

Doing business in China



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preface

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Chapter 1- General introduction

Geography

Located in the east of the Asian continent, on the western shore of the Pacific Ocean, the People's Republic of China (China) has a land area of about 9.6 million square kilometres and a population of 1.3 billion. It is the third largest country by land area and the largest country by population in the world.

Language and Currency

The official language of China is Putonghua, also referred to as Mandarin Chinese, which is spoken throughout the country. However, numerous other dialects are also spoken in different parts of China, the most common being Cantonese in southern China and Shanghainese in the greater Shanghai region.

The currency used in China is Renminbi (RMB). The main unit is the Yuan.

Time

China's entire territory is situated in a single time zone, which is eight hours ahead of Greenwich Mean Time (GMT). They do not implement "daylight savings."

Communications and Transport

Communication and transportation are well developed in China. The Internet is used widely: telephone and mobile phone services are also well developed. There are about 135 civil airports in mainland China, of which about 39 are international airports. China has 8 out of the top 10 container ports in the world. China also has a strong expressway network and railway system, which are improving all the time.

Constitution

The People's Republic of China is a communist republic. The socialist system is the basic system of the People's Republic of China.

Legal Systems

Legislation drawn up by the central government and local governments at various levels are enacted through the national people's congress and the local people's congress.

The judicial system comprises four levels of courts, from county level up to the Supreme Court, with escalation and appeal processes. These courts

deal with both civil and criminal cases.

Major Exports and Imports

China is one of the most important markets in the world. For the present, it is the largest exporter and the third largest importer in the world, with exports of US\$ 1, 578 billion and imports of US\$ 1, 395 billion in 2010.

Major exports are electrical and other machinery, including data processing equipment, textiles, apparel, steel and iron, optical and medical equipment. Major imports are electrical and other machinery, oil and mineral fuels, optical and medical equipment, metal ores, plastics, organic chemicals.

Sources of finance

China is the world's most important developing country, with an investment environment attracting the world's financial institutions. The present financial system in China is under the leadership of the People's Bank of China, with exclusively State-owned commercial banks as the main body, but allowing the co-existence of and co-ordination with State policy-related banks, other commercial banks and various financial institutions. The various sources of finance including: commercial banks, policy banks (China Development Bank, Export-Import Bank of China, China Agricultural Development Bank, etc), investment institutions, credit unions and the stock exchanges.

China Development

From the time Deng Xiaoping (a former leader of China) adopted the Open Door Policy for China in the 1980s, economic developments have steadily burgeoned as its national GDP consistently remained in the double digits. China's low business costs and cheap labour prices made it possible for an inpour of foreign investments and helped focus governmental efforts in preventing widening inequalities through the designation of special economic zones including cities such as Shenzhen, Zhuhai, and Xiamen.

In recent years, from the 2008 Beijing Olympics to the Shanghai World Expo in 2010, China has quickly transformed into one of the fastest growing global centres of the world. Currently in its Twelfth Five-Year national plan, China's leaders have not only set targets to continue and increase its overall economical growth, but they have also taken the initiative to engage in environmental and clean energy efforts.

In 2010, China with a GDP of 39.8 trillion Yuan, approximately US\$ 5.9 trillion, surpassed Japan's US\$5.5trillion, became the second largest economy in the world after U.S.

In recent years, China's policy moved away from "export dependent" to "developing internal market." In addition, China is now gearing towards "innovated in China" rather than "made in China." These changes are two key factors for continue growth in China's economic during the world economic crisis. These changes will continue contribute to China's economic growth during the next couple of years.

Chapter 2- Types of Business Structure

The main business structures used in China are:

- *Sino-Foreign Equity Joint Ventures (EJV)*
- *Wholly Foreign Owned Enterprises (WFOE)*
- *Cooperative Joint Ventures (CJV)*
- *Partnerships*
- *Representative offices*
- *Branches*
- *Trusts*

Sino-Foreign Equity Joint Venture (EJV)

An EJV is an enterprise set up by a foreign entity (including foreign companies, enterprises and other economic organizations or individuals) and a Chinese entity (including Chinese companies, enterprises and other economic organizations). An EJV is jointly operated by the entities, who share the risk, profit and loss according to the proportion of the capital they contribute.

Set-up procedures

- Submit the following documents to the examination and approval authorities:
 - Application for setting up an EJV
 - Feasibility study report
 - The signed agreement, contract and articles of association for the EJV
 - Names of board members
 - Any other documents required by the examination and approval authorities
- Approval by the examination and approval authorities.

The examination and approval authorities should decide to approve or not within three months. After approval, the administrative department in charge of foreign trade and economy will issue a certificate of approval.
- The EJV should register and obtain a business licence within one month of the date of approval.

Registered Capital and Total Investment

- Registered Capital

The registered capital of an EJV is the capital registered with the Industrial and Commercial Bureau, which equals the total investments of all venturers. It must meet the following requirements:

- (a) The foreign capital investment may not be less than 25% of the total registered capital.
- (b) During the contract term of a joint venture, it may not reduce its registered capital. Increasing the registered capital needs approval by the board, and must be submitted to the examination and approval authorities.
- (c) The amount of the EJV's registered capital may not be less than the minimum registered capital stated under the provisions of Chinese Company Law, as follows:

Type of Company	Amount (RMB)
Commercial retail company	300,000
Manufacturing or commercial wholesale company	500,000
Technology development .consulting , or service company	100,000
Limited liability company with one personal shareholder	100,000
Company limited by shares	10,000,000

Companies in special industries need to comply with the special regulations issued by the relevant government agencies.

B. Total Investment

Total investment comprises registered capital and loans. The State Administration for Industry and Commerce sets the registered capital as a proportion of total investment as follows:

Total Investment	Registered capital as proportion of total investment
Up to US\$3m	70%
US\$3m to US\$10m	50% (not less than US\$2.1m)
US\$10m to US\$30m	40% (not less than US\$5m)
Above US\$30m	One third (not less than US\$12m)

Wholly Foreign Owned Enterprise (WFOE)

A WFOE is an enterprise set up in China with all the capital invested by foreign investors. A WFOE is a separate economic entity, which has an independent accounting system, is responsible for its own profit and loss, and takes all legal responsibilities.

