

Worldwide Tax Summaries

Corporate Taxes 2014/15

*Quick access
to information
about corporate
tax systems in
155 countries
worldwide.*



All information in this book, unless otherwise stated, is up to date as of 1 June 2014.

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Significant developments

Pilot Program of indirect tax reform

In order to mitigate the multiple taxation issue associated with goods and services and to support the development of 'modern service industries' in China, the State Council resolved to introduce a Pilot Program in the city of Shanghai from 1 January 2012 to expand the scope of value-added tax (VAT) to cover transportation and certain specified modern service industries that were originally subject to business tax (BT).

The Pilot Program has been rolled out to the whole country from 1 August 2013.

It is generally contemplated that the Pilot Program will be expanded to the other service industries that are still subject to BT before the end of 2015.

See VAT in the Other taxes section for more information.

Taxes on corporate income

Tax resident enterprises (TREs) are subject to corporate income tax (CIT) on their worldwide income. A non-TRE that has no establishment or place in China is taxed only on its China-source income. A non-TRE with an establishment or place in China shall pay CIT on income derived by such establishment or place from sources in China as well as income derived from outside China that effectively is connected with such establishment or place.

Under the CIT law, the standard tax rate is 25%.

A lower CIT rate is available for the following sectors/industries:

- Qualified new/high tech enterprises are eligible for a reduced CIT rate of 15%. An enterprise has to fulfil a set of prescribed criteria and be subject to an assessment in order to qualify as a new/high tech enterprise.
- Integrated circuit (IC) production enterprises with a total investment exceeding 8 billion renminbi (CNY), or that produce integrated circuits with a line-width of less than 0.25 micrometre, are eligible for a reduced CIT rate of 15%.
- Key software production enterprises and IC design enterprises are eligible for a reduced CIT rate of 10%. An enterprise has to fulfil a set of prescribed criteria and be subject to an assessment in order to qualify as a key software production enterprise or key IC design enterprise.
- From 1 January 2009 to 31 December 2018, qualified technology-advanced service enterprises in 21 cities (e.g. Beijing, Shanghai, Tianjin, Guangzhou, and Shenzhen) are eligible for a reduced CIT rate of 15%. This incentive is only available to certain technology-advanced service sector members, and an enterprise has to fulfil a set of

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prescribed criteria and be subject to an assessment in order to qualify as a technology-advanced service enterprise.

- Enterprises established in the Qianhai Shenzhen-Hong Kong Modern Services Industry Cooperation Zone are eligible for a reduced CIT rate of 15%, provided that the enterprise is engaged in projects that fall within the Catalogue for CIT Preferential Treatments of the zone.
- Enterprises established in Zhuhai's Hengqin New Area are eligible for a reduced CIT rate of 15%, provided that the enterprise is engaged in projects that fall within the Catalogue for CIT Preferential Treatments of the area.
- Enterprises established in the Pingtan Comprehensive Experimental Zone are eligible for a reduced CIT rate of 15%, provided that the enterprise is engaged in projects that fall within the Catalogue for CIT Preferential Treatments of the zone.
- Qualified small and thin-profit enterprises are eligible for a reduced CIT rate of 20%. If the annual taxable income is less than CNY 100,000, the CIT rate is further reduced to 10% for the period from 1 January 2014 to 31 December 2016. An enterprise has to fulfil certain conditions in order to qualify as a small and thin-profit enterprise.
- From 1 January 2011 to 31 December 2020, encouraged enterprises in the Western Regions are eligible for a reduced preferential CIT rate of 15%.

Local income taxes

There is no local or provincial income tax in China.

Corporate residence

Enterprises established in China are always TREs. A foreign enterprise with a place of effective management in China is also regarded as a TRE.

Permanent establishment (PE)

An 'establishment or place' is defined in the CIT regulations as an establishment or place in China engaging in production and business operations, including the following:

- Management organisations, business organisations, and representative offices.
- Factories, farms, and places where natural resources are exploited.
- Places where labour services are provided.
- Places where contractor projects, such as construction, installation, assembly, repair, and exploration are undertaken.
- Other establishments or places where production and business activities are undertaken.
- Business agents who regularly sign contracts, store and deliver goods, etc. on behalf of the non-TRE.

Other taxes

China has a turnover tax system consisting of the following three taxes: value-added tax (VAT), business tax (BT), and consumption tax.

Value-added tax (VAT)

The sales or importation of goods and the provision of repairs, replacement, and processing services are subject to VAT. VAT is charged at a standard rate of 17%, and the rate for small-scale taxpayer is 3%. The sales of certain necessity goods may be subject to VAT at a reduced rate of 13%, as specified in the VAT regulations.

The VAT system is a consumption-based VAT system, which means that input VAT on fixed assets is fully recoverable, except for situations specified in the VAT regulations.

Export of goods from China may be entitled to a refund of VAT incurred on materials purchased domestically. The refund rates range from 0% to 17%. There is a prescribed formula for determining the amount of refund, under which many products do not obtain the full refund of input VAT credit and suffer different degrees of export VAT costs.

