

Tax efficient investment structure into China for UK corporate investors - The Seychelles CSL

It does not appear to be widely known that China has negotiated, signed and ratified a double taxation agreement with The Republic of The Seychelles.

The tax treaty has been in force since 1999, and on-the-ground reports from our local management in the Seychelles following discussions with the Seychelles International Business Authority (SIBA) indicate that China is supportive of the treaty and would like to encourage its use.

The fact that there is a Chinese Embassy in The Seychelles which can legalize documentation on behalf of Seychelles companies doing business in China is evidence of the good relationship between the two countries, and the importance China places on the treaty to encourage foreign investment into its growing economy.

This document sets out the key terms of the double tax treaty between The Seychelles and China, and examines the tax mitigation opportunities arising from the use of a Seychelles holding company to invest in the shares of a Chinese corporate enterprise.

Key provisions of the China/ Seychelles double tax treaty:

- The treaty mitigates the impact of Chinese income tax applicable both to distributions from Chinese enterprises to Seychelles “Special Licence Companies” and to the Seychelles “Special Licence Company” (CSL) which is trading in China.
- The “Business Profits” article (Article 7) exempts a Seychelles CSL from Chinese tax on its trading profits arising in China provided that the CSL does not create a “permanent establishment” in China (as defined in Article 5).

The definition of a permanent establishment expressly excludes the case of a building site, or construction, installation or assembly project in China where the site, construction, installation or assembly continues for less than 12 months.

Therefore, a Seychelles CSL which receives business profits from trading in China can only be taxed in China if it creates a taxable permanent establishment in China.

- The fact that a Seychelles CSL controls a Chinese subsidiary company will not, of itself, create a permanent establishment of the CSL in China.
- The maximum rate of withholding tax which China can levy on dividends paid from a Chinese company to a Seychelles CSL is 5% of the gross dividend (assuming that the CSL is the beneficial owner of the dividend).
- The maximum rate of withholding tax which can be levied by China on interest paid from a Chinese company to a Seychelles CSL is 10% of the gross interest (assuming that the CSL is the beneficial owner of the interest).
- The maximum rate of withholding tax which can be levied by China on royalties paid by a Chinese company to a Seychelles CSL is 10% of the gross royalties (assuming that the CSL is the beneficial owner of the royalties).
- If a Seychelles CSL owns at least 25% of the shares of the capital stock of a Chinese company, then resulting capital gains from the sale of such shares will not be taxed in China (unless the principal assets of the Chinese company consist of Chinese land or property).
- Capital gains of a Seychelles CSL are not taxed in the Seychelles

- To avoid double taxation, any Chinese tax paid by a Seychelles CSL can be deducted from the taxes due in the Seychelles on the same income.
- There are no anti-conduit or anti-treaty-shopping provisions in the double tax treaty. There is an “associated enterprises” provision (Article 9) and a similar provision in the Royalty article (article 12) but these are not applicable where arm’s length arrangements are put in place between the Seychelles CSL and any Chinese subsidiary company.

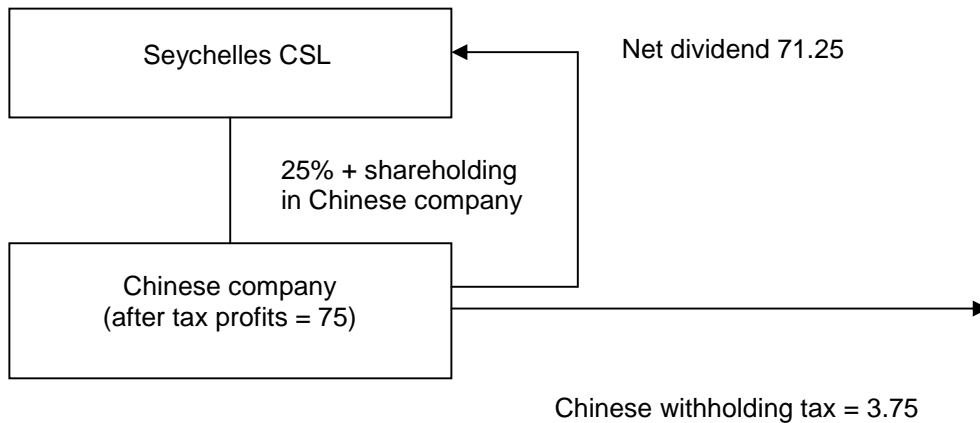
The Seychelles CSL company

The Seychelles CSL is liable to pay Seychelles corporation or business tax on its worldwide income at a rate of 1.5% (one and a half per cent).

It is to be noted that the Seychelles tax of 1.5% is a tax on income only. There is no capital gains tax levied in the Seychelles. This means that capital gains realised from shareholdings in Chinese enterprises are potentially exempt from tax not only in China, but also in The Seychelles.

Given the rate of Seychelles corporation tax, it follows that where a CSL receives a dividend, royalty or interest payment from China it will pay no tax in The Seychelles, as the double tax treaty with China enables it to deduct or “credit” its Chinese tax liabilities (i.e. source withholding tax) from or against its Seychelles tax liability.

