

## **Info Sheet: Licensee China**

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## **1. Introduction**

Intercompany license agreements between the parent company in Germany and the subsidiary in China are of considerable importance in practice.

From the perspective of the German management, the granting of intercompany licenses for intellectual property is another option besides the distribution of dividends to repatriate profits from China. In addition, quality standards within the group can be ensured with intercompany license agreements.

From the perspective of German tax law, the granting of paid licenses from the parent company to the Chinese subsidiary for the use of intellectual property (trademarks, patents, know-how, etc.) is often necessary in order to avoid a so-called “transfer of functions” to China and a final taxation of future profit chance (similar to a sale).

From the perspective of Chinese tax law, on the other hand, the outflow of capital from the subsidiary in the form of license fees is viewed critically, as this capital is withdrawn from regular corporate income tax. According to Chinese tax law, license fees that are paid to an affiliated licensor abroad for the use of intellectual property can therefore only be deducted as operating expenses if the licensor has also made a value-added contribution to the intellectual property. A relevant contribution to the value would not exist, for example, if the rights to the know-how for a certain technology are held by a holding company in Singapore that has not been involved in the development or marketing of the know-how and the rights are licensed from this holding company to the Chinese subsidiary. In this case, the holding company would only be considered a pure rights holder from the perspective of tax law in general. Therefore, the tax impact should be carefully checked before setting up license chains.

Furthermore, it must be possible to present the economic benefits for the licensee. In practice, for example, the tax authorities can dispute an economic benefit if the licensed know-how is already out of date or completely freely available on the market. Therefore, the parent company must also regularly check the amount of the license fees based on the market value of the technology (see below under 3.6.). In this regard, however, the parent company is not obliged to proactively demonstrate the benefit of the know-how to the tax authorities when registering a license. But it should be prepared for

corresponding inquiries from the tax authorities.

In the following, we have described the license agreements which are most important in practice:

- Trademark license,
- Know-how license,
- Patent license,
- Software license.

## **2. Trademark License**

The trademark license between parent and subsidiary is common in practice. In China, trademark licenses have to be registered with CNIPA (the license agreement itself does not have to be registered). With the official registration of the license, third parties can no longer invoke the so-called protection of good faith and claim that they did not know about the trademark license.

### **2.1. Requirements for the Registration**

The trademark to be licensed has to be registered in China directly or via international trademark agreements ("Madrid Agreement"). The trademark license can only be registered after successful registration in China. In the case of a patent license, the patent application can already be the subject of the licensing (see No. 4 below).

### **2.2. Registration Procedure**

#### **2.2.1. In-Charge Authority**

The registration of the trademark license is meanwhile carried out exclusively by the China National Intellectual Property Administration ("CNIPA") based in Beijing.

#### **2.2.2. Time Line**

The license has to be registered with CNIPA during the term of the license agreement. In practice, the registration takes place at the latest before the contractual due date of the license fees.

### 2.2.3. Documents

The following documents are required to register the license:

- Application form (see example in Appendix 1). The application form must include the term of the license and the goods / services that are subject of the trademark license.
- Copy of the excerpt from the commercial register of the licensor.
- Copy of the licensee's business license.
- Power of attorney for the lawyer or agency submitting the registration application on behalf of the company.

In contrast to the know-how license (see 3 below), it is no longer necessary to present the actual license agreement.

### 2.2.4. Term

Generally, the registration of the trademark license takes about 3 months until the CNIPA issues a certificate (see example in Appendix 2).

### 2.2.5. Fees

There is no official fee for registering the license.

## 2.3. Change of Registration Information

A new application is required in the following situations:

- Change of the scope of the licensed products
- Change of the term of the licensing (including extension of the license)
- Change of trademark owner

A change request is required in the following situations:

- Change of name of licensor or licensee
- Early termination of the license agreement

## 2.4. Taxes

In China, 6% VAT and a 10% withholding tax is levied on the license fee, which is in line with the German-Chinese double taxation agreement.

The licensee has to withhold the taxes for the licensor and pay them to the tax authorities. The licensee can claim the paid VAT as input tax. In the event that the license fee is more than USD 50,000, tax must be paid to the tax authorities prior to transferring the license fees. For license fees below USD 50,000, the tax can also be paid after the license fees have been transferred.

A separate registration of the license agreement with the tax authorities is no longer necessary. In December 2017, the requirement for registration of the license agreement with the tax authorities within 30 days of its conclusion was abolished. See also:

<http://www.chinatax.gov.cn/n810341/n810755/c2878645/content.html>.

## **2.5. Payment of License Fees**

In order to transfer the license fee, the following documents generally have to be presented to the bank:

- Certificate from the CNIPA for the registration of the trademark license
- License agreement
- Invoice for the license fee
- Tax payment notice for license fees of more than USD 50,000 (see above under 2.4.)

