



# People's Republic Of China Tax Profile

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# 1 Corporate Income Tax

## 1.1 General Information

### Tax Rate

25 percent

There is also a 15 percent rate applicable to certain Chinese enterprises with “High and New Technology” or “Advanced Technology Services” status or those operating in the western region of China. A 20% rate applies to certain qualifying small and low profit enterprises – as these are subject to tax on just 50% of their income their effective tax rate is 10%.

### Residence

A company is considered resident in the People’s Republic of China (“PRC”) if it is established under PRC law, or is an enterprise that is established under the laws of foreign countries (regions), but its place of effective management is located in PRC.

A resident enterprise is taxed on its worldwide income.

### Basis of Taxation

Tax is calculated on the basis of profits per the financial accounting statements, subject to certain tax adjustments as prescribed by the tax laws. Resident and non-resident enterprises may also be taxed on a deemed basis under certain circumstances.

### Tax Losses

Tax losses may be carried forward for 5 years. This is extended to 10 years for Chinese enterprises with “High and New Technology” status and science and technology small and medium sized enterprises (SMEs). No carry-back is allowed.

### Tax Consolidation/Group Relief

There is no tax consolidation regime in the PRC for CIT purposes, though this may be available for VAT in certain circumstances.

### Transfer of Shares

Stamp duty applies on the transfer of shares.

### Transfer of Assets

Value Added Tax (“VAT”), stamp duty, deed tax and land appreciation tax may apply on the transfer of land and buildings.

Transfers of inventory and fixed assets may be subject to VAT and stamp duty.

Transfers of intangible assets may be subject to VAT and stamp duty.

Gains resulting from transfers of assets are subject to Corporate Income Tax (“CIT”).

Certain corporate asset reorganizations may be eligible for tax relief, including from both income tax and turnover taxes.

### Capital Duty (Non-tax Planning)

The PRC has no capital duty rules.

### CFC Rules

The PRC has a CFC regime, which taxes profits of subsidiaries subject to an effective tax rate less than half of the PRC statutory CIT rate, and other conditions are met. There are let outs for, inter alia, active business income and for cases where the subsidiary has reasonable business purposes (e.g. reinvestment plans) for profits retained overseas.

### Thin Capitalization

Yes - CIT law effectively restricts the deductibility of interest paid to related entities if the company is excessively financed with related party debt. In general, this will be the case where the related party debt-to-equity ratio of the company exceeds 2:1 (or 5:1 for financial institutions). A deduction of excess interest can, however, be secured where it can be shown that it is applied at an arm's length rate in certain circumstances.

### Interest Deductibility Restrictions

See Thin Capitalization section above.

### Amalgamations of Companies

The PRC has implemented a reorganization tax relief regime, though the circumstances in which relief is granted are somewhat restrictive.

### General Anti-avoidance

PRC tax law includes general anti-avoidance provisions. Under these, the tax authorities may apply a 'substance over form' approach to make special tax adjustments.

### Anti-treaty Shopping

PRC tax treaties typically require that a treaty applicant must be the beneficial owner of certain passive income derived from the PRC, in order to qualify for treaty benefits. Under the relevant tax guidance from the State Administration of Taxation (SAT), the beneficial owner, amongst others, needs to conduct substantive business activities, commensurate with the income it earns and for which it claims treaty benefits. A number of safe harbors, and a 'derivative benefits' test, can facilitate the claiming of treaty benefits by multinational enterprises. However, variance in local tax authority interpretation of the beneficial ownership threshold, and inconsistent administrative procedures across authorities, complicate treaty relief access in practice.

### Other Specific Anti-avoidance Rules

PRC tax law contains anti-avoidance rules with respect to the indirect disposal of equity interest in a PRC enterprise (Announcement 7).

### Rulings

There is currently no formal ruling system for PRC taxes currently, although this is set to be introduced with the introduction of the new Tax Collection and Administration Law, possibly from 2018.

Informal rulings can be sought with tax officials. However, the rulings are typically just given orally, and may reflect the personal views of the officials consulted.

### Hybrid Instruments

There is limited guidance in SAT Announcement 41 [2013] regarding hybrid instruments in the PRC with a list of debt instrument criteria which, if lacking, will result in the instrument being classified as equity and

interest deductions denied. While this does not deal with cross-border hybrid mismatch arrangements, *per se*, the SAT has signaled their intent to introduce such provisions in the future.

A cross-border hybrid loan document needs to be registered with the foreign exchange authorities. If the terms are different from a traditional loan document, it will be questioned and challenged. Taxpayers should be prepared to negotiate with the local government.

## Hybrid Entities

For outbound investment cases, in determining the tax characterization of a foreign entity controlled by a PRC entity, the PRC tax authorities may look at whether that foreign entity has a separate legal person status under local law, or is a tax resident for treaty purposes. The relevant SAT guidance notes that this should drive the treatment the foreign entity as tax transparent or tax opaque. For inbound investment cases, the default position is to treat all foreign 'organizations' as falling within the scope of CIT (i.e. *de facto* tax opaque). This can complicate access to treaty relief, unless the relevant treaty contains specific provisions allowing for transparent treatment (solely the China-France treaty at present).

## Related Business Factors

### *Forms of legal entities typically used for conducting business*

To conduct business in the PRC, foreign enterprises typically set up a Chinese limited liability company (LLC) as a Wholly Foreign Owned Enterprise (WFOE), with special forms of WFOE being used depending on the nature of the business activity. For example as a Foreign Invested Commercial Enterprise (FICE) may be used for domestic trading activities. However, in some economic sectors there is a requirement to have a Chinese joint venture partner which means that an EJV (equity joint venture) or cooperative joint venture (CJV) must be used [The term 'foreign invested enterprise' (FIEs) is used to refer collectively to all the varieties of foreign owned enterprises used for conducting business in the PRC]. The government is progressively reducing the number of sectors for which JV requirements apply.

