



## **SAT ISSUES FURTHER CLARIFICATION ON ENTERPRISE INCOME TAX**

On 20 February 2010 the State Administration of Taxation issued a further clarification on certain aspects of the Enterprise Income Tax Law (EITL) in Guoshuihan [2010] 79 (Circular 79). Circular 79 answers some common problem areas of the operation of the EITL.

The clarifications in Circular 79 include the following:

1. "Income" from equity transfers refers to the consideration from the transfer less the original cost incurred to obtain the equity. Further, undistributed profits cannot be deducted from the transfer price for tax purposes.
2. An enterprise obtaining equity investment income (such as dividends, bonus shares etc) are deemed to have received the income on the date when board of directors or general meeting of shareholders make decision to distribute profits or issue the bonus shares .
3. A enterprise begins to calculate its profit and losses in the year that the enterprise started commenced production and operation of its business. The cost and expense occurred during preparations before the enterprise engaged in production and operation, shall not be counted as a loss of current period.
4. Costs and expenses relating to exempt income may be deducted when the enterprise calculates its taxable income, unless otherwise specified.

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Please feel free to contact us in respect of any China taxation issue at:

**china@hwuason.com**

[www.hwuason.com](http://www.hwuason.com)

## **RECONCILIATION AND COMPROMISE TO PLAY CRITICAL ROLES IN TAX DISPUTES IN CHINA**

On 10 February 2010 the State Administration of Taxation (SAT) issued new *Tax Administrative Review Rules* (SAT Order [2010] 22) (the "Rules") providing a comprehensive guideline for tax disputes in China. There are 105 articles in the Rules, which is 53 more articles than was contained in the original. A fundamental component of the new Rules is the introduction of a reconciliation and compromise system. The Rules are operable from 1 April 2010.

### **Reconciliation and compromise**

As introduced by the stakeholder, the added reconciliation and compromise system stipulates the applicable scope and fundamental principle of the reconciliation and compromise. It also designs details of procedures and requirements . The new rules allow the applicant and the respondent to reach a settlement agreement voluntarily and the administrative review shall terminate after permitted by institution of administrative review, however, the applicant shall not apply the administrative review again for the same fact and reason .The institution of administrative review shall conduct the conciliation in accordance with the principle of voluntary.

### **Other issues**

Some of the other more important changes in the Rules include guidance on the admissibility of evidence, a shift from documentary hearings to full public oral hearings, stipulations on which level of local taxation bureaus have jurisdiction for administrative review and a direction that tax authorities of all levels must provide guidance and supervision in respect of tax administrative review.

A more detailed analysis of these new rules will be provided in the late March edition of *Hwuason Insights* – our detailed monthly analysis of China's tax laws



## **IN FOCUS: CHANGES TO TAXATION OF REPRESENTATIVE OFFICES**

On 20 February 2010, State Administration of Taxation issued Guoshuifa [2010] 18 entitled “Notice of the State Administration of Taxation on Issuing ‘Tentative Measures Regarding Administration of Taxation on Representative Offices of Foreign Enterprises’ ” (Circular 18), updating China’s tax policies with respect to representative office (ROs). Circular 18 abolishes all previous circulars with respect to the taxation of ROs. Circular 18 applies retroactively as from 1 January 2010. The key points of Circular 18 are as follows:

1. **The scope of taxpayer:** All ROs in China shall apply and pay the enterprise income tax (EIT) on the profits attributable to the ROs , only except some ROs which shall apply for EIT exemption in according with relevant tax treaty.
2. **The type of taxes:** ROs in China shall submit EIT, as well as Business Tax(BT) and Valued Added Tax(VAT).
3. **The method of tax filing:**
  - (i) The methods of filing EIT of ROs in China are no longer determined based on the principal business of the head office, but on the profits actually attributable to RO itself.
  - (ii) ROs shall settle accounting books and record based on official and valid vouchers, calculate its taxable turnover and profits based on actual performed functions and business risks (namely actual method), and submit EIT and BT within 15 days after the quarter ending, meanwhile, submit VAT based on deadline in Provisional Regulations of the PRC on VAT.
  - (iii) If the accounting records required by the laws are not intact, or the cost and income cannot be verified with reasonable certainty, the RO cannot use the actual method. In such case, the tax authority shall have the right to determine the amount of taxes payable through the following two methods (deemed profit methods):
    - (a) *Expense method:* calculating taxable incomes based on appropriation expense, it is applicable to an RO which can provide accurate details of business expenses but cannot accurately substantiate its turnover or cost.
    - (b) *Income method:* calculating taxable income based on the gross income of the RO. This is applicable to an RO which can provide accurate gross income information but cannot provide cost and expense details.
  - (iv) ROs shall calculate and submit VAT and BT in accordance with relevant laws and regulations
  - (v) *Deemed profit rate:* If the deemed profit method is used, the deemed profit rate shall not be less than 15%, an increased from the old 10%.
4. **Tax exemption application:**
  - (i) The methods of tax exemption application of ROs in China is no longer determined based on the principal business of the head office, but on the applicable tax treaty and Guoshuifa [2009] 124 entitled “Notice of the State Administration of Taxation on Issuing ‘Administrative Measures on the Application for Preferential Treatment under a Tax Treaty by Nonresident’”
  - (ii) Local tax authorities shall no longer accept application from ROs for tax exemption from EIT, and shall revisit the taxability of ROs whose tax exemption has been previously approved based on the old rules.