

Chapter 1

Legislative Background and Tax Reform

The Chinese tax system has recently developed closely to the economic growth of the country. The entry of China into the World Trade Organization (WTO) and the economic boom that has characterized recent years have made clear the necessity of overhauling a regulatory system in order to provide stability in the administration of the country, even in the tax field. The desire of becoming a leader in the Asian region, keeping up with the major world powers, has led China to make numerous amendments to improve the tax system and make it adapt to the rapid expansion of the economy and, at the same time, to attract an increasing number of foreign companies.

As a result, a significant tax system overhaul was achieved on March 16, 2007 with the enactment of the *Enterprise Income Tax Law*, which then came into force on January 1, 2008. The new scheme joined together two systems of corporate income tax that were previously separated, the *Domestic Invested Enterprises* and the *Foreign Invested Enterprises*. The main purpose of the reform was to standardize tax treatments for foreign and local companies, removing privileges for foreign companies and formulating new tax legislation in harmony with Occidental laws.

1.1 Sources of Chinese Tax Law

In China, competent authorities with the power to legislate within the tax field can be listed as in Table 1.1.

1.2 People's Republic of China

The Chinese law system has a hierarchical organization. At the top, there is the *Constitution of the People's Republic of China*, enacted in 1982 and containing the fundamental rights and duties of Chinese citizens and the structure and principles of the government. It states that supreme legislative powers are extended to the

Table 1.1 Chinese tax authorities

The <i>National People's Congress</i> , which has legislative powers
The <i>State Council</i> , which has executive powers
The <i>People's Congress</i> , which has legislative powers at local level (provinces, regions, and cities)
The <i>Ministry of Finance</i> (MOF) and State Administration of Taxation (SAT), which is responsible for the regulation of financial assets, tax, and currency activities

National People's Congress, which de facto establishes the validity and priority of legal sources, having the last word for enacting and interpreting laws.

1.3 State Council

The State Council is the supreme organ of the executive power controlling ministries and other administrative organizations. It is composed of about 50 members and chaired by the Prime Minister. The National People's Congress delegates most of the legislative powers to the State Council, which promulgates administrative regulations. In addition, these regulations are supplemented with instructions, rules, and precepts in the form of circulars, issued by ministries under the supervision of the State Council. The authorities responsible for fiscal matters are the Ministry of Finance (MOF) and the State Administration of Taxation (SAT).

1.4 Local Tax Bureau

The local Assemblies are authorized to implement local laws and regulations, but these laws and regulations must not be in conflict with the Constitution, laws enacted by National People's Congress, and regulations issued by the State Council.

1.5 Ministry of Finance (MOF) and State Administration of Taxation (SAT)

The State Administration of Taxation (SAT) and Ministry of Finance (MOF) interpret tax laws through the issuance of circulars. The key role in the formulation and coordination of tax policies is played by the SAT, which oversees tax offices' ongoing work at provincial and municipal levels; the MOF provides support to the development of fiscal policies implemented by the SAT. The SAT is put in charge by the State Council of collecting and administrating taxes, which generate revenues for both the central government and local governments. The individual

tax offices are responsible for the ordinary resolution of tax matters and for the collection and administration at a local level.

However, the local tax offices must follow the directives of the SAT. For its complexity, the Chinese tax system reflects not only a single national tax law or code but also a system built on several levels that drives individuals and companies' taxation. The MOF and SAT implement, clarify, and supervise the overall tax system by issuing regulations, rulings, and interpretations. In actual fact, laws constituting China's tax code are only general principles, while the mentioned circulars contain detailed provisions regarding tax purposes, taxpayers, and calculation of tax burden. Although circulars do not have the force of law in the sources' hierarchy, those issued by MOF and SAT are guidelines for all taxpayers and courts when addressing tax disputes.

1.6 Tax Classification

See Table [1.2](#).

