CHINA LEGAL UPDATE

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<u>Taxation</u>

The new Enterprise Income Tax Law applies a unified tax rate to domestic and foreign-invested enterprises in China.

- **The Enterprise Income Tax Law of the People's Republic of China**
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Introduction

Domestic and foreign-invested enterprises in China were governed by different legislations on enterprise income tax. Foreign-invested enterprises were governed by the *Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises* adopted at the 4th Session of the 7th NPC in 1991, whereas domestic enterprises were governed by the *Provisional Regulations of the People's Republic of China on Enterprise Income Tax* promulgated by the State Council in 1993. The NPC adopts the Enterprise Income Tax Law of the People's Republic of China (hereinafter referred to as the New Tax Law) on March 16, 2007.

The New Tax Law highlights "four unifications", that is, unification of income tax law applicable to both domestic and foreign-invested enterprises in China; unification and appropriate reduction of enterprise income tax rates; unification and standardization of deduction; and unification of preferential income tax policies to introduce a new preferential tax system of granting the industry-based incentives as the mainstay while the region-based ones as the supplement.

With the entry into force of the New Tax Law, the statutory nominal income tax rate for both domestic enterprises and foreign-invested enterprises will see an eight percentage point decrease from 33 percent to 25 percent. However, for those foreign-invested enterprises that have been enjoying the preferential tax rate of 24 percent or 15 percent, their statutory nominal tax rate will rise by one or ten percentage points respectively.

Main provisions

Below are the main provisions of the New Tax Law. The State Council will formulate implementing regulations according to the new Tax Law, which will further detail relevant provisions.

1. Tax Rate and Tax Preference The New Tax Law sets a new tax rate of 25 percent. And the average enterprise income tax rate is 28.6 percent in 159 countries (regions) around the world in which an enterprise income tax is applied.

The New Tax Law integrates existing preferential income tax policies in the following six manners: (1) applies a preferential rate of 20 percent to eligible small low-profit enterprises and a preferential rate of 15 percent to hi-tech enterprises receiving priority support from the State, and grants more tax preferential treatment to venture investment enterprises and to enterprises investing in environmental protection, energy and water conservation, work safety, and so on; (2) retains the preferential tax policy on investment in agriculture, forestry, animal husbandry, fisheries and infrastructure construction; (3) replaces the policy of direct tax reduction or exemption with a substitute preferential policy for labor service enterprises, welfare enterprises and enterprises making comprehensive use of resources; (4) transitional preferential tax treatment shall apply to newly-established hi-tech enterprises receiving priority support from the State and located in special zones prescribed by law to develop foreign economic cooperation and technological exchanges (i.e. special economic zones) or in the zone where the special policies for above-mentioned special zones are implemented with the approval of the State Council (i.e. the Pudong New Area in Shanghai); (5) enterprises may enjoy tax reduction and exemption treatment for their "income from environmental protection projects" and "income from eligible technology transfer", demonstrating the country's policy to encourage environmental protection and technological progress; (6) some preferential policies are canceled: for example, the regular tax reduction and exemption for production-orientated foreign-invested enterprises as well as the 50 percent tax reduction for export-oriented foreign-invested enterprises are abolished.

The New Tax Law develops some transitional preferential measures for old enterprises established before the promulgation of the New Tax Law which enjoy low tax rates or regular tax reduction and exemption treatment under current tax laws and administrative regulations. According to these transitional measures, old enterprises entitled to enjoy an income tax rate of 15 percent or 24 percent under the old tax laws may, pursuant to the regulations of the State Council, continue to enjoy a gradually increasing transitional income tax rate within five years after the New Tax Law becomes effective. Given the policy considerations and complex background of these transitional measures, it is provided in the New Tax Law that the State Council shall develop measures for implementing such transitional incentives.

2. Taxpayer It defines a taxpayer as an enterprise or other organization that earns income. To avoid double taxation, the New Tax Law does not apply to individual proprietorship enterprises and partnership enterprises. To be compatible with international practice, the terms of “resident enterprise” and “non-resident enterprise” are used in the New Tax Law. A resident enterprise shall perform comprehensive obligation of tax payment and pay tax on all of its income from sources inside and outside the territory of China. A non-resident enterprise shall perform limited obligation of tax payment and generally pay tax on its income from sources inside the territory of China.

