



SAT clarifies implementation issues with Corporate Income Tax incentives for China's western regions

Regulations discussed in this issue:

- Announcement regarding Corporate Income Tax issues in the Implementation of the Western Development Strategy, State Administration of Taxation Announcement [2012] No.12, issued by the State Administration of Taxation on 6 April 2012, effective from 1 January 2011
- Notice on Tax Policies Relating to Further Implementation of the Western Development Strategy, Cai Shui [2011] No.58, issued by the Ministry of Commerce, General Administration of Customs and the State Administration of Taxation on 27 July 2011, effective from 1 January 2011

Background

The State Administration of Taxation (SAT) issued Announcement [2012] No. 12 (Announcement 12) on 6 April 2012, clarifying various implementation issues with the Corporate Income Tax (CIT) incentives stipulated in Cai Shui [2011] No.58 (Circular 58) related to the implementation of the western region development strategy. For details of Circular 58, please refer to [China alert 2011 Issue 28](#).

Both Circular 58 and Announcement 12 take effect from 1 January 2011.

The salient points of Announcement 12 and our discussions are summarised below:

1. What are the CIT incentives available for enterprises that operate in encouraged industries in western China?

Where the conditions below are satisfied, enterprises in western China are eligible for a reduced 15 percent CIT rate upon approval from the tax authority in charge, effective from 1 January 2011 to 31 December 2020.

- The enterprise's main business must fall within the scope prescribed in the 'Catalogue of Encouraged Industries in western China' ('The Catalogue')

- The enterprise shall derive 70 percent or more of its total revenue from its main business.

2. Can enterprises in western China that are eligible for a 15 percent CIT rate enjoy other CIT incentives in the meantime?

Announcement 12 states that a qualified enterprise in western China can enjoy both the 15 percent reduced CIT rate and other tax incentives stipulated in the CIT Law, CIT implementation rules and circulars issued by the State Council as long as the relevant conditions are satisfied. For enterprises that are entitled to the preferential '50 percent statutory CIT rate' treatment, they can use 15 percent as the base statutory CIT rate for calculating the actual CIT rate during the tax holiday.

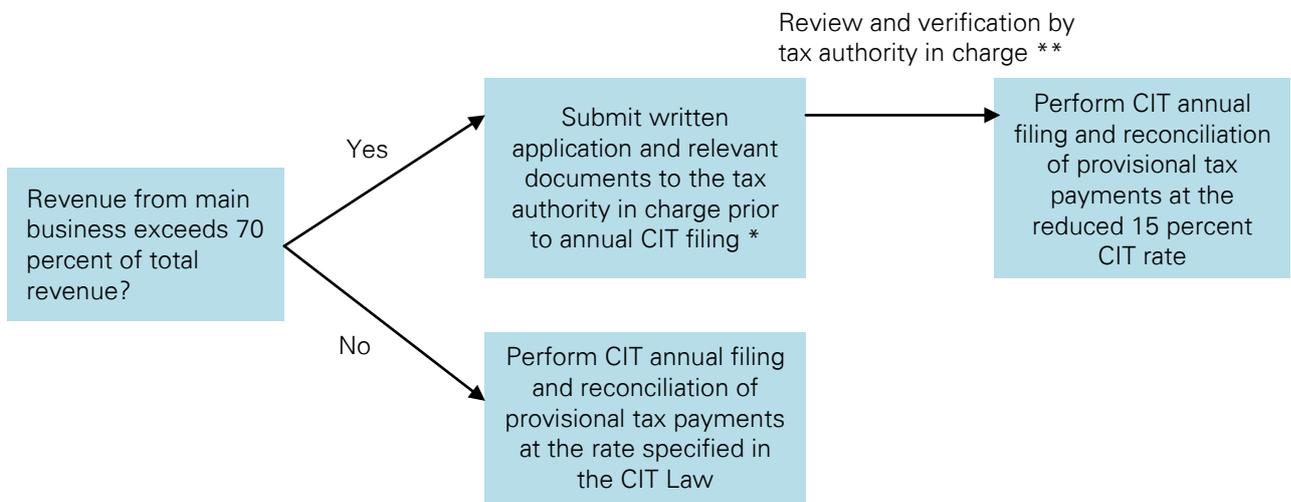
3. What procedures do enterprises have to complete to enjoy the 15 percent CIT rate?

Provisional filing

An enterprise whose business falls within The Catalogue can file its provisional CIT returns using the CIT rate of 15 percent. However, this needs to be authorised by the tax authority in charge.

Annual filing

The enterprise shall first assess the ratio of the revenue from its main business to its total revenue from the tax year, and then follow the procedure below during the annual CIT return filing process:



* Where there is difficulty in determining whether the main business of an enterprise falls within the scope of the Catalogue, the enterprise is required to provide verification documents issued by the relevant administrative authority in charge at the provincial/sub-provincial level, or by a designated administrative authority at the next lower level.

** The review and verification procedures by the tax authority in charge only apply in the first year when an enterprise applies for the 15 percent CIT rate incentive. Once the 15 percent CIT rate incentive for the first year is granted, the enterprise is only required to lodge a record with the tax bureau in charge for the second year and the years afterwards.

4. The Catalogue has not been released yet. In practice, how do an enterprise and the tax authority in charge determine whether the main business of the enterprise falls within the scope of the Catalogue?

