Joint Venture Law. Allocation of voting rights and earnings of an EJV is proportionate to the subscription of capital by each of the EJV's investors.

³ CJVs are established under the China-foreign Co-operative Joint Venture Law and may take the form of a legal entity or otherwise. Allocation of voting rights and earnings of a CJV is as stipulated in its joint venture contract.

⁴ WFOEs are legal entities incorporated under the Wholly Foreign-owned Enterprise Law of the People's Republic of China. All investors to the WFOE must be foreign entities or individuals.

The procedures concerning the establishment of an FIE can be burdensome. Prior to company registration, all FIEs must obtain the approval of the Ministry of Commerce (or its local branches) and some should obtain the endorsement of the National Development and Reform Commission. Depending on the nature and scale of the proposed business, approval of various industry regulatory bodies, such as the Ministry of Industry and Information Technology and the Ministry of Environmental Protection, will also be required. After obtaining the approval, the FIE should be registered with other relevant government authorities, e.g., State Administration for Industry and Commerce, tax bureau, foreign exchange bureau, and Public Security Bureau. Nevertheless, we have witnessed continuous efforts of local governments to streamline the process, thanks to the fierce competition for foreign direct investments among different locations.

With respect to the tax system, the National People's Congress enacts all tax laws of the People's Republic of China (PRC), while the State Council promulgates supplementary and provisional regulations. The Ministry of Finance (MOF) and State Administration of Taxation (SAT) are empowered to interpret the tax laws and regulations, with the publication of ad-hoc tax circulars. PRC's tax system reflects the complexity of PRC's legal system. There is no single tax law governing the taxation of individuals and enterprises. Rather, separate laws and regulations impose different taxes on different taxpayers and on different types of activities. Normally, the taxes would be divided into four main categories as follows:

- Individual Income Tax
- Corporate Income Tax (CIT)
- Turnover taxes, i.e., Value-Added Tax (VAT), Business Tax and Consumption Tax (including surcharges)
- Transaction and Property taxes, i.e., Stamp Duty, Deed Tax, Land Appreciation Tax, Urban Real Estate Tax and Resource Tax.

We have summarized in Appendix I the specifics of some of these taxes in China.

The Corporate Income Tax laws and regulations are relatively new. Prior to 1 January 2008, the income tax systems for

domestic entities and foreign enterprises have developed separately over the years. Efforts have been made to unify the corporate income tax system such that foreign enterprises and domestic enterprises will be taxed under the same tax scheme. In this regard, a new Corporate Income Tax Law was enacted on the Tenth National People's Congress on 16 March 2007. The new Corporate Income Tax law unifies the income tax treatment of domestic enterprises, FIEs and foreign enterprises. This law attempts to balance the competing goals of encouraging and attracting foreign and domestic investment, spurring economic development and innovation, enhancing tax administration and achieving tax justice.

B. Selected Key Issues of Investing in China

1. Foreign exchange controls

China has relatively stringent currency control, both under the current and the capital accounts. Foreign capital injection, international trade and service trade, profit repatriation, and other cross-border transactions are subject to the control and supervision of State Administration of Foreign Exchange.

2. Other financing considerations

In addition to tax, regulatory and foreign exchange control, other factors such as financing structure, framework of law, customs, local practices of government authorities and cultural differences should also be considered in making a decision to invest in China.

An FIE has only a limited number of alternatives to finance its business operation, including equity, debt, and a mix of both. In terms of debt financing, the FIE is able to take out loans, including domestic currency loans and foreign currency loans, from commercial banks, its investor(s), and other entities. The FIE can borrow locally as much as the bank is willing to lend. Yet in practice, the bank will tend to adhere to the debt-equity ratio and consider also the actual financial situation of the borrowers. The amount of foreign loans the FIE can raise, however, is strictly capped by its foreign debt capacity, which is the difference between its total investment⁵ and registered

⁵ In general terms, total investment is defined as the aggregate of funds required for "construction of operations" and "circulating" fund. The conventional interpretation is that funds required for "construction of operations" are the net book value of fixed assets while "circulating" funds are working capital.

capital. In general, the ratio of the registered capital and the total investment of an FIE in China should range from 33.33 percent to 70 percent, depending on the amount of the total investment. A summary of the ratio of the registered capital and the total investment of an FIE is as follows.

Unit: US dollars

Total Investment (X)	Minimum Registered Capital (Y)	Equity/Debt ratios
$X \leq 3$ million	$Y/X \geq 70\%$	7:3
$3 \text{ million} < X \leq 10$ million	$Y/X \geq 50\%$; and $Y \geq 2.1$ million	1:1
$10 \text{ million} < X \leq 30$ million	$Y/X \geq 40\%$; and $Y \geq 5$ million	2:3
$X > 30$ million	$Y/X \geq 33.33\%$; and $Y \geq 12$ million	1:2

Table 1: Ratio of registered capital and total investment

C. Case Study: Canadian Company Investing in China

In this section of our paper, we discuss several possible structuring alternatives of Canadian investments into China, and the key Canadian and PRC tax implications. We also highlight some of the key offshore tax considerations that are relevant to some of the intermediary structures discussed.

In this case study, a Canadian equipment manufacturer (Canada Co) is considering establishing a subsidiary in China (China Sub) which will manufacture equipment. A majority of the finished goods will be sold back to Canada Co. China Sub will also sell some of its finished goods in the Chinese domestic market and provide technical training to its Chinese customers. Neither the Hong Kong Holding Company (HK Co) nor China Sub are listed in Hong Kong, nor does China Sub have a shareholder’s register in Hong Kong.

We will discuss the case study from the following perspectives:

- Investment structuring alternatives
- Key Canadian and PRC tax issues
- Profit repatriation
- Exit strategies
- Internal corporate reorganization and transfer.

1. Investment structuring alternatives

There are two common approaches in structuring of investments into China. Under the direct investment option, Canada Co will establish a wholly owned China Sub that is a WFOE to carry on the Chinese business. Under the indirect investment alternative, Canada Co will establish offshore intermediaries to hold and finance the China Sub through equity and debts. Commercial reasons and tax efficiency are usually important considerations to the Canadian investors in the selection of the investment and holding structures.

a) Direct Investment

In the structure illustrated in figure 1, Canada Co holds 100% of China Sub. Canada Co finances China Sub through equity and interest-bearing loans (as allowed under the PRC regulations as discussed above). Canada Co also grant China Sub licensing rights to use certain of its intellectual property to carry on the manufacturing activities in China. China Sub pays interest, royalties and dividends to Canada Co.

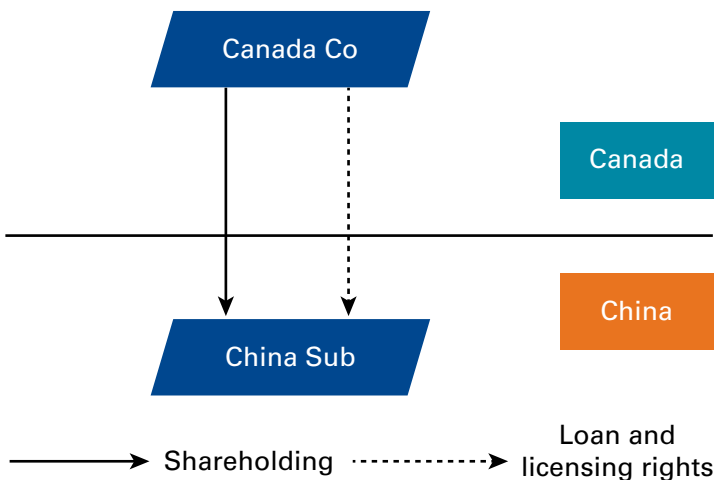


Figure 1: Direct Investment structure

(1) Key PRC Tax Considerations

China Sub will be subject to CIT in respect of its taxable income at the standard rate of 25% (unless it can otherwise qualify for tax incentives). China Sub’s taxable income will be calculated based on its taxable revenues by deducting various deductible costs and expenses, including interest and royalties payments, as well as allowable tax losses, if any, brought forward from previous years. The deductibility of these cross-border

payments for PRC tax purposes is subject to the applicable thin capitalization and transfer pricing rules.

The thin capitalization rules operate to disallow deduction of excessive interest expense incurred in related-party financing⁶. In order for the related party interest expense to be deductible for tax purposes, the related party debt to equity ratio cannot exceed 2:1 in all cases except for financial institutions. Related-party interest expense exceeding the threshold is non-deductible in the current and subsequent periods, unless the entity can provide supporting documentation demonstrating that the financing is at arm's length or, in the case of pure domestic borrowing, the effective tax rate of the borrower is not higher than the rate of the lender. From a regulatory perspective, the entity must comply with the minimum registered capital requirement and the debt to equity ratios for an FIE as outlined in the foregoing.

All the transactions occurring among China Sub and its related parties should be in line with the arm's length principle. The SAT reinforces such transfer pricing compliance requirements through a taxpayer self-assessment approach, whereby all CIT payers are required to submit the annual disclosures for their related party transactions and prepare their contemporaneous transfer pricing documentation if the amount of the transactions exceeds a certain threshold. Such compliance requirements will result in the SAT receiving a large influx of information about taxpayers, which will be at the SAT's disposal when conducting audits in the future. This will significantly increase the transparency of transfer pricing activity in China, and further the Chinese government's efforts in working within the international norms established by the OECD and its member countries. Although these improved standards will be beneficial for multinationals, they will also provide additional challenges for companies involved in transfer pricing controversies. In effect, the tax authority will have access to comprehensive information on almost all comparable companies, facilitating the SAT in conducting its transfer

pricing audits. It is therefore imperative for Chinese FIEs and their foreign parents to conduct transfer pricing studies to substantiate the terms and conditions of their cross-border non-arm's length transactions.

In the present scenario, Canada Co will be subject to the Chinese withholding tax (WHT) at 10 percent on receipts of dividends, interest and royalties from China Sub. The China and Canada double tax agreement (the "China-Canada Treaty"⁷) does not provide any substantial relief in this regard. Canada Co will also be subject to Business Tax and local levies at a combined rate of 5.5 percent - 5.6 percent on the receipts of interest and royalties.

