

Is invoice King? —— China Released the Administrative Measures for CIT Deduction Vouchers

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In brief

On 6 June 2018, the State Administration of Taxation (SAT) released the *Administrative Measures for CIT Deduction Vouchers* (the SAT Public Notice [2018] No.28, hereinafter referred to as the Administrative Measures) and its official interpretation. The Administrative Measures further specify the key principles in the administration of CIT deduction vouchers, clarify the classification and management of internal and external vouchers, explain the relationship between invoices and deduction vouchers, and regulate the administration on specific situations, such as unable to obtain external vouchers, cost sharing, etc.

The Administrative Measures shall take effect from 1 July 2018. It is recommended that enterprises should immediately sort out their CIT deduction vouchers and evaluate their compliance level by referring to the Administrative Measures. From a long-term perspective, enterprises may need to adjust their internal management on fiscal and taxation vouchers to comply with the new requirements under the Administrative Measures.

In detail

Background

Under the Corporate Income Tax Law (CIT Law), an enterprise is allowed to deduct reasonable expenditures which have actually been incurred and are related to the generation of income. In this regard, authenticity is a primary criterion for CIT deduction. According to the interpretation of the CIT Law, in determining the authenticity of expenditures, enterprises shall provide “sufficient” and “appropriate” documents to substantiate these expenditures that have actually been incurred. However, since the implementation of the CIT Law,

the SAT has only released administrative measures on vouchers relating to certain specific issues such as, asset loss, accelerated depreciation of fixed assets, super deduction of research and development expenditures, etc., but has not released anything on the requirements for CIT deduction vouchers relating to general costs and expenditures. Enterprises have been eagerly waiting for the release of such Administrative Measures for a long time.

Three key principles for the administration of CIT deduction vouchers

As enterprises generally engage in various business activities and receive different types of vouchers, it is very difficult to list them out one by one. The Administrative Measures require both taxpayers and tax

authorities to manage CIT deduction vouchers based on the following three principles: authenticity, legality and relevancy.

Among the above three principles, authenticity is fundamental. If an enterprise's economic business activities and relevant expenditures are not authentic, it will naturally not be a CIT deduction issue. The other two principles namely legality and relevancy are the core principles. Enterprises' vouchers are allowed to be used as supporting documents for CIT deduction only when such vouchers are generated and used in compliance with the relevant laws and regulations, related to the enterprises' corresponding expenditures and can be supported proved with evidence.

Besides, it is noteworthy that the provision of deduction vouchers is only a “necessary but not the only condition” for CIT deduction. Enterprises with valid vouchers should still have to satisfy the relevant deduction scope and criteria prescribed in the CIT law before claiming a CIT deduction.

Invoices vs CIT deduction voucher vs relevant documents

Vouchers can be classified as internal and external ones according to their original source. In particular, internal vouchers refer to the original accounting vouchers for calculating cost, expenses, loss and other expenditures self-produced by enterprises, which shall be written and used in accordance with relevant accounting laws and regulations. External vouchers refer to vouchers that enterprises acquire from other units and individuals, which include invoices (i.e., paper invoices and e-invoices), fiscal vouchers, tax payment certificates, receipts and split payment vouchers, etc. We have summarised the voucher requirements for different types of expenditures in Appendix 1.

Obviously, invoice is one type of important external vouchers, but it is not the only CIT deduction voucher. Under the Administrative Measures, for VAT-able items where the counterparty has already performed the VAT registration, enterprises should use the VAT invoice as the CIT deduction voucher. However, it should be noted that VAT-exempt activities also belong to taxable items, as such, enterprises shall also require the counterparty to issue general VAT invoices for CIT deduction purpose. Non-compliant invoices such as forged ones, illegally acquired ones, falsified ones or improperly completed ones cannot be used for CIT deduction purpose. Unfortunately the Administrative Measures do not further specify the meaning of “properly completed”, hence, enterprises should refer to the relevant VAT and invoice administrative regulations in order to understand this term. For instance, the enterprise name, the taxpayer identification number and the unified social credit number should be accurately specified in the purchaser column of a general VAT invoice.

For non-VAT-able items, or VAT-able items of which the counterparty is not eligible to issue VAT invoices, other receipts or internal vouchers can be

used for CIT deduction purpose. Furthermore, under the current VAT regulations, invoices are allowed to be issued for a few specified non-VAT-able items. As such, whether enterprises are allowed to use these invoices for CIT deduction purpose remains to be further clarified.

Meanwhile, to prove the authenticity of CIT deduction vouchers, the Administrative Measures also specify that enterprises should keep relevant supporting documents such as contracts and agreements, payment vouchers, receipts, etc. for tax authorities’ future examination. In the official interpretation, judicial adjudicative document issued by the court requiring an enterprise to pay compensation for the breach of contract is one kind of supporting document. Invoice for such kind of compensation generally cannot be obtained, enterprises can therefore use external vouchers (e.g., receipts) together with the above mentioned related supporting document to claim a CIT deduction.

