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Peeling the Onion - 16

Compliance, Compliance and more Compliance ... keeps the China authorities away !



Setting up a business in China involves a lot of paperwork, as anyone who has already done this will know. This though is the easy bit, maintaining the legal entity you have set up starts from the moment you receive your business license. There is no dormant status for companies in China, once alive they are required to prepare accounts, complete annual audits and file for taxes, even if nil filing when loss making. Additionally, because companies are required to have a registered office address and receipts to support, they have transactions from day one as well. Maintaining a company can be a daunting task therefore to any new business. This articles aims to provide an overview of what is required and when it is requirement.



Accounting regulations

In January 2001 the Ministry of Finance (MOF) introduced the Accounting System for Business Enterprises (ASBE). The MOF intended the new System adopted by all local large and medium sized enterprises and all foreign invested enterprises (FIEs) in China except those in banking, insurance other financial enterprises. The idea was to try and eliminating the accounting distinctions based industries or on the form of business enterprises that have existed in the past. The timetable for implementation of this was staggered, with joint stock limited enterprises being required to use it from 1st January 2001, all foreign enterprises from 1st January 2002. ASBE was optional for small enterprises.

For small-sized enterprises, either local or FIE, they are expected to adopt "Accounting System for Small Business Enterprises" (ASSBE) from 1st January 2005. However, if they have adopted ASBE, they should not choose to adopt ASSBE. Small enterprises are defined in terms of number of employees, turnover, total assets, etc. For example, an industry entity with not more than 300 employees, annual sales of RMB 30 million and total assets of RMB 40 million will be classified as small enterprise.

The good news was that ASBE brought the China accounting system much more in line with International Financial Reporting Standards (IFRS). The main problem with it though was that the Government did not change the tax system, therefore creating in its wake a larger portion of permanent adjustments. Significant however strides were made in July 2004, with the State Administration of Taxation (SAT) allowing the following without prior approval:

1. Changing method of depreciation: The straight-line depreciation method no longer requires mandatory for prior approval Taxpayers no longer need to obtain advance approval to elect to depreciate an acquired used asset over its remaining life even though that period is shorter than the minimum allowable period set under the rules. Previously this was the only method allowable without prior approval. However, taxpayers should report details of newly acquired assets, depreciation method, reason, etc., for tax authority review after yearend. If tax authority does not agree with the depreciation method, the tax authority can do necessary adjustments.

2. Bad debt expense deduction: As long as the requirements are met to qualify as a bad debt expense (i.e. the debtor is bankrupt or deceased, or the receivable has been outstanding for more than two years), taxpayers are not required to obtain approval prior to claiming a deduction. Taxpayers should provide detailed information to tax authority's review when they do tax filing.

3. Exemption on transfer of technology: Foreign companies and foreign individuals are no longer required to apply for a business tax exemption when transferring technology into China. Relevant documents should be properly maintained for possible review from tax authority.

4. Spreading stock option gain over a six-month period: Upon the exercise of stock options, if the amount of stock option gain is relatively large, taxpayers may elect to spread the amount of stock option gain over a six-month period for the purpose of computing individual income tax, without submitting a request for advance approval. Explanations on choosing this method should be provided when tax return is filed.

Additionally, approval requirements were also eliminated in eleven other areas, including changing the inventory cost method, loss on an asset disposal, changing the method of taxation of representative offices, enjoying of an income tax exemption for the first two profit-making years by qualified high-tech companies, management fees which are arms length in nature, claiming deductions on various subsidies (i.e. rentals, meals and other subsidies) against the taxable income of expatriates when computing individual income tax and excluding the portion of bonuses that are related to overseas employment from an expatriate's taxable salary in China.



Audit requirements in China

The year-end of companies in China is set by the State and must be from January 1 to December 31, regardless of that of the China company's overseas parent. All foreign investment enterprises (FIEs) require an audit and to submit their auditor's reports for year then ended (together with other specified documents) to the relevant industrial and commercial administrative bureau for the Annual Review by 30 April each year. Any companies failing to do so may be penalized (i.e. in the extreme case, may revoke their business license), it is possible though to gain extensions with valid reason. The audit should be carried out by a CPA firm, which is registered with relevant Chinese authorities, who will then usually assist in filing various copies with the tax bureau and Administration of Industry and Commerce for annual inspection purposes.

Audited financial statements are similar to those in other counties, required an Auditor's report, Balance sheet, Profit and loss account, Cash flow statement, and notes on the accounts, along with comparatives for previous years. The audited accounts are to be in Chinese language, however, FIEs may request an English translation of the financial statements.



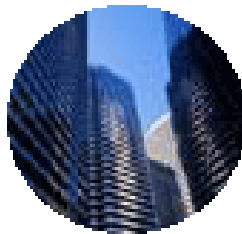
Foreign Currency Report

Companies are required to engage a CPA to complete a foreign currency report annually, which summarizes the foreign currency transactions during the year. This is filed with the State Administration of Foreign Exchange by the end of April for the year past. FIE's will also come up against SAFE when bringing funds into the country and sending funds out of the country, though the latter depends on the nature and size as to whether SAFE approval is required.



