

## Overseas Employment in China: New Rules on Secondment

*By Robin Tabbers*

Over the past few years, Chinese tax authorities have been focusing increasingly on secondment (also referred to as dispatchment) arrangements of foreign companies in China. Under a secondment arrangement a foreign company assigns a foreign manager to its Chinese subsidiary, while the employee remains an employee of the foreign company. This structure is often used when there are some specific benefits to keeping the manager on the own payroll, or for example when the manager is only staying in China for a short period of time. Secondment arrangements usually involve a secondment fee, transferred from the subsidiary to the multinational company.

The big question is whether a secondment arrangement must be regarded as a services arrangement, under which a multinational company which is not a Chinese tax resident seconds a manager to work at a Chinese subsidiary. If this is the case – and according to Chinese tax authorities this usually is the case – the multinational company is considered to be subject to Chinese corporate income tax as it has created a taxable presence in China.

### Public Notice 19

This issue has recently led to various legal disputes. Some judges have ruled that multinational companies should pay tax in China for these secondment arrangements, others are still ongoing. In order to reduce the uncertainty, the China State Administration of Taxation (SAT) recently issued Public Notice [2013] no. 19. Public Notice 19 (effective as of 1 June 2013), which tries to provide a clear legal framework on how secondment arrangements should be treated. It is important for multinational companies to review their existing

secondment arrangements in the light of this new public notice and adapt their arrangements accordingly.

### i) Conditions and additional factors

Public Notice 19 states that if i) the multinational company bears all or part of the risks and responsibilities related to the work of the foreign manager and; ii) also regularly assesses the work performance of the foreign manager, it is considered to have a taxable presence in China. In that case, the multinational company is subject to Chinese corporate income tax.

Besides these two conditions, Public Notice 19 also stipulates five additional factors that should be considered before reaching a conclusive decision, namely i) the Chinese subsidiary pays some sort of management fee or service fee to the multinational company; ii) the payment of the Chinese subsidiary exceeds the manager's wage, additional salaries, social security payments and other related payments (paid in advance by the multinational company); iii) the multinational does not transfer the whole payment from the Chinese subsidiary to the manager but retains a share of the payment; iv) Individual income tax in China is not fully paid on the total income of the manager borne by the multinational company; v) the multinational company decides on work-related matters such as payment, qualifications and working locations.

As one can easily recognize, the first three factors are mainly used to determine whether the multinational company would gain from such an arrangement. Furthermore, according to Public Notice 19 sending foreign managers to the Chinese subsidiaries merely to exercise shareholder

rights such as attending the AGM is not considered as a taxable presence in China.

## ii) Documentation and information

Public Notice 19 also determines the documents and information that the Chinese tax authorities may review when assessing a particular secondment arrangement. According to Public Notice 19 it is essential that government departments search for hidden transactions that may be hidden by secondment arrangements. For multinationals documentation is key, as they (together with the Chinese subsidiary and the foreign manager) will need to prove the nature of their secondment arrangement.

As Public Notice 19 was only issued last June, it will have to be seen how this notice works out in practice and whether it indeed provides the highly needed clarifications.

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