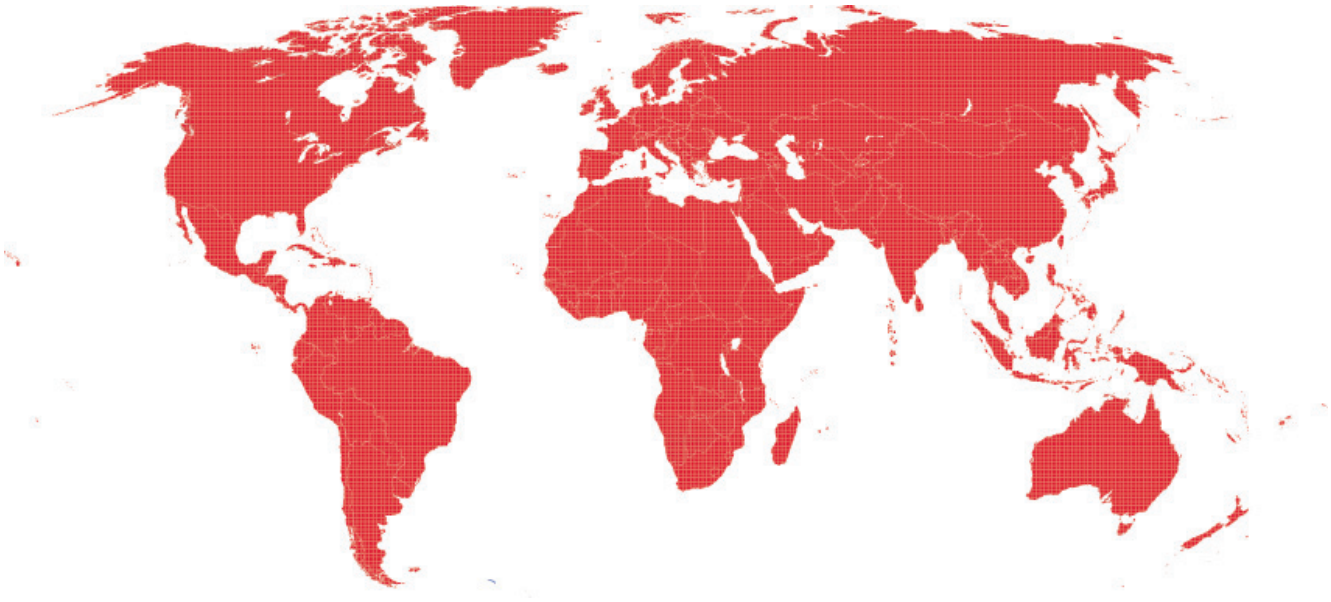
wtsChina

Taxation of Permanent Establishment (PE) in China



With representation in over 100 countries, WTS Global has already grown to a leadership position as a global tax practice offering the full range of tax services and aspires to become the preeminent non-audit tax practice worldwide. WTS Global deliberately refrains from conducting annual audits in order to avoid any conflicts of interest and to be the long- term trusted advisor for its international clients.

WTS China is a WTS Global Member in China. Established in 2004, WTS China has been in China for over 17 years, serving finance / tax services predominantly to MNCs. Our China team has a strong international exposure and a comprehensive hands-on experience, capable to provide you a strong and efficient support. In recent years, we have been helping many multinational companies in their China projects planning, compliance work and tax risk assessment.

Located in Shanghai of China, we serve the world. With WTS Global's coordination, WTS has constituted a global network with member firms over 100 countries. We can claim enforcement globally with the support from the global team. (Website at www.wts.cn)

Glossary of terms

CIT	Corporate Income Tax
DTA	Double Tax Agreement / Arrangement
FE	Foreign Enterprise
IIT	Individual Income Tax
MOF	Ministry of Finance
NTRE	Non-tax-resident Enterprise
OECD	Organization for Economic Co-operation and Development
PE	Permanent Establishment
PRC	The People's Republic of China
ROs	Representative Offices
SAT	State Administration of Taxation
SD	Stamp Duty
TRE	Tax-resident Enterprise
UN	United Nations
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise
WHT	Withholding Tax

wtsChina

Table of Contents

wtsChina

01

Preface

1. Preface

How a PE issue occurs can be illustrated in a simple analogy: when a foreign company sells to China or sends its staff to China for business, one may think that China taxes are irrelevant because the company has not maintained an office in China – until a taxman pops up to declare, “Sorry, you need to pay China taxes”.

This publication explains the practices and complexity of PE assessment in China. It also provides an update on how PE is addressed in the event of force majeure such as a COVID-19 pandemic.

PE is a common taxation issue but quite often ignored by international business operators. This publication may have caused some concern about the tricky tax issues in cross-border operations. If so, it has achieved what it is supposed to achieve.

Martin Ng

Managing Partner
WTS Greater China

wtsChina

02

Development of PE in China

2.1. General introduction – What is PE?

2.1.1. Domestic law

Tax-resident enterprises (TRE) and non-tax-resident enterprises (NTRE) are subject to different CIT implications per China's CIT Law.

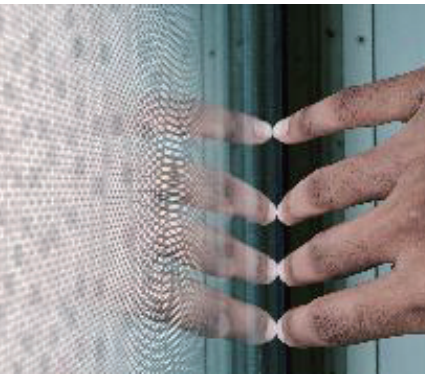
- TRE, is either established according to China law or is established overseas but has its place of effective management in China. Effective management in China is defined as an establishement that exercises, in substance, overall management, and control over an enterprise's business, personnel, accounting, properties, etc. in China. TRE should pay CIT on income derived from sources inside and outside China.

