CHINA BRIEFING

The Practical Application of China Business

The China Tax Guide

Fifth Edition

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China Briefing

The Practical Application of China Business

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Chris Devonshire-Ellis · Andy Scott ·
Sam Woollard
Editors

The China Tax Guide

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Editors
Chris Devonshire-Ellis
Andy Scott
Sam Woollard
Dezan Shira & Associates
Asia Briefing Ltd.
Unit 1618, 16/F., Miramar Tower
132 Nathan Road, Tsim Sha Tsui, Kowloon
Hong Kong, PR China
e-mail: editor@asiabriefingmedia.com

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About China Briefing's China Business Guides

Thank you for buying this book. China Briefing's publications are designed to fill a niche in the provision of information about business law and tax in China. When we decided, several years ago, to commence this series, we did so in the knowledge that much that was available about China was either expensive, or completely contradictory. This guide is designed to change that perspective and provide detailed information and the regulatory background to business in China—but with a firm eye also on the details of making money and remaining in compliance.

Accordingly, we have made this guide informative, easy to read and inexpensive. To do so, we have engaged not a team of journalists or academics—but the services of a respected professional services firm to assist us. The articles and materials within have been researched and written by China-based Chinese and international accountants and auditors, familiar with the issues that foreign invested enterprises face in China—as they service them in China as clients. These professionals have come from the nationally established practice, Dezan Shira & Associates, and we are grateful for their support. Without them this book would not have been possible, and we wholeheartedly recommend their services should you require sensible and pragmatic advice as contained within this book.

Contributors to and editors of previous editions of this guide included Steven Carey, Hannah Feng, Amanda Gan, Ronin Lin, Helen Liu, Jennifer Lu, Crystal Yang, Candice Zeng, Becky Jian, Gong Jie, and Andy Scott. The fifth edition of this guide was revised by Hannah Feng, Eunice Ku, and Samantha Jones. All editions were designed by Chris Wei.

At China Briefing, our motto is "The practical application of China business" and we hope that within this volume and our other publications you feel we have achieved this, and helped point you in the right direction when it comes to understanding and researching this vast and complicated business environment.

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An Introduction to Tax in China

1 Tax Planning as Part of Your China Investment Strategy

Tax is never a popular topic, wherever you do business, but it is unavoidable. The current system in China, as it applies to foreign companies, is also in a process of transition, with significant evolutions planned for the next few years.

Every foreign investor in China needs to understand what their liabilities are, both as an individual and a business, and whether they are eligible for any relief or exemptions. While tax evasion is, of course, punished as much in China as any other country, there is no need to pay more than you have to.

Tax planning is a complicated matter as the tax regime levies different taxes, and at different tax rates, depending on your location and your scope of business. When structuring your investment, detailed attention also needs to be paid to the value-added tax rates, customs duties and other business taxes.

It is important this is done as part of your pre-incorporation and planning stages. Tax planning is an integral part of the business establishment process and it is vital that detailed attention is paid to tax issues and how these affect your proposed investment. If not, you stand to lose out on investment incentives, the ability to reduce profits tax liabilities, and the reclamation of VAT. Simply put, without taking into account taxation, your business will not be as financially effective or efficient as it could be, and you will be spending more money than necessary in your business operations.

Business structuring in China therefore is not just a simple administrative process, nor purely a legal application for obtaining a license. It involves attention to detail concerning China's tax administration and the appropriate tax structuring, as well as company law, legal administration and the regulatory environment. As all businesses are different, each investment into China requires a bespoke approach to handling tax efficiency.

The information contained within this book was written and updated in January, 2011 and is based on the information available at the time. It is intended to address

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important issues within China's taxation system that affect foreign investors. As China's regulatory environment continues to evolve, it is advisable to get professional advice before addressing any specific issues that may occur.

2 China's Tax Laws and Administration

Tax Laws

The formulation of tax law in China follows four steps—drafting, examination, voting and finally promulgation by the National People's Congress or its Standing Committee. Detailed implementing rules are created, as appropriate, by the Ministry of Finance, the State Administration of Taxation (SAT) or the General Administration of Customs.

Since China began its reform and opening up in the early 1980s, the government has carried out three major reforms of its taxation system. Valued-added taxes were introduced for the first time in 1984 and first reformed in 1993. Further reforms in 1994 introduced the division of tax collection and revenue between the central and local governments. China continued to overhaul its taxation system in 2006, focusing on several areas including:

- Reform of VAT, turning production VAT into consumption VAT.
- Reform of corporate income tax, unifying the differing arrangements for domestic and foreign enterprises.
- Reform of personal income tax—the thresholds for both foreign and local staff have been increased.
- The launch of a new fuel consumption tax to replace the current road maintenance fees.
- Reform and reduction of rural taxes.

The main laws with which foreign investors are likely to be concerned are as follows:

- *Individual Income Tax Law of the PRC*—adopted on September 10, 1980, and revised on October 31, 1993; August 30, 1999; October 27, 2005, and November 2006.
- *Interim Regulations of the PRC on Value-added Tax*—adopted December 13, 1993 and revised on November 5, 2008.
- *Interim Regulations of the PRC on Business Tax*—adopted December 13, 1993 and revised on December 15, 2008.
- *Implementing Rules for the Interim Regulations of the PRC on Consumption Tax*—adopted December 25, 1993.
- *Corporate Income Tax Law of the People's Republic of China*—adopted March 16, 2007.

Other relevant laws as well as those mentioned above are available on the SAT's web site: www.chinatax.gov.cn.

Tax Administration

The SAT, the ministry-level department directly under the State Council, is the highest tax authority in China. It is the equivalent of the Internal Revenue Service in the United States or HM Revenue and Customs in the United Kingdom.

The State Administration of Taxation's main functions are: drafting tax laws and regulations, and formulating implementation procedures in conjunction with the Ministry of Finance; supporting the Ministry of Finance in developing national tax and economic policies; executing collection and administration of central taxes, shared taxes, and contributions to funds designated by the state; and dealing with collection and refund of VAT or consumption tax on imports and exports.

Because tax revenues are collected and shared in various ways between central and local government, tax organizations at and below the provincial level (or equivalent) are divided into SAT offices and local tax bureau offices.

The key split is as follows, for the main taxes:

- Collection
  - SAT—VAT, consumption tax, business tax, and enterprise income tax, and various other specialized taxes.
  - Local tax bureau—business tax, individual income tax, and various other specialized taxes.
  - Customs—these include Customs duties, and notably, VAT and consumption tax on imports and exports.
- Revenue use
  - State level—75% of VAT, 60% of enterprise income tax (100% of that collected from various state owned companies such as banks and railways), 60% of individual income tax.
  - Local level—25% of VAT, 40% of enterprise income tax, 40% of individual income tax.

Every business entity has to register with both the SAT and the local tax bureau, and customs if importing or exporting.

Bear in mind, too, that many tax regulations are subject to interpretation by officials, and the same regulation may thus be implemented in different ways even in different parts of the same city.

The total tax collected in China since the beginning of opening up and reform in 1978 and the percentage amounts of the main business taxes are shown in the tax tables on the following pages.

China's tax revenues 1978–2009 (100 million yuan)

Year	Total	Domestic value-added tax[a]	Business tax	Domestic consumption tax[a]	Tariffs	Corporate income tax[b]	Individual Income Tax
1978	519.28				28.76		
1980	571.70				33.53		
1985	2,040.79	147.70	211.07		205.21	696.06	
1990	2,821.86	400.00	515.75		159.01	716.00	
1991	2,990.17	406.36	564.00		187.28	731.13	
1992	3,296.91	705.93	658.67		212.75	720.78	
1993	4,255.30	1,081.48	966.09		256.47	678.60	
1994	5,126.88	2,308.34	670.02	487.40	272.68	708.49	
1995	6,038.04	2,602.33	865.56	541.48	291.83	878.44	
1996	6,909.82	2,962.81	1,052.57	620.23	301.84	968.48	
1997	8,234.04	3,283.92	1,324.27	678.70	319.49	963.18	
1998	9,262.80	3,628.46	1,575.08	814.93	313.04	925.54	
1999	10,682.58	3,881.87	1,668.56	820.66	562.23	811.41	413.66
2000	12,581.51	4,553.17	1,868.78	858.29	750.48	999.63	659.64
2001	15,301.38	5,357.13	2,064.09	929.99	840.52	2,630.87	995.26
2002	17,636.45	6,178.39	2,450.33	1,046.32	704.27	3,082.79	1211.78
2003	20,017.31	7,236.54	2,844.45	1,182.26	923.13	2,919.51	1418.03
2004	24,165.68	9,017.94	3,581.97	1,501.90	1,043.77	3,957.33	1737.06
2005	28,778.54	10,792.11	4,232.46	1,633.81	1,066.17	5,343.92	2094.91
2006	34,804.35	12,784.81	5,128.71	1,885.69	1,141.78	7,039.60	2453.71
2007	45,621.97	15,470.23	6,582.17	2,206.83	1,432.57	8,779.25	3185.58
2008	54,223.79	17,996.94	7,626.39	2,568.27	1,769.95	11,175.63	3722.31
2009	59521.59	18481.22	9013.98	4761.22	1483.81	11536.84	3949.35

[a] Domestic value-added tax does not include value-added tax from imports. Domestic consumption tax does not include consumption tax from imports

[b] Before 2001, corporate income tax only included state-owned and collective-owned enterprises's income tax. Since 2001, corporate income tax also includes the income tax levied on other enterprises in addition to state-owned and collective-owned enterprises, the figures are not comparable with the previous years

National Government Revenue: Central and Local Governments (2009) (100 million yuan)

Item	National Government Revenue	Central Government	Local Governments
National government revenue	**68518.30**	**35915.71**	**32602.59**
Total tax revenue	**59521.59**	**33364.15**	**26157.44**
Domestic value added tax	18481.22	13915.96	4565.26
Domestic consumption tax	4761.22	4761.22	
VAT and consumption tax from imports	7729.79	7729.79	
VAT and consumption tax rebate for exports	−6486.61	−6486.61	
Business tax	9013.98	167.10	8846.88
Corporate income tax	11536.84	7619.09	3917.75
Individual income tax	3949.35	2366.81	1582.54
Resource tax	338.24		338.24
City maintenance and construction tax	1544.11	124.19	1419.92
House property tax	803.66		803.66
Stamp tax	897.49	495.04	402.45
Stamp tax on security exchange	510.38	495.04	15.34
Urban land use tax	920.98		920.98
Land appreciation tax	719.56		719.56
Tax on vehicles and boat operation	186.51		186.51
Tax on ship tonnage	23.79	23.79	
Vehicle purchase tax	1163.92	1163.92	
Tariffs	1483.81	1483.81	
Farm land occupation tax	633.07		633.07
Deed tax	1735.05		1735.05
Tobacco leaf tax	80.81		80.81
Other tax revenue	4.80	0.04	4.76
Total non-tax revenue	**8996.71**	**2551.56**	**6445.15**
Special program receipts	1636.99	223.71	1413.28
Charge of administrative and institutional units	2317.04	359.54	1957.50
Penalty receipts	973.86	35.25	938.61
Other non-tax receipts	4068.82	1933.06	2135.76

National Government Expenditure: Central and Local Governments (2009) (100 million yuan)

Item	National Government Expenditure	Central Government	Local Governments
National government expenditure	**76299.93**	**15255.79**	**61044.14**
Expenditure for general public services	9164.21	1084.21	8080.00
Expenditure for foreign affairs	250.94	249.71	1.23
Expenditure for external assistance	132.96	132.96	
Expenditure for national defense	4951.10	4825.01	126.09
Expenditure for public security	4744.09	845.79	3898.30
Expenditure for armed police	866.29	679.11	187.18
Expenditure for education	10437.54	567.62	9869.92
Expenditure for science and technology	2744.52	1433.82	1310.70
Expenditure for culture, sport and media	1393.07	154.75	1238.32
Expenditure for social safety net and employment effort	7606.68	454.37	7152.31
Expenditure for affordable houses	725.97	26.43	699.54
Expenditure for medical and health care	3994.19	63.50	3930.69
Expenditure for environment protection	1934.04	37.91	1896.13
Expenditure for urban and rural community affairs	5107.66	3.91	5103.75
Expenditure for agriculture, forestry and water conservancy	6720.41	318.70	6401.71
Expenditure for transportation	4647.59	1069.22	3578.37
Expenditure for purchasing vehicles	1085.08	648.81	436.27
Expenditure for mining and quarrying, electricity and information technology	2879.12	508.23	2370.89
Expenditure for reserve for cereals and oils	2218.63	781.44	1437.19
Expenditure for financial affairs	911.19	778.04	133.15
Expenditure for post-earthquake recovery and reconstruction	1174.45	130.60	1043.85
Interest payments on government bonds	1491.28	1320.70	170.58
Other expenditure	3203.25	601.83	2601.42

China's Business Taxes

1 Corporate Income Tax

On March 16, 2007 Chinese lawmakers passed the Corporate Income Tax Law, unifying the tax rates for foreign and domestic enterprises. The law, which took effect January 1, 2008, brought China's tax laws more in-line with international standards. It has unified the two existing tax codes—one for domestic enterprises, the other for foreign-invested enterprises—into one and represents a fundamental change in China's tax policy.

