



Accountants &
business advisers

Doing business in China



Contents



Chapter 1 - Introduction

• Useful tips for doing business in China	1
• Geography and population	2
• Language and time	3
• Public Holidays	4
• Political environment	5
• Economic system	6
• Legal system	7
• Intellectual property	7
• Financial system	8
• Stock Exchanges	10
• Currency and foreign exchange control	11

Chapter 2 - Business structure

• Structures used by domestic entities	13
• Joint stock companies	14
• Limited Liability Companies	14
• One-person Limited Liability Companies	15
• Companies limited by shares	15
• Partnerships	15
• Foreign Investment Enterprises	17
• Sino-foreign equity joint ventures	17
• Contractual joint ventures	17
• Wholly foreign-owned enterprises	17
• Share company with foreign investment	18
• Foreign Invested holding company	18
• Joint exploration	18
• New types of foreign investment	19
• Foreign enterprises	19
• Representative offices	19
• Branch offices	19

Chapter 3 - Business finance	21
• <i>Equity finance</i>	21
• <i>Loan funding - RMB working capital loan</i>	22
• <i>Fixed asset loan</i>	22
• <i>Foreign currency loan</i>	23
• <i>Syndicated loan</i>	23
• <i>Policies and preferences</i>	23
• <i>Industrial policies</i>	24
• <i>Regional policies</i>	27
• <i>Preferential tax policies</i>	28
Chapter 4 - Financial reporting and accounting	31
• <i>Requirements of accounting records</i>	31
• <i>Disclosure, reporting and filing requirements</i>	32
• <i>Accounting standards</i>	33
• <i>Audit - Type of audit</i>	34
• <i>Audit requirements</i>	34
• <i>Auditor qualifications</i>	35
• <i>The role of an auditor</i>	35
Chapter 5 - Taxation	37
• <i>Overview of China's current tax system</i>	37
• <i>Types of taxes</i>	37
• <i>Taxes on foreign investment, foreign enterprises and/or foreigners</i>	38
• <i>VAT - Applied scope</i>	39
• <i>Tax rate</i>	39
• <i>Operation</i>	40
• <i>Consumption Tax - Applied scope</i>	45
• <i>Operation</i>	45
• <i>Business Tax - Applied scope</i>	47
• <i>Operation</i>	48
• <i>Enterprise Income Tax - Taxpayers</i>	50
• <i>Tax base</i>	50
• <i>Tax rates and computation of tax payable</i>	50
• <i>Major tax exemptions and reductions</i>	51
• <i>Income Tax on Enterprises with Foreign Investment and Foreign Enterprises</i>	
- <i>Taxpayers</i>	52
• <i>Rates of Corporate Tax</i>	53

• <i>Tax incentives</i>	53
• <i>Administration</i>	55
• <i>Foreign tax relief</i>	55
• <i>Determination of taxable income</i>	56
• <i>Inventories</i>	56
• <i>Depreciation and amortization allowances</i>	57
• <i>Related companies</i>	58
• <i>Individual Income Tax</i>	59
• <i>Resource Tax - Taxpayers</i>	59
• <i>Computation of tax payable</i>	59
• <i>The main tax reductions and exemptions</i>	60
• <i>Urban and Township Land Tax - Taxpayers</i>	60
• <i>Computation</i>	60
• <i>Major exemptions</i>	60
• <i>City Maintenance and Construction Tax - Taxpayers</i>	61
• <i>Tax rates and computation of tax payable</i>	61
• <i>Farm Land Occupation Tax - Taxpayers</i>	61
• <i>Computation</i>	61
• <i>Major exemptions and reductions</i>	61
• <i>Land Appreciation Tax - Taxpayers</i>	62
• <i>Tax base and tax rates</i>	62
• <i>Computation of tax payable</i>	63
• <i>Major exemptions</i>	63
• <i>House Property Tax - Taxpayers</i>	64
• <i>Tax base, tax rates and computation of tax payable</i>	64
• <i>Major exemptions</i>	64
• <i>Vehicle and Vessel Usage Tax - Taxpayers</i>	65
• <i>Tax base and computation of tax payable</i>	65
• <i>Major exemptions</i>	65
• <i>Stamp Tax - Taxpayers</i>	66
• <i>Computation</i>	66
• <i>Major exemptions</i>	66
• <i>Deed Tax - Taxpayers</i>	67
• <i>Tax base</i>	67
• <i>Major tax exemptions and reductions</i>	67
• <i>Customs Duties - Duty payers</i>	68
• <i>Computation of duty payable</i>	69
• <i>Major reductions and exemptions</i>	69

Chapter 6 - Foreign personnel in China

71

- *Entry into China* 71
- *Visa application* 71
- *Residence permits* 72
- *Employee rights* 73
- *Taxation on residents and non-residents* 73
- *Territoriality* 73
- *Definition of resident* 73
- *Income subject to tax* 74
- *Exempt income* 75
- *Computation* 76
- *Individual income tax rates* 77
- *Non-residents* 78
- *Individuals leaving China* 80

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Introduction



Useful tips for doing business in China

- *The building of relationships in China is critical to success. In the absence of a dependable judicial system, the spirit and intent of personal relationships will guide the business relationship more than terms of a contract.*
- *Humbleness is the primary virtue in China. However, for Chinese the signaling of high status is becoming increasingly more common.*
- *Localization and individualism are important features in China. Every region and organization has different interests. Paying detailed attention to individual needs works toward your own advantage.*
- *Presenting a gift is an act of sincerity in China. However, if the gift is too expensive, the recipient may feel uncomfortable. If it is too cheap, it will be considered an insult. If you know the business partner well, you could present less-expensive imported goods targeted to a particular family member.*
- *Your potential business partners may claim that they have a good relationship with an “important figure” to increase your trust in him. At an appropriate time, you could ask your business partner to invite the “important figure” for a dinner together as an initial but not conclusive validation.*
- *In any meeting, it is rude to make the first move. For example, you should not pick a seat first, and you should not be the first to start eating.*
- *In Chinese business culture, conservative suits and ties in subdued colors are the norm. Bright colors of any kind worn during formal or business meetings are considered inappropriate.*
- *Seniority is an important concept in China. It is more polite for you to start*

conversing with those who are of the same rank as yourself. More often though, when those who are more senior than you are talking, you do not talk.

- *Business and government hours are 08.00-17.00, Monday through Friday. Avoid plans to visit government offices on Friday afternoon. Most Chinese workers take a break between 12.00 and 14.00.*
- *“Small talk” is considered especially important at the beginning of a meeting; any of the following topics will be appropriate: Chinese scenery, weather, and Chinese art, and don’t be surprised if the Chinese want to talk about your age or how much money you make. Politics, religious beliefs, news and academic theories are not topics for this purpose and should be avoided.*
- *The standards of logistics services vary significantly in different regions of China and represent one of the major impediments to domestic marketing and distribution. It is important to have more than one back-up plan.*

Geography and population

Located in the east of the Asian continent, on the western shore of the Pacific Ocean, the People’s Republic of China has a land area of about 9.6 million sq km, and is the third-largest country in the world, after Russia and Canada. Its vast territory yields impressive natural resources.

China is a country with a 5,000-year-long civilization and rich history. The compass, gunpowder, the art of paper-making and block printing invented by the ancient Chinese have contributed immensely to the progress of mankind. The Great Wall, Grand Canal, (600 – 1,400 years ago) and Three Gorges Dam, Beijing Tibet Railway (the past decade) and other projects built by the Chinese are world-renowned engineering feats.

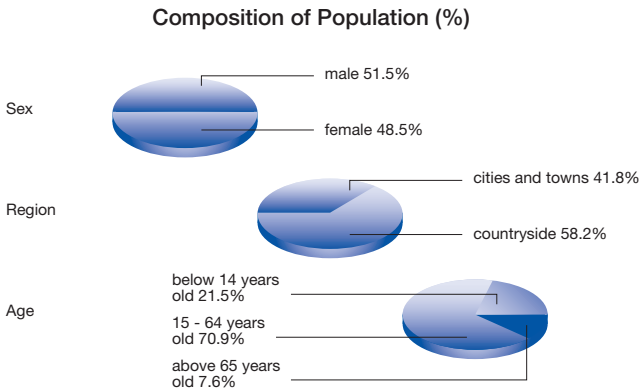
China is a united multi-ethnic nation of 56 ethnic groups. As the majority (91.6 percent) of the population is of the Han ethnic group, China’s other 55 ethnic groups are customarily referred to as the ethnic minorities.

For administrative purposes, China is separated into 23 provinces, 5 autonomous regions and 4 directly administered municipalities. Government and the majority of governmental organizations exist at four administrative tiers: central, provincial, city and township.

In addition, China has two special administrative regions (SARs). Following an agreement with the United Kingdom, Hong Kong became the Hong Kong SAR of China on 1 July 1997. Following an agreement with Portugal, Macau became the Macau SAR of China on 20 December 1999. China does not impose the Chinese socialist economic system in these two SARs, and both Hong Kong and Macau exercise autonomy, except in defense and foreign affairs.

China is the most populous country in the world; moreover, the population density is high, with 135 people per sq km. This population, however, is unevenly distributed. The eastern coastal areas are densely populated, with more than 400 people per sq km; in the central areas, over 200; and in the sparsely populated plateaus in the west there are less than 10 people per sq km.

The following table gives an overall view of the composition of the population of China:



Language and time

The official language in China is Putonghua, also referred to as Mandarin, which is spoken throughout China but is a dialect more commonly spoken around the greater Beijing area. However, numerous other dialects are also spoken in different parts of China, the most common being Cantonese in southern China and Shanghaiese in the greater Shanghai region. Although the written language is ideographic, many areas frequented by foreigners also utilize the Pinyin system of romanization.

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 saving". Time differences between Beijing and other major world cities are shown in the following table.

City**Hours ahead of or behind Beijing**

Buenos Aires	- 11
Cairo	- 6
Cape Town	- 6
Frankfurt	- 7
London	- 8
Los Angeles	- 16
Moscow	- 6
New Delhi	- 2
New York	- 13
Paris	- 7
Rome	- 7
Sydney	+ 2
Tokyo	+ 1

Public Holidays

National public holidays are listed in the table below. Dates for the Chinese New Year are based on the lunar calendar and vary from year to year.

Holiday**2006**

New Year's Day	1 - 2 January
Chinese New Year	29 - 31 January
International Women's Working Day*	8 March
International Labor Day	1 - 3 May
Youth Day	4 May
Children's Day	1 June
Anniversary of Founding of Communist Party	1 July
Anniversary of Founding of Chinese PLA	1 August
National Day	1 - 3 October

The number of days provided for the legal holidays of Chinese New Year, Labour Day and National Day is 3 days, however, prior or post weekend days are often worked to extend the holiday to 7 consecutive days.

* Holiday granted for women only.

Political environment

It is the guiding principle that all power in China belongs to the people. The organs through which the people exercise state power are the National People's Congress (NPC) and local people's congresses. Therefore, the people's congress system is China's fundamental political system.

The NPC has a wide range of powers and responsibilities, including:

- *Amending the constitution and enacting legislation*
- *Electing the premier and State Council members on the recommendation of the CCP standing committee*
- *Approving the national economic plan and state budget.*

Deputies to the people's congresses at all levels are elected, answerable to and accepting supervision from the people. They include people from all ethnic groups, all walks of life, and all regions, classes and strata. When the congresses meet, they can air their views fully. They can also address inquiries to governments at the corresponding level and their affiliated departments, and the parties concerned are duty-bound to reply to the inquiries. Electors or constituencies have the right to recall their elected deputies according to procedures prescribed by law.

A standing committee of the NPC is elected at the first session of each congress and performs the work of the NPC when it is not in session. NPC members are elected for terms of five years and meet in session once each year.

The State organs of the People's Republic of China (PRC) include:

- *Organs of state power – the NPC and the local people's congresses; President of the State*
- *State administrative organs – the State Council and the local people's governments*
- *State leading military organ – the Central Military Commission*
State judicial organs – the Supreme People's Court, local people's courts and special people's courts

- *State procuratorial organs – the Supreme People’s Procuratorate, local people’s procuratorates and special people’s procuratorates.*

Economic system

In late 1978, Deng Xiao-ping initiated an “open door policy” to modernize China by encouraging foreign investment and trade. The economic reforms that flowed from the open door policy have created an economic system often referred to as a “socialist economy with Chinese characteristics”. Unlike the rigid, centrally planned economies in most traditional socialist nations, China’s economy is a hybrid structure in which strategic commodities and industries are controlled by the State, while other industries, including the commercial and private sectors, are governed by a market-orientated system.

