



In 2008, with the new Enterprise Income Tax (“EIT”) Law’s taking into effect, starting of the indirect tax reform and changing of global economic environment, China issued several tax regulations and circulars, most of them are very important and their tax implications will affect enterprises in several sectors. This special issue is a summary of China Tax & Business 2008 major changes regarding the following taxes:

- Enterprise Income Tax;
- Individual Income Tax (“IIT”);
- Value-Added Tax (“VAT”);
- Consumption Tax (“CT”); and
- Business Tax (“BT”).

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Enterprise Income Tax

Year 2008 is the first year of the enactment of the new EIT regime in China. The Chinese government issued several regulations and circulars to clarify some unclear issues of the new EIT Law, including (but not limited to) tax incentive policies, EIT filing, etc.

Tax incentive policies

Grandfathering rules for the incentives of the existing enterprise under the New EIT Law

In December 2007, China issued two circulars (Guofa [2007] No.39 and No.40) to clarify grandfathering treatment for the tax incentives of the existing enterprise (approved to be established prior to the New EIT Law's 16 March 2007 enactment date) under the new EIT Law. In February 2008, China issued three new important tax circulars (Caishui [2008] No.1 and No.21, Guoshuifa [2008] No.23) with wide spread impact to Foreign Invested Enterprises ("FIEs") and their foreign investors.

Caishui [2008] No.21 mainly clarifies how the half-rate reduction during the unutilized tax holiday period should overlay with the gradually increased tax rate during the grandfathering period addressed in Guofa [2007] No. 39. Details as following:

Year	2008	2009	2010	2011	2012
Transitional Tax Rate	18%	20%	22%	24%	25%
Net Rate with 50% reduction	9%	10%	11%	12%	12.5%

Where the old FIEs were subject to 24% or 33% under the Foreign Enterprise Income Tax ("FEIT") regime, then the half-rate reduction during the unutilized tax holiday period should be calculated based on 25%, i.e. the net rate will be 12.5%.

Caishui [2008] No.1 mainly addresses new tax incentives available to certain industries on the basis of Article 36 of the EIT Law.

1. Tax incentives for software and integrated circuit industries

Caishui [2008] No.1 provides generous tax incentives to software production companies and integrated circuit companies, including EIT exemption on VAT rebate used for R&D and production expansion, tax holiday for newly established companies, a reduced EIT rate at 10% for qualified companies, fully deduction of staff training expenses incurred, shortening of depreciation period for fixed assets, etc.

2. Tax incentives for securities investment funds industries

Following income are temporarily exempt from EIT: income derived by securities investment funds from the stock market, income derived by investors from distribution from securities investment funds and gain derived by fund managers from trading of stocks and bonds using the securities investment funds.

3. Transitional arrangements of preferential tax treatments available to certain industries and enterprises under the previous regimes

Caishui[2008] No.1 allows the continuation of 6 types of fixed-period preferential tax policies available to certain industries and enterprises until their expiry, including re-employment, 2008 Olympic Games and 2010 World Expo, social welfare, enterprise reform, etc.

4. Special tax concession for dividend received by foreign investors

Distributions of the pre-2008 earnings of a FIE to a foreign investor in 2008 or after are exempt from EIT.

5. Revocation of previous preferential policies

The circular states that, except for as provided in the EIT Law and its detailed implementation rules, Guofa [2007] No.39 and No.40 and Caishui [2008] No.1, the other preferential policies under the previous income tax laws shall cease to be effective as of 1 January 2008. It also prevents local authorities from issuing other preferential EIT policies overriding the state regulations.

Caishuifa [2008] No.23 clarifies the transitional treatments of several EIT incentives that have been revoked under the new EIT Law.

- Reinvestment tax refund: Tax refund will be awarded for qualified reinvestment made, and relevant registrations with authorities completed on or before the end of 2007. Reinvestment made with the pre-payment of 2007 profits (interim dividends) will not qualify for the tax refund.
- Withholding tax on interest and royalties: EIT exemption on interest or royalties arising from loan agreement or license contracts entered into on or before the end of 2007, which met the withholding tax exemption criteria under the FEIT Law and already approved by the tax authorities, will remain in effect until the expiry of the agreement or contract. However, this transitional treatment shall not apply to any extensions or modifications to the original agreement or contract.
- The qualification requirements for the tax incentive benefits for tax holidays under the previous FEIT Law (i.e. the business nature/scope and operating period) will remain applicable in and after 2008.

Recognition of High-New Technology Enterprise (“HNTE”)

China’s new EIT Law includes certain benefits for enterprises that qualify for HNTE. The principal incentive for HNTE is a reduced 15% tax rate in contrast to the normal 25% tax rate.

On 30 January 2008, China issued a Circular Guoshuifa [2008] No.17 stated that enterprises which were recognized as HNTE before 1 January 2008 should conduct provisional EIT filings based on the standard EIT rate of 25% until they are re-recognized as such under the new EIT Law. The Ministry of Science and Technology, the Ministry of Finance and the SAT jointly issued circulars (GKFH [2008]No.172 dated 14 April 2008 and GKFH[2008] No.362 dated 8 July 2008) to set forth the key requirements and relevant administrative procedures of recognition of the HNTE.

