KAIZEN CPA LIMITED
啓源會計師事務所有限公司
Rooms 2101-05, 21/F., Futura Plaza
111 How Ming Street, Kwun Tong, Hong Kong
香港觀塘巧明街111號富利廣場21樓2101-05室
T: +852 2341 1444
E: info@kaizencpa.com

Contracting Parties and Payees in Cross-Border Services

When an enterprise in China purchases consulting, design or marketing services from overseas, the service provider named in the contract may differ from the company receiving payment. For example, one overseas company may enter into the contract, personnel from an affiliated company may carry out the project, and another group company may collect the payment. The business team may deal with the same contacts throughout, while the finance team needs to identify each company involved when reviewing the payment documentation.

Although a group may allocate responsibility for accepting engagements, carrying out projects and collecting payments among its members, a reference to "centralised group settlement" in a payment notice will not ordinarily resolve the purchaser's concerns. The enterprise in China still needs to establish which company is responsible for the services and whether payment to the designated account will discharge its payment obligation to the service provider.

1. The Contracting Company and the Party Performing the Services

Companies within the same group may share a brand, website and sales team. The contract should nevertheless identify the service provider by its registered legal name. The signatory's authority also requires verification, as the person coordinating the project may not be authorised to enter into a contract on the company's behalf.

Where a contract is governed by Chinese law, Article 465 of the Civil Code of the People's Republic of China provides that a lawfully concluded contract generally binds only the parties to it. Having an affiliate perform part of the services does not, in itself, transfer the contracting company's obligations to that affiliate. Article 523 further provides that, where the parties have agreed that an obligation will be performed by a third party, the original obligor remains liable to the obligee for breach if the third party fails to perform as agreed.

For example, Company A, an enterprise in China, engages Company B, an overseas company, to provide design services. Company B arranges for designers from Company C to work on the project. Direct discussions between Companies A and C about drawings or revisions may form part of normal project coordination. Unless the contractual responsibilities have been changed, Company B remains Company A's contractual counterparty. The delivery standards and liability for breach agreed between Companies A and B do not change merely because Company A begins communicating with Company C. Whether Company B may subcontract the work, and which tasks it may subcontract to Company C, depends on the contract, the nature of the services and the applicable law..

2. Project Documentation and the Place of Performance

SHENZHEN 深圳
Rooms 1203-06, 12/F.
Di Wang Commercial Centre
5002 Shennan Road East
Luohu District, Shenzhen, China
中國深圳市羅湖區深南東路5002號
地王商業中心12樓1203-06室
T: +86 755 8268 4480

SHANGHAI 上海
Room 1201, 12/F., Tower A
Guangqi Culture Plaza
2899A Xietu Road, Xuhui District
Shanghai, China
中國上海市徐匯區斜土路2899甲號
光啓文化廣場A座12樓1201室
T: +86 21 6439 4114

BEIJING 北京
Room 303, 3/F.
Interchina Commercial Building
33 Dengshikou Street
Dongcheng District, Beijing, China
中國北京市東城區燈市口大街33號
國中商業大廈3樓303室
T: +86 10 6210 1890

TAIPEI 台北
Rooms 7F-702, 7/F., 188 Section 5
Nanjing East Road
Songshan District, Taipei
Taiwan 105411
台灣台北市松山區南京東路五段
188號7樓7F-702室
郵編: 105411
T: +886 2 2711 1324

TOKYO 東京
Rooms 502-03, 5/F.,
Lions Mansion Matsugaya
1-4-6 Matsugaya, Taito, Tokyo
Japan 111-0036
日本東京都台東區松谷1-4-6
獅子大廈5樓502-03室
郵編: 111-0036
T: +81 3 5776 2637

SINGAPORE 新加坡
138 Cecil Street, #13-02 Cecil Court
Singapore 069538
T: +65 6438 0116

KUALA LUMPUR 吉隆坡
Menara Suezcap, Tower 2
E-13A-3A, No. 2 Jalan Kerinchi
Gerbang Kerinchi Lestari
59200 Kuala Lumpur, Malaysia
T: +60 19 2177 344

NEW YORK 紐約
202 Canal Street, Suite 303, 3/F.
New York, NY 10013, USA
T: +1 646 850 5888

LONDON 倫敦
Room 5, 2/F., 39-41 High Street
New Malden, Surrey
KT3 4BY, UK
T: +44 20 3910 8392

A service contract records the work the parties have agreed to undertake; project documentation shows whether that work has actually been performed. In a design engagement, interim drawings, revision records and acceptance records can demonstrate the deliverables and their completion status. Consulting projects may be supported by research materials, meeting records and reports. A contract and a bank payment confirmation alone may not adequately explain the specific work underlying a service fee.

