



Representative offices subject to scrutiny in re-certification exercise

Regulations discussed in this issue:

- Notice on format for the revised business registration certificates of Representative Offices and the annual reports of Representative Offices, Gong Shang Wai Qi Zi [2011] No. 26, issued by the State Administration for Industry and Commerce on 16 February 2011, effective 1 March 2011.
- Notice on implementing of rules governing registration administration of Representative Offices of foreign enterprise, Gong Shang Wai Qi Zi [2011] No. 27, issued by the State Administration for Industry and Commerce on 17 February 2011, effective 1 March 2011.

Background

The State Administration for Industry and Commerce (SAIC) issued circulars, Gong Shang Wai Qi Zi [2011] No. 26 ("Circular 26") and Gong Shang Wai Qi Zi [2011] No. 27 ("Circular 27") on 16 and 17 February 2011 respectively. Circular 27 lays down the procedure for implementing the rules that govern the registration administration of representative offices of foreign enterprises as set out in State Council Decree No. 584 ("Decree 584") issued on 19 November 2010. Circular 26 prescribes the format for the business registration certificates of representative offices and the annual reports of representative offices. For details on Decree 584, please refer to [China alert Issue 21 2010](#).

In particular, Circular 27 requires all representative offices of foreign enterprises to carry out re-certification with the local offices of SAIC. During the re-certification process, the registration authorities will assess if the representative offices have complied with the rules that govern the operation of representative offices. The key features of the re-certification procedures are set out below:

1. Who are required to perform re-certification?

All representative offices of foreign enterprises that are governed by Decree 584 are required to do so. According to Decree 584, "foreign enterprises" refer to profit-making organisations that have been set up outside of China in accordance with foreign laws, including enterprises set up in Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region; "representative offices" refer to business organisations that have been set up by foreign enterprises in accordance with Decree 584 to

carry out non-profit making activities that are related specifically to those foreign enterprises.

2. What certificates will be affected by re-certification?

Both the business registration certificates of representative offices and the representative certificates of the individual representatives will have to be replaced in the re-certification exercise.

3. When should re-certification be carried out?

The local registration authorities, with whom the representative offices were originally registered, should have notified the representative offices of the re-certification requirement by the end of February 2011 via media channels such as the Internet. The local registration authorities should commence the registration work on 1 March 2011 and complete it by 30 June 2011. If it is necessary to extend the time of the re-certification process, the completion date should not be later than 31 August 2011.

4. What key documents should be submitted to the local registration authorities for purposes of re-certification?

In carrying out re-certification application, the representative offices should produce the business registration certificates and representative certificates that are currently valid. For representative offices that were established before 1 January 2011, annual reports of the representative offices should also be submitted during re-certification application. However, for representative offices that were established on or after 1 January 2011, no such annual reports will be required.

The annual reports referred to above should indicate whether the foreign enterprises that have set up the representative offices continue to exist, and describe the activities of the representative offices and present the receipts and payments of the representative offices based on information that has been audited by firms of certified accountants.

5. What matters will the local registration authorities consider when dealing with re-certification?

Generally, the local registration authorities will consider if the representative offices have complied with the rules as set out in Decree 584, including:

- Whether the representative offices only carry out non-profit making activities specifically in relation to the foreign enterprises under whose name the representative offices have been registered
- Whether the representative offices generally comply with the Chinese laws and whether they carry out activities that jeopardise the national security of China or the public interests of the society
- Whether the chief representatives, other representatives and non-representative staff of the representative offices are in compliance with the regulations in connection with immigration, residence, employment, taxation and foreign exchange registration.

In particular, according to Circular 27, where a representative office has more than four representatives (i.e. one chief representative and three other representatives), the procedure that the representative office should only carry out "in principle is the cancellation of the registration of representatives". This can be taken to mean that the excess personnel will lose the status of a representative.

6. Will the local registration authorities also consider if the representative offices have accounted for their Chinese tax liability correctly during the re-certification process?

In principle, there is an obligation under Decree 584 on the local registration authorities to consider if the representative offices comply with the Chinese laws in general. However, in practice, taxation is too specialised an area for the local registration authorities to get involved in.

But Decree 584 does require the local registration authorities to set up an information sharing system with “the other relevant departments” to exchange information relating to representative offices. It is therefore conceivable that the local registration authorities will notify the tax authorities of matters that will potentially affect the tax status of representative offices, e.g. the breaching of the business scope of representative offices.

The implications of the abovementioned risk are even more serious following the release of the circular of the State Administration of Taxation, Guo Shui Fa [2010] No.18 (“Circular 18”). Under Circular 18, the rules on the taxation methods of representative office have been tightened, and the deemed profit margin of representative offices has been increased from 10 percent to 15 percent with effect from 1 January 2010. For details, please see [China alert Issue 4 2010](#).

7. What if representative offices are found to have breached some of the rules in Decree 584 during the re-certification process?

In those cases, the local registration authorities are empowered to require the representative offices or individual representatives or non-representative personnel to carry out remedial action or penalise the representative offices or its personnel or both, depending on the nature of the breach. The local registration authorities may refuse to complete the re-certification unless and until the required remedial action has been taken. However, in serious cases, the business registration certificates of the representative offices may be revoked.

8. What if representative offices fail to carry out the re-certification in time?

In those cases, the representative offices will be required to carry out re-certification within a period of time subsequently stipulated by the registration authorities, and the representative offices may be subject to a penalty ranging from RMB 10,000 to RMB 30,000. If the representative offices fail to carry out re-registration within the stipulated period of time, the business registration certificates of the representative offices may be revoked.

