

# People's Republic of China changes business tax filing requirements to reach international law firms providing services to clients located in China

## In Brief

The People's Republic of China has enacted a new tax law aimed at reaching international service providers with clients in China. At the end of 2008, the amended Provisional Regulation of the People's Republic of China on Business Tax ("Amended BT Regulation") and its Detailed Implementation Rules ("Amended BT DIR") were released with an effective date of January 1, 2009. These new provisions will have a far reaching impact upon some international law firms by expanding the reach of China's taxing authority beyond firms that actually perform services within China. Law firms whose only nexus with China is the location of the client will now be subject to tax in China. Moreover, this tax is in addition to Circular 82 income tax, discussed below.

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## New definition of "provision of labor services within China"

The Amended BT DIR changes the definition of "provision of labor services within China." The prior version of the law provided that labor services rendered within China were subject to the Business Tax ("BT"). However, the Amended BT DIR now refers to the place where the service recipient or service provider is located as being subject to the BT. Thus, when either the service recipient or the service provider is located within China, the BT will be imposed on the service income, regardless of the physical location where services are actually rendered. Thus, the entire concept of determining taxable labor services within China has changed.

We have been told by PwC China that the Chinese authorities are considering granting some transitional treatments to ease the burden related to the contracts concluded but not completed before 1 January 2009. However, the details have not been published.

## PwC Observations

The anticipated impact from this change in the definition of "provision of labor services within China" is depicted in the tables below. As indicated, starting from January 1, 2009, as long as the service-provider or the service recipient is located in China, the service will be taxable for BT purposes, regardless of being onshore or offshore services. It appears that the only exclusion is the situation where both the service-provider and service-recipient are located outside China.

## Law Firm Services

### Pre- 1 January 2009

Scenario	Service-provider	Service-recipient	Services provided onshore China	Service provided offshore China	BT-payer
A	In-China	Ex-China	BT-able	Non-BT-able	In-China Service-provider
B	Ex-China	In-China	BT-able	Non-BT-able	Ex-China Service-provider
C	In China	In China	BT-able	Non-BT-able	In-China Service-provider
D	Ex-China	Ex-China	BT-able	Non-BT-able	Ex-China Service-provider

### Post- 1 January 2009

Scenario	Service provider	Service recipient	Services provided onshore China	Service provided offshore China	BT-payer
A	In-China	Ex-China	BT-able	BT-able	In-China Service-provider
B	Ex-China	In-China	BT-able	BT-able	Ex-China Service-provider
C	In-China	In-China	BT-able	BT-able	In-China Service-provider
D	Ex-China	Ex-China	Non-BT-able	Non-BT-able	N/A

### Applicability of Circular 82

Circular 82 provided that where an international law firm's overseas office is providing services jointly with its PRC office to a recipient in China, at least 60% or 80% of the total service fee is taxable for BT and Corporate Income Tax ("CIT") purposes. On March 4, 2009, a tax circular Guoshuifa (2009) No. 29 was issued to repeal contents of the old tax rules that are in conflict with the Amended BT DIR, among which Circular 82 was enlisted. This means that the 60% or 80% apportionment of Circular 82 will no longer apply to determine the taxable income for BT purposes starting January 1, 2009. However, the repeal of Circular 82 for BT purposes should not be interpreted as good news given the change in BT taxing principle illustrated above. When a Chinese service recipient seeks to remit the professional fees to an international law firm's overseas office, it is now more likely than before that the tax authority will require the Chinese service recipient to withhold BT based on 100% of the total fees payable. This will result in an increased overall tax burden for international law firms providing services to Chinese clients.

Notwithstanding this change in the BT, it seems that the 60% or 80% rules set out in Circular 82 will continue to apply in the revenue recognition for Chinese Income Tax purposes, when a law firm provides services to a Chinese client. We have clarified with the Beijing State Tax Bureau - Foreign Taxation Branch, the authority in charge of the taxation of income of international law firms operating in Beijing, that they will continue to take this position unless the SAT issues a policy otherwise. The Shanghai Tax Bureau has also confirmed that they will take a comparable position.

### Conclusion

The change in China's BT will increase the amount of Chinese tax paid by multinational law firms with clients in China. Firms that routinely provide services to clients located in China should consider the impact of the BT. Similarly, firms may need assistance in establishing systems, policies and procedures to address these issues. There are several opportunities where we can assist law firms. For example, law firms may consider modifying existing fee and billing arrangements with Chinese clients by exploring the possibilities to recover BT (5% of gross billed amount) from the Chinese clients in future assignments. Firms may also consider arranging for the overseas office to bill and collect the fees from their Chinese clients' international affiliates if possible, as well as separately billing (splitting invoices) the Chinese clients from the international office and the China office respectively in order to minimize the impact of double BT.

PwC's worldwide team of professionals has extensive experience assisting our clients with these issues. If we can assist your firm, please contact Stanley Kolodziejczak at 646-471-3160, Gregg Sincoff at 646-471-1335, or Nancy Regan at 646-471-6104.

### Solicitation

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