

An Overview of Taxation System in China

The new Corporate Income Tax Law and Implementation Regulations came into effect on the 1st of January 2008. Understanding tax rules and regulations in China can be a particularly daunting task. Many rules are not published, while those that are can often be ambiguous and contradictory. Moreover, practice often does not parallel the written regulations.

In an attempt to assist in understanding this increasingly complex and ever changing area, we drafted this brief overview of applicable taxes for Foreign Invested Entities (FIEs) and exporters of goods and services to China. The key applicable categories covered below are:

Corporate Income Tax

Withholding Tax

Consumption Tax

Value - Added Tax

Business Tax

Individual Income Tax

Corporate Income tax

Under the new Corporate Income Tax Law, many preferential policies and tax holidays previously available under the old system designed to attract foreign investments have now been abolished. The corporate income tax rate has been unified to 25 percent with no differentiation between local and foreign ownerships.

Corporate Income Tax might apply to foreign investors in the following circumstances:

- FIEs in China, including equity and cooperative joint ventures (JVs), and wholly foreign owned entities (WFOEs);
- Foreign entities that have a 'permanent residence' in China. Normally a permanent residence requires physical presence, however, a foreign entity without a physical presence may qualify if it provides services in China for a period lasting more than six months in any twelve months;
- Foreign entities without a 'permanent residence' in China but importing through a business agent arrangement are equivalent to a 'permanent residence'.

Business Tax

Business tax is payable by all entities providing taxable services (e.g. transportation, construction, finance and insurance, entertainment, services, etc.), transfer possession of immovable properties (e.g. real estate) and intangible assets. Business tax is levied on the gross income from services and non-production activities regardless of whether a foreign entity has a permanent establishment in China or not.

Business tax rates vary in accordance with different industries and jurisdictions. The most common business taxes are:

Percentage (%)	Industry Affected
Five (5)	Service sectors: travel agency, warehouse, advertising, consulting etc.
Eight (8)	Finance, banking, and insurance industries
Three (3)	Public transportation, construction, postage & telecommunications, cultural activities
Five - Twenty (5-20)	Entertainment industry
	Sales of immovable properties and intangible assets

Value-added Tax

Foreign entities engaging in non-service or production related activities (e.g. trading or manufacturing) are subject to Value-Added Tax (VAT) instead of business tax. VAT applies in the sale of taxable goods (excluding intangible assets and real estate), the provision of taxable labour services (i.e. processing and repairing services only), as well as the import of taxable goods into China.

VAT taxpayers can be categorised into 'general taxpayers' and 'small-scale taxpayers'. General taxpayers are subject to VAT at 17 percent based on output VAT minus input VAT. In addition, a simplified VAT calculation applies for 'small-scale taxpayers' under which no credit or deduction is allowed for input VAT but only output VAT at a lower rate of 3 percent for all entities.

A VAT rate of 13 percent applies for certain exceptions. Some examples include:

Cereals and edible vegetable oils	Gas (i.e. LPG, LNG, and bio-gas)
Coal products (for home use)	Books, newspapers, and magazines

Entities pay VAT on inputs and collect VAT on outputs. If the VAT collected is greater than VAT paid, companies must remit the balance owing. Exporters are eligible to apply for refund on VAT paid. The refund rate is determined and updated by State Administration of Taxation.

Consumption Tax

The import, processing and manufacturing or production of taxable goods, including alcohol and tobacco, automobiles, jewellery, cosmetics, petroleum products etc. are subject to consumption tax. Consumption tax is levied on different taxable categories at their respective fixed tax rates - either in percentage ranging from 3 to 56 percent or in the quantity consumed, for example, RMB per litre or RMB per ton.

Withholding Tax

Foreign entities that do not have a 'permanent presence' in China but derive interest, dividends, royalties or any other forms of income from China-based operations or activities are subject to a 10 percent withholding tax on China-sourced income (the new Corporate Income Tax Law provides a temporary reduction on withholding tax to 10 percent while the standard withholding tax rate is 20 percent, and the rate on dividends is still 20 percent).

The withholding obligations should be explicitly written on the invoice issued to China-based clients in remittance to the Chinese tax authorities. Note however, foreign countries may have double tax agreements (DTAs) signed with China which may reduce the withholding tax rate applicable.

China has signed over eighty DTAs with countries worldwide to date, as well as its two Special Administrative Regions of Hong Kong and Macau.

Individual Income Tax

The rate of individual income tax varies depending on the types of income. For salaries and wages, income received by foreigners in China is taxed at the same progressive rates as Chinese nationals. The current tax deduction allowable on wages and salaries for Chinese nationals and foreigners are RMB2,000 and RMB4,800 respectively, with the highest tax bracket at 45 percent:

RMB (Month)

%

<500	5
500 - 2,000	10
2,000 - 5,000	15
5,000 - 20,000	20
20,000 - 40,000	25
40,000 - 60,000	30
60,000 - 80,000	35
80,000 - 100,000	40
100,000 +	45

The tax rate on other sources of income is 20 percent; while the deductions may vary. For income received, that is less than RMB4,000, for services, royalties, remuneration by authors, or leasing, the tax deduction is RMB800. If it is above RMB4,000, the deduction is 20 percent of the gross income. For the ownership transfer of buildings and intellectual property, for example, the deductions include the acquisition cost, plus other reasonable costs like taxes. There are no deductions on income derived from interest, dividends, or winnings from lotteries.

Individual income tax is assessed on a monthly basis and must be paid to local tax authorities by either individuals directly or employers as a 'withholding agent' within seven working days following the end of the month.

Reporting & Bookkeeping

China adopts the Gregorian calendar as a tax year which starts from the 1st of January and ends on the 31st of December. FIEs are required to file income tax returns and pay provisional tax on a quarterly basis. Business tax, VAT, consumption tax, and individual income tax returns are filed on a monthly basis. Withholding tax is filed on transaction basis.

Chinese is the only official language in China. All accounting records: documents, books, financial statements and tax returns must be expressed in Chinese. However, a foreign language might be used in parallel.

Currency officially used in China is Renminbi (RMB) and also referred to as Yuan, which is still unconvertible. Accounting books, records and tax returns shall be reported in RMB and foreign currencies must be converted into RMB based on the official foreign exchange rates quoted by the State Administration of Foreign Exchange (SAFE).