



## PERMANENT ESTABLISHMENT IN CHINA: BRANCH OR SUBSIDIARY?

### DEFINITION OF A PERMANENT ESTABLISHMENT

The term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "permanent establishment" includes especially a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

If the home country of a foreign company has a double tax agreement (DTA) with China, it may be able to get a corporate income tax exemption if the establishment does not constitute a permanent establishment (PE) under the relevant DTA. DTA aims to prevent income from being taxed by two or more countries through tax credits.

According to the various DTAs, foreign companies can be deemed to have a PE in China in the following situations:

- 1) Fixed place PE:** has an establishment or place of business in China;
- 2) Construction PE:** has a building site, a construction, assembly, or installation project or related supervisory activities that last for a certain period of time;
- 3) Agent PE:** appoints an agent in China to conclude contracts or accept orders in China; or
- 4) Service PE:** has employees working in China for a certain period of time.

China has signed DTA(s) with over 100 different countries, including Hong Kong and Macau. DTA(s) signed in the past adopted a 6 month rule to determine PE status, but in the recently signed DTAs, the 6 month rule has changed to a 183 days rule. The DTA signed between China and France adopts the 6 month rule, and according to that rule, the term "permanent establishment" likewise encompasses:

- a building site, or construction, assembly, or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 12 months;
- the furnishing of services, including consultancy services, by an enterprise through employees or other personnel who are present in a contracting state for such purpose, but only if activities of that nature continue (for the same or a connected project) within that contracting state for a period or periods aggregating more than 183 days within any 12 month period.

The start and end dates of the aforesaid activities may be determined in accordance with the date on which the contract starts to implement after execution of the contract to the date on which all works have been completed and delivered.

Furthermore, if the foreign enterprise undertakes two or more consecutive projects in the same construction, the projects will count together towards the six month period.

Presence of employees in China: Where a person is acting in China on behalf of the non-resident enterprise and that enterprise shall be deemed to have a permanent establishment in China in respect of any activities which that person undertakes for the enterprise if the employee stays in China for more than six months within a 12 month period. The labor services shall refer to professional services and activities such as engineering, technology, management, design, training, consultancy, etc.

The duration of stay shall be calculated based on the period of stay of all the employees providing labor services in China in different time periods. However, the duration of stay for the same batch of employees working in the same period shall not be calculated separately.

Among other things, dispatch of personnel to provide services in China may trigger permanent establishment issues if



the dispatching enterprise assumes partial or full responsibility and risks for the work of the dispatched personnel, and examines and assesses their work performance regularly the enterprises should be regarded as having established an agency and premises to provide labor services; if the dispatching enterprises are enterprises of tax treaty contracting parties and the institution or premises are relatively fixed and permanent, the institution or premise shall be regarded as a permanent institution in China.

## DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

- 1) Legal type:** Branch is not a separate legal entity but an extension of the subsidiary. Subsidiary is a separate legal entity distinct from its parent company.
- 2) Liabilities:** Branch office liabilities are extended to the subsidiary; the subsidiary's liabilities are limited to itself.
- 3) Entity name:** Branch office must have the same as the subsidiary with city and branch location. Subsidiary can have the same name or different one from the parent company.
- 4) Annual filing:** Branch office must file the branch office as well as the subsidiary's accounts; a subsidiary must file its own accounts. The books must be closed by year end and annual tax must be filed by April.
- 5) Set up another branch:** Branch office cannot open another branch office in Mainland China; subsidiary can open its branch office in Mainland China.

## TAX AND ACCOUNTING OBLIGATIONS

Subsidiaries and branches must perform corporate tax filing every quarter and file annual returns by the end of the accounting year - i.e., December 31st.

## REGISTRATION FORMALITIES

Registration formalities for both the subsidiary and the branch are the same:

- 1) Apply for company name approval (exception: branch will keep the same company name as its parent company)
- 2) Obtain certificate of approval
- 3) Obtain business license registration
- 4) Apply for organization code certificate
- 5) Obtain tax registration
- 6) Register with several bureaus
  - Customs Bureau
  - Statistics Bureau
  - Finance Bureau
  - Safe
  - Open a Bank Account

## STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

Chinese subsidiary companies need to submit their own books of accounts, profit or loss statement, and balance sheet when filing annual returns in Mainland China. However, branch offices may be required to submit the audited accounts of the the parent company as well, since it is simply an extension of the foreign head office.

The company will need to fill in an extensive list of administrative files containing general and financial information to be remitted to 7 different administration departments for the purpose of annual evaluation. The files shall be done both online and on specific paper forms as provided by the corresponding local authorities.