- NTRE, which has an establishment or a place in China shall pay CIT on income that is derived by such establishment or place in China from sources inside China as well as on income that, although derived from sources outside China, is effectively connected with such an establishment or a place". NTRE which does not have an establishment or a place in China will not be liable to CIT except its income derived from or accruing in China.

It should be noted that the CIT Law uses the wording of "establishment" but not "permanent establishment", and there is no minimum period set for such "establishment".

It is further stated in the Income Tax Law that an "establishment" or a "place" are those establishments and places in China engaged in production and business operations, including:

- Management organizations, business organizations, representative offices;
- Factories, farms, places where natural resources are exploited;
- Places where labor services are provided;
- Places where contractor projects, such as construction, installation, assembly, repair and exploration, etc. are undertaken;
- Other establishments or places where production and business activities are undertaken.



2.1. General introduction – What is PE?

2.1.2. Double Tax Treaty

By the end of 2021, China has concluded 109 comprehensive tax treaties (102 of which have come into effect), two tax arrangements, and one tax agreement. They cover almost all the important trading partners of China.

In general, China follows the general principles of the OECD and the UN Model Conventions on Bilateral Tax Treaties in defining PE but has adopted a slightly broader definition in her DTAs concluded with other countries and regions.

General deviations of the DTAs from the OECD Model Tax Convention:

According to a China tax circular (Guo Shui Fa [2010] No. 75), PE refers to a fixed place of business through which the business of an enterprise is wholly or partly carried on. PE does include only a fixed place solely to carry on any activity of a preparatory or auxiliary character.

2.1. General introduction – What is PE?

2.1.2. Double Tax Treaty

General deviations of the DTAs from the OECD Model Tax Convention:

The term "business" includes not only production and operation activities but also general business activities carried on by non-profit organizations. In other words, a non-profit organization operating at a fixed place can also be deemed as a PE in China, unless it carries on activities merely of a preparatory or an auxiliary character.

The preparatory or auxiliary character is determined by the following principles:

- Whether the fixed place provides services solely for the head office or whether it has business interactions with other parties;
- Whether the nature of the business of the fixed place is consistent with the nature of the business of the head office; and
- Whether the business activities of the fixed place constitute an important integral part of the business of the head office.

If the fixed place provides not only services to the head office but also interacts with other parties, or if the nature of its business is consistent with the nature of its head office's and constitutes an important integral part of the head office's business, its activities may not be accepted as merely "preparatory or auxiliary".

For example, an oil company exploring oil resources in China should generally be regarded as a PE. A PE may also be deemed to exist if an oil company from another contracting state has a place of management in China.

The activities carried out "through" the business premise shall be interpreted widely to include any circumstance relating to the activities engaged in by the enterprises in their locations of disposal. For example, a road construction enterprise shall be deemed as engaging in business activities at the place of occurrence "through" its construction behaviour.



Notwithstanding the provision stated above and according to the UN Model, China has adopted a wider PE definition than the one reflected in the OECD Model. As a consequence, most of the DTAs concluded by China have adopted a PE definition which includes – in addition to building sites, construction or installation projects – assembly and supervisory activities. A PE is deemed as created when such activities last for more than 6 to 24 months, which differs from the OECD Model, 12-months stipulation.

In line with the UN Model, services provided in China by a foreign enterprise through its employees or other personnel it has engaged would create a PE in China if the service duration exceeds 6 months in any 12 months. Some China-concluded DTAs have an even broader PE definition to include an installation, a drilling rig, a ship or structure used for the exploration or exploitation of natural resources for more than 6 months;

Since the update of the Sino-Germany DTA in 2016, followed by other DTA updates, we have observed a trend that the 183-days rule is generally adopted for determining a service PE and the six-month rule for a construction PE.

Specific deviations from OECD Model Convention:

In line with the OECD Model Convention, PE is defined as “a fixed place of business through which the business of an enterprise is wholly or partly carried on” in the DTAs concluded by China. It includes especially:

a) a place of management;

b) a branch;

c) an office;

d) a factory;

e) a workshop;

f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources;

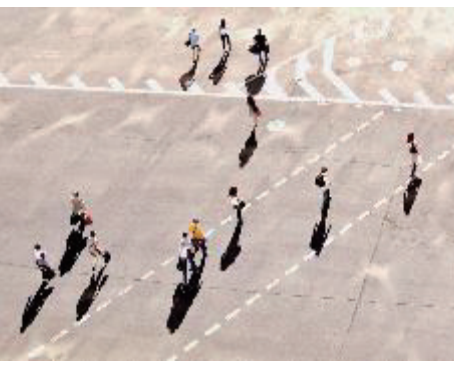
Among the DTAs that China has concluded, there are no further definitions on “a place of management”, ”a branch”, “an office”, “a factory”, “a workshop”, “a mine”, “an oil or gas well”, “a quarry”, or “any other place of extraction of natural resources”.

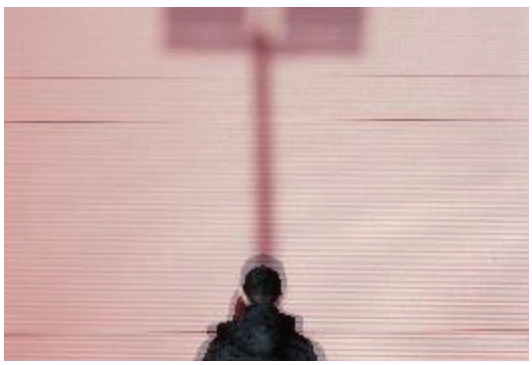
In addition, certain DTAs concluded by China has covered the following in their PE definition:

g) a warehouse, to a person providing storage facilities for others;

h) a farm or plantation (China-Malaysia DTA).

