

PRC TAX: THE IMPACT OF RECENT DEVELOPMENTS ON INTERNATIONAL SHIPPING



Recent developments in PRC tax law in relation to international transportation have caused a certain amount of consternation amongst international owners and operators of seagoing vessels doing business in China¹. This Briefing offers a brief practical guide to these developments.

PRC law has long provided that, subject to relevant double taxation treaties, foreign owners and operators may be liable to pay (1) PRC Enterprise Income Tax² and (2) PRC Value Added Tax³ on revenues earned from China. In the first instance, the foreign party has in theory been liable to pay these taxes, although the extent of liability and how the taxes were to be paid was often unclear. In practice, the taxes were rarely paid by foreign owners or operators.

In recognition of the difficulty PRC tax authorities faced when collecting taxes from foreign parties, their Chinese counterparties, such as charterers, were required – in theory – to pay the tax on owners' account by making deductions from payments to owners at source. Charterers' secondary liability for these taxes was again not strictly enforced, but did become the subject of a number of arbitrations in the wake of the global financial crisis, where PRC charterers sought to avoid payment of hire in full on the basis that it would be illegal for them to do so in the place of performance. So far as we are aware, none of the arbitrations relating to the PRC withholding tax ever resulted in an award or court judgment and the issue of illegality raised by charterers was never finally resolved.

1 TradeWinds "Tax surprise for foreign shipowners in China", 29 August 2014 (<http://www.tradewindsnews.com/weekly/343706/Tax-surprise-for-foreign-shipowners-in-China>), BIMCO "Alert on China's new enterprise income tax notice for non-resident taxpayers", 24 July 2014 (https://www.bimco.org/news/2014/07/24_tax_china.aspx).

2 The Enterprise Income Tax Law of the People's Republic of China (《中华人民共和国企业所得税法》) effective as of 1 January 2008.

3 Value Added Tax is imposed instead of Business Tax in accordance with the Notice on the Nationwide Trial of Transition from Business Tax to Value Added Tax for Transportation and Certain Modern Service Industries [2013] No. 37 (国家税务总局关于《在全国开展交通运输业和部分现代服务业营业税改征增值税试点税收政策》的通知 财税 [2013] 37号) effective as of 1 August 2013.



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LILLIAN SHI, ASSOCIATE

The recent interest in the subject was generated by a notice published by the State Administration of Taxation of China⁴ (Notice [2014] No. 37), which sought to clarify and implement the existing PRC Enterprise Income Tax in relation to international transportation. Specifically, Notice [2014] No.37 defines which businesses are liable to pay PRC Enterprise Income Tax and how, in the case of non-resident tax payers such as foreign owners, the earnings arising from international transportation connected with China are to be registered and paid over. Notice [2014] No.37 makes it clear that the tax applies to owners and carriers not only under time charters, but also voyage charters, freight forwarding agreements and other shipping

contracts with counterparties resident in the PRC. Notice [2014] No. 37 also provides that where non-resident tax payers fail to register and pay over taxes on earnings under the PRC Enterprise Income Tax legislation, the Chinese counterparties will be required to withhold these taxes at source when making payment. The obligation to withhold payment may now even apply to payments made by Chinese counterparties through overseas subsidiaries – a common arrangement given exchange controls within China.

Effective from 1 August 2014, it remains to be seen whether Notice [2014] No.37 will lead to a rash of new disputes over payment of PRC Enterprise Income Tax in relation to international transportation. It is also not certain at present to what extent the tax authorities in China will enforce the provisions of the existing laws more



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NICK POYNDER, PARTNER

rigorously as a result of Notice [2014] No.37. However, owners would be well advised in the meantime to check their potential exposure to the tax, in particular whether any exemptions apply and whether the terms of the contracts between owners and their PRC counterparties already make provision for which party is ultimately to bear liability for PRC taxes. Where questions of potential liability for the taxes arise, owners should consider appointing a local accountant familiar with the legislation or applying to the PRC tax authorities for confirmation of whether exemptions from the tax apply. When negotiating new contracts with PRC based counterparties, it may well also be sensible to agree provisions which deal directly with liability for PRC taxes in order to avoid future disputes that may arise. For example, owners may wish to include express provisions requiring charterers to accept liability for all PRC Enterprise Income Tax and Value-Added Tax.

HFW's Shanghai office has significant experience of handling disputes arising in relation to PRC taxes in the shipping sector.

⁴ The Notice on Provisional Measures on the Collection of Tax on Non-Resident Taxpayers Engaged in International Transportation Business [2014] No.37 (关于印发《非居民企业从事国际运输业务税收管理暂行办法》的通知 国家税务总局公告2014年第37号) effective as of 1 August 2014



For more information, please contact the authors of this Briefing:

Nick Poynder

Partner, Shanghai
T: +86 21 2080 1001
E: nicholas.poynder@hfw.com

Lillian Shi

Associate, Shanghai
T: +86 21 2080 1001
E: lillian.shi@hfw.com

HFW's Shanghai office is part of an international network of 13 offices in 11 countries. For further information about shipping issues in other jurisdictions, please contact:

Paul Hatzler

Partner, Hong Kong
T: +852 3983 7666
E: paul.hatzler@hfw.com

Dimitri Vassos

Partner, Piraeus
T: +30 210 429 3978
E: dimitri.vassos@hfw.com

Paul Aston

Partner, Singapore
T: +65 6411 5338
E: paul.aston@hfw.com

Jeremy Davies

Partner, Geneva
T: +41 (0)22 322 4810
E: jeremy.davies@hfw.com

Gavin Valley

Partner, Melbourne
T: +61 (0)3 8601 4523
E: gavin.valley@hfw.com

Konstantinos Adamantopoulos

Partner, Brussels
T: +32 2 643 3401
E: konstantinos.adamantopoulos@hfw.com

Nic van der Reyden

Partner, Sydney
T: +61 (0)2 9320 4618
E: nic.vanderreyden@hfw.com

Guillaume Brajeux

Partner, Paris
T: +33 1 44 94 40 50
E: guillaume.brajeux@hfw.com

Hazel Brewer

Partner, Perth
T: +61 (0)8 9422 4702
E: hazel.brewer@hfw.com

Paul Dean

Partner, London
T: +44 (0)20 7264 8363
E: paul.dean@hfw.com

Simon Cartwright

Partner, Dubai
T: +971 4 423 0520
E: simon.cartwright@hfw.com

Jeremy Shebson

Partner, São Paulo
T: +55 11 3179 2900
E: jeremy.shebson@hfw.com

Lawyers for international commerce

hfw.com

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