Timing for obtaining CIT deduction vouchers

The Administrative Measures reiterate that the timing for obtaining CIT deduction vouchers should be “before the end of CIT filing period”. If enterprises cannot obtain invoices or other external vouchers before the end of CIT filing period, they are not allowed to deduct such expenses in that year. When they are able to obtain such invoices or external vouchers in subsequent years, they are allowed to retrospectively deduct the expenses in the year when these expenses are incurred. However, the retrospective period shall not exceed five years. This is consistent with the treatment on “deductible expenditures which should have been claimed but not claimed in previous years” under the SAT Public Notice [2012] No.15.

Besides, combining with the current administration thinking of optimising the business environment under the “Delegated Powers, Improved Regulation and Services” reform in China, the Administrative Measures allows enterprises to provide supplementary invoices, vouchers, or replace ineligible invoices, vouchers with eligible ones or provide interpretation documents within 60 days of being notified in situations where the tax authority discovers after the CIT filing period that the enterprise has claimed CIT deduction

without obtaining valid deduction vouchers. In other words, the enterprise can still enjoy the CIT deduction if it can provide the relevant CIT deduction vouchers within 60 days after receiving the notice from the tax authority. Otherwise, the enterprise will face the risks of being unable to deduct the expenses in the current year for CIT purpose. The attached Appendix 2 summarises the different time period for obtaining CIT deduction vouchers.

Enterprises failing to obtain invoices or external vouchers still have opportunity to deduct expenses for CIT purpose!

There are certain circumstances where enterprises are unable to obtain invoices or have obtained non-compliant invoices and vouchers. The Administrative Measures require enterprises to supplement invoices or replace non-compliant invoices or vouchers with compliant ones before the end of CIT filing period. If the invoices or vouchers cannot be supplemented or replaced by the counterparty because of certain special reasons, such as, it has been deregistered, terminated, its business license has been revoked or has been deemed as an unusual taxpayer by the tax authorities, the enterprise can still enjoy the CIT deduction treatment by providing supporting documents, such as, contracts or agreements, receipts, freight delivery documents, as well as accounting records, etc.. This new provision will help protect the CIT deduction for authentic transactions between enterprises.

Nevertheless, the Administrative Measures has not addressed how to claim a CIT deduction in case the invoice is lost. As a reference, the VAT regulation¹ stipulates that when a special VAT invoice is lost, enterprises can still claim authentication input credit based on the copy of corresponding special VAT invoice (for book keeping purpose) provided by the seller.

The requirement on vouchers for the sharing of the common expenditure

To address the scenario that services are jointly received by several enterprises (including related-party enterprises) in China, the Administrative Measures specify that in case the allocation method is adopted, the enterprise allocating the expenditures would claim the CIT deduction by providing the invoices

and split payment voucher, while the other enterprises receiving the allocated expenditures would claim the CIT deductions by providing the split payment vouchers issued by the enterprise allocating the expenditures. This allocation method allows all involved enterprises to enjoy the CIT deduction treatment. However, from a VAT perspective, as the allocated expenditures are not supported by VAT invoices, the enterprises receiving the allocated expenditures cannot claim any input VAT credit. On the other hand, the enterprise allocating the expenditures would be able to obtain special VAT invoices for the full amount of the expenditure but only receive a part of services, it is uncertain whether it can claim input VAT credit on the full amount.

In practice, a generally accepted method is for one party to issue invoices to the other party based on the taxable activities. If the activity is regarded as a “purchase of a VAT-able activity and on sale to another party” activity, both parties can use the VAT invoice obtained to support the CIT deduction and input VAT credit. For

the treatment on sharing of public service fees incurred by an enterprise on the leasing of a property, the Administrative Measures follow the above practical implementation, i.e., the enterprise (lessee) can claim a CIT deduction with the invoice issued by the lessor; meanwhile, if the above-mentioned cost allocation method is used, the lessee can also use other external vouchers issued by the lessor as CIT deduction vouchers.

The takeaway

The Administrative Measures set forth requirements for CIT deduction vouchers under various specific circumstances, which provide pro forma compliance guidance for taxpayers, and contribute to reducing their tax risks. However, there are still issues in the existing regulations on the CIT deduction that need to be further clarified. For example, how to distinguish an expense among the following expense category: advertising expense, business entertainment expense and sponsorship expense, whether depreciation expense of investment

property can be claimed for CIT purpose, etc. The tax treatments for such issues need further clarification in practice.

As a whole, the Administrative Measures offer lenient and tightened treatments at the same time. For VAT taxable items, enterprises should still try their best to obtain VAT invoices to ensure successful CIT deductions. For situations where invoices cannot be obtained, enterprises should also sort out the other supportive documents related to these expenditures and seek to claim CIT deductions according to special regulations.

