

Limited Partnership Tax Circular Eases Investor Concerns

By Wayne Chen and Patrick Chen

Since the amendments to the *Law of Partnership Enterprise* (new partnership law) were promulgated on 27 August 2008, tax policy for limited partnerships has become an important issue and concern for investors.

After the new partnership law took effect on December 23, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued the *Circular on Income Tax for Partner of Partnership Enterprise* (Circular 159).

- Tax payers – pursuant to Circular 159, every partner of a partnership enterprise is a tax payer. An individual partner shall be obliged to pay individual income tax, and a partner in the form of a corporation or other entity shall be obliged to pay enterprise income tax;
- Taxable incomes – pursuant to Circular 159, the taxable incomes, including the business income and the other incomes of a partnership enterprise, shall be calculated in light of the principle of “dividends first and tax second”.

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Individual partner applicable tax rate

Prior to the implementation of Circular 159, the *Regulations on Individual Income Tax on the Investors of Sole Proprietorships and Partnership Enterprises* (Regulations 91) stipulates that an individual partner shall pay individual income tax for the business income of a partnership enterprise. This was according to the Law of Individual Income Tax at the same tax rate as that levied on a self-employed entrepreneur.

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The *Circular on the Execution Principles for Regulations 91* (Circular 84) further stipulates that all interest, dividends and profits gained from investment into a partnership enterprise shall be considered as interest, dividends and profits of the partner's individual income and be taxed at the corresponding individual income tax rate.

Pursuant to Article 6 of Circular 159, "if there are any conflicts between the previous provisions and this Circular, the stipulations in this Circular shall prevail". But there are no conflicts among Circular 159, Regulations 91 and Circular 84, in respect of income tax for an individual partner. An individual partner shall pay individual income tax for the business income of a partnership enterprise according to Regulations 91 and Circular 84. And the interest, dividends and profits from the investment into a partnership enterprise shall be taxed at a rate of 20% pursuant to the Law of Individual Income Tax.

We note that, under Circular 159, the taxable income of a partner includes both the business income and other incomes of the partnership enterprise. Regulations 91 stipulates the business income rather than the other incomes – to our understanding "other incomes" are the non-business incomes including government allowances and rewards – but there is no other stipulation regulating individual income tax for the other incomes of a partnership enterprise. How the partner pays this is waiting for SAT's further clarification.

Another issue is how to apply recent local tax policies concerning partnerships. In both Shanghai and Ningbo, individual partners of a limited partnership are organised into the general partners who operate the partnership business and the limited partners who do not. The limited partner and general partner respectively pay income tax at a rate of 20%, and at the five-grade progressive rates of 5% to 35%.

In Beijing, limited partners and general partners are treated identically: the individual partners pay income tax at a rate of 20% as applied on the income of "interest, dividends and profits" or "yields from property assignment".

We understand that it is reasonable to treat limited partners and general partners differently in respect of individual income tax because of the differing nature of income sources. But Regulations 91 and Circular 84 do not stipulate different tax rates for limited partners and general partners. Whether these are different is still waiting SAT's further clarification.

Corporations or other entities applicable tax rates

According to Circular 159, partners in the form of corporations or other entities shall pay enterprise income tax for the corresponding income of a partnership enterprise pursuant to the Law of Enterprise Income Tax. This stipulates that the incomes gained from the equity investment in qualified resident enterprises, such as dividends and profits, are exempted incomes.

But, in cases where a partnership enterprise invests in a resident enterprise, should the incomes gained therefrom also be considered as exempted income for the partners in the form of corporations or other entities?

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A partnership enterprise is considered as a “pipe entity”, so its investment in other enterprises is also considered as its partners’ direct investment. To some extent it is reasonable that the income of a partnership enterprise – gained from an equity investment in qualified resident enterprises – is exempted income for corporations or other classified entities. However, there are no relevant laws to regulate tax on the investment income of a partnership enterprise for partners in the form of corporations or other entities. This also needs to be further clarified by SAT.

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