

CHINA

Master Tax Guide 2008/09



6TH EDITION

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CHINA

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2008/09

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About the Technical Reviewer

Deloitte enjoys a long history of serving clients with business interests in China. As China continues to adopt open-door policies and encourage international trade and investment, Deloitte will continue its commitment to assist foreign companies doing business in China, and Chinese companies expanding domestically and globally with its multidisciplinary professional services in the areas of audit, tax, consulting and financial advisory.

Deloitte was one of the first foreign accounting organisations to establish a presence in China by opening an office in Shanghai in 1917. In 2004, Deloitte unveiled its five-year plan to invest US\$150 million in Mainland China, Hong Kong SAR and Macau SAR. This is the most significant investment Deloitte has ever made in a single market in its more than 100 years history. Since the 1980s, Deloitte has increased its presence and is now one of the leading professional services providers in Mainland China, Hong Kong SAR and Macau SAR with 8,200 employees in 10 cities including Beijing, Dalian, Guangzhou, Hong Kong, Macau, Nanjing, Shanghai, Shenzhen, Suzhou and Tianjin. Deloitte serves the largest share of China's top 200 companies, more than 800 MNCs and their affiliated companies in Mainland China, and nearly 300 Hong Kong listed companies.

Deloitte's experience in China is extensive and the firm continues to play a significant role in developing the accounting and tax professions in China by assisting the PRC Government in formulating tax policies and accounting standards. With the establishment of Deloitte Tax Research Foundation, the firm promotes education, research and innovation in the field of taxation by supporting an array of national and local program, including Deloitte Tax Championship as a key initiative for developing future talents in taxation in China.

In its sixth edition, the *China Master Tax Guide 2008/09* is updated by Deloitte's tax professionals. The publication is intended to provide an overview of the current China tax system, helping companies to gain an understanding of how the system has developed to date. While every effort is made to ensure that the information contained in the Guide is up-to-date, readers are advised to seek professional advice when special projects are being undertaken. The first edition published in 2003, was written by CCH Tax Editors and was reviewed by Deloitte's tax professionals.

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Foreword

In its sixth edition, the *China Master Tax Guide 2008/09* provides comprehensive and up-to-date information on the concepts governing taxation of companies, businesses, individuals, etc, in China.

The Guide examines various taxes imposed in China. The full spectrum of taxation issues is explored, including procedural matters such as assessments and payments. Legislation, Tax Bureau Interpretation and Circulars are also examined. Main contents include an overview of China taxes, individual and enterprise income taxes, turnover taxes, consumption tax, transaction and property-related taxes, applicable tax rates, exemptions and preferential tax treatments, withholding tax, tax registration, administration and collection, disputes and penalties, double tax relief and more.

To enable quick and easy access to information, a comprehensive subject Index and Legislation Finding List are provided.

The legislation covered in this Guide is available in full text in CCH's three-volume loose-leaf publication *China Laws for Foreign Business — Taxation & Customs*.

CCH Tax Editors
September 2008

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PART I: INTRODUCTION

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Chapter 1

LEGAL AND ADMINISTRATIVE FRAMEWORK OF CHINA TAX

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¶1-010 Tax reform background

China's current tax system is relatively new, having been developed only since the 1980s. Prior to that, China's tax system was concerned primarily with the taxation of domestic enterprises. With the introduction of "open door" economic policies, the tax system was reformed and developed in order to levy tax on foreigners, foreign enterprises and foreign investment enterprises.

To attract foreigners and foreign enterprises to make investment in China, China issued a separate income tax law in 1991 to tax on foreigners, foreign enterprises and foreign investment enterprises, which provided tax incentives and various favourable tax treatments, whereas domestic enterprises were governed under another tax code with less beneficial treatments, thus resulting in unbalanced taxation and unfair competition over the years. In addition, due to the existence of the two different tax regimes, there were ambiguity and inefficiency reported in tax levy and administration.

