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Beijing Tax Bureau's report on Foreign individual income tax payments

New FOREX rules for bonded zones to be introduced as of October

Beijing Tax Bureau's report on Foreign individual income tax payments

Initial results of the Beijing Municipal Tax Bureau's audit of individual income tax payments by foreign employees of foreign representative offices registered in Beijing were reported last month.

The audits were part of a crackdown on representative offices and evasion of individual income tax obligations by foreign employees. The first stage of the investigation, which was completed in mid-July, required representative offices to conduct internal audits of their own taxation and payments, with a view of reporting any mistakes found throughout the 2000 and 2001 fiscal years. With over 3,200 representative offices targeted in the audits, the reports have found that over 1,000 offices made mistakes in filing, resulting in \$7.6 million in late payments. Given that many representative offices were found to also have inadequate resources to comply with China's often confusing taxation and accounting systems, the government and tax bureau has decided to accept these late payments without imposing any additional fines.

The second phase, however, is not expected to be so lenient. This will involve the Beijing tax bureau reporting on its own audit findings of taxation reporting by companies and representative offices. Whilst firms have had the opportunity to report mistakes over recent months without any penalties, fines are now expected to be imposed for mistakes of up to 250 per cent of the understated taxation obligations. As a result, the tax authorities have warned companies, especially foreign offices, to get their books in order and self-report any errors before they are audited by the tax bureau.

With the shifting of the tax collection base away from import duties (in line with WTO requirements for a reduction in such duties), the government is under pressure to crack down heavily on individual income taxes so as to fund public spending. This has seen a blitz on private PRC businessman and high-profile citizens who fail to pay individual income taxes, or under report their tax obligations (by not including overseas salaries for example). Whilst previously such crackdowns have been very random and not well executed, it would appear that the new round of tax audits are being conducted more thoroughly and systematically.

A quick reminder:

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In view of this government direction, foreign firms are urged to review all their financial accounts and tax payments. It is suggested that all employees, no matter whether they are ultimately required to pay tax in China or not, should be registered with local tax authorities as soon as they begin work in the mainland.

Taxpayers in China fall under two categories:

1. *Individuals who are **domiciled** in China.*

Such individuals are taxed on worldwide income unless they seek approval from the relevant tax department, whereby they may pay Individual Income Tax only on the income derived in China, provided that they reside in China for a period no longer than five years continuously (after which time tax is calculated on world-wide income).

2. *Individuals who are **neither domiciled nor resident** in China or who do not have domicile and are resident for less than one year in China.*

Such individuals are subject to tests regarding the length of their continuous or cumulative residence in China. These tests are based on taxpayer's country of residence.

There are a number of exemptions for individual income tax purposes, especially relevant to foreign employees. These may include housing allowances, return trips home, education allowances etc, but are subject to certain terms and conditions. Such exemptions should be confirmed with tax officials.

What if you are not in compliance?:

There is a general consensus that the tax authority will be more lenient on companies who self-report errors in taxation obligations. Whilst the Beijing tax authority has instigated a grace period for companies to review their taxation payments, generally speaking (and throughout other jurisdictions in China), penalties for under payment of tax can be up to 5 times the amount underpaid, plus the actual tax due.

It must be remembered that, generally speaking, in China it is the employer's responsibility to calculate taxation obligations for employees and it is the employer's obligation to withhold any tax payable on behalf of the employee. Thus, penalties for underpayment of tax are borne by the employer and the tax authorities will hold the employer responsible and seek retribution through this entity (not the individual). For companies who have been operating in China for a number of years with a number of expatriate staff and have not properly reported tax obligations, such penalties could be quite substantial.

Once a company acknowledges a mistake in tax payments, it is recommended that they contact either professional advice and then present their case immediately to the tax department. From this initial contact there are basically two methods to calculate taxes payable and possible penalties:

1. The tax authority reviews the case and comes up with a number of questions (such as time spent in China etc.) which the taxpayer must answer. Based on these answers the tax bureau will estimate the tax payable and any fines applicable.
2. The tax payer presents and explains their case to the tax authority, along with a compromise solution to the outstanding taxes payable.

