Understanding Mainland China & Hong Kong’s Tax Systems - A Comparison

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The respective tax systems of the People’s Republic of China and Hong Kong have some key differences that a business operating in both tax jurisdictions should be aware of in order to ensure full compliance.

This brief article will explain the both systems and offer a simple comparison.

Mainland China
Tax is the most important source of fiscal revenue collection in the People’s Republic of China ("PRC") making China more competitive as it has progressively opened up to the outside world and also promoting further development of China’s national economy.

Since the tax system underwent substantial reform in 1994 and a subsequent series of policies for optimisation and refinement since, China has built a tax system that is both conducive and adaptable to the market economy.

Under the current tax system in China as of 1st May 2016, there are Five Categories of Taxes which have been organised in the below chart according to both their type and function:

* Customs duty regulated by China Customs, not Tax bureau
B2V Reform

On 5th March 2016, Premier Li Keqiang announced at the opening of the National People’s Congress that Construction, Real Estate, Financial Services and Consumer / Daily Life Services sectors would be included in the final phase of “Business Tax to VAT” (“B2V”) reform which has since come into effect as of 1st May, 2016.

From 1st May 2016 onwards, these four industries would be covered by Value-Added Tax (“VAT”) rather than Business Tax (“BT”). As such the policy of B2V tax reform will be completed, making China’s Indirect Tax System introduced in 1994 comprising of both VAT and BT obsolete.

The completion of B2V reform is expected to bring in a series of changes on VAT policy and administration which will have a profound impact on all enterprises operating in China.

According to Circular 36, the new VAT rates for construction, real estate, financial services and consumer services are as follows:

<table>
<thead>
<tr>
<th>Sector</th>
<th>New VAT Rate</th>
<th>Current BT Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>11%</td>
<td>3% (possible net basis)</td>
</tr>
<tr>
<td>Financial Services</td>
<td>11%</td>
<td>5%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Consumer Services, e.g., F&amp;B, Hospitality</td>
<td>6%</td>
<td>Generally 5%</td>
</tr>
</tbody>
</table>

Hong Kong’s Tax System

Hong Kong has one of the most tax-friendly economies for business in the world making it a competitive destination for Foreign Direct Investment (“FDI”) and establishing an investment platform for global businesses or those looking to invest into the PRC.

The tax jurisdiction of Hong Kong is regarded as both simple and stable and only imposes four direct taxes as shown in the below chart. Hong Kong’s tax system also allows for specific allowances and deductions which can reduce a legal entity’s tax liabilities:

- Profits Tax
- Salaries Tax
- Property Tax
- Stamp Duty

Significantly, the tax jurisdiction of Hong Kong does not levy tax on the following:

- Sales Tax or VAT
- Withholding Tax
- Capital Gains Tax
- Tax on Dividends
- Estate Tax
Based on the Territorial Principle, only Hong Kong sourced income is subject to Hong Kong income tax. Hong Kong is also known for its free port status and easy customs procedures.

Duty is levied on a narrow range of products such as tobacco (notably alcohol importing of alcoholic beverages is deemed Duty Free).

**China Vs Hong Kong: A Direct Comparison of the Two Systems**

**Corporate Income Tax**
The first point of comparison concerning Corporate Income Tax ("CIT"), China imposes a tax of 25% CIT while Hong Kong since 2008/09 onwards has implemented a comparatively low 16.5% CIT on profits.

While in Hong Kong as previously mentioned, there is no Turnover Tax and Custom Duty is imposed on a limited range of imports. The PRC following the ratification and full implementation of B2V reform applies both Consumption Tax and Customs Duty on imported goods in addition to VAT.

**Individual Income Tax**
Individual Income Tax ("IIT") is also taxed according to progressive rates of between 3% and 45% depending on income and applicable tax bracket. Service / Freelance Income is taxable at the rate of 20% for income of 20,000 RMB or below ranging up to 40% according to the respective income bracket. Under provision of services and income generated through freelancing, the total taxable income equates to 80% with 20% being exempted for business expenses.