Following 20 years of negotiations, China officially joined the WTO on 11 December 2001. China’s accession bears great significance for the country’s economy and the future of global trade. Many industries that were previously restricted only to domestic enterprises are now open to foreign investors. These industries include banking, telecommunications, distribution, construction, engineering insurance, plus professional services including legal, accounting, and architectural services. Furthermore, restrictions on domestic sales by foreign manufacturing companies will also be lifted.

A socialist market economic system has now taken shape, and the basic role played by the market has been improved in the sphere of resource allocation. At the same time, the macro-control system continues to be perfected. The pattern has basically been formed in which the public sector plays the main role alongside non-public sectors, such as individual and private companies, to achieve common development. According to the plan, China is forecast to have a relatively complete socialist market economy in place by 2010, and this will become comparatively mature by 2020.

China, economically backward before 1949, has become one of the world’s major economic powers, with the greatest potential, and with an improving overall living standard. In the 22 years following reform and opening-up in 1979 in particular, China’s economy developed at an unprecedented rate, and that momentum has been held steady into the 21st century.

Legal system

China's legal system consists of seven categories: constitutional and related law, civil and commercial law, administrative law, economic law, social law, criminal law, and litigation and non-litigation procedural law. Since 1979, the building of China's legal system has developed rapidly on all fronts. By the end of 2004, more than 460 laws and law-related decisions had been made by the National People's Congress and its Standing Committee; over 1,000 administrative regulations had been made by the State Council; and more than 10,000 local regulations had been made by local people's congresses, covering political, economic and social fields. A relatively complete basic legal system is now in place.

Intellectual property

China recognizes intellectual property rights (IPRs) and has decreed the Patent Law, the Trademark Law, the Copyright Law and subsequent measures to protect and enforce such rights. To receive protection under the laws, patents, trademarks and copyrighted works must be registered with the relevant authority.

The government announced a series of measures in 1996 to control the import, publication and reproduction of recorded audiotapes, recorded videotapes, records, compact discs, laser discs, and other audio and video products. The State Press and Publications Administration must approve the import, publishing and reproduction of such products, and the necessary permits must be obtained. In addition, the relevant authorities must examine the goods. Violation of these measures may result in the confiscation of illegal income, cessation of business and imposition of fines. In serious cases, criminal proceedings may be initiated against the offenders.

A. Patents

The Patent Administration Department, which is controlled by the State Council, administers the registration of patents. Registration is governed on a priority basis. Chinese patent law encompasses not only patents for inventions, but also for unique utility models and designs. Patents may not be granted for scientific discoveries, methods of diagnosing or treating diseases, rules and methods for thought processes, animal and plant varieties, and substances obtained by means of nuclear transformation. Patents protect inventions for a term of 20 years from the date of filing the patent application. Patents protect utility models and designs for a term of 10 years.

B. Trademarks

The Trademark Office of China is responsible for the registration and administration of trademarks. The right of priority governs the registration of trademarks. Registered trademarks include trademarks, service marks, collective marks, and certification marks that have been approved and registered with the Trademark Office. Trademarks must be “so distinctive as to be distinguishable.” Marks do not qualify for registration if they are generic in nature, lack distinctive features, or have direct reference to the physical characteristics of the goods the trademark is representing. A registered trademark is valid for a term of 10 years from the date the registration is approved. A registration may be renewed for an additional 10-year period by filing a renewal application within six months of the trademark’s expiration. If registration of the same trademark has been filed in a foreign country, documents concerning its examination overseas must be submitted when applying for registration in China.

C. Copyrights

The Copyright Administration Department, which is controlled by the State Council, is responsible for the nationwide administration of copyrights. In each province, autonomous region and municipality under the central government, Copyright Administration Departments of the People’s Government administer copyrights in their respective administrative regions.

Copyrights protect the rights of publication, authorship, alteration, integrity, reproduction, distribution, rental, exhibition, performance, showing, broadcast, communication of information on networks, making cinematographic work, adaptation, translation and compilation. The rights of authorship, alteration and integrity have an unlimited duration. All other rights are protected for a term of the life of the author plus 50 years (ending on 31 December) after the author’s death. The copyright law protects works, published or unpublished, of Chinese citizens, legal entities and organizations, as well as those of foreign nationals or stateless persons. Foreign nationals are not required to appoint an agent to apply for copyright protection.

Financial system

The creation of a modern banking system is a continuing objective of the Chinese leadership as it seeks to strengthen fiscal and macroeconomic control over the economy. Reforms have focused on modernizing the banking system to fit international

standards, strengthening the role of the central bank and separating policy-oriented lending from commercial lending.

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.

A. People's Bank of China

The People's Bank of China (PBOC) is China's central bank, responsible for establishing and implementing national financial policies, as well as regulating currency circulation and credit activities. It represents the country to foreign countries and supervises and administers all domestic financial activities.

The PBOC has the following responsibilities:

- *Formulating and implementing monetary policies, including regulating interest rates*
- *Issuing currency and regulating its circulation*
- *Coordinating and implementing credit plans*
- *Improving the macro adjustment policy of the financial markets*
- *Performing inter-bank borrowings.*

B. Commercial banks

The Chinese commercial bank system is composed of three parts: exclusively State-owned commercial banks, other shareholding commercial banks and foreign-funded commercial banks. The exclusively State-owned banks constitute the main body of Chinese commercial bank system.

In early 1994, the Chinese government announced significant reforms to the banking system. Under the reforms, the four major specialized banks – the Industrial and Commercial Bank of China, Bank of China, Agricultural Bank of China and Construction

Bank of China – were transformed into purely commercial entities. The banks are now responsible for their own profits and losses and can provide a full range of commercial banking services.

C. Policy-related banks

Since 1994, China has constructed three policy-related banks directly under the State Council: the State Development Bank, Agriculture Development Bank of China and the Export-Import Bank of China.

D. Foreign-funded banks and branches

Currently, foreign-funded banks are limited regarding to whom they may lend, where they may lend, and what currency they may lend. Such banks are not allowed to negotiate with domestic Chinese businesses or lend money to Chinese individuals. However, since 2002, China has designated certain cities where foreign-funded banks are allowed to handle Renminbi business. Within five years of China's accession into the World Trade Organization (WTO), regional limitations will no longer be imposed on foreign-funded banks handling renminbi business in China, and foreign-funded banks will be allowed to apply their analytical models for credit risk.

In anticipation of China's accession to the WTO, at the end of 2001 the government implemented the Regulations on the Administration of Foreign-Invested Financial Institutions, which allow foreign financial institutions to establish branches in China.

E. Non-bank financial organizations

Chinese non-bank financial organizations mainly include Trust & Investment Corporation, Securities Company, Insurance Company, Finance Company, Leasing Company and Credit Union.

Stock Exchanges

China currently has two stock exchanges, the Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchange (SZSE). The exchanges are regulated by the China Securities Regulatory Commission (CSRC), which establishes regulatory guidelines, formulates and enforces market rules, and authorizes initial public offers.

Over-the-counter trading is carried out in many cities including Beijing, Chongqing, Guangzhou, Shanghai, Shenyang and Wuhan. Although shares of unlisted companies continue to be traded on the over-the-counter markets, listed shares are now traded on only the two exchanges.

Currency and foreign exchange control

The Renminbi (RMB) (also referred to as the Yuan or informally Kwai – as in Bridge Over The River . . .) is China's legal currency, and is issued and controlled solely by the People's Bank of China. The RMB is denominated in units of fen, jiao and yuan (¥). Ten fen equal 1 jiao, and 10 jiao equal 1 yuan. (1 yuan is valued at \$0.12 USD so don't spend too much time on jiao or fen.) In general, references to amounts of RMB indicate units of yuan, unless otherwise indicated. RMB exchange rates are decided by the People's Bank of China and issued by the State Administration of Foreign Exchange, the latter exercising the functions and powers of exchange control.

The Chinese foreign exchange control system implements convertibility on current accounts, certain control on capital items, and supervision and management on foreign exchange business of financial organizations.

A. The convertibility of RMB under current accounts:

- i. To implement banking settlement of exchange system on foreign exchange revenue of current accounts
- ii. To lift limitations on the foreign exchange payment of current account
- iii. To carry out the system of cancel after verification on the exchange of import and export acceptance and payment
- iv. To check the authenticity of trade through customs declaration net checking system on import and export.

B. Foreign exchange control under capital items

The basic principle for managing foreign exchange receipts and disbursements of Chinese capital items is to boost the exchange of Renminbi under capital items by perfecting foreign exchange control and creating conditions to while abandoning the limitations on the convertibility of current accounts.

Business structure



Three primary sectors operate within the Chinese economy: state-owned, collective and private. The State-owned and collective sectors are limited exclusively to domestic businesses. The private sector consists of individually owned Chinese businesses, as well as all foreign business entities.

Structures used by domestic entities

State-owned enterprises (SOEs) are primarily large concerns operating in critical areas of the economy, including post and communications, transportation, pharmaceuticals, energy and heavy industry.

To stimulate the economy, the government has implemented policies to reform SOEs by granting the entities autonomy in management. This requires them to establish an independent accounting system and holds them fully responsible for their financial affairs. More significantly, the State is reducing its holdings in certain SOEs by allowing them to form joint stock companies and to list shares on domestic and foreign stock exchanges. SOEs are also being restructured through mergers and acquisitions. As a result of these reforms, it is intended that non-competitive SOEs would become financially unviable.

Collective enterprises (COEs) are formed by private individuals and domestic business organizations. Because approximately 70% of the population resides in rural areas, COEs were originally established to promote employment opportunities and economic development of rural areas. Most of the COEs are in the light industrial sector and produce consumer-orientated products. Although COEs are generally smaller than SOEs and are located primarily in second and third tiered cities and rural areas, they are more entrepreneurial than their state-owned counterparts.

Private or individually owned enterprises, located in both rural and urban areas, are engaged in small-scale industry and commerce.

Joint stock companies

The Company Law (revised in 2005) of the PRC governs the establishment, organization and operation of joint stock companies. The two primary organizational forms of joint stock companies in China are limited liability companies and companies limited by shares. The Company Law does not apply to many existing Chinese business entities, including SOEs, COEs, private enterprises (enterprises individually owned by Chinese nationals), joint ventures and wholly foreign-owned enterprises, unless they are converted into one of the two types of joint stock companies.

A joint stock company is an entity with limited liability in which shareholders contribute all registered capital and the capital is represented by shares. Shareholders participate in management, enjoy rights and interests, and assume risks according to their shareholdings.

The objective of permitting the establishment of joint stock companies is to reform the system of enterprise management. By separating government administration from enterprise management and by changing the structure of ownership, Chinese leaders hope to improve the operating efficiency and autonomy of companies. Enterprises represented by shares also open new channels of finance, and encourage increased and more effective foreign investment.

Limited Liability Companies

A limited liability company is a legal entity in which the investors' liability is limited to their respective investment contributions. The company itself is liable for its obligations only to the extent of its total assets. A limited liability company must have no more than 50 shareholders. Capital contributions may be made with cash or assets. The minimum amount of registered capital of a limited liability company shall be RMB 30, 000 Yuan. Registered capital must be certified and investment certificates issued to all investors. Shareholders may transfer among themselves all or part of their capital contributions. Capital may be transferred to third parties if a majority of the investors approve such a transfer. Because capital is not divided into shares, such companies do not have the option to raise capital in the stock market.

Management powers are vested in the investors, not the directors. A board of directors comprises between 3 and 13 members.

One-person Limited Liability Companies

One-person Limited Liability Company refers to a limited liability company with only one natural person shareholder or a juridical person shareholder. The minimum amount of registered capital of a one-person limited liability company shall be RMB 100, 000 Yuan. The shareholder shall, in a lump sum, pay the capital contribution as specified in the articles of association. One natural person is allowed to establish only one one-person limited liability company, and must not set up any additional one-person limited liability company. A one-person limited liability company shall make a financial statement at the end of every fiscal year, which shall be subject to audit by an accounting firm.

Companies limited by shares

A company limited by shares is an enterprise with the status of a legal person. A company limited by shares may be formed by promotion or by offering shares to the public. The company must have at least 2 but no more than 200 promoters, more than half of which must be domiciled in China. Total registered capital is equivalent to the value of all shares. The minimum amount of registered capital is RMB 5 million, and for listed shares, the minimum amount is RMB 30 million. The capital is divided into shares of equal value, which are evidenced in the form of share certificates. Shares may be freely transferred; however, shares held by the promoters may not be transferred within one year of the company's date of establishment.