The requirements for the HNTE include:

- Be established within China (excluding Hong Kong, Macau or Taiwan);
- Have existed for more than one year;
- Continuously conducts R&D activities and transform Intellectual Property (“IP”) developed into products and/or services;
- Has its own IP rights; and
- Carries out business in “State-Encouraged High Technology Areas”, etc.

The IP rights can be obtained through the following means: conduct of independent R&D activities; transfer; acquisition through a corporate merger and acquisition transaction; donation or gift; exclusive license rights for more than five years. The exclusive license right must be the worldwide rights and not merely the right to exploit the relevant IP in China.

The worldwide exclusive license right seems to create an obstacle for subsidiaries of foreign-based multinationals to successfully qualify for HNTE status. From a commercial perspective, the multinationals will be very reluctant to license the worldwide exclusive license right to their subsidiaries in China.

Cataloguers and implementation issues of preferential EIT treatments for specialized equipments and projects

In accordance with Article 27 and Article 34 of the new EIT Law and Article 100 of the Detailed Implementation Rules of the EIT Law, 10% of the investment on special equipment used in environmental protection, energy or water conservation, or safe production can be credited against tax payable by the enterprise for the current year; any excess in such credit may be carried forward for the following five tax years. An enterprise that transfers or leases these specialized equipment within five years of purchase will no longer be eligible for the preferential EIT treatment, and will have to repay the amount already credited against EIT payable.

In accordance with Article 27 of the new EIT Law and Article 87 of the Detailed Implementation Rules of the EIT Law, where an enterprise is engaged in the projects prescribed in *the catalogue of preferential EIT treatments for public infrastructure projects*, the income derived from the investment of those projects can be entitled to the tax holiday of “3-year exception followed by 3-year 50% reduction”. Enterprises undertaking the prescribed projects on a contractor basis or for own use cannot enjoy the preferential treatment.

In accordance with Article 27 and Article 33 of the new EIT Law and Article 99 of the Detailed Implementation Rules of the EIT Law, an enterprise can take into account 90% of the revenue derived from the use of resources prescribed in *the catalogue of preferential EIT treatments for synergistic utilization of resources* as raw materials in production that are neither restricted nor prohibited by the State and that comply with State and industry standards.

In 2008, the relevant government authorities issued the 2008 versions of the five cataloguers:

- the catalogue of preferential EIT treatments for specialized equipment in environmental protection (Caishui [2008] No.115)
- the catalogue of preferential EIT treatments for specialized equipment in energy or water conservation (Caishui [2008] No.115)

- the catalogue of preferential EIT treatments for public infrastructure projects (Caishui [2008] No.116)
- the catalogue of preferential EIT treatments for synergistic utilization of resources (Caishui [2008] No.117)
- the catalogue of preferential EIT treatments for specialized equipment in safe production (Caishui [2008] No.118)

Those catalogues retroactively came into force on 1 January 2008 to be in line with the effective date of the new EIT Law and the Detailed Implementation Rules of the EIT Law.

In September 2008, the Ministry of Finance and the SAT jointly issued circulars (Guoshuifa [2008] No.46, No.47 and No.48) to clarify some issues regarding the tax incentive policy of those catalogues. However, as the relevant administrative measures have not been promulgated yet, the application procedures and documents requirement to enjoy the preferential EIT treatments remain unclear.

EIT filing

Group consolidated EIT filing

According to Article 52 of the EIT Law, enterprises are not allowed to consolidate their filing and settlement of EIT except as otherwise prescribed by the State Council.

On 14 July 2008, the SAT issued a notice (Suobianhan [2008] No.27) to notify that since the State Council has not released any policy regarding this issue, enterprises approved by the SAT for consolidated EIT filing and settlement can continue enforcing the current policy until new notice released.

Three months later, the Ministry of Finance and SAT have jointly issued a circular (Caishui [2008] No.119) to allow some groups of enterprises that were originally approved to perform consolidated EIT filing on a group basis prior to 31 December 2007 to continue the same for the year 2008 EIT filing. For the list of approved enterprises attached to the circular, there is no FIE which has been allowed to file on a consolidated basis prior to 31 December 2007, all of these enterprises are domestic enterprises with some of them State-owned. The circular also states clearly that these enterprises would not be allowed to perform group consolidated EIT filing from 2009 onwards.

New Provisional EIT Filing Returns

The new EIT return forms were promulgated by a SAT circular (Guoshuihan [2008] No.44) dated 4 February 2008, including:

- The Monthly/Quarterly Provisional EIT Returns (Type A): applicable to taxpayers filing on an actual bases
- The Monthly/Quarterly Provisional EIT Returns (Type B): applicable to taxpayers filing on a deemed bases
- The Withholding EIT Return: applicable to EIT withholding agents

- The Tax Payment Allocation Return (for companies with branches carrying on business independently and filing EIT on a consolidated basis)

Tax filing obligations are the same under both the old and the new EIT Laws. Taxpayers are obliged to file monthly or quarterly EIT returns, to be followed by an annual return upon completion of audit.

