

Investment holding structures



Issues

The location of the overseas holding company of a foreign investment enterprise (FIE) can have China tax as well as foreign tax implications. A thorough review of all location options is essential to arranging the lowest possible tax burden.

The equity interest in the FIE may be held by a special purpose vehicle outside China. The overseas investment holding company may be located in a tax treaty country. Alternatively, it may be established in a low tax jurisdiction or there may be one or more intermediate overseas holding companies in the investment structure.

An investment holding company may be set up in China to hold the subsidiaries. In addition, the China investment holding company may be used to provide centralised services to these subsidiaries as well as to distribute their products.

How we can help

To help you meet your business needs, we provide these services:

- Comparing and contrasting the tax effects of different holding structures
- Quantifying the tax effects of the different holding structures
- Recommending feasible and tax effective investment structures
- Advising on withholding tax implications of dividends under tax regulations and the relevant tax treaties
- Advising on capital gains tax implications of different holding structures under the China tax regulations and the relevant tax treaties
- Advising on tax sparing relief under the relevant tax treaties
- Advising on the use of different tax treaties

- Co-ordinating with other KPMG member firms or your in-house tax specialists with a view to enhancing global tax efficiency.

Transfer pricing



Issues

As the Chinese tax authorities step up their efforts to enforce transfer pricing compliance, transfer pricing has become an important concern for enterprises doing business in China.

The authorities aim to bolster and protect tax revenue, and have steadily increased their total tax adjustments since 1998. Special anti-avoidance teams have been set up at the national, provincial and local levels to conduct audits, focusing on related party sales, purchases, services, funding and licensing of intangibles. Upward adjustments could be made on the Chinese side, leading to increased tax liabilities, and perhaps even a shortening of the remaining life of tax holidays.

The Chinese government, through the State Administration of Taxation, has also brought out new laws to deal with transfer pricing, with complex new requirements both for documentation and for tax agreements such as Advance Pricing Arrangements and Cost Sharing

Agreements. While before 2007 transfer pricing was governed mostly by circulars and court rulings, the new Corporate Income Tax Law devotes a complete chapter to "special tax adjustments," dictating a more organized approach. The Administrative Regulations on Special Tax Adjustments (Provisional) published on 8 January 2009 provide detailed guidance on reporting of related party transactions, contemporaneous documentation administration and thin capitalization etc. Enterprises will now have to be much more careful in justifying their transfer prices, especially since transfer pricing adjustments in China apply retroactively for up to a ten year period.

How we can help

While most taxpayers view transfer pricing compliance as an administrative burden, some recognise that when used effectively, with proper planning and efficient implementation, transfer pricing can create potential tax saving opportunities. Our transfer pricing team can assist you in several ways:

- We can help you to document your transfer pricing policies, and perform the appropriate functional and benchmarking analyses
- We can help you identify areas that may be subject to challenges from the tax authorities, and we can recommend strategies for mitigating such risks
- We can help you to draft and negotiate Advance Pricing Arrangements and Cost Sharing Agreements with tax authorities
- During a transfer pricing audit, we can represent your enterprises in order to defend their transfer pricing positions
- During mergers and acquisitions, we can help to design and restructure transfer pricing policies and conduct due diligence transfer pricing analysis with an aim to enhance tax savings and benefits while controlling the risks of potential challenges.

Tax due diligence review



Issues

In the past decade, foreign investors have become increasingly active in mergers and acquisitions in China. The Chinese government has relaxed rules concerning the ownership by foreign investors of Chinese domestic companies and, as a result, we have seen remarkable growth in mergers and acquisitions activities in China.

One of the most critical issues foreign investors face in an acquisition is the hidden tax and customs liabilities of the targets. As China tax regulations are complicated and the tax compliance culture in China has traditionally been weak, the potential for tax exposure can be substantial.

Penalties for tax evasion can be as high as five times the underpaid tax. There is also a surcharge of 0.05 percent of the unpaid tax liabilities per day. While

the statute of limitations is generally three years, there is no time limit for tax evasion. As such, in-depth tax due diligence is always vital when deciding on a business acquisition.

How we can help

Our team of tax professionals are well-trained to conduct tax due diligence reviews. They are equipped with up-to-date compliance knowledge and are particularly aware of non-compliance situations. We have extensive experience in conducting tax due diligence reviews and our services include:

- conducting due diligence reviews on foreign investment enterprises as well as domestic enterprises
- identifying as well as quantifying major potential exposures where the relevant information is available
- conducting reviews covering corporate income tax, withholding tax, value added tax, business tax, consumption tax, customs duty, stamp duty, land appreciation tax, individual income tax and the various local levies and charges
- working with your legal counsel on indemnity clauses and advising on strategies to discharge outstanding tax liabilities, ring-fencing tactics and post-acquisition restructuring
- working with you on the applicable taxes for valuation models.

