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Global Newsflash

China

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People's Republic of China - Implications of Golden Tax System III on individual income tax reporting and administration

(1) Overview

A major tax administration project, which should be implemented nationwide by the end of 2016, will have a significant impact on filing and reporting obligations relating to individual income tax ("IIT") in China.

The "Golden Tax System" ("GTS") is an electronic tax administration system developed by the Chinese government in the 1990s as one of 12 government information management systems. The first two iterations of the system, GTS I and II, used information technology mainly to improve compliance with China's value-add tax regulations, notably the use and authentication of invoices (fapiaos), etc. The third version of GTS ("GTS III") contains more sophisticated functionality that ultimately will be integrated with all industries, tax categories and tax administration areas, especially for People's Republic of China IIT purposes.

The cities of Shanghai and Beijing will roll out GTS III before September 2016, and Jiangsu and Zhejiang provinces will officially launch the system in the fourth quarter of 2016; GTS III is expected to be implemented nationwide by all levels of the tax authorities by the end of 2016. The IIT filing process will be significantly affected by the implementation of GTS III since the tax authorities are aiming to establish a centralized data system for all companies and individual taxpayers that will facilitate intensified IIT administration.

(2) Key implications of GTS III

1) New and revised IIT returns and forms

All tax reporting forms used in the GTS III are in line with requirements of Bulletin 21 (issued in 2013). Bulletin 21 reduced the number of IIT returns / forms to 12, nine of which are new or revised and three of which remained unchanged. GTS III will require taxpayers to disclose more basic information during the initial tax registration process, which likely will result in enhanced scrutiny of income reporting, information collection and the administration of IIT compliance for all taxpayers.

2) Comprehensive data reporting requirements

GTS III entails more comprehensive reporting requirements (e.g. personal data, income details, etc.) for both foreign and Chinese employees. Using this information, the local tax bureaus will be able to create a centralized data base that will be used to analyze data across companies in the same / similar industries and identify instances where reported taxable income appears to be "unreasonably" high or low.

3) New reporting requirements for nontaxable benefits-in-kind ("BIK") granted to foreign individuals

The GTS III will require disclosure of more information related to benefits-in-kind offered to expatriates. The existing IIT regulations allow a tax exemption on specific BIKs offered to foreign employees if certain requirements are met. Although many local tax bureaus already have stepped up the examination of BIKs in recent years, the launch of GTS III will be the first time individuals will be required to disclose BIKs (along with monthly salary withholding and reporting) at the national level. The new system will help the local tax authorities in reviewing and determining the reasonableness of certain tax-exempt benefits (e.g. qualified housing rentals, meals, laundry) claimed by expatriates.

(3) Deloitte's view

The launch of GTS III is expected to result in increased scrutiny of IIT returns and forms by the local tax bureaus. All companies (and especially those employing foreigners) should carefully evaluate the impact of GTS III and take steps to ensure that sufficient documentation is maintained and that they are in compliance with the relevant rules. The following factors, in particular, should be considered:

- Whether the company's employees are familiar with the new system and the relevant changes;
- Whether the company documents and properly monitors employment details (e.g. tracking the number of days expatriates are present in China, etc.);
- Whether all employment income (e.g. offshore income, overseas social security costs, non-qualifying BIK, etc.) has been reported for IIT purposes;
- Whether the company has proper internal procedures and exercises strict internal controls over BIK claims; and
- Whether the company has sufficient internal resources to collect all relevant data/documents to substantiate tax positions.

In response to the new reporting requirements relating to tax-exempt benefits, employers should take steps to ensure that such benefits are structured properly to differentiate them from cash allowances and that application of the benefits complies with the tax regulations and local practice. Additionally, relevant internal administrative procedures should be well documented and adhered to in order to sustain eligibility for tax-exempt status.

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