Global CPA (Shanghai) Co., Ltd.

Taxation in China

Tax Guide for doing business and investing in China

Wholly Foreigner Owned Enterprises (WFOE)

PREFACE

Tax laws and policies are developed jointly by the regulatory bodies of the State Administration of Taxation (SAT) and the Ministry of Finance. The SAT is the body charged with collecting tax and enforcing compliance and is assisted by the state and local tax bureaus at the provincial level and below. Applicable tax laws and policies will vary depending on the city and province in which a business is operating as there can be additional local surcharges that may apply based on provincial tax regulations.

China's taxation system includes a wide range of imposts on businesses and individuals including income taxes (corporate income tax and individual income tax), turnover taxes (value added tax, business tax and consumption tax), taxes on property (land appreciation tax and real estate tax), as well as taxes such as stamp tax, customs duties, motor vehicle acquisition tax, vehicle and vessel tax, and urban construction and maintenance tax. Not all applicable taxes are covered here and the information that is provided should only be used as a guide. China's laws and regulations, which underpin the nation's tax system, are currently in a state of transition and discussion drafts looking at various aspects, including the Taxation Collection Administration Law (TCAL), and the VAT and Business Tax systems.

CONTENT

1. Tax framework

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

2. Enterprise Income Tax (EIT)

2.1 Taxation of Resident Enterprises and Income

All People Republic of China(PRC) resident enterprises, except partnerships and sole proprietorships, are subject to 25% enterprise income tax ("EIT") on their worldwide taxable income, unless a reduced rate or special exemptions or deductions apply. The resident enterprises include companies and other entities/organizations that (i) were incorporated within China, or (ii) were incorporated under the laws of a foreign jurisdiction but have their place of effective management located in China.

China is revising its accounting standards to adhere with the international accounting practice. In brief, China accounting standards are modeled on International. Accounting Standards with minor difference. However, for certain categories of expenses, for example like commission, entertainment and traveling, certain restrictions are imposed by tax laws and regulations. There are maximum amounts allowable and for certain categories of expenses, for example depreciation, enterprises expenses.

Taxable income of a resident enterprise is the balance derived from the annual gross income. Under the EIT Law, reasonable expenses that are actually incurred and relevant to the income obtained, including costs, expenses, fees, tax payments, losses and other expenses, may be deducted for computation of taxable income.

There is some distinction between profits for accounting purposes and tax purposes.

2.2 Enterprise Income Tax Rate and Base

Tax rate: 25%.

Taxation base: Taxable Income (adjusted according to EIT Law and its implementation rules and regulations from the audited accounting profit).

2.3 Transfer Pricing

TChinese tax authorities have the right to make reasonable adjustments if the business dealings between two affiliated enterprises were not conducted in accordance with the arm's length principle thereby causing the taxable income of either of the affiliated enterprises to decrease. According to the EIT Law, enterprises shall provide information and document regarding transactions with affiliated enterprises by filing annual transfer pricing information returns together with their annual income tax returns.

2.4 Controlled Foreign Corporation

The profit of a foreign subsidiary is not required to be imputed to a parent company that is a PRC resident enterprise; except that, if the foreign subsidiary is established in a jurisdiction where the actual tax burden is obviously lower than PRC tax burden, and the profits of such foreign subsidiary are not distributed or are partially distributed without reasonable business needs, the portion of the profits attributable to the PRC resident enterprise shall be included in the income of the PRC resident enterprise of the current period accordingly.

2.5 Foreign Tax Credit

A PRC resident enterprise would be able to claim a direct foreign tax credit (“FTC”）for foreign withholding taxes withheld and paid to the foreign tax authorities on the dividends, interest and royalties received by it, and claim an indirect FTC for foreign income taxes indirectly borne by it and paid by its foreign subsidiaries on the earnings out of which the dividends were paid.

2.6 Taxation of Non-resident Enterprises

Under the EIT Law, nonresident enterprise are enterprises that were incorporated in a foreign jurisdiction and whose place of effective management are not located in China; however, they either engage in production or other daily business activities through a place or establishment in China or derive income from sources within China even though they do not have a pace or establishment for production or other business activities in China. The “place or establishment” includes a management office, business establishment, representative office, factory, site for extraction of natural resources, place where services are provided, site for operating a construction, installation, assembly, repair or exploration project, and the place of business of an agent who has the authority to sign contracts and exercises authority to conclude contracts on behalf of a nonresident enterprise.

