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THE TAX SYSTEM OF CHINA

Introduction and Summary

The People's Republic of China (PRC) has transformed its tax system in recent years. It has adopted many types of taxes common in major nations with large private sectors that engage actively in world trade. China seeks an appropriate balance between revenue raising, fairness, and growth-permitting types and levels of taxes. Growth is an important goal, because raising living standards can benefit everyone.

The central government relies chiefly on a value added tax for its revenue. The VAT is one of several types of consumption-based tax in which investment in plant and equipment is expensed immediately, not depreciated over time. Consumption-based taxes are less damaging to saving and investment than traditional income taxes.

The corporate income tax rate is 25 percent, close to the average for developed nations and well below the rates in the United States and Japan.

The provinces are allowed individual and business income taxes, but their structure is determined by the central government, and contain several provisions that are friendly to saving and investment. To avoid multiple layers of taxation on saving and returns on saving:

- Capital gains on stock trades are tax exempt.
- Half of dividends from companies listed on Chinese stock exchanges are tax exempt.
- Bank deposit and government bond interest are tax exempt.
- Foreign investors are free from tax on capital gains and dividends.
- At present, there is no estate or transfer tax.
- Social insurance contributions are tax deductible and social insurance benefits are tax free.

Rural workers own their social insurance accounts, as in many countries that have private accounts for social insurance rather than centralized tax/transfer programs.

In short, China has a tax system that relies relatively heavily on consumption taxes, and its individual income tax is structured to avoid or reduce the excess layers of tax on saving and investment usually found in income tax systems.

Institute for Research on the Economics of Taxation

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1710 Rhode Island Avenue, N.W., 11th Floor • Washington, D.C. 20036
(202) 463-1400 • Fax (202) 463-6199 • Internet www.iret.org

General Government Taxes

Taxes are collected for the general operations of the national, provincial, and local governments. (China defines general operations to exclude social insurance programs.) According to 2007 data from the State Administration of Taxation[1], total government tax revenues (excluding social insurance taxes) were RMB 4,417.6 billion. This was equivalent to US$580.8, at the average 2007 exchange rate of RMB 7.6058 per dollar.[2] Approximately 70 percent went to the central government, while the rest was reserved for the provincial and local governments. The 4,417.6 billion RMB equaled 17.57 percent of China's GDP.[3] (The corresponding 2007 figure for general government taxes in the United States was 21.6 percent of U.S. GDP.)

The Chinese tax system is a mix of consumption, income, property, and other taxes. In 2007, 57.2 percent of China's total tax revenue (net of export tax rebate) came from consumption taxes, which consisted of a VAT (net of export rebate), business sales taxes and other consumption taxes; 29.1 percent came from income taxes; 5.7 percent came from various property taxes and taxes related to property investment; and the rest came from other forms of taxes. Compared to the 62.3 percent of federal, state, and local general government tax revenues contributed by income taxes in the United States, it is clear that China's tax system has relatively heavy reliance on consumption taxes, while income taxes come in second place, and various property taxes come next.

Tax legislative power in China is highly centralized.[4] Local governments only have the right to abandon the banquet and slaughter taxes as well as changing tax rates for a few minor taxes (city maintenance and construction tax, vehicle and vessel usage tax, house property tax, etc.) for certain social groups (disabled people, the elderly, minorities, etc.) or/and under certain conditions (natural disasters, etc.)[5] The local tax administrations have no legislative power on major tax rates and external taxation. As a consequence, there exists limited scope for competition among provinces in the use of tax policies to attract investment. The central government has tried to spread the successful experience of special coastal economic zones throughout the country by gradually spreading the more favorable tax treatment of investment nationwide, reducing regional disparities.

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[1] Unless specified, all data on China's tax rates in this paper, excluding social insurance contribution rates, are retrieved from the Online Tax Code Library of State Administration of Taxation, PRC: http://www.chinatax.gov.cn.

[2] For exchange rate data, see Council of Economic Advisers, *Economic Report Of The President* (Washington, DC: Government Printing Office, 2008), p. 352.

[3] Unless specified, all data on China's tax revenue and national GDP in this paper are retrieved from annual bulletin released by China National Bureau of Statistics of China: http://www.stats.gov.cn/tjsj.

[4] State Council, PRC, *Guofa* [1993] No. 85, Dec. 15, 1993.

[5] State Council, PRC, *Guofa* [1994] No.7, Jan. 23, 1994.

However, additional preferential tax policies legislated by the central government have been implemented in relatively underdeveloped regions in west and northeast China in order to speed development in the poorer areas. The recent unification of tax treatment of domestic and foreign enterprises (described below) also contributes to a more uniform tax structure in China.