A company limited by shares raises capital by issuing share certificates (or share equity certificates) either by promotion or by offer. Shares may be issued at par value or at a premium, and shares of the same class carry equal rights. Shareholder liability is limited to the amount of shares purchased, and the company is liable for its obligations to the extent of its assets. Capital contributions may be made in cash or assets. Similar to limited liability companies, management powers are vested in the shareholders. The company's board of directors is composed of 5 to 19 members.

Partnerships

Partnership enterprise refers to a profit-making organization established within the territory of China according to the law, with their partners associated under a partnership agreement, each making capital contributions, carrying out business operations, distributing profits, undertaking risks and bearing unlimited and joint liability for the partnership enterprise's debts.

The following conditions apply to the establishment of a partnership enterprise:

- i. Two or more partners each bearing unlimited liability according to law
- ii. A written partnership agreement
- iii. Capital contributions actually made by each of partners
- iv. The name of the partnership enterprise
- v. The place of business and conditions necessary for partnership operations.

A partner may make his capital contributions in currency, or by providing material objects, land-use rights, intellectual property rights or other property rights. These capital contributions shall be legal property or property rights owned by the partner.

A partnership agreement shall include the following items:

- i. The name of the partnership enterprise and address of its place of business
- ii. The purpose of partnership and the business scope of the partnership enterprise
- iii. Names and residences of each partner
- iv. The form, amount and time limit for each partner to make capital contributions
- v. The method of distributing profits and undertaking risks
- vi. Execution of the partnership enterprise's affairs
- vii. Entering into and withdrawal from partnership
- viii. Disbandment and liquidation of the partnership enterprise
- ix. Default liability.

A partnership agreement may include the operation term of the partnership enterprise and the means of dispute settlement among partners.

A partnership enterprise shall pay off its debts first out of all its property. If the property of the partnership enterprise is insufficient to pay off its due debts, each partner shall bear the unlimited and joint liability for paying off debts.

Foreign Investment Enterprises

In general, the intention of the Chinese government is that the FIEs must contribute to the development of China's economy and promote exports. FIEs may take forms such as Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, wholly foreign-owned enterprises, joint exploitation, foreign-funded share holding companies, joint development, compensation trade and processing and assembling.

Sino-foreign equity joint ventures

Sino-foreign equity joint ventures are also known as share-holding corporations. They are formed in China with joint capital by foreign companies, enterprises, other economic organizations and individuals with Chinese companies, enterprises and other economic organizations. The main feature is that the parties concerned invest together, operate together, jointly take risk (according to the ratio of their capital investment) and jointly take responsibility for losses and profits. The capital from different parties is turned into the ratios of capital, and the capital from foreign parties should not be lower than 25%. The Sino-foreign equity joint ventures were among the first forms of foreign direct investment, and accounted for the majority of foreign investment prior to 2002.

Contractual joint ventures

Contractual joint ventures are formed in China with joint terms of cooperation by foreign companies, enterprises, other economic organizations and individuals, and Chinese companies. The rights and obligations of different parties are embedded in a contract.

Wholly foreign-owned enterprises

Wholly foreign-owned enterprises are totally invested by foreign parties in China (and in accordance with the laws of China). Again, these parties must be foreign companies, enterprises, or other economic organizations and individuals. According to Chinese law, a prospective foreign-capital enterprise must benefit the development of China's national economy and be capable of positive economic results. The State encourages foreign-capital enterprises to use advanced technology and equipment, engage in the

development of new products, realize the upgrading of products and the replacement of old products with new ones, and economize on energy and raw materials. Foreign-capital enterprises which are export orientated are also encouraged (though not exclusively). The wholly foreign-owned enterprises often take the form of limited liability.

Share company with foreign investment

Share companies with foreign investment are stock limited companies set within China's territory. Foreign companies, enterprises, or other economic organizations invest in their Chinese counterparts, in a relationship established according to the principle of stock. Shares are held by both Chinese and foreign shareholders, and stockholders assume responsibility for the company in proportion with the amount of stock they own. The company itself is responsible for all debts and assets. The shares purchased and held by foreign investors must account for more than 25% of the total registered capital of the company.

Limited companies can be founded either by means of starting-up or raising, and the limited liability company invested by the foreigners can also apply to turn into share-holding companies. The qualified enterprises can also apply to issue A & B shares and be listed abroad.

Foreign Invested holding company

Foreign invested holding companies are Chinese–foreign equity joint ventures or wholly foreign-owned enterprises within Chinese territory. They deal with direct investment, usually in the form of limited liability companies. Foreign investors who apply to establish such a company need substantial assets backed up by a good reputation. They need to have established a certain number of companies within China, and have over \$30 million of fully paid-in registered capital. Upon the approval of the Chinese government, foreign invested holding companies could enjoy a broader scope of management than other ordinary companies, as an incentive for big overseas companies to carry out their investment plans.

Joint exploration

Joint exploration is the abbreviation of maritime and overland oil joint exploration. It is a widely adopted measure of economic cooperation in the international natural resources field. The key features are high risk, high investment and high reward. The joint project is often divided into three steps: exploration, development and production. Such joint exploration account for a relatively small proportion of enterprises.

New types of foreign investment

While opening up its domestic market, China is also exploring and actively expanding the use of new types of foreign investment such as BOT and joint exploration. Since multinational merger and acquisition has become the major type of international direct investment, the Chinese government is now researching and enacting relevant policies so as to facilitate foreign investment in China by means of merger and acquisition.

Foreign enterprises

Foreign enterprises (FEs) are forms of foreign companies' activities and operations other than FIEs. These activities and operations include representative offices, contracted projects and foreign companies receiving income and payments from Chinese sources other than contractual agreements.

Representative offices

Foreign companies may establish representative offices in China under limited conditions. Representative offices may only engage in indirect operating activities, including liaison work, consulting, market research, general information gathering, and sourcing and procurement of products and materials. Representative offices may not conclude or direct product sales. In addition, a representative office may not employ local Chinese nationals in its own name. The office must use employment agencies. To establish a representative office, a foreign company must complete a formal registration process. Currently, most foreign companies are not permitted to establish branch offices in China.

Branch offices

Currently, only FIEs, foreign banks, foreign insurance companies and foreign law practices may establish branches in China with the approval of the relevant authorities. All other businesses are prohibited from establishing branches in China, because there are no clear regulations on establishing branch offices for other industries. 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 civil liability for the operational activities of its branches in China.

Business finance



Equity finance

There are three main methods of raising equity:

A. Retained profits

This simply means retaining profits, rather than paying them out as dividends. This is the most important source of equity.

Where a company distributes its after-tax profits of the current year, it draws 10 per cent of the profits as the company's statutory common reserve. The company may stop drawing if the accumulative balance of the common reserve has already accounted for over 50 percent of the company's registered capital.

If the accumulative balance of the company's statutory common reserve is not enough to make up for the company's losses of the previous year, the current year's profits will first be used for making up the losses before the statutory common reserve is drawn from them as described above. Once the company has drawn its statutory common reserve from the after-tax profits, it may, upon a resolution made by the shareholders' meeting, draw a discretionary common reserve also.

The capital accumulation funds of the company may be used for making up losses, expanding the production and business scale, or increasing the registered capital of the company. However, the capital accumulation funds may not be used to address losses. When the statutory common reserve is changed to capital, the remainder of the common reserve cannot be less than 25 % of the registered capital prior to the increase.

B. Rights issues

After retained profits, rights issues are the next most important equity source. A rights issue is an invitation to existing shareholders to purchase additional shares in

the company. It is easy and relatively cheap (compared with new issues). Rights issues are generally very successful as shareholders are usually given strong incentives to act. The shares are usually offered at a significantly discounted price from the market value. Shareholders can either buy these shares themselves or sell the right to buy to another investor. For further reassurance that the firm will raise the anticipated finance, rights issues are usually underwritten by institutions.

C. New issues of shares to new shareholders

Issuing of new shares must be done with fairness and impartiality, and shares of the same class must have the same rights and benefits. Stocks issued at the same time must be equal in price and subject to the same conditions. Prices must likewise be uniform, no matter who is the purchaser.

The stocks may be issued at a price equal to or above the par value, but not below the par value. They may be registered or unregistered stocks; however, stocks issued to initiators or juridical persons must be registered. These stocks must state the names of the persons to whom they are issued, and cannot be registered in any other person's name or the name of any representative.

Loan funding

RMB working capital loan

The RMB working capital facility is a kind of loan used to meet short-term demands of corporations in the course of production and operation. According to the length of maturity, RMB working capital loans can be divided into short-term (a year or less) and medium-term (between one to three years) categories. With its simplified procedures, high flexibility and lower financing cost, RMB working capital has become an efficient and practical financing means for the short to medium term.

Fixed asset loan

Fixed asset loans are granted by the Bank of China to meet the fund demands of enterprises as they invest in fixed assets. This includes investment in capital construction, technical innovation, and developing and manufacturing of new products, as well as related house purchase, civil engineering, and purchase and installation of technical equipment.

Fixed asset loans come in several categories: long-term loans, temporary circulating loans and foreign exchange loans.

Foreign currency loan

Foreign currency loans are raised solely by the Bank and are granted to enterprises. They are available both at fixed rate and floating rate. Compared with foreign government loans and export credit, foreign currency loans have diversified uses, such as in equipment and material purchase, to meet the requirements of both working capital and fixed asset investment. Short, medium and long-term loans are available.

Syndicated loan

The syndicated loan is a financing method evolved from the bilateral loan. A syndicated loan is when one bank or several banks (as the arrangers) organize other banks to grant loans to the same borrower under one loan agreement, according to agreed terms.

Syndicated loans have these key features:

- *Huge amount, long term*
- *Fewer restrictions on the use of proceeds (compared with government loans and export credit)*
- *Easier management (compared with loans borrowed separately from different banks)*
- *Less pressure on banks*
- *Diversified risk.*

As far as the borrower is concerned, syndicated loans are attractive in providing high-volume, long-term loans with easy operation management (since they only have one point of contact, the agent bank).

Policies and preferences

If you or your company decides to do business in China, it is essential to know as much

as possible about the preferential policies available in China, so you can take advantage of them. The purpose of these policies is to stimulate overseas investment.

Industrial policies

According to Provisions on Guiding Foreign Investment Direction and Industrial Catalogue for Foreign Investment, industrial projects are divided into four categories:

1. Encouraged
2. Permitted
3. Restricted
4. Prohibited.

Foreign investment projects belonging to encouraged, restricted and prohibited categories are listed in the Catalogue for the Guidance of Foreign Investment Industries (permitted projects which do not belong to the other three categories are not listed).

A. The following are encouraged foreign investment projects:

- *Projects for new agricultural technology and comprehensive agricultural development and for energy, transportation and key raw materials industries.*
- *Projects for new and high technology, advanced and applicable technology which can improve performance of products and increase the techno-economic efficiency of enterprises, or produce new equipment and new material where the domestic capacity is deficient.*
- *Projects that meet market demands, can promote the quality of products, enter into new markets, or help products to compete in international markets.*
- *Projects adopting new technology and new equipment for saving energy and raw materials, for comprehensive utilization of resources and renewable resources, and for preventing environment pollution.*
- *Projects that can make full use of manpower and resource advantage in the mid-west region, and which are in accordance with the State's industrial policies.*

B. The following are restricted foreign investment projects:

- *Projects adopting out-of-date technologies.*
- *Projects unfavorable to resource-saving and ecological environment improvement.*
- *Projects for prospecting and/or mining specified mineral resources protected by laws and regulations of the State.*
- *Projects in those industries that currently restrict the percentage ownership of the foreign party*

C. The following are prohibited foreign investment projects:

- *Projects that endanger the safety of the State or damage social and public interests.*
- *Projects that pollute the environment, destroy natural resources or impair the health of human beings.*
- *Projects that occupy large amounts of arable land, or are unfavorable to protection and development of land resources.*
- *Projects that endanger the safety of military facilities and/or their performance.*
- *Projects that adopt the unique craftsmanship or technology of China to make products.*
- *Other cases that are regulated by laws and administrative regulations of the State.*

China's government has recently worked out some other favoured policies for foreign investment in high-tech fields:

1. Technology innovation should be readily available to foreign-funded enterprises, foreign-invested research and development centres, and high-tech, export-oriented foreign-funded enterprises that are listed in the Industrial

Catalogue for Foreign Investment and the Industrial Catalogue Restricted for Foreign Investment (B).

The import of vital equipment that cannot be manufactured domestically would be exempt from import tariffs and import VAT. This also applies to related technology, components and spare parts.