Set up procedures

- A. Submit a report to the local government (county level or above), including:
- (a) the objective of establishing the WFOE
 - (b) scope and scale of business
 - (c) products
 - (d) technical equipment
 - (e) land area and requirements
 - (f) energy conditions and volume required
 - (g) requirements for community facilities

The government will reply to the investor within 30 days of receiving the report.

- B. Submit an application to the examination and approval authorities with the following documents:
- (a) application for establishing the WFOE
 - (b) feasibility study report
 - (c) official certificate and reference of the foreign investor
 - (d) written replies by the local government at county level or higher about the plan to establish WFOE
 - (e) the list of goods which need to be imported.

The examination and approval authorities will approve or not within 90 days.

- C. The foreign investor must register with the Industrial and Commercial Bureau and obtain a business licence within 30 days of receiving the certificate of approval.
- D. The WFOE should register with the Tax Bureau within 30 days of the date on the business licence.

Separation, consolidation or other significant changes of a WFOE need the approval of the examination and approval authorities and a capital verification report issued by a Chinese CPA. After approval by the authorities, the WFOE should change its registration at the Industrial and Commercial Bureau accordingly.

Registered Capital

The registered capital as a proportion of the total investment should be in accordance with regulations. Please refer to the Regulations for Sino-Foreign Equity Joint Ventures.

Cooperative Joint Venture (CJV)

A CJV is set up within China by foreign entities (including foreign companies, enterprises and other economic organizations or individuals) and Chinese entities (including Chinese companies, enterprises and other economic organizations). All venturers have separate rights and responsibilities according to the contract.

Set-up procedures:

- A. Submit the following documents to the examination and approval authority:
 - (a) Proposal letter for the project
 - (b) Feasibility study report
 - (c) The agreement, contract and constitution
 - (d) Business licence or certificate of incorporation, reference and other relevant documents of all the venturers
 - (e) Names of board members
 - (f) Other documents required by the examination and approval authority
- The authority will approve or not within 45 days.
- B. If approved, the CJV should apply to register at the Industrial and Commercial Bureau, and obtain a business licence.

Registered Capital

Please refer to the relevant regulation about registered capital as a proportion of total investment.

Partnerships

Partnerships include both general partnerships and limited liability partnerships, both of which are established under partnership law by natural persons, legal persons or other organizations.

A general partnership is composed of general partners who bear unlimited joint and several liability for the debts of the partnership. A limited liability partnership is composed of general partners and limited partners, with the former bearing unlimited joint and several liability for the debts of the partnership and the latter bearing liability for such debts respectively within the limits of the capital contributions subscribed for.

Set-up procedures:

To establish a partnership, documents such as a written application for registration, a partnership agreement and the identity papers of the partners must be submitted to the registration authority. If the documents are in order, the authority shall, if it can, grant the registration on the spot and issue a business licence. If the authority cannot do it on the spot, it must, within 20 days, decide whether or not to grant registration. If it decides to grant registration, it must issue a business licence; otherwise, it must give a written reply and state the reasons.

Representative Office

Representative offices may only engage in non-operating activities in China. They act on behalf of foreign companies including making contacts,

extending volume growth of products, research and marketing, technical exchange, etc within the business scope of the foreign companies. Representative offices may engage in any business activities and sign any business contracts necessary to maintain the office as a going concern.

Set-up procedures

There are no uniform laws or regulations at the national level about set-up procedures for representative offices in detail. For detailed set-up procedures, please refer to the relevant local regulations. However, the general set-up procedures are as follows:

- A. A foreign company must make an application to the Bureau of Commerce or State Council and relevant departments to obtain a certificate of approval.
- B. The company must go to the Administration of Industry and Commerce office to complete a registration form within 30 days of obtaining the certificate of approval and submit the following documents:
 - (a) Certificate of approval
 - (b) Application form signed by the Chairman of the Board or the General Manager. The application form shows: the representative office's name, responsible officer, scope of business, duration of residence, location, etc
 - (c) Official licence to do business provided by the local relevant authorities
 - (d) Capital credit certificate provided by the relevant financial institutions
 - (e) Letter of authorization for permanent representative provided by the company and the résumé of the permanent representative

There are some differences in detailed set-up procedures in different regions. We suggest consulting local government and relevant government agencies before setting up representative offices.

Tax registration and payment

A representative office should declare business tax quarterly and pay the tax within 15 days of the end of the quarter. Enterprise Income Tax should also be prepaid within 15 days of the end of a quarter, and the balance of tax settled within four months of the end of the year.

A consulting service representative office engaged in commerce, law, tax, accounting and audit should establish accounting books, calculate its taxable income and declare and pay the tax.

A service representative office engaged in agency and trade should calculate deemed revenue and tax based on grossing up its expenses and costs.

Except for the above two types, representative offices may declare tax based on revenue from operating activities. If there is no operating income, the office may make a declaration about the operating circumstances within one month after the end of the year.

Customs

If the office needs to import office supplies and equipment, it must declare and pay customs duties.

Employment

If the office wants to employ local employees, it must make requests to the appointed authority and go through the formalities.

Branches

Currently, only FIEs, foreign banks, foreign insurance companies and foreign legal practices may establish branches in China with the approval of the relevant authorities. A foreign company must appoint a representative in charge of the branch and must allocate operational funds to the branch. Branches of foreign companies in China do not have the status of Chinese legal entities; the foreign company itself assumes liability for the operational activities of its branches in China.

Tax payments of branch office

Income tax

If the head office of a foreign enterprise is located in China and all the branches including the head office are located in the same city, the head office should declare, calculate and file income tax on the behalf of the foreign enterprise based on the profit and loss of the branch sourced within China.

If the head office and the branches are not located in the same city, the branches should declare, calculate and file income tax respectively..

Value added tax and business tax

The branches should pay VAT and business tax to the relevant local authorities. Unless the head office and branches are in the same city, the head office does not need to pay the VAT for branches.

Trusts

In China, trusts are used as public investment vehicles or for private charitable funds. They are not generally used for business purposes and there is no equivalent of the private trust funds used in some countries to hold assets for the benefit of named, private beneficiaries.

Public investment trusts may invest in listed stocks and bonds and other types of securities provided for by the securities regulatory authority.

Directors

The principal controlling body of a company is the board of directors, which is appointed by the shareholders. A public company must have between five and nineteen directors.