(2) Key Canadian Income Tax Considerations

Canada Co should not be subject to any immediate Canadian income taxation on income earned by its controlled foreign affiliate, China Sub, as long as such income is from an "active business"; as that term is defined in subsection 95(1) of the Income Tax Act (Canada) (the "Act")⁸. Paragraph 95(2)(a.1), which deems certain affiliate's income to be income from a business other than an active business (and thus foreign accrual property income), should not apply in this case. Since the goods are manufactured in China, China Sub is formed in China and governed by its laws, and China Sub's business is



⁶ Circular of Ministry of Finance and State Administration of Taxation on Deduction for the Interest Expense from Related Party Financing.

⁷ Agreement between the Government of the People's Republic of China and the Government of Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, enacted in Canada by S.C. 1986, c. 48, Part III.

⁸ The definition of foreign accrual property income in subsection 95(1) does not include the affiliate's income from an active business.

principally carried on in China, the so-called “Home Country goods” exception pursuant to clause 95(2)(a.1)(iii)(A) of the Act should apply⁹. Thus, the active business income earned by China Sub should be considered “exempt earnings”¹⁰ of China Sub and be included in China Sub’s “exempt surplus” (ES) account.¹¹

If China Sub realizes a taxable capital gain computed under the rules in Part I of the Act,¹² such taxable capital gain will be included in foreign accrual property income (“FAPI”) of China Sub, except taxable capital gain that arose from the disposition of “excluded property”¹³ where none of the rollover provisions dealing with internal reorganizations in paragraphs 95(2)(c), (d) or (e) of the Act apply to the excluded property¹⁴. We have summarized below the allocation of China Sub’s gross capital gain and losses to the various surplus accounts.

Surplus accts	Excluded properties that are active business assets ¹⁵	Other excluded properties ¹⁶	Non-excluded properties ¹⁷
ES	100%	50%	50%
Taxable Surplus (TS)	0%	50%	50% / 1/2 taxable capital gain in FAPI

Any dividends paid by China Sub to Canada Co are included in computing Canada Co’s income¹⁸. Canada Co, however will be

able to claim a deduction on the portion of the dividend that is prescribed to have been paid out of the ES or pre-acquisition surplus of China Sub,¹⁹ resulting in no Canadian corporate tax.

If the dividends are paid from the TS of China Sub, Canada Co will be able to claim a deduction for the “underlying foreign tax” prescribed to be applicable to those dividends paid by China Sub, as well as the WHT paid on the dividends²⁰. Furthermore, dividends deductible under subsection 113(1) of the Act are included in the General Rate Income Pool,²¹ from which eligible dividends can be paid.

Canada Co could potentially claim the WHT paid on the interest and royalties as a foreign tax credit pursuant to subsection 126(1) of the Act or as a deduction against income under subsection 20(12) of the Act. Note that, even though the WHT on the royalties is 10 percent, Article 21²² of the China-Canada Treaty deems the Chinese profit tax paid on the royalties to be 15 percent. The CRA has confirmed in a technical interpretation that 15 percent of the gross payments shall be used for the purpose of calculating the foreign tax credit for the Canadian corporation²³.

On August 19, 2011, the Department of Finance released certain proposals that will treat gains from disposal of excluded property that is shares of foreign affiliates as “hybrid surplus”.

⁹ See also the definition of “designated property” pursuant to subsection 95(3.1) of the Act for goods that are on-sale by a foreign affiliate to its Chinese customers. If the goods are “designated property,” paragraph 95(2)(a.1)(i) does not apply to deem the active business income to be income from a business other than an active business and to be included in the affiliate’s foreign accrual property income calculation.

¹⁰ Defined in Regulation 5907(1).

¹¹ *Ibid*, at 9.

¹² Paragraph 95(2)(f) of the Act and Regulation 5907(5).

¹³ Defined in subsection 95(1) of the Act. Excluded property is a property that is (a) used or held by the foreign affiliate principally for the purpose of gaining or producing income from an active business, (b) shares of the capital stock of another foreign affiliate of the taxpayer where all or substantially all of the property of the other foreign affiliate is excluded property, or (c) an amount receivable the interest on which is, or would be if interest were payable thereon, income from an active business by virtue of subparagraph 95(2)(a)(ii).

¹⁴ See B in the FAPI calculation formula under subsection 95(1) of the Act. See also the proposed amendment to B which expands the inclusion of other rollover provisions, applicable for taxation years of a foreign affiliate that end after December 19, 2002.

¹⁵ *Ibid*, at 9. Capital gains that arose from disposition of excluded properties that are active business assets are included in “exempt earnings” under Regulation 5907(1)(a) and “exempt surplus”.

¹⁶ The taxable capital gains that arose from the disposition of “excluded properties” that are shares of capital stock of another foreign affiliates are included in “net earnings” under Regulation 5907(1)(d)(iii), taxable earnings under Regulation 5907(1)(b)(v), and Taxable Surplus under Regulation 5907(1)(A)(ii). The non-taxable portion of the capital gain from disposition of the excluded properties that are not active business is included in “exempt earnings” under Regulation 5907(1)(a)(ii).

b) Use of Hong Kong Intermediary

(1) PRC Tax

In the structure illustrated in figure 2, Canada Co holds 100 percent equity interest in HK Co. HK Co finances China Sub by a mix of equity and interest-bearing debts. Canada Co grants HK Co the rights to use its intellectual property, where HK Co sub-licenses such rights to China Sub. It is assumed in this case study that HK Co is considered a tax resident of Hong Kong pursuant to the China-HK DTA (defined herein). China Sub pays interest and royalties to HK Co.

The CIT implication for China Sub would be the same as that under the direct holding structure.

However, under the double tax arrangement between the PRC and Hong Kong (the “China-HK DTA”²⁴), the WHT rate on dividends received from China Sub by HK Co will be reduced from the normal rate of 10 percent to 5 percent if HK Co is the “beneficial owner” and owns at least 25 percent of the equity interest in China Sub. The WHT rates would be 7 percent on interest and royalties derived from China Sub by HK Co, again, if HK Co is the beneficial owner of such income.

From PRC tax perspective, it would be more tax-efficient for Canada Co to set up its China Sub through an intermediate holding entity in Hong Kong than to hold China Sub directly. This is primarily due to the lower WHT rates on cross-border dividends, royalties and interest payments under the China-HK DTA than the comparable WHT rates under the China-

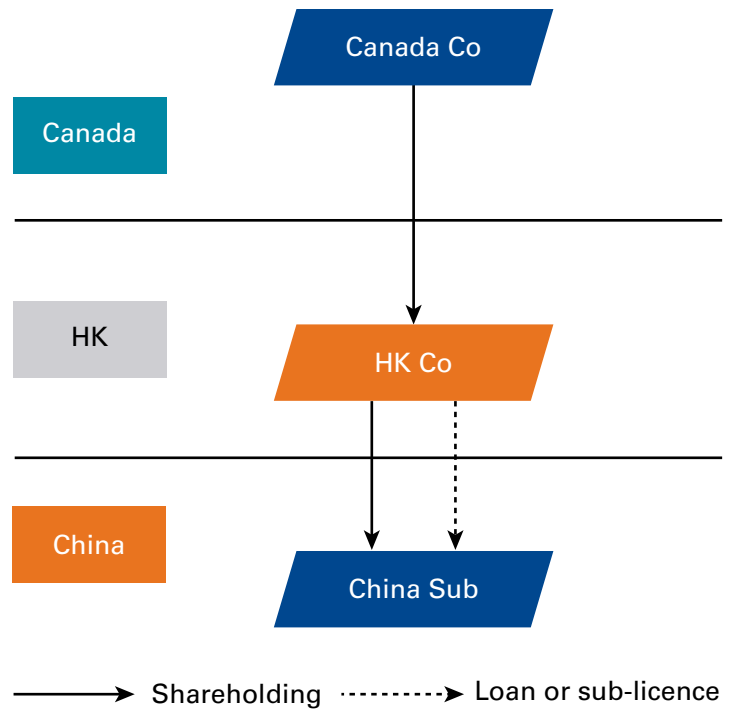


Figure 2: Indirect Investment via HK intermediary

¹⁷ The taxable capital gains that arose from disposition of “non-excluded properties” are included in “net earnings” under Regulation 5907(1)(b), taxable earnings under Regulation 5907(1)(b)(ii), and Taxable Surplus under Regulation 5907(1)(A)(iii). The non-taxable portion of the capital gain from the disposition of the non-excluded properties that are not active business is included in “exempt earnings” under Regulation 5907(1)(a)(i).

¹⁸ Section 90 of the Act.

¹⁹ Paragraphs 113(1)(a) and (d) of the Act.

²⁰ Paragraphs 113(1)(b) and (c) of the Act, Regulation 5900(1)(d) and the definition of “underlying foreign tax applicable” under Regulation 5907(1).

²¹ As defined under subsection 89(1) of the Act, E(b) in the GRIP formula. ²² Clause 2(e)(III) of Article 21 of the China-Canada Treaty. ²³ Technical Interpretation (external) 2002-0153395—Foreign tax credit—article 21 China Treaty, dated September 18, 2002.

²² Clause 2(e)(III) of Article 21 of the China-Canada Treaty.

²³ Technical Interpretation (external) 2002-0153395—Foreign tax credit—article 21 China Treaty, dated September 18, 2002.

²⁴ Agreement between the mainland of China and the Hong Kong Special Administration Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

Canada Treaty for the direct investment structure as discussed above. From a Canadian tax perspective, if these cross-border payments are not immediately taxable in Canada or are non-taxable in Canada upon repatriation under the foreign affiliate taxation regime, the reduction in WHT by investing through Hong Kong represents an absolute tax saving to the ultimate Canadian parent corporation.

When planning for investment into China through intermediaries, taxpayers should be aware that the SAT has set out specific rules to curb the abusive use of tax treaty benefits. In particular, the intermediate holding company in Hong Kong must have sufficient business substance to be recognized as the beneficial owner of the China sourced income. This will be discussed in further detail in the following sections of this paper.