2. When the foreign-funded enterprises imports equipment vital to the manufacture of products listed in the Catalogue of National High-tech Products, this would also be exempt from import tariff and import VAT. This also applies to related technology, components and spare parts listed in the purchase contract.
3. There would be no import tariff or import VAT on the software fee paid overseas when the foreign-funded enterprises imports the related technology listed in Catalogue of National High-tech Products.
4. The products listed in Export Catalogue of National High-tech Commodities would receive drawback after export (if their export drawback rates stand under the taxation rates) in accordance with taxation rates and the existing export drawback stipulations, approved by the State Bureau of Taxation.
5. The foreign-funded enterprises listed in the Industrial Catalogue for Foreign Investment and the Industrial Catalogue Restricted for Foreign Investment (B) may reclaim all VAT on home-made equipment when they purchase domestically manufactured equipment within their investment volume, on condition that the imported equipment remains in the category of those exempted from import tax.
6. The income tax of foreign-funded enterprises in technology innovation and high-tech production can be offset by a certain amount for the purchase of domestically manufactured equipment, in line with national industry policy.
7. Sales tax is waived for foreign-funded enterprises, foreign-funded research and development centers, overseas enterprises and international individuals on profits from technology transfer, technology exploitation, and related technology consultation and technology services.

8. Income tax can be offset by 50 per cent of the amount of the technology exploitation fee if foreign-funded enterprises increase their exploitation fee by 10 per cent from the previous year.
9. The research exploitation fee could be deducted from income tax when foreign-invested or overseas enterprises fund unrelated scientific research institutes and universities. This is in accordance with Law of Income Tax of Foreign-funded and Overseas Enterprises P.R.C.

Regional policies

China's policy of opening to the outside world adopts a holistic strategy, proceeding in an orderly, step-by-step way from coastal region to inland cities. Currently there are several categories of special economic areas:

- A. Special Economic Zones (including but not necessarily limited to Shenzhen, Zhuhai, Xiamen, Shantou and New Area of Pudong in Shanghai)
- B. 14 coastal port cities (Shanghai, Tianjin, Dalian, Qinhuangdao, Yantai (including Weihai), Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai)
- C. 49 state economic and technological development areas
- D. 53 state high-tech and new technological industrial development areas. In 1999, the Chinese government carried out the policy of central and western regions exploitation. Investment (including foreign investment) is encouraged to put into inland China in the central and western region.

Policies and measures relevant to foreign investment are:

- *Projects included in the Catalogue of Advantageous Sectors for Foreign Investment in Central and Western Regions shall enjoy the same policies as encouraged projects.*
- *For the foreign invested projects in infrastructures or advantageous sectors in the west, restrictions on the proportion of foreign investment shall be appropriately eased.*

- *Foreign investment in the west region is encouraged to support the infrastructure construction and resources development of agriculture, irrigation works, ecology, transportation, municipal works, environmental protection, mining and tourism, and to establish technical research and development centers.*
- *Service and trade sectors in the west region shall continue to be made more open. The pilot projects of foreign investment in banks, retailing enterprises and foreign trade shall be expanded to include municipalities and capital cities of provinces and autonomous regions. Foreign invested banks shall gradually be permitted to run RMB business. Foreign investors are permitted to enter industries such as telecommunications, insurance, tourism, Sino-foreign public accountant services, lawyer services, engineering design companies, railway and highway transportation enterprises, and municipal engineering enterprises. Some industries are permitted to open in the west first for a trial.*
- *The channel of foreign investment shall be expanded: BOT and TOT trials are permitted in the west region for foreign investors. Foreign invested projects are permitted to gather capital, including RMB capital. Qualified foreign invested enterprises in the west region shall be supported to get listed in stock markets home and abroad. Enterprises belonging to encouraged and permitted industries in the west region shall be supported to absorb foreign investment through the transfer of operation right, selling of share holdings, merging and reorganizing etc. The methods of Sino-foreign joint venture fund and risk investment fund in absorbing foreign investment are to be actively explored.*
- *Foreign invested enterprises of eastern regions are encouraged to come to western China and reinvest. Projects with more than 25% foreign investment can be considered foreign invested enterprises and enjoy the appropriate benefits.*

Preferential tax policies

The Chinese government levies lower initial corporate income tax on enterprises with foreign investment. The main preferential tax policies include: preferential rate of Corporate Income Tax, reduced Corporate Income Tax, and waiving of import tariff and import VAT on important equipment.

A. Preferential rate of Corporate Income Tax

See chapter 6.

B. Deduction and exemption of import tariff

The present average (mean, not weighted average) import tariff rate is 12%. Equipment imported for foreign-invested or domestic-invested projects that are encouraged and supported by the State shall enjoy tariff and import-stage VAT exemption, in addition to all the commodities in the Catalogue of Imported Commodities not Entitled for Tariff Exemption for Projects with Foreign Investment.

Financial reporting and accounting



Requirements of accounting records

All enterprises must maintain books or accounts for their business activities. At the end of each business year, an enterprise must submit its annual financial report to its shareholders' meeting for approval or ratification. The annual financial report, which must be prepared using PRC accounting rules, includes a balance sheet, profit and loss account, cash flow statement, statement of profit appropriation, notes to the financial statements, supplementary statements and management's commentary on the entity's financial performance.

Enterprises are expected to prepare and present external financial reports with true and fair views. In accordance with the relevant laws and regulations, enterprises must have their financial statements audited and certified by a CPA at the end of each financial year. All companies have December 31 year ends.

Safekeeping time for accounting files is classified as permanent and periodic. Periodic time covers periods of three years, five years, ten years, fifteen years, and twenty-five years.

Enterprises must use double-entry bookkeeping and record transactions using the accrual method of accounting. Enterprises carrying out accounting activities (such as preparing accounting vouchers, recording accounting books and managing accounting records) must comply with the provisions contained in the Accounting Law of the PRC, the Basic Standards in Accounting Practice and the Management of Accounting Records. Management is responsible for exercising judgment and making proper provisions. Enterprises must apply their adopted accounting practices and policies consistently from one period to another and may not change such practices and policies arbitrarily.

Enterprises must maintain their accounting records in RMB. If an enterprise's operating income and expenses are primarily denominated in currencies other than RMB, the enterprise may choose any one of the currencies as its book currency. However, the enterprise's financial statements must be translated into RMB.

Disclosure, reporting and filing requirements

An enterprise must include the following items in its financial statements:

- *Balance sheet*
- *Income statement*
- *Cash flow statement*
- *Statement of profit appropriation*
- *Notes to the financial statements*
- *Supplementary statements*
- *Management's commentary on the entity's financial performance.*

Certain statements are prepared monthly, while others are prepared quarterly or on a semiannual or annual basis. The Accounting System for Business Enterprises regulates the contents of the financial reports, types and forms of the financial statements, and details of the notes to the financial statements. An enterprise may decide on the format of financial statements that are used for internal purposes.

The notes to the financial statements must contain the following disclosures:

- *Explanation of non compliance with any accounting concepts or standards*
- *Details of significant accounting policies and estimates*
- *Explanation of changes in significant accounting policies and estimates*
- *Details of contingencies and post-balance sheet events*

- *Disclosure of related party relationships and transactions*
- *Details of transfers or disposals of assets*
- *Details of business combinations and divisions*
- *Details of significant items in the accounting statements, such as receivables, inventories and fixed assets*
- *Other disclosures that may help the reader understand the accounting statements.*

The management's commentary on the entity's financial performance explains the following information about an enterprise:

- *Profile of the business operation*
- *Profits realized and distributed*
- *Increase or decrease of the capital funds and their turnovers*
- *Details of any events with significant impact on the enterprise's financial positions, operation results and cash flows.*

At the end of each business year, a company must submit its financial statements to the shareholders' meeting for approval or ratification. Except for the first year of operation, annual financial statements must include comparative figures for two consecutive accounting years or two related accounting periods.

An accounting year generally is the calendar year. A FIE does not adopt the same accounting year as its parent company if the parent company's accounting year does not end on 31 December.

Accounting standards

FIEs and joint stock companies must prepare their financial statements in accordance with PRC accounting standards and the Accounting System for Business Enterprises (accounting system). The MOF (Ministry of Finance) issues the accounting standards and accounting system, which apply to various industries and sectors.

In general, PRC accounting principles conform to IAS. In the last few years, the Chinese government has eliminated most of the differences between PRC accounting practices and IAS. In February 2006, the MOF announced the newest 38 accounting standards, to be enforced from 1 January 2007. These standards conform even more closely to IAS.

The basic accounting concepts include the characteristics of objectivity, relevance, comparability and reliability, which must be reflected in the accounting statements. In addition, the accounting principles of going concern, consistency, timeliness, accruals, prudence, matching, substance over form and materiality must be applied in preparing financial statements.

Audit

Type of audit

The PRC's government-driven audit process is very different from the prevailing system found in western countries. The auditing profession comprises three major segments: government auditing, internal auditing and social auditing (the equivalent of western public auditing).

Audit requirements

<i>Organization Type</i>	<i>Auditor</i>	<i>Requirements</i>
People's Bank of China	The Chinese National Audit Office China	Law with respect to the People's Bank of China
Securities and futures organizations	Approved CPA firms	Approved CPA firms must audit financial institutions
Commercial banks Limited liability companies	Approved CPA firms law CPA Firms	Commercial banking law Company law
Not-for-profit organizations	The Chinese National Audit Office	Budget law

Auditor qualifications

Auditors within CPA firms must be practising members of CICPA. A further qualification – License of CPA and CPA Firms for Securities Related Practice – is required to audit securities-related businesses. Historically, CPAs received their certificates through subjective evaluation, which raised questions as to their technical competence. As a result, the MOF and the China Securities Regulatory Commission granted special licenses to those who sat and passed a special examination relating to accounting and auditing, and to the securities law. The special license enables CPAs to audit securities businesses.

The role of an auditor

The auditor will examine the accounts and accounting records of the company and prepare a report for the company's members. The report, included in the published report and accounts, will contain an opinion on whether or not the company's annual accounts have been properly prepared in accordance with the Companies Act, and whether or not they give a true and fair view of the company's financial affairs. The auditor will also consider whether or not the information given in the directors' report is consistent with the annual accounts.

Taxation



Overview of China's current tax system

Tax is the most important source of fiscal revenue of 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. The current tax system was established after the tax system reform in 1994 and the fine-tuning of it in subsequent years.

Whilst the following information is comprehensive, the tax regulations in China can be complex and may be liable to periodic change. Professional advice is therefore recommended on matters that may have tax implications.

Types of taxes

Under the current tax system in China, there are many types of taxes, which can be divided into the following categories:

1. Turnover taxes. There are three kinds of turnover tax: VAT, Consumption Tax and Business Tax. The levy of these taxes is normally based on the volume of turnover or sales of the taxpayers in the manufacturing, distribution or service sectors.
2. Income taxes. This includes Enterprise Income Tax (applicable to such domestic enterprises as state-owned enterprises, collectively-owned enterprises, private enterprises, joint operation enterprises and joint equity enterprises), Income Tax on Enterprises with Foreign Investment and Foreign Enterprises, and Individual Income Tax. These taxes are levied on the basis of the profits gained by producers or dealers, or the income earned by individuals.
3. Resource taxes. The two kinds are Resource Tax and Urban and Township Land Use Tax. These taxes are applicable 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, and aim to account for the difference in profits caused by taxpayers having varying degrees of access to natural resources.

4. Taxes for special purposes. These taxes are City Maintenance and Construction Tax, Farmland Occupation Tax, and Land Appreciation Tax. These taxes are levied on specific items for special regulative purposes.
5. Property taxes. These are House Property Tax and Urban Real Estate Tax
6. Behaviour taxes. There are 7 behaviour taxes, namely Vehicle and Vessel Usage Tax, Vehicle and Vessel Usage License Plate Tax, Stamp Tax, Deed Tax, Slaughter Tax, Banquet Tax and Tobacco Leaf Tax. As the name implies, these taxes are levied on specific behaviours.
7. Customs duties. Customs duties are imposed on goods and articles imported and exported.

Taxes on foreign investment, foreign enterprises and/or foreigners

There are a number of taxes currently applicable to enterprises with foreign investment, foreign enterprises and/or foreigners. These are:

- *VAT*
- *Consumption Tax*
- *Business Tax*
- *Income Tax on Enterprises with Foreign Investment and Foreign Enterprises*
- *Individual Income Tax*
- *Resource Tax*
- *Land Appreciation Tax*
- *Urban Real Estate Tax*
- *Vehicle and Vessel Usage License Plate Tax*
- *Stamp Tax*

- *Deed Tax*
- *Slaughter Tax*
- *Customs Duties*

VAT

Applied scope

All units and individuals, within the territory of the People's Republic of China, who are engaged in the sales of goods, provision of processing, repair and replacement services, and the import of goods, are persons liable to pay VAT (hereafter referred to as "taxpayers"). Outlined below are the VAT regulations

Tax rate

- A. For taxpayers selling or importing goods, the basic tax rate shall be 17%.
- B. For taxpayers selling or importing the following goods, the tax rate shall be 13%.
 - *Food grains, edible vegetable oils*
 - *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 taxpayers exporting goods, the tax rate shall be 0%, except as otherwise stipulated by the State Council.
- D. For taxpayers providing processing, repair and replacement services (hereafter referred to as "taxable services"), the tax rate shall be 17%.

