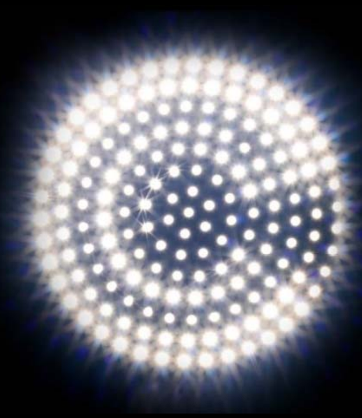
International Tax
China Highlights 2018



Investment basics:

Currency – Renminbi (RMB) or Yuan (CNY)

Foreign exchange control – The government maintains strict exchange controls, although the general trend has been toward a gradual liberalization of China's foreign exchange markets and specific controls over companies and individuals.

Accounting principles/financial statements – Accounting standards similar to IFRS are mandatory for publicly held companies listed in China and certain other companies (e.g. banks), and have been widely applied to large and medium-sized enterprises established in China.

Principal business entities – China maintains a matrix of laws and regulations that includes pure domestic enterprises, wholly foreign-owned enterprises, equity joint ventures, cooperative joint ventures, holding companies, domestic partnerships, foreign-invested partnerships, trusts, branches and representative offices. Branches of foreign companies are permitted for certain industries (e.g. banks and insurance companies). An enterprise that is set up as a company may be established as a joint stock company or a limited liability company.

Corporate taxation:

Residence – An enterprise is resident in China if it is established in China or if its place of effective management is in China. Effective management is defined as substantial and overall management and control over manufacturing and business operations, human resources, financial and property aspects of the entity. A foreign company also will be subject to tax in China if it has an "establishment" in China or, if it does not have an establishment in China, if it derives income from China. The definition of an establishment is broad and does not include an exemption for an independent agent. If a foreign company has an establishment in China, it will be subject to China tax on all income effectively connected with that establishment.

Basis – Residents are taxed on worldwide income, while nonresidents are taxed on China-source income and income effectively connected with their establishments (if any) in China.

Taxable income – Taxable income is the amount remaining from gross income in a tax year after deducting allowable expenses and losses, nontaxable and tax-exempt items and any prior-year loss carryforwards. All documented costs incurred in connection with operating activities on a reasonable and actual basis are allowable, except those specifically identified as nondeductible.

Taxation of dividends – An exemption applies for dividends paid by a resident enterprise to another resident enterprise (with certain limits). Dividends received from a foreign entity are included in taxable income and generally are subject to income tax at a rate of 25%, with a tax credit granted for foreign tax paid.

Capital gains – Gains and losses from the transfer of assets generally are combined with other operating income and taxed at the applicable enterprise income tax rate.

Losses – Losses may be carried forward for five years. The carryback of losses generally is not permitted.

Rate – The standard enterprise income tax rate is 25%. Special rates mainly apply to small-scale enterprises (20%, or 10% if certain requirements are met), enterprises with new/high-technology status (15%), advanced technology service enterprises that perform qualifying outsourcing services (15%) and enterprises incorporated in certain regions of China and engaged in encouraged business activities (15%). Special rates are available for certain other encouraged business.

Surtax – No

Alternative minimum tax – No

Foreign tax credit – Foreign tax paid may be credited against Chinese tax on the same profits, but the credit is limited to the amount of China tax payable on the foreign income. If the foreign tax credit exceeds the limit, the excess may be carried forward for five years. An indirect tax credit also is allowed when dividends are distributed to a resident enterprise that holds directly or indirectly at least 20% of the foreign entity (within five tiers) deriving the underlying profits.

Participation exemption – No

Holding company regime – No

Incentives – The principal incentives include a 15% preferential tax rate applicable to new/high-technology enterprises and advanced technology service enterprises, and a 50% or 75% super deduction for qualifying R&D expenditure. There is a geographically based incentive focused on new/high-technology enterprises established as from 2008. The incentive (in addition to the 15% rate that applies to all new/high-technology enterprises) is a two-year tax holiday, followed by three years at a 12.5% rate. Encouraged industries in certain regions (e.g. western China, Hengqin (Guangdong), Pingtan (Fujian) and Qianhai (Shenzhen)) can enjoy a reduced 15% enterprise income tax rate until 31 December 2020. Tax exemptions and other forms of preferential treatment apply to the agriculture, forestry, animal husbandry and fishery sectors, software and integrated circuit industries, major infrastructure projects, certain environmental projects and certain transfers of technology.