The board of directors is responsible for:

- *establishing company regulations and books*
- *financial reporting to shareholders*
- *applying for liquidation if the company becomes insolvent*
- *holding shareholder meetings and reporting on their work to shareholders*
- *production, operational plans and investment programmes*
- *internal management structures*
- *approving company basic management systems*
- *considering the general managers' report and making decisions*
- *establishing an annual budget, final accounts and profit allocation or deficit coverage plan*
- *proposing increases or decreases of capital*
- *major issues such as division, acquisition, termination and liquidation*
- *appointing or dismissing the company's general manager, deputy general manager and financial director, and making decisions on their reward or punishment.*

Chapter 3- Major Government Administration and Control

Government Policies on Foreign Investment in China

In order to expand foreign trade cooperation and technical exchange, China permits foreign investors to establish companies in China. The investment and profits made in China and the lawful rights and interests of foreign investors are protected by Chinese law.

The establishment of foreign invested companies in China is subject to examination and approval by the Ministry of Foreign Trade and Economic Cooperation. Within 30 days of receiving a certificate of approval, foreign investors should register with the Industrial and Commercial Bureau and obtain a business licence. They should then register with the tax bureau.

China welcomes enterprises with foreign capital, which shall be established in such a manner as to help the development of China's national economy. The State encourages the establishment of foreign invested enterprises that are export-oriented or technologically advanced. Enterprises meeting any of the following conditions may not be established in China:

- *China's sovereignty or public interest would be harmed;*
- *China's state security would be jeopardized;*
- *China's laws and regulations would be violated;*
- *The requirements for the development of China's national economy would not be satisfied; or*
- *Environmental pollution might be caused.*

Accounting and Independent Auditing

The Accounting System for Business Enterprises (ASBE) and new accounting standards apply to foreign invested enterprises. The new accounting standards, which are similar to International Financial Reporting Standards, were issued by the Ministry of Finance in 2006 and came into force on 1 January 2007. Public enterprises and state-owned businesses must use the new accounting standards, and others are encouraged to use them. It is strongly suggested that foreign invested enterprises use the new accounting standards.

Foreign invested enterprises should prepare financial statements for each year and engage an audit firm to audit the financial statements.

Fiscal Year

The fiscal and tax year are both from 1 January to 31 December.

Foreign Exchange Control System

China has controls on foreign exchange receipts and disbursements. Note the following when using foreign currencies:

- A. China does not restrict normal international trading receipts and payments. However, an entity in China that purchases goods or services from abroad must register the liability that arises with the State Administration of Foreign Exchange (SAFE). Then when the entity wishes to pay that liability, it must notify SAFE that it will remit the funds abroad. Similarly, when an entity in China sells goods or services to a customer abroad, it must register the debt with SAFE. Then when funds are received, the entity must notify SAFE in order to convert the funds into RMB. Notification can be done online or at SAFE offices.
- B. Offshore entities and offshore individuals who want to invest in China need approval by the departments responsible for the work and must register with SAFE.
- C. Loans from abroad should be processed according to regulations and be registered with SAFE.
- D. Chinese entities wishing to give guarantees on behalf of foreign entities must obtain approval from SAFE. After the award of the guarantee contract, enterprises should register them with SAFE.

Import Control System

When importing, a company must declare the condition of the goods. The goods can be released after examination and approval by customs and payment of relevant tariffs and taxes. There are controls on the import of dangerous chemicals, drugs, old and scrapped goods, and endangered wildlife.

Registration requirements and filing procedures for public securities (shares)

A company that applies for the listing of its stocks shall satisfy the following requirements:

- A. The stocks have been subject to examination and approval by the securities regulatory authority and shall have been publicly issued;
- B. The total amount of capital must be at least RMB 30 million;
- C. The publicly issued shares must be more than 25% of the total; where the total exceeds RMB 0.4 billion, the publicly issued shares must be no less than 10%; and
- D. The company may not have any major irregularity over recent years or false record in its financial statements.

An application to list any securities must be filed with a stock exchange and is subject to examination and approval of the stock exchange and a listing agreement shall be reached by both parties.

The information disclosure documents mainly include prospectuses, listing announcements, periodic reports and temporary reports.

Export Finance and Insurance

The Export-Import Bank of China (China Eximbank) is state owned. Its objectives are to implement state policies in industry, foreign trade and economy, finance and diplomacy; promote, through the provision of financing, the import and export of Chinese products; encourage Chinese companies to undertake offshore construction contracts and overseas investment projects; and strengthen China's relations with foreign countries and enhance economic and trade cooperation.

China Export & Credit Insurance Corporation (SINOSURE) is the only policy-oriented Chinese insurance company specializing in export credit insurance. It offers cover against political risks and commercial risks.

Chapter 4- Grants and Incentives

Favourable Policies for Investing in Special Industries

VAT preferential policies for special industries

VAT-free industries include:

- *agricultural primary products (self grow)*
- *re-export of goods processed with imported material*
- *equipment and raw materials donated by foreign governments or international organizations*
- *special imported goods conforming to national regulations for the disabled*
- *personal (not including self-employed) sale of self-used goods*
- *construction materials produced by waste residue conforming to national regulations*

Income tax preferential policies for special industries

- A. Approved high-tech enterprises enjoy a 15% income tax rate
- B. The following industries are free of income tax:
- *Various agriculture and forestry and related industries*
 - *Traditional Chinese medicinal materials*
 - *Livestock and poultry*
 - *Distant water fisheries*
- C. The following are taxable at half the standard rate:
- *Flower, tea, other beverage crop and spice crop planting*
 - *Sea culture and inland aquaculture*
- D. Income from conditional environmental protection, energy-saving and water-saving projects is tax free for the three years from first making an operating profit, then at half the standard rate for the following three years.
- E. Income for conditional technology transfer
Corporate income tax law and regulations include provisions for tax-free and reduced rate income tax. The first RMB 5 million resident enterprise technology transfer income is tax-free and the remainder is taxable at half the standard rate.

- F. The income tax rate is 20% for small low-profit enterprises, defined as follows:
- (a) for industrial undertakings, taxable profits are no more than RMB 300,000, employees are no more than 100 and total assets are no more than RMB 30,000,000.
 - (b) for others, taxable profits are no more than RMB 300,000, employees are no more than 80 and total assets are no more than RMB 10,000,000.

