People's Republic of China Tax Profile

Updated: September 2016

Produced in conjunction with the
KPMG Asia Pacific Tax Centre

Contents

1	Corporate Income Tax	1
2	Income Tax Treaties for the Avoidance of Double Taxation	8
3	Indirect Tax (e.g., VAT/GST)	10
4	Personal taxation	11
5	Other Taxes	12
6	Free Trade Agreements	13
7	Tax Authorities	15

1 Corporate Income Tax

Corporate Income Tax

Corporate income tax (“CIT”)

Tax Rate

25 percent

There is also a 15 percent rate applicable to certain Chinese enterprises with “High and New Technology” status or those operating in the western region of China.

Residence

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

A resident enterprise is taxed on its worldwide income.

Compliance requirements

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

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

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

International Withholding Tax Rates

Dividends paid to a non-resident enterprise are subject to withholding tax at 10 percent (this rate may be reduced under certain treaties). A 20 percent base rate applies for payments to individuals (this rate may be reduced under applicable treaties).

Royalties paid to a non-resident enterprise are subject to withholding tax at 10 percent (this rate may be reduced under certain treaties). In addition, 6 percent Value Add Tax (“VAT”) and local levies will apply. A 20 percent base rate applies for payments to individuals.

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

Holding rules

Dividend distribution from a PRC resident enterprise to another PRC resident enterprise is exempt from PRC CIT. Dividend distribution from a non-resident enterprise to a PRC resident enterprise is subject to 25 percent CIT, but foreign tax credits may be available.

CIT at 25 percent also applies to capital gains derived by a PRC resident enterprise. PRC does not have a participation exemption regime.

Tax Losses

Tax losses may be carried forward for 5 years. No carry-back is allowed.

Tax Consolidation / Group relief

There is no tax consolidation regime in PRC in general.

Transfer of shares

Stamp duty applies on the transfer of shares.

Transfer of assets

VAT, stamp duty, deed tax and land appreciation tax may apply on the transfer of land and buildings (VAT replaces BT on property transactions from 1 May 2016)

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

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

Gains resulting from transfers of assets are subject to CIT.

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

CFC rules

The PRC has a CFC regime.

Transfer Pricing

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

Contemporaneous TP documentation is required to be kept on file if certain threshold conditions are met and a detailed related party transactions filing is required to be made with annual CIT filings. Further to the BEPS reform of TP documentation the structure and timing of both contemporaneous TP documentation and the related party transactions filing have been altered, as have the transaction volume thresholds which trigger an obligation to prepare the documentation.

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

The related party transactions filing date will remain, as per pre-BEPS rules, as 31 May. However, the required detail is expanded significantly under BEPS, including a country by country (CBC) report where the relevant threshold is exceeded and the parent company (or designated surrogate CBC filer) is in China. Mechanisms are in place for the Chinese tax authorities to obtain CBC reports from other countries where the group parent companies are overseas. CBC reporting and exchange will be commenced by China from 2018.

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

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

Thin Capitalisation

Yes – CIT law effectively restricts the deductibility of interest paid to related entities if the company is excessively financed with related party debt. In general, this will be the case where the related party debt-to-equity ratio of the company exceeds 2:1 (or 5:1 for financial institutions).

General Anti-avoidance

PRC tax law includes general anti-avoidance provisions.

Anti-treaty shopping

PRC requires that a treaty applicant must be a beneficial owner of certain passive income derived in PRC in order to qualify for treaty benefits. Normally, a beneficial owner needs to possess commercial substance and bear risk at the residence jurisdiction. Chinese guidance on beneficial ownership and treaty anti-abuse provisions are in the process of being clarified, to define beneficial ownership more clearly as a test of control over income and assets, and separately apply treaty anti-abuse rules or the domestic law general anti-avoidance rule to treaty shopping cases.

Other specific anti-avoidance rules

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

Rulings

There is currently no formal ruling system for PRC taxes currently, although this is set to be introduced with the introduction of the new Tax Collection and Administration Law, likely from 2017.

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

Intellectual Property Incentives

PRC resident enterprises that own independent intellectual property used in products or services of prescribed high-tech fields supported by the State, may be recognized as high-tech enterprises if other qualification criteria are also met. These companies can enjoy a reduced 15 percent CIT rate, instead of the 25 percent standard CIT rate.

R&D Incentives

Qualifying R&D expenses enjoy an additional 50 percent deduction for CIT purposes.

Other incentives

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

From 1 July 2014 to 31 December 2018, recognized technologically-advanced service enterprises in 21 Chinese cities can pay enterprise income tax at the reduced rate of 15 percent, instead of the 25 percent standard CIT rate.

