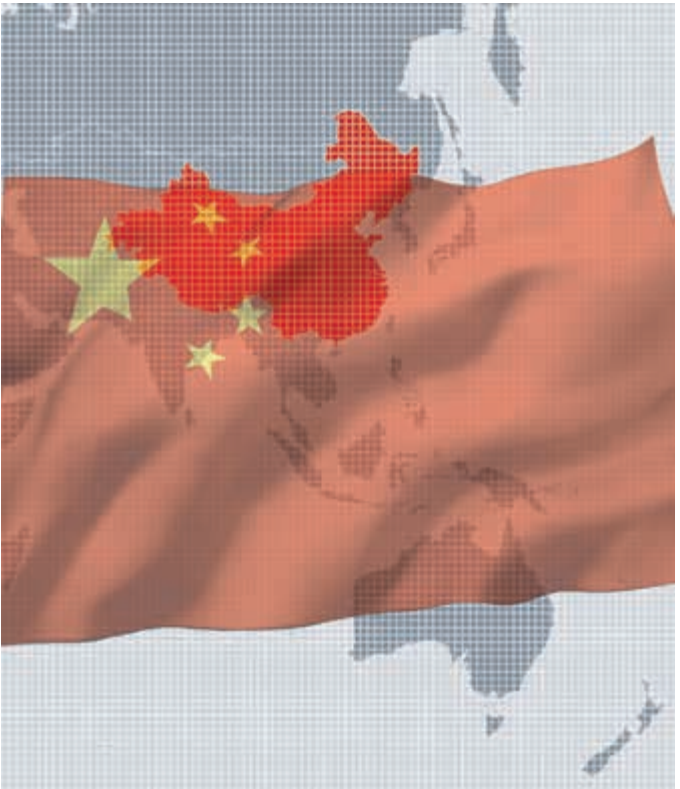


# Tax and Investment Facts

A Glimpse at Taxation and  
Investment in China



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# 1 Types of Business Structure / Legal Forms of Companies

There are several forms of legal vehicles for foreign enterprises:

- Wholly foreign owned enterprise (WFOE)
- Joint venture (JV) , equity joint venture (EJV) or cooperative joint venture (CJV)
- Partnership
- Representative office (RO) of a foreign enterprise.

For different types of establishments, the requirements may vary, depending on the category the foreign investment belongs to based on the foreign investment industrial guidance catalogue: encouraged, restricted or forbidden.

Enterprises and other organizations ("Companies") that obtain income from or generate income in the People's Republic of China (PRC) are corporate income tax (CIT) payers. Enterprises wholly-owned by an individual and partnership enterprises are not considered CIT payers.

Companies may be resident or non-resident in the PRC.

- Resident enterprises, established in the PRC, or established in a foreign country (region) but have their actual management functions conducted in the PRC, are required to pay CIT on income sourced within and outside of the PRC.
- Non-resident enterprises (NREs), which are established in a foreign country (region) with an office or premises located in the PRC (but without actual management functions performed in the PRC) or have income generated in the PRC without an office or premises in the PRC, must pay CIT for income sourced within the PRC and for income sourced outside the PRC which is connected with their establishment in the PRC. An NRE which has no office or premises established in the PRC, or its income has no de facto relationship with the office or premises, pay CIT only on PRC-sourced income.

### 2.1 Applicable Taxes / Tax Rates

CIT is applied at the rate of 25% for regular enterprises. The rate is 20% for qualified small enterprises with low profit and NREs which have no office or premises established in PRC or their income has no de facto relationship with the office or premises. The rate is 15% for qualified high-tech enterprises.

## 2.2 Resident Companies

### 2.2.1 Computation of taxable income

The taxable income is the total income of the enterprise in each tax year less non-taxable income, tax-exempted income, allowable deductions and the permitted amount of losses from previous years:

#### a) Income

The total income includes monetary and non-monetary forms of income received by the enterprise from different sources, including

- Sale of goods
- Providing labour services
- Transferring of property
- Equity investment (e.g. dividends and bonuses)
- Interest
- Rental
- Royalties
- Donations
- Deemed sales
- Other sources.

#### b) Non-taxable income:

- Financial fund appropriation
- Administrative and institutional expenses and government funds
- Other non-taxable income stipulated by the State Council.

#### c) Tax-exempted income

- Income from interest on national debt
- Gains from equity investment between resident enterprises
- Gains from equity investment obtained by an NRE with an office or premises established in the PRC from a resident enterprise which has a de facto relationship with the mentioned offices or premises

→ Income of qualified non-profit organizations.

#### d) Allowable deductions

The expenditure to be deducted must have been related to revenue and within a reasonable range. Special cases apply (see below).

#### Non-deductible amounts

The State Administration of Taxation (SAT) disallows deductions for expenditure that is unrelated to revenue. Examples of non-deductible amounts include:

- Dividends, bonus issues or other returns on equity investment issued to investors
- CIT payments
- Interest on late tax payments
- Penalties, fines and losses on confiscated property
- Sponsorship expenditure
- Reserve fund without being audited and approved by the SAT
- Capital expenditure
- Expenses incurred to obtain the non-taxable income
- Depreciation of unqualified fixed assets
- Amortization of unqualified intangible assets
- Asset investment costs during an external investment period
- Management fees between related parties
- Other expenses unrelated to income.

#### Limited deduction

Examples of expenses for which a limited deduction is available include:

- Employee benefits, up to 14% of wages and salaries
- Union funds, up to 2% of wages and salaries
- Employee education funds, up to 2.5% of wages and salaries; amounts in excess can be deducted in the following years
- Entertainment charges, deductible at 60% of the amount or a maximum of 5% of sales revenue

- Advertising and promotional expenses, up to 15% of sales (business) revenue; amounts in excess can be deducted in the following years
- Donations, up to 12% of the gross annual profits
- Handling charges and commission expenses. The limitation for property insurance companies is 15% of the premium income deducting surrenders value. The limitation for life insurance companies is 10% of the premium income deducting surrenders value. The limitation for any other company is 5% of the revenue amount of the agreement.

