



SAT clarifies “place of actual management” of overseas company invested by Chinese enterprise(s) under the PRC Enterprise Income Tax Law

In Brief

Guo Shui Fa [2009] No. 82 (“**Circular 82**”) issued by the State Administration of Taxation (“**SAT**”) clarifies when an overseas company invested by company invested by Chinese enterprise(s) will be considered as having its "place of actual management" in China. If so, the subsidiary would be considered a resident enterprise for PRC enterprise income tax purposes and be subject to tax on its worldwide income pursuant to Article 3 of the *PRC Enterprise Income Tax Law* (the “**EIT Law**”)¹. The circular is effective retroactively from 1 January 2008.

Overseas Company Invested by Chinese Enterprise(s)

Circular 82 defines an overseas company invested by Chinese enterprise(s) as a company incorporated pursuant to the laws and regulations of a foreign jurisdiction and which has a Chinese domestic enterprise or group of Chinese enterprises as its majority shareholder.

Place of Actual Management in China

Circular 82 provides that an overseas company invested by Chinese enterprise(s) (“**Company**”) will be considered a resident enterprise due to its "place of actual management" being in China where all of the following conditions apply:

- 1) The senior management personnel responsible for the day-to-day production and operation of the Company is located primarily inside China and their management duties are performed primarily inside China;
- 2) The Company’s financial decisions (e.g. borrowing, lending, raising capital and financial risk control etc) and decisions on employment (e.g. appointment, dismissal, wage and compensation, etc) are made or approved by the Chinese domestic enterprise or its personnel;
- 3) The Company’s major properties, financial and accounting books, company chops, and minutes of meetings of board of directors and meetings of shareholders are located or stored inside China; and
- 4) At least half of its directors or senior management personnel who have voting rights reside in China.

In determining “place of actual management”, the authorities will look at substance over form.

¹ Under the *Enterprise Income Tax Law of People’s Republic of China* taking effect on 1 January 2008 (the “**EIT Law**”) and the *Detailed Implementation Regulations of the Enterprise Income Tax of People’s Republic of China* (the “**Detailed Implementation Regulations**”), a resident enterprise is defined as either an enterprise incorporated in China pursuant to the China laws and regulations or an enterprise incorporated pursuant to foreign law but with “a place of actual management” in China. A resident enterprise under the EIT Law is subject to EIT in China on its worldwide income derived from inside and/or outside China.



Other Provisions

Circular 82 further provides the following guidance on the legal and tax treatment of a Company considered a resident enterprise because of its place of actual management.

- 1) A Company is eligible to the PRC tax exemption treatment on dividends, interests and other equity investment proceeds received from other Chinese resident enterprises (Article 26 of the EIT Law and Article 83 of the Detailed Implementation Regulations), subject to meeting the conditions under the relevant provisions.
- 2) Investor(s) of a Company are taxed on dividends, interests and other equity investment proceeds received from the Company on the basis that they are considered as China-sourced for the purposes of the EIT Law.(including any available exemption therein).
- 3) An enterprise established by a Company in China will maintain its status as a foreign investment enterprise for PRC tax purpose.
- 4) For the PRC investors, a Company is not considered a Controlled Foreign Corporation ("CFC") pursuant to Article 45 of the EIT Law. However, foreign entities controlled by the Company can be subject to the relevant laws and regulations.
- 5) A Company may apply for registration as a resident enterprise at the tax bureau in charge of the region of either its place of actual management or the location of the Chinese domestic enterprise investor, subject to the verification by the tax bureau and the final approval by the SAT. In the event no such application is made, the tax bureau may make its own preliminary determination on the tax resident status, subject to confirmation by the SAT.
- 6) Where a Company is also considered a resident of another jurisdiction, the rules of any applicable tax treaty (or arrangement) would apply to resolve any double taxation issues.

Circular 82 provides clearer guidelines on defining "place of actual management" though it has limited application to overseas company invested by Chinese enterprise(s). We anticipate further guidance may be issued to cover other situations, such as a foreign company with regional management located in China. We will keep close watch on any development of this matter and keep you posted.

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Please note that under current Chinese regulations, foreign lawyers such as ourselves are not admitted to practice law in the People's Republic of China and thus are not permitted render formal opinions on matters of PRC law.

By DLA Piper HongKong
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