The State Council shall determine any adjustments to the tax rates.

Operation

- A. For taxpayers dealing in goods or providing taxable services with different tax rates, these shall be accounted for separately. If the sales amounts have not been accounted for separately, the higher tax rates shall apply.
- B. For taxpayers engaged in the sales of goods or the provision of taxable services (hereafter referred to as “selling goods or taxable services”), the tax payable shall be the balance of output tax for the period minus the input tax for the period.

If the output tax for the period is insufficient to offset against the input tax for the period, the excess input tax can be carried forward for set-off in subsequent periods.

- C. For taxpayers selling goods or taxable services, the output tax shall be the VAT payable calculated based on the sales amounts and the tax rates. The formula for computing the output tax is:

Output tax = sales amount x tax rate

- D. The sales amount shall be the total compensation and all other charges received from the purchasers by the taxpayer selling goods or taxable services, but excluding the output tax due.

The sales amount shall be calculated in RMB. The sales amount of the taxpayer settled in foreign currencies shall be converted into RMB according to the exchange rate prevailing in the foreign exchange market.

- E. Where the prices used by the taxpayer in selling goods or taxable services are obviously low and without proper justification, the sales amount shall be determined by the competent tax authorities.

For taxpayers purchasing goods or taxable services, VAT paid or borne shall be restricted to the amount of VAT payable as indicated on the following VAT deduction documents:

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

- *VAT indicated in the special VAT invoices obtained from the sellers*
- *VAT indicated on the tax payment receipts obtained from the customs office.*

The deductible input tax for the purchasing of tax exempt agricultural products is calculated based on a deemed deduction rate at 10% on the actual purchasing price. The formula for calculating the input tax is as follows:

Input tax = Purchasing price × Deduction rate

- F. Where taxpayers purchasing goods or taxable services have not obtained and kept the 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 shall be deducted from the output tax.
- G. Input tax on following items shall not be deducted from the output tax:
- *Fixed assets purchased*
 - *Goods purchased or taxable services used for non-taxable items*
 - *Goods purchased or taxable services used for tax exempt items*
 - *Goods purchased or taxable services used for group welfare or personal consumption*
 - *Abnormal losses of goods purchased*
 - *Goods purchased or taxable services consumed in the production of work-in-progress or finished goods, which suffer abnormal losses.*
- H. Small-scale taxpayers engaged in selling goods or taxable services shall use a simplified method for calculating the tax payable.

The Ministry of Finance determines the standard for small-scale taxpayers.

The rate levied on the small-scale taxpayers goods or taxable services shall be 6%. Any adjustment to tax rates shall be determined by the State Council.

For small-scale taxpayers selling goods or taxable services, the tax payable shall be calculated on the sales amount and the tax rate 6%. No input tax should be deducted. The formula for calculating the tax payable is as follows:

Tax payable = sales amount × tax rate.

Small-scale taxpayers with sound accounting who can provide accurate taxation information may, upon the approval of the competent tax authorities, not be treated as small-scale taxpayers. The tax payable shall be computed according to the relevant requirements.

- I. For taxpayers importing goods, tax payable shall be computed based on the composite assessable price and the tax rates prescribed in Article 2 of the Regulations. No tax will be deducted. 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

- J. 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*

- *Equipment and machinery required to be imported under contract processing, contract assembly and compensation trade*
- *Articles imported directly by organizations for the disabled for special use by the disabled*
- *Sale of goods, which have been used by the sellers.*

In all other cases, the VAT exemption and reduction items shall be regulated by the State Council. Local governments or departments shall not regulate any tax exemption or reduction items.

- K. For taxpayers engaged in tax exempt or tax reduced items, the sales amounts for tax exempt or tax-reduced items shall be accounted for separately. If the sales amounts have not been separately accounted for, no exemption or reduction is allowed.

Taxpayers whose sales amounts have not reached the VAT minimum threshold set by the Ministry of Finance, shall be exempted from the VAT.

- L. The time at which VAT liability arises is as follows:
- *For sales of goods or taxable services, it is the date on which the sales sum is received or the documented evidence of right to collect the sales amount is obtained.*
 - *For importation of goods, it is the date of import declaration.*
- M. Taxpayers selling goods or taxable services shall issue special VAT invoices to the purchasers. Sales amounts and output tax shall be separately indicated in the special VAT invoices.

Under any of the following situations, the invoice to be issued shall be an ordinary invoice rather than the 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.*

- N. The location for payment of VAT is as follows:
1. Businesses with a fixed establishment shall report and pay tax with the local competent tax authorities where the establishment is located. If the head office and branch are not situated in the same county (or city), they shall report and pay tax separately with their respective local competent tax authorities. The head office may, upon the approval of the State Administration for Taxation or its authorized tax authorities, report and pay tax on a consolidated basis with the local competent tax authorities where the head office is located.
 2. Businesses with a fixed establishment selling goods in a different county (or city) shall apply for an outbound business activities tax administration certificate from the local competent tax authorities where the establishment is located, and shall report and pay tax with the same tax authorities. Businesses selling goods and taxable services in a different county (or city) without the outbound business activities tax administration certificate shall report and pay tax with the tax authorities where the sales activities take place. The establishment's local tax authorities shall then collect this overdue (unreported) tax from the other tax authorities.
 3. Businesses without a fixed base selling goods or taxable services shall report and pay tax with the local tax authorities where the sales activities take place.
 4. For importation of goods, the importer or his agent shall report and pay tax to the customs office where the imports are declared.
 0. The VAT assessable period shall be one day, three days, five days, ten days, fifteen days or one month. The actual assessable period of the taxpayer shall be determined by the competent tax authorities according to the magnitude of the tax payable of the taxpayer; tax that cannot be assessed in regular periods may be assessed on a transaction-by-transaction basis.

Taxpayers that adopt one month as an assessable period shall report and pay tax within ten 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 ten days from the first day of the following month.

Consumption Tax

Applied scope

All units and individuals engaged in the production, subcontracting for processing or the importation of consumer goods within the borders of the People's Republic of China shall pay Consumption Tax ("taxpayers").

Operation

- 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. If the sales amounts and volumes are not accounted for separately, or if the goods are combined into a whole set of consumer goods for sales, the higher tax rate shall apply.
- B. Taxable consumer goods produced by the taxpayer shall be subject to tax upon sales. For self-produced taxable consumer goods for the taxpayer's own use in the continuous production of taxable consumer goods, no tax shall be levied. Tax shall be assessed when the goods are transferred for other use.

Where a portion of the consumer goods processing is outsourced, the tax shall be collected and paid by the contractor upon delivery to the taxpayer. Where the taxpayer uses the portion of the consumer goods outsourced as an input to complete the processing, the tax paid to the outsourcer can be credited in accordance with the regulations.

Imported taxable consumer goods shall be subject to tax upon import declaration.

- C. Consumption Tax payable shall be calculated using the ad valorem method or the specific value method. The formulae for calculating the tax payable are as follows:

The ad valorem method:

Amount of tax = sales amount x tax rate.

The specific value method:

Amount of tax = sales volume x tax amount per unit.

Where the sales amount of taxable consumer goods are calculated in foreign currency, the taxable amounts shall be converted into RMB according to the exchange rates prevailing in the foreign exchange market.

Contract processed taxable consumer goods shall be assessed according to the sales price of similar consumer goods of the contractor. If the sales price of similar consumer goods is not available, the tax shall be assessed according to the composite assessable value. The formula for this is as follows:

Composite assessable value = (Cost of material + Processing fee) % (1 - Consumption Tax rate)

When tax under the ad valorem method, taxable consumer goods shall be assessed according to the composite assessable value. The formula for calculating the composite assessable value is as follows:

Composite assessable value = (Customs dutiable value + Customs Duty) % (1 - Consumption Tax rate)

- D. Where the taxpayer uses a price, in calculating tax on taxable consumer goods, which is clearly too low and without proper justification, the responsible tax authorities will determine which price to use in calculating tax.

Where taxpayers export taxable consumer goods, the Consumption Tax will not be levied, unless otherwise determined by the State Council. The State Administration shall regulate the procedures for exemption of exported taxable consumer goods for taxation.

- E. On behalf of the tax authorities, the Customs Bureau shall collect Consumption Tax on the imported taxable consumer goods.

Where taxable consumer goods are brought or mailed into China by individuals, the Consumption Tax shall be levied together with Customs Duty. The Tariff Policy Committee of the State Council together with the relevant departments shall formulate the detailed measures.

Where taxpayers sell taxable consumer goods and self-producing taxable consumer goods for their own use, they shall report and pay tax to the local responsible tax authorities, unless otherwise determined by the State.

Where taxable consumer goods are contract processed, the Consumption Tax due shall be paid to the local responsible tax authorities where the contractors are located.

Where taxable consumer goods are imported, the tax shall be reported and paid by the importers or their agents to the customs offices where the imports are declared.

- F. Time limits on payment of Consumption Tax shall be one day, three days, five days, ten days, fifteen days or one month. The actual time limits of the taxpayers shall be separately determined by the responsible tax authorities according to the amount of the tax payable. Tax that cannot be assessed in fixed time limits can be assessed on a transaction-by-transaction basis.

Taxpayers that adopt one month as their time limit shall report and pay tax within ten days following the end of the period. If a time limit 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 filed, with any balance of tax due settled within ten days from the first day of the following month.

Where taxpayers import taxable consumer goods, they shall pay tax within seven days after the completion and issuance of the tax payment certificates by the Customs Bureau.

Business Tax

Applied scope

Within the borders of the People's Republic of China, individuals and organizations that supply services, transfer intangible assets, or sell immovable properties, shall be liable to Business Tax ("taxpayers").

Operation

A. Where a taxpayer provides taxable services, transfers intangible assets or sells immovable properties, the tax payable shall be calculated according to the amount of turnover and the following prescribed tax rates. The formula for calculating the tax payable is as follows:

$$\text{Tax Payable} = \text{Turnover} \times \text{Tax Rate}$$

The tax payable shall be calculated in RMB, The amount of the taxpayer's turnover settled in foreign currency shall be converted into RMB according to the exchange rate prevailing in the foreign exchange market.

For taxpayers engaged in taxable activities which fall into different tax items, the turnover, transfer and sales amounts (hereinafter referred to simply as 'turnover') within different taxable items shall be calculated separately. If it is not calculated separately, then the higher tax rate is applicable to all.

The taxpayer's turnover shall be the total price plus other charges received from the parties for the supply of taxable services, transfer of intangible assets or sales of immovable properties. However, the situations listed below are excluded:

- a. The turnover of transport enterprises that carry passengers or goods from within the borders of the People's Republic of China to locations overseas and carry passengers or goods to other transport enterprises outside the borders, shall be determined by subtracting the transport charges paid to the sub-contracting enterprises from the transport charges for the whole journey.
- b. For travel enterprises that organize tourist groups to travel outside the borders of the People's Republic of China and sub-contract the group care to other travel enterprises overseas, the turnover shall be determined by subtracting the payments made to the sub-contracting travel enterprise from the total tourist charges for the whole journey.
- 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. For re-lending businesses, the turnover shall be determined by subtracting the interest cost of borrowing from the interest received from lending.
- e. 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.
- f. The Ministry of Finance shall rule on other situations

Where a taxpayer concurrently has both tax-exempt or tax reduced items, he shall make an appropriate independent calculation of the business amount of the exempt and reduced tax items. If no independent calculation of the business amount is made, he shall not receive exemption or reduction of tax.

B. Business Tax withholding agents are as follows:

- a. Where financial organizations are authorized to extend loans, the financial organizations given authorization to extend loans shall be the withholding agents.
- b. Where construction and installation businesses sub-contract out work, the main contractors shall be the withholding agents.
- c. Other withholding agents are determined by the Ministry of Finance.

C. Locations for payment of Business Tax are as follows:

- a. Taxpayers providing taxable services shall report and pay tax to the local tax authorities where the taxable services are provided. Taxpayers engaged in the transportation business shall report and pay tax to the tax authorities where the business establishment is located.
- b. Taxpayers transferring land use rights shall report and pay tax to the local tax authorities where the land is located. Taxpayers transferring other intangible assets shall report and pay tax to tax authorities where the establishment is located.
- c. Taxpayers selling immovable properties shall report and pay tax to the local tax authorities where the properties are located.