### Super deduction

Super deductions (up to 150% and 200%) may be available for the following expenses incurred by an enterprise:

- Research and development costs for the development of new technology, new products and new skills
- The wages paid by enterprises for disabled staff and for other personnel (as encouraged by the State)
- Depreciation of fixed assets, once approved by the tax authorities.

### e) Permitted amount of losses in previous years

The enterprise is allowed to carry losses forward to subsequent years for offset against income earned within five years.

## 2.2.2 Relief from double taxation

Income tax paid overseas may be used to reduce the amount of tax payable for the current period. The total allowable deduction is limited to the total tax imposed on such income by Chinese CIT law. Any excess foreign tax paid may be carried forward and deducted in a subsequent period, within five years.

## 2.2.3 Incentives

Tax incentives are also granted to key industries and projects supported and encouraged by the State.



The autonomous authorities of an ethnic autonomous region may reduce or waive the autonomous region's entitlement to a portion of the tax payable by enterprises of that region, with approval of the government.

## 2.3 Non Resident Enterprises (NREs)

### 2.3.1 Concept of permanent establishment

NREs with establishments in the PRC will be subject to CIT on all income sourced within the PRC and all income sourced outside the PRC that has a substantial relationship with such establishment or premises. Consistent with the general terms in the double taxation agreements (DTA) entered into by the PRC, only the business profits attributed to the permanent establishment (PE) constituted by the NRE in the PRC is subject to CIT in the PRC. The NRE is the relevant tax payer.

In general, the PRC follows the principle of the OECD Model and the UN Model in defining the term "PE". However, the PRC has adopted a wider definition of PE than the one reflected in the treaty of the OECD Model. In line with the OECD Model Convention, the term "PE" is defined as "a fixed place of business through which the business of an enterprise is wholly or partly carried on" in the DTAs concluded by the PRC. It includes especially:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

In addition to the above, in certain DTAs concluded by the PRC, the definition of "permanent establishment" also includes the following (which are not found in the OECD Model definition):

- a warehouse, in relation to a person providing storage facilities for others;
- a farm or plantation.

### 2.3.1.1 Computation of taxable income

#### a) Taxable income

The business profits attributed to the PE are subject to CIT in the PRC. A PE is required to maintain accurate and complete accounts to determine the actual profits. If a PE is unable to correctly compute taxable income due to inaccurate or incomplete accounts or other reasons, the Chinese tax authorities may assess the taxable income using one of the "deemed profit methods", namely:

#### → Actual revenue deemed profit method

The actual revenue and deemed profit method may be applied to determine the taxable income generated by the PE of an NRE in the PRC where revenue of the PE can be ascertained but not costs and expenditures. The general formula for computing the CIT amount is set out below:

$$\text{CIT} = \text{Gross Revenue} * \text{Deemed Profit Rate} * \text{CIT Rate}$$

#### → Cost-plus method

The cost-plus method may be applied in cases where the income attributable to the PE is not easily measurable, but the costs can be monitored accurately. This would be suitable for a trading agent PE.

$$\text{Gross Income} = \text{Cost} / [1 - \text{Deemed Profit Rate}]$$

$$\text{CIT} = \text{Gross Income} * \text{Deemed Profit Rate} * \text{CIT Rate}$$

#### → Expenditure-plus method

The expenditure-plus method may be applied in cases where the revenue and costs cannot be ascertained but expenditures can be ascertained.

The general formula for computing the CIT and Business Tax (BT) amounts is set out below:

$$\text{Gross Income} = \text{Expenditures} / (1 - \text{Deemed Profit Rate} - \text{BT rate})$$

$$\text{CIT} = \text{Gross Income} * \text{Deemed Profit Rate} * \text{CIT Rate}$$

If a PE arises in the PRC, the CIT would usually be calculated based on one of these three deemed methods. The deemed profit rate would range from 15% to 50% and is assessed by the PRC tax authorities on a case-by-case basis.

#### b) Tax rate

The applicable tax rate is 25%.

#### c) Tax incentive

Where a PE does not arise for the NRE, the NRE may enjoy a CIT exemption according to the DTA. As the CIT exemption is not applicable automatically. The NRE will need to comply with the exemption recording procedure of the tax authority in the PRC to enjoy the DTA benefit.

### 2.3.1.2 Administration of tax collection

The NRE is required to register with the tax authority – within 30 days after the project contract or agreement is concluded – at the place where the project is located and settles the relevant taxes.

### 2.3.2 Withholding taxes

PRC-sourced income derived by an NRE with no PE in the PRC, or by an NRE with a Chinese PE but to which the income is not connected, is subject to CIT (with the NRE being the relevant tax payer) on a withholding basis. In this case, the withholding agent has the direct obligation to make the relevant payment on behalf of the NRE. However, if the withholding agent fails to fulfil its withholding obligation, the NRE is required to declare and pay CIT to the tax authorities in charge at the location where the income is

derived within 7 days from the date of payment by the withholding agent or the date of the sum becoming due and payable.

### 2.3.2.1 Computation of taxable income

#### a) Taxable income

- Returns on equity investments such as dividends, bonuses, etc.
- Interest income
- Rental income
- Income from royalties
- Capital gains income, and
- Other income sourced from the PRC.

#### b) Tax rate

The applicable tax rate is 20%, which is further reduced to 10%.

#### c) Tax incentive

Returns on equity investments such as dividends, bonuses, etc.

- Dividend
- Interest
- Royalty, and
- Property income.

The beneficial-owner principle is examined by the tax authorities when deciding to grant a tax incentive to the NRE. A beneficial owner is a person who has ownership and control rights over the income, rights or property derived from the source of income. Conduit companies set up for the purposes of evasion or reduction of tax, or transfer or accumulation of profits, etc. attract the most attention of the tax authorities in relation to this issue.

Where a withholding agent is required to make payment before an application for tax reduction or exemption is approved, it must withhold the applicable CIT. The levied tax

will be refunded if the tax authorities later confirm that the NRE is entitled to a tax reduction, exemption or incentives under the tax treaty.

Unless the exemption application has been approved, the taxpayer or withholding agent should record the following with the tax authorities in charge:

- Business profits
- Independent personal services
- Non-independent personal services, and
- Others as required.

