



TaxFacts China



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China

Update and Contact Information

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Last updated: January 1999

Controls/Restrictions on Business

Foreign Exchange

The PRC government supervises the foreign exchange market through the State Administration of Foreign Exchange. Since 1 December 1997, the Reminbi has been fully convertible under the current account.

Trade-related foreign exchange receipts and disbursements are basically not subject to foreign exchange restrictions whilst capital-account foreign exchange receipts and payments are still subject to fairly strict control. Entities in the PRC (including domestic enterprises, institutions, government agencies and foreign investment

enterprises) may buy and sell foreign currency in relation to trade through designated banks.

Foreign Investor Participation

All foreign investors must register with the local office of the State Administration for Industry and Commerce and the local tax bureaux. Business registration is made on a project by project basis and a business license is issued on a regional rather than national basis. Business licenses issued in one region do not give rights to the enterprise to operate in other regions.

Foreign investors are allowed to form equity joint ventures, co-operative joint ventures and wholly foreign owned enterprises, and these are termed "foreign investment enterprises". Foreign companies are allowed to set up resident offices such as representative offices and contractors offices. Foreign banks and foreign insurance and shipping companies are allowed to open branch offices in designated areas.

Equity joint ventures are legal entities with limited liabilities. There is no minimum capital requirement and the minimum participation of the foreign party is 25%. Partners in the joint venture share assets, liabilities, risks and profits and losses according to the equity ratio.

Co-operative joint ventures are similar to equity joint ventures with the exception that the obligations, share of profits and losses between the foreign and Chinese partners are spelled out specifically in the joint venture contract. A co-operative joint venture can choose to be or not to be a legal entity with limited liability.

Wholly foreign owned enterprises are legal entities with limited liability. Due to the lack of Chinese party participation, there are specific criteria for establishing this form of enterprise. In principle, wholly foreign owned enterprises should use advanced technology or energy saving equipment or market all or the majority of its products outside China.

Capital contributions by the foreign investor can be made in cash or in-kind such as machinery and equipment, technology and know-how, land, buildings and facilities. If a foreign investment enterprise is formed by acquiring the assets previously held by PRC domestic enterprises, the foreign investors should pay the purchase consideration within three months of the issue of a business licence to the foreign investment enterprise. This may be extended to one year, subject to approval from the authorities.

Thin capitalisation

The law stipulates a minimum registered capital to total investment ratio.

<i>Total investment</i>	<i>Registered capital to total investment</i>
below US \$3,000,000	70%
US \$3,000,001 - 10,000,000	50% (but not less than US\$2,100,000)
US \$10,000,001 - 30,000,000	40% (but not less than US\$5,000,000)
over US \$30,000,000	33 1/3% (but not less than US\$12,000,000)

Capital should be contributed according to the joint venture contract or the articles of association. The PRC authorities also set out prescribed time limits in which the investors should contribute capital into the foreign investment enterprise. If the investor fails to make the stated capital contribution on time and the enterprise seeks outside financing, the interest expense attributable to the shortfall will not be deductible for income tax purposes.

Assignment of interest and the sale of shares

Gains on assignment of equity interests in foreign investment enterprises will be liable to PRC tax. For foreign investors with no establishment in the PRC, the gain is subject to withholding tax. The standard withholding tax rate is 20% and it is reduced to 10% if the income is derived from one of the special designated zones in the PRC.

Joint stock companies are enterprises with share capital. Certain joint stock companies have their shares listed on the Shenzhen and Shanghai Stock Exchanges and overseas stock exchanges. "B" shares listed on the Shanghai and Shenzhen exchanges can be purchased by non-PRC citizens. Gains derived from the sale of shares on the stock exchanges are provisionally exempt from tax.

Take-overs, Mergers and Acquisitions

In 1997, the PRC authorities issued several circulars concerning the Foreign Enterprise Income Tax treatment and procedural matters relating to mergers, spin-offs and equity transfers of foreign investment enterprises. If the take-over, merger or acquisition results in the formation or continuing existence of a joint venture or a wholly-owned foreign enterprise, the relevant rules and regulations will apply.