The key changes to the new EIT returns are procedural. Taxpayers with headquarters and branches in multiple provinces or municipalities are required to settle provisional EIT locally. That is, starting 2008, those taxpayers should calculate their taxable income and EIT payable on a consolidated basis, but should conduct separate monthly/quarterly provisional EIT filings and settle the apportioned (50%) provisional EIT with their local tax authorities. To determine the allocation basis, the head office should file a Tax Payment Allocation Return Form before the end of May each year reporting the information of revenue, staff salary and total assets of the head office and the branch or branches for the preceding calendar year.

On 30 June 2008, the SAT issued a circular (Guoshuihan [2008] No.635) to clarify some issues regarding the new EIT return forms, i.e. the "Total Profit Amount" of Type A Item 4 should be revised as "Total Actual Profit Amount".

For consolidated EIT filing and settlement for enterprises with headquarters and branches in multiple provinces and municipalities in China, the SAT issued several circulars (Caiyu [2008] No.10, Guoshuifa [2008] No.28 and Guoshuihan [2008] No.747) to conduct measures governing it.

The circular of Caiyu [2008] No.10 provides the policy on how the EIT liabilities shall be calculated and settled by the headquarters and branches across different provinces in China, and how the EIT revenue shall be allocated between central and local governments for taxpayers with headquarters and branches.

Circular Guoshuifa [2008] No.28 clarifies issues such as the payment of provisional EIT with local tax authorities and tax allocation among branches by Chinese resident enterprises. It makes available more detailed and taxpayer-centric procedures, including:

- Who is required to file provisional monthly/quarterly EIT returns with their local in-charge tax bureaus and remit the provisional EIT locally?
Headquarters and second-tier branches with business operations
- How to allocate provisional EIT?
 1. Calculate provisional EIT on the consolidated taxable income of the taxpayer. The consolidated taxable income of the enterprise may be determined either based on the actual profits of the current period or based on one twelfth (for monthly reporting) or one quarter (for quarterly reporting) of the previous year's taxable income. The provisional EIT liability is calculated by multiplying the consolidated taxable income by the applicable EIT rate.
 2. Allocate the provisional EIT liability among headquarters and branches: 50% of the provisional EIT liability of the taxpayer shall be allocated to the headquarters and the remaining 50% shall be allocated among the branches
 3. Allocate the provisional EIT liability among branches considering factors of revenue, staff

salary and total assets of participating branches

On 21 August 2008, the SAT issued Guoshuihan [2008] No.747 to clarify two additional issues regarding provisional EIT filing. Firstly, it confirms the right of the tax authority in a branch location to demand the taxpayer's headquarters and the tax authority at the headquarters' location to make available a Tax Payment Allocation Return. Secondly, it confirms that the calculation of EIT on a deemed bases does not apply to provisional EIT filing involving branches.

Annual Enterprise Income Tax Return

On 30 October 2008, the SAT released the 2008 Annual EIT Return Package under a circular (Guoshuifa [2008] N0.101) which should be used for the annual EIT filing of 2008 on 30 October 2008.

The Annual EIT Return Package includes one lead form and 11 schedules, titles of the lead form and 12 schedules are as following:

- Lead form: PRC Annual EIT Return
- Schedule I: Breakdown of income
- Schedule II: Breakdown of expense
- Schedule III: Breakdown of tax adjustments
- Schedule IV: Breakdown of making up for loses
- Schedule V: Breakdown of tax incentives
- Schedule VI: Breakdown of foreign tax credit
- Schedule VII: Tax adjustments of assets measured at fair value
- Schedule VIII: Tax adjustment of advertising and business promotion expenses
- Schedule IX: Breakdown of tax adjustment of depreciation and amortization
- Schedule X: Breakdown of tax adjustment of provisions
- Schedule XI: Breakdown of income/loss from long-term investments

(For Schedule I and II, there are different sets of schedules for financial institutions and public institutions, social organizations and privately-owned non-corporate institutions.)

The Annual EIT Return Package adopts most of the features of the former annual income tax return applied for domestic companies and requires more schedules and information disclosure than the former annual income tax return applied for foreign-invested enterprises.

Schedule VII is new introduced for tax adjustment of assets which are required to be measured at fair value under the new China Accounting Standards. It is designed to accommodate a circular (Caishui [2007] No.80) 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. Balance of disposal income and original cost of these assets should be recognized as taxable income or loss for the tax year when disposal or settlement happened.

Under the new EIT regime, the filing deadline of the Annual EIT Return Package is 31 May which provide more time of one month for taxpayers to prepare it. However, as the new EIT return is

much more complicated and there are still some unclear issues regarding preparation for the Annual EIT Return Package (i.e. the definition of “non-deductible advertising and business promotion expenses” for Schedule VIII), it would be a challenge for enterprises to better monitor its information collection and disclose them in the Annual EIT Return Package.

