



# JONES DAY COMMENTARY

## CHINA STRENGTHENS TAX ADMINISTRATIONS ON FOREIGN CONTRACTORS

Recently, the China State Administration of Taxation has issued several circulars strengthening the administration of, and tax collection relating to, services provided by nonresident enterprises. Foreign service providers should be aware of new requirements and their implications.

### IS A FOREIGN SERVICE PROVIDER LIABLE FOR TAX IN CHINA?

**Corporate Income Tax ("CIT").** If a foreign company is a resident of a country or region that has a tax treaty (or tax arrangement) with China, the business profit of the foreign company will not be subject to CIT in China unless the foreign company has a permanent establishment in China and the business profit is derived from the permanent establishment. A "permanent establishment" in China under China tax treaties is a fixed place of business through which the business of an enterprise of a treaty country is wholly or partly carried on, including a place of management,

a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources. A permanent establishment also includes a building site, a construction, assembly, or installation project, or supervisory activities in connection therewith, but only where such site, project, or activities continue for a period of time as specified in a tax treaty, commonly six months. Furthermore, a permanent establishment includes the furnishing of services, including consultancy services, by a foreign enterprise through employees or other personnel engaged by the foreign enterprise for such purpose, but only where such activities continue within China for a certain period of time. Most treaties provide that the relevant period is a period or periods aggregating more than six months within any 12-month period. Accordingly, whether a foreign service provider is subject to CIT depends on the nature of service and time spent in China.

If a foreign service provider has a permanent establishment in China, the profits derived from the

permanent establishment are subject to a 25 percent CIT. In practice, the Chinese tax authorities often use a deemed profit rate to assess the taxable income of foreign enterprises for performing contracts in China. The deemed profit rate is 10 percent to 40 percent, determined on a case-by-case basis. Under the current CIT rate of 25 percent, the effective CIT rate would be 2.5 percent to 10 percent of gross revenue.

**Business Tax.** According to the amended Business Tax regulations, services provided or received in China will be subject to Business Tax. Business Tax is imposed on a foreign service provider regardless of whether the activities of the service provider constitute a permanent establishment in China. Even if all the services are provided outside China, the foreign service provider can be subject to Business Tax because the services are received in China. The Business Tax rate for most services is five percent of gross revenue, while three percent is applicable to transportation, construction, telecommunication, culture, and sport services.

## REQUIREMENT OF TAX REGISTRATION

On and after March 1, 2009, a nonresident enterprise that undertakes engineering projects or provides services in China should register with the relevant Chinese tax authorities within 30 days of a service contract being signed. “Engineering projects” refers to contracts for construction, installation, assembly, repair, decoration, exploration, and other engineering projects. “Services” includes processing, repair and fitting, transportation, warehousing, consultation agency, design, culture and sports, technical service, education and training, tourism, entertainment, and other labor services in China. The broad definitions of “engineering projects” and “services” basically cover all the services performed by foreign contractors in China. This means that all foreign service providers performing services in China are required to perform tax registration. Such requirement imposes a significant administrative burden on foreign service providers, in particular for those that perform small service contracts. Furthermore, a foreign contractor that undertakes an engineering project must submit the project completion evidence to the tax authorities and perform tax deregistration within 15 days of completing the project.

## TAX FILING AND PAYMENT

**CIT.** The primary obligation to file tax returns and pay CIT is on nonresident service providers. Nonresident enterprises undertaking engineering projects or providing services in China should pay estimated tax quarterly, file an annual tax reconciliation, and settle all tax liabilities upon the completion of contracts. A nonresident service provider does not need to perform an annual filing if one of the following conditions are met:

- The duration of the provision of services in China is less than one year, the operations in China have been terminated during the year, and the tax payments have been settled;
- The foreign contractor has deregistered with the tax authority before the due date of annual tax reconciliation; or
- Nonparticipation in the annual reconciliation has been approved by the tax authority in charge.

If the activities of a nonresident enterprise do not constitute a permanent establishment in China under an applicable tax treaty, the foreign service provider must submit an application in prescribed form for enjoying treaty benefits, and attach proof of residence identification and other proving documents required by the tax authority.

In spite of the primary obligation of CIT filing of foreign service providers, the tax authorities may designate the payor as a withholding agent in one of the following situations:

- Where the work on a project or the provision of services is projected to last less than a tax year, and there is evidence of nonfulfillment of tax obligations by the foreign contractor;
- Where tax registration or temporary tax registration has not been completed, and an agent in China has not been appointed to fulfill tax obligations on behalf of the foreign contractor; or
- Where the annual or quarterly CIT return has not been filed within the prescribed time limits.

In such situations, the tax authority should deliver a notice in standard form to the designated withholding agent.

**Business Tax.** If a foreign contractor has established an operating organization in China, it must declare and pay Business Tax. Where a foreign contractor has not set up an operating organization in China, its agent is the withholding agent; if it has no agent, the service purchaser is the withholding agent. If the purchaser fails to provide the following evidential documents to the tax authority in charge within 30 days of signing the contract, it will be obligated to withhold tax:

- Photocopies of the business registration certificate and the tax registration certificate of operating organization established within China by the foreign contractor; or
- A letter from the foreign contractor authorizing a domestic organization or individual as its agent and the confirmation proof of the agent.

The same rule is also applicable to VAT payment where a foreign contractor is a VAT payor.

## TRACKING AND ENFORCEMENT

The tax authorities are required to set up files for engineering projects and other service projects and to monitor their progress to ensure tax collection. The tax authorities may conduct a tax audit of the projects. The tax authorities can also enforce tax collection in conjunction with other government agencies. On or after January 1, 2009, a certificate issued by the tax authorities is required for foreign currency remittance of any single payment in the amount of more than US\$30,000 for various services. The tax authorities may also ask the border control agency to prevent the legal representative of a nonresident enterprise or nonresident individuals from leaving the territory of China before settling taxes.

## LAWYER CONTACT

For further information, please contact your principal Firm representative or the lawyer listed below. General email messages may be sent using our “Contact Us” form, which can be found at [www.jonesday.com](http://www.jonesday.com).

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