

News Flash

China Tax and Business Advisory

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Our China Registration & Corporate Compliance Service Team is a dedicated and experienced team with thorough knowledge on tax reporting and tax compliance. Our China based resources in Beijing, Shanghai, Guangzhou and Shenzhen offices maintain regular dialogue with the tax authorities on latest filing requirements. Through the efficient use of technology, we aim to improve connectivity and information management for your reporting and as a basis for tax planning, provide you with assurance that your compliance process are under control.

New Look of Annual Corporate Income Tax Return Package

Year 2008 is the first year of the enactment of the new Corporate Income Tax (CIT) Law in China. As the year end is approaching, the State Administration of Taxation ("SAT") published the 2008 Annual CIT Return Package (under a circular Guoshuifa [2008] No.101 on 30 October 2008) which has to be used for the annual CIT filing for year 2008.

The new Annual CIT Return is a package of forms and schedules comprising one lead return and 15 schedules. Please use the link below to the SAT website to download the full Package.

<http://www.chinatax.gov.cn/n480462/n480513/n480902/8470590.html>

In this issue of News Flash, we will introduce the features of the new Annual CIT Return Package, share our insight on how it interacts with other filing requirements and what we believe the companies should do to prepare themselves to comply with the new Annual CIT Return Package.

Comparison with the Former Annual EIT and FEIT Returns

Below are the titles of the lead return and 15 schedules:

Schedules	Package
	Lead Return
1	Breakdown of income for:
a.	a. ordinary enterprises;
b.	b. financial institutions;
c.	c. public institutions, social organisations and privately-owned non-corporate institutions
2	Breakdown of expense for:
a.	a. ordinary enterprises;
b.	b. financial institutions;
c.	c. public institutions, social organisations and privately-owned non-corporate institutions
3	Breakdown of tax adjustments
4	Breakdown of make up for tax loss
5	Breakdown of tax incentives
6	Breakdown of foreign tax credit
7	Tax adjustment of assets measured at fair value
8	Tax adjustment of advertising and business promotion expenses
9	Breakdown of tax adjustment of depreciation and amortisation
10	Breakdown of tax adjustment of provisions
11	Breakdown of income/loss from long-term investments

- The Annual CIT Return Package adopts most of the features of the former Annual Enterprise Income Tax (“EIT”) Return which required more schedules and more information disclosure than the former Annual Foreign Enterprise Income Tax (“FEIT”) Return.
- There are schedules which are new to Foreign Investment Enterprises (“FIEs”) but not unfamiliar to Domestic Enterprises (“DEs”), e.g., schedules for tax incentives, adjustment of advertising and business promotion expenses and income/loss from long-term investments, etc.
- There are different sets of schedules on the breakdown of income and expenses for two special groups of entities, namely financial institutions; and public institutions, social organisations and privately-owned non-corporate institutions.
- Moreover, the Annual CIT Return Package appears to be more complicated than its predecessors under the former tax regimes. To name a few:
 - There is a new Schedule 7 for values of assets which are required to be marked to market under the new China Accounting Standards. It is designed to accommodate a tax circular issued in 2007 which stipulates that for financial assets, financial liabilities and investment properties which are measured at fair market value, the fluctuation in the market value of these assets and liabilities recognized in the accounts should not be recognized as taxable income or loss during the holding period.
 - In the “Breakdown for Income/Expense for Financial Institutions”, the income/expense items are further classified into different business sectors such as banking, insurance, securities and other financial services. This is even more detailed than the corresponding schedule in the former EIT return.
 - There is a “Breakdown of Tax Adjustment of Provisions”. Apart from the bad / non-performing debt provisions which were included in the former EIT return, this schedule also covers other provisions for impairment in inventories, short-term / long-term investments, investment real properties, fixed assets, production-nature biological assets, intangible assets, goodwill, etc. In addition, some of these provisions are specifically for the enterprises that adopt the new China Accounting Standards, whereas some are specifically for those that adopt other accounting systems.

Other Main Features of Annual CIT Return Package

- It is interesting to find that there are some hints buried in the Annual CIT Return Package in respect of some tax policies which have not been fully unveiled by the SAT at this stage. To name a few examples:
 - For instance, the detailed policies and rules on Foreign Tax Credit have yet to be finalized, but Schedule 6 has already reserved a column for information on “deemed foreign tax credit”.
 - Another example is the deductibility of investment expenses. While no written circular has been issued so far to clarify that investment expenses (such as interest expense for investment financing purpose) are deductible under the CIT regime, the Annual CIT Return Package does not indicate that investment expenses should be added back to arrive at the taxable income.
- In the meantime, there are still some uncertainties in the requirement for completing the Annual CIT Return Package.
 - For instance, in the “Breakdown of Tax Adjustments”, related party interest expense exceeding the prescribed thin capitalization ratio is required to be adjusted but no further instruction has been provided on how to calculate the non-deductible related party interest expense. This should be unveiled after the long-awaited “Administration Regulations for Special Tax Adjustments” is issued.
 - Also, in the Schedule for “Tax Adjustment of Advertising and Business Promotion Expenses”, the “non-deductible advertising and business promotion expenses” should be excluded but the definitions of these expense items have not been clarified.

- It is imperative to note that Schedule 3 for “Breakdown of Tax Adjustments” contains an item for “taxable income for special tax adjustment”. However, the instruction for preparing Schedule 3 indicates that the taxpayer may only make “upward” adjustment to increase its taxable income. Again, it has to wait and see if further guidance would be provided in the forthcoming “Administrative Regulations on Special Tax Adjustments”.