While foreign invested partnerships (FIPs) may be used as business vehicles since 2010, registration issues mean these have not been used extensively outside the funds sector to-date. About holding companies, generally offshore holding companies are used. It is possible for a general LLC or a special Chinese Holding Company (CHC) to be used for onshore holding, though this is complicated by regulatory restrictions on M&A activities by general LLCs, and the high investment thresholds for the CHC regime. It should be noted that the new Foreign Investment Law (anticipated to be implemented in 2018) may move to consolidate the special legal forms existing for FIEs – the precise terms of the new law remain to be seen.

### *Capital requirements for establishing a legal entity*

Statutory minimum registered capital requirements were abolished in 2014, though some local regulators continue to insist on high levels of registered capital before approving FIE establishment. Specific industries such as banking and insurance continue to be subject to special minimum capital requirements.

### *Other local requirements for establishing a legal entity*

Certain industrial sectors require foreign investment to be made together with a Chinese partner in an equity or cooperative joint venture (EJV, CJV). Foreign participation may be limited to a given percentage of enterprise share capital. Such restrictions are found in the official 'Catalogue of Industry Guidelines for Foreign Investment', which guides the Ministry of Commerce (MOFCOM) and local departments of commerce (local MOFCOM) in supervising foreign investment. China has transitioned to a new 'Negative List' system under which, for investment in most sectors (M&A or greenfield), solely a record filing must be made with MOFCOM; the foreign investor can proceed directly to registering a new company with the local Administration of Industry and Commerce (AIC). For a limited number of sectors the 'Negative List' prohibits or restricts foreign investment – MOFCOM pre-approval is needed for the restricted sectors.

## 1.2 Determination of taxable income and deductible expenses

### 1.2.1 *Income*

#### General

Taxable income is defined as total income less non-taxable income, exempt income, allowable deductions, and losses of previous years. Taxable income is calculated on an accrual basis.

#### Branch Income

Foreign enterprises are only permitted to operate a branch structure in China in a limited number of industries (e.g. banking, insurance) and must generally operate through local subsidiaries. Representative offices (ROs) can be established for non-direct profit earning (e.g. liaison) activities. It is also possible that the activities of staff of a foreign company in China, or Chinese persons acting on its behalf, may rise to the level of a PE and be subject to tax. Both the accrual basis and deemed basis tax calculations may be used in this regard.

#### Capital Gains

There is no separate tax on capital gains, which are included in ordinary taxable income. CIT at 25 percent applies to capital gains derived by a PRC resident enterprise. The term “gains” is defined as the proceeds from the transfer of property, which exceed the original cost of the property. The source of gains is generally the place where the property-giving rise to the gains is situated (e.g. equity interest).

Gains on the transfer of non-cash assets used for the investment may be allocated over a period of 5 years, and included in the taxable income of the relevant tax year (Cai Shui [2014] 116).

There is currently no ‘participation exemption’ regime allowing for exemption of disposals of equity in subsidiaries, whether domestic or foreign.

#### Dividend Income

Dividend distribution, from a PRC resident enterprise to another PRC resident enterprise, is exempt from PRC CIT (except dividends from publicly traded shares of resident enterprises that have not been held for at least 12 consecutive months). There is no equity percentage holding requirements for this treatment to apply. Dividend distribution from a non-resident enterprise to a PRC resident enterprise is subject to 25 percent CIT, but foreign tax credit (FTC) may be available.

#### Interest Income

CIT at 25 percent applies to interest income derived by a PRC resident enterprise.

### 1.2.2 *Expenses*

#### General

Generally, costs, expenses, (certain) taxes and losses are deductible to the extent that they are incurred in producing income and if the amount to be deducted is evidenced and in accordance with the relevant laws and regulations. Expenditures incurred in the course of carrying on business, such as cost of goods sold, manufacturing costs, marketing expenses, administrative expenses, financial expenses and taxes on sales are deductible in the period in which they are incurred. Costs and expenses actually incurred in the preceding tax years, but unclaimed as deductions, may be adjusted within 5 years. From 1 July 2018, supporting documents of the costs and expenses incurred, for CIT purposes, must meet requirements set out under SAT Announcement [2018] No. 28.

#### Minimum Taxation Requirements for the Deductibility of Losses

Losses are generally deductible. Under CIT law, losses include a shortfall loss, damage loss, and loss from the scrapping of fixed assets and inventories, loss on property transfer, loss on doubtful accounts, loss on bad debts, loss resulting from a force majeure such as natural disasters, and other losses that are incurred in the process of production and business operation activities of an enterprise.

#### Capital Losses

Losses from the sale of shares are deductible. Losses incurred from an equity investment may be deducted on a one-off basis in the tax year in which the losses are recognized (SAT Announcement [2010] No. 6). Expenses and losses arising from investment in enterprise may not be off set against income from other sources, nor may losses incurred by an enterprise's overseas establishments be utilized. No deduction is allowed for unrealized capital losses. Self-created goodwill is not allowed to be amortized or deducted.

### **Carry Forward**

Losses may be carried forward for a maximum of 5 years without any restriction.

### **Carry Back**

Losses may not be carried back.

### **Bad Debts**

Reserves and provisions are generally not deductible, except for special funds prescribed by law and regulations. Provisions for bad debt are deductible for taxpayers engaged in banking and insurance services or other similar businesses.

### **Depreciation/Capital allowance**

Depreciation is compulsory and generally may not be deferred. Fixed assets under certain conditions may not be depreciated. The basis for depreciation is historical cost.

### **Double Deductions**

No special rules.

### **Interest Expenses**

Interest expenses are generally deductible in calculating income if they are incurred in connection with the business activities of the taxpayer and the amount of the interest is reasonable. Interest paid between the branches (or business units) of an enterprise is not deductible except for banking businesses. Non-financial institutions are generally not allowed to grant loans.

