

The China's Tax System and its Coming Reform

Presented by Professor Zhu Qing, School
of Finance, Renmin University of China

- **China's Current Tax Systems**
- **The Discussion of the Coming Tax Reforms**

1.China's Current Tax Systems

- **Overview of China's Tax Systems**
- **Major Taxes Applicable to FDI**

1.1 Overview of China's Tax Systems

Currently the Chinese governments levy as many as 24 taxes, which, according to their nature and function, can be divided into the following 7 categories:

(1) Turnover (commodity) tax:

- **VAT (36%)**
- **Excise Tax (5.9%)**
- **Business Tax (14.2%)**
- **Customs Duties(4.6%)**

Note:the figure in brackets is the ratio of tax income to the total tax revenue in 2003.

(2)Income Taxes:

- **Income Tax for Enterprises** (11.2%)
- Income Tax for Foreign Investment Enterprises and Foreign Enterprises (3.37%)
- Personal Income Tax (7%)

Note:the taxes written in blue color are not levied on foreign investment enterprises and foreigners.

(3)Property Taxes:

- House Property Tax
- Urban Real Estate Tax

(4)Resource Tax

- Resource Tax(0.4%)
- Tax on Use of the Urban and Township Land

(5) Special Purpose Taxes (or called earmarked taxes):

- Urban Maintenance and construction Tax (2.7%)
- Social insurance contributions (but not administrated under the Tax Administration Law)

(6) Behavior Taxes:

- Vehicle Purchase Tax(2.3%)
- Vehicle and Vessel Usage Tax
- Vehicle and Vessel Usage License
Plate Tax
- Stamp Tax(2%)
- Deed Tax
- Banquet Tax
- Animal Slaughtering Tax(0.16%)

- Land Appreciation Tax
 - Farmland Occupation Tax(0.45%)
- (7) Agriculture Tax(2.1%)

- In 2003, the total tax revenue is 2046 billion yuan, accounting for 92% of the total government revenue (excluding government debt financing) and 17.6% of GDP.

- There are two tax administration systems: State tax bureaus, which are responsible for collecting central government taxes and central-local shared taxes, and Local tax bureaus, which are in charge of levying local government tax revenues.

1.2 Major Taxes Applicable to FDI

- Growth of FDI in China
- Value-Added Tax
- Excise Tax (Consumption Tax)
- Business Tax
- Income Tax for Foreign Investment Enterprises and Foreign Enterprises
- Personal Income Tax
- Urban Real Estate Tax

1.2.1 Growth of FDI in China

- Until June 2004, 0.487 million foreign investment enterprises have been established in China and out of them 0.25 million ones have been operating.

- Until June 2004, China has absorbed by contracts about \$1016 billion of FDI and out of this amount, \$535 billion has been actually used. China ranked the first largest country absorbing FDI in the world in the last two years.

1.2.2 Value-Added Tax

- **Tax Payers and Taxable Activities**

VAT is subject to any person or enterprise engaged in the selling or importation of goods, or in the provision of processing, repairing and replacement services in China

- **Tax rates**

The normal rate is 17 percent, but for certain specified goods such as food grains, vegetable oils, books, coal, agricultural chemicals, etc., the tax rate is reduced to 13 percent.

- **VAT Liabilities**

VAT payable = output tax - input tax

Special regulations on the input tax deductible have been ruled out. For instance, taxpayers are allowed to deduct from their output tax 7 percent of transport charges they paid out to transportation companies which are not subject to VAT.

However, VAT paid on some items,
such as fixed assets, goods purchased
for producing VAT-exempted items or
fringe benefits, is not deductible

1.2.3 Excise Tax

- **Taxable Activities**

Excise tax is levied on 11 categories of products, of which many are the luxury goods, such as tobacco, alcoholic drinks, cosmetics, precious jewelry, gasoline, motorcycles, motor cars, etc.

- **Taxpayers**

Any person or unit who engaged in the manufacturing, contracting-out of processing, and importation of taxable products is liable to pay excise tax.

- **Tax Rates**

The rates of excise tax range from 3% to 45%. Beer, yellow spirits, gasoline and diesel oil are taxed at tax amounts, not at percentage tax rate. For example, for beer, 220 Yuan per ton; for gasoline, 0.2 yuan per litre. Cigarette and alcohol are taxed at compound rates.

- **Tax Liabilities**

In general, excise tax is levied on the whole sales revenue of taxable goods and there is no deduction or credit allowed for arriving at the tax amount payable.

1.2.4 Business Tax

- **Taxpayer and Taxable Activities**

Any person or unit engaged in the provision of services, the transfer of intangible assets or the selling of immovable property, is subject to business tax. Business tax is parallel with VAT, so enterprises doing business in China will pay either VAT or business tax.

- **Tax Rates**

The rates of business tax generally range from 3% to 5%, but the tax rate for entertainment sector can be as high as 20%. The tax rate is appointed for every sector and industry. For example, the rate for telecommunication is 3%. The rate of 5% applies to selling of immovable property and transfer of intangible assets.

- **Tax Liabilities**

Business tax liability is generally determined by applying the applicable tax rate to the amount of gross turnover. But in some cases, the taxable turnover is arrived at after deducting certain sums from the gross turnover.

- **Business tax applicable to the representative office of foreign enterprises**

The representative offices of foreign enterprises engaging in business operations and receiving commissions for provision of liaison should pay business tax, at a rate of 5% on their gross commissions, fees and rebates.

1.2.5 Income Tax for Foreign Investment Enterprises and Foreign Enterprises

- **Taxpayers**

FIEs with their head offices located within China are Chinese residents and in this case they are liable to pay income tax to the Chinese government on their worldwide income and capital gains. FEs are non-residents of China and only their income and gains derived from within China are subject to the Chinese income tax.

