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Taxation in China

Understanding Taxation in China

Foreign enterprises with their head offices in China are taxed on their worldwide income. Tax credit is allowed for income taxes paid to other countries on certain incomes. Other foreign enterprises doing business in Shanghai and non-resident enterprises are taxed on income derived from China source only.

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

The new Enterprise Income Tax Law, effective from 1 January 2008, stipulates that both local and foreign companies are to be taxed at 25%.

All currently eligible Foreign Investment Enterprises (FIEs), which have commenced the 2+3 tax holidays (2-years tax free incentive plus 3-years 50% exemption from taxation), will continue to enjoy the remaining unutilized tax holidays until expiry, but not later than 31 December 2013. However, the new law will not affect certain industry-specific preferential tax policies. We, Manivest, provide a comprehensive advisory in China tax to those who are planning to invest in China.

MAJOR TAXES ON FOREIGN ENTERPRISES

Foreign enterprise taxpayers can be classified into (1) Foreign investment enterprises, which include equity joint ventures, cooperative / contractual joint ventures and wholly foreign-owned enterprises and (2) Foreign enterprises, which include representative offices and branches.

Foreign invested enterprises and foreign enterprises doing business in China are liable to the following types of taxes:

1. Income Tax
2. Transaction Tax : Value added tax, Consumption tax, Business tax
3. Other taxes: Vehicle and vessel license tax, Stamp tax, Property tax, Deed tax

In addition, custom duties are levied on imports and exports and individuals working in China are liable to individual income tax.

TAXABLE INCOME – Income tax

Basis for computation of taxable income

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

The New Enterprise Income Tax Law

Unified tax rate

Under the new law, the general enterprise income tax rate of 25% will apply to both local and foreign companies, which unifies the pre-payment tax reduction and preferential tax policies.

Residential and Non-Residential Enterprise

China tax laws distinguish the tax liabilities “Residential Enterprise” and “Non-Residential Enterprise”, as follows.

The Definition of Residential Enterprise

- any company which is incorporated in China under PRC laws; or
- any foreign company which is incorporated under foreign laws with effective management in China

Residential Enterprises are required to pay tax on their global income.

For example, companies registered in China, such as Wal-Mart (China) Corporation and General Motors Corporation (China), are treated as Residential Enterprise. Companies registered in the United Kingdom (UK), British Virgin Island (BVI) or other offshore countries with their Board of Directors, head offices, major management decision made in China are treated as Resident Enterprises. All the above companies are required to pay tax on their global income.

The definition of Non-Resident Enterprise

Any foreign company incorporated under foreign law, without effective management in China, are required to pay tax only on income generated in China, for example income generated by the foreign company’s representative office (Rep. Office) or its branches in China.

Tax Transition Period

The new law allows a five years tax transition period to those enterprises which were incorporated before 16 March, 2007. Please refer to below table for details:

Item	Enterprises' Year of Registration	Applicable Tax Rate from 2008
1	Before 16 March 2007	Eligible to enjoy lower tax rate of 15% until expiry
2	From 16 March 2007 to 31 December 2007	18% in 2008 (20% in 2009, 22% in 2010, 24% in 2011, 25% in 2012)
3	After 1 January 2008	25%

Income Tax for Enterprises

Tax Payer	Taxable income	Tax Rate
Resident Enterprises	Global income	25%
• Small Scale enterprises (annual income is less than RMB300,000)	Global income	20%
Non-resident Enterprises (1)	Business income generated in China	20%
	Dividends, interests and loyalty fees	Non-treaty nations 20%, treaty nations 5% to 15%
Preferential Enterprises – Hi-tech enterprises, aviation, electronic, cutting-edge pharmaceutical, computer software (2)		15%

(1) This is a withholding tax. The entity paying the money to the non-resident enterprise is required to withhold the tax for the government.

(2) These types of enterprises must obtain approval from the National Technical Department or technical department in their respective provinces.

Tax Year

The tax year is calendar year but a foreign enterprise may apply to the tax authorities to adopt its own fiscal year as the tax year.

Depreciation

Fixed assets with a useful life of one year or more may be depreciated. Fixed assets with cost less than RMB 2,000 can be written off immediately. Straight-line method shall be applied according to the law. There are regulations providing the minimum useful lives for different categories of assets. Residual value should not be less than 10 %

	<u>Minimum number of years</u>
Premises, buildings and structures	20
Trains, ships, machinery and other production equipment	10
Electronic equipment, means of transportation other than trains and ships, appliances, tools and furniture relating to production and business operations	5

Accelerated depreciation may be allowed in special circumstances.

Operating Loss

Operating loss for enterprises carrying on business can be used to set-off taxable profits in the future years for up to five years.