With effect from 1 September 2013, in the case of a hybrid investment by an enterprise, the interest paid by the invested enterprise must be recognized on the due date of the interest (including guaranteed minimum interest, fixed profit or fixed dividends) and included in the taxable income of the investing enterprise. Correspondingly, the same interest is deductible by the paying enterprise up to the market-rate interest. The difference between the amount of repayment (or amount of redemption) by the invested enterprise and cost of investment (the principal amount) must be treated as gains or losses from debt restructuring, and included in the taxable income of the current period (SAT Announcement [2013] No. 41).

### **Inventories**

Inventories used or sold by an enterprise, the inventories costs valued by law are deductible. The valuation methods include FIFO, specific identification method, or weighted average. A change in a valuation method requires the approval of the tax authorities.

### **Other Significant Items**

Expenditure incurred for acquiring intangibles such as patents, proprietary technology, trademarks, copyrights, and land use rights, know-how and goodwill may be amortized on a straight-line basis.

## 1.3 Tax Compliance

### Compliance Requirements

The tax return system is one of self-assessment, subject to audit by the tax authorities.

Annual CIT returns are due on the 31 May after the end of the tax year.

### Mandatory Electronic Filing

The annual CIT returns may be filed on paper or electronically. They must be filed in the Chinese language, or in both the Chinese and foreign language.

### Requirement to Prepare Tax Computation / Return in Functional Currency

The PRC has no requirements on this, though generally renminbi (RMB) is applied given that this is the reporting currency of an enterprise.

### Documents to File with Tax Return

Enterprises shall attach the financial accounting report and other relevant materials pursuant to the provisions when filing corporate income tax returns.

### Language to File Return, Computation and Supporting Documentation(s)

CIT shall be calculated in RMB. Where the income of an enterprise is not computed in RMB, the enterprise shall compute the taxable amount of income in RMB using the middle price of the RMB exchange rate on the last day of the month or the quarter when making prepayment of CIT.

### Filing Extension Availability and Details

An application for an extension of time for the submission of tax returns may be made to the tax authorities.

### Payment of Estimated Tax

The amount of tax is computed as 1 month or quarter of the planned annual profit or the actual income in the preceding year, payable should be made within 15 days from the end of each quarter. The final settlement must be made within 5 months from the end of each tax year. Any shortfall must be made up and any excess payment is refunded.

### Interim Tax Returns

Quarterly (or monthly) returns are due 15 days after the end of the quarter (or month).

### Payment of Tax

Monthly or quarterly advance payments are required within 15 days after the end of the month or quarter concerned. The annual payment should be made within 5 months of the end of the tax year.

### Penalties for Non-Compliance

A penalty of no more than RMB 2,000 may be incurred for a taxpayer fails to file the tax return. For serious case, a penalty ranging from RMB 2,000 to RMB 10,000 may be imposed.

### Penalties and/or Interest for Underpayment of Taxes

Where a taxpayer fails to pay tax, a late payment surcharge may be imposed on a daily basis at the rate of 0.05% of the amount of tax in arrears, from the date that the tax payment is defaulted.

A penalty of 50% to 500% of the underpayment of taxes may be imposed.

### Statute of Limitation

Where a taxpayer or withholding agent fails to pay or underpays taxes owing to its own miscalculation or other faults, the taxation authorities may, within three years, recover the taxes in arrears and the penalties



for late payment; under special circumstances, the time limit for recovering the taxes in arrears may be extended to five years.

In transfer pricing cases, the statute of limitations is 10 years. In the case of tax fraud, evasion, or refusal to pay tax, no limitation is set for tax collection.

If a taxpayer has overpaid tax, upon verification by the tax authorities, the taxpayer shall be entitled to a refund on the tax overpayment within 3 years after the tax payment.

## 1.4 Financial Statements/Accounting

### Details of Local Accountant Requirements

Accounting records and annual financial statement are required to be prepared and maintained in accordance with the accounting regulations/standards issued by Ministry of Finance (MOF). The audited statutory financial statement is required to be submitted to the PRC tax authority when conducting the annual CIT filing.

### Fiscal Year

1 January to 31 December.

### Periodicity of Local Books to be Closed

The annual account settlement day is 31 December of every calendar year.

### Retention Period for Statutory Financial Statements / Working papers

Monthly, quarterly, and half-yearly financial statements should be retained for 10 years, and annual financial statements should be permanently retained.

### Requirements to Retain Physical Copies Locally/Electronically Stored Data to Reside on In-country Server

The temporary retention period of accounting records by the enterprise's accounting management department shall not exceed three years. After that, the accounting records shall be handed over to the archive management department of the enterprise.

At the time of handover of accounting records, the accounting management department of an enterprise shall compile a list of handover accounting records, and complete handover formalities pursuant to the relevant provisions of the State on administration of archives.

Hard copy accounting records shall retain the original volume's packaging at the time of handover. At the time of handover of electronic accounting records, electronic accounting records and the metadata shall be handed over together, and the document format shall comply with the relevant provisions of the State on administration of archives. Special format electronic accounting records shall be handed over together with the accessible platform.

### Requirements to Prepare Financial Statements in Local Currency

RMB is the reporting currency of an enterprise. Certain foreign currency may be used as the reporting currency for an enterprise heavily engaged in foreign currency transactions. However, foreign currency transactions should be restated into the reporting currency when financial statements are prepared and submitted.

### What GAAP must the Financial Statements be Prepared Under?

Financial statements must be prepared according to national accounting standards, which are substantially converged with IFRS Standards.

### Prescribed Format and Details for Financial Statements

Annual and half-year financial and accounting reports include: (i) financial statements; (ii) annotations to accounting statements; and (iii) an explanation of the financial situation. The financial statements include balance sheet, income statement, cash flow statement, statement of stockholders equity and corresponding attachments.

