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In This Issue

New Laws:

1. New PRC Tax Crackdown on Foreign Investors Using an Offshore Intermediary Holding Company to Invest in China

2. New Time Limits set for Payment of Land Grant Fee by Developers

3. Details of Customs Tariffs In 2010 Announced

General News:

1. China to Develop Hainan into International Tourism Destination

2. Investor Optimism for Shanghai

1. New PRC Tax Crackdown on Foreign Investors Using an Offshore Intermediary Holding Company to Invest in China

Authority: The State Administration of Taxation (SAT)

Date of Promulgation: 12/15/2009

Effective Date: 01/01/2008

The Chinese State Administration of Taxation (SAT) has released a circular (Guoshuihan No. 698 - Circular 698, i.e. Circular Regarding Strengthening the Administration of Taxation of Sale of Shares by The Non-resident Enterprises on 15 December 2009 that addresses the tax treatment of (a) the transfer of shares by foreign non resident companies in a Chinese domestic company and (b) transfer of shares in an offshore holding company that the foreign non resident investor uses to hold equity in a Chinese domestic company.

In accordance with this new regulation, in addition to capital gains tax levied on the sale of shares or equity stakes in a domestic company by a non-resident company, as set out in New EIT Law, the Chinese tax authorities may have the power to tax the sale of shares in an offshore holding company utilized by such non-resident investor to hold the domestic equity stakes in situations where either (a) the tax rate of the jurisdiction where the offshore holding company is incorporated is less than 12.5% or (b) the tax rate is greater than 12.5%, but the jurisdiction (through a tax treaty with China) provides a tax credit with respect to foreign-sourced income, which results in the net tax burden in such a jurisdiction being lower than 12.5%.

Under the "12.5%" rule, the offshore holding company will be required within thirty days of execution of share transfer agreement, submit to the tax authority of the place where the domestic company is located, (i.e. the SAT) the share transfer agreement and all the relevant documents relating to relationship between the non-resident investor, the offshore holding company and the domestic company, including the documentation regarding the affiliated transactions or arrangements between the offshore company and the domestic company, for review and examination.

Where SAT, upon review and examination of the documents, deems such offshore holding

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company to be a vehicle incorporated for the purpose of tax evasion, it has the power to tax the transfer of the shares of such offshore vehicle.

This new rule will significantly impact a great number of foreign investors which use an offshore vehicle to invest in China as it potentially imposes an onerous administrative and disclosure obligation on the foreign non-resident investors and their offshore holding vehicles, however, some issues still remain to be clarified such as, how to define an "actual tax burden being lower than 12.5%"; ie does this rule apply to a jurisdiction which does not levy tax on capital gains? How will SAT become aware of a share transfer which takes place offshore and how to enforce its tax ruling on the offshore company? Who will serve as withholding agent for such tax? What are the potential consequences or sanctions for non-compliance?

Though the abovementioned issues remain unclear, this Circular is a strong indicator that the SAT is starting to flex its muscles on cross-border taxation and is seeking to crackdown on tax evasion activities through use of an offshore holding company in a low-tax jurisdiction. Implementing measures are usually issued some time after such a Circular in order to clarify these issues. Therefore this space will need to be watched.

2. Notice Regarding Further Strengthening the Administration of the Payment of Land Grant Fee

Issuing Authority: The Ministry of Finance and the Ministry of Land Resource

Date of Promulgation: 12/17/2009

Effective Date: 12/17/2009

Notice Regarding Further Strengthening the Administration of the payment of Land Grant Fee jointly issued by Ministry of Finance and Ministry of Land Resource on December 17th, 2009 in which the central government tightens their control over payment of Land Grant Fee by Real Property Company by expressly setting a one-year time limit for a property developer's payment by installments of Land Grant Fee (for some special project, one more year extension may be granted if approved by government on a case-by case basis) and also setting the threshold for first installment of payment ,i.e. not less than 50% of total Land Grant Fee , and further providing that a developer failing to meet the above requirement will be prohibited from bidding for new land , in an attempt to curb the skyrocketing property price and to prevent the forming of inflationary bubbles. Before this regulation was passed, the time limit for payment and the installments schedule had been negotiable between local government and the property developer.

Certainly, this rule will have a significant impact on investment in the real property sector.

3. Details of Customs Tariffs In 2010 Announced

Issuing Authority: Customs Tariff Commission of the State Council

Date of Promulgation: 12/07/2009

Effective Date: 01/01/2010

The government has published its plans for administering the customs tariffs in 2010 in which the temporary tariff rate for aviation fuel is 6%. Tariff rates for imported fuel and imported naphtha are 3% and 1% respectively. It has also been announced that tariff rates for most types of imported coal are almost nil for the purpose of encouraging coal companies to import coal and increase the supply in the market.

1. China to Develop Hainan into International Tourism Destination

The Chinese government said on 5 January that it aims to build the southern island of Hainan into a top international tourism destination by 2020.

Hainan's preliminary GDP stood at 145.9 billion yuan (\$21.36 billion) in 2008, up 9.8 percent year on year.

The island will also become a base of agricultural production and a base for developing resources and services in the South China Sea, said the statement.

The government said it would maintain the healthy development of the island's property sector and encourage developers to build premium hotels and resorts. It also supports family-run hotels and property-rental services.

Efforts should also go to the financial sector in the island by pushing forward the trial program of cross-border trade RMB settlement and backing qualified tourism companies to get listed in the stock market.

The plan also includes measures to promote modern tropical agriculture in Hainan, including tropical fruits, aquatic products and others, and expand its agricultural cooperation with Taiwan.

The government will further extend its favorable visa-free policy to five other nations including Finland, Denmark, Norway, Ukraine and Kazakhstan from the previous 21 nations including the United States, Japan and Canada.

The statement also said the government would boost the island's development by expanding oil and gas exploration, offering more duty free services, improving transportation networks, developing logistics, reducing pollution, building more information networks and infrastructure.

The government plans to lift the value-added output of tourism in Hainan to more than 8

percent of its gross domestic product (GDP) by 2015 and more than 12 percent by 2020, the statement said. Figure of how much value-added output of tourism accounted for in the province's GDP in 2008 was not available.

The country also plans to develop its only tropical island province into a platform for international economic cooperation and cultural exchanges, according to a statement of the State Council, equivalent to the Cabinet, released on Gov.cn, the official web portal of the Chinese government.

2. Investor Optimism for Shanghai

Investors grew more optimistic about Shanghai's economic outlook in the fourth quarter of last year compared with the previous quarter, indicating a firmer foundation for the city's economy to grow, a survey showed on 6 January, 2010.

The Shanghai Investor Confidence Index, compiled by Shanghai University of Finance and Economics, increased to 120.6 points in the last quarter of 2009, up 3.9 points from the previous quarter and 17.61 points from a year earlier.

An index reading above 100 refers to optimism among investors.

"They (investors) gained more confidence from a stronger recovery in Shanghai's economy in recent months," said Xu Guoxiang, the research program leader and director of the university's Applied Statistics Research Center. "They have sensed more positive economic changes and may raise their investment, which will help the city to grow."

The component indices showed that confidence among institutional investors rose 12.4 points from a quarter earlier to 121.85 in the fourth quarter. The confidence of entrepreneurs dipped 0.3 point to 122.86 while that of individual investors was flat from a quarter earlier.

Shanghai's exports, hardest hit by the global financial crisis, fell 5.3 percent annually in November, extending a losing streak for 12 straight months.

The city's GDP expanded 9.8 percent in the third quarter of 2009 from a year earlier, strengthening from the increase of 7.9 percent in the second quarter.

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