- **Tax Rates**

The normal rate of income tax for both FIEs and establishments or places of business of foreign companies is 30%.

Besides, local governments may levy additional 3% on the taxable income as a local tax.

Foreign enterprises, which have no establishments in China or their establishments in China are not relevant to their China-sourced income, are subject to a withholding tax of 10% on their China-sourced income, such as dividends, interest, rentals or royalties.

But this withholding tax is not applicable to the repatriation of dividend income from after-tax profits of FIEs to their parent companies.

- **Taxable Income**

The income from taxpayers' main business or other sources is subject to the tax. But the capital gains derived by foreign enterprises from the sale of shares of the Chinese company whose shares are listed on an overseas securities exchange will not be subject to the tax.

- **Tax Incentives**

(1) The tax holidays

FIEs engaged in production in China and with an operating period of not less than 10 years are entitled to take a two-years tax holiday. The tax holiday will begin from the first profit-making year of FIEs after taking into account previous losses carrying-forward.

When the two-years tax holiday ends up, the FIEs are allowed a 50% reduction in tax rate for the subsequent three years.

Export-oriented and technologically advanced FIEs may enjoy a longer period of tax concessions.

(2) Preferential tax rates

There are also some tax incentives for foreign investors in the form of reduced tax rate. For example, the FIEs established in the Special Economic Zones (SEZs) , the establishments of foreign companies doing business in the SEZs and the production-oriented FIEs established in the Economic and Technological Development Zones (ETDZs) or in the Shanghai Pudong New Area, are entitled to pay their income tax at a reduced rate of 15%

(3) The tax refund on reinvested profits

The foreign investors of FIEs can derive a refund of income tax on their reinvested profits if they reinvest some of their after-tax profits to the FIEs of their own or to other FIEs. The tax refund rate is normally 40%.

- **Income Tax of Representative Offices of Foreign Enterprises**

If representative offices supply services to other companies outside China on behalf of their headquarters, they have to pay income tax on the commissions, rebates derived from the those companies.

The income tax rate applicable to representative offices is normally 30%, plus 3% of local tax. But if the offices are located in SEZs, the rate will be 15%.

1.2.6 Personal Income Tax

- **Taxpayers**

The personal income tax is applicable to both Chinese nationals and foreigners.

Residents and non-residents have different tax liabilities.

Residents are those who have domicile in China (by reason of their permanent registered address, family or main economic interests in China) or reside there for not less than 365 days in the tax year (calendar year). Generally, for residents, their worldwide income is subject to the Chinese personal income tax.

Individuals who are not domiciled in China and resident in China for less than 365 days in the tax year, are non-residents of China. Non-residents should pay Chinese personal income tax just on their China-sourced income.

- **Categories of Taxable Income**

The taxable income includes wages and salaries, compensation for personal services, interests, dividends, royalties, income from transfer of property, windfall income, etc.

- **Source of Income**

The source of wages and salaries will be the location of the company in which the taxpayer is employed and gets the wages.

The source of a royalty is the place where the patent or copyright is used. The source of interests or dividends is the place where the company which pays or distributes the dividends or interests is located.

- **Personal Allowance and Deductions and Tax Rate**

The Chinese individual income tax is a kind of categorized income tax, the deductions or applicable tax rate may differ between categories of income.

- For example, the tax rate applicable to employment income is nine-grade progressive rates ranging from 5 percent to 45 percent; but interests, dividends and royalties are applied to a percentage rate of 20 percent.

For employment income, the standard monthly deduction is RMB 800 (individuals must pay their tax on employment income every month), foreigners are granted an additional deduction of RMB 3200, their total monthly deduction is RMB 4000.

For compensation for personal services, author's remuneration and royalties, deduction standard is following: if the amount of income is less than RMB 4000, the deduction is RMB 800; if the amount of income is more than RMB 4000, the deduction will be determined by multiplying the income by 20 percent. For interest, dividends and distributed profit, no deductions are allowed to arrive at the taxable income.

1.2.7 Urban Real Estate Tax

- **Tax Payers**

This tax is only applied to FIEs, Fes, foreigners and people from Hong Kong, Macao and Taiwan. Domestic enterprises and mainland Chinese pay House Property Tax.

- Tax base and rate

Two different rates are applied to two different bases: 1.2% is applied to the value of house property, and 18% is applied to the rental income from the property.

- Exemptions

Newly constructed buildings shall be exempt from the tax for three years.

The buildings acquired for non-business use by individuals may be exempt from the tax.

2.The discussion the coming Tax reforms

2.1 The purpose of the tax reforms

- Adapting the tax systems to WTO rules
- Enhancing the competitiveness of the domestic Chinese enterprises
- Improving of tax equality

2.2 The proposed measures of the tax reforms

- VAT transition from “production type” to “consumption type”

Now days input taxes on equipment and fixed assets are not allowed to be credited against output taxes, but this rule will be changed very soon.

- Enlargement of VAT coverage over transportation and construction industries .
- Changes of products applicable to the excise tax.

Skin-care and hair-care products, motor vehicle tires will not be liable to excise taxes. But the tax will be levied on some luxurious services.

- **Integration of two enterprise income taxes**

Tax incentives(reduced rates) will not be given to FIEs in coastal areas and thus all the enterprises within China will have a level playing field of taxes to compete with each other. But FIEs in the areas may enjoy a 5-year transition period.

- Some new taxes will be statuted, including Real Estate Tax, Social Insurance Tax, Fuel Tax.
- Some small taxes will be removed from the tax regime, such as Banquet Tax, Animal Slaughtering Tax, Land Appreciation Tax.

Thank you for your time

Zhuq@sfruc.org

Zhuqing2@mail.china.com