SINO-BRIDGE
Consulting Group

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Consumer Price Index ("CPI") may exceed 3% in 2010

According to the National Bureau of Statistics ("NBS"), China's CPI, the main gauge of inflation, soared to a 25-month high of 4.4% in October. In addition to the upward pressure from commodity prices domestically, the import led inflation resulting from quantitative easing of the US is a major contributor. Mr. Zhang, head of National Development and Reform Commission ("NDRC"), said that CPI may rise more than the government's target ceiling of 3% this year. This is the first time that a senior government official has confirmed that the full-year target will be missed. The inflationary pressure has made enterprises more cautious about their costs and expenditures.

Clarification on Corporate Income Tax ("CIT')

Under certain conditions, income derived from transfer of equity, non-monetary investment, corporate reconstruction and donation could be spread over no more than 5 years when arriving at the CIT payable. However since no grandfathering policy had been released for the implementation of this regulation after the new CIT Law becoming effective on 1st January 2008, local practices varied due to differences in the understanding. To maintain consistency, State Administration of Taxation ("SAT") issued the 19th pronouncement on 27th October 2010 which requires such income to be taxed generally on a one-off basis in the year when it is recognized. This regulation will be effective from 26th November 2010. The new basis for tax calculation will also apply to any untaxed income between 1st January 2008 and 26th November 2010.

SAT also released Pronouncement No. 20 on 27th October 2010 which allows losses for previous years found in tax inspections to be offset by eligible profits. This regulation will be effective from 1st December 2010 and will also apply to all relevant outstanding cases before this date.

Foreign Invested Enterprises ("FIEs") no longer exempted from Urban Construction Tax ("UCT") and Education Surcharge ("ES")

The State Council issued a notice, Guofa [2010] No. 35, to unify the different policies of UCT and ES on FIEs and domestic enterprises. FIEs have been exempted from UCT and ES for many years and this will no longer be the case from 1st December 2010. UCT and ES are generally calculated by reference to the amount of Value Added Tax ("VAT"), Consumption Tax ("CT") and Business Tax ("BT"). The removal of this exemption is intended for fair competition between domestic and foreign businesses.

Restrictions on purchase of property by foreigners

On 15th November 2010, China's Ministry of Housing and Urban-Rural Development ("MOHURD") and SAFE jointly issued a circular, Jianfang [2010] No. 186, to impose restrictions on purchase of property by foreign organizations and individuals (including those from Hong Kong, Macau and Taiwan). According to the circular, foreigners would only be eligible to purchase one property for their own use and are required to prove that they have been working in China for more than a year prior to the purchase. They are also required to provide a written statement to declare that they do not own any other property in the country. For individuals from Hong Kong, Macau and Taiwan who wish to purchase property in China, they have to provide documents proving that they are working, studying or residing in

China. Foreign organizations are only permitted to purchase local non-residential property for office use provided that they have registered branches or representative offices in China. The new regulation is interpreted as a move to combat inflationary pressure of the property market caused by capital influx.

Tax implications of loans from overseas shareholders

Capital from overseas parent company or shareholders is an important source of finance for many FIEs in China. However, there are some regulations with regard to this type of capital, especially from the perspective of tax, which are summarized below:

Firstly, all overseas borrowings should be filed as "foreign loan" with the Foreign Exchange Authority and the cumulative amount should not exceed the difference between registered capital and total investment. Secondly, Article 38 of the new "Implementation Rules for CIT", which has been effective since 1st January 2008, states that the deductible interest expense of loans from non-financing enterprises should be no more than those calculated based on the rate applied to financing enterprises which have the same borrowing nature and term. Thirdly, the circular, Caishui [2008] No. 121, issued by SAT in September 2008 to avoid thin capitalization through loans from related parties (including natural person, Guishuihan [2009] No. 777), stipulates that the amount of total outstanding loans should not be more than 2 times of the equity investment from the corresponding related party for the purpose of calculating tax deductible interest expenses. Thus, enterprises which have a big loss might not be able to fully deduct their interest expenses incurred on loans from related parties.

Moreover, there are some ambiguities over "the rate applied by financing enterprises which have the same borrowing nature and term". The current practice is the Central Bank announces the benchmark lending rates in a nonscheduled manner, and commercial banks conclude their lending rates at their discretion with 90% of the benchmark rate as a floor. The best approach to this is to communicate timely, effectively and sufficiently with the tax authority in charge of your company to reach a consensus.

Service Highlight

Since the year end is approaching, Sino-Bridge would like to remind you that preparation for important annual reports (such as the annual statutory audit, annual government examinations, annual CIT settlement, transfer pricing contemporaneous documentation, etc) should commence imminently. Our experienced professional teams are ready and pleased to provide any assistance and support that you may need.

If you need any assistance, please do not hesitate to contact May Lau, our Marketing Executive at maylau@sinobridge-consulting.com.

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