



Covid-19 disruption period guidance on permanent establishment and tax residence

Summary:

- The Chinese State Taxation Administration (STA) has clarified how the Permanent Establishment (PE) and tax residence rules will be applied in the context of the Covid-19 disruption period. These are of use to foreign businesses in assessing and limiting their China tax exposures.

Background



In the Covid-19 disruption period many countries have imposed restrictions on cross-border travel. This has resulted in the staff of numerous enterprises, including their key executives, being 'stranded' in jurisdictions different to their normal location of employment. This has raised business concerns on PE and tax residence risks, which the STA has sought to address in a Q&A notice issued on 14 August 2020. This cross-references the most substantive piece of China tax guidance on treaty interpretation issued to-date, STA Circular 75 (2010).

KPMG observations



Fixed place PE: For staff of a foreign company carrying on 'home office working' in China, the STA has clarified that 'intermittent and occasional' home work activity should not result in fixed place PE.

PE is defined in tax treaties as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Circular 75, drawing on elements of the OECD Model Treaty Commentary, states that a place of business is relatively fixed, with a certain degree of permanence. It also states that carrying on activities "through" a place of business applies to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise. However, in contrast to the OECD Model Treaty Commentary, Circular 75 does not provide any further guidance on meaning of 'at the disposal of'. This has meant that foreign companies have struggled in the past to assess whether staff present in China at a location other than an office (e.g. at a home, hotel, client premises) could give rise to a risk of PE. The STA has now clarified that 'intermittent and occasional' home work activity during the Covid-19 disruption period should not result in fixed place PE. This is in line with the OECD's April 2020 guidance that temporary home working should not result in PE, given that it lacks permanency and that home working resulting from government movement and travel restrictions should not be viewed as putting an employee's home at the disposal of the enterprise.

Agency PE: For staff of a foreign company carrying on 'home office working' in China, the STA has clarified that 'occasional' conclusion of contracts on behalf of the foreign enterprise should not result in agency PE.

Tax treaties recognize an agency PE where an agent has and habitually exercises an authority to conclude contracts in the name of a foreign enterprise. The STA Q&A recognizes that occasional contract signing from a home office may not rise to this level. However, it qualifies this by saying that agency PE might still be regarded as arising if the relevant staff had been acting in China on behalf of the enterprise for a long time before the Covid-19 disruption period or if their role has shifted for the longer term, in consequence of Covid-19, to habitually concluding contracts for the foreign enterprise.

Construction PE: The STA has clarified that when calculating PE time threshold for construction projects, downtime as a result of Covid-19 disruption can be subtracted.

This limits PE risk where the period for a construction project needs to be extended. Compared with the OECD analysis issued in April, the STA position is more favorable to taxpayers. The OECD notes that any temporary break in construction projects as a result of the outbreak should be included in the duration of the project for the purposes of calculating whether there is a PE.

Tax residence

- Place of effective management: The STA clarifies that where the decision-making location of senior executives of an enterprise has been temporarily changed due to Covid-19 disruption, the assessment of the place of effective management for determining corporate tax residence will not be affected.
- Individual dual tax residence: The STA clarifies that, when applying the residence tie-breaker rule, they will not treat a temporary change to the location in which an individual lives as resulting in a change to the place of their permanent home or center of vital interests.

The STA considers that the temporary relocation of senior executives to a different location as a result of Covid-19 should not have an impact on a company's tax residence. This is also in line with the OECD position. While the decision-making location is an important factor in judging the place of effective management, STA indicate they will take a broader perspective, i.e. looking at the decision-making location under normal circumstance, rather than solely at temporary arrangements in the special context of Covid-19 disruption.

In parallel, for the individual tax residence tie breaker test, the STA state that a temporary change to the location in which an individual lives due to Covid-19 disruption should not result in a change to the place of their permanent home or center of vital interests, for treaty residence determination. However, it is noted that if an individual stays in China in excess of the relevant time thresholds, China individual income tax obligations for the individuals as non-residents would still arise.

The STA also emphasizes that where Covid-19 disruption related complexities give rise to tax disputes for China's 'going out' enterprises the mutual agreement procedure (MAP) can be accessed and utilized.

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