Social Insurance Taxes and Contributions

In China, the social insurance program is separate from the general taxation system. Government employees and workers in the state-run institutions such as schools and hospitals have a separate retirement program. Currently, the social insurance program is supposed to cover most non-government urban employees, retirees, and some of the rural labor force. However, in 2007, only 76 percent of the urban non-government employees and less than 10 percent of the rural labor force were covered by the basic pension fund program.[6] The other social insurance plans, such as medical care and unemployment and work injury insurance, have even lower participation rates. This indicates that further expansion of social insurance coverage remains to be achieved.

The retirement program for rural workers consists of personal, tax-deductible retirement savings accounts at banks, to which a worker may contribute up to RMB 20 per month (equivalent to US$2.63). These contributions are not properly called taxes, because the rural workers own their accounts and get back the earnings of their own savings when they retire. An unusual feature of the retirement saving incentive is that the withdrawals from the accounts after retirement are also tax exempt. This is more generous than ordinary pension treatment of saving, in that neither the contribution nor the withdrawal is taxable income.

Social insurance contributions of the urban employees are more properly viewed as taxes, because the workers do not own the accounts (except for a modest portion, about 8%), and there is only a limited relationship between the amount of taxes that they pay and the benefits they receive later. The benefits are set by law and can be changed by the local government. The tax can be collected through either local taxation departments or the labor and social security authority. Total social insurance contributions by both urban employers and employees in 2007 were RMB 947.3 billion (equivalent to US$124.5 billion).

The social insurance tax rates in China are higher than in the United States and closer to those of the European nations. The total amount of pensions, medical care, and unemployment and work injury insurance contributed by both the employer and employee may add up to a maximum of 40%

[6] Unless specified, all Chinese social insurance data in this paper are retrieved from the official website of Ministry of Labor and Social Security, PRC: http://www.molss.gov.cn/index/index.htm.

of an employee's gross salary.[7] It is worth noting that there is no double taxation by the income tax and the social insurance taxes in China for either employers or employees, since both the employer and employee insurance premiums are tax-deductible under the corporate enterprise and personal income taxes. Furthermore, all the income received by the beneficiaries of these mandatory insurance programs is tax-exempt. This treatment is more generous than simple tax-deferral of pension contributions and earnings until retirement.

Tax Treatment of Individual Income and Saving

Income taxes contain features that tax saving and investment more heavily than consumption, and can work against economic development. They can also discourage investment by foreign businesses.

A typical "broad-based" income tax taxes income when earned. If the income is used for immediate consumption, it is not subject to additional income tax. (It may be subject to sales, value added, or excise taxes.) If it is saved, then the earnings of the saving (profit, dividends, or capital gains, which are what one "buys" by saving) are also subject to income tax, a layer of tax not imposed on consumption. (The future spending of the accumulated savings, principal and earnings, is also subject to the consumption taxes listed above.) If the saving is invested in corporate stock, the corporate tax is imposed before the dividends or capital gains are received. If an estate or gift tax is imposed, that is a third or fourth layer of tax on the income that was saved. A saving-consumption neutral tax would tax either the saving or the returns on the saving, but not both. That is, it would either tax income when first saved, and not tax the returns (a returns exempt treatment); or it would defer tax on income that is saved, and tax any withdrawals used for consumption (a saving deferred treatment). In addition, it would not double tax corporate income at both the business and shareholder level, nor would it impose an estate or gift tax.

China's income tax contains several elements that partially offset these anti-growth features of the income tax. Indeed, it goes beyond purely neutral treatment in some cases to further encourage saving. As a result, it is a hybrid system, with some features that fall in between income tax and consumption tax treatment of income that is used for saving and investment. As is mentioned above, China's tax system has a lower level of reliance on income taxes, which leads to less discouragement of domestic and foreign investment.

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[7] The marginal tax social insurance tax rate for Social Security is 15.3% for most workers in the United States; it is a bit higher for those below the maximum wage subject to the unemployment and workers compensation taxes; it is 2.9% for those subject to the Medicare tax but who are over the maximum covered wage for the retirement and disability portions of the payroll tax.

China's individual income tax is based on a classification system where different types of income are subject to different graduated tax rates. The highest marginal tax rates are 45% for income from wages and salaries, 35% for non-corporate business income, and 40% for income from investment, property renting and remunerations for services. Most taxpayers are in lower tax brackets and face less than the top marginal rates. Since the individual income tax is the only income tax that non-corporate businesses have to pay, the relatively lower top tax rates for non-corporate business income and investment may contribute to China's economic growth by encouraging saving and investment. Nevertheless, the top marginal tax rate on labor income can become quite high, when combined with social insurance and VAT tax rates. Consideration should be given to reducing marginal tax rate to 35% or less. (See appendix for additional details.)