Announcement 12 clarifies that, prior to the issuance of the Catalogue, if an enterprise's main business falls within the scope of the following catalogues, upon verification by the tax bureau in charge, the enterprise can file annual CIT return and make CIT payment using the 15 percent tax rate.

- *'Catalogue of Guidance for Industrial Structural Adjustment (2005 version)'*
- *'Catalogue of Guidance for Industrial Structural Adjustment (2011 version)'*
- *'Catalogue of Industrial Guidance for Foreign Investment (2007 revised version)'*
- *'Catalogue of Priority Industries in Central and Western China (2008 revised version)'*

Where an enterprise has filed its annual CIT return at the rate of 15 percent, but following the issuance of the Catalogue, fails to satisfy the requirements set out in Question 1 above, the enterprise should file amended CIT return using the tax rate specified in the CIT Law after completing the relevant procedures. Announcement 12 does not say in this case whether late interest surcharge should be levied on the enterprise if CIT is underpaid in the original tax return.

5. Is any grandfathering treatment available for enterprises operating in western China that were previously eligible for the "2 + 3 CIT holiday" but have not fully utilized such holiday?

According to the now expired Guo Shui Fa [2002] No.47 (Circular 47), newly established foreign-invested and domestic enterprises that are engaged in transportation, electric power, water conservation, postal services and TV broadcasting in western China and meet certain requirements are eligible for a '2+3 tax holiday'. For foreign-invested enterprises, the tax holiday starts from the enterprise's first profit-making year. For domestic enterprises, the tax holiday begins with the commencement of the enterprise's business operation. The applying enterprise should complete appropriate verification procedures with the tax authority in charge before enjoying the tax holiday.

An enterprise that operates in the five sectors above and was established before 31 December 2010, may not have fully utilised the '2+3 tax holiday' as of 31 December 2010. This could happen if the enterprise has not commenced business operation or has not turned profitable by 31 December, 2010, and as a result, has not fulfilled the proper verification procedures with the tax authority in charge. In such a case, Announcement 12 states that the enterprise can continue to enjoy the '2+3 tax holiday' after 1 January 2011 until the tax holiday expires by completing certain procedures with the tax authority in charge.

6. How is the 15 percent CIT rate applied to the enterprise with branches in or outside western China?

We summarise the various tax treatment as follows:

Location of the head office	What income may be eligible to the 15 percent CIT rate?	Determine whether the main business qualifies and assess whether the '70 percent' ratio is met	Tax bureau in charge of verification and record-logging
Western China	Income from head office and branches in western China (Note 1)	<ul style="list-style-type: none"> Does the main business of the head office AND the branches in western China fall within the scope of the Catalogue? Do the head office AND the branches in western China derive 70 percent or more of their total revenue from the main business? 	Tax authority in charge of the head office
Areas other than western China	Income from branches in western China (Note 2)	<ul style="list-style-type: none"> Does the main business of the branches in western China fall within the scope of the Catalogue? Do the branches in western China derive 70 percent or more of their total revenue from the main business? 	Tax authority in charge of the branches in western China (Note 3)

Note 1: Third-tier (and below) branches in western China established by second-tier branches in areas outside western China are not included.

Note 2: If the head office has only third-tier (and below) branches in western China, such branches are included.

Note 3: The tax authority in charge of the branches shall promptly communicate the branches' eligibility to the tax incentives in western China to the tax authority in charge of the head office in written form.

KPMG observations

Announcement 12 has been released at an opportune time. Since the issuance of Circular 58, many businesses operating in the western region have been waiting eagerly for guidance from the central government on what industries may be entitled to the preferential 15 percent CIT rate and what CIT rate should be used for their 2011 annual CIT returns. Announcement 12 clarifies that businesses and local tax authorities in the western region can use certain existing industrial catalogues for reference when assessing the CIT rate to be applied on the tax returns. After the Catalogue is finalised, taxpayers should re-evaluate their previous tax positions and file amended tax returns as appropriate.

The economic development of China's western regions has been playing an important role in the country's overall economic progress. The central government has attached great importance to the modernisation of the western region and provided a number of tax incentives in support of the policy. Circular 58 and Announcement 12 have not only extended the original tax preferential policies for developing western China, but also modified the previous approval and verification procedures. These modifications will help reduce the administrative burden of businesses applying for the incentives. For example, although Circular 47 stipulates that an enterprise shall apply with the tax authority at the provincial level to enjoy the 15 percent rate for the first year, Announcement 12 delegates the approval rights to the lower-level tax authority in charge. Similarly, even though Circular 47 requires that project verification documents be issued by the administrative authority at the provincial or higher level, Announcement 12 indicates that verification documents issued by the administrative authorities at the sub-provincial level or lower are acceptable.

Announcement 12 also notes that the tax authority at the provincial level should develop detailed administrative measures on the verification and record-lodging process and take into account local practices when making the rules. The due date for 2011 annual CIT filing is 31 May 2012. To benefit from the relevant CIT incentives, enterprises in western China should keep a close eye on the development of local administrative measures and prepare the application materials as soon as possible.

Finally, as mentioned before, the 'Catalogue of Encouraged Industries in western China' is still in process of being finalised. If enterprises wish to communicate with the relevant government authorities and provide further arguments for their industries to be included in the Catalogue, there may still be time to do so. KPMG would be glad to provide assistance in this regard, if requested.

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