The Corporate Income Tax Law contains general provisions as well as chapters on what constitutes taxable income, taxes payable, tax incentives, withholding tax at the source, special tax adjustments, administration of the levy and collection of taxes, as well as some supplementary provisions.

Corporate income tax is calculated against the net income in a financial year after deducting reasonable business costs and losses—in other words it is effectively a tax on profits. It is settled on an annual basis but is often paid quarterly with adjustments either refunded or carried forward to the next year. The final calculation is based on the year-end audit.

The income tax rate for all companies in China, both foreign and domestic, is 25%. Industry-based tax incentives exist which reward enterprises involved in the high or new technology sectors.

Tax rate	Percentage	Applicable enterprises
Standard rate	25	Most enterprises
Reduced rate	20	Small and low-profit enterprises
Withholding income tax	20	Foreign enterprises without permanent establishment in China but who derive income from China

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Tax Incentives

A number of tax incentives exist:

- Qualified advanced technological service enterprises are eligible for a reduced income tax rate of 15% in 21 model cities.
- "Encouraged" high-tech enterprises are eligible for a reduced income tax rate of 15%, irrespective of the location of such enterprises in China.
- Research and development expenses can be deducted from the taxable income by 150% of the total amount.
- More tax incentives will be granted to start-up companies, and enterprises investing in environmental protection, energy and water saving, or industrial safety.
- Existing preferential tax policies for investments in infrastructure facilities, agricultural, forestry, animal husbandry and fishery industries and for those enterprises established in the western regions, have been retained.

Existing tax incentives available to those qualifying enterprises which employ laid-off or handicapped workers have been replaced with super deductions applied to the wages paid to disabled employees. For CIT, the super deduction of salary paid to disabled employees is 200%, for IIT, monthly taxes of less than RMB2000 are exempt.

Three important tax circulars were issued in February 2008 which significantly impact foreign-invested enterprises in China. These circulars further clarified several significant areas of the corporate tax regime including tax incentives for high-technology industries and grandfathering treatments.

Circular Caishui (2008) No. 1, issued February 4, 2008, specifies tax incentives available to certain industries in the tax law. It provides tax incentives to software production companies, IC production companies and security investment funds. These tax incentives mirror the incentives granted under the old tax regime. Preferential tax treatment will also continue to apply to IC production and assembly companies and software production companies newly established in the western region of China. Circular 1 also states that tax holidays for software production companies and IC production companies will start from the first profit-making year.

Grandfathering

Circular 21 clarifies how the half-rate reduction during an unutilized tax holiday period should be calculated during the grandfathering period for qualifying FIEs. Circular 21 states that the half-rate reduction during the unutilized tax holiday period should be calculated based on the gradually increased tax rates of 18, 20, 22 and 24% for the years 2008, 2009, 2010, 2011 respectively, and 25% from 2012 forward. That means the net rates will be 9, 10, 11, 12, and 12.5%, depending on the year in which the half-rate reduction applies. For FIEs that were subject to a 24 or

33% tax rate under the old tax regime, the half-rate reduction during the unutilized tax holiday period should be calculated based on 25%, making the net rate 12.5%.

Old foreign enterprise income tax	Transitional rate (%)	Transition period
15%	18	January 1, 2008
	20	January 1, 2009
	22	January 1, 2010
	24	January 1, 2011
	25	January 1, 2012

Circular Guoshuifa (2008) No. 23, released on February 23, 2008, clarifies aspects of the grandfathering treatments of previously enjoyed tax incentives. To qualify for reinvestment tax refunds, FIEs must have completed all reinvestment steps and obtained the dated business license of the new business license on or before the end of 2007.

For contracts involving interest or royalties that were entered into before 2008, have met the criteria for withholding tax under the old tax regime, and have been already approved by the tax authorities, the withholding tax exemption will continue to apply until the expiration of the original contract. This will not apply to any extension, expansion or supplementary contract of the original contract.

Foreign-invested enterprises eligible for grandfathering treatments of unutilized tax holidays will still need to observe the original requirements stipulated under the old tax law, chief among these would be business scope and operation period. If an FIE fails to fulfill the original requirements, the tax exempted or reduced period during the tax holiday, including the part falling after 2008, would be drawn back.

Representative Offices

Effective from January 1, 2010, representative offices are no longer exempt from corporate income tax, business tax and VAT in China. However, ROs may be able to acquire non-CIT status by invoking treaty protection after completing the relevant filing procedures as stipulated in Guoshuifa (2009) No. 124. Guoshuifa (2010) No. 18, issued on February 20, 2010, explicitly stipulates that ROs shall pay corporate income tax on their taxable income, as well as business tax and VAT. In accordance with the relevant laws, administrative regulations, and the State Council, ROs must provide valid accounting records. Tax authorities have the right to penalize ROs providing incomplete or incorrect records. Representative offices should also perform the principles of actual functions in matching with potential risks, and accurately calculate their taxable income—declaring to the tax authorities at least 15 days after the end of the quarter.

Representative offices are required to keep proper accounting records to ascertain their actual revenue and profits and file taxes on the same. Representative offices that cannot determine their profits on an actual basis must ascertain

their deemed tax value by either using the cost-plus method or the actual revenue deemed profit method. Under either method, the new tax circular states that the deemed profit margin shall be no less than 15%, an increase from the previous deemed profit margin of 10%.

Actual Basis Method

Representative offices should file taxes on an actual basis, based on books and records, with reported profits in line with the function of the RO.

Calculation:

$$\text{CIT} = \text{Actual taxable profit} \times \text{CIT rate}$$

$$\text{BT/VAT} = \text{Actual taxable revenue} \times \text{applicable BT/VAT rate}$$

Cost-Plus Method

This method is for representative offices that are able to accurately ascertain expenses but not revenue or cost.

Calculation:

$$\text{CIT} = \text{Deemed gross revenue} \times \text{deemed profit rate} \times \text{CIT rate}$$

$$\text{BT} = \text{Deemed gross revenue} \times \text{applicable BT rate}$$

Actual Revenue Deemed Profit Method

This method is for representative offices that are able to accurately ascertain revenue but not cost or expenses.

Calculation:

$$\text{CIT} = \text{Actual gross revenue} \times \text{deemed profit rate} \times \text{CIT rate}$$

$$\text{BT/VAT} = \text{Taxable revenue} \times \text{applicable BT/VAT rate}$$

An RO that files taxes using cost-plus or actual revenue methods may, after filing with the in-charge tax authority, switch to the actual basis provided that it can maintain complete accounting books, and accurately calculate its taxable revenue, profit and tax liabilities.

Dealing with Non-compliance

Firstly, if you have not been conducting filing, is this because you were exempt or did it just get overlooked? A quick license check will tell the story. If you have not

filed, did you ever register? Again, a look at your tax registration certificate will show if you did. This is potentially now two problems—lack of registration, and lack of filing.

If you never registered for tax, you will need to. Beforehand, you will need to prepare a full set of accounts backdated to the day you begun operations. You should then go to the tax bureau and own up. They may well look somewhat dimly at you, and mutter threats of ‘‘five times amount due’’ to you. Do not attempt to negotiate with them—you have no right to do so. Instead this is a time to be meek and mild, and above all compliant. They may well ask you to submit your accounts for audit, and you will need to hire a professional firm to arrange this for you. Go back with the audited accounts, register for tax, and then see what they have to say about the tax assessment over what is due.

For businesses, it is common when non-registration has occurred for the original business license to be out of date in other ways—maybe change of address or of chief representative. It makes sense to get all of these issues addresses at the same time—so check for other licensing inconsistencies while you are about it.

This is a bit easier to deal with if at least you did register for tax—but you will still need to go cap in hand to the tax bureau with a set of prepared accounts and say ‘‘sorry.’’ This may also need to be audited for previous years, so you will need to arrange to get this done. Again, up to five times the amount due can be levied.

In terms of dealing with the bureau, it is you that is not in compliance—not they who need to be in compliance with you. You are going to get a bill, certainly for the amount of tax that is due. So go armed with a proper set of accounts and then be prepared for an audit request. This will almost certainly mean you need to see a professional firm, but this is not a time to skimp on fees. You have already caused the tax bureau grief in non-compliance so make it easier for them.

Be pleasant, non-confrontational and do not argue. Do not attempt to give them any presents. If you are seen to be penitent and to have a legitimate desire to pay and comply in future, they are more likely to be lenient with you, and maybe not even levy any late payment penalties. However, it is wise to approach the tax bureau having already fixed the problem and being able to provide revised accounts—it makes sense to get in professional advise to ascertain exactly what needs to be done to rectify the situation, have them conduct this work—and then approach the tax bureau with both the problem, the solution, and the overdue tax payment all in one go. It makes their life easier and they are more likely to be lenient with you. This scenario applies just as much to companies in China as it does individuals.

2 Withholding Tax

Withholding tax is a PRC tax levied on overseas companies providing services to China-based businesses.

For companies based outside of China but who are supplying services to clients in China (this can include a China-based subsidiary), your invoices are in effect "China-derived income" and the Chinese tax authorities levies taxes on these amounts. These are withheld by your client in China, being deducted from your gross invoice amount. This is why many overseas companies without a legal presence in China cannot receive the total gross amount due on their invoices to the China entity.

Your client has the responsibility of passing this tax onto the tax bureau. If they do not, or do not subtract the relevant amount of tax from your invoice, then the Chinese tax bureau will pursue the local business—and not the overseas operation—for settlement.

The withholding income tax rate for non-tax resident enterprises in China for passive income is 20% under the CIT law. This was reduced to 10% under the detailed implementation regulations of the CIT law. From January 1, 2008, this rate shall be applied to the dividends that a non-resident company receives from a resident company, unless otherwise prescribed in the tax treaty with the relevant foreign government. If the rate in the tax treaty is higher than 10%, 10% of dividends shall be adopted according to current rules; if the rate in the tax treaty is lower than 10%, the rate in the tax treaty should be adopted.

Tax rate on dividends from tax treaties

Tax rate (%)	Countries (regions)
0	Georgia (If the beneficial owner holds directly or indirectly at least 50% of the capital of the company paying the dividends and the total investment is no less than EUR2 million)
5	Kuwait, Mongolia, Mauritius, Slovenia, Jamaica, Yugoslavia, Sudan, Laos, South Africa, Croatia, Macedonia, Seychelles, Barbados, Oman, Bahrain, Saudi Arabia, Ethiopia
5 (holds directly 10% of the capital of the company paying the dividends)	Venezuela, Georgia (investment in the company paying the dividends is no less than EUR100,000; 10% of gross dividends if the beneficial owner holds directly less than 10% of the capital of the company paying the dividends)
5 (holds directly 25% of the capital of the company paying the dividends)	Algeria, Luxemburg, Korea, Ukraine, Armenia, Iceland, Lithuania, Latvia, Estonia, Ireland, Moldova, Cuba, Trinidad and Tobago, Tajikstan, Hong Kong, Macau, Singapore (10% of gross dividends if the beneficial owner holds directly less than 25% of the capital of the company paying the dividends)
7	United Arab Emirates
7 (holds directly 25% of the capital of the company paying the dividends)	Austria (10% of gross dividends if the beneficial owner holds directly less than 25% of the capital of the company paying the dividends)
8	Egypt, Tunisia, Mexico
10	In all other cases

China has tightened its policies and procedures regarding withholding tax from non-tax resident enterprises for their China-sourced income. Non-resident enterprises with or without establishment or place in China, and those with income not effectively connected with such establishment or place, shall pay CIT on their China-sourced income. Such income includes: income from the sales of goods; income from the provision of services; income from the transfer of property, dividends and profit distribution; income from equity investment, interests, rentals, royalties; income from donation; and any other income not included in the categories listed.