These items are not covered by the OECD Model.





Special Cases

− Fixed place PE:

Fixed business premises would include offices, branches, or other facilities used for providing services, such as a hotel room rented for a long term.

For certain activities frequently migrating between adjacent locations, even not located at a fixed place, if they are inherent or connected, they could be deemed as existing in a fixed premise. For example, if different rooms or floors are rented in the same hotel, the hotel may be deemed as a fixed business place. In another example, if a businessman sets up stores in different locations inside a shopping mall or a market, the shopping mall or the market may also be deemed as a fixed business premise.

− Services PE:

As mentioned above, China – like other countries – follows the UN Model, which grants an extended right of taxation to the state where a service is rendered, i.e. extended taxation at source.

The relevant UN Model provision is Article 5 under section 3 (b), which explains how a service PE is determined.

The latest practice shows that some Chinese tax authorities are increasingly interested to evaluate the economic substance of a staff secondment arrangement. In the absence of economic substance, the secondee may be assumed as actually serving a foreign enterprise and thereby creating a PE. The concept of “economic employer” has started to be utilised.

− Agent PE:

If an NTRE commissions an agent, be it an entity or an individual, to carry out business activities in China, to regularly conclude contracts, or to store or deliver goods, etc. on behalf of an NTRE, such an agent should be considered as an establishment or a place in China for the NTRE.

In a published case (the San Rong case), an enterprise incorporated in Hong Kong was engaged in sales of equipment and provisions of technical services to customers in China. The contracts with the Chinese customers are habitually signed by its Chinese subsidiary on behalf of this Hong Kong enterprise and the technical services are provided by the Chinese subsidiary. The Hong Kong enterprise was deemed as having a PE in China and all the profit related to this PE was subject to CIT.

Special Cases

− Construction PE:

China has been adopting a standard DTA provision specifying that only a building site, a construction, an assembly or an installation project, or supervisory activities for a site or a project lasting over six months will be treated as a construction PE. In practice, the provision is implemented per the following principles:

a) The starting and ending dates of a site, a project, or its related supervisory activities will be determined from their commencement date (including preparatory activities) to their delivery date (including trial operations); if they last over six months (even carrying over a yearend), the foreign contractor will be considered as having a PE in China; if they last under six months, no PE is considered constituted in China. The non-existence of a PE should however not affect the levy of other taxes triggered by other causes.

b) if a foreign enterprise continually undertakes multiple projects at the same site or for the same construction project in China, the project duration should be counted from the commencement of the first project to the completion of the last, rather than counting each project separately.

c) Two or more projects performed at the same site or for the same construction project shall be viewed as belonging to the same task. Such a pooling method should not apply if the projects are not related to the same site or construction task.

d) Special rules would apply to temporary suspension. If a project's operation is suspended due to a shortage of equipment or materials, weather, or any other reasons, but is not yet determined as completed or abandoned and its staffing and materials are not yet withdrawn, the suspension period should be counted as part of the project duration.

e) If a project involves a task being sub-contracted to another party, which start even earlier than the main contractor's task, then this earlier date should be taken as the commencement date for the main contractor; however, this should not affect the sub-contractor whose project duration should be determined solely based on its projects.

Discrepancies between local law and tax treaties

It should be noted that how a discrepancy between domestic laws and DTAs will be handled. Article 58 of the CIT Law provision stipulates that “where a DTA provision is different from the CIT Law provision, the DTA provision shall prevail”.



2.2. Business trends – more PE formed in China

Strictly speaking, representative offices (ROs) are not supposed to perform any business activities other than a liaison office. In practice, their presence and function in China are considered as bearing PE implications.

In February 2010, SAT released a set of measures for the taxation of ROs and NTREs, setting a tone that an RO will not be immune from PE implications.

With further economic opening up and growing foreign capital, China is witnessing a fast growth of PE cases, particularly in servicing and construction sectors.

Selling into China, buying from China, and serving in China, etc. could easily create PE issues, affecting foreign enterprises' China tax position.

2.3. Tax administration trends – stricter and more sophisticated

China's PE taxation regime, while in alignment with international practices, still bears its own characteristics. Firstly, it adopts a broader PE definition in her domestic tax codes (e.g. no time limit in some cases vs. six months by other nations) and some of her DTA provisions (e.g. application of a service PE). Secondly, PEs are predominantly taxed by a deemed profit method, not by the books even though the latter remains technically an option, leading to double taxation. Thirdly, there is a treaty override in those cases where ROs are always taxed although DTAs have no such provisions for ROs.

Some regulations were issued in recent years to enhance tax administration over NTREs and set out the measures governing the tax registration and filing for PEs.

Chinese customers, as the payer, are encouraged to withhold China taxes for the NTREs where a PE is constituted; if both contracting parties are located overseas, a self-declaration method will apply.

PE issues are drawing much more attention than ever from the local tax authorities with the augmentation in general awareness and tax administration measures. However, while PE legislation is still developing, interpretation variations still exist from place to place. Communication and negotiation with local tax authorities remains a foremost and time-consuming task in a PE assessment case. Treatments based on a discretionary decision are not uncommon.

wtsChina

03

PRC Tax Implications on PE

3.1. CIT

3.1.1. Determination of time threshold for PE constitution

Most DTAs have adhered to the trend of adopting the six-month threshold for a PE constitution.

