

# CHINA TAX ON CHARTER HIRE AND FREIGHT



*“Cargo Operations at Beihai, China”.*

## The Development

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The Association has previously advised on this issue in its update of 18 August 2014 ([Skuld Advisory 18.08.2014](#))<sup>1</sup>.

Since then, a large number of members have contacted the association seeking further clarification on this new and potentially complex issue.

Although the Association would advise members to seek the assistance of specialist tax counsel, in case detailed and specific situations need to be considered, the following bulletin seeks to provide

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further information in order to allow Members a better understanding of the new Chinese regulations and their impact on shipping.

### Caution Note

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The association will ask members not familiar with this issue to first refer to the advisory of 18 August 2014, before considering the following. However, specialist tax counsel advice may still need to be obtained in any event.

### Further information available

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With the assistance of Steven Wise at Smyth & Co / RPC in Hong Kong and Weidong Chen of Dacheng Law Offices in Shanghai, the following information is now available. The association is also grateful to Huatai for their Circular No. PNI 1403.

This information cover:

1. The Scope of the New Rules
2. Tax Exemption
3. Registration procedure for non-resident companies
4. Charterparty Advice
5. Matters that remain to be Developed Further

### Scope of the New Rules

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There has been confusion about the scope of the new regulations, as well as whether a particular company will have to comply and whether tax exemptions are available.

In this regard it can be clarified that the intention of the regulation is to extend to time charters as well as voyage charters, both hire and freight. With respect to Bare boat Charters, this income may be subject to income tax in China, and such would already be governed by existing regulations.

Further, it is intended that all non-resident companies engaged in relation to transport activities originating from or destined to Chinese ports will be subject to the enterprise income tax.

A key issue is whether or not a non-resident company can benefit from a tax exemption, subject to bilateral treaty between that company's place of incorporation or tax residence and China (more on exemptions below).

For the companies that seek to benefit from tax exemption, there will be procedural and administrative matters to comply with. However, once the exemption is confirmed, matters will be relatively straight forward.

By far the most significant challenge will be for those companies that are not able to claim tax exemption, as then the following issues will arise:

1. how will tax be calculated
2. who will have to pay the tax
3. can charter terms regulate who pays the tax
4. what if tax is overpaid
5. what if tax is paid directly by the non-resident shipowner, but the charterer counterparty claims they are obliged to withhold it and make a hire deduction
6. what if the charterer counterparty makes an excess hire deduction on the basis of tax withholding

Based on discussions with legal advisors and correspondents, it is clear that these questions may potentially be problematic. Members who are unable to claim a tax exemption are strongly recommended to seek the assistance of specialist tax counsel, especially in China. Specialist tax counsel can assist in working out what the likely tax exposure may be and how to best arrange for the payment of the tax.

Furthermore, it may be necessary to consider whether express charter terms are needed to regulate the relationship between a non-resident shipowner (or disponent owner) and a Chinese resident charterer, in order to agree in advance whether tax may be withheld from hire and how that is to be calculated.

The alternative is likely to mean unexpected and unwanted charterparty disputes as well as potential complications with the tax authorities in China.

## Tax Exemption

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While tax exemptions exist, these do not apply automatically. The good news is that China has tax treaties with over 100 countries in the world, and that should mean a number of members should (subject to following the correct procedure) be able to claim an exemption.

A list of such countries, and links to the treaties themselves, can be found on the website of the State administration of taxation of the PRC ([tax treaty list](#)).

In order to be eligible for a tax exemption, a non-resident company must:

- A. be incorporated in a jurisdiction which enjoys an applicable tax treaty with the PRC
- B. register and claim the exemption (on registration, see below)

This means both owners and charterers should check whether their main place of incorporation (which may mean a particular vessel's home port / flag) or their place of tax residency, or the place of the main head office (depending on the precise wording of the applicable treaty) is in a state that has concluded a tax treaty with China, and that this tax treaty extends to cover matters such as this new regulation.

It is likely that members will need to seek assistance of specialist tax counsel in their home jurisdiction as well as in China, to successfully check and complete the process of claiming tax exemption.

In any event a form needs to be submitted to claim the exemption, which is the "Non-residents claim for treatment under double taxation agreement". This process is also in a transition period and final rules and forms have yet to be implemented.

Other required documents may include the following, but this is not necessarily an exhaustive list:

1. a duplicate or copy of the applicant's certificate of incorporation (or similar document);
2. the original or certified copy of a certificate issued by the tax authorities (or shipping administration authorities) of the applicant's country certifying that the applicant was a resident of the relevant country for tax purposes;
3. copies of the contracts under or in relation to which the income was / will be generated;
4. a written statement giving details of the related operations in China and a list of the ports in China that are to be called at

In case tax has been paid by a company that could have enjoyed an exemption, there is a procedure to apply for a refund, subject to a three year time limit.