The income tax payable on such income derived by non-resident enterprises shall be withheld at source, and the payer shall be the withholding agent. The withholding agent shall withhold tax from the amount of each payment that is paid or that becomes due at the time of payment or at the time the payment falls due, which means that the withholding obligation arises when such income is remitted or when the payer accrues the amount as a cost or expense under the accrual method of accounting, and the China enterprise who remits the fund overseas shall be the withholding agent. Calculation of tax liability:

$$\text{Withholding tax payable} = \text{taxable income} \times \text{tax rate}$$

For dividends, interest, rental and royalty income, the taxable amount is the gross amount remitted before deduction of any taxes, including business tax. If the withholding tax and business tax is borne by the payer, the amount of income should be grossed up to arrive at the taxable income. For dividends paid overseas, no business tax is levied. For income from the transfer of property, the taxable income amount shall be the balance of the total income amount less the net value of the property. For other income, the taxable income amount shall be calculated according to the approaches as mentioned in the preceding two items.

Administration of Withholding Tax

Non-resident enterprises subject to withholding tax in China and the China withholding agents are strongly advised to comply with the procedures to avoid potential penalties. The procedures are applied to a non-resident enterprise's China sourced dividend, interest, rental and royalty income, and income from transfer of property. The filing procedure is fairly straight forward. A copy of the contract giving rise to taxable income, along with a contract registration record for withholding income tax and other relevant documents must be submitted to the in-charge tax bureau within 30 days of signing the contract.

This procedure also applies to each subsequent revision, supplementation or extension of the contract. All documentation, including those originally in a foreign language, must be translated into Chinese. If an equity transfer is between two non-Chinese parties and the transaction takes place outside China, the resident enterprise whose equity is exchanged should file a copy of the share transfer

agreement when applying for a change of its tax registration. The seller of the equity should report its taxes on its own or by appointing an agent.

The tax will be withheld from the cash payment by the payer and within 7 days from the payment date, the withholding agent shall pay the amount withheld on each payment to the state treasury and submit the withholding return to local tax authorities. In the case the income is paid by installment, the withholding agent should, within 15 days before making the last payment, report to the tax bureau in charge the details of all payments already paid, together with previous withholding returns and tax payment evidence, to complete a tax withholding clearance.

The China withholding agent should maintain books and records for taxes withheld and a file of the relevant contracts, which will be subject to inspection by tax bureaus.

If the withholding agent fails to fulfill its obligation to withhold tax, non-resident enterprises shall file and pay corporate income tax to the local tax authorities where the income is derived from within 7 days of the due date for tax filing and payment.

3 Value-Added Tax

China's value-added taxes contribute a large percentage of China's annual tax revenue and account for a significant proportion of tax liabilities for many Chinese enterprises. They affect companies that sell, manufacture, process or repair tangible goods in China and can be quite complex.

In China, VAT is administered by the State Administration of Taxation (import VAT is collected by Customs on behalf of SAT), and the tax revenue, except import VAT, is shared between the central government (75%) and local governments (25%). VAT is the major source of fiscal revenue for the government of China, particularly the central government. In 2009, the revenue from VAT amounted to RMB1.84 trillion, accounting for 31% of China's total tax revenue for the year, the largest percentage of the China's annual tax revenues (see table in Chap. 1).

China started to implement VAT in 1984 on 24 specified taxable items. On December 13, 1993, the State Council promulgated the Interim Regulation of the People's Republic of China on Value Added Tax (VAT Interim Regulations) with the intent of "unifying taxation management, equalizing the tax burden, simplifying the tax system, and guaranteeing financial revenue." This law codified China's VAT system and continued to be in use until November 2008.

In 2004, China introduced VAT reforms in the provinces of Heilongjiang, Jilin and Liaoning in an effort to revitalize the old industrial base of Northeast China. The method of "increment deduction" was adopted and the scope of the reform was confined to eight industries: equipment manufacturing, petrochemical, metallurgy, automobile, shipbuilding, new- and high-tech industries, and agricultural products processing. Following the success of the pilot reform in the Northeast, it

was extended in 2007 to 26 old industrial base cities in the Central Chinese provinces of Henan, Hunan, Hubei, Shanxi, Anhui and Jiangxi. In the second half of 2008, five areas of eastern Inner Mongolia and the earthquake-devastated region of Wenchuan in Sichuan Province were also designated as VAT reform pilot areas. In 2009 the central government implemented the VAT reforms nationally.

VAT Reform

On November 10, 2008, the State Council of China approved the amendments to the VAT Regulations, which took effect in the beginning of 2009. The key change is a shift from a production-based VAT regime to a consumption-based one. With the exception of specific industries that the state has mandated are to be restricted, all industries in China now fall under the VAT reform system and companies are able to offset the full amount of input VAT paid on newly purchased machinery and equipment against VAT collected when they sell their products.

The main changes to the amended VAT Interim Regulations are as follows:

- Full VAT credit on fixed assets, but VAT-In paid on consumer goods used by taxpayers themselves (for example, cars and yachts) cannot be creditable.
- The VAT rate for small scale taxpayers was reduced to 3% from 4 or 6%.
- Cancellation of VAT exemption policy on imported equipment for companies in‘‘encouraged’’ industries.
- Cancellation of VAT refund policy on purchasing domestically manufactured equipment for companies in ‘‘encouraged’’ industries.
- Cancellation of VAT exemption policy on imported equipment for contract processing, assembly or compensation trade.

This is good news for most companies because the measures are expected to reduce the tax burden on companies. However, please be aware that this change could adversely affect cash flow in companies in ‘‘encouraged’’ industries as the aforementioned VAT exemption policies have been abolished. VAT exemptions on imported equipment are now gone and companies will need to increase fund reserves to pay for VAT in advance.

They may also lack sufficient VAT-Out to absorb VAT-In credit (explained in detail below) on fixed assets if they export all or most of their products. The VAT reform also presents an additional tax burden for R&D centers that imported equipment on a tax-free basis in the past. They now have to pay VAT on imported equipment under the new VAT regulation and are not able to claim any credit against their business tax liability. Companies engaged in transfer sales with local customers should note that the VAT-In paid on imported equipment cannot be refunded. In another words, it will be an additional cost under the current VAT system.

Companies may consider setting up new entities in bonded zone to alleviate the impact on cash flow as well as tax burdens arising from the cancellation of preferential VAT exemption on imported equipment imported into bonded zones.

VAT Rates

The Chinese government rules that all enterprises and individuals engaged in the sale of goods, provision of processing, repairs and replacement services, and import of goods within China shall pay VAT. There are a few exemptions, such as self-produced agricultural products sold by agricultural producers, contraceptive medicines and devices, antique books, importation of instruments and equipment directly used in scientific research, experiment and education, importation of materials and equipment from foreign governments and international organizations as assistance free of charge, articles imported directly by organizations of the disabled for special use by the disabled, and sale of goods which have been used by the sellers. However, pretty much every business will be liable for this tax.

For the sale of goods or taxable services, VAT is incurred on the date when the sales sum is received, or documented evidence of the right to collect the sales sum is obtained. For imported goods, it is incurred on the date of import declaration.

VAT on imported goods is collected by Customs on behalf of the tax authorities. VAT on articles for personal use brought or mailed into China by individuals is levied at the same time as customs duty.

VAT taxpayers are divided into general taxpayers and small-scale taxpayers, and their respective tax obligations are elaborated below.

General Taxpayer Status

According to the Measures for the Administration of the Qualification Recognition of VAT General Taxpayers enacted on February 10, 2010, taxpayers with an annual sales value not exceeding the level for small-scale taxpayers set by MOF and SAT as well as taxpayers who have newly established their business may apply to the tax department for recognition as general taxpayers.

However, full general taxpayer status is not instantly granted to wholesalers. Only after passing a 3-month trial testing period as a general taxpayer under a tax officer's supervision can the wholesaler become a fully certified general taxpayer.

Taxable items	Rate (%)
Exportation of goods (except where otherwise stipulated by the state)	0
Cereals and edible vegetable oils; tap water, heating, cooling, hot air supplying, hot water, coal gas, liquefied petroleum gas, natural gas, methane gas, coal/charcoal products for household use; books, newspapers, magazines (excluding the newspapers and magazines distributed by the post department); feeds, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic covering film for farming; agriculture, forestry, products of animal husbandry, aquatic products; audio-visual products; electronic publications; dimethyl ether; edible salt	13
The import and sales of goods other than those listed above; services of processing, repairs and replacement	17

VAT Calculation for General Taxpayers

The VAT rate for general taxpayers is generally 17%, or 13% for some goods (see table above). For taxpayers who deal in goods or provide taxable services with different tax rates, the sale amounts for the different tax rates shall be accounted for separately. If this is not done, the higher tax rate shall apply.

VAT payable relies on two figures: output VAT and input VAT. Output VAT is that payable on the services and goods sold by a company, namely: output VAT = A × B, where A = sales value and B = tax rate. Input VAT is that payable on the goods and services a company buys from another supplier.

The input VAT is used as a credit against the output tax levied on selling the goods. The VAT payable shall be the output VAT for the period, after deducting the input VAT for the period, i.e.:

$$\text{VAT payable} = \text{output VAT} - \text{input VAT}$$

VAT Calculation for Small Scale Taxpayers

From January 1, 2009, the VAT thresholds for those enterprises that do not qualify for general taxpayer status have been amended. First, the sales threshold for small scale taxpayers has been reduced from RMB1 million (for enterprises engaged primarily in the production of goods or the provision of taxable services) and RMB1.8 million (for enterprises engaged in the wholesaling or retailing of goods) to RMB500,000 and RMB800,000, respectively. And second, non-enterprise units and entities that normally do not engage in taxable activities are given the choice whether or not they are taxed as small-scale taxpayers while individual (natural person) taxpayers with business turnover exceeding the threshold shall continue to be taxed as small-scale taxpayers. The current VAT rate for small scale taxpayers is 3%. As such taxpayers cannot deduct input VAT, the formula is as follows:

$$\text{VAT payable} = \text{sales value} \times \text{tax rate (i.e., 3\%)}$$

Export Tax Rebates

Since 1985, China has had in place a tax rebate system designed to support export trade and increase the international competitiveness of companies involved in this business.

Over the past years, Chinese government has been actively discouraging the development of industries which consume high amounts of energy and natural-resources or those that pollute the environment to a great extent by lowering the export refund rates applicable to the relevant products and prohibiting the use of processing trade models.

With China's trade surplus growing rapidly, the central government has made significant changes to its VAT refund system in an attempt to slow export growth. Because of the ongoing changes to the system, export tax rebates and exemptions have now become a major cause for concern among most foreign enterprises.

As the world financial crisis took hold, the central government moved to increase the VAT refund rates on several industries in an effort to boost production. For example, China has increased the tax rebate on textiles at least four times in 2009. In October, 2009, the Ministry of Finance raised export tax rebates on 2,486 different types of products, an estimated one-quarter of all exports listed by Chinese customs authorities. However, there has been a steady recovery in import/exports since 2010. In June 2010, the trend of increasing export rebate rates was reversed when the Ministry of Finance cancelled the export tax rebates for 406 products, mainly high pollution, high energy consumption products.

So exactly who qualifies for export tax rebates? There are two important concepts to understand; the "exemption, deduction and refund" method, and the "maximum refundable amount."

The exemption, deduction and refund method and formula is generally applicable only to production enterprises qualified as general taxpayers (as noted above, there is no refund for small scale taxpayers), which are either directly engaged in export or which consign goods to other import and export enterprises for export.

Exemption, deduction and refund are defined as:

- Exemption—goods which are exported by production enterprises either directly or on consignment through foreign trade companies are exempt from VAT-Out.
- Deduction—applies to enterprises whose self-produced goods are both exported (directly or through export agents) and sold domestically. The VAT-In credit on materials purchased for the production of export goods is offset against the VAT-Out on domestic sales.
- Refund—applies if there is excess input VAT above that amount retained for credit (to be carried forward).

Exemption, deduction and refund calculation:

$$\text{VAT payable} = \text{VAT-Out} - \text{VAT-In} + \text{non-refundable VAT} \\ - \text{VAT-In brought forward from previous period}$$

$$\text{Non-refundable VAT} = (\text{export-imported free duty raw materials}) \\ \times (\text{levy rate-refund rate})$$

If VAT payable is a positive figure, then the enterprise will have to pay VAT to the tax bureau, if it is negative, then the tax bureau will refund the enterprise.

Maximum refundable amount calculation:

$$\text{Maximum refundable amount} = (\text{collection amount from overseas for the export sales} - \text{free duty imported raw material}) \times \text{refund rate}$$

If the absolute value of VAT payable is less than the maximum refund amount, the refund amount equals the absolute value of VAT payable. If the absolute value of VAT payable is greater than the maximum refund amount, then the refund amount equals the maximum refund amount (the balance between the absolute value of VAT payable and maximum refund amount will be carried forward to the next period).

Example Assumptions for the example are shown in the following table (in this case, we assume there is no custom duty applied).