3. Taxable Income The taxable income of an enterprise is the amount remaining from its gross income in a tax year after the excluded income, exempted income, deductions, and carry-forward loss in previous years are deducted. “Gross Income”, “Excluded Income”, and “Exempted Income” are stipulated respectively in article 6, 7 and 26 of the New Tax Law.

4. Deductions and Taxation of Assets Domestic enterprises and foreign-invested enterprises were subject to different deduction of costs and other expenditures as far as income tax is concerned. For example, a limited deductible salary and wage system applies to the income tax of domestic enterprises while an actual salary and wage deduction system to the income tax of foreign-invested enterprises. The New Tax Law unifies the policy for deducting various actual expenditures of enterprises, prescribes the standards for deducting expenditures for public welfare donations and defines the scope of nondeductible expenditures. It also makes unified provisions for the deduction of expenditures related to an enterprise’s fixed assets, intangibles, long-term prepaid expenses, and investment assets and inventory.

Property

The new Property Rights Law grants equal protection for State, collective and individual property rights.

- **The Property Rights Law of the People's Republic of China**
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Main Provisions and Contents

1. Adherence to the basic socialist economic system Clear-cut stipulations are made on ownership by the State and the collective and by the individual. On the premise that ownership of property is established according to law, as subjects of property, no matter

whether it is the State, collective or individual, their right of property shall be given equal protection. Equal protection does not necessarily mean that the economic sectors of different forms of ownership play the same role or perform the same function in the national economy. According to the provisions of the Constitution, the economic sector of public ownership is dominant, the State-owned economic sector is the leading force, and the economic sector of non-public ownership constitutes an important component of the socialist market economy, each playing a different role and performing a different function in the national economy.

2. <u>State-owned property, Property of the Collective and Private Property</u> The Property Law, in accordance with the Constitution and relevant laws, explicitly stipulates that State-owned property includes: the natural resources and infrastructure belonging to the State, the property of government departments and the institutions sponsored by the State, etc.; and, in addition, it stipulates that the State Council or the local people's governments shall, in accordance with the provisions of laws and administrative regulations and on behalf of the State, respectively perform the duties of promoters of the enterprises and enjoy the rights and interests of promoters.

In accordance with the Constitution, the Property Law explicitly stipulates, "Rural collective economic organizations apply the dual operation system characterized by the combination of centralized operation with decentralized operation on the basis of operation by households under a contract." The Property Law has made stipulations in principle on the property of the collective in cities and towns in term of the right to things, as follows, "The immovables or movables owned by the collective in cities and towns shall, in accordance with the provisions of laws and administrative regulations, be possessed and used by, shall benefit, and shall be disposed by, the said collective."

The Property Law stipulates, "Lawful deposits and investments of individual persons and the gains derived from their investments shall be protected by law." Proceeding from the purpose of maintaining the lawful rights and interests of the owners of buildings, the Property Law explicitly stipulates that the owners shall enjoy ownership over the special parts within a building, such as the residential units and the units for business purposes, and enjoy the right of sharing and jointly managing the common parts other than the special parts, such as the public facilities like the lifts and public places like the greens.

3. <u>Compensation for expropriation</u>. In accordance with the Constitution, the Property Law stipulates that, for public interests, land owned by collectives and the houses and other immovables of the units and individuals may be expropriated within the limits of power and according to the procedures as provided for by law. At the same time, the Property Law provides for the principles for compensation for expropriations and the specific items to be compensated for.

4. Others In addition, the Property Law contains the following provisions:

- on the question of security rights, on the basis of the Guaranty Law, provisions on the property that can be used for providing guaranty are added in the Property Law, which serves to further improves the guaranty system, in order to promote financing and economic development.

- on the question of protection of property, the Property Law made comprehensive stipulations governing the ways and means of protection of property, and provides that any unit or individual that infringes on the property right shall bear, apart from civil liability, administrative or criminal liability according to law, thus improving the system for protection of property.

- on the question of possession, the Property Law mainly provides for the protection of possession and the liability for tort committed by illegal possessors, to maintain public order and protect the lawful rights and interests of the obligees.

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