

The State Administration of Taxation Releases New Circular to Strengthen Tax Collection and Administration

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The State Administration of Taxation ("SAT") recently released a tax notice, Guoshuifa [2009] No.85 (hereafter referred to as "Circular 85") setting out the Guidelines for Strengthening the Collection and Administration of Various Types of Taxes. Circular 85 covers four major types of taxes: turnover taxes, income taxes, property-related taxes and international taxes.

Background

The SAT has experienced a decline in its overall tax revenue as a result of the global economic crisis. According to the data released by the Ministry of Finance, the national revenue for the first quarter of Year 2009 decreased about RMB149.6 billion, which represents about a drop of about 10.3 percent as compared with previous year. As a response to central government's requirement for increasing tax revenue, the SAT promulgated Circular 85 to push the local tax authorities to strengthen tax collection and administration.

Impact of Circular 85 and LehmanBrown's Suggestions

Circular 85 set out operational guidelines to strengthen the collection and administration of various taxes. Tax authorities are paying close attention to certain areas and certain industries. Foreign investment enterprises should ensure its compliance status and be aware of the key areas stipulated in Circular 85.

Key impacts of Circular 85 are summarized below:

(1) Turnover Taxes

Value-added Tax ("VAT")

- Enhancing the verification of input VAT credits arising from procurement of agricultural products;
- Monitoring the credit of imported VAT arising from the importation of materials, goods or equipments where applicable;
- Monitoring the mechanism for Export VAT refund.

Consumption Tax

- Verifying the tax base for calculating consumption tax on white spirit.

Business Tax

- Monitoring transportation invoices obtained from road and sea transportation, and the related tax credit;
- Focusing on construction and real estate industries.

Taxpayers are suggested to conduct tax health checks to review its indirect tax

compliance for its previous years and current year in order to get prepared for any potential tax review carried out by the state and local tax authorities.

(2) Income Taxes

Corporate Income Tax

- Strengthening the administration and collection from Corporate Income Tax filings, including quarterly and annual tax filings, consolidation filings for enterprises which have headquarter and branches in China;
- Enhancing the verification of granting of corporate income tax preferential treatments.

Individual Income Tax ("IIT")

- Strengthening the administration and collection IIT filings for expatriates.

Enterprises having long-term losses, marginal or fluctuating profits, making losses or fluctuating taxable income after the expiry of tax holidays would be the target companies for corporate income tax assessment.

Key industries, such as banking, real estate, food and beverages, iron and steel, cigarettes, electrical power, construction etc. would be the target industries for tax assessment and daily review. In order to mitigate the tax risks, enterprises are suggested to review its previous years and current year's corporate income tax filing status.

Furthermore, the SAT aims to bring all withholding agents into the National IIT Filing Management System before the end of 2009. Enterprises are suggested reviewing its IIT filings for both local and expatriates immediately.

(3) Property-related Taxes

Property-related taxes covers urban land use tax, urban real estate tax, city maintenance and construction tax, education levy, land value added tax, vehicle tax and deed tax. Circular 85 requested the local tax authorities to strengthen the administration and collection of property-related taxes.

(4) International Taxes

- Enforcing transfer pricing investigation and subsequent reviews for anti-avoidance purpose;
- Enhancing bilateral tax negotiation between two countries;
- Monitoring tax filings and enhancing management for non-PRC residents who are engaged in foreign contractor business and provision of services in China;
- Monitoring tax withholding compliance on non-PRC residents, in particular the situation where a non-PRC resident transfers the equity interests of its PRC investee to other non-residents;
- Monitoring tax certificates serving as supporting documents for remittance of service fees out of China.

Multi-national companies ("MNCs") should take this opportunity to review their transfer pricing methodologies and prepare relevant related party documentation for their entities in China. MNCs should ensure that their transfer pricing methodologies, arrangements and documentation are properly planned and implemented on a continuous basis.

Foreign investors should revisit their current arrangement and agreements for the projects or services conducted in China and overseas in order to comply with the latest regulations and requirements, identify tax planning opportunities for tax savings or tax relief as well as obtain requisite documents for remittance of service fees from China.

Conclusion

Taxpayers should revisit their tax compliance status in order to deal with the potential tax checks/tax investigations carried out by the tax authorities, especially under current situation where China government has experienced a decline in its tax revenue. Taxpayers are advised to consult their tax advisors before acting on any information contained in Circular 85.