



Shenzhen strictly enforces tax registration of non-resident contractors and service providers

Regulation discussed in this issue:

- Announcement of Shenzhen State Tax Bureau on strengthening the administration on tax registration and record lodging of non-resident enterprises, Shen Guo Shui Gao [2011] No. 7, issued by Shenzhen State Tax Bureau on 2 August 2011

Background

Shenzhen State Tax Bureau (STB) issued the announcement, Shen Guo Shui Gao [2011] No. 7 (Announcement 7), on 2 August 2011, strengthening the administration on tax registration and record lodging of non-resident enterprises and clarifying the consequences of non-compliance based on the Corporate Income Tax (CIT) Law and its implementation rules, Decree No. 19 of State Administration of Taxation (Decree 19), and the circular, Guo Shui Fa [2009] No. 3 (Circular 3).

The requirements for registration and record lodging, as well as the consequences of non-compliance set out in Announcement 7 are summarised below:

Requirements for registration and record lodging

Item	Non-resident enterprises	Domestic enterprises and individuals (Withholding agents)
Non-resident enterprises carrying out projects or providing services	<ul style="list-style-type: none">Foreign contractors shall register with the STB at district / branch level in the locations where the projects are located within 30 days of conclusion of the contracts or agreements	<ul style="list-style-type: none">Domestic enterprises or individuals that contract out projects or services to non-resident enterprises shall lodge records with the STB in charge at district / branch level within 30 days of conclusion of the contracts or agreements, and provide the relevant documents such as the tax registration certificates of the non-resident enterprises and contractsWhere a contract is revised, the party that contracts out the project or service shall report the changes to the STB in charge within 10 days of the revision
Non-resident enterprises receiving China-sourced passive income		<ul style="list-style-type: none">Where non-resident enterprises receive China-sourced income of an investment nature such as dividends and shared profits, as well as interest, rentals, royalties, capital gains and other income, the CIT payable on such incomes will be withheld at source. The enterprises or individuals who are directly obligated to pay the non-resident enterprises in accordance with relevant laws and regulations or contracts shall be the withholding agentsWithholding agents shall lodge records for the relevant contracts with the STB in charge within 30 days of conclusion of the contracts or agreements and provide the related documents

Consequences of non-compliance

Where one of the following non-compliance circumstances occurs, the STB in charge may order the enterprise to rectify the situation within a specified period of time and may impose a penalty on the enterprise of no more than RMB 2000:

- Domestic enterprises or individuals that contract out projects or services fail to lodge the record for the relevant contracts within the period stipulated in Decree 19
- Withholding agents fail to lodge the record for the relevant contracts within the period stipulated in Circular 3.

KPMG observations

Before the issuance of Announcement 7, there was some uncertainty as to whether Decree 19 would be strictly enforced because of practical difficulties surrounding the performance of tax registration by non-resident project contractors and service providers. With the issuance of Announcement 7, it appears that such difficulties can be overcome by means of temporary tax registration. It would not be surprising if other cities will follow the example of Shenzhen in implementing Decree 19.

The implementation of Decree 19 may have serious practical implications for foreign project contractors and service providers as well as project owners and service recipients in China. Firstly, the compliance burden on both sides could increase significantly. It should be noted that Decree 19 covers a wide range of projects and services, potentially including services provided by the staff of overseas headquarters while they are in China.

Secondly, the non-resident contractors or service providers will be required to perform the tax registration regardless of whether the activities of the staff concerned in China constitute a permanent establishment in China for CIT purposes. In practice, such tax registration would increase the risk of the Chinese tax authorities raising queries about the Business Tax and local tax as well as Individual Income Tax implications of the projects and services

concerned. Therefore, there would be greater need for non-resident enterprises to consider whether to lodge a record with the Chinese tax authorities to avail themselves of tax treaty relief in relation to permanent establishment in accordance with the circular, Guo Shui Fa [2009] No. 124 (Circular 124).

Thirdly, although the penalties for non-compliance with Decree 19 are relatively low, the non-resident enterprises will be required to make up the tax registration every time they are found to have breached the tax registration rules. In addition, when the project owners or service recipients in China apply for foreign currency to remit the contract prices or service fees to the foreign contractors or service providers, they will have to apply for tax clearance. As such, any breach of the tax registration rules would be discovered very quickly.

Therefore, the project owners / service recipients and the contractors / service providers should put in place a system to handle the required tax registration and record lodgement on an effective and sustainable basis.

Before Shenzhen STB issued Announcement 7, some local tax authorities, such as Fujian, Sichuan, Shandong and Beijing, issued certain implementation measures concerning Decree 19 and Circular 3, which were not restricted to registration and record lodging. Given the trend of the strengthening of tax administration on non-resident enterprises, it is reasonable to expect that more local tax authorities may follow suit and step up the enforcement of Decree 19 and Circular 3.

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