(2) Key Hong Kong Income Tax Considerations

Hong Kong does not levy any withholding tax on payments of interest and dividends to non-residents of Hong Kong. However, Hong Kong withholding tax of either 4.95 percent or 16.5 percent can apply to royalties paid to non-residents, depending on the circumstances.

Dividend income received from China Sub by HK Co is not subject to Hong Kong profits taxation. If the interest-bearing debts were advanced to China Sub from a non-Hong Kong bank account of HK Co, then the interest income earned by HK Co from China Sub will not be subject to Hong Kong profits taxation. However, the profit realized by HK Co on the sublicensing arrangements may be taxable in Hong Kong.

(3) Key Canadian Income Tax Considerations

The key Canadian income tax considerations will be substantially the same as those discussed under the direct investment option above. Dividends received by HK Co from China Sub are excluded from FAPI calculation pursuant to A(b) of the definition of FAPI in subsection 95(1) of the Act. Furthermore, Regulation 5907 generally allows the flow-through of ES from China Sub to HK Co via dividends prescribed to be paid out of China Sub's ES to HK Co²⁵. Therefore, Canada Co should be able to claim a dividend deduction under section 113 of the Act on dividends paid by HK Co, as long as such dividends are prescribed to be paid out of HK Co's ES.

Furthermore, inter-corporate payments, such as interest and royalties earned by HK Co from China Sub, could be re-characterized as "active business income" pursuant to subparagraph 95(2)(a)(ii) of the Act, and therefore not FAPI of HK Co that will otherwise be subject to immediate Canadian taxation. However, since HK Co is not considered a resident of a "designated treaty country" for exempt surplus calculation purpose²⁶, such recharacterized subparagraph 95(2)(a)(ii) active business income will not be included in the ES of HK Co, but will be included in the TS of HK Co instead.

The WHT assessable on the interest and royalties payable by China Sub to HK Co should be regarded as "Underlying Foreign Tax" as defined under Regulation 5907(1) for purpose of calculating the paragraph 113(1)(b) deduction with respect to dividends payable by HK Co to Canada Co prescribed to be paid from the TS of HK Co.

²⁵ Regulation 5907(1)(iii), which includes "the portion of any dividend received by the subject affiliate from another foreign affiliate of the corporation that was prescribed by paragraph 5900(1)(a) to have been paid out of the payer's affiliate's exempt surplus in respect of the corporation."

²⁶ As defined in Regulation 5907(11). In Technical Interpretation 1999-0014605 – Hong Kong, dated February 22, 2001, Hong Kong would be considered part of China only for the Home Country Goods exception under paragraph 95(2)(a.1) of the Act. A Hong Kong company would not be considered to be part of a "designated treaty country" for purposes of determining "exempt earnings" under the Canadian foreign affiliate rules. Since Hong Kong has maintained its own tax system, the term "Chinese tax" is defined in paragraph 1 of Article 2 (Taxes Covered) of the China-Canada Treaty and does not include taxes imposed under Hong Kong's tax regime. As a result, it is CRA's opinion that a corporation that is resident in Hong Kong and subject to Hong Kong's tax regime (rather than China's tax regime) would not be considered a resident of China under the China-Canada Treaty and would fail the test in paragraph 5907(11.2)(a) of the *Income Tax Regulations* for purposes of determining exempt earnings under Canada's foreign affiliate rules.

Hong Kong has commenced negotiations of an income tax treaty or a tax information exchange agreement (TIEA) with Canada.

If Hong Kong becomes a non-qualifying country (which generally means no TIEA is in force and has effect at that time, where both countries have begun negotiations for a comprehensive TIEA more than 60 months ago, income earned by a Hong Kong company from carrying on a business through the Hong Kong permanent establishment would be considered to be income from a non-qualifying business, which will be included in FAPI of the Hong Kong company and subject to immediate Canadian taxation. In this situation, the WHT paid by HK Co on the cross-border payments received from China Sub should provide some relief for the FAPI as a subsection 91(4) foreign accrual tax deduction.

As an alternative to using a Hong Kong Company as an intermediary holding company, Canadian multinationals could consider forming intermediary holding companies in jurisdictions where there are currently tax treaties with Canada and with China, such as Luxembourg, Ireland and Singapore ("Treaty Co"). These Treaty Cos have to be considered residents of the treaty jurisdictions under the relevant treaties to be entitled to the treaty benefits, and be considered a resident of a "designated treaty country" under the foreign affiliate regime. Any active business income (or deemed active business income) earned by the Treaty Co will be excluded from FAPI calculation. Furthermore, such income, if repatriated to Canada as a dividend from the ES of Treaty Co, will not be subject to any Canadian corporate taxation.

c) Use of Treaty Jurisdiction Intermediary (1) PRCTax

In the structure illustrated in figure 3, Canada Co forms two holding structures to equity-finance and debt-finance China Sub. For the equity holding structure, Canada Co

owns 100 percent equity interest in HK Co. HK Co in turn owns 100 percent equity interest in China Sub. For the debt financing structure, Canada Co forms Lux Co, a resident of Luxembourg for purposes of the Canada.

Luxembourg Income Tax Convention and the China (People's Rep.) – Luxembourg Income and Capital Tax Treaty. Lux Co establishes a branch in Hong Kong (HK branch). Lux Co's HK branch makes an interest-bearing loan to China Sub, the funds of which are advanced from a non-Hong Kong bank account of the HK branch. China Sub pays interest to HK branch.

It is assumed that HK Co and Lux Co are considered tax residents of Hong Kong and Luxembourg respectively under the relevant tax treaties.

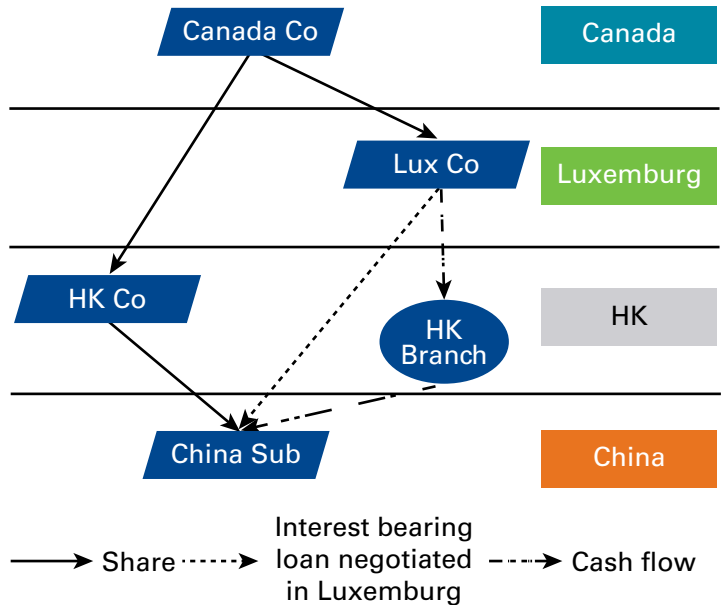


Figure 3: Indirect Investment via HK/Luxembourg intermediary



HK Co will be subject to a WHT at 5 percent on dividend payments received from China Sub, provided that it is considered a resident of Hong Kong pursuant to the China-HK DTA and has sufficient business substance to benefit from the reduced treaty rate. The interest received from China Sub by Lux Co's HK branch will be subject to WHT at 10 percent according to the China and Luxembourg double tax agreement (the "China-Luxembourg Treaty"²⁷). In this case, Lux Co has a permanent establishment (PE) in Hong Kong through its HK branch. According to the interpretations stipulated in Guoshuifa 2010 No. 75²⁸, a Luxembourg resident enterprise's PE in Hong Kong is a part of the Luxembourg resident enterprise and is not a resident of Hong Kong. As such, the interest income earned by HK branch from China Sub shall be governed by the China-Luxembourg Treaty instead of the China-HK DTA. The HK branch of Lux Co will also be subject to Business Tax and local levies at the combined rate of 5.5 percent - 5.6 percent on the receipts of interest and royalties.

(2) Key Hong Kong Tax Considerations

Interest income earned by HK branch is not subject to Hong Kong profits tax if China Sub received loaned funds from a non-Hong Kong bank account of HK branch, and it can be demonstrated that all activities which lead to the conclusion of the loan agreement have been undertaken outside of Hong Kong.

(3) Key Luxembourg Tax Considerations

Pursuant to Article 7 of the Hong Kong - Luxembourg Income and Capital Tax Treaty (2007) ("HK-Luxembourg Tax Treaty"), the taxing rights of the interest income earned by the HK branch are allocated to the HK branch. Furthermore, Article 23 of the HK-Luxembourg Tax Treaty should exempt branch profits (i.e., from assets duly allocated to the HK branch) from taxation in Luxembourg, provided the HK branch qualifies as a permanent establishment, including interest income earned from loans allocated to the HK branch, as well as any foreign exchange gains and/or any market gains realized on such loans held by the HK branch.

Dividends paid by Lux Co to Canada Co should not be subject to Luxembourg withholding tax if the conditions of the participation exemption are fulfilled²⁹.

In addition, Lux Co may be subject to other local taxes, such as net wealth tax. A detailed analysis of the Luxembourg tax implication is beyond the scope of this paper.

(4) Key Canadian Income Tax Considerations

The key Canadian income tax considerations have been discussed in the foregoing paragraphs. Comparing this structure with the preceding financing structure using a Hong Kong company, Canada Co will have an additional PRC WHT cost of 3 percent on the interest expense payable by China Sub. Also, there will be additional professional costs in setting up and maintaining the equity and financing structures. However,

²⁷ Agreement between the Government of the People's Republic of China and the Government of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.

²⁸ Circular of the State Administration of Taxation Concerning Interpretation Issues Relevant to the Arrangement and the Agreement between the PRC and Singapore to Avoid Double Taxation and Prevent Tax Evasion. Canada Co Lux Co HK Co Canada Luxemburg China Sub China.

