Tax

The People's Republic of China

Tax Facts and Figures – 2010

Foreword

This booklet has been prepared to provide the reader with an overview of taxes levied in the People's Republic of China. The material contained in this publication was assembled on 31 December 2009 and, unless otherwise indicated, is based on information available at that time. It is not intended to cover exhaustively the subjects it addresses but rather to answer some of the important, broad questions that may arise for the reader. When specific issues arise in practice, it will be necessary to refer to the laws, regulations and interpretations of the PRC. Since the laws and regulations are still evolving and are not always uniformly interpreted, it is advisable to obtain appropriate professional advice.

If you would like more information on any of our services described on pages 23 to 24, please contact one of our specialists listed at the back of this booklet.

The commentary in this booklet does not cover taxes levied in Hong Kong and Macao, which became Special Administrative Regions of the PRC on 1 July 1997 and 20 December 1999 respectively. Hong Kong and Macao continue to retain their own tax systems and the taxes applicable in Mainland China do not apply in Hong Kong and Macao.

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Overview

An overview of PRC taxes

The People's Republic of China levies a wide range of taxes including income taxes (corporate income tax and individual income tax), turnover taxes (value added tax, business tax and consumption tax), taxes on real estates (land appreciation tax, real estate tax and urban and township land-use tax) and other taxes such as deed tax, stamp duty, custom duties, motor vehicle acquisition tax, vehicle and vessel tax and resource tax.

There is no capital gains tax as such in the PRC. Gains on the sale of fixed assets are taxable as ordinary income.

Tax administration

China's major tax laws are passed by the People's Congress, and implementation regulations formulated by the State Council. The Ministray of Finance ("MOF") and the State Administration of Taxation ("SAT") are delegated to provide interpretation and implementation of the tax laws and regulations. Meanwhile the SAT is also responsible for supervising the enforcement of the tax collection at the local levels.

The tax administration of enterprises, including domestic enterprises, foreign investment enterprises ("FIEs") and foreign enterprises ("FEs"), and individuals, including chinese residents and foreign residents is administered by two separate lines of tax bureau, namely the local branches of the SAT and the local branches of the Local Tax Bureau. Generally, value added tax ("VAT") is administered by the local branches of the SAT whereas business tax ("BT"), individual income tax ("IIT") and other local taxes are administered by the local tax bureaux. With the introduction of the new corporate income tax ("CIT") in 2008, the allocation of administration duties of CIT are as follows: for enterprises established before 1 January 2009, CIT is generally handled by the local branches of the SAT; for enterprises established on or after 1 January 2009, CIT of enterprises which are mainly VAT taxpayers is generally administered by the local branches of the SAT, while CIT of enterprises which are mainly BT taxpayers is generally administered by the local branches of the Local Tax Bureau. There are adjustments and variations adopted in the tax administration from time to time.

Investment restrictions on foreign investors

Foreign companies, enterprises or individuals may, subject to approval from the Ministry of Commerce or other relevant ministries, establish equity joint ventures, contractual joint ventures or wholly foreign-owned enterprises in the PRC. Starting from 1 March 2010, foreign investors are allowed to establish partnership in China.

The minimum registered capital of a FIE is as follows:

Amount of total investment	Minimum registered capital
US$3 million or less	70% of total investment
US$3-10 million	Higher of US$2.1 million or 50% of total investment
US$10-30 million	Higher of US$5 million or 40% of total investment
More than US$30 million	Higher of US$12 million or 33.3% of total investment

Foreign investment is categorised as encouraged, permitted, restricted or prohibited.

Encouraged: certain agriculture, forestry, animal husbandry and fisheries projects; mining; manufacturing; production and supply of electricity, gas and water; certain transportation and warehousing services; logistics; rent and commercial service; scientific research, technical service and geological exploration; water, environment and public facility management; higher education; service organisations for elders, handicapped and children; certain culture, sports and entertainment business, etc.

Restricted: certain agriculture, forestry, animal husbandry and fisheries (e.g. breeding and seeds developing, processing of precious varieties of trees, cotton (raw cotton) processing); mining of precious metal and certain ores; certain manufacturing (e.g. soda beverage manufacturing, tobacco processing, etc.); certain production and supply of electricity, coal and water; certain transportation and telecommunications services; wholesale and retail of certain products; banking and insurance industries; real estate industry in high end property market; certain leasing and commercial services; certain scientific research and technical services; certain environment and public utilities management; high-school education; medical institutions; art, sports and entertainment industries and other industries that are restricted by the State or by international treaties concluded or acceded to by the PRC; etc.

Prohibited: certain agriculture, forestry, animal husbandry and fisheries (e.g. breeding and growing of precious, high-quality breeds, production and development of genetically modified plants' seeds, etc.); mining (mining of radioactive minerals, rare earth, exploring and mining of tungsten, molybdenum, tin, antimony, fluorite, etc.); certain manufacturing (e.g. Chinese medicine manufacturing, arms and ammunition manufacturing, etc.); certain production and supply of electricity, gas and water; air traffic control and postal services; social investigation; compulsory education; certain scientific research and geological exploration; gambling, pornography, publication of books and newspaper, production and importation of audio visual products and other industries that are prohibited by the State or by international treaties concluded or acceded to by the PRC. etc.

