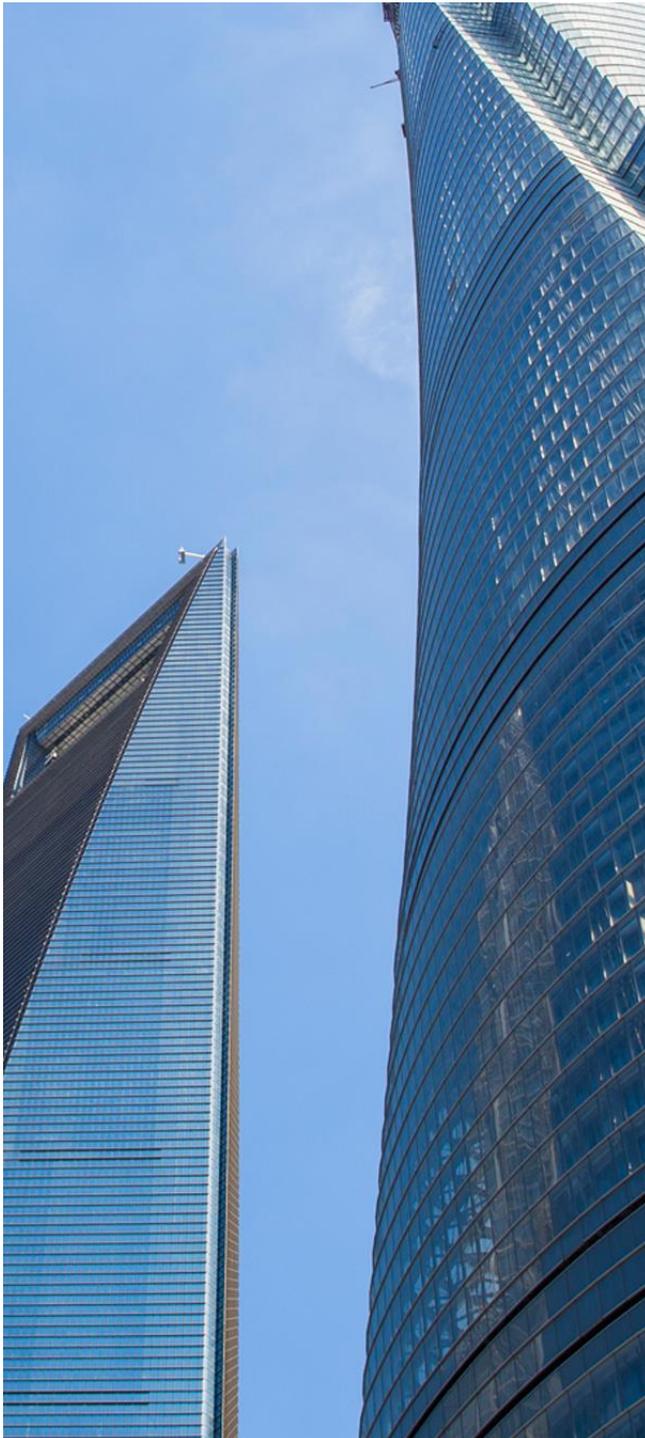


China offices

Legal flash

October 2020



Introduction

The COVID-19 pandemic has forced governments to take extraordinary measures such as restrictions on travel, which has affected the normal operation of companies. These exceptional circumstances have caused controversial tax issues for crossborder movement of workers.

To provide guidance on the interpretation of tax treaty provisions on permanent establishments (“PE”) and residence status under the impact of the COVID-19 pandemic, on April 3, 2020, the OECD Secretariat released the Analysis of Tax Treaties and the Impact of the COVID-19 Crisis (the “OECD Analysis”).

On August 14, 2020, the International Tax Department of the State Taxation Administration (“STA”) released a Q&A on the implementation of tax treaties under the COVID-19 pandemic on its official website, providing the Chinese interpretation of PE and residence status under the tax treaty provisions and Guoshuifa [2010] No. 75 (“Circular 75”; i.e., the Interpretation on China-Singapore Double Taxation Treaty and its Protocols, which is applicable to all tax treaties signed by China). Although the Q&A is not a regulation, in practice, its interpretation is expected to be uniformly applied by the local tax authorities.



Q&A on the implementation of tax treaties under the COVID-19 pandemic

Questions about the creation of a PE

- > **Home office: A temporary home office in China due to the COVID-19 pandemic will not create a PE as a fixed place of business.**

Under Circular 75, the PE definition of “a fixed place of business through which the business of an enterprise is wholly or partly carried on” refers to a relatively fixed place of business, which usually has the following characteristics: (i) it actually exists; (ii) it is relatively fixed with a certain degree of permanence; and (iii) the enterprise carries out its business through this fixed place of business.

