

Impacts of the new protocol PRC-Barbados DTA

On February 10, 2010, the Government of Barbados and the Government of the People's Republic of China concluded a new protocol to amend the existing agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (hereafter referred to as the "old DTA") that was signed on May 15, 2000. The new protocol will become effective after ratification by both countries.

Key Changes under the New Protocol

1. Dividends

Under the new protocol, the withholding tax rate on dividends is now reduced from 10% to 5%, if the Barbados investor holds 25% or more of equity interests of the Chinese company paying the dividend. In all other cases, a 10% withholding tax rate will be applied.

2. Capital Gain

Under the old DTA, capital gains derived from the sales of equity interests in a Chinese company by a Barbados resident company is exempt from paying a withholding tax of 10%. However, under the new protocol, China now has taxing rights in the following situations:

- if more than 50% of the value of equity interests disposed is derived, directly or indirectly, from immovable property situated in China; OR
- if the Barbados investor's shareholding in the Chinese company is at least 25% during the 12-month period before the date of alienation.



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In other words, under the new protocol, an exemption from paying Chinese tax on capital gains derived by a Barbados investor from the disposition of equity interests in a Chinese company will only be available provided that: (a) the Barbados investor's shareholding in the Chinese company is less than 25% during the 12-month period before the disposition of equity interests; AND (b) no more than 50% of the value of equity interests disposed of is derived, directly or indirectly, from immovable property situated in China.

3. General anti-avoidance rules (GAAR)

GAARs are not available under the old DTA whilst the new protocol contains an anti-avoidance provision that allows each treaty party to apply its domestic tax regulations and measures to combat tax avoidance.

The PRC tax authorities may rely on this provision to deny or override treaty benefits based on the application of general anti-avoidance rules stipulated in the new PRC corporate income tax law and regulations that became effective on January 1, 2008.

4. Exchange of Information

The Exchange of Information (EoI) Article in the old DTA adopted the 1977 OECD Model Tax Convention whilst in the new protocol the EoI Article has been updated to follow the 2005 OECD Model Tax Convention, which is more comprehensive and extensive.

What are the Impacts after the New Protocol?

Until now, because of the favourable capital gains article stipulated in the old DTA, Barbados has been favoured by foreign investors considering investments into Chinese companies holding real estate. With the new protocol, we believe that Barbados will become less attractive to some MNCs as their preferred intermediate holding vehicle jurisdiction to hold their PRC investments.

MNCs that adopt Barbados as the special purpose holding vehicle for their investments into China should evaluate the impact of changes immediately. In addition, the foreign investors that adopt Barbados as the holding vehicle should take into account the impact of a tax notice, Guoshuihan [2009] No. 698 (Circular 698), issued by the State Administration of Taxation. Circular 698 addresses the PRC tax on capital gains arising from the sale of an offshore intermediary holding company owning a Chinese resident enterprise (i.e., an indirect transfer).

Our Initial Suggestions

Under the prevailing China treaty network, there are still a few tax treaties under which China does not have taxing rights over capital gains from the disposal of equity interests of property-rich Chinese companies (i.e., where more than 50% of the value is derived, directly or indirectly from immovable property situated in China). Those jurisdictions include Venezuela, Belarus, and Armenia. Nevertheless, these jurisdictions are not commonly adopted by MNCs for holding their PRC investments.

There are also a few tax treaties where China does not have taxing rights on the disposal gains of equity interests in non-property-rich Chinese companies. Those jurisdictions include Ireland and Switzerland.



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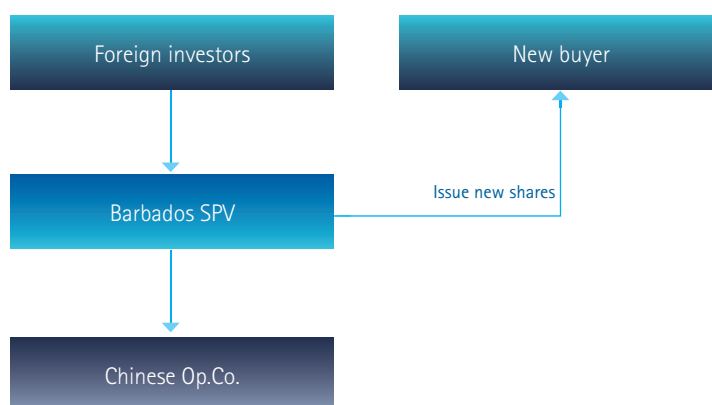
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A direct transfer of equity interests in the PRC investment requires going through an onerous approval process. Further to the issuance of Circular 698, both direct transfer and indirect transfer could have PRC tax exposures on capital gain.

In light of the above, we offer the following initial suggestions for foreign investors who currently adopt Barbados, or will do so in the future for holding their PRC investment. Please note that our suggestions are also applicable to jurisdictions other than Barbados, but will at all times need to be confirmed with tax and legal opinions.

