

## **One-year transitional period for the New Business Tax (BT) Regulation**

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Business Tax is one of the major turnover taxes currently being implemented in China. It is levied on (i) Transfer of intangible assets in China; (ii) Sales of immovable assets in China; and on (iii) Services provided within China.

Starting from 2009, a revised Business Regulation and its implementation rule take effect. While the stipulation wording on the chargeable activities as referred to above remains unchanged under the new regulations, the scope of levy in respect of the service activities in particular, has been expanded due to a revised interpretation for the 'Services provided within China'. According to Article 4 of the business tax implementation rule, the "the provision of labour services within China" is now expressly defined as the "where either the service recipient or service provider is located in China." Under the new Business Tax regulations, the Business Tax liability is now to be determined by the "location of the service recipient or of the service provider rather than the location of the service provision. As long as either of the service recipient or the service provider is located in China, the relevant service income would be subject to BT in China - regardless of whether the services are rendered physically inside the PRC or outside of the PRC. In other words, where the services are being provided is no longer relevant in determining the BT taxability. The implication is that under the new BT regulation, the 100% offshore services may also become subject to BT, i.e. the charging scope is extended from the onshore services only to encompass certain offshore services as well.

Apparently, this change has significant impacts on Foreign Service providers who are doing business with Chinese clients. The changes may particularly affect architecture design services, software development services, advertising services, tourism service, marketing services, consulting services etc. For instance, a foreign media service engaged by a Chinese client for advertising services, previously the fees paid by the Chinese clients were not subject to Business Tax because no service activities were incurred in China, the core services, i.e. posting the advertisements in the media occurred out of China. However, under the new BT regulation, since the service recipient in this case i.e. the Chinese clients are located in China, therefore the respective services are now defined as "Provided in China" and are hence subject to Business Tax. The foreign media will now lose 5% of its gross revenue due to the regulation change.

Likewise, it also affects Chinese companies that undertake service projects overseas. For example, a Chinese construction company, which is engaged by a foreign property developer, where the Chinese company shall conduct all the architecture and construction activities on the site, which is located in the foreign country. Such services were not subject to Business Tax under the old regulation, however now it will be taxable because the service provider, i.e. the Chinese company is located in China.

The enlarged charging scope of Business Tax in respect of the service activities was formally announced towards the end of 2008 with the effective date of the new position set

as 1st January 2009. As such, most of the affected business operators had little time to adapt yet were required to bear the increased burden with immediate effect.

Recently, in August 2009, the State Administration of Taxation and the Ministry of Finance jointly issued a tax circular, Caishui [2009] No. 112, formally offering a one-year transitional period for the enforcement of the new Business Tax regulation. Stated in this circular, the old Business Tax regulation shall continue to apply to certain on-going contracts that were signed on or before the 31st December 2008 for a transitional period until December the 31st 2009 or the end of the contract term, whichever is the earliest. These eligible contracts prescribed include, Labour service contracts, immovable property sales contracts and intangible asset transfer contracts. The old Business Tax treatment that will still be in force was referred to the following aspects: (1) the interpretation of the "Service provision in China"; and (2) the ascertainment of taxable revenue for construction, tourism, foreign exchange sub-lending and other taxable activities. For other taxation attributes, such as the tax rate, arising time of the tax liability, location of the tax payment, appointment of the withholding agents, RMB conversion rates, tax reduction and exemption policies, it should be conforming to the new Business Tax regulation.

This circular has also provided that for the Business Tax already paid or withheld in 2009, and which now is deemed excessive due to this transitional measure, a tax refund or credit against future liability is allowed.

This transitional arrangement is a positive response from the State Administration of Taxation and is large due to the widespread criticism received because of the short notice period of the new regulation. The affected service providers should take this opportunity to actively adjust to the new regulation, for instance, price renegotiations with clients to shift the increasing cost to the extent possible and restructure the contractual relationship by contracting to overseas affiliate companies of the original Chinese clients. In the meantime, the company should take the initiative to make application for the refund or credit on any Business Tax overpayment in 2009.

For advice on how this new Business Tax regulation may impact your business, please contact Chris Wong, Senior Manager of Taxation, LehmanBrown International Accountants on: 8532 1720 or [cwong@lehmanbrown.com](mailto:cwong@lehmanbrown.com)