Permitted: not falling within encouraged, restricted or prohibited.

Corporate income tax ("CIT") law

The CIT law which took effect from 1 January 2008 consolidates the two former separate enterprise income tax regimes, one for domestic-invested enterprises and one for FIEs and FEs, into a single regime. In addition, the new CIT law provides for a fundamental change in China's tax incentive policies for shaping and directing the future development of the economy of the country.

Concept of "tax resident enterprise" ("TRE")

Tax resident enterprise ("TRE") is a new concept in the CIT Law. TRE refers to an enterprise established according to the Chinese law or an enterprise established according to foreign law but with its effective management located in China. TREs are subject to CIT on worldwide income while non-TREs only on China sourced income. Enterprises registered in China are always TRE. A FE with effective management in China is also regarded as a "TRE". This new concept goes beyond the "permanent establishment" concept which taxes FEs only on their China sourced income.

Tax rate for TREs

The standard CIT rate is 25%. A lower tax rate is available for qualified small and thin-profit enterprises (20%) and for qualified new/high tech enterprises (15%).

Withholding income tax rate for non-TREs

Withholding income tax ("WHT") rate for passive income derived by Non-TREs is 20% under the CIT Law and is reduced to 10% under the Detailed Implementation Regulations ("DIR") of the CIT Law. This unilaterally concessionary WHT rate is applicable to dividend, interest, rental, royalty, and other passive income such as the gains from the sale or transfer of real estate property, land use right and shares in a PRC company.

WHT rates may be lower than 10% or exempted under a tax treaty.

Tax incentive policies

The CIT regime adopts the "predominantly industry-oriented, limited geography-based" tax incentive policy. Key emphasis is placed on "industry-oriented" incentives aiming at directing investments into those industry sectors and projects encouraged and supported by the State. The new tax incentive policies mainly include:

Tax reduction and exemption

CIT may be reduced or exempted on income derived from the following projects:

Projects/industries	CIT incentive[3]	Valid period
Agriculture, forestry, animal-husbandry and fishery projects	Exemption or 50% reduction	All years as long as it is engaged in these projects
Specified basic infrastructure projects[1]	3 + 3 years tax holiday	Starting from the 1st income-generating year
Environment protection projects and energy/water conservative projects[2]	3 + 3 years tax holiday	Starting from the 1st income-generating year
Qualified new/high tech enterprises established in Shenzhen, Zhuhai, Shantou, Xiamen, Hainan and Pudong New Area of Shanghai newly established after 1 January 2008	2 + 3 years tax holiday[4]	Starting from the 1st income-generating year
Software production enterprises	2 + 3 years tax holiday	Starting from the 1st profit-making year
Integrated circuits ("IC") production enterprises with a total investment exceeding RMB8 billion, or which produce IC with a line-width of less than 0.25um provided that its operation period exceeds 15 years	5 + 5 years tax holiday	Starting from the 1st profit-making year
IC production enterprises which produce IC with a line-width of less than 0.8um	2 + 3 years tax holiday	Starting from the 1st profit-making year

Notes:
1. Including harbour, wharf, airport, railway, highway, city public transportation, electric power, water resources utilisation projects, etc.
2. Including public sewage treatment, public refuse treatment, comprehensive development and utilisation of methane, technologies alteration for energy-saving and emission reduction, seawater desalination projects, etc
3. “2 + 3 years tax holiday” refers to two years of exemption from CIT followed by three years of 50% reduction of CIT; similarly, “3 + 3 years tax holiday” refers to three years of exemption plus three years of 50% reduction of applicable CIT.
4. New/high tech enterprises in these cities/areas enjoy reduced tax rate (see below). In addition, they also enjoy “2 +3 years tax holiday”. During the 3 years of 50% reduction of CIT, the applicable CIT rate is 12.5%.

For income derived by a TRE from the transfer of qualified technology in a tax year, the portion that does not exceed RMB5 million shall be exempted from CIT; and the portion that exceed RMB5 million shall be allowed a half reduction of CIT.

CIT is exempted on dividend derived by a TRE from the direct investment into another TRE except for the case that the investment income is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

CIT is exempted on income derived by non-profit-making organisations from engaging in non-profit-making activities.

Reduced tax rate

Qualified new/high tech enterprises are applicable to the reduced CIT rate of 15%. An enterprise has to fulfil a set of prescribed criteria and be subject to assessment in order to be qualified as a new/high tech enterprise.

IC production enterprises with a total investment exceeding RMB8 billion, or which produce integrated circuits with a line-width of less than 0.25um are applicable to the reduced CIT rate of 15%.

