

TAXATION ISSUES FOR FOREIGN ENTERPRISES

Foreign enterprises with their head offices in China are taxed on their worldwide income. Tax credit is allowed for income taxes paid to other countries on certain incomes. Other foreign enterprises doing business in Shanghai and non-resident enterprises are taxed on income derived from China source only.

There are two systems of tax authorities in China, namely, National Tax Bureau and the Local Tax Bureau. The National Tax Bureau is responsible for assessing and collecting taxes for enterprises and corporations, while the Local Tax Bureau is responsible for individual income taxes and property taxes.

MAJOR TAXES ON FOREIGN ENTERPRISES

Foreign enterprise taxpayers can be classified into (1) Foreign investment enterprises, which include equity joint ventures, cooperative / contractual joint ventures and wholly foreign-owned enterprises and (2) Foreign enterprises, which include representative offices and branches.

Foreign invested enterprises and foreign enterprises doing business in China are liable to the following types of taxes:

1. Income Tax
2. Transaction Tax: Value added tax, Consumption tax, Business tax
3. Other taxes: Vehicle and vessel license tax, Stamp tax, Property tax, Deed tax

In addition, custom duties are levied on imports and exports and individuals working in China are liable to individual income tax.

INCOME TAX

Generally speaking, there is no distinction between profits for accounting purposes and tax purposes, since all accounts have to be prepared according to various legislations on accounting. However, for certain categories of expenses, for example entertainment and traveling, there are maximum amounts allowable and for certain categories of expenses, for example depreciation, organisation expenses, strict line shall apply.

Tax Year

The tax year is calendar year but a foreign enterprise may apply to the tax authorities to adopt its own fiscal year as the tax year.

Income Tax Rate

The current income tax rate is 30% and local income tax is 3%, making a total of 33%.

Tax Concession

Foreign enterprises engaged in manufacturing in Shanghai pay income tax at a reduced rate of 24%. Those established in the economic and technological development zones of Shanghai and Pudong New Area pay income tax at a reduced rate of 15%. In some areas, tax holidays still apply to foreign enterprises engaged in preferred industries.

Depreciation

Fixed assets with a useful life of one year or more may be depreciated. Fixed assets with cost less than RMB2,000 can be written off immediately. Straight-line method shall be applied according to the law. There are regulations providing the minimum useful lives for different categories of assets. Residual value should not be less than 10 %.

Categories of Fixed Assets	Minimum number of years
Premises, buildings and structures	20
Trains, ships, machinery and other production equipment	10
Electronic equipment, means of transportation other than trains and ships, appliances, tools and furniture relating to production and business operations	5
Accelerated depreciation may be allowed in special circumstances	

Operating Loss

Operating loss for enterprises carrying on business in Shanghai can be used to set-off taxable profits in the future for a maximum of five years.

(1) Value Added Tax

Enterprises engage in the business of selling commodities, repair and maintenance services or import and export business in China are subject to value added tax. The standard rate for value added tax is 17%, but the rate for certain basic commodities such as grain, cooking oil, running water, forage, fertilizer, pesticide, and farming machinery is 13%.

(2) Consumption Tax

Production, processing and importation of the following 11 commodities in China are subject to consumption tax: tobacco, alcoholic drinks or alcohol, cosmetics, skin and hair care products, jewellery, fireworks, gasoline, diesel, automobile tire, motorcycle and motorcar. Consumption tax is calculated in accordance with quantity (e.g. gasoline) or according to the fixed scheduled rates (e.g. the rate for motorcar with its engine cylinder capacity under 2,200ml is 8%).

(3) Business Tax

Enterprises engage in transportation, post and telecommunication, finance and insurance, construction, art, sports, entertainment, and services, or transfer of intangible assets and immovable properties are subject to business tax. Business tax rate is 3% or 5%. The tax rate for entertainment sector is 10% or 15%.

OTHER TAXES

The following types of taxes are levied on the taxpayers according to a fixed schedule. The scheduled rates may be amended from time to time. Investors are advised to check to relevant authorities for current information.

