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SAT further clarifies EIT filing requirements for enterprises with branches

China's State Administration of Taxation (SAT) issued a tax bulletin in December 2012 (SAT Bulletin [2012] No. 57 (Bulletin No. 57)) to provide additional guidance on 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. Specifically, Bulletin No. 57 addresses certain unresolved matters in a circular issued in June 2012 (Caiyu [2012] No. 40,[1] (Circular No. 40)), which provided that the annual filing and final settlement of the EIT liability is no longer the sole responsibility of the head office, but instead is to be carried out by both the head office and its second-tier branches with their in-charge tax authorities. Bulletin No. 57 supersedes other guidance (i.e. Guoshuifa [2008] No. 28); it applies as from 1 January 2013 and will be applied to the EIT provisional filing for January or the first quarter of 2013.

Highlights of Bulletin No. 57

- Allocation of EIT payment in final settlement: Bulletin No. 57 confirms that the allocation of the EIT payment in the year-end final settlement will follow the same method that applies to the monthly/quarterly provisional filings, i.e. the head office will pay 50% to the tax authorities in the place where the head office is located, with the remaining 50% further allocated and paid by its second-tier branches based on three factors: operating revenue, employee remuneration and total assets of the previous year.

- Documentation requirement in EIT filings: The head office and its second-tier branches must submit the following documents to their in-charge tax authorities:

	Head office	Branches
Monthly/quarterly provisional filings	• Tax return for provisional filing • Monthly/quarterly financial statements	• Tax return for provisional filing (with only branch-relevant items completed)

[1] See Deloitte Tax Analysis: New EIT filing requirements for enterprises with branches
http://www.deloitte.com/assets/Dcom-China/Local%20Assets/Documents/Services/Tax/Tax_analysis_2012/cn(zh-cn)_tax_tap1752012eng_271212.pdf

(Continued)

	Head office	Branches
Monthly/quarterly provisional filings	• EIT allocation statement • Annual financial statements of all branches (or statements showing the financial status of the branches and operating revenue/costs, expenses) for the previous year	• EIT allocation statement (that has been accepted by the in-charge tax authorities of the head office)*
Annual filing	• Annual tax return • Annual financial statements • EIT allocation statement • Annual financial statements of the branches • Explanatory notes on all branch-related book-to-tax adjustments**	• Annual tax return (with only the branch-relevant items completed) • EIT allocation statement (that has been accepted by the in-charge tax authorities of the head office)* • Annual financial statements of the branch (or statements showing the financial status of the branch and operating revenue/costs, expenses) for the current year • Explanatory notes on branch-related book-to-tax adjustments**

* If the in-charge tax authorities disagree about the allocation, they may, within 30 days of receipt of the allocation statement, send a written request to the tax authorities in charge of the head office to conduct a review and decide whether to adjust the allocation within another 30 days.

** Adjustment items that must be calculated and made on a whole legal entity basis by the head office (e.g. adjustments for entertainment or advertising expenses exceeding certain limits) are not considered "branch-related" tax adjustments and no explanations are required.

- Clarification of the definition of "newly established second-tier branch": Circular No. 40 followed previous guidance to the effect that a newly established second-tier branch does not have to pay EIT locally for the year in which it is established. Bulletin No. 57 clarifies that a branch will not be considered a newly established second-tier branch in the following cases and, therefore, it should be included in the allocation from the time of its establishment:
  - A second-tier branch newly acquired from another enterprise, where the branch had been paying EIT locally before the acquisition; and
  - A second-tier branch newly established as a result of a merger, separation or internal management reorganization of the head office and the original branches, where the original branches had been paying EIT locally before the reorganization.
- Tax inspections of branches: The tax authorities in charge of a second-tier branch are allowed to carry out a separate tax inspection of the branch and initiate branch-related book-to-tax adjustments by themselves, except where the adjustments have to be calculated and made on a whole entity basis. Any EIT payment arising from an inspection will be shared equally between the tax authorities in charge of the head office and the branch that was inspected.

- Application of geographical tax incentives: In the case of an enterprise with a head office and/or branches located in different areas where different EIT rates are applied, the taxable income first has to be allocated using the same allocation method to calculate the EIT liability, and then the EIT liability will be allocated among the head office and its branches for payment and settlement purposes. Bulletin No. 57 confirms that the previous year's financial data (i.e. operating revenue, employee remuneration and total assets) of the branches, rather than data of the current year (as stated in a previous circular Guoshuihan [2009] No. 221), will be used for the allocation.

- Branches located in the same province: Bulletin No. 57 will not apply to resident enterprises with a head office and branches located in the same province (autonomous regions, municipalities and cities specifically designated in the State plan). In such case, it will be up to the provincial tax authorities to decide whether a similar filing mechanism should be followed or whether all EIT filings are to be made only by the head office.

Comments

- Determination of second-tier branch: Bulletin No. 57 defines a second-tier branch as a branch registered as a non-legal entity whose finance, business and personnel issues are centrally accounted for and managed by its head office. However, the bulletin does not provide specific guidance to the tax authorities on how to determine a second-tier branch, which is a frequent question arising in practice. It is common for a Chinese enterprise to establish multiple branches, some of which act as regional offices; these regional offices may be considered second-tier, with the remaining offices designated third- or lower-tier. However, the tax authorities could take a different view and treat all of the branches as second-tier if their legal status is the same (e.g. all registered directly under the head office).

- Financial reporting for branches: Bulletin No. 57 clearly introduces significant requirements for enterprises to report the financial information of their branches, but does not provide much practical guidance on how to account for the relevant items for EIT purposes. The accounting for the three allocating factors plays an important role in the EIT allocation and may even have an impact on the calculation of final tax liabilities (if a geographic tax incentive applies). The tax rules seem to simply rely on the taxpayer's own financial accounting system, which may not fit well with the tax needs. Companies sometimes combine several branches (or with the head office) as one business unit where segment reporting may not be available.

- Branch-related tax adjustments: Bulletin No. 57 authorizes the in-charge tax authorities of a second-tier branch to review and make branch-related tax adjustments. Although certain items are excluded from such adjustments, the absence of further explanation may lead to potential disagreements between taxpayers and the various tax authorities. In practice, an enterprise may find it more difficult to take a consistent position on a common tax issue in all branches if the relevant tax authorities adopt different views.

With the issuance of Bulletin No. 57 and Circular No. 40, the tax authorities in charge of branch offices should be more motivated to step up their administrative efforts in EIT filings. As a result, a Chinese enterprise with branches in different provinces likely will face enhanced compliance burdens and tax inspections with respect to branch EIT filings. Therefore, it is advisable for Chinese enterprises to be more careful in handling branch-related EIT issues to ensure compliance. Although Bulletin No. 57 does provide certain clarifications, it too leaves some open issues (e.g. it is unclear whether an enterprise is allowed to combine its second-tier branches in the same province for EIT allocation and filing purposes). Affected taxpayers should closely monitor developments and consult tax experts where necessary.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

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