



China Practice Global Vision



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Insights & Ideas

1. China Releases New Taxation Provisions to Strengthen Administration of Resident Representative Offices of Foreign Enterprises

Legal Updates

1. China Further Extends FIE Capital Contribution Deadline to End of 2010
2. Second Amendment to the PRC Copyright Law
3. Special Rules Applicable to Enterprises in Zhongguancun National Innovation Model Park
4. SAT Regulations on Calculation of Enterprise Income Tax on Nonresident Companies

■ ■ Insights & Ideas

China Releases New Taxation Provisions to Strengthen Administration of Resident Representative Offices of Foreign Enterprises (Author: Li ZHANG)

On February 20, 2010, the Chinese State Administration of Taxation (“SAT”) promulgated the *Interim Provisions on the Administration of Taxation of Resident Representative Offices of Foreign Enterprises* (Guo Shui Fa [2010] No.18, the “Provisions”). The Provisions came into force on January 1, 2010 retrospectively. Just one month before the Provisions were promulgated, the State Administration for Industry and Commerce and the Ministry of Public Security jointly promulgated the *Notice on Further Strengthening the Administration of Registration of Resident Representative Offices of Foreign Enterprises*(the “Notice”) to strengthen the administration of resident representative offices of foreign enterprises (“ROs”) and crack down on such phenomena as changing a RO’s registration matters without going through required procedures, submitting fraudulent documents to finish registration, and conducting business operations illegally etc.

The Provisions rescind previous tax circulars on ROs, including the *Circular of the State Administration of Taxation on Relevant Issues Concerning the Strengthening of the Collection and Administration of Taxes of Resident Representative Offices of Foreign Enterprises* (Guo Shui Fa[1996]No.165, “Circular 165”), the *Circular of the State Administration of Taxation on Relevant Issues Concerning the Administration of Taxation of Resident Representative Offices of Foreign Enterprises* (Guo Shui Fa[2003]No.28, “Circular 28”) and the *Circular of the State Administration of Taxation on Relevant Issues Concerning the Examination and Approval Procedures of Tax Exemption of the Establishment of Representative Offices in China by Foreign Government, etc.* (Guo Shui Han[2008]No.945, “Circular 945”). The Provisions stress specifically that ROs shall declare and pay enterprise income tax (EIT) on the income attributable to them, and shall declare and pay business tax (BT) and value-added tax (VAT) on the taxable earnings in accordance with law. Key points of the Provisions are addressed below.

Taxation registration and deregistration

Pursuant to the Provisions, a RO shall register with the competent tax authorities in the place where it resides within 30 days from the day on which it obtains the Registration Certificate issued by the local administration for industry and commerce (or the approval by the relevant authorities). The Provisions also set forth the specific document requirement. It is worth noticing that the Provisions require that a RO, when going through tax registration procedures, shall submit a list of the other ROs established by the foreign enterprise within China (including name, address, contact information and name of the chief representative etc.).

The Provisions also require a RO to file for change of registration or deregistration with the

competent tax authorities in accordance with the relevant laws and regulations on tax collection and administration, where the RO's registration matters change, or its operation term expires, or its business is closed ahead of schedule. A RO shall declare and pay EIT on its liquidation income before deregistration.

Tax declaration and payment

The Provisions set forth rules on ROs' declaration and payment of their EIT and BT: a RO shall declare and pay EIT, BT and VAT on an actual basis within 15 days following the end of each quarter, and shall declare and pay VAT on an actual basis within the time limit as specified in the *PRC Interim Regulation on Value-added Tax* and its implementing rules.

It is worth noticing that ROs shall declare and pay EIT and BT within 15 days following the end of each quarter, and a RO still needs to submit BT returns even if it has no business income in a certain quarter. ROs is not required to submit VAT returns on a quarterly basis, instead, it shall declare VAT within the timeline as specified in Article 23 of the *PRC Interim Regulation on Value-added Tax*.

Tax calculation and deemed profit rate

The Provisions abolish the rules of Circular 28 and Circular 165, which apply different taxation methods to ROs of different business nature. According to the Provisions, all ROs shall maintain accounting books and records on the basis of valid and effective vouchers. It shall also accurately calculate theist taxable income and profits in accordance with the functions the RO actually carries out and the risks borne by it, and declare and pay taxes on an actual basis. If the accounting books of an RO are not complete, or it cannot calculate the incomes or costs accurately, or it cannot declare pay tax on an actual basis pursuant to the Provisions, the in-charge tax authorities have the power to calculate the taxable income of the RO by using one of the two deemed amount methods, i.e., based on operating expenses or based on total turnover. The Provisions provide that when applying the deemed amount method, the deemed profit rate shall not be lower than 15%, an increase from 10% in the previous regulations.

