China Enterprise Income Tax

In the People's Republic of China ("the PRC", hereinafter refer to as China), there are around fifteen types of taxes that foreign entities may need to pay, which includes Enterprise Income Tax ("EIT"), Individual Income Tax ("IIT"), Value Added Tax ("VAT"), Business Tax ("BT"), Consumption Tax, City Construction Tax, Custom Duty, Stamp Duty, Property Tax, Vehicle and Vessel Tax, City Land Usage Tax, Deed Tax, Land Value Added Tax, Resource Tax, Vehicle Purchase Tax. This paper aims to introduce the fundamental principles and guidelines of EIT liability in China. Additionally, the key elements of China's VAT and BT systems are also introduced.

Many SME's will enjoy tax benefits, such as reduced rates for small or low-profit enterprises. Further incentives are provided for high-tech enterprises or those that are established in western regions. Section 6 provides a list of these incentives.

It should be understood that taxation is a tool which State authorities frequently adjust to achieve economic and social initiatives in a rapidly evolving economy. As such, specific tax incentive policies, tax rates and calculation methodologies may change with seemingly little warning. Furthermore, tax rates may also vary based on the specific scope, industry, or local jurisdiction in which a company operates. This paper should serve only as a starting point for familiarizing yourself with China's EIT system.

1.0 Legal Framework

1.1 Legal Sources of EIT

The current China EIT regulations include "EIT Law of the People's Republic of China", "Detailed Implementation Rules of EIT Law of China" effective on 1 January 2008, and other related circulars issued by the Ministry of Finance ("MoF") and the State Administration of Taxation ("SAT"). The SAT maintains an English website, which provides news, statistics, tax treaties, and translations of China's tax laws (the information provided on the website is not guaranteed comprehensive and up-to-date and should be taken cautiously).

1.2 Taxpayers of EIT

According to Chinese EIT law, all enterprises or organizations which have obtained income within China, other than Wholly Individual Owned Enterprises or Partnership Enterprises, are subject to EIT. EIT taxpayers are divided into two distinct groups: resident enterprises and non-resident enterprises.

A resident enterprise (“RE”) is defined as an enterprise that is: a) legally established within China; or b) an enterprise which has been established according to the laws of a foreign jurisdiction, but whose effective management institution is within China. In this case, the effective “management institution” refers to the institution that exercises substantive and overall management and control of the production, business operation, personnel, finance functions and assets of an enterprise.

A non-resident enterprise (“NRE”) is defined as an enterprise that is: a) legally established according to the laws of a foreign jurisdiction and have effective management outside of China, but with institutions or management set up within China; or b) enterprises which have income originating from China without setting up any formal Chinese institution or establishment.

1.3 Income Subject to EIT

REs are subject to EIT on their global income. NREs are only subject to EIT on income originating from China, and income originating from outside China but related to the institutions or establishments within China. For example, a Chinese Wholly Foreign Owned Enterprise (“WFOE”) would qualify as an RE. All income, including foreign income, is subject to EIT in China. Types of income originating from China include but are not limited to: a) sales income from transactions which occurred within China; b) services income where services were provided within China; c) transfer income related to immovable property located within China; d) transfer income related to movable property, where the transferor was located within China; e) dividend income obtained from enterprises located within China; and f) interest income, rental income or royalty income obtained from enterprises located within China or individual residents of China.

1.4 Applicable EIT Rates

The standard EIT rate is 25%. This rate is applicable to REs and NREs which have setup institutions or establishments within China and have an income related to those institutions or establishments. The State provides reduced rates for certain businesses which operate in sectors or jurisdictions which the government would like to stimulate (details can be found in Section 6).

2.0 Resident Enterprise EIT

REs shall pay EIT on their global income. The basic formula for calculating EIT payable for an RE is as follows:

$$EIT\ Payable = Taxable\ Income \times Applicable\ EIT\ Rate$$

where:

$$Taxable\ Income = Gross\ Income - Nontaxable\ Income - Tax\ Exempted\ Income - Deductions - Allowable\ loss\ Carryforwards\ from\ previous\ years$$

If an RE is not able provide complete and accurate income, cost, and expenses documentations to calculate the taxable income, the China tax authority has the right to assess its taxable income.