### Filing Due Date

Interim financial statements shall be submitted to the tax authorities on quarterly basis, i.e., within 15 days of the end of each quarter; annual financial statements shall be submitted to the tax authorities within 5 months from the end of the each tax year.

### Filing Format of Financial Statements



The requirement may be various in different location. If a taxpayer files its tax return online, then it may submit the financial statements to tax authorities via online system, by using the format provided by the system.

### **Filing Extension Availability and Details**

An extension of time for the submission of financial statements may be subject to the approval on the extension of submission of tax return to the tax authorities.

## 1.5 Incentives

### Intellectual Property Incentives

PRC resident enterprises that own the intellectual property used in the products or services they supply may be recognized as high-tech enterprises, as long as the products/services fall within certain high-tech fields supported by the State, and other qualification criteria are met. These companies can enjoy a reduced 15 percent CIT rate, instead of the 25 percent standard CIT rate.

### R&D Incentives

Qualifying R&D expenses enjoy an additional 50 percent deduction for CIT purposes. From 1 January 2017 to 31 December 2019, qualifying R&D expenses incurred by science and technology small and medium enterprise may enjoy additional 75 percent deduction for CIT purposes. The Chinese government announced on 23 July 2018 that the additional 75 percent deduction incentive will be extended to all enterprises in China going forward (effective date is yet to be announced).

From 1 January 2018, 80% of the amount of an R&D payment made to an overseas service provider, under an R&D outsourcing arrangement, can qualify for the super deduction incentive (the 80% cap already existed for payments to domestic outsourced R&D service providers). A further limitation also exists that the super deduction for the outbound payments may only be enjoyed to the extent that they do not exceed two thirds of the total qualifying R&D expenses incurred within China.

### Other Incentives

Companies located in the western region of the PRC, and which conduct business in encouraged industries or projects (with revenue from the encouraged business representing more than 70 percent of its total revenue in a tax year), are eligible for the reduced 15 percent CIT rate, instead of the 25 percent standard CIT rate.

Recognized advanced technology service enterprises can pay CIT at the reduced rate of 15 percent, instead of the 25 percent standard CIT rate.

Income earned from major state-supported public infrastructure facility projects can be approved by the relevant authorities to be exempt from CIT for the first to the third year, and subject to 50 percent reduction in CIT for the fourth to the sixth year, commencing from the first year of generating the project revenue.

Income earned from qualifying environment protection projects, and water or energy saving projects is exempt from CIT for the first to the third year and subject to a 50 percent reduction in CIT for the fourth to the sixth year, commencing from the first year of generating the project revenue.

Companies purchasing prescribed equipment that aids in the advancement of various environmental or other goals, such as protecting the environment, conserving water or reducing energy usage, and enhancing production safety, are eligible for a CIT credit equivalent to 10 percent of the qualifying equipment investment cost. This credit is applied against the current year's CIT payable, with any unutilized credit to be carried forward for the following five tax years.

Income of up to RMB 5 million earned from the transfer of qualifying technology by a PRC company is exempt from CIT, while the excess income amount is subject to a 50 percent reduction in CIT.

### Special Tax Regimes for Specific Industries or Sectors

#### *Agriculture, forestry, animal husbandry and fisheries*

Income earned by PRC resident enterprises from activities in agriculture, forestry, animal husbandry and fisheries may be entitled to CIT exemptions and reductions, dependent on the categories of business the companies are engaged in. Income from preliminary processing of certain agricultural products may also be entitled to CIT exemptions.

#### *Integrated circuit and software industry*

A qualifying software manufacturing company is entitled to the preferential treatment of two years exemption from CIT, followed by three years with a 50 percent reduction in CIT, commencing from its first profit-making year. A reduced CIT rate of 10 percent is also available to certain key software companies as designated by the Government.

Chinese enterprises producing integrated circuits with particular product specifications are eligible for different preferential CIT treatments depending on the product sophistication. The available preferential treatments include a reduced 15 percent CIT rate, two years exemption from CIT followed by three years with a 50 percent reduction in CIT commencing from its first profit-making year, and five years exemption

from CIT followed by five years with a 50 percent reduction in CIT commencing from its first profit-making year.

*Small and low-profit enterprises*

From 1 January 2018 to 31 December 2020, eligible small and low-profit enterprises whose taxable income falls under RMB 1 million may pay CIT on 50% of their whole income at a rate of 20%.

*Venture capital*

A venture capital (VC) enterprise that invests in a non-listed small to medium-sized high and new technology enterprise for more than 2 years may deduct an amount up to 70% of its investment from the taxable income. Unused allowance may be carried forward to the following years.

From 1 January 2018, a VC enterprise investing in science and technology enterprises at seed capital or start-up stage, 70% of the investment amount can be offset against the taxable income of the VC enterprise for CIT purposes if certain conditions are met.

## 1.6 International Taxation

### Double Taxation Relief

A credit against CIT imposed on a Chinese enterprise is granted for foreign tax, paid on foreign sourced income. Two credit methods:

- 'Country-by-country' credit method, under which the FTC for foreign tax is limited to the China CIT payable on foreign income, as calculated on country-by-country basis.
- 'Integrated credit method', under which income from all countries (and of all types) will be considered together for the calculation of the FTC limits.

The 'integrated credit method' applies from 1 January 2017. Taxpayer may elect either of the two credit methods. Once the election is made, it may not be changed within 5 years (Cai Shui [2018] No. 4).

Indirect tax credit that may be claimed for 'underlying' foreign taxes (i.e., taxes imposed on foreign subsidiaries and sub-subsidiaries). The China FTC calculation now may go down as far as the fifth tier (third tier prior to 2017) of foreign subsidiaries (in which there is a direct or indirect 20% shareholding).

### Foreign-Exchange Controls

The RMB is not fully convertible and PRC imposes control over all types of foreign exchange (FX) transactions across its borders. FX settlement for current account transactions is relatively straightforward and from 2009, the RMB has been increasingly used for cross border trade settlement. Currently, capital account transactions are still subject to restrictive treatment.