In order to mitigate the multiple taxation issue associated with goods and services and to support the development of 'modern service industries' in China, the State Council resolved to introduce a Pilot Program in the city of Shanghai from 1 January 2012 to expand the scope of VAT to cover transportation and certain specified modern service industries that were originally subject to BT.

The Pilot Program has been rolled out to the whole country since 1 August 2013.

The industries that have been selected for the Pilot Program and the applicable VAT rates (for general VAT payers) are set out in the following table.

Pilot industries	Applicable VAT rate (%)
Tangible movable property leasing service	17
Transportation service	11
Postal service	11
Basic telecommunications service	11
Value-added telecommunications service	6
Certain modern service industries, including:	
• Research, development, and technical service.	
• Information technology service.	
• Cultural creative service.	
• Logistic auxiliary service.	
• Certification and consulting service.	
• Broadcasting, cinematic, and television service.	6

Small-scale VAT payers in the above Pilot Industries are subject to the VAT rate of 3%.

Enterprises (including foreign enterprises) providing Pilot Services are now subject to VAT instead of BT.

It is generally contemplated that the Pilot Program will be expanded to the other service industries that are still subject to BT before the end of 2015.

Business tax (BT)

A BT is imposed on services, transfer of intangible assets, and immovable property taking place within China. Services taking place within China refers to situations where the service provider, the service recipient, or both are in China. This may make services even being rendered outside China subject to BT in China. BT rates are 3% or 5%, except for the leisure and entertainment industry, which may be subject to a rate of up to 20%. BT is not recoverable but is deductible for CIT purposes.

As indicated above, under the Pilot Program of indirect tax reform, enterprises providing Pilot Services (including the transfer of certain intangible assets) are now subject to VAT instead of BT.

Customs duties

In general, a customs duty is charged in either specific or *ad valorem* terms. For specific duty, a lump sum amount is charged based on a quantitative amount of the goods (e.g. CNY 100 per unit or per kg). For *ad valorem* duty, the customs value of the goods

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is multiplied by an *ad valorem* duty rate to arrive at the amount of duty payable. The applicable duty rate generally is determined based on the origin of the goods.

An exemption from customs duty applies to machinery and equipment imported by a foreign investment enterprise within the amount of its total investment, for its own use, if the project falls within the encouraged category of the 'Catalogue for the Guidance of Foreign Investment Industries' and the imported machinery or equipment is not within the list of commodities that are not exempted from customs duty.

A customs duty and VAT exemption may be allowed on importation of raw materials for contract processing or import manufacturing. Goods may be imported into, and exported out of, designated Free Trade Zones and Bonded Logistics Zones without liability to customs duty or VAT.

Consumption tax

A consumption tax is imposed on 14 categories of goods, including cigarettes, alcoholic beverages, and certain luxury and environmental unfriendly items. The tax liability is computed based on the sales amount and/or the sales volume, depending on the goods concerned. Consumption tax is not recoverable but is deductible as an expense for CIT purposes.

Real estate tax

A real estate tax, which is based on the value of the property or rental received, is assessed annually on land and buildings used for business purpose or leased. The tax rate is 1.2% of the original value of buildings. A tax reduction of 10% to 30% is commonly offered by local governments. Alternatively, tax may be assessed at 12% of the rental value. Real estate tax is deductible for CIT purposes.

Urban and township land-use tax

An urban and township land-use tax is levied on taxpayers who utilise land within the area of city, country, township, and mining districts. It is computed annually based on the space of area actually occupied by a taxpayer multiplied by a fixed amount per square metre that is determined by the local governments.

Arable land occupation tax

Arable land occupation tax is levied on companies and individuals who build houses or carry out non-agricultural construction on arable lands. It is computed based on the space of area actually occupied by a taxpayer multiplied by a fixed amount per square metre that is determined by the local governments and is settled in a lump sum.

Land appreciation tax

A land appreciation tax is levied on the gain from the disposal of properties at progressive rates from 30% to 60%. Land appreciation tax is deductible for CIT purposes.

Stamp tax

All enterprises and individuals who execute or receive 'specified documentation', including 11 types of contracts and a few specified documents, are subject to stamp tax. The stamp duty rates vary between 0.005% on loan contracts to 0.1% for property leasing and property insurance contracts. A flat amount of CNY 5 applies to certification evidencing business licences and patents, trademarks, or similar rights.

Deed tax

A deed tax, generally at rates from 3% to 5%, may be levied on the purchase, sale, gift, or exchange of ownership of land use rights or real properties. The transferee/assignee is the taxpayer.

Urban construction and maintenance tax

Urban construction and maintenance tax is imposed at a certain rate on the amount of China's indirect taxes (i.e. VAT, BT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of urban construction and maintenance tax. It is charged at three different rates depending on the taxpayer's location: 7% for urban areas, 5% for county areas, and 1% for other areas.

Educational surtax

Educational surtax is imposed at 3% on the amount of China's indirect taxes (i.e. VAT, BT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of educational surtax.

Local educational surtax

Local educational surtax is levied at 2% on the amount of China's indirect taxes (i.e. VAT, BT, and consumption tax) payable by the taxpayer. Effectively, the taxpayers of indirect taxes are also the taxpayers of local educational surtax.