### **2.3.2.2 Administration of tax collection**

The withholding agent must declare and process withholding tax registrations with the tax authorities in charge within 30 days from the date of execution of the contract from which the tax liability arises.

### 3 Double Taxation Agreements

As of 16 September 2015, the PRC has concluded 1 multi-national tax treaty, 100 tax treaties, 2 tax arrangements and 1 tax agreement. Generally speaking, these treaties cover almost all of the PRC's important trading partners.<sup>1</sup>

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<sup>1</sup> Source: Website of the State Administration of Taxation.  
For details, please refer to <http://www.chinatax.gov.cn/n810341/n810770/index.html>

### 4.1 Annual related party transaction filing

An enterprise that has transactions with related parties is required to file the "Enterprise Annual Reporting Forms for Related Party Transactions of the People's Republic of China" when filing the annual CIT return.

These forms include detailed information of the amounts and types of related party transactions, controlled foreign company reports, and outbound payment status.

### 4.2 Transfer pricing documentation

Transfer pricing documentation must be prepared by enterprises that do not meet any of the following exemption requirements:

- Annual amount of related party tangible goods transactions is below RMB 200 million
- Annual amount of other related party transactions is below RMB 40 million
- The transactions are covered by an advanced pricing arrangement (APA)
- The foreign shareholding is below 50 percent and the enterprise only transacts with domestic related parties, or
- No annual loss is incurred by a wholly foreign owned entity (WFOE) with single or limited functions.

The transfer pricing documentation must cover the period from 1 January to 31 December of the calendar year, and must include five parts: organizational structures, business overview, related party transaction analysis, comparable analysis, and selection of transfer pricing methods.

Enterprises must prepare the transfer pricing documentation by 31 May of the following year and submit it within 20 days of a request by the tax authority.

### 4.3 Transfer pricing method

The "Regulation on Implementation of Corporate Income Tax Law" stipulates five acceptable transfer pricing methods for arm's length testing purposes, which are listed below:

- Comparable Uncontrolled Price Method (CUP) – The CUP method compares the prices of the same or similar transactions conducted between third parties with those of the related parties. It applies to all types of related party transactions.
- Resale Price Method (RPM) – The RPM compares the gross profit margin realized in the third party sales with the related party sales. It generally applies to the distribution transactions.
- Cost Plus Method (CPM) – The CPM compares the markup applied on the direct costs of third party transactions with the related party transactions. It generally applies to transactions involving transfer of tangible assets, provision of services, or financing.
- Profit Split Method (PSM) – The PSM determines the profits to be allocated to each related party based on their contribution to the consolidated profits generated from the related party transactions. It generally applies in the case that the related party transactions are highly integrated and difficult to separately assess the transaction results for each participant.
- Transactional Net Margin Method ("TNMM") – The TNMM compares the net margin indicators realized by an enterprise in the transactions with the related parties with the third parties conducting same or similar transactions with non-related parties. It generally applies to transfer of tangible assets, use and transfer of intangible assets, and provision of services.

### 4.4 Transfer pricing audit

The CIT law empowers the tax authorities with the right to make transfer pricing adjustments via a transfer pricing audit on enterprises if it is found that their related party transactions are not in line with the arm's length principle.



In general, companies with the following attributes are likely to be selected for a transfer pricing audit:

- substantial amount or various types of the related party transactions; or
- consecutive losses, low or fluctuating profit levels; or
- lower profit than the average of the industry, or the profit level does not match their functions and risks; or
- trading with the related parties located in tax havens; or
- failure to declare related party transactions and prepare transfer pricing documentation; or
- where there is an obvious inconsistency with the arm's length principle.

After being audited, enterprises are usually subject to the underpaid taxes determined by the transfer pricing adjustment, an interest charge at the rate of a contemporaneous bank loan on the underpaid taxes, and a penalty.

## 4.5 Advanced pricing arrangement

Advanced pricing arrangements (APAs) are generally applicable to enterprises satisfying all of the below criteria:

- The annual related party transaction volume exceeds RMB 40 million; and
- The obligations of all required related party transaction filings are fulfilled; and
- The required transfer pricing documentation is prepared, maintained and submitted.

An approved APA application for the enterprise will be effective for three to five years following the year in which the approval is granted.

## 5 Anti-avoidance Measures

The PRC has a relatively complete anti-avoidance system, with both general anti-avoidance rules ("GAARs") and special anti-avoidance rules ("SAARs") stipulated in CIT Law and the Implementation Regulations of CIT Law. Further guidance is found in the Administrative Measures for General Anti-Avoidance Rule and Implementation Regulations for Special Tax Adjustments (Guo Shui Fa [2009] No.2).

### 5.1 General Anti-avoidance Rule

On 2 December 2014, SAT issued the Administrative Measures on the General Anti-Avoidance Rule ("GAAR") (Trial Implementation), which provide comprehensive guidance on implementation of the GAAR, including elaboration on certain principles, adjustment methods, procedures throughout GAAR life cycle and relevant documentation requirements.

The Measures apply to CIT avoidance arrangements, which are arrangements established for the purpose of obtaining tax benefits but that lack any reasonable commercial purpose. The following two scenarios are specifically excluded from the application of these Measures:

- Arrangements not involving cross-border transactions or payment, and
- Failure / refusal to make tax payments, cheating of tax refunds, forging tax invoices, and other tax-related violations of law.

A tax avoidance arrangement is defined as an arrangement which has the following two features:

- The sole purpose or the main purpose of the arrangement is to obtain a tax benefit, and
- The tax benefit is obtained by using an arrangement permitted in accordance with the tax rules but not consistent with its economic substance.

Once the GAAR is invoked, tax authorities are empowered to make special tax adjustments by using any of the following methods to deny the tax benefits obtained through a tax avoidance arrangement:

- Re-characterizing all or part of the transactions in the arrangement
- Disregarding the existence of a transaction party for tax purposes, or treating relevant transaction parties as a single entity
- Re-characterizing relevant income, deductions, tax incentives, and foreign tax credit, or re-allocating these items among transaction parties, or
- Any other reasonable method.

The GAAR should serve as the last resort in countering aggressive tax avoidance arrangements, to be applied when all other tax adjustment rules have been exhausted.