(1) Vehicle and Vessel Licence Tax

Vehicles owned and used by foreign invested enterprises are subject to Vehicle and Vessel Licence Tax

(2) Stamp Tax

Stamp taxes are levied on contracts made in China in respect of purchases and sales, processing contracting, engineering project, asset leasing, transportation, storage and warehouse, loan, asset insurance, technology contract, transfer of property rights, accounting ledger, royalty license. The minimum rate of a stamp tax is 0.005% and the maximum is 0.1%. royalty license and accounting books (not including wage records) taxed on per piece basis, at RMB5.

(3) Property Tax

- (a) The tax is levied at an annual rate of 1.2% on the original value of the real estate, after 20% is deducted therefrom.
- (b) The tax rate is 12% if it is levied on the rental income.
- (c) Newly constructed houses, which are built or purchased by the foreign-invested enterprises in **Pudong New Area** and Economic and **Technological Development Zones**, shall be exempt from real estate tax for 5 years as of the month of completion of construction or purchase.

(4) Deed Tax

Purchaser or acquirer of land and building is subject to deed tax. The transfer of ownership of land and building refers to:

- (a) The granting of land use right by the state (not including the transfer of management right of the rural collective land);
- (b) Transfer (including selling, bestowal and exchange) of land use right;
- (c) Sale and purchase of buildings;
- (d) Bestowal of buildings
- (e) Exchange of Buildings.
- (f) The current tax rate is 3-5%.

WITHHOLDING TAXES

Non-Resident

Foreign enterprises without a permanent establishment in China are subject to a withholding tax of 20% on its profits, interests, rentals, royalties and other income sourced in China. Double tax agreements (DTA) may reduce the rate.

Withholding tax on Profit, Interest, Rental and Royalty

A 20% withholding tax shall be levied on the income derived from profits, interests, rentals, royalties and other sources in China by foreign enterprises that have no establishments in China. However they enjoy *a reduced withholding tax rate of 10%* in Shanghai.

Other types of concession and preferential treatment in terms of income tax reduction or exemption may be granted upon approval of municipal government in accordance with current policies on enhancement of industry and development.

Dividends

Dividends from foreign investment enterprises are excluded from the taxable income of another foreign investment enterprise.

Dividends paid to foreign shareholders (individuals or corporation) at present are not subject to income tax or withholding tax.

Capital Gains

For tax purposes, there is no distinction between capital gains and other types of revenue received in China. Therefore, foreign shareholders are subject to foreign enterprises income tax on capital gains at 20% (withholding tax) from the sales of their investments in foreign investment enterprise. No indexation allowances will be taken into account.

Taxation on Partnership and Joint Venture

Partnership is uncommon in China, but cooperative joint venture (CJV), which is not a legal entity on its own, is widely used in China. A CJV is not a legal entity and its partners carry unlimited liabilities. The foreign partner of a CJV is taxed on its share of pretax profits according to rules applicable to a foreign enterprise.

Double Taxation Treaty

China maintains over 60 DTAs with its trading partners. In general, China adopts a mixed model of OECD and UN, with emphasis on the right to tax when the income is derived from or in China.

A WORD OF CAUTION

Since its accession to WTO, China has promised to change its tax laws so that all business entities in China have to pay the same rates of taxes. This is not a good news for foreign enterprises operating in special zones and are enjoying preferential tax treatments. The current tax rate of all local business and foreign enterprises not operating from special zones is 33% while enterprises in special zones may be enjoying tax rates as low as 15%. It is expected that the tax rate may be 24-25% for all types of enterprises in the future.

The legal system of China is similar to the European Code Law system. There may be numerous regulations and implementation notices relating to a particular subject. Investors should always check out for the latest development in those laws and regulations and consult experienced professionals before deciding on their investment plans.

For more information or assistance, please contact:

Kaizen Corporate Services Limited

Hong Kong Office

Room 1106, Futura Plaza
111 How Ming Street, Kwun Tong, Hong Kong
Tel: +852 2341 1444
Fax: +852 2341 1414
Email: info@by-cpa.com
Website: www.by-cpa.com

Shenzhen Office

Room 702, Oriental Plaza
1072 Jianshe Lu, Luohu District, Shenzhen
China
Tel: +86 755 8229 1144
Fax: +86 755 8229 1444
Email: cn@by-cpa.com

Website: www.by-cpa.com