



Implementation Details of the New Tax Filing System for Companies with Branches Across Provinces under the Corporate Income Tax Regime

In the last issue of our China Tax/Business News Flash, we reported on two circulars, Cai Yu [2008] No.10 ("Circular 10") and Guo Shui Han [2008] No.44 (Circular 44), relating to the new tax filing system for companies with branches across provinces under the Corporate Income Tax ("CIT") regime. Since then, the State Administration of Taxation ("SAT") has issued Guo Shui Han [2008] No.28 ("Circular 28") addressing the implementation details of this new tax filing system which clarifies some unclear issues we highlighted in our last issue. We discuss below the salient points of Circular 28 and an observation we have on the new CIT quarterly provisional return provided in Circular 44.

Salient Points of Circular 28

1. Two Important Clarifications of Circular 10

- (i). Companies may be able to apportion more provisional CIT payment to the headquarters location

According to the allocation arrangement and the prescribed formula in Circular 10, the headquarters of a company does not participate in the allocation of quarterly CIT payable among branches. There was a concern whether it is fair to apportion 50% of the total CIT payable to the participating branches in cases where the majority of the profits of the company is generated by the headquarters.

Circular 28 now makes it possible to allocate a portion of the 50% provisional CIT payable by branches to headquarters with large operation scale as it states that "*If a headquarters has an independent manufacturing or operational division which is able to book its revenue, salary and assets separately, such division can be treated as an additional branch and file its apportioned provisional CIT locally.*"

We understand that tax bureaus in major cities have forwarded this circular to taxpayers and reminded them to follow Article 10 in their provisional returns.

- (ii). The profit and loss of headquarters and branches subject to different tax rates should still be allowed to offset each other

Circular 10 requires that where headquarters and branches are subject to different tax rates, the taxable income and tax payable should be separately accounted for based on their respective tax rates. This has led to the uncertainty as to whether the profit and loss of headquarters and branches can still be combined and set off against each other where they are subject to different tax rates.

Circular 28 clarifies the method for calculating provisional CIT payable where headquarters and branches are subject to different tax rates as follows:

- The profit and loss of the headquarters and branches should be combined to arrive at the overall taxable income (not tax payable) of the company as a whole;

- The overall taxable income should then be allocated firstly between headquarters and branches on a 50:50 basis and then among branches based on the prescribed formula;
- The taxable income allocated to headquarters and branches respectively should then be multiplied by their respective tax rates to arrive at the final CIT payable;
- Finally the headquarters and branches should pay their allocated tax payable at their respective locations.

2. Other Significant Developments in Circular 28

Circular 28 clarifies that where a participating branch is liquidated, its apportioned CIT payable during the rest of the year after liquidation should be paid to the central government. It also requires the amounts of gross revenue, salary cost and asset values used in the allocation formula to be supported by the management accounts of the company. Furthermore, if the in-charge tax authority of a participating branch has a different view on the CIT payable apportioned to that branch, it may raise an enquiry to the tax authority in-charge of the headquarters to re-assess the allocation percentages for CIT payable among the branches. The in-charge tax authority at the headquarters location is empowered to determine whether to maintain or adjust the original percentage.

New CIT Quarterly Provisional Tax Return

Under the FEIT regime, the tax loss carried forward from prior years/quarters could be offset against the current quarter's profit for quarterly provisional FEIT filing purpose. However, in the new CIT quarterly provisional return provided in Circular 44, there is no space for taxpayers to fill in the tax loss carry forward from prior periods, which appears to indicate that the tax loss of prior years/quarters is not deductible for quarterly CIT filing purpose. Although it is not yet clarified at the State level, we understand that some local tax authorities have already confirmed either verbally or by written circular that this is the case.

PwC Observations

Circular 28 should be welcomed by both taxpayers and local tax authorities as it clarifies some of the uncertain issues in Circular 10. The treatment of headquarters with large operation scale as a branch for the purpose of computing provisional CIT payable by branches should be welcomed by those local tax authorities which have many companies with large-scale headquarters in their jurisdictions. It is also attractive to companies with financial subsidies based on the CIT paid at the headquarters location and companies with a lower tax rate at the headquarters location.