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

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

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

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

Hybrid Instruments

There is limited guidance in SAT Announcement 41 [2013] regarding hybrid instruments in the PRC with a list of debt instrument criteria which, if lacking, will result in the instrument being classified as equity and interest deductions denied. While this does not deal with cross-border hybrid mismatch arrangements, per se, the SAT have signalled their intent to introduce such provisions in the future.

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

Hybrid entities

For the tax characterisation of a foreign entity, the PRC tax authorities may look at whether that foreign entity has a separate legal person status under local law, or is a tax resident for treaty purposes, to determine whether to treat the foreign entity as tax transparent or tax opaque.

Special tax regimes for specific industries or sectors

Agriculture, forestry, animal husbandry and fisheries

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

Integrated circuit and software industry

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

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

Related Business Factors

Forms of legal entities typically used for conducting business

For conducting business in the PRC, foreign enterprises typically set up a Chinese limited liability company (LLC) as a Wholly Foreign Owned Enterprise (WFOE), with special forms of WFOE being used depending on the nature of the business activity. For example as a Foreign Invested Commercial Enterprise (FICE) for domestic trading activities. However, in some economic sectors there is a requirement to have a Chinese joint venture partner which means that an EJV (equity joint venture) or cooperative joint venture (CJV) must be used.

While foreign invested partnerships (FIPs) may be used as business vehicles since 2010, registration issues mean these have not been used extensively outside the funds sector to-date.

In respect of holding companies, generally offshore holding companies are used. It is possible for general LLC or special Chinese Holding Companies (CHC) to be used for onshore holding. Collectively, foreign owned enterprises used for conducting business in PRC are generally referred to as foreign invested enterprises (FIEs). It should be noted that the new Foreign Investment Law (anticipated to be implemented in 2017) is expected to abolish the above special legal forms and, going forward, both wholly Chinese invested entities and foreign invested entities would adopt the same legal forms without distinction.

Capital requirements for establishing a legal entity

Changes to Chinese Company Law and to the regulations governing FIEs, effective from 1 March 2014, abolished the previous statutory minimum registered capital requirements for Chinese enterprises, including for FIEs, and provided that FIE investors may also decide on the amount, manner and timeline of capital contributions to the FIE. The Ministry of Commerce (MOFCOM) is pushing local regulators to comply with these new liberalised rules, though in practice some local regulators may continue to insist on high levels of registered capital before approving FIE establishment. Specific industries such as banking and insurance will continue to be subject to special minimum capital requirements.

Other local requirements for establishing a legal entity

Certain industrial sectors require foreign investment to be with a Chinese partner in an equity or cooperative joint venture (EJV, CJV) and foreign participation is limited to a given percentage of enterprise share capital.

Such restrictions are found in the official ‘Catalogue of Industry Guidelines for Foreign Investment’, which guides MOFCOM and local departments of commerce in approving foreign investment. China is likely to move in the near future to a new ‘Negative List’ system (currently being piloted in the Free Trade Zones) under which certain sectors are on a ‘Negative List’ prohibiting or restricting investment but foreign investment in all other sectors can be made without MOFCOM pre-approval and simply by registering the new company with the local Administration of Industry and Commerce.

Foreign exchange control rules

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

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

Accounting and reporting

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

2 Income Tax Treaties for the Avoidance of Double Taxation

In Force

Albania
Algeria
Armenia
Australia
Austria
Azerbaijan
Bahrain
Bangladesh
Barbados
Belarus
Belgium
Bosnia and Herzegovina
Brazil
Brunei
Bulgaria
Canada
France
Georgia
Germany
Greece
Hong Kong
Hungary
Iceland
India
Indonesia
Iran
Ireland
Israel
Italy
Jamaica
Japan
Kazakhstan
Malaysia
Malta
Mauritius
Mexico
Moldova
Mongolia
Montenegro
Morocco
Nepal
Netherlands
New Zealand
Nigeria
Norway
Oman
Pakistan
Papua New Guinea
Singapore
Slovak Republic
Slovenia
South Africa
Spain
Sri Lanka
Sudan
Sweden
Switzerland
Syria
Tajikistan
Thailand
Trinidad and Tobago
Tunisia
Turkey
Turkmenistan

Croatia
Cuba
Cyprus
Czech Republic
Denmark
Ecuador
Egypt
Estonia
Ethiopia
Finland
Korea (Republic of)
Kuwait
Kyrgystan
Laos
Latvia
Lithuania
Luxembourg
Macau
Macedonia
Philippines
Poland
Portugal
Qatar
Romania
Russia
Saudi Arabia
Serbia
Seychelles
Ukraine
United Arab Emirates
United Kingdom
United States
Uzbekistan
Venezuela
Vietnam
Zambia

Negotiated, not yet in force at time of publication

New treaties or amendment protocols are being negotiated with: Botswana, Chile, Taiwan, Uganda, and Zimbabwe.

