



## GES NewsFlash

# People's Republic of China (PRC) — Intensifying Administration of PRC Individual Income Tax (IIT)

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### Summary

Following the issuance of Circular Guoshuifa (2011) No. 50 ("Circular 50"), which aims to intensify the tax collection and administration on "high income individuals," tax authorities in various jurisdictions across mainland China have started to intensify efforts on strengthening the reporting, collection, and administration of PRC IIT.

In 2011, the 1st Investigation Bureau of Guangzhou Local Tax Bureau ("1st Investigation Bureau") conducted a special tax audit on the rental invoices raised by expatriates as substantiation to claim nontax benefits. The audit was focused on senior management and expatriates in the foreign-invested enterprises (FIEs).

On July 3, 2012, the 3rd sub-bureau of Guangzhou Nansha Development Zone Local Tax Bureau (GZNS-LTB) issued a notification ordering self-examination of PRC IIT compliance status on expatriates working within the jurisdiction.

Similar exercises were also carried out by Beijing, Shanghai, and Suzhou Industrial Park Local Tax Bureaus, where a number of FIEs had been randomly selected for self-review of their prior-year tax reporting. One of the focused areas is tax filing of expatriates' salaries and benefits received.

### Key implications

#### Special audits on rental invoices and other tax-efficient benefits offered

As a result of special tax audits carried out in the nation, which found cases of fake invoices being used to support claims for preferential tax treatment, authorities are placing increased scrutiny on tax-efficient benefits programs operated in the region. In Beijing, there was also a focus on lease agreements. Actions being taken include special tax audits with a focus on senior personnel and foreign national employees, as well as enhanced internal training on invoice verification for tax officials to more efficiently spot compliance failures.

In Beijing, Shanghai, and Suzhou, in addition to the registration of employee benefit policy, some local tax bureaus also requested for semiannual/annual report of actual tax-efficient benefits incurred by category along with submission of documentation support, e.g., lease contract, rental receipts, airfare tickets). Where reported expenses exceeded preapproved threshold(s) and/or failed to meet the regulatory qualification, underpayment of IIT and penalty assessment was imposed to rectify the noncompliance.

#### Self-examination of expatriates' IIT compliance

Starting from 2012, local tax bureaus in various jurisdictions, i.e. Beijing, Shanghai, Suzhou, and Guangzhou, have initiated self-examination audits targeting FIEs with foreign nationals stationed in China as well as frequent business travelers working in the region. Unlike usual tax audits, the program focuses specifically on individual tax compliance.

The examination period ranges from October 2009 to April 2012, although this can be broadened if evidence of noncompliance in previous years is found.

Areas covered by the program include:

- Whether both onshore and offshore incomes are accurately reported
- Whether there is any misclassification of employment income and service remuneration that results in underpayment of IIT liabilities
- Whether bonuses are spread over and allocated to the monthly income to inappropriately reduce the IIT liability
- Whether the residence days and the actual working days in the PRC are counted in accordance with the relevant PRC regulations, and whether residence days are consistent with the immigration record
- Whether director's fees paid are taxed properly as service income or employment income based on the actual condition of employment/appointment

Information such as income statement issued by overseas employing entity, employee compensation, and benefit policy, as well as the expatriate's 2011 overseas individual return, should be submitted by the FIEs to the tax bureau.

### **Deloitte's view**

These programs highlight a growing trend of increased scrutiny on the reporting and administration of IIT compliance for foreign nationals working in China. As growth in China's economy weakens, we expect such scrutiny to get more intense.

In view of the above, we would recommend companies and expatriates to take the following actions:

1. Review current human resources policy, tax-planning ideas, and tax-reporting procedures for employees — especially senior executives of companies in high-income industries, as well as high-income expatriates and local PRC nationals to make sure relevant documentation and reporting are in line with the prevailing tax regulations. Professional assistance may be required.
2. Ensure the tax-efficient benefits are structured properly to differentiate from cash allowance and that the application of such benefit for achieving tax efficiency is in accordance with the prevailing tax regulations and the local practice. Meanwhile, relevant internal administrative procedures should be well documented and strictly followed so as to sustain the eligibility.
3. Make sure relevant registrations as required by the local tax bureaus are properly performed and proper documentations are substantiated (i.e., equity plans implemented in China and nontaxable benefits offered to expatriate employees).
4. For expatriate individuals who are not domiciled in the PRC but have not yet stayed in the PRC for more than five full consecutive tax years, consider adopting a tracking and planning system so that the five-year threshold is not inadvertently crossed. Similarly, closely monitor expatriates who are working in the PRC on a project basis to ensure PRC IIT is properly reported.
5. Review equity transactions and other investment-related transactions/income to seek proper tax planning and mitigate tax exposures and risks.

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