Attachment to Annual EIT Return – Annual Related-Party Transactions Disclosure Forms

As prescribed in Article 43 of EIT Law, enterprises should enclose annual related-party transactions disclosure forms (“the RPT Disclosure Forms”) when submit annual EIT return to tax bureaus. On 5 December 2008, the SAT issued the RPT Disclosure Forms in the circular of Guoshuifa [2008] No.114 and ended enterprises’ long waiting. The RPT Disclosure Forms should be submitted together with annual EIT return on or before 31 May 2009.

The RPT Disclosure Forms include a front cover and 9 forms.

- The front cover asks for some basic information of the taxpayer, i.e. company name, tax code, legal representative, contact number, submission date, report year, etc.
- Form I (Related Party Relationship Form) lists the basic information of related parties.
- Form II (RPT Lead sheet) is a summary of Form III to Form IX, which summaries the total transaction amount, domestic and overseas amount and relevant ratios of each type of RPT.
- Form III to Form IX are the breakdown of each type of RPT, including: purchases and sales, service, transfer of intangible assets, transfer of fixed assets, financing, outbound investment and outward payments.

Below is the comparison with the RPT Disclosure Forms and the old ones which should be submitted together with the Annual Income Tax Return of FIE.

RPT Disclosure Forms	Old Forms	Comparison
Front Cover	A13-A A13-B	<ul style="list-style-type: none"> - Simplify the basic information to be disclosed - Remove the requirement of disclosing total capital amount and major business scope
Related Party Relationship (Form I)	A1301	<ul style="list-style-type: none"> - Revise the definition of 8 RPT types coded form A to H - Disclosure information includes tax code, address, legal representative’s name of related party besides company name and located country/region
RPT Lead Sheet (Form II)	A1301 A13-B	<ul style="list-style-type: none"> - Add a wording to disclose if contemporaneous documentation is exempted or prepared according to the requirement - Add a wording to disclose if a cost-sharing agreement exists - Specify the different transactions types - Disclosure information for each type of transaction includes total transaction amount, RPT amount, domestic RPT amount, overseas RPT amount, and relevant ratios

		<ul style="list-style-type: none"> - Remove the tax bureau's verification part on the transaction amount
Purchases and Sales (Form III)	A1302	<ul style="list-style-type: none"> - Add a new column to disclose the export sales income by dividing export trading into processing of consigned imported materials and other trading - Set threshold for disclosing: overseas sales/purchases income accounts for more than 10% of the total export sales/purchases - Disclosure information includes located country/region of related or unrelated party and pricing method for RPT besides the related or unrelated party's name and transaction amount
Services (Form IV)	A1303	<ul style="list-style-type: none"> - Set threshold for disclosing: overseas service income/payment accounts for more than 10% of the total export labor service income/payment - Disclosure information includes located country/region of related or unrelated party and pricing method for RPT besides the related or unrelated party's name and transaction amount, while excludes the content of the services
Transfer of Intangible Assets (Form V)	A1306	<ul style="list-style-type: none"> - Separate the transactions into two sections of "use rights" and "ownership rights" - Add a column to specify the categories of intangible assets, including land use right, patents, know-how, trademarks, copyrights and others - Remove the requirement of disclosing each related party's name of each RPT
Transfer of Fixed Assets (Form VI)	A1305	<ul style="list-style-type: none"> - Change the name of "Tangible Assets" to "Fixed Assets" - Separate the transactions into two sections of "use rights" and "ownership rights" - Add a column to specify the categories of fixed assets - Remove the requirement of disclosing each related party's name of each RPT
Financing (Form VII)	A1304	<ul style="list-style-type: none"> - Add a wording to disclose the ratio of debt investment from related parties to equity investment - More information should be disclosed, i.e. currency; interest rate, start/end dates, country/region, guarantee rate - Remove the requirement to disclose the financing with unrelated parties - The financing information is required to be disclosed based on each related party
Outbound Investment Status	N/A	<ul style="list-style-type: none"> - This form is newly introduced and is applicable to taxpayer which own shares of a foreign enterprise ("FE"), separate form for each FE should be completed if the taxpayer holds

(Form VIII)		<p>shares in more than one FE</p> <ul style="list-style-type: none"> - Disclose following information of the invested FE: <ul style="list-style-type: none"> a. Certain basic information, i.e. name, address, date of establishment, business scope, legal representative, etc. b. Details on its total shares c. Whether it is registered in the non-low-tax-rate country appointed by the SAT d. Whether its annual profit is no more than RMB 5 millions e. Annual enterprise income tax (“EIT”) burden f. Information of its shareholders, i.e. name, country/region, etc. g. Annual Profit and Loss Statement and Balance Sheet - Disclose details on shares of the invested FE owned by the reporting taxpayer and dividend distributed to the reporting taxpayer
Outward Payment Status (Form IX)	N/A	<ul style="list-style-type: none"> - The form is newly introduced and is required to disclose the outward payment made (or accrued) to overseas entities, especially to overseas related party - Information should be disclosed by different categories of payment - The taxpayer should report any withholding EIT paid and indicate whether the transaction is entitled to preferential tax treatment under tax treaty

