

Break Through the Chinese Wall

**- Legal and practical guidelines
for establishing a company in China**

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About the book

“Break Through the Chinese Wall” is an accessible handbook which provides an introduction to the fundamental rules, regulations and common practices related to establishing and running a business in China. The handbook provides answers to the most frequently asked questions from our clients.

The handbook has been jointly written by Capital Associates and NCO China. Capital Associates is a Chinese law firm specialised in providing commercial legal services and assistance to foreign companies investing in and trading with China. NCO China is a consulting firm that offers corporate services with regard to the establishment of an enterprise in China, Hong Kong etc., and provides accounting, tax and HR services to foreign investors in China. Both Capital Associates and NCO China serve a variety of clients; from large multinational companies to small and medium sized enterprises.

China’s rapid development means that regulations and practices are constantly changing. The handbook is meant to be an introduction to the current laws and practices in China. Updates and further information regarding the subjects covered by the handbook can be obtained from our offices or websites. Please refer to the contact information in the back of the book.

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Tax in China

The government agency in charge of tax policy is the Ministry of Finance, whereas the State Administration for Taxation (SAT) is the agency responsible for tax collection. SAT is also responsible for drafting relevant regulations and detailed rules for the implementation of tax laws, supervision of local tax administrations, and organizing and executing the collection of taxes.

Types of taxes

Under the Chinese tax system there are currently 26 taxes, which can be classified into 8 categories:

- Turnover taxes (including Value Added Tax, Consumption Tax and Business Tax)
- Income taxes
- Resource taxes
- Property taxes
- Taxes for special purposes
- Behaviour taxes (including Vehicle and Vessel Usage Plate Tax, Stamp Duty, Deed Tax and Slaughter Tax)
- Agricultural taxes
- Customs duties

14 of the 26 taxes are currently applicable to enterprises with foreign investment and/or foreigners. The 9, which are most relevant for FIE's, will be discussed in detail below. They are:

- Enterprise Income Tax
- Value Added Tax
- Business Tax
- Consumption Tax

- Customs Duties
- Withholding Tax
- Property Tax
- Stamp Tax
- Individual Income Tax

Enterprise Income Tax

The Enterprise Income Tax rate for all enterprises in China, both foreign and domestic, is 25%.

The Enterprise Income Tax is calculated from the net income in a financial year. The tax is settled on an annual basis but paid quarterly with adjustments refunded. The final calculation is based on a year-end audit.

Enterprises that began operating before 1 January, 2008, when Enterprise Income Tax rates were calculated differently depending on whether the enterprise was a domestic or foreign enterprise, can enjoy the previous tax rate or tax exemptions for a defined period. The transitional preferential tax period is 5 years at tax rates to be increased from current tax to full tax rate. Enterprises involved in the high or new technology sector can obtain some tax incentives.

Value Added Tax (VAT)

All enterprises engaged in the sale or importations of goods to China are subject to a Value Added Tax. The standard rate of Value Added Tax is 17%. However, a reduced rate of 13% applies to specific products such as books and certain types of oils and gases.

Small businesses with a turnover of less than RMB 500,000 for industrial enterprises or RMB 800,000 for commercial enterprises pay a Value Added Tax of 3%.

Exports from China are not subject to Value Added Tax. Neither are:

- Imported goods processed for export
- Instruments and equipment imported for direct use in scientific research, experimentation and education
- Imported materials and equipment granted by foreign governments or international organizations

Business Tax

Business Tax is imposed on enterprises that provide services like consulting, entertainment, or transportation companies.

The Business Tax rate is between 3% and 20%, depending on the type of services provided. For most types of services the rate is between 3% and 5%.

Business tax may be exempt for some services, such as medical services provided by medical institutions, and educational services provided by schools and other educational institutions.

Consumption Tax

Consumption Tax is imposed on luxury goods, such as tobacco, alcohol, cosmetics and skin care products, jewellery, cars, motor-cycles and fuel.

All enterprises engaged in production or imports of taxable consumer goods within the territory of the PRC are subject to Consumption Tax. Enterprises processing taxable goods for others shall pay Consumption Tax based on the value of the raw material and the processing fee. Exported consumer goods are exempt from Consumption Tax.

