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People's Republic of China: Tax authorities enhance administration and scrutiny on PRC individual income tax

Overview

The local tax authorities nationwide are further stepping up their efforts on the enhancement of the PRC individual income tax ("IIT") collection and, as part of this initiative, are carrying out more frequent and expansive investigations on individuals and companies. This trend is expected to continue, with an increased focus on both foreigners working in China and Chinese individuals receiving foreign-source income.

Non-taxable benefits-in-kind (BIK)

In accordance with the prevailing PRC IIT regulations, some BIKs are not considered taxable benefits to the foreign employees if certain criterions are satisfied. Such benefits should be paid to the foreign employees on a non-cash/reimbursement basis or settled directly by the employer. These non-taxable benefits include:

- Housing accommodation in the PRC;
- Meal and laundry expenses in the PRC;
- Relocation and moving expenses;
- Home leave expenses;
- Language training expense incurred in the PRC; and
- Children tuition costs incurred in the PRC.

In the year 2016 and 2017, we have seen an increasing number of tax audits/inspections on foreign individuals' non-taxable BIK claims in various cities.

Beijing: A real case revealed publically by media of tax authority is that a Beijing-located company applied tax exemption claim of BIKs at a much higher percentage than industry benchmark. This attracted attention from their in-charge tax authority and led to a thorough tax audit. Tax officers reviewed all accounting records and investigated the nature of these expenses. The reasonableness of the BIKs tax exemption treatment was questioned and non-qualified items were identified for tax adjustment. Finally, the company was requested to pay the underpaid IIT of RMB16million and the relevant penalty of RMB12million.

Suzhou: More and more local tax authorities require companies to perform a formal tax registration of the foreign individuals' BIKs. Since March 1, 2017, Suzhou Industrial Park ("SIP") local tax bureau has enforced the registration of the non-taxable BIKs offered to foreign individuals. In addition to the initial registration, an ongoing reporting is also required in the following months if there is any change of the non-taxable BIKs amount.

Permanent establishment (PE) risks created by overseas business travellers

The local tax authorities are working more closely with the State Administration of Taxation and the other authorities to expand the information channel for discovering PEs.

Recently, Suzhou state tax bureau and local tax bureau are jointly launching an inspection on tax administration of non-resident companies & individuals in respect of "trade in services". Tax authorities are reviewing foreign exchange remittance paid by companies in name of "service fees" in order to identify IIT exposure arising from a potential permanent establishment ("PE") constituted by an overseas company when sending business travellers to provide services in China. Under the inspection, an overseas company was deemed to have created a PE in China and the business travellers working for the PE were considered costs borne by the PE. As a result, the travellers were not entitled to the treaty relief, even though their actual physical stays in China were less than 183 days during a calendar year. A backlog of IIT and surcharges total of RMB 31 million was collected by the local tax bureau on this case.

IIT exposure of Chinese outbound employees: Under current IIT rules, Chinese individuals generally are subject to PRC IIT on their worldwide income.

Since late 2016, tax authorities in many cities (like Beijing, Shanghai, Suzhou, Wuhan etc.) have announced concrete plans to tackle the IIT administration of Chinese outbound employees from "Going Out" enterprises. Tax authorities are establishing name records of "Going Out" enterprises and their outbound employees, collecting the detailed income/tax and assignment information as well as supporting documentations. By investigations over the information and facts, tax authorities are mainly focusing on the following tax risks may arising from the outbound employees:

- Failure to perform tax withholding obligation by Chinese company on employees' onshore income and/or failure to perform self-reporting obligation by outbound employees on their own offshore income;
- Incorrect IIT reporting with respect to director's fee derived by the Chinese individual who is appointed as the board of directors of an overseas affiliated company;
- Under-reporting of overseas income, incorrect usage of foreign exchange rate and foreign tax credit in IIT calculation; and
- Delayed IIT reporting due to the discrepancy of tax filing and payment deadline of China and the host country.

Deloitte's view

The implementation of value-added tax reform in China results in decline of tax revenues of local tax authorities and, in the meantime, relieves the tax officers' administration burden in relation to business tax. Various local tax authorities are executing the decisions and orders by their higher-level superior to shift the efforts on PRC IIT collection and administration. Foreigners working in China and Chinese employees working overseas have been recognized as the focused group and their IIT reporting are the key targets of tax audits by local tax authorities.

With the implementation of Golden Tax System III and information exchange mechanism with the other authorities, the local tax bureaus have established BIG DATA nationwide for all company and individual taxpayers through which the tax administration and Scrutiny could be more effective and directive.

