

- Question 1: **If a foreign owner has a long term charter with a Chinese charterer and**
- a) the ship never comes to China then will the hire earned under that charter be subject to tax?**
 - b) the ship comes to China only on occasions instead of on consecutive voyages during the charter period then is tax payable based on charter hire on a pro rata basis i.e. only for the durations of the Chinese voyages?**

As per the Provisional Measures, time charter is a transportation service and the international transportation services within China do not include voyages completely outside of China, and as a result, time charter hire for such voyages shall not be subject to enterprise income tax.

However Article 7 of the Implementation Regulation of the Law of the Enterprise Income Tax ("Implementation Regulation") provides that the place where the payer locates is the place of source for rental income. There is no clarification that whether this "rental income" includes time charter hire. If it does, then since the Chinese Charterer resides in China, the payable charter hire is therefore deemed as sourced from China and taxable despite that the vessel might never call at Chinese ports.

On the other hand, one can argue that the "rental income" shall not include time charter hire because according to the Provisional Measures time charter is a transportation service and the source of transportation income is the place where such service is performed. If the voyage is outside of China, then the place of source is not China. It remains unclear how the tax authority interprets these two regulations.

If the tax authority takes the stance that "rental income" does not include time charter hire, and therefore only Chinese voyages are counted, then the payable tax will be a pro rata one. If the tax authority sees all voyages as taxable, as long as there is Chinese Charterers involved, then the whole charter hire will be taxed.

- Question 2: **The requirements are stated to be effective from 1 August 2014. Do the Provisional Regulations apply only to new transportation agreements signed after that date, or also to older transportation agreements, perhaps agreed some time ago?**

Enterprise Income Tax liability arises when the income is considered earned by applicable PRC accounting and tax rules. For transportation services, the date when the transportation is actually performed is the time such income is deemed earned. Therefore even it is a C/P before 1 August, if the actual transportation occurs after 1 August, the Provisional Regulations still apply.

- Question 3: **Where there is a charter and a sub-charter, does that mean that the tax will be payable on both hire and freight?**

Every party on the charter chain shall pay tax as long as the vessel is engaging in International Transportation Services ("ITS") within China. If an Owner time-charters out the vessel to a Time Charterer, who then voyage-charters out the vessel to a Voyage Charterer to perform ITS in China, both the Owner and the Time Charterer shall pay income tax for the charter hire/freight they earned from the ITS. The Time Charterer can deduct the hire payable to the Owner as necessary expense from the freight he receives from the Voyage Charterer. The Owner can deduct expenses (e.g., crew wages, vessel depreciation) from the hire he receives from the Time Charterer. No doubt the Voyage Charterer shall also pay tax for any income he receives from various shippers.

- Question 4: **Who is responsible for payment of the tax, i.e. Owners or Charterers?**

If an Owner time or voyage charter out the vessel, the Owner is responsible for paying tax for the hire or freight he earned from the ITS. If the Owner does not declare and pay tax by himself or through an agent, the tax authority can designate the Charterer as withholding

agent. The Charterer then is obliged to withhold part of the hire or freight payable to the Owner, and pay the same to the tax authority.

Question 5: For the purposes of double-taxation treaty relief, is the relevant country, the flag state, the country in which the vessel's managers are domiciled or the country in which the vessel's registered owners are domiciled?

The domicile of the party who signs the Charter Party ("C/P") is what matters here. To give an example, if the C/P is between a Greece Owner and a Chinese Charterer and the voyage is an ITS in China, the Greece Owner can apply for a tax treaty exemption for the charter hire or freight he earns in accordance with the tax treaty between Greece and China. It does not matter whether the vessel is Panama or Greece flagged or how the Greece Owner procures the vessel (e.g., bareboat charter in or time charter in).

Question 6: If the c/p is signed by the vessel managers as agent, for and on behalf of the Owner, would this mean that it would be the managers' domicile that would be taken into account for the double taxation treaty relief? If so, can you confirm what is meant by 'domicile' – is it only the place of the company's incorporation or can it also be the place where the company has established a branch?

If the C/P is signed by the vessel managers as agent, for and on behalf of the Owners, it would be the Owners' domicile that determines the applicability of the double taxation treaty relief. However Owners' domicile is not necessarily the place where Owners are incorporated. The Owners' domicile could be the place of the vessel's management. "Domicile in one country" in tax treaties means by reason of place of incorporation, residence, place of head office, place of effective management or other similar criteria, one company is liable to tax in that country. Chinese tax laws provide that to be a domiciled company in one country, that company must pay taxes in that country and has a tax residence identity issued by the tax authority of that country. For example, if the vessel files a Panamanian flag, and the Owner is incorporated in Panama, but the effective management is in Greece, and the Owner is certified by Greece government as resident company, then the Owner's domicile is at Greece, and the Sino-Greece double taxation treaty shall apply. The tax applies to ongoing C/P concluded before 1 August 2014.

Question 7: How do Owners go about registering with the tax authorities?

Within 30 days upon conclusion of the C/P, Owners shall by themselves or through agents go through the registration formalities at a competent tax authority in places (e.g. a Chinese port) where they conducts ITS. Necessary documents for registration include, among others, Owner's Certificate of Incorporation, C/P, voyage details, and documents indicating the contact points in China. Upon successful registration, the Owners shall set up account books, keep account voucher, carry out accounting in accordance with applicable PRC accounting rules, and compute/pay tax accurately. If Owners apply for a tax treaty exemption, besides the above documents, Certificates of Residential Identity issued by the tax authority or Shipping Department of Owners' countries shall also be provided.

Question 8: Would registering with the tax authorities in China have any wider consequences/disadvantages for Owners?

When registering with the tax authority, Owners need to submit the C/P and set up account books. During the tax calculation/declaration, Owners have to provide information regarding their incomes and expenses. A lot of commercial information will be stored in the tax authority's system. Although according to laws, the tax authority shall keep such information confidential, the possibility of leakage cannot be ruled out.

Also such information can be used to trace Owners enforceable assets in China in court proceedings (e.g., Owners' creditor rights against Chinese Charterers). For example, Owners

register a long term time charter with the tax authority. There is a new claim raised by a third party against Owners before Chinese courts. The Chinese courts can obtain the time charter detail from the tax authority and issue an order to the Chinese Charterers requesting the Chinese Charterers to withhold the full charter hire pending the litigation conducted in Chinese courts.

Question 9: In relation to information provided about income and expenses, would Owners have to provide details of all earnings under a time-charter or simply in respect of the voyages involving Chinese ports?

It remains unclear that whether only voyages in relation to a Chinese Charterer shall be taxed or only voyages involving Chinese ports shall be taxed, Owners could be required to provide details of all earning involving Chinese Charterers or Chinese ports.