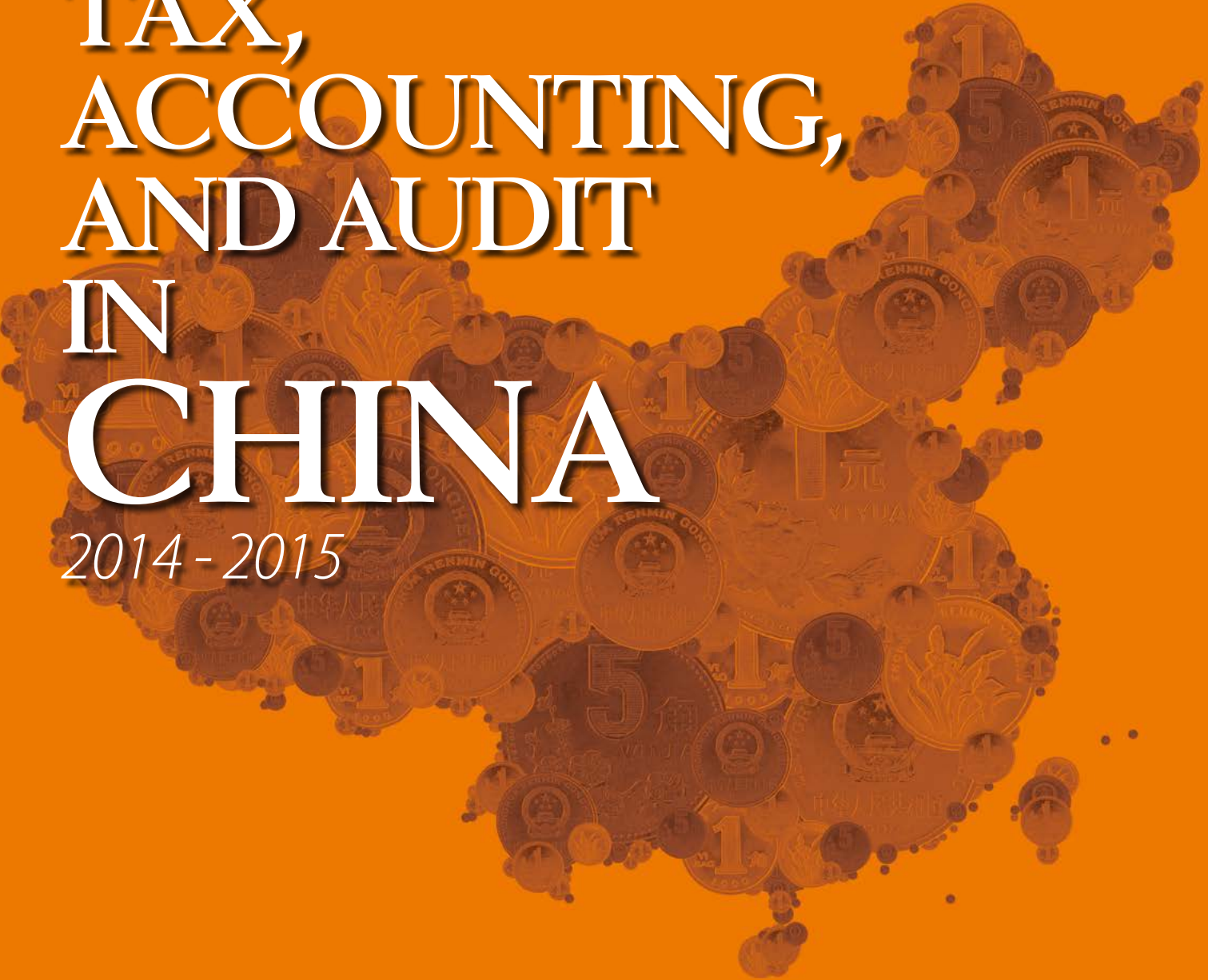



TAX, ACCOUNTING, AND AUDIT IN CHINA

2014-2015



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- I. China's Tax System
 - II. China's Business Taxes
 - III. Individual Income Tax

- IV. Accounting, Audit and Tax Compliance
- V. International Taxation

Produced in association with

 **DEZAN SHIRA & ASSOCIATES**

Introduction

Taxation permeates business transactions in China, and a strong understanding of tax liabilities enables foreign investors to maximize the tax efficiency of their foreign investments while ensuring full compliance with all tax laws and regulations.