## **2.6. Practical Tips**

- In practice, it is advisable to link the trademark license to the term of the registered trademark. The term of a trademark registered in China is 10 years. If a trademark is registered e.g. with the CNIPA with a validity until the end of 2025, the trademark license can also be granted up to this date.
- Because of the considerable administrative effort involved in the payment, it is better not to agree on monthly, but annual or quarterly payments of license fees.
- In practice, trademark licenses license fees agreed between the parent company and the subsidiary are often based on revenue. The amount of license fees is usually between 1-5% of the revenue amount.

### **3. Know-how License**

Know-how license agreements have to be registered in China. In contrast to trademark licenses, the license agreement itself is registered and not the license. In practice, however, there are no consequences from this legal differentiation.

#### **3.1. Requirements for the Registration**

Not all know-how can be the subject of a license agreement. Rather, it depends on the specific technology to which the know-how relates.

Technology that is on the negative list for imported technology cannot be imported (prohibited technology) or only with prior approval from the trade authority (restricted technology). The current negative list is available from the following link:

<http://file.mofcom.gov.cn/article/gkml/200804/20080490711981.shtml>

In the case of restricted technology, the license agreement will only take effect with the approval of the commerce bureau.

In the case of freely imported technology, the know-how license agreement is effective upon conclusion of the contract and not only after registration. In the following, only the procedure for freely imported technology is shown.

#### **3.2. Registration Procedure**

##### **3.2.1. In-charge Authority**

The local commerce bureau as a subdivision of the Ministry of Economic Affairs is responsible for the registration of know-how license agreements.

##### **3.2.2. Timeline**

The know-how license agreement has to be registered with the local commerce bureau within 60 days after the conclusion of the contract. In the case of a revenue-based license fee, the contract must be registered within 60 days of the determination of the license fee. In practice, experience shows that the authorities do not check the deadlines very strictly.

### 3.2.3. Documents

The following documents are required for the registration:

- Application form (see example in Appendix 3). The type of license fees (fixed or revenue based), the payment modalities and the term of the license must be specified in the application form. In principle, the application has to be submitted online to the Ministry of Commerce (Link: <http://jsickqy.fwmys.mofcom.gov.cn>) first. Afterwards, all documents have to be submitted in original to the relevant local commerce bureau.
- Copy of the license agreement. In contrast to the trademark license, here the know-how license agreement itself must be submitted.
- Copy of the excerpt from the commercial register of the licensor
- Copy of licensee's business license
- In the case of revenue-based license fees, proof of the determination of the revenue of the contractual products should be prepared, e.g. official receipts (Fapiao) for the contractual products, audited annual financial statements of the licensee from the previous financial year (with information on sales of the contractual products), etc. The exact requirements should be checked and coordinated individually with the local authority.

### 3.2.4. Term

The license agreement will be registered within 3 working days after submission of the complete documents. The local commerce bureau issues a certificate with an appendix (see example in Appendix 4). The details of the license fees are shown in the appendix.

### 3.2.5. Fees

No fees are to be paid to the authorities for the registration of the contract.

## **3.3. Change of Registration Information**

A change request is required if the entered information is changed.

In the case of a revenue-based license fee, each individual instalment is viewed as a change in registration information, which is why in practice the annex to

the registration certificate usually has to be reissued each time license fees are paid. This is not the case with the trademark license.

Example: In 2019, the Chinese subsidiary paid the German parent company a revenue-based license fee of EUR 100,000 for the use of know-how. Due to declining China sales in 2019, the license fee in 2020 is only EUR 50,000. A separate application process to the commerce bureau is necessary for each payment.

### **3.4. Taxes**

Regarding taxes, please refer to the trademark license (please see above 2.4.).

### **3.5. Payment of License Fees**

Also, with regard to payment of the license fees by the bank there is nothing special to consider compared to the trademark license (see 2.6 above). Accordingly, the certificate and the appendix have to be presented to the bank.

### **3.6. Practical Tips**

- It is always advisable to coordinate the exact requirements with the responsible local commerce bureau in advance, as the local handling may be different.
- Whether the online application to the Ministry of Commerce is a prerequisite for submitting the original documents to the local commerce bureau or not, can vary locally. In Beijing, for example, this is not absolutely necessary when changing the registration information.
- Whether the authority accepts automatic renewal clauses in the license agreement may also be handled differently locally. In Beijing, for example, every renewal of the license agreement must be registered again, while other locations (e.g., in Hebei) accept an automatic renewal and therefore no new registration is required.
- In the case of revenue-based license fees, the license fees should be paid annually because of the large effort involved in registration and tax formalities. Also, for know-how license agreements, the amount of the license fees is usually between 1-5% of the revenue amount.



- The parties can freely agree on the term of the know-how license agreement. In practice, terms of around 5 years are common. In case of a longer contract term, it has to be ensured that the know-how is still of

commercial interest for the subsidiary, so that the license fees in China can be deducted as operating expenses (see also above 1).

#### **4. Patent License**

The CNIPA is responsible for registering patent licenses (see point 2.3.1. above). The procedure for registering a patent license is similar to the procedure for registering a trademark license. In contrast to the trademark license, both patents registered in China and patent applications can be licensed. In addition, the patent license agreement itself must be submitted for the registration of the patent license.