Several additional national-level tax arrangements have been adopted to further reduce the negative impact of multiple taxation on saving and investment. Bank deposit interest earned after October 9, 2008 is exempt from the individual income tax. Interest on saving for educational purposes is tax exempt as well.[8] Income from stock transfers (capital gains) and 50% of dividend income from corporations listed on China's two stock exchanges are tax-exempt under the individual income tax. Income from interest on bonds issued by the Treasury Department of the State Council is exempt from both individual and corporate enterprise income tax. To encourage business formation, venture capital enterprises may receive special state support in the form of an immediate deduction from taxable income of up to 70% of an investment.[9] Various favorable regional-level tax treatments are implemented to encourage development in certain regions, according to local conditions, especially in Special Economic Zones.

Corporate tax

The statutory enterprise income tax rate is 25% under the New Enterprises Income Tax Law, effective January 1, 2008. In some special cases, lower tax rates can be adopted. The law will provide equal treatment for domestic and foreign enterprises. The tax is global, imposed on income generated inside China by all corporations, domestic and foreign, and on foreign earnings of Chinese-based enterprises. The tax on foreign source income is offset by a foreign tax credit, up to the amount due to China. Excess foreign tax credits must be carried over.

Before the new law became operative, the old statutory tax rate was 33%. Several allowances (now repealed) reduced the effective tax rate to 25% for domestic companies. Additional allowances

8 State Administration of Taxation, Ministry of Finance, PRC, *Caishui* [2008] No. 132, Oct. 9, 2008.

9 State Administration of Taxation, Ministry of Finance, PRC, *Guoshuifa* [2009] No.87, Apr. 30, 2009.

designed to attract foreign investment reduced the effective rate to 15% for foreign enterprises.[10] Foreign investment enterprises (FIEs) and other foreign businesses were exempt from the city maintenance tax, urban and township land use tax, and farmland occupation tax. Most enterprises located in special economic zones and tariff-free zones could enjoy a favorable tax-deduction, tax-exemption or tax rebate on consumption taxes and income taxes. The new enterprise tax law will equalize the tax treatment of domestic and foreign enterprises. However, foreign enterprises that used to enjoy an effective income tax rate lower than 25% under the old law are provided with a 5-year period of transition to adjust to the new tax system.

The depreciation of capital investment (plant, equipment, and structures) for tax purposes is in line with international norms, and usually takes the form of straight-line write-offs over moderate time periods. Nonetheless, the depreciation rules understate the cost of investment and overstate profits, leading to higher-than-ideal effective tax rates. Shorter asset lives or some form of acceleration or immediate expensing would be better for growth. (See the appendix for details.)

Reliance on consumption taxes

China, like many other major nations, relies more on consumption taxes and less on income taxes than the United States. Consumption taxes (the largest being a VAT) are the main source of revenue for the national government, with some of the business income taxes also going to the national government. Individual income taxes and most corporate enterprise income taxes are reserved for the provincial and local governments, which also receive most of the property taxes. Resource taxes are split between the local and national governments. These lower levels of government also share in the VAT. This is different from the distribution of taxes in the United States, where the national government relies more on various income taxes and less on consumption taxes, and where the states rely more on sales taxes and somewhat less on income taxes.

China has a moderately large VAT, with two basic rates of 13% and 17%. Before 1994, China had an unusual production-based VAT, which only allowed for a deduction of the purchased inputs of goods and services other than fixed investment in capital assets.[11] The old VAT was designed to ensure collection of a reasonable amount of tax revenue in what was then an underdeveloped taxation system, while constraining what was then viewed as excessive investment. A gradual VAT reform has been undertaken in stages since 1994. Various industries and regions became eligible to deduct purchases of capital assets.

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[10] Delloite Press Release, China's Unified Enterprise Income Tax Law brings greater clarity, transparency & fairness to the tax system, Mar 16th, 2007, http://www.deloitte.com/dtt/press_release/0,1014,sid=7062&cid=149787,00.html.

[11] Information on VAT reform is retrieved from the VAT Reform Report, State Administration of Taxation, PRC: http://202.108.90.130/n8136506/n8136593/n8137681/n8532970/index.html.

The recent 2009 VAT reform is a key part of China's economic stimulus plan. It fully transformed China's old production-based VAT to a consumption-based VAT that allowed for full deduction of all purchased inputs of goods and services, including fixed assets, throughout China.[12] The reform also increased the export VAT rebate rate. The reform may provide a big incentive for companies to make investments in fixed assets such as equipment and machinery, and help to ease the pressure on Chinese exporting industries. One unusual VAT exemption, for certain imported technology-related equipments, was eliminated in the reform. This reform gives China a VAT similar to that found in Europe and other parts of the world. It differs from the United States, Japan, and Canada, where national sales taxes are non-existent (U.S.) or present with a low rate (Japan and Canada).

The following pages provide more details on the types of taxes in China.