Corporate restructuring



Issues

Corporate restructuring in China can sometimes lead to unintended tax consequences. It is important that tax planning is an integral part of any restructuring strategy.

There are numerous reasons for restructuring foreign investments in China.

Many reorganisations have resulted from mergers and acquisitions at the group level outside China, while some restructures are driven by the need to streamline operations in China, and others are caused by the buy-out of joint venture partners. Restructuring may also ensue from the establishment of a China holding company to take over China-based subsidiaries from an overseas holding company.

Restructuring may be effected through merger, de-merger, equity transfer or asset transfer. Transaction taxes may arise during the process and past tax incentives may also be affected.

Within the framework of the new CIT law, circulars concerning Corporate Income Tax treatment for corporate restructuring were successively promulgated. These circulars should be an important guide for the tax treatment of corporate restructuring and business alignment of enterprises.

How we can help

To help you meet your business needs, we provide these services:

- Advising on ways to help minimise claw-back of past incentives, including tax holidays, reinvestment tax refunds and duty exemptions for imported equipment
- Advising on ways to preserve losses brought forward, continue ongoing tax holidays or secure new tax incentives
- Advising on the approval and registration requirements for restructuring and assisting you in securing approval and registration
- Comparing and contrasting restructuring strategies from tax, customs, forex and regulatory points of view and recommending feasible and tax effective strategies
- Advising on ways to help minimise transaction taxes including income tax, value added tax, business tax and stamp duty, and eligibility for corporate restructuring tax deferral

Customs assistance



Issues

With trade globalisation and regional economic integration, customs and related policies are playing an increasingly important role in trade facilitation and supply chain optimisation for enterprises. The duties and trade measures, multi-form special areas supervised by customs, and regional and international free trade agreements all affect the planning and operation of industry and commerce. In addition, the legal system and trade facilitation reform of customs in China are making customs affairs a complex, professional issue of great importance.

In recent years, for macro economic control purposes, China has undertaken timely reforms to help industry by constantly adjusting and improving the supervision of processing and logistics in tax-protected zones, as well as broadening the scope of customs services and supervision. Customs planning and supply chain management can both reduce production and transportation costs for enterprises and form a part of global tax planning.

Tax authorities are also imposing increasingly strict rules on transfer pricing. Since the definition of transfer pricing in tax is different from that in customs, enterprises should pay close attention to price when it comes to making declarations.

All of the above make the compliance management for enterprises important, while at the same time making high-level customs planning and restructuring possible. Solutions that are cost effective and help to improve operation efficiency on customs affairs are being adopted by a growing number of enterprises.

How we can help

- Analysing and assessing customs operations, and offering suggestions on improvement opportunities
- Helping enterprises improve internal control on customs affairs; developing internal control compliance manuals or internal control data management systems for customs affairs
- Offering assistance in the optimisation of regional logistics arrangements or supply chain management based on the customs rules on tax-protected processing and logistics
- Offering professional technical guidance on goods classification, customs valuation and the application of rules of origin, including coordinating negotiations with customs, pre-valuation, pre-classification rulings, etc.
- Offering transfer pricing analysis, and helping the client with their application for advanced pricing
- Providing technical assistance when the client is involved in customs inspections and investigations
- Providing long-term advisory services on customs affairs with experts specially assigned on a case-by-case basis
- Providing tailored training on customs affairs according to the client's business model and the latest policies.

International executive services



Issues

An employer has the obligation to file the tax returns and withhold individual income tax from payment of remuneration to its employee. Hence it is imperative that the correct mode of filing and withholding are complied with to avoid penalties. As individual income tax liabilities are high and rules are complicated, appropriate structuring of employment contracts would yield benefits to both employer and employee.

How we can help

We can provide the following services:

- Advising you on tax effective remuneration packages and assisting you in structuring employment contracts, secondment agreements and dual contract arrangements
- Advising you on the implication of foreign exchange control and corporate income tax on various modes of payment including reimbursement of salaries paid by an overseas affiliate
- Assisting in the design of tax equalisation policies
- Assisting in the preparation and filing of individual income tax returns, including the withholding returns and self-reporting returns
- Advising your employees, especially foreigner individuals, on their understanding of Chinese individual income tax and their obligations
- Advising you on the level of compliance with individual income tax rules and regulations through conduct of health checks
- Advising you on social security contributions.