Withholding tax:

Dividends – A 10% withholding tax, which is lowered from a 20% statutory rate, is imposed on dividends paid to a nonresident company unless the rate is reduced under a tax treaty. As a measure to further promote foreign investment in China, the government has issued rules to provide a deferral of withholding tax on dividends and profits distributed to foreign investors and reinvested into encouraged investment projects in China, with retroactive effect from 1 January 2017.

Interest – A 10% withholding tax, which is lowered from a 20% statutory rate, applies to interest paid to a nonresident unless the rate is reduced under a tax treaty. A 6% VAT also is imposed.

Royalties – A 10% withholding tax, which is lowered from a 20% statutory rate, applies to royalties paid to a nonresident unless the rate is reduced under a tax treaty. A 6% VAT generally is applicable, but may be waived when royalties are paid for the transfer of qualified technology.

Technical service fees – Technical service fees paid to a nonresident are subject to the statutory enterprise income tax rate (i.e. 25%) on a net-profit basis to the extent the services are rendered in China, unless the tax is reduced under a tax treaty. A minimum 15% deemed profit rate is used where documents substantiating costs and expenses are unavailable. A 6% VAT generally will be levied, regardless of where the services are rendered.

Branch remittance tax – No

Other taxes on corporations:

Capital duty – No

Payroll tax – No

Real property tax – Real estate tax, levied on land and buildings, is paid by the owner of real estate at 1.2% per year on the original cost, less a variable allowance depending on the location, or at 12% per annum on rental income. An urban land usage tax is imposed on the land area occupied, at rates ranging from RMB 0.6 to RMB 30 per square meter. Other minor local levies may apply.

Social security – The employer is required to contribute approximately 20% of basic payroll to the state-administered retirement scheme, as well as to medical insurance, maternity insurance, unemployment insurance and work-related injury insurance funds. The total employer contribution can be up to 40% of the employee's base monthly salary, although the rates can vary across the country. The employee is required to contribute a certain percentage of his/her monthly salary to the above funds. There generally are limits on the total contribution payable if the employee's salary reaches a threshold set by the local authorities.

Foreign individuals legally working in China (including both those locally hired and those seconded from abroad to work) generally are required to participate in the social security scheme, unless an exemption applies under a bilateral social security totalization agreement. Both the employer and the employee must contribute into these schemes.

Stamp duty – Stamp duty at varying rates applies to contracts, agreements and certain legal documents.

Transfer tax – No

Other – Deed tax is imposed at rates between 3% and 5% on the total value of land use rights or building ownership rights when transferred. Land appreciation tax is imposed on gains realized on the transfer of real estate. The gain is calculated based on sales proceeds, less certain deductions, and the tax is charged in four bands ranging from 30% to 60%.

As from 2018, environment protection tax will be collected on taxable pollutants (atmospheric pollutants, water pollutants, solid waste and noise), based on the “pollution emission equivalent amount.”

Anti-avoidance rules:

Transfer pricing – China has transfer pricing rules and has adopted a broad definition of associated enterprises, with a strong emphasis on control. A related party can include an entity with significant control over the taxpayer's senior management, purchases, sales, production and the intangibles and technologies required for the business. Accepted transfer pricing methodologies are the comparable uncontrolled price, resale price, cost plus, transactional net margin, profit split and other methods that comply with the arm's length principle. Contemporaneous documentation is required (with certain exemptions) and cost sharing agreements may be used for developing intangible property or for shared services arrangements. A resident taxpayer that is the ultimate parent of a multinational group with annual consolidated revenue exceeding a threshold amount or that is appointed as the filing entity of a multinational group is required to file a country-by-country report. Advance pricing agreements are available.

