

Apr 2010

Guoshuifa [2010] No. 18 : Provisional Administrative Measures on Representative Offices of Foreign Enterprises



On 20th February 2010, the PRC State Administration of Taxation (“SAT”) issued Circular Guoshuifa [2010] No. 18 (“Circular 18”). Named as “Provisional Administrative Measures on Representative Offices of Foreign Enterprises”, this Circular has a retrospective effect starting from 1 January 2010.

➔ This newsletter is to explain the salient points of this Circular and to comment possible implications for foreign companies having representative offices (“RO”) in China.

1. Tax registration/de-registration procedures

Under the Circular, all ROs must register with the tax bureau in charge within 30 days after the RO has obtained the registration certificates/approval documents. In applying for a tax registration certificate, a RO must produce the following documents:-

- a) Registration certificates/approval documents
- b) Organization Code Certificate
- c) Lease agreement, property right certificates (as the case may be).
- d) Identity documents of the Chief Representative
- e) Resolution documents for approving the establishment of the RO and information about other ROs of the same entity in China.

Any changes in registration information about ROs must be reported and registered with the tax bureau in charge accordingly. If ROs intend to apply for de-registration, they should report any income and pay the relevant taxes to their tax bureau-in-charge before being allowed to do so.

2. Taxation basis of ROs

It is the part of this Circular that draws the most attention. In general, a RO must maintain proper books and records so that taxable income and thus taxable profit can be accurately computed on actual basis. Besides, such books and records should duly reflect the amount of taxable income which is commensurate with the risks and functions of the concerned ROs.

ROs are required to report Enterprise Income Tax ("EIT") and Business Tax ("BT") within 15 days after the end of each quarter. Moreover, the RO should report VAT on actual basis according to the PRC VAT Provisional Regulations.

In case that the ROs are unable to maintain proper books of records, the tax authorities are empowered to charge the taxes on deemed basis.

The Circular mentions two deeming methods namely: 1) Cost plus method and 2) Deemed profit method.

Cost plus method is applied to situations where expenditures can be accurately accounted for but not the income.

The applicable formulas are:

1) Taxable income = Total Expenditure for the period / 1 – 15% (Deemed profit rate) – 5%

2) EIT = Taxable income x 15% x 25%

3) BT = Taxable income x 5%

Those formulae do not have much different from the previous ones. However, the deemed profit rate has been changed from 10% to 15%. As such, other things being equal, the ROs shall suffer higher tax liabilities.

The Circular specifies that expenditures shall include salaries paid inside and outside China, bonus, allowances, staff benefits, procurement costs (including motor vehicle, office equipment), costs of communication, travelling, rent, facilities leasing, traffic, entertainment and others.

The Circular also sets out how certain expenditures are treated:-

Any expenditure on fixed assets or renovation costs in connection with establishment or moving of ROs should be wholly treated as expenses in the year incurred.

Interest income cannot be used to set off against expenditures of ROs.

Cash donations for charitable purpose, late payment surcharges, penalties and any expenses paid on behalf of headquarters that are not related to the operation of the RO should not be included in the expenditures.

This Circular also defines other expenses as sample and transportation expenses in relation to purchase of sample on behalf of head office; storage and customs declaration charges incurred for importing sample from overseas to China; translation fees for head office visiting China, amount incurred for making bidding on behalf of head office.

Deemed profit method

It applies to those ROs which can ascertain income but not expenditures.

Applicable formulae are as follows:-

- 1) Taxable income = Total Revenue x 15% (Deemed profit rate)
- 2) EIT = Taxable income x 25%
- 3) BT = Total Revenue x 5%

3. Abolishment of tax exemption and treaty benefit entitlements

The Circular specifies that no more exemption shall be granted to ROs. However, if the ROs are entitled to treaty protection, they may apply for enjoying such benefits under Circular Guoshuifa [2009] 124.

Under most tax treaties between China and foreign countries, certain activities are not considered as permanent establishment even those activities are carried out through a fixed place and therefore are not subject to PRC income tax. Those activities are mainly of preparatory and auxiliary nature such as for collecting information.

4. Observations

Change of taxing basis

This Circular drastically changes the ways of taxing ROs. In the past, the taxing basis depended on the nature of business that the foreign enterprises were carrying on. The Circular places great emphasis on “actual” basis. It appears that the SAT is of the view that a RO is a profit making entity although under the prevailing business regulations, it is not allowed to carry on any direct business.

In this regard, ROs which have been granted exemption in the past must revisit their situations to see whether they are still entitled to income tax exemption by claiming tax treaty benefits. Even so, they may have to budget for payment of business tax as such tax is not normally covered under double tax treaties.

Those ROs which are currently computing their income tax and business tax under cost plus method and deemed profit method must confirm with the tax bureau in charge whether such methods are still applicable in 2010.

VAT

Due to the nature of ROs, it is more likely that ROs should be subject to business tax rather than VAT. It is not clear that ROs should all file nil VAT returns or they are only required to file VAT returns when they have VAT able activities.

Contacts

Hong Kong

42nd floor, Central Plaza
18 Harbour Road
Wanchai, Hong Kong

Alexander MAK

Managing Director
Tel: (852) 2909 5660
Email: alexander.mak@mazars.com.hk

Beijing

1608 Tower E1 Oriental Plaza
No.1 East Chang An Ave.
100738 Beijing

Joey ZHOU

Manager
Tel: (8610) 8518 9780
Email: joey.zhou@mazars.com.cn

Shanghai

8/F Shanghai ONE LUJIAZUI,
68 Yin Cheng Road(M),
2000120 Shanghai

Guangzhou

1308, Grand Tower,
No. 228 Tianhe Road
Tianhe District -
510620 Guangzhou

Peter LAW

Manager
Tel: (8621) 6168 1088
Email: peter.law@mazars.com.cn

Benoit STOS

Managing Director
Tel: (8620) 3833 0235
Email: benoit.stos@mazars.com.cn

This Newsletter is issued in summary form exclusively for the information of clients of Mazars and others interested in our services and should not be used or relied upon as a substitute for detailed advice or as a basis for formulating business decisions.