2.1 Gross Income

Gross income includes all global income earned during the tax period. This includes but is not limited to sales income, service income, asset transfer income, dividend income, interest income, rental income, royalty income, donation income, and other income in both monetary and non-monetary nature. For income which is non-monetary, the market value of the consideration received in the transaction is taxable. This is an important point which must be considered when executing larger transactions which are not settled in cash, as it creates the possibility of liquidity shortages related to the tax liability.

Sales income is recognized and taxable on an accrual basis based on China GAAP which, in many ways, is similar to International GAAP. Dividend income and the related taxes are recognized and payable as of the dividend declaration date of the investee. Interest, rental, and royalty income are taxable as of the date which they become payable under the related contract. Similarly, for goods sold on instalment, income is taxable on the date on which the payment becomes payable under the contract.

2.2 Non-taxable Income

Non-taxable income is less common for business structures utilized by European SME's entering or operating in China. An example of non-taxable income includes funds obtained by the enterprise, which are to be used for specific purposes as designated by MoF and SAT and approved by the State Council.

2.3 Tax-exempt Income

There are generally three types of tax-exempted income: interest on state debt, income to non-profit organizations, and dividend income from an RE. Like many other nations, China does not levy a tax on interest which is received on State debt. Qualified non-profit organizations are also generally exempt from paying EIT on income obtained through not-for-profit activities. Non-profit organizations are being subject to EIT on income obtained through profit-making activities.

Most relevant to SMEs, China does not tax dividends which are obtained through direct investment in another RE. This makes it possible for enterprises to utilize parent/subsidiary structures.

2.4 Deductions

Real and reasonable expenses related to income generating activities are deductible from taxable income (subject to the limitations in the table below). Reasonable expenses include costs, expenses, taxes, losses, and other expenses which are actually incurred during the course of generating income. All deductions must be in accordance with tax regulations and be supported by valid documentation.

Following accrual basis methodology, expenditures of the enterprise should be divided into revenue expenditures and capital expenditures. Revenue expenditure should be deducted in the period incurred. Capital expenditures should be capitalized and depreciated or amortized over the applicable useful life. Specific guidance is provided for the depreciation and the amortization of assets in Section 3.5.

The common expenses include: marketing and sales expenses, financing costs, charitable donations, and other administrative expenses. Some losses may be deductible, upon the condition that the appropriate documentation is provided to satisfy the tax authority. These include: damage or scraping losses on fixed assets and inventories, losses arising from transfer of property, bad debts expenses, or (net) losses resulting from natural disasters.

The EIT regulations provide limitations on the maximum amounts which may be deducted for certain expense types. They are as follows:

Item	Limitation
Interest Expenses	• Interest expenses related to the loan of financial enterprises or approved bonds are deductible. • Interest expenses related to the loans of non-financial enterprises are deductible up to the amount equal to the interest which would be charged by a financial enterprise under same terms. • The portion of interest expenses related to the debt of a related party which exceeds the prescribed related party debt to equity ratio is not deductible (the related party debt to equity ratio of non-financial enterprise is 2:1). • Interest expenses related to a loan incurred for the purpose of purchasing or constructing fixed assets, intangible assets, long term (over 12 months) inventories, which incur in the period of purchase or construction of related assets, shall be capitalized to the related assets cost.
Entertainment	• Only 60% of total entertainment expenses may be deducted, which shall be no more than 0.5% of annual revenue.
Promotion/Advertising	• Promotion /advertising expenses actually incurred are deductible up to an amount equal to 15% of annual revenue; the exceeding amount can be carried forward. • Non-alcoholic beverages, cosmetics, and pharmaceutical manufacturers are permitted to deduct up to an amount equal to 30% of annual revenue. • Promotion/advertising expenses of tobacco enterprises are non-deductible.
Wages, Social Security, Staff Welfare, Labour Unions and Education Fees	• Reasonable wages paid to employees are deductible. • Social security contributions and housing fund contributions paid for employees in accordance with the State Council or municipal government bodies are tax deductible. • Contributions paid to additional or supplemental pension or medical insurance plans are deductible up to an amount that does not exceed 5% of total wage and salary costs. • Staff welfare expenses actually paid are deductible up to an amount equal to 14% of total wage and salary costs. • Labour Union contributions paid to the enterprise's legally established Labour Union are deductible up to an amount equal to 2% of total wage and salary costs. • Education fees actually paid are deductible up to an amount equalling 2.5% of total wage and salary costs. • Training fees related to software of manufacturing enterprises, if able to be distinguished from other education fees, are fully deductible.

