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China Tax Update on New Computation of Withholding Income Tax on Passive Income

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The New Corporate Income Tax Law and its implementation regulations took effect on 1 January 2008, stating that the withholding income tax ("WHT") should be calculated based on the total amount of passive income without any indication on the continuance of the deductibility of Business Tax ("BT"). The effectiveness of Caishuizi [1998] No.59 ("Circular 59") and Guoshuifa [1996] No.212 ("Circular 212") which allow the deduction of BT became unclear, and this has led to different practical treatments for calculating WHT.

The issuance of Caishui [2008] No.130 (Circular 130) by the Ministry of Finance and the State Administration of Taxation on 25 September 2008 clarifies the above uncertainty. This update serves to discuss the related changes.

Old Treatment

Under the old Corporate Income Tax Law for Foreign Investment Enterprises and Foreign Enterprises and its Implementation Regulations, when a foreign enterprise which does not have an establishment or place of business in the PRC but derives passive income from the PRC, or a foreign enterprise which has an establishment or place of business in the PRC but the aforesaid PRC-sourced passive income is not effectively connected to the establishment or place of business, the income should be subject to PRC WHT. The WHT rate was 10% as stipulated in Guofa [2000] No.37 (Circular 37) issued by the State Council in 2000.

The aforesaid passive income refers to the following income:

- Dividend (WHT was exempted prior to January 1, 2008);
- Interest;
- Rental;
- Royalties;
- Capital gains.

According to Circular 37, BT paid for royalties and rentals were deductible in calculating WHT.

For example, if the amount of royalty is RMB100, BT at 5% is RMB5. WHT is calculated at 10% of RMB(100 – 5 (BT paid)) = RMB9.5. The total of BT and WHT is RMB14.5. In other words, the effective PRC tax rate was 14.5%.

New Treatment



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"Zeng Zhi Shui"
(Value Added Tax)



"Ying Ye Shui"
(Business Tax)

Circular 130 clarifies that the relevant tax paid or expenses should not be deductible in calculating WHT on passive income for non-resident enterprises effective from 1 January 2008. Hence, the effective PRC tax rate would be increased to 15% (BT rate 5% + WHT rate 10%).

Uncertainty of Circular 130

The circular is effective from 1 January 2008, while the actual issuance date of Circular 130 was 25 September 2008. The time lag between the effective date and the circular issuance date causes practical questions. That is whether BT which have been deductible in calculating WHT during the period from 1 January 2008 to 24 September 2008 should be added back to the taxable income for calculating WHT, and whether the relevant WHT should be paid back to the tax authority. This matter has not yet been clarified up to the date of issuance of this Tax Update. Taxpayers should seek professional advices for the local treatment.

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