The Consumption Tax rate depends on the type of good. The highest rates (up to 50%) are imposed on tobacco, alcohol and cars.

Consumption Tax must be filed and paid monthly.

Customs duties

The payers of customs duties include consignees, who import goods permitted by China, and consignors who export goods permitted by China. The former shall pay import duties and the latter shall pay export duties.

The tariff rates for imports fall into two categories: general tariff rates and preferential tariff rates. The general tariff rates apply to imports originating in the countries with which China has not concluded most-favoured-nation trade agreements. The preferential tariff rates apply to imports originating in countries with which China has concluded most-favoured-nation trade agreements.

Withholding Tax

In China, Withholding Tax is levied on overseas companies providing services to enterprises based in China. For example, when a company transfers net income (dividends, royalties, rentals or capital gains) from a Chinese affiliate to the foreign parent company, Withholding Tax is collected.

The general Withholding Tax rate is 10% with some exceptions; e.g. if the parent company is located in Hong Kong or Singapore, the Withholding Tax rate is only 5%. To obtain the 5% withholding tax rate, the parent company is required to own 25% or more of the shares of the Chinese affiliate. If the parent company owns less than 25% of the Chinese affiliate, the Withholding Tax rate is 10%.

Property Tax

Foreign invested enterprises, foreign organizations and foreign individuals only need to pay real estate tax levied on residential property. Taxpayers are owners, mortgagees, custodians and users of such properties.

The tax is calculated on a residual amount following a deduction of between 10% and 30% of the original value of the property. The provincial government, autonomous region or municipality directly under the central government determines the amount of the deduction.

Stamp Tax

Any enterprise, unit, business, individual, household or other who executes or receives specific contract documents, e.g. sales contracts and title transfer documents, are liable to pay Stamp Tax.

The tax rates are in general between 0.03% and 10% depending on the type of document.

Individual Income Tax

China has a global system of tax liabilities. That means that Individual Income Tax (IIT) is imposed on all income earned both in China and outside of China.

The IIT liability status is determined on the basis of the number of days the foreigner has effectively spent in China following a 90 (183) days rule. The 90 days rule applies to foreigners from a country, which has not signed a double taxation treaty with China, and the 183 days rule applies to countries that have signed such a double taxation treaty.

For the first 90 (183) days a foreigner spends in China, he/she only needs to pay IIT of the income earned in China from a Chinese source. If the stay is longer than 90 (183) days but less than 1 year, the foreigner also needs to pay IIT of income earned from a Chinese source and paid outside of China.

If the stay in China is longer than 1 year but less than 5 years, the income in China from non-Chinese sources, for instance income from the home country, will also be taxable.

When a foreigner has stayed more than five years in China, without residing outside of China for more that 90 consecutive days within the 5 years period, the Chinese government considers the foreigner as a full tax resident, and the foreigner must pay tax in China of his/her worldwide income; also of income from non-Chinese sources.

Days in China	China Source; income paid in China	China Source; income paid outside of China	Non-China Source; income paid in China	Non-China Source; income paid outside of China
Less than 90(183) days	Yes	No	Top Manager: Yes Staff: No	No
> 90 (183) ≡ 1 year	Yes	No	Top Manager: Yes Staff: No	No
> 1 year ≡ 5 years	Yes	Yes	Yes	No
More than 5 years	Yes	Yes	Yes	Yes

If a foreigner resides outside of China for more than 90 consecutive days, a new “5 years tax calculation” starts when the foreigner enters China again.

The IIT rate is calculated using a progressive scale. IIT is not

imposed on the first RMB 4,800 of the monthly earnings. Of the amount exceeding RMB 4,800, a tax rate of between 5% and 45% is used to calculate the IIT.

The below table lists the salary brackets, tax rates, and quick tax deduction amounts.

