

Hwuason Alerts.

A summary of China tax developments for the fortnight ending 15 December 2009.



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BVI AND CHINA SIGN TAX INFORMATION EXCHANGE AGREEMENT

On 7 December 2009, the State Administration of Taxation and the British Virgin Islands signed an *Agreement on Tax information Exchange between the People's Republic of China and British Virgin Lands* (TIEA).

This is the second TIEA that China has signed with an offshore financial center possibly ushering in a new era of tax cooperation between China and offshore financial centers.

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INCREASED OPTIONS FOR FOREIGN INVESTORS - LIMITED PARTNERSHIP'S ARRIVE IN CHINA

The Chinese government will permit foreign investor's to establish limited partnerships in China as of 1 March 2010. On 25 November 2009 the State Council issued *Regulations on Foreign Enterprises and Individuals Establishing Partnership in China* (the "Regulations"). The Regulations provide that both foreign enterprises and individuals can establish a limited partnership and that such enterprises can directly registered at the local Administration for Industry and Commerce without the need for approval from the Ministry of Commerce. Previously, local persons and organizations could establish a limited liability partnership in accordance with the *Partnership Enterprise Law*. Now the Regulations extend the benefits of using a partnership form to foreign investors. Limited liability partnerships can provide tax benefits to investors as no tax is applied at the partnership level, rather the partners are taxed directly on their portion of the partnership's income. Traditionally, the forms of business organizations available to foreign invested business set up within the Chinese territory included joint ventures, WFOEs and representative offices. However, the introduction of this regulation provides an alternative for foreigners wishing to penetrate the Chinese market.

EPIC TRANSFER PRICING CASE COMES TO A CONCLUSION

After 5 years a transfer pricing investigation by the Xiamen tax authorities has finally concluded and represents the first successful use of information exchange by Chinese tax authorities in respect of related party transactions. The case involved transactions between a company established in Xiamen and a related American company. The anti-avoidance investigation resulted in an adjustment in the company's taxable income in the amount of 28.07 million yuan, and back taxes in the amount of 2.93 million yuan. The exchange of information refers to China and competent authorities of contracting countries, in accordance with relevant tax treaties, exchanging information with respect to relevant taxpayers.

A more detailed analysis of this case will be provided in the December edition of *Hwuason Insights* – our detailed monthly analysis of China's tax laws



IN FOCUS : RISK TIP FOR HIGH-TECH ENTERPRISES

The State Administration for Taxation has issued a notice outlining a recurrent problem that it has seen this year with respect to high tech enterprise tax incentives. The tax authorities in all provinces have noticed that enterprises have used outdated high-tech enterprises recognition certificates to apply for tax incentives. Where such conduct has been uncovered, the tax authorities have taken the following measures in dealing with the taxpayers:

- The withdrawal of the high-tech enterprise status;
- Pursue preferential treatment of tax reduction in 2008; and
- Impose a surcharge on the overdue fines.

The tax authorities have reminded taxpayers that as high-tech enterprises need to apply for recertification in accordance with the provisions of the Measures for the Recognition and Administration of High-Tech Enterprise (Circular Guokefahuo [2008] 172) and the guidelines on the Recognition and Administration of High-Tech Enterprise (Circular Guokefahuo [2008] 362), only with a current high-tech enterprise certificate jointly sealed by the Ministry of Science and Technology, the Ministry of Finance and the provincial level Administration of Taxation, shall enterprises enjoy the preferential enterprise income tax rate of 15%.

PURCHASE TAX FOR SMALL-DISPLACEMENT CARS RISES

The State Council approved that from January 20th to December 31st 2009, the purchase tax rate for small-displacement cars with 1.6L and less will be 5% temporarily. However, the State Council has recently issued that whilst tax reduction policy for such cars will extend to the end of 2010, the tax rate for that period will be 7.5%. As a result, the purchase tax for small-displacement cars will rise next year.

PREFERENTIAL TREATMENT ON HOUSING TRANSFER FOR BUSINESS TAX ENDS

At the end of 2008 the State Council, in order to cushion the impact of financial crises, especially the impact on the real estate market, adjusted the business tax exemption period for housing transfers from 2 years to 5 years. However, the State Council has recently declared that the housing transfer business tax exemption period will change back to 2 years.

AUSTRALIA AND CHINA TO RESUME FTA NEGOTIATIONS

Bilateral discussions on a free trade agreement (FTA) between China and Australia recommence in February 2010. The last round of FTA discussions were suspended in December 2008.

As China is Australia's largest trading partner, brokering an FTA is critically important for both China and Australia. Both countries will be looking for greater cooperation in areas such as manufacturing ,agriculture, and natural resources, especially coal and iron ore.