Others

Taxes or expenses not deductible for withholding tax calculation effective from 1 January 2008

Under the new EIT Law, non-resident enterprise does not have an establishment or place of business in PRC but derives dividends, interest, rental, royalties, capital gains and so on from PRC, or which has an establishment or place of business in PRC but the aforesaid PRC-sourced income is not effectively connected to the establishment or place of business, the withholding tax is to be applied on the total amount of incomes without any deduction of taxes paid or expenses incurred.

On 25 Sep 2008, the Ministry of Finance and the SAT jointly issued a circular (Caishui [2008] No.130) to further reiterate that, when calculating the withholding tax on PRC-sourced income derived by non-resident enterprises, any tax paid or expense incurred is not deductible effective 1 January 2008. Guoshuifa [1996] No.212 and Caishuizi [2008] No.59 stated that BT paid from the gross rental or royalty income before applying the withholding tax is deductible. There is no clear guidance on withholding tax on PRC-sourced income derived by non-residence enterprises after 1 January 2008 while before 25 September 2008. Whether the BT could be deductible remains uncertain.

EIT implications of service fees charged from a parent company to its subsidiaries in China

On 25 Sep 2008, the SAT issued a circular (Guoshuifa [2008] No.86) clarifying the EIT implications of service fees charged from a parent company to its subsidiaries in China, including:

- The service fee should be charged based on arm's length principle, otherwise, the tax authorities have the right to make adjustments;
- Service provided by a parent company to its subsidiaries should be supported with a contract or an agreement which specify the service scope, fee quota and total charges.
- When a parent company providing similar services to its several subsidiaries, the service fee may be charged based on a cost sharing agreement, i.e. the service fee is allocated in the subsidiaries based on the total actual cost incurred plus a certain level of profit.
- The management fee charged by a parent company cannot be deducted for its subsidiaries' EIT purpose.
- Service fee cannot be deducted for the subsidiaries' EIT purpose without a service contract or agreement and other supporting documents.

Parent companies that provided services to their subsidiaries should review their service arrangements to confirm that they are comply with the requirements set up in the circular. The transactions between a parent company and its subsidiaries should also meet relevant transfer pricing requirements (i.e. documentation requirement) since they are treated as transactions between related parties.

Thin capitalization ratios

The Ministry of Finance and the SAT jointly issued a circular (Caishui [2008] No.121) to specify the two debt-to-equity ratio standards and other requirements for deduction of interest expenses incurred on loans from related parties for EIT purposes.

1. Interest expenses incurred on loans from related parties could be deductible for EIT purposes if they meet the two debt-to-equity ratio standards: 5:1 for financial enterprises and 2:1 for others. Excess interest expenses are not deductible for the current and following tax year.
2. Actual interests paid to the resident related parties could be deductible for EIT purpose if the enterprise could provide relevant documents and substantiate relevant transactions are in arm's length principle according to the relevant tax circulars/regulations; or its actual tax liability of the resident borrower is less than that of the resident lender.
3. Enterprises should portion the actual interest expenses for financial business and other business if they are simultaneously engaged in both services. Otherwise, ratio for others should be applicable for the interest expenses incurred from both services.

The circular did not mention about how to calculate the debt-to-equity ratio, while the drafted version of Management Rule on Special Taxation Adjustment ("the Rule") issued on 1 Apr 2008 indicates it in Chapter Nine.

$$\text{Debt-to-equity ratio} = \frac{\text{Sum of average related-party debt investment from Jan to Dec of the year}}{\text{Sum of average equity investment from Jan to Dec of the year}}$$

Where:

Average related-party debt investment of each month

= related-party debt investment opening and ending balance of the month / 2

Average equity investment of each month

= equity investment opening and ending balance of the month / 2

If the company's debt-to-equity ratio is in excess of the standard and cannot fulfill one of the two conditions, the non-deductible interest expenses may be calculated as following:

Non-deductible interest expenses = Annual interest payable to related parties x (1- debt-to-equity ratio standard / debt-to-equity ratio of the company)

Interest expenses deemed as dividends may be calculated as following:

Interest expenses deemed as dividends = Annual interest payable to foreign related parties x (1- debt-to-equity ratio standard / debt-to-equity ratio of the company)

The Rule also specifies documentation requirements if the company's debt-to-equity ratio exceeds the standards:

- Analysis on the borrower's credit and borrowing capacity
- Interest rate, period and capital transactions are in arm's length principle
- Comparability analysis on the conditions and interest determination of related-party and non-related party investment, including the scale and structure of the whole investment, scale and structure of related-party investment, requirements for non-related party to gain similar investment, difference for the interest rate of related-party investment comparing with that of market, and so on.
- Movement of registered capital and investment conditions.