2.7 Nonresident Enterprises Acting through a Place or Establishment in China

Nonresident enterprises which carry out business in China through a place or establishment therein are generally taxed on their profits generated from daily business activities of their place or establishment in China in the same manner as resident enterprises are taxed; however, unlike resident enterprises that are taxed on a net profit basis, nonresident enterprises would generally be subject to income tax on a deemed profit basis, or in the case of PRC representative offices of nonresident enterprises most frequently on a cost-plus basis.

2.8 Nonresident Enterprises not Acting through a Place or Establishment in China

Nonresident enterprises are subject to 10% withholding tax on dividends, interest, royalties, rental, capital gains or other passive income received from China, unless the applicable bilateral tax treaties would reduce the withholding tax to a lower rate or exempt the withholding tax.

2.9 Filing and Payment Requirements

Resident enterprises and nonresident enterprises with a place or establishment in China shall file EIT returns to the tax authority within 15 days of the completion of a month or a quarter to make tax prepayment and file an annual tax return to the tax authority and make the settlement of the payable and refundable tax payment within five months of the completion of the year.

3. Individual Income Tax (IIT)

3.1 Scope

An individual that has his domicile in China or living in China continuously for one full calendar year would be considered a tax resident in China. A foreign national living in China shall be considered as living in China for one full calendar year if he leaves China for no more than 30 days for one single trip or for no more than 90 days for multiple trips in such year.

3.2 Individuals Income Tax Rate and Base

Tax rate (for remuneration income):

Taxable income after the Standard Deduction	Tax rate %
0 - 1,500	3
1,500 - 4,500	10
4,500- 9,000	20
9,000 - 35,000	25
35,000 - 55,000	30
55,000 - 80,000	35
Above 80,000	45

Taxation base (for remuneration): Monthly gross wage.
Filing requirement: Monthly filing.
Annual reconciliation filing (annual filing should include all kinds of income derived in the year, not just remuneration).

3.3 Filing and Payment Requirements

IIT is generally withheld and paid to tax authorities by payers of the income as withholding agents on a monthly basis. In the following circumstances, individuals that receive the income shall file IIT return to the tax authorities.

4. Turnover and Other Tax

4.1 Value-added Tax

4.1.1 Scope

Enterprises and individuals that sell commodities or providing processing or repair services in China or import goods into China must pay Value-added Tax ("VAT") generally at 17%. Sale or import of a few categories of goods such as grain, tap water and gas, etc. is taxed at 13%.

4.1.2 Value Added Tax Rate and Base

Tax rate: 17% (3% for small size taxpayer).
Filing requirement: Monthly filing.

4.2 Business Tax to Value-added Tax ("B2V") Pilot Program

4.2.1 Scope

In 2012, the State Council resolved to implement a B2V Pilot Program, replacing Business Tax ("BT") with VAT, to mitigate the whole tax burden associated with goods and services. Before the Pilot Program, BT, along with VAT, were the two most important taxes applicable for doing business in China in addition to the income tax.

4.2.2 Business Tax Rate and Base

Tax rate: 3% – 20% depending on the service type.
Taxation base: Gross service income.
Filing requirement: Monthly filing.

4.3 Stamp duty

4.3.1 Scope

Stamp duty is imposed on various dutiable contracts, the enterprises' accounting books, certificates and licenses, and evidence of title transfer. Share/equity transfer agreements are subject to stamp duty as they fall within the category of evidence of title transfer. A 0.05% stamp duty is imposed on a transfer of equity interest (shares) in Chinese companies. Both the seller and buyer are liable for this stamp duty, and each of them must pay 0.05% stamp duty for each original equity transfer agreement or duplicate copy used as an original.

4.3.2 Stamp Duty Rate and Base

Tax rate: 0.03% – 0.1%.

Taxation base: Dutiable value.

Filing requirement: Upon incurrence.

4.4 Dividends

Dividends received from local and foreign enterpris.es are taxable income. The parent company of a WOFE is a foreign company and is therefore a non-resident enterprise. A non-resident enterprise has to pay income come on the income received from China. This is a withholding tax. The WOFE paying the money to the shareholder is required to withhold the tax for the government.

4.5 Capital Gains

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

No indexation allowances will be taken into account.

5. Tax Treaties

China has entered into tax treaties with 102 countries for avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. In general, China adopts a mixed model of OECD and UN, with emphasis on the right to tax when the income is derived from or in China. China has also entered into similar tax arrangements with Hong Kong SAR, Macao SAR and Taiwan. These DTAs are in fact DTTs which confers very favorable terms to Hong Kong companies

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