

Clarification Issued on Corporate Income Tax Collection Verification

The State Administration of Taxation (SAT) has issued a notice to clarify certain terms detailed in the *Measures for Verification Collection of Enterprise Income Tax (Guoshuifa [2008] 30)* (the "Measures") concerning corporate income tax. The Measures outline the SAT's approach to verifying the reported taxable income of certain taxpayers.

Importantly, Article 3 of Measures excludes certain "special taxpayers" from its scope. However, Article 3 did not specify which types of enterprises were termed under the umbrella of a special taxpayer. The new notice clarifies this term specifying that the following will be special taxpayers for the purpose of the Measures:

1. Enterprises who are entitled to one or even several corporate income tax policies as stated in the Corporate Income Tax laws, and its implementing regulations;
2. Enterprises that fall under consolidated tax payments;
3. Listed companies;
4. Financial institutions, such as banks, credit associations, small loan companies, and insurance companies; and
5. Social agent institutions engaged in economic associations, for example, accounting firms and audit firms.

The second clarification to the Measures is with respect to the term 'taxable income' as found in Article 6. The recent notice indicates that this shall be worked out based on the following formula:

$$\text{Taxable Income} = \text{Total Income} - (\text{Non-Taxable Income} + \text{Exempt Income})$$

SAT Fears Multinationals Will Dump Losses on Chinese Affiliates

To mitigate losses suffered in the financial crisis, Chinese authorities fear multinational corporations (MNCs) may transfer those losses to affiliate enterprises in China. The State Administration of Taxation and local Tax Bureaus are preparing to prevent multinational corporations from transferring losses to Chinese affiliates by calling on MNCs to keep those affiliates' profits at a reasonable level.

In the event of Chinese affiliates bearing the losses, the affiliates are to prepare and submit the appropriate tax materials to the relevant tax authorities before June 2010. To ferret out and prevent or correct for the transfer of such losses, local tax authorities will strengthen the investigation and monitoring process for cross-border transactions.

Investigation into Under-Pricing in Second-Hand Real Estate Market

The State Administration of Taxation (SAT), in response to existing taxation problems within the real property market, has issued a notice that second hand properties that are not sold at a reasonable value will be subject to investigation and re-assessment.

The noticed detailed what were to be subjected to SAT investigation. The taxes payable in the entire process of selling the property, including land reservation, construction, land surveying, property management, and many other factors will be within the scope of investigations carried out.

Beginning with a temporary trial run of the scheme, the operation will be able to assess what are the tax liabilities on the sale of a second hand property at a low price. Where the value of the sale of a property cannot be justified with sufficient reasons, then the taxpayer will be assessed based on an official estimation.

Ministry of Finance to Exempt Certain Imports from Tariffs and VAT

From 1 July 2009 to 30 June 2011, if a processing plant that uses imported materials wishes to establish a corporate enterprise that employs non-price equipment financed by foreign investment, such non-priced equipment shall be exempt from import tariffs and VATs. To be eligible for the exemption, the Customs supervision period must not have ended, the trade manual must have been filed on or before 31 December 2008, and the declaration of imports must have been transacted on or before 30 June 2009. For those enterprises not meeting the filing or declaration deadlines, the standard supplementary tariff payment regulations shall apply.

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VAT is a tax on all entities and individuals in relation to the sale of goods, the supply of processing repair and replacement services and the import of goods where such matters occur within the People's Republic of China ("PRC"). "Goods" is defined as all tangible movables, including electric power, heating power and gas. "Processing" is defined as the business of processing goods upon commission. This definition obviously requires further clarification and helpfully the detailed rules provide an example – a contractor producing goods with raw materials and other main materials for an employer according to set requirements, although processing and repair services provided by an employee of an entity of individual are specifically excluded. "Sale of goods" refers to the paid transfer of the ownership of goods.

The applicable VAT tax rate for an eligible entity or individual depends on whether the taxpayer is a general taxpayer or a small-scale taxpayer (a taxpayer whose annual sales are below a certain level and who do not have sound accounting systems). The thresholds for small-scale taxpayer status are as follows:

1. taxpayers engaged in the production of goods or the provision of taxable services whose annual sales amount that is subject to VAT is less than RMB500,000; and
2. any other taxpayer whose annual sales amount that is subject to VAT is less than RMB800,000.

All individuals will always be regarded as small-scale taxpayers irrespective of their overall turnover. Small-scale taxpayers that have sound accounting systems can apply to be treated as a general taxpayer.

The tax rate for small-scale taxpayers is 3%. For general taxpayers the standard rate of VAT is 17%, although the sale and import of specified goods is taxed at a concessional rate of 13%. This may suggest that it is better to be characterized as a small-scale taxpayer. However in most cases it is preferable to be a general taxpayer, who receive a credit for the input tax amount (i.e. the VAT paid previously in the supply chain).

A further factor is that small-scale taxpayers are not generally entitled to VAT export exemptions and refunds (see inset). Accordingly, obtaining general taxpayer status can be extremely important for organizations engaged in export trade in China. The requirements to obtain such status tend to be different depending upon the locality of the company. For example in our experience Beijing tends to take a more liberal approach to such applications, whereas in Guangzhou the process can be quite difficult.

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VAT Exemptions and Refunds

Various goods are entitled to tax exemptions or refunds upon export. The exemption refers to the fact that the goods when exported will not attract VAT. The refund refers to the entitlement to obtain a rebate on such goods for the VAT paid previously in the supply chain.

In certain circumstances, the company exporting the goods will be entitled to both exemption and a refund. In other circumstances, generally where no VAT was paid previously or the circumstances were such that an exemption would not have applied to the relevant taxpayer, the company may be entitled to the exemption but not a refund.

The refund rate varies from 3% to 17% depending upon the nature of the goods.

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