SHEPPARD MULLIN
SHEPPARD MULLIN RICHTER & HAMPTON LLP
ATTORNEYS AT LAW

China Law Update BLOG
The Latest Developments On China Law

China Law Update

Posted at 1:44 PM on December 14, 2010 by Sheppard Mullin

China Ends an Era of Special Tax Treatments for Foreign Companies and Individuals

Beginning December 1, 2010, foreign-invested enterprises, foreign enterprises, and foreign individuals are now required to pay the city maintenance and construction tax as well as the education surcharge, from which these entities and individuals were formerly exempt. Prior to this regulation, the PRC levied those taxes only on Chinese-owned and funded enterprises and Chinese citizens.

Neither of the two taxes applies to dividends. The city maintenance and construction tax is levied on transactions that are subject to the value-added tax ("VAT"), the business tax, and the consumption tax. The sum of the amount paid for each of these three taxes, if applicable, also serves as the tax base. In urban districts of cities, the tax rate is seven percent (7%) of that tax base, while it is five percent (5%) for taxpayers in towns, and one percent (1%) in all other areas. Similarly, the education surcharge is levied on transactions subject to the VAT, the business tax, and the consumption tax. The tax rate is three percent (3%) of the amount paid for those three taxes.

For example, the standard rate of VAT in China is 17% of the sales or service price for the sale and import of goods and for certain services. Foreign VAT payers would now need to pay an additional 1.19% of the sales price for the city maintenance and construction tax and 0.51% for the education surcharge. This additional 1.7% tax may be deducted when calculating the taxpayer's corporate income tax. Business tax payers at the current rate of 5% of the gross service fee will now pay an additional 0.5% of the gross service fee for both the city maintenance and construction tax and the education surcharge. The additional tax and surcharge affect all foreign-invested enterprises because they are all subject to either the VAT, business tax, or both.

China's tax reform has long been on a path of equalizing the tax burden on domestic and foreign parties. The exemption for foreign companies and individuals had been in place since the two taxes were first levied in the middle 1980s and had also survived China's 1994 tax reform, when the government began to levy VAT and business and consumption taxes also on foreign companies and individuals. The end of the exemption does continue the trend of rising operating costs in China for foreign-invested businesses, but China hopes its growing economy and consumer market will outweigh or compensate the costs of higher taxes.

Authored by:

Cheng Xu
86.21.2321.6000
cxu@sheppardmullin.com

Josie Shi
86.21.2321.6000
jshi@sheppardmullin.com

Jun Hua
86.21.2321.6000
jhua@sheppardmullin.com