As China's economy continues to grow, efforts had been made to unify the income tax system such that foreign enterprises, foreign investment enterprises and domestic enterprises can be taxed under the same tax scheme. The new *Enterprise Income Tax Law* (EITL) was finally enacted in the Tenth National People's Congress on 16 March 2007. The EITL, which unifies the income tax treatment of domestic enterprises and foreign enterprises, has come into effect on 1 January 2008.

The EITL attempts to balance the sometimes competing goals of encouraging and attracting foreign and domestic investments, spurring economic development and innovation, enhancing tax administration and achieving tax justice. The EITL not only responds to the appeal from domestic enterprises for balanced taxation and fair competition, but also provides some transitional

relief to foreign investment enterprises for the loss of certain incentives. The EITL balances the government's financial revenue needs with the goal of keeping China's tax environment internationally competitive.

¶11-020 Sources of law

China's legal system is a legislative (as opposed to common law) system. The regulation-making system is not strictly centralised in practice. Regulations are codified in statutory instruments which are derived from various sources at different levels of government (from national to local) and with a hierarchical basis of authority.

According to *The Constitution of the People's Republic of China* (Constitution), supreme legislative authority is vested in the National People's Congress (NPC) and its Standing Committee, which also have the final authority to make and interpret legislation. In practice, much of this power has been delegated to the State Council.

The State Council, headed by the Premier, is the chief executive organ of government at the central level. Administrative regulations made by the State Council rank immediately below those laws enacted by the NPC. These regulations are in turn supplemented by instructions, orders and rules issued by the appropriate subordinate ministries under the State Council. The major ministry responsible for tax matters is the State Administration of Taxation (SAT).

At a provincial level, People's Congresses are empowered to make local rules and regulations, provided they do not contravene the *Constitution* or the laws made by the NPC or the administrative regulations made by State Council. People's Congresses and their Standing Committees in provinces, autonomous regions, centrally administered municipalities and large cities are authorised to make local regulations. The large cities include cities where the People's Governments of provinces or autonomous regions are located, or where Special Economic Zones (SEZs) are located, and other cities approved by the State Council. People's Governments in these jurisdictions are also authorised to make provisions or measures.

¶11-030 Types of laws and regulations

Laws promulgated by National People's Congress

Enactments promulgated by the NPC and its Standing Committee are broadly categorised as either:

- basic laws; or
- laws and amendments.

Before a new basic law is promulgated by the NPC, a bill must be introduced. New legislation proposed is usually vetted by the Legal Work Committee of

NPC, which will examine and research the proposed bill, and recommend any changes that may be necessary.

The NPC commonly uses resolutions to make amendments to laws, or to enact supplementary provisions to laws and/or orders promulgating basic laws.

Administrative regulations issued by the State Council

With effect from 1 January 2002 administrative regulations issued by the State Council are normally designated as “regulations”, “provisions” or “measures”. (Previously the State Council also issued administrative regulations designated as “articles”, “rules for observation”, “guiding principles”, “principles”, “rules” or “detailed rules for implementation”.)

Similar to enactments promulgated by the NPC, bills must be drafted and submitted to the legislative body of the State Council. Normally, draft versions are first prepared by the appropriate subordinate ministries or commissions and then submitted to the State Council for examination and approval.

All administrative regulations are published in the *Gazette* of the State Council and national newspapers. This is a requirement of the *Regulations on the Enactment of Administrative Regulations* (Art 28). Administrative regulations usually take effect 30 days after promulgation unless otherwise specified.

Other administrative documents

In addition to NPC basic laws and resolutions, and State Council administrative regulations, various other administrative documents are issued to State agencies including decrees, directives, notices and circulars which give instructions or provide clarification regarding specific laws or legal provisions.

Many of these documents have been classified as “internal” and for these, foreigners must rely on the opinion of professional advisors, or on unofficial summaries of the documents provided by Chinese business partners, in order to understand how the documents affect and alter the published laws and regulations. Chinese legal officials have recognised that practices regarding “internal” law are unsatisfactory and have pledged to reduce the number of such documents.

