

Business Tax – Enlargement of scope of charge

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The PRC State Administration of Taxation ("SAT") and the Ministry of Finance issued the Detailed Implementation Rules ("DIRs") for Business Tax on 15 December, 2008. Surprisingly, the amended DIRs include a major change to the basis in determining the scope of charge for Business Tax. This new principle may have significant and adverse impacts on many service providers. The revised Business Tax Provisional Regulations and related DIRs became effective from 1 January 2009.

What are the Changes?

In the past, all entities and individuals that provide labour services within the PRC territory would be subject to Business Tax. However, under the new DIRs, the "provision of labour services in China" is defined to include where either the service provider or the service recipient is located in China. Literally speaking, the locality of service providers or the service recipients would become the crucial factor in determining the scope of charge. This appears that Business Tax would be imposed regardless of whether services are rendered in the PRC. This fundamentally changes the old Business Tax principle which focuses on whether services were actually carried out in China.

This unanticipated change would have adverse impacts to those foreign entities rendering services outside China but the service recipients are located in China. It is a common practice for MNCs which allocate various types of expenses and "value added" services incurred by global or regional headquarters, such as marketing, IT support, finance and human resources support, to their PRC affiliates. Most countries would allow these to be charged in the form of management fees, however Chinese does not allow these to be deducted except for a few companies that meet certain requirements. Hence, this change may have negative impacts to their current arrangement as additional Business Tax would be incurred.

Besides the additional Business Tax burden, double taxation may arise on the same service income as the foreign service providers may be subject to turnover tax in the locality of services rendered. Generally speaking, tax treaties for the avoidance of double taxable would only cover income tax but not Turnover tax.

Suggestions

Service providers, in particular foreign enterprises, should review their current business models, estimate the potential Business Tax exposure arising therefrom, and devise appropriate strategies.

We are aware that many service providers and companies are worried about this change as it can have a direct impact on their bottom line. It appears that some local tax authorities are awaiting further clarification from the SAT for the implementation of this new principle, which could provide some exceptions.

We shall be pleased to assist companies in reviewing their existing models, advising on the potential impacts under the new Business Tax rules and developing appropriate strategies.