From 1 January 2009 to 31 December 2013, qualified technology-advanced service enterprises in 20 cities (such as Beijing, Shanghai, Tianjian, Guangzhou, Shenzhen, etc.) are applicable to a reduced CIT rate of 15%.

Qualified small and thin-profit enterprises are applicable to the CIT rate of 20%. An enterprise has to fulfil certain conditions in order to be qualified as a small and thin-profit enterprise.

Reduction of revenue

Where an enterprise uses resources specified by the State as its major raw materials to produce non-restricted and non-prohibited products, only 90% of the total income derived may be assessed as taxable total income.

Offset of certain venture capital investment

For a venture capital enterprise that makes an equity investment in a non-listed small-to-medium sized new/high tech enterprise for more than 2 years, 70% of its investment amount may be used to offset against the taxable income of the venture capital enterprise in the year after the holding period has reached 2 years. Any portion that is not utilised in that year may be carried forward and deductible in the following years.

Investment tax credit

Enterprises purchasing and using plant and machinery specified by the State for environmental protection, energy and water conservation, or production safety purposes may claim 10% of the investment in such equipment to offset against its CIT payable.

Grandfathering of previous preferential tax treatments

Before the new CIT became effective, there were reduced tax rate and tax holiday benefits for FIEs based on geographical locations. In order to provide transitional relief to the adversely affected taxpayers due to the increase of tax rates and cancellation of tax holiday benefits provided under the former tax regimes, enterprises established on or before 16 March 2007 will still be able to enjoy, to a certain extent, reduced tax rate and tax holiday treatments in accordance with the former income tax laws.

Further, dividends distributed by FIEs out of pre-2008 profit to foreign shareholders are exempted from withholding income tax. For the purpose of this exemption, the aggregate equity held by the foreign investors in a FIE has to exceed 25% of its total equity.

In addition, the following income tax treatments are also offered by the State during the transitional period from 1 January 2008 to the end of 2010:

- If investors of an IC production or encapsulation enterprise use the after-tax profits derived from that enterprises to increase the registered capital of that IC production or encapsulation enterprise or use such profits as capital to invest in another IC production or encapsulation enterprise in China with an operating period of not less than 5 years, they shall be entitled to a refund of 40% of the CIT previously paid on the reinvested profits.
- If investors reinvest their after-tax profits derived from China to establish IC production enterprises, encapsulation enterprises or software production enterprises located in the western region which operates for a period of not less than 5 years, they shall be entitled to a refund of 80% of the CIT previously paid on the reinvested profits.
- Enterprises established in the western region and engaged in encouraged projects may be applicable to a reduced CIT rate at 15%. In addition, for certain infrastructure projects, they may be eligible for a "2 + 3 years tax holiday".

Tax deductions and other treatments

Depreciation

Wear and tear allowances are granted on fixed assets and other capital assets used in the production of income. Production-nature biological assets are also classified as capital assets under the CIT regime and can also be depreciated. Generally the straight-line method of depreciation is allowed.

Depreciation on fixed assets and production-nature biological assets is computed beginning from the month following that in which the assets are put into use and ceasing from the month following that in which the assets are no longer used.

Minimum depreciation periods for different kinds of assets are specified as follows:

Asset	Period
Buildings and structures	20 years
Aircrafts, train, vessels, machinery, mechanisms and other production equipment	10 years
Appliances, tools, furniture, etc,	5 years
Means of transport other than aircrafts, trains and vessels	4 years
Electronic equipment	3 years
Production-nature biological assets in the nature of forestry	10 years
Production-nature biological asset in the nature of livestock	3 years

Accelerated depreciation

Shorter tax depreciation life or accelerated depreciation is allowed for particular types of fixed assets due to advancement of technology or suffering from constant vibration or severe corrosion.

Where shorter depreciation period method is applied, the minimum depreciation period shall not be less than 60% of the minimum depreciation period as prescribed in the CIT Law; where accelerated depreciation method is applied, double declining balance method or sum-of-years-digits method may be used.

Intangibles

Intangible assets are amortised by the straight-line method over a period of not less than ten years or the stipulated time limit set out in the contract or agreement under which use of the intangible asset is made available.

Purchased goodwill is not deductible until the enterprise is entirely transferred or liquidated.

Management fees

Management fees of stewardship nature are not deductible. However, service fees paid for valuable services and charged at arm's length may be allowed for deduction.

Interest on loans

Interest on loans is generally deductible. For interest expenses on borrowings from non-financial institutions by a non-financial institution, the portion that does not exceed the commercial rate is deductible.

Interest of capital nature has to be capitalised and depreciated or amortised.

The deductions of interest paid to related parties are subject to the thin capitalisation rule under the new CIT (see explained below).

Entertainment

60% of the actually incurred entertainment expense is deductible but the deduction shall not exceed 0.5% of the sales or business income of that year.

Commercial insurance premiums for individuals

Commercial insurance premium paid for employees and individual investors of an enterprise is not deductible unless it is paid for safety insurance for workers conducting special types of works.