However, procedures are being streamlined (for example with the SAT Announcement 40 [2013]) simplification of tax clearances required in the FX settlement process, and capital account FX settlement relaxation under the Shanghai Free Trade Zone pilot program) which may herald further national level liberalization in the future.

Foreign enterprises in pilot free trade zones now are allowed to convert their foreign currency holdings, in their domestic foreign accounts, in China into RMB (Hui Fa [2017] No. 3).

### International Withholding Tax Rates

**Dividends** paid to a non-resident enterprise are subject to withholding tax (WHT) at 10 percent (this rate may be reduced under certain treaties). A 20 percent base rate applies for payments to individuals (this rate may be reduced under applicable treaties, subject to anti-abuse rules and beneficial ownership requirements).

For distributed profits of a foreign invested enterprise (FIE), where the relevant amounts are reinvested in 'encouraged' projects in China, the dividend WHT may be deferred if certain conditions are met. The encouraged projects include those listed in the 'Catalogue of Industries for Guiding Foreign Investment' or 'Catalogue of Priority Industries for Foreign Investment in Central and Western China'. This incentive retroactively applies from 1 January 2017. The relief is applicable to profits distributed to foreign investors, on or after that effective date. Any foreign investors who are entitled to the concession, but which have paid WHT previously, can retroactively apply for the benefit and claim tax refunds within 3 years of payment (Cai Shui [2017] No. 88).

**Royalties** paid to a non-resident enterprise are subject to WHT at 10 percent (this rate may be reduced under certain treaties, subject to anti-abuse rules and beneficial ownership requirements). In addition, 6 percent VAT and local levies will apply. A 20 percent base rate applies for payments to individuals. In administrative practice, the concept of royalties can be interpreted broadly to capture payments for services that are considered to involve transfer of know-how, or facilitate the use of licensed IP (this is argued under the royalties' article of treaties as Chinese treaties only include technical service articles in very limited cases). Payments for digital services involving incidental use of copyright (e.g. software license fees) and for use of software processes (e.g. cloud computing) can be readily caught under the royalty category as well.

**Interest** paid to a non-resident is subject to WHT at 10 percent (this rate may be reduced under certain treaties, subject to anti-abuse rules and beneficial ownership requirements). In addition, 6 percent VAT and local levies will apply (VAT applies to interest from 1 May 2016; BT had applied at 5 percent up to that point in time). A 20 percent base rate applies for payments to individuals.

## Withholding Tax Rates under the Income Tax Treaties

### People's Republic of China – Treaty Withholding Rates Table

	Dividends		Interest	Royalties
	Individuals, companies	Qualifying companies		
	(%)	(%)	(%)	(%)
<b>Domestic Rates</b>				
<b>Companies:</b>	30 (27.5)	30 (27.5)	30 (27.5)	30 (27.5)
<b>Individuals:</b>	Individual's marginal tax rate	Individual's marginal tax rate	Individual's marginal tax rate	Individual's marginal tax rate
<b>Treaty Rates</b>				
<b>Albania</b>	10	10	10	10
<b>Algeria</b>	10	5	7	10
<b>Armenia</b>	10	5	10	10
<b>Australia</b>	15	15	10	10
<b>Austria</b>	10	7	10	10
<b>Azerbaijan</b>	10	10	10	10
<b>Bahrain</b>	10	10	10	10
<b>Bangladesh</b>	10	10	10	10
<b>Barbados</b>	10	5	10	10
<b>Belarus</b>	10	10	10	10
<b>Belgium</b>	10	5	10	7
<b>Bosnia and Herzegovina</b>	10	10	10	10
<b>Brazil</b>	15	15	15	15/25
<b>Brunei</b>	5	5	10	10
<b>Bulgaria</b>	10	10	10	7/10
<b>Canada</b>	15	10	10	10
<b>Chile</b>	10	10	4/5/10/15	2/10
<b>Croatia</b>	5	5	10	10
<b>Cuba</b>	10	5	7.5	5
<b>Cyprus</b>	10	10	10	10

Treaty Rates	Dividends	Dividends (Qualifying)	Interest	Royalties
Czech Republic	10	5	7.5	10
Denmark	10	5	10	10
Ecuador	5	5	0/10	10
Egypt	8	8	10	8
Estonia	10	5	10	10
Ethiopia	5	5	7	5
Finland	10	5	10	10
France	10	5	10	10
Georgia	10	0/5	10	5
Germany	10	5 /15	10	6/10
Greece	10	5	10	10
Hong Kong (SAR)	10	5	7	5/7
Hungary	10	10	10	10
Iceland	10	5	10	10
India	10	10	10	10
Indonesia	10	10	10	10
Iran	10	10	10	10
Ireland	10	5	10	10
Israel	10	10	7/10	10
Italy	10	10	10	10
Jamaica	5	5	7.5	10
Japan	10	10	10	10
Kazakhstan	10	10	10	10
Korea (Rep.)	10	5	10	10
Kuwait	5	5	5	10
Kyrgyzstan	10	10	10	10
Laos	5	5	10	10
Latvia	10	5	10	10
Lithuania	10	5	10	10

Treaty Rates	Dividends	Dividends (Qualifying)	Interest	Royalties
Luxembourg	10	5	10	10
Macau (SAR)	10	5	7	5/7
Macedonia (FYR)	5	5	10	10
Malaysia	10	10	10	10/15
Malta	10	5	10	10
Mauritius	5	5	10	10
Mexico	5	5	10	10
Moldova	10	5	10	10
Mongolia	5	5	10	10
Morocco	10	10	10	10
Nepal	10	10	10	15
Netherlands	10	5	10	10
New Zealand	15	15	10	10
Nigeria	7.5	7.5	7.5	7.5
Norway	15	15	10	10
Oman	5	5	10	10
Pakistan	10	10	10	12.5
Papua New Guinea	15	15	10	10
Philippines	15	10	10	10/15
Poland	10	10	10	10
Portugal	10	10	10	10
Qatar	10	10	10	10
Romania	0/3	0/3	0/3	3
Russia	10	5	0	6
Saudi Arabia	5	5	10	10
Serbia and Montenegro	5	5	10	10
Seychelles	5	5	10	10
Singapore	10	5	7/10	10
Slovak Republic	10	10	10	10