Kindly note the Rule is drafted and is not statutorily final. The calculation formulas and documentation requirements may be changed. Enterprises should wait for the final version to step into the relevant stage.

EIT treatment on asset disposals

The SAT issued a notice to clarify EIT treatment on asset disposals (Guoshuihan [2008] No.828) on 30 Oct 2008. The following assets disposals, excluding assets transferred to overseas could be treated as internal disposals without any deemed sales income issues since assets' ownership remains unchanged:

1. Use of assets to produce, manufacture or process another production;
2. Change of assets' status, structure or function;
3. Change of assets' use, i.e. self-built commercial estates being transferred for self-use or transaction);

4. Use of assets to transferred between a headquarters and its branches;
5. Combination of the above two or more situations;
6. Other use of assets without changing the assets' ownership.

The following use of assets disposals should be treated as deemed sales:

1. Promotion or sales;
2. Entertainment;
3. Staff incentive or welfare;
4. Dividend;
5. Donation;
6. Other situations with changing of assets' ownership.

The deemed price of the self-produced assets should be ascertained based on the sales price of the similar assets in the same period; that of the purchased assets should be ascertained based on the cost price at the time of purchase.

Kindly note that the definition of deemed sales is different from the perspective of EIT compared to that of VAT. For example, use of assets to transferred between a headquarters and its branches will not be treated as deemed sales for EIT purposes, while it could be treated as deemed sales under certain circumstance for VAT purpose. Enterprises should consider these differences and understand relevant tax implications.

Individual Income Tax

Amended Detailed Implementation Rules of IIT

On 18 February 2008, the State of Council issued the amended Detailed Implementation Rules of IIT which incorporate some revisions made in separate circulars before, reorganize the order of certain items and revise some wording and descriptions. Details are as following:

- Include “other types of economic profit” in the individual’s income type and remove the wording of tax authority is responsible for assessing the taxable income for income derived from physical objects without price certificate or the price is obviously low and securities. The remaining problem is how to assess the taxable income of “other types of economic profit” and who can assess the taxable income for income derived from certain physical objects and securities.
- Uplift the monthly standard deduction for income derived from contract or lease operation from to RMB1,600 to RMB2,000 and reduce the relevant monthly additional deduction from RMB2,000 to RMB1,600.
- Uplift the monthly standard deduction for income derived from salaries/wages from to RMB1,600 to RMB2,000 and reduce the relevant monthly additional deduction from RMB3,200 to RMB2,800. Thus, the tax-free threshold for IIT calculation of local individuals is raised while that of expatriates remains unchanged. On 20 February 2008, the SAT issued a circular (Guoshuifa [2008] No.20) to clarify the standard deduction of RMB2,000 is taken effective since 1 March 2008.

IIT treatment on dividend distributed to Individual shareholder as credit or debt

The SAT issued a circular (Guoshuihan [2008] No.267 to clarify that for individual shareholder, the income derived from dividends distributed in types of net income of credit and debit should be subject to IIT. The taxable income should be the actual dividend and the balance of account receivable (credit) and account payable in book value.

IIT treatment on individual’s income derived from house or other property paid by the company

The SAT stated that income derived from following sources should be treated as taxable income for PRC IIT purpose in the circular of Caishui [2008] No.83:

- House or other property owned by individual investors, their family members or other company’s staff while the cost is paid by the company; or
- Individual investors, their family members or other company’s staff purchase house or other property with the money borrowed from the company and did not pay back at the end of the borrowing year.
- For individual investors and their family members of personal owned enterprises and partnership enterprises, abovementioned income should be subject to IIT as “Income from

operation of private business". Otherwise, the income should be included in the monthly salaries/wages and subject to IIT.

Value Added Tax

Uplifting of export VAT refund rates

With the influence of reduction of international market demand, appreciation of RMB, price rising of raw material and labor, the percentage growth in export declined in the first nine months of 2008 compared with the same period in 2007. In order to ease the economic pressure on export companies, the Ministry of Finance and the State Administration of Tax jointly issued circulars to uplift export VAT refund rates four times in the second half of 2008.

Key Items	Old refund rate	New refund rate
1st Adjustment (Caishui[2008] No.111, effective 1 August 2008)		
Certain textiles and clothing accessories	11%	13%
Certain bamboo products		11%
Korean pine-nuts, certain agricultural pesticides, rosin, certain silver products, certain lacquer products, certain batteries		export VAT refund cancelled
2nd Adjustment (Caishui [2008] No.138, effective 1 November 2008)		
Certain textiles, certain garments and toys		14%
Certain daily used/ornamental ceramic products		11%
Certain plastic products		9%
Certain furniture		11%, 13%
Certain anti-AIDS drugs, insulin and its salts, certain yellow collagen products, certain toughened glass, wire of tantalum, certain chains, certain sewing machines, certain fans, certain metal carbide knives for machines, certain books and notebooks		9%, 11%, 13%
3rd Adjustment (Caishui [2008] No.144, effective 1 December 2008)		
Certain rubber products and forestry products	5%	9%
Certain modules and glassware	5%	11%
Certain aquatic products	5%	13%
Certain handbags, certain footwear and headgear, certain umbrellas, certain furniture, certain bedding, certain lamps, certain clocks and watches	11%	13%
Certain chemical products, certain articles of stone, certain non-ferrous metal products	5%, 9%,	11%, 13%
Certain mechanical and electrical products	9%, 11%, 13%	11%, 13%, 14%
4th Adjustment (Caishui [2008] No.177, effective 1 January 2009)		