China Briefing's *Tax, Accounting, and Audit in China*, produced in collaboration with the tax experts at Dezan Shira & Associates, aims to provide an overview of taxes for businesses and individuals in China, as well as fundamental accounting and audit information in the China business context.

This guide was created in mid-2014 based on the information available at the time. As the tax situation of each enterprise is unique and China's regulatory environment is constantly evolving, it is advisable to seek professional tax advice specific to your business.

Dezan Shira & Associates is a specialist foreign direct investment practice providing corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia. The firm's experienced business professionals are committed to improving the understanding and transparency of investing in emerging Asia.

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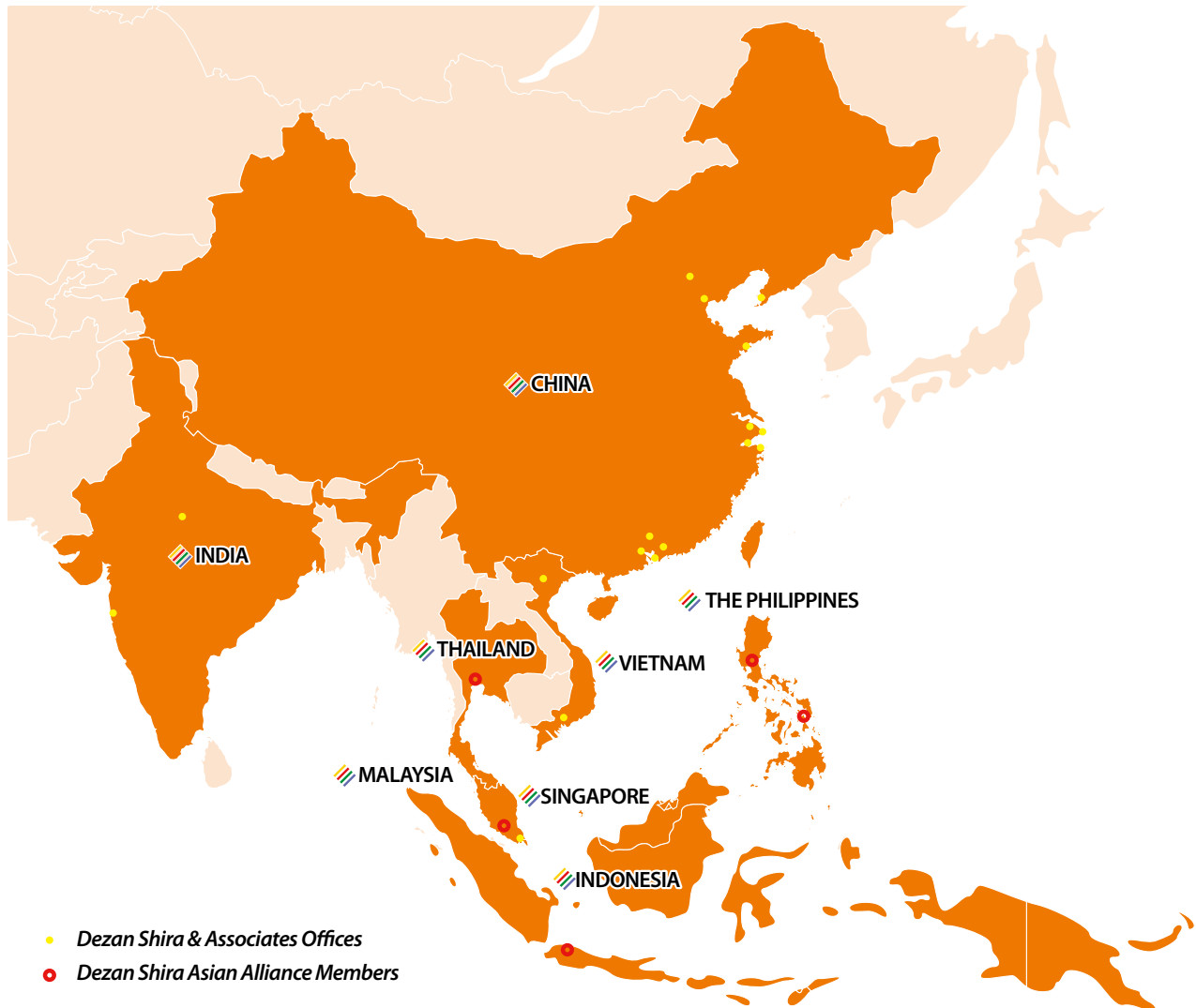