Local regulations and rules

There are three types of local regulations:

- regulations required to implement the laws of the central government in accordance with special local conditions;
- supplementary regulations; and
- regulations dealing with strictly local issues.

Made at a provincial level, these regulations must first be reviewed by the Legal Work Committee of NPC to ensure that they do not conflict with the Constitution. The State Council also examines the legislation to ensure that it does not conflict with other administrative laws or superior regulations. Local regulations made below provincial level must be approved by the legislative authorities at the provincial level.

The number of local regulations is significant. Accordingly, local regulations can have a significant impact on China's legal system. Being local in nature they can lead to different consequences arising in similar matters depending on the jurisdiction. Some local regulations also may deal with topics which have not yet been regulated by national legislation.

All local government rules are published in the *Gazette* of the relevant government and local newspapers as required under the *Regulations on the Enactment of Administrative Regulations* (Art 31). They usually take effect 30 days after issue unless otherwise specified.

¶1-040 Language and interpretation of laws

The language of the law is Chinese. Where laws have been translated, the original Chinese version is the most authoritative version and should prevail in case of any conflict. The Chinese Government has produced books of Chinese laws translated into English on an ad hoc basis. CCH produces a loose-leaf library, *China Laws for Foreign Business* that contains English translations of legislation in the areas of Taxation and Customs, Business Regulation and Special Zones and Cities.

Formal interpretation of laws and regulations is conducted by government agencies and the judiciary:

- *Legislative interpretation* — the Standing Committee of the NPC interprets the Constitution, laws enacted by the NPC and laws enacted by itself which need to be further clarified or supplemented.
- *Administrative or executive interpretation* — the State Council interprets administrative regulations where questions arise relating to their application. The *interpretation* has the same effect as the administrative regulation in question. Ministries under the State Council interpret the rules they have made and the interpretation has the same effect as the rules in question.
- *Local interpretation* — the standing committees of provincial People's Congresses supplement or clarify the scope of local regulations and rules that they have issued. Provincial governments and their departments interpret questions of regulations arising out of their respective local rules and regulations. The interpretation has the same effect as the rules or regulations in question and is only binding in the jurisdiction concerned.

- *Judicial interpretation* — technically, the Supreme People's Court and the Supreme People's Procuratorate are limited to making binding interpretations of laws only within the context of trial and procuratorial work. However, the power of the Supreme People's Court to interpret national legislation has been expanding in practice. The Court has given detailed "explanations" of major laws (eg *Civil Law*, *Security Law*) without which it would be impossible to enforce national laws which have been framed in general principles and vague terms. The power of the Supreme People's Court is, however, restricted to interpreting laws promulgated by the NPC and its Standing Committee (except the Constitution). Generally, it will not interpret administrative regulations, government rules or local rules and regulations.

¶1-050 Tax policy and administration

The SAT and Ministry of Finance (MOF) are empowered to interpret the country's tax laws and regulations by the issuance of circulars to its branches, rulings, notices and replies.

Responsibility for tax policy and administration lies with the SAT. The SAT is responsible for formulating and coordinating tax policies and for supervising the work of local tax bureaus which are established as provincial and municipal levels. The MOF also continues to play a key role in developing tax legislation and policy.

The State Council has stipulated that the SAT is responsible for the collection and administration of taxes that generate revenue for the central government or revenue which is shared between the central and local governments. Local tax bureaus of State tax are in charge of the day-to-day administration of State tax matters.

Local taxes are handled by bureaus of local tax in the relevant locations. Local tax bureaus are responsible for collecting taxes that only generate revenue for the respective local governments. Although the authority for tax collection is divided, the local tax bureaus must follow the direction of the SAT with respect to tax policy and the interpretation of tax laws and regulations.

In most locations, specialised departments under the State tax bureaus and local tax bureaus respectively handle matters relating to tax collection and enforcement of foreign individuals, foreign enterprises and foreign investment enterprises.

The Offshore Oil Taxation Bureau manages tax enforcement and collection for businesses involved in offshore oil exploitation.