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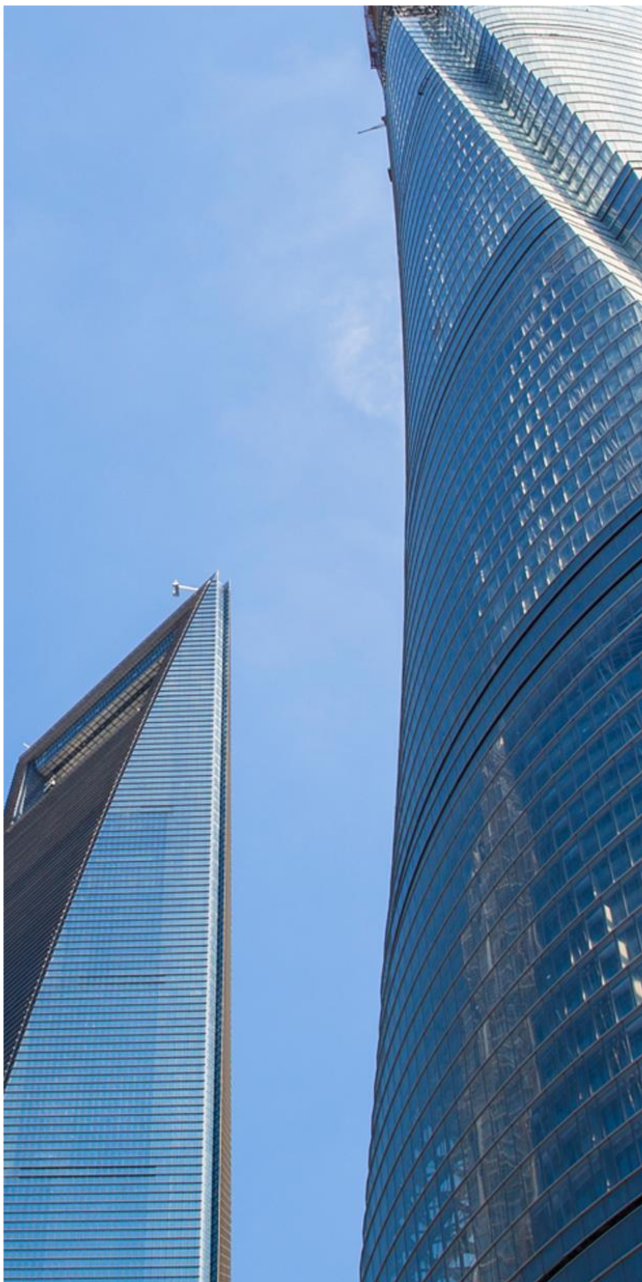
New interpretation of service permanent establishments under double taxation treaties in China

Tax Legal flash

April 9, 2018



On February 9, 2018, the State Administration of Taxation ("SAT") released an announcement on new domestic interpretations of several issues relating to the implementation of double taxation treaties ("DTT") (Announcement [2018] No. 11, "Circular 11"). This circular includes new official guidelines on when foreign service provider creates a service permanent establishment ("PE") in China.

Definition of a service PE

Many old DTT signed between China and other contracting states (including Spain and Portugal) define a service PE as:

"Providing services in China for the same project or connected projects, through employees or other engaged personnel, for a period or combined periods exceeding six months within any 12-month period."

Therefore, how to interpret "six months" is crucial when determining whether a foreign service provider creates a PE in China.

When a foreign service provider creates a PE in China, the business profit attributable to the PE is subject to enterprise income tax in China. In addition, the salary of the personnel attributable to their work for the PE is subject to individual income tax in China.

Old interpretation of "six months" rule

Until the China-HK DTT was signed and enforced in late 2006 (with the same definition of service PE), there were no official guidelines on how to interpret the "six months" rule. Its official interpretation was released in early 2007 (Guoshuihan [2007] no. 403).

Under this old interpretation, the tax authorities could only count "months," and not "specific days" in the implementation. The time starts the month the personnel first arrive and ends the month of their departure, regardless of how many days the personnel stay in China in between. However, if 30 consecutive days pass without any personnel present in China, one month can be deducted from the total.

Under this rule, it is easy for the foreign service provider to create a PE in China. For example, if a foreign service provider were to send personnel to China for seven months (even with only a few days present in each month China), it would create a PE.

Following China-HK DTT's amendment in 2008 to replace the "six months" rule with the "183 days" rule, under which a PE is created when the service provider's presence in China exceeds 183 days in any 12-month period, the old interpretation was abolished in 2011 to avoid the contradiction with the China-HK DTT.

Since that time, there has been no official guidance on how to interpret the "six months" rule.

Practical implementation in absence of official guidance

Even after the old interpretation was abolished, the tax authorities continued to refer to it for guidance.

However, in recent years, China started to renegotiate and amend DTT with several European countries and began to apply the “183 days” rule, which is fairer to the service provider if they provide services in the other contracting state. Therefore, in practice, many tax authorities started to apply this rule to all tax treaties China has signed.

New interpretation under Circular 11

From April 1, 2018, the tax authorities will interpret “six months” in all DTT as “183 days.”

SAT has finally responded to this practical concern and provided the legal grounds for local tax authorities to apply the “183 days” rule to all DTT.

As a more favorable rule, this is good news for foreign service providers. When a project involves sending personnel to work in China, foreign service providers, to avoid creating a PE in China, must keep a record of personnel’s entry and exit, and be mindful of the total number of days personnel are present in China in any 12-month period (not a calendar year).

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