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ACHIEVING CLARITY

China: Tax Framework

Overview of the Chinese Tax System

Taxpayers can be individuals, entities and economic organizations.

The major types of taxes in the People's Republic of China ("China") are:

- Income taxes: Individual Income Tax ("IIT"), Corporate Income Tax ("CIT")
- Turnover taxes: Value Added Tax ("VAT"), Consumption Tax ("CT")
- Property and behavior taxes: Stamp Duty, Deed Tax, Land VAT, Real Estate Tax
- Customs duty

There are no longer any tax incentives / preferential tax treatments for Foreign Invested Enterprises ("FIE") after the Corporate Income Tax Law ("CITL") was enacted in 2007 to unify the income tax treatments of domestic and foreign companies.

But there are still some key factors which would probably be relevant to many Foreign Enterprises and FIEs, such as:

- Tax resident enterprises ("TRE") / non-tax resident enterprises ("Non-TRE")
- Tax incentives: e.g. high and new technology enterprise ("HNTE") incentive, research and development (R&D) super deduction from taxable income, technology transfer turnover tax / income tax exemption, etc.
- Withholding tax
- Transfer pricing

Corporate Income Tax (”CIT”)

SCOPE

All enterprises (including foreign investment enterprises, foreign enterprises and domestic enterprises) and income-generating organizations within the territory of China shall be liable to pay enterprise income tax, except for sole proprietorships and partnerships.

Tax resident enterprises:
- Tax resident enterprises refer to an enterprise established in China, or an enterprise that is established under the laws of a foreign country but whose actual management or control is located in China;
- Tax resident enterprises shall pay enterprise income tax for income sourced within and outside China;

Non-tax resident enterprises:
- Non-tax resident enterprises refer to an enterprise that is established under the laws of a foreign country and whose actual management or control is located outside China but which has an establishment or place in China, or that does not have an establishment or place in China but derives income from sources within China;
- Non-tax resident enterprises with an establishment in China shall pay income tax on income sourced within and outside China that is effectively connected with such an establishment, as well as income sourced within China that is not effectively connected with such an establishment;
- Non-tax resident enterprises without an establishment in China shall pay income tax on income sourced within China.

TAX RATES

Basically, enterprise income tax shall be levied at the rate of 25%. But there are some tax policies, including but not limited to:

- Small enterprises with thin profits are taxed on 25% of the taxable income less than RMB 1 million and on 50% of the taxable income exceeding RMB 1 million but less than RMB 3 million at a reduced rate of 20% till December 31, 2021
- High and new technology enterprises engaged in state-encouraged industries are taxed at 15%
- Enterprises incorporated in western region and engaged in encouraged industries are taxed at 15%
- Advanced technology enterprise are taxed at 15%
- Non-tax resident enterprises with an establishment in China are taxed at 25% based on deemed profits from income sourced within China
- Non-tax resident enterprises without an establishment in China are taxed at 10% on income sourced within China

Generally, the items permitted for deduction from taxable income are the following, which are incurred directly relating to the income derived by the enterprise on reasonable and actual basis when computing taxable income:

- Costs
- Expenses
- Taxes
- Losses

Transfer Pricing ("TP")

China has adopted three-tier TP documentation structure, i.e. Master file, Local file and Country-by-Country reporting. In addition, for specific transactions, special files are required. The detailed reporting requirements are as follows:

TP-Documentation	Application Scope	Deadline
Master file	– Annual related party transactions over RMB 1 billion; or – Having cross-border related party transactions and the Master file is already available by the group level	Within 12 months of the fiscal year ending of the ultimate shareholder
Local file	Taxpayers meeting ANY of the following criteria: – Annual buy-sell transaction value over RMB 200 million; – Annual related party transaction for financial assets (e.g. share / debt transfer) value over RMB 100 million; – Annual related party transaction value for intangible ownership transfer over RMB 100 million; or – Annual aggregate value for other related party transactions (interests for intercompany loans) over RMB 40 million.	June 30, the following year (should be submitted within 30 days upon request)
Special file	Taxpayers meeting ANY of the following criteria: – Participate in the group cost sharing arrangement; or – Exceed the related party debt / equity ratio (i.e. 5 for financial institutions and 2 for the other companies)	June 30, the following year (should be submitted within 30 days upon request)

