



New Rules in Individual Income Tax Regime

As the newly amended Individual Income Tax ("IIT") Law has come into effect on 1 January 2006, we need to pay attention to the below new treatments some of which will soon be implemented when the IIT filing for the month of January 2006 is going to be made next month.

Statutory Monthly Deduction

By virtue of the new IIT Law, the statutory monthly deduction allowable for IIT calculation has been raised from RMB800 to RMB1,600. Local staff of your company in China may enjoy tax free income up to RMB1,600 per month. Given that the additional monthly deduction amounting to RMB3,200 is still available to expatriate staff who may get a total deduction of RMB4,800 per month.

Subsequent to the increase of statutory monthly deduction to RMB1,600, the Ministry of Finance and the State Administration of Taxation ("SAT") have jointly issued a circular on 19 December 2005 to require local tax authorities to standardize the deduction amount for IIT calculation of local staff at the statutory amount (i.e. RMB1,600 per month). Before that, tax authorities in different cities respectively allowed different deduction amounts (i.e. ranging from RMB800 to RMB1,600 per month) for IIT calculation of local staff.

Reporting Obligations

In general, IIT filings of a taxpayer should be made by his/her withholding agent. However, the following types of taxpayers are obliged to report their income to tax authorities:

- Taxpayer having income derived from more than one source;
- Taxpayer having income derived from overseas source; and
- Taxpayer having income derived in China without any withholding agent.

Meanwhile, pursuant to Guo Shui Fa [2005] 207, taxpayers derived income more than RMB120,000 per annum are required to furnish tax authorities with details of their income by the end of March of the following year. It appears to be an additional enforcement step to require further disclosure. However, in the absence of details on the reporting scope and format, it remains unclear that whether an annual reconciliation of IIT filings made will be required. Since this circular applies to income derived on or after 1 January 2006, the first reporting due date if so required should be around March 2007. We look forward to further clarification from the SAT and the tax authorities at local level in this regard in the future.

The State Administration of Taxation Streamlines the Administration of the Advance Pricing Arrangements

On 13 December 2005, the SAT issued "Notice on Issues Concerning Advance Pricing Arrangements" - Guo Shui Han [2005] 1172 (the "Notice"). The Notice is aimed to clarify and reinforce certain procedures regarding administration of the advance pricing arrangement ("APA") program by the Chinese tax authorities.

Introduction

The APA is an arrangement between a taxpayer and the tax authority setting out, in advance of inter-company transactions, the method for determining the transfer pricing for those transactions. The APA program is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional dispute resolution process involving transfer pricing audits and tax audit defense.

In September 2004, the SAT issued a set of detailed rules on the application, negotiation, approval, and monitoring of APAs (the "APA Rules"). Approximately fifty APAs have been concluded since the issuance of the APA Rules, including China's first bilateral APA.

Under the APA Rules, the local in-charge tax authorities are primarily responsible for evaluating the taxpayer's application, and negotiating, concluding, and monitoring the APAs. However, for APAs under certain special circumstances ("Special APAs"), the SAT is more heavily involved and its roles range from coordination, supervision to direct handling. Such Special APAs include (1) APAs involving related parties across three or more provinces, (2) APAs for which the value of the covered intercompany transactions exceeds RMB10 million (approximately US\$1.25 million) a year, and (3) bilateral or multilateral APAs.

Overview of the Notice

The Notice is aimed to clarify and reinforce the APA Rules, instructing local tax authorities to focus on quality rather than quantity of APAs to be concluded.

In selecting the APA candidates, the Notice encourages local tax authorities to choose from the APA-seeking companies that have already been audited or that are in the industries with which the tax authorities are already experienced. For Special APAs, the local tax authorities must report to and obtain approval from the SAT before proceeding to a next step of the APA process. The Notice clarifies that a streamlined reporting and approval procedure can be utilized by the local tax authorities in communicating with the SAT in order to expedite the process.

Impact on Multinational Companies Seeking APAs in China

The Notice's streamlined procedures should reduce the time required to obtain Special APAs involving SAT. Multinational companies that may consider an APA with the Chinese tax authorities should therefore regard the Notice as a positive development.

In the context of this China Tax / Business News Flash, China refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

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