9. Should the representative offices carry out the change of their tax registration certificates after re-certification?

Generally the representative offices should not be required to change their tax registration certificates with the state and local tax bureaux in charge if the re-certification does not result in the change of the key content of the business registration certificates. If the re-certification results in the changes of the key content of the business registration certificates, then there should be corresponding changes in the tax registration certificates.

The change of tax registration certificates can have practical implications on the tax status of the representative offices. Following the issuance of Circular 18 as mentioned in Point 6 above, the state tax bureaux, in some locations, continue to allow or have not challenged the use the old taxation methods. However, the change of the tax registration certificates might prompt the tax authorities to apply the new taxation methods as prescribed by Circular 18. Therefore, it is important to clarify with the state and local tax bureaux at the local level as to whether it is necessary to carry out the change of tax registration after re-certification.

KPMG Observations

Representative offices of foreign enterprises will be subject to much greater scrutiny going forward. In particular, the Chinese government is becoming more concerned about representative offices operating beyond their permitted scope of activities, and such scope of activities is very narrowly defined in Decree 584.

In reality, it can be difficult for many representative offices to fully comply with the rules set out in Decree 584. For one, many representative offices of foreign enterprises carry out activities for parties other than the foreign enterprises that have set them up e.g. group companies in or outside China. As such, there is an increasing trend of foreign companies converting their representative offices to wholly foreign owned enterprises (WFOEs). The recent changes in the rules governing the tax affairs of representative offices, principally Circular 18 as mentioned in Point 6 above, have made the need to consider the WFOE option more compelling. Of course, both the representative office model and WFOE model have their pros and cons from operational, financial and fiscal perspectives. As such, it is a choice that needs to be considered carefully.

Contact us

Khoonming Ho

Partner in Charge, Tax
China and Hong Kong SAR
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Beijing/Shenyang

David Ling

Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Qingdao

Vincent Pang

Tel. +86 (532) 8907 1728
vincent.pang2@kpmg.com

Shanghai/Nanjing

Chris Ho

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Hangzhou

Martin Ng

Tel. +86 (571) 2803 8081
martin.ng@kpmg.com

Chengdu

Anthony Chau

Tel. +86 (28) 8673 3916
anthony.chau@kpmg.com

Guangzhou

Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen

Jean Jin Li

Tel. +86 (592) 2150 888
jean.j.li@kpmg.com

Shenzhen

Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong

Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

David Ling

Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Vaughn Barber

Tel. +86 (10) 8508 7071
vaughn.barber@kpmg.com

Roger Di

Tel. +86 (10) 8508 7512
roger.di@kpmg.com

Jonathan Jia

Tel. +86 (10) 8508 7517
jonathan.jia@kpmg.com

Vincent Pang

Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang2@kpmg.com

Michael Wong

Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Irene Yan

Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Tracy Zhang

Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Catherine Zhao

Tel. +86 (10) 8508 7515
catherine.zhao@kpmg.com

Hiroyuki Takahashi

Tel. +86 (10) 8508 7078
hiroyuki.takahashi@kpmg.com

Leonard Zhang

Tel. +86 (10) 8508 7511
leonard.zhang@kpmg.com

Central China

Chris Ho

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Anthony Chau

Tel. +86 (21) 2212 3206
+86 (28) 8673 3916
anthony.chau@kpmg.com

Cheng Chi

Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Bolivia Cheung

Tel. +86 (21) 2212 3268
bolivia.cheung@kpmg.com

Dawn Foo

Tel. +86 (21) 2212 3412
dawn.foo@kpmg.com

Sunny Leung

Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Lewis Lu

Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Martin Ng

Tel. +86 (21) 2212 2881
+86 (571) 2803 8081
martin.ng@kpmg.com

Yasuhiko Otani

Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Grace Xie

Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Zichong Xu

Tel. +86 (21) 2212 3404
zichong.xu@kpmg.com

Jennifer Weng

Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

William Zhang

Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

David Huang

Tel. +86 (21) 2212 3605
david.huang@kpmg.com

Amy Rao

Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Southern China

Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Jean Jin Li

Tel. +86 (755) 2547 1128
+86 (592) 2150 888
jean.j.li@kpmg.com

Jean Ngan Li

Tel. +86 (755) 2547 1198
jean.li@kpmg.com

Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Kelly Liao

Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Angie Ho

Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Hong Kong

Ayesha Macpherson

Partner in Charge, Tax
Hong Kong SAR
Tel. +852 2826 7165
ayasha.macpherson@kpmg.com

Chris Abbiss

Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern

Tel. +852 2826 7166
darren.bowdern@kpmg.com

Alex Capri

Tel. +852 28267223
alex.capri@kpmg.com

Barbara Forrest

Tel. +852 2978 8941
barbara.forrest@kpmg.com

John Gu

Tel. +852 2978 8983
john.gu@kpmg.com

Ken Harvey

Tel. +852 26857806
ken.harvey@kpmg.com

Nigel Hobler

Tel. +852 2143 8784
nigel.hobler@kpmg.com

Charles Kinsley

Tel. +852 2826 8070
charles.kinsley@kpmg.com

John Kondos

Tel. +852 26857457
john.kondos@kpmg.com

Curtis Ng

Tel. +852 2143 8709
curtis.ng@kpmg.com

Kari Pahlman

Tel. +852 2143 8777
kari.pahlman@kpmg.com

John Timpany

Tel. +852 2143 8790
john.timpany@kpmg.com

Christopher Xing

Tel. +852 2978 8965
christopher.xing@kpmg.com

Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com

Jennifer Wong

Tel. +852 2978 8288
jennifer.wong@kpmg.com

kpmg.com/cn

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