



Tax Newsflash

STA issues guidance on COVID-19 effects on PEs and residency



On 14 August 2020, China's State Taxation Administration (STA) issued guidance (in the form of questions and answers) regarding the effects that employees working from home temporarily during the COVID-19 pandemic have on China's double taxation agreements (DTAs). In particular, the guidance addresses whether a permanent establishment (PE) arises due to such temporary working arrangement, and uses as a reference Circular 75 (Guoshuifa [2010] No. 75), which provides interpretations of the China-Singapore DTA and also applies to similar provisions in other DTAs.

The guidance discusses a fixed place PE, an agency PE, and a construction PE, and also the residency status of companies and individuals, all of which are impacted by the COVID-19 pandemic as discussed below.

1. Fixed place PE

Question: whether an employee working temporarily from home in China due to the COVID-19 pandemic has a home office in China that constitutes a fixed place of business through which the business of an enterprise is wholly or partly carried on (as defined under the PE provisions in the DTA).

STA response: if the situation of working from home during the COVID-19 pandemic is intermittent or accidental, then the situation does not rise to the level of a fixed place of business under the PE provisions of the DTA.

2. Agency PE

Question: if an employee working temporarily from home in China due to the COVID-19 pandemic concludes contracts in China on behalf of the nonresident employer, whether such activity constitutes the habitual exercise of authority to conclude contracts in the name of the employer and, thus, constitutes an agency PE under the DTA.

STA response: such activity is generally incidental in nature rather than habitual and, therefore, does not constitute an agency PE. However, this conclusion will not apply if the employee had been performing such activities in China for a substantial period of time before the COVID-19 pandemic or on a long term basis in China since the start of the pandemic.

3. Construction PE

Question: for construction projects that have been temporarily discontinued due to the COVID-19 pandemic, whether the number of days of such temporary interruption should be excluded when determining whether the duration of a project has reached the specific time period required to constitute a construction PE under the DTA.

STA response: in such situations where all the construction and management personnel were removed from the site, resulting in a complete shutdown of the construction project, the number of days of

the shutdown will be excluded from determining whether the project meets the time period threshold to constitute a construction PE.

4. Residency status of companies

Question: the COVID-19 prevention and control measures have forced some corporate senior executives to change their place of decision making. Will this affect the company's place of effective management and, thus, change its residency status?

STA response: in determining the place of effective management of a company, various factors should be considered comprehensively (including the place where senior management makes its decisions). However, the location where such decisions are normally made should be taken into consideration, rather than the location during a special period of time (e.g., during the COVID-19 pandemic). Therefore, the temporary change of location where the senior executives make decisions during the COVID-19 pandemic generally will not change the place of effective management of the company and, hence, not impact the residency status of the company under a DTA.

5. Residency status of individuals

Question: the COVID-19 prevention and control measures have changed the location where some individuals live, which may cause the individual to be considered tax resident in both contracting states of a DTA according to their respective domestic tax rules. How to deal with this situation?

STA response: under Circular 75, in the case of a dual resident individual, the tie-breaker rule under a DTA should be applied, which considers (in order of importance) the permanent home, center of vital interests, habitual abode, and nationality in determining the contracting state to which the individual will be considered tax resident for purposes of the DTA.

A permanent home (as set forth in Circular 75) needs to be permanent in nature rather than serve as a temporary stay for certain reasons. The determination of the center of vital interests should take into account an individual's family and social relationships, occupations, political and cultural activities, any business locations, and the location of any assets managed by the individual. Accordingly, the temporary change of an individual's living circumstances during the COVID-19 pandemic generally

will not result in a change in the location of the individual's permanent home or center of vital interests and, consequently, should not affect their tax residency status under a DTA.

6. Dispute resolution

Question: in the event Chinese resident companies or individuals encounter tax authorities of the other contracting state interpreting the relevant DTA provisions differently from the above-mentioned approaches, which would result in double taxation or other tax disputes under the DTA, how to resolve the issue?

STA response: such companies and individuals may apply for the mutual agreement procedure (MAP) to Chinese tax authorities pursuant to *Implementing Measures for Tax Treaty Mutual Agreement Procedures* (STA Bulletin [2013] No. 56), so as to enable the STA to communicate and resolve the dispute with the competent tax authorities of the other contracting state.

Our Comments

As the pandemic gradually subsides, the arrangements of working from home may or may not continue; however, the STA's guidance generally is based on the assumption that such arrangements are temporary in nature. If working from home becomes the new normal, the guidance may no longer apply.

In addition, the new guidance is the STA's interpretation of relevant provisions under a DTA and Circular 75, rather than creating an exception or exemption under the law. As such, relevant provisions under a relevant tax treaty, Circular 75, and domestic tax laws should be referred to when determining PE and residency issues under a DTA.

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