## 5.2 Thin Capitalization Rules

According to the relevant provisions of the CIT Law and its Implementation Regulations, the interest fee incurred in excess of the prescribed criteria, obtained by enterprises from investments in debt securities and equity investment of their affiliates, may not be deducted from the taxable income.

According to Cai Shui [2008] No.121, an enterprise must observe the following criteria for the ratio between investments in debt securities and equity investment it accepts from the affiliated parties:

- In the case of a financial enterprise, 5:1; or
- In the case of any other enterprise, 2:1.

The above-mentioned "investments in debt securities" refers to the financing arrangements which are received directly or indirectly by an enterprise from its affiliated parties and for which principal and

interest will be paid, or any other form of compensation on which interest may be paid. Investments in Debt Securities indirectly entered into by an enterprise with its affiliated parties include:

- Investment in debt securities provided by an affiliated party through an arm's length third party; or
- Investment in debt securities provided by an arm's length third party and guaranteed or secured by a related party who assumes joint liabilities; or
- Other investments in debt securities received from an affiliated or related party which assumes the nature of debt.

The "equity investment" in the above provision refers to investments in which no repayment of principal and interest is required, and by which the investor has the ownership in the net assets of the invested enterprise.

In case an enterprise, in calculating taxable income, seeks to deduct interest expenses for which the associated liability-asset ratio exceeds the criteria ratio, the enterprise must prepare, maintain and, as required by the taxation authority, provide the contemporaneous documentation to prove that the amount, interest rate, term, and financing conditions of its associated debt investments as well as its liability-assets ratio, among others, comply with the arm's length principle.

Where an enterprise fails to prepare, maintain and provide the required contemporaneous documentation, the interest expenses paid by the enterprise in excess of the criteria ratio will not be deductible in calculating its taxable income.

### 5.3 Controlled Foreign Company Provisions

In the Controlled Foreign Company (CFC) legislation, pursuant to Article 45 of the CIT Law, a CFC refers to a company that is controlled by a resident company (or a resident company and

Chinese residents in an overseas country (or a region)) where the actual tax burden is obviously lower than the tax rate prescribed by Paragraph One of Article 4 hereof (i.e. 25%), and profits are not distributed or distributed at a reduced rate due to reasons other than reasonable business needs.

In such cases, the portion of the above profits that belongs to such resident companies is to be included in the income of the resident companies of the current period.

According to Guo Shui Fa [2009] No.2, if the Chinese resident company shareholder can provide documents to prove that the foreign company which is under its control satisfies one of the following conditions, the profits of the foreign company that are not distributed or are distributed at a reduced rate may be exempted from being regarded as a deemed dividend and may be excluded from the taxable income of the Chinese resident company for the current period:

- The controlled foreign company is located in a non-low tax rate country/region as recognized by the SAT or
- The revenue is mainly generated from active business operations; the annual profit does not exceed RMB 5 million.

Unlike some other countries, the PRC does not have the potentially unacceptable jurisdictions ("grey list") and unacceptable jurisdictions ("black list") in current legislation, while a white list is mentioned. Countries with acceptable tax levels ("white list") include Australia, Canada, France, Germany, India, Italy, Japan, New Zealand, Norway, South Africa, the U.K. and the U.S., as indicated in Guo Shui Han [2009] No. 37 issued by the SAT. If the CFC is located in one of these countries mentioned, the profits of the foreign company that are not distributed or are distributed at a reduced rate may be exempted from being regarded as a deemed dividend and may be excluded from the taxable income of the Chinese resident company for the current period.

This white list may be updated from time to time by the SAT if necessary. At present, the white list has not been updated since it was promulgated.

## 5.4 Non-resident Company Share Transfer

Previously, in cases of multi-national share transfers, companies had been relocating actual transactions that had originally taken place in the PRC to regions overseas, so as to enjoy an optional, more simplified and lower tax rate on the related capital gains. In view of such cases, the SAT promulgated a special regulation, Guo Shui Han [2009] No. 698 and issued Announcement [2015] No. 7 (Circular 7) in order to clarify tax issues regarding the non-resident company transfer of Chinese taxable property (including equity investment in Chinese companies, real property and assets in the PRC).

Where the foreign investing party (which is the actual controlling party) indirectly transfers shares in a Chinese resident company for an unreasonable commercial purpose in order to evade the corporate income tax obligation, the competent tax authorities may re-define the nature of such a share transfer transaction in accordance with its economic substance and deny the existence of the offshore holding company(-ies) used for such taxation arrangement.

Blacklist and safe-harbour scenarios were introduced in Circular 7. Even if the transaction is neither qualified by the blacklist criteria, nor falls under the safe-harbour situations, the transaction should be tested against the seven prevailing criteria that apply when assessing the commercial purpose of the transaction.

## 6.1 Residency Rules

Whether an individual is a Chinese resident is determined by one of following standards:

- Domicile rule: habitually resides in PRC due to household registration or family / economic involvement.
- Residence threshold: resides in PRC for one full tax year, which refers to any calendar year with temporary absence(s) from mainland PRC for not more than 30 consecutive full days or 90 cumulative full days.

## 6.2 Income Liable to Tax

Residents with a domicile in the PRC are subject to PRC individual income tax (IIT) on worldwide income, including PRC-sourced income and foreign-sourced income. Income derived by individuals includes cash, in-kind receipts, priced securities and economic interests in other forms.

Non-residents and residents without a domicile in PRC are normally subject to PRC IIT only on PRC-sourced income. However, once the threshold of 5 consecutive full years has been reached, they are taxed on worldwide income for each full tax year that they are in mainland China.

The table below summaries the taxation of employment income received by both residents and non-residents.