Tax compliance



Issues

Foreign investment enterprises (FIEs) as well as representative offices and branches of foreign enterprises in China have heavy tax compliance requirements. Some foreign enterprises carrying on business in China are also required to file tax returns and make tax settlements in China.

An FIE is generally liable for corporate income tax and various turnover taxes in China including value added tax, business tax and consumption tax. There may also be other local taxes or levies, such as stamp duty and real estate tax. Representative offices, branches and foreign enterprises which carry on business in China through an establishment or permanent establishment may have similar compliance requirements.

Some FIEs are liable for withholding China taxes on payments made to foreign entities, including royalties, interest and rental as well as payments

to foreign contractors. An FIE is also obliged to withhold individual income tax and social security contributions on salaries paid.

Most tax returns are required to be submitted monthly or quarterly and the tax regulations allow for heavy penalties and surcharges for non-payment or late payment of taxes. Moreover, the tax authorities have become increasingly strict in enforcing these regulations.

How we can help

We can assist in the preparation and filing of tax returns, including:

- Corporate income tax returns
- Value added tax, business tax and consumption tax returns
- Stamp duty returns
- Land appreciation tax returns
- Withholding tax returns in respect of payments made overseas

- Individual income tax returns, including the withholding returns and self-reporting returns.

We can also assist you in carrying out tax registration with both local and state tax bureaux for companies as well as individuals.

Funding structures



Issues

There are several types of possible funding structures for investments in China, each carrying its own tax-related risks and benefits.

A foreign investment enterprise (FIE) may be funded with capital, loans or a combination of both. The capital may be injected upfront or in instalments. The capital contribution may be made in cash or in-kind, including plant, machinery, technology, land use rights and intangible assets. An FIE may borrow from its foreign investors. It may also borrow from banks inside or outside China.

How we can help

To help you meet your business needs, we provide these services:

- Comparing and contrasting the tax effects of different funding structures
- Quantifying the different tax effects of different funding structures
- Recommending feasible and tax effective structures
- Advising on the debt/equity ratios and thin capitalisation rules
- Advising on withholding tax implications of dividends and loan interest under tax regulations and relevant tax treaties
- Advising on tax deductibility of loan interest at the level of the FIE
- Advising on stamp duty implications of loan agreements
- Assisting in the preparation of loan agreements, including tax gross-up clauses
- Assisting in the appropriate procedures to meet approval and registration requirements for different funding structures
- Performing capital verification
- Assisting in foreign debt registration
- Advising on the forex remittance procedures for dividends and loan interest.

Forex assistance



Issues

China has a set of strict foreign exchange controls in place. At present, remittance of capital account items, such as registration, conversion and repayments of foreign loans, are subject to approval by the State Administration of Foreign Exchange (SAFE). Current account items, such as payments for imports of goods (trade items) or service fees (non-trade items), do not require SAFE's approval for remittance and may be processed directly by designated banks. There are administrative measures to monitor settlements of imports and exports and all of these controls are likely to continue for some time to come.

In recent years, the Chinese government issued rules to set out procedures for remitting different types of payments, especially non-trade current items. At first glance, these new procedures appear to increase the transparency of the remittance process. However, the forex system

has in fact become more rigid. Banks can now refuse to process a remittance application if an item does not fall within any of the specific categories of payments set down in the rules. At the same time, Chinese government has been strengthening the control on the forex collection in advance under export and payment in deferral under import recently. The Foreign Exchange Control Regulations of the People's Republic of China published in August 2008 also put more emphasis on the control of foreign exchange inflows.

There is close interaction between SAFE, the customs and tax authorities in the forex control process. Remittance applications generally have to be supported by customs declarations, tax certificates for foreign currency payments.

How we can help

We can advise you on the structure of your operations, systems and transactions so as to facilitate forex remittance.

We can assist you in applying for forex remittance as follows:

- Reviewing or advising on the operating mode of foreign related transactions and fund settlement arrangements, where applicable
- Reviewing or advising on the structure of agreements for service fees and cost sharing, where applicable
- Applying for tax certificates for foreign currency payments
- Assisting in negotiations with the tax authorities on tax exemptions, onshore/offshore income splits or deemed profit rates
- Corresponding registration procedure for foreign exchange payment
- Reducing the backlog of funds by considering the request of capital requirements and reflow.