Example 1



Tax computation

(NB Underlying Chinese corporate tax = 25%)

Post-tax profits in China	75
Chinese dividend withholding tax (limited to 5% by Chinese/Seychelles treaty)	3.75

Gross dividend receipt in Seychelles	71.25
Tax payable in Seychelles (1.5% x 75)	1.125
Less Chinese tax credit (WHT)	(3.75)
Maximum credit in Seychelles	(1.125)
Tax payable in Seychelles	Nil

Net after tax profits in Seychelles	71.25

Distribution of profits by Seychelles CSL

The net profits of the CSL in the above example can be distributed by way of dividend free of any Seychelles withholding tax to foreign investors. Likewise, there are no Seychelles withholding taxes on distributions of royalty or interest made by the CSL to non-residents of the Seychelles.

UK corporate investment into China

The UK/China treaty is not as favourable as the Seychelles/China treaty as can be seen from the example below.

Tax computation

(NB Underlying Chinese corporate tax = 25%)

Post-tax profits in China	75
Chinese dividend withholding tax (limited to 10% by Chinese/UK treaty)	7.5

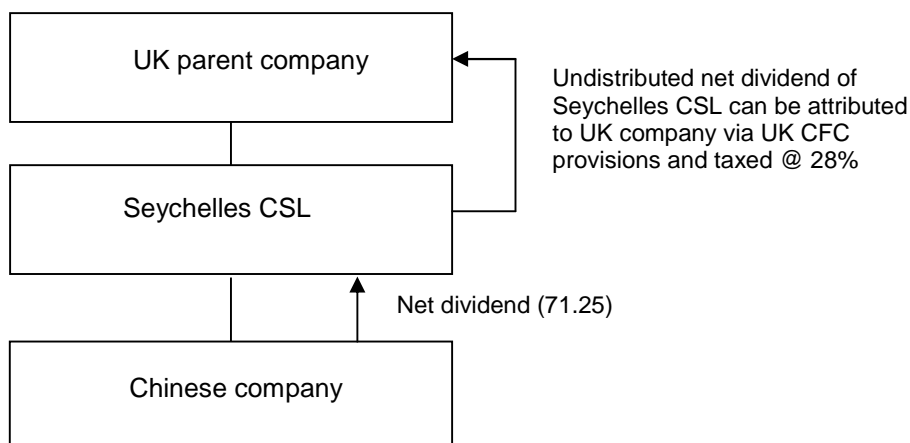
Gross dividend receipt in UK	67.5
Tax payable in UK (28% x 100)	28
Less Chinese tax credit (WHT)	(7.5)
Plus underlying Chinese tax credit	(25)

	(32.5)
Maximum Chinese tax credit in UK	(28)
Net UK tax payable	Nil

Net after tax profits in UK	67.5

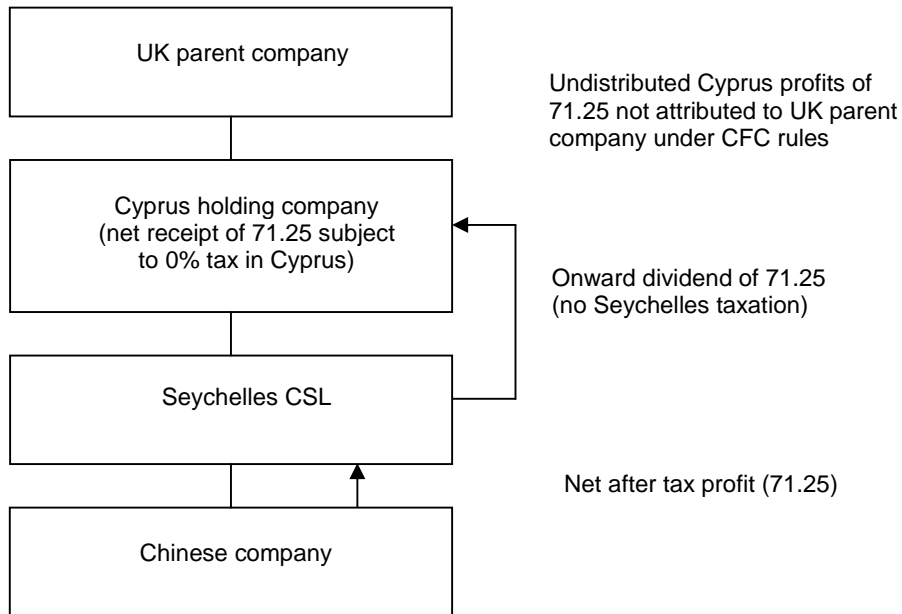
UK CFC issues

Despite the potentially significant tax saving that a UK company can achieve through investing in China via a Seychelles CSL (as shown by the above examples) the Controlled Foreign Companies legislation in the UK could attribute the profits of the Seychelles CSL to the UK parent :



Solution

The UK company needs to create an intermediate holding company situated within the European Union e.g.



Comment

The European Treaty protects the UK company from a CFC assessment in respect of the Cyprus company's profit (*Cadbury Schweppes PLC v IRC*).

Features of the CSL

- Liable to Seychelles corporation tax of 1.5% on worldwide income.
- No capital gains tax.
- No Seychelles withholding tax on profits distributions.
- No stamp duties.
- Minimum of two resident directors required (NB all the directors or a majority should be resident in The Seychelles).
- Must file annual audited accounts (not published) with the Seychelles tax authorities.
- Double tax treaty with China which
 - 1: Reduces Chinese dividend withholding tax to 5%.
 - 2: Reduces Chinese royalty withholding tax to 10%.
 - 3: Reduces Chinese interest withholding tax to 10%.
- Withholding taxes creditable against Seychelles corporation tax .
- Advance rulings on profit spreads available in The Seychelles prior to onward distribution.

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