



## Secondment of Expatriates vs Permanent Establishment in China



October 2009

*Prepared by Michael To and Newton Shum  
of Mazars Tax Services Limited*

It is very common among multinational corporations to send their staff working for their overseas affiliates under secondment arrangement. The arrangement is preferable to secondees rather than having direct employment with the overseas affiliates. Under the secondment arrangement, to certain extent, the secondees can maintain a relationship with their employers at home. They can continue making social security contributions in their home countries and return home to work for their home country employers once the secondment assignments are accomplished.

Under a typical secondment arrangement, a secondee would continue to be employed by his/her employer in the home country and seconded to work for the overseas affiliate. His/Her payroll will be maintained with the home country company and recharged to the affiliate that receives his/her services.

In the past, the State Administration of Taxation ("SAT") in China has not addressed the issue whether or not a secondment arrangement would trigger Permanent Establishment ("PE") in China. Therefore, when remitting the remuneration costs of secondees by the China affiliates, the outbound remittances would normally be exempt from withholding taxes in China.

### **Recent Development**

There are some recent developments about the secondment arrangement starting from the second half of 2009. The SAT issued two notices, *JiBianHan (2009) No.103* and *GuoShuiFa (2009) No.114*, in July 2009 requesting local tax authorities to examine secondment arrangement adopted by non-resident companies when sending their expatriates to work in China. Focuses would be put on expatriates taking up the roles of management, design, authentication and consulting services in the China affiliates.

If a secondment arrangement is considered as an arrangement for the provision of services in China through secondees, the non-resident company could be deemed as having a PE in China. As a consequence, the recharge of the secondees' remuneration to the non-resident company by its China affiliate would be considered as a service fee and will be subject to Enterprise Income Tax ("EIT") and Business Tax ("BT").

According to *JiBianHan (2009) No.103*, it appears that the SAT has not really denied genuine secondment arrangement, at least it has not been stated as such in the tax notice but rather it would like to identify those “disguised secondment arrangements” that the non-resident companies are in fact providing services in China through secondees; and the so-called “remuneration recharge” are service fees in nature. However, neither *JiBianHan (2009) No.103* nor *GuoShuiFa (2009) No.114* contains any guidelines on how to differentiate a genuine secondment arrangement from provision of services in China.

## Our Observation

Both the substance and form of a genuine secondment arrangement need to be in line before a non-resident company can defend itself against challenges from the tax authorities. It is important to identify the characteristics and differences between a secondment and a services arrangement and below are some key features for reference:

	<b>Secondment Arrangement</b>	<b>Services Arrangement</b>
Substance	<ul style="list-style-type: none"> <li>• China affiliate has control over the secondees’ daily work</li> <li>• China affiliate enjoys the benefits arising from the secondees’ work</li> </ul>	<ul style="list-style-type: none"> <li>• Home country company has control over the secondees’ daily work</li> <li>• Services provided by secondees are for the benefits of the home country company</li> </ul>
Form	<ul style="list-style-type: none"> <li>• Employment contract between the secondee and the home country company; and</li> <li>• Secondment contract/assignment letter between the secondee, the home country company and the China affiliate</li> </ul>	<ul style="list-style-type: none"> <li>• Only employment contract between the secondee and the home country company exists, insufficient documentation is available to substantiate the existence of a secondment arrangement</li> </ul>

Besides, multinational corporations should pay attention to the followings:

- the secondment arrangement is supported by valid business reasons.
- sufficient documentations can be provided to substantiate the genuineness of the secondment arrangement (e.g. secondment contract, assignment letter and etc.).
- whether the home country company recharges only the cost of the secondees or at a mark-up.

There is no quick way in determining whether or not a secondment arrangement is genuine, so each arrangement is needed to be considered on a case-by-case basis. Multinational corporations should review their secondment arrangement, like reviewing the secondment contract/assignment letter to make sure the contents are in line with the true nature of the intended secondment arrangement, and the arrangement will be supported with sufficient documents.

In addition to the above, even if the China affiliate / non-resident company can defend themselves against the challenges on the genuine secondment arrangement by the tax authorities, the China affiliate may still encounter difficulties when remitting the remuneration to the non-resident company due to foreign exchange control in China. This is because the China affiliate may not be recognized as a “multinational company” as stipulated in *HuiFa (2004) No.62* which is one of the essential conditions allowing the remittance of expatriates’ remunerations.

Therefore, it is advisable for non-resident companies to carry out careful studies before seconding expatriates to China.

You are advised to contact our colleagues in Hong Kong and /or China offices for further advice should the above have impact on your business.

## Contacts

### *Hong Kong*

42/F., Central Plaza,  
18 Harbour Road  
Wanchai  
Hong Kong

#### **Michael To**

Executive Director  
Tel: (852) 2909 5680  
Email: michael.to@mazars.com.hk

### *Shanghai*

One Lujiazui, Floor 8,  
68 Middle Yin Cheng Road,  
Shanghai, PRC 200120

*This Newsletter is issued in summary form exclusively for the information of clients of Mazars and others interested in our services and should not be used or relied upon as a substitute for detailed advice or as a basis for formulating business decisions.*