

# Essential aspects of China's Tax Law



If you are doing business in China, then you need to be aware of its tax laws, **Zhixiong Liao** explains

**C**hina fundamentally reformed its tax law in 1993. Currently, the most important types of taxes in China are income tax, valued-added tax (VAT), and business tax.

## Income tax

In China, there are two separate types of income tax, namely, the Enterprise Income Tax (EIT) and Individual Income Tax (IIT). Capital gains are taxable income, whether for companies or individuals. Shareholders are double taxed for income derived by a company because no imputation credit is allowed to shareholders for income tax paid by the company. This could be a major concern for those using limited liability companies as an investment vehicle. Therefore, for tax-saving purposes, sole trader, partnership, and "individual sole investor enterprise" (registered under individual sole investor enterprises laws) may be good alternatives for small-scale investors. There is no EIT imposed on such kinds of 'enterprises'. For limited liability companies, there



Royalties, interest, dividends, rents, capital gains, incidental income, and income from personal service other than employment are taxed at a flat rate of 20 per cent, but, currently, interests income

books/newspaper/magazines, animal food, and agricultural machinery/fertiliser. Similar to New Zealand's GST, VAT in China is zero-rated for exports. For imported goods, VAT is taxed on the sum of the total price of the goods plus customs duty, which means the payment of customs duty is GST taxable. The total price of imported goods is generally CIF (cost, insurance and freight) based.

## Business Tax (BT)

BT applies to the supply of services (excluding the limited sorts of services subject to VAT), disposition of intangible assets (including intellectual property) or real estate. BT is exempted for services supplied by kindergartens/schools, hospitals, and some agricultural-related services. BT is a cascading tax, taxable on the total amount of turnover at every stage in the supply chain, without any deduction for the tax/prices paid at the earlier stages. The only exception is that the price paid to a subcontractor can be subtracted from the turnover.

may be good alternatives for small-scale investors. There is no EIT imposed on such kinds of 'enterprises'. For limited liability companies, there are no anti-avoidance rules regarding the deferral of paying dividends to shareholders, so profits can be accrued and kept in the company for a very long period of time, without triggering shareholders' personal income tax liability.

The EIT has a flat rate of 25 per cent. Non-resident enterprises without establishment in China are taxed on 20 per cent for China-sourced income, whereas their non-China-sourced income is not subject to EIT. EIT is exempted for income derived from high seas fishing, and producing, primary processing, and creating new varieties of most agricultural products; or income from holding central-government-issued bonds, dividends from other resident enterprises (excluding those that are public-listed); or income from operation of important infrastructure projects or projects protecting the environment or saving energy or water; or income from particular transfer of technology. A rate of 12.5 per cent applies to income from aquaculture or from growing flowers, tea or other crops for beverage, and flavour. Lower EIT rates are also available to tiny enterprises (20 per cent) and high-tech enterprises (15 per cent).

IIT is basically a schedular income tax. Different sources of income are separately taxed (PAYE) at different rates. Salaries/wages are taxed at progressive rates from three per cent to 45 per cent, after a deduction of RMB ¥3,500 per month. Business income of a sole trader, business partner, operator of an "individual sole investor enterprise", or a contractual business operator is taxed at progressive rates from five per cent to 35 per cent.

incidental income, and income from personal service other than employment are taxed at a flat rate of 20 per cent, but, currently, interests income from deposits in banks or other licensed saving service providers are exempt from IIT.

An investor may take advantage of such a schedular personal income tax system by splitting investments into different or separate types. For a person who has no permanent place of abode in China, if he or she stays in China for less than 365 days in a tax year, then only his or her China-sourced income will be subject to IIT. However, the number of days of "temporary departure" from China is not subtracted from the calculation of the number of days for staying in China. "Temporary departure" means a departure for no more than 30 consecutive days, or multiple-departures for a total of no more than 90 days in a tax year. This tax-residency rule is much more lenient than New Zealand's 183-day rule. It is true that China has a double tax agreement (DTA) with New Zealand and has lower personal tax rates, but the process of claiming credit for tax paid overseas is complicated and costly (at the least you have to pay translation costs). So it is a better idea to take advantage of the lenient tax residency rule.

#### Value-Added Tax (VAT)

China's VAT mechanism is very similar to New Zealand's GST, but VAT in China generally covers only the supply/import of goods only. Services are generally not subject to VAT, except for very limited sorts of services which are very often supplied with materials, such as processing and repairing services. The VAT rate is generally 17.5 per cent, but it's 13 per cent for the supply/import of food, plant oil for food, electricity, tap water,

earlier stages. The only exception is that the price paid to a subcontractor can be subtracted from the turnover.

BT rates are:

- › three per cent for the supply of services of transportation, construction, post and telecommunication, culture and sport;
- › five per cent for other services and the disposition/transfer of intangible assets or real estate; and
- › five to 20 per cent for entertainment services.

#### Tax administration

As a business person, you have to deal with two separate tax departments – a local one and a national one. You must register with each separately. Furthermore, you must use the standard-form invoices or invoices approved by the tax departments, each of which has a unique identifier number. If your business is subject to VAT, you must purchase special VAT invoices from the local office of the State Tax Department. They are very valuable and must be kept absolutely safe.

In practice, tax avoidance will very often be treated as tax evasion. If you have a dispute with the tax department, you may apply for reconsideration, but the tax department may decline your application before you pay in full the tax as assessed by the tax authority, and you are not allowed to take the tax dispute to court unless you have obtained a decision on your application for reconsideration! ☹

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