

China alert

Tax and regulatory developments

TAX

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Administrative measures for withholding CIT specified

In brief

- The State Administration of Taxation has prescribed specific procedures for withholding Corporate Income Tax. Non-resident enterprises subject to withholding in China and Chinese withholding agents are strongly advised to observe and comply with these procedures to avoid potential penalties.

Regulations discussed in this issue:

Provisional Measures for the Administration of Withholding of CIT for Non-resident Enterprises, Guoshuifa [2009] No. 3, promulgated by the State Administration of Taxation on 9 January 2009 (Provisional Measures)

Guoshuifa [2009] No. 3 was promulgated on 9 January 2009, and took retroactive effect on 1 January 2009.

Background

The Corporate Income Tax (CIT) Law, which took effect on 1 January 2008, and its detailed Implementation Rules, provide that non-resident enterprises with no establishment or place of business (EPB) in China, and those with income not effectively connected with their EPBs in China, are subject to CIT on their China-sourced income (the income referred to in Article 3, Paragraph 3 of the CIT Law, or the Article 3(3) income) at a 10 percent tax rate.

Article 3(3) income cannot effectively be traced to any physical presence that a non-resident enterprise may have in China. This presents a challenge to the SAT and its conventional collection and enforcement mechanisms. The SAT has therefore set forth procedures for the collection of CIT on Article 3(3) Income, and laid out the consequences of noncompliance.

Withholding agents

Enterprises or individuals who are bound under law or contract to remit Article 3(3) income to non-resident enterprises are obligated to withhold proper amounts of CIT. This withholding obligation arises when Article 3(3) Income is remitted or when the payer accrues the equivalent as a cost or an expense under the accrual method of accounting, whichever comes first.

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Withholding procedures

The procedures prescribed under the Provisional Measures primarily apply to a non-resident enterprise's China-sourced dividend, interest, rental and royalty income, and gains from the alienation of properties. For dividend, interest, rental and royalty income, the taxable amount is the gross remittance before the deduction of corresponding taxes, including business tax. Where the withholding tax is to be borne by the payer, the taxable amount must be grossed up.

A copy of each contract giving rise to Article 3(3) income, along with a registration form and other relevant documents, must be submitted to the in-charge tax bureau within 30 days of signing of the contract. This procedure also applies to each subsequent revision, supplementation or extension of the contract.

In addition, each incidence of withholding should be accompanied by the PRC Return for CIT Withholding and other relevant documents, and the amount withheld should be remitted to the central treasury within seven days of it being withheld.

The 10 percent withholding rate may be reduced or exempted under either domestic tax laws and regulations or bilateral income tax treaties. However, a non-resident enterprise must first seek review and approval from the relevant tax bureau for reductions or exemptions under domestic laws and regulations, or must apply for reductions or exemptions under income tax treaties.

Consequences of noncompliance

Noncompliance with the prescribed procedures by a Chinese withholding agent must be rectified within three days and carries a fine. The liability for the underlying CIT, however, remains with the non-resident enterprise deriving Article 3(3) income, even if it is the Chinese withholding agent who is guilty of noncompliance.

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