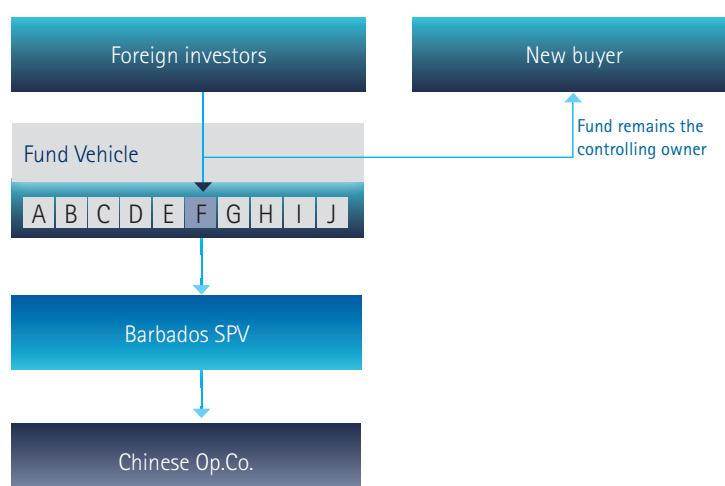
Option 1

The Barbados SPV can dilute its shares and issue a new slot of shares to the buyer. The existing owner of the Barbados SPV will be deprived of dividend entitlement and the voting right. Instead of transferring the shares in the Barbados SPV from the existing owner to the buyer, the buyer obtains the ownership in the Barbados SPV that holds the PRC investment by holding the new slot of shares. This option is viable under group restructuring.



Option 2

Holding the existing Barbados SPV through an existing fund with segregated classes of shares. Instead of transferring the shares of the existing Barbados SPV, the new buyer merely acquires the class of shares from the fund.





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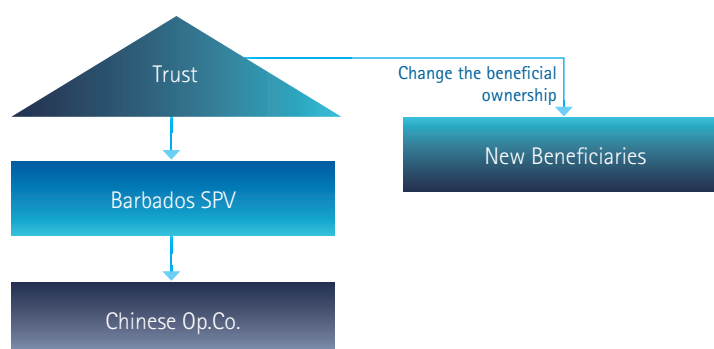
Option 3

The existing owner will list the existing Barbados SPV in an offshore public stock exchange such as the stock exchange in Curacao. The buyer will acquire the listed shares of Barbados SPV through an exchange custodian. Gains derived from buying and selling of shares listed in public stock exchanges are explicitly excluded from the scope of Circular 698. (Whether an offshore public stock exchange will be recognized for this purpose may possibly be subject to the interpretation of the local tax authorities).



Option 4

Holding the existing Barbados SPV through a trust. The existing owner will become one of the beneficiaries of the trust, and transfer its entitlement to the buyer. Instead of transferring the shares of the existing Barbados SPV, there is only a change in the beneficial ownership in the trust.



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Amicorp does not provide legal or tax advice. Amicorp works on the basis of a lawyer's or tax advisors' structuring advice.

For further information please contact any of our staff below:

Derk Scheltema
Amicorp Shanghai
d.scheltema@amicorp.com

Kit-wah Poon
Amicorp Hong Kong
c.poon@amicorp.com

Careen A. Byfield-Leyshon
Amicorp Barbados
c.leyshon@amicorp.com



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Amicorp offices

EUROPE

Amicorp Baltic UAB
Konstitucijos ave. 7
24th floor
LT-09308 Vilnius
Lithuania
Tel.: +370 5248 7532
Fax.: +370 5248 75350
Email: vilnius@amicorp.com

Amicorp (Cyprus) Ltd.
1 Avlonos street
Maria House
Nicosia 1075
Cyprus
Tel.: +357 22 504 000
Fax.: +357 22 504 100
E-mail: cyprus@amicorp.com
Post address
PO Box 23293
Nicosia 1680
Cyprus

Amicorp de España, S.L.
Paseo de Gracia 21, 4º 1ª
Barcelona 08007
Spain
Tel.: +34 93 241 7563
Fax.: +34 93 241 7564
E-mail: barcelona@amicorp.com

Amicorp Luxembourg SA
47, Boulevard Royal
L-2449 Luxembourg
Grand Duchy of Luxembourg
Tel.: +352 26 27 43
Fax.: +352 26 27 43 50
E-mail: luxembourg@amicorp.com

Amicorp Netherlands B.V.
WTC Amsterdam, Tower C-11
Strawinskylaan 1143
1077 XX Amsterdam
The Netherlands
Tel.: +31 20 578 8388
Fax.: +31 20 578 8389
E-mail: netherlands@amicorp.com

Amicorp Switzerland AG
Zug Representative Office
Baarerstrasse 75
6300 Zug
Switzerland
Tel.: +41 41 712 1355
Fax.: +41 41 712 1356
Email: switzerland@amicorp.com