Corporate Taxation

Overview

Foreign investment enterprises and foreign enterprises are taxed according to the Foreign Enterprises Income Tax Law whereas the Enterprises Income Tax Provisional Regulations are applicable solely to domestic Chinese enterprises. The tax rate under both income taxes is 33%. Domestic enterprises or foreign investment enterprises are entitled to certain preferential tax incentives if certain criteria are met.

All enterprises, domestic and foreign alike, are liable to turnover taxes which include Value Added Tax (for sales of goods and repair and processing services), Business Tax (for services and transfer of intangible assets and immovable properties) and Consumption Tax (for certain listed items).

Individuals are liable to Individual Income Tax.

Residence

All foreign investment enterprises with a head office in China are subject to Chinese tax on income attributable to the enterprise, including their world-wide income. An enterprise will be a resident in China if it establishes a head office in China. A foreign enterprise which has an establishment in China is subject to Foreign Enterprise Income Tax on its China source income only.

Income Liable to Tax

Income from all sources of a resident company is liable to Chinese tax. The determination of taxable income is based on the results of a foreign investment enterprise's annual accounts prepared in accordance with the Chinese accounting

regulations, subject to adjustments according to prevailing tax provisions. A company which is not a resident in China is liable for tax in respect of income derived from the business established in China. The tax authorities may assess income tax on a deemed profit basis if the foreign enterprise cannot provide complete and accurate accounting records to substantiate its costs and expenses.

Deductions

As a general rule, all expenses incurred for the purpose of gaining taxable income are deductible. However, certain items regarded as ordinary operating expenses are not deductible, such as royalties paid to a head office by a PRC branch of a foreign enterprise. There are also limits for deducting certain expenses such as entertainment expenses, stock provisions and bad debts.

Expenses incurred by an enterprise during its pre-operating period are allowed to be capitalised and amortised for a period of not less than five years.

Exempt Income

Dividends derived by a foreign investment enterprise from other enterprises in China are exempt from foreign enterprise income tax.

Relief from Tax

Foreign tax credit system

Foreign investment enterprises can deduct from their Chinese income tax payable the amount of income tax paid outside China on income derived from sources outside China. The tax credit is calculated on a country by country basis. The deductible amount may not exceed the amount of foreign enterprise income tax payable on the income computed in accordance with the provisions of the Foreign Enterprise Income Tax law. Unused foreign taxes can be carried forward for 5 years.

Double taxation treaties

By the end of May 1998, China had concluded 59 double taxation treaties with other countries. The contents of the treaties generally follow the model treaty developed by the Organisation of Economic Co-operation and Development in 1977. The country of source has the prior right of tax and the country of residence provides tax relief in the form of either an exemption or tax credit.

Losses

Losses incurred can be carried forward to offset against net income of subsequent tax years for a period not exceeding five years. No carry back of losses is permitted.

No group relief is available at present.

Branch vs. Subsidiary

At present, only foreign banks, insurance companies and shipping companies are allowed to set up branches in designated areas.

A branch carrying on business in China is taxable only on income attributable to the branch, while a subsidiary set up in China is subject to income tax on its world-wide income. Otherwise there is no difference in tax liabilities of a Chinese branch and a subsidiary.

Grouping/Consolidated Returns

There are no rules for group consolidation of foreign investment enterprises for tax purposes.

No group relief is available at present.

Dividends & Distributions

Dividends received by foreign investors from foreign investment enterprises are exempt from Chinese tax.

Tax Rates & Payment Dates

Tax rates

The standard Foreign Enterprise Income Tax rate is 33%, which is made up of State tax of 30% and a local tax of 3%. A reduction in the income tax rate is available to specialised industries and special zones and regions.

Payment dates

Quarterly provisional income tax returns and tax payments must be made within 15 days after the end of each quarter. Final income tax returns and final settlement of income tax should be made within four months and five months after the end of the tax year respectively. The tax year runs from 1st January to 31st December.

Anti-avoidance Measures

There are specific provisions in the tax laws dealing with related party transactions, which give the tax authority the power to make tax adjustments accordingly. Also, the tax authority is empowered to carry out general inspection and unannounced investigations.