As further interpreted in a Chinese tax circular, Guo Shui Fa [2010] No. 75, for a construction PE, "six months" is counted from the starting date of a contracted project (including preparation period) to its completion date (including trial operation). If a project is temporarily postponed for any reason before its completion but its personnel, equipment, and materials, etc. have not been evacuated, its duration should be considered as uninterrupted and the suspension period should not be excluded from the project duration.

For a service PE, another Chinese tax circular, Guo Shui Han [2007] No. 403, has clarified how to count a "month". The said circular is for interpreting the articles under the "China-Hong Kong Double Taxation Avoidance Arrangement". However, the views reflected therein by SAT are considered and accepted as bearing general application to similar articles in other DTAs concluded by China with other jurisdictions – as long as no other interpretations nor guidelines are available.

After Circular 403, China and Hong Kong signed the "Second Protocol" to the tax arrangement to replace the "six months" with "183 days". Consequently, the original interpretation on the "six months" term in Circular 403 becomes null and void. It thus results in some uncertainty when it comes to the "six months" term in other DTAs that China has concluded (for example, with the United States and Australia, in which "six months" is still kept as the criterion for a service PE). In this regard, sufficient communication with the local Chinese tax authority is recommended to avoid any tax dispute due to different interpretations on a PE threshold.

China's other DTA updates enacted thereafter (e.g. the one concluded with Germany) have reflected the general trend of adopting the 183-day threshold.

3.1.2. Determination of profit attributed to PE

CIT Law and Implementation Rule

- Inbound cases:

  A NTRE shall pay CIT, for the income derived from or accruing in China by its office or premises established in China, and for the income derived from or accruing outside China, with which the office or premises has a de facto relationship.

- Outbound cases:

  TREs with a foreign PE are liable to CIT in China for their worldwide income.

DTA and relevant interpretation

A cardinal principle of a DTA is that the profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other contracting state through a PE situated therein. In other words, if the enterprise carries out business as aforesaid, the profits of the enterprise may be taxed in the other state but only so much of them as are attributable to a PE.

Interestingly, the China-Singapore DTA has not specified a concrete method to compute business profits but several principles for the computation. It mentions the principle of an independent enterprise, i.e. a PE should be treated as an independent tax entity, no matter whether the PE engages in business transactions with its head office or with other PEs of the enterprise, and the profit attributed to the PE should be calculated based on the fair market price and by the arm's length principle.

3.1.3. Duration affected by the force majeure

Due to the long-lasting effect of the pandemic and the sporadic virus outbreak in some regions in China, projects are witnessing frequent interruptions or continuous deferrals. Foreign personnel is kept stranded in China for an exceedingly long time. It gives rise to a question not well addressed in DTAs or domestic tax provisions: how would a PE duration threshold be interpreted if it is affected by the force majeure such as a pandemic?

So far, at the time of this publication, there is not yet any formal edition or updates to the tax laws and regulations. However, SAT issued in September 2020 a clarification statement in this regard and urged local tax authorities to take a concessional view when interpreting PE terms affected by the COVID-19 pandemic, as summarised below.

a) Would a home office in China constitute a PE under the tax treaty clause like "fixed business place where an enterprise conducts all or part of the business" if a home office is temporarily adopted during the COVID-19 period?

   No. If it is intermittent or occasional, it will not constitute a PE as “a fixed business place where an enterprise conducts all or part of its business”.

b) Would there be an agent PE - if someone temporarily works from home during the COVID-19 period, represents an overseas corporate employer to sign a contract in the name of the employer, by virtue of the tax treaty clause that "one Contracting State conducts activities on behalf of enterprises of the other Contracting State, and has the right and regularly exercises this right to sign contracts in the name of the enterprise"?

   No. If the activities are occasional and non-recurrent, it will not constitute an agent PE in China. However, if the individual conducts activities on behalf of an overseas enterprise in China for a long term, or pursues it as a long-term practice to act on behalf of an overseas enterprise in China after the COVID-19 period, and has the right and regularly exercises this right to sign contracts in the name of the overseas enterprise, then the home office will constitute an agent PE.

c) Can a shutdown period during the COVID-19 period be excluded from the duration of a construction project which has reached the construction PE time threshold?

   No. If a construction project constitutes a PE, its duration should be counted incessantly, and the suspension days should not be excluded. However, if COVID-19 has led to the evacuation of the entire construction and management crew from the site, and the entire shutdown of the project, resulting in its project period exceeding the PE time threshold, the shutdown days (only due to the COVID-19) can be excluded.

3.1. CIT

3.1.4. Determination of taxable income

Normally, if a PE has maintained a profit/loss account, its CIT assessment should be based on its financial reporting, or book earnings.

Under the book-based taxation method, when determining a PE's profit, the expenses incurred by the PE should also be deductible, no matter where they are incurred. They do not have to be expenses actually incurred by the PE but can be those allocated to it by its head office, such as administrative and general management expenses. In doing so, it is required that the expenses must be PE-related and that the allocation ratio must be reasonable. In the implementation, supporting data has to be provided to justify the reasonableness, e.g. expenses breakdown, allocation basis, and allocation methods, etc.

However, in reality, it is usually difficult to pinpoint the exact revenue and costs attributable to a PE, let alone to compile a separate profit/loss account for it.

Circular 75 specifies that when the profit of a PE cannot be separately accounted for, the head office may resort to apportioning its profit to the PE using a reasonable formula.

By doing so, there will be inevitably a discrepancy between the two methods, by books and by apportionment, resulting in potential disagreement with the tax authority.