Treaty Rates	Dividends	Dividends (Qualifying)	Interest	Royalties
<b>Slovenia</b>	5	5	10	10
<b>South Africa</b>	5	5	10	10
<b>Spain</b>	10	10	10	10
<b>Sri Lanka</b>	10	10	10	10
<b>Sudan</b>	5	5	10	10
<b>Sweden</b>	10	5	10	10
<b>Switzerland</b>	10	5	10	9
<b>Syria</b>	10	5	10	10
<b>Tajikistan</b>	10	5	8	8
<b>Thailand</b>	20	15	-/10	15
<b>Trinidad and Tobago</b>	10	5	10	10
<b>Tunisia</b>	8	8	10	5/10
<b>Turkey</b>	10	10	10	10
<b>Turkmenistan</b>	10	5	10	10
<b>Ukraine</b>	10	5	10	10
<b>United Arab Emirates</b>	7	7	7	10
<b>United Kingdom</b>	10	5/15	10	10
<b>United States</b>	10	10	10	10
<b>Uzbekistan</b>	10	10	10	10
<b>Venezuela</b>	10	5	5/10	10
<b>Vietnam</b>	10	10	10	10
<b>Zambia</b>	5	5	10	5
<b>Zimbabwe</b>	7.5	2.5	7.5	7.5

**Note:**

Please note, the maximum rates of withholding under each treaty have been included in the table, however in certain cases an alternative rate, or nil rate, may apply depending on whether certain criteria are met. In this regard, the table should be used as a guide and not relied upon in isolation.

### Other Agreements

China has realized exemption of indirect taxes on international transport services with over 60 countries/regions in the form of different types of inter-governmental agreements such as tax agreements, international transport agreements, and exchange of documents between the governments.

### Income Tax Treaties for the Avoidance of Double Taxation (Negotiated, not yet in force at time of Publication)

New treaties, arrangements, and amendment protocols with Botswana, Taiwan, Uganda and Kenya are not yet in force. China's treaties will see extensive amendment under the OECD's multilateral instrument (MLI). At the time of writing, 83 jurisdictions had committed to the MLI and these matched to China in 57 cases. This means that more than half of China's 106 treaties (including treaties with sovereign states and arrangements with non-sovereign jurisdictions) would see MLI updates. The MLI updates cover the treaties with China's major OECD trading partners (with the exception of the US) and partly cover treaties with China's BRICS trading partners (excluding Brazil and India).

### **Agreements for the Exchange of Information**

China has entered into agreements for the exchange of tax information with Bahamas, the British Virgin Islands, the Isle of Man, Guernsey, Jersey, Bermuda, Argentina, Cayman, San Marino, and Liechtenstein.

### **Indirect Offshore Disposal Rules**

Arrangements executed by non-resident enterprises, which indirectly transfer the shares or other properties in a Chinese enterprise (without reasonable commercial purposes in order to avoid enterprise income tax in China) must be re-characterized as direct transfer with reference to article 47 of the CIT law (SAT Announcement [2015] No. 7, "Announcement 7").

Announcement [2017] No. 37 states that the tax authorities will now prescribe a timeframe for sellers to pay tax, where the withholding agent fails to do so, and that payment within this period would be recognized by the Chinese tax authorities as being "on-time settlement". There is a degree of uncertainty as to whether the late interest portion would be imposed on the seller if the tax was paid to the China tax authorities within the prescribed timeframe (as set by the authorities under Announcement 37), but after the June due date, as stipulated under Announcement 7.

## 2 Transfer Pricing

### Requirements

PRC tax law contains a set of rules that allows for income adjustment by tax authorities on related party transactions if transfer prices are not determined at an arm's length.

A company can enter into an Advance Pricing Agreement with the tax authorities for transfer pricing purposes.

Taxpayers can request that the competent authorities activate the Mutual Agreement Procedure process, pursuant to the relevant tax treaties, to seek relief from double taxation.

### Country-by-Country Reporting

An annual related party transactions filing (due 31 May) applies. The required detail has been expanded significantly post-BEPS, with addition of a country-by-country (CBC) report. This must be filed where the relevant thresholds are exceeded and the parent company (or designated surrogate CBC filer) is in China. Mechanisms are in place for the Chinese tax authorities to obtain CBC reports from other countries where the group parent companies are overseas. CBC reporting and exchange will be commenced by China from 2018.

### Master and Local Files Reporting

Contemporaneous TP documentation is required to be kept on file if certain threshold conditions are met. For contemporaneous TP documentation filed in 2017 and subsequent years, a BEPS Master File-Local File structure applies. This is supplemented by a so-called Special Documentation requirement if the enterprise is subject to Thin Capitalization rules and/or engages in a Cost Sharing Arrangement. Local Files/Special Documentation need to be prepared by 30 June after the tax year, so the first Local File under the new approach will be prepared for fiscal year 2016 by 30 June 2017. These changes from the 31 May date under the pre-BEPS documentation. Master Files, if required, must be prepared within 12 months of the end of the fiscal year.

### Common Reporting Standard

China is set to commence Common Reporting Standard (CRS) exchanges in September 2018. To facilitate this, financial institutions in China are currently putting the systems and protocols in place to enable collection and reporting of the requisite non-resident account holder information. China has signed the CRS Multilateral Competent Authority Agreement (MCAA) and has activated 57 bilateral exchange relationships through it, with more to follow.