Taxes on Undistributed Profits

There is no tax on undistributed after tax profits.

Special Regimes

A lower State income tax rate of 15% or 24% and other miscellaneous tax preferential treatments are enforced in Special Economic Zones, Economic and Technological Development Zones and certain other regions.

Other

Income tax refund

Where a foreign investor reinvests his share of profits within China, there will be a refund of 40% of the State income tax paid on that reinvested amount. If the reinvestment is reversed within five years, the refund must be paid back.

If the reinvestment is for establishing or expanding an export oriented or advanced technology enterprise, the refund may be as much as 100%. There are also some location-specific reliefs.

Individual Taxation

Residence

Foreign individuals resident in China for less than one year, and who are solely there to carry out their tasks and engage in businesses without the intention of settling in China, are only liable to income tax on their China source income.

However, a foreign individual who is present in China for not more than 90 days (or 183 days if he is from a tax treaty country or Hong Kong) during a calendar year is exempt from tax on that part of his income paid by a foreign employer and not borne by a PRC establishment.

Individuals who have resided for more than one year but less than five years are, subject to the approval of the tax authorities, assessed on income derived in China and the income derived outside China but paid by an enterprise or individual in China.

Individuals who have resided in China for more than five years consecutively are assessed on a world-wide income basis. The five year period is counted from 1 January 1994 or the actual date of arrival, if later.

Income Liable to Tax

The following categories of income are taxable:

- salaries and wages;
- business income from sole proprietorships;
- income from contracting or leasing operations;
- compensation for professional services;
- author's remuneration;
- royalties;
- interest, dividends and bonuses;
- rentals from the lease of properties;
- income from the transfer of property;

- windfall gains; and
- other kinds of income specified by the Ministry of Finance as taxable.

Individual income tax should be computed separately for each category of income. Individual income tax on wages and salaries is assessed and paid on a monthly basis.

Deductions

Applicable to salary and wage income:

- RMB ¥800 is allowed to be deducted from monthly salary and wage income. Tax allowances may be higher in certain cities. There is an additional tax deduction of ¥3,200 per month available to foreigners (including overseas Chinese) to take account of their high cost of living, making a total deduction available of ¥4,000 per month.

Applicable to compensation for personal services, author's remuneration, royalties and lease of properties:

- A fixed deduction equal to the greater of RMB ¥800 or 20% of the gross income is allowed against "each item" of income.

Applicable to interest, dividends, bonuses, gains on transfer of property, windfall gains and other income:

- No deduction is available.

Donations to approved educational and charitable organisations within the prescribed limit are deductible.

Exempt Income

The following categories of income are exempt from individual income tax:

- prizes and awards for scientific, technological, cultural, public health, sports and environmental protection achievements;
- interest on savings deposits and government debentures;
- subsidies and allowances paid under government regulations;
- welfare benefits, disability benefits and relief payments;
- indemnification payments from insurance;

- salaries of diplomatic officials of foreign embassies and consulates;
- tax-free income as stipulated in international conventions to which China is a party; and
- other tax-free income as specified by the Ministry of Finance.

Relief From Tax

In relation to individuals whose non-China source income is subject to PRC individual income tax, income tax paid to foreign authorities by individuals on income earned outside China may be credited against the amount of Chinese income tax assessed.

Tax Rates & Payment Dates

Tax rates

There are eleven categories of income subject to individual income tax and each category should be computed separately for individual income tax purposes. Tax is levied on taxable income after deducting available deductions.

Salaries and wages

<i>Monthly taxable income</i>	<i>Tax rate</i>
First ¥500	5%
Next ¥1,500	10%
Next ¥3,000	15%
Next ¥15,000	20%
Next ¥20,000	25%
Next ¥20,000	30%
Next ¥20,000	35%
Next ¥20,000	40%
Balance	45%

Other categories

Income from personal services are taxed at progressive tax rates from 20% to 40%. Business income from sole proprietorships and income from contracting or leasing operations is taxed at progressive tax rates of 5% to 35%. The tax rate on other categories of income is 20% of taxable income.

