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## China Alert

### Further guidance issued by China's SAT for the assessment of permanent establishment exposure arising from cross-border secondment arrangements

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On 19 April 2013, the State Administration of Taxation ("SAT") in China issued Bulletin [2013] No. 19 ("Bulletin 19") to provide clarifications on when the secondment of expatriates by foreign enterprises to China will give rise to a permanent establishment ("PE") in China. Bulletin 19 provides further guidance over the assessment of PE exposure associated with secondment arrangements in China that were not previously covered in Guo Shui Fa [2010] No.75<sup>1</sup>. The SAT subsequently elaborated its position in a policy explanatory note published on its official website on 6 May 2013. Bulletin 19 took effect from 1 June 2013.

#### Assessment factors for determining the existence of a PE

Pursuant to Bulletin 19 and its explanatory note, the SAT sets out a 2-tier test for determining whether a foreign enterprise has an establishment or a place of business in China through the dispatch of secondees to provide services in China. The 2-tier test consists of 1 basic factor and 5 reference factors as set out below:

##### *Basic factor (the first tier test):*

If a foreign enterprise bears all or part of the responsibilities and risks in relation to the work results of the secondees and also conducts reviews and appraisals on their job performance, the seconding enterprise is first treated as having provided services at the establishment or a place of business inside China. Second, if a foreign enterprise is a resident of a contracting state which concluded a double tax treaty / arrangement with China and has provided services through an establishment or place of business in a relatively fixed and permanent nature in China, the establishment or place could constitute a PE in China.

The basic factor serves to examine the performance results of the secondees and which party is the responsible party for the risks arising from the work performed by the secondees, thereby determining which party (i.e. seconding enterprise or the Chinese enterprise) has real economic connections with the nature of work carried out by the secondees in China.

<sup>1</sup> Guoshuifa [2010] No. 75 "Interpretations for the provisions in the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and its protocols" ("Circular 75") was issued in July 2010. Circular 75 provides interpretation and guidelines to the 2007 double tax treaty and protocol between China and Singapore and it also applies to other similar provisions in the double tax treaties concluded between China and other jurisdictions.



*5 reference factors (the second tier test) :*

The SAT takes the position that a foreign enterprise would create an establishment and place or a PE if the basic factor and one of the following 5 reference factors are satisfied :

1. The Chinese enterprise pays the seconding enterprise management fees or settles costs in the nature of service fees;
2. The payments made by the Chinese enterprise to the foreign enterprise exceed the secondees' wages, salaries, social insurance contributions and other expenses paid on behalf of the Chinese enterprise by the seconding enterprise;
3. The seconding enterprise does not distribute the full payment received from the Chinese enterprise to the secondees, and partly retains such payment;
4. The secondees' wages and salaries borne by the seconding enterprise have not been fully subject to Individual Income Tax ("IIT") in China;
5. The seconding enterprise decides the number, qualification, remuneration and working location of the secondees.

The purpose of applying the 5 reference factors is to assess whether the seconding enterprise generates China sourced income from the secondment arrangement, so as to support the judgment made with regard to the existence of an establishment or a PE based on the basic factor.

In such circumstances, the seconding enterprise will be required to fulfill the registration and Enterprise Income Tax ("EIT") compliance requirements as stated in Order of the State Administration of Taxation [2009] No. 19.

**Documentation**

To reinforce the tax administration of secondment arrangements, Bulletin 19 stipulates that the tax bureau in-charge should focus on reviewing the following documents or information, as well as the substance and execution of the secondment arrangements, to assess whether the foreign enterprise has any EIT liability:

- The agreement or contract among the seconding enterprise, the Chinese enterprise and the Secondee;
- The management guidelines for the Secondee set by the seconding enterprise or Chinese enterprise, such as regulations for the Secondee's work duties, work contents, performance appraisal, and undertaking of risk;
- Information in respect of the payments made by the Chinese enterprise to the seconding enterprise and the related accounting treatment, and the filing and payment of the Secondee's IIT;
- Information indicating situations where the Chinese enterprise conceals the payment to the foreign enterprise in relation to the secondment arrangement via debts forgiveness, setting off of intercompany transactions, and related party transactions, etc.



### Stewardship services

Bulletin 19 contains a provision that excludes stewardship services from the triggering of an establishment or a PE. Stewardship services refer to services furnished by the secondees dispatched by a foreign enterprise to work in China solely for the purpose of exercising and protecting the foreign enterprise's right as a shareholder. Examples of such services include the provision of investment advice related to the investing Chinese enterprise, and participation in the investing Chinese enterprise's shareholders' and/or board of directors' meetings on behalf of the foreign enterprise.

### Our Observations

Generally, Bulletin 19 provides clearer guidelines and clarifications for foreign enterprises with secondment arrangements in China. It introduces detailed evaluation criteria in determining the existence of a taxable establishment or PE through services provided by secondees in China. This is helpful for foreign enterprises to assess and manage their potential PE risks arising from secondment arrangements in China.

The list of documentation requirements laid down under Bulletin 19 provides useful guidelines for foreign enterprises to prepare and maintain sufficient documentary evidence to support the nature and tax position in respect of their secondment arrangements in China.

We welcome the exception provision provided in Bulletin 19 in respect of stewardship services, which is expected to relieve foreign enterprises from potential PE risks arising from a variety of activities related to the exercise of shareholders' rights.

It is worth noting that certain secondment arrangements that are structured with a mark-up retained by the foreign enterprise would fall into one of the negative factors, triggering a potential PE exposure in China. Foreign and Chinese enterprises that enter into secondment arrangements should also be aware of the tightening of tax administrative control exercised by the SAT in monitoring registration and EIT compliance status of foreign enterprises.

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