Local purchased raw material price	300
Imported raw material price	50
Local sales price	100
Export sales price (assuming the collection has been received in current month)	400
Levy rate	17%
Refund rate	13%

Let us suppose that one-fifth of imported raw material is used for local sales based on the proportion of local sales out of total sales. The calculation of the refund amount is:

Calculation		
VAT-Out	100*17%	17
VAT-In	300*17% + 50*(1/5)*17%	52.7
Non-refundable	(400–50*(4/5))*(17–13%)	14.4
VAT payable	(17–52.7) + 14.4	−21.3
Maximum refund amount	(400–50*(4/5))*13%	46.8

As the absolute VAT payable is less than the maximum refund amount, the tax bureau will refund RMB21.3 to the enterprise. Note that no VAT or customs duty is levied on imported raw material used for export sales only if a company uses the Customs Handbook for importing and exporting; for imported raw material used for local sales, VAT and customs duty apply.

Profit and loss for the above case	RMB
Sales	500
Cost of raw material	350
Non-refundable VAT	14.4
Gross margin	135.6

Since the refund rate is different from the levy rate, export-oriented enterprises shall bear additional tax burdens, which ultimately will affect profit and loss.

Export Tax Rebate and Exemption Declaration Procedures

Export enterprises must follow up formal registration of tax refund to apply for a VAT refund or exemption. They should submit the following documentation to the responsible tax authority for the approval of registration, which should be obtained within 30 days from the date of export approval:

- Declaration form.
- Business license.
- Ministry of Commerce documentation approving export operation.

After a production enterprise carries out export procedures and records the sales in their financial statement—based on the requirements of their accounting system—it can apply to the tax bureau for VAT payment and exemption and deduction, and to the same bureau for VAT refunds.

The application period for a tax refund is from the 1st until the 15th of the following month. When an enterprise applies for a VAT payment and exemption or deduction, the following documentation needs to be provided:

- Declaration of VAT payment form and other required forms.
- Summary declaration form of VAT exemption, deduction and refund for production enterprise, issued and approved by the local tax refund authority.
- Export invoice, import and export declaration form, export proceed cancellation and verification from the State Administration of Foreign Exchange.
- Other documents as may be required by the tax authority.

For newly incorporated manufacturing companies, accumulated negative VAT payable for the first 12 months cannot be refunded—this amount will be refunded in the 13th month in one lump sum. If the company cannot collect money from overseas customers for the export sales, it also cannot obtain a refund on time. If the company cannot complete the VAT effective date of registration filing for export sales within 90 days (for example: the goods are shipped outside of China and the export declaration form obtained in January, but the VAT effective date of registration filing is not completed prior to the end of March), these export sales must be deemed as the local sales, and are liable for 17% VAT.

4 Business Tax

This is a tax payable against turnover by all enterprises and individuals undertaking the following business: providing taxable services, including communications, transport, construction, finance and insurance, telecoms, culture, entertainment and service industries; transferring the provision of intangible assets; and selling immovable properties.

The basic formula is:

$$\text{Tax payable} = \text{turnover} \times \text{tax rate}$$

Only a very few items are excluded from turnover
Rates of business tax vary considerably, dependent on industry.

Business tax rates

Industry	Tax rate (%)
Transportation	3
Construction	3
Finance and insurance	5
Post and telecommunications	3
Culture and sports	3
Entertainment	5–20
Servicing agencies	5
Transfer of intangible assets	5
Sales of immovable properties	5

The Ministry of Finance and State Administration of Taxation jointly issued revised Implementation Rules for Provisional Business Tax Regulations on December 15, 2008, making some fundamental changes to the taxing principals of the business tax regulations. The revised rules took effect January 1, 2009.

Under the old business tax rules, the service providers were only liable to business tax in China if the taxable service was rendered within China. Thus when a foreign enterprise provided services to China clients and such services were conducted outside China, the foreign enterprise would not be subject to business tax in China. However, under the new rules, the definition of taxable services subject to business tax has been expanded to include services performed where either the service provider or the service recipient is located in China, without regard to where the service is actually been rendered. Therefore, as long as the service provider or service recipient is located in China, the service will be taxable for business tax purposes, regardless of being onshore or off shore. The only exclusion is where both service provider and service recipient are located outside China.

Financial institutions used to be subject to business tax on the trading of foreign exchange, marketable securities and futures, but non-financial institutions and individuals were not. Under the new regime, the trading of foreign currency, marketable securities, non-commodity futures and other financial commodities by any taxpayer are subject to business tax.

Formerly, deemed sales applied only to a company transferring immovable property to other parties without any consideration, however under the new rules, deemed sales apply to either a company or an individual transferring immovable property or land use rights to other companies or individuals without any consideration.

The changes in China's business tax rules have increased the amount of tax paid by multinational service providers with clients in China (see chart below). Service

providers should consider modifying billing arrangements with Chinese clients by charging business tax from Chinese clients or arranging for an overseas office to bill and collect payment from their Chinese client's international affiliates if possible.

Scenario	Service provider	Service recipient	Service provided in China	Service provided outside China	Business taxpayer
Before January 1, 2009					
A	In China	Outside China	Business taxable	Non-business taxable	In China service provider
B	Outside China	In China	Business taxable	Non-business taxable	Outside China service provider
C	In China	In China	Business taxable	Non-business taxable	In China service provider
D	Outside China	Outside China	Business taxable	Non-business taxable	Outside China service provider

Scenario	Service provider	Service recipient	Service provided onshore China	Service provided offshore China	Business taxpayer
After January 1, 2009					
A	In China	Outside China	Business taxable	Business taxable	In China service provider
B	Outside China	In China	Business taxable	Business taxable	Outside China service provider
C	In China	In China	Business taxable	Business taxable	In China service provider
D	Outside China	Outside China	Non-business taxable	Non-business taxable	N/A

Business tax is usually calculated, filed and paid to the local tax bureau every month.

When first registering for business tax, the tax bureau will issue a form showing all the taxes applicable. Businesses must be careful if they are selling goods and services simultaneously, as in these cases there are complicated criteria to judge whether business tax or VAT is applicable. Professional advice is recommended.

5 Consumption Tax

The current consumption tax system was introduced in 1994 along with the nationwide indirect taxes reform, including VAT and business tax. Consumption tax is levied on five categories of products:

1. Products the overconsumption of which is harmful to health, social order and the environment, e.g., tobacco, alcohol, firecrackers and fireworks.
2. Luxury goods and non-necessities, such as precious jewelry and cosmetics.

3. High-energy consumption and high-end products, such as passenger cars and motorcycles.
4. Non-renewable and non-replaceable petroleum products, such as gasoline and diesel oil.
5. Financially significant products such as motor vehicle tires.

This tax applies whenever certain luxury or other goods are manufactured, processed or imported. Consumption tax is levied only once. Tax rates vary considerably with the product and the tax paid is computed directly as a cost and cannot be refunded (except in rare cases upon the receipt of a consumption tax special invoice from the domestic supplier for consumption taxes paid for export goods). In addition, consumption tax is part of the base upon which VAT is levied. Be careful if you are processing taxable goods for others, since you are liable to withhold and pay consumption tax based on the value of the raw material and your processing fee. Consumption tax should be filed and paid monthly.

Consumption tax rates

Taxable items	Tax rate	Comments
Tobacco		
Grade A cigarettes	56% or RMB150 per box (250 cartons)	Includes imported
Grade B cigarettes	36% or RMB150 per box (250 cartons)	Includes imported
Cigars	36%	
Cut tobacco	30%	
Alcohol		
White spirits	20% plus RMB0.5 per 500 g/ml	Plus RMB0.5 per 500 g/ml
Yellow spirits	RMB240/ton	
Beer	Type A: RMB250/ton Type B: RMB220/ton	
Other alcoholic drinks	10%	
Alcohol	5%	
Precious jewelry and precious jade and stones	Gold, silver, platinum and diamond: 5% Other precious jewelry and precious jade and stones: 10%	Includes all kinds of gold, silver, jewelry and precious stone ornaments
Firecrackers and fireworks	15%	
Gasoline	Leaded: RMB1.4/l Unleaded: RMB1.0/l	
Diesel oil	RMB0.8/l	
Passenger cars, with a cylinder capacity of 1.5 l and below	1 l and below: 1% 1–1.5 l: 3%	
1.5–2 l	5%	
2–2.5 l	9%	
2.5–3 l	12%	

(continued)

(continued)

Taxable items	Tax rate	Comments
3–4 l	25%	
Above 4 l	40%	
Small-to-medium size commercial vehicle (e.g. cross country vehicles, minibuses and vans)	5%	
Motorcycles, with a cylinder capacity of		
250 ml below	3%	
Over 250 ml	10%	
Motor vehicle tires	3%	Radial tire exempt
Cosmetics	30%	Luxurious skin-care products are classified as "cosmetics" and are subject to consumption tax at 30%
Golf balls and equipment	10%	
Luxury watches	20%	
Yachts	10%	
Disposable wooden chopsticks	5%	
Solid wood flooring	5%	
Naphtha	RMB1.0/l	
Solvent oil	RMB1.0/l	
Lubricating oil	RMB1.0/l	
Fuel oil	RMB0.8/l	
Aviation oil	RMB0.8/l	Temporary exemption

6 Other Specialist and Smaller Applicable Taxes

Urban Construction and Maintenance Taxes (UCMT) and Education Surcharge (ES)

Urban Construction and Maintenance Tax (UCMT) and Education Surcharge (ES) were originally enacted by the State Council in 1985 and 1986, respectively. Circulars were subsequently issued exempting foreign-invested enterprises, foreign enterprises and foreign individuals from these two surtaxes. On October 18, 2010, the Notice of the State Council on Unifying the Collection of UCMT and ES on Domestic and Foreign-Invested Enterprises and Individuals was issued, abolishing previous circulars exempting foreign entities from UCMT and ES tax liability. As a result, FIEs, FEs and foreign individuals are now subject to the two surtaxes.

The UCMT rates are 7% for urban areas, 5% for counties (towns), and 1% for other regions, while the ES rate is 3% regardless of location.

The UCMT and ES amounts payable are the total turnover tax liability (including VAT, Business Tax and Consumption Tax) multiplied by the corresponding tax rates.

Example calculation:

A company in the urban area of Beijing is subject to VAT of RMB 50 and Business Tax of RMB 50.

Total turnover tax liability:

$$\text{RMB 50 VAT} + \text{RMB 50 BT} = \text{RMB 100}$$

Tax rate of the surtaxes:

$$3\%\ \text{ES} + 7\%\ \text{UCMT} = 10\%$$

Total surtax:

$$\text{RMB } 100 \times (7\% + 3\%) = \text{RMB } 10$$

Total tax liability (inclusive of the two surtaxes):

$$\text{RMB } 100 + \text{RMB } 10 = \text{RMB } 110$$

Resource Tax

Companies or individuals engaged in the exploitation of mineral resources or salt production are liable for resource tax.

Item	Rate
Crude oil	RMB8–RMB30 per ton
Natural gas	RMB2–RMB15 per 1,000 cubic meters
Coal	RMB0.3–RMB5 per ton
Other non-metal ores	RMB0.5–RMB20 per ton or cubic meter
Ferrous metal ores	RMB2–RMB30 per ton
Non-ferrous metal ores	RMB0.4–RMB30 per ton
Salt	RMB2–RMB10 per ton (liquid)
	RMB2–RMB60 per ton (solid)

The formula is:

$$\text{Tax payable} = \text{quantity of taxable products} \times \text{applicable tax amount per unit}$$

Land Appreciation Tax

This is paid by enterprises, units, individual household businesses and other individuals who receive income from the transfer of state-owned land use rights, buildings and their attached facilities.

The tax is based on the amount of appreciation, i.e. the balance of proceeds received by the taxpayer on the transfer of real estate after deducting the sum of deductible items as prescribed in the Interim Regulations of the PRC on Land Appreciation Tax.

Based on the percentage of the appreciation amount over the sum of the deductible items, the tax is levied progressively according to a four-level tax rate schedule as follows:

Grade	Appreciation/deduction (%)	Tax rate (%)	Quick deduction (%)
1	≤50	30	0
2	>50 and ≤100	40	5
3	>100 and ≤200	50	15
4	>200	60	35

The amount of tax payable shall be calculated respectively for each portion of the appreciation by applying the applicable tax rates in line with the percentages of the appreciation amount over the sum of the deductible items. The sum of the amount of tax payable for different parts of the appreciation shall be the full amount of tax payable by the taxpayers.

The formula is:

$$\text{Tax payable} = (\text{appreciation} \times \text{tax rate}) - (\text{sum of deductible items} \times \text{quick deduction})$$

The tax is payable except in situations where the appreciation amount on the sale of ordinary standard residential buildings construction does not exceed 20% of the sum of deductible items, and when the real estate is taken over or repossessed in accordance to the laws related to the construction requirements of the state.