- D. The Business Tax assessable period shall be five days, ten days, fifteen days or one month. The responsible tax authorities, according to the amount of tax payable, shall determine the actual assessable period of taxpayers. Tax that cannot be assessed in fixed periods can be assessed on a transaction-by-transaction basis.

Where a taxpayer uses one month as an assessable period, he shall report and pay tax within ten days following the end of the assessment period. If an assessable period of five days, ten days or fifteen days is used, the taxpayer shall report and pay tax within five days after the end of the assessment period and a monthly tax return shall be filed, with any balance of tax due settled within ten days from the first day of the following month.

The tax payment deadlines for withholding agents shall be implemented according to the two requirements above.

Enterprise Income Tax

Taxpayers

Taxpayers of Enterprise Income Tax include any state-owned enterprise, collective enterprise, private enterprise, joint operation enterprise, joint equity enterprise, and include some other organizations too.

Tax base

The taxpayers' world-wide income from production and business operations, and from other sources, shall be subject to Enterprise Income Tax. The Enterprise Income Tax is computed on the basis of taxable income. This is the total income earned by the taxpayer in a tax year, minus permitted deductions for that tax year.

Tax rates and computation of tax payable

Normally, the amount of Enterprise Income Tax payable is calculated on the basis of the taxable income at the rate of 33%, i.e. the formula is:

$$\text{Income tax payable} = \text{taxable income} \times 33\%$$

Besides the statutory rate, two lower rates of 18% and 27% are designed for some less profitable enterprises.

Major tax exemptions and reductions

- A. Enterprises operating in autonomous regions may be given on request tax reductions or exemptions for a specified period, upon the approval of the People's Government at provincial level.
- B. Tax exemption/reduction may be granted to enterprises or businesses that meet the relevant rules of the State. These include:
 - *high-tech enterprises*
 - *enterprises engaged in tertiary industry (in line with the relevant State regulations)*
 - *enterprises using wastes as their key raw materials*
 - *newly-registered enterprises located in the revolutionary base areas, minority nationality areas, remote areas and poor areas approved by the State*
 - *enterprises suffering from serious natural disasters*
 - *newly-registered service enterprises providing social employment opportunities*
 - *factories and farms run by schools under the educational administration departments*
 - *welfare production enterprises belonging to the civil administration departments*
 - *township enterprises*
 - *State-owned agricultures.*

Income Tax on Enterprises with Foreign Investment and Foreign Enterprises

Taxpayers

Domestic state-owned enterprises (SOEs) are subject to tax at a rate of 33%. A different set of tax computation rules applies to foreign or foreign-funded enterprises. Income Tax on Enterprises with Foreign Investment and Foreign Enterprises covers a variety of enterprises. These include:

- *Sino-foreign equity joint ventures (EJVs)*
- *cooperative joint ventures (CJVs)*
- *wholly foreign-owned enterprises (WFOEs)*
- *other forms of business activities and operations conducted by foreign companies.*

All foreign investment enterprises (FIEs) and foreign enterprises (FEs) are subject to the Income Tax Law of the PRC on Enterprises with Foreign Investment and Foreign Enterprises, which is levied by the central government. In addition, local authorities are entitled to levy a surcharge and collect certain registration and license fees.

FIEs include EJVs, CJVs and WFOEs. A FIE is subject to tax on its worldwide income. However, a foreign tax credit is allowed for income taxes paid to other countries by branches of the FIE, limited to the PRC income tax payable on the same income. If CJVs are not legal persons, the parties to the joint ventures may elect to be taxed separately on their share of the income received or, with the approval of the local tax bureau, taxed as a single entity.

FEs include foreign companies, enterprises and other economic organizations such as representative offices, contracted projects and royalty arrangements. FEs are subject to tax only on their income from PRC sources. The taxation of FEs depends on whether the enterprise has an establishment in China. FEs with establishments in China are subject to tax on all income derived from the PRC; however, those without establishments in the PRC are subject only to withholding tax on income from PRC sources.

The term “establishment” is broadly defined to include the following: a place of

management; a branch; an office; a factory; a workshop; a mine or an oil and gas well or any other place of extraction of natural resources; a building site; a construction, assembly, installation or exploration project; a place for the provision of labor services; and business agents.

Rates of Corporate Tax

In general, FIEs and FEs with establishments in China are taxed at an effective rate of 33% (national tax rate of 30% plus local tax rate of 3%).

A reduced rate of 15% applies to FIEs and FEs with establishments in China located in Special Economic Zones (SEZs). These SEZs are in Shenzhen (including Shekou), Zhuhai, Shantou in Guangdong Province, Xiamen in Fujian Province and Hainan Province.

The reduced rate of 15% also applies to FIEs engaged in production or manufacturing activities located within the Pudong Development Zone in Shanghai and within the Economic and Technology Development Zones of the 14 Open Cities. The Open Cities are Beihai, Dalian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinhuangdao, Shanghai, Tianjin, Wenzhou, Yantai and Zhanjiang. FIEs engaged in infrastructure projects, including energy, transportation and port development, are also taxed at the reduced rate of 15%.

The location of special zones and the income tax rates that apply are subject to change. Each location opportunity and its applicable income tax rate need to be confirmed in every case.

FIEs engaged in production and manufacturing activities located within the Coastal Open Economic Regions (Liaodong Peninsula, Shandong Peninsula, Changjiang and Pearl River Deltas, and Southern Fujian, including Zhangzhou and Quanzhou Delta Areas) and within the 14 Open Cities, Provincial Capitals and Changjiang Cities, are taxed at a reduced rate of 24%. FIEs engaged in production and manufacturing activities in Beijing and Chongqing are also taxed at a reduced rate of 24%.

Tax incentives

A. The following enterprises may qualify for tax holidays and significant reductions in the applicable tax rate:

- *FIEs engaged in production and manufacturing activities with an operating period of 10 years or more.*
- *FIEs engaged in production and manufacturing activities in SEZs, the Pudong Development Zone, and Economic and Technology Development Zones.*
- *Export-oriented and technologically advanced FIEs.*
- *Infrastructure projects in SEZs and in the Pudong Development Zone scheduled to operate 15 years or more.*

B. Start-up tax benefits

FIEs engaged in production and manufacturing activities are granted favorable tax treatment during their start-up period. These entities are granted a two-year tax exemption and a three-year 50% tax rate reduction beginning from the venture's first profit-making year. In addition to the initial five-year tax holiday, China also grants special tax concessions for certain priority industries, low-profit operations and projects in remote or economically depressed areas.

C. Reinvestment tax incentives

Foreign investors reinvesting their share of profits in the same investment venture or in a newly created foreign investment venture for a period of five years or longer are entitled to a 40% refund of the tax paid on the amount reinvested. The tax refund increases to 100% if the reinvestment is in an export-orientated or technologically advanced enterprise.

D. Export-orientated enterprises and technologically advanced enterprises

A FIE that exports 70% or more of its total output value for any year may enjoy a further 50% tax reduction for that year after the end of the five-year tax holiday. Enterprises that are already subject to a reduced tax rate of 15%, and that are eligible for the reduction applicable to export-orientated enterprises, are subject to corporate income tax at a rate of 10%.

If a FIE qualifies as a "technologically advanced enterprise" after the tax holiday period, it is granted a three-year extension of the 50% tax reduction.

E. High-technology development zones

China has established more than 110 high-technology industrial development zones to promote the development of technology. Enterprises in such development zones enjoy a reduced tax rate of 15%, a tax holiday for the initial period and other preferential treatment.

F. Capital gains and losses

Capital gains and losses are subject to the same treatment as other taxable income. Capital gains realized by foreign investors who dispose of an interest in a FIE are subject to a 10% withholding tax, even if the gain is realized outside the PRC. In addition to income tax, real property gains tax is imposed on gains derived from transfers of real property.

Administration

The tax year in China is the calendar year. An annual return, together with an audited financial statement issued by a CPA registered in China, is due within four months after the close of the tax year for all FIEs and FEs with establishments in China. Such enterprises must settle all outstanding tax liability within five months after the end of the tax year.

FIEs and FEs with establishments in China must also file quarterly provisional returns within 15 days after the end of each quarter, together with payments of provisional tax based on actual profit. If an enterprise has difficulty filing a provisional tax return based on the actual quarterly profit, it may pay tax based on its estimated profit. The estimated profit is normally computed by reference to one-quarter of the enterprise's actual profits for the preceding year. Otherwise, the estimated profit is computed using other methods approved by the tax bureau.

Foreign tax relief

A tax credit is allowed for foreign taxes paid by FIEs to other countries. This is not to exceed the relevant PRC tax payable on such income. Excess foreign tax credits may be carried forward for a period of five years.

China has concluded double taxation agreements with most European and Asia-Pacific countries, Canada and the United States. The terms of most treaties are modeled on

the United Nations Double Taxation Convention Between Developed and Developing Countries, which encourages investment by industrialized countries in less developed countries.

Determination of taxable income

A. Starting point for determining taxable income

Taxable income is defined as revenues minus deductible expenses, based on accounts prepared in accordance with the Accounting Regulations of the PRC for Enterprises with Foreign Investment (also applicable to FEs by reference). No differences exist between tax and accounting methods to compute income. Taxable income includes dividends, bonuses, interest, royalties, rent and other income. However, dividends received by FIEs from other FIEs in the PRC are exempt from tax.

B. Deductions

All necessary and reasonable expenses incurred in carrying on a business are deductible for tax purposes. Employee expenses are fully deductible. Entertainment expenses related to production or operations are deductible subject to limitations and must be substantiated with supporting documentation. For head office expenses, only actual amounts paid are deductible, and must be properly documented and verified by a CPA registered in the country of the head office. For interest on loans, only reasonable amounts are deductible.

Nondeductible expenses include interest on equity capital, income tax payments (including penalties and surcharges), royalties paid to the head office and other expenses not related to production or operations.

Inventories

Inventory valuation is based on historical cost, computed using one of the following four methods: first-in, first-out (FIFO); moving average; weighted average; or last-in, first-out (LIFO). The local tax authorities must approve any change in the adopted method. The principle of lower-of-cost or market value does not apply. A provision for stock obsolescence is generally not permitted, but write-offs for actual obsolescence are allowed.

C. Provisions

FIEs operating as financial institutions may establish bad debt allowances. However, the allowances may not exceed 3% of the year-end balance of loans receivable.

Unrealized foreign exchange gains or losses may be recognized or amortized over one to five years, subject to approval by the local tax authorities.

Depreciation and amortization allowances

Depreciation of tangible properties must be computed using the straight-line method. Unless approval is obtained from the tax authorities, the residual value of fixed assets may not be less than 10% of cost. The tax authorities must approve the use of accelerated depreciation. The following table lists minimum useful lives for certain assets.

<i>Asset</i>	<i>Years</i>
Buildings	20
Production equipment, trains and ships	10
Furniture, electronic equipment, other transportation equipment	5

Intangible assets, including technical know-how, patents and trademarks, are amortized over the contractual term, or over 10 years if a time period is not specified.

D. Restrictions on interest deductions

Reasonable interest payments on loans are deductible after examination by the local tax bureau. However, no deduction is allowed for shareholders' loans if the registered capital pledged by the parties is not fully paid-up.

One of the more important concepts to understand for FIEs is the "thin capital" or debt/equity guidelines that prescribe the amount of registered capital that aligns with the total investment required for the FIE.

The following debt-to-equity ratios apply for FIEs in China:

- *For investment projects less than US\$3 million, the capital contribution must equal or exceed 70% of the total investment*

- *For investment projects from US\$3 million to US\$10 million, the minimum capital requirement is 50% of the total investment, but not less than US\$2.1 million*
- *For investment projects from US\$10 million to US\$30 million, the minimum capital requirement is 40% of the total investment, but not less than US\$5 million*
- *For investment projects in excess of US\$30 million, the minimum capital requirement is 33.3% of the total investment, but not less than US\$12 million.*

E. Foreign exchange gains and losses

Exchange gains or losses incurred due to differences in exchange rates are reflected in the profit-and-loss account in the period during which the exchange difference arises. On obtaining approval from the local tax bureau, taxpayers may charge or credit differences from revaluation (such as differences between year-end rates and book rates) to a foreign-currency translation account, and may amortize them over a period from one to five years.

Exchange gains or losses are generally taxable or deductible when realized.

F. Relief for losses

Tax losses may be carried forward for up to five years. Carry-backs are not allowed.

