cutting through complexity

CHINA TAX ALERT

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New CIT Rules on Assets-related Expenses

Regulations discussed in this issue:

- *Announcement of the State Administration of Taxation on Several Issues Concerning Corporate Taxable Income,* SAT Announcement [2014] No. 29, issued on 23 May 2014.

Background

The State Administration of Taxation (SAT) recently published *Announcement of the State Administration of Taxation on Several Issues Concerning Corporate Taxable Income* (hereinafter referred to as "the Announcement"), which is another important regulation regarding the substantive policy concerning corporate taxable income following Guoshuihan [2010] No. 79, SAT Announcement [2011] No. 34 and SAT Announcement [2012] No. 15. The regulation further explains the tax treatment for several controversial tax issues. The effective date of the Announcement was backdated to 1 January 2013.

According to the Announcement, enterprises should reconsider planned investments or receipt of investments in order to find a reasonable tax planning strategy. Enterprises are also advised to review the current depreciation policy to identify any differences in the accounting treatment and tax treatment to avoid any unnecessary tax costs. In addition, nuclear power plants should book training expenses for operators separately and increase such training expenses to a reasonable extent.

Key points of the Announcement

The Announcement specifically explains the tax treatment for the following five Corporate Income Tax (CIT) issues:

- Assets received by enterprises from government allocation
- Assets received by enterprises from shareholder allocation
- Reserve provisions of insurance enterprises
- Training expenses for operators of nuclear power plants
- Depreciation of fixed assets

1. Assets received by enterprises from Government allocation

With respect to the state-owned assets allocated by the government at or above the county level (including the relevant government departments, hereinafter referred to as the "Government"), the accounting treatment as well as tax treatment can be classified into the three categories below:

	Accounting treatment	Tax treatment
The state-owned assets allocated as equity investment in an enterprise by the Government	• Treated as state capital (including capital surplus)	• Not recognised as income • For non-monetary assets, the tax base shall be determined based on the value confirmed by the Government
The state-owned assets allocated to an enterprise for free by the Government according to Caishui [2011] No. 70	• Treated as asset-related Government subsidy	• Non-taxable income • For non-monetary assets, the non-taxable income shall be determined based on the value confirmed by the Government
Other state-owned assets allocated to an enterprise by the Government	• Treated as donation income or other income	• The income shall generally be determined based on the value confirmed by the Government and is subject to CIT • If the above value is not available, the income shall be determined based on the fair market value of assets

2. Assets invested by shareholders

With respect to the assets allocated by shareholders, the accounting treatment and tax treatment can be classified into the following two categories:

	Accounting treatment	Tax treatment
The assets allocated by shareholders (by donation, waiver, etc.)	• Treated as shareholder's capital (including capital surplus)	• Not recognised as income • The tax base shall be determined based on the fair market value of assets
	• Treated as donation income or other income	• The income shall be determined based on the fair market value and is subject to CIT • The tax base shall be determined based on the fair market value of assets

3. Reserve provisions of insurance enterprises

The five types of reserve provisions accrued by insurance enterprises shall be calculated and deducted for CIT purposes according to the relevant accounting regulations issued by the Ministry of Finance. Please refer to China Tax Alert: Financial Service Focus Issue 1.

4. Training expenses for operators of nuclear power plants

The training expenses incurred by nuclear power plants for training operators can be deducted as its power generation costs before CIT. The training expenses for operators should be strictly distinguished and recorded separately from the general educational expenses for other staff. In other words, the educational expenses incurred for other staff may not be included in the training expenses for operators and may not be directly deducted from the taxable income for CIT purposes.

5. Depreciation of fixed assets

According to the relevant provisions of the *Announcement of the State Taxation Administration with Respect to Several Tax Treatment Issues Relating to Taxable Income of Corporate Income Tax* (SAT Announcement [2012] No.15), "The expenses that are actually recognised in the accounting treatment in accordance with the financial and accounting rules, which are consistent with the scope and standard for pre-tax deductions under the relevant tax regulations, can be deducted from the taxable income for CIT purposes."

The Announcement further clarified the tax treatment of the book-tax difference derived from the depreciation of fixed assets in SAT Announcement [2012] No. 15:

If the accounting depreciation period is shorter than the minimum tax depreciation period	• The excess amount of the accounting depreciation amount compared with the minimum tax depreciation amount should be added back to the taxable income for CIT purposes. • The tax depreciation amount which has not been fully deducted can continually be deducted within the rest of the minimum tax depreciation period when the accounting depreciation has been fully depreciated and adjusted for CIT purposes.
If the accounting depreciation period is longer than the minimum number of years set by the tax law	• The depreciation amount should be calculated and deducted according to the accounting depreciation period, unless otherwise specified by the tax regulations.
Provision for impairment loss of fixed assets	• Not deductible for CIT purposes • The depreciation amount should be calculated and deducted according to the tax base of the fixed assets stipulated in the tax regulations.

Accelerated depreciation of fixed assets	• The depreciation amount of the following fixed assets which can be depreciated based on an accelerated method according to the tax regulations, regardless of the accounting depreciation method, can be fully deducted for CIT purposes: ✓ Fixed assets with short renewal periods due to the technological progress ✓ Fixed assets which are in a state of strong vibration and high corrosion for a long period
Depreciation of oil and gas assets by petroleum and natural gas enterprises	• The book-tax difference on the depreciation due to the different methods should be adjusted in accordance with tax regulations for CIT purposes.

KPMG's observations

Consistency of accounting treatment and tax treatment

For the majority of tax issues, the Announcement tends to maintain the consistency of the accounting treatment and tax treatment in order to mitigate the book-tax difference. For fixed assets allocated to an enterprise by the Government or shareholders, the tax treatment on the recognition of shareholder investment or income is consistent with the accounting treatment; for the reserve provisions accrued by insurance enterprises, the recognition and deduction should be in accordance with the relevant regulations issued by the Ministry of Finance under both accounting treatment and tax treatment.

Noteworthy points of the Announcement

The Announcement has expanded the clarification for the following issues:

- The financial subsidy indicated in Caishui [2011] No. 70 can include non-monetary assets.
- The methods for shareholder investment which will not be recognised as income are extended to donations of assets and waivers of share equities.
- The scope of industries where training expenses for special jobs can be directly deducted for CIT purposes has spread to the nuclear power industry.

Clarification of the tax treatment on fixed asset depreciation

SAT Announcement [2012] No. 15 indicates the general rule for the treatment of the book-tax difference of fixed assets, but leads to several tax disputes during the practical implementation. The Announcement clarifies the general rule for the book-tax difference of fixed assets and provides the explicit tax treatments in different scenarios.

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