Advertising and business promotion expenses

Advertising expenses and business promotion expenses are deductible up to 15% (30% for certain specified industries) of the sales (business) income of that year unless otherwise ruled in the tax regulations. Any excess amount is allowed to be carried forward and deductible in the following tax years. Advertising expenses and business promotion expenses incurred by tobacco industry is entirely disallowed for deduction.

Super deductions

R&D expenses incurred by an enterprise for new technology, new products or new craftsmanship are deductible. An extra 50% of the actual expenses incurred by the enterprise is also deductible as an incentive.

Also as incentive, 200% of the actual salary expenses paid to handicapped staff are deductible.

Other non-deductible expenses

Provisions for asset impairment reserves and risk reserves are generally not deductible unless otherwise prescribed in the tax regulations.

Non-advertising in nature and non-charitable in nature sponsorship expense is non-deductible.

Inventory valuation

Inventory of commodities, finished products, work-in-progress, semi-finished goods and raw materials of an enterprise must be valued according to costs. In computing the cost of inventories that are sold or used for delivery, the enterprise may choose one of the following methods: first-in first-out, weighted average or specific identification.

Loss carryovers

Tax losses incurred by an enterprise may be carried forward for a period of up to five years, subsequent to the year of the loss.

Treatment of dividends

Dividends between TREs are not taxable except for the case that the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

Currency

CIT is computed in renminbi (RMB) currency. Income in foreign currency is converted into RMB for tax payment purposes.

Exchange gains or losses are generally taxable or deductible regardless whether realised or unrealised unless otherwise prescribed by the tax regulations.

Deemed taxable income

If an enterprise cannot submit complete and accurate documentation of its costs and expenses to enable its taxable income to be calculated, the chinese tax authorities may assess a taxable income. Normally, a deemed profit percentage is applied to its gross income or turnover. This deemed profit percentage will vary depending on the industry in which the enterprise operates and will usually be between 3% and 30%.

Foreign tax credit

A TRE may credit against the PRC tax payable the foreign income tax already paid overseas in respect of income derived from sources outside the PRC based on a country-basket principle. However, the creditable amount may not exceed the amount of income tax otherwise payable in the PRC in respect of the non-china sourced income.

Corporate restructuring

Generally, gains (or losses) of all corporate restructuring (including debt restructuring, share acquisition, assets acquisition, merger and spin-off) shall be subject to CIT (deductible for CIT purposes) when the transaction takes place. Fair value shall be used to determine the gains or losses. Restructuring transactions meeting certain prescribed conditions are eligible for concessionary treatment, i.e., the realisation of the gain arising from the corporate restructuring may be deferred wholly or partly to later years, and the resulting tax liabilities may be effectively deferred.

Anti-tax avoidance rules

The CIT regime devotes a whole chapter to cover transfer pricing rules, and advance pricing arrangements ("APA"), and introduce many new concepts for tax avoidance:

Related party transactions

All enterprises are required to conduct revenue and capital transactions with related parties on an arm's-length basis. The Chinese tax authorities pay special attention to transfer pricing practices and have broad powers to disregard, vary or make adjustments to related party transactions that reduce taxable income of an enterprise.

Documentation of related party transactions

China adopts stringent requirements on filing and submission of related party information for transfer pricing enforcement. Taxpayers are required to file annual related party transactions reports as part of their corporate income tax annual return package on or before the statutory filing due date which is 31 May of each year. In addition, enterprises are required to prepare transfer pricing documentation in place for inspection upon request by the Chinese tax authorities. Enterprises meeting certain conditions are exempted from such documentation requirement. With the existence of such documentation, the enterprise may avoid an addition "interest levy" of 5% on any transfer pricing adjustments.

Cost sharing

Cost sharing is allowed in respect of intangible assets developed and shared among related parties, and for the provision and receiving of common services (generally limited to group procurement and group marketing strategies) if the sharing basis is on arm's length as assessed by the chinese tax authorities.

Controlled foreign corporation rules ("CFC Rules")

CFC rules are introduced such that undistributed profits derived by CFCs located in low-tax jurisdictions with an effective income tax rate less than 12.5% may be taxed in China as a deemed distribution. A group of countries is specifically exempted from the designation of low-tax jurisdictions ("White List") by the Chinese tax authorities.

Thin-capitalisation rule

Thin-capitalisation rule is introduced to disallow interest expense arising from excessive related party loans. The safe harbour debt/ equity ratio for enterprises in the financial industry is 5:1 and for enterprises in other industries is 2:1. However, if there is sufficient proof to show that the financing arrangement is at arm's length, these interests may still be fully deductible even if the ratios are exceeded.