Rental Expenses	• Rental expenses incurred for fixed assets under operating lease (the ownership, risk and return of the fixed assets not transferred to the lessee) are deductible in the leasing period evenly. • Rental expenses incurred for fixed assets under financing lease are capitalized to the value of the fixed assets and depreciated over the life of the fixed assets.
Donations	• Only donations to organizations on the list of qualified charitable organizations may be deducted. • Donations up to 12% of annual profits are deductible.

2.5 Depreciation and Amortization

The depreciation expense of fixed assets could be deductible in calculation of taxable income. The Chinese tax code generally provides for straight-line depreciation of fixed assets. Fixed assets can be depreciated from the month following the month that they are put into use. Fixed assets may not be depreciated if they are not in service (except for buildings) or are not used for business purposes. Fixed asset depreciation must be based on historical cost.

The enterprise can determine the remained value and depreciation period of the fixed assets. But the depreciation period shall not be lower than the following minimum periods stipulated by the EIT laws and regulations:

Asset Type	Minimum Deprecation Period
Building	20 years
Aircraft, vessels, railway transportation vehicles	10 years
Machinery, mechanical equipment	10 years
Appliances, tools, furniture related to business activities	5 years
Other transportation vehicles	4 years
Electronic equipment	3 years

The amortization expense of intangible assets is calculated using the straight line method and is tax deductible. The amortization period of intangible assets shall not be less than 10 years. An exception is made where related laws or contracts prescribe the useful life of the intangible assets. The intangible assets should then be amortized within the prescribed useful life. Expenditures that are incurred in acquiring goodwill shall be deductible upon complete disposal or liquidation of the enterprise.

The amortization of long-term deferred expenses is deductible according to the following table:

Long-term Deferred Expenses Type	Amortization Period
Expenses incurred for the alteration of fully depreciated fixed assets	estimated remaining useful life
Expenses incurred for the overhaul of fixed assets	estimated remaining useful life
Expenses incurred for the alteration of fixed assets leased from other party	remaining lease term
Other expenses that shall be treated as long-term deferred expenses (e.g. pre-establishment fee of the enterprise)	No less than 3 years

2.6 Allowable Loss Carry-forwards from Previous Years

China's EIT regulations provide that operating losses can be carried forward to offset future taxable income. Losses can be carried forward for a maximum of 5 years. Losses may not be used to offset or recuperate taxes paid on income in prior years.

2.7 Non-Deductions

The following expenditures are not deductible in calculating the taxable income of an RE:

1) Dividends, profit distributions and other returns on equity investments paid to investors;
2) EIT;
3) Late payment interest charged on tax underpayment;
4) Fines, penalties and losses resulting from confiscation of property;
5) Sponsor expenses incurred by an enterprise that are not connected with the production and business operations and that are not of the nature of advertising expenses;
6) Provisions for asset impairment, risk reserves, etc. that are not in compliance with the regulations prescribed by the departments of the State Council in charge of finance and taxation;
7) Management fees paid between enterprises; and
8) Other expenditures which are not relevant to the obtaining income.

3.0 Non-resident EIT ("Withholding Tax")

REs are responsible for withholding EIT on payments to NRE. The RE, as the withholding agent, shall then pay the withheld amount to its tax bureau on behalf of the NRE. The RE (withholding agent) is required to report transactions with non-resident companies to the tax bureau within 30 days by submitting a registration form and a copy of the contract.

4.1 Passive Income of a Non-resident Enterprise

Passive income most commonly occurs in the form of dividend income, interest income, rental income, royalty income, asset transfer income and share transfer income. The formulas for calculating EIT on various forms of passive income obtained by NREs, and which are not related to its Chinese institutions are:

Income obtained as dividend, interest, rental, or royalty income from China:

$$EIT\ Payable\ = Income \times Applicable\ EIT\ Rate$$

Income obtained from an asset transfer in China:

$$EIT\ Payable = (Income - Net\ Value\ of\ Asset) \times Applicabe\ EIT\ Rate$$

Income obtained from share transfers in China:

$$EIt\ Payable = (Income - Share\ Investment\ Cost) \times Applicable\ EIT\ Rate$$

The current applicable EIT rate for passive income of an NRE is 10%. This may be reduced if the NRE is located in a country that benefits from favourable treatment under a tax treaty (for a list of such treaties, see Appendix C). In order, for an NRE, to obtain benefits under a double tax treaty, it must apply for, and obtain approval from, the tax bureau of the withholding agent.