On one hand, it is difficult for the Chinese tax authorities to verify the profits of the head office outside its jurisdiction. On the other hand, the profit assessed by China's accounting practice may not match with that assessed by the other jurisdictions.

Therefore, more practicably, even an income determination method is provided by a DTA, a different practice could be adopted in reality, depending on the circumstances of each case.

When a PE is engaged in procuring, it should not be deemed as deriving profits from the procurement activities, and the profit derived from the procurement should not be assessed according to the profit attribution method.

Further, for ensuring continuity and comparability, a profit apportionment method, once adopted, should not be changed on the ground that other methods offer a more favourable outcome.



3.1.4. Determination of taxable income

As said before, in practice, an accounting book is rarely set up for a PE. Therefore, it is also rarely seen in China that a PE is taxed using an actual profit method. Instead, more practicably, the Chinese tax authorities tend to apply the method provided by Circular 19, meaning if a PE is unable to report its taxable income due to inaccurate or incomplete financial reporting or any other reasons, the Chinese tax authorities may assess its taxable income using one of the following deemed profit methods.

Actual revenue deemed profit method

This method would be applied to determine a PE's taxable income when a PE's revenue can be ascertained but not its costs. The formula for computing CIT is as follow:

CIT = Gross Revenue x Deemed Profit Rate x CIT Rate

This has turned out to be a popular approach to most PEs in China.

Cost-plus method

This method would apply to those PE whose income can hardly be determined but their costing data are readily available and considered accurate, e.g. a trading agent PE. Their CIT is then assessed using the following formulae:

Gross Income = Cost/expenditure / [1 - Deemed Profit Rate]

CIT = Gross Income x Deemed Profit Rate x CIT Rate

PEs adopting this method must be able to accurately account for their expenses in China, and should have them audited. The deemed profit rate may vary from 15% to 50%, depending on the business, as listed below:

Industry	Deemed profit rates
Construction projects, designing and consulting services	15% - 30%
Management services	30% - 50%
Other operating and service income	No less than 15%

When a service PE is constituted by the personnel sent to China, the profits derived from the services in China shall be deemed as the profits for the PE and be taxed.

A real-life headache will frequently arise as to which deemed profit rate should apply for a particular service PE, among the rates from 15% to 50%, and what documents can be accepted as sufficient to justify the rate.

In this regard, no further clarification rules are available. It inevitably leaves generous room for a discretionary decision by the local tax officers, depending on judgement, local practice, and quality of the financial data.

This earning determination issue is particularly prominent in a typical case in which foreign enterprise is selling machinery to China and also providing after-sales services, such as installation, assembly, training, and supervision, etc. The service income, if subject to China taxes in some circumstances, has to be determined separately from the sales income.

Yet when the service charges are not separately accounted for in a contract or billings, or if the charges are considered unreasonable, the Chinese tax authority may determine the service charges by making reference to the pricing of comparable services, or in the lack of any comparable services, based on a minimum amount, being 10% of the total contract price.

3.2. VAT

3.2.1. VAT taxable scope

China's VAT legislation provides that entities or individuals engaging in the sale of goods, services, intangible assets, immovable, and financial products, and importation of goods are subject to VAT.

In detail, VAT applies in China to:

a) Sale and importation of goods;

b) Repair, replacement, and processing services to goods;

c) Provision of modern services such as consulting, logistics, IT services, cultural and creative services, leasing of tangible movable property;

d) Transportation services;

e) Postal and telecommunication services; and

f) Construction, real estate, financial services, and lifestyle services.

3.2.2. Determination of taxable income

The taxable income amount is the total price plus any out-of-pocket expenses collected from the buyer by a taxpayer engaging in sales of goods or taxable services but should exclude the output VAT.

3.2. VAT

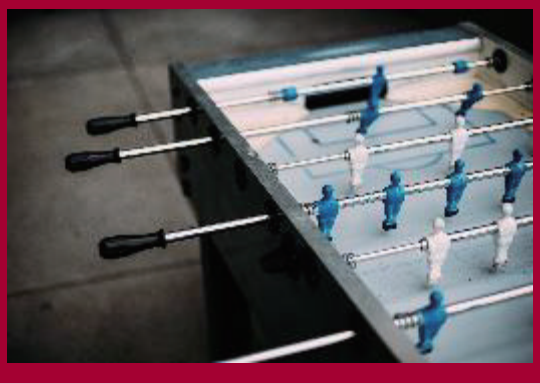
3.2.3. VAT rate

The applicable VAT rates are as follows:

Tax Items	Tax Rates		
	Old	Traditional	New
	From 1 July 2017 to 30 April 2018	From 1 May 2018 to 31 March 2019	From 1 April 2019 to present
Sale and importation of goods	17%	16%	13%
Leasing of tangible movable property	17%	16%	13%
Sale of transportation services	11%	10%	9%
Sale of postal services	11%	10%	9%
Sale of basic telecommunication services	11%	10%	9%
Sale of construction	11%	10%	9%
Lease and sale of immovable	11%	10%	9%
Transfer of land use rights	11%	10%	9%
Sale of services and intangible assets except for described above	6%	6%	6%
Exporation of goods unless otherwise stipulated by the State Council	0%	0%	0%
Cross-border sale of services and intangible assets within the scope stipulated by the State Council	0 %	0%	0%

When a taxpayer, in selling goods and services, is subject to different VAT rates, it should manage to break down the sales and bill each category separately using the appropriate VAT rates; otherwise, the highest VAT rate among them will prevail.

VAT remains a major tax revenue for China (40% on average of the total tax revenue). According to China's 14th Five-Year Plan, which sets out the national five-year strategies for economic and social development from 2021 to 2025, tax system optimization and tax burden minimization are one of the strategic targets. Thus, continuous adjustments to the VAT regime would be foreseeable.