Property Tax

From January 1, 2009, foreign-invested enterprises, foreign enterprises and organizations and foreign individuals have to pay the real estate tax in accordance with the Interim Regulation of the People's Republic of China on Real Estate Tax.

At present, this tax is only applied to enterprises with foreign investment, foreign enterprises and foreigners, and levied on residential property only. Taxpayers are owners, mortgagees, custodians and users of such properties.

The tax is calculated on the residual following the subtraction of between 10 and 30% of the original value of the property. Details of the scope of the subtraction are determined by provincial government, autonomous region or municipality directly under the central government. Should the property's original value not be available as a basis, the local tax organ will examine and decide on an amount with reference to the value of other real estate of a similar nature. Where the property is leased, the rental income from the property will be used as a basis for tax calculations.

The tax is calculated on the residual value of the property at a rate of 1.2%. Rental income from the property is calculated at a rate of 12%.

Vehicle and Vessel Usage License Plate Tax

The Interim Regulations of the People's Republic of China Concerning Vehicle and Vessel Tax went into effect as of January 1, 2007.

Schedule of the tax items and tax amount of vehicle and vessel tax

Tax unit	Tax item	Annual tax amount	Note
Passenger automobile	Per vehicle	RMB60–RMB660	Including trolley
Cargo automobile	Per ton of its dead weight	RMB16–RMB120	Including tractor-truck and trailer
Three-wheeled and Low-speed truck	Per ton of its dead weight	RMB24–RMB120	
Motor vehicle	Per vehicle	RMB36–RMB180	
Vessel	Per ton of its net tonnage	RMB3–RMB6	The tax amount of tugboat or non-motor barge shall be paid at 50% of that of vessel

The formula is:

$$\text{Tax payable} = \text{quantity (or net-tonnage) of taxable vehicles} \times \text{applicable tax amount per unit}$$

$$\text{Tax payable} = \text{net-tonnage (or deadweight tonnage) of taxable vessels} \times \text{applicable tax amount per unit}$$

Tax exemptions may be given on diplomatic vehicles and vessels.

Stamp Tax

Those liable for stamp tax include any enterprise, unit, individual household business operators and other individual who executes or receives specified documents.

Taxable items	Rate (%)
Purchase/sale contracts	0.03
Processing contracts	0.05
Survey arid design contracts for engineering and construction projects	0.05
Construction installation and engineering contracts	0.03
Property, leasing contracts	0.10
Goods transportation contracts	0.05
Warehousing contracts	0.10
Loans contracts	0.005
Property insurance contracts	0.10
Technology contracts	0.03
Property title transfer documents	0.05
Business accounting documents—capital recording documents; other accounting documents	0.05; RMB5/piece
Permits and licenses	RMB5/piece
Stock exchange	0.10 (paid by transferees only)

The formulas for computation are:

$$\text{Tax payable} = \text{amount of payment (or fees, receipt) indicated in taxable documents} \times \text{applicable rate}$$

$$\text{Tax payable} = \text{number of pieces of taxable documents} \times \text{tax amount per unit}$$

Tax exemptions may be granted on duplicates or copies of documents on which the stamp tax has already been paid; some documents related to charities etc.; non-interest bearing or discounting loan contracts; preferential loan contracts concluded between foreign governments or international financial institutions and the Chinese government or state financial institutions; and insurance contracts for agriculture and forestry products and animal husbandry.

Deed Tax

Those liable are enterprises, units, individual household businesses and other individuals who are the transferees of residential property.

Deed tax is normally based on one of the following: the transactional price of the sale or purchase of residential property, sale of land use rights, or lease of use rights of state-owned land; the market price of land use rights or residential property transferred as gift or inheritance as assessed by tax officials; and the price difference in the exchange of land use rights and residential property.

Deed tax is applied at a flat rate between 3 and 5%. The rate applicable is determined at provincial level.

The formula is:

$$\text{Tax payable} = \text{tax base} \times \text{applicable rate}$$

Exemptions may be granted in cases such as state-owned residential properties purchased for the first time by employees; the use rights of barren mountains, barren gullies, barren hills and/or barren beaches received for use in agriculture, forestry, animal husbandry and fishery industry; diplomatic organizations and staff; and residential properties purchased as a result of residential property loss due to force majeure (such as natural river flooding or earthquakes).

Customs Duties

Those liable are consignees who import goods permitted by China and consignors who export goods permitted by China—the former pay import duties and the latter pay export duties.

Tariffs include import duty rates and export duty rates. Import duty rates fall into two categories—general tariff rates and preferential tariff rates. The general tariff rates apply to the imports originating in the countries with which China has not concluded "most favoured nation" trade agreements, while the preferential tariff rates apply to imports originating in the countries with which China has concluded such agreements.

Customs duties are computed either on an ad valorem basis (based on value) applying an applicable rate, or on a quantity basis applying an amount of duty per unit.

The formulas are:

$$\text{Duty payable} = \text{quantity of imported/exported goods} \times \text{tax} - \text{inclusive price} \times \text{rate}$$

$$\text{Duty payable} = \text{quantity of imported/exported goods} \times \text{amount of duty per unit}$$

Major reductions and exemptions include: the duty amount to be paid for one consignment of goods if it is below RMB50, advertising materials and trade samples of no commercial value, goods gifted by international organizations or foreign governments, and fuels, stores and beverages loaded on a means of conveyance entering or leaving the country for use en route.

Raw materials, subsidiary materials parts, accessories, components and packing materials imported for overseas businesses to process, assemble or produce export-oriented products shall be exempt from duties on the portion of those actually processed and exported, or duties are collected first on the imported materials and parts and then refunded on the basis of the completed products actually processed and exported.

7 Tax Aspects of Processing and Assembly Operations

Processing and assembly operations have accounted for a significant part of China's exports and have been particularly popular amongst Hong Kong and Taiwanese investors since the early 1980s. Under this arrangement, the Chinese party (either a local Chinese company or an FIE) processes materials or assembles parts supplied from abroad by the foreign party, and then ships the completed products back to the foreign party. No local sales are allowed and the whole production must be exported.

Chinese laws provide two structures for the importation of materials and components to be processed in China for exports of final products: the *lai liao jia gong* (LLJG).

The key distinction between the two structures lies in the title of the materials and finished products. Under LLJG, the title to the raw materials is under the name of the foreign investor. The raw materials enter China on a consignment basis and the title to all the raw materials and the finished products remains with the contractor outside China. The foreign party would normally pay the Chinese party a set processing fee for each unit produced.

Under a JLJG arrangement, the wholly foreign-owned enterprise in China purchases the raw materials from its overseas suppliers for its own account and the title of the goods is passed on to the WFOE. The WFOE would then sell to the previous supplier the finished products at a margin.

Tax Issues for LLJGs

The tax situation for an LLJG is significantly simpler than with a WFOE and may suit some operations. Neither import duty nor VAT is applicable as final products are 100% exported. The CIT for the LLJG factory is based on the processing fee.

This processing fee is paid by the foreign party to the Chinese LLJG factory. This processing fee will be used towards fixed costs such as rent, wages, equipment depreciation and management fees, and variable costs such as overtime, raw material purchases and so on.

For a more detailed tax comparison between an LLJG and a WFOE, please see the table below.

Anti-avoidance Provisions and Practice

The Chinese CIT provisions contain a general anti-avoidance rule (GAAR) provision (Article 47) that states that the SAT is able to adjust a taxpayer's tax liability where a transaction

WFOEs vs LLJGs—comparison list for establishment and tax

Issue	Item	WFOE	LLJG
Establishment	Minimum registered capital	RMB30,000 for a multiple shareholder company and RMB100,000 for a single shareholder company with regional variations	N/A
	Type of company	Foreign-invested enterprise	Chinese domestic company
	Legal representative	Foreign investor	Chinese partner
	Timescale for set up	60 days	About 15 days
	Operational term	10–50 years	Less than 10 years
Tax	Customs duties	Imported raw materials should pay the customs duty if the final products are sold domestically. Customs duty does not apply if all the final products are exported	Customs duty does not apply on imported materials
		1. Encouraged WFOE—No customs duty on imported equipment 2. Export WFOE—Pay customs duty on imported equipment firstly, and then be refunded within 5 years 3. Other type WFOE—Pay customs duty on imported equipment	No customs duty on non-priced equipment provided by foreign investor
	VAT	Normal rate is 17% based on increased value	N/A
		Tax system of "exemption, set-off and refund" is practiced for the exports sales	No refund for the export sales
		VAT-In can be deducted and can apply for VAT refund	N/A
	Tax deposit	Normally need tax deposit for free duty imported materials	Normally need tax deposit for free duty imported materials
	CIT	25% based on net profit nationally	25% based on net profit nationally
	Management fee	N/A	18–25% as processing fees paid to the local government/local factory

- results in a reduction of taxable income; and
- has no reasonable business purpose.

This latter term, "no reasonable business purpose," is defined as an action in which "the main purpose is to reduce, exempt or defer the payment of taxes." The CIT implementation measures specifically mention the following areas for anti-avoidance investigation:

- Abusing tax preferences
- DTA or treaty "shopping"
- Avoiding tax through tax havens
- Abusing the corporate organizational form
- Any other arrangement without a reasonable business purpose

These areas of investigation are very broad, however, it is clear that the principle of "substance over form" will be increasingly applied, and the SAT will generally disregard the form of any tax arrangements and re-characterize a transaction according to its economic substance.

In fact, a number of recent cases indicate that the SAT may well intend to take a very aggressive approach to the application of the GAAR provision, particularly towards foreign companies. There have recently been a number of high profile indirect equity transfers wherein offshore transfers of indirect interests in Chinese entities with no direct connection to China have been deemed to be direct transfers of Chinese entities. Consequently, a capital gains tax is payable to the Chinese tax authorities. These decisions have put into doubt the efficacy of many holding company arrangements used by foreign investors in China. We suggest that foreign investors review their current arrangements, and new investors take specific professional advice on the structuring of investments into China.

We expect that the GAAR provision will be increasingly used by the SAT in the future.

Expatriate Individual Income Tax in China

1 Individual Income Tax

There has unfortunately been a lot of nonsense spoken about registering for individual income tax in China, how much to pay, being paid partially overseas, actually working here but consistently on tourist visas and so on that the real picture over registering for, assessing liabilities and the payment of IIT in China has become rather muddled. Ask one expatriate, then ask another, and they will give you different opinions. However unfortunately, expatriates do not decide China's tax regulations. Neither is the situation short of clarity in the eyes of China's tax bureau, who are quite clear on the subject and who are progressively clamping down on abuse of non-working visas and the under-declaration of income by foreigners in China.

Here we outline the circumstances, liabilities and procedures for registering for individual income tax, explain the rationale and hope to take some of the pain away from being a tax payer in China. Assessment of IIT can be very complex—if you have concerns take good professional advice. You should also do your homework well in advance to assess your personal tax situation with the related authorities and ensure you are in compliance—China's tax authorities are increasingly targeting expatriates who evade or only partially declare their IIT, with painful consequences for them and the international companies who employ them if tax is found to have been under declared.

2 Tracking Liabilities

Up until recently, China has been able to effectively track potential tax abuse only by inspecting foreigners' passports and crosschecking with the tax bureau over

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whether or not registration had been completed. In practice such inter-government bureau cooperation never really transpired, with the immigration and tax bureau worlds apart. This has now changed and more information-sharing activities are taking place between different bureaus in the country. Entry/exit forms are computerized with the data compiled and made available to the tax bureau who now, at a glance, can ascertain visa types, length of stay, numbers of entries /exits and other information to assess whether IIT is applicable or not. This effectively means that the Chinese authorities can properly track movements of aliens through the country and retrieve data pertinent to tax assessments, as is routinely common in most western nations. New regulations have also specified how to count the days in China and specifically the arrival date and departure date. These will all be counted as days effectively spent in China and are actively used for computation of IIT purposes.

3 Self Reporting Individual Income Tax Rules

At the beginning of November 2006, the State Administration of Taxation released the "Trial Individual Income Tax Self Reporting Regulation," Guoshuifa (2006) No. 162. This stipulated that individuals with a yearly income of over RMB120,000 need to "self report" their income tax together with other personal information within 3 months of the end of the tax year.

This follows an amendment made on October 27, 2005 to Article 8 of the Individual Income Tax Law, stating that "individuals with an income exceeding the amount set by the State Council" shall self-report their income and pay taxes thus incurred. The State Council set this threshold at RMB120,000 and authorized SAT to make a detailed regulation on the matter, which they have now done.