TAXABLE INCOME – Value Added Tax, Consumption Tax and Business Tax

1) Value Added Tax

Enterprises engage in the business of selling commodities, repair and maintenance services or import and export business in China are subject to value added tax. The standard rate for value added tax is 17%, but the rate for certain basic commodities such as grain, cooking oil, running water, forage, fertilizer, pesticide, and farming machinery is 13%.

2) Consumption Tax

Production, processing and importation of the following 11 commodities in China are subject to consumption tax: tobacco, alcoholic drinks or alcohol, cosmetics, skin and hair care products, jewellery, fireworks, gasoline, diesel, automobile tire, motorcycle and motorcar. Consumption tax is calculated in accordance with quantity (e.g. gasoline) or according to the fixed scheduled rates (e.g. the rate for motorcar with its engine cylinder capacity under 2,200ml is 8%).

3) Business Tax

Enterprises engage in transportation, post and telecommunication, finance and insurance, construction, art, sports, entertainment, and services, or transfer of intangible assets and immovable properties are subject to business tax. Business tax rate is 3% or 5%. But the tax rate for entertainment sector is 10% or 15%.

TAXABLE INCOME – Other taxes

These taxes are levied on the taxpayers according to a fixed schedule. The scheduled rates may be amended from time to time, for current information, please check with the relevant authorities.

1) Vehicle and Vessel Tax

Vehicles owned and used by foreign invested enterprises are subject to Vehicle and Vessel Licence Tax.

2) Stamp Tax

Stamp taxes are levied on contracts made in China in respect of purchases and sales, processing contracting, engineering project, asset leasing, transportation, storage and warehouse, loan, asset insurance, technology contract, transfer of property rights, accounting ledger, royalty license. The minimum rate of a stamp tax is 0.005% and the maximum is 0.1%. Royalty license and accounting books (not including wage records) are taxed on per piece basis, at RMB5.

3) Property Tax

The tax is levied at an annual rate of 1.2% on the original value of the real estate, after 20% is deducted therefrom. The tax rate is 12% if it is levied on the rental income.

4) Deed Tax

Purchaser or acquirer of land and building is subject to deed tax. The transfer of ownership of land and building refers to:

1. The granting of land use right by the state (not including the transfer of management right of the rural collective land);
2. Transfer (including selling, bestowal and exchange) of land use right;
3. Sale and purchase of buildings;
4. Bestowal of buildings
5. Exchange of Buildings.

The rate of deed tax is 1% to 5%.

Dividends

Dividends received from local and foreign enterprises are taxable income.

Capital Gains

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

Taxation on Partnership and Joint Venture

Partnership is uncommon in China, but cooperative joint venture (CJV), which is not a legal entity on its own, is widely used in China. A CJV is not a legal entity and its partners carry unlimited liabilities. The foreign partner of a CJV is taxed on its share of pretax profits according to rules applicable to a foreign enterprise.

Double Taxation Treaty

China maintains over 86 DTAs with its trading partners. In general, China adopts a mixed model of OECD and UN, with emphasis on the right to tax when the income is derived from or in China.

A WORD OF CAUTION

The legal system of China is similar to the European Civil Law system. There may be numerous regulations and implementation notices relating to a particular subject. Investors should always check out for the latest development in those laws and regulations and consult experienced professionals before deciding on their investment plans. See Fact sheet – Shanghai for a full explanation.

The Role of Maninvest

Maninvest can help investors to:

1. Prepare pre-establishment documents (minutes, power of attorney etc.), arrange translation, notarization and certification from various authorities.
2. Engage Registration Agent and supervise the registration work.
3. Draft the necessary project proposal and feasibility study report.
4. Engage auditors for the examination of capital injection and annual examination.
5. Locate suitable business address and arrange for leasing, set up office, including arranging telephone, fax and broadband, acquisition of office machine and furniture.
6. Employ local staff and complete formalities in accordance with labour laws.
7. Post-establishment registration work and open bank accounts.
8. Annual Joint Inspection Report.

Through our offices and staff in Shanghai and Hong Kong, Maninvest shall follow through the establishment process and save investors time and trouble.

How Maninvest Can Help You

The directors and management of Maninvest are professionals in the offshore industry having served the Asia market for over 22 years. Through our offices in Hong Kong, Shanghai and Macao as well as our associates in other Asia cities, we offer a full range of comprehensive value-added services to professional advisors and their clients.

Maninvest offers the following services:

- Formation of corporate and business structures in Shanghai
- Incorporation of companies/structures in other onshore/offshore jurisdictions
- Full corporate management services
- Registered office, business office, mail redirection and business centre
- Accounting and re-invoicing services
- Tax and asset planning services
- Asset protection and preservation advisory services
- Business establishment services
- Market exploration services

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