²⁹ The minimum participation that qualifies for the dividend exemption is ownership of 10 percent of share capital or an acquisition price of at least €1,2 million of the share capital. In addition, the participation must have been held for at least 12 months on the date the income is allocated or realized for tax purposes. Further requirements include that the shareholder must be a "collective entity" (e.g., company or similar legal person) and be subject to a comparable corporate income tax as Luxembourg's (normally a Canadian company subject to Canadian corporate income tax fulfills these requirements).

from a Canadian tax perspective, the interest income earned by the HK branch of Lux Co that is deemed to be active business income pursuant to paragraph 95(2)(a)(ii) as they are “directly or indirectly” related to amounts payable by China Sub will be “exempt earnings” that will be included in the ES of Lux Co (compared to the case of HK Co in the foregoing, where such income will be part of the TS of HK Co). Dividends that are prescribed to be paid out of ES of Lux Co to Canada Co will not be subject to Canadian corporate taxation.

The 2008 amendments with the introduction of TIEAs may offer new planning opportunities for Canadian multinationals structuring their international investments. “Designated treaty country” now includes countries that have TIEAs with Canada that have been entered into force³⁰. Generally, active business income earned by a foreign affiliate that is a resident in a TIEA country (agreement in force) may be included in the exempt earnings and exempt surplus of that foreign affiliate, which facilitates the future repatriation of profits from the foreign affiliate to Canada free of Canadian tax. Most of the TIEA countries do not levy income tax, or have low domestic income tax.

For financing foreign investments, considerations could be given to interposing a company resident in a TIEA country which has a TIEA with Canada in force (TIEA FA) in the Canada Co-HK Co-China Sub structure as discussed above. The TIEA FA is a wholly owned subsidiary of Canada Co and will be the immediate parent of HK Co. Canada Co will finance the TIEA FA with equity. TIEA FA will finance HK Co with interest-bearing debts, where HK Co will advance the loaned funds to China Sub (from a non-Hong Kong bank account) on an interest-bearing basis. The loaned funds will enable China Sub to carry on its active business in PRC. It is expected that the TIEA FA will be located in a low or nil tax jurisdiction such that the interest income it earned from HK Co will be subject to nominal domestic taxes. Using a company in a TIEA country as an intermediary achieves similar results from a Canadian tax perspective as using a company established in a treaty jurisdiction (as illustrated in the Lux Co alternative herein).

However, based on our experience, costs associated with establishing a TIEA company are a lot lower than costs for a company established in a treaty jurisdiction.

The interest income earned by TIEA FA from HK Co will be FAPI, unless it is deemed to be active business income pursuant to subparagraph 95(2)(a)(ii). To qualify as deemed active business income, subparagraph 95(2)(a)(ii) requires the interest income to be derived from amounts that were paid or payable, directly or indirectly, to TIEA FA by China Sub, another foreign affiliate of Canada Co, to the extent these expenditures were deductible in computing China Sub’s prescribed earnings from an active business.

The issue is whether TIEA FA derives such income from amounts paid or payable by China Sub in this type of back-to-back financing. The CRA’s view is that the words “directly or indirectly” were meant to address back-to-back arrangements, and the amounts would be considered to be paid indirectly by a foreign affiliate to another foreign affiliate if an arm’s length intermediary is involved in a payment flow. A strong link (or direct tracing) is required for an amount paid or payable to be considered indirectly related to the particular income source³¹. In a technical interpretation, the CRA suggested that the agreements would have to clearly set out that one loan is conditional on the other loan³².

Even though the CRA has expressed some positive views in this context, one needs to be aware of the PRC tax authority’s views on back-to-back financing arrangement and the beneficial ownership issues. Further, establishing the substance of an intermediary in a TIEA country may be more challenging than establishing substance in a treaty jurisdiction.

2. Exit Strategies

Tax-efficient exit strategies are integral to the overall investment, holding and financing structures for Canadian multinationals investing in China. The PRC tax implications upon disposition of investment in China by Canada Co under direct and indirect holding structures would be different.

³⁰ As of the date of this paper, no Canadian TIEAs are in force.

³¹ CRA Views 9517445, Meaning of “directly or indirectly” in 95(2)(a), dated February 1, 1996, CRA Views 9526865-95(2)(A), Directly or indirectly, dated May 21, 1996, CRA Views 2002-0122335 – Indirect payment through a trust, dated May 8, 2002.

³² CRA Views 2004-0073431E5, Foreign Accrual property income, dated November 28, 2005.

a) Direct Investment

(1) PRC Tax

Under the direct investment structure, Canada Co will be subject to WHT at 10 percent on the gain, if any, arising from the transfer of equity interest in China Sub. Gains on transfer of equity interest are calculated as the transfer price less the cost of the original investment.

(2) Key Canadian Income Tax Considerations

Any capital gain realized on the disposition of the shares of China Sub will be taxable in Canada. The 10 percent WHT on the non-treaty exempted gain is creditable against Canadian tax on the gain. In addition, Canada Co may elect under section 93 of the Act to treat part or all of the proceeds of disposition as a dividend received from China Sub. This has the effect of reducing the proceeds and thus the capital gain realized on the disposition of China Sub's shares. If China Sub has sufficient ES, or TS and underlying foreign tax prior to the sale, such dividend deemed to have been paid out of ES or TS with sufficient underlying foreign tax via the section 93 election will not be subject to Canadian corporate tax.

b) Hong Kong Intermediary

(1) PRC Tax

In the past, it is quite common for foreign corporations to establish intermediary offshore holding companies to hold their investments in China to facilitate future exit. Such a structure allows a transfer of the foreign corporations' indirect interest in China on a PRC-tax-neutral basis. However, in recent years, the PRC tax authorities have been scrutinizing such offshore transactions.

The tax circular 2009 No. 698 ("Circular 698")³³ assigns to the transferor the obligation of self-assessment and reporting in respect of an offshore indirect transfer of Chinese equity interest. Effectively, this gives the PRC tax authorities the taxing rights where such rights are not fully exercised by the jurisdiction in which the transferor is located. Following the issuance of Circular 698, we have come across a number of cases where the SAT disregarded the existence of the

intermediate holding company (e.g., HK Co) and treat the disposal of the intermediate holding company as a disposal of the Chinese entity for which the WHT applies. However in practice, some potential issues about the interpretation of Circular 698 need further clarification from the SAT, such as:

- What is the level of business substance required in the intermediate holding company in order for PRC tax authorities not to consider it as a conduit?
- What types of documentation and evidence do the PRC Tax authorities require to substantiate the existence of the intermediary as a separate legal entity and beneficial owner of the various payments?
- How to allocate proceeds and determine the tax basis for indirect transfers where a lump-sum consideration is paid for more than one underlying entity?

So far there has been no answer to the above questions – Circular 698 has created a steep learning curve for both the taxpayers and the PRC tax authorities. Each case, therefore, must be assessed on its own merits.

(2) Key Hong Kong Income Tax Considerations

Hong Kong levies a stamp duty on a transfer of shares of HK Co, which is equal to 0.2% of the fair market value of the shares. To mitigate the stamp duty liabilities, a company formed in a low tax jurisdiction (such as the Cayman Islands or British Virgin Islands) with central management and control established in Hong Kong could be used in place of a Hong Kong incorporated company. We have received opinions from offshore tax advisors that companies established under the laws outside of Hong Kong but with its central management and control established in Hong Kong should be considered as factual tax residents of Hong Kong for purpose of various tax treaties that Hong Kong entered into. Such companies will therefore be entitled to treaty benefits under the relevant treaties. Furthermore, the transfer of shares of these companies will not attract any Hong Kong Stamp duty.

³³ Circular of the State Administration of Taxation on Strengthening the Administration of Enterprise Income Tax on Incomes from Non-resident Enterprises' Equity Transfers.

Where HK Co sells shares of China Sub, the taxation of the sales proceeds would depend on whether the gain is revenue or capital in nature and whether it is onshore or offshore sourced. Only where the gain is revenue in nature and onshore sourced would it be subject to Hong Kong profits tax. Where HK Co holds China Sub on capital account and as a long term investment, it may be reasonably argued that the investment is capital in nature. Further, a gain should be offshore sourced where both the contracts for the purchase of China Sub as well as for the sale would be affected outside Hong Kong.

(3) Key Canadian Income Tax Considerations

Please refer to the above discussion on disposition of shares of HK Co, the top tier foreign affiliate in the chain of companies. If Canada Co elects under section 93, the proposed legislation would require the surplus accounts (surplus and deficit) of the underlying foreign affiliates to be consolidated for purpose of the section 93 election on the sale of the top tier foreign affiliate.

3. Internal Corporate Reorganization and Transfer

In principle, companies involved in corporate restructuring in China should be liable for CIT/WHT on any gains incidental to the restructuring process, where gains are computed based on the fair market value of the transfer in excess of historical costs. However, under certain circumstances, the gains are allowed to be deferred. Such cases are referred to as "special restructuring" under SAT circular 2009 No. 59³⁴ (Circular 59), which for tax purposes recognizes the following types of restructuring:

- Change of the legal form (from legal entity to non-legal entity and vice versa)
- Debt restructuring

- Equity transfer
- Asset transfer
- Merger
- De-merger.

Generally speaking, provided that a restructuring transaction has sound commercial substance and does not change the normal mode of operation of the transferred entity, the amount of equity interest involved in the transfer exceeds a certain threshold, the cash consideration for the transfer is below a certain threshold, and a required holding period for the transferred shares or equity interests is complied with, the PRC tax authorities may conclude that the restructuring is not tax-driven thus there is no need for cash tax at this stage. In that case, the taxpayer may opt to have any gains carried over to the time of future disposal.

Specific assessment criteria are set out in Circular 59 in respect of the above general conditions. For cross-border restructurings, the rules are more stringent than for domestic reorganization.

We set out below two examples of cross-border equity transfer which would qualify as a special tax-deferred restructuring for PRC tax purposes:

a) Case 1

Before the internal reorganization transactions, Canada Co owns 100% of the share capital of China Sub. As part of the internal reorganization, Canada Co transfers 100% of its share investment in China Sub to HK Co in consideration for shares of HK Co.

