

## International Taxation in China (III)

**ALFRED CHAN**

KUALA LUMPUR  
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### Agenda

1. Taxation on Permanent Establishment (FE with PE)
2. Taxation on Foreign Enterprise without a PE in China
3. Withholding income tax

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### Part I

## Taxation on Permanent Establishment (Foreign Enterprise with PE)

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### What constitutes a PE?

- Establishment or place of business
- Presence of employee (183 days in any 12 months)
- Agent appointed to conclude contract, or accept orders

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### Establishment or place of biz

1. Management establishment, business establishment or an office;
2. Factory, farm, or place of extraction of natural resources;
3. Place where services are provided;
4. Place where a project of construction, installation, assembly, repair, exploration, etc is carried out;
5. Other establishments or places of business where production and business operations are carried out.

As per Art. 5 of Implementation Reg.

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### Examples: Foreign Enterprise with a PE in China

- Representative Office;
- Presence of employees / agent
- Foreign party in a CJV

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## What **IS** permanent establishment ?

### Properties of PE

- Taxable vs. non-taxable activities
- Domestic rules vs. treaty rules
- Computation methods

### Nature of PE

- PE is an exception to residence jurisdiction

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## Taxation on service PE - I

If activities inside China continue, for same and connected projects, for period(s) aggregating 183 days in any 12-month period, a service PE will arise.

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## Taxation on service PE - II

### Computation of business profit (PE)

1. Actual profit method
2. Deemed profit method
3. Conversion of expense into revenue method

See SAT circular (2010) No. 18

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## Taxation on service PE - III

### ■ Deemed profit method

Tax liability = revenue of PE x deemed profits rate x CIT rate  
(where CIT is 25% and deemed profits rate may range from 15% to 50%.)

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## Taxation on service PE - IV

### ■ Computation of business profit Conversion of expense into revenue method

#### Tax liability (two steps):

- Revenue = expense for period / (1 - deemed profits rate - BT rate)
- Tax liabilities = revenue x deemed profits rate x 25%

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## PE exemptions under DTA

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DTA exceptions	
Constituting P. E.	Not constituting PE
1) Have a fixed business place on other side	(a) Use of facilities for storage, display, delivery of goods belonging to the enterprise (b) Maintenance of stock of goods belonging to enterprise for storage, display & delivery purposes (c) Maintenance of stock of goods belonging to enterprise for purpose of processing by others

Ref: China-Singapore DTA

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DTA exceptions	
Constituting P. E.	Not constituting PE
1) Have a fixed business place on other side (continued)	(d) Sourcing of goods, collecting information, from China (e) Performing activities of preparatory or auxiliary character

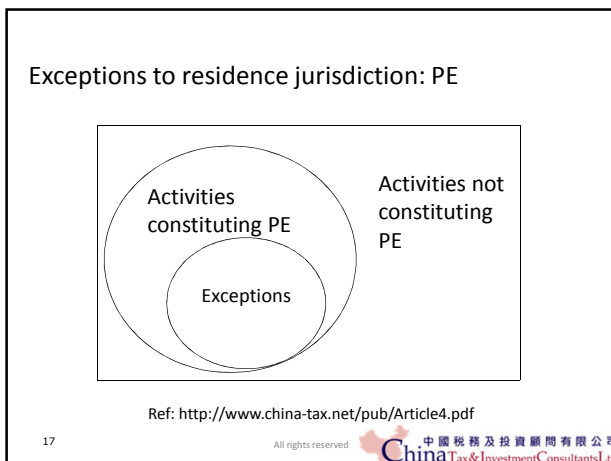
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DTA exceptions	
Constituting P. E.	Not constituting PE
2. Having an agent conclude contracts on other side	(a) Having agent conclude contracts for activities relating to (1) above (b) Broker and general commission agent on the other side

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DTA exceptions	
Constituting P. E.	Not constituting PE
3. Presence of employees providing services on other side	Performing such activities for periods not aggregating 183 days within any 12 month period
4. Control over enterprises set up on other side	Not to be considered a PE

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- Taxation on P.E.
- Duration - physical presence PE
  - Scope of activities – what constitutes taxable activities (i.e. what if PE accepts orders on other side?)
  - Agency PE?
  - Domestic rules and treaty provision are different
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PART II  
Taxation on Foreign Enterprise  
With no PE in China

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Taxation on Foreign Enterprise  
without a PE in China

Scope of Taxes: PRC source income

Type of Income: Dividend, Royalty, Interest,  
Rental, Service charge, Gain on disposal of  
PRC property

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Tax on dividends

Tax on gross income (no deduction)

- DTA tax rate: 10%
- DTA tax rate: 5% (HK, Singapore)

Conditions for 5%, => no less than 25%  
ownership in dividend payment company for  
12-month period preceding the receipt of  
dividends.