In comparison, IIT in Hong Kong is calculated according to progressive rates of between 2% and 17% or on a flat rate of 15% and personal deduction is allowed on other non-related additional income.
Optimising the PRC and Hong Kong DTA
On 1st April 2015, the PRC and Hong Kong signed the Fourth Protocol of the China-Hong Kong Double Taxation Agreement (“DTA”) in Hong Kong.

When repatriating profits from Mainland China to Hong Kong, by way of dividend remittance a withholding income tax rate of 5% is applied, while with reference to interest and royalties, a rate of 7% is levied. Only profit derived from or arising in Hong Kong is taxable under Hong Kong profits tax. If a taxpayer can arrange their business operations outside of Hong Kong, this would be deemed as such and is therefore exempt from Hong Kong profits tax. The Fourth Protocol of the China-HK DTA brings both benefits as well as tax obligations to the taxpayer.

Both the PRC and Hong Kong authorities are committed to ensuring that the terms of the DTA are not abused and strive to work collaboratively in the facilitation and future information exchange concerning tax matters.

For more resources on Mainland China and Hong Kong tax, please contact us at enquiries@lehmanbrown.com
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Founded in 2001, LehmanBrown is a China-focused accounting, taxation and business advisory firm, operating in Beijing, Shanghai, Hong Kong, Macau, Shenzhen, Guangzhou and Tianjin. Our firm also manages an extensive affiliate network, providing service throughout China and reach across the globe.

Combining years of international expertise with practical Chinese experience and knowledge, LehmanBrown offers expert advice and support to both local and international clients. Within the mid-tier, we are regarded as a market leader and our clients enjoy access to a combination of senior and experienced counsellors from both China and abroad.

At LehmanBrown we recognise that you are unique, that you have unique requirements and we are committed to providing individually tailored financial solutions. LehmanBrown is dedicated to providing personalised service by working closely with our clients to understand your individual business needs. This enables us to offer the most up-to-date and expert advice.

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Professional Services

Audit & Assurance
- External Audit
- China Statutory Audit
- US GAAP Audit
- IFRS Audit
- Hong Kong Statutory Audit

Internal Audit
- Fraud Investigation
- Forensic Accounting

Special Purpose Audit
- Foreign Currency Audit
- Royalty Audit
- Capital Verification Audit

Valuation Services
- Corporate Valuation
  - Damage Assessment Valuation
  - Intellectual Property Valuation
  - Asset Valuation
  - Special Purposes Valuation

Corporate Finance
- Debt Restructuring
- Acquisition, Disposal & Financing

Mergers & Acquisitions
- Transaction Advisory
- MBA Diversiture
- M&A Integration
- Financial Due Diligence

Business Services
- Company Registration & Maintenance
  - Market Entry Advisory
  - Updating Company Certificates
  - Annual Inspection & Reporting
  - Company Secretarial Services
  - Company Ownership Transferring/Corporate Restructuring
  - Background/Credit Checking
  - Company Deregistration & Bankruptcy

HR Support Services
- China Visa Services for Expatriates
- Social Welfare Structures

Outsourcing Services

Accounting & Bookkeeping
- Budgeting & Forecasting
- Financial Statement Preparation
- Head Office Reporting

Financial Management
- Interim Financial Management
- Finance Manager Function
- CFO Function
- Cash Flow Management

Treasury Management
- Set-up of Bank Account

Payroll Services
- Payroll Processing Setup
- Expatriate Employees
- Local Employees

Secondment & Temping Service
- Chop Custodian Services

Taxation Services

Individual Tax Planning (IIT)
- Tax Immigration & Investment Review
- US & Overseas Personal Income Tax Planning & Filing
- IT Tax Payment Facilitation
- Application for Individual Income Tax Refund
- Expatriate Staff Individual Income Tax Staff Filing
- Local Staff Individual Income Tax

