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## **Difference in Tax Treatment of Individual Industrial and Commercial Households, Sole Proprietorship Enterprises and One-person Limited Liability Companies**

When starting a business, individual entrepreneurs often fail to understand the difference between Individual Industrial and Commercial Households, Sole Proprietorship Enterprises and One-person Limited Liability Companies, therefore are confused in choosing which form to register. This article will elaborate in details the difference in tax treatment of these three forms of business.

### **1. Definition**

#### **(1) Individual Industrial and Commercial Households**

A natural person conducting industrial and commercial operations upon registration in accordance with the law is an individual industrial and commercial household. Where the business of an individual industrial and commercial household is operated by an individual, the debts of the individual industrial and commercial household shall be assumed by the individual with his or her own property; where that is operated by a family, the debts of the individual industrial and commercial household shall be assumed by the family with family property; or where if it is impossible to ascertain whether that is operated by an individual or a family, the debts of the individual industrial and commercial household shall be assumed by the family with family property. Individual Industrial and Commercial Households shall be unlimitedly liable for the debts, and not qualified as a legal person.

#### **(2) Sole Proprietorship Enterprises**

A sole proprietorship enterprise refers to a business entity established in China in accordance with this law, invested by a natural person, the property of which is personally owned by the investor, and the investor assumes unlimited liability for the debts of the enterprise with his personal property. A sole proprietorship enterprise is not qualified as a legal person.

#### **(3) One-person Limited Liability Companies**

The term "one-person limited liability company" as mentioned in this Law refers to a limited liability company with only one natural person shareholder or legal person shareholder. All the shares or capital contributions of the company belong to one shareholder, and such a company is a legal person.

One natural person is allowed to establish merely one one-person limited liability company, which shall not establish any more one-person limited liability companies.

The shareholder of a one-person limited liability company shall only bear limited liability for the debts of the enterprise with his capital contributions. Where the shareholder of a one-person limited liability company cannot prove that the company assets are separate from his personal assets, he shall bear joint liability for the company's debts.

## 2. Taxation Rules

### (1) Individual Industrial and Commercial Households

The business owners of individual industrial and commercial households shall be deemed as taxpayers of individual income tax. Therefore, individual industrial and commercial households shall pay individual income tax instead of enterprise income tax.

In accordance with Individual Income Tax Law of the People's Republic of China, the operating income of the owner of an individual industrial and commercial household, i.e. the taxable income, shall be calculated as the balance of annual income deducting costs, expenses and losses in a tax year. The applicable progressive tax rate shall range from 5% to 35%.

In accordance with Measures for the Administration of Regular and Fixed-Amount Taxation on Individual Industrial and Commercial Households, where the individual industrial and commercial households do not meet the requirements of establishing accounting books, regular and fixed-amount taxation rules shall apply. Tax authority shall assess the fixed amount based on the business size, operating area, operating content, industry features and management level, etc.

Where a taxpayer obtains operating income, he shall calculate his individual income tax per annum, declare the income tax within 15 days after the month end or quarter end, and pay in advance. In addition, he shall file a tax return on a consolidated basis before 31 March in the following year in which he obtained income.

### (2) Sole Proprietorship Enterprises

In compliance with Provisions on Collection of Individual Income Tax on Investors of Sole Proprietorships and Partnership Enterprises, of the income obtained by a sole proprietorship enterprise from its production and business operations, the taxable business income of the investor shall be the balance after deducting costs, expenses and losses, and shall be taxed as the individual income tax on 'the production and business income of an individual industrial and commercial household' in the light of the Individual Income Tax Law. The applicable progressive tax rate shall range from 5% to 35%.

(3) One-person Limited Liability Companies

A one-person limited liability company shall pay enterprise income tax in compliance with Enterprise Income Tax Law of the People's Republic of China at rate of 25%. Enterprise income tax shall be calculated per annum. A tax year commences on January 1 and ends on December 31 of the Gregorian calendar year.

When the company distributes profits, if the investor is a natural person, the shareholder shall pay individual income tax on the dividends he obtained; if the investor is a legal person, the dividends that shareholder obtained are exempt from enterprise income tax if the dividends belong to equity investment income such as dividends between qualified resident enterprises.

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