3.2. VAT

3.2.4. Withholding/Filing obligations

A tax resident engaging in any VAT taxable behavior or having established an entity in China is required to declare and pay VAT itself.

A NTR is required to submit a tax declaration form when filing its VAT.

For the sale of goods or taxable services, VAT liability will occur on the date when the sales fund is collected or the proof of a sales fund is obtained; if a VAT invoice is issued in advance, then VAT liability will occur on the date when the invoice is issued.

3.2. VAT

3.2.5. Changes to indirect tax surcharges

Surcharges are levied whenever VAT liability occurs, which include the following taking effect from 1 December 2010:

1) From December 1st 2010 onward: Urban maintenance and construction tax at the rate of 7%, 5% or 1%(depending on the location of the project);

2) From December 1st 2010 onward: Education surcharge at the rate of 3%;

3) From December 1st 2021 onward: Local education surcharge at the rate of 2%.

The newly promulgated “Urban Maintenance and Construction Tax Law”, effective since 1 September 2021, has amended the decade-old surcharge practice by exempting imported services from surcharges. This move is believed to be an effort to align imported services with imported goods so that both are surcharge-free.

3.3. IIT

3.3.1. IIT taxable income and calculation method

Foreigners working for a PE in China will be subject to IIT since the first day of their presence in China, regardless of how long they have stayed in China. Depending on their in-China duration, different IIT methods would apply, as further explained below:

1) If an expatriate has stayed in China under 183 days, the taxable salary in a month is determined as follows:

   Salary income of the current month = total amount of salary of the current month paid inside and outside China X (salary of the current month paid inside China / total amount of salary of the current month paid inside and outside China) X (working days in China / days of the month)

   It should be noted that the said salary does not have to be a payment made and borne in China. According to a tax regulation (MOF and SAT Announcement [2019] No. 35), when a PE is taxed for its deemed profit but not accounting profits (for the lack of books) or not taxed at all for CIT, one should not assume that the person working for the PE is not subject to IIT on the ground that their salaries are never booked in China. Even so, per the said regulation, their salaries will still be deemed as borne and paid by the PE in China.

2) If an expatriate works in China over 183 days cumulatively in a tax year but less than six consecutive years, the taxable salary in a month is calculated as follows: Salary income of the current month = total amount of salary of the current month paid inside and outside China X (working days in China / days of the month)

3) If an expatriate has no domicile in China but resides in China for 183 days or more cumulatively in a tax year for over six consecutive years, he/she is subject to unlimited taxation in China.

When computing IIT liability, a yearly deduction of RMB 60,000 is available to expatriates staying in China for 183 days or more in a calendar year (being a China tax resident for that year); a monthly deduction of RMB 5,000 applies to expatriates staying in China under 183 days in a calendar year (being a non-tax resident in China for that year). The PE should act as the IIT withholding agent for them in China.

Sometimes, expatriates are sent to China for preparatory missions (e.g. meetings) for a short time but they may not be those executing the delivery in China. This situation creates a doubt that whether they are subject to IIT as soon as they are in China.

Technically speaking, the time from preparation to conclusion of a project should be taken entirely as a PE duration. However, regarding what kind of preparation or conclusion tasks could be excluded or should be included, the tax codes have fallen short of clarification. It remains a topic to be negotiated with the local tax authority.



3.3. IIT

3.3.2. IIT rate

The IIT rates for tax residents and non-tax residents are different.

For tax residents (individuals who have domiciled in China, or have not domiciled in China but have been in China over 183 days in a calendar year), they are subject to seven-level progressive IIT rates, depending on their yearly income level:

Level	Yearly Taxable Income (after deducting RMB 60,000 from the total income)	Tax Rate (%)	Quick Deduction
1	If not exceeding RMB36,000	3	0
2	for the part exceeding RMB36,000 but no more than RMB144,000	10	2,520
3	for the part exceeding RMB144,000 but no more than RMB300,000	20	16,920
4	for the part exceeding RMB300,000 but no more than RMB420,000	25	31,920
5	for the part exceeding RMB420,000 but no more than RMB660,000	30	52,920
6	for the part exceeding RMB660,000 but no more than RMB960,000	35	85,920
7	for the part exceeding RMB960,000	45	181,920

For non-tax residents (individuals who are not domiciled in China and has been in China for less than 183 days in a calendar year), they are subject to IIT rates with different income brackets from those applicable to tax residents, as follows:

Level	Monthly Taxable Income (after deducting RMB 5,000 from the total income)	Tax Rate (%)	Quick Deduction
1	if not exceeding RMB3,000	3	0
2	for the part exceeding RMB3,000 but no more than RMB12,000	10	210
3	for the part exceeding RMB12,000 but no more than RMB25,000	20	1,410
4	for the part exceeding RMB25,000 but no more than RMB35,000	25	2,660
5	for the part exceeding RMB35,000 but no more than RMB55,000	30	4,410
6	for the part exceeding RMB55,000 but no more than RMB80,000	35	7,160
7	for the part exceeding RMB80,000	45	15,160

3.3. IIT

3.3.3. Withholding/Filing obligations

A PE has to withhold and file IIT for its personnel rendering services in China. In principle, IIT should be withheld and filed monthly.

In practice, a PE may not have the resources to handle the tax withholding tasks, so it is more common to have its foreign employees filing their IIT via a self-declaration approach. Non-tax residents have to file monthly whereas tax residents can file annually (any time from 1 March to 30 June of the next year).