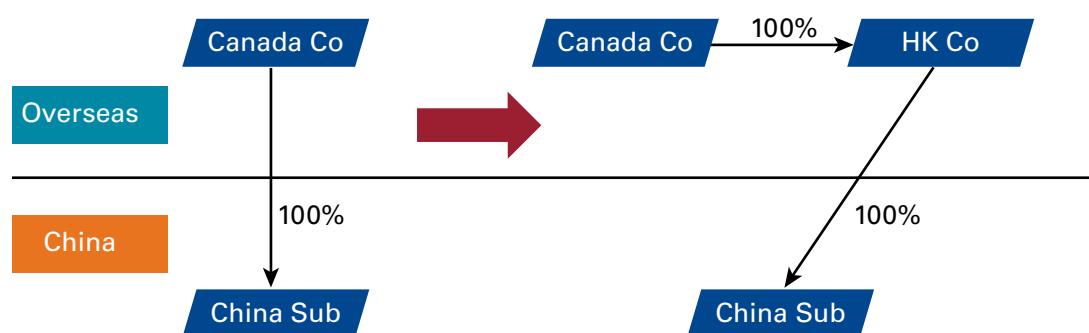


Figure 4: Cross border transaction case 1

³⁴ Cai Shui [2009] No. 59, "Circular on Issues Concerning Process of Enterprise Income Tax in Enterprise Restructuring Business."

Canada Co needs to satisfy the following conditions to enjoy the special tax deferral:

- All general conditions mentioned above
- Canada Co directly controls 100% of HK Co
- The transfer will not cause future change in the capital gains tax burden on the equity in China Sub (i.e., no treaty-shopping)
- Canada Co will not transfer equity in HK Co within three consecutive years after the transfer of equity in China Sub.

b) Case 2

Before the internal reorganization transactions, Canada Co owns 100% of the share capital of China Sub. As part of the internal reorganization, Canada Co transfers 100% of its share investment in China Sub to China Co 1 in consideration for shares of China Co 1.

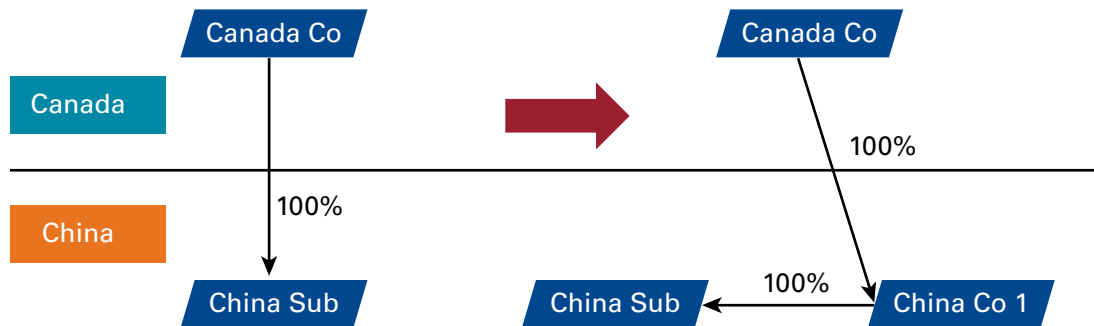


Figure 5: Cross border transaction case 2

Canada Co needs to satisfy the following conditions to enjoy the special treatment:

- All general conditions mentioned above
- Canada Co directly controls 100% of China Co 1.

Key Canadian Income Tax Considerations

Generally speaking, the internal reorganization described under cases 1 and 2 could be carried out on a tax-deferred basis pursuant to subsection 85.1(3) of the Act. To the extent the underlying foreign affiliates have surplus, a subsection 93(1) election could be used concurrently with the subsection 85.1(3) rollover provision to convert the surpluses into adjusted cost base of the shares of the acquirer-foreign affiliate.

4. Specific PRC Tax Issues Relating to Income Earned in China
a) Permanent Establishment and Employees

In July 2009, SAT issued a circular, Ji Bian Han [2009] No. 103,³⁵ requiring State Tax Bureau at the local level to examine the secondment arrangements of enterprises in their jurisdictions with a view to detecting foreign enterprises providing services under the guise of secondment. Whether the home country entity providing services in China through its employee to the host country entity under a secondment arrangement would constitute a PE is a question of fact. According to Circular 75, the following issues would be considered as PE indicators:

- The home entity takes responsibility and risk over the activities of the secondees and the secondees work under the instruction of the home entity
- The home entity determines the standard and the number of secondees to be sent to the host entity

- The remuneration packages of the secondees are borne by the home entity
- The home entity gets a profit from the host entity by sending secondees to work in the host entity.

Once the overseas entities would be regarded as having their respective PEs in China, based on circular Guo Shui Fa [2010] No.19,³⁶ the overseas entities should be liable for CIT at 25% on the taxable income attributable to the PE, calculated based on the accounting books. The revenue and costs/expenses should be matched with the PE's function and the risks that it bears. If the PE cannot maintain proper accounting books or accurately account for its revenue or costs/expenses, the tax authority has

³⁵ Circular of the International Taxation Department of the State Administration of Taxation on Investigating the Collections of Enterprise Income Tax on Foreign Institutions for Their Provision of Services for Domestic Enterprises via Dispatching Personnel.

³⁶ Circular on Printing and Distributing the Administrative Measures for the Assessment and Collection of Income Tax against Non-resident Enterprises.

the discretion to deem the taxable income attributable to the PE. The tax authority may adopt either a cost plus or a deemed profit method to calculate the taxable income of the PE. The general deemed profit rates for different business would be ranged from 15 percent to 50 percent, e.g., 15 percent - 30 percent for construction service and 30 - 50 percent for hotel management service.

b) Profit Repatriation

In general, China Sub can repatriate the profit through remittance of dividends, interest, royalties service fees, cost sharing and capital reduction to the overseas investors or other entities. Among these methods, dividend, service fee and royalty agreement strategies are relatively easy to implement. Shareholder loans or loans from overseas entities, cost sharing and capital reduction face many restrictions; capital reduction is the least possible solution among all of these.

(1) Dividends

Under the current regulations, a subsidiary could repatriate dividends, out of its after-tax retained earnings,³⁷ to its investor upon the satisfaction of the following conditions:

- China Sub should be in a positive retained earnings position from the accounting perspective
- All the relevant taxes must have been paid
- The appropriations have been made to the mandatory “three funds”:
 - The general reserve fund
 - The enterprise expansion fund
 - The staff welfare and incentive fund.

According to the relevant WFOE Law, a WFOE, i.e., China Sub, is only required to make allocations to two reserve funds, i.e., the general reserve fund and the staff welfare and incentive fund. The percentage of allocation to the staff welfare and incentive fund shall be determined by the Board of Directors of China Sub. Other considerations include, for example, declaration of interim or final dividends and the cash trap issues.

³⁷ Company Law of the People's Republic of China.

³⁸ Guoshuihan [2009] No. 81 Circular of the State Administration of Taxation on Relevant Issues relating to the Implementation of Dividend Clauses in Tax Treaty Agreements.

³⁹ Circular of the State Administration of Taxation on Issues Concerning the Identification of China-controlled Overseas-registered Enterprises as Resident Enterprises on the Basis of the Standard of Actual Management Organization.

⁴⁰ Circular of the State Administration of Taxation on How to Understand and Determine “Beneficial Owners” under Tax Conventions.

PRC Tax considerations

Provided that it has economic substance, the foreign investor, i.e., HK Co, should be subject to the reduced PRC WHT rate at 5% on dividends distributed by China Sub pursuant to the China-HK DTA. HK Co should apply for such treaty benefits as a tax resident of Hong Kong by submitting the required documents.³⁸ In addition, HK Co may also be required to prove that it is the beneficial owner of the dividends.

Tax resident test

The foreign investor of China Sub, i.e., HK Co, may qualify as a tax resident of Hong Kong if it has neither tax resident status in a third country nor falls under the concept of having the “place of effective management” in China. The tax authority will issue a tax resident certificate, which is one of the critical documents, to enable HK Co to enjoy the reduced WHT rate stipulated in China-HK DTA.

In China, the “place of effective management” concept was first introduced in the CIT law promulgated on 16 March 2007 and was subsequently defined in the related implementation rules.

The SAT issued a tax circular, Guoshuifa [2009] No. 82,³⁹ to clarify the concept of “place of effective management” for Overseas Incorporated Domestically Controlled Enterprise (OIDCE) and to set out the related CIT implications. It is important to note that Guoshuifa [2009] No. 82 is retroactively implemented from 1 January 2008. The Chinese tax authority will consider OIDCEs as resident enterprises in China for CIT purposes if their place of effective management is in China even though they are incorporated outside China. This is the case if overall management and control over their operations, personnel, finance, assets, etc. are exercised in China.

In practice, the Chinese tax authority is reluctant to deem an OIDCE as a resident enterprise because a dividend received from a resident enterprise by another resident enterprise is exempt from CIT.

Beneficial owner test

Based on the circular, Guo Shui Han [2009] No.601,⁴⁰ which provides general guidance in assessment of beneficial owner, a non-resident company should have economic substance to be

regarded as the beneficial owner. Under the “substance over form” principle, a conduit company that does not have actual operation activities and was incorporated for the purposes of avoiding or reducing taxes or transferring profits will not be regarded as the beneficial owner. Circular 601 identifies the following major negative factors that the PRC tax authorities may review in assessing a recipient of income as not qualifying as the beneficial owner. The recipient:

- Will distribute a major part (e.g., above 60 percent) of the proceeds within a specified time limit (e.g., within 12 months after receiving them) to residents of a third country
- Has pure shell holding company status or is a company that has limited assets, operation scale or staff
- Is located in a low tax jurisdiction
- Has a loan agreement or royalty agreement with a third jurisdiction company that is similar to its agreements with China Sub.

Equity holding test

According to Guoshuiha [2009] No. 81, the foreign investor of China Sub, i.e., HK Co, should hold no less than 25 percent equity of China Co to enjoy the reduced WHT on dividends. Where the treaties provide that a tax resident of the other contracting state should directly hold no less than a certain percent (generally 25 percent or 10 percent) of the total equity of a PRC enterprise in order to enjoy the income tax rate for the dividends received from the PRC enterprise, such taxpayer of the other contracting state should meet all of the following conditions:

- The tax resident in the other contracting state who receives the dividend can only be an enterprise
- The stipulated ratio must be met with respect to both the total shareholder equity and the shares with voting rights in the PRC enterprises
- The stipulated ratio should be met anytime in the 12 consecutive months prior to receipt of the dividends.