The temporary change to home office due to the COVID-19 pandemic is considered an intermittent or incidental activity, which does not create a PE as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. This interpretation is consistent with the OECD Analysis.

- > **Agency PE: Employees temporarily working from home due to the COVID-19 pandemic in China and concluding contracts for and on behalf of their overseas employers will not create an agency PE, with two exceptions.**

Under Circular 75, if an enterprise of a contracting state carries out its activities in another contracting state through an agent that has and habitually exercises the authority to conclude contracts in the name of the enterprise, the enterprise will create an agency PE in the other contracting state. The term “habitually” will be determined based on the type of contract, nature of the business and frequency of the agent’s activities.

Therefore, in the context of the COVID-19 pandemic, the activities of employees temporarily working from home and concluding contracts for and on behalf of their overseas employers are exceptional, so they will not be considered an agency PE. This interpretation is consistent with the OECD Analysis.



However, the STA establishes two exceptions:

- a) an individual has been carrying out activities in China on behalf of an overseas enterprise for a long time before the outbreak of the COVID-19 pandemic; and
- b) an individual starts to carry out activities in China on behalf of an overseas enterprise on a long-term basis after the outbreak of the COVID-19 pandemic and has and habitually exercises the authority to conclude contracts on behalf of the overseas enterprise.

➤ **Construction PE: The duration of a full suspension of activities due to the COVID-19 pandemic will not be included when determining whether a construction site constitutes a PE.**

Under the tax treaty provision on PEs, a construction site will be considered a PE if the construction takes more than certain periods (6 or 12 months according to the relevant tax treaties) to complete. Under Circular 75, when calculating the duration of a construction site, the period of temporary interruption (e.g., due to a shortage of equipment or materials or season and weather) before the project is completed and labor and equipment or materials are fully withdrawn must be counted when calculating the duration.

However, due to the COVID-19 pandemic, some construction sites have fully withdrawn their labor and management personnel, causing a full suspension of activities. The STA considers this situation is not a temporary interruption as defined by Circular 75, so that suspension can be excluded when calculating the duration of a construction site for PE purposes. This interpretation is more relaxed than the OECD Analysis, which includes the interruption of activities caused by the COVID-19 pandemic when calculating the duration of a construction site.

Questions about the definition of residence status

➤ **The residence status of a company: The temporary change of the place where a company's senior management makes their decisions due to the COVID-19 pandemic will not affect the residence status of a company under the tax treaties.**

In most tax treaties, when a company becomes a tax resident of both contracting states under their respective domestic laws, it should be determined as the tax resident of only one contracting state based on the place of its effective management.



When determining the place of a company's effective management, comprehensive factors, such as the place where the senior management makes their decisions, must be considered. However, the place of decisions should be the location where a decision is usually made, instead of where a decision is made in an extraordinary situation (e.g., the COVID-19 pandemic).

Therefore, generally, this temporary change of the place where senior management makes their decisions due to the COVID-19 preventive measures will not change the place of a company's effective management, so it will not affect its residence status, which is determined based on the place of effective management under the tax treaties. This interpretation is consistent with the OECD Analysis.

- **Tax residence status of an individual: The temporary change of an individual's place of residence due to the COVID-19 pandemic will not change the residence status of the individual under the tax treaties.**

When individuals become tax residents of both contracting states under their respective domestic laws, they should be determined as the tax residents of only one contracting state by applying the tie-breaker rules, usually in a sequence of permanent home, center of vital interests, place of habitual abode and nationality.

Under Circular 75, permanent home refers to any form of permanent dwelling, rather than a temporary stay for certain reasons. Center of vital interests should be determined by considering comprehensive factors such as the individual's family and social relations, profession, political, cultural and other activities, place of business, and place from where the person manages the property.

Generally, the temporary change of an individual's residence due to the COVID-19 preventive measures will not cause a change of the individual's permanent home or center of vital interests. Therefore, it will not change the person's residence status under the tax treaties. This interpretation is consistent with the OECD Analysis.

If a Chinese resident company or individual encounters any of the above situations, and the tax authorities of the other contracting state have a different interpretation or implementation of the treaty that causes double taxation or a tax-related dispute, the company or individual can apply to initiate the mutual agreement procedure under the tax treaties with the Chinese tax authorities, and the STA will negotiate to resolve the issue with the counterparty of the other contracting state.



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