Monthly Taxable Income (RMB) > RMB 4.800	Tax %	Estimated "quick" deduction (RMB)
≦ 500	5	0
> 500 ≦ 2,000	10	25
> 2,000 ≦ 5,000	15	125
> 5,000 ≦ 20,000	20	375
> 20,000 ≦ 40,000	25	1,375
> 40,000 ≦ 60,000	30	3,375
> 60,000 ≦ 80,000	35	6,375
> 80,000 ≦ 100,000	40	10,375
> 100,000	45	15,375

The total tax liability is calculated as follows:

$$\text{IIT} = (\text{Income} - \text{RMB } 4,800) \times \text{tax rate} - \text{quick tax deduction}$$

Example with an income of RMB 60,000:

Monthly taxable income: $60,000 - 4,800 = 55,200$ RMB

Tax: $55,200 \times 30\% - 3,375 = 13,185$ RMB

Individuals in China with annual incomes of more than RMB 120,000 have to complete and submit an annual self-declaration of their income by the end of March the following year.

An expatriate package often includes a number of non-taxable benefits, such as housing, tuition fees for children, health insurance etc.

Preferential treatment

In 2008, a new Enterprise Income Tax Law was adopted. The law shifted the focus of incentives from a regional to a national level. Furthermore, the law signalled a move away from an export oriented to a domestically driven economy.

Another key point to note is that there was a considerable shift in emphasis towards the environmental industry rather than just attracting business regardless of its nature or impact on the environment.

Benefits are no longer granted to more traditional industries, such as manufacturing, but shifted to the budding technology and hi-tech sector, which is now eligible for a low 15% tax rate regardless of location, and a deduction for qualifying research and development expenses.

China also offers tax incentives (exemptions) to investments in projects relating to environmental protection, agricultural development, water conservation, production safety, high-tech development and public welfare undertakings. Certain tax breaks may also be granted to enterprises in special development zones and less developed western areas of the country with the "Go West Policy".

Ongoing changes in rules and regulations

The tax law and system in China is complex, and rules and regulations are often amended. It can be very difficult and time consuming to stay updated on changes in rates, declaration requirements, deadlines and interpretation of the numerous laws and regulations. It is therefore recommended that you seek professional advice for accounting and tax issues.

Frequently Asked Questions

1. *When does a company need to register for tax purposes?*

Within 30 days after a FIE obtains its Business License, the foreign enterprise needs to register with the SAT.

2. *When should taxes be reported and paid?*

The tax year in China ends on 31 December of a calendar year. If an enterprise commences business or terminates its business activities during the taxable year, and the actual business period of such taxable year is less than 12 months, the actual business period shall be treated as the taxable year.

It is compulsory to file a report and pay advances monthly or quarterly. Enterprises shall submit a prepaid tax return to the competent tax authority within 15 days of the end of the month, or the quarter, as the basis for tax prepayment.

Enterprises shall submit an annual tax return to the competent tax authority within five months of the end of the year and settle the payable and refundable tax payment. A financial report and other relevant information shall be attached to the tax return.

Taxes shall be calculated in renminbi. Where the income is calculated in a currency other than renminbi, it shall be converted into renminbi for tax payment.

3. *What is the timetable for tax declaration for RO and WFOE?*

The tax declaration requirements for RO and WFOE are:

Type of tax	RO	WFOE
Enterprise Income Tax	Every quarter + an annual declaration	Every quarter + an annual declaration
Business Tax	Every quarter	Every quarter
Consumption Tax/VAT	Monthly	Monthly
Individual Income Tax	Monthly for all employees	Monthly for all employees

4. *When a WFOE buys goods that are subject to VAT from a Chinese sub-supplier or a foreign sub-supplier, how much VAT can be “offset” in the accounts of the WFOE?*

Whether a WFOE purchases goods from a domestic supplier or an international supplier, the WFOE is required to pay VAT of 17% of the purchase value. The VAT can be fully offset by sales VAT as long as a proper special VAT fapiao is obtained.

Useful links

Help and advice when establishing a FIE in China

- www.capitallaw.cc
Capital Associates' website.
- www.ncochina.com
NCO China's website.

