



A summary of China tax developments for the fortnight ending 30 November 2009.

CHINA AND DENMARK SIGN BILATERAL

China and Denmark have signed the first China-Europe Bilateral Advance Pricing Agreement (APA).

It is the first APA signed between China and Denmark after the successful conclusion of the Sino-Japan, Sino-US and Sino-Korea APAs. APAs have started to exert considerable influence in solving cross-border tax disputes and avoiding international double taxation. APAs can be useful in promoting business relationships between two countries.

See more details about APA Rules in China in Focus on Page 2

CLARIFICATION ON INDIVIDUAL INCOME TAXATION ON SUBLETTING

The State Administration of Taxation has issued a notice indicating that it will allow sub-lessors to deduct the costs of the head lease from their income from the sub-lease for individual income tax purposes. Under the notice, the following points are made:

- Rent paid to a lessor is counted as a cost that can be deducted from the taxable income received from the sub-tenant;
- A contract of tenancy or other proof of payment of the rent should be submitted, otherwise the deduction will be denied; and
- The order of deduction when calculating individual income tax on a sub-lease is as follows:
 1. Taxes and fees paid to obtain the lease;
 2. Rent paid to the lessor;
 3. Maintenance fees assumed by the taxpayer;
 4. In respect of maintenance fees, the maximum allowable deduction is ¥800 if the expense is less than ¥4000, and 20% if more than ¥4000.

NOTICE ON TAX-FREE INCOME FOR NOT-FOR-PROFIT ORGANIZATIONS

The State Administration of Taxation (SAT) and the Ministry of Finance (MOF) have just published two notices on tax-free income scope and qualification recognition for not-for-profit organizations.

The first notice outlined the types of income that will be exempt for non-profit organizations including

- Donations;
- Memberships fees, however income in respect of the purchase of services is not included;
- Bank deposit interest from non-taxable income and tax-free income; and
- Other income stipulated by the MOF and SAT.

The second notice contains relevant regulations on the requirements to be recognized as a tax exempt non-profit organization. The non-for-profit sector is very heavily regulated in China so it is unlikely that these tax exemptions will be widely available.

A detailed analysis of application conditions and documents will be provided in the December edition of *Hwuason Insights*



IN FOCUS: ADVANCE PRICING AGREEMENTS IN CHINA

An Advance Pricing Arrangements (APA) is an agreement between a taxpayer and the authorities as to the appropriate pricing methodology to be utilized by the taxpayer for their transfer pricing practices. China's transfer pricing rules allow for APAs. On 8 January 2009, the SAT issued Circular 2 called "Implementation Regulations for Special Tax Adjustments (Trial)", which officially regulates the administration of APAs.

Under the regulations, an APA is commonly applicable for the coming three to five years. Further, an APA can be used by an enterprise that satisfies all the following conditions:

- Annual amount of related party transactions exceeds RMB 40 million;
- The enterprise fulfilled the obligations of declaring its related party transactions; and
- The enterprise prepared, maintained and provided contemporaneous documents in accordance with regulations.

Additionally, circular 2 sets out detailed procedures on APA administration, including six phases: pre-filing meeting, formal application, review and evaluation, negotiations, signing of the agreement, and monitoring and execution.

AUTOMOBILE INDUSTRY SURGES TAX GROWTH

On October 20 2009, automobile production and sales broke through the 10 million unit. Although taxation on the purchase of vehicles with engine displacements below 1.6 liters was reduced by half, automobile acquisition tax revenue increased 6.3 percent to 91.2 billion yuan. The State Administration of Taxation said that value added tax paid by the transportation equipment manufacturing industry grew 28.8 percent to 88.6 billion yuan during the period, and business income tax revenue was 30.7 billion yuan, up 29.6 percent.

CHANGES TO VALUE-ADDED TAX POLICY ON IMPORT OF SPECIFIED EQUIPMENT

On November 16 2009, an exemption notice has been published on import value-added tax for equipment imported pursuant to projects supported by loans from foreign governments and/or international financial groups. Importantly, for taxes already paid for equipment imported before Jan 1st, 2009, an application for a refund can be made.

TAXPAYERS CHARTER ISSUED BY SAT

In mid-November, the SAT issued a charter on taxpayers rights and obligations. It is quite a lengthy document so we will not detail it in full. However, we note some of the rights include the right for information to be kept confidential, the right to knowledge about China's tax laws and the right to apply for a refund where there has been an overpayment in tax. The important question is whether the charter will lead to an improved tax administration in China. At this early stage we think that it is very unlikely that the charter will lead to any in substance changes. However, we have been hearing noises for sometime that suggest some positive changes in respect of China tax administration may be on the horizon