Thin capitalization – Excessive interest expense from related party financing is nondeductible for tax purposes. In general, if an entity’s debt-to-equity ratio exceeds 2:1 (5:1 for financial institutions), the excess portion of interest expense will be nondeductible, unless contemporaneous documentation demonstrates the arm's length nature of the expense.

Controlled foreign companies – Resident companies must include in taxable income their relevant share of the undistributed profits of a CFC in certain cases. This rule applies to CFCs incorporated in low-tax countries where their effective tax rates are lower than 12.5%. The inclusion in income is not required in certain situations (e.g. where the undistributed profits of a CFC are lower than a threshold amount).

Disclosure requirements – Resident taxpayers are required to disclose related party transactions in the annual tax return. There are other disclosure requirements for contracting or services provided by nonresident companies, certain foreign investments, etc.

Other – A general anti-avoidance rule requires a bona fide business purpose for any business arrangement that has the effect of reducing, deferring or avoiding taxable revenue or taxable income. In the absence of such a purpose, the tax authorities have the power to make adjustments going back 10 years.

Compliance for corporations:

Tax year – Calendar year

Consolidated returns – The filing of consolidated returns generally is not permitted; each company must file a separate return.

Filing requirements – Enterprises must file a provisional income tax return with the local tax authorities within 15 days of the end of each quarter, and pay quarterly installments of tax, generally based on the profits for the quarter. An annual tax return and final settlement of the tax liability must be made within five months of the end of the tax year.

Penalties – A late payment surcharge will be imposed on a daily basis at a rate of 0.05% of the amount of underpaid tax. Penalties may be imposed in addition to the late payment surcharge. An interest-based penalty, calculated at the basic RMB lending rate plus 5%, applies in the case of transfer pricing, thin capitalization, CFC and general anti-avoidance tax adjustments.

Rulings – There generally is no advance ruling procedure, but the tax authorities can issue rulings in special cases. Taxpayers normally consult their local in-charge tax officials when issues arise. As noted above, advance pricing agreements may be concluded.

Personal taxation:

Basis – An individual "domiciled" in the Chinese mainland is subject to individual income tax on his/her worldwide income. A nondomiciled individual staying in China for less than one year is subject to personal tax only on China-source income. A nondomiciled individual staying in China for one full year, but less than five consecutive full tax years, is subject to individual income tax on China-source income, plus foreign income borne by Chinese entities or establishments. A nondomiciled individual staying in China for more than five consecutive full tax years is taxed on worldwide income as from the sixth year, for each full tax year spent in China.

Residence – There is no specific definition of a tax resident for personal tax purposes in the domestic law (see above under “Basis”). However, the test for domicile in China is whether an individual is usually or habitually residing in China due to his/her household, family or economic situation.

Filing status – Each individual must file a separate return; joint filing is not permitted. Non-Chinese nationals may need to register with the competent Chinese tax authorities as soon as they become liable to individual income tax.

Taxable income – Taxable income comprises employment income; production and business income; income derived from the contracting for, or leasing operations of, enterprises or institutions; income from personal services; dividends; interest income (except interest from bank deposits); royalty income; income from leasing property; income from the assignment or transfer of property; contingency income; income from manuscripts; and other income specified as taxable by the finance department of the State Council.

Capital gains – Gains derived from the sale of property, net of relevant expenses and taxes, are subject to tax at a rate of 20%. Individuals generally are exempt from tax on gains from the sale of their sole private dwelling if they have occupied the residence for five years.

Deductions and allowances – Deductions and allowances are available, depending on the category of income. Individuals are entitled to a fixed monthly deduction of RMB 3,500 (foreign nationals are entitled to an additional fixed deduction of RMB 1,300) for wages and salaries received in China. Personal basic contributions also are deductible. These include payments to housing funds and certain medical insurance, pension and unemployment insurance payments.

Rates – Seven progressive tax rates, ranging between 3% and 45%, are levied on wages and salaries. Dividends, interest, royalties, income from leasing property, income from the transfer or assignment of property, income from manuscripts and contingency income are taxed at 20%. Interest on bank deposits is temporarily exempt from individual income tax (previously taxed at 5%). Income from production and business and income derived from contracting or leasing operations are taxed at progressive rates between 5% and 35%. Income from personal services is subject to progressive rates up to 40%.

