China Alert

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Be Prepared – 2010 Year-End China Tax Checklist

It is that time of the year again. Corporations are finalising their financial statements and having them audited. The Corporate Income Tax filing season has also begun. Subsequently, corporations may also plan to repatriate profits out of China. Corporations have to consider and resolve many complex issues that are presented by the tax and foreign exchange regulations issued by Chinese authorities in 2010 and earlier. To help corporations to assess their major tax compliance requirements, identify potential tax issues and develop solutions for these issues, we set out below a 2010 Year-End China Tax Checklist.

When going through the checklist, it is important to note that if a corporation fails to meet the tax filing and payment deadlines set by the relevant tax regulations, the tax authorities may impose penalties and late payment surcharges on the taxpayers or withholding agents. Penalties range from 50 percent to 500 percent of the amount of tax underpaid. Late payment surcharge is as high as 0.05 percent per day on the amount of tax underpaid. It is also important to note that the Chinese tax authorities have the power to recover tax liability within three years after the fiscal year in which the tax liability arises and, where the amount of tax payable is significant, the tax recovery period can be extended to five years. In the event of tax evasion, the tax authorities may pursue the taxpayer indefinitely.

Conversely, in the event that a taxpayer has overpaid tax, the taxpayer may seek to obtain a tax refund from the tax authorities within three years from the tax year in which the excess tax payment was made, together with interest. If that deadline is missed, the taxpayer will not be able to obtain the refund.

The following checklist does not purport to be an exhaustive list of key China tax compliance requirements. The deadlines may be subject to change by central / local tax or finance authorities.

Corporate Income Tax (CIT)					
Action	**Key points**	**Deadline**	**Y**	**N**	**N/A**
Prepare and submit 2010 annual CIT return & reconciliation of quarterly provisional tax payments	CIT Law and Implementation Rules This requirements applies to corporations set up in China as well as foreign corporations that have permanent establishments in China	31 May 2011	☐	☐	☐
Prepare and have ready for submission 2010 transfer pricing documentation reports and related information	Circular Guoshuifa [2009] No. 2 • "Nine forms" detailing related party transactions shall be submitted with the annual CIT returns • Documentation reports should be ready for submission as and when required by the tax authorities	31 May 2011	☐	☐	☐
Apply with the relevant tax authority for CIT deduction of asset losses	Circular Guoshuifa [2009] No. 88 • Losses on assets are deductible in the year in which the losses actually occur • Six type of asset losses may be deducted without prior approval	14 February 2011	☐	☐	☐
Notify the relevant tax authorities of special tax treatments of corporate restructuring (rollover relief)	Circular Caishui [2009] No. 59 and SAT Announcement [2010] No. 4 Where relevant conditions are satisfied, tax on capital gains on share transfers, mergers, de-mergers, etc may be deferred.	31 May 2011	☐	☐	☐
Consider the risks of lapsing of allowable losses	Article 18 of CIT Law Losses may only be carried forward for five years.	31 December 2010 (for losses incurred in 2005)	☐	☐	☐
Consider the impact of expiration of grandfathered tax incentives	Circular Guofa [2007] No. 39 Pre-2008 foreign invested enterprises may enjoy grandfathering relief for five years.	31 December 2011 on which most grandfathered incentives will expire.	☐	☐	☐
Consider the risks of cancellation of debts (COD) income	Article 22 of CIT Implementation Rules & Circular Guoshuifa [1999] No. 195 Amounts payable that have been outstanding for more than two years and have not been pursued by the creditor might be treated as taxable income. (effectiveness of Guoshuifa [1999] No. 195 is not clear but in practice certain tax authorities still apply it).	31 December 2010 for debts outstanding since 2008 or before	☐	☐	☐
Apply for approval of tax treaty relief for dividends where applicable	Circulars Guoshuifa [2009] No. 124, Guoshuihan [2009] No. 81 & Guoshuihan [2009] No. 601 The applicant shall prove residency status in the relevant foreign jurisdiction and beneficial ownership of the dividends. Similar rules apply to loan interest, royalties and capital gains.	When applying to remit dividends	☐	☐	☐

Other Taxes					
Action	**Key points**	**Deadline**	**Y**	**N**	**N/A**
Prepare and file Urban Maintenance and Construction Tax / Education Levy returns	Circulars GuoFa [2010] No.35 and Caishui [2010] No.103 • These taxes are applicable to foreign investment enterprises, foreign enterprises and foreign individuals • December 2010 is the first filing month	20 January 2011	☐	☐	☐
Prepare and submit 2010 Annual IIT Self Filing Returns	Circular Guoshuifa [2006] No.162 • This filing requirement is applicable individuals whose annual income exceed RMB120,000, including non-Chinese residents	31 March 2011	☐	☐	☐

Of the above issues, the most challenging is the application for approval of reduced withholding tax rates for dividends under the relevant tax agreements or arrangements. For example, under the China-Hong Kong Double Tax Arrangement, the withholding tax rate for dividends may be reduced to 5 percent as opposed to 10 percent under the CIT Law. This could be a substantial tax saving. In those cases, the foreign recipients of dividends will have to prove that they have the beneficial ownership of the dividends. That generally means that the foreign investors have to demonstrate that they have sufficient substance in the jurisdictions in which they are resident. In this regard, the tax authorities will examine the head count, assets and revenues of the foreign investors.

It is therefore important to handle the tax treaty benefit application process and the information submitted during the process at the year end very carefully. KPMG has achieved successes in assisting our clients in obtaining tax treaty benefits for dividends as well as loan interest, royalties and capital gains.

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