3.4. SD

3.4.1. SD taxable income

China's SD provisions have been called "temporary regulations" for some decades until 10 June 2021 when the "Stamp Duty Law" was enacted, taking effect from 1 July 2022.

SD taxpayers cover all entities and individuals executing in China the taxable documents or securities trading documents, which include:

- Taxable documents cover ten types of contracts listed in the "Stamp Duty Law", ownership transfer documents, and accounting books.
- Securities trading documents cover all stocks or any stock-based depository receipts being traded at the stock exchanges.

As far as PE is concerned, contracts are more relevant to SD. When they are taxable, it will be the contract price to be taxed for SD. SD should be filed and paid in a manner prescribed by the law.

3.4. SD

3.4.2. SD rates

The SD for contracts are as follows:

Taxable vouchers	Tax Rates	
	Effective before July 1, 2022	Effective from July 1, 2022
1) Loan contracts	0.005%	0.005%
2) Finance leasing contracts	-	0.005%
3) Purchase and sale contracts	0.03%	0.03%
4) Process contracting contracts	0.05%	0.03%
5) Engineering project reconnaissance and design contracts	0.05%	
6) Construction and installation project contracts	0.03%	
7) Transportation contracts	0.05%	0.03%
8) Technology contracts	0.03%	0.03%
9) Leasing contracts	0.1%	0.1%
10) Storage and custody contracts	0.1%	0.1%
11) Warehousing contracts	0.1%	0.1%
12) Property insurance contracts	0.003%	0.1%

3.4.3. Withholding/Filing obligations

Where contracts are concerned, a foreign company shall file SD itself, using an SD declaration form based on the contract price and the required materials.

wtsChina

04

Tax Compliance Procedure

4.1. Tax registration

4.1.1. Has a PE been constituted?

In some cases, PEs are triggered by a representative office ("RO"). In commercial contexts, when an FE establishes a RO in China, the FE is often considered as having a PE in China.

In other cases, PEs are triggered by the services or projects in China. When an FE's onsite presence in China has exceeded a duration threshold prescribed by a related DTA provision, a PE will then be considered as constituted in China. Some Chinese tax bureaus might have their own view on how to measure a China-presence duration in some extraordinary circumstances, leaving some room for disagreement on PE constitution.

4.1.2. Where should PEs be registered?

Representative offices (ROs), for establishment purposes, are subject upfront to business and tax registration in the locality where they operate. Hence, their PE-related tax returns should be filed locally in the same place of their registration.

For those PEs triggered by onsite services or projects, they should conduct a discrete tax registration with the local tax bureau in the locality where a PE is constituted.

Practical challenges may arise in PE tax registration and filing formalities. FEs, without a permanent presence in China and due to language issues, may find it difficult to handle the tax tasks themselves. Some would also be bewildered by technical complications as to where a PE should be registered when it involves multiple projects and locations, and mobile workforce. A Chinese tax agent will become helpful in this regard.

4.1.3. When should a PE be registered?

When an NTRE is engaged in an operation or services in China, it is required to conduct a tax registration within 30 days after concluding a contract at a local tax bureau. Missing the registration deadline could lead to a fine.

However, in practice, few FEs can accomplish their tax registration within 30 days once a contract is concluded. It is necessary to negotiate with the tax bureau regarding the schedule realistically feasible to complete the tax registration.

4.1.4. How should a PE be registered?

FEs constituting a PE in China should submit a registration application to a local tax bureau. The procedures and document requirements can vary largely from place to place.

For tax registration purposes, a PE, not an entity per se and without a legal representative, needs to nominate a person in charge to handle the communication with the Chinese tax officers, and to execute and submit documents on behalf of the PE – unless such tasks are outsourced to a tax agent.

Sorting out the nitty-gritty of PE registration procedures is often the most challenging and time-consuming task due to local variations, lack of transparency in tax office structure, and language barrier. By and large, Chinese tax officer can rarely speak English and all submissions and communications have to be in Chinese.

4.2. Regular tax filing

Once the tax registration is done, tax filings for CIT, VAT, SD and IIT should follow according to their corresponding filing schedules:

- CIT should be filed quarterly whereas VAT should be filed monthly. In practice, it may be possible to file according to the payment installments, upon the approval by the tax authorities in charge.

- SD should be filed when the SD liability occurs.

- IIT filing should be conducted monthly.

In the implementation, making tax payments can be very problematic due to the constraint that Chinese tax bureaus cannot receive payments from overseas nor in any currency other than RMB. Furthermore, the payment must be from a local bank account – which an FE or a PE would not possibly have. Thus, in each PE case, it will always call for a special tax payment mechanism to be set up in advance either having a Chinese agent as a payment proxy or having a Chinese customer as a tax withholding agent. As things have turned out, the former is the most popular than the latter as Chinese customers are often reluctant to handle tax troubles that concern little to their interest.

4.3. Annual CIT Filing and Annual IIT filing

An annual CIT filing is always mandatory for a PE. However, it should be noted that its enforcement varies from location to location.

In additional, annual IIT filing is also mandatory for tax residents in one of the following scenarios:

1) Those who have derived an income from two or more sources in china, and the balance after deducting special allowances has exceeded RMB 60,000;

2) Those who have derived an income from other sources(e.g. servicing) ship on author's royalties, and the balance after deducting special allowances has exceeded RMB 60,000;

3) Then tax amount paid in advance within a tax year is less than the tax payable amount;and

4) They intend to apply for tax refund.

An exception is granted to those without any domicile in China and having stayed in China less than 183 days within a tax year.

4.4. Tax de-registration

According to China's "Administrative Measures on Tax Registration", an FE should, within 15 days upon the completion of the services provided for the PE, conduct a tax de-registration.

