Taxation

Overview

China's rapidly-changing corporate and individual tax regulations make ongoing tax planning an essential part of doing business in China. Tax incentives are one of the most important factors foreign investors should consider when deciding whether to invest in China.

Tax Administration

The Law on Tax Administration is the basic law on taxation and is also a procedural law. All enterprises, domestic and foreign, are treated equally under this law.

Tax Registration

Joint ventures (JVs), wholly-owned foreign enterprises (WOFEs), representative offices and other similar organizations in China are required to register with local tax authorities within a period of time specified in the relevant regulations. In general, registration must be completed within 30 days after the business license is issued.

Registration papers are to be filed with both the local branch of China's State Taxation Administration and the local government's Taxation Administration office. The two administrations have their own tax jurisdictions. To qualify as an ordinary Value Added Tax (VAT) payer and be able to issue VAT invoices, a taxpayer has to undertake VAT registration as well.

Upon completion of the tax registration, the applicant will be issued a tax registration certificate that must be renewed every year. Any changes in business license or operating office oblige the taxpayer to reregister with the tax authorities.

Tax Year

The tax year is the calendar year, i.e., it lasts from Jan. 1 to Dec. 31. If a foreign enterprise experiences difficulties in computing its taxable income on a calendar-year basis, it may apply to the tax authorities to adopt its own financial year as the tax year. If an enterprise commences business within a calendar year or has been in operation for less than 12 months in a calendar year, the actual operating period will be treated as the tax year.

An FIE is required to file its annual tax returns, audited financial statements and the auditor's report with the tax administrations within four months after the end of the year. Alternatively, an application for deferring the filing of these documents may be submitted within four months after the end of the year. The penalty for failure to file the necessary documents within the prescribed time limit is 0.2% of the tax owed per day that the documents are overdue.

Tax Audits

The tax authorities have the power to carry out tax audits to examine taxpayer records and relevant documents. Refusal to submit to a tax examination carries a maximum penalty of RMB 50,000. In general, the tax authorities provide the enterprise a written notice prior to any tax audit.

Tax Reporting and Payment

Different taxes have different reporting periods and payment due dates. In general, Corporate Income Tax (CIT) is paid on a quarterly basis, and VAT and Business Tax are usually paid on a monthly basis, as is Individual Income Tax (IIT). Tax authorities will not send taxpayers tax returns. Instead, taxpayers should collect blank tax returns from tax offices, complete them and file them accordingly.

Approved methods of submission differ from place to place. Reporting via mail may be acceptable, or submission in person may be required. Some regions, such as Shanghai, have adopted electronic filing.

Late payment of taxes carries a fine of 0.05% of the tax owed per day it is overdue. Withholding agents who fail to observe these obligations will be subject to a maximum penalty of 500% of the tax involved. Under the tax regulations, the foreign-invested company may apply to the tax authorities for deferred tax filing and payment. (Top)

Tax Applicable to Foreign Invested Enterprises

Over the past 20 years, China has made significant progress and has gained more experience in its tax legislation. In particular, it has improved the tax laws relating to foreign-invested enterprises. While China continues to use preferential tax treatment as an important means to attract FDI, it has shifted its emphasis from the amount or quantity of foreign investment to the quality of foreign investment, believing that this will help promote the sustainable economic development of the country.

Major Taxes Applicable to Foreign-Invested Enterprises (FIEs)

- Corporate Income Tax
- Personal Income Tax
- Value Added Tax
- Customs Duties
- Business Tax
- Resources Tax
- Land Appreciation Tax
- Stamp Duty
- Consumption Tax
- Real Estate Tax
- Vehicle Usage and License Tax

Corporate Income Tax (CIT)

The following summarizes the key aspects of the New Law and its impact on foreign investors.

New CIT Rate

The new standard corporate income tax (CIT) rate is 25%. The reduced CIT rate of 20% applies to small-scale enterprises with narrow profit margins. The preferential CIT rate of 15% is only available to high-tech and newly established technology enterprises that require support from the State.

Taxpayers

The New Law distinguishes between 'resident enterprises' and 'nonresident enterprises' as explained below.

Figure 3.3.1 CIT Taxpayer

Taxpayers	Definition	Taxable Income
Resident Enterprise	Established in China under PRC laws Established under foreign laws but has its place of effective management in China	global income
Nonresident Enterprise	Established under foreign laws, and has its place of effective management outside China	income derived from China

Source: China Knowledge

CIT Preferential Policies

The New Law grants some tax privileges by industry rather than by location.