4.2 Active Income of a Non-resident Enterprise

If an NRE obtains active income (normally referred to as service income) for services rendered in China, the EIT is calculated as follows:

$$EIT\ Payable\ =\ Income \times Assessed\ Profit\ Rate \times EIT\ Rate\ (25\%)$$

The assessed profit rate is determined by the tax authority based on the service type provided. Per the current SAT circular guidelines, the assessed profit rates of NREs are: 15%-30% for construction, design and consulting services; 30% to 50% for management services; and not less than 15% for other services. Example A5 illustrates the EIT calculation for active income of an NRE.

4.0 Special Case: Representative Office

A representative office (“RO”) is treated somewhat uniquely under China’s tax regulations. An RO is not a separate legal entity from its foreign parent company and its operations are subject to taxation

within China. Most ROs are not permitted to engage in income generating activities and instead taxed on their assessed income, which is derived from the RO’s total expenditures. The formula is as follows:

$$EIT = Assessed\ Income \times Assessed\ Profit\ Rate \times EIT\ Rate$$

where:

$$Assessed\ Income = \frac{RO\ Expenditures}{1 - (Assessed\ Profit\ Rate + Business\ Tax\ Rate)}$$

Currently, the assessed profit rate of an RO is 15%, the EIT rate is 25%, and the Business Tax ("BT") rate is 5%.

ROs are also responsible for paying business tax ("BT") and other tax surcharges, which may be applied. BT for an RO is calculated as follows:

$$BT = Assessed\ Income \times Assessed\ Profit\ Rate \times BT\ Rate$$

Where an RO is permitted to engage in income generating activities, the EIT liability can be determined using the actual taxable income of the RO or by applying a deemed profit rate to total revenues. Example A3 of Appendix A illustrates the BT and EIT calculations for an RO.

5.0 Tax Incentives

China provides the following tax incentives to specific types of income, industries and some regions in order to stimulate the related industries and regions. It is important to note that companies need to submit an application with tax authorities and be approved, before they can enjoy any tax incentives. The following tables provide special rates and treatment of specific types of income. Example A2 of Appendix A illustrates the EIT calculation, with incentives.

5.1 Income Subject to Tax Reduction or Exemption

Income by Project Type		Applicable EIT Rate
Agriculture	Agriculture, forestry, animal husbandry and fishery project income.	Exempt
Infrastructure	Infrastructure Projects involving ports and wharfs, airports, railways, highways, urban public transportation, electric power, water supplies, or other infrastructures which are within the scope of key support from the State.	Exempt for the first three years, and a 50% reduction in EIT for the following three years, starting from in year which the project first generates operating income.

Conservation	Environmental protection and energy or water conservation projects (e.g. public sewerage treatment, public refuse treatment, synergistic development and utilization of methane, sea water desalination etc. projects).	Exempt for the first three years, and a 50% reduction in EIT for the following three years, starting from in year which the project first generates operating income.
Technology	Qualified technology transfer income obtained by an RE.	Exempt up to 5 million RMB annually and a 50% reduction for any amounts which exceed 5 million RMB.

5.2 Additional Deduction Incentives

Expense Type	Treatment
Research & Development	An additional 50% of R&D expenses incurred in the development of new technologies, new products and new technological processes, if not capitalized as intangible assets, can be deducted from taxable income. If capitalized as intangible assets, these expenses can be amortized based on 150% of the capitalized amount.
Salary of Disabled persons	An additional 100% of salary expenses paid to disabled personnel can be deducted from taxable income.

5.3 Tax Incentives to Specified Regions, Industries and Enterprises

Income by Project Type		Applicable EIT Rate
Small or Low-Profit Enterprises	Enterprises must have less than 300,000 RMB in annual taxable income, less than 10 million RMB in total assets, less than 80 employees, and not be engaged in prohibited or restricted industries. An exception is provided for manufacturing companies, which may have less than 100 employees and a maximum of 30 million RMB in total assets.	20%
Small or Low-Profit Enterprises	From 1 January 2012 to 31 December 2015, the income of small-size or low-profit enterprises, having less than 60,000 RMB in annual taxable income.	Additional 50% EIT reduction, and reduced rate of 20%
Western Regions	From 1 January 2011 to 31 December 2020, enterprises in western regions (Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang, Inner Mongolia and Guangxi etc.) which engage in encouraged industries may be eligible to enjoy a reduced EIT rate.	15%