It is recommended that tax payers adopt the second method in order to solve their outstanding tax obligations. In our experience, this has proven to be a great deal less costly than simply letting the tax bureau do all the background work and is certainly less confrontational. Of course, this method requires the tax payer to understand the tax system in China and present a logical compromised solution. It is recommended that professional advice is sought to help with this negotiation process.

Final say:

Individual Income Tax in China, especially where foreigners are concerned, can be a burdensome and often confusing task. It is suggested that, given the current taxation environment (which is likely to continue in the future), all companies operating in China completely understand their taxation obligations and possibly seek professional advice or assistance to ensure they are compliant. Accounting firms are able to assist companies to get their books in order, negotiate with the tax authorities and prepare and

[Taxation Terms](#)

增值税

"Zeng Zhi Shui"

(Value Added Tax)

增值税

"Ying Ye Shui"

(Business Tax)

消费税

"Xiao Fei Shui"

(Consumption Tax)

所得税

"Suo De Shui"

file individual tax reports on a monthly basis.

Underreporting, whether a genuine mistake or evasion, is a very serious offence and the monetary and non-monetary penalties can be quite severe. If you are unsure as to whether you or your company is complying with Chinese taxation regulations, it is recommended that you seek professional advice or contact the local tax authority.

New FOREX rules for bonded zones to be introduced

The State Administration of Foreign Exchange (SAFE) has recently amended the Measures of Foreign Exchange (FOREX) Control in Bonded Zones. These measures, to be made effective on October 1, 2002, update the initial measures which were first introduced in 1995. The new changes adopted by SAFE are in line with policies namely to:

- Align FOREX controls in bonded zones with customs, taxation and foreign trade policies;
- Relax controls over FOREX which have been restrictive in the development of bonded zones.

The new measures cover foreign exchange registration, annual inspection, foreign exchange accounts, settlement and sale of foreign exchange, foreign exchange revenues and expenditures and other similar issues in bonded areas will introduce three major changes:

1. **Unification of FOREX registration certificates** - Previously foreign invested enterprises (FIE) and Chinese-invested enterprises (CIE) were issued with different types of FOREX registration certificates.

This system, it was found, did not promote effective tracking of FOREX transactions by the FOREX administration authority or the banks. As a result, the new changes will introduce a uniform registration certificate for both FIEs and CIEs called the "Bonded Zone Foreign Exchange Registration Certificate".

2. **Relaxation of controls over the purchase of FOREX** - In 1998 SAFE established strict controls over the purchase of FOREX in bonded zones so as to safeguard against an outflow of FOREX in light of the Asian financial crisis.

In light of improvements in the current business environment, SAFE has adopted measures which allow for FOREX purchases under three conditions:

- Enterprises engaged in the processing or goods distribution are able to use RMB revenues derived from selling goods on the domestic market to purchase FOREX;
- Enterprises in the bonded zones may purchase FOREX with their RMB paid-up-capital;
- Shareholders of FIEs may expatriate FOREX with their earned profits, dividends and bonuses.

3. **Lifting of restrictions regarding with whom FOREX accounts can be opened with in bonded zones** - Enterprises will now be allowed to open FOREX accounts outside of the bonded zones subject to approval from the foreign exchange administration authority.

Previously, enterprises were only allowed to establish FOREX accounts with financial institutions within the bonded zones. This had allowed for greater control over FOREX supply and safeguarded against any illegal capital outflows.

With these new changes, coupled with the regulations allowing enterprises registered in bonded zones to setup Representative Offices outside the zones (see: [article in March issue of insights@lehmanbrown](#)), bonded zones continue to present FIEs with preferential treatment and greater flexibility in export-processing,

"Providing an alternative in China"

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LehmanBrown also provides a monthly newsletter *Peeling the Onion* which investigates certain topical issues affecting businesses in China, particularly for those companies and individuals with operations in the PRC, or looking to establish a presence in-country.



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