The clarification of the computation of provisional CIT payable for companies where headquarters and branches are subject to different tax rates would provide certainty to those companies in filing their provisional returns.

The non-deductibility of loss carry forward in filing the provisional quarterly return could have a big impact on both taxpayers and local tax authorities. This is definitely a new burden on the cash flow of taxpayers with huge losses carried forward from 2007 as they are now not allowed to deduct their losses in the provisional filings (either quarterly or monthly).

Since the tax loss carry forward is not deductible for the provisional filings, there is likely to be tax refund at the year-end annual filing, which will increase the administrative burden for both taxpayers and tax authorities.

In addition, where headquarters and branches are involved, the tax authority in-charge of the headquarters will likely suffer a loss in tax revenue as they have to make tax refund on an "entire-company" basis at the year-end annual filing, while 50% of the provisional tax payments have gone to the tax authority in-charge of the branches.

We look forward to a clarification and confirmation from the SAT on this matter.

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

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PricewaterhouseCoopers client service team.

Beijing

Tel: (86) (10) 6533 2866
Fax: (86) (10) 6533 8800
Edward Shum
edward.shum@cn.pwc.com

Hong Kong

Tel: (852) 2289 3669
Fax: (852) 2810 9888
Petrina Tam
petrina.tam@hk.pwc.com

Suzhou

Tel: 86 (512) 6273 1888
Fax: 86 (512) 6273 1800
Billy Hsieh
billy.hsieh@cn.pwc.com

Chongqing

Tel: (86) (23) 6393 7888
Fax: (86) (23) 6393 7200
Tony Kwan
tony.kwan@cn.pwc.com

Qingdao

Tel: (86) (532) 8089 1888
Fax: (86) (532) 8089 1800
Steven Wong
steven.wong@cn.pwc.com

Tianjin

Tel: (86) (22) 2330 6789
Fax: (86) (22) 2339 3662
Alan Wu
alan.wu@cn.pwc.com

Dalian

Tel: (86) (411) 8379 1888
Fax: (86) (411) 8379 1800
Edward Shum
edward.shum@cn.pwc.com

Shanghai

Tel: (86) (21) 6123 2515
Fax: (86) (21) 6123 8800
Tony Kwan
tony.kwan@cn.pwc.com

Xian

Tel: (86) (29) 8720 3336
Fax: (86) (29) 8720 3335
Elton Huang
elton.huang@cn.pwc.com

Guangzhou

Tel: (86) (20) 3819 2128
Fax: (86) (20) 3819 2100
Charles Leung
charles.leung@hk.pwc.com

Shenzhen

Tel: (86) (755) 8261 8899
Fax: (86) (755) 8261 8800
Charles Lee
charles.lee@cn.pwc.com

To make enquiries about our China tax and business advisory services, please feel free to contact the following lead specialist partners:

Human Resources Services

Tel: (86) (21) 6123 2517
Fax: (86) (21) 6123 8800
Nora Wu
nora.wu@cn.pwc.com

Indirect Tax

Tel: (86) (10) 6533 2889
Fax: (86) (10) 6533 8800
Alan Wu
alan.wu@cn.pwc.com

Registration & Corporate Compliance Services

Tel: (86) (21) 6123 3052
Fax: (86) (21) 6123 8800
Matthew Wong
matthew.mf.wong@cn.pwc.com

International Assignment Services

Tel: (86) (10) 6533 2812
Fax: (86) (10) 6533 8800
Edmund Yang
edmund.yang@cn.pwc.com

Mergers & Acquisitions

Tel: (852) 2289 3097
Fax: (852) 2810 9888
Danny Po
danny.po@hk.pwc.com

Transfer Pricing

Tel: (86) (21) 6123 2580
Fax: (86) (21) 6123 8800
Spencer Chong
spencer.chong@cn.pwc.com

Worldtrade Management Services

Tel: (86) (21) 6123 3599
Fax: (86) (21) 6123 8800
John Robinson
john.p.robinson@cn.pwc.com

Additionally, we welcome you to visit our PricewaterhouseCoopers China website at <http://www.pwccn.com> or <http://www.pwchk.com> for practical insights and professional solutions to current and emerging business issues.