Xiaoxi (Shannon) Zheng
Research Assistant

[12] In a typical consumption-style VAT, businesses pay VAT on their sales, and receive a rebate of the VAT they have paid on their purchases of intermediate goods and services from other businesses. The result is a tax levied only the payments to labor and capital (= the value added by labor and capital) employed in the business. In effect, purchases from other businesses are fully deductible, including the immediate deduction of the full cost of capital investment. The expensing of investment means that only consumption goods and services are taxed. In an income-style VAT, businesses may deduct (receive a rebate of VAT paid on) only a portion of their investment outlays, an amount equal to the depreciation of their capital as would be allowed in an income tax. The production-based VAT in China was even less generous, in that no deduction was allowed for capital investment.

Appendix – Additional Details About the Tax System Of China

1. Overview

1.1 Types of taxes

Under the current tax system in China, there are 25 types of taxes, which, according to their nature and function, can be divided into the following 8 categories:

Tax Categories	Type of Tax	Brief Description
Turnover taxes	Value Added Tax	A tax levied on value added. Tax rates: 0% (for exports), 13%, 17%. Input tax refundable for exports.
	Consumption Tax	A tax levied on consumer goods produced and imported. Exports are tax-exempt.
	Business Tax	A tax levied on taxable services, transfer of intangible assets or sales of immovable properties in PRC. Tax rates: 3%, 5%, 8%, 5%-20% (entertainment).
Income taxes	Enterprise Income Tax	A tax levied on income of enterprises (both domestic and foreign). Tax rate: 25%.
	Income Tax on Enterprises with Foreign Investment and on Foreign Enterprises	A tax levied on income of enterprises with foreign investment (EFI) and on foreign enterprises. Abolished Jan. 1, 2008.
	Individual Income Tax	A tax levied on individual income. See Section 2.8 for individual income tax rates.
Resource taxes	Resource Tax	A tax levied on mineral resources and salt production within PRC.
	Urban and Township Land Use Tax	A tax levied on land occupied by enterprises and individuals (excluding FIEs, FE and foreigners). Tax rate depends on the region.
Taxes for special purposes	City Maintenance and Construction Tax	A local tax based on the amount of VAT, Consumption Tax and/or Business Tax paid by taxpayers. Tax rate: 7% (city), 5% (town and county), 1% (other).
	Farmland Occupation Tax	A tax levied on the area of farmland occupied for building construction or for other non-farm purposes.
	Fixed Asset Investment Orientation Regulation Tax	A tax levied on total amount of investment in fixed assets (infrastructure, state projects, office and residential buildings) within the territory of PRC. Tax rates: 0%, 5%, 10%, 15%, 30%.

Tax Categories	Type of Tax	Brief Description
Taxes for special purposes, cont.	Land Appreciation Tax	A capital gain tax levied on income from a sale or other means of transfer with consideration of state-owned land use rights, buildings on land and their attached facilities. Not imposed on the disposal or transfer of ordinary owner-occupied housing (with residential area less than 120 m^2) or on ordinary residential construction where the gains are less than 20% of the original cost.
Property taxes	Housing Property Tax	A tax levied on housing property in cities, county capitals, townships and industrial and mining districts. Not imposed on owner-occupied housing.
	Urban Real Estate Tax	A tax only applied to FIE, foreign enterprises and foreigners, and levied on housing property only. Abolished as of Jan. 1, 2009.
	Inheritance Tax	In planning stages, not yet levied.
Behavior taxes	Vehicle and Vessel Usage Tax	A tax levied on vehicles and/or vessels within the territory of the PRC.
	Vehicle and Vessel Acquisition Tax	A tax levied on vehicles purchased. Tax rate: 10% of pre-tax price for domestic vehicles; 12% for imported vehicles.
	Stamp Tax	A tax levied on the execution or receipt of specified economic documents. Tax rates: depends on the item, with rates ranging from 0.005%-0.4%.
	Deed Tax	A tax levied on the transfer of housing property and land-use right within the territory of PRC. Not imposed on first purchase of public housing by urban workers. Tax rate: 3%-5%.
	Securities Exchange Tax	Not yet legislated and levied.
	Slaughter Tax	A tax levied on the slaughter of livestock.
	Banquet Tax	A tax imposed on individuals or businesses that provide banquets in hotels, restaurants and other venues.
Agricultural taxes	Agriculture Tax	A tax levied on agricultural production. Tax paid in kind (grain). Real average burden 2.5%.
	Animal Husbandry Tax	A tax imposed on individuals and units who engage in animal husbandry.
Customs duties	Customs Duties	A tax levied on imports to and exports from PRC. Tariff rates for imports range from 0% to 270%. Tariff rates for exports range from 20% to 50%.