Individuals should file the tax "self report" if they have:

- Personal income that exceeds RMB120,000
- Two income sources within China
- Income derived from outside China
- Taxable income but without specific taxpayers designated (i.e. taxable income but no withholding agent such as an employer)
- Other cases where the State Council thinks they should pay income taxes

There are a few limited exceptions. Individuals staying in China less than one full year will not be affected by the first and third items above. To qualify, they must be absent for more than 30 consecutive days or more than 90 cumulative days in the relevant calendar year.

Eleven types of taxable income are included when assessing whether an individual has annual income of more than RMB120,000. They are:

- Income from wages and salaries
- Income from production and business operations by industrial or commercial households
- Income from contractual or leasing operations of enterprises or institutions by individuals
- Income from remuneration for labor services
- Income from remuneration for manuscripts
- Income from royalties
- Income from interest or dividends
- Income from the leasing of property
- Income from sales of property
- Contingent income
- Other kinds of income specified as taxable by the relevant authorities

There does remain some uncertainty about whether expatriates who have lived in China for more than 1 year but less than five full years are required to report non-employment income from overseas such as investment or property incomes, and further clarification on these issues may be needed from SAT.

Taxpayers with annual incomes of more than RMB120,000 should complete an annual tax return as well as their routine monthly tax filing, whether via their employer or individually. This annual return should be finished before the end of March each year (the Chinese tax year is the same as the calendar year).

This system makes the IIT mechanism similar to that for corporate income tax, which requires monthly and annual returns. It also gives the tax bureau a "reconciliation" role to ensure that monthly returns by employers can be matched with what the individuals themselves report.

In addition, for expatriate staff, company accountants have often been responsible for making IIT filings without the direct involvement of the foreign employee. By insisting on this declaration from the foreigner directly the responsibility is passed onto the foreigner—there is no way out. And, if the two filings do not balance then tax authorities can easily identify false declarations.

But overall, the policy intention would appear to be to provide an additional check that high earning individuals—domestic and foreign—have paid all their tax, some of which may be on income that is not simply from a single employer. It also brings the Chinese system, at least for such taxpayers, into line with the likes of, for example, the USA and UK systems. A sample of this self reporting form can be seen below.

个人所得税纳税申报表 INDIVIDUAL INCOME TAX RETURN

（适用于年所得12万元以上的纳税人申报） (FOR INDIVIDUALS WITH AN ANNUAL INCOME OF OVER 120,000 YUAN)

所得年份： 年
YEAR OF INCOME INCURRED:

填表日期： 年 月 日
DATE OF FILING: DATE MONTH YEAR

金额单位：人民币元（列至角分）
AMOUNT IN RMB YUAN

纳税人姓名 Tax payer's name		国籍(地区) Nationality /region		身份证照类型 ID Type		身份证照号码 ID number			
任职、受雇单位 Employer		任职受雇单位税务代码 Employer's Tax ID Code		任职受雇单位所属行业 Industry of Employer		职务 Title		职业 Profession	
在华天数 Days of stay in China		境内有效联系地址 Address in China				境内有效联系地址邮编 Post code		联系电话 Tel number	
此行由取得经营所得的纳税人填写 This line is to be filled by taxpayers with business income	经营单位纳税人识别号 Tax ID Code of the business					经营单位纳税人名称 Name of the business			

所得项目 Categories of income	年所得额 Annual Income 境内 Income from within China	境外 Income from outside China	合计 Total	应纳税所得额 Taxable income	应纳税额 Tax payable	已缴（扣）税额 Tax pre-paid and withheld	抵扣税额 Tax credit	减免税额 Tax exempted or deducted	应补税额 Tax owed	应退税额 Tax refundable	备注 Notes
1、工资、薪金所得 Wages and salaries											
2、个体工商户的生产、经营所得 Income from production or business operation conducted by self-employed industrial and commercial households											
3、对企事业单位的承包经营、承租经营所得 Income from contracted or leased operation of enterprises or social service providers partly or wholly funded by state assets											
4、劳务报酬所得 Remuneration for providing services											
5、稿酬所得 Author's remuneration											
6、特许权使用费所得 Royalties											
7、利息、股息、红利所得 Interest, dividends and bonuses											
8、财产租赁所得 Income from lease of property											
9、财产转让所得 Income from transfer of property											
其中：股票转让所得 Income from transfer of stocks											
个人房屋转让所得 Income from transfer of personal estate											
10、偶然所得 Incidental income											
11、其他所得 Other income				–	–	–	–	–	–	–	
合计 Total											

我声明，此纳税申报表是根据《中华人民共和国个人所得税法》及有关法律、法规的规定填报的，我保证它是真实的、可靠的、完整的。
Under penalties of perjury , I declare that this return has been filed according to THE INDIVIDUAL INCOME TAX LAW OF THE PEOPLE'S REPUBLIC OF CHINA and other relevant laws and regulations, and to the best of my knowledge and belief. I guarantee the information provided is true, correct and complete.
纳税人(签字)：Taxpayer's signature

代理人(签章)：Preparer (Other than taxpayer)'s firm 联系电话：Phone number

税务机关受理人(签字)：
Signature of responsible tax officer:

税务机关受理时间： 年 月 日
Filing date: Time: Year/Month/Date

受理申报税务机关名称（盖章）：
Responsible tax officer

4 Who Has to Pay?

China has a multi-tiered system of tax liabilities for foreigners, which has lead to some confusion, particularly over the so-called “90 or 183 days rule.” We identify the more likely scenarios and the tax liabilities as follows.

Expatriates on Extended Business Trips to China

If you are sent by your organization to China and your salary is paid off-shore (probably in your home country) and you spend more than 183 days in China in a calendar year, than you have to pay IIT in China based on the days you effectively spend in the country. This means that if you spend in China, let us say, 184 days within a calendar year, than you would have to pay taxes on all income sourced from China (meaning income related to your work performed in China).

Foreigners Working for Legal Enterprises in China

Without going into too many complicated calculations and theories, if you hold positions such as the chief representative of a representative office or the general manager of a Chinese limited company, wholly foreign-owned enterprise or a joint venture anywhere in China, then you are subject to IIT from the first day you commence work in the country.

Interestingly, should you not actually visit China within a calendar year but are still acting as the part-time chief representative of a representative office, then zero tax filings should still be made monthly to the local authorities. Some locations (such as Shenzhen) may not require this.

According to the law you should declare the full salary for the position and pay IIT accordingly. In practice, however, it is common to see foreigners declaring an “arranged” fixed salary for their China position (with the rest being paid off-shore) and pay taxes accordingly, lowering to a great extent their full tax liability. This practice is illegal, so be careful should you decide to pursue this route. While this has been common practice in the past, it also puts the employer out of compliance—fines of several million RMB have been levied just recently to FIEs engaged in such practices—and the risk of being caught—with the issue now highlighted at audit—is increasing.

Foreigners Holding Concurrent Posts Both in China and Elsewhere

Firstly, you should be arriving in China on a business visa, and are subject to IIT-based on the number of physical days you are in China. This is assessed upon the

total salary you are claiming from your local employment position and from the parent company overseas—the Chinese tax bureau may want to see proof of earnings from your parent (tax slip, payment voucher etc) to support your case. At the end of each month, your China office should take copies of your passport, together with the entry/exit stamps for that month, and file and pay for taxes based upon the number of days spent in China. The tax bureau will issue a receipt showing this has been paid, this can be credited against the tax paid in your resident location (you would not have to pay tax both in China and your resident location for the time spent in China).

China Residency Status and IIT on Your Worldwide Income

Be aware that if you are regarded as a tax resident by the Chinese government, which means you have stayed in China for more than 5 years (without residing outside China for more than 90 days cumulatively each calendar year or 30 consecutive days always within a calendar year), you have to pay IIT on your worldwide income without limitation of source. This means that shall you have income elsewhere related to property rentals or interests, these shall also be declared to the Chinese tax authorities. The taxes paid overseas can be deducted from the taxes payable to the Chinese tax authorities.

Work Permit Registration Procedures

If a person is based in China and working, then they should apply for an employment license and residence permit. Please be aware that constant checks in residential areas are conducted by the local Public Security Bureau and one of the first things that needs to be done when arriving and renting an apartment in the country is to get registered with the local police station responsible for the area where you live. If you check in at a local hotel you will be given a form to fill out with your details.

Before you obtain all the documents mentioned above you should also go through a medical examination at the appointed local hospital. It should not take you more than a couple of hours to get through the exams with the results normally being issued within a few days. Your spouse and children (if any) should also have to register with the local authorities.

5 Expatriate Tax Rates and Liabilities

The first RMB4,800 of the expat’s monthly income in China is tax free. That does not mean you can rush out and declare salaries of RMB5,000. The tax bureaus are

wise to this and will demand to see concrete proof of your earnings elsewhere. If you cannot provide this they may refuse to register you, effectively and immediately making your presence in China illegal.

China's IIT rates are high compared to neighbouring countries. The following table demonstrates salary brackets and tax rates, plus the quick tax deduction system. Your total liability can be calculated as follows:

Salary minus 4,800 × tax rate, less quick deduction figure = IIT tax bill

Monthly taxable salary	Tax rate (%)	Quick calculation deduction
<RMB500	5	RMB0
≥RMB500 and <RMB 2,000	10	RMB25
≥RMB2,000 and <RMB5,000	15	RMB125
≥RMB5,000 and <RMB20,000	20	RMB375
≥RMB20,001 and <RMB40,000	25	RMB1,375
≥RMB40,001 and <RMB60,000	30	RMB3,375
≥RMB60,001 and <RMB80,000	35	RMB6,375
≥RMB80,001 and <RMB100,000	40	RMB10,375
≥RMB100,000	45	RMB15,375

There are some implicit or explicit benchmarks at local tax bureaus on what a reasonable salary is in certain industries and this could vary with your position, your education background and the country you come from. Local authorities have the power to increase your declared salary. Should this be manifestly low or inadequate to your position, they shall assume and attempt to obtain proof that you are deliberately reducing the figure to escape from a higher IIT threshold. This can be enormously damaging for you and your employer who would be placed under far greater tax scrutiny in the future for potential tax evasion issues within the business.

6 Deductible Allowances

China is also pretty reasonable in regards to non-taxable elements as part of an expat package, however some attention may need to be paid to the structuring of the inclusive package with certain items needing to be properly defined in the employment contract. As a rule of thumb, if you pay for the expenses yourself (against local official invoices) and the company provides you with cash allowances, then these are considered taxable. On the other hand if the company pays for certain expenses on your behalf (e.g. your apartment rental), then this kind of allowance may be exempt from tax and can be deducted from your company CIT computation basis. However, whether or not these expenses are tax-exemptible is ultimately subject to the tax officer's judgment.

7 Provisional Examples of Benefits

- Housing, meal and laundry allowances
- Relocation expenses
- Travel Allowance
- Home Trip Allowance
- Language training
- Children education allowance
- Social security benefits

Enterprises are obligated to withhold employees' IIT when paying salaries to them; failing to do so will cause penalties. Meanwhile, the enterprises can get 2% of the IIT withheld from the tax bureau as commission or handling charge. Pay attention to the calculation of the IIT if the companies are paying IIT for the employees, in this case the income has to be grossed up for the purpose of calculating IIT.

Individual income tax calculations for standard salaries are fairly easy to assess, but get more intricate according to the complexity of the expatriate's salary package. It makes sense to take professional advice when structuring expatriate salary packages to ensure liabilities can be planned, and catered for in the most tax-efficient manner.

8 Permits Required by Foreign Staff

Foreign personnel who work and reside in China need to apply for work permits and resident visas. Applying for an employment and residence certificate in China can be roughly broken down into four steps: the Alien Employment License application; the Employment Visa and Residence Permit Notification application; the Alien Employment Permit application; and the Residence Permit application.

Alien Employment License

The Alien Employment License is a document which basically states that a foreigner is allowed to work in China. It is needed to apply for an employment (Z) visa invitation letter from the Ministry of Commerce. An invitation letter is needed to apply for an entry visa that can be converted into a work and residence permit. While in the past it was common for F visas to be converted into work and residence permits, currently most cities require an applicant to obtain their Z visa from their country of residence (their home nation or country where they possess legal residency). The following documentation must be submitted:

- Application for Employment Permit for Foreigners
- Valid passport
- Copies of the health certificate issues by the Entry–Exit inspection and Quarantine Authority[1]
- Copies of the business license issued by the Administration of Industrial and Commerce Business License (duplicate) and any other government registration or ratification
- Reasons for employment
- Credentials required for job
- Curriculum vitae of foreigner to be employed
- Letter of intention for employment
- Criminal record check[2]

Notification for Application of Employment Visa and Residence Permit

The Entry–Exit Administration of the Public Security Bureau in the city where a foreigner wishes to work and reside must issue this notification before an Alien Employment Permit will be issued. The following documentation must be submitted by the employer:

- Employment license
- Valid passport of the applicant (copies of main pages and valid visa shall be attached)
- Application for Residence Qualifications of Working Foreigner in China (with photos)
- Two copies of the business license
- Temporary accommodation registration of the applicant (from local police station or hotel where applicant is residing)

Alien Employment Permit

The Alien Employment Permit allows foreigners to work legally in China. It is usually valid for 1 year and must be renewed annually. The following documentation must be submitted by the employer:

[1] This can vary from city to city and even nationality to nationality; some nationalities do not need this certificate prior to obtaining their entry visa.