Motor vehicle acquisition tax

A motor vehicle acquisition tax at a rate of 10% of the taxable consideration will be levied on any purchase and importation of cars, motorcycles, trams, trailers, carts, and certain types of trucks.

Vehicle and vessel tax

A vehicle and vessel tax is a tax that is levied on all vehicles and vessels within China. A fixed amount is levied on a yearly basis. Transport vehicles generally are taxed on a fixed amount according to their own weight, with passenger cars, buses, and motorcycles being taxed on a fixed unit amount. Vessels are taxed on a fixed amount, according to the deadweight tonnage.

Vessel tonnage tax

Vessel tonnage tax is levied on any vessel entering into a port inside the territory of China from overseas and is collected by the General Customs. The tax payable is computed based on the net tonnage multiplied by the applicable tax rate that is determined based on the net tonnage and the term of the tonnage tax licence.

Resource tax

The exploitation of crude oil and natural gas is subject to resource tax on a sales turnover basis. The exploitation of other natural resources, including coal, other raw non-metallic metals, raw ferrous metals, non-ferrous metallic minerals, and salt (including solid and liquid salt), is subject to resource tax on a tonnage or volume basis. The range of tax rates are specified by the State Council.

For Sino-foreign joint ventures exploiting crude oil or natural gas established before 1 November 2011, mine area usage fees are levied in lieu of resource tax.

Tobacco tax

Tobacco tax is levied on taxpayers who purchase tobacco leaves within the territory of China. The tax is assessed at the rate of 20% on the purchasing value and shall be settled with the local tax bureau at the place of the purchase.

Cultural business development levy

Companies and individuals engaged in entertainment and advertising businesses shall pay cultural business development levy at 3% on the relevant income.

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Social security contributions

Employers are responsible for making social security contributions to pension funds, medical funds, unemployment funds, maternity and work-related injury, etc. for their employees. The percentage of social security to be borne by the employers and the contribution base vary from city to city.

Branch income

Under the CIT law, a branch of a non-TRE in China is taxed at the branch level. If there is more than one branch, they may elect to file their tax at the main office in China on a consolidated basis. There is no further tax upon remittance of branch profits.

Income determination

Taxable income is defined as “gross income in a tax year after deduction of non-taxable income, tax exempt income, various deductions, and allowable losses brought forward from previous years”. The accrual method of accounting should be used.

Gross income refers to monetary and non-monetary income derived by an enterprise from various sources, including, but not limited to, the sales of goods, provision of services, transfer of property, dividends, interest, rentals, royalties, and donations.

Non-taxable income refers to fiscal appropriation, governmental administration charges, governmental funds, and other income specified by the central government.

Inventory valuation

Inventory must be valued according to costs. In computing the cost of inventories, the enterprise may choose one of the following methods: first in first out (FIFO), weighted average, or specific identification.

Unrealised gain or loss due to changes in fair value

An unrealised gain or loss due to changes in the fair value of financial assets, financial liabilities, and investment properties held by an enterprise is not taxable/deductible for CIT purpose. The gain/loss is taxable/deductible only when the asset/liability actually is disposed of or realised.

Capital gains

Capital gains are treated in the same way as ordinary income of a revenue-nature for a TRE.

Dividend income

An exemption exists for CIT on dividend derived by a TRE from the direct investment into another TRE except for where the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

Interest income

Interest income is treated as ordinary income.

Rental income

Rental income is treated as ordinary income.

Royalty income

Royalty income is treated as ordinary income.

Partnership income

Partnerships registered in China are not subject to CIT. The income of a partnership is taxable at the partners' level.

Unrealised exchange gains

Unrealised exchange gain (loss) from the year-end translation of assets (liabilities) denominated in foreign currency generally is taxable (deductible).

Foreign income

The worldwide income of a TRE and its branches both within and outside China is taxable. There are no provisions in the CIT law that allow foreign income directly earned by the TRE to be deferred for tax purposes. The CIT law contains a controlled foreign company (CFC) rule under which the unremitted earnings of a foreign company controlled by Chinese enterprises may be taxable in China (*see the Group taxation section for more information*). A foreign tax credit is allowed for foreign income taxes paid on foreign-source income.

Deductions

Generally, an enterprise is allowed to deduct reasonable expenditures that actually have been incurred and are related to the generation of income.

Depreciation of fixed assets

Fixed assets with useful lives of more than 12 months must be capitalised and depreciated in accordance with the CIT regulations. Generally, depreciation is calculated by the straight-line method. Shorter tax depreciation life or accelerated depreciation may be allowed due to advancement of technology or suffering from constant vibration or severe corrosion. Production-nature biological assets, such as livestock held for breeding and commercial timber, also have to be capitalised and depreciated using the straight-line method.