Incentives applications



Issues

As part of the policy of encouraging foreign investment in China, the government offers a variety of tax incentives to foreign investors. However, with the promulgation of the new Corporate Income Tax Law (New CIT Law), which went into effect on 1 January 2008, tax incentives offered to foreign investors are revoked basically. Instead, the New CIT Law introduces tax incentives that are in accordance with China's industrial policy and sustainable development goal. The new tax incentives are applicable to both domestic enterprises and foreign invested enterprises.

Successful applications for these valuable tax incentives involve complicated procedures and often involve more than one group of authorities, including the Ministry of Commerce, the State Administration of Taxation, local tax bureaux, customs authorities, the Ministry of Science and

Technology and trade associations such as software enterprise associations.

How we can help

We have extensive experience in assisting our clients in securing a range of tax incentives, including:

- Duty exemptions for imported equipment
- Value added tax and duty exemptions for key components and raw materials
- Value added tax refunds for software developers
- Export value added tax refunds
- Business tax exemptions for technology transfers.

We could assist our clients in applying for the tax incentives introduced by the New CIT Law, including:

- The reduced tax rate of 15 percent for high and new technology enterprises

- The reduced tax rate of 20 percent for small-scale and low-profit enterprises
- Bonus research and development deductions
- Others.

We can help you assess your eligibility for incentives and safeguard your rights to these incentives. We can also offer advice on the structure of your operations and transactions to help you maximise your entitlement to incentives.

Tax audit and appeal



Issues

There is a range of tax audits in China. A foreign investment enterprise may be subject to an annual general tax audit, an audit on a specific tax such as value added tax, or a special audit such as transfer pricing, invoicing or export value added tax refunds. Special audit teams independent of the tax collection teams conduct tax audits. While the statute of limitations is generally three years, there is no time limit for "tax evasion," which can simply mean any overstatement of expenses or understatement of revenue.

Where a taxpayer disagrees with the outcome of a tax audit, he may appeal to the next higher level of authority. However, the taxpayer should settle all the taxes, penalties and surcharges first. If the taxpayer is still not satisfied with the appeal outcome, he may bring the case to the People's Court. It may also

appeal directly to the People's Court in the first place. In practice, the taxpayer and the tax authorities normally attempt to resolve the issues without going through the appeal process.

How we can help

To help meeting your business needs, we provide these services:

- Advising on the merits of the case and the strategies of dealing with challenges by the tax authorities
- Assisting in dealing with the tax authorities in a tax audit. We have a longstanding relationship with tax authorities at different levels throughout China, which is helpful in discussing the technical merits of the company's tax filing position
- Assisting in negotiating with the tax authorities for reduction of penalties or surcharges.

Profit repatriation strategies



Issues

Repatriation of profits from China can be a complex matter. There are a number of possible repatriation mechanisms a foreign investment enterprise can employ, including:

- Paying royalties to overseas group companies
- Paying loan interest to overseas group companies
- Paying service fees to overseas group companies
- Sharing various costs and expenses of overseas group companies, including headquarters expenses
- Distributing dividends to the overseas holding company.

Each profit repatriation strategy has significant tax and forex implications.

How we can help

To help meeting your business needs, we provide these services:

- Comparing and contrasting profit repatriation strategies in terms of China tax, forex and regulatory issues
 - Quantifying the tax effects of profit repatriation strategies
 - Advising on the feasibility of profit repatriation strategies from regulatory and forex points of view
 - Advising on China withholding tax, corporate income tax, business tax and stamp duty implications of royalties, loan interest, service fees and shared costs under China tax regulations and the relevant tax treaties
- Assisting in the drafting of loan, royalties, service fee and cost sharing agreements
 - Assisting in applying for the relevant tax certificate for foreign currency payments and the approval for and registration of the relevant agreements with the authorities.

Exit strategies



Issues

The closure of a foreign investment enterprise (FIE) can be complex from a tax point of view. An FIE can be liquidated or the equity interest in an FIE may be disposed of directly. The equity interest may also be transferred indirectly, with the shares in the overseas holding company being sold instead. The assets of an FIE may also be sold separately.

How we can help

To help meeting your business needs, we provide these services:

- Comparing and contrasting different exit strategies in terms of tax, forex and regulatory issues
- Quantifying the tax effects of different exit strategies
- Recommending feasible and tax effective exit strategies
- Advising on the approval and registration requirements for transfer of equity interest in or liquidation of an FIE
- Advising on withholding tax and corporate income tax implications of direct and indirect equity transfers, asset transfers and liquidation of an FIE
- Advising on the value added tax, business tax and stamp duty implications of direct and indirect equity transfers, asset transfers and liquidation of an FIE
- Advising on corporate restructuring relief or tax treaty relief that may be available.