General anti-avoidance provision

There is a general anti-avoidance provision allowing the Chinese tax authorities to make adjustments to taxable revenue or taxable income where business transactions are regarded as arranged without reasonable commercial purpose. The Chinese tax authorities may commence, upon approval by the State Administration of Taxation, general anti-avoidance investigation if they suspect that an enterprise undertakes any of the following transactions: abuse of preferential tax treatments, abuse of tax treaties, abuse of corporate structure, use of tax havens for tax avoidance purposes or other arrangements that do not have a reasonable commercial purpose.

Interest levy on tax adjustments

Tax adjustments made by tax authorities under the anti-avoidance chapter may be subject to interest levy at the base rate for loans announced by the People's Bank of China plus a penalty interest of 5%. If the enterprise has complied with the transfer pricing documentation requirements, the 5% penalty interest may be waived.

CIT filing and payment

Tax period

The tax year in the PRC is the calendar year.

Consolidated CIT filing

TREs in China are not allowed to file consolidated returns on a group basis unless otherwise prescribed by the State Council. Up to now, the State Council has not yet clarified the conditions and criteria for adopting group consolidated CIT filing.

However, a non-TRE having two or more establishments in the PRC may select one establishment for combined tax filing and payment. That establishment must meet the following requirements:

- it assumes supervisory and management responsibility over the business of the other establishment(s); and
- it keeps complete accounting records and vouchers that correctly reflect the income, costs, expenses, profits and losses of the other establishment(s).

Tax filing

Annual tax return has to be filed on or before 31 May following the end of a tax year (subject to local variation). Provisional reporting and payments have to be made on a monthly basis or quarterly basis which is determined by the in-charge tax authorities.

Individual income tax liability

Individuals domiciled in the PRC are subject to China individual income tax ("IIT") on their worldwide income.

Foreign individuals residing in the PRC for less than one year are subject to IIT on their PRC sourced income only. Remuneration from foreign employers to individuals working in the PRC is exempt from tax if the individual resides in the PRC for less than 90 days in a calendar year, provided that the remuneration is not borne or paid by an establishment in the PRC. This 90-day period may be extended to 183 days if the individual is entitled to protection under a tax treaty/tax arrangement.

Employees of foreign employers can reduce their IIT liability and be taxed based on the actual number of days residing in the PRC if certain criteria are met.

Individuals who do not domicile in the PRC but reside in the PRC between one to five years may, with approval, pay tax only on their PRC sourced income and non-PRC sourced income, the payment of which is borne by PRC establishments. They will be taxed on their worldwide income for each full year residing in the PRC from the sixth year onward.

Individual income tax rates for employment

Income from wages and salaries is taxed according to the following progressive rates, ranging from 5% to 45%:

Monthly taxable income*		Tax on lower amount	Percentage on excess %
Over	Not over		
RMB 0	RMB 500	RMB 0	5
500	2,000	25	10
2,000	5,000	175	15
5,000	20,000	625	20
20,000	40,000	3,625	25
40,000	60,000	8,625	30
60,000	80,000	14,625	35
80,000	100,000	21,625	40
100,000		29,625	45

* Monthly taxable income is calculated after a standard monthly deduction of RMB2,000 (starting from 1 March 2008)). For foreign individuals working in China (including residents of Hong Kong, Taiwan and Macau), the standard monthly deduction is increased to RMB4,800 (starting from 1 March 2008).

If the individual income tax is borne by the employer, a different tax rate table will be used to reflect the tax-on-tax effect.

Employment benefits

For IIT purposes, taxable income refers to “wages, salaries, bonuses, year-end bonus, profit shares, allowances or subsidies or other income related to job or employment”.

Certain employment benefits for foreign individuals could be specifically treated as not being taxable under the IIT law if certain criteria can be met. These include:

- employee housing costs (with supporting invoices) borne by an employer;
- reasonable home leave fares of 2 trips per annum for the employee (with supporting invoices);
- reasonable employee relocation and moving costs (with supporting invoices); and
- reasonable reimbursement of certain meals, laundry, language training costs and children’s education expenses in the PRC (with supporting invoices).

Any cash allowance paid to cover expected work-related expenditures (such as an entertaining or travel allowance) will be fully taxable to an employee. IIT may be reduced by reimbursing specific work-related expenses incurred by an employee (which may include entertainment, health or social club fees, local travel, newspapers and journals, telephone costs, etc.) instead of paying an allowance. The expense reimbursement may not be subject to IIT if prescribed administrative procedures are followed.

Income other than employment income

Proprietors; contracting and leasing

Operating profit of individual industrialists and merchants production and business operations or from the contracting or leasing of operations of enterprises and institutions is subject to tax at progressive rates ranging from 5% to 35%. The 35% marginal rate applies to annual taxable income (gross revenue less allowable costs, expenses and losses) over RMB50,000.

Income of authors

Such income is taxed at a flat rate of 20%, applied to 70% of gross authorship income.

Compensation for personal services

Such income is taxable at 20% if the taxable income (after allowable deductions) from a single payment does not exceed RMB20,000; 30% for the portion over RMB20,000 but not exceeding RMB50,000; and 40% for the portion exceeding RMB50,000.