Favourable Policies for Investing in Special Regions

Some regions of China, particularly those where there is a large ethnic minority, have a degree of autonomy. In these regions, local governments can introduce preferential enterprise income tax policies, such as tax-free periods or reduced rate policies.

In the special economic zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and Shanghai Pudong New Area, certain high-tech enterprises are given preferential policies on income tax. Income generated in these areas is tax-free for the two years from first making sales and is taxed at half the standard rate in the following three years.

Incentives on Research and Development (R&D)

150% of R&D costs may be deducted in arriving at taxable profit. Capitalized R&D costs may be amortized on the basis of 150% of the total costs.

Incentives on Export

China has special preferential policies for exported goods. Exported goods are zero-rated for VAT and free of consumption tax.

Regional Headquarters (RHQ) Concession

A number of concessions are designed to encourage transnational corporation to set up regional headquarters and business organ in China. These concessions include preferential tax policies, regional Headquarters with research and development functions established in Shanghai are eligible for treatment under the preferential policies available to high and new technology enterprises in accordance with provisions. Regional Headquarters registered in Pudong New Area are eligible for the preferential policies available in Pudong New Area in accordance with provisions. These concessions also include some subvention or rewards and so on.

Protection of Intellectual and Industrial Property

Copyright

Copyright is protected in China by law. Copyright belongs to the author. The rights of authorship, alteration and integrity of an author are unlimited in time.

Trade Marks

Some types of goods are required by law to bear a trademark. For these, a trademark registration must be applied for. Where no trademark registration has been granted, such goods cannot be marketed. Any trademark in respect of which an application for registration is filed shall be so distinctive as to be distinguishable, and must not conflict with any prior right acquired by another person. A trademark registrant has the right to use the words “registered trademark” or a symbol to indicate that his trademark is registered.

Patents

Any invention or utility model for which patent right may be granted must possess novelty, inventiveness and practical applicability.

For any exploitation of the patent without the authorization of the patentee, constituting an infringing act, the patentee or any interested party may request the administrative authority for patent affairs to handle the matter or may directly institute legal proceedings.

Chapter 5- Taxation

Brief Introduction

Tax is the most important source of fiscal revenue in China. It is also an important economic lever utilized by the State to strengthen macro-economic regulation, which plays a key role in China's economic and social development.

Tax regulations in China can be complex and are liable to periodic change. Professional advice is therefore recommended on matters that may have tax implications.

In China, there are many types of taxes, which can be divided into the following categories:

- A. Turnover taxes. These include Value Added Tax, Consumption Tax, Business Tax and Customs Duty. They are normally based on the volume of turnover or sales of the taxpayers in the manufacturing, distribution or service sectors.
- B. Income taxes. These include Enterprise Income Tax and Individual Income Tax. They are levied on the basis of the profits gained by producers or dealers, or the income earned by individuals.
- C. Resource taxes – Resource Tax and Urban and Township Land Use Tax. They apply to those engaged in natural resource exploitation or to users of urban and township land. They reflect the chargeable use of state-owned natural resources.
- D. Taxes for special purposes. These include City Maintenance and Construction Tax, and Land Appreciation Tax. They are levied on specific items for special regulatory purposes.
- E. Property taxes – House Property Tax and Urban Real Estate Tax.
- F. Behaviour taxes. These include Vehicle and Vessel Usage Tax, Stamp Tax, Deed Tax etc. As the name implies, these taxes are levied on specific behaviours.

The following taxes will be introduced in detail in this chapter.

- VAT
- *Business Tax*
- *Enterprise Income Tax (EIT)*
- *Consumption Tax*
- *Customs Duties*
- *State Taxes*

Individual Income Tax (IIT) is covered in Chapter 6.

Due to the low tax rates and limited coverage, other taxes are not dealt with here.

Value Added Tax (VAT)

Applied scope

All units and individuals in China who are engaged in the sale of goods, provision of processing, repair and replacement services, or the import of goods are liable to pay VAT (hereafter referred to as “taxpayers”). The VAT regulations are outlined below.

General taxpayers and small-scale taxpayers

A small-scale taxpayer is a corporate VAT payer with sales below defined limits, which does not have a sound accounting system and cannot report and submit tax information under the provisions.

A sound accounting system is defined by the ability to calculate the VAT amount on input tax, output tax and tax liability.

The sales limits for small-scale taxpayers are:

- A. for those engaging in production of goods or providing services, less than RMB 500,000 a year;
- B. for wholesaler and retailer, less than RMB 800,000 a year.

Non-enterprise entities and entities which do not have regular taxable activities can choose whether to be a small-scale taxpayer or not when declaring VAT.

A general taxpayer is an enterprise with a sound accounting system and which can report and submit tax information under the provisions or where the sales amount is above the sales limits for a small-scale taxpayer. General taxpayers should obtain certification from the tax authority.

Tax rate

- A. For general taxpayers engaged in the sales of goods, provision of processing, repair and replacement services, or the import of goods, the VAT rate is 17% except in specific circumstances.
- B. Specific circumstances are identified as where a general taxpayer sells or imports the following goods, in which case the tax rate is 13%:
 - Food grains, edible vegetable oils, raw milk
 - Tap water, heating, air conditioning, hot water, coal gas, liquefied

petroleum gas, natural gas, methane gas, coal/charcoal products for household use

- *Books, newspapers, magazines*
- *Feeds, chemical fertilizers, agricultural chemicals, agricultural machinery and covering plastic-film for farming*
- *Other goods as regulated by the State Council.*

C. For small-scale taxpayers, the tax rate is 3% (but see below).

Calculation

1. General VAT payers

(1) Tax liability

For taxpayers selling goods or taxable services, VAT payable is the balance of output tax minus input tax for the period. If the output tax is less than the input tax for the period, the excess input tax can be carried forward for set-off in subsequent periods. Excess input tax cannot be recovered from the tax authorities as it can in some other countries.

(2) Output tax

Output tax is calculated as sales x tax rate.

(3) Input tax

The input tax allowed for deduction from output tax is limited to the VAT amounts shown on the documents listed below.

