

Tax Administration on Foreign Enterprise Representative Offices

The Provisional Measures for Tax Administration of Foreign Enterprise Representative Offices ("Provisional Measures") was issued by the State Administration of Taxation on February 20th, 2010 and became effective since January 1st, 2010.

The Provisional Measures mainly regulate the following aspects:

1. Tax Reporting and Payment

Foreign enterprise representative offices should report and pay the enterprise income tax to the tax authorities. The business tax and the valued-added tax should also be reported and paid if they are involved in the relevant taxable activities carried out by the representative offices.

2. Tax Calculation

There are three kinds of tax calculation methods under different circumstances:

- (1) If the income and cost of the representative offices can be clearly calculated through the account book:

Calculation Method: Calculate the tax through the income of the representative offices, which is counted from the effective account book, in accordance with the actual performed functions and risks;

- (2) If the account books of the representative offices only show the expenditure:

Calculation Method: Calculate the tax through the income which is converted from the expenditure;

- (3) If the income of the representative offices can be shown or counted by the account book while the cost cannot be shown:

Calculation Method: Calculate the tax through the taxable income which is converted from the income.

The account books of most representative offices only show the expenditure, therefore, the second method is mostly applied to the tax calculation.

3. New Changes in the Provisional Measures

- (1) Increased Rate of Profit

Before this Provisional Measures were issued, the rate of profit was not less than 10%. Now, this Provisional Measures regulate that the new rate of profit is not less than 15%. Obviously, the rate of profit has been increased by 5% so far. As a result, the tax burden levied on the foreign enterprise representative offices will also be increased.

- (2) Abolished Tax Regulations

According to this Provisional Measures, the following regulations are abolished:

- a. Notice of Strengthening the Tax Administration of Foreign Enterprise Representative Offices, which was issued in 1996;
- b. Notice of the Tax Administration of Foreign Enterprise Representative Offices, which was issued in 2003;
- c. Notice of Free-tax Approval Procedure of the Foreign Enterprise Representative Offices, which was issued in 2008.

4. Conclusion

The promulgation of Provisional Measures integrates the tax policies with respect to foreign enterprise representative offices in China. This new Measures have clarified three methods of tax calculation and defined a higher rate of profit, which are the most important changes in the Measures.

However, the higher rate of profit will also lead to the heavier tax burden levied on the representative offices, because the rate of profit plays an important role in the tax calculation.

Therefore, the cost of foreign enterprise representative offices which operate in China will be higher than before. Moreover, in the light of the regulation regarding the management of foreign enterprise representative offices issued on January 4th, 2010, foreign enterprise representative offices will be supervised more strictly by the Chinese authorities in future.

The foreign enterprises shall pay attention to these changes of the policies and consider carefully the strategy on the structure of entering into China or operating in China.