# 3 Indirect Tax

## Indirect Tax

VAT and Consumption Tax

### Standard Rate

VAT is, subsequent to the completion of the 2012-2016 Business Tax (BT) to VAT reform on 1 May 2016, generally imposed on sales of goods and provision of services. VAT applies at rates of 3% (small enterprise simplified VAT scheme), 6% (many types of service), 11% (construction, real estate, financial services and certain categories of goods), and 17% (the standard rate applied to most types of goods).

Starting 1 July 2017, goods that were previously subject to a rate of 13% (e.g. agricultural products, natural gas, etc.) became subject to the 11% rate when both bands were consolidated. Further consolidation of the rate bands is forthcoming in 2018.

Starting 1 May 2018, sectors (such as manufacturing) that are subject to a rate of 17% will become subject to the reduced 16% rate, and certain sectors/goods, such as transportation, construction, basic telecom services, agricultural products that are subject to a rate of 11% will become subject to the reduced 10% rate.

### VAT Reform

Effectively from May 1, 2016, China fully implemented its VAT reform. Whereas as service supplies, transfers of IP and immovable property were formerly subject to BT, these all transitioned to VAT. Grandfathering relief is applicable to real estate and construction industries so that former BT rates are replicated under VAT for properties where construction commenced before 1 May 2016, or for properties that are held as at 1 May 2016 and are later sold or leased. The VAT rate of 11 percent is applied to new developments commenced post 1 May 2016, or on the 2nd sale which takes place post 1 May 2016 (excluding residential properties held by individuals).

Generally, exports are subject to zero rate of VAT with varying degrees of refund available for related input credits. A refund of input VAT incurred on materials purchased domestically for the export of goods is available but as VAT refund rates vary from 0 percent to 17 percent, certain products do not enjoy a full refund of input VAT. Exports of services are generally exempt from VAT, not zero rated (except for R&D, design, certain international transportation services and offshore outsourcing services). Exemption from VAT means that related input VAT credits must be denied or 'transferred out'. VAT returns generally are filed on a calendar month basis.

### Further Information

For more detailed indirect tax information, refer to:

[KPMG's 2017 Asia Pacific Indirect Tax Country Guide](#)

# 4 Personal Taxation

## Top Rate

The top tax rate for individuals' employment income is 45 percent (applies on monthly taxable salary income of greater than RMB 80,000).

Different tax rates apply depending on the sources of income.

China plans to reform its individual income tax law in 2018. At the time of writing, the proposed amendments are still under public consultation.

## Social Security

Employers and Employees must both make contributions to Social security insurance (SSI). Rates of both employer and employee contributions vary depending on the fund category and location in the PRC.

Employer contributions to SSI apply to the pension, medical, unemployment, maternity, and injury funds (A pilot program to merge the social security contribution made by employees and employers under the maternity insurance and employees' basic medical insurance schemes is being piloted in 12 cities, including Handan, Jinzhong, Shenyang, Taizhou, Hefei, Weihai, Zhengzhou, Yueyang, Zhuhai, Chongqing, Neijiang and Kunming).

Employee contributions to SSI apply to the pension, medical, and unemployment funds.

## International Social Security Agreements

- Germany
- Korea (Republic of)
- Denmark
- Finland
- Switzerland
- Canada
- Netherlands
- Spain
- France (entered into 2016, not yet effective)
- Luxembourg (entered into in 2017, not yet effective)
- Japan (entered into 2018, not yet effective)
- Serbia (entered into 2018, not yet effective)

China is also negotiating agreements with further countries, including Belgium and Romania.

## Visa Requirements

A simplified work visa (Z-visa) application process applies from 13 March 2017. A foreigner can apply for a Z visa with an overseas Chinese embassy, consulate or (air)port visa office by submitting its passport or equivalent ID, and a work permit notification letter issued by the respective labor bureau in China.

## Further Information



For more detailed personal taxation information, refer to:

[KPMG's Thinking Beyond Borders](#)

# 5 Other Taxes

## Consumption Tax ('CT')

CT applies to the manufacturing, processing, importation, or selling of 14 different kinds of goods in PRC, principally luxury goods.

No standard rate applies as CT rates differ depending upon factors such as the stage of production at which the sale occurs, type, weight, or capacity.

## Stamp Duty

PRC stamp duty is imposed at rates ranging from 0.005 percent to 0.3 percent with respect to documents executed or used in the PRC.

From 1 May 2018, stamp duty on capital account injections will be levied at a reduced 0.025% rate. Stamp duty is also currently levied at fixed amounts (i.e. RMB 5 per document) on certain types of documents (such as land use certificates, business licenses). This levy will also be scrapped from 1 May 2018.

## Land Appreciation Tax (LAT)

The Land Value Appreciation Tax imposes tax on the appreciated value arising from the transfer of land-use rights, after the deduction of certain specified items.

## Real Estate Tax

The urban real property tax is a local tax imposed on the owner or user of a building at the rate of either:

- 1.2 percent of assessed value (calculated as the original value, less a discount of between 10 to 30 percent, as determined by the local government); or
- 12 percent of rentals in the case of leased property.

The tax is imposed on an annual basis and collected periodically as determined by local government.

## Environmental Protection Tax ('EPT')

The environmental protection tax replaces pollution discharge fees imposed on taxable pollutions from 1 January 2018. The taxable pollutions include air pollution, water pollution, solid waste, and noise pollution.

## Other Taxes

There is a vast array of other forms of taxation applicable to various business or investment activities in PRC, including Urban Maintenance & Construction Tax, Education Levy, Cultural Business Levy, and Deed Tax. In addition, PRC has various mining taxes and motor vehicle taxes.

# 6 Trade & Customs

## 6.1 Customs

### Customs Duty

Import and export duties are imposed on most imports and a limited number of exports. Customs duties that apply from 1 January 2018 has been released by the Tariff Commission of the State Council on 12 December 2017 (Shui Wei Hui [2017] No. 27).