Other taxes on individuals:

Capital duty – No

Stamp duty – Stamp duty at varying rates applies to contracts, agreements and certain documents.

Capital acquisitions tax – No

Real property tax – An individual who rents out his/her property is subject to real estate tax, which is 12% of the rental income. The rate may be reduced to 4% for the leasing of residential property. However, the practice may vary across China, since the rates are determined by the local authorities.

Inheritance/estate tax – No

Net wealth/net worth tax – No

Social security – Both the employer and the employee must contribute to a pension fund, medical insurance fund, maternity insurance, unemployment insurance and work-related injury insurance. The employee is required to contribute a certain percentage of his/her monthly salary to the above funds, up to certain limits set by the local authorities.

Foreign individuals legally working in China (including both those locally hired and those seconded from abroad to work) generally are required to participate in the social security scheme, unless an exemption applies under a bilateral social security totalization agreement. Both the employer and the employee must contribute into these schemes.

Compliance for individuals:

Tax year – Calendar year

Filing and payment – Individual income tax on wages and salaries is calculated and levied on a monthly basis. Withholding agents and individuals who file returns personally must submit a tax return to the tax authorities and make the tax payment to the state treasury within 15 days after the end of the month in which the income was derived. Annual filing is required within three months of the end of the tax year for individuals with annual income exceeding RMB 120,000. Nondomiciled individuals who have resided in China for less than a full tax year may be exempt from the filing requirement. In most cases, an employer or a person who pays taxable income to a taxpayer is obliged to act as a withholding agent and is responsible for filing a tax return and remitting tax payments to the tax authorities on behalf of the individual. If there is no withholding agent, the individual must file his/her tax return and pay the tax assessed.

Penalties – A late payment surcharge will be imposed on a daily basis at a rate of 0.05% of the amount of underpaid tax. Penalties may be imposed in addition to the late payment surcharge.

Value added tax:

Taxable transactions – VAT applies on the supply of goods; the provision of processing, repair or replacement services; and the import of goods. The VAT reform program has been rolled out nationwide to cover all goods and services (including those that used to fall under the scope of the business tax that no longer is imposed after 1 May 2016).

Rates – The standard VAT rate is 17%, with a lower rate of 11% applying to certain foods, goods, books and utilities. A 3% rate applies under the small-scale taxpayer scheme. Lower rates apply to certain transactions involving used goods. Exports generally are zero-rated. The rates under the VAT reform program are as follows: 17% for the leasing of moveable and tangible goods; 11% for transportation services, construction services, postal services, basic telecommunication services, leasing of real estate and the sale of real estate and land use rights; and 6% for value-added telecommunication services, financial services, modern services and lifestyle services and the sale of intangible assets other than land use rights. A 5% rate may apply to certain transactions involving real estate (e.g. sales of real estate that was acquired by 30 April 2016). Certain specified cross-border taxable activities can be zero-rated.

Registration – A company is required to register with the local tax authorities at the time of incorporation to have its status recognized. If the taxpayer's status is approved, VAT taxpayers (other than small-scale VAT taxpayers) must register for VAT purposes with the tax authorities. A nonresident company is not required to register for VAT.

Filing and payment – VAT returns generally must be filed each calendar month and submitted before the 15th day of the following month. Taxpayers importing goods must pay tax within 15 days after the issuance of the tax payment certificate by Customs.

Other – Consumption tax applies to alcoholic beverages, luxury cosmetics, diesel fuel, fireworks, jewelry, motorcycles, motor vehicles, petrol, luxury watches, tobacco, golf equipment, yachts, etc., at rates ranging from 1% to 56% of the value of the goods. Once the taxpayer's tax status has been approved by the tax authorities, the vendor should register as a consumption tax payer. Returns generally must be filed each calendar month and submitted before the 15th day of the following month.

Source of tax law: Enterprise Income Tax Law; Individual Income Tax Law; Provisional Rules on Value Added Tax, etc.

Tax treaties: China has over 100 tax treaties.

China signed the OECD MLI on 7 June 2017.

Tax authorities: Ministry of Finance, State Administration of Taxation

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