Under the straight-line method, the cost of an item, less its residual value, is depreciated over the useful life of the asset. Residual value should be reasonably determined based on the nature and usage of the asset. The CIT law provides minimum useful lives for the following assets:

Assets	Years
Buildings and structures	20
Aircraft, trains, vessels, machinery, mechanisms, and other production equipment	10
Appliances, tools, and furniture etc. related to production and business operations	5
Means of transport other than aircraft, trains, and vessels	4
Electronic equipment	3
Production-nature biological assets in the nature of forestry	10
Production-nature biological assets in the nature of livestock	3

Amortisation of intangibles and goodwill

A deduction is allowed for amortisation of intangible assets, such as, but not limited to, patents, trademarks, copyrights, and land use rights. Generally, intangible assets have to be amortised over a period of not less than ten years. For an intangible asset obtained through capital contribution or assignment, it can be amortised according to the useful life prescribed in the laws or agreed in the contracts, if any. However, acquired goodwill is not deductible until the invested enterprise is entirely transferred or liquidated.

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Organisational and start-up expenses

Organisational and start-up expenses are tax deductible fully in the first year of operation.

Research and development (R&D) expense

For R&D expenses incurred for new technology, new products, or new craftsmanship, an extra 50% of the actual expenses incurred are also tax-deductible as an incentive.

Asset loss

Asset loss (including bad debt loss) may be deductible in the tax year during which such loss is incurred, provided that supporting documents are submitted to and accepted by the in-charge tax bureau before annual income tax reconciliation filing.

Interest expenses

Interest on loans generally is tax-deductible. For interest expenses on borrowings from non-financial institutions by a non-financial institution, the portion that does not exceed the commercial rate is deductible. The tax deduction of interest paid to related parties is subject to the thin capitalisation rule under the CIT law (*see the Group taxation section for more information*).

Reserves and provisions

Provisions for asset impairment reserves (e.g. bad debt provisions) and risk reserves generally are not tax-deductible unless otherwise prescribed in the tax rules. Financial institutions and insurance companies may deduct certain provisions and reserves subject to the caps specified in the relevant tax circulars.

Contingent liabilities

The CIT law does not specifically address the deductibility of contingent liabilities. According to the general principle of the CIT law, contingent liabilities are liabilities that an enterprise has not actually incurred and thus shall not be tax-deductible.

Charitable donations

Charitable donations are tax-deductible at up to 12% of the annual accounting profit. Non-charitable donations, as well as sponsorship expenditures that are non-advertising and non-charitable in nature, are not deductible.

Wages and staff welfare expenses

Reasonable wages and salaries of employees incurred by an enterprise are tax-deductible. Directors' fees are also tax-deductible.

Basic social security contributions, including basic pension insurance, basic medical insurance, unemployment insurance, injury insurance, maternity insurance, and housing funds, that are made by an enterprise in accordance with the scope and criteria as prescribed by the state or provincial governments are deductible.

Commercial insurance premiums paid for investors or employees shall not be tax-deductible unless it is paid for safety insurance for workers conducting special types of work.

Staff welfare expenses, labour union fees, and staff education expenses are tax-deductible at up to 14%, 2%, and 2.5% of the total salary expenses, respectively. For qualified enterprises, the cap for tax-deductible staff education expenses is increased to 8% of the total salary expenses.

Entertainment expenses

Entertainment expenses are tax-deductible to the lesser of 60% of the costs actually incurred and 0.5% of the sales or business income of that year. The excess amount must not be carried forward to and deducted in the following tax years.

Advertising expenses and business promotion expenses

Advertising expenses and business promotion expenses are deductible at up to 15% (30% for certain enterprises in the cosmetics, medicine, and beverage industries) of the sales (business) income of that year unless otherwise prescribed in the tax regulations. Any excess amount is allowed to be carried forward and deductible in the following tax years. Advertising expenses and business promotion expenses incurred by the tobacco industry are entirely not tax-deductible.

Fines and penalties

Fines, penalties, and losses arising from confiscation of property are not deductible for CIT purposes.

Taxes

CIT payments and surcharges that are imposed on overdue taxes are not deductible for CIT purposes.

Net operating losses

Tax losses can be carried forward for no longer than five years starting from the year subsequent to the year in which the loss was incurred. Carryback of losses is not permitted.

Payments to affiliates

Management fees for stewardship are not deductible, but services fees paid for genuine services provided by affiliates in China or overseas and charged at arm's length should be deductible. Other payments to affiliates, such as royalties, are also tax-deductible, provided that the charges are at arm's length.

Group taxation

Group taxation is not permitted under the CIT law unless otherwise prescribed by the State Council.

Transfer pricing

All enterprises are required to conduct transactions with related parties on an arm's-length basis. The Chinese tax authorities are empowered to make adjustments to transactions between related parties that are not conducted at arm's length and result in the reduction of taxable income of the enterprise or its related parties using the following appropriate methods: comparable uncontrolled price method, resale price method, cost plus method, transactional net margin method, profit split method, and other methods that are consistent with the arm's-length principle. China also adopts stringent requirements on the disclosure of related party transactions in the filing of the annual tax return. In addition, there is also a requirement to prepare contemporaneous transfer pricing documentation if the amount of related parties' transactions with an enterprise exceeds a certain prescribed threshold.

The CIT law also contains transfer pricing provisions relating to cost sharing arrangements and advance pricing arrangements (APAs). In addition, it also contains a few tax avoidance rules, such as a CFC rule, a thin capitalisation rule, and general anti-avoidance rules.