Country-by-Country Report ("CbC-Report")	– The taxpayer is the ultimate shareholder of a multinational group and has its total income of the consolidated financials over RMB 5.5 billion; or – The taxpayer is appointed by the multinational group as the reporting entity for the CbC-reports	Within 12 months of the fiscal year ending of the ultimate shareholder

On the other hand, companies only having domestic related party transactions have been exempted from TP documentation preparation.

Enterprises with single function should prepare the local TP file for the period in which the loss occurred, regardless whether they reach the threshold for preparing the contemporaneous TP documentation or not.

Double Tax Treaty between China and Germany

China and Germany have signed a revised double taxation agreement ("DTA") on March 28, 2014 and which has become effective on January 1, 2017.

WITHHOLDING TAX RATE OF DIVIDEND

The withholding tax rate on dividends is lowered from 10 % to 5 % if the beneficial owner is a company which holds directly at least 25 % of the shares in the company paying the dividend.

In addition, capital gains derived from a transfer of shares in a Chinese company, in which less than 25 % of the shares are held by a German company, could be exempted from taxation in China if certain conditions are fulfilled.

TAX RELEVANT PERIODS

The threshold of service permanent establishment ("PE") is 183 days within any 12 months, and the threshold of "construction PE" is extended to "12 consecutive months".

The threshold for taxation upon Independent Personal Services & Employment is 183 days within "any 12 months", which is identical with the determination of a PE.

ROYALTIES DIFFERENTIATED

The actual tax burden for royalties in some cases may be lowered from 7% to 6% if the royalties are paid as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment. The royalties for patent, trademark, information (know- how) concerning industrial, commercial or scientific experience, etc. shall be still subject to 10% withholding tax.

In the new DTA, 15% deemed withholding tax credit in Germany for interest and royalties provided in the previous DTA is omitted.

Individual Income Tax (”IIT”)

TAX PAYMENT OBLIGATION

Individuals are obliged to pay IIT in China if they:
- Are domiciled in China
- Have resided in China for 183 days or more accumulatively in a calendar year
- Have resided in China for less than 183 days in a calendar year but have income derived from China

Individuals who meet the first two criteria are defined as resident taxpayers, and those who meet the third criterion are defined as non-resident taxpayers.

TAXABLE INCOME AND TAX RATES

IIT is levied on the following types of income, including but not limited to:
- Income from wages and salaries;
- Income from remuneration for personal services;
- Income from author‘s remuneration;
- Income from royalties;
- Income from business operation;
- Income from interest, dividends and bonuses;
- Income from lease of property;
- Income from transfer of property;
- Incidental income, etc.

For the first four types of income, progressive tax rates ranging from 3 % to 45 % shall apply. For income from business operation, progressive tax rates ranging from 5 % to 35 % shall apply. For income from interest, dividends and bonuses, income from lease of property, income from transfer of property and incidental income, a proportional tax rate of 20 % shall apply.

GENERAL TAX TREATMENTS

For resident taxpayers, the first four types of income should be subject to IIT in a consolidated manner based on a tax year (hereinafter referred to as the „consolidated income“); and non-resident taxpayers shall declare IIT based on each income item under each category on a monthly basis.

- For consolidated income of resident taxpayers, the amount of taxable income shall be the balance after the standard deduction of RMB 60,000, as well as special deductions, additional special deductions and other deductions specified by regulations from the income amount of each tax year;
- For income from wages and salaries of non-resident taxpayers, the amount of taxable income shall be the balance after the standard deduction of RMB 5,000 from the monthly income;
- for income from remuneration for personal services and income from royalties, the amount of taxable income shall be 80% of the amount of each income item;
- for income from author's remuneration, the amount of taxable income should be 56% of the income amount.