- "Encouraged" high-tech enterprises are eligible for a reduced 15% CIT regardless of location in China.
- CIT exemption or reduction is reserved for specific technology transfers and investments in infrastructure, agriculture, forestry, animal husbandry and fisheries.
- "Super deduction" is allowed for R&D expenses and salary expenses for employment of handicapped workers.
- CIT credit is granted to specific venture capital enterprises and investments in environmental protection, energy, water conservation and some safety equipment.

The following CIT policies formerly available to FIEs have been revoked.

- Five-year tax break for manufacturing FIEs.
- Extension of tax holiday to export-oriented FIEs.
- Reduced CIT rate of 15% to 24% applicable to FIEs in special zones.
- CIT refund on reinvestment.
- 50% CIT reduction for three additional years after the tax holiday for FIEs that qualify as "technologically-advanced enterprises."
- CIT exemption for after-tax profit repatriation by foreign investors.

Transition Period

The New Law allows for a five-year transition period. The transition arrangement is as follows.

- FIEs enjoying a 15% or 24% tax rate are eligible for a five-year transition period to move up to a 25% tax rate.
- Manufacturing FIEs that were not able to take advantage of the five-year tax holiday before the effective date of the new tax law can do so after the effective date.
- Manufacturing FIEs that did not start their tax holidays under the old law are considered as having started their tax holidays from the effective date of the New Law.

Figure 3.3.2 Corporate Income Tax Rates during the Transition Period

Year	Tax Rate for FIEs Taxed at 15% (%)	Tax Rate for FIEs Taxed at 24% (%)
2008	18	25
2009	20	25
2010	22	25
2011	24	25
2012	25	25

Source: China Knowledge

Withholding Rate

The New Law stipulates a flat 10% tax rate for dividends, interest, royalties, rent, capital gains and other income of non-resident enterprises from sources in China.

The New CIT Law represents a huge change of direction for China. For the past decade and a half, China has operated on a dual tax system.

Before the New Law, for domestic enterprises the CIT was 33%, while the CIT for FIEs was 30% plus 3% local surtax when no preferential tax treatments were applicable. CIT for enterprises in coastal regions, border regions and some other places was 24% or 15% in the Special Economic Zones. There were, however, quite a number of tax incentives available to FIEs tailored to specific industries and locations.

This resulted in significant disparities in the effective tax rates generally applicable to domestic enterprises and to FIEs. The New Law eliminated these differences, creating a level playing field.

Personal Income Tax (PIT)

The PIT Law was adopted by the Third Session of the Fifth National People's Congress on Sep. 10, 1980. The Law was amended in 1993, 1999 and 2005.

Individual income tax shall be levied on the following:
- income from wages, salaries
- income from production, operation derived by industrial and commercial households
- income from contractual or leasing operations to enterprises or institutions
- income from labor service payment
- income from author remuneration
- income from royalties
- income from interest, dividends and extra dividends
- income from lease of property
- income from transfer of properly
- contingent income
- other income specified as taxable by the finance department of the State Council

Like most countries, China does not use a flat tax system. Instead, there are nine marginal tax rates. The first RMB 500 of taxable income is taxed at 5%; the next RMB 1,500 is taxed at 10%. The part exceeding RMB 100,000 is taxed at 45%. Currently, the threshold income, which was set in 2008, is RMB 2,000.

In 2006, the threshold for foreign taxpayers was increased from RMB 4,000 per month to RMB 4,800 per month. Income from compensation for personal services, royalties, interest, dividends, bonuses, lease of property, transfer of property, and other kinds of income shall be taxed at 20%.

As of Jan. 1, 2007, individuals with an annual income over RMB 120,000 have the obligation to declare their individual income to the local tax authority and pay the tax. This new regulation targets the high-income group and is designed to bridge the wealth gap.

The income gap in China is widening. The ratio of income and consumption to GDP has been decreasing since the 1970s.

Value Added Tax (VAT)

China's current regulation methods for value added tax took effect on Jan. 1, 2009. The new methods reduced the tax burden on small and medium-sized enterprises.

Taxpayers selling or importing goods or providing processing, replacement and repair services must pay a VAT of 17%. Taxpayers selling or importing grains, edible vegetable oil, coal gas, natural gas, coal or charcoal products for household use, books, newspapers, magazines, chemical fertilizers, agricultural chemicals or agricultural machinery must pay 13%. Taxpayers exporting goods, except as stipulated by the State Council, are exempt from paying VAT.
Enterprises and individuals engaged in production or providing taxable services whose annual sales revenue is less than RMB 1 million, along with wholesalers and retailers whose annual sales revenue is less than RMB 1.8 million and those designated by the tax authority as small VAT payers, pay 3%.

