

Top 5 China tax issues to avoid

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In brief

- » Tax audit happens every now and then. We list Top 5 tax issues that the corporate management executives in China are advised to pay attention to:
- Malpractice in VAT invoicing;
 - Salaries packaged as expense reimbursement;
 - Leaving a company dormant;
 - Abnormality in AP aging; and
 - Irregularity in non-trade payments to overseas

Feedback

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In detail**1. Malpractices in VAT invoicing**

- » Turning a blind eye to malpractice in VAT billings in a company is like “running with the hares and hunting with the hounds” - it may invite criminal implication against oneself. VAT malpracticing does not confine only to issuing, but also obtaining of improper VAT invoices. Management personnel, like chairmen, general managers, chiefs, and senior executives, if involved in the approval chain, may be held liable for criminal liabilities – which usually means an imprisonment term from a few year to life time. For security reasons, independent and regular check against VAT invoicing practices is always advisable.

2. Salary packaged as expense reimbursement

- » By default, the company (employer) is the tax withholding agent for salaries paid to employees. If salaries are paid in the form of expense reimbursement without settling individual income tax (IIT), it is decidedly tax evasion, and the company will bear the brunt – facing a penalty based on 0.5 to 3 times of the tax evaded. It could easily be caught in the tax audit radar due to its high expense claim per head. Such a practice should be discontinued.

3. Leaving a company dormant

- » Operation shutdown does not mean automatic business de-registration. A company left dormant for six months without a formal liquidation would risk business license revoking and its senior executives, if liable for licensing failure, could be blacklisted and banned from serving any senior posts for three years. In addition, the company, even in its dormancy, is not immuned from its compliance obligations, such as annual registration renewal, tax filings and bookkeeping (monthly, quarterly, annually). Discontinuing these tasks prematurely could lead to disciplinary consequences and deny liquidation possibility.

4. Abnormality in AP aging

- » Accounts payables (APs) of a Chinese company in favour of foreign parties for imports are potential foreign debts to China, not merely business issues. They are thus subject to the oversight of State Administration of Foreign Exchange (SAFE). According to SAFE’s regulations, for any AP aging over 90 days, an importer should report them to local SAFE via an online system within 30 days after the import date. If failing to do so and letting APs snowball to a certain scale, it may trigger a SAFE audit, a penalty or decrediting (resulting in restricted usage of a bank account). Further, long-term APs (non-trade deals) may create additional tax exposures (as China withholding tax is calculated on an accrual basis).

5. Irregularity in non-trade payments to overseas

It is fair to say that most remittances from China to overseas for non-trade reasons are taxable (unless particularly exempted). It is a common misunderstanding that remittance under USD 50,000 is “tax-free” – simply because the bank does not insist on seeing a tax payment evidence (per a SAFE policy that has simplified the procedure for remittance of small amounts). Some companies keep remitting the funds to overseas, by even breaking down each remittance under the US\$50,000 threshold, and do not withhold the corresponding taxes. Once the issue is audited or exposed, the companies would face penalties and interest charges. It is advised that a regular check should be done on remittance cases to ensure they are all duly taxed (or officially exempted).

WTS observation

It is a challenge to companies in ensuring daily operations are conducted under a tax compliant context. Aggressive tax schemes may bring short-term benefits but will brew risks to executives. To eliminate tax risks, it goes without saying that controlling by internal and external means should be considered.

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