Related companies

A. Transfer pricing

The PRC tax law includes rules on transfer pricing. Under these rules, all fees paid or charged in business transactions between related parties must be determined according to an “arm’s length” standard. If the parties fail to meet this requirement, the tax bureau may make reasonable adjustments by using one of the following methods:

- *Comparable uncontrolled price*
- *Reasonable profit margin*

- *Cost-plus formula with a reasonable markup*
- *Other methods deemed appropriate by the tax authorities.*

For purposes of the transfer pricing rules, parties are related through direct or indirect ownership, common control by a third party or a relationship with a common interest. Intercompany transactions covered by the transfer pricing rules include sales or purchases of goods, technology transfers, provision of services, financing transactions and other business transactions.

B. Consolidated Returns

In general, consolidated returns are not permitted. All companies must file separate tax returns. However, FIEs and FEs may adopt consolidated filing for units operating in different areas of China. To calculate their tax liability, these enterprises must apply the relevant tax rate for the location of each operating unit. Losses in one location may offset income in another location.

Individual Income Tax

See Chapter 6.

Resource Tax

Taxpayers

The taxpayers of Resource Tax include all units and individuals engaged in the exploitation of mineral resources or production of salt prescribed in the Resource Tax Regulations within the territory of the People's Republic of China.

Computation of tax payable

The amount of Resource Tax payable is based on the quantity of the taxable products by applying the applicable tax amount per unit. The formula is:

Tax payable = quantity of taxable products × applicable tax amount per unit

The main tax reductions and exemptions

- *Crude oil used for heating or repairing wells in the course of exploiting crude oil may be exempt*
- *For taxpayers suffering huge losses due to accidents or natural disasters in the course of exploiting or producing taxable products, tax reduction/exemption may be given depending on the seriousness of the situation*
- *The Resource Tax payable on iron ores and on the non-ferrous metal ores by independent mines may be reduced.*

Urban and Township Land Tax

Taxpayers

The taxpayers of Urban and Township Land Use Tax include all enterprises, units, individual household businesses and other individuals. The only exclusions are enterprises with foreign investment, foreign enterprises and foreigners.

Computation

The amount of tax payable is computed on the basis of the actual size of the land occupied by the taxpayers and by applying the specified applicable tax payable per unit. The formula is:

Tax payable = size of land occupied × tax payable per unit

Major exemptions

Tax exemptions may be given on land occupied by governmental organs, people's organizations and military units for their own use; land occupied by units for their own use which are financed by the institutional allocation of funds from financial departments of the State; land occupied by religious temples, parks and historic scenic spots for their own use; land for public use occupied by Municipal Administration, squares and green land; land directly utilized for production in the fields of agriculture, forestry, animal husbandry and fishery industries; land used for water reservation and protection; and land occupied for energy and transportation development upon approval of the State.

City Maintenance and Construction Tax

Taxpayers

Taxpayers of City Maintenance and Construction Tax include enterprises of any nature, units, individual household businesses and other individuals who are obliged to pay VAT, consumption Tax and/or Business Tax. The only exceptions are enterprises with foreign investment, foreign enterprises and foreigners.

Tax rates and computation of tax payable

Differential rates are adopted: 7% rate for city area, 5% rate for county and township area and 1% rate for other area. The tax is based on the actual amount of VAT, Consumption Tax and/or Business Tax paid by the taxpayers, and paid together with the three taxes mentioned above. The formula for calculating the amount of the tax payable:
Tax payable = tax base × tax rate applicable

Farm Land Occupation Tax

Taxpayers

Taxpayers of Farm Land Occupation Tax are enterprises, units, individual household businesses and other individuals who occupy farm land for building construction or for other non-farm purposes. The exceptions are enterprises with foreign investment, foreign enterprises and foreigners.

Computation

This tax is based on the area of farm land actually occupied by taxpayers and is paid in lump-sum. The formula for computing the tax payable is:

Tax payable = area of farm land actually occupied by taxpayer × applicable amount of tax per square metre

Major exemptions and reductions

- A. Exemptions may be given on land for military facilities; land for railroads and airports; land for schools and hospitals; land for farm irrigation facilities;

brownfield land for construction of new houses in rural areas, where the land has been turned to agriculture; land for settling immigrants due to reservoir construction, victims of calamity or refugees.

- B. Tax reductions or exemptions may be given on land for construction of new houses for:
- *rural residents*
 - *families of revolutionary martyrs*
 - *disabled revolutionary military servants*
 - *widows and orphans in rural areas*

Also on land for the construction of

- *welfare factories set up by Civil Affairs Department for settling the employment of the disabled*
- *motor roads.*

Disadvantaged peasants in old revolutionary base areas, minority nationality areas and remote mountain regions who build new houses within the stipulated standards of land use, and who have real difficulty in paying the tax, may also be eligible.

Land Appreciation Tax

Taxpayers

The taxpayers of Land Appreciation Tax include enterprises, units, individual household businesses and other individuals who receive income from a transfer of real estate (i.e. a disposal or other means of transfer with consideration of State-owned land use rights, buildings on land and their attached facilities).

Tax base and tax rates

The Land Appreciation Tax is based on the appreciation amount derived by the taxpayer from the transfer of real estate, which equals to the balance of proceeds received by the

taxpayer on the transfer of real estate after deducting the sum of deductible items as prescribed.

The Land Appreciation Tax adopts four levels of progressive rates:

<i>Level</i>	<i>Tax base</i>	<i>Tax rates</i>
1	That part of the appreciation amount not exceeding 50% of the sum of deductible items	30%
2	That part of the appreciation amount exceeding 50%, but not exceeding 100%, of the sum of deductible items	40%
3	That part of the appreciation amount exceeding 100%, but not exceeding 200%, of the sum of deductible items	50%
4	That part of the appreciation amount exceeding 200% of the sum of deductible items	60%

Computation of tax payable

To calculate the amount of Land Appreciation Tax payable, the first step is to arrive at the appreciation amount derived by the taxpayer from the transfer of real estate. This is equal to the balance of proceeds received by the taxpayer on the transfer of real estate after deducting the sum of relevant deductible items. The tax payable is then calculated respectively for different parts of the appreciation by using the applicable tax rates in line with the percentages of the appreciation amount over the sum of the deductible items.

The total amount of tax payable is the sum of the different parts of the appreciation. The formula is:

$$\text{Tax payable} = \Sigma (\text{part of appreciation} \times \text{applicable rate})$$

Major exemptions

The Land Appreciation Tax is not applied in situations where the appreciation amount on the sale of ordinary standard residential buildings construction does not exceed 20% of the sum of deductible items. Neither does it apply when the real estate is taken over or repossessed in accordance to the laws due to the construction requirements of the State.

House Property Tax

Taxpayers

House Property Tax is levied in cities, county capitals, townships and industrial and mining districts. Taxpayers are owners of house property, operational and managerial units of house property, mortgagees, custodians and users of house property. The exceptions are enterprises with foreign investment, foreign enterprises and foreigners.

Tax base, tax rates and computation of tax payable

Two different rates are applied, depending on the circumstances. In cases where the tax base is the residual value after the subtraction of 10% to 30% of the original value from the original value of the property, the tax rate is 1.2%. In cases where the tax base is the rental income from the property, the rate is 12%. The formula for calculating House Property Tax payable is:

Tax payable = tax base × applicable rate

Major exemptions

Those potentially exempt from House Property Tax include the following:

- *house property for the own use of State organs, people's organizations and the armed forces*
- *house property for the own use of institutions whose operating funds are allocated by State finance departments*
- *house property for the sole use of religious temples and shrines, parks and places of historic interest and scenic beauty*
- *house property owned by individuals for non-business use*
- *damaged or hazardous houses verified as being out of use by the relevant department.*

Vehicle and Vessel Usage Tax

Taxpayers

Taxpayers include enterprises, units, individual household businesses and other individuals who possess and operate vehicles and/or vessels within the territory of the People's Republic of China. The exceptions are enterprises with foreign investment, foreign enterprises and foreigners.

Tax base and computation of tax payable

The tax base falls into two categories: vehicles and vessels. The tax base for vehicles is the number of the taxable vehicles or the net tonnage of the taxable vehicles. The tax base for vessels is the net tonnage or the deadweight tonnage of the taxable vessels. The formula for each is:

- *Tax payable = number (or net tonnage) of taxable vehicles × applicable tax amount per unit*
- *Tax payable = net tonnage (or deadweight capacity) of the taxable vessels × applicable tax amount per unit*

Major exemptions

There may be exemption from this tax for:

- *vehicles and vessels used exclusively by governmental organs, people's organizations and military units*
- *vehicles and vessels used exclusively by units financed by financial fund allocation*
- *fishing vessels with a deadweight capacity not in excess of one tonne*
- *pontoons and floating docks used exclusively for passengers, the loading or unloading of cargo and the storage of goods*
- *vehicles and vessels used by the police department, fire department, health*

department or environmental department

- *vessels subject to payment of Vessel Tonnage Tax according to Rules*
- *special vehicles for the disabled*
- *tractors used mainly in agriculture production.*

Stamp Tax

Taxpayers

The taxpayers of Stamp Tax include any enterprise, unit, individual household business operators, and other individuals who execute or receive specified economic documents within the territory of China.

Computation

The computation of Stamp Tax is based on the amount of payment, fees or receipts listed on the taxable documents, or the number of pieces of the taxable documents. Tax is calculated using the applicable tax rate listed in the Schedule of Stamp Tax Taxable Items, or by using the amount of tax per unit. The two formulae are:

- *Tax payable = amount of payment (or fees, receipt) indicated in taxable documents × applicable rate*
- *Tax payable = number of pieces of taxable documents × tax amount per unit*

Major exemptions

Tax exemptions may be granted on the following:

- *duplicates or copies of documents on which Stamp Tax has already been paid*
- *documents executed when property is donated to the government, social welfare units supporting the widowed, the aged, the injured and the disabled, or schools*
- *non-interest bearing or discounting loan contracts*

- *preferential loan contracts concluded between foreign governments or international financial institutions and the Chinese government or State financial institutions*
- *insurance contracts for agriculture and forestry products, and animals in animal husbandry.*

Deed Tax

Taxpayers

The taxpayers of Deed Tax are those enterprises, units, individual household businesses and other individuals that are the transferees of house property transferred within the territory of China.

Tax base

The Deed Tax is normally based on one of the following:

- *The transactional price in case of sale/purchase of houses or sale or use right of State-owned land*
- *Assessment made by tax collection offices in reference to the market price of land use right sale or house sale (in cases of transferring land use right or house(s) as a gift)*
- *The difference of the land use right price and the house price, in cases of exchange of land use right and house(s).*

Deed Tax adopts a flat rate within the range of 3%–5%. The rate applicable in jurisdictions at provincial level shall be determined within this range by the government at the provincial level. The formula is:

Tax payable = tax base × applicable rate

Major tax exemptions and reductions

Deed Tax exemptions/reductions may be granted for:

- *land and houses received by Governmental organs, institutions, social organizations and military units for the use of*
 - *offices*
 - *lecturing*
 - *medical treatment*
 - *scientific research*
 - *military facilities*
- *State-owned houses purchased for the first time by employees in cities and towns under the relevant rules*
- *the use right of barren mountains, barren gullies, barren hills and/or barren beaches received for use in*
 - *agriculture*
 - *forestry*
 - *animal husbandry*
 - *fishing industry;*
- *diplomatic organizations and staff satisfying the relevant rules of tax exemption*
- *residential houses purchased as a result of house loss due to force majeure.*

Customs Duties

Duty payers

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.

Computation of duty payable

Customs Duty is computed either on ad valorem basis with the use of an applicable rate, or on a quantity basis by applying amount of duty per unit.

The formula is:

a. Duty payable = quantity of imported/exported goods × tax-inclusive price × rate
or

b. Duty payable = quantity of imported/exported goods × amount of duty per unit

Major reductions and exemptions

- *The following goods may be exempted from Customs Duties upon verification by the Customs:*
 - *the duty amount to be paid for one consignment of goods below RMB 10 yuan*
 - *advertising matter and trade samples of no commercial value*
 - *goods gifted by international organizations or foreign governments*
 - *fuels, stores and beverages loaded on a means of conveyance entering or leaving the country for use en route.*
- *Duty reduction or exemption shall be given to goods and articles specified as duty reduction or exemption items by international treaties to which the People's Republic of China is either a contracting or an acceding party.*
- *Raw materials, subsidiary materials parts, accessories, components and packing materials imported for overseas businesses to process, assemble or produce export-oriented products shall be exempt from duties on the proportion actually processed and exported; alternatively, duties may be collected first on the imported materials and parts and then refunded on the basis of the completed products actually processed and exported.*

Disclaimer: Please check with local tax authorities to ensure regulation and/or terms of regulations have not been amended. The information above can only serve as a guideline as new circulars are regularly being distributed that will amend portions of the regulations.