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Thin capitalisation

The CIT law has a thin capitalisation rule disallowing interest expense arising from excessive related party loans. The safe harbour debt/equity ratio for enterprises in the financial industry is 5:1 and for enterprises in other industries is 2:1. However, if there is sufficient evidence to show that the financing arrangement is at arm's length, these interests may still be fully deductible even if the ratios are exceeded.

Controlled foreign companies (CFCs)

Under the CFC rule, the undistributed profits of CFCs located in low-tax jurisdictions with an effective income tax rate of less than 12.5% may be taxed as a deemed distribution to the TRE shareholders. The Chinese tax authorities have published a list of countries (i.e. a 'white list') that they do not regard to be low-tax jurisdictions.

Tax credits and incentives

The CIT law adopts the 'Predominantly Industry-oriented, Limited Geography-based' tax incentive policy. Key emphasis is placed on 'industry-oriented' incentives aiming at directing investments into those industry sectors and projects encouraged and supported by the state. The tax incentive policies mainly include the following and are applicable to both domestic and foreign investments.

Tax reduction and exemption

CIT may be reduced or exempted on income derived from the following projects:

Projects/industries	CIT incentive	Valid period
Agriculture, forestry, animal-husbandry, and fishery projects	Exemption or 50% reduction	All years, as long as it is engaged in these projects
Specified basic infrastructure projects	3 + 3 years tax holiday (2)	Starting from the first income-generating year
Environment protection projects and energy/water conservative projects	3 + 3 years tax holiday (2)	Starting from the first income-generating year
Qualified new/high tech enterprises established in Shenzhen, Zhuhai, Shantou, Xiamen, Hainan, and Pudong New Area of Shanghai after 1 January 2008	2 + 3 years tax holiday (1)	Starting from the first income-generating year
Software enterprises	2 + 3 years tax holiday (1)	Starting from the first profit-making year
Integrated circuits design enterprises	2 + 3 years tax holiday (1)	Starting from the first profit-making year
Integrated circuits production enterprises with a total investment exceeding CNY 8 billion or that produce integrated circuits with a line-width of less than 0.25um, provided that its operation period exceeds 15 years	5 + 5 years tax holiday (3)	Starting from the first profit-making year
Integrated circuits production enterprises that produce integrated circuits with a line-width of less than 0.8um	2 + 3 years tax holiday (1)	Starting from the first profit-making year
Qualified energy-saving service enterprises	3 + 3 years tax holiday (2)	Starting from the first income-generating year
Encouraged enterprises in underprivileged areas of Xinjiang	2 + 3 years tax holiday (1)	Starting from the first income-generating year

Notes

1. '2 + 3 years tax holiday' refers to two years of exemption from CIT followed by three years of 50% reduction of CIT.
2. '3 + 3 years tax holiday' refers to three years of exemption plus three years of 50% reduction of CIT.
3. '5 + 5 years tax holiday' refers to five years of exemption plus five years of 50% reduction of CIT.

For income derived from the transfer of technology in a tax year, the portion that does not exceed CNY 5 million shall be exempted from CIT; and the portion that exceeds CNY 5 million shall be allowed a 50% reduction of CIT.

A CIT exemption applies to the dividend derived by a TRE from the direct investment into another TRE, except where the dividend is from stocks publicly traded on the stock exchanges and the holding period is less than 12 months.

A CIT exemption also applies to the income derived by recognised non-profit-making organisations engaging in non-profit-making activities.

Reduced tax rate

The CIT rate may be reduced under certain conditions for different industries (*see the Taxes on corporate income section for more information*).

Reduction of revenue

Where an enterprise uses resources specified by the state as its major raw materials to produce non-restricted and non-prohibited products, only 90% of the income derived is taxable.

Offset of certain venture capital investment

For a venture capital enterprise that makes an equity investment in a non-listed small to medium-sized new/high tech enterprise for more than two years, 70% of its investment amount may be used to offset against the taxable income of the venture capital enterprise in the year after the holding period has reached two years. Any portion that is not utilised in that year can be carried forward and deducted in the following years.

Investment tax credit

Enterprises purchasing and using equipment specified by the state for environmental protection, energy and water conservation, or production safety purposes are eligible for a tax credit of 10% of the investment in such equipment. Any unutilised amount can be carried forward and creditable in the following five years.

Other incentives

There are also tax incentives in relation to the deduction of expenses and cost (e.g. 50% additional R&D deduction, shorter tax depreciation period, and accelerated depreciation). *See the Deductions section for more information*.

Foreign tax credit

A TRE is allowed to claim foreign tax credit in relation to foreign income tax already paid overseas in respect of income derived from sources outside China based on a country-basket principle. The creditable foreign tax also includes foreign income tax paid by qualified CFCs. However, the creditable amount may not exceed the amount of income tax otherwise payable in China in respect of the foreign-sourced income. In addition, there is a five-year carryforward period for any unutilised foreign tax.

Withholding taxes

Foreign enterprises without establishments or places of business in China shall be subject to a unilaterally concessionary rate of withholding tax (WHT) at 10% on gross income from dividends, interest, lease of property, royalties, and other China-source passive income unless reduced under a tax treaty. Nevertheless, dividends distributed by a foreign investment enterprise out of its pre-2008 profit are still exempted from WHT.