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Tax on royalties

Tax on gross income (no deduction)

- DTA tax rate: 10%
- DTA tax rate: 10%, (7% for HK Co if  
prescribed conditions are met)

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Tax on royalties

- Application issue: royalty or service  
fees?
- Is it that the service gives rise to  
transfer or license of technology?
- If not, it is not royalty.

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Tax on royalties

What if the activities include both supply of  
service and transfer / license of technology?

- If PE arises, income should be treated  
separately.
- Service income is taxed as business profit  
under Art. 7, DTA (or independent service  
income under Art. 14, DTA); royalty taxed  
under Art. 12, DTA.

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### Tax on royalties

What if the supply of service consists of after-sale service or service relating to product warranty?

- Service income is taxed as business profit (Art. 7, DTA) or independent service income (Art. 14, DTA).

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### Part III Withhold Income Tax on cross-border payments

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### Why withholding Income Tax arises?

WIT arises when foreign company derives income from China, which results from exchange of rights and obligations across-border including movement of money, people, goods, use of assets, and disposal of properties.

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### How does WIT arise?

Scope of WIT:

- a) Dividend
- b) Interest
- c) Royalty
- d) Rental
- e) Gain on disposal of PRC assets
- f) Service charge
- g) Service charge in connection with royalty (c) and rental (d) above

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### Ascertainment of withholding income tax

- Gross amount with no deductions: dividend, interest, rental, royalty
- Gain on disposal of property: gross income after deducting amount of depreciated assets;
- Other income: by reference to above 2 methods

See SAT Document: Guo Shui Fa [2009] No. 3

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### Computation of taxable income (TI)

- (a)  $TI = \text{gross income} \times \text{deemed profit rate}$
- (b)  $TI = \text{total costs} / (1 - \text{deemed profit rate}) \times \text{deemed profit rate}$
- (c)  $TI = \text{total expenses} / (1 - \text{deemed profit rate}) \times \text{deemed profit rate}$

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Deemed profits rate:

- 15% to 30% for contracted construction, design and consulting services;
- 30% to 50% for management services;
- No less than 15% for other services.

See "The Administrative Measure on the Use of Deemed Profit Methods Regarding the Corporate Income Tax for Non-resident Enterprises", per SAT document [2010] 19.

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## Withholding obligations - service charges

1. Payment to non-residents for the provision of services within PRC in connection with the following activities:

(IT and BT) Construction, installation, supervision, repairing, design, testing, consulting, accounting, training, agency, engineering work, etc

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### Case 1 - Service charge

I.	Services wholly performed outside China	100% not taxable
II.	Some services performed inside and some outside China, and service user is situated inside China	If information for apportionment not available, no less than 60% is deemed to have earned inside China
III.	Services all performed inside China	100% taxable

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**Case 2** – Installation, assembling, training and supervision services provided in connection with sales of machinery and equipment

■ Where the services charges are not included in the sales contract, or service charges are fixed at unreasonably low level, the tax authority is empowered to deem the service charge at 10% on gross amount of sales contract.

See administrative order GSF [2010] 19, SAT

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### Case 3 – Rental from leasing of movable assets (finance lease)

- Rental income shall be treated as interest income
- tax computation: (gross rental income - costs of equipment) x 10%
- If foreign owner has appointed a resident agent to collect income, it is considered to have a PE in China. The income shall be taxed as business profits at 25% on net basis.

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### Taxation of rental income

	Constituting any P. E.?	Computation of tax payable	Applicable article in DTA?
a.	No PE exists	Tax on gross income at 10%	Article 6, <b>rental income</b>
b.	PE exists	Tax on net income at 25%	Article 7, <b>business profits</b>

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### Rental income derived from immovable properties in China

- ◆ If it is derived with a PE, then income tax shall be imposed on business profits on net basis (Article 7, DTA);
- ◆ If it is derived with no PE, then income tax shall be imposed on gross basis.

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### Case 4 – shipping and air service income

a) Resident of non-PRC treaty country:

The income is taxable if ship or aircraft departs from Chinese territories, wherever it is received

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### Case 4 – Shipping and air service income

b) Resident of a PRC treaty country:

The shipping and air service income derived by residents of a PRC treaty country will be exempted from Chinese tax, even if received in China

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### Document required for outward remittances (1)

1. Tax payment certificate or tax exemption certificate 完稅證或免稅證

Type of taxes: Income tax and business tax

Issuing body: national income tax office and local income tax office

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### Document required for outward remittances (2)

2. Non-tax documents: contracts, invoices

3. Additional non-tax documents :

- Technology import licensing certificate
- Filing record of trade mark licensing registration  
商標使用許可合同備案通知書
- Filing record of patent licensing registration  
專利實施許可合同備案通知書

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### Payment for non-trade items (1A)

Distribution & Repatriation of dividends

1. Foreign exchange registration certificate
2. Resolution passed by board of directors
3. Tax payment (exemption) certificates

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### **Payment for non-trade items (1B)**

4. Auditor's report certifying appropriation of the after-tax profits
5. Capital examination report

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## **Thank you**

**alfred@china-tax.net**

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