Certain inertial navigator, certain gyroscopic apparatus, certain ionic rays detectors, certain nuclear reactors and certain industrial robots	13%, 14%	17%
Certain motorcycles, certain sartoriuses and certain electric conductors	11%, 13%	14%

The adjustments increase the VAT refund of labor-intensive commodities, high-tech and high value added goods, while abolish the VAT refunds of certain high-energy-consuming, high pollution or natural resource products merchandise.

Amended Provisional Regulation and Detailed Implementation Rules of VAT

Chinese government has inaugurated the VAT reform from the “production-base” to “consumption base” step by step since 2004, details of the steps for expanding the scope of input VAT credit for fixed assets for certain industries as following:

Effective Date	Circular	Applicable Area
14 September 2004	Caishui [2004] No.156	Northeast Region of mainland China
11 May 2007	Caishui [2007] No.75	Central region of mainland China
2 July 2008	Caishui [2008] No.94	Eastern Inner Mongolia
1 August 2008	Caishui [2008] No.108	The Wenchuan Earthquake stricken areas

On 14 November 2008, the Chinese Government made amendments to the Provisional Regulations of VAT, which take effective from 1 January 2009. On 15 December 2008, the Ministry of Finance and the SAT have revised the Detailed Implementation Rules of VAT. Thus the scope of input VAT credit for fixed assets has been expanded to virtually all industries with a nation-wide coverage.

Highlights of the key points are summarized as follows:

1. Transform from "production-base" to “consumption base”
 - All general VAT taxpayer can claim input VAT for the new equipment purchased, unused input VAT can be carried forward to offset the future output VAT.
 - Input VAT for fixed assets with mixed use for VAT taxable projects and other purposes (i.e. non VAT taxable projects, VAT-exempt projects, collective welfare, and personal consumption) is creditable.
 - Small motor cars, motorcycles and yachts that should be subject to Consumption Tax and could be used for private purposes are excluded from the scope.
 - Goods or VAT taxable services used for entertainment purposes is not deductible from the output VAT.
 - VAT exemption on equipment import and VAT refund on foreign enterprise purchasing domestically-made equipment will be canceled as complied policy to the reform. Separate circulars are expected since the Detailed Implementation Rules of VAT have not stressed it.

2. Clarify of “mixed sales” and “concurrently activities”

- The general principle to determine whether a taxpayer shall be subject to VAT or BT in a “mixed sale” depends on the nature and the main business scope of the taxpayer. Meanwhile, special rule for taxpayers in the construction business which was addressed in a former tax circular is now introduced into the Amended Detailed Implementation Rules of VAT.
- For enterprises engaged in concurrently activities, provision of VAT taxable businesses and BT taxable businesses should account separately for the sales value and the business turnover. Otherwise, it could end up in the whole turnover being subject to VAT in currently practice. Under the amended Provisional Rules of VAT, the in-charge tax authorities are empowered to assess the sales values attributable to VAT payable business and BT payable business respectively.

3. Support to small-scale taxpayer

- Threshold for general VAT taxpayers is reduced from the current annual sales value of RMB 1 million to RMB 0.5 million (for the manufacturing companies) and from RMB 1.8 million to RMB 0.8 million (for the trading companies) respectively.
- Tax rate for small-scale taxpayer is reduced to 3%.

4. Revisions on administration

- Introduce Quarterly VAT filing which is only applicable to the small-scaled taxpayer
- Extend the filing deadline from 10 days to 15 days. For goods import, the tax payment should be settled within 14 days instead of 7 days after the issuance of the tax payment certificate by the customs office.
- Clarify the timing of VAT liability for sales of goods on credit or on installments, for advance payment and for manufacturers of large machinery or equipment, ships, and airplanes where the production period exceeds 12 months
- Remove items of “losses resulting from natural disasters” and “other abnormal losses” from the definition of “abnormal losses”: This change narrowed the scope of abnormal losses and will be helped on avoiding unnecessary disputes between taxpayers and tax bureaus.
- Empower the tax authorities to make tax adjustments: If the sales price of goods is obviously and unjustifiably low or where the amounts of turnover are not available in deemed sales activities, the tax authorities have the right to access the turnover as the tax basis and they can refer to the average sales price of similar goods sold by other taxpayers in recent period.