1.7 Direct Taxes

Individual Income Tax is governed by the *Individual Income Tax Law* (IITL), which was enacted on January 1, 1994 and amended on June 30, 2011, and related regulations (*Individual Income Tax Implementing Rules—IITIR*) were promulgated on January 28, 1994 and recently amended in July 2011.

1.8 Individual Income Tax

Chinese citizens and foreigners residing in China or having a source of income in the country are subject to taxation (*Individual Income Tax, IIT*) on income earned from employment, self-employment, and other categories of personal income.

The tax liabilities depend on the status of residence in China and on the source of income; salaries and wages are taxed at a rate ranging from 3 % to 45 % in seven brackets.

Table 1.2 Chinese tax categories

a) Direct taxes	<i>Individual Income Tax</i> <i>Company Income Tax</i>
b) Indirect taxes	<i>Value Added Tax</i> <i>Business Tax</i> <i>Consumption Tax</i>
c) Other taxes	<i>Stamp Duty</i> <i>Deed Tax</i> <i>Land VAT</i> <i>Real Estate Tax</i> <i>Resource Tax, etc.</i>
d) Customs duties	

1.9 Company Income Tax

The new tax law concerning the Corporate Income Tax (*Enterprise Income Tax Law—EITL*, also known as *Company Income Tax—CIT*), which entered into force on January 1, 2008, was adopted to eliminate the distinction in treatment between local companies and those with foreign participations. A 5-year transition period is guaranteed to those firms that had previously gained advantage from significant tax benefits because the government aims to gradually increase the tax rate by 1–3 % per year until it will reach the new single rate of 25 %.

Taxpayers of the new Company Income Tax are both resident companies for income produced globally (not just within PRC) and nonresident companies that have a permanent establishment in China, limited to the income earned in that territory or effectively connected with it, and nonresident companies without a permanent establishment, limited to the income generated in China in case there is no agreement to avoid double taxation between the countries.

Corporate Income Tax is paid on income from sale of goods, delivery service, and transfer of ownership, as well as on income from dividends, interests, and royalties.

With the reform, the flat tax rate has become 25 % for all companies, dropping to 20 % for small firms (small and thin-profit enterprises) and to a preferential rate of 15 % for firms with high technological investments.

1.10 Indirect Taxes

Turnover taxes can be grouped into three categories:

- Value Added Tax
- Business Tax
- Consumption Tax

1.11 Value Added Tax

The *Provisional Rules on Value Added Tax* were adopted on December 13, 1993 and amended several times till the end of 2008, while the *Provisional Rules on Value-added Tax Implementing Rules* were adopted on December 23, 1993, and amended on October 28, 2011. Deductibility of tangible assets and an introduction of a 3 % VAT single rate for the small-scale taxpayers, which are not required to have the approval of the status of normal taxpayer, were the recent innovations in the area of indirect taxes (small taxpayer).

The VAT is imposed upon entities performing activities such as supply of goods, manufacturing, repair and replacement services, transportation and certain modern services in some regions, and import of goods. The calculation of the VAT is computed by compensation between the VAT paid on purchases (input tax) and on sales (output tax). The relevant period for calculating the VAT is variable and computed by tax authorities according to the amount of tax due. Taxpayers with monthly settlement are required to pay the tax within 15 days after the new month begins.

1.12 Business Tax

Business Tax is levied on services provided by enterprises (not subject to VAT), sales of intangible assets, and real estate transfers in the territory of the People's Republic of China. Business Tax is calculated by multiplying the gross turnover of a single transaction for its tax rate; it is important to remember that costs related to the gross income are deductible only in certain circumstances indicated by MOF (for example, for some forwarding companies under certain conditions).

The rate varies in a range between 3 % and 20 % (the most frequent is 5 %), and the period for the calculation of the tax is variable and is computed by the local tax authorities according to the total tax due. Individuals with monthly settlements are obliged to state and pay the tax within the first 15 days of the following month.