- *special VAT invoices obtained from sellers*
- *tax payment receipts obtained from the customs office*
- *the purchasing of tax exempt agricultural products from producers of agricultural and small-scale taxpayers, calculated based on a deemed deduction rate at 13% on the actual purchase price.*

Input tax on the following items may not be deducted from output tax:

- *goods or services used for non-taxable items*
- *goods or services used for tax exempt items*
- *goods or services used for group welfare or personal consumption*
- *abnormal losses of goods purchased*
- *goods or services consumed in the production of work-in-progress or finished goods, which suffer abnormal losses*

From 1 January 2009, input taxes on purchased or self-constructed fixed assets may be deducted from output tax.

2. **Small-scale taxpayers**

Small-scale taxpayers use a simplified method for calculating tax payable. Tax payable is calculated based on sales and a net tax rate of 3%. Taxpayers are not entitled to claim any input VAT paid to set off against the output VAT.

Other provisions

- A. For taxpayers dealing in goods or providing services with different tax rates, these shall be accounted for separately.
- B. Where the prices used by the taxpayer in selling goods or taxable services are obviously low and without proper justification, the sales amount will be determined by the tax authorities.
- C. The sales amount shall be calculated in RMB. Sales settled in foreign currencies shall be translated into RMB at the mid-rate on the transaction day or the first day of the month.
- D. Where taxpayers have not obtained and kept VAT deduction documents in accordance with the regulations, or the VAT payable and other relevant items are not indicated on the VAT deduction document, no input tax can be claimed.
- E. For taxpayers importing goods, tax payable is based on the composite assessable price and the tax rates. The formulas for computing the composite assessable price and the tax payable are as follows:
 - *Composite assessable price = Customs dutiable value + Customs Duty + Consumption Tax*
 - *Tax payable = Composite assessable price × Tax rate*
- F. The following items are exempt from VAT:
 - *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 for the disabled for special use by the disabled*
 - *Sale of goods that have been used by the sellers.*

In all other cases, VAT exemption and reduction items are decided by the State Council, not by local governments or departments.
- G. For taxpayers engaged in tax exempt or tax reduced items, sales of tax exempt or tax-reduced items shall be accounted for separately.
- H. The time at which VAT liability arises is:
 - *for sales of goods or taxable services, when the sales sum is received or documented evidence of the right to collect the sales*

amount is obtained

- *for importation of goods, the date of import declaration*

I. Sellers must issue special VAT invoices to purchasers. Sales amounts and output tax shall be separately shown, but in any of the following situations, the invoice may be an ordinary invoice rather than a special VAT invoice:

- *Sale of goods or taxable services to consumers*
- *Sale of VAT exempt goods*
- *Sale of goods or taxable services by small-scale taxpayers.*

Payment of Tax

The VAT assessable period may be one day, three days, five days, ten days, fifteen days or one month.

Taxpayers that adopt one month as an assessable period shall report and pay tax within 15 days following the end of the period. If an assessable period of one day, three days, five days, ten days or fifteen days is adopted, the tax shall be prepaid within five days following the end of the period and a monthly return shall be filled with any balance of tax due settled within 15 days from the first day of the following month.

Business Tax (BT)

Applied scope

Within China, individuals and organizations that supply services, transfer intangible assets, or sell immovable properties are liable to Business Tax.

Business tax is taxable in the following industries: traffic and transportation, building, financial and insurance establishments, postal and services, culture and sports, entertainment, service trade, transfer of intangible assets and sale of real estate.

Tax rate

The business tax rate differs between industries and types:

- A. In traffic and transportation, building, postal and services, and culture and sports, the rate is 3%;
- B. In service trades, financial and insurance establishments, transfer of intangible assets and sale of real estate, the rate is 5%;
- C. In the entertainment industry, the rate is between 5% and 20%.

Calculation

Tax payable is turnover times the tax rate.

Turnover is the total price plus other charges received. However, the

situations listed below are excluded:

- A. Taxpayers distribute some of the contracts for transportation work to other companies or individuals. The sales amount is calculated using the total costs plus additional fees and charges minus the expenses paid to other companies and individuals.
- B. Taxpayers are in the tourism industry. The sales amount is calculated using the total costs plus additional fees and charges minus the expenses paid on the behalf of the travellers to other companies or recommendation fees, dinner fees, transportation fees, tickets and payment to other travel corporations.
- C. The turnover of the main contractors in the construction business who sub-contract work to other parties shall be determined by subtracting the payments made to sub-contractors from the total contract sum.
- D. The turnover of businesses buying and selling foreign currencies, negotiable securities and futures shall be determined by subtracting the buying prices from the selling prices.
- E. Other circumstances defined by the finance department of the State Council and tax authority.

Other provisions

- A. The tax payable must be calculated in RMB. Turnover settled in foreign currency is translated into RMB at the exchange rate prevailing in the foreign exchange market.
- B. Where taxable activities fall into different tax items, the turnover, transfer and sales amounts within different taxable items must be calculated separately.
- C. Where a taxpayer has both tax-exempt or tax reduced items, he must calculate the amount of the exempt and reduced tax items separately.

Payment of Tax

The Business Tax assessable period shall be five days, ten days, fifteen days, one month or one quarter. Taxpayers that adopt one month or one quarter as an assessable period shall report and pay tax within fifteen days following the end of the period. If an assessable period of five days, ten days or fifteen days is adopted, the tax shall be prepaid within five days following the end of the period and a monthly tax return shall be filed with any balance of tax due settled within fifteen days from the first day of the following month.

Enterprise Income Tax (EIT)

Taxpayers

Income tax payers are classified into resident and non-resident enterprises.

- A. Resident enterprise means an enterprise set up under Chinese law within China, or set up under the law of a foreign country (region) but whose actual management organ is within China.
- B. Non-resident enterprise means an enterprise which is set up under the law of a foreign country (region) and whose actual management organ is not within China but which has organs or establishments within China, or which does not have any organ or establishment within China but has income sourced in China.

Applied scope

- A. Resident enterprise: liable to EIT for income sourced from both inside and outside China.
- B. Non-resident enterprise:
 - *If it sets up an organ or establishment within China, it will be liable to EIT on its income sourced from China and income sourced from outside China but connected with the said organ or establishment.*
 - *If it has no organ or establishment within China or its income has no connection to its organ or establishment in China, it will be liable to EIT on income sourced from China. In this circumstance, the law states that a favourable tax rate of 10% will be used.*

Tax rate

The standard rate of EIT is 25%.

