

Further Clarification on Tax Treatments for Technology Transfer-Related Services

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Following the issuance of tax circular Guoshuihan [2009] No.507 (Circular 507), Notice on Certain Issues Concerning the Implementation of Articles on Royalties in Double Tax Treaties (DTT), issued on 14th September 2009, the State Administration of Taxation (SAT) issued Circular Guoshuihan [2010] No.46 (Circular 46), Notice on the Implementation of Some Articles in DTT, on 26th January 2010, further clarifying tax treatments in relation to technology transfer-related services.

Background

During the implementation of Circular 507, the local tax authorities in South China encountered some issues regarding the applicable tax treatments for technology transfer-related services and the associated individual income tax (IIT), which was duly reported to SAT. In light of the fact that these issues needed to be further clarified, SAT issued Circular 46 as a supplement to Circular 507.

Highlights of Circular 46

1. Technology transfer-related services shall be considered as part of the technology transfer and the relevant service incomes shall fall into the scope of royalties as set forth in the DTT. However, based on the DTT, under the following circumstances, the technology transfer-related services would be treated differently in terms of PRC taxes.

- The foreign technology provider has sent personnel to China to provide services in relation to the technology transfer;
- The time spent by the foreign personnel in China has constituted the foreign technology provider a Permanent Establishment (PE) in China according to the applicable DTT.

Under such circumstances, the incomes related to the PE should be taken as service income, and the profits attributable to the PE shall be treated as business profits, hence they are subject to Corporate Income Tax (CIT). The foreign personnel involved shall be taken as dependant service providers and subject to IIT.

2. In case the technology transfer-related service cannot be ascertained in advance as to whether it will constitute a PE in China, the terms of royalties as set forth in the DTT would apply temporarily and Withholding Tax (WHT) would be levied on the incomes. Once it is ascertained that the services constitute a PE in China and the incomes are actually related to the PE, the incomes should be taken as service incomes and levied with CIT accordingly and the personnel involved shall be duly levied with IIT as well. The WHT previously paid is allowed to be credited against the relevant CIT and IIT payable.

3. For technology transfer and service provision contracts signed prior to 1st October 2009, in cases where the related service provision has not been completed by 1st October 2009 and the relevant taxes have not yet been cleared, both Circular 507 and Circular 46 should be applicable.

In addition, for technology transfer-related services not yet concluded by 1st October 2009, the whole service period of the foreign personnel working in China shall be included for the purpose of determining whether a PE has been constituted, including the days prior to 1st October 2009. However, adjustment would not be required for part on which WHT had been settled before 1st October 2009 under the articles on royalties as set forth in the DTT.

LehmanBrown Observations

Circular 46 clarifies important implementation issues in relation to Circular 507 and the associated IIT treatment for foreign personnel sent to China to provide technology transfer-related services. However there are still some issues, which need to be clarified, especially in the case where a PE is triggered. For example, how much of the total income should be attributed to the PE?

In addition, whether the WHT previously paid could practically be credited against the CIT and IIT payable remain to be seen.

Please also note that once a PE has been constituted, all the foreign personnel providing services should be subject to IIT in terms of their incomes associated with the provision of services, regardless of how long they stay in China, since their incomes are deemed as borne by the PE.