Royalties, interest, dividends, leases on or assignment of property, other income

Such income is taxed at a flat rate of 20%.

Allowable deductions

On income from the contracting and leasing of operations of enterprises and institutions, a monthly deduction of requisite expenses of RMB2,000 is allowed. On income from compensation for personal services, royalties, or leases on property, a deduction of RMB800 is allowed if the income received in a single payment is less than RMB4,000. If the income received in a single payment is more than RMB4,000, a 20% deduction is allowed. No deduction is allowed against income from interest, dividends, bonuses or other income. For transfers of property, the original cost plus reasonable expenses are deductible.

Tax filing and payment

IIT is normally withheld from wages or salaries by employers and paid to the tax authorities on a monthly basis. Individual income tax returns must be filed within 7 days following the end of each month.

Annual IIT self reporting requirement

Starting from 1 January 2007, individuals under four circumstances are required to perform annual self-IIT reporting with the PRC tax authorities. Foreign individuals may be exempted from this obligation in certain situations.

Other taxes

Value-added tax ("VAT")

Turnover tax includes VAT and business tax. Whether an enterprise should pay VAT or business tax depends on the nature of its business and the type of products/services involved. VAT applies to enterprises engaged in importation, production, distribution or retailing activities in respect of tangible goods and a few prescribed services. Input VAT incurred (i.e. the VAT paid on goods, certain prescribed VAT-able services and equipment acquired) may be credited against output VAT (i.e. the VAT collected from the customers) in computing the VAT payable.

The general VAT rate is 17% but necessities, such as agricultural and utility items, are taxed at 13%. Certain limited categories of goods are exempt from VAT.

Enterprises regarded as small businesses (annual production sales of less than RMB0.5 million or annual wholesale or retail sales of less than RMB0.8 million) are subject to VAT at the rate of 3%. Unlike other VAT payers, small businesses are not entitled to claim input VAT credits for the VAT paid on their purchases.

Export of goods from China may be entitled to a refund of VAT incurred on materials purchased domestically. As the refund rates ranges from 0% to 17% and there is a prescribed formula for determining the amount of refund, many products do not enjoy the full refund of input VAT credit and suffer different degree of export VAT costs.

Business tax

Enterprises may be liable to business tax instead of VAT, depending on the business or assets involved. Business tax is imposed on services provided by enterprises, except for a few prescribed services, as long as either the service provider or the service recipient is within China. In addition, the transfer of immovable properties and intangible assets in China are also liable for business tax.

Business tax is levied on gross turnover at rates between 3% and 20%. The most common rates are either 3% or 5%. Limited exemptions from business tax may apply to some services.

Consumption tax

Consumption tax is levied on manufacturers and importers of specified categories of consumer goods, including tobacco, alcoholic beverages, ethyl alcohol, cosmetics, jewellery, fireworks, gasoline and diesel and certain petroleum products, automobile tyres, motorcycles, automobiles, golf equipment, yacht, luxury watch, disposable chopsticks and wooden floorboard. The tax liability is computed based on the sales amount and/or the sales volume depending on the goods concerned. Consumption tax is imposed in addition to applicable customs duties and VAT.

Other taxes

Land appreciation tax ("LAT")

LAT is levied on certain gains realised from real property transactions at progressive rates from 30% to 60%, based on the "land value appreciation amount" which is the consideration received from the transfer or disposition of real property less the "total deductible amount".

For taxpayers engaged in a real estate development business, the "total deductible amount" includes:

- the amount spent on obtaining the land use right;
- costs and expenses of land development;
- costs and expenses of the construction of new buildings and supplementary facilities;
- taxes in connection with the transfer of real property (generally business tax and stamp tax); and
- other deductions as determined by the Ministry of Finance.

For taxpayers engaged in a real estate development business, an additional deduction equal to 20% of the sum of the first three cost items noted above is allowed.

Finance expenses, such as interest, may be deducted in certain circumstances. Other real property development expenses (i.e. selling and administrative) are limited to 5% of the total amount expended to acquire the land use right and the costs of land development and construction.

For disposal of used properties, the deductible amount includes the assessed value of the used building and the taxes incurred upon the disposal.

Customs duties

In general, customs duty is charged in either specific or ad valorem terms. For specific duty, a lump sum amount is charged based on a quantitative amount of the goods, e.g. RMB 100 per unit or per kg. Ad valorem duty is charged based on the customs value of the goods. Under the ad valorem system, the customs value of the goods is multiplied by an ad valorem duty rate to arrive at the amount of duty payable.

The applicable duty rate is generally determined based on the origin of the goods. The origin of a product also plays a part in determining the applicability of a number of other policies such as: quotas, preferential tariffs, anti-dumping actions, countervailing duty etc. For goods originated from WTO members, the most favoured nation ("MFN") duty rate is generally applicable unless other policy, such as preferential tariff (e.g. under a free trade agreement), anti-dumping duty and countervailing

duty, is applied. Preferential tariff (which is generally lower than the MFN duty rate) may be claimed by an importer if the goods are originated from a free trade agreement ("FTA") member and such goods are covered by the FTA. Obviously, all other conditions stipulated in the FTA, such as the FTA rules of origin, direct consignment requirements and documentation requirements, must also be satisfied by the importer to claim such benefits.

