



JONES DAY  
**COMMENTARY**

## CHINA'S NEW ADMINISTRATIVE REGULATION ON PREPAID CORPORATE INCOME TAX FOR REAL ESTATE DEVELOPERS

On April 7, 2008, the State Administration of Taxation ("SAT") issued a circular governing provisional Corporate Income Tax ("CIT") payment issues for real estate developers [Guo Shui Han (2008) No. 299] ("Circular 299"), which is retrospectively effective from January 1, 2008.

In brief, Circular 299 requires real estate developers to prepay CIT on pre-sales based on stipulated profit rates. After the final completion of a project, the pre-paid CIT will be reconciled to actual CIT payable, based on the project's actual profit.

This *Commentary* will provide a summary of Circular 299 as well as an analysis of its impact.

### HIGHLIGHTS OF CIRCULAR 299

**Applicability.** Circular 299 applies to the following enterprises:

- (i) Chinese resident enterprises that are engaged in the real estate development business, including both domestic Chinese enterprises and foreign-invested enterprises; and
- (ii) Those enterprises that make monthly or quarterly provisional CIT payments based on actual profits.<sup>1</sup>

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1. According to China Corporate Income Tax Law and its implementation regulations, the provisional CIT payments shall be determined based upon the actual profits for the month or quarter. Where it is difficult for an enterprise to determine its provisional CIT payments based on the actual profit, the provisional CIT payments shall be determined based on the average monthly or quarterly profits for the immediate preceding year, or based on other methods permitted by the tax authorities. Once a provisional payment method is determined, that method shall not be arbitrarily changed within the tax year.

**Method for Provisional CIT Payments.** The tax authority shall determine whether an enterprise makes provisional CIT payments on a monthly or a quarterly basis.

For the revenue generated by real estate developers from pre-sale transactions, the relevant taxable profits for provisional CIT payment purposes should be determined based on the pre-sale revenue and designated profit rates. The provisional CIT payable is the result of multiplying such profit by the CIT rate (standard rate of 25 percent from January 1, 2008).

After the final completion of a project that has been pre-sold, the prepaid CIT will be reconciled with the actual CIT payable, based on the project's actual profits.

**Minimum Profit Rate for Pre-Sales.** For typical real estate projects, the profit rate shall be:

- Not lower than 20 percent, for projects located in provincial capital cities as well as certain cities in special administrative regions and other designated cities.
- Not lower than 15 percent, for projects located in second-tier cities.
- Not lower than 10 percent, for projects located in other areas.

For low cost residential, the profit rate shall not be lower than 3 percent.

## FORMER PRACTICE

Prior to the issuance of Circular 299, foreign-invested real estate developers and domestic Chinese developers paid provisional CIT on pre-sales based on different methods.

**Domestic Real Estate Developers.** Domestic developers typically calculated the gross profits of the pre-sales based on the designated gross profit rates. They then worked out the

taxable income for provisional CIT purposes by deducting allowable expenses from the gross profits. The provincial CIT payable was the result of multiplying such taxable income by the CIT rate (standard rate of 33 percent before January 1, 2008). The designated gross rates were promulgated by the tax authorities at the provincial level, with the minimum rates as shown above.

**Foreign-Invested Real Estate Developers.** Previously, the provisional CIT payments on pre-sales generated by foreign-invested real estate developers were made on a quarterly basis. The method to calculate the relevant profit was commonly determined by the local tax authorities in charge of each jurisdiction. The tax authorities had discretion to choose the deemed profit method or other reasonable methods to determine the profit on pre-sales based on the administrative measures issued by the tax authority at the provincial level. As a result, the local practice on the provisional CIT payments on pre-sales by foreign-invested real estate developers varied in different locations.

## IMPACT

In general, Circular 299 clarifies certain matters concerning the provisional CIT payments on pre-sales of real estate properties in China. It has unified the two provisional tax filing regimes that previously applied to domestic and foreign-invested developers separately, which we believe follows the underlying principle of the new China CIT law.

For foreign-invested developers, the provisional CIT may increase due to the fact that profit rates under Circular 299 are higher than the rates promulgated by most provincial tax authorities in the past. For instance, the profit rate in Beijing was 10 percent for ordinary property projects, the highest profit rate in Hebei province was 15 percent, etc.

Unlike gross profit rates previously applied to Chinese companies, Circular 299 provides “profit” rates, under which the expenses are not allowed to be further deducted. Therefore, the taxable profit for domestic companies may also increase.

However, given that the CIT rate has been reduced from 33 percent to 25 percent, the effect on the increased taxable profit may be mitigated.

Finally, heavier administrative costs for provisional CIT payments may arise, in cases where the tax authority in charge determines that the provisional payments should be made on a monthly basis, rather than a quarterly basis.

For real estate developers who have already performed provisional CIT filing for the first quarter of 2008 based on the previous methods, the provisions of Circular 299 should be adopted from the second quarter of 2008.

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