Days in PRC	Employment Income Paid by PRC Employer		Employment Income Paid by Non-PRC Employer	
	PRC Source of Income	Non-PRC Source of Income	PRC Source of Income	Non-PRC Source of Income
Not more than 90 days / 183 days if tax treaty applied in a calendar year	Taxable	Non-taxable	Non-taxable	Non-taxable
More than 90 days / 183 days if tax treaty applied in a calendar year but less than one full tax year	Taxable	Non-taxable	Taxable	Non-taxable
One full tax year or more, but not more than five consecutive full tax years	Taxable	Taxable	Taxable	Non-taxable
More than five consecutive full tax years	Taxable	Taxable	Taxable	Taxable

## 6.3 Allowable Deductions

### 6.3.1 Deduction allowed for employment income

- A standard deduction of RMB 3,500 may be applied to monthly employment income.
- An additional deduction of RMB 1,300 for expenses is applicable for IIT calculations in the following cases:
  - Foreign personnel working for foreign investment enterprises and foreign enterprises in the PRC.



- Foreign experts employed by enterprises, institutions, social groups and State bodies to work in the PRC.
- Individuals who have a domicile in the PRC and derive income from wages and salaries in relation to tenure of office or employment outside the PRC.
- Other personnel determined by the finance department and tax department of the State Council.

### 6.3.2 Fixed amount deduction/fixed rate deduction

A fixed amount deduction of RMB 800 or a fixed rate deduction, i.e. 20%, is applicable for income from personal services, income from author's remuneration, income from royalties and income from the lease of property.

### 6.3.3 Specific item deductions

- The costs, expenses and losses associated with production and business operations of individual industrial and commercial households may be deducted from the total income amount in each tax year.
- The requisite expenses associated with the contracted and leasing operations of enterprises and institutions may be deducted from income generated from these activities.
- The original value of the property and reasonable expenses may be deducted from the income derived from the transfer of property for IIT calculation purposes.

## 6.4 Non-taxable benefits

Reasonable allowances for housing, relocation, home leave, language training fees and children's education etc. for non-Chinese nationals may be tax-exempt from the employment income with the support of tax invoices.

Dividends and bonus income received by foreign individuals from foreign-invested enterprises and dividends distributed by listed company to individuals may be exempted from IIT in PRC.

Further exemptions may be granted from time to time by local governments to comply with state and/or local tax policies.

## 6.5 Tax rates

Under the current PRC IIT system, different categories of income are taxed at different tax rates using appropriate calculation methods.

### 6.5.1 Employment income

Employment income (wages and salaries) are taxed at progressive rates ranging from 3% to 45% as follows:

Grade	Monthly Taxable Income Amount (RMB)	Tax Rate (%)	Quick deduction (RMB)
1	RMB 1,500 or Less	3	0
2	The part exceeding RMB 1,500 and up to RMB 4,500	10	105
3	The part exceeding RMB 4,500 and up to RMB 9,000	20	555
4	The part exceeding RMB 9,000 and up to RMB 35,000	25	1,005
5	The part exceeding RMB 35,000 and up to RMB 55,000	30	2,755
6	The part exceeding RMB 55,000 and up to RMB 80,000	35	5,505
7	The part exceeding RMB 80,000	45	13,505

\* The monthly taxable income amount in the above table is the balance after the standard deduction of RMB 3,500 (plus any additional deduction of RMB 1,300) from the monthly employment income.

### 6.5.2 Income from personal services

Income from personal services is taxed at a flat rate of 20%.

Where one-off income derived from a specific personal service is excessively high, additional tax is levied according to the following tax rate table:

Grade	Monthly Taxable Income Amount (RMB)	Tax Rate (%)	Quick deduction (RMB)
1	RMB 20,000 or less	20	0
2	The part exceeding RMB 20,000 and up to RMB 50,000	30	2,000
3	The part exceeding RMB 50,000	40	7,000

\* The gross taxable income amount in the above table is the balance after a fixed-amount deduction of RMB 800 or a fixed rate deduction, i.e. 20% from the gross remuneration income.

### 6.5.3 Production and business operations income derived by individual industrial and commercial households & income from contract and leasing operations of enterprises and institutions

Progressive rates ranging from 5% to 35% are applied as follows:

Grade	Monthly Taxable Income Amount (RMB)	Tax Rate (%)	Quick deduction (RMB)
1	RMB 15,000 or less	5	0
2	The part exceeding RMB 15,000 and up to RMB 30,000	10	750
3	The part exceeding RMB 30,000 and up to RMB 60,000	20	3,750
4	The part exceeding RMB 60,000 and up to RMB 100,000	30	9,750
5	The part exceeding RMB 100,000	35	14,750

\* The taxable income amount in the above table is the balance after deduction of costs, expenses and losses from the total income amount from production and business operations of individual industrial and commercial households in each tax year; or the balance after deduction of the requisite expenses from the total income amount from contracted and leasing operations of enterprises and institutions in each tax year.

### 6.5.4 Other income

A flat rate of 20% is applicable to income from author's remuneration, royalties, interest, dividends and bonuses, lease of property, transfer of property, contingent income and other income.

## 6.6 Tax Compliance

In the PRC, there are mainly two methods for declaring IIT: the withholding method and the self-declaration method.

### 6.6.1 Withholding method

- A withholding agent is the organization or individual that pays the income to an income earner. When making payment of taxable amounts to individuals, withholding agents must withhold tax in accordance with the provisions of the IIT Law.
  
- Filing due date:  
Generally, monthly tax withheld by withholding agents must be paid to the treasury within 15 days of the following month and the tax returns must be filed with the tax authorities.

### 6.6.2 Self-declaration method

- The tax payer is the income earner. Individuals who fall under one of the following categories are required to make a self-declaration on an annual or monthly basis:
  - Those with annual income of RMB 120,000 or more (excluding non-PRC domiciled individuals who have not resided in the PRC for one full year during the relevant tax / calendar year)
  - Those who have offshore income
  - Those who receive salaries and wages from two or more sources within the PRC
  - Those who receive taxable income but without tax withholding agent – monthly tax reporting
  - Those who earn income from production and business operations of individual industrial and commercial households
  - Other situations specified by the PRC State Council.
  
- Filing due date:  
Monthly tax payable by taxpayers who make a declaration voluntarily is payable to the treasury within 15 days of the following month, and tax returns must be filed with the tax authorities by the relevant due dates.