Pursuant to the foregoing provisions, ROs shall maintain complete accounting books, check and calculate income or costs accurately, and declare and pay taxes on an actual basis in accordance with the Provisions, otherwise, the in-charge tax authorities are entitled to execute the power to use the deemed amount method to calculate their taxable income and profits. This may create a tax burden or risk for ROs.

Tax exemption treatment of ROs

Since the Provisions rescind Circular 165, Circular 28 and Circular 945, the provisions concerning tax exemption and non-taxable treatment of ROs under the foregoing three circulars are not

applicable from January 1, 2010. Meanwhile, the Provisions specifically provide that the tax authorities nationwide shall no longer accept and approve ROs' application for EIT exemption and shall sort and clear up the ROs which have been approved to enjoy tax exemption in accordance with the Provisions.

The Provisions do not abolish all tax exemption treatment of ROs but further regulate the administration of tax deduction and exemption of ROs. Article 10 of the Provisions provides that "where a RO wishes to enjoy any tax treaty benefits or exemption, it shall go through formalities according to tax treaties and the relevant rules of the *Circular of the State Administration of Taxation on Issuance of the Provisions on the Administration of Tax Treaty Benefits Enjoyed by Nonresidents (Trial Implementation)* (Guo Shui Fa[2009]No. 124), and shall declare and pay taxes within the time limit as provided in Article 6 of the Provisions." According to the foregoing provision, ROs which believe that they are eligible for any tax treaty benefits or exemption, they may apply to the tax authorities for tax exemption treatment under a relevant tax treaty.

Conclusion

The successive promulgation of the Notice and the Provisions indicates the Chinese government's efforts and attempts to strengthen the administration of ROs established in China. Foreign investors who intend to enter into the Chinese market and those who have already established ROs in China shall reconsider and inspect their business operation in China pursuant to the Notice and the Provisions to ensure that their operation comply with the requirements of the new provisions and rules. In addition, the last article of the Provisions provides that the state and local tax bureaus of all provinces, autonomous regions, municipalities and cities specifically designated in the state plan may formulate detailed operation guidance in accordance with the Provisions and submit the same with the International Taxation Department of SAT. We will pay close attention to and update you on any guidance local tax bureaus may release in the coming future on a timely manner.

Legal Updates

1. **China Further Extends FIE Capital Contribution Deadline to End of 2010 (Author: Xiaolin TENG)**

On February 12, 2010, the PRC Ministry of Commerce, the Ministry of Finance, the State Administration of Taxation, the State Administration for Industry and Commerce, the National Bureau of Statistics and the State Administration of Foreign Exchange jointly released the Circular on the *Joint Annual Inspection of Foreign-invested Enterprises for 2010* (the “**Circular**”). Pursuant to the Circular, the joint annual inspection of foreign-invested enterprises (“**FIEs**”) for the year 2010 shall be conducted from March 1, 2010 to June 30, 2010.

In consideration of the current international economic environment, the Circular made the following special provisions: (i) if the registered capital contribution deadline of a FIE is after July 1, 2008 and the FIE’s shareholders cannot pay up the full amount of its registered capital prior to such deadline due to the shortage of fund, the administration for industry and commerce will further defer such deadline to the end of 2010 per the application of the enterprise, provided that the initial capital contribution of the FIE has been paid up by the shareholders and it has been operated legitimately; (ii) if a FIE, due to the international financial crisis, fails to commence its business within six months of its establishment or suspends its business consecutively for more than six months at its own choice, the administration for industry and commerce, which has the power to cancel the business license of the FIE in accordance with the *Company Law of the People’s Republic of China*, will allow the existence of the FIE to the end of 2010., i.e. the business license of a FIE will not be cancelled if either of the above circumstances occurs before the end of 2010.