Customs duty is exempt on machinery and equipment imported by a FIE within the amount of its total investment, for its own use if the project falls within the encouraged category of the new "Catalogue Guiding Foreign Investors on Industries for Investment", and the imported machinery or equipment is not within the listed of commodities that are non-exempted for importation.

Limited exemptions from customs duty may also apply to machinery and equipment and other goods which are temporarily imported into the PRC, provided they are re-exported. The temporary importation period is generally six months, although this period may be extended to one year. A deposit for the duty may be required.

Customs duty and VAT exemption may be allowed on importation of raw materials for contract processing or import manufacturing.

Goods may be imported into, and exported out of, designated Free Trade Zones such as the Waigaoqiao Free Trade Zone in the Pudong New Area, Shanghai, without liability to customs duty or VAT.

Stamp tax

All enterprises and individuals who execute or receive "specified documentation" are subject to stamp tax. Rates vary between 0.005% on loan contracts to 0.1% for property leasing and property insurance contracts. A flat amount of RMB5 applies to certification evidencing business licences and patent, trademark or similar rights.

Real estate tax

Real estate tax is a tax imposed on the owners, users or custodians of houses and buildings. The tax rate is 1.2% of the original value of buildings. A tax reduction of 10% to 30% is commonly offered by local governments. Alternatively, tax may be assessed at 12% of the rental value.

Motor vehicle acquisition tax

Motor vehicle acquisition tax at a rate of 10% of the taxable consideration will be levied on any purchase and importation of cars, motorcycles, trams, trailers, cart and certain types of trucks.

Other taxes

Deed tax

Deed tax, generally at rates from 3% to 5%, may be levied on the purchase or sale, gift or exchange of ownership of land use rights or real properties. The transferee/assignee is the taxpayer.

Vehicle and vessel tax

Vehicle and vessel tax is a tax that is levied on all vehicles and vessels registered within the PRC. A fixed amount is levied on either a yearly or quarterly basis. Transport vehicles are generally taxed on a fixed amount according to own weight, with passenger cars, buses and motorcycles being taxed on a fixed unit amount. Vessels are taxed on a fixed amount according to deadweight tonnage.

Urban and township land-use tax

Urban and township land-use tax is levied on taxpayers who utilise land within the area of city, country, township and mining districts. It is computed, on an annual basis, based on the space of area actually occupied by a taxpayer multiplied by a fixed amount per square meter that is determined by the local governments.

Resource tax

Resource tax may be levied, generally on a tonnage or volume basis, at rates specified by the Ministry of Finance in consultation with relevant ministries of the State Council on natural resources including crude oil, natural gas, coal, other raw non-metallic metals, raw ferrous metals, non-ferrous metallic minerals and salt (including solid and liquid salt).

In lieu of resource tax, mine area usage fees are collected from joint ventures exploiting crude oil or natural gas.

Capital gains tax

There is no capital gains tax as such in the PRC. Gains on the sale of fixed assets are taxable as ordinary income. The transfer of immovable properties and intangible assets may also give rise to a business tax liability. LAT may also be payable in respect of certain gains realised from real property transactions.

Tax treaties/arrangements

Foreign tax relief (for PRC tax residents) and exemption or reduction in PRC tax (for foreign tax residents) may be offered under a tax treaty (or arrangement) to which the PRC is a party. Tax treaties may operate to reduce the amount of withholding income tax or CIT payable in the PRC by a FE or a foreign individual. A tax treaty may also operate to reduce the amount of overseas withholding or income tax payable by a resident of the PRC. Tax treaties exist with the following countries or jurisdictions:

Albania	Indonesia	Philippines
Algeria	Iran	Poland
Armenia	Ireland	Portugal
Australia	Israel	Qatar
Austria	Italy	Romania
Azerbaijan	Jamaica	Russia
Bahrain	Japan	Saudi Arabia
Bangladesh	Kazakstan	Seychelles
Barbados	Korea, Rep. of	Singapore
Belarus	Kuwait	Slovak Republic
Belgium	Kyrgizastan	Slovenia
Brazil	Laos	South Africa
Brunei	Latvia	Spain
Bulgaria	Lithuania	Sri Lanka
Canada	Luxembourg	Sudan
Croatia	Macao SAR	Sweden
Cuba	Macedonia	Switzerland
Cyprus	Malaysia	Tajikistan
Czech Republic	Malta	Thailand
Denmark	Mauritius	Trinidad and Tobago
Egypt	Mexico	Tunisia
Estonia	Moldova	Turkey
Ethiopia	Mongolia	Ukraine
Finland	Morocco	United Arab Emirates
France	Nepal	United Kingdom
Georgia	Netherlands	United States
Germany	New Zealand	Uzbekistan
Greece	Nigeria	Venezuela
Hong Kong SAR	Norway	Vietnam
Hungary	Oman	Yugoslavia
Iceland	Pakistan	
India	Papua New Guinea	

Foreign exchange administration

Foreign exchange transactions are administered by the State Administration of Foreign Exchange ("SAFE") and its branches.