In the long term, enterprises should also adjust their internal management on fiscal and taxation vouchers, perform a through verification on the vouchers so as to establish a solid foundation for CIT deduction.

Endnote

1. Please refer to SAT Public Notice [2014] No. 19 <http://hd.chinatax.gov.cn/guoshui/acttion/GetArticleView1.do?id=480451&flag=1>

Appendix 1: Category and Examples of CIT Deduction Vouchers*

*The form is summarised according to the Administrative Measures and its official interpretation. The Administrative Measures shall prevail in case of inconsistent comprehension.

| Expenditure category | | Counterparties | Examples of CIT deduction vouchers |
|------------------------------------|--------------------|--|--|
| Expenditures incurred within China | VAT-able items | The counterparty has performed tax registration (e.g., purchasing of goods and services) | <ul style="list-style-type: none"> • Special VAT invoice • General VAT invoice |
| | | The counterparty is not required to perform tax registration, or individuals engaging in small-amount and occasional business (e.g., payment to an individual below the VAT threshold) | <ul style="list-style-type: none"> • Invoices issued by the tax authority on behalf of the counterparty • Receipts (indicating the unit name, the individual’s name and ID number, expenditure items and the amount received, etc.) • Internal vouchers |
| | Non VAT-able items | Payment to units (e.g., governmental funds, administrative charges, taxes, “Five Social Securities and One Housing Fund”, land transfer fee, union dues, charitable donation, etc.) | <ul style="list-style-type: none"> • External vouchers other than invoices (e.g., receipts supervised by the financial department, tax payment certificates, and receipts issued by relevant authorities, etc.) |
| | | Payment to individuals (e.g., wages and salaries) | <ul style="list-style-type: none"> • Internal vouchers (e.g., salary sheet) |

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| Expenditure category | Counterparties | Examples of CIT deduction vouchers |
|--|---|--|
| Expenditures incurred outside of China | Payment to overseas suppliers providing goods or services | <ul style="list-style-type: none"> • Invoices issued by the counterparty • Receipts similar to invoices • Relevant tax payment certificates |
| Common expenditure sharing | Expenditures incurred for services jointly received by several enterprises and individuals in China | Based on expenditure allocation method: <ul style="list-style-type: none"> • The enterprise allocating the expenditures: the invoice (VAT-able services), other external vouchers (non-VAT-able services) and the split payment voucher • The other enterprises receiving the allocated expenditures: the split payment voucher issued by the enterprise allocating the expenditures |
| | Expenses of water, electric power, gas, air conditioning, heating, communication lines, cable TV and internet generated from property lease | Invoice issuance based on VAT-able items <ul style="list-style-type: none"> • The lessor shall issue invoices Based on expenditure allocation method: <ul style="list-style-type: none"> • Other external vouchers issued by the lessor |

Appendix 2: Time period of obtaining invoices and external vouchers

| Timing | Vouchers obtained by enterprises for CIT deduction purpose | Deductible or not | |
|--|--|---|--|
| Before the end of CIT filing period (prior to 31 May) | Compliant invoices and external vouchers have been obtained | √ | |
| | Compliant invoices and external vouchers that should have been obtained but not, expenditures are actually incurred, and invoices have been supplemented or non-compliant invoices or external vouchers have been replaced with compliant ones | √ | |
| | Prescribed supporting documents are required in case invoices cannot be supplemented or non-compliant invoices or external vouchers cannot be replaced with compliant ones | √ | |
| | Prescribed supporting documents are unavailable | ×Non-CIT deductible in the year the expenditures are incurred | |
| After the end of CIT filing (after 31 May) | In cases where the expenditures are not deducted in the year they were incurred and compliant invoices, external vouchers or prescribed supporting documents are obtained in subsequent years | √Expenditures are allowed to be retrospectively deducted in the year they were incurred. The retrospective period shall not exceed 5 years. | |
| | <table border="1"> <tr> <td>Expenditures were deducted in the year they were incurred, but compliant invoices or external vouchers were not obtained</td> <td>Enterprises supplemented the compliant invoices or external vouchers or replace the non-compliant ones with compliant ones, or provided prescribed supporting documents within 60 days of the notice issued by the tax authorities</td> </tr> </table> | Expenditures were deducted in the year they were incurred, but compliant invoices or external vouchers were not obtained | Enterprises supplemented the compliant invoices or external vouchers or replace the non-compliant ones with compliant ones, or provided prescribed supporting documents within 60 days of the notice issued by the tax authorities |
| Expenditures were deducted in the year they were incurred, but compliant invoices or external vouchers were not obtained | Enterprises supplemented the compliant invoices or external vouchers or replace the non-compliant ones with compliant ones, or provided prescribed supporting documents within 60 days of the notice issued by the tax authorities | | |

Let's talk

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