Amicorp Switzerland AG
Zollikerstrasse 164
CH-8008 Zurich
Switzerland
Tel.: +41 44 252 0880
Fax.: +41 44 252 0881
Email: switzerland@amicorp.com

Amicorp (UK) Limited
3rd Floor
5 Lloyds Avenue
London
EC3N 3AE
Tel.: +44 207 977 1250
Fax.: +44 207 977 1251
E-mail: london@amicorp.com

THE AMERICAS

Amicorp Americas LLC, Agencia en Chile,
(Representative Office)
Augusto Leguía Norte 100, Of. 712
Las Condes
Santiago, Chile
Tel.: +56 2 570 5650
Fax.: +56 2 570 5669
E-mail: santiago@amicorp.com

Amicorp Argentina S.A.
Torre Chacofi
25 de Mayo 555, Piso 22 C1002ABK
Buenos Aires
Argentina
Tel.: +54 (11) 4311 2090
Fax.: +54 (11) 4314 4978
Email: argentina@amicorp.com

Amicorp Barbados Ltd.
Carleton Court, 2nd Floor
High Street, Bridgetown
Barbados
BB11128
Tel.: +1 (246) 228 5363
Fax.: +1 (246) 228 5981
E-mail: barbados@amicorp.com

Amicorp do Brasil Ltda.
Rio de Janeiro Representative Office
Rua Lauro Müller 116
31 Andar, sala 3104
Edifício Torre do Rio Sul
22290-160, Botafogo
Rio de Janeiro - RJ
Tel.: +55 21 2295 7525
Fax.: +55 21 2295 7948
E-mail: riodejaneiro@amicorp.com

Amicorp do Brasil Ltda.
Rua Helena 260
14 Andar-conj. 141, Villa Olímpia
04552-050 São Paulo - SP
Brazil
Tel.: +55 11 3049 3454
Fax.: +55 11 3049 3455
E-mail: saopaulo@amicorp.com

Amicorp BVI Limited
2nd Floor Marcy Building
Purcell Estate
P.O. Box 2416, Road Town
Tortola
British Virgin Islands
Tel.: +1 284 494 2565
Fax.: +1 284 494 2552
E-mail: bvi@amicorp.com

Amicorp Curaçao B.V.
Pareraweg 45
P.O. Box 4914, Curaçao
Netherlands Antilles
Tel.: +599-9 434 3500
Fax.: +599-9 434 3533
E-mail: curacao@amicorp.com

Amicorp Mexico
Mexico Representative Office
Edificio Torre Esmeralda III
Bldv. Manuel Ávila Camacho
No. 32, Piso 4
Col. Lomas de Chapultepec
11000 México, D.F.
Tel.: +52 55 5202 5999
Fax.: +52 55 5202 1004
E-mail: mexico@amicorp.com

Amicorp Services Ltd.
Miami Representative Office
Brickell Bay Office Tower
1001 Brickell Bay Drive
Suite 2310
Miami, Florida 33131
U.S.A.
Tel.: +1 305 416 4730
Fax.: +1 305 416 4738
E-mail: miami@amicorp.com

Amicorp Services Ltd.
New York Representative Office
641 Lexington Avenue
Suite 1504
New York, NY 10022
U.S.A.
Tel.: +1 212 752 3267
Fax.: +1 212 634 6305
E-mail: newyork@amicorp.com

ASIA/PACIFIC

Amicorp Advisory Services Pvt. Ltd.
1907 - 19th Floor
World Trade Centre - Centre 1
Cuffe Parade
Mumbai 400 005
India
Tel.: +91 22 2216 6783
Fax.: +91 22 2216 6784
E-mail: mumbai@amicorp.com

Amicorp (Shanghai) Consultants Ltd.
3108 United Plaza
Shanghai 200040
1468 Nanjing Road West
Jing'an District
Shanghai 200040
P.R. China
Tel.: +86 21 6289 6665
Fax.: +86 21 6289 6697
E-mail: shanghai@amicorp.com

Amicorp Hong Kong Limited
Suites 1306-07
13th Floor, ING Tower
308 Des Voeux Road Central
Hong Kong
Tel.: +852 3105 9882
Fax.: +852 3105 9883
E-mail: hongkong@amicorp.com

Amicorp Management India Private Ltd.
1st Floor, RMZ Titanium
135, Old Airport Road
Bangalore 560017
India
Tel.: +91 80 4005 4900
Fax.: +91 80 4005 4906
E-mail: bangalore@amicorp.com

Amicorp New Zealand Ltd.
Unit C3
17 Corinthian Drive
North Shore City 0752
Auckland
New Zealand
Tel.: +64 9 414 4614
Fax.: +64 9 414 4362
E-mail: newzealand@amicorp.com
Post address
PO Box 300125
North Shore City 0752
Auckland
New Zealand

Amicorp Singapore Pte. Ltd.
30 Cecil Street
#19-01/02 Prudential Tower
Singapore 049712
Tel.: +65 6532 2902
Fax.: +65 6534 1244
E-mail: singapore@amicorp.com