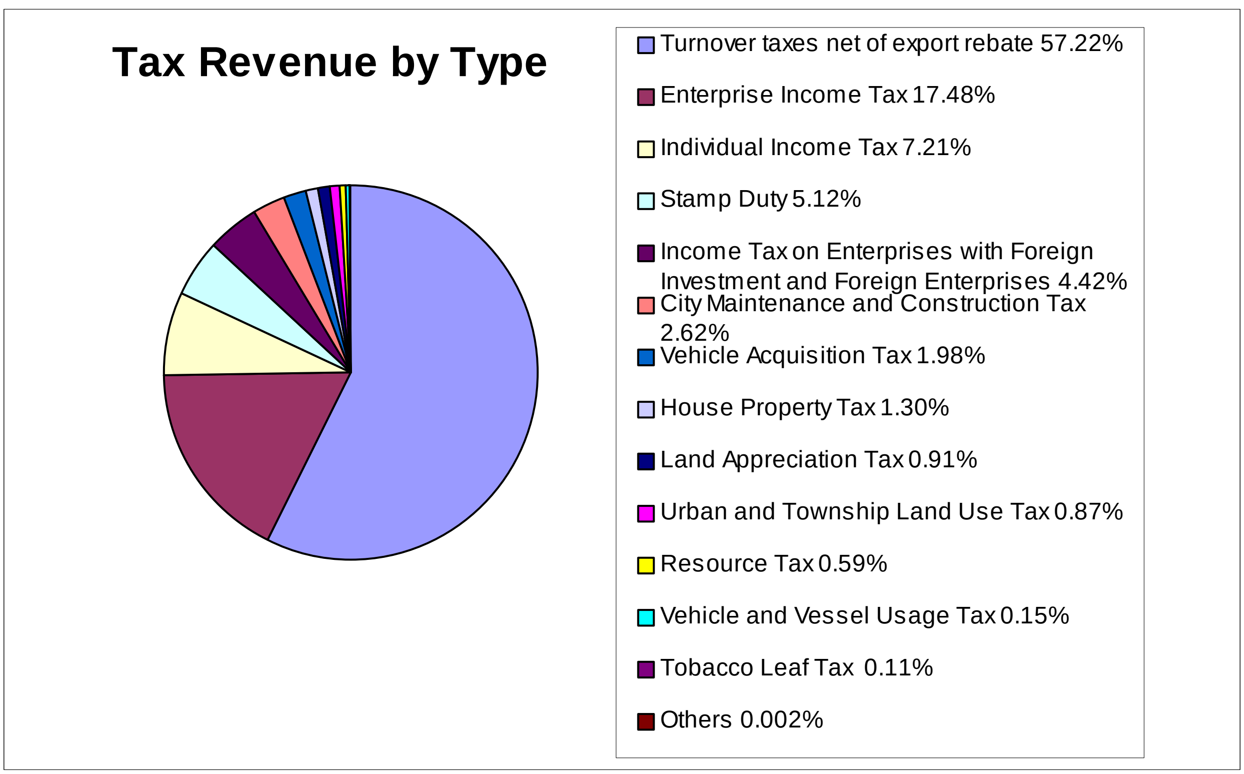
Notes:
1. Income Tax on Enterprises with Foreign Investment and Foreign Enterprises, and the Urban Real Estate Tax have been abolished. Foreigh firms are now treated the same as domestic firms and are subject to the regular enterprise income tax. Fixed Asset Investment Orientation Regulation Tax is temporarily suspended.
2. Inheritance Tax and Securities Exchange Tax are not yet legislated and levied.

1.2 Tax revenue statistics

China has an individual income tax and a corporate income tax. These account for about 7.21% and 21.90% of national and provincial government revenue (2007 data).

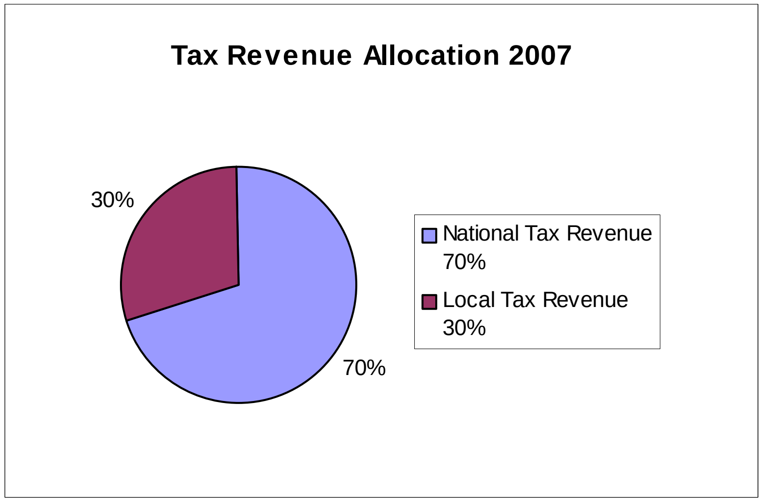
Tax Revenue and Percentage of Enterprise Income Tax and Individual Income Tax (in RMB)