(2) Loan Interest

The overseas lender, i.e., HK Co, would be subject to PRC WHT at 10 percent on the interest received from China Sub. Pursuant to the China-HK DTA, HK Co would enjoy the reduced WHT of 7 percent if it is the beneficial owner of the interest received. HK Co should generally be subject to Business Tax and local levies with their combined rate in the range of 5.5 percent to 5.6 percent. HK Co is also subject to Stamp Duty at 0.005 percent on the loan principal.

In addition to PRC tax implications mentioned above, some other issues need to be considered for the loan between the overseas lender and China Sub, i.e., whether the foreign debt is within the loan quota of China Sub, registration of foreign debt, whether the interest rate is in line with the arm’s length principle, etc.

(3) Royalties

HK Co should generally be subject to WHT at 10 percent on the royalties received. HK Co would enjoy the reduced WHT of 7 percent if it is the beneficial owner of the royalties. HK Co should generally be subject to Business Tax and local levies at the combined rate of 5.5 percent - 5.6 percent on the royalties received. Business Tax will be exempted for royalties on the transfer of technology and the related technology services. HK Co is subject to Stamp Duty at 0.05 percent on the transfer amount stipulated in the royalty contract.

In addition to PRC tax implications mentioned above, there are some other issues to consider, i.e., registration of a royalty agreement with the government authority, which would enable HK Co to be exempt from Business Tax if certain conditions are satisfied, for example, whether the royalty rate is in line with the arm’s length principle, and whether the service fee would be treated as royalties.

(4) Foreign Exchange Administration

China has relatively stringent foreign exchange control. According to PRC foreign exchange regulation,⁴¹ outbound remittance of foreign exchange by a PRC company is subject to the assessment and approval of the in-charge SAFE office. In recent years, SAFE has delegated the assessment/approval authority for certain types of remittance to foreign exchange banks. To process the remittance of the above mentioned profit repatriation items, the foreign exchange banks of China Sub would require the following basic documents:

- Agreements, e.g., service agreement, licensing agreement; certain agreements may need to be registered with in-charge authorities
- Board resolution of China Sub to distribute the dividend
- Payment advice and invoices
- Tax clearance documents for CIT, Business Tax and WHT, where applicable
- Other documents as required.

⁴¹ Foreign Exchange Administrative Regulations of the People’s Republic of China.

III. Investment in India



A. Overview of Indian Tax and Regulatory Regime

1. Investment in India

India is one of the fastest growing economies in the world, with a population of 1.2 billion. The country has attracted significant foreign investments in recent years.

2. Overview of Indian tax and regulation system

Foreign investors may choose to establish a presence in India through the creation of an Indian entity (Company or Limited Liability Partnership (LLP)), a representative office or a branch office.

As per the Foreign Direct Investment Guidelines, foreign investors are freely allowed to invest in most of the business sectors in India. However, in certain business sectors or activities, there are maximum levels, prohibitions and restrictions on foreign investment. Foreign investment in an LLP is available where 100% foreign direct investment is allowed but it is subject to government approval.

Foreign exchange controls regulate movement of funds into and out of India.

India has a comprehensive tax system. The taxes include corporate tax and personal income tax, wealth tax, sales tax, value-added tax, service tax and other indirect taxes. India has proposed to introduce a Goods and Services tax which is likely to replace the VAT, sales tax and service tax.

Income Tax

Corporate income tax is levied at a rate of 33.22 percent,⁴² and 42.23% in case of foreign companies.⁴³ There is no further tax in India on repatriation of the profits of a branch of a foreign company.

⁴² The rate of 33.22 percent top rate comprises of corporate income tax rate of 30% plus Surcharge and Education Cess of 3.22%.

⁴³ The rate of 42.23% comprises of Surcharge of 2% and Education Cess of 3%.

Under the proposed Direct Taxes Code (DTC), which will replace the current Indian Income Tax Act, 1961, corporate income will be taxed at a rate of 30% in the case of Indian as well as foreign companies. Further, an Indian branch will be subject to an additional branch profit tax of 15% on its after tax profits.

Indian withholding tax provisions apply to payments of interest, royalties, technical fees, commission, professional fees, etc. for payments made locally. In the case of payments made to non-residents, tax needs to be withheld if the non-resident's income is liable to tax in India.

On distribution of dividends by an Indian company, the company is subject to a Dividend Distribution Tax (DDT) of 16.61%.⁴⁴ The recipient shareholder (whether resident or non-resident) is not taxable on the dividend received from an Indian company. No dividend withholding tax is levied on dividends paid by an Indian company to its non-resident shareholders.

Transfer pricing regulations potentially affect cross-border transactions between Indian taxpayers and related parties.

India generally levies capital gain tax on the disposition of the shares of Indian companies. The tax rate on the capital gain depends on whether the gain is a short-term capital gain or a long-term capital gain and whether the shares disposed of are listed on a recognized stock exchange. A long-term capital gain arises if the shares have been held for more than 12 months. A short-term capital gain arises if the shares have been held for 12 months or less.

Long-term capital gains from the sale of a listed security are generally not taxable in India.

Long-term capital gains from sale of an unlisted security are taxable at a rate of 21.12 percent.

A new DTC is proposed to replace the Income Tax Act of India (1961). The DTC is the most significant reform of tax laws in India for many decades. The DTC is based on a strategy to bring structural changes to direct taxation in India to minimize tax exemptions or broaden the base, and to address the problems of tax avoidance and tax evasion.

The DTC is proposed to bring several path-breaking structural changes to the taxation laws in India. Key DTC proposals are given as follows:

- General anti-avoidance rules (GAAR)
- Controlled Foreign Corporation (CFC)
- Branch Profit Tax (BPT)
- Limited Treaty override
- Concept of place of effective management in the residency rules

B. Case Study: Canadian Company Investing in India

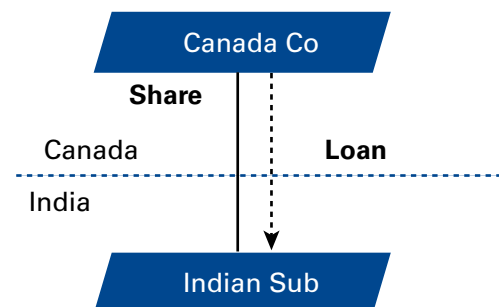
1. Tax structuring of investments from Canada into India

The following case study reviews direct and indirect investment structures for investments in India. The key tax considerations discussed below are minimization of Indian tax on repatriation of profits and disposition of the investment in India.

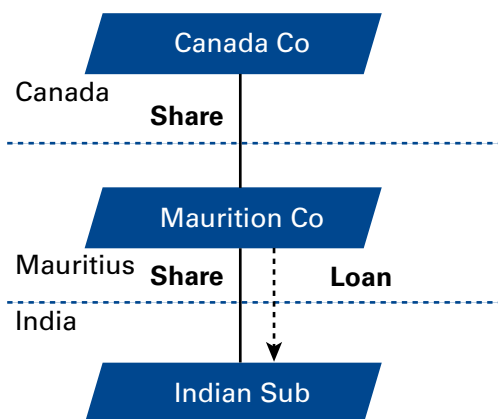
Option 1 below considers a direct investment structure, and option 2 reviews investing through a holding company established in an intermediate jurisdiction. The intermediate jurisdiction chosen for discussion below is Mauritius, as it has been a popular holding company jurisdiction for foreign investors structuring their investments in India.

Option 1 – Direct investment from Canada into India

Canada Company (Canada Co) may capitalize an Indian subsidiary (Indian Sub) with share capital and loan capital.



⁴⁴ The 16.995 percent DDT rate comprises Income Tax of 15 percent, Surcharge of 1.5 percent (10 percent of 15 percent), and Education Cess of 0.495 percent (3 percent of 16.5 percent).



The Indian foreign exchange guidelines govern the regulation of provision and utilization of foreign loans, generally referred to as External Commercial Borrowings.

Indian Sub is liable to corporate income tax at a rate of 33.22%. Payment of dividends are not subject to withholding tax in India. However, the dividend paying Indian Sub is subject to DDT of 16.61% off the dividend.

The dividend received by Canada Co is taxable for Canadian tax purposes.⁴⁵ As the dividend is a liability off the dividend payer company (i.e., Indian Sub) and not of the shareholder (i.e., Canada Co), Canada Co will not be eligible to claim a foreign tax credit in computing Canadian tax payable for the Indian DDT incurred by Indian Sub on the dividend. The tax treaty between Canada and India does not provide any protection to Canada Co against the DDT.

India currently does not have “thin capitalization” rules. The GAAR provisions under the proposed DTC may cover situations where an Indian company is thinly capitalized. However, the DTC is silent on the Debt-Equity ratio. The interest on the loan from Canada Co to Indian Sub should be deductible by Indian Sub subject to the transfer pricing rules. Interest paid on the loan by Indian Sub to Canada Co is subject to Indian withholding tax.⁴⁶

For Canadian tax purposes, if Indian Sub is not resident in Canada, the active business income of Indian Sub is not currently taxable in Canada. If Indian Sub is resident in India on the basis of its mind and management being situated in India, the active business income of Indian Sub from a business carried on in India is added to the exempt surplus in respect of Indian Sub and dividends paid out of such exempt surplus to Canada Co are eligible for deduction under section 113 of the Act in determining the taxable income of Canada Co.

Disposition of Shares of Indian Sub

Capital gains arising on disposition of shares of Indian companies are generally taxable in India. As per the Canada-Indian tax treaty, capital gains on disposition of shares are taxable in both countries, i.e. India as well as Canada. The treaty provides that Indian tax on the capital gain be creditable against Canadian income tax on the capital gain.

For Canadian tax purposes, Canada Co may be eligible to elect under section 93 of the Act to deem a portion of the proceeds of disposition of the shares of Indian Sub as a dividend paid by Indian Sub. Also, Indian Sub should be eligible for a foreign tax credit in respect of the Indian capital gain tax.⁴⁷

Option 2 – Indirect Investment - Mauritian intermediate holding company

As an alternative to holding the shares of Indian Sub directly, Canada Co could structure the Indian investment through an intermediate holding company in a foreign jurisdiction, such as a Mauritius holding company (Mauritius Co).