Calculation

Taxable income equals total income less tax-free and tax-exempt income less deduction items less permitted losses of previous year(s).

- *Total income refers to monetary and non-monetary income from various sources and includes:*
 - (1) income from selling goods;
 - (2) income from providing labour services;
 - (3) income from transferring property;
 - (4) equity investment gains, such as dividends and bonuses;
 - (5) interest income;
 - (6) rental income;
 - (7) royalty income;
 - (8) income from accepting donations; and
 - (9) other income.
- *The following types of income are tax-free:*

- (1) interest from treasury bonds;
- (2) dividends, bonuses and other equity investment gains generated between qualified resident enterprises;
- (3) dividends, bonuses and other equity investment gains obtained from a resident enterprise by a non-resident enterprise with organs or establishments in China and which have connection with such organs or establishments; and
- (4) income of qualified not-for-profit organizations.
- *When calculating taxable income, reasonable expenditures which actually happened and are connected with the business operations of an enterprise, including costs, expenditures, taxes, losses, etc. may be deducted.*

Special deduction regulations:

- A. When calculating taxable income, none of the following expenditures may be deducted:
 - (1) equity investment gains such as dividends or bonuses paid to investors;
 - (2) EIT payments;
 - (3) late payment fees for taxes;
 - (4) pecuniary punishment, fines, and losses of confiscated properties;
 - (5) non-public welfare donations;
 - (6) sponsorship expenditures;
 - (7) unverified reserve expenditures; and
 - (8) other expenditures unrelated to obtaining revenues.
- B. As regards an enterprise's expenditures for public welfare donations, up to 12% of the total annual profit before tax may be deducted.
- C.
 - (1) Reasonable salary payments may be deducted.
 - (2) Social insurance charges may be deducted.
 - (3) Welfare expenditures for employees may be deducted up to 14% of total salaries.
 - (4) Union fees may be deducted up to 2% of total salaries.
 - (5) Training fees may be deducted up to 2.5% of total salaries during the current year and the balance may be carried forward to later tax years.
 - (6) Commercial insurance for investors or employees may not be deducted.
- D. Interest payable on loans that a non-financial enterprise borrows from other non-financial enterprises is limited to the amount that would be paid on the same type of loan from a financial enterprise.
- E. 60% of business entertainment costs related to operating activities may be deducted, up to 0.5% of sales revenue.

- F. Advertising may be deducted up to 15% of current year sales revenue. The excess may be carried forward to later years.
- G. Property insurance paid as stated in regulations may be deducted.

Relief for losses

Losses suffered during a tax year may be carried forward for up to five years.

Preferential Tax Treatments

- *Important industries and projects whose development is supported and encouraged by the state enjoy preferential EIT treatment.*
- *EIT on income from the following may be exempted or reduced:*
 - (1) agriculture, forestry, husbandry and fishery
 - (2) investment in and business operations of important public infrastructure projects supported by the state
 - (3) projects of environmental protection, energy and water saving
 - (4) transferring technologies
- *For small enterprises satisfying prescribed conditions, EIT is levied at a reduced rate of 20%.*
- *For important high-tech enterprises needing to be supported by the state, EIT is levied at a reduced rate of 15%.*
- *An enterprise may additionally deduct the following in calculating taxable income:*
 - (1) costs of researching and developing new technologies, new products and new techniques
 - (2) wages paid to disabled employees or other employees whose hiring is encouraged by the state
- *Income from producing products complying with the industrial policies of the state by comprehensively utilizing resources may be reduced in calculating taxable income.*
- *Investment in purchasing special equipment for protecting the environment, saving energy and water, work safety, etc., may be deducted at a certain rate.*

Payment of Tax

EIT on the monthly or quarterly basis must be paid in advance.

An enterprise must submit a tax return for advance payment to the tax bureau and pay the tax in advance within 15 days after the end of a month or quarter.

An enterprise shall submit an annual EIT return for the settlement of tax payments to the tax bureau and settle the payable or refundable amount of taxes within 5 months after the end of each year.

Repatriation of Profits and Transfer Pricing

Profits earned by FIEs before 1 January 2008 may be paid to foreign investors after that date free of withholding tax. However, profits earned by FIEs after 1 January 2008 are subject to withholding tax at 10% when distributed to foreign investors.

The term "investor" as used above means a non-resident enterprise which does not have any organ or establishment within China but which has income sourced in China.

Related party transactions must be at arm's length and use a reasonable transfer pricing method. Transfer pricing methods include the comparable uncontrolled price (CUP) method, the resale price method, the cost-plus method, the transactional net price method, the profit split method and other reasonable methods.

The tax authorities identify enterprises for inspection, check related party transfer prices and make necessary adjustments. Enterprises being inspected must report detailed information on related party transactions and provide relevant pricing information.

Consumption Tax

Applied scope

All units and individuals engaged in the production, subcontracting for processing or the importation of consumer goods in China have to pay Consumption Tax. Consumer goods include cigarettes, alcohol, cosmetics, compact cars, valuable jewellery, petroleum products, etc.

Tax rate

Proportional tax rate and fixed tax rate are used to calculate consumption tax. Consumption tax rates differ between goods.

Calculation

Consumption Tax is calculated using the ad valorem method or the specific value method.

Other provisions

- A. Where taxpayers deal in taxable consumer goods with different tax rates, the sales amounts and sales volumes for the taxable consumer goods shall be accounted for separately.
- B. Taxable consumer goods produced by the taxpayer are subject to tax on sales. For self-produced taxable consumer goods for the taxpayer's own use in the continuous production of taxable consumer goods, no tax is levied. Tax is assessed when the goods are transferred for other

use.

- C. Where the taxpayer uses a price that is clearly too low and without proper justification, the tax authorities will determine the price to use in calculating tax.
- D. Where taxpayers export taxable consumer goods, Consumption Tax will not be levied, unless otherwise determined by the State Council.

Payment of Tax

The Consumption Tax assessable period shall be one day, three days, five days, ten days, fifteen days, one month or one quarter. Taxpayers that adopt one month or one quarter as an assessable period must report and pay tax within fifteen days of the end of the period. If an assessable period of one day, three days, five days, ten days or fifteen days is adopted, the tax shall be prepaid within five days following the end of the period and a monthly tax return must be filed with any balance of tax due settled within fifteen days from the first day of the following month.