Type of tax	Tax Revenue in 2005	Percentage in 2005	Tax Revenue in 2006	Percentage in 2006	Tax Revenue in 2007	Percentage in 2007
(1) Enterprise Income Tax	436.31	15.87%	554.59	16.63%	772.37	17.48%
(2) Income Tax from EFI	114.77	4.17%	153.48	4.60%	195.12	4.42%
(1) +(2)	551.08	20.04%	708.07	21.23%	967.49	21.90%
(3) Individual Income Tax	209.39	7.62%	245.23	7.35%	318.50	7.21%
(1)+(2)+(3)	760.47	27.66%	953.30	28.58%	1,285.99	29.11%
(4) Turnover taxes net of export rebate	1,741.25	63.33%	2,059.14	61.74%	2,527.97	57.22%
(5) Other taxes	247.70	9.01%	322.70	9.68%	603.64	13.66%
(1)+(2)+(3)+(4)+(5) Total Tax Revenue Net of Export Rebate	2,749.43	100.00%	3,335.14	100.00%	4,417.60	100.00%



1.3 Revenue allocation between the central government and local government

1.3.1 National tax revenue:
Domestic Consumption Tax; Customs Duties; VAT and Consumption Tax collected by the Customs Service.



1.3.2 Local tax revenue:
Individual Income Tax; Urban and Township Land Use Tax; Farmland Occupation Tax; Fixed Assets Investment Orientation Regulation Tax; Land Appreciation Tax; Housing Property Tax; Urban Real Estate Tax (abolished since Jan. 1, 2009); Inheritance Tax (not yet legislated); Vehicle and Vessel Usage Tax; Vehicle Acquisition Tax; Deed Tax; Slaughter Tax; Banquet Tax; Agriculture Tax and Animal Husbandry Tax and local surtaxes.

1.3.3 Tax revenue shared between the central and local governments:

- Domestic VAT: 75% for the central government and 25% for local governments;
- Business Tax: the Business Tax paid by the railway department, the headquarters of various banks and insurance companies, and the additional 3% Business Tax paid by financial and insurance enterprises belongs to the central government; the Business Tax collected from other businesses is assigned to the local governments;
- Enterprise Income Tax: the enterprise income tax paid by central government enterprises, local banks and non-bank financial institutions, the railway department, and the headquarters of various banks and insurance companies belongs to the central government; the income tax paid by other businesses goes to local governments;
- Resource Tax: the central government keeps the resource tax paid by offshore oil enterprises; the resource tax on other industries is assigned to local governments;
- City Maintenance and Construction Tax: the portion of this tax paid by the railway department, and the headquarters of various banks and insurance companies belongs to the central government; the portion paid by other businesses goes to the local governments;
- Stamp Tax: 88% of the Stamp Tax revenue collected on stock transactions goes to the central government; the remaining 12% goes to local governments.

1.4 Tax Treatments for Five Social Security Insurance and House Funding Program

In addition to the general tax system, China has a number of social insurance programs. Employees in urban enterprises and urban institutions managed as enterprises are covered by the "Five Social Security Insurance and House Funding" Program. Contributions are made by both employers and employees. All are legally required except the House Funding Plan. Contribution percentages may vary according to regulations by local governments. The contribution percentages in Beijing are listed as follows. Unless specified, the contribution percentages are based on average monthly base wage, excluding welfare allowance.

Insurance Types	Contribution Percentage	
	Employers	Employees
Pension Funds	maximum 20%	8%
Medical Insurance	10%	2%+RMB 3
Unemployment Insurance	1.5%	0.5%
Work Injury Insurance	Differ according to industry	0%
Childbearing Insurance	0.8%	0%
House Funding Program	5%-12%	same contribution as employers

All the employee contributions listed above are tax-deductible under the individual income tax. Individual income taxes are based on net income after deducting social insurance and house funding contributions. Employer premiums for the five insurance plans are also tax-deductible under the enterprises income tax. Contributions to the house funding program are deductible up to a certain amount regulated by local government.

2. The Local Individual Income Tax

2.1 Taxpayers

- Individuals and non-corporate businesses pay tax under the local individual tax system;
- Spouses file separately.

2.2 Taxable income includes:

- Income from wages, salaries and other labor services;
- Income from business operations of individuals in the non-corporate business sector;
- Income from capital gains, dividends, interest and bonuses (special treatments);
- Income from the leasing of property;
- Income from remunerations to authors;
- Income from royalties and license fees;
- Income from capital gains on the transfer of property;
- Occational income;
- Other income specified as taxable by financial departments under the State Council.

2.3 Tax exempt earnings, benefits, and allowances

- Allowances and subsidies issued under uniform standards by the state;
- Welfare benefits, pensions for the disabled and survivors and relief payments;
- Insurance indemnities;
- Decommission and demobilization pay of officers and soldiers;
- Settlement pay, severance pay, and pensions to staff members and workers and pensions and subsidies to veteran cadres issued under uniform standards formulated by the State;
- Awards for outstanding performances in science, education, technology, culture, public health, sports, environmental protection and other fields granted by provincial people's governments, ministries and commissions, and organizations of foreign countries and international organizations;
- Income of foreign diplomats, consulate officials and other officials of foreign embassies and consulates in China;
- Income exempted from individual income tax in accordance with the provisions of the international conventions and agreements the Chinese government has participated in or signed;
- Other income exempted from individual income tax by the departments of finance under the State Council.