The tax filing deadline for the annual IIT return is as follows:

Categories	Annual IIT Return Filing Deadline
Individuals with annual income $\geq$ RMB 120,000	March 31 in the following year
Individual industrial and commercial households	Prepayment within 15 days in the following month and final settlement within three months after the end of the tax year.
Individuals with offshore income	If the income is paid on a yearly basis, IIT must be filed within 30 days after the end of the tax year. If the income is paid on a periodic basis, IIT must be prepaid within 15 days each time the individual receives the income, the final settlement must be completed within three months after the end of the tax year.
Income from contract and leasing operations of enterprises and institutions	Within 30 days after the end of the tax year

## 6.7 Social Security Contributions

### 6.7.1 General rules of social security contributions

The Chinese government has established 5 types of basic social insurance. The contribution base for social insurance is generally the average monthly salary of the employee in the previous year. The rates for social insurance contributions for employee and employer vary depending on the location.

The table shows the types of social insurance and their rates in Shanghai and Beijing in the PRC for year 2015/2016 below (subject to annual changes):

City	Shanghai		Beijing	
	Employer's Portion	Employee's Portion	Employer's Portion	Employee's Portion
Basic pension insurance	21%	8%	20%	8%
Basic medical insurance	11%	2%	10%	2%+RMB 3
Unemployment insurance	1.5%	0.5%	1%	0.2%
Work-related injury insurance	0.5%	-	0.2%~3%	-
Maternity insurance	1%	-	0.8%	-
The upper limit for 2015/2016 monthly base salary for contribution	RMB 15,108		RMB 19,389	
The lower limit for 2015/2016 monthly base salary for contribution	RMB 3,022		RMB 2,585 (for pension and unemployment); RMB 3,878 (for other insurance items)	

Employers are required to withhold the monthly employee contribution, file both the employer and employee contributions, and complete the settlement to the local social security office.

### 6.7.2 Special rules for foreigners

Enforcement of the PRC's social security requirements on foreigners differs from region to region. In principle, foreigners are required to contribute, although German, Danish and Korean nationals may be exempted in certain insurance categories based on social security agreements between these countries and the PRC.

## 7 Indirect Taxes

### 7.1 Value Added Tax

#### 7.1.1 VAT taxpayers

Organizations and individuals engaging in the sale of goods, the provision of labour services for processing & repair and certain other services, or importation of goods in the PRC are required to pay value-added tax (VAT).

Taxpayers are categorized as general taxpayers and small-scale taxpayers:

Taxpayers whose annual VAT taxable sales amount or taxable service amount exceeds the standard stipulated by the Ministry of Finance and the SAT are general taxpayers.

The standards for "general taxpayers" are:

- Taxpayers engaging in manufacturing of goods or the provision of processing and repair labour services as well as taxpayers primarily engaging in manufacturing of goods or provision of processing and repair labour services and concurrently engaging in wholesale or retail of goods whose sales revenue subject to VAT in the year exceeds RMB 500,000 (excluding RMB 500,000);
- Taxpayers other than those stipulated in the item above whose annual taxable sales revenue exceeds RMB 800,000;
- Taxpayers whose annual VAT taxable sales revenue of taxable services (excluding the processing and repair service) exceeds RMB 5,000,000 (inclusive).

Taxpayers whose annual sales revenue of taxable services does not exceed the stipulated standard are small-scale taxpayers.

#### 7.1.2 VAT Rate and VAT Levying Rate

Tax rates for VAT general tax payers are generally as follows:



Consideration / Value of property	Tax Rates on VAT General Taxpayers	Tax Levying rate on Small-scale Taxpayers
Sale or importation of goods by a taxpayer in general; Processing and repair labour services provided by a taxpayer; Leasing services of tangible movable property.	17%	
Sale or importation of special goods by a taxpayer such as edible vegetable oils, etc.	13%	3%
Transportation services; Postal services; Basic telecommunication service	11%	
Modern services.	6%	
Goods exported by a taxpayer, unless otherwise stipulated by the State Council; International Transport Services (including Hong Kong, Macau and Taiwan); Air transport services; Qualified R&D services and design services provided to the overseas entities.	Zero	
Qualified engineering survey and exploration services, conference and exhibition services, warehousing services, leasing services of tangible movable property, postal services and collection & delivery services provided for exported goods, services provided overseas for distributing or broadcasting radio, film and television programs (works), advertising services, and some other taxable services provided to overseas entities	VAT Exemption	VAT Exemption

The VAT rate of 3% is applied to small-scale tax payers, individuals, and entities which do not incur VAT-liable business frequently.

VAT is being reformed currently in the PRC. It is likely in due course that financial and real estate development services will be subject to VAT, pending official announcements.

### 7.1.3 Calculation of VAT Payable

#### → For VAT general tax payers

As a general tax payer, the entity can enjoy a recovery mechanism by crediting the input VAT against its output VAT. Specifically, the formula for computation of tax amount payable is as follows:

VAT payable = output VAT for current period – input VAT for current period  
where the output VAT = NET sales amount × VAT rate.

The input VAT is the VAT paid or borne by a taxpayer for procurement of goods or acceptance of taxable labour services.

If the output VAT for the current period is less than the input VAT for the current period and insufficient for offsetting, the shortfall may be carried forward to the next period for offsetting.

#### → For small-scale tax payers – the simplified VAT computation method

Tax amount payable under the simplified tax computation method means the VAT amount computed based on the sales amount and VAT levying rate is not offset by the input tax amount. The formula for computation of the tax amount payable is as follows:

VAT payable = NET sales amount × VAT levying rate

#### 7.1.4 C=VAT refund (exemption)

##### → Scope of VAT refund (exemption)

Exportation of goods and VAT-liable services may obtain a VAT refund / exemption if they fall within the following categories:

- Exports by export enterprises
- Processing, repair and replacement services provided by export enterprises to overseas parties.
- Certain services as set out in item 7.1.2.

##### → Measures for VAT refund / exemption

Depending on the specific conditions, either of the following method could be used to apply for VAT refund / exemption.

##### → **Measures for tax exemption, credit and refund**

Exports manufactured and exported by manufacturing enterprises, deemed self-produced goods exported by manufacturing enterprises, processing, repair and replacement services provided to overseas parties and non-self-produced goods exported by listed manufacturing enterprises are exempted from VAT, and the corresponding input tax is credited to the payable VAT amount (excluding payable VAT amounts to which the policies of VAT refund-upon levy and first-levy-then-refund apply). The balance after the credit will be refunded. The VAT implication for provision of zero-rate services is the same as above.