Related-Party Transaction Disclosure Forms

We understand that the SAT is preparing 9 new forms for disclosing related-party transactions (collectively called “RPT Disclosure Forms”). These RPT Disclosure Forms may cover the disclosure of almost all aspects of related-party transactions, transfer pricing (“TP”) information, thin capitalization, controlled foreign companies, etc. However, the published Annual CIT Return Package has not contained these RPT Disclosure Forms. It is anticipated that these Forms would be issued by the end of November 2008. Although the published Annual CIT Return Package is silent on these forms, it is not unreasonable to anticipate that the Disclosure Forms should be completed and submitted together with 2008 Annual Corporate Income Tax Return Package to the local-level tax bureaus by the statutory due date in May 2009.

Group Consolidated CIT Filing

According to Article 52 of the CIT Law, enterprises are not allowed to consolidate their filing and settlement of CIT except as otherwise prescribed by the State Council. Recently with the State Council’s blessing, the Ministry of Finance and SAT have jointly issued a circular, entitled Caishui [2008] No.119, which allows some groups of enterprises that were originally approved to perform consolidated CIT filing on a group basis prior to 31 December 2007 to continue the same for the year 2008 CIT filing. All of these enterprises are domestic enterprises with some of them State-owned. However, the circular states clearly that these enterprises would not be allowed to perform group consolidated CIT filing from 2009 onwards.

PwC Observations

We have the following observations and suggestions to the companies which are required to complete and submit the Annual CIT Return Package:

More than a compliance exercise

- On the face of it, the Annual CIT Return Package is merely a brand new set of returns designed for the new CIT Law. However, it is not advisable for companies to simply take it as another set of forms replacing the former annual EIT return and FEIT return, or take it as a clerical form-filing exercise. As a matter of fact, there are a lot of new tax concepts, policies, and treatments introduced under the new CIT regime. Unfortunately, some of them, including taxability of some special-type income and deductibility of some costs/expenses, have not been clarified by the Chinese tax authorities at the time of this News Flash. In addition, we envisage that some of them may still not be announced by the time of the filing season in 2009. Hence, thorough understanding of the CIT Law and its Detailed Implementation Regulations as well as having sufficient insights on the uncertain issues is necessary to reduce the non-compliance risks in the course of preparation of this Annual CIT Return Package.
- To a certain extent, this new Annual CIT Return Package is a combination of the former annual EIT return and FEIT return together with some new requirements under the new CIT regime. So some schedules or information required are new to both the DEs and FIEs. More importantly, the new Annual CIT Return Package is actually much more complicated and requires more information disclosure than the former annual EIT return and FEIT return. It would be a challenge for enterprises to better monitor its information collection and disclose them in the Annual CIT Return and its schedules. Enterprises should get themselves prepared for this new set of return as soon as possible.
- The filing deadline of the Annual CIT Return Package is 31 May under the CIT regime which is one month longer than that under the former EIT and FEIT regimes. This should give taxpayer more time to prepare it. However, as mentioned above, the new CIT return is much more complicated and taxpayers should plan ahead for its preparation to avoid the last-minute rush. Please note that it is not unusual for local-level tax bureaus to make the filing deadline earlier than 31 May. So taxpayers should stay tuned for the latest local requirements.

Interaction with other compliance requirements

- As mentioned above, the RPT Disclosure Forms, though not yet released, are required to be included in the Annual CIT Return Package. Accurate completion of these Forms again requires a good understanding and knowledge of

both tax and TP regulations. They must be completed with due care since the enterprise is disclosing essential TP information on the forms and hence presenting the TP profile of the group to the Chinese tax authorities.

- In addition to the RPT Disclosure Forms, there will be new TP Documentation Requirements to be released by the SAT soon. The information disclosed in the RPT Disclosure Forms should be consistent with the details in the TP Documentation. Given this, it should be more efficient for the in-house TP team which are responsible for the TP Documentation to work closely with the in-house tax-compliance team or finance team which is responsible for the Annual CIT Return Package preparation to ensure accurate and consistent information flow reflected in all these documents.

A “full-stop” to Group Consolidated Tax Filing

- It appears from the list of approved enterprises attached to the circular that there is no FIE which has been allowed to file on a consolidated basis prior to 31 December 2007. The continuance of the group consolidated CIT filing treatment to those approved DEs for year 2008 seems to be unfair to FIEs. However, from 2009 onwards, all enterprises will be put under equal footing. It also signifies a “full-stop” to the strong advocacy for group consolidated CIT filing from the business community and profession, at least for year 2009. This warrants very accurate calculation of the taxable income and loss for each group company, as they are not allowed to set off each other which might otherwise be available under group consolidated CIT filing.
- The Chinese government will be able to generate more tax revenue by cancellation of group consolidated tax filing for those previously approved DEs (most of them are very large DEs) from 2009 onwards. This would hopefully reduce the impact of significant tax collection reduction that would arise from the implementation of VAT transformation nationwide in 2009. Besides, the conflict among the local-level governments on the keeping of tax revenues at the consolidated holding-company locations could also be a catalyst to the change.

As this is the first year of the CIT regime, the annual CIT filing for 2008 is very crucial to all companies. The issuance of the Annual CIT Return Package is only the beginning. We will closely monitor the development and keep you posted.

In the context of this 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.

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