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UPDATE: SENDING EMPLOYEES TO CHINA

By Allan Marson and Li Dai

If you send expatriate (non-Chinese) employees to China, this article is for you. China has issued new visa and tax regulations in recent years that affect your company's and your employees' rights and obligations.

If you have already registered a representative office or subsidiary in China, it can apply for a "Z" visa for an expatriate to enter China and an employment permit to work in China. Hong Kong, Macau or Taiwan residents are generally treated like expatriates, but do not require a "Z" visa.

There are some pitfalls. For example, the employer in China may be required to demonstrate that no Chinese worker is available for positions outside of high-level management. Further, Chinese law allows male employees to retire at 60, and foreign male employees exceeding that age may be denied a "Z" visa. As another example, some cities, such as Hangzhou, are now denying applications by newly established foreign-invested companies to hire non-management foreign employees during their first year of operation.

In addition, an expatriate employed by a Chinese entity is subject to the Chinese labor regime, which permits dismissal only on narrow statutory grounds and is highly protective of employee rights.

In the past, expatriates in most cities were not required to contribute to the retirement and other funds of the Chinese social insurance scheme. However, according to the Interim Measures for the Participation in Social Insurance of Foreigners Employed in China, effective Oct. 15, 2011, employers in China must now withhold and pay contributions to such funds. These measures implement a new provision on expatriate employees in the Social Insurance Law of the People's Republic of China, effective July 1, 2011.

On the positive side, contributions to the social insurance funds are calculated with reference to maximum compensation of three times the average local annual salary, which is substantially less than the typical salary of a highly-compensated expatriate. One city, Dalian, removed this limit on the employer's contribution rates for three months in 2011, but re-implemented it in 2012.

If you have no registered entity in China, your expatriate employees can still engage in certain commercial activities in China by obtaining an "F" (short-term business) visa. "F" visas may be

single- or multiple-entry. The duration of stay per entry ranges up to 180 days and extensions are available.

Many expatriates have used “F” visas to work long-term in China by periodically exiting and re-entering the country to refresh their visas. Recently, however, the Beijing Public Security Bureau implemented a “100-day” campaign, ending in August of this year, that targets foreign nationals working in China without proper visas and employment permits. The campaign includes increased police presence in areas frequented by foreigners and a hot-line to report suspicious persons.

Further, under the newly issued Exit-Entry Administration Law of the People's Republic of China, effective from July 1, 2013, extensions of stay under an “F” visa may not cumulatively exceed the duration stated in the original visa. The law authorizes employees without a work visa to be detained for investigation, fined, deported and banned from re-entry. Employers are subject to a fine for each illegal employee up to a maximum of RMB 100,000 (approximately $16,700) and local sponsors may be fined for issuing improper invitation letters for expatriates.

Expatriates sent to China are subject to individual income tax on China-sourced compensation. Although the rules are complex, “China-sourced compensation” generally refers to compensation received by an individual for services performed while in China, even if the individual does not have a work visa and the compensation is paid offshore.

Chinese tax law provides relief to expatriates staying in China temporarily. If an expatriate stays no more than 90 days in a calendar year and her compensation is not borne or paid by an establishment in China, she should be exempted from individual income tax. Under the China-U.S. bilateral tax treaty, a U.S. expatriate who otherwise qualifies is exempted for stays up to 183 days in a calendar year.

At the corporate level, your activities in China are subject to Chinese enterprise income tax. However, bilateral treaties, such as the China-U.S. bilateral tax treaty, exempt foreign employers that do not have a permanent establishment in China for tax purposes.

To come within the protection of the China-U.S. treaty, any expatriates your company sends to China should not habitually exercise the authority to sign contracts in the name of your company or represent that you have an office in China (e.g., on any of their name cards). In addition, they should not provide consultancy or other business services on your behalf in China for the same or connected projects for more than six months in any 12-month period. This six-month period runs whenever any personnel are providing services in China – it is not necessary for the same person to be present for the full period.

If you are deemed to have a permanent establishment in China, it is subject to tax at the rate of 25 percent on income that is attributable to that establishment. Since it is often difficult to

determine actual revenue and expenses, the Chinese tax authorities may deem that a permanent establishment receives a taxable profit calculated on the total revenue attributable to it or, alternatively, on its expenses. The deemed profit rate for services provided in China ranges from 15 percent to 50 percent of actual or deemed revenue.

A permanent establishment providing services in China is additionally subject to business tax at a rate of 5 percent of actual or deemed revenue. The business tax is a turnover tax. Unlike value-added tax, the other main turnover tax in China, business tax is not creditable and business tax paid on inputs is not directly passed on to consumers.

Under the Notice on Issuing the Pilot Plan for Levying Value Added Tax in Lieu of Business Tax, a pilot program was launched in Shanghai on Jan. 1, to substitute value-added tax for business tax on transportation industry services and "certain modern services," defined as research, development and technical, information technology, logistics support, consulting, and other listed services. Value-added tax rates range from 6 percent to 17 percent. Because the tax is creditable, the burden is passed on to consumers or other end-users and the tax burden for most service industries is less than under the business tax regime.

This pilot program has recently been extended to an additional 10 cities and provinces including Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen. This extension is to be implemented from Aug. 1 to the end of this year.

The Chinese authorities are unlikely to require you to withhold Chinese individual income tax from your employees' salaries as long as you do not have a permanent establishment in China. If your employees' activities were to create a permanent establishment, each employee would become liable to individual income tax retroactively from the first day of her entry into China to provide services attributable to the permanent establishment, even if she works less than 183 days. You, as the employer, should withhold and pay tax to the relevant treasury in China and may use an agent in China for this purpose.

To avoid creating a permanent establishment, many foreign employers enter into a secondment arrangement with a local company, such as their subsidiary in China. Under this arrangement, your expatriate remains your employee but is assigned to work for the Chinese company. You pay her compensation, and, typically, the Chinese company reimburses you because it receives the benefit of her services. Chinese labor laws should not apply to your contract with the expatriate, and she can usually continue to participate in employee plans in her home jurisdiction, such as her U.S. 401(k) plan. If properly structured, a secondee can work long-term in China without creating a permanent establishment.

In 2009, local tax bureaus, responding to national guidance, disallowed many secondment arrangements and treated reimbursement as a service fee subject to withholding. Secondment

arrangements are now again accepted throughout China and reimbursement payments made under them are not subject to withholding, but they must be carefully crafted.

An employee must have proper employment documents and pay individual income tax if she works long-term in China. However, with proper attention to her activities and by putting in place a properly documented secondment arrangement, you can avoid the pitfalls of a permanent establishment while she continues to be treated as a home-country employee.

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