About Dezan Shira & Associates

At Dezan Shira & Associates, our mission is to guide foreign companies through Asia's complex regulatory environment and assist them with all aspects of establishing, maintaining and growing their business operations in the region. Since its establishment in 1992, Dezan Shira & Associates has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam, as well as liaison offices in Italy and the United States, and partner firms across the ASEAN region. With over 20 years of on-the-ground experience and a large team of professional advisers, we are your reliable partner in Asia.

Our tax and compliance services include:

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- Profit Repatriation Processing
- Offshore Tax Withholding and Exemption Services
- Corporate Tax Filings
- Personal Tax Filings
- Transfer Pricing Services (China only)
- Legal and Financial Health Checks
- Temporary Finance Manager
- Annual Consolidated Inspection (China only)
- Annual Tax Compliance
- Assistance with Closure Audit, Tax Clearance and De-registrations
- VAT Compliance and Planning
- Specialist Tax Advice
- Inter-company Service Agreement Implementation



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1. China's Tax System

1.1 A Brief History

1.2 Legislative Organs

1.3 Tax Administration

1.4 Tax Revenue and Expenditure

1.1 A Brief History

China's tax system was practically in chaos when the People's Republic of China was first established in 1949. The Government Administration Council, now the State Council, promulgated the *Implementation Standards of National Tax Policies* in 1950, which unified the tax rules applied nationwide and laid the basic legal framework for taxation in China; several revisions and improvements were made in the following decades. Rather than as a tool to adjust the economy, China's tax system from 1950s to 1970s was designed solely for the purpose of collecting capital.

In 1978, two years after the death of Chairman Mao Zedong and the end of the Cultural Revolution (1966-1976), the state government led by Deng Xiaoping decided to introduce market principle to China and adopted the policy of "reform and opening up" on the Third Plenary Session of the 11th Central Committee of the Communist Party of China (CPC).

A series of reformative measures were adopted to facilitate the market economy, which placed taxation in an increasingly prominent role in the on-going economic transition. Several important tax laws were promulgated in the 1980s, including the *Corporate Income Tax (CIT) Law for Joint Ventures*, *CIT Law for Foreign Enterprises*, and *Individual Income Tax (IIT) Law*. The first drafts of the regulations on value-added tax (VAT)(增值税) and business tax (营业税) were released in 1984.

In 1994, a significant tax reform took place, which established the current tax revenue sharing system between the central and local government, granting greater fiscal power to the central government. The *Interim Regulations* of VAT, business tax, and consumption tax, which are the blueprints of the current rules, all came into effect on January 1, 1994. The reform further integrated various income taxes into three categories: CIT (on domestic enterprises), CIT on foreign enterprises and foreign-invested enterprises, and IIT; which were further synthesized into only one CIT and IIT in 2008.

Today, with the VAT reform underway (see **2.3 Value-added Tax**), China's tax system is still evolving at a rapid pace, and in the process of developing a truly sophisticated tax system.

1.2 Legislative Organs

China's tax laws and policies are mainly formulated by these state organs:

- National People's Congress (**NPC**) and its Standing Committee;
- State Council;
- Ministry of Finance (**MOF**);
- State Administration of Taxation (**SAT**); and
- General Administration of Customs (**GAC**).

The legislation of tax laws in China follows five steps: proposing, drafting, examination, voting and finally promulgation by the NPC Standing Committee. In China, NPC and its Standing Committee are the highest legislative organs and possess the power to formulate laws.

According to China's Constitution, all laws passed by NPC and its Standing Committee become effective only after they have been signed by the Chairman of the country (presented as "Chairman Order" by reference number), even though the Chairman does not actually have the power to veto the decision.

