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China Tax Insights

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China Law Highlights

Individual Income Tax on non-PRC Individuals

In China the tax year for an individual is the same as the calendar tax year, and interest and penalties may be levied on late tax payment. PRC employers of expatriates are required to register with the appropriate local tax bureau in order to commence filing the individual income tax returns. The documentation required for registration varies from city to city.

The *Individual Income Tax ("IIT") Law* came into effect on 1 January 1994 and applies to foreign individuals, Chinese nationals and individually owned business. IIT is levied on different sources of an individual's income depending on whether the individual has a place of residence in the PRC and the number of days the individual is present in the PRC. For employment income, it is levied in respect of most earnings and benefits-in-kind including the following:

1 Salaries;

2 Overtime;

3 Cash allowances;

4 Bonuses (special calculations apply);

5 Stock options (special calculations apply);

6 Medical and life insurance; and

7 Home leave costs for family members and home leave costs for the expatriate in excess of two trips per year.

There are some payments that are treated as tax exempt, including:

1 Reimbursement of relocation costs incurred on moving to China;

2 Housing costs paid in China that are supported by tax rental invoices;

3 Two home leave trips per annum for the employee; and

4 Educational costs for dependent children studying at an educational institution in China.

A PRC employer is responsible to withhold all IIT liabilities and carry out the PRC monthly IIT withholding filing for its employees. The returns must be filed and tax settled with the tax bureau within seven days of the following month, unless an individual elects to file his/her own tax return and pay his/her own tax to the tax bureau.

Starting from 2006, an expatriate is also required to file an annual tax return within the first three months of the following year if his/her annual income is more than RMB120,000.

If an expatriate performs his/her duty partly in the PRC and partly outside the PRC, subject to the approval by the PRC tax authority, the IIT liability in respect of his/her PRC-sourced income can be determined by "time-apportionment", ie based on the ratio between the days worked in the PRC and days worked outside the PRC. It is to be noted that it is the IIT liability, instead of the taxable income, which is subject to time apportionment. The monthly IIT liability on employment income is calculated as follows:

$$\left(\text{Total monthly taxable income} \times \text{tax rate} - \text{Quick Reckoning Deduction} \right) \times \frac{\text{Days in the PRC during the month}}{\text{Days in the month}}$$

(*Guoshuifa [2009] 114*)

In case an individual holds employment positions in both PRC and overseas entities, he/she should report his/her **total employment income** to the tax bureau. The IIT liability will then be computed based on his/her actual working periods in the PRC. The formula to compute the IIT in respect of the employment income for the month is as follows:

$$\text{IIT liability} = \text{IIT computed based on total employment income} \times \left(1 - \frac{\text{Overseas Employment Income}}{\text{Total Employment Income}} \times \frac{\text{Overseas Working days in that month}}{\text{Total number of days in that month}}\right)$$

The PRC tax authorities would expect the reporting of all sources of employment income to the tax bureau regardless of the source of the income.

(*Guoshuihanfa [1995] 125*)

Tax News

British Virgin Islands Sign Agreement on Exchange of Tax Information

Mr. QIAN Guanlin, Vice Administrator of State Administration of Taxation of China, and Mr. Ralph T. O'Neal, Prime Minister and Finance Minister of British Virgin Islands, on behalf of their respective governments, formally signed the Agreement on Exchange of Tax Information between the Government of People's Republic of China and the Government of British Virgin Islands. This is the second information exchange agreement between China and the off-shore financial centre posterior to the first one with Bahamas on Dec. 1, thus opening a new chapter of successful cooperation in tax negotiation between China and off-shore financial centers.