##### → **Tax exemption and refund measures**

Exported goods and services of export enterprises without manufacturing capacity (hereinafter referred to as "foreign trade enterprises") or other entities are exempted from VAT, and the corresponding input tax is refunded. The VAT implication for provision of zero-rate services is the same as above.

## 7.1.5 Tax Compliance

### → Tax Payment Obligations

The deadlines for VAT payment are 1 day, 3 days, 5 days, 10 days, 15 days, monthly or quarterly. In practice, the monthly deadline is most commonly adopted. Taxpayers who opt for the monthly or quarterly tax payment period must declare and pay tax within 15 days from the date of expiry of the tax payment period.

Where taxpayers opt for a tax payment period of 1, 3, 5, 10 or 15 days, the tax must be prepaid within five days from the date of expiry of the tax payment period and a final declaration and payment must be made 15 days from the 1st day of the following month, in addition to settling in full any outstanding amount of tax payable for the preceding month fully.

### → The place of VAT payment

Businesses with a fixed establishment must declare and pay tax to the tax authorities in charge where the establishment or residence is located. Where the head office and branch are not located in the same county (or city), the head office and branch will need to declare and pay tax to the tax authorities in charge in their respective jurisdictions. The head office may, upon the approval by the Ministry of Finance and the SAT or their authorized finance and taxation authorities, declare and pay tax on a consolidated basis to the tax authorities in charge where the head office is located.

Businesses without a fixed establishment must declare and pay tax to the tax authorities in charge where taxable services take place. Where they fail to declare and pay tax, the tax authorities in charge of the business's region of establishment or residence will levy the tax retrospectively.

Withholding agents must declare and pay the tax withheld to the tax authorities in charge where the establishment or residence is located.

## 7.2 Business Tax

### 7.2.1 Business tax payers

Organizations and individuals engaging in the provision of labour services stipulated in the table below, transfer of intangible assets or the sale of real property in the PRC will be subject to Business Tax (BT).

### 7.2.2 Tax items and tax rates for Business Tax

Tax Item	Tax Rate
Construction industry	3%
Financial and insurance industry	5%
Cultural and sports industry	3%
Entertainment industry	5%–20%
Transfer of intangible assets	5%
Sale of real property	5%

### 7.2.3 Calculation of BT payable

The amount of tax payable by a taxpayer engaging in provision of taxable labour services, transfer of intangible assets or the sale of real property is computed pursuant to the turnover amount and the stipulated tax rate. The formula for computation of tax amount payable is:

$$\text{Tax amount payable} = \text{Gross turnover amount} \times \text{tax rate}$$

#### 7.2.4 Tax payment obligations and place

The amount of tax payable by a taxpayer engaging in provision of taxable labour services, transfer of intangible assets or the sale of real property is computed pursuant to the turnover amount and the stipulated tax rate. The formula for computation of tax amount payable is:

##### → Tax payment obligations

The tax payment obligation for business tax arises on the date on which a taxpayer collects the business revenue or obtains proof of business revenue for the provision of taxable labour services, transfer of intangible assets or sale of immovable property.

The deadline for payment of business tax must be 5 days, 10 days, 15 days, monthly or quarterly. The specific tax payment deadline for a taxpayer will be assessed respectively by the tax authorities in charge, having regard to the tax amount payable by the taxpayer. A taxpayer who is unable to pay the tax by the fixed deadline may pay tax on a transaction basis.

A taxpayer who opts for a monthly or quarterly tax payment period must file a tax return and make the tax payment within 15 days from the date of expiry of the tax payment period.

A taxpayer who opts for the tax payment period of five days, 10 days or 15 days must pre-pay the tax within 5 days from the date of expiry of the tax payment period, and file a tax return and make the tax payment within 15 days from the 1st day of the following month, as well as settle the tax amount payable for the preceding month fully.

##### → The place of BT payment

A taxpayer providing taxable labour services must file a tax return with, and make the outstanding tax payment to, the tax authorities in charge at the location or place of residence of the taxpayer. However, a taxpayer providing labour services

for the construction industry and other taxable labour services (as stipulated by the finance and tax authorities of the State Council) must file a tax return with, and make the tax payment to, the tax authorities in charge at the place of performance of the taxable labour services.

A taxpayer transferring intangible assets must file a tax return with, and make tax payment to, the tax authorities in charge at the location or place of residence of the taxpayer. However, a taxpayer transferring or leasing a land use right must file a tax return with, and make tax payment to, the tax authorities in charge at the location of the land plot.

A taxpayer selling or leasing real property must file a tax return with, and make tax payment to, the tax authorities in charge at the location of the real property.

A withholding agent must file a tax withholding return with and pay the tax withheld to the tax authorities in charge at the location or place of residence of the withholding agent.

## 7.3 Consumption Tax (CT)

### 7.3.1 Taxpayer and taxation scope

Units and individuals engaging in manufacturing, entrusted processing and importation of consumables are subject to consumption tax. Activities within this scope include:

- Manufacturing taxable consumer goods within the PRC
- Commissioning the processing of taxable consumer goods within the PRC
- Importing taxable consumer goods
- Selling taxable consumer goods stipulated by the State Council within the PRC.<sup>2</sup>

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<sup>2</sup> For tax objects and rates please refer to <http://www.chinatax.gov.cn/2013/n2925/n2956/c310093/content.html>

### 7.3.2 Tax base

Consumption tax payable is computed using the ad valorem method, specific fixed amount method or compound tax method.

The tax basis includes the sales amount and sales quantity. The sales amount is the total price and out-of-pocket expenses collected from the buyer by a taxpayer (VAT is not included).

Consumption tax paid for a consumable may be deducted when it is directed into the production of new taxable goods.

### 7.3.3 Tax payment

The deadline for payment of consumption tax is 1 day, 3 days, 5 days, 10 days, 15 days, monthly or quarterly. The specific tax payment deadline for a taxpayer will be assessed by the tax authorities in charge based on the tax amount payable. A taxpayer who is unable to pay the tax by the fixed deadlines may pay tax on a transaction basis.