Related Parties Transaction Report

This is a new requirement with 2004 being the first year it is required for completion. When related parties transactions (RPT) occur, the taxpayer now has an obligation to submit a declaration form. The deadline for this filing is the same as the annual audit and foreign currency report, being the end of April for the year past.



Ministry of Statistics

Despite having provided much of the same information already, The Ministry of Statistics (MoS) has a package of forms for completion, requiring much of the same information as provided for everyone else. MoS requires these annually, however certain areas require monthly. Many firms do not bother completing and the MoS is not the most diligent in chasing or fining, however they are becoming more diligent in ensuring filing.



Tax reporting and payment

There are 13 types of Chinese tax applicable to FIE's. The major taxes applicable to foreigners, "FIEs" and foreign enterprises ("FEs") doing business in China are as follows:

Category	Type	Application and filing Requirements
Tax on income	Corporate Income Tax ("CIT"): 15 %C 20%	Provisional payment quarterly within 15 days after the end of each quarter. Final settlement within four months after the end of a year, where an annual filing is required.
	Withholding income tax ("WHT"): 10 %C 20%	Charged on payments to non-residents of China. Applicable to rental, royalty and other income, as well as payments for services rendered in China where the period is over that allowable by the respective taxation treaty.
	Individual income tax ("IIT"): 0-45%	Monthly basis for local and expatriate employees, China income earning, within 7 days from month end.
Tax on transactions (turnover tax)	Value-added tax ("VAT"): 13-17% small company pays 6% on sales	Monthly basis within 10 days after the end of month. Days basis of 3, 5, 10 or 15 days, estimated instalments within 5 days after the end of period and final settled within the first 10 days in next month.
	Consumption tax ("CT"): 3-50%	Luxury goods tax, and levied on items such as consumer goods, including tobacco, alcoholic beverages, ethyl alcohol, cosmetics, skin and hair care products, jewellery, fireworks, etc. Payment is the same as with VAT.

	Business tax ("BT"): 3-20%, norm is 5% on services	Payable monthly within 10 days after the end of each month, for a Representative Office, payable on quarterly basis within 10 days
Tax on specific objective	Land appreciation tax: 30% to 60%	Charged on all gains realized from transfer of the real property and its attachments, payable within 7 days after the contract issued.
Tax on resource	Resources tax Rates varies according to type of resource	Charged on the natural resources per measurable unit of resource. Charged on a monthly basis and should be paid within 10 days after the end of month. As with VAT, it can also be levied on daily basis
Tax on property	Urban real estate tax: 1.2% of the original value with certain deduction (10% to 30% is commonly offered by local governments) or 12% on the rental value.	A tax imposed on the owners, users or custodians of houses and buildings. Payable on a quarterly or semi-annual basis.
Tax on behaviour	Vehicle and vessel usage and license plate tax	This is charged at a fixed rate either a yearly or quarterly basis.
	Motor vehicle acquisition tax 10% on importation	Paid within 60 days after obtained or imported date.
	Stamp tax 0.005% to 0.1%.	This is charged on "specified documentation" such as contracts and paid when occurred
Tax levied by the Customs	Customs duties Rate varies by product	Charged on import or export goods. It is to be paid within 15 days after the issuance of Customs Duties Tax Advise
Tax levied by finance department	Deed tax: 3-5%	Charged on transfer of ownership of land use rights or real properties, and is to be paid within 10 days after the transaction.

The responsibility for filing in China is with the tax payer. The tax bureau does not send out tax returns as in many countries, it is for the payer to collect the forms and file. The method of also filing varies depending on location, with some cities using electronic filing whilst others still require hand delivery. It is possible to obtain extensions for some filing, such as yearend CIT, though application for extension is not usually advisable as it can provide a red flag to the

authorities.



Keeping of records

The tax authority requires that accounting records and ledgers be set up and kept properly and they require that details of the Accounting System be filing with them. The chart of accounts is governed by the Chinese accounting regulations and is the same of all companies. Accounts must be prepared according to ASBE and not the regulations of headoffice. The later have to be prepared separately. The accounting regulations provide that the records must be in Chinese, however, practically, the accounting software can be an English based software as long as the supporting documentation such as journal vouchers are Chinese and these can easily be cross referred back to the system. Actual reporting to Government must be in Chinese and therefore the system would need to be able to extract the information into the Chinese reports, or have Chinese reports written to pull information for review.



Summary

Though the red tape in China is burdensome, the key is to be organized, on time and ensure proper supporting records should the taxman ever wish to review. The regulations are continually changing, and generally for the better, and overall life should become easier for foreign firms going forward.

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Peeling the Onion is a series of newsletters designed to assist your company with the financial and accounting control of your China operations. We are interested in receiving your feedback on our articles and any suggestions as to future topics are more than welcome at newsletter@lehmanbrown.com



"Providing an alternative in China"

<u>Professional Services</u>	<u>Financial Accounting</u>	<u>Taxation</u>
<u>Business Management</u>	<u>Management Solutions</u>	<u>Corporate Restructuring</u>

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