Tax Preferences for Enterprises Involved in Environmental Protection, Energy-Efficient and Water-Saving Projects

The ministry of Finance, the State Administration of Taxation and the State Development and Reform Commission recently released the Directory of the Income Tax Preferences of the Enterprises under the Environmental Protection, Energy-Efficient and Water-Saving Projects (for trial implementation) approved by the State Council, which came into effect from January 1, 2008. Reportedly, in accordance with the provisions of Article 27 of the Enterprise Income Tax Law, the income taxes of the enterprises engaged in the qualified environmental protection, energy-efficient and water-saving projects can be exempted or reduced. The directory released this time respectively provides the specific conditions of the environmental protection, energy-efficient and water-saving projects classified in No. 17 sub-categories of No. 5 categories, including public sewage treatment, public waste disposal, comprehensive development and utilization of biogas, energy-saving and emission-reduction technological transformation and sea water desalinization.

In 2010, the small and low-profit enterprises will have 50% of their income taxes levied as the taxable incomes and pay their income taxes at a rate of 20%

Recently, the Ministry of Finance and the State Administration of Taxation have issued the Circular concerning the Policy on Small and Low-profit Enterprises' Corporate Income Tax. In accordance with the Circular, small and low-profit enterprises with a taxable income of less than RMB 30,000 (inclusive) shall, within a period from January 1, 2010 to December 31, 2010, have 50% of their income taxes levied as the taxable incomes and pay their income taxes at a rate of 20%. Meanwhile, the Circular stipulates that small and low-profit enterprises refer to those enterprises eligible according to the Enterprise Income Tax Law along with the rules for implementation, as well as related tax policies.

The financial and tax authorities introduce this favorable tax treatment policy for small and low-profit enterprises when our national economy suffers a strong impact from global financial crisis and the small and medium-sized enterprises (SMEs) have much trouble in production and operation. According to some tax experts, the SMEs play a significant role in promoting the development of our national economy and boosting the market prosperity. Current classification standard shows that the SMEs constitute a vast majority of about 10 million enterprises which have gone through the industrial and commercial registration across China. Actually, GDP attributable to these enterprises account for over 60% of the total.

The SMEs have developed into the industrial clusters and also the main force of technical innovation. Moreover, they serve as a major employment channel in that they've provided over 80% job opportunities in the urban areas, not only solving the employment problems of many laid-off workers in the cities, but also absorbing lots of surplus rural laborers. In other words, they're playing an increasingly significant role in easing employment pressure and maintaining social stability.

The experts also state that the SMEs have encountered many problems during current national economic development, especially under the impact of global financial crisis, mainly including: financial shortage, limited financing channels, and hard access to loans, which resulted in inadequate direct financing of SMEs; radical decrease in orders due to the noticeable decline in demands caused by the world economy downturn and consequent considerable challenge for export; and increase in the enterprise cost of export-oriented SMEs due to the increasing pressure on RMB appreciation and consequent small profit margin

In recent years, the government has attached much importance to the healthy development of SMEs. The taxation authorities have also adopted a series of policies and measures to help them overcome their difficulties. First of all, a variety of special funds are established to support their development. In 2009, the central budget set several special funds, such as the technical innovation fund of high-tech SMEs, to support their technical innovation, credit guarantee, industrial upgrading, market exploration, and improve their development environment. In the meantime, the local budget also provided more supports for SMEs. Secondly, special preferential taxation policies are practiced to ease their tax burden. According to the Enterprise Income Tax Law, the small and low-profit enterprises, once confirmed as eligible, can pay their income taxes at a rate of 20%, and the VC-backed companies which invest in the high-tech SMEs can enjoy the preferential tax treatment. The VAT bearing rate for small tax payers is lowered from 4% and 6% to 3%. Since the second half of 2008, the central government has adjusted the export rebate rate for seven times and raised the export rebate rate for some labor-intensive goods. Thirdly, the administrative fees are cleared up. Since September 1, 2008, the management fees of individual industrial and commercial households and marketplace management fees shall not be collected. Since January 1, 2009, 100 administrative fees related to SMEs shall be cancelled. Finally, the special social security policy is provided for some enterprises in difficult operation, including SMEs.

According to some experts, implementation of these policies will significantly facilitate the SMEs' development and relieve their pressures in production and operation. Yet, China's SMEs, small enterprises in particular, still face considerable difficulties, and need further supports from national policy. The preferential policy jointly issued by the financial and tax authorities is expected to play a positive role.

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