7.1. Corporate Income Tax and tax adjustments(RC)

Introduction

There are considerable differences between the trade balance and the tax balance, that have to be taken into account during the calculation of the Corporate Income Tax. If in doubt, it is always recommended to use the support of a Tax Auditor who can support you in preparing a correct tax calculation.
Please still bear in mind that in the end you are responsible for the correct tax declaration and this responsibility cannot be outsourced to a third party.

Corporate Income Tax payment schedule

Corporate Income taxes have to be paid in a quarterly fashion as Pre-Payments until the 15th of the following month based on the quarterly closing of the company.

After the fiscal year has ended, the company has to do a yearly audit with an authorized auditing company to determine the profits of the year. Since there are certain differences between the commercial financial statement and the financial statements effective for tax purposes, adjustments have to be made to this profit before tax and the corporate income tax difference has to be paid until end of May of the following year.

Tax Residency

Companies with a residence in China or with their effective management (e.g. for company headquarters with centralized management functions in China) must pay taxes for all of their worldwide income in China.

Capital Gains

Capital gains and losses, originating in the sales of fixed assets, will be considered as "other income" or "other expenses" and therefore will be taxed with the usual corporate income tax.

Tax Audit

To support your final determination of the taxable profit, it is advisable to contract a tax audit company even while legally it is not required.

The tax auditor will mostly use a format similar like the following in the summary to make the adjustments clear:

Accounting Profit
+ Adjustment for non-deductible items
- Adjustment for deductible items
= Tax Profit
x Applicable tax rate (mostly 25%)
= Corporate Income Tax

Tax Benefits / Government Grants

To encourage new projects, higher investments in Research and Development and/or for other reasons, the (local) government might give you additional benefits. They mostly take the form that you have to pay the relevant taxes fully but you will get a (partial) refund after fulfilling the relevant requirements.
Benefits often can be classified into:

- Refund of taxes during start-up: For the first few years after founding of the company, you get a refund of certain taxes (e.g. Corporate Income Tax, Personal Income tax of management) or other monetary or non-monetary benefits
- Refund for certain activities during start-up: If your company has to do certain activities to start up your company and has to bear the cost for it, you might be able to receive local incentives based on these activities, e.g. reimbursements of incurred costs.
- Support during ongoing operations: If you fulfill certain requirements you will get the benefits, e.g. lower tax rates if you fulfill the requirements for a High-Tech enterprise (which is amongst others based on R&D cost and number of patents).

Accounting Profit vs. taxable Profit

For calculating the taxable profit, the audited accounting profit has to be adjusted to calculate the corporate income taxes.
The adjustment of the accounting profit to the taxable profit is usually supported by specialized tax audit companies which write an additional tax audit report. While the tax audit report is being used for the company income tax calculation of a fiscal year, the tax audit company supports the tax authorities in calculating the tax basis. Still, the company itself is liable for this basis in the end.
Common items for adjustment are:

- Low-Value Assets:
  If equipment is not considered as major equipment and has either a value of less than 5000 RMB or have a useful lifetime of less than two years it can be itemized as expense for tax purposes. This value is the threshold for each independent item (e.g. 10 chairs for 4500 RMB each can still be expensed directly).
- Non-deductible services:
  Services can either be non-deductible because the service itself is considered non-deductible or because there is no appropriate Fapiao available.
  While the issue of non-appropriate Fapiao can be repaired by obtaining a deductible Fapiao within 3 years after the fiscal year, non-deductible services cannot be repaired.
- Entertainment cost:
  Entertainment cost can only be deducted up to 60% of the total entertainment cost or to the maximum of 0.5% of the sales/business income of a year, whichever one is lower.
- Fines and penalties cannot be deducted from the corporate income tax.
- Net operating losses can only be carried forward to a maximum of 5 years.
- Genuine service fees and Royalties to related companies can be tax deducted only if they are under the arm´s length principle.
- Actual Salaries of handicapped people are 200% deductible
- Research & Development costs for new technology, new products or new craftsmanship are deductible and additional deductions as incentives are possible
- Commercial insurance for employees is not tax-deductible unless it is paid for safety insurance for workers conducting special types of work
- Staff welfare expenses, labor union fees and staff education expenses are deductible up to certain limits
- Advertising expenses and business promotion expenses are deductible up to certain limits
- While Loans in general are tax-deductible, Loans between related parties can only be accepted if they are at arm´s length principle and the correct Fapiao can be presented
- Provisions of Impairment of assets can only be tax-deductible when a permission was acquired beforehand from the tax authorities
- For tax purposes, only the straight-line depreciation is allowed except under special circumstances. The tax authorities also additionally can set a minimum depreciation method for certain assets.
- Organizational and startup expenses can be deducted in the first year of operation
- Bad debt provisions are in general not tax-deductible unless otherwise prescribed in the tax rules

Common pitfalls and considerations

- While a tax auditor might be very helpful to determine the taxable corporate income, he just has a supportive role and can help you to reduce risk for underpaying your corporate income tax. Since the final report will be in the name of your company, there is still a risk that your auditor has a different interpretation than the tax office.

- After the final corporate income tax has been declared, you will not hear anything from them until there is a disagreement from their side. This feedback usually happens within the year in which the tax was declared.
- If your company fulfills certain requirements (e.g. considering holding patents, thresholds for R&D, etc.) it can be considered as a High-Tech company and might qualify for a lower corporate income tax. To check these requirements and to execute the change to a High Tech company, it is recommended to use a specialized agency which can help you to identify if you fulfill the requirements and can help you with the relevant applications.

Deeper Reading:

PriceWaterhouseCoopers has a great source to check the tax deductions: http://taxsummaries.pwc.com