Laws promulgated by the NPC are supplemented by detailed implementing regulations formulated by the State Council -- the Chinese cabinet and the highest administrative organ empowered to promulgate administrative regulations. As an example, China's *IIT Law* is promulgated by the Standing Committee of the NPC, while the *Implementing Guidelines* which regulate the specific enforcement of the *IIT Law* are promulgated by the State Council.

The MOF, the SAT, and the GAC are ministries/institutions subordinated to the State Council which are authorized to issue tax announcements, circulars, and replies to supplement, interpret or clarify the laws and regulations.

In addition, some local tax regulations and rules may be promulgated by the local People's Congress and the government authorities at provincial or municipal levels, and are only enforceable in certain regions.

1.3 Tax Administration

The State Administration of Taxation (**SAT**), a government institution directly under the State Council, is the highest tax authority in China. It is the equivalent of the Internal Revenue Service of the United States or HM Revenue and Customs of the United Kingdom.

The SAT is authorized by the State Council to oversee the country's tax system, draft national tax regulations (sometimes in conjunction with the MOF), support the MOF in developing national tax and economic policies, and execute the collection and administration of taxes attributed to the central government. Some of the major taxes attributed to the central government and therefore administered by the SAT are:

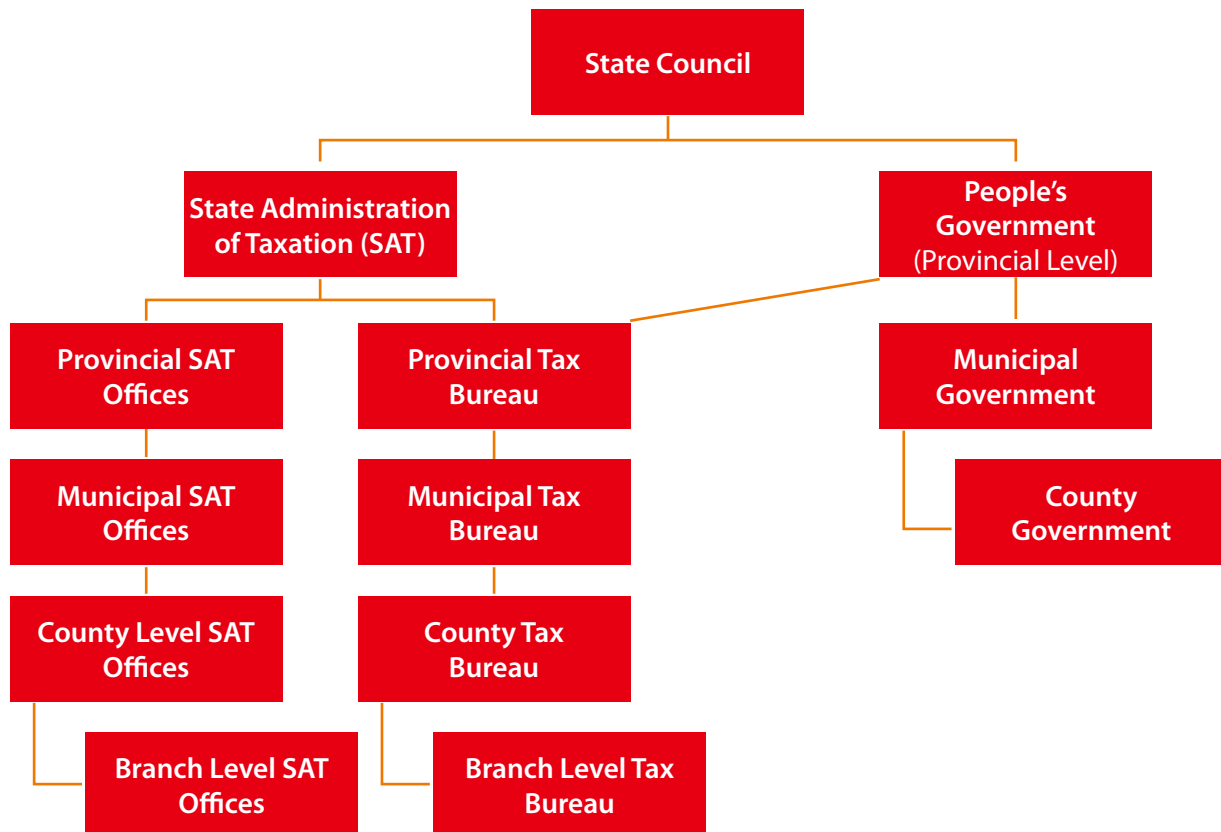
- Corporate income tax (**CIT**) of foreign-invested enterprises (**FIEs**) and foreign enterprises
- Value-added tax
- Consumption tax