[2] This is a relatively new requirement that is not yet implemented in every city in China. We suspect that in the near future, it will become a standard requirement in every city.

- Employment license
- Notification for Application of Employment Visa and Residence Permit
- Copies of the labor contract or certificate of appointment (those who have a clear and defined position specified on the business license may be exempt)

Residence Permit

The Residence Permit allows foreigners to legally reside within China. It is usually valid for 1 year and allows the holder to enter and leave China whenever they choose. The following documentation must be submitted:

- Valid passport
- Alien Employment Permit
- Certificate of Verification for Physical Examination Record for Foreigners
- Notification for Application of Employment Visa and Residence Permit
- Interview Record of Residence Qualification Application for Foreigners
- Chinese visa or residence application form

Once these four steps have been completed, a valid work and residence permit will be issued and the foreigner is legally able to work and reside within the People's Republic of China for the validity period of their permit (usually, but not always, 1 year). Both permits can be renewed prior to their expiration.

9 Individual Income Tax for Local Staff

Individual income tax rates for domestic taxpayers are the same as for foreigners, with the exception of the threshold now being RMB2,000 per month nationwide (lower than that for expatriates, who currently enjoy RMB4,800 per month). Mandatory welfare benefits do vary from region to region though.

Example Ms. Wu is a local employee who works for a foreign-invested enterprise in Shanghai Her monthly income is RMB4,000. Her IIT liability is calculated as follows:

$$\begin{aligned}\text{Tax liability} &= \text{income} - \text{personal welfare allocation} - \text{allowable deductions}\\ &= \text{RMB4,000} - \text{RMB720} - \text{RMB2,000}\\ &= \text{RMB1,280}\end{aligned}$$

$$\begin{aligned}\text{Tax payable} &= (\text{taxable income} \times \text{applicable tax rate}) - \text{quick deduction figure}\\ &= (\text{RMB1,280} \times 10\%) - 25\\ &= \text{RMB103}\end{aligned}$$

Mandatory welfare contributions by employees are calculated on a percentage of salary. The percentages for each contribution vary from city to city and includes:

- Medical insurance
- Unemployment benefit
- Employment injury insurance
- Maternity insurance
- State pension
- Housing fund

Audit

All foreign-invested enterprises in China are required to prepare annual financial statements, including balance sheets and income statements for their annual Chinese audit. Such accounts must be in accordance with the Chinese accounting standards for business enterprises, irregardless of if they are foreign or domestic companies. Foreign-invested enterprises, including their legally responsible persons, must take full responsibility for the truthfulness, legitimacy and completeness of these financial statements. These documents must be completed ahead of the submission of consolidated accounts for tax purposes by the end of April every year, for the financial calendar year ending the previous December 31.

These statements will be used for computing the FIEs taxable and distributable profit. Thus, an annual audit by a firm of certified public accountants registered in the PRC is required under Chinese law.

There are a number of areas where you need to take particular care and where there are some differences between Chinese and western accounting practice. These are guidelines only, as every business is different.

1 Audit items Often Queried by Chinese Independent Auditors

Adjustments for Foreign Related Payment Income

If the foreign company has paid overseas insurance for their expat employees, it should be noted that this is not tax deductible unless it is recorded as a salary payment with IIT paid. Foreign-sourced income needs to be accounted for by providing evidence of foreign taxes paid with relevant foreign documentation. Otherwise, foreign taxes may be accrued by the FIE.

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Related Party Transactions and Transfer Pricing

If your FIE had any transactions with related parties, you must make sure that these were at arm's length and with adequate documentation to substantiate the charges/income, so that the results were not materially affected by related party transactions that were not in the ordinary course of business. Pay particular attention to transfer pricing issues. Tax officials reserve the right to adjust transfer prices, interest charged by related parties based on market prices or even based on the prescribed profit margin. Transfer pricing should not be used as a mechanism to reduce the amount of profit retained in China. The tax bureau regards this as tax evasion and the penalties and repercussions can be severe.

Withholding Obligations

If the FIE made or accrued in its costs or expenses any payments, royalty charges, interest, services or management fees for services performed in China by foreigners (individuals or organizations), pursuant to related contracts and agreement, the relevant withholding obligation should be provided for on an accrual basis. This means 10% withholding enterprise income tax and 5% business tax apply (the tax rate may be different according to individual cases). These charges shall be accompanied by substantial evidence—otherwise they are not deductible. All the above debts in foreign currency also need to be registered with SAFE prior to approval for remittance.

Input VAT

The VAT invoice must be verified by the tax bureau within 90 days of the invoicing date, otherwise it cannot be deducted. Furthermore, if you have any unusual loss of inventory, then the Input VAT related to the inventory previously credited has to be reversed in the period when the loss is recognized.

VAT Refund on Export

For FIEs, VAT refunds on export should be reconciled with the tax bureau. Foreign-invested enterprises should register all export receivables of the previous year with the bureau. Failure to do so may result in the export sales being deemed as domestic transactions, subject to Output VAT if the payment for export sales is not received and related documents are not presented within the deadline.

Stamp Duty

Although not a material issue with much cost, FIEs should not forget to pay stamp duty on all books, records and applicable contracts. Fines for non-compliance outweigh the dutiable value.

2 General Accounting Treatments on Significant Audit Areas

Trade Debtors

Generally speaking, China's GAAP rules allow enterprises to make a bad debt provision without any percentage limitation.

Long-term Debt Investments

Long-term debt investments of FIEs should be recorded at cost and based on the actual payments. Any interest should be accrued based on the face value of the investments and applicable interest rate, and recorded in the amount of "other receivables." The premium or discount on acquisition of the investment needs to be amoritized over the holding period under either the straight-line method or the effective interest rate method. Long-term investments that mature within 1 year need to be reclassified as short-term debt investments.

Fixed Assets

Purchase of the fixed asset should be recorded in the fixed assets account and annual depreciation should be calculated and allocated to expenses. All construction in progress items should be transferred into fixed assets when they are put into use with any interest expenses, and the disposal gain or loss should also be recorded and approved by the tax authority.

Fixed Asset Qualification

More than 12-month usage period, however no minimum value requirement compared to the previous tax law.

Residual Value

There is more flexibility on residual value as it can be determined based on the nature of the assets and conditions.

Depreciation Years

Transportation facilities except aircraft, trains and vessels: 4 years; electronic equipment: 3 years.

Accelerated Depreciation

If assets need to be updated frequently due to technology improvement, the depreciation period can be shorter (limited to 60% of the statutory minimum depreciation period).

Intangible and Other Assets

Intangible assets are amoritized on a straight-line basis over the investment period of not less than 10 years (there is no set term for other deferred expenses). Intangible assets should be recognized and recorded at an objective value, i.e. for purchased assets at the purchase price, for self-built assets at cost except for research expenses. Intangible assets are recorded at a lower book value and recoverable amount. If the recoverable amount is lower than the book value, a provision for impairment on intangible assets should be made for the remaining difference.

Pre-operating Expenses

Such expenses and exchange losses for FIEs during the start-up period can be charged to the profit and loss account in one lump sum during the first month after commencing operations.

Reserve Funds

For WFOEs, not less than 10% of the after-tax profit should be appropriated to the general reserve fund. Appropriations to other funds should be made in accordance with the articles of association and a board resolution (see Chap. 5).

Mandatory Company Fund Allocations

Prior to the annual audit, and the subsequent settlement of taxes with the tax bureau, there are items that need to be calculated and presented in the accounts as mandatory fund dispersals. These include amounts to the company's enterprise expansion fund, the reserve fund and staff and workers welfare and bonus fund.

By law, WFOEs need to specify the amount for the reserve fund in the articles of association. This must not be less than 10% of after-tax profits, and must be contributed to until a ceiling is reached, being the equivalent of 50% of the total registered capital in the company. Once this amount is achieved no further amounts need to be contributed to the reserve fund. The amounts for the other funds do not need to be specified—an anomaly that means FIEs rarely contribute towards them.

Special Attention to Stock Inventories

Inventory comprises raw materials, components, and finished products. Many companies do not adequately control inventory utilization and disposal of inventory. Common problems include discrepancies of bills of lading and goods received, improper storage of raw materials and safeguarding inventory, and illegitimate disposal of scrap materials and containers.

The process that ties inventory into the financial controls of a company is working-capital management, one of the key components of return on invested capital.

For both trading and manufacturing companies, inventories must form a significant proportion of the total assets. Auditors will therefore pay close attention to the existence and valuation of such stocks. The inventories valuation can be clearly identified from the purchase invoices or cost calculation sheet. But auditors will also take care to confirm the existence of the inventory and how stocktaking is carried out. The following steps should be followed:

- Observe whether the stocks are neatly kept, whether bins are properly labeled, and whether large items are properly piled and marked
- Check that counting is systematic and that precautions are taken to ensure everything is counted and counted just once
- Pay attention to high value items
- Investigate whether discrepancies arise between the physical count and stock records
- Note any items that appear to be damaged, obsolete or slow moving, so as to ascertain whether adequate provisions for loss has been made
- Some FIEs may have missed the stocktake at year-end. If so, roll-back procedures can also be carried out to check the stock movements in the intervening period and ensure the year-end balance

For stock valuation, FIFO and specific identification methods are recommended for China.

3 Other Required Annual Licensing and Renewals

Audit is not just about financial issues. Business also have to submit a range of other documents and licenses to the authorities for checking and renewal if necessary—the so-called annual cooperative examination. This is a bureaucratic process, but it is a good time to take stock and ensure all paperwork is up-to-date.

This business license review is a fairly straight-forward process and can be done via the internet, or by going to an office where officials from a total of seven different agencies convene together temporarily for the process.

These seven agencies include:

- The Bureau of Foreign Trade and Economic Cooperation
- The Administration of Industry and Commerce
- The Economic Committee
- The Financial Bureau
- The State Administration of Taxation
- The State Administration of Foreign Exchange
- China Customs

The procedure for the annual cooperative examination for FIEs as described below.

Preparation for the Annual Cooperative Examination

First of all, every company needs to apply for and obtain the annual cooperative examination documents from the same office of the Administration for Industry and Commerce from which the company has obtained its original business license. The company must also download the annual cooperative examination report form from the relevant provincial or municipal AIC web site.

Companies must also select one of two options to apply for annual examination—they can apply either through the internet or by taking their documentation directly to the authorities.

Requirements for Annual Cooperative Examination Documents

As we have mentioned, there are seven sets of documentation you need to bring together, one for each authority, as follows. Note that all photocopied documents need to be stamped with the enterprise's seal.

The Bureau of Foreign Trade and Economic Cooperation

- Original of annual cooperative examination report
- Original and photocopy of approval certificates of foreign invested enterprises

- Audit report issued by CPA firm, or photocopy of capital verification report for enterprises newly set up with no accounting records in the current year
- For enterprises in encouraged industries, photocopy of encouraged project confirmation certificate
- For advanced technology enterprises and export enterprises, photocopies of certificates for these two kinds of enterprises

The Administration of Industry and Commerce

- Photocopy of annual cooperative examination report
- Audit report issued by CPA firm, or photocopy of capital verification report for enterprises newly set up with no accounting records in the current year
- Duplicate of business license—Annual financial report

The Economic Committee

- Photocopy of the annual cooperative examination report

The Financial Bureau

- Photocopy of the annual cooperative examination report
- Annual financial statement (full set) of foreign invested enterprises
- Audit report issued by CPA firm
- Duplicate of finance registration

State Administration of Taxation

- Original of the annual corporate income tax return forms (one main form plus 11 appendix forms)
- Audit report issued by CPA firm or tax compliance audit report issued by CTA firm
- Related party transaction documentation (see Sect. 4)

State Administration of Foreign Exchange

- Annual cooperative examination report (Forex part). Foreign currency registration certificate (IC card) of foreign invested enterprises
- Audit report of foreign currency issued by CPA firm

China Customs

- Photocopy of the annual cooperative examination report
- Audit report issued by CPA firm and annual financial report
- Original registration certificate for custom declaration

4 Transfer Pricing Contemporaneous Documentation

Transfer pricing is a reality for any multinational company. Tax authorities need to protect their revenue base and are actively enforcing the arm's length principle for

pricing of intergroup transactions. This means that detailed transfer pricing documentation is required and that companies need to disclose related party information on tax returns, as well as prepare themselves for possible audits.