Payment date

Individual income tax is paid on a monthly basis in respect of wages and salaries. Tax returns, together with tax payments, must be filed within seven days of the end of each month. The employers are withholding agent for tax purposes.

Fringe Benefits

Although under the Individual Income Tax law both cash and non-cash benefits are taxable, in practice, the PRC tax authorities tend to tax cash benefits only at present. Also, certain allowances and benefits such as housing allowances will not attract tax if they represent the reimbursement of actual expenses incurred by employees or are supported by valid receipts.

If an employee receives pay net of tax, his taxable income is required to be grossed up to include this payment.

Other

Tax registration

A foreign individual employed by an enterprise in China must register with the local tax authority within 30 days of taking up an employment appointment in China.

Other foreign individuals should register with the local tax authorities at the time when they become liable to tax. Frequent travellers who are present in China in excess of 90 days (or 183 days if they are from tax treaty countries or Hong Kong) in a calendar year, should register with the local tax authorities within seven days after the month in which the period of his stay exceeds 90 days (or 183 days).

Foreign individuals who are liable to pay Chinese tax and intend to leave China permanently are required to pay off all outstanding tax seven days before departure and to complete tax de-registration formalities.

Other Taxpayers

Partnerships

There are no specific tax provisions concerning partnerships. Income accrued to a partner in a partnership will be taxable on the partner.

Trusts

There are no specific tax provisions concerning trusts.

Unit Trusts

There are no specific tax provisions concerning unit trusts.

Mutual Funds

There are no specific tax provisions concerning mutual funds.

Other

Not applicable.

Withholding Taxes

Personal Services Income

Not subject to withholding tax.

However, a withholding obligation is imposed on the enterprise or individual paying the taxable income. The payer is required to withhold the individual income tax payable from each payment, file the tax return and pay the tax withheld to the local tax authorities.

Construction/Engineering Contract Payments

Not subject to withholding tax.

However, the project owner or the general contractor will be the withholding agent for tax purposes if payments are made to the contractor or subcontractor without a PRC establishment or without an agent in the PRC.

For offshore oil operations which have not carried out business registration in China, a 12% security deposit is required to be withheld from payments made to the foreign contractors. The security deposit will be set off against the income tax liabilities of the foreign contractor. The amount of deposit in excess of the tax will be refunded.

Other Payments to Non-Residents

Foreign enterprises which do not have establishments in China are liable to withholding tax on certain types of China sourced income. The standard withholding tax rate is 20%. It is reduced to 10% in respect of income derived from one of the specially designated zones in the PRC. The withholding tax rate may also be reduced under tax treaties.

Service fees paid to foreign enterprises in relation to taxable services provided in the PRC are not subject to withholding tax. However, the tax authorities may appoint the payer in the PRC as withholding agent for income tax and Business Tax purposes.

Payments Between Residents

Not subject to withholding tax.

Indirect Taxes

VAT/Sales Tax

The current turnover tax system, which comprises Value Added Tax ("VAT"), Business Tax and Consumption Tax, was introduced on 1 January 1994.

VAT

VAT is charged on the supply of goods, the provision of repairs and processing services in China as well as on the importation of goods into China. VAT is charged at each stage of production with each supplier receiving credit for the relevant input VAT so that VAT is actually borne by the final consumer.

The standard VAT rate is 17% but certain listed products are taxed at 13% or exempted. Goods exported by foreign investment enterprises established before 1 January, 1994 are currently treated as tax exempt. Exports by foreign investment enterprises established after 31 December, 1993 are subject to an "exempt, set-off, refund" treatment. Under this treatment, there is a potential VAT charge on the value of exports.

Credits for input VAT paid are limited to the amount of VAT paid as stated on the supplier's prescribed VAT sales invoices or the tax payment certificates received from Customs. Purchasers of VAT exempted agricultural goods are allowed input VAT credits at 10% of the purchase price.