The State Tax Bureau (**STB**) in each municipality serves as the local office of the SAT. Local tax bureaus (**LTB**) are institutions directly subordinated to local government, but also under the supervision of SAT. They are in charge of the administration of taxes attributed to the local government. The major taxes administered by the LTB are as follows:

- CIT of local domestic enterprises
- Business tax
- Individual income tax
- Resource tax
- Land appreciation tax

Every business entity has to register with both the SAT and the LTB, and Customs if importing or exporting. The General Administration of Customs (**GAC**) supervises the collection of customs duties, import VAT and import consumption tax, which are all directly attributed to the central fiscal revenue. It also oversees the operation of bonded zones.

Tax Administration Organization Chart



1.3.1 Tax Registration

All enterprises in China, including partnerships and sole proprietors, are required to complete tax registration. If a company in a corporate group or a branch of a company has a separate business license, separate tax registration at the tax bureau is mandatory. For branches without their own business license:

- For branches located in the same city as their company headquarters, separate tax registration is only required if the branch keeps its own accounting records for daily operations; otherwise, the headquarters should make a consolidated tax filing for its branches; and
- For branches located in a city other than that of their headquarters, separate tax registration is required if the branch has tax liabilities generated from its own operations.

1.4 Tax Revenue and Expenditure

The first two charts below show China's total tax revenue and expenditure in 2012, respectively, as well as the relevant breakdowns by tax categories and between the central and local governments. The last chart shows the total tax collected in China since the beginning of opening up and reform in 1978 up to 2012, as well as the respective amount breakdowns according to the major taxes.

Total Government Expenditure: Central and Local Governments (2012) (RMB100 million)			
Item	National Government Expenditure	Central Government	Local Governments
National government expenditure	125952.97	18764.63	107188.34
Expenditure for general public services	12700.46	998.32	11702.14
Expenditure for foreign affairs	333.83	332.39	1.44
Expenditure for national defense	6691.92	6481.38	210.54
Expenditure for public security	7111.60	1183.47	5928.13
Expenditure for education	21242.10	1101.46	20140.64
Expenditure for science and technology	4452.63	2210.43	2242.20
Expenditure for culture, sport and media	2268.35	193.56	2074.79
Expenditure for social safety net and employment effort	12585.52	585.67	11999.85
Expenditure for medical and health care	7245.11	74.29	7170.82
Expenditure for environment protection	2963.46	63.65	2899.81
Expenditure for urban and rural community affairs	9079.12	18.19	9060.93
Expenditure for agriculture, forestry and water conservancy	11973.88	502.49	11471.39
Expenditure for transportation	8196.16	863.59	7332.57
Expenditure for affairs of exploration, power and information	4407.68	473.15	3934.53
Expenditure for affairs of commerce and services	1371.80	20.09	1351.71
Expenditure for affairs of financial supervision	459.28	209.59	249.69
Expenditure for post-earthquake recovery and reconstruction	103.81		103.81
Expenditure for affairs of land and weather	1665.67	298.08	1367.59
Expenditure for affairs of housing security	4479.62	410.91	4068.71
Expenditure for affairs of management of grain and oil reserves	1376.29	645.20	731.09
Interest payments for domestic and foreign debts	2635.74	2060.41	575.33
Other expenditure	2482.38	38.31	2444.07