Beginning in 2008, the State Administration of Taxation in China introduced a mandatory requirement for taxpayers to prepare and retain detailed transfer pricing documentation to support the arm's length nature of their related party transactions. This documentation needs to be completed by May 31 of the year following the tax year. The documentation must be in Chinese and must be provided with 20 days of a request. It should be retained for 10 years from June 1 of the relevant tax year. Any taxpayer that meets one of the following conditions is exempt from preparing contemporaneous documentation:

- Per annum related-party purchases and sales totalling less than RMB 200 million and other related-party transactions totalling less than RMB 40 million. These amounts shall not include related-party transactions under cost sharing arrangements or advance pricing arrangements within the year
- Related-party transactions under advance pricing arrangements
- Foreign-owned shares account for <50% and related-party transactions are conducted with domestic-related parties only

Even if taxpayers are not required to prepare transfer pricing documentation, it may still be highly recommended to do so in the following circumstances:

- The taxpayer has characteristics that render it at high risk of transfer pricing audit and investigation, such as being a loss-making manufacturer or a distributor achieving net margins lower than the industry norm
- The taxpayer operates in a high-risk industry or is part of a large multinational group that is at high-risk of a transfer pricing audit
- The taxpayer discloses unusual or suspicious related party transactions or transfer pricing methods when completing the obligatory related party disclosure forms
- The taxpayer is exempt for the year 2008 due to the thresholds on related party transactions, but subsequent years are expected to see an increase in the number of related party transactions

The detailed transfer pricing documentation should include information related to organizational structure, descriptions of business operations, descriptions of related party transactions, comparability analysis and documentation of the selection and application of the transfer pricing method utilized.

It should be noted that documentation prepared at the time or shortly after the transactions take place is considerably more persuasive to the tax authorities than documentation prepared at a later point when the relevant information and personnel may not be available. Such documentation is the only accepted method of giving the tax authorities a clear understanding of the transfer pricing model and commercial realities of the business of a taxpayer. More significantly, it is the best means of presenting the company's case to the local tax bureau staff in a favorable light, with a view to avoiding a lengthy and costly transfer pricing audit.

Procedures for the Declaration and Repatriation of Dividends

1 Preparing for Declaration of Dividends in China

Your decision on planning for declaration of dividends for repatriation and/or re-investment of profits will obviously depend on the current situation of your Chinese company and its parent company abroad, but there are a number of tax-related factors to bear in mind. This chapter introduces the procedure that must be followed when declaring dividends.

Repatriation of profits may be preferable if your organization requires the funds for reinvestment abroad or return to shareholders.

The process for declaring dividends and repatriating funds:

1. First of all, the amount of funds available must be confirmed. The final quarter CIT filing for the year in question will be made in early January of the following year, and after this an annual audit must be carried out. The annual clearance process reflects the results of the audit on the accounts, and this is submitted to SAT for approval.
2. Assuming there are no problems with the submitted documents, the State Administration of Taxation will issue a tax receipt confirming the final amount of CIT payable.
3. With this figure defined, the tax payment for the year in question can be completed and the net profit figure derived.
4. Not all profit can be repatriated or reinvested. A portion of the profit (which must be at least 10% for WFOEs) must be placed in a reserve fund account. This is treated as part of owner's equity on the balance sheet. This account is capped when the amount of reserves equals 50% of the registered capital of the company. In addition the investor may choose to allocate some of the remainder to a staff bonus or welfare fund or an expansion fund, although these are not mandatory for WFOEs.

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5. The remaining balance is available for redistribution. Firstly, a resolution of the board of directors to authorize such redistribution must be signed by each director. Then an application form supported by the following documents must be submitted to the SAT:
   - Annual audit
   - Capital verification report
   - Annual clearance report
   - Quarterly CIT filings
   - Receipts proving CIT payments have been made in full
   - Bank and general details of the Chinese entity and entities receiving funds.
6. SAT will review all these documents to check that everything is legitimate and issue an evidence of CIT payment certificate.
7. This certificate authorizes the bank to disperse funds as detailed on the certificate.

Note that dividends from profits made after January 1, 2008 are subject to a 10% withholding tax while those dividends connected to profits made prior to January 1, 2008 are exempt from this withholding tax. A lower withholding rate may be applicable under double tax treaties.

Double Tax Treaties and Agreements

1 Double Tax Treaties

China currently has many double tax treaties in force with various countries and regions worldwide. These are intended to ensure that individuals are not unfairly taxed twice on income or other assets. In September 2009, the State Administration of Taxation issued Circular 124 further regulating the tax administration for non-residents availing of the benefits provided by double tax treaty arrangements on their income in China. Foreign executives based in China for limited periods over a 12 month time frame currently may not have to declare taxable income in China if their stay is less than 183 or 90 days depending on their nationality.

Circular 124 provides filing requirements to support such claims and have them pre-approved. The circular seems aimed at offshore companies in jurisdictions that have tax treaties with China.

Filings requiring pre-approval with the SAT:

(1) Dividends derived from the same equity investment in the same enterprise.
(2) Interest derived from the same debt and due from the same debtor.
(3) Royalties derived from granting the same right to the same individual or enterprise.

Treaty benefits and articles now requiring registration:

(1) Permanent establishment and business profits.
(2) Independent individual services.
(3) Dependent individual services.
(4) Other articles, including dividends, interest, royalties and capital gains.

Documentation requirements to be presented to your local tax bureau as part of the pre-qualification process:

(1) Applicable contracts, agreements and payment receipts.

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(2) Tax registration certificate from the domicile in question, dated within the past 12 months.
(3) Similar details for any other involved domiciles.
(4) Shareholders residency status.

Documentation needs to be filed with the local responsible tax bureau for a pre-approval process lasting up to 40 days, with a further 10 days if additional investigation be required. If no answer is provided by this time, the application shall be deemed as having been approved.

However, should the applicant be asked to submit further documentation, the time this takes shall not be considered as part of the pre-approval time.

Circular 124 also permits the random investigation of cases. The circular tightens considerably the application requirements and procedures for applying for tax treaty status and demands more disclosure.

It should be noted that these requirements now also allow the SAT to look into movements of business into individuals or companies special vehicles or off shore company transactions. It is recommended to practice caution and seek professional advice when completing such documentation for the local tax authorities.

China's double tax treaties

Country or region			
Albania	France	Macedonia	Seychelles
Algeria	Georgia	Malaysia	Singapore
Armenia	Germany	Malta	Slovakia
Australia	Greece	Mauritius	Slovenia
Austria	Hong Kong	Mexico	South Africa
Azerbaijan	Hungary	Moldova	Spain
Bahrain	Iceland	Mongolia	Sri Lanka
Bangladesh	India	Montenegro	Sudan
Barbados	Indonesia	Morocco	Sweden
Belarus	Iran	Nepal	Switzerland
Belgium	Ireland	Netherlands	Tajikistan
Brazil	Israel	New Zealand	Thailand
Brunei	Italy	Norway	Trinidad and Tobago
Bulgaria	Jamaica	Oman	Tunisia
Canada	Japan	Pakistan	Turkey
Croatia	Kazakhstan	Papua New Guinea	Ukraine
Cuba	Korea (Rep.)	Philippines	UAE
Cyprus	Kuwait	Poland	UK
Czech Republic	Kyrgyzstan	Portugal	USA
Denmark	Laos	Qatar	Uzbekistan
Egypt	Latvia	Romania	Venezuela
Estonia	Lithuania	Russia	Vietnam
Ethiopia	Luxembourg	Saudi Arabia	
Finland	Macau	Serbia	

Hong Kong residents should note that a double tax agreement was reached between the central government and the government of Hong Kong on August 21, 2006 and went into force on or after January 1, 2007 for mainland taxpayers, and April 1, 2007 for Hong Kong taxpayers. This replaced the agreement signed in February 1998. There are a number of important elements worthy of note given below.

Withholding Tax Rates

The rates are as per the table below.

China–Hong Kong double tax agreement

Type of rate	Dividend	Royalty (%)	Interest
China non-treaty rate	10%	10	10%
Hong Kong non-treaty rate	Nil	5.25	Nil
Treaty rate	5%/10% (note 1)	7	0%/7% (note 2)

Notes: (1) The 5% withholding tax rate applies to dividends paid by a mainland company to a Hong Kong resident, provided that the recipient is a company that holds at least 25% of the capital of the mainland company. 10% in all other cases. (2) The 7% withholding tax rate applies to interest payable from the mainland, while the 0% rate applies to interest received by the Hong Kong government or recognized institutions

Although the tax exemption for dividends received by foreign investors from a foreign investment enterprise in the mainland under the old arrangements has been withdrawn, the provision in the new agreement provides some reassurance for Hong Kong investors against any possible withdrawal of this exemption at a later date.

The reduced withholding tax rates are amongst the lowest rates available in double tax treaties signed by the mainland.

Income from Employment

There is an important change in the basis period for counting the number of days of presence in the mainland for Hong Kong employees who frequently visit the mainland, from a calendar year to a 12 month period. This has made it harder for tax residents on one side to claim exemption from taxes on the other side.

Under the double tax agreement, a resident of one side is exempt from tax on the other side if they satisfy all the following criteria:

- They are present on the other side for a period or periods not exceeding an aggregate of 183 days in any 12 month period commencing or ending in the taxable period concerned.
- The remuneration is paid by, or on behalf of, an employer who is not a resident of the other side.
- The remuneration is not borne by a permanent establishment that the employer has on the other side.

Exchange of Information

Various guidelines have been issued on this topic. While it does allow some information to be exchanged, it is more restrictive and only allows information necessary for carrying out the provisions of the new arrangement or the domestic laws of the mainland and Hong Kong concerning taxes. The two governments are not obliged to supply information which is not obtainable under domestic law or the normal course of administration, and which would disclose any trade, business, industrial, commercial or professional secrets.

Glossary of Terms

AIC	Administration of Industry and Commerce
BOFTEC	Bureau of Foreign Trade and Economic Cooperation
CIT	Corporate Income tax
CJV	Cooperative joint venture
DTA	Double Tax Agreement
EDR	Effective date of registration (for VAT)
EJV	Equity joint venture
EPZ	Export processing zone
FDI	Foreign direct investment
FICE	Foreign-invested commercial enterprise
FIE	Foreign-invested enterprise
FTZ	Free trade zone
GAC	General Administration of Customs
IIT	Individual income tax
IPR	Intellectual property rights
JV	Joint venture
LLJG	*lai liao jia gong*—processing factory (processing with supplied materials by foreign party)
M&A	Merger and acquisition
MOC	Ministry of Commerce
MOF	Ministry of Finance

MRA Maximum refundable amount

NDRC National Development and Reform Commission

PRC People's Republic of China

PSB Public Security Bureau

RMB Renminbi (Chinese currency unit)

RO Representative office

SAFE State Administration of Foreign Exchange

SAIC State Administration of Industry and Commerce

SAT State Administration of Taxation

SDPC State Development and planning Commission

SETC State Economic and Trade Commission

SEZ Special economic zone

VAT Value-added tax

WFOE Wholly foreign-owned enterprise

WTO World Trade Organization

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Beijing Office:
Sabrina Zhang
Regional Partner
beijing@dezshira.com
+86 10 6566 0088

Shanghai Office:
Olaf Griese
Partner
shanghai@dezshira.com
+86 21 6358 8686

Guangzhou Office:
Rosario DiMaggio
Manager
guangzhou@dezshira.com
+86 20 3825 1725

Dalian Office:
Adam Livermore
Regional Manager
dalian@dezshira.com
+86 411 6299 0101

Hangzhou Office:
Helen Ye
Manager
hangzhou@dezshira.com
+86 571 5685 9956

Zhongshan Office:
Lisa Qian
Manager
zhongshan@dezshira.com
+86 760 8826 9592

Qingdao Office:
Liming Zhang
Senior Associate
qingdao@dezshira.com
+86 532 6677 5461

Ningbo Office:
Lily Wang
Manager
ningbo@dezshira.com
+86 574 8733 8682

Shenzhen Office:
Alberto Vettoretti
Managing Partner
shenzhen@dezshira.com
+86 755 8366 4120

Hong Kong Office:
Joe Sze
Manager
hongkong@dezshira.com
+852 2376 0334

www.dezshira.com

Also in India and Vietnam

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