



*cutting through complexity*

# People's Republic of China Tax Profile

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# 1 Corporate Income Tax

<b>Corporate Income Tax</b>	Corporate income tax (“CIT”)
<b>Tax Rate</b>	25 percent  There is also a 15 percent rate applicable to certain Chinese enterprises with “New and High Technology” status or those operating in the western region of China.
<b>Residence</b>	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.
<b>Compliance requirements</b>	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).
<b>International Withholding Tax Rates</b>	Dividends paid to a non-resident are subject to withholding tax at 10 percent (this rate may be reduced under certain treaties).  Royalties paid to a non-resident 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.  Interest paid to a non-resident is subject to withholding tax at 10 percent (this rate may be reduced under certain treaties). In addition, 5 percent Business Tax and local levies will apply.
<b>Holding rules</b>	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.

<b>Tax Losses</b>	Tax losses may be carried forward for 5 years. No carry-back is allowed.
<b>Tax Consolidation / Group relief</b>	There is no tax consolidation regime in PRC in general.
<b>Transfer of shares</b>	Stamp duty applies on the transfer of shares.
<b>Transfer of assets</b>	<p>Business tax, stamp duty, deed tax and land appreciation tax may apply on the transfer of land and buildings.</p> <p>Transfers of inventory and fixed assets may be subject to VAT and stamp duty.</p> <p>Transfers of intangible assets may be subject to VAT and stamp duty.</p> <p>Gains resulting from transfers of assets are subject to CIT.</p> <p>Certain corporate asset reorganizations may be eligible for tax relief, including from both income tax and turnover taxes.</p>
<b>CFC rules</b>	Yes – PRC has a CFC regime.
<b>Transfer Pricing</b>	<p>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 at arm's length.</p> <p>Contemporaneous documentation is required if certain threshold conditions are met. The documentation is due to be lodged on 31 May after the tax year.</p> <p>A company can enter into an Advance Pricing Agreement with the tax authorities for transfer pricing purposes.</p> <p>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.</p>
<b>Thin Capitalisation</b>	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).
<b>General Anti-avoidance</b>	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 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 a 50 percent supplementary deduction for CIT purposes.

### **Other incentives**

Companies located in PRC's western region, that 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 2010 to 31 December 2018, recognized technologically-advanced service enterprises in 31 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 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 2016.

A 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

Foreign characterization generally does not affect the tax determination of a Chinese entity from the PRC tax perspective.

For a foreign entity, the PRC may look at whether that entity has a separate legal person status under local law, or is a tax resident for treaty purposes, to determine whether to view that entity as an independent legal person.

### 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 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 much 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 special legal forms, outlined above 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.





## 2 Income Tax Treaties for the Avoidance of Double Taxation

In Force				
	Albania	France	Malaysia	Singapore
	Algeria	Georgia	Malta	Slovak Republic
	Armenia	Germany	Mauritius	Slovenia
	Australia	Greece	Mexico	South Africa
	Austria	Hong Kong	Moldova	Spain
	Azerbaijan	Hungary	Mongolia	Sri Lanka
	Bahrain	Iceland	Montenegro	Sudan
	Bangladesh	India	Morocco	Sweden
	Barbados	Indonesia	Nepal	Switzerland
	Belarus	Iran	Netherlands	Syria
	Belgium	Ireland	New Zealand	Tajikistan
	Bosnia and Herzegovina	Israel	Nigeria	Thailand
	Brazil	Italy	Norway	Trinidad and Tobago
	Brunei	Jamaica	Oman	Tunisia
	Bulgaria	Japan	Pakistan	Turkey
	Canada	Kazakhstan	Papua New Guinea	Turkmenistan
	Croatia	Korea (Republic of)	Philippines	Ukraine
	Cuba	Kuwait	Poland	United Arab Emirates
	Cyprus	Kyrgystan	Portugal	United Kingdom



Czech Republic	Laos	Qatar	United States
Denmark	Latvia	Romania	Uzbekistan
Ecuador			
Egypt	Lithuania	Russia	Venezuela
Estonia	Luxembourg	Saudi Arabia	Vietnam
Ethiopia	Macau	Serbia	Zambia
Finland	Macedonia	Seychelles	

**Negotiated, not yet in force at time of publication**

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

Source: IBFD



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

#### Indirect Tax(es)

Value Added Tax (VAT); Business Tax and Consumption Tax

#### Standard Rate

VAT is generally imposed on sales of goods and repair/maintenance services on movable goods. The general VAT rate is 17 percent and a reduced rate of 13 percent may be available for sales of certain goods.

#### VAT Reform

PRC has been progressively rolling out a reform to extend VAT to services where business tax previously applied. After an initial pilot programme in 2012, the reforms were extended nationwide from August 2013. Sectors initially covered were transportation and 'modern' services, such as IT, R&D services and consulting services. Railways, broadcasting, telecommunications and postal services are now in scope. Real estate and financial services sectors are in prospect for 2016. The general VAT rate for transportation and postal services is 11 percent, leasing 17 percent, and other 'modern' services 6 percent. Small-scale VAT taxpayers are subject to a 3 percent VAT levy rate.

Generally, exports attract a zero rate of VAT. 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. VAT returns generally are filed on a calendar month basis.

#### Further information

For more detailed indirect tax information, refer to: [KPMG's 2015 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

### Business tax (BT)

Business tax is a turnover tax imposed on activities involving immovable property and services that are not subject to VAT. Services are subject to business tax when either the service provider or the recipient is located in PRC, although certain services consumed outside PRC can be exempt.

Business tax rates are between 3 percent and 20 percent. The 5 percent rate applies to service income and interest. Rates between 5 percent and 20 percent apply to the provision of entertainment services. Unlike the system for VAT, there is no business tax input credit granted to an enterprise, against either output VAT or business tax on supplies made by the enterprise. Consequently, business tax may give rise to a cascading series of tax charges.

### 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

### *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	Hong Kong	Macau	Peru
Chile	Iceland	New Zealand	Singapore
Costa Rica	Korea	Pakistan	Switzerland
			Taiwan



## In negotiation

New bilateral free trade agreements are in negotiation with Norway, Maldives and Sri Lanka.

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 Africa 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. In KPMG PRC's experience, the majority of companies can 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](mailto:Khoonming.Ho@kpmg.com)

**Chris Xing**  
**Partner, International Tax**  
**KPMG in China**

**T** 852 2978 8965

**E** [Christopher.xing@kpmg.com](mailto:Christopher.xing@kpmg.com)

[www.kpmg.com/tax](http://www.kpmg.com/tax)

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