#### **5. Software License**

In contrast to trademark, patent and know-how licenses, there is no mandatory registration for software licenses. Prior registration is also not required for the payment of license fees. However, a software license agreement can be registered with the Copyright Protection Center of China ("CPCC") on a voluntary basis. However, this only applies to exclusive licenses. See also: <http://www.ccopyright.com.cn/index.php?optionid=1091>.

#### **6. References to Customs Regulations**

##### **6.1. Consideration of License Fees in Customs Regulations**

According to the customs regulations in China, when importing goods, license fees should be considered in the customs declaration. An exception to this principle applies, if the license fee is not relevant to the imported goods or if the payment of the license fees is not a prerequisite for the resale of the imported goods in China. Payment of the license fees is considered a requirement for reselling the imported goods in China, e.g., in case the parent company only sells the goods to the Chinese subsidiary if the latter is also willing to pay license fees.

For the trademark license, "relevance" of the license fees in relation to the imported goods is assumed by the customs authorities in the following cases:

- The licensed trademark is already affixed to the imported goods when they are imported.
- The goods can be resold directly in China after the trademark is affixed to the goods in China.
- The goods can be resold in China after simple processing as well as affixing the trademark (no in depth and complicated processing).

In the case of know-how licenses and patent licenses, "relevance" is assumed by the customs authorities in the following cases:

- The imported goods were manufactured with the licensed know-how or patent.
- The goods contain the know-how or patent.
- The goods were specially manufactured for the implementation of the know-how or patent.

In the aforementioned cases, the license fee must therefore be added to the value of the goods in the customs declaration.

### **6.2. Practical Tips**

Due to an even closer exchange of information between the customs authorities and foreign exchange authorities, specifically companies which import goods from the parent company and pay license fees to the parent company, have recently been inspected by the customs authorities. Therefore, the following points are particularly important:

- When submitting the customs declaration, the license fee paid by the company must be taken into account, provided that it is relevant to the imported goods. Otherwise, there will be unexpected supplementary payments later, possibly also fines for evading customs duties.
- If the business model and German tax law allow, the license and the imported goods should ideally be separated. When drafting the license agreements, the scope of the licensed products should therefore be checked carefully and a possible overlap with the imported goods, raw materials and semi-finished products should be avoided.

### **6.3. Case Study**

A paint manufacturer from Jiangsu province in China (Company L) has signed a trademark license agreement with the parent company in Germany. On the basis of the license agreement, Company L can use the parent company's brand to manufacture and sell its products on the Chinese market. As consideration, Company L pays a license fee of 2% of the turnover that is achieved with the licensed products every year.

At the same time, Company L imports the following goods from the parent company in Germany:

- Product A: paint as a finished end product.
- Product B: raw materials for the production of paint.

The licensed trademark was affixed on both products in Germany.

Company L resells Product A directly to customers in China. For product A, the license fee must therefore be added to the value of the goods in the customs declaration, since the license is "relevant" for the imported goods.

Product B is first processed by Company L in China through complicated procedures and then sold on to customers in China. In the case of product B, Company L can argue during the inspection by the customs authorities, that based on the description of the production processes, product B is only resold after in depth processing by Company L in China. Therefore, no "relevance" of the license fees in relation to product B should be assumed. In this case, the license fee does not have to be added to the value of the goods.

## **7. List of Important Regulations**

### **7.1. Trademark License**

- Trademark Law of the People's Republic of China (Revised in 2019)  
中华人民共和国商标法 (2019 修订)
- Implementation Regulations for the Trademark Law of the People's Republic of China (Revised in 2014)  
中华人民共和国商标法实施条例 (2014 修订)
- Measures for the Record-filing of a Trademark Licensing Contract (1997)  
商标使用许可合同备案办法(1997)

### **7.2. Know-how License**

- Regulations of the People's Republic of China on the Administration of the Import and Export of Technology (Revised in 2020)  
中华人民共和国技术进出口管理条例 (2020 修订)
- Administrative Measures on Registration of Technology Import and Export Contracts (Revised in 2009)  
技术进出口合同登记管理办法 (2009 修订)
- Administrative Measures of Ministry of Commerce on Import Banned and Import Restricted Technology (Revised in 2019)  
禁止进口限制进口技术管理办法(2019 修订)
- Catalogue of Technologies Prohibited and Restricted from Import by China (Revised in 2007)  
中国禁止进口限制进口技术目录(2007 修正)

### **7.3. Customs**

- Measures of the PRC Customs on Determination of Dutiable Value for Imports and Exports (2013)  
中华人民共和国海关审定出口货物完税价格办法(2013)

### **7.4. Tax**

- Announcement of the State Administration of Taxation on Promulgation of the Administrative Measures on Special Tax Investigation, Adjustment and Mutual Agreement Procedure (2017)  
国家税务总局关于发布《特别纳税调查调整及相互协商程序管理办法》的公告 (2017)

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