Customs Duties

China entered the World Trade Organization in 2001. In 2008, the aggregate import duty was lowered from the 43.2% rate established in 1992 to 9.8%. The rate is 15.2% for agricultural products and 8.9% for industrial products.

Duty rates on import goods include most-favored-nation duty rates, conventional duty rates, special preferential duty rates, general duty rates, and tariff quota duty rates. Temporary duty rates may also apply.

- The most-favored-nation duty rates apply to goods imported from members of the WTO that are subject to the common application of the most-favored-nation clause, goods imported from countries or regions with which China has concluded a bilateral trade agreement for the reciprocal granting of most-favored-nation treatment, and goods reimported from the customs territory of the People's Republic of China.

- The conventional duty rates apply to goods imported from countries or regions with which China has concluded a regional trade agreement that includes preferential duty clauses.
- The special preferential duty rates apply to goods imported from countries or regions with which China has concluded a trade agreement that includes special preferential duty clauses.
- The general duty rates apply to goods imported from countries or regions other than those specified above and to goods of unknown origin.

The customs value of import goods is determined by Customs according to the transaction value as well as the cost of transportation, the charges associated with transportation, and the cost of insurance incurred prior to unloading of such goods at the port or place of entry within the customs territory of China.

China also imposes duties on export goods. Temporary duty rates may also apply.

The customs value of export goods is determined by Customs according to the transaction value as well as the costs of transportation, charges associated with transportation, and the cost of insurance incurred prior to loading of such goods at the port or place of departure within the Customs territory of China.

Business Tax

Business tax shall be levied on organizations and individuals involved in supplying taxable labor, transfer of intangible assets and sale of real estate. The tax rate is 3% for communications and transportation, civil construction, postal services and telecommunications, culture and sports; 5% for banking and insurance, transfer of intangible assets and real estate. The rates for entertainment industries are between 5% and 20%. Generally, tax is applicable to companies in service industries.

Resources Tax

Foreign enterprises that mine and explore mineral and natural resources within the territory of China are subject to a resources tax.

Figure 3.3.3 Resources Tax Levied during the Transition Period

Category	Tax Rate
Crude Oil	8–30 RMB per ton
Natural Gas	2–15 RMB per square meter
Coal	0.3–5.0 RMB per ton
Ferrous Metal Ore	0.4–30 RMB per ton
Nonferrous Metal Ore	10–60 RMB per ton
Nonmetal Ore	2–30 RMB per ton
Salt	2–10 RMB per ton

Source: China Knowledge

Land Appreciation Tax

Land appreciation tax is levied on income from the transfer of state-owned land use rights, buildings and their attached facilities. The appreciation amount shall be the balance of proceeds received by the taxpayer on the transfer of real estate after deducting the following items:

- the sum paid to acquire the land use rights
- the cost to develop the property
- the cost of constructing new buildings, or the assessed value of existing buildings
- the taxes related to the transfer
- other items as stipulated by the Ministry of Finance

Stamp Duty

Activities involving purchases and sales, processing, contracting, leasing, transportation, storage, lending, property insurance, technology contract and property transfer vouchers, business account books and licenses are subject to stamp duty. The minimum rate is 0.005% and the maximum rate is 0.3%.

Consumption Tax

A consumption tax is levied on the sale of 11 types of goods. For details regarding the 25 different tax rates, which range between 1% and 45%, see the Rules for the Implementation of the Interim Regulations of the PRC on Consumption Tax.

Tax on goods used in the production process shall be levied based on the price of the goods, whereas tax on yellow rice wine, gasoline and diesel shall be levied based on the value per unit quantity.

Taxable consumer goods exported, except those taxable consumer goods subject to export restrictions imposed by the Government, shall be exempt from the consumption tax.

Real Estate Tax

Real estate tax is levied on real estate used for business purposes. The tax on buildings shall be assessed annually at the rate of 1.2% of the standard value of the building, and the tax on rent shall be assessed annually at the rate of 12% of the rent for the building.

Vehicle Usage and License Tax

The rate for vessels and vehicles is assessed based on weight capacity and vehicle type. In the case of passenger vehicles, tax is assessed based on the number of seats. For example, the tax payable for passenger vehicles with no more than 10 seats is between RMB 360 and RMB 660 per year. (Top)