High-Tech	Companies which qualify as 'high-tech', as determined by tax authorities.	15%
Venture Capital	Venture capital enterprises which make equity investments in small or medium sized, advanced and new technology enterprises that have not been listed on a stock exchange.	70% of invested amount may be deducted from taxable income, beginning in the year that the equity has been held for at least two years.
New Circuit Manufacturing	Newly established software manufacturing and integrated circuit designing enterprises.	Exempt for the first two years, and a 50% reduction in EIT for the following three years, starting the first profit-making year.
Integrated Circuit Manufacturing	Integrated circuit manufacturing enterprises which manufacture integrated circuit products with a line width of less than 0.8 millimetres.	Exempt for the first two years, and a 50% reduction in EIT for the following three years, starting the first profit-making year.
Large Investments in Circuit Manufacturing	Integrated circuit manufacturing enterprises with investment amounts exceeding 8 billion RMB or which manufacture integrated circuit products with a line width less than 0.25 millimetres.	15%; or in the case the operational period of the investment is more than 15 years, exempt in the first five years and a 50% reduction in the following five years, starting in the first profit-making year.
Software and Circuit Design	Key software manufacturing and integrated circuit designing enterprises, within the state planning layout.	10% for years not otherwise exempt

6.0 EIT Filing Requirements

6.1 EIT Filing Period

EIT is calculated for a tax year, based on the calendar year, starting 1 January and ending on 31 December. If an enterprise commences or terminates its business during a calendar year, its actual operating period in the current calendar year shall be treated as a tax year. When an enterprise is liquidated, the liquidation period is treated as a tax year.

6.2 EIT Filing method

China EIT is paid, or advanced, on a monthly or quarterly basis, as determined by the in-charge tax bureau (a quarterly basis is normally adopted). The advanced EIT payment shall be calculated based on the actual profits for the month or the quarter. If it is difficult to calculate advanced EIT payment on actual profits, the tax bureau may permit calculation based on the average monthly or quarterly profits of the prior year. Generally, once the advance payment method is determined, it shall not be arbitrarily changed during the tax year.

An enterprise shall file an EIT return with, and make advanced tax payment to the tax bureau within 15 days after the end of each month or quarter.

An enterprise shall file an annual EIT return, together with its financial and accounting reports and other relevant information, and perform the annual tax reconciliation to settle EIT amounts to be paid or refunded within five months after year end. If an enterprise terminates its business operation in the middle of a tax year, it shall perform a reconciliation and settle the annual EIT payment for the current period within 60 days after the date of actual termination of business operations.

If an RE has branches without legal person status in other cities of China, 50% advance EIT payment shall be paid at the place of head office and 50% advance EIT payment shall be paid at the place of branch office. If there are more than two branch offices, the EIT payment percentage of each branch shall be calculated as follows:

$$\begin{aligned} &EIT\ Payment\ \%\ of\ Branch \\ &\quad = \left(.35 \times \frac{Total\ Branch\ Revenue}{Total\ Revenue\ of\ all\ Branches}\right) \\ &\quad + \left(.35 \times \frac{Total\ Branch\ Salary}{Total\ Salaries\ of\ all\ Branches}\right) \\ &\quad + \left(.3 \times \frac{Total\ Branch\ Assets}{Total\ Assets\ of\ all\ Branches}\right) \end{aligned}$$

The head office is responsible for filing an annual EIT return, on a consolidated basis, with its tax bureau.

7.0 Non-compliance and Disagreement

7.1 Appeal or Lawsuit

In the case of a tax dispute between the tax authority and a taxpayer, the taxpayer must first pay or remit the taxes and late payment fees in accordance with the decision on tax payment made by the tax authority. The tax payer may then apply for an administrative reconsideration in accordance with the law. If they object to the decision made during administrative reconsideration, they may bring a lawsuit in the people's court.

7.2 Late Payment Fee

If a taxpayer has special difficulties paying taxes within a prescribed period, it may, upon the approval of municipal tax bureau, defer the tax payment for a period of not more than three months.

If a taxpayer fails to pay taxes or a withholding agent fails to remit taxes within a prescribed period, the tax authority shall impose a late fee at the rate of 0.05% per day of the amount of taxes in arrears, calculated from the day the tax payment is overdue until the day the tax payment is made.