In light of the above, companies and individuals should consider the following actions:

- Set up internal procedure and internal control over foreign employees' BIK claim more strictly.
- Review company's BIK tax efficiency arrangement and make the proper adjustment to ensure it is compliant with the regulations.
- Monitor the duration of overseas projects in China closely, and assess if any PE exposures.
- Review current tax compliance status of Chinese outbound employees to ensure relevant IIT withholding and/or self-reporting obligations have been properly fulfilled from a company and an individual perspective.
- Seek for professional advice where necessary.

— Joyce W. Xu (Shanghai)
Partner
Deloitte People's Republic of China
joycewxu@deloitte.com.cn

Huan Wang (Beijing)
Partner
Deloitte People's Republic of China
huawang@deloitte.com.cn

Tony Jasper (Hong Kong)
Partner
Deloitte People's Republic of China
tojasper@deloitte.com.hk

Irene Yu (Shanghai)
Partner
Deloitte People's Republic of China
iryu@deloitte.com.cn

Global Rewards Updates:
France: Withholding tax reform postponed, refund of employer social contribution paid at grant of qualified awards, and estate & investment income tax reform

Withholding tax reform postponed to January 1, 2019

The French government have been planning to introduce an income tax withholding regime for French resident employees. This was originally scheduled to be introduced on January 1, 2018. The Prime Minister however officially announced recently the postponement of the withholding regime to January 1, 2019.

This one-year postponement aims to ensure that the new withholding system is sufficiently robust before implementation, and also to help employers anticipate and budget for the costs involved. Prior to announcing the postponement, three decrees were also published. These provide more details and information with regard to the effective set up of the Reform. The French Government have confirmed that they intend to keep these provisions, including the measures for the year of transition that will simply be pushed forward one year (i.e. from 2017 to 2018).

We predict this postponement will be a welcome announcement for employers as it provides reassurance that they have one more year to prepare and budget for any costs. The withholding regime will be a significant change for employers with non-qualified plans in France but should have no impact on those with qualified plans.

Refund of employer social contribution paid at grant of qualified awards

As previously announced in Global Reward Update, February 2017 a question was raised to the French Constitutional Council asking whether the employer social security contribution, paid at grant of qualifying free share awards (RSUs) granted before the Macron law took effect (*i.e.* before August 8, 2015), was constitutional even in those cases where the free share award was forfeited prior to the plan participant receiving the underlying shares. (*e.g.*, in the case of

termination of an employee prior to vesting or in the case of unsatisfied performance conditions). The Council's decision has now been delivered.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-rewards-update-france-28-february-2017.pdf

The question presented to the Constitutional Council was how the social security contribution payment date (i.e. the payment of a social security charge at grant) could be compatible with the French constitutional principle of equality before the law and fair taxation, since the income from free share awards remains hypothetical prior to vesting in those cases where award vesting is subject to performance and /or continued employment tests.

The argument presented to the Constitutional Council also highlighted the fact that there was no restitution with respect to the employer social security contribution paid at grant in those cases where the award was subsequently forfeited prior to vesting.

The Constitutional Council ruled that the application of the employer social contribution at grant of qualified awards was constitutional, so long as a refund can be claimed for those contributions when the awards are forfeited and the employee never acquires the underlying shares.

Investment income tax and wealth tax reforms as from 2018

On July 12, 2017, the French Prime Minister, confirmed the entry into force, from 2018, of the tax reforms announced during the campaign of the new French President, Emmanuel Macron, elected in May 2017.

Investment income subject to a flat tax of 30%: From 2018, taxable investment flows higher than EUR 150,000 should be subject to a flat tax rate of 30% (including all social surtaxes). This is welcome news for investors since certain investment incomes are currently taxable at up to 60% (progressive rates up to 45% plus 15.5% social surtaxes).

The French wealth tax replaced by a real estate tax: From 2018, the French wealth tax (*i.e. Impôt de Solidarité sur la Fortune* – ISF) should be replaced by a real estate tax and only what qualifies as "real estate" assets will be taxed.

The brackets and rates applicable for the new real estate tax will be the same as the one provided for the current French wealth tax. This is welcome news for shareholders whose shares are currently included in the wealth tax basis but will not be subject to the new real estate tax.

Deloitte's view

Companies should evaluate their French qualifying free share and stock option award plans to determine whether they have any awards that may be eligible for a refund and proceed to file a refund claim.

More details about the withholding tax and the estate and investment tax reforms should be available in the next few months.

— Nicolas Meurant (Paris)
Partner
Deloitte France
nmeurant@taj.fr

Alexis Fillinger (Paris)
Partner
Deloitte France
afillinger@taj.fr

Christina Melady (Paris)
Partner
Deloitte France
cmelady@taj.fr