2. **Second Amendment to the PRC Copyright Law (Author: Kun MA)**

On February 26, 2006, the Thirteenth Meeting of the Standing Committee of the Eleventh National People’s Congress passed the *Decision to Amend the Copyright Law of the People’s Republic of China* (the “**Decision**”), a second amendment to the *Copyright Law of the People’s Republic of China* first promulgated in 1990 (the “**Amendment**”). The Decision and the articles amended thereunder shall come into force on April 1, 2010. The content of the Amendment is as follows:

- ◆ Article 4 (of the original Copyright Law) shall be amended and read as: “the copyright owner, in exercising their copyright, shall not violate the Constitution or laws or prejudice the public interests. The State shall conduct supervision and management on the publication and distribution of works in accordance with law.” The Amendment removed

the first sentence of Article 4 of the old law, which prescribed that “works whose publication or distribution is prohibited by law shall not be protected by this law”. This deletion attributes to an appeal lodged by the U.S. to the Dispute Settlement Body of the WTO back in 2007. In the appeal, the U.S. claimed, among other things, that authors of works whose publication or distribution has not been authorized (and whose publication or distribution is therefore prohibited) appear not to enjoy the minimum standards of protection specially granted by the Berne Convention in respect of those works. In 2009, the panel concluded that the PRC Copyright Law, specifically the first sentence of Article 4, is inconsistent with China's obligations under Article 5 (1) of the Berne Convention (1971), as incorporated by Article 9.1 of the TRIPS Agreement; and Article 41.1 of the TRIPS Agreement. The deletion of the first sentence of Article 4 reflects China's performance of its promise to implement the panel's foregoing rulings prior to March 2010.

- ◆ Besides, the amendment adds a separate article on copyright pledge and clarifies the registration authority for copyright pledge as Article 26, which prescribes that “the pledgor and the pledgee, who use copyrights as pledge, shall jointly register the pledge with the copyright administration authority under the State Council (i.e., the National Copyright Administration).” This Article 26 reiterates the relevant provisions of the *Measures on Registration of Copyright Pledge Contracts* promulgated by the National Copyright Administration in September 1996, Article 4 of which specifically provides that “the National Copyright Administration is the competent authority for the registration of copyright pledge contracts. The National Copyright Administration shall designate a special institution to conduct the registration of copyright pledge contracts.”

3. Special Rules Applicable to Enterprises in Zhongguancun National Innovation Model Park (Author: Yue ZHENG)

On 25 November 2009, Beijing Administration for Industry and Commerce issued the *Opinion on Implementing the Policies of the State Administration for Industry and Commerce Regarding Supporting the Development of A National Innovation Park by Zhongguancun Science and Technology Park* (Gongshang Ban Zi[2009]No.200, the “**Opinion**”). This Opinion is applicable to enterprises located in Zhongguancun National Innovation Model Park (the “**Model Park**”). Under this Opinion, the State Administration for Industry and Commerce (“**SAIC**”) delegates some of its registration powers in respect of domestic-funded enterprises and foreign-invested enterprises (“**FIEs**”) to its counterparts at the Model Park level. Salient points of this Opinion include:

- ◆ This Opinion calls for establishment of a special and separate registration window for enterprises located at the Model Park. It states that local AIC branches at the

county/district level shall set up such registration windows to take charge of the registration matters of domestic-funded enterprises, FIEs, branches of FIEs, etc. authorized by SAIC.

- ◆ SAIC authorizes some of its power to register domestic-funded enterprises to the local AIC of the Model Park. In accordance with the Opinion, upon application, enterprises whose domicile is located at the Model Park and which shall be registered with SAIC by law may be registered with the local AIC of the Model Park .
- ◆ In addition, the Opinion delegates the registration power of the following FIEs to local AIC of the Model Park:
 - a) FIEs or FIE branches approved by the approval authorities of the Model Park;
 - b) FIEs located in the Model Park engaged in business of restricted industries with a registered capital below 6 million dollars;
 - c) FIEs whose domicile is located at the Model Park and which, by law, shall be registered with SAIC;
 - d) as otherwise specified by the laws, administrative regulations and regulations issued by SAIC.
- ◆ The Opinion also sets forth provisions on equity pledge registration. It states that the registration department (i.e., the local AIC) should process equity pledge registration applications in accordance with the *Measures of Equity Pledge Registration by the Administration for Industry and Commerce* as issued by the AIC and conduct on-site registration and issue an acceptance notice right away. To facilitate the development of the enterprises located in the Model Park, the Opinion further requires that local AIC shall provide administrative guidance on capital contribution. Where the registered capital of an enterprise is set to be paid in installments, the local AIC shall notify the enterprise of the same 30 days prior to the deadline of its capital contribution. Where an enterprise is found to fail to pay up its registered capital within the specified deadline, the government may urge it to reduce its registered capital.
- ◆ In accordance with the *PRC Sino-foreign Equity Joint Venture Law* and the *PRC Sino-foreign Cooperative Joint Venture Law*, Chinese citizens are not allowed to be a party to an EJV or CJV, i.e., a Chinese nature person shall not act as a shareholder of an EJV or CJV. The Opinion relaxes such shareholder restriction and provides that, subject to approval of the approval authorities, Chinese citizens could be registered as natural person shareholders of Sino-foreign equity joint venture and cooperative joint venture high-tech enterprises located in the Model Park.