Source: China Statistical Yearbook 2013

Total Government Revenue: Central and Local Governments (2012) (RMB100 million)			
Item	National Government Revenue	Central Government	Local Governments
National government revenue	117253.52	56175.23	61078.29
Total tax revenue	100614.28	53295.20	47319.08
Domestic VAT	26415.51	19678.35	6737.16
Domestic consumption tax	7875.58	7875.58	
VAT and consumption tax from imports	14802.16	14802.16	
VAT and consumption tax rebate for exports	-10428.89	-10428.89	
Business tax	15747.64	204.73	15542.91
Corporate income tax	19654.53	12082.93	7571.60
Individual income tax	5820.28	3492.65	2327.63
Resource tax	904.37	48.61	855.76
City maintenance and construction tax	3125.63	190.87	2934.76
House property tax	1372.49		1372.49
Stamp tax	985.64	294.39	691.25
Stamp tax on security exchange	303.51	294.39	9.12
Urban land use tax	1541.72		1541.72
Land appreciation tax	2719.06		2719.06
Tax on vehicles and boat operation	393.02		393.02
Tax on ship tonnage	40.98	40.98	
Vehicle purchase tax	2228.91	2228.91	
Tariffs	2783.93	2783.93	
Farm land occupation tax	1620.71		1620.71
Deed tax	2874.01		2874.01
Tobacco leaf tax	131.78		131.78
Other tax revenue	5.22		5.22
Total non-tax revenue	16639.24	2880.03	13759.21
Special program receipts	3232.63	412.67	2819.96
Charge of administrative and institutional units	4579.54	377.20	4202.34
Penalty receipts	1559.81	40.35	1519.46
Other non-tax receipts	7267.26	2049.81	5217.45

Source: China Statistical Yearbook 2013

China's Tax Revenues 1978-2012 (RMB100 million)							
Year	Total	Domestic Value-added Tax*	Business Tax	Domestic Consumption Tax*	Tariffs	Corporate Income Tax**	Individual Income Tax
1978	519.28				28.76		
1980	571.70				33.53		
1985	2040.79	147.70	211.07		205.21	696.06	
1990	2821.86	400.00	515.75		159.01	716.00	
1991	2990.17	406.36	564.00		187.28	731.13	
1992	3296.91	705.93	658.67		212.75	720.78	
1993	4255.30	1081.48	966.09		256.47	678.60	
1994	5126.88	2308.34	670.02	487.40	272.68	708.49	
1995	6038.04	2602.33	865.56	541.48	291.83	878.44	
1996	6909.82	2962.81	1052.57	620.23	301.84	968.48	
1997	8234.04	3283.92	1324.27	678.70	319.49	963.18	
1998	9262.80	3628.46	1575.08	814.93	313.04	925.54	
1999	10682.58	3881.87	1668.56	820.66	562.23	811.41	413.66
2000	12581.51	4553.17	1868.78	858.29	750.48	999.63	659.64
2001	15301.38	5357.13	2064.09	929.99	840.52	2630.87	995.26
2002	17636.45	6178.39	2450.33	1046.32	704.27	3082.79	1211.78
2003	20017.31	7236.54	2844.45	1182.26	923.13	2919.51	1418.03
2004	24165.68	9017.94	3581.97	1501.90	1043.77	3957.33	1737.06
2005	28778.54	10792.11	4232.46	1633.81	1066.17	5343.92	2094.91
2006	34804.35	12784.81	5128.71	1885.69	1141.78	7039.60	2453.71
2007	45621.97	15470.23	6582.17	2206.83	1432.57	8779.25	3185.58
2008	54223.79	17996.94	7626.39	2568.27	1769.95	11175.63	3722.31
2009	59521.59	18481.22	9013.98	4761.22	1483.81	11536.84	3949.35
2010	73210.79	21093.48	11157.91	6071.55	2027.83	12843.54	4837.27
2011	89738.39	24266.63	13679.00	6936.21	2559.12	16769.64	6054.11
2012	100614.28	26415.51	7875.58	15747.64	19654.53	5820.28	2783.93

* Domestic value-added tax (VAT) does not include VAT from imports. Domestic consumption tax (CT) does not include CT from imports.

** Prior to 2001, corporate income tax (CIT) only included state-owned and collective-owned enterprises's income tax. Since 2001, CIT also includes the income tax levied on other enterprises. As such, the figures are not comparable with the previous years.

Source: China Statistical Yearbook 2013