1.13 Consumption Tax

Consumption Tax is paid by producers and importers of certain goods classified by Chinese law as "luxury" or "non-essential," such as alcohol, cosmetics, fireworks jewelry, luxury watches, motorcycles, tobacco, tires, yachts, etc. There are 14 subcategories with different consumption tax rates and different mechanisms for calculating their tax base.

Table 1.3 Other taxes

<ul style="list-style-type: none"> • <i>Stamp Duty</i>: a tax related to contracts, corporate documents, and books • <i>Deed Tax</i>: a tax calculated on the allocation or transfer of ownership rights for land and buildings • <i>Land VAT</i>: a tax calculated on income resulting from allocation or transfer of land use rights, buildings, and associated structures within the Chinese territory • <i>Real Estate Tax</i>: a property or mortgage tax levied on the owner or lender of a property; it is calculated on land value, buildings, and leases • <i>Resource Tax</i>: a tax imposed on entities engaged in an extraction of some mining and natural resources or in a production of salt within the Republic of China

1.14 Other Taxes

See Table 1.3.

1.15 Customs Duties

Customs duties on import/export of goods are calculated on the value of the asset multiplied by the corresponding rate; the value of the property results from the customs declaration. This usually follows a regular check by competent authorities; the single rate is defined from its HS-code (code similar to the INTRASTAT European classification) that identifies the specific product category (Taxable Entities Covered).

1.16 Individual Income Tax Subjects

The National People's Congress enacted the law imposing personal income tax for the first time on September 10, 1980, entering into force on the same day. In the following two decades, there have been numerous amendments made to the original text with the last dated April 25, 2011, when the National People's Congress announced a plan for the amendment of the law subsequently approved on June 30, 2011 and in force since September 1, 2011. The organ carrying out the control and administration of IIT is the State Administration of Taxation, which is also responsible for the collection and distribution of tax revenue, together with local tax offices in provinces and metropolitan cities locally in charge of tax administration. Tax revenue is then divided between the central and local governments.

Individuals regularly residing in China (for family relationships, economic interests, or possession of a home registered under their own name) and those that have spent a period exceeding a year are legally obliged to pay IIT on their income.

An individual is also considered a taxpayer if, despite not having a domicile or being a resident in China for a period exceeding a year, he earns income generated within the Chinese territory. This is its unique IIT tax base.

Regarding the taxable amount of those domiciled and residing in China, the IIT is based on the income globally earned. However, with the approval of the competent tax department, it is usually granted the benefit of paying taxes only on income earned within the Chinese territory to those people living in China for more than a year if they prove they have not been living in China for over 5 years. Once this threshold is passed, the IIT is calculated on the overall income, regardless of their geographical location.

1.17 Company Income Tax Subjects

The new CIT entered into force on January 1, 2008, responding to the demand of an action able to adapt the Wholly Foreign-Owned Enterprises Taxation with Local Firms Taxation. Taxpayers of Company Income Tax are two: resident companies and nonresident companies. The first are established both in China and outside, but their administration and control activities are carried out within the Chinese territory; the latter are companies constituted outside China, whose activities of management and audit are performed outside its boundaries. The resident companies are subject to CIT on income earned inside and outside PRC territory, while the nonresident enterprises pay taxes on income earned either in the territory of the PRC or outside but connected with a permanent establishment located in China.

Eventually, the CIT is collected in the form of withholding tax for nonresidents without a permanent establishment in the country but with a source of income situated therein, as well as for companies having a permanent establishment in China and also generating income not connected with the Chinese territory. All companies subject to the CIT must be registered with the competent tax authorities within 30 days after receiving the business license. The CIT is collected on an annual basis, but the taxpayer on a monthly or quarterly basis must submit periodic financial statements and tax returns to the competent tax office within 15 days by the end of the reporting period as an advance payment of the annual settlement.



<http://www.springer.com/978-3-319-00274-3>

Chinese Tax Law and International Treaties

Riccardi, L.

2013, XII, 270 p., Hardcover

ISBN: 978-3-319-00274-3