4. SAT Regulations on Calculation of Enterprise Income Tax on Nonresident Companies (Author: Kuinan WEI)

On February 20, 2010, the State Administration of Taxation (“SAT”) issued the Administrative Measures on Calculation and Collection of Enterprise Income Tax on Nonresident Companies (Guo Shui Fa [2010] No.19, the “Measures”) which came into force as of the date of promulgation. The Measures are aimed at regulating the assessment and collection of enterprise income tax (EIT) on nonresident companies.

The Measures are applicable to nonresident companies as stipulated in Paragraph 2 of Article 3 of the Enterprise Income Tax Law, i.e. nonresident companies that have establishments in China. Kindly note that the calculation of the EIT of foreign companies’ representative offices in China is not subject to the Measures, and is, instead, particularly addressed by a separate circular issued by SAT on the same day entitled the *Interim Provisions on the Administration of Taxation of Resident Representative Offices of Foreign Enterprises* (Guo Shui Fa [2010] No.18).

Basic calculation methods

The Measures provide that nonresident companies should maintain accounting books and records based on lawful and valid vouchers, and declare and pay taxes on an actual basis. If a nonresident company is unable to accurately calculate and file its taxable income because of incomplete accounting books, a lack of information or for any other reasons, the tax authorities are entitled to assess taxable income using one of the following methods:

Calculation method	Applicable situation	Calculation formula
Deemed taxable income based on gross revenue	The taxpayer can accurately calculate its gross revenue but can not calculate its costs or expenses	Taxable income=gross revenue × deemed profit rate
Deemed taxable income based on costs and expenses	The taxpayer can accurately calculate its costs and expenses, but can not calculate its gross revenue	Taxable income=(total costs and expenses)/(1 – deemed profit rate) × deemed profit rate
Deemed taxable income based on cost-plus	The taxpayer can accurately calculate its total expenditures, but can not calculate its gross revenue, costs or expenses	Taxable income=(total expenditures)/(1 – deemed profit rate – business tax rate) × deemed profit rate

Deemed profit rates

The Measures set out the range of deemed profit rate applicable under the aforementioned tax calculation methods for different types of business engaged by the nonresident companies. The ranges are: i) provision of contracted construction, design and consulting services: 15%-30%; ii) provision of management services: 30%-50%; iii) provision of other services or operations other than services: no less than 15%.

The tax authorities can adopt a higher profit rate if they have reason to consider that the actual profit margin is significantly higher than the above rates. If a company engages in different business activities within China where different deemed profit rates may apply, the taxable income shall be assessed separately and calculated at the appropriate profit rate; if the taxable income can not be assessed separately, the tax authorities will apply the highest applicable profit rate.

Income from after-sale, onshore and offshore services

The Measures provide that where one contract entered by and between a nonresident company and a Chinese resident company involves the sale of machinery, equipment or other goods and after-sale services (such as installation, assembly, training, direction, supervision, etc.), if the contract does not specify the services fee or such services fee is unreasonable, the tax authorities will deem the amount of services income by applying the portion that would apply in similar industries depending on actual conditions or deem the services income to be no less than 10% of the total contract value if there is nothing for reference.

For the scope of taxable services income, the Measures provide that where services provided to a customer within China by a nonresident company are totally performed within China, the nonresident company shall pay its income tax on all of the onshore service income. Where services are provided both within and outside China, onshore and offshore service income will be allocated according to where the services were performed and the nonresident company shall pay its income tax on the onshore service income. If the tax authorities question the rationality and authenticity of the allocation, they can require the nonresident company to provide a real and valid certificate and allocate the onshore service income reasonably based on the workload, working time, costs and other factors; if the nonresident company can not provide a real and valid certificate, the tax authorities may deem 100% of the services to have been performed within China, ascertain the amount of service income and levy enterprise income tax accordingly.

Application of deemed taxation method

A nonresident company who intends to apply the deemed taxation method shall complete the

taxation method assessment form for nonresident company and submit it to the competent tax authorities. After examination, the competent tax authorities will issue a notice to the nonresident company and let it informed of the result within 15 days of receipt of the assessment form if the nonresident company does not meet the deemed conditions. If the resident company dose not receive the notice within the 15-day period, the authorities are presumed to agree with the method applied by the nonresident company.

Meanwhile, if the tax authorities find that the taxable income calculated by using the deemed taxation method is not true or obviously mismatches the functional risk it burdens, the tax authorities has the right to adjust it.

Important Announcement

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