WHT rates under China's tax treaties with other countries/nations are as follows (as of 31 May 2014):

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Recipient	Dividends (%)	Interest (%) (1)	Royalties (%) (2)
Albania	10	10	10
Algeria	5/10 (3a)	7	10
Armenia	5/10 (3a)	10	10
Australia	15	10	10
Austria	7/10 (3b)	7/10 (4a)	6/10
Azerbaijan	10	10	10
Bahrain	5	10	10
Bangladesh	10	10	10
Barbados	5/10 (3a)	10	10
Belarus	10	10	10
Belgium	5/10 (3j)	10	7
Bosnia and Herzegovina (7)	10	10	10
Botswana (9)	5	7.5	5
Brazil	15	15	15/25 (5a)
Brunei	5	10	10
Bulgaria	10	10	7/10
Canada	10/15 (3f)	10	10
Croatia	5	10	10
Cuba	5/10 (3a)	7.5	5
Cyprus	10	10	10
Czech Republic	5/10 (3a)	7.5	10
Denmark	5/10 (3a)	10	7/10
Ecuador (6, 9)	3/5 (6)	8/10 (6)	8/10 (6)
Egypt	8	10	8
Estonia	5/10 (3a)	10	10
Ethiopia	5	7	5
Finland	5/10 (3a)	10	7/10
France	10	10	6/10
Georgia	0/5/10 (3c)	10	5
Germany	10	10	7/10
Greece	5/10 (3a)	10	10
Hong Kong Special Administrative Region	5/10 (3d)	7	7
Hungary	10	10	10
Iceland	5/10 (3a)	10	7/10
India	10	10	10
Indonesia	10	10	10
Iran	10	10	10
Ireland, Republic of	5/10 (3b)	10	6/10
Israel	10	7/10 (4a)	7/10
Italy	10	10	7/10
Jamaica	5	7.5	10
Japan	10	10	10
Kazakhstan	10	10	10
Korea, Republic of	5/10 (3a)	10	10
Kuwait	0/5 (3k)	5	10
Kyrgyzstan	10	10	10
Laos	5	5 (in Laos)	5 (in Laos)
		10 (in Mainland China)	10 (in Mainland China)
Latvia	5/10 (3a)	10	7

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Recipient	Dividends (%)	Interest (%) (1)	Royalties (%) (2)
Lithuania	5/10 (3a)	10	10
Luxembourg	5/10 (3a)	10	6/10
Macao Special Administrative Region	5/10 (3a)	7	7
Macedonia	5	10	10
Malaysia	10	10	10/15 (5b)
Malta	5/10 (3a)	10	7/10
Mauritius	5	10	10
Mexico	5	10	10
Moldova	5/10 (3a)	10	10
Mongolia	5	10	10
Morocco	10	10	10
Nepal	10	10	15
Netherlands	10	10	6/10
New Zealand	15	10	10
Nigeria	7.5	7.5	7.5
Norway	15	10	10
Oman	5	10	10
Pakistan	10	10	12.5
Papua New Guinea	15 (3m)	10	10
Philippines	10/15 (3g)	10	10/15 (5b)
Poland	10	10	7/10
Portugal	10	10	10
Qatar	10	10	10
Romania	10	10	7
Russia	10	10	10
Saudi Arabia	0/5 (3l)	10	10
Seychelles	5	10	10
Singapore	5/10 (3a)	7/10 (4a)	6/10
Slovak Republic	10	10	10
Slovenia	5	10	10
South Africa	5	10	7/10
Spain	10	10	6/10
Sri Lanka	10	10	10
Sudan	5	10	10
Sweden	5/10 (3a)	10	6/10
Switzerland	10	10	6/10
Syria	5/10 (3a)	10	10
Tajikistan	5/10 (3a)	8	8
Thailand	15/20 (3a)	10	15
Trinidad and Tobago	5/10 (3e)	10	10
Tunisia	8	10	5/10 (5c)
Turkey	10	10	10
Turkmenistan	5/10 (3a)	10	10
Uganda (9)	7.5	10	7/10
Ukraine	5/10 (3a)	10	10
United Arab Emirates	0/7 (3k)	7	10
United Kingdom	5/10/15 (3i)	10	6/10
United States	10	10	7/10
Uzbekistan	10	10	10

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Recipient	Dividends (%)	Interest (%) (1)	Royalties (%) (2)
Venezuela	5/10 (3h)	5/10 (4a)	10
Vietnam	10	10	10
Yugoslavia (8)	5	10	10
Zambia	5	10	5

Source: State Administration of Taxation, China

Notes

This table is a summary only and does not reproduce all the provisions relevant in determining the application of WHT in each tax treaty/arrangement.