Small scale businesses as defined by the VAT regulations will be taxed at an assessable rate without any entitlement of input VAT credits. The assessable rate is 6% in relation to taxpayers who produce goods or provide repair and processing services. The assessable rate in relation to taxpayers who are engaged in wholesale or retail businesses is 4%.

Business tax

Business tax is a turnover tax charged on the provision of services, the transfer of intangible assets and the sale of immovable properties in China.

Tax rates vary from 3% to 8% depending on the type of taxable service. The rate for the entertainment industry ranges from 5% to 20%.

No credit for any input tax is available. However, deductions from gross revenue are allowed for subcontracting fees paid in the transportation, tourism and construction industries. For the financing and securities industries, business tax is levied on the net amount of certain types of income.

Consumption tax

Consumption tax is charged on the production, processing and importation of listed goods. There are 11 categories of goods which are subject to Consumption Tax, including tobacco, liquor, cosmetics, skin and hair care products, jewellery, firecrackers, gasoline, diesel oil, motor vehicle tires, motorcycles and certain types of motor vehicles. Tax rates range from 50% as the highest on tobacco products to 3% as the lowest on motor cars. Consumption tax is levied in addition to Value Added Tax.

Customs & Excise Duties

Imported goods are subject to customs duties and Value Added Tax. Customs duty rates vary according to the type and make of imports. The average customs duty rate of China is 17% as from 1 October 1997. Value Added Tax is charged at 17% or 13% or items are exempt, depending on the type of goods.

Consumption tax ranging from 3% to 50% will be levied on the importation of certain items.

With effect from 1 January 1998, foreign investment enterprises can import equipment for self-use free from customs duty and import Value Added Tax if certain conditions are satisfied. However, certain items are explicitly identified as taxable.

Transfer/Stamp Duties

Stamp duty

Stamp duty is payable on documents specified in the Stamp Duty regulations. Different stamp duty rates are applicable to different types of documents, ranging from 0.005% to 0.1%.

Land appreciation tax

Land appreciation tax applies to the transfer of real estate in China from 1 January 1994. It is imposed on all entities and individuals, whether foreign or domestic. Land appreciation tax is charged at progressive tax rates of 30% to 60% depending on the

proportion of the gain to the total deductible costs. The tax is payable upon the transfer of land use rights, buildings and other real property in China.

Total deductible costs include the cost of the land use rights, construction costs, design fees, selling and administrative expenses. The amount of financial, selling and administrative expenses which will be included in total deductible costs are subject to certain limitations. A developer will be entitled to an additional deduction which is equal to 20% of certain development costs.

This tax does not apply to bequests on death, gifts, transfers for no consideration and expropriation by the government.

Development contracts entered into before 1994 will be exempt from this tax on the first transfer within five years from 1 January 1994 if the capital injection has occurred as scheduled.

Deed tax

The transfer of real estate in the PRC by means of a sale, a gift or an exchange will be subject to deed tax. The deed tax rate ranges from 3% to 5%, which is determined by the local People's government. Deed tax is payable by the buyer/transferee of properties.

Property Taxes

Urban real estate tax is levied on the owners of properties in cities specified by the Ministry of Finance.

Urban real estate tax is charged at 1.2% on the assessed value of property, or at 12% or 18% on rental. The assessed value is computed by discounting the original value of the property by 10% to 30%. Local variations exist.

Payroll Taxes

Employers are required to make contributions to social security funds including pension, unemployment, medical, work-related injury, maternity and other local social insurance schemes. The amount and type of social security contributions vary across cities and provinces in China and are determined by local governments.

Wealth/Net Assets Taxes

Not applicable.

Death, Gift & Inheritance Taxes

Not applicable.

Capital Taxes

There is no capital duty on equity and share capital. Enterprises are required to pay a business registration fee at a percentage of the amount of registered capital. The rate is 0.1% on capital amount of less than Renminbi ¥10 million and 0.05% on any amount over and above Renminbi ¥10 million, subject to a maximum of RMB55,000.

Others

Not applicable.