## Registration Procedure

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Under the previous regulations, a non-resident company did not have to register with a PRC tax authority before claiming a tax exemption. It was possible to do this through their nominated Chinese agent.

Under the new regulation, an applicant is required to register itself with the local authority (which may mean the authority or authorities at the port or ports of loading). This is required whether or not a tax exemption will be claimed. If more than one port in China is involved, then registration may be undertaken at one port only.

At present this registration procedure is not yet fully implemented.

Further it is not yet fully clarified as to whether a non-resident company with no office or other premises in China would still be exempt from the registration requirement.

Information that may need to be provided during registration would include :

1. Certificate of incorporation
2. Relevant business contracts (that may mean C/Ps, COAs, etc.)
3. Details of any appointed agent in China

It would be necessary to carefully check the full documentation required with Chinese agents and tax counsel.

### Charterparty Advice

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If members are able to successfully claim a tax exemption, and have successfully completed the procedure, then this new regulation should hopefully have a very limited impact.

Nevertheless it would be prudent to consider incorporating charterparty terms that make it clear to the charterer that the owner (or Disponent Owner) enjoys the tax exemption and that no tax may be legitimately withheld by the charterer from hire or other sums due.

**Hot Tip** : it is best to deal with issues such as these ***before*** concluding a fixture, not as an afterthought sometime later !

Such clause may include terms such as the following :

*"Owners are entitled to and [have obtained / will obtain] exemption from taxes levied on income under this charterparty by the tax authorities of the People's Republic of China. Charterers are not entitled to make any deduction from sums due under this charterparty in respect of such taxes."*

For companies unable to benefit from the tax exemption, they need to consider more developed charterparty terms to address the situation.

Such terms need to consider whether the company or the charterer shall pay the tax, and if the latter, whether this can be done by way of deduction from hire or freight.

Furthermore it should be considered what kind of indemnity provisions are needed in case tax withheld by the charterers is excessive, or if the charterers fail to properly account for that tax to

the Chinese authorities. These issues may also impact on issues relating to possible rights to withdraw or suspend the service of the vessel, as well as possible rights of lien, that may exist under the charterparty.

It is likely that such a charterparty clause may be complicated and it would be beyond the scope of this article to provide a detailed exposition of what such a clause (or indeed clauses) may involve.

It may also be considered whether clauses are agreed that either take the matter out of the hands of charterers completely, by owners agreeing to take on the burden of compliance, or alternatively to agree that hire / freight paid under the charterparty is already net of tax which Charterers then need to account for themselves to the Chinese tax authorities. Such clauses may be simpler and less challenging.

If it is agreed that Owners are to bear the tax, a clause with the following wording may be a starting point for further charterparty drafting:

*"Owners will bear and pay any taxes levied on income under this charterparty by the tax authorities of the People's Republic of China. Charterers are not entitled to make any deduction from sums due under this charterparty in respect of such taxes."*

If charterers are to bear the tax, or if it is considered likely that the charterers will be appointed by the Chinese tax authorities to act as withholding agents, the charterparty should address the issue and a clause may need to include wording such as the following:

*"Charterers will bear and pay any taxes levied on income under this charterparty by the tax authorities of the People's Republic of China, and it is agreed that the rate of [hire / freight] stated herein is net of any such taxes. Charterers are not entitled to make any deduction from sums due under this charterparty in respect of such taxes."*

### Matters that remain to be developed further

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Members will note that the association had to caution at several stages that the new regulations are not yet fully implemented and that their practical side is yet to be fully developed in some respects.

Further, the exact full scope is also not yet known, for instance it is not clear whether a vessel owned by a non-resident, and time chartered to a non-resident, but lifting a cargo in China would be subject to pay the tax on that time charter hire.

For these matters it will be necessary to continue to follow further developments and seek latest information from both local agents and possibly specialist tax counsel, in order to ensure that business transacted remains in compliance with regulations.

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## CREDITS

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By

**Christian Ott**

Vice President Head of Claims, Skuld Singapore Branch  
Loss Prevention and Recurring Claims Team Leader

*For further information and feedback, Members are asked to contact the Loss Prevention and Recurring Claims Group : [lossprevention@skuld.com](mailto:lossprevention@skuld.com)*

The Association is grateful to the following for their detailed advice and input towards this article :

**Steven Wise**

Partner, Smyth & Co (in Association with RPC)  
Hong Kong

**Weidong Chen**

Partner, Dacheng Law Offices  
Shanghai

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## References

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The association also has had reference to Huatai Insurance Agency & Consultant Service's Circular No. PNI 1403 of September 2014 when preparing this loss prevention bulletin.