If Companies B and C jointly carry out a project, the documentation should also show the work undertaken by each. Company A's payment of the design fee to Company B and Company B's payment of subcontracting fees to Company C relate to separate service arrangements. The intercompany agreements and settlement records between Companies B and C should correspond to their actual division of work.

The place of performance also affects the determination of the source of income. Article 7 of the Regulations for the Implementation of the Enterprise Income Tax Law of the People's Republic of China provides that the source of service income is determined by the place where the services are performed. Neither signing the contract outside China nor receiving payment in an overseas account is, on its own, sufficient to determine whether the income is sourced in China. Where an overseas company sends personnel to work in China, or a team in China contributes to the delivery of the services, further analysis is required of the activities actually undertaken, any establishment or place of business in China, and the applicable tax treaty.

This discussion concerns the enterprise income tax treatment of ordinary services. Value-added tax is governed by separate rules, so the same conclusions cannot simply be applied to VAT. Where the fees also cover intellectual property licensing or other elements, the nature of each component must first be determined.

3. Payment Collection by a Third Party

When a service provider requests payment to another company, the first point to establish is whether that company is collecting payment on the service provider's behalf or has acquired the right to payment under the contract. The basis for payment differs between these arrangements. If responsibility for providing the services is also transferred, the arrangement involves a change in contractual rights and obligations.

An arrangement solely for collection on behalf of the service provider may be documented in the original contract, a supplemental agreement or a written authorisation signed by the service provider's authorised representative. In addition to the receiving company's name and bank account details, the documentation should specify the relevant contract, amount and currency, and state whether payment to the designated account discharges the customer's payment obligation to the original service provider. The form and legal effect of the documentation depend on the law governing the contract.

Returning to the design services example, if Company B appoints Company C to collect the design fee on its behalf, Company A's payment records need to correspond with Company B's authorisation. The subcontracting fee earned by Company C for its design work arises from a separate arrangement between Companies B and C. Even if the same account is used, the collection of Company A's contractual payment and Company C's own subcontracting income arise from

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different arrangements. Company A's bank payment confirmation alone is insufficient to explain the settlement between Companies B and C.

If Company B has assigned the receivable to Company C, the arrangement cannot be treated solely as collection on behalf of another company. Where Chinese law applies, the Civil Code provides for notification to the debtor in connection with an assignment of claims. A transfer of obligations requires the creditor's consent, while a transfer of contractual rights and obligations as a whole requires the consent of the other contracting party. The documentation should reflect the arrangement actually adopted.

4. Bank Remittances and Related Accounting and Tax Matters

Where the service provider named in the contract differs from the actual payee, the bank may request further details of the payment arrangement. The Guidelines for Current Account Foreign Exchange Business (2020 Edition) require foreign exchange receipts and payments for trade in services to be supported by genuine and lawful underlying transactions. Banks conduct a reasonable review of the documents' authenticity and their consistency with the relevant foreign exchange receipts or payments. Contracts, records of service delivery and collection authorisations can explain the relationships between the parties. Whether the proposed payment route can be processed remains subject to the bank's review of the particular transaction and applicable requirements. A company considering a third-party collection arrangement may first provide the relevant documents to its bank to establish the processing requirements.

When an enterprise in China claims an expense deduction for enterprise income tax purposes, supporting documentation must also be considered. Under the Administrative Measures for Supporting Documents for Enterprise Income Tax Deductions, supporting documents for expenditure on purchases from outside China comprise invoices or receipts equivalent to invoices issued by the counterparty, together with evidence of payment of the relevant taxes and charges. The measures also require contracts, documents substantiating the expenditure and payment records to be retained for inspection. Where another company collects payment on the service provider's behalf, these documents need to correspond with one another, identifying the payee and the services purchased from the service provider named in the contract.

The receiving company's accounting treatment depends on its rights and obligations in the transaction. Funds collected solely on behalf of another company should not be recognised in full as service revenue merely because they have been credited to its bank account. Fees earned for subcontracted services provided to the contracting company, and any separately charged settlement service fees, are accounted for according to the nature of the services and the applicable accounting standards. These fees are distinguished from amounts collected on behalf of another company.

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Where an outbound payment for trade in services falls within the scope of the tax filing requirements, the prescribed filing must be completed. Under the relevant filing rules, completing the tax filing does not mean that the tax authority has confirmed the income to be exempt from tax, nor does it replace the bank's review. Tax liabilities and withholding obligations are assessed separately, taking into account the contract terms, the services actually performed and the applicable tax rules.

If you wish to obtain more information or assistance, please visit the official website of Kaizen CPA Limited at www.kaizencpa.com or contact us through the following and talk to our professionals:

Email: info@kaizencpa.com
Tel: +852 2341 1444
Mobile : +852 5616 4140, +86 152 1943 4614
WhatsApp/ Line/ Wechat: +852 5616 4140
Skype: kaizencpa

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