- 0% is due on interest paid to government bodies, except for Australia, Bosnia and Herzegovina, Brunei, Cyprus, Israel, Slovenia, and Spain. Reference should be made to the individual tax treaties.
- The lower rate on royalties applies for the use of or right to use any industrial, commercial, or scientific equipment.
- The following notes apply to dividend WHT:
 - The lower rate applies where the beneficial owner of the dividend is a company (not a partnership) that directly owns at least 25% of the capital of the paying company.
 - The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 25% of the voting shares of the paying company.
 - The lowest rate (i.e. 0%) applies where the beneficial owner is a company that directly or indirectly owns at least 50% of the capital of the paying company and the investment exceeding 2 million euros (EUR). The lower rate (i.e. 5%) applies where the beneficial owner is a company that directly or indirectly owns at least 10% of the capital of the paying company and the investment exceeding EUR 100,000.
 - The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 25% of the capital of the paying company.
 - The lower rate applies where the beneficial owner of the dividend is a company that directly or indirectly owns at least 25% of the capital of the paying company.
 - The lower rate applies where the beneficial owner of the dividend is a company that owns at least 10% of the voting stock of the paying company.
 - The lower rate applies where the beneficial owner of the dividend is a company that directly owns at least 10% of the capital of the paying company.
 - The lower rate applies where the beneficial owner is a company (other than a partnership) that directly owns at least 10% of the capital of the paying company.
 - The lowest rate (i.e. 5%) applies where the beneficial owner of the dividend is a company that directly holds at least 25% of the capital of the paying company. The highest rate (i.e. 15%) applies where those dividends are paid out of income or gains derived directly or indirectly from immovable property within the meaning of Article 6 by an investment vehicle that distributes most of this income or gains annually and whose income or gains from such immovable property is exempted from tax. The 10% rate applies in all other cases.
 - The lower rate applies where the beneficial owner of the dividend is a company (not a partnership) that directly owns at least 25% of the capital of the paying company within at least 12 consecutive months before the payment takes place.
 - The lowest rate (i.e. 0%) applies where the beneficial owner of the dividend is (i) the government of the other contracting state or any of its institutions or other entity wholly owned, directly or indirectly, by the government of the other contracting state or (ii) a company that is a resident of the other contracting state whose shares are at least 20% owned, directly or indirectly, by the government of the other contracting state.
 - The lowest rate (i.e. 0%) applies where the beneficial owner of the dividend is the government of the other contracting state or any of its institutions or other entity wholly owned, directly or indirectly, by the government of the other contracting state.
 - In the case of Papua New Guinea, the WHT shall be limited to 10% of the dividend while the Chinese tax law existing on the date of the signing of the tax treaty regarding dividends still applies; otherwise, the tax rate shall be 15%.
- The following notes apply to interest WHT:
 - The lower rate applies to interest payable to banks or financial institutions.
- The following notes apply to royalties WHT:
 - The higher rate applies to trademarks.
 - The higher rate applies to copyright of literary, artistic, or scientific work, including cinematograph films or tapes for television or broadcasting.
 - The lower rate applies to royalties paid for technical or economic studies or for technical assistance.
- The lower rates apply in cases where the dividend, interest, or royalty paid from Ecuador to China is applicable to the Foreign Exchange Control Tax in Ecuador.
- The tax treaty with the former Socialist Federal Republic of Yugoslavia is now applicable to Bosnia and Herzegovina.
- The tax treaty with the former Federal Republic of Yugoslavia is now applicable to the nations of Serbia and Montenegro.
- These tax treaties have not yet entered into force as of 1 January 2014.

In addition to the above tax treaties, China has also entered into tax information exchange agreements (TIEAs) with a few countries. For example:

- Argentina.
- Bahamas.
- Bermuda.
- British Virgin Islands (BVI).
- Cayman Islands.
- Guernsey.
- Jersey.
- Isle of Man.

C

Tax administration

Taxable period

The tax year commences on 1 January and ends on 31 December.

Tax returns

Enterprises are required to file their annual income tax return within five months after the end of the tax year, together with an audit certificate of a registered public accountant in China. Information on related party transactions must be filed with the annual income tax return.

Payment of tax

Enterprises are required to file and pay provisional income taxes on a monthly or quarterly basis within 15 days following the end of each month/quarter. Three options are available to the taxpayer in computing the provisional tax: (i) actual profits of the month/quarter, (ii) average monthly or quarterly taxable income of the preceding year, or (iii) other formulas approved by the local tax authorities.

Settlement of tax payment is due, in conjunction with the annual income tax return, within five months after the end of the tax year.

Tax audit process

There is no fixed audit cycle in China. Tax audit targets are selected pursuant to certain criteria.

Statute of limitations

For unintentional errors (e.g. calculation errors) committed by the taxpayer in its tax filing, the statute of limitation is three years and extended to five years if the amount of tax underpaid is CNY 100,000 or more. For transfer pricing adjustments, the statute of limitation is ten years. There is no statute of limitation for tax evasion, refusal to pay tax, or defrauding of tax payment.

Recent focus of Chinese tax authorities

Since 2009, the Chinese tax authorities have strengthened their tax administration on transfer pricing and income derived by non-TREs. The State Administration of Taxation (SAT) has released a number of tax circulars addressing the tax administration of transfer pricing, foreign contractors and service providers, WHT on passive income, etc.