3 Indirect Tax (e.g., VAT/GST)

Indirect Tax(es)

VAT and Consumption Tax

Standard Rate

VAT is, subsequent to the completion of the 2012-2016 BT to VAT reform on 1 May 2016, generally imposed on sales of goods and provision of services. VAT applies at rates of 3% (small enterprise simplified VAT scheme), 6% (many types of service), 11% (construction, real estate and financial services), 13% (certain categories of goods), and 17% (the standard rate applied to most types of goods).

VAT Reform

Effectively from May 1, 2016, China fully implemented its VAT reform by replacing all business tax (“BT”) with VAT after expanding the scope to cover the construction, real estate, finance and lifestyle (including hospitality, food and beverage, healthcare, and entertainment) services sectors (Circular 36 [2016]). The completion of VAT expansion fully replaces the BT with VAT which ultimately applies to the import and sale of all goods in China, and that the provision of all services in China will be subject to VAT. BT will effectively cease to apply while the preferential BT policies will be retained into the VAT regime. In addition, new preferential treatments have been introduced to complement the VAT system post reform, for example, input VAT credit is deemed for purchases of land use rights for developers to deduct from the sale proceeds in calculating VAT liability for new construction projects.

Transitional or grandfathering relief is applicable to real estate and construction industries which effectively ensures that the current rates of BT are replicated under a VAT for properties where construction commenced before 1 May 2016, or for properties which are held as at 1 May 2016 and are later sold or leased and such tax burden impact on the industry does not immediately increase to 11 percent. VAT rate of 11 percent is applied to new developments commenced post 1 May 2016, or on the 2nd sale which takes place post 1 May 2016 (excluding residential properties held by individuals).

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

Further information

For more detailed indirect tax information, refer to:

KPMG’s 2016 Asia Pacific Indirect Tax Guide

4 Personal taxation

Income Tax

Individual income tax

Top Rate

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

Different tax rates apply depending on the sources of income.

Social Security

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

Employer contributions to SSI apply to the pension, medical, unemployment, maternity, and injury funds.

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

Further information

For more detailed personal taxation information, refer to:

KPMG’s Thinking Beyond Borders

International Social Security Agreements

- Germany
- Korea (Republic of)
- Denmark
- Finland
- Switzerland (entered into in 2015 – not yet effective)
- Canada (entered into in 2015 – not yet effective)

5 Other Taxes

Consumption tax (CT)

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

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

Stamp duty

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

Land appreciation tax (LAT)

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

Real estate tax

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

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

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

Other taxes

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

In addition, PRC has various mining taxes and motor vehicle taxes.

6 Free Trade Agreements

In force

Regional Multilateral Free Trade Agreements

Asia-Pacific Trade Agreement

Member countries:	China	Bangladesh	India
	Laos	Korea	Sri Lanka
	Mongolia		

China and ASEAN Free Trade Area Trade Agreement

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

Bilateral Free Trade Agreements

Australia

Chile

Costa Rica

Hong Kong

Iceland

Korea

Macau

New Zealand

Pakistan

Peru

Singapore

Switzerland

Taiwan

In negotiation	New bilateral free trade agreements are in negotiation with Norway, Maldives, Sri Lanka and Georgia. New multilateral free trade agreements are in negotiation with Gulf Cooperation Council (member countries include the United Arab Emirates, Oman, Bahrain, Qatar, Kuwait, and Saudi Arabia); Southern African Customs Union (member countries include Botswana, Lesotho, Swaziland, and South Africa); Regional Comprehensive Economic Partnership (RCEP), involving the ten ASEAN nations, China, Japan, Australia, New Zealand, Republic of Korea, and India; as well as a joint agreement with Korea and Japan *Source:* China FTA Network

7 Tax Authorities

Tax Authorities

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

Link to State Administration of Taxation

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

Tax audit activity

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

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

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

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

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

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

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

Appeals

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

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

Tax governance

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

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

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

The taxpayer may promise to:

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

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

Contact us

Khoonming Ho
Partner in Charge, Tax
China & Hong Kong SAR
KPMG in China
T 86 (10) 8508 7082
E Khoonming.Ho@kpmg.com

Chris Xing
Partner, International Tax
KPMG in China
T 86 (10) 8508 7072
E christopher.xing@kpmg.com

www.kpmg.com/tax

This profile was provided by professionals from KPMG’s member firm in China.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG International Cooperative (“KPMG International”), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved

The KPMG name and logo are registered trademarks or trademarks of KPMG International.