The regulatory administration on foreign exchange transactions by a FIE depends on whether the transaction is a current account item or a capital account item. Under the PRC Foreign Exchange Administration Regulations, current account items refer to ordinary transactions within the context of international receipts and payments, including balance of payments from trade, labour services, unilateral transfers, etc. Capital account items refer to items of increase or decrease in debt and equity due to inflow or outflow of capital within the context of international receipts and payments, including direct investment, all forms of loans, investment in securities, etc.

If a transaction falls under the category of capital account items, generally prior approval from the SAFE should be obtained.

Generally, if a transaction falls under the category of current account items, a FIE can purchase and sell foreign currency through designated banks on the interbank foreign exchange trading system without prior approval of the SAFE. When a FIE has to make a payment in foreign currency, it can instruct its bank to pay from its foreign exchange account. In the meantime, it should provide supporting documents such as contracts, invoices and shipping documents to the bank.

In order to slow down the inflow of "hot money" which may potentially affect the stability of China's economy, the SAFE introduced a few measures in 2008 to tighten up the administration of foreign currency inflow on both current and capital account items. One of the measures is that when a FIE receives payment in foreign currency from exports, the receiving bank is requested to impose a quota which is the maximum amount of foreign currency the exporter is allowed to convert into RMB. Another example is that FIEs are not allowed to convert their registered capital into RMB to invest in real properties or equity interest in other companies except for certain conditions.

PricewaterhouseCoopers' services and solutions in China

PricewaterhouseCoopers offers a wide range of tax and business advisory solutions to companies with operations in the PRC. These include:

Accounting services

Initial set-up of accounting system, cashier services, prepare PRC books in compliance with PRC statutory requirements, compilation of management accounts.

Corporate restructuring

Advise on share transfers, transfers of businesses, reorganisations of the capital and assets of enterprises, and liquidations.

Corporate tax compliance and planning

Preparation and submission of corporate income tax and turnover tax returns. Negotiations with the tax authorities on corporate tax compliance issues, advice on tax planning opportunities.

Customs & trade solutions

Assist in identifying import and export savings opportunities and compliance needs.

Distribution strategies

Advise on strategies to optimise the opportunities in China's distribution market within the latest legal framework.

Establishment of representative offices and PRC wholly foreign-owned enterprises

Set up representative offices and PRC entites, obtain business licenses and tax registrations, confirm for appropriate tax reporting methods, tax compliance, etc.

Foreign contractors

Tax effective structuring for foreign contractors involving in China power plant and infrastructure projects, contract reviews, registrations, tax bureau negotiations, compliance requirements.

Handling tax audits

Assist in preparing for a tax audit, handling queries from the tax authorities and negotiating tax settlements, etc.

PricewaterhouseCoopers’ services and solutions in China

Health check of PRC operations

Diagnose compliance of PRC operations with relevant rules and regulations, corrective actions, tax planning opportunities.

Indirect tax planning

Assist in actively managing indirect tax processes and exploring indirect tax saving opportunities.

Market entry advice

Assist in developing entry strategies and setting up entities and offices within China.

Mergers and acquisitions — due diligence reviews

Perform a full-scope due diligence review or a specific — procedures review of regulatory risks and tax exposures.

Payroll services

Assist in setting up initial payroll, payroll calculation and prepare employee pay slips, prepare and file employees’ PRC individual income tax returns and assist in settling tax payment.

PRC individual income tax planning and compliance

Help companies with foreign employees working in China to devise tax-effective compensation package, register their employees with the tax authorities, and prepare their monthly individual tax filings. Develop tax equalisation programs for China assignees.

Structuring of investment and financing

Advise on appropriate ownership structures and financing methods to minimise taxes and maximise returns.

Transfer pricing

Perform a risk assessment review of transfer pricing policies and related exposures, reporting requirements, documentation of policies, tax planning, obtaining Advance Pricing Agreements, etc.

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PricewaterhouseCoopers China, Hong Kong and Singapore operate on a combined basis, subject to local applicable laws. Taken together, we have more than 470 partners and a strength of 13,000 people. The China Tax Services group has more than 800 client service professionals — including over 50 tax partners and directors — committed to surpassing client expectations.

PricewaterhouseCoopers has been named by the International Tax Review in 2009 the Asia Tax Firm of the Year; **Tax Firm of the Year in China**, Hong Kong, India, Singapore, Taiwan, Thailand; Transfer Pricing Firm of the Year in Australia, Indonesia, Philippines, Thailand; Indirect Tax Firm of the Year in Indonesia.

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