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Financial Accounting

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增值税

"Zeng Zhi Shui"

(Value Added Tax)

营业税

"Ying Ye Shui"

New Tax Administration Rules for Representative Offices

A new tax notice concerning the taxation of representative offices (ROs) established by foreign entities came into effect this week. In China most ROs are not permitted to record income or perform true business activities, even though such offices are still subject to taxation, causing some considerable concern to foreign companies. The new notice is designed to clarify and standardise previous measures aimed at ROs and at the same time to ease their tax treatment.

The notice encourages ROs to file their tax returns and activity reports based upon their actual business activities in China. The tax base varies according to industry as follows:

- ROs with a head office engaged in business advisory, tax advisory, law, accounting, auditing or other types of consulting services are required to maintain complete accounting records and evidence of properly calculated revenue and taxable income. Their tax liabilities will be based on actual revenue and profit.
- ROs of entities that engage in agency or trading activities perform business activities on behalf of the head office. Since such ROs do not enter into agreements with their customers directly and since income attributable is normally collected by the head office, revenue of these ROs is determined on a cost-plus basis.
- Any RO that does not fall into the above two categories, but still carries out taxable activities, will be taxed according to the actual revenue generated, including amounts received by head offices outside of China and attributable to the RO. If no revenue is generated then annual activity reports must be filed with the tax bureau within one month of the year-end.
- A tax exemption is still available for ROs established by foreign governments and international, non-profit and non-governmental organisations. Any application for exemption should be filed with the RO's local tax bureau and include documents providing evidence of the nature of the RO issued by the tax authorities of the RO's head office. Application is subject to final approval by the State Administration of Taxation.

It is likely that the new measures will not represent any ease in tax authorities control of ROs and there also concern that thorough tax-audits will become more common, particularly for those ROs that report zero revenue.

Tax Treatment of FIEs with Less than 25% Foreign Investment

In order to further clarify previous regulations, a circular was recently issued jointly by MOFTEC and the State Administration of Taxation to clarify issues relating to the tax treatment of newly-established enterprises with foreign investment with actual capital contributions by foreign investors lower than 25%.

(Business Tax)

Such enterprises are not eligible to enjoy the various privileged tax policies normally available to FIEs. The applicable tax system is the same as that to domestic enterprises.

The same applies to tax registration procedures for such enterprises with the procedures also following that of local companies.

New Rules on Deductible VAT Input

A measure newly introduced by the State Administration of Taxation of interest to general VAT payers became effective in March this year. All VAT input official receipts, which were issued by the fake-proof VAT parameters, should be reported to local tax authority for approval within 90 days after the receipts were issued. Otherwise, the VAT input cannot be deducted.

VAT payers who want to claim their VAT input for invoices dated before March 1 2003 have until the end of September this year to do so at their local tax bureau.

消费税

"Xiao Fei Shui"

(Consumption Tax)

New Measures for Evaluation of Royalties of Imported Goods

Effective from July, the Customs General Administration of the PRC recently provided measures regarding the evaluation of royalties of imported goods.

Royalties in these measures are referred to as fees paid by the buyer of the imported goods in order to get the permission to use the patent, copyright, trademark, know-how, right to distribute and sell, and other rights.

The main points of the measures:

- Royalties paid by buyers should be included in the dutiable transaction value if the royalties are related to the imported goods and a condition of the export sale of the goods to the PRC. If the buyer fails to pay the royalty, then the imported goods would not be traded according to the stipulated contract.
- The imported goods with the royalty included in the duty-paid price will be taxed accordingly.
- The customs office will evaluate the royalties, as well as determine the duty-price of the imported goods.
- If any consignee of the imported goods fails to report the royalties, or make any false report, they will be subjected to legal liabilities in accordance with the Customs Law.

所得税

"Suo De Shui"

(Income Tax)

Latest Measures to Combat Financial Impact of SARS

The Chinese government has issued a number of measures aimed at minimising the financial impact of SARS on certain industries, most importantly the hospitality and service industries, transportation and tourism. Opinions about the actual economic impact of SARS upon the Chinese economy vary though it's estimated indirect economic losses could total more than RMB 200 billion.

For the period 1 May 2003 to September 2003 the central government has exempted passenger transport and tourism business from paying business tax, urban maintenance and construction tax and education surtax.

In addition, several local governments, including Shanghai, Shenzhen and Hangzhou, have granted similar tax concessions to alleviate the impact of SARS on hotels and restaurants. Many hotels are already facing difficulties as a result of a dramatic fall in the number of customers during the SARS period.

In Shanghai, the city government has provided loan guarantees on the short-term operating capital loans of those SMEs in the tourist, entertainment and hospitality industry. In a move designed not only to limit the economic impact of SARS but also to further encourage improved hygiene municipal governments in Guangzhou and Hangzhou waived fees for hygiene supervision, disinfection and in some areas lowered the fee for running water by 50%.

Wholly-Foreign Owned Travel Agents Allowed from July

According to the Provisional Regulations on the *Establishment of Travel Agencies Controlled or Wholly Owned by Foreign Entities* jointly issued by the National Tourism Administration and the Ministry of Commerce, the first wholly foreign-owned travel agencies can apply in July for approval to operate.

Under the new regulations, foreign-owned and joint venture travel agencies must be members of the China (Regional) Travel Industry Association with annual turnover of US\$500 million and US\$40 million respectively. In addition to compliance with China's tourism development plan and market needs, these travel agencies must also have a minimum registered capital of RMB4 million.

The new rules also impose restrictions on the business scope of these operations. For example, they are not permitted to organise tours for Chinese mainland citizens to foreign countries or to Hong Kong, Macau or Taiwan.

Qualified foreign investors are allowed to set up travel agencies in State Council-approved national holiday resorts and in the five cities of Beijing, Shanghai, Guangzhou, Shenzhen and Xian. However, each foreign investor can only set up one majority-owned or wholly-owned travel agency in China.

Overseas Brands Less Popular

According to a survey in the newspaper *Shanghai Morning Post*, foreign brands are less influential in Shanghai, as locals don't have blind faith in foreign products.

Less than 5 percent of the best-selling brands in the city are foreign ones, indicated the survey, which was conducted by the Shanghai Commercial Information Center on some one hundred products in eight categories at more than 100 retailers and 3,000-plus commercial outlets.

This is in contrast to the expectation by some industry analysts that more foreign products would be purchased in China as import tariffs declined after China's entry into the World Trade Organization.

From last year, the average tariffs on imported products have dropped from 15.3 percent to 12 percent. About 5,300 products were involved in the tariff reduction, accounting for 73 percent of total imported products.

Although the tariff cuts have had little effect on consumption overall, they have fueled sales in imported automobiles and information technology products.

"Providing an alternative in China"

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LehmanBrown also provides a monthly newsletter "**Peeling the Onion**" which investigates certain topical issues affecting businesses in China, particularly for those companies and individuals with operations in the PRC, or looking to establish a presence in-country.



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