

Taxes on Licensing Income In China

BY SHAOJIE CHI*



Discussion of various classifications of taxes on royalty paid to licensors

In China, the tax levied on licensing income varies with the capacities of the licensors. Identification of differences in licensing taxation in the PRC is of significance to foreigners intending to conduct technology transfer in the country. This discusses the various classification of taxes on royalty paid to licensors with different capacities.

Foreign Enterprise Outside China as Licensor

As stipulated by Article 11 of the PRC Income Tax Law Concerning Foreign Enterprises, "Foreign companies, enterprises and other organizations having no establishments in China shall pay an income tax of 20% on all dividend, interest, rental, royalty and other income with a source in China. Such a tax shall be withheld by the paying unit from the amount of each payment."

Royalty here means income from licensing out patent, know-how, trademark, copyright, etc. to any enterprise in the PRC. For the payment of tax on income of this kind, the total amount of royalty, without any deduction, shall be taxable income. The foreign licensor is the taxpayer and the Chinese paying unit is the withholding agent.

The withholding agent shall withhold 20% of each royalty payment to the foreign licensor, and shall, within five days from each withholding, turn over the withheld tax to the state treasury and file a tax return to the taxation authorities. The income tax shall be computed in terms of Renminbi (Chinese currency). If the royalty is

paid in foreign currency, it shall be taxed on the equivalent amount converted to Renminbi at the rate quoted on the paying day by the State General Administration of Exchange Control of the PRC. If a withholding agent does not withhold income tax as stipulated by the law, a fine shall be imposed of up to, but not exceeding, 100% of the tax that should have been withheld, in addition to paying the tax within a new time limit set by the taxation authorities.

In view of the above-mentioned, such clauses as "licensee shall be liable to any tax levied in China upon any payment under this contract" is regarded as a violation of Chinese law, thus being invalid and unenforceable. Besides, it is advisable for the foreign licensor to stipulate in the licensing contract that the licensee, as the income tax withholding agent, shall be responsible for its failure to execute the obligation under PRC Income Tax Law Concerning Foreign Enterprises.

Foreign Individual as Licensor

If a foreign individual licenses out his or her patent, know-how, etc. to a Chinese entity, he or she shall be subject to taxation under the PRC Personal Income Tax Law for the royalty received from licensing. As regulated by the law, personal income from royalty is taxable at a fixed rate of 20% with a deduction of Renminbi 800 yuan, if each payment amounting to less than 4,000 yuan, and a deduction of 20% of the total income, if each payment being more than 4,000 yuan.

For the individual income tax, the foreign royalty earner is the taxpayer, and the paying unit is the withholding agent. Taxpayers without a withholding agent are re-

quired to file returns and pay tax themselves. The tax withheld each month by a withholding agent and the tax to be paid each month by a taxpayer personally filing a return must be paid to the state treasury. The tax return must be submitted to the taxation authorities within the first seven days of the following month.

Withholding agents and taxpayers personally filing returns must pay the tax within the prescribed time limit. In case of failure to do so, the taxation authorities, in addition to setting a new time limit for tax payment, shall impose a surcharge for overdue payment equal to 5% of the overdue tax for every day in arrears, starting from the first day payment becomes overdue.

To encourage the withholding agents to perform their duty, the law stipulates that a service fee of 1% of the withheld tax shall be paid to the withholding agents.

Sino-foreign Joint Venture in PRC as Licensor

The Income Tax Law of the People's Republic of China Concerning Sino-foreign Joint Ventures stipulates, "Income tax shall be paid in accordance with the provisions of this law by Sino-foreign joint ventures hereafter referred to as joint ventures) located in the People's Republic of China on all their income from production and business operations and on other income." Other income here includes royalty income received by joint ventures from licensing out their technology in China. The law does not classify tax on royalty separately. Thus, a fixed rate of 30%

*Patent Agency, CCPIT, Beijing.

is applied to total taxable income which is the excess of the joint venture's gross income in a tax year over its deductible costs, expenses and losses, in addition to a local income tax of 10% of the assessed income tax.

Income tax on joint ventures shall be computed and levied on an annual basis and paid in advance in quarterly installments. Such advance payment shall be made within 15 days after the end of each quarter, and the final settlement shall be made within three months after the end of each tax year, with a refund for any overpayment or a supplemental payment for any deficiency.

If a joint venture receives its income in foreign currency, it will pay the tax on the income by an equivalent amount converted into Renminbi at the rate quoted by the PRC State General Administration of Exchange Control on the day the taxpayer being taxed.

If a joint venture fails to pay its tax within the prescribed time limit, a surcharge shall be imposed for overdue payment equal to 5% of the overdue tax for every day in arrears, starting the first day payment becomes overdue. In case of a joint venture that has evaded or refused to pay tax, the taxation authorities, in addition to pursuing the tax payment, may impose a fine of up to, but not exceeding, five times the tax underpaid or not paid, in accordance with the seriousness of the case. Cases of gross violation shall be handled by the local people's courts.