7.3 Additional Penalties

If a taxpayer or withholding agent fails to file tax returns or submit the required information within the prescribed time limit, the tax authority shall order the taxpayer or withholding agent to correct the acts within a prescribed time limit and may impose a fine of not more than 2,000 RMB. If the case is serious, the tax authority may impose an additional fine of 2,000 to 10,000 RMB. If a taxpayer or withholding agent fails to correct unpaid taxes within the prescribed time limit, the tax authority may impose an additional fine of between 50% and 5 times the amount of unpaid or underpaid taxes.

In additional to criminal liability, a penalty ranging from 50% to 5 times the amount of unpaid taxes is applicable in cases where a taxpayer forges, revises, conceals or destroys accounting books or supporting vouchers, misstates expenses or income, or files fraudulent tax returns.

8.0 Transfer Pricing

According to relevant EIT laws and regulations, the transactions between related parties shall be based on the arm’s length principle; if not, the tax bureau may perform special tax adjustment. When filing annual EIT returns, an RE needs to submit related party transactions reports, which include related party relationships, purchases and sales, services, transfers of intangible and fixed assets, financing arrangements, outbound investments and outbound payments.

The RE needs to prepare transfer pricing documentation within 5 months after the year end for submission to the tax bureau. The transfer pricing documentation should include organizational structure, overall business operations, details of related party transactions, functional and risk analysis, comparability analysis, selection and application of transfer pricing method, and other relevant documents.

REs could be exempt from preparation of transfer pricing documentation in the following circumstances:

a. The annual sales turnover with related parties is less than 200 million RMB and other related party transaction amounts are less than 40 million RMB;
b. The related party transactions are within the scope of an advancing pricing arrangement;
c. The share of foreign shareholders is less than 50% and only has related party transactions with related parties located within China.

The SAT allows for use of the following methods in adjusting transfer prices:

a. the comparable uncontrolled price method (CUP);
b. the resale price method;
c. the cost-plus method;
d. the transactional net margin method (TNMM);
e. the profit split method; and
f. any other arm's length methods.

While defining each of the criteria used to identify related parties, it should be noted that China’s definition of a related party may be broader than other jurisdictions.

9.0 Other taxes: Value Added Tax and Business Tax

9.1 Value Added Tax

Value-Added Tax (VAT) is a tax charged on the importation, sales of goods, or provision of processing, repair and replacement services in China. China has started a pilot plan in Shanghai as of 1 January 2012, which adds many service industries into the scope of VAT. For these industries, VAT will replace BT.

VAT taxpayers are divided into VAT general taxpayers and VAT small-sized taxpayers. Taxpayers with annual turnover exceeding the set standard are classified as VAT general taxpayers. The annual turnover standard for taxpayers mainly engaged in manufacturing of goods, processing, repair and replacement services is 0.5 million RMB. The annual turnover standard for other taxpayers is 0.8 million RMB. The annual turnover standard for Shanghai taxpayers transferred from BT to VAT under the Shanghai pilot plan is 5 million RMB. For VAT general taxpayers, VAT will be calculated as a percentage of turnover, less the VAT paid on input. Taxpayers with annual turnover less than the standards above are classified as small scale taxpayers. They will pay a reduced VAT rate equal to 3% on turnover but cannot deduct VAT paid on inputs. Small scale taxpayers can apply with the tax authority to be treated as VAT general taxpayers, provided they have sound accounting systems which can provide accurate tax filing information.

Exportation and sales of certain goods (e.g. Antique books, contraceptive medicine, agricultural goods, imported materials and equipment from foreign entities for scientific research) enjoy VAT exemption. In addition, certain VAT refunds are in place for exports. These rebates tend to fluctuate dependent on the government willingness to stimulate exports or slow them down. The rebate can be as large as the entire applicable VAT, or it can be a small percentage of such.

All VAT input values must be supported by VAT invoices. The VAT invoices obtained must be verified by the tax bureau within 180 days after the issuance date in order to be deductible in calculation of VAT.

9.2 Business Tax

Business Tax (“BT”) is a tax charged on the provision of taxable services (including communications and transportation, construction, finance and insurance, posts and telecommunications, culture and sports, entertainment and other service industries) and transfer of intangible assets or immovable property in China.

The provision of taxable services in China here refers to the entity or individuals who provide or receive taxable services which are located within China. If a person or an enterprise located in a European country provides a BT taxable service to a person or an enterprise located in China, even if those services were rendered from outside of China, the European enterprise shall be subject to China BT. The applicable BT rate is applied directly to turnover. An example of the BT calculation is provided in Appendix A.