The Indian Sub’s Indian corporate income tax position will be the same as in option 1.

Interest on the loan to Indian Sub should be deductible by Indian Sub subject to transfer pricing rules.

Interest paid by Indian Sub to Mauritius Co on the loan from Mauritius Co to Indian Sub is subject to Indian withholding tax at a rate of 21.115%. Mauritius Co is subject to tax in Mauritius at a flat rate of 15%. However, Mauritius Co should be eligible

⁴⁵ Dividends received from a non-resident corporation are included in the Canadian resident shareholder’s income under section 90 of the Act.

⁴⁶ The withholding tax rate may be reduced from the ordinary Indian withholding tax rate on interest payments of 21.115% to the rate of 15% pursuant to the Canada-India tax treaty.

⁴⁷ Subsection 126(1) of the Act should provide a foreign tax credit in respect of the Indian income tax component of the capital gain tax in India.

to claim the Indian interest withholding tax as a foreign tax credit⁴⁸ for Mauritius tax purposes, with the result that the interest income of Mauritian Co should not be taxable in Mauritius or is taxed at a maximum effective rate of 3%.

Mauritius and Canada currently do not have a tax treaty and have not commenced to negotiate a tax information exchange agreement. Therefore, the interest income of Mauritian Co should be included in the taxable surplus in respect of Mauritian Co.

There is no dividend withholding tax imposed in Mauritius on dividends paid by a Mauritian company to a non-resident shareholder.

Dividends received by Canada Co from Mauritian Co that are derived from the exempt surplus in respect of Indian Sub should be deductible by Canada Co under section 113 of the Act.

Dividends received by Canada Co from Mauritian Co that are derived from the taxable surplus in respect of Indian Sub would be taxable to Canada Co with a deduction for underlying foreign tax.

Where Mauritian Co disposes of the shares of Indian Sub, in accordance with the treaty between Mauritius and India, any gain on the shares is not taxable in India.⁴⁹ Mauritian Co must be prepared to provide documentary evidence to substantiate a claim of residency in Mauritius including a tax residency certificate for the purpose of claiming benefit under the Mauritius-India tax treaty.

As a method of returning capital to its shareholder, Indian Sub could buy back its shares held by Mauritian Co. This buy back of shares however, is subject to various conditions and ceilings under Indian corporate law and the buy-back price needs to

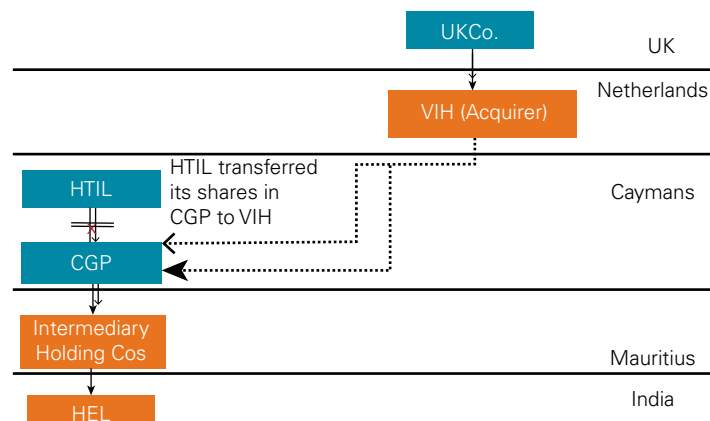
comply with the fair value provisions under Indian foreign exchange regulations.

Under the proposed DTC, the GAAR empowers the tax authorities with the power to deny the tax benefits of an arrangement if its main purpose is to obtain a tax benefit. In such situations, the tax authorities may disregard all or part of an arrangement including any intermediate holding company in an investment structure.

Other jurisdictions that may serve as intermediate holding company jurisdictions for investment in India include Cyprus, Singapore and the Netherlands.

C. Indirect Disposal Rules— Bombay High Court’s decision in Vodafone International Holdings BV (“Vodafone”)

The Bombay High Court rendered a landmark decision in September 2010 that is of great interest to the global tax communities concerning the Indian indirect disposition rules. The Bombay High Court has ruled that Vodafone, as the acquirer of the shares of an offshore entity, CGP Holdings Ltd (“CGP”) which indirectly owned Indian telecommunication assets, has failed to withhold from the proceeds a US\$2.6 billion tax on the estimated gain realized by the seller, Hutchison Telecommunications International Ltd. Accordingly, Vodafone is held liable for the failure to withhold taxes from the seller. The organization structure is depicted below:



⁴⁸ Under Mauritius law, any resident entity may claim a foreign tax credit for actual foreign tax suffered on income derived from outside Mauritius against Mauritius tax payable (up to the amount of Mauritius tax) provided written evidence of the foreign tax suffered is available. If evidence is not available and the entity holds a Category 1 Global Business Licence (GBL1), the foreign tax is deemed to be 80% of the Mauritian tax payable on the income, resulting in an effective tax rate of 3%.

⁴⁹ Article 13(4) of the Mauritius-India tax treaty.

Under the Indian tax law at the time, a capital gain is taxable in India only if it arises from a transfer of capital assets situated in India. Vodafone asserts that the impugned transaction involved transfer of shares of a foreign company outside of India and hence the gain on the sale of the shares was not taxable in India. The Indian tax department, however, assessed the transaction as a transfer of capital assets situated in India, the gain on which was taxable in India.

The Bombay High Court, in considering arguments from both the taxpayer and the tax authority, has concluded the following:

1. Tax planning is a legitimate activity. Indian tax law recognizes the right of every person to structure their affairs in the most tax-efficient manner. Absent a sham, the legal character of the transactions needs to be respected.
2. Shareholder rights are distinguishable from the underlying assets held by the corporations. Controlling interest is an incident of ownership and is not a distinct capital asset taxable in India for purposes of the Indian tax act.
3. However, the impugned transaction was not simply a sale of the shares of CGP by HTIL—It was also a disposal of the underlying Indian assets, the gain on which was subject to Indian income taxation. These assets included indirect interest in HEL through a network of subsidiaries, use

and rights to the Hutchison brand in India, a non-compete agreement with the Hutchison Group, and interest in the form of preference share capital in indirect holding companies of HEL.

4. The consideration paid by Vodafone was to be apportioned between the fair market value of the CGP shares and fair market value of the Indian business and capital assets that were disposed of.

Vodafone has appealed the High Court decision to the Supreme Court of India. In addition, we understand the Indian tax authority is aggressively going after several multinationals that have undertaken similar mega-transactions in the past.

It should be noted that the proposed DTC could apply to future indirect disposal transactions. Under the proposed rule, income from transfer of shares or interest in a foreign company outside of India shall be deemed not to be accrued or arise in India, unless the fair market value of assets situated in India (owned directly or indirectly) represents at least 50% of the fair market value of all assets owned by that foreign company at any time during the 12 months prior to the transfer. If the above condition is met, the transferor will be liable to Indian tax on the income calculated based on the proportionate fair market value of the Indian assets over the fair market value of all the assets owned by the foreign company.



IV. Investment in Russia



A. Overview of Russian Tax and Regulatory Regime

Taxation of foreign investment in Russia

The rate of foreign investment in Russia has grown steadily in recent years. While the Russian taxation system is continuing to evolve and foreign investors still face various challenges in navigating that system, it has become more stable for foreign investors.

Forms of Business Operations in Russia for Foreign Investors

Foreign investors may choose to establish a presence in Russia through participating in a Russian entity,⁵⁰ a representative office (RO) or a branch. An RO is authorized to conduct certain “preparatory and auxiliary” activities for the head office. A branch can perform all business activities, including execution of sales contracts.

1. Russian tax system

Types of taxes

Taxes and levies are imposed in Russia at the federal, regional and local levels. Federal taxes and levies include profits tax, personal income tax, value-added tax, excise tax, mineral extraction tax, water tax, levies for natural and biological resources consumption and stamp duty.

Regional taxes include property tax, gambling tax and transport tax. Local taxes include land tax and individual property tax.

Profits tax

The maximum profit tax rate is 20 percent, of which 2 percent is paid to the federal budget and 18 percent to the regional budget. The regional profits tax rate can be reduced to 13.5 percent at the discretion of the regional authorities.

⁵⁰ The most common forms of corporate structures are limited liability companies (LLC) and joint stock companies. LLCs are often used by foreign companies to conduct wholly owned businesses in Russia. JSCs are often used to raise capital for the business' activities.

Foreign entities with a permanent establishment (PE) in Russia are subject to profits tax on profit attributable to the Russian PE. A PE includes a branch, office or other independent unit as well as an independent agent who regularly exercises the right to conclude contracts in the name of the principal. Foreign entities without a PE in Russia are subject to withholding tax on Russian source income.

Withholding taxes

Foreign entities in receipt of Russian source income not attributable to a PE in Russia are subject to withholding income tax. The withholding tax rate on dividends paid by a Russian entity to a foreign investor is 15 percent. The withholding rate on most other Russian source income such as interest, royalties and leasing and rental income is 20 percent. Such withholding rates are subject to reduction under an applicable double taxation treaty.⁵¹

Russian tax authorities may try to challenge the application of treaty benefits in case recipient entity does not have enough substance in the jurisdiction of its tax residence.

Value-added tax

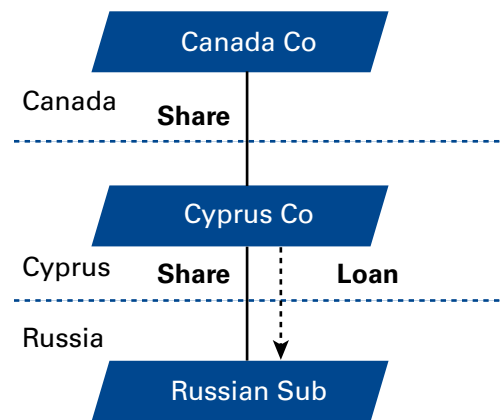
VAT is a key source of tax revenues for Russia. VAT is a tax designed to be borne ultimately by consumers. VAT applies to the sale of goods, provision of services and other activities. The general VAT rate is 18%. A 10% rate is applicable to essential commodities, foods, goods for children, etc. Exports are taxable at 0% rate. There are special place of supply rules. For example, consulting, legal and engineering services are subject to VAT in Russia if the buyer of such services is a Russian company. The same relates to royalties for the usage of intellectual property. However, transfer of rights to use patented technology or know-how is exempt from VAT.