Customs Duty

Applied scope

Import and export duties are levied on goods imported to or exported from China.

Taxpayers

The consignee of imported goods, consignor of export goods, and owners of entry articles are parties held liable for paying customs duties.

Tax rate

Imported goods classification, prices after tax and tax rates are made according to the import duty rate schedule.

Calculation

Customs duties of import and export goods may be levied by means of ad valorem, specific duties or otherwise as specified by the State.

Reductions and exemptions

Various reductions and exemptions are available under detailed rules.

Payment of Tax

A duty payer must pay the duties within 15 days from the day when the duty payment form is issued by the Customs. There are penalties for late payment.

State Taxes

State Taxes comprise house duty, city and town land use tax, land value increment tax, deed tax, tax on land occupation, stamp duties, city maintenance construction tax, vehicle and vessel use tax, resource tax and tobacco tax.

Stamp duties and land tax are described briefly below.

Stamp duties

Local tax bureaux levy stamp duty on a number of transactions including transfers of property, mortgages, leases, deeds, hire purchase agreements, contracts, licences and permits and business account books. Different rates apply to different transactions and the stamp duty is often calculated based on the amount of money involved or fixed tax rate.

Land tax

Urban land use tax applies to taxpayers in cities, counties, towns, the use of state-owned land within urban industrial units and individuals. Land use tax is based on the actual area of land used by the taxpayer and the stipulated tax rate.

Gift, Estate and Death Duties

There are currently no gift, estate or death duties in mainland China.

Superannuation Guarantee

China has a compulsory superannuation scheme with employers required to make monthly contributions to approved superannuation funds on behalf of their employees. Currently, the rate is about 20% of the employee's average monthly wage in the previous year. Where the employer fails to make the minimum level of monthly contributions, they are subject to a late payment penalty. Superannuation contributions made by employers are tax deductible, whilst penalties are not.

Taxation of Partnerships & Trust Funds

Operating income of partnerships in China is not subject to EIT, but the partners are subject to Individual Income Tax at rates from 5% to 35%.

Securities investment funds are exempt from EIT for revenue arising from purchasing and selling stocks, bonds and other securities, dividends and bond interest.

Interaction with International Tax Regime

China is a signatory to a number of double taxation agreements, based on the UN Model. Counterparties include Japan, Singapore, many Asian nations, Australia, New Zealand, Canada, the USA, the UK and many European nations.

If an enterprise has already paid tax overseas on the types of income below, it may deduct it from the tax payable for the current period. The limit of tax credit is the tax payable on such income calculated under the present law. Any excess may, during the five subsequent years, be offset against the balance of the limit of tax credit of each year minus the tax amount to be offset in that year.

- A. Income of an enterprise resident in China sourced from outside China; and
- B. Income obtained outside China of a non-resident enterprise having organs or establishments inside China, but having actual connection with such organs or establishments.

Chapter 6- Foreign Personnel in China

Entry into China

Visitors to China must apply for visas from Chinese diplomatic missions, consular offices or other authorized resident agencies. In specific situations foreigners may apply for visas to visa-granting offices at designated ports.

APEC Business Travel Card

Business visitors from Australia, Brunei, Canada, Chile, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Taiwan, Thailand, the USA and Vietnam can apply for an APEC Business Travel Card, which gives them visa-free travel to China and other participating APEC countries.

Residence permits

An initial visa grants the holder the right to enter China for a specific purpose, but expires after a few months. To stay longer in China, one needs to apply for a residence permit, which is a multiple-entry visa, allowing one to leave the country and return without an additional visa as long as the permit remains valid. Upon arrival in China, one has 30 days to obtain a residence permit.

There are three types of residence permit that allow one to live in China:

- *Permanent residence permits.*
- *Temporary residence permits are valid for 6-12 months. Generally required for visiting scholars or those entering for job training.*
- *Foreigner residence permits are normally valid for one year and are renewable annually. They are the standard residence permits issued to the majority of foreigners working in China.*

The ministry of public security has released new regulations that allow five categories of foreigners to apply for residence permits in China. (Effective since 1 June 2010):

- *Chinese citizens' foreign spouse, as well as their parents and children;*
- *Foreigners above 60 years-old, who have no relatives in their countries, but have relatives in China, as well as their foreign spouse;*
- *Foreigners above 60 years-old who own houses in China, as well as their spouse and children who are under 18 years old;*
- *Foreigners who come to China to look after their Chinese parents who*

- are above 60 years old and with no children in China;*
- *Children of overseas Chinese or children of Chinese citizens who have residence permits in other countries.*

There are no entry or exit limitations for visitors with residence permits noted above, and the permit is valid for 2 years.

To obtain a residence permit, one must provide the following documentation:

- *A passport with the respective visa matching the residence permit for which one is applying*
- *A passport photo*
- *Residence registration*
- *The respective application form*
- *Health certificate*
- *If applicable, job contract and work permit*

Physical Exam Certificate

In theory, one is required to present a physical examination certificate in order to obtain a residence permit (the Chinese embassy lists them as required documents for residence visas). However, people are not always asked to submit the paperwork.

Labour Agreements

The employer and its foreign employee should, by law, conclude a labour contract. The employer should, within 15 days after the entry of the employed foreigner, take to the office that granted the employment licence (see below) the employment licence, the labour contract with the foreigner and his passport and fill out a foreigner employment registration form to receive his employment permit.

The term of the labour contract shall not exceed five years. Such contract may be renewed upon expiration after the completion of clearance process.

Work Permits

An employer intending to employ foreigners must obtain approval and an employment licence for foreigners.

A foreigner seeking employment in China must:

- *be 18 years of age or older and in good health*
- *have professional skills and job experience required for the intended employment*

- *have no criminal record*
- *have a clearly-defined employer*
- *have a valid passport or equivalent.*

Foreigners seeking employment in China must hold an employment visa and may work within China only after obtaining an employment permit for foreigners and a foreigner residence certificate.

Foreigners may be exempted from the employment licence and employment permit if they meet some special conditions – please consult local departments for details.

Individual Income Tax (IIT) on Foreign Personnel

Which Foreign Individuals Need to Pay IIT in China?