The BT rates for each industry are as follows:

Taxable item	BT rate
Communications and transportation, construction, post and telecommunications	3%
Finance and insurance, other services, transfer of intangible assets, transfer of immovable property	5%
Entertainment	5%-20%

10.0 Appendix

Appendix A: Sample Tax Calculation Cases

The following Sections provide sample calculations for the most common tax scenarios European SME's are likely to encounter in China.

A1 Standard EIT Calculation

Scenario:

- Sample Co. is a China WFOE which generated 100 RMB in income in China (a).
- Sample Co. is subject to business tax (b).
- Sample Co. has 75 RMB of expenses, which are all deductible (c).

(a)	Revenue	100.00	
(b)	**Business Tax**	**5.00**	= (a) x 5% Business Tax Rate
(c)	Deductible Expenses	75.00	
(d)	Taxable Income	20.00	= (a) - (b) - (c)
(e)	**EIT Payable**	**5.00**	= (d) x 25% EIT Rate
(f)	Net Income	15.00	= (d) - (e)

Summary:

- Sample Co. will pay Business tax of 5 RMB (b).
- Sample Co. will pay EIT of 5 RMB (e).
- Sample Co. will realize Net Income of 15 RMB (f).

A2 Standard EIT Calculation with Non-deductions and Tax Incentives

Scenario:

- Sample Co. is a Chinese WFOE which generated 100 RMB in income in China (a).
- Sample Co. is subject to business tax (b).
- 75 RMB of total expenses (c).
- 10 RMB of expenses which are supported and not deductible (d).
- 5 RMB of qualified R&D expenses, which are subject to an additional 50% deduction (e).
- Sample Co. qualifies for the reduced small or low-profit EIT rate of 20% (h).

(a)	Revenue		100.00	
(b)	**Business Tax**		**5.00**	= (a) x 5% Business Tax Rate
(c)	Total Expenses	75.00		
(d)	Non-Deductible Expenses	10.00		
(e)	Additional Deduction Incentives	2.50		= 5 RMB Incentives x 50%
(f)	Total EIT Deductions		67.50	= (c) - (d) + (e)
(g)	Taxable Income		27.50	= (a) - (b) - (f)
(h)	**EIT Payable**		**5.50**	= (g) x 20% EIT Rate
(i)	Net Income		22.00	= (g) - (e)

Summary:

- Sample Co. will pay Business tax of 5 RMB (b).
- Sample Co. will pay EIT of 5.5 RMB (h).
- Sample Co. will realize Net Income of 22 RMB (i).

A3 Representative Office EIT Calculation

Scenario:

- Sample Co. has an RO in China.
- The RO has 100 RMB of expenses (a).

(a)	Expenses	100.00	
(b)	Deemed Income	117.65	= (a) / (100% - 10% Profit Rate - 5% Business Tax Rate)
(c)	**Business Tax**	**5.88**	= (b) x 5% Business Tax Rate
(d)	Taxable Income	11.76	= (b) x 10% Profit Rate
(e)	**Enterprise Income Tax**	**2.94**	= (d) x 25% EIT Rate

Summary:

- Sample Co. will pay Business tax of 5.88 RMB (c).
- Sample Co. will pay EIT of 2.94 RMB (d).

A4 China WFOE Issues Dividend to European Parent (Non-resident Enterprise)

Scenario:

- Sample Co. is a China WFOE (See A1 above).
- Europe Co. is a foreign company which owns 100% of Sample Co.
- Sample Co. is distributing 15 RMB of earnings to Europe Co. by dividend (a).

(a)	Decl. Dividend	15.00	
(b)	**EIT Withholding**	**1.50**	= (a) x 10% Div. EIT Withholding Rate
(c)	Net Dividend Received	13.50	= (a) - (b)

Summary:

- Europe Co. will pay 1.5 RMB in China EIT (b).

A5 European Company has Active Income for Services Provided in China

Scenario:

- Europe Co. is a foreign enterprise without a separate legal entity in China.
- Europe Co. has 100 RMB in income for services to a customer in China (a).
- 40% of income is attributed to services provided in Europe (c).
- 60% of income is attributed to services provided in China (d).
- The China tax authority has determined that Europe Co. has a 30% Profit Rate (e).