For foreign individuals who meet the condition as a resident taxpayer, they may choose to adopt the following additional special deductions:

Items of additional special deduction	Deductible amount standard
Children's education	RMB 12,000 per year (RMB 1,000 per month) for each child
Continuing education with degree	RMB 4,800 per year (RMB 400 per month)
Advanced Vocational Training	RMB 3,600 per year (only deductible in the year of obtaining certificate)
Medical treatment of critical illnesses	Deduction based on actual amount for expenses over RMB 15,000 that are borne by the taxpayer (under the medical insurance directory). Upper limit is RMB 80,000 each year.
Interest expense of housing loan for first-time buyers	RMB 12,000 per year (RMB 1,000 per month)

Housing rent expense	RMB 9,600~18,000 each year (RMB 800 / 1100 / 1500 per month depending on cities)
Caring for parents (older than 60 years)	RMB 24,000 per year (RMB 2,000 per month)

or to enjoy the particular tax-exempted allowances which are applicable to foreign individuals, i.e., housing rent allowance, meal allowance, laundry expenses, relocation allowance, reasonable travelling allowances for business travels, reasonable allowance for home visits, language training expenses, children's education allowance, on an actual basis during a 3 years' transition period from January 1, 2019 to December 31, 2021. The additional special deductions and the tax-exempted allowances cannot be applied at the same time. Once the selection is made, it cannot be changed during a calendar year.

Turnover Tax

VALUE ADDED TAX ("VAT")

Taxpayers are obliged to pay VAT if they are engaged in the following activities within the territory of China:
- Sale of goods
- Provision of processing, repair or replacement services
- Importation of goods or
- Provision of services

The current VAT rates are as follows:

Taxable Transaction	Applicable Rate
Sales or imports of goods*	13 %
Provision of processing, repair and replacement services	13 %
Provision of transportation services	9 %
Leasing of tangible goods	13 %
Provision of other modern service	6 %
Provision of postal service	9 %
Provision of telecommunication service – Basic service – Value-added service	 9 % 6 %
Provision of finance service	6 %
Provision of construction service	9 %
Provision of personalized services, such as entertainment, hospitality	6 %
Transfer or leasing of immovable assets	9 %

* Agricultural products and natural gas will be subject to a VAT rate of 9 %.

VAT taxpayers in China are divided into General and Small-scale payers. Which type of taxpayer is applicable is determined by the competent tax authority depending on the business operations and the degree of sophistication of the accounting system. The annual sales amount criteria is RMB 5 million. Enterprises that have already been registered as General payers are allowed to be re-registered as Small-scale payers.

General taxpayer and Small-scale taxpayer are subject to two differentiated taxation systems which feature differences in tax rates of output VAT and crediting of input VAT. Small scale VAT payer is subject to a reduced tax rate of 3% for all transactions but could not credit any input VAT.

It should be noted as a transition period, currently not all input VATs are allowed to be credited such as those levied on receiving the finance and personalized services. And for some transactions, General VAT payers could also choose to pay VATs on simplified method which is levied on a reduced tax rate (e.g. 5%) without crediting the relevant input VATs.

Tax refund is granted to taxpayers who export goods from China, with few exceptions, so that the amount of the overall tax burden for export goods is limited. In addition, taxpayers providing cross-border VAT-subject services are eligible to enjoy “zero” VAT rate or VAT exemptions.

Customs Duty

IMPORT / EXPORT DUTY

China customs imposes import customs duty ("CD") on imports into China, and export CD on a few goods exported from China. The CD is generally calculated by ad valorem and in a few cases, calculated by quantity, or by any other means as stipulated by the State.

CUSTOMS DUTY 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.

EXPORT DUTY RATES

There are export duties on a few export goods and the duty rates are decided by the tariff codes of the goods.

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