Incentives

Direct Tax Incentives

The standard Foreign Enterprise Income Tax rate is 33%, which is made up of State tax of 30% and local tax of 3%. The State tax rate may be reduced to 10%, 15% or 24% if the enterprises are located in one of the specially designated zones in China and/or engaged in the relevant operations or projects. The local tax of 3% may be waived or reduced by the local government.

Examples of tax holidays and tax reductions include:

- Subject to approval, a newly established foreign investment enterprise scheduled to operate for at least ten years and engaged in production will enjoy the following income tax holidays: exemption from State income tax for the first two profit making years and a 50% reduction in State income tax for the following three years. The definition of the 'first profit-making year' is the first year during which all prior year losses have been utilised, leaving a taxable profit. Losses may only be carried forward for a period of 5 years.
- Foreign investment enterprises exporting 70% or more of their production in a year may receive a 50% reduction in State income tax for that year, subject to a minimum tax rate of 10%.

- If a foreign investment enterprise qualifies as a technologically advanced enterprise, it may continue to enjoy a 50% reduction in the State income tax for up to three years after the initial tax holidays mentioned above, subject to a minimum tax rate of 10%.
- Foreign investment enterprises engaged in farming, forestry or husbandry, or which are located in remote, economically under-developed areas may be allowed a 15%-30% reduction in State income tax for a further ten years after the expiry of the initial tax holidays.
- For foreign investment enterprises engaged in energy, communications, harbour, wharf projects in certain designated zones or projects encouraged by the government, the State income tax rate is 15%.
- Foreign investment enterprises in a Special Economic Zone which have periods of operation of ten years or more and foreign investment of over US\$5 million and which operate in service sectors may enjoy income tax exemption in the first year and a 50% reduction in the next two years, starting from the first profit making year.
- For enterprises located in the Special Economic Zones, the State income tax rate is 15%.
- For foreign investment enterprises engaged in production and located in Economic and Technological Development Zones of the 14 Coastal Open Cities and the Pudong New Area, the State income tax rate is 15%. A reduced State tax rate of 24% is levied on foreign investment enterprises engaged in production in Coastal Open Economic Zones, in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located.

Indirect Tax Incentives

General

Withholding tax may be levied on certain types of income derived from China by foreign enterprises without a PRC establishment. The standard withholding tax rate is 20%. The rate may be reduced to 10% if the income is derived from one of the specially designated zones. Dividends received by foreign investors from a foreign investment enterprise are exempt from PRC withholding tax.

Interest

The following interest income is exempt from income tax:

- interest from loans to the Chinese government or Chinese state banks by international financial organisations;
- interest from loans to Chinese state banks by foreign banks at preferential interest rates;
- interest on deposits paid to foreign banks or foreign individuals by Chinese state banks where the interest rate is lower than the interest rate of the depositor's own country;
- interest from loans in connection with compensation trades where the Chinese entity uses the finished products to repay the loans; and
- interest received by the state banks of foreign countries from China may be exempt from PRC withholding tax under certain double tax treaties.

Royalties

An exemption is available on royalties paid for the use of advanced technology or technology provided on preferential terms.

A reduced rate of 10% may be available for royalties received for the supply of technical know-how in:

- scientific research;
- exploitation of energy resources;
- development of the communication industry;
- agricultural, forestry and animal husbandry production; and
- certain important proprietary technologies.

Subsidies & Grants

Government subsidies or other financial assistance are generally not available to foreign investment enterprises set up in China. However, some local authorities may be prepared to negotiate special concessions on a case-by-case basis.

Financial Assistance & Guarantees

In general, the PRC authorities will not guarantee the rate of return of foreign investment enterprises. However, some local authorities may provide financial assistance such as tax rebates to some encouraged projects on a case-by-case basis.

Imported Goods

If certain criteria are satisfied, capital equipment imported by foreign investment enterprises for self-use may be exempted from customs duty and Value Added Tax. However, certain items are explicitly listed as taxable.

Goods imported into China for the processing of exports will be exempt from customs duty and Value Added Tax, subject to the approval of Customs.

There are 15 Bonded Zones in China. Import or export of goods from a Bonded Zone to a destination outside China is exempt from customs duty and Value Added Tax.

Other Help & Assistance Available

No information available.