TAX TIPS

How to pay tax on distributions to shareholders (investors) of companies in Mainland China

Net profits derived by a limited company in Mainland China after setting off of all accumulated losses from prior years (if any), paying all Enterprise Income Tax (“EIT”) and providing for statutory reserves can be declared as dividends and paid to its shareholders. Dividend and other distributions with respect to equity interests (hereinafter referred to as “dividend and profits distribution”) received by shareholders are taxable on the recipients. According to the relevant provisions of the Chinese tax law, the applicable tax rates vary for different types of shareholders. At present, the common types of shareholders are individuals (natural persons) and corporations.

I. Individual shareholders (Natural persons)

The Individual Income Tax (“IIT”) Law of the People's Republic of China stipulates that dividend and profits distribution received shall be taxed at the rate of 20%.

The following types of profits distributions received by individual shareholders are, subject to certain conditions, exempt from IIT:

1. Dividend and profits distributions received from listed companies in Mainland China by individual shareholders

   Individuals holding shares in listed companies in Mainland China acquired at public offerings or secondary markets are liable to IIT on dividend and profits distributions but the amount of IIT payable varies with the length of holding period.

   - Where the holding period is over one year, such income shall be temporarily exempt from IIT.
   - If the holding period is over one month and up to one year, 50% of such income shall be temporarily exempt from IIT.

2. Dividend and other distributions received from foreign-invested enterprises in China by foreign individual shareholders

- Where dividend and other distributions are received from foreign-invested enterprises in Mainland China, such income received by foreign individuals shall be temporarily exempt from IIT.
- Where dividend and profits distributions from B shares or overseas shares (including H shares) issued by enterprises in Mainland China are received by foreign individuals, such income shall be temporarily exempt from IIT.
- Foreign individuals receiving dividend and profits distributions from listed companies in Mainland China are not liable to IIT.

II. Corporate shareholders

1. Resident enterprise shareholders

   According to the EIT Law of China and its Implementation Regulation, dividend and profits distributions paid /received between qualifying resident enterprises are tax-exempt, except for investment income derived from holding of listed shares issued by resident enterprises for a continuous period of less than 12 months. In other words, dividend and profits distributions received by resident enterprise from listed companies are not subject to EIT except for those derived from shares held for less than 12 months.

2. Non-resident enterprise shareholders

   Non-resident enterprise shareholders are subject to EIT at 10% on dividends and profits distributions received from resident enterprises in China. However, if the country or jurisdiction where the non-resident enterprise is a tax resident has a tax treaty with China, and the relevant treaty tax rate is lower than 10%, the treaty tax rate would be applicable. Take Hong Kong resident companies as an example. According to the comprehensive double tax arrangement between Mainland China and Hong Kong, a 5% EIT rate on dividend is applicable if the beneficial owner is a company that directly owns at least 25% of the capital of the dividend-paying company, subject to other conditions.

   Withholding tax ("WHT") on profits (i.e. dividends and other distributions) distributed from resident enterprises in Mainland China to foreign investors with direct investment in encouraged projects can be deferred if certain conditions are met. If foreign investors withdraw their direct investments through equity transfer, re-purchase, liquidation etc., they should repay, in accordance with the relevant regulations, the WHT deferred within 7 days upon receipt of the relevant proceeds.

III. Investments in H shares by individuals in Mainland China

1. Direct investments in H shares by individuals in Mainland China

   For individuals in Mainland China investing in H shares, any gains on buying and selling of share each time shall be subject to tax at 20%. Dividends received each time shall also be subject to tax at 20%.

2. Investments in H shares by individuals in Mainland China via Shanghai-Hong Kong Stock Connect

   From 17 November 2014 to 31 December 2022, individuals in Mainland China are temporarily exempt from IIT on gains on sale of investments in H shares via Shanghai-Hong Kong Stock Connect.

   However, dividends and other distributions derived from such investments are still subject to IIT at 20%.