- *Foreigners and residents of Hong Kong, Macau and Taiwan (“foreign individuals”) who derive income from work or employment with enterprises or organizations within China.*
- *Foreign individuals who derive income from personal services provided (including design work, shows, performances, advisory positions, brokerage services, agency services, etc.)*
- *Foreign individuals who derive income from author’s remuneration, royalties, interest, dividends, bonuses, the leasing of property, transfer of property, contingent income and income from other sources inside China.*

Any non-Chinese passport holder working for a local company, a foreign company’s representative office, subsidiary in China, or a WFOE in China needs to pay IIT. In short, if the entity for which you work is registered in China, you need to pay IIT.

Determining the Source of Wages and Salaries for Foreign Individuals

For wages and salaries derived by foreign individuals, the place where he/she works is considered the source of income. The location of payment is not relevant in determining the income source.

In other words, wages and salaries derived by the foreign individual for work while inside China will be considered as China-based income, regardless of whether they are paid by enterprises or individuals inside or outside China. Wages and salaries derived by the foreign individual for work while outside China will be considered as income based outside China, regardless of whether they are paid by enterprises or individuals inside or outside China.

Local employees

Salaries of Chinese employees in China are subject to IIT according to a progressive scheme with rates from 3% to 45%. The calculation is as follows. First, the employee's social insurance contributions (usually about 18%, but with regional differences) are subtracted from the monthly salary as fixed in the labour contract (i.e. gross salary). Then a deduction of RMB 3,500 is made. The resulting amount is the monthly taxable income, which is taxed at the rate according to the income level.

$$\text{Tax payable} = (\text{gross income} - \text{social insurance} - 3,500) \times \text{applicable tax rate} - \text{allowable quick deduction}$$

Level	Monthly taxable income (RMB)	Tax Rate	Allowable quick deduction (RMB)
1	1,500 or less	3%	0
2	1,501 to 4,500	10%	105
3	4,501 to 9,000	20%	555
4	9001 to 35,000	25%	1,005
5	35,001 to 55,000	30%	2,755
6	55,001 to 80,000	35%	5,505
7	80,001 upwards	45%	13,505

Example:

Gross Salary	Social Insurance (18%)	Income After Social Insurance	Taxable Income (-3,500)	Tax Rate	Quick Deduction	Tax Payable	Net Salary
8,500	1,330	7,170	3,670	10%	105	262	6,908

Effective since 1 September 2011

Foreign employees

The incomes of foreign employees in China are taxed at the same rates as incomes of Chinese employees. However, the important question is when foreign nationals' incomes are subject to Chinese IIT.

Tax Liability

The criterion used to determine a foreign employee's tax liability in China is the duration of stay.

A distinction is also made between junior staff and senior executives. Foreigners and Chinese from Hong Kong, Macao and Taiwan have to pay IIT on incomes derived from Chinese sources for work in China even if they have lived in the country for less than 90 days (183 days for citizens of countries that have signed a double tax treaty with China). If a foreign

employee has been living in China for more than 90 days (183 days) but less than a year, income for work in China from all sources is taxable. Foreign senior executives (e.g. CEOs, General Managers, Chief Representatives, etc.) however, are liable for their full income derived from Chinese sources from the first day in the country.

For better understanding taxable income for longer periods of stay and for senior officials compared to ordinary employees please see the chart below.

	Foreign Employees				Foreign Senior Executives			
	Work in China		Work abroad		Work in China		Work abroad	
Source of income	China	Abroad	China	Abroad	China	Abroad	China	Abroad
0 days	✓				✓		✓	
90/183 days	✓	✓			✓	✓	✓	
1 year	✓	✓	✓		✓	✓	✓	
5 years	✓	✓	✓	✓	✓	✓	✓	✓

However, one special situation needs to be mentioned: the salary of a chief representative (of a representative office) which is paid by the parent company abroad is taxed on a prorated basis, even for durations of stay of less than 90/183 days per year. The chief representative must apply for part-time status, which allows him to pay taxes on his income from abroad only for the time spent in China. This rule does not apply to senior officials of WFOEs, because these are registered as Chinese companies and pay their employees from within China.

Registration Procedures

If the employee is liable for China tax filing, the following procedures for registration apply and the following documents are required:

- *Original salary certificate from overseas employer*
- *Copy of employment contract*
- *Copy of all pages of passport*
- *If the employer is a “permanent establishment” in China then: employee’s work permit, employer’s tax registration certificate and employer’s business licence.*

Significant fines apply to both employer and employee if this is not adhered to.

Tax Calculation

The calculation process is only slightly different from the one described for Chinese nationals. Foreign employees may deduct an amount of RMB 4,800 pending (instead of RMB 3,500) before calculating the tax payable according to the scheme above. Moreover, foreigners do not have to pay social insurance in China. Therefore some allowances and benefits such as housing allowance paid by the employer are not taxable.

Example:

Gross Salary	Taxable Income (-4,800)	Tax Rate	Quick Deduction	Tax Payable	Net Salary
8,500	3,700	10%	105	265	8,235

Self Declaration of IIT

China’s tax regulations require taxpayers who fall under any of the following five categories to self-declare their earnings:

- (1) Annual income over RMB 120,000
- (2) Receiving salary and remuneration from two or more employers in China
- (3) Generating income abroad
- (4) Generating taxable income without withholding agent
- (5) Other cases as specified by the State Council

For scenario (1), taxpayers must declare taxes to the relevant authorities within three months after the end of a tax year (i.e. by 31 March each year). For scenarios (2) to (4), they shall make a tax declaration upon receipt of the income.

As shown in the examples above, taxpayers are allowed some deductions from their taxable income, such as social insurance contributions and a personal allowance of RMB 3,500 for locals and RMB 4,800 pending for

foreigners. There are also certain tax exemptions, such as particular rewards in respect of science, education, technology, culture, etc, interest on treasury and financial bonds issued by China, specific academicians subsidy or allowance, welfare and relief for the disabled, etc.

Liabilities for non-payment of tax

If an individual fails to declare his/her tax within the specified period, a penalty of 0.05% per day may be imposed based on tax liability.

Taxation of Capital Gains

Gains from individual disposals of capital assets are subject to IIT. The taxable income is the gross transfer income after deducting the original value of the property and reasonable expenses. The tax rate is 20%.

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