Special Economic Zones

Special economic zones (SEZ) are territories in Russia where certain tax, customs and other concessions are granted to entities operating in these zones. The possible advantages of SEZs include the reduction of profits tax, property tax and land tax. As well, foreign goods placed within a free customs zone regime are not subject to VAT and import customs duties.

B. Structuring Investments in Russia

The tax treaty between Russia and Canada does not reduce the withholding tax rate on dividends and interest. Withholding income tax rates may be reduced to only 10%. A Canadian investor investing in Russia may consider structuring the investment through an intermediate jurisdiction, such as Cyprus, to minimize Russian profits tax and withholding taxes.



Repatriation of Dividends

Where the value of the Cyprus holding company's shares in the Russian subsidiary is at least USD100,000,⁵² the Russia dividend withholding tax is reduced to 5% from the general dividend withholding tax rate of 15%.⁵³ A new protocol amending the existing Cyprus-Russia tax treaty provides that the minimum investment level will be changed too €100,000 from USD100,000. The protocol has not been ratified yet by the Russian Duma.

Debt Financing

Debt financing of the business activities of the Russian subsidiary may permit the Russian subsidiary to claim interest deductions in computing profits for profits tax purposes in Russia. The deduction of interest expense by the Russian subsidiary on related party debt is restricted by Russian thin capitalization rules.

⁵¹ To claim the benefit of a double taxation treaty with the Russian Federation, a certificate confirming residency in the foreign jurisdiction should be obtained from the relevant foreign authorities.

⁵² If this test is not met, the dividend withholding rate is 10 percent.

⁵³ The Canada-Russia tax treaty provides for a dividend withholding tax rate of 15 percent, which is the same rate as the general dividend withholding tax rate.

Under these rules, the interest on related party debt obligations of a Russian legal entity owing to a foreign lender may be restricted by Russian thin capitalization rules if:

- The Russian borrower entity has a debt obligation owed to the foreign lender that owns directly or indirectly more than 20 percent of the share capital of the Russian entity or a debt obligation owed to another Russian entity that is affiliated with the foreign lender, or a debt obligation guaranteed by the foreign lender or affiliated Russian entity; and
- The amount of the debt obligation is more than three times the difference between the Russian borrower entity's assets and liabilities.

Any non-deductible amount of interest is reclassified as a dividend and should be subject to withholding income tax at a rate applicable to dividends (15%, however, as was mentioned above, subject to reduction under the relevant double tax treaty).

There are recent court cases in which Russian courts stated that thin capitalization rules should not be applicable when the Russian borrower has a Cypriot shareholder. However, the Russian tax authorities are still challenging claims of non-application of thin capitalization rules in these situations.

Under the Cyprus-Russia tax treaty, interest paid by a Russian entity to a Cyprus resident is exempt from Russian interest withholding tax.

Where the interest is deductible in computing the Russian subsidiary's active business income, the interest should be included in the exempt surplus of the Cyprus corporation for Canadian tax purposes.⁵⁴

Cyprus currently does not levy income tax on dividends received from a foreign corporation and on gains on disposition

of the shares of foreign corporations. Also, Cyprus does not impose withholding tax on dividends paid by a Cyprus corporation to a non-resident shareholder if:

- (a) the foreign company paying the dividend does not engage directly or indirectly in more than 50% of its activities which lead to passive income (non-trading income), or
- (b) the foreign tax burden on the income paying the dividend is not substantially lower than the tax burden in Cyprus. A tax rate of 5% or more in the country in the country paying the dividend satisfies this condition.

C. Disposal of shares in a Russian entity

Proceeds from the disposal of shares in a Russian entity are subject to withholding income tax of 20 percent unless reduced by an applicable double taxation treaty.

However, a foreign entity with no PE in Russia is not subject to withholding income tax on the sale of the shares of a Russian entity if immovable property located in Russia owned by the Russian entity accounts for less than 50 percent of its assets.

The Cyprus-Russia tax treaty exempts from Russia taxation gains from disposal of shares of a Russian entity. The new protocol to the Cyprus-Russia tax treaty continues to give the sole right to tax a gain from the disposal of shares of a Russian company to Cyprus but only if not more than 50% of the assets of the company consist of Russian real property⁵⁵. Thus, in the above scenario, if Cyprus Co disposes of Russian Sub shares, and not more than 50% of the assets of Russian Sub consist of Russian real property, the gain should not be taxable in Russia under the new protocol to the tax treaty.

⁵⁴ S95(2)(a)(ii)(B)(I) of the Act.

⁵⁵ However, this provision of the protocol will have effect as from the calendar year following the expiration of the period of four years from the date on which the protocol enters into force.



Canadian companies that want to take advantage of the many business opportunities becoming available in China, India and Russia can benefit from considering the tax implications of investing in those countries as part of their business plans. The choice of structure for the investment can have a significant impact on a company's tax liability in the foreign country and in Canada, both while it carries on business in the foreign country and when it disposes of its interest in that business. Since restructuring multinational operations can be difficult and costly, Canadian companies can benefit from carefully considering how they structure their outbound investments at the time they first make those investments.

Conclusion

Appendix—Key Taxes in China



Type	Taxpayer	Rate & Calculation Basis	Tax Bureau	Withholding Agent
Corporate Income Tax ("CIT")	Enterprises and other organizations that derive income	<ul style="list-style-type: none"> Levied on income sourced from within and outside China by resident enterprise and the China establishment of nonresident enterprise, and the China sourced income of non-resident enterprise without establishment in China Standard rate is 25%. Rates may be reduced if the enterprises are eligible for tax holidays or incentives 	State Tax Bureau	The party making the payment to the taxpayer in case the taxpayer is a foreign entity
Value Added Tax ("VAT")	Entities and individuals who sell goods or provide processing and repair services or import goods	<ul style="list-style-type: none"> For ordinary taxpayers: Basic VAT rate is 17%. VAT Payable = Output tax – Input tax For small-scale taxpayers: 3%. No credit of input tax is allowed. 	State Tax Bureau or Customs (for importation of goods)	N/A
Consumption Tax	Entities and individuals who import, produce or process certain luxury or high-end goods into or in China	<ul style="list-style-type: none"> Applicable to 14 categories of goods Mainly ad valorem The tax rate ranges from 1% to 45% 	State Tax Bureau or Customs (for importation of goods)	N/A
Business Tax	Entities and individuals who provide services, transfer intangible assets or sell immovable properties	<ul style="list-style-type: none"> 3% to 20% on the revenue 	Local Tax Bureau	The party making the payment to the taxpayer in case the taxpayer is a foreign enterprise
Urban Maintenance & Construction Tax (UMCT) and Education Levy	Enterprises and establishments that pay turnover taxes	<ul style="list-style-type: none"> Calculated based on Business Tax, VAT and Consumption Tax payable UMCT rate is 7%, 5% or 1% and Education Levy rate is 3% 	Local Tax Bureau	
Customs Duty	Consigner of imported goods or the exporter for specific products	<ul style="list-style-type: none"> Calculated based on the CIF value of imports or based on quantity Rates on particular types of products are determined according to a tariff schedule 	Customs	N/A

Type	Taxpayer	Rate & Calculation Basis	Tax Bureau	Withholding Agent
Stamp Duty	Entities and individuals who conclude or receive legal documents	<ul style="list-style-type: none"> Levied on contractual documents that are concluded or received in China Rates range from 0.005% to 0.1% or levied at the fixed amount of RMB5 for certain types of documents 	Local Tax Bureau	N/A
Real Estate Tax	Enterprises and individuals that own property for business operations	<ul style="list-style-type: none"> 1.2% of property cost, subject to local deductions; or 12% of the rental income from leased property 	Local Tax Bureau	N/A
Land Appreciation Tax	Entities and individuals who sell land use right and real estate property in China	<ul style="list-style-type: none"> Levied on the gains on the sale of land use right and property, subject to allowable deductions Four-level progressive tax rates ranging from 30% to 60% 	Local Tax Bureau	N/A
Withholding Tax	Foreign Enterprises	<ul style="list-style-type: none"> Levied on China-source income including interest, dividends, rentals, royalties and gains from disposal of properties The standard tax rate is 10% 	State Tax Bureau	The party making the payment to the taxpayer
Individual Income Tax	Individuals who are tax residents in China or otherwise derive taxable income in China	<ul style="list-style-type: none"> Computed separately for each category of income Progressive tax rates ranging from 5% to 45% are applicable to wages and salaries 	Local Tax Bureau	The employer or the party making remuneration payment to the taxpayer
Social Security	Enterprise and individuals respectively	<ul style="list-style-type: none"> Required to make contributions towards local employees' social security plans including pension, unemployment, medical, work injury, maternity plans and housing fund On the basis of payroll costs subject to limitations 	Social Security Agencies	The employer
Stamp Duty	Entities and individuals who conclude or receive legal documents	<ul style="list-style-type: none"> Levied on contractual documents that are concluded or received in China Rates range from 0.005% to 0.1% or levied at the fixed amount of RMB5 for certain types of documents 	Local Tax Bureau	N/A
Real Estate Tax	Enterprises and individuals that own property for business operations	<ul style="list-style-type: none"> 1.2% of property cost, subject to local deductions; or 12% of the rental income from leased property 	Local Tax Bureau	N/A
Land Appreciation Tax	Entities and individuals who sell land use right and real estate property in China	<ul style="list-style-type: none"> Levied on the gains on the sale of land use right and property, subject to allowable deductions Four-level progressive tax rates ranging from 30% to 60% 	Local Tax Bureau	N/A
Withholding Tax	Foreign Enterprises	<ul style="list-style-type: none"> Levied on China-source income including interest, dividends, rentals, royalties and gains from disposal of properties The standard tax rate is 10% 	State Tax Bureau	The party making the payment to the taxpayer

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