It would be required to provide a formal statement confirming the completion of the project and the acceptance by the Chinese customer. Upon a successful taxed-de-registration, the tax registration certificate of the PE will be canceled, de-registered.

wtsChina

05

Case Sharing

5.1.Construction PE vs. Service PE

A Singapore company ("Company A") has entered into a construction contract with a Chinese company ("Company B"). To perform this contract, Company A has dispatched its staff to perform commissioning and training at the site of Company B. The onsite services have lasted over six months.

Treating the said services as related to the construction project, the Chinese tax authority would apply a stricter six-month construction threshold for the assessment, and thus would conclude that a PE is constituted in China.

However, Company A has viewed it differently that a service PE threshold (183 days) should apply and prefers not to conduct any PE registration or tax filing. Such an omission has led to a fine imposed by the tax authority.

The case has reflected that PE assessment could be at the mercy of judgment and treatments.

5.2. Consortium vs. standalone PE assessment

Several German companies have registered a consortium for VAT purposes in Germany. The consortium has entered into a service contract with a Chinese customer. According to the contract, the consortium has sent its employees to provide onsite services in China.

There is no clarity in China's tax regulations as to whether a consortium as a whole or its members should separately be assessed for PE implications.

A China tax circular, Guo Shui Fa [2010] No. 758, which offers though a general interpretation of DTA articles, has used the customary terminology that an enterprise (i.e. a legal entity) would be considered for a PE assessment (except in subcontracting cases).

Yet in practice, having realized the consortium treatment under the German tax regime, the Chinese tax authority has adopted the substance-over-form principle and has accepted to treat the consortium as an "entity" for PE assessment and for executing China tax obligations.

5.3. Royalty or service fee?

A Chinese company, Company C has introduced an enterprise management system developed by a Singapore company, Company D. Company D is engaged to provide technical support to Company C, including installation and upgrade services based on an IT service agreement, and has charged company C a service fee.

Company D views that the service in question can hardly fit the definition of royalties and should be categorized as a service fee.

However, the Chinese tax authority, upon a detailed assessment, has pointed out that Company D has granted Company C, the right to use the software, but has failed to reflect its change as a royalty. In the end, the tax authority has determined to treat it as a royalty and has held Company C responsible for withholding China taxes for Company D.

It is noted that when services are involved, as in this case, the nature of the remuneration can be controversial regarding whether it is a royalty or a service fee. Tax assessment can be a technically demanding task, requiring exhaustive examination into details of the case.

5.4. Cost reimbursement or service fee?

Company E has dispatched some employees to work in its Chinese subsidiary (“Company F”). Company E has remunerated them in overseas and then billed Company F for reimbursement.

Company E intends to treat it as a cost-reimbursement case to avoid any China VAT or CIT.

However, the Chinese tax authority in charge has rejected the cost reimbursement treatment, viewing that the reimbursement amount is larger than that declared for IIT. They have viewed it as a service fee and that China taxes (CIT and VAT) should be chargeable.

In practice, it will be conducive to treat it as a cost-reimbursement case if the Chinese subsidiary economic employer of the dispatched, and the reimbursement amount should also match the payment amount advanced by the overseas company. Then in such a case, the tax bureau will usually examine more details such as whether the Chinese subsidiary has any right of command over the personnel and has borne any risks and responsibilities, and whether it has the right to determine the number of dispatched employees and the standards for the work, etc.

It should be highlighted that cross-border cost reimbursement has been a thorny issue over the years for its undeniable potential to avoid China taxes and due to the remittance constraints it would face under China’s foreign exchange control mechanism.

Martin Ng
Managing Partner

WTS China
Unit 06-07, 9th Floor, Tower A, Financial Street Hailun Center,
No.440 Hailun Road, Hongkou District, Shanghai, China
200080
Tel: + 86 21 5047 8665 ext. 202
Fax: + 86 21 3882 1211
Mob: + 86 138 0188 7400
Email: martin.ng@wts.cn
www.wts.cn

Maggie Han
Partner

WTS China
Unit 06-07, 9th Floor, Tower A, Financial Street Hailun Center,
No.440 Hailun Road, Hongkou District, Shanghai, China
200080
Tel: + 86 21 5047 8665 ext. 206
Fax: + 86 21 3882 1211
Mob: + 86 137 6468 6912
Email: maggie.han@wts.cn
www.wts.cn

Ened Du
Associate Partner

WTS China
Unit 06-07, 9th Floor, Tower A, Financial Street Hailun Center,
No.440 Hailun Road, Hongkou District, Shanghai, China
200080
Tel: + 86 21 5047 8665 ext. 215
Fax: + 86 21 3882 1211
Mob: + 86 138 1713 3131
Email: ened.du@wts.cn
www.wts.cn

Conrad Lin
Manager

WTS China
Unit 06-07, 9th Floor, Tower A, Financial Street Hailun Center,
No.440 Hailun Road, Hongkou District, Shanghai, China
200080
Tel.: + 86 21 5047 8665 ext. 223
Fax: + 86 21 3882 1211
Mob: + 86 136 1179 3354
Email: Conrad.Lin@wts.cn
www.wts.cn

Disclaimer

The above information is intended for general information on the stated subjects and is not exhaustive treatment of any subject. Thus, the content of this study is not intended to replace professional tax advice on the covered subjects. WTS China Co., Ltd. cannot take responsibility for the topicality, completeness or quality of the information provided. None of the information contained in this study is meant to replace a personal consultation. Liability claims regarding damage caused by the use or disuse of any information provided, including any kind of information which is incomplete or incorrect, will therefore be rejected. If you wish to receive the advice of WTS China Co., Ltd., please make contact with one of our advisors.