2.4 Special treatment of certain capital gains, dividends and interest.

- Fifty percent of dividend income from corporations listed on the Shanghai and Shenzhen Stock Exchanges is counted as taxable income. (i.e. 50% is exempt from tax);
- Capital gains on stock transfers are exempt.
- Interest accrued from savings accounts for educational purposes is exempt from tax;
- Interest on savings deposits, state bonds and financial debentures issued by the state is exempt from tax. (Interest accrued from savings after Oct. 9, 2008 is temporarily tax-exempt; there had been a 5% income tax for interest accrued from savings between Aug. 15, 2007 and Oct. 8, 2008; 20% income tax for interest accrued from savings between Nov. 1, 1999 and Aug. 14, 2007.)
- Dividend income of a foreigner from Foreign Investment Enterprises is tax-exempt; Foreigners' income from stock transfer (capital gains on stocks) is tax-exempt;

2.5 Individual income tax deductions, tax rates, and brackets

Income is divided into three broad categories, subject to different tax rates. The first is wages and salaries. The second is individual business income. And the third is income from services, royalties, and rental property.

2.5.1 Wages and salaries

Individual Income Tax on wages and salaries, calculated on a monthly basis.

Grade	Taxable income during the month in RMB	Taxable income during the month in US$ (1US$= RMB 6.8274, in May 2010)	Tax rate (%)
1	0 - 500	0.00 - 73.23	5
2	500 – 2,000	73.23 - 292.94	10
3	2,000 – 5,000	292.94 - 732.34	15
4	5,000 – 20,000	732.34 – 2,929.37	20
5	20,000 – 40,000	2,929.37 – 5,858.75	25
6	40,000 – 60,000	5,858.75 – 8,788.12	30
7	60,000 – 80,000	8,788.12 – 11,717.49	35
8	80,000 – 100,000	11,717.49 – 14,646.86	40
9	100,000 and over	14,646.86 and over	45

- The first RMB 2,000 of net income from wages and salaries is exempt. Income taxes are paid monthly via payroll withholdings on the amount above RMB 2,000 (US$292.94, this is roughly equivalent to a yearly deduction of US$3,515). For workers with only one job
- For people earning less than RMB 120,000, and with no other taxable income, the withholding matches tax liability, and no further filing by the individual is required.
- Other taxpayers are obligated to file income tax forms (self-declare) and compute their own tax: Individuals with an annual income of over RMB 120,000 (US$17,576); Individuals with multiple income from wages and salaries within China; Individuals with income outside China; Taxpayers without a withholding agent; Other individuals regulated by the State Council.

2.5.2 Individual business income

Individual Income Tax on business income, calculated annually.

Grade	Taxable income during the year in RMB	Taxable income during the year in US$ (US$1 = RMB 6.8274)	Tax Rate (%)
1	0 - 5,000	0.00 - 732.34	5
2	5,000 – 10,000	732.34 – 1,464.69	10
3	10,000 – 30,000	1,464.69 – 4,394.06	20
4	30,000 – 50,000	4,394.06 – 7,323.43	30
5	50,000 and over	7,323.43 and over	35

- Taxable income from production or businesses of individuals in the non-corporate sector is gross income in a tax year after deduction of costs, expenses, and losses, including other taxes.
- It is calculated on an annual basis, with estimated tax paid quaterly or semiannually.

2.5.3 Individual capital and service income

Individual Income Tax on certain capital gains, dividends, interest, service income, occasional income, royalties, license fees, and rental property

Grade	Taxable Income during the month in RMB	Taxable income during the month in US$ (US$1= RMB 6.8274)	Tax Rate (%)
1	0 – 20,000	0.00 – 2,929.37	20
2	20,000 – 50,000	2,929.37 – 7,323.43	30
3	50,000 and over	7,323.43 and over	40

- For capital gains from transfer of property (securities other than stock, buildings, equipments, land use rights, etc.), initial asset value and reasonable fees can be deducted from total income of selling property. (Capital gains from stock sales are tax-exempt.)
- Fifty percent of cash dividends are deductible before tax.
- Interest income listed in 2.4 is tax-exempt. All other interest income is subject to tax.
- For income from remunerations for services, remunerations to authors, royalties, and income from leasing property, there is a monthly deduction of RMB 800 (US$117.17) if monthly income is no more than RMB 4,000 (US$585.87), and a deduction for 20% if monthly gross income exceeds RMB 4,000. The excess is taxable income.
- The full amount of occasional income is subject to tax.