Foreign personnel in China



Foreign citizens must obtain the permission of the Chinese government in order to enter, travel through or reside in China. For entry, exit and transit, foreigners must pass through the designated ports and will be subject to inspection by the frontier inspection offices. The same applies to foreign-owned means of transport (i.e. vehicles). Foreign citizens in China must abide by Chinese laws and may not endanger the State security of China, harm public interests or disrupt public order.

Entry into China

For entry into China, visitors must apply for visas from Chinese diplomatic missions, consular offices or other resident agencies authorized by the Ministry of Foreign Affairs. In specific situations foreigners may, in compliance with the provisions of the State Council, apply for visas to visa-granting offices at ports designated by Chinese government authorities.

The entry of nationals from countries that have visa agreements with the Chinese government shall be handled in accordance with those agreements. In cases where another country has special provisions for Chinese citizens entering and transiting that country, the Chinese government may adopt reciprocal measures depending on the circumstances. Visas are not required for aliens in immediate transit on connected international flights who hold passenger tickets and stay for no more than 24 hours in China entirely within airport boundaries. Anyone desiring to leave the airport temporarily must obtain permission from the frontier inspection office.

Visa application

Quite simply, a Chinese visa is a permit issued to a foreigner by the Chinese visa authorities for entry into, exit from, or transit through the Chinese territory. The Chinese visa authorities may issue a diplomatic, courtesy, service or ordinary visa to a foreigner according to their identity, purpose of visit and passport type. Ordinary visas consist of eight sub-categories, which are marked with Chinese phonetic letters (D, Z, X, F, L, G, C, J-1 and J-2 respectively).

Visa D: Issued to foreigners who are to reside permanently in China.

Visa Z: Issued to foreigners who are to take up posts or employment in China, and to their accompanying family members.

Visa X: Issued to foreigners who come to China for study, advanced studies or job-training for a period of six months or more.

Visa F: Issued to an applicant who is invited to China on a visit, on a study or lecture, business tour, for scientific-technological and cultural exchanges, for short-term refresher course or for job-training, for a period of no more than six months.

Visa L: Issued to foreigners who come to China for sightseeing, visiting relatives or other private purposes. Tourist applicants must in principle be able to give evidence of their financial capability of covering the traveling expenses in China and, when necessary, supply their air, train or ship tickets to the destination country/region after leaving China.

Visa G: Issued to foreigners who transit through China.

Visa C: Issued to train attendants, air crew members and seamen operating international services, and to their accompanying family members.

Visa J-1: Issued to foreign resident correspondents in China.

Visa J-2: Issued to foreign correspondents who make brief trips to China on reporting tasks.

Residence permits

Foreign nationals may obtain residence permits valid for one to five years. A permit may be renewed an unspecified number of times. A renewed permit is normally valid for one year.

When applying for an entry visa, if a foreign national intends to take up permanent residence or stay in China for one year or more, he or she must present a notarized health certificate issued by a health and medical unit designated by the government of their home country, or issued by any health and medical unit. The health certificate must remain valid for six months from the date of issue.

Employee rights

The Chinese Government shall protect the lawful rights and interests of foreigners on Chinese territory.

Foreigners have inviolable freedom of person. No foreigner may be arrested except by the approval or decision of a people's procuratorate, or by decision of a people's court, and arrest must be made by a public security organ or state security organ.

The employer and its foreign employee should, in accordance with law, conclude a labour contract, the term of which cannot exceed five years. Such contract may be renewed upon expiration after the completion of clearance process.

The wage paid to the foreign employee by the employer shall not be lower than the minimum wage in the locality.

Working hours, rest and vacation, work safety and hygiene, as well as the social security of the foreign employees in China, shall follow the relevant provisions of the State.

Taxation on residents and non-residents

In accordance with the PRC Individual Income Tax (IIT) Law adopted by China's NPC in 2005, individual income tax is imposed on all individuals, including both PRC and foreign nationals residing in or deriving income from the PRC.

Territoriality

PRC residents are generally subject to tax on their worldwide income. Nonresidents are subject to tax on their PRC-source income only.

Definition of resident

PRC residents include the following persons:

- *Individuals who maintain a permanent home in China*
- *Individuals who do not maintain a permanent home in China, but reside in China for one year or longer.*

Individuals are considered to have resided in China for one year if they reside in China for 365 days during one calendar year. In calculating the number of days an individual is present in China, temporary absences from China may not be excluded. A temporary absence is defined as a single absence from China for a period of no longer than 30 days, or as multiple absences from China for an aggregate of no longer than 90 days.

Individuals who are considered one to five-year tax residents are subject to PRC individual income tax on income earned in China and on foreign income remitted to China during the period of residency.

Individuals who maintain a permanent home in China and those residing in China for five years or longer are subject to PRC individual income tax on worldwide income, regardless of whether the income is remitted to the PRC.

Income subject to tax

Income from:

- *wages and salaries*
- *production or business operation derived by individual industrial and commercial households*
- *contracted or leased operation of enterprises or institutions*
- *remuneration for personal service*
- *author's remuneration*
- *royalties*
- *interest, dividends and bonuses*
- *lease of property*
- *transfer of property*
- *contingent income*

- *other income specified as taxable by MOF.*

Exempt income

The following types of income are exempt from tax:

- *Awards for achievements in science, education, technology, culture, public health, physical culture and environmental protection granted by the Provincial People's Governments, Ministries and Commissions under the State Council, the People's Liberation Army Units at army level and above and by foreign or international organizations*
- *Interest income on saving deposits and national debt obligations and other financial debentures issued by the State*
- *Subsidies and allowances received under the State uniform provisions*
- *Welfare benefits, survivors pensions and relief payments*
- *Insurance indemnities*
- *Military severance pay and demobilization pay received by members of the armed forces*
- *Settlement pay, severance pay, retirement pay and retirement living allowances received by public servants and workers under State uniform provisions*
- *Income derived by the diplomatic agents and consular officers and other personnel who are exempt from tax under the provisions of the relevant laws of China*
- *Income exempt from tax as stipulated in the international conventions to which the Chinese Government is a party and in agreements it has entered into*
- *Income exempt from tax with the approval of the finance department of the State Council.*

In any of the following situations, individual income tax may be reduced upon approval:

- *The income is derived by disabled persons, unsupported aged persons or members of a martyr's family*
- *A taxpayer suffers major losses due to natural disasters*
- *Miscellaneous other cases in which reduction is approved by the finance department of the State Council.*

Computation

The amount of taxable income is computed as follows:

- A. For income from wages and salaries, a monthly deduction of 1600 yuan shall be allowed for expenses and that part in excess of 800 yuan shall be the taxable income.
- B. For income from production or business operation derived by individual industrial and commercial households, the taxable income shall be the amount remaining from the gross income in a tax year after the costs, expenses and losses have been deducted.
- C. For income from contracted or leased operation of enterprises or institutions, the taxable income shall be the amount remaining from the gross income in a tax year after the deduction of necessary expenses.
- D. For income from remuneration for personal service, author's remuneration, royalties and lease of property, a deduction of 800 yuan shall be allowed for expenses, if the amount received in a single payment is less than 4000 yuan. For single payments of 4000 yuan or more, a deduction of 20% shall be allowed for expenses. The remaining amount after the deduction shall be the taxable income.
- E. For income from transfer of property, the taxable income shall be the amount remaining from the gross transfer income after deducting the original value of the property and reasonable expenses.
- F. For interest, dividends, bonuses, contingent income and other income, the taxable income may be the full amount received in each payment.

The part of individual income donated to educational and other public welfare undertakings shall be deducted from the taxable income in accordance with the relevant regulations formulated by the State Council.

For taxpayers who are not domiciled in China but derive wages and salaries from sources within China, or have domicile in China but derive wages and salaries from sources outside China, the additional deduction for expenses shall be based on the average income level, living standard and the changes of exchange rates. The scope of application and amount of the additional deduction for expenses shall be regulated by the State Council.

Income tax paid to foreign tax authorities on income derived from sources outside China shall be allowed as credit against the amount of income tax payable. The creditable amount, however, shall not exceed the amount of tax otherwise payable under this Law in respect of the income derived from the sources outside China.

Individual income tax rates:

- A. Income from wages and salaries shall be taxed at progressive rates ranging from 5% to 45%.

(Applicable to income from wages and salaries)

Grade	Monthly taxable income	Tax rate (%)
1	Income of 500 yuan or less	5
2	That part of income in excess of 800 to 2000 yuan	10
3	That part of income in excess of 2000 to 5000 yuan	15
4	That part of income in excess of 5000 to 20000 yuan	20
5	That part of income in excess of 20000 to 40000 yuan	25
6	That part of income in excess of 40000 to 60000 yuan	30
7	That part of income in excess of 60000 to 80000 yuan	35
8	That part of income in excess of 80000 to 100000 yuan	40
9	That part of income in excess of 100000 yuan	45

Note: "Monthly taxable income" mentioned in this schedule refers to the amount remaining from the gross income in a month after the deduction of 1600 yuan and any additional deduction for expenses in accordance with the provision.

- B. Income from production and business of individual industrialists and merchants and income from contracted or leased operation of enterprises or institutions shall be taxed at progressive rates ranging from 5% to 35%.

<i>Grade</i>	<i>Monthly taxable income</i>	<i>Tax rate (%)</i>
1	Income of 5000 yuan or less	5
2	That part of income in excess of 5000 to 10000 yuan	10
3	That part of income in excess of 10000 to 30000 yuan	20
4	That part of income in excess of 30000 to 50000 yuan	30
5	That part of income in excess of 50000 yuan	35

Note: "Annual taxable income" mentioned in this schedule refers to the amount remaining from the gross income in a tax year after the costs, expenses and losses have been deducted in accordance with the provisions.

- C. Income from author's remuneration shall be taxed at a flat rate of 20%; the amount of tax payable, however, shall be reduced by 30%.
- D. Income from remuneration for personal service shall be taxed at a flat rate of 20%. Where a specific payment of income from remuneration for personal service is excessively high, additional tax can be levied at a rate to be specifically determined by the State Council.
- E. Income from royalties, interest, dividends, bonuses, lease of property and transfer of property, as well as contingent income and other income, shall be taxed at a flat rate of 20%.

Non-residents

Individuals who do not maintain a permanent place of abode in China and who work in the PRC fewer than 365 days in a calendar year are considered nonresidents and are subject to individual income tax under different rules, as described below.

A. Resident for 90 days or less

Individuals who reside in China continuously or intermittently for not more than 90 days during a calendar year are treated in the following manner.

The expatriate is exempt from individual income tax if the salary is paid and borne by an overseas employer. Employment income paid or borne by the employer's establishment in China is subject to individual income tax to the extent that the income is attributable to services actually performed in China. Normally, the tax liabilities are apportioned into PRC and non-PRC services in accordance with the actual number of days the expatriate resides in China. An establishment for these purposes includes a representative office and the site of a contract project in China.

B. Residents for 90 to 364 days

Individuals who reside in China for more than 90 days, but less than one year, are treated in the following manner.

The expatriate is subject to individual income tax on employment income derived from services actually performed in China. Assessable income includes all employment income, whether it is paid or borne by an employer inside or outside China. Employment income attributable to services performed outside China is exempt from individual income tax.

C. Directors and managers

If an expatriate is a director, general manager or deputy general manager of an enterprise registered in China, all employment income paid or borne by Chinese enterprise is subject to individual income tax, whether the relevant services are performed inside or outside China.

Income paid by an employer outside China to these individuals is taxed in one of the following ways:

- *The income is exempt from individual income tax if the individual resides in China for not more than 90 days during a calendar year*
- *The income is subject to individual income tax if the period of residency extends to more than 90 days to the extent that the income is attributable to services performed in China.*

Individuals leaving China

On exit from China, foreign visitors shall present their valid passports or other valid certificates. Foreigners belonging to any of the following categories shall not be allowed to leave China:

- *Defendants in criminal cases or criminal suspects confirmed by a public security organ, a people's procuratorate or a people's court.*
- *Persons who, as notified by a people's court, shall be denied exit owing to involvement in unresolved civil cases.*
- *Persons who have committed other acts in violation of Chinese law who have not been dealt with and against whom the competent authorities consider it necessary to instigate prosecution.*

Frontier inspection offices shall have the power to stop foreigners in any of the following categories from leaving the country and to deal with them according to law:

- *holders of invalid exit certificates*
- *holders of exit certificates other than their own*
- *holders of forged or altered exit certificates.*

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