Cancellation of VAT refund on foreign enterprise purchasing domestically-made equipment

Previously, qualified foreign enterprises could apply for VAT refund on purchasing domestically-made equipment. In light with the VAT reform, the Ministry of Finance and the SAT jointly issue a circular (Caishui [2008] No.176 dated 25 December 2008) to cancel this VAT refund policy effective from 1 January 2009.

- Abolish relevant circulars, including Guoshuifa [1997] No.171, Item 1 of Caishui [2004] No.116, Caishui [2006] No.61, Guoshuifa [2006] No.111 and Guoshuifa [2006] No.637.
- Foreign enterprises purchased equipment on or before 30 June 2009 can claim for VAT refund with following requirements are met:
 1. VAT special invoice for purchasing the equipment can be verified by the tax authorities
 2. Obtain *the confirmation of foreign invested projects complying with the State's industry policy* on or before 9 November 2008 and complete the documentation requirement in tax authorities by 31 December 2008
 3. Obtain valid VAT special invoice for purchasing the equipment and apply for VAT refund in tax authorities
 4. the domestically-made equipment purchased is specified in *domestically-made equipment lists of the project*
- Foreign enterprises which enjoyed VAT refund on purchasing domestically-made equipment should not claim for the relevant VAT input offset the VAT output
- Domestically-made equipment which enjoyed VAT refund is subject of a supervision period of five years. VAT refund could be claimed back if the enterprise is not qualified for the VAT refund policy, i.e. the foreign enterprise is changed to a domestic company, or the equipment is transferred, donated, leased or re-invested to other entities, etc. The VAT repaid amount should be calculated as following:

$$\text{VAT repaid amount} = \text{net value of the domestically-made equipment} \times \text{tax rate}$$

This circular provides another choice for foreign enterprise when considering the VAT input for purchasing domestically-made equipment. Qualified enterprise can either choose to apply for VAT refund or claim VAT input credit when purchasing the domestically-made equipment during the transition period.

Consumption Tax

Amended Provisional Regulation and Detailed Implementation Rules of CT

In light of the recent VAT reform, the Chinese government made amendments to the Provisional Regulations of CT on 14 November 2008 and revised the Detailed Implementation Rules of CT on 15 December 2008.

Highlights of the key points are summarized as follows:

1. Incorporate revisions made to CT rules and regulations since 1994
 - Incorporate the composite taxation method on cigarettes and distilled spirits
 - Made adjustments on taxable categories (including luxury watches, golf balls and equipment, hardwood flooring, yachts and disposable chopsticks, excluding skin care and hair care products)
 - Adjust the applicable rates for cigars, jewellery, tyres, certain automobiles
 - Include “other institutions or individuals that are specified by the State Council” considering CT for jewellery payable at the point of sale rather than on production or importation as previously
 - Specify the principal should be the CT payer under a subcontract processing arrangement where the processor is an individual
2. Revise certain CT articles to complement the changes in the new provisional regulations of VAT
 - Introduce quarterly filing requirement for certain companies
 - Extend the filing deadline from 10 days to 15 days
 - Change the filing location from the place of the taxpayer’s bookkeeping to where it is resided or located
 - Clarify that the scope of additional charges should not include the administrative fees or funds collected on behalf of government or government departments
 - Clarify the tax points about when the liability arises to pay CT

Business Tax

Amended Provisional Regulation and Detailed Implementation Rules of BT

To keep pace with the latest VAT reform, the State of Council issued the provisional regulation of BT on 14 Nov 2008 which will be effective on 1 January 2009. On 15 December 2008, the Ministry of Finance and the SAT have revised the Detailed Implementation Rules of BT.

Highlights of the key points are summarized as follows:

1. Change the BT levying principle and rules

- Change the BT levying principle from where the service is performed to where the entity or individual is established or domiciled: Currently, only services performed within the territory of China are subject to BT. The new Detailed Implementation Rules of BT defines that entities and individuals located within the PRC who are providing or receiving the BT taxable services are subject to the BT.
- Eliminate the rule of levying BT on the net interest income for sub-lending business: In current BT practice, for foreign currency sub-lending business, the interest paid to the upper-stream lender can be deducted from the total interest income generated from the sub-lending business. Under the new Provisional Regulation of BT, the foreign currency sub-lending should be calculated on the total interest income without any deduction.
- Insurance services for exported goods by an insurance company within the territory of China is exempt from BT.

2. Revisions on administration

- The liability to pay BT arises when the business proceeds are received or when the supporting documents to claim it is obtained.
- The location for BT payment should be the place where the business establishment is located or resident.
- Taxpayer can file BT on a quarterly basis and the filing deadline is extended from 10th to 15th.

3. Others

- Empower the tax authorities to make tax adjustments: If the transaction price of service, intangible assets transition and estate sales is obviously low and without proper justification, the tax authorities have the right to access the turnover as the tax basis and they can refer to the average price for a similar transaction of other taxpayers in recent period.
- Remove the detailed description of taxable items from the table of tax scope and rate attached to the Provisional Rules of BT.

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