3. Enterprise Income Tax

3.1 Taxpayers

Foreign invested enterprises (“FIE”) and domestic enterprises are subject to the same income tax regulations and tax rates in China. Enterprises are classified into resident and non-resident enterprises:

- ***Resident Enterprise***: an enterprise which is set up under Chinese law within China, or set up under the law of a foreign country (region) but whose actual management is within China;
- ***Non-Resident Enterprise***: an enterprise which is set up under the law of a foreign country (region) and whose actual management is not within China but which has organs or establishments within the territory of China, or which does not have any organ or establishment within China but which has income sourced in China.

3.2 Deductions

3.2.1 Tax-deductible expenses and tax-exempt business income:

- Payroll expenses;
- Business-related expenses, losses, and other taxes (consumption tax, maintenance and construction tax, etc.);
- Income from certain qualified socially beneficial projects (environmental protection, agriculture, infrastructure, etc.);
- Income from a qualified technology transfer;
- Income derived from or accruing in China and received by a non-resident enterprise without an institution or premise in China; non-Chinese-source income of a non-resident enterprise with an institution or premise in China.

3.2.2 Non-payroll compensation that is tax-deductible:

- Social security contributions paid by the taxpayer for employees according to provisions of central or provincial governments (Five Social Insurance Program);
- Contributions to the disabled employment security fund paid according to the standard rates;
- Contributions to the statutory personal safety insurance paid for employees engaged in special jobs;
- The part of employee pensions and medical insurance purchased by the employer in addition to basic social insurance not exceeding 5% of total payroll.

3.2.3 Tax-exempt investment income

- Interest on Treasury bonds issued by the Treasury Department of the State Council;
- Dividends, bonuses and other returns on equity investments between qualified resident enterprises;
- Dividends, bonuses and other returns on equity investments received from a resident enterprise by a non-resident enterprise which has an institution or premise in China, provided such income is related to its Chinese institution or premise;
- Other income received by qualified non-profit organizations.

3.3 Tax Rates and Tax Brackets

- The income tax levied on domestic and foreign investment enterprises (FIE) has been unified at a single tax rate of 25%, according to the New Enterprise Income Tax Law (effective Jan. 1, 2008);
- Previously, the income tax rate for domestic enterprises was 33%. After available incentives, the average effective tax rate for domestic enterprises was 25%, while the average effective tax rate for FIEs was 15%.

3.3.1 Low tax rate

- 20% for income derived from or accruing in China and received by a non-resident enterprise without an institution or premise in China, or by a non-resident enterprise with an institution or premise in China if the income is not related to its Chinese property;
- 20% for certain qualified enterprises (small and medium-sized enterprises);
- 15% for qualified new and high-tech enterprises.

3.3.2 Transitional preferential policies

- For an enterprise enjoying a tax rate of 15% under previous tax laws, its applicable tax rate in the next five years is 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012;
- For an enterprise enjoying a tax rate of 24% under previous tax laws, its applicable tax rate is 25% starting in 2008;
- Where income is subject to tax treaties with foreign governments and treaty rates differ from normal tax rates, the provisions of the tax treaties shall prevail.

3.4 Asset Depreciation and Amortization

3.4.1 Depreciation of fixed assets

Asset categories	**Write-off periods (years)**
Housing and other buildings	20
Train, steamship, machinery and other production equipment	10
Appliances, tools and furniture relating to production and operation	5
Transportation other than aircrafts, trains and vessels	4
Electronic equipment	3
Land use right	not less than the use life specified in the purchase contract
Key equipment that promotes technical advance, environmental protection, or is encouraged for investment by the state; and machinery and equipment subject to unusual stress, or seriously eroded by acid or alkali	a reduced depreciation life or accelerated depreciation

3.4.2 Write-off method

- Straight line depreciation;
- Accelerated depreciation method allowed for special cases.

4. Housing Property Tax

4.1 Taxpayers

Initial buyers of housing property, operational and managerial units of housing property, mortgagees, custodians and users of housing property. This is a tax on the purchase of the property, not an annual tax. Commercial residential buildings developed by real estate companies are not considered a housing property before sale. The housing property tax is levied once on the first purchase of the property.

4.2 Tax rate applicable and valuation method

Tax Valuation Method	Tax Base	Tax Rate
Residual Value Method	Residual value after the subtraction of 10% to 30% from the original value of the property.	1.2%
Rental Income Method	Rental income from the property.	12%
	Rental income from the property rented at market price for individual residential use.	4%

4.3 Major exemptions

- The purchase of owner-occupied housing;
- Housing for the use of State organs, people's organizations and the armed forces;
- Housing for the use of institutions whose operating funds are allocated by State finance departments;
- Housing for the use of religious temples and shrines, parks, and places of historic interest and scenic beauty;
- Damaged and unsafe housing verified as being out of use by the relevant department.