IPO restructuring and planning



Issues

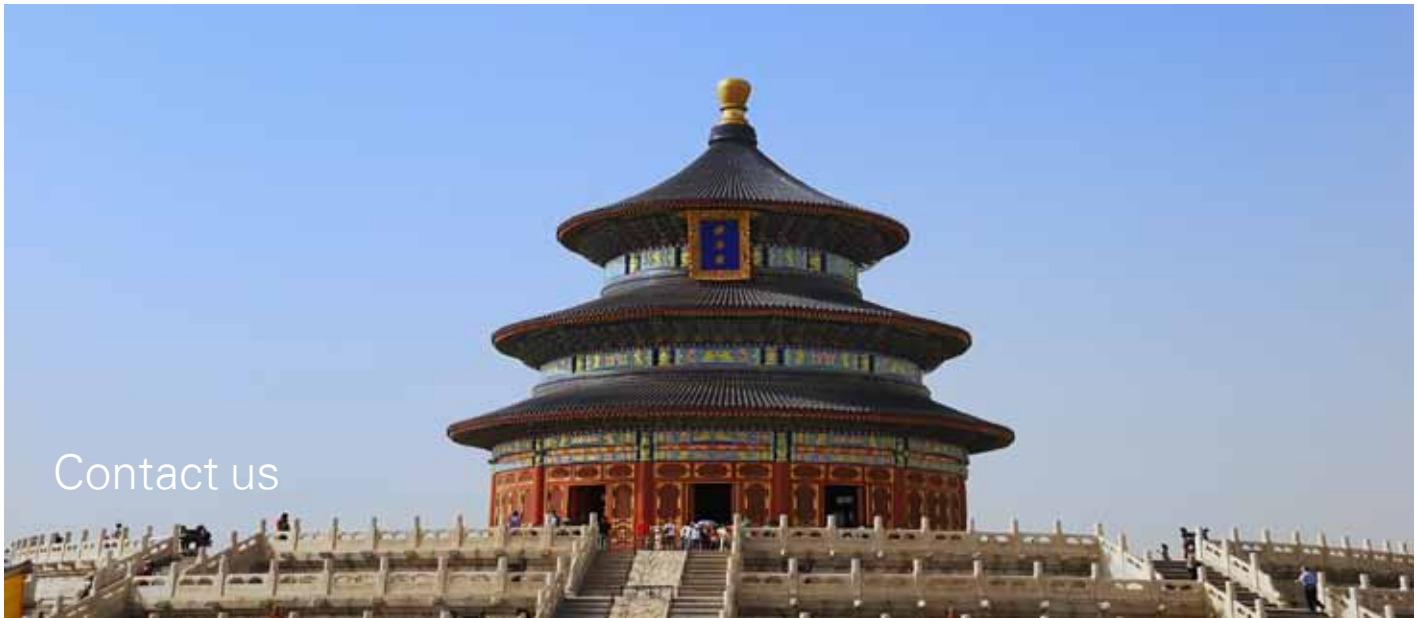
There are many financing channels, among which enterprises can choose the appropriate one based on their situation. As one such channel, an Initial Public Offering (“IPO”) serves more than finance alone. An IPO helps enterprises to enhance their corporate image and reputation, and moreover, it enables enterprises to fully realise their value in the public market and thus benefit their shareholders. Therefore, IPO attracts increasing attention from enterprises.

A successful listing requires sufficient preparation and is a complex process. An enterprise’s pre-IPO preparation may involve design of group structure for listing, adjustment of its current holding structure and selection of a stock exchange, etc. During this preparation, it is important for the enterprise to take tax implications into account when it restructures its equity or asset, chooses a holding location and holding levels and plans for backflow of the raised funds.

How we can help

To help you successfully complete your IPO, we can provide a range of services:

- Conducting tax health check for the enterprise to be listed, identifying material tax non-compliance issues and other significant tax risks and recommending effective solutions
- Assisting in the design of the listing structure:
 - Advising on the pre-IPO group restructuring and special tax treatment on such restructuring
 - Assisting in establishing the listing structure
 - Evaluating the tax residence risk of the overseas SPV and providing suggestions on mitigating relevant tax risks for an overseas listing
 - Commenting on the tax implications on different exit strategies and recommending the most tax efficient option
- Advising on the optimisation of individual tax burden for individual shareholders.



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