Import of retail goods up to RMB 2,000 through e-commerce (B2C) is exempt from customs duty (Cai Guan Shui [2016] No. 18).

From 1 July 2018, import duties on automobiles (under 139 HS codes), auto parts (under 79 HS codes) and 1449 daily consumer goods are reduced (Shui Wei Hui [2018] No. 3 and No. 4).

Advance ruling regime has been introduced in China's Customs from 1 January 2018. An applicant may, prior to its actual import or export of goods, apply for advance rulings on the following:

- Classification of goods imported or exported;
- Place of origin, or qualifications as original products, for imported and exported goods;
- Relevant factors for dutiable value and valuation methods for imported goods. "Relevant factors for dutiable value" include royalties, commissions, insurance premiums and freight fees, special relationships and other factors related to the determination of dutiable value; and
- Other customs affairs stated by the General Administration of Customs (GAC).

### Excise Duty

See 'consumption tax' section above.

## 6.2 Free Trade Agreements (FTA)

### In Force

#### Regional Multilateral Free Trade Agreements

##### *Asia-Pacific Trade Agreement*

Member countries:	China	Bangladesh	India
	Laos	Korea	Sri Lanka

##### *China and ASEAN Free Trade Area Trade Agreement*

Member countries:	China	Brunei	Indonesia
	Malaysia	Philippines	Singapore
	Thailand	Cambodia	Laos
	Myanmar	Vietnam	

#### Bilateral Free Trade Agreements

Australia	Hong Kong (SAR)	Macau (SAR)	Peru
Chile	Iceland	New Zealand	Singapore
Costa Rica	Korea	Pakistan	Switzerland

Taiwan

Georgia

Maldives

### In Negotiation

New bilateral free trade agreements are in negotiation with Norway, Sri Lanka, Israel, Mauritius, Moldova and Panama.

New multilateral free trade agreements are in negotiation with Gulf Cooperation Council (member countries include the United Arab Emirates, Oman, Bahrain, Qatar, Kuwait, and Saudi Arabia); Regional Comprehensive Economic Partnership (RCEP), involving the ten ASEAN nations, China, Japan, Australia, New Zealand, Republic of Korea, and India; as well as a joint agreement with Korea and Japan

Source: [China FTA Network](#)

# 7 Tax Authority

## Tax Authority

The State Administration of Taxation (SAT) is the national tax authority, which provides guidance to various local tax authorities.

Link to [State Administration of Taxation](#)

Depending on the region within PRC, there is often a State Tax Bureau (STB) responsible for taxes such as Income Tax and VAT and a Local Tax Bureau (LTB) that manages taxes such as the Business Tax within their area.

Currently, China's State Council is in the process of merging many government authorities and agencies. This includes merging LTBs and STBs, which have up to now separately administered tax revenues flowing to local governments and to the central government.

All provincial LTBs were officially merged into STBs on 15 June 2018. According to the reform plan, the merger of LTBs and STBs below provincial level was to be completed before the end of July 2018.

## Tax Audit Activity

The tax authorities historically conduct audits on a random selection basis. However, they have increasingly adopted a risk-based approach to the selection of returns for audit. A tax audit may be commenced on any tax return filed. Companies may expect to be audited by the tax authorities every 5 to 6 years.

The tax audit process can be lengthy, and usually involves the following steps:

- The tax authority's initial review of questionnaires or forms completed by taxpayers at the request of the tax authority
- Visits to the taxpayer's office and examination of financial, accounting, tax and other related documents
- Discussions and negotiations between the taxpayer and tax authorities regarding the issues raised in the course of the tax audit
- Internal review and approval by the tax authorities of a proposed settlement, or additional assessment, as appropriate
- Issuance of a determination notice by the tax authority

Taxpayers are advised to contact their tax advisor immediately when a tax audit commences or any audit related correspondence is received from a tax authority.

## Appeals

If a taxpayer disagrees with a tax assessment from a tax authority, it may submit an appeal to a higher-ranking tax authority for reconsideration. However, before submitting the appeal application, the tax payment must be settled first.

Applications for an appeal must be made within 60 days of receipt of the tax assessment notice. If the taxpayer is dissatisfied with the decision of the higher-ranking tax authority, it may file legal proceedings with the People's Courts.

## Tax Governance

In 2011, the Chinese tax authorities introduced a new tax management process called the tax compliance agreement (TCA). The TCA system is similar to the horizontal monitoring system in the Netherlands, and is developed from the notion that a well-established tax risk control framework for enterprises will reduce tax non-compliance risks.

In short, a TCA is a legal agreement entered into between a taxpayer and its in-charge tax bureau. The agreement normally states the obligations of the tax bureau and the taxpayer, at least in broad terms. For example, the tax bureau may promise that it will:

- Respond to the taxpayer's inquiries with more definitive responses
- Assist the taxpayer with improving their internal tax risk control system
- Eliminate repetitive tax inspections

The taxpayer may promise to:

- Maintain good tax compliance status
- Build an effective internal tax risk control system
- Make timely disclosures to the tax bureau on significant tax matters

Under a TCA, the tax authorities still supervise taxpayers. However, such supervision will be conducted with a higher level of understanding and trust.

### Current Topics for Focus by Tax Authorities

Key focus areas for tax authorities in tax audits conducted in recent years have included:

- Capital transactions such as equity investment and disposition
- Enterprises that are issued with VAT special invoices for finished oil products
- Enterprises that claim VAT refunds on exports of electronic products, garments, and furniture
- Trading companies that undertake export business on behalf of their clients
- Cross-border intercompany transactions.

Under the guidance of the SAT, local tax authorities sometimes use data analysis methodology technology to enhance the targeting and focus of their tax audit activity. Various local tax authorities have developed their own systems to identify red flags and select targets.



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