Foreign Enterprises Inside China as Licensor

"Foreign Enterprises Inside China" refers to foreign companies, enterprises and other economic organizations having establishments inside China and engaging in independent business operations or in cooperative production or cooperative business operations with Chinese enterprises. Like Sino-foreign joint venture in the PRC, foreign enterprises inside China pay tax on the gross income. This includes royalty, etc. in a tax year over its deductible costs, expenses and losses. But instead of a fixed

rate, progressive rates of 20-40% are applied in accordance with the taxable incomes. In addition, a local income tax of 10% of taxable income is levied. Other regulations are more or less similar to those concerning Sino-foreign joint ventures in China.

Tax Preferential Treatment to Foreign Investors

To make the investment environment better and more attractive to foreign investors, China amended the income tax laws so they are more favorable to foreign investors. For example, the period of tax exemption and reduction for Sino-foreign joint venture is prolonged under the Decision Regarding the Amendment to PRC Income Tax Law Concerning Sino-foreign Joint Venture by the Standing Committee of National People's Congress, passed on September 2, 1983. Those joint ventures with a term of more than 10 years, after applying with and being approved by the taxation authorities, may enjoy a 2-year (originally 1-year) period of tax exemption starting from the first profitable year and a further 3-year (originally 2-year) period of 50% tax reduction.

To make foreign investors more relaxed, the State Council promulgated a 22-article Provisions to encourage foreign investment. As stipulated in the Provisions, enterprises with foreign investment (i.e. Sino-foreign equity joint venture, Sino-foreign cooperative ventures, and wholly foreign-owned enterprises) with an annual export amounting to 70% or more of the value of their products of the year, after the expiration of the period for the reduction or exemption of enterprise income tax in accordance with the provisions of the State, may pay income tax at one-half of the present rate. If enterprises of this kind are located in the special economic zones and the economic and technological development zones, which already enjoyed a preferential rate of 15% and comply with the aforesaid 70% export condition, they are entitled to a further tax reduction to 10%. Production enterprises possessing advanced technology supplied by foreign

investors and engaging in developing new products or upgrading and replacing existing products in order to increase exchange earnings from exports or import substitution, after the expiration of tax exemption and reduction period originally stipulated by law, may be allowed a 3-year extension to pay income tax at one-half of the current rate.

In order to introduce more technology up to advanced world level, the State Council enacted the Provisional Regulations Concerning Reduction and Exemption of Income Tax and Consolidated Industrial and Commercial Tax in Special Economic Zones and 14 Coastal Open Cities. Under these regulations only a 10% income tax shall be levied on dividends, interest, rental and royalty, etc. received from the mentioned areas by foreign enterprises having no business establishments in China. If investment and equipment are provided on favorable terms, or technology transferred is truly advanced, the local governments are empowered to grant more incentives in tax exemption and reduction. Recently, similar preference was given to Hainan Island by the Central Government.

Chinese Enterprise or Non-Enterprise Organization as Licensor

Based on the Provisional Regulations Concerning Technology Transfer promulgated by the State Council of the People's Republic of China on January 10, 1985, if an enterprise under the ownership of the whole people or a unit under collective ownership receives an annual net income of no more than 100,000 yuan from technology transfer, it shall not pay any tax on the income. For an amount more than 100,000 yuan, two kinds of rates apply. One is the fixed rate of 55% applied to large and medium state-owned enterprises. The other consists of progressive rates of 10-55% varying with eight equal-gap grades of taxable income applied to small state-owned enterprises, service sectors and enterprises under collective ownership. Those non-enterprise organizations under the ownership of the people, universities, colleges and research

institutions, etc. are conveyed a 3-year exemption of tax on licensing income.

Chinese Individual as Licensor

If a Chinese individual licenses out his or her patent, know-how, etc. to an enterprise inside China, he or she shall be subject to a regulating tax on personal income. A fixed rate of 20% is applied to license fees with a deduction of 800 yuan, if each payment being less than 4,000 yuan, or a 20% deduction of the total income if each pay-

ment being more than 4,000 yuan. This kind of regulating tax shall be withheld by the licensee as the withholding agent while paying royalty, to whom a service fee of 3% of the withheld tax shall be granted.

Tax on Technology Export Earnings

The Provisional Regulations for the Encouragement of Technology Export jointly promulgated by the Ministry of Foreign Economic Affairs and Trade and the State Science and Technology Commission on July 27, 1987, stipulates that

the State-owned enterprises and non-enterprise organizations are exempted from taxation upon their income from technology export from July 1, 1987, to June 30, 1989. Collective enterprises and individuals are obliged to pay tax on technology export income at the rates mentioned before.

Last, but not least, if an effective bilateral treaty for the avoidance of double taxation exists between China and any other country, it shall prevail whenever it contradicts provisions described in this paper.