Collaborating globally

China Tax Guide
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”)
  - Enterprise Income Tax (“EIT”)

- **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 new Enterprise Income Tax Law (“EITL”) 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”)
- New 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

**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

Starting from August 1, 2013, the Pilot VAT Reform Program which aims to transforming the tax levied on the services originally levied Business Tax (“BT”) to VAT has been rolled out national-wide and has been completed in May 1, 2016. As such, BT has been entirely excluded from the Chinese tax regime from May 2016.

<table>
<thead>
<tr>
<th>Taxable Transaction</th>
<th>Applicable Rate</th>
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<tbody>
<tr>
<td>Sales or imports of goods*</td>
<td>17%</td>
</tr>
<tr>
<td>Provision of processing, repair and replacement services</td>
<td>17%</td>
</tr>
<tr>
<td>Provision of transportation services</td>
<td>11%</td>
</tr>
<tr>
<td>Leasing of tangible goods</td>
<td>17%</td>
</tr>
<tr>
<td>Provision of other modern service</td>
<td>6%</td>
</tr>
<tr>
<td>Provision of postal service</td>
<td>11%</td>
</tr>
<tr>
<td>Provision of telecommunication service</td>
<td></td>
</tr>
<tr>
<td>Basic service</td>
<td>11%</td>
</tr>
<tr>
<td>Value-added service</td>
<td>6%</td>
</tr>
<tr>
<td>Provision of finance service</td>
<td>6%</td>
</tr>
<tr>
<td>Provision of construction service</td>
<td>11%</td>
</tr>
<tr>
<td>Provision of personalized services, such as entertainment, hospitality</td>
<td>6%</td>
</tr>
<tr>
<td>Transfer/leasing of immovable assets</td>
<td>11%</td>
</tr>
</tbody>
</table>

* Agricultural products and natural gas will be subject to a VAT rate of 11% instead of 13% from Jul 1, 2017.

VAT taxpayers in China are divided into General payers 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. General taxpayer and Small-scale taxpayer are subject to different 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.

**Enterprise Income Tax (“EIT”)**

**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.
Individual Income Tax ("IIT")

Tax Liability

Individuals are subject to IIT in China if they:

- Domicile in China
- Have resided in China for more than one year or
- Have resided in China for less than one year but derived income sourced within China

The monthly IIT exemption threshold is:

- RMB 3,500 for Chinese nationalities
- RMB 4,800 for non-Chinese nationalities plus payments or reimbursements for housing, meal, laundry costs, language training fees, children’s education fees, etc. on a reasonable and actual basis supported by valid invoices

Taxable Income and Tax Rates

IIT is levied on the following types of income, including but not limited to:

- Wages/salaries
- Bonuses
- Allowances
- Subsidies
- Tax borne by employer
- Production and business income of sole proprietors and partnerships
- Leasing income
- Independent contractor’s service income
- Director’s fees
- Royalties for use of patents, trademarks, copyrights, technology rights, etc.
- Interest, dividends, bonuses in connection with loan or share rights
- Income from leasing buildings, land use rights, etc.
- Income from assignment or transfer of marketable securities, buildings, etc.

For wages/salaries, production and business income of proprietors and partnerships, progressive tax rates are applicable ranging from 3%~45% and 5%~35% respectively.

For others, a general tax rate of 20% is applied with tax exemption or reduced tax rates applied to a few items.

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

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:

<table>
<thead>
<tr>
<th>Contemporaneous TP Documentation</th>
<th>Application Scope</th>
<th>Deadline</th>
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</thead>
<tbody>
<tr>
<td>Master file</td>
<td></td>
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<tr>
<td></td>
<td>› Annual related party transactions over RMB 1 billion; or</td>
<td></td>
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<tr>
<td></td>
<td>› Having cross-border related party transactions and the Master file is already available by the group level</td>
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<tr>
<td></td>
<td></td>
<td>Within 12 months of the fiscal year ending of the Ultimate shareholder</td>
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</table>

| Local file | Taxpayers meeting ANY of the following criteria: |       |
|           | › Annual buy-sell transaction value over RMB 200 million; or |       |
|           | › Annual related party transaction for financial assets (e.g. share/debt transfer) value over RMB 100 million; or |       |
|           | › Annual related party transaction value for intangible ownership transfer over RMB 100 million; or |       |
|           | › Annual aggregate value for other related party transactions (interests for inter-company 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: | June 30, the following year (should be submitted within 30 days upon request) |
|             | › 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) |       |

| 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 | Within 12 months of the fiscal year ending of the Ultimate shareholder |
|                                           | › The taxpayer is appointed by the multinational group as the reporting entity for the Cbc-reports |       |

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.

New 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.