A taxpayer who opts for a monthly or quarterly tax payment period must file a tax return and make the tax payment within 15 days from the date of expiry of the tax payment period; a taxpayer who opts for the tax payment period of 1 day, 3 days, 5 days, 10 days or 15 days must prepay tax within 5 days from the date of expiry of the tax payment period, and file a tax return and make the tax payment within 15 days of the following month, and pay tax for the preceding month.

A taxpayer importing taxable consumables must make tax payment within 15 days from the date of issuance of the customs special certificate of payment of consumption tax.



## 7.4 Surcharges

On top of the VAT, BT and CT amounts, surcharges may be imposed, which include the Urban Maintenance and Construction Tax (UCMT), Education Surcharges (ES), and Local Education Surcharges (LES).

UMCT is a surtax levied on the total VAT, BT and CT actually payable. Any organization or individual liable to VAT, BT and CT are subject to UMCT. The tax rate differs depending on the location of the taxpayers:

- 7% for taxpayers located in a city;
- 5% for taxpayers located in a county and town area;
- 1% for taxpayers located in other regions.

ES and LES are surcharges based on the total amount of VAT, BT and CT actually paid by each entity or individual at the rate of 3% and 2%, respectively, and must be paid simultaneously with VAT, BT and CT.

## 7.5 Others

### 7.5.1 Customs duty

#### → Objects of taxation and taxpayers

PRC Customs imposes import customs duty ("CD") on imports into the PRC and certain goods exported out of the PRC.

Consignees of imports, consignors of exports and owners of articles brought into the country are the taxpayers.

#### → Duty rate

The Regulations on Import and Export Tariff of the PRC ("Tariff Regulations") and the Schedule of Import Duties of the PRC ("Schedule of Import Duties") issued by the State Council stipulate the tariff items, codes and rates.

Import duty rate is mainly decided by the tariff code of the goods to be imported. The country of origin of the goods is also a deciding factor of the applicable import duty rate, which categorizes the import duty rate into the following categories: the most favoured nation tariff rates, conventional tariff rates, special preferential tariff rates, general tariff rates and tariff rates for quota items. Provisional rates of import and export duties may be implemented for a specified period of time.

#### → Dutiable value

According to the Measures of PRC Customs for the Examination and Determination of Dutiable Value of Imported and Exported Goods ("Valuation Rule"), the dutiable value of imported goods in PRC should be calculated based on the transaction value, and should include the freight and related costs and insurance expenses incurred up to the point of uploading on arrival in the PRC. In other words, the dutiable value of imported goods should be assessed at CIF value.

The dutiable value of exported goods should be FOB value less export duty (if any).

The PRC Customs officers would generally use the "transaction value" agreed by both parties as the primary basis for determining the customs value of imported goods. If a "transaction value" is unavailable or inappropriate in a particular incident, the following valuation methods are applied in descending order:

- Value of identical goods
- Value of similar goods
- Determination by "deductive" method
- Determination by "computed" method
- Other reasonable methods.

### → Calculation

CD is levied on the basis of value, quantity or other methods stipulated by the State. The formula for calculation of customs duties is:

Amount of duties payable = Dutiable value × Duty rate  
(on a value basis)

Amount of duties payable = Quantity of goods × Duty amount per unit (on a quantity basis)

### → Declaration and Payment

Taxpayers for imports must submit a declaration to PRC Customs within 14 days after the date of declaration of the transportation vehicle or vessel's entry into the PRC. Taxpayers for exports must submit a declaration to the PRC Customs upon arrival of the goods at the customs supervision and control zone and 24 hours prior to loading, unless they have special approval from PRC Customs.

Taxpayers must pay the outstanding duties to the designated bank within 15 days from the date of issue of the payment notice by PRC Customs.

## 7.5.2 Excise duties

Excise duties are levied on certain behaviours, which have the characteristic of contingency, including Stamp Duty, Deed Tax, etc.

### → Stamp duty

All units and individuals that conclude or receive the specified documents that are protected under the PRC laws, such as various types of contracts, documents of the transfer of property title, business books and accounts, etc., are subject to stamp duty.<sup>3</sup>

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<sup>3</sup> For detailed tax rates please refer to <http://www.chinatax.gov.cn/2013/n2925/n2956/c310037/content.html>

→ **Deed tax**

Where land use rights or building ownership rights are transferred within the PRC, whether by means of grant, purchase, gift, exchange or other means, transferee entities or individuals must pay deed tax. The deed tax rate ranges from 3% to 5% (depending on the region) of the transaction price or the value of the assignment or transfer.

→ **Vehicle purchase tax**

Organizations and individuals who purchase vehicles in the PRC are subject to tax. The tax objects include automobile, motorcycles, trams, trailers, farm vehicles. The vehicle purchase tax payable is computed using the ad valorem method, with the tax rate of 10%. The formula for computation of the payable amount is:

$$\text{Tax payable amount} = \text{taxable price} \times 10\%$$

Taxpayers who purchase a taxable vehicle for their own use must declare and pay tax within 60 days from the date of purchase; taxpayers who import a taxable vehicle must declare and pay tax within 60 days from the date of importation; taxpayers who obtain a taxable vehicle through self-manufacture, gift, prize-winning or any other method must declare and pay tax within 60 days from the date of obtaining the vehicle.

## 8 Inheritance and Gift Tax

There is no inheritance and gift tax regime in the PRC.

## 9 Wealth Tax

### 9.1 Real Estate Tax

Real estate tax is levied on the owners, users or custodians of houses and buildings used for business purposes. The tax rate is as follows depending on the usage of the real estate:

- If the real estate is held by the entity for self-use, 1.2% of the original value will be imposed as the real estate tax. A tax reduction of 10% to 30% will be offered by the local government.
- 12% of the rental value will be imposed as real estate tax if the real estate rented to other parties.

### 9.2 Vehicle and Vessel Tax

A fixed amount of vehicle and vessel tax is levied on a yearly basis on all vehicles and vessels in the PRC, depending on the size, capacity, number of passengers or tonnage.

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