Government and organizations

- <http://english.gov.cn/index.htm>
The official website of the Chinese central government.
- www.ebeijing.gov.cn
Official website of the Beijing Municipal Government.
- www.shanghai.gov.cn
Official website of the Shanghai Municipal People's Government.
- www.china.org.cn
Government portal site to China that offers broad access to news about China.
- www.fdi.gov.cn
Website of the Chinese Ministry of Commerce directed to foreign investors. The site comprises government news and information about investment directions, economy, statistics and law.
- <http://english.mofcom.gov.cn/>
Official website of the Chinese Ministry of Commerce.

- www.chinainvest.com.cn
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- www.tdctrade.com
Hong Kong Trade Development Council's website. Provides information about CEPA.
- www.tid.gov.hk/english/cepa/
Website of Hong Kong Trade and Industry Department. Provides full text documents on all CEPA agreements and annexes.
- www.adb.org
Website of the Asian Development Bank.

Other sources of information about China

- www.transparency.org
Website of Transparency International, a coalition against corruption.
- www.hoover.org/publications/clm
Website of the Hoover Institution of Stanford University. Provides information about China's leadership politics and its foreign and domestic policies.
- www.chinaeconomicreview.com
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- www.worldbank.org/transitionnewsletter
World Bank newsletters on developing economies.

- www.cia.gov/library/publications/the-world-factbook/
U.S. CIA World fact book.
- www.expatsinchina.com
A guide for foreigners living in China.

Logistics

- www.maps-of-china.com
Maps of Chinese cities, provinces and regions in the principal areas of China.
- www.primecargo.com
Website of the international transportation and freight forwarding company Primecargo.
- www.dsv.com
A transportation company that offers end-to-end transport and logistics solutions.

News in English

- www.chinadaily.cn
Website of China Daily, the Chinese government's official mouthpiece.
- www.scmp.com
Website of South China Morning Post, which is a little less censored than China Daily.
- www.shanghaidaily.com
Website of the local Shanghai newspaper
- <http://english.peopledaily.com.cn>.

Chambers of commerce

- www.amcham-china.org.cn
The American Chamber of Commerce in China.
- www.europeanchamber.com.cn
The European Chamber of Commerce in China.
- www.pek.britcham.org
The British Chamber of Commerce in China.
- www.ccifc.org/
The French Chamber of Commerce in China.
- www.dccc.com.cn
The Danish Chamber of Commerce in China.
- www.swedishchamber.com.cn
The Swedish Chamber of Commerce in China.

Abbreviations

AIC	Administration of Industry and Commerce
AMEA	Anti-Monopoly Law Enforcement Agency
ASBE	Accounting Standards for Business Enterprises
BLTB	Beijing Local Tax Bureau
CAS	Chinese Accounting Standards
CBRC	China Banking Regulatory Commission
CCPIT	China Council for the Promotion of International Trade
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual or Cooperative Joint Venture
CO (CEPA)	Certificate of Hong Kong Origin (CEPA)
COFCOM	Commission of Commerce
CPA	Certified Public Accountant
CSRC	China Securities Regulatory Commission
DTT	Double Taxation Treaty
EJV	Equity Joint Venture
EPZ	Export Processing Zones
FESCO	Foreign Enterprise Service Corporation
FIE	Foreign Investment Entity
FIP	Foreign Invested Partnership
FR	Factory Registration with TID (CEPA)
HKTDC	Hong Kong Trade Development Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LoI	Letter of Intent
MII	Ministry of Information Industries
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NPC	National People's Congress

PBOC	People's Bank of China
PRC	People's Republic of China
RMB	Renminbi
RO	Representative Office
ROOs	Rules of Origin (CEPA)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAR	Special Administrative Region (Hong Kong and Macau)
SAT	State Administration for Taxation
SIPO	State Intellectual Property Office of the PRC
TID	Hong Kong Trade and Industry Department
TRIPs	Trade-Related Aspects of Intellectual Property Rights (agreement under WTO)
WFOE	Wholly Foreign Owned Enterprise
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

References

We have found inspiration for the handbook on the websites listed under “Useful links”. In addition, various materials from events and presentations together with “Danmarks Nationalbank, Quarterly Review 1, 2009” have been used.

Last, but not least, we have drawn on the long experience of Capital Associates and NCO China in advising clients.

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