

# Tax Analysis

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PRC Tax

## New EIT filing requirements for enterprises with branches

A joint circular issued by the Ministry of Finance (MOF), the State Administration of Taxation (SAT) and the People's Bank of China (PBOC) in June 2012 makes some changes to the filing obligations and the settling of Enterprise Income Tax (EIT) liability by enterprises whose head offices and branches are located in different provinces (including provinces, autonomous regions, municipalities and cities specifically designated in the State plan) in China (Caiyu [2012] No. 40, (Circular No. 40)). While Circular No. 40, which applies as from 1 January 2013, generally follows previous guidance (Caiyu [2008] No. 10, (Circular No. 10)), it revises the filing responsibility; the key change from Circular No. 10 is that the annual filing and final settlement of the EIT liability will no longer be the sole responsibility of the head office, but instead will be carried out by both the head office and its branches with their in-charge tax authorities. Circular No. 10 will be superseded by Circular No. 40.

### Background

Circular No. 10 was issued by the MOF, SAT and PBOC in 2008 shortly after the new EIT law was introduced. The circular provides the mechanism for calculating and settling the EIT liability of enterprises with their head offices and branches throughout China, as well as how EIT revenue is to be allocated between the central and various local governments. Circular No. 10 provides as follows:

- The taxable profit and EIT payable by a resident enterprise must be computed based on the total results of the head office and its branches.<sup>1</sup>
- A head office and its branches must make monthly or quarterly EIT filings with the relevant tax authorities and pay provisional EIT to the local authorities. For each provisional EIT filing, 50% will be allocated to the branch offices and 50% to the head office (in other words, the head office will pay 50% of its EIT liability for the relevant period to the tax authorities in the place where the head office is located). The 50% of provisional EIT allocated to the branch offices will be further allocated based on three factors: operating revenue, employee remuneration and total assets.
- After the tax year-end, the final EIT payable and the amount of EIT under- or overpaid during the year must be calculated and final settlement made by the head office with its in-charge tax authorities.

<sup>1</sup> The monthly/quarterly EIT provisional payment and allocation requirement is not applied to a resident enterprise's overseas branches, i.e. for purposes of Circular No. 10, "branch(es)" refers only to Chinese established branches (excluding those in Hong Kong, Macau or Taiwan).

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Circular No. 40 makes changes to the final annual settlement and to the selection of historical data to allocate the provisional EIT among branches.

#### Key amendments made by Circular No. 40

	Circular No. 10	Circular No. 40
Year-end final settlement	Branches are not required to make the year-end final settlement; the head office is responsible for calculating the annual EIT liability. After deducting all provisional taxes paid by the head office and its branches, the head office must pay any underpaid EIT (or claim a refund for overpaid EIT) to (from) its in-charge tax authorities.	The head office is responsible for calculating the annual EIT liability. After they have deducted their respective provisional taxes paid, the head office and the branches must pay their own underpaid EIT (or claim a refund for their own overpaid EIT).
Three factors to allocate provisional tax among branches	<ul style="list-style-type: none"> <li>Operating revenue, employee remuneration and total assets of prior years (for the period January-June, the figures from the year before the previous year and for the period July-December, the figures from the previous year)</li> <li>The total assets of a branch refer to the total monetary measurable economic resources owned or controlled by the branch, other than intangible assets</li> </ul>	<ul style="list-style-type: none"> <li>Operating revenue, employee remuneration and total assets of the previous year</li> <li>The total assets of a branch refer to the total assets owned or controlled by the branch on 31 December (of the previous year)</li> </ul>

#### Comments

##### 1. Changes to final EIT settlement

According to existing EIT rules, since the final settlement is the sole responsibility of the head office, the tax authorities in charge of the head office generally are responsible for reviewing the final computation of the enterprise's annual EIT liability and the various book-to-tax adjustments. The tax authorities in charge of the branches have relatively limited responsibilities in this regard and for practical purposes may only make enquiries with the tax bureau of the head office with respect to issues relating to the allocation of provisional tax paid.

The intent of Circular No. 40 seems to be to give the tax authorities in charge of the branch offices more say with respect to EIT filings. These authorities, therefore, are likely to step up their administrative efforts (e.g. by scrutinizing branch accounting records to verify the allocation factors) once Circular No. 40 is implemented. However, the circular fails to allocate responsibilities among the various tax authorities. If the final EIT computation has to be reviewed both by the tax authorities in charge of the head office and those in charge of the branches, enterprises may find themselves confronted with more burdensome communication and coordination obligations, particularly if the various tax authorities have different opinions. Based on our preliminary discussions with the Shanghai tax bureau, it is anticipated that the tax authorities in charge of the head office still will take the lead in reaching the final settlement; however, this will become clearer if and when the SAT releases further implementation details.

## 2. Refresh of other branch EIT filing rules

Following the release of Circular No. 10, the SAT issued other branch-related EIT filing rules, which may not be fully reflected in Circular No. 40, but are still worth noting:

- Second tier and lower tier branches that only have auxiliary functions (e.g. after-sales services of products, internal research and development, warehousing), that do not carry out manufacturing or business operations and that are not required to pay VAT and Business Tax locally do not have to make local EIT payments.
- A unit within the head office may be treated as a branch for EIT purposes if the unit separately carries out manufacturing or business operations and its operating revenue, employee remuneration and total assets are accounted for separately from the administrative functions of the head office.
- Second tier branches are carrying out tax registration must submit their (non-legal entity) business license and other documents issued by the head office substantiating branch status (e.g. documents substantiating operating fund transfers from the head office, internal management policies, etc.) for review by the tax authorities.
- A branch operating in the name of a head office will be treated as a separate taxpayer rather than a branch of the head office for EIT purposes unless it can provide supporting documents to substantiate its branch status.

Since Circular No. 40 becomes effective on 1 January 2013, the provisional EIT filing and payment for January or the first quarter of 2013 will be impacted. Enterprises that have their head office and branches in different provinces should familiarize themselves with the circular and its potential impact, closely monitor developments and consult the tax authorities or experts to ensure compliance.

Note: Contents discussed in this Tax Analysis pertains to Deloitte Global Business Tax Services.

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