Company Taxation (CIT)
- Tax Consulting
  - Corporate Tax Planning
  - Business Restructuring
  - Value Chain Review
  - Onshore / Offshore Investment
  - Transfer Pricing

Tax Compliance
- Tax Due Diligence
- Tax Deregistration
- Negotiation of Tax Penalties
- Tax Refund Application
- Tax Representatives for Tax Audit
- VAT & Customs Duty Clearance
- PRC Tax Receipt Verification
- VAT Application
- VAT & Sales Tax Filing
- Corporate Income Tax Reporting

Specialist Accounting & Risk Management

Internal Controls
- Systems
- Risk Management
- Sarbanes - Oxley (SOX 404)

GAAP, SEC & IFRS Compliance
- US GAAP
  - US GAAP Financial Statement Preparation
  - US GAAP Conversion

Other GAAP
- GAAP Conversion
- Public Company Compliance
- Financial Statement Preparation

IFRS
- IFRS Accounting Repackaging
- IFRS Financial Statement Preparation
- IFRS Public Company Compliance

SEC
- SEC Public Company Compliance

Legal Services

Legal Advisory
- Workforce Downsizing Advisory
- Labour Tribunal Assistance & Advisory
- Labour Law Review & Audits
- Review & Preparation of Employment Contracts

Corporate Legal Advisory
- Legal Due Diligence
- Corporate Restructuring Advisory
- Review & Preparation of Articles of Association (AoA)
- Review & Preparation of JV Contracts
- Review & Preparation of Repatriation Agreements

Other Legal Services
- Dispute Mediation & Advisory
- Trademark & Intellectual Property Advisory
- Debt Collection Assistance
- Litigation Support
Contact Us 联系我们

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Beijing 北京
6/F, Dongwai Diplomatic Building, 23 Dongzhimenwai Dajie, Beijing 100600, China
中国北京市朝阳区东直门外大街23号，东外交办公大楼602
Tel: +86 10 8532 1720
Fax: +86 10 8532 2746
E-mail: beijing@lehmanbrown.com

Shanghai 上海
Room 1501 & 1504, WanTai International Building, No. 480 North Urumqi Road, Shanghai 200040, China
中国上海市静安区乌鲁木齐北路（华山路）480号1501 & 1504
Tel: +86 21 6249 0055
Fax: +86 21 6288 1636
E-mail: shanghai@lehmanbrown.com

Guangzhou 广州
Room 3317, China Shine Plaza, 9 Lin He Xi Road, Guangzhou 510610, China
中国广州市林和西路9号耀中广场3317室
Tel: +86 20 2205 7883
Fax: +86 20 2205 7880
E-mail: guangzhou@lehmanbrown.com

Shenzhen 深圳
Room 3206, News Building 2, Shennan Middle Road, Shenzhen 518027, China
中国深圳市深南中路2号新闻大厦3206
Tel: +86 755 8209 1244
Fax: +86 755 8209 0672
E-mail: shenzhen@lehmanbrown.com

Tianjin 天津
Unit 2901-04, The Exchange Tower 2 189 Nanjing Road, Heping District Tianjin 300051, China
中国天津市和平区南京路189号津汇广场2座2901-104室
Tel: +86 22 2318 5056
Fax: +86 22 2318 5001
E-mail: tianjin@lehmanbrown.com

Hong Kong 香港
Suite 03, 16/F, Sino Plaza, 255-257 Gloucester Road, Causeway Bay, Hong Kong
香港铜锣湾告士打道255-257号信和广场16楼03室
Tel: +852 2426 6426
Fax: +852 2426 6427
E-mail: hongkong@lehmanbrown.com

Macau 澳门
No. 367, Avenida da Praia Grande, "Keng Ou" Commercial Building #16, A & B, Macau
中国澳门南湾大马路367号京奥商业大厦16楼AB座
Tel: +853 2835 5015
Fax: +853 2837 1884
E-mail: macau@lehmanbrown.com

www.lehmanbrown.com