Under the CIT Law, non-TREs are subject to CIT on the capital gain derived from the disposal of equity investment in Chinese companies. In addition, the transfer has to be effected at fair value so that any gain shall be recognised for tax purpose at the time when the transaction takes places (unless the transaction qualifies for deferral tax treatment provided under the tax regulations). The Chinese tax authorities have, in recent years, challenged and clawed back CIT on several equity transfer cases whereby

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non-TREs disposed of their equity investment in China to related parties at cost or below 'fair value'. In addition, they have become more knowledgeable on valuation theories and methodologies and are applying them in reviewing valuation reports in order to ascertain the fair value of equity transfer transactions for tax purposes.

In addition, the Chinese tax authorities have geared up their efforts in recent years to scrutinise investment structures involving intermediate holding companies incorporated in low-tax jurisdictions. One of their focuses is on the indirect equity transfer of Chinese companies by non-TREs. The income derived by a non-TRE from the disposal of a non-Chinese company is not taxable under China's domestic income tax law. However, if the Chinese tax authorities are of the view that the non-TRE transferor has used an abusive arrangement to indirectly transfer the equity of the Chinese company (i.e. interposing and disposing of the special purpose vehicle for no reasonable commercial purpose, but just for avoidance of China withholding income tax), it may re-characterise the equity transfer based on the 'substance over form' principle and disregard the existence of the special purpose vehicle. Once the special purpose vehicle is disregarded, the transfer would be effectively a transfer of the underlying Chinese company's equity, and the transfer gain would be China source and subject to China withholding income tax.

The SAT has also released circulars relating to the claiming of treaty benefits by non-TREs and interpretation of certain articles and terms in the tax treaties, such as dividends, royalties, beneficial ownership, etc. Aggressive tax planning (including, but not limited to, tax-avoidance and treaty-abusive arrangements) not supported by reasonable commercial purposes and substance will be subject to scrutiny by the Chinese tax authorities.

On 26 July 2010, the SAT issued a Departmental Interpretation Note (DIN) for the tax treaty concluded between China and Singapore. It is the first time the SAT has introduced a set of technical views, interpretation, and practice guidelines for the implementation of a tax treaty in such a comprehensive manner. More importantly, this set of interpretation is also applicable to other tax treaties concluded by China if the provisions of the relevant articles in those tax treaties are the same as those in the China/Singapore tax treaty. Thus, it is likely to have a wide impact to tax residents of other countries/regions that have entered into tax treaties with China.

General anti-avoidance rules (GAAR)

There is a GAAR provision in the CIT law allowing the Chinese tax authorities to make adjustments to taxable revenue or taxable income where business arrangements, structures, or transactions are entered into without reasonable commercial purpose and result in a reduction, exemption, or deferral of tax payment. The Chinese tax authorities may initiate a GAAR investigation if they suspect that an enterprise undertakes any of the following arrangements: abuse of preferential tax treatments, abuse of tax treaties, abuse of corporate structure, use of tax havens for tax avoidance purposes, or other arrangements that do not have a reasonable commercial purpose.

Other issues

Choice of business entity

Foreign companies, enterprises, or individuals may establish equity joint ventures, contractual joint ventures, wholly foreign-owned enterprises, or representative offices in China. Certain foreign financial institutions, including banks and insurance companies, may, subject to approval, set up branches in China. Foreign investors are allowed to establish foreign invested partnerships in China. For certain foreign invested industries and projects, approval is needed from the relevant Chinese government authorities.

Exchange controls

Foreign exchange transactions are administered by the State Administration of Foreign Exchange (SAFE) and its branches. The regulatory administration on foreign exchange transactions of an enterprise depends on whether the transaction is a current account item or a capital account item. Current account items refer to ordinary transactions within the context of international receipts and payments, including, but not limited to, balance of payments from trade, labour services, and unilateral transfers. Capital account items refer to items of increase or decrease in debt and equity due to inflow or outflow of capital within the context of international receipts and payments, including, but not limited to, direct investment, all forms of loans, and investment in securities. Generally, a payment that falls under the category of a current account may be remitted to overseas if supported with proper contracts, invoices, and tax payment/exemption certificates. In the past, most of the transactions under the category of capital account items had to be approved by the SAFE. Since the end of 2012, the SAFE has relaxed the administration of certain capital account items so that approval is no longer needed for a few types of transactions.

Intellectual properties

Patents, trademarks, and copyrights are governed by separate laws and administered by separate governmental bodies. The government encourages the development and transfer of intellectual properties. The transfer of technology and technical services are currently exempted from BT.

Mergers and acquisitions (M&A) activities

Both Chinese domestic and foreign investors increasingly are using M&A transactions to establish or expand their Chinese operations.

The Ministry of Finance (MOF) and the SAT jointly released a tax circular that addresses the CIT treatments for six forms of restructuring transactions, namely, change in legal form, debt restructuring, equity acquisition, assets acquisition, merger, and spin-off. The general principle is that enterprises undergoing corporate restructuring should recognise the gain/loss from the transfer of relevant assets/equity at fair value when the transaction takes place. However, if certain prescribed conditions are satisfied, the parties involved could opt for special tax treatments, which are essentially tax deferral tax treatment. In other words, recognition of gain/loss of the transferor from transfer of assets/equity can be deferred with respect to the equity-payment portion; and the transferee may take over the transferor's tax basis of the acquired assets/equity. Such special tax treatments are only available to a very few specific types of cross-border transactions.

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