(a)	Project Income	100.00	
(b)	**Business Tax**	**5.00**	= (a) x 5% Business Tax Rate *BT is not deductible for NRE EIT
(c)	Income Attributed to Europe	40.00	= (a) x 40%
(d)	Income Attributed to China	60.00	= (a) x 60%
(e)	**EIT Payable**	**4.50**	= (d) x 30% Profit Rate x 25% EIT Rate

Summary:

- Europe Co. will pay Business tax of 5 RMB (b).
- Europe Co. will pay EIT of 4.5 RMB (e).
- Business Tax is not deductible for calculating EIT of Non-resident Enterprises (b)(c).
- Income attributed to Europe is not subject to China EIT (e).

Appendix B: List of concepts, organizations and abbreviations

Abbreviation	Name
BT	Business Tax
EIT	Enterprise Income Tax
GAAP	General Accepted Accounting Principle
IIT	Individual Income Tax
MoF	Ministry of Finance

NRE	Non-resident Enterprise
R&D	Research and Development
RE	Resident Enterprise
RO	Representative Office
SAT	State Administration of Taxation
SME	Small or Medium Size Entity
the PRC	the People's Republic of China
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise

Appendix C: List of EU Members with tax treaties with China

Country	Signed on	Effective from	Applicable Since
Austria	1991.4.10	1992.11.1	1993.1.1
Belgium	1985.4.18	1987.9.11	1988.1.1
Belgium	2009.10.7		
Bulgaria	1989.11.6	1990.5.25	1991.1.1
Cyprus	1990.10.25	1991.10.5	1992.1.1
Czech Republic	2009.8.28	2011.5.4	2012.1.1
Denmark	1986.3.26.	1986.10.22	1987.1.1
Estonia	1998.5.12	1999.1.8	2000.1.1
Finland	2010.5.25	2010.11.25	2011.1.1
France	1984.5.30	1985.2.21	1986.1.1
Germany	1985.6.10	1986.5.14	1985.1.1/7.1
Greece	2002.6.3	2005.11.1	2006.1.1
Hungary	1992.6.17	1994.12.31	1995.1.1
Ireland	2000.4.19	2000.12.29	2001.1.1/2001.4.6
Italy	1986.10.31	1989.11.14	1990.1.1
Latvia	1996.6.7	1997.1.27	1998.1.1
Lithuania	1996.6.3	1996.10.18	1997.1.1
Luxembourg	1994.3.12	1995.7.28	1996.1.1
Malta	1993.2.2	1994.3.20	1995.1.1
Malta	2010.10.18		
Poland	1988.6.7	1989.1.7	1990.1.1
Portugal	1998.4.21	2000.6.7	2001.1.1
Romania	1991.1.16	1992.3.5	1993.1.1
Slovakia	1987.6.11	1987.12.23	1988.1.1
Slovenia	1995.2.13	1995.12.27	1996.1.1
Spain	1990.11.22	1992.5.20	1993.1.1
Sweden	1986.5.16	1987.1.3	1987.1.1
The Netherlands	1987.5.13	1988.3.5	1989.1.1
United Kingdom	1984.7.26	1984.12.23	1985.1.1

Source: P.R. China State Administration of Taxation

Appendix D: Selected China Tax Treaty Withholding Rates[1]

Country	Dividend	Qualifying Dividend[2]	Interest	Royalties
Austria	10%	7%	10%	10%
Belgium	10%	10%	10%	10%
Bulgaria	10%	10%	10%	7%/10%
Cyprus	10%	10%	10%	10%
Czech Republic	10%	5%	8%	10%
Denmark	10%	10%	10%	10%
Estonia	10%	5%	10%	10%
Finland	10%	5%	10%	10%
France	10%	10%	10%	10%
Germany	10%	10%	10%	10%
Greece	10%	5%	10%	10%
Hungary	10%	10%	10%	10%
Ireland	10%	5%	10%	10%
Italy	10%	10%	10%	10%
Latvia	10%	5%	10%	10%
Lithuania	10%	5%	10%	10%
Luxembourg	10%	5%	10%	10%
Malta	10%	5%	10%	10%
Poland	10%	10%	10%	10%
Portugal	10%	10%	10%	10%
Romania	10%	10%	10%	7%
Slovakia	10%	10%	10%	10%
Slovenia	5%	5%	10%	10%
Spain	10%	10%	10%	10%
Sweden	10%	5%	10%	10%
The Netherlands	10%	10%	10%	10%
United Kingdom	10%	10%	10%	10%

[1]Exceptions and additional criteria may apply to listed rates.
[2]Generally applied to ownership stakes greater than 25%. Additional criteria may apply in order to qualify for reduced rates.

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