SAT Clarifies Rules on Tax Residence, Time Apportionment and Non-resident Senior Management Executives

By: Gus Kang, Tax Director – Beijing
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The Chinese State Administration of Taxation ("SAT") issued a circular on 23 July 2004 that clarifies the rules relating to individual income tax (IIT) for non-residents in China. The circular, entitled “Notice on Issues in Implementation of IIT Regulations and Tax Treaty for Non-residents in China,” (Guishuifa [2004] No. 97), entered into effect on 1 July 2004. The new circular was issued in response to questions the SAT has received after the tax amnesty was announced on 11 March 2004. That amnesty allowed foreign residents taxable in China to pay overdue/underreported tax liabilities in China without penalties. A number of questions had arisen with respect to calculation of the number of days spent in China as well as calculation of the tax liability as prescribed in other circulars and relevant tax treaties.

**Entry and Exit Days**

In general, an expatriate taxpayer may be subject to Chinese IIT if the taxpayer resides in China for more than 90 or 183 days, depending on the facts and circumstances as well as any applicable tax treaty. The 90-day rule usually applies to taxpayers from a country that does not have a tax treaty with China, whereas the 183-day rule applies to taxpayers from a country that has concluded a tax treaty or agreement with China.

How should a taxpayer count the number of days in China for purposes of the 90/183-day test? Before the new rule was issued, only the entry day was counted as a China day; the exit day was not counted for either the 90 or 183-day residence test and calculation of IIT liability. According to the new rule, when counting the 90/183 days to determine whether a taxpayer is subject to China IIT, both the entry day and the exit day are to be counted as a full day in China. However, the counting of days is different when calculating the IIT liability for a taxpayer that is taxed based on the time apportionment method. In such cases, both the entry day and the exit day are counted only as half days.

Under the new rule, it will be easier for expatriates, including Hong Kong residents, to exceed the 183-day threshold. Since some individuals may enter and exit China on the same day, the new rules provide that, for purposes of the 90/183-day threshold, entry and exit on the same day will be counted as one day, whereas for purposes of computing tax liability, the day will be counted as a half day.
Senior Management Executives/Directors

Previously, the salary of a non-resident taxpayer holding a senior management position in a PRC entity was fully taxable in China from the first day until the last day of the taxpayer’s PRC assignment if his salary was paid by a PRC entity, regardless of how many days the individual spent in China during a calendar year. In contrast, the tax liability of a non-senior management taxpayer—even if his salary was paid by a PRC entity—could be assessed based on the number of days spent in China.

Under the new circular, the tax liability of a senior management executive is assessed as follows (subject to the facts and circumstances and provisions in an applicable tax treaty):

1. If an individual in a senior management position resides in China for less than 90 (or 183) days in a tax year, the individual is exempt from tax if his salary is not paid or borne by a Chinese employer. If the salary is paid or borne by a Chinese employer, tax is computed without regard to “day in/day out” rule mentioned above.

2. If an individual in a senior management position resides in China for more than 90 (or 183) days but less than one year in the tax year, the individual is subject to tax based on the “day in/day out” rule if the salary is not paid or borne by a Chinese entity.

3. If an individual in a senior management position resides in China for more than one year but less than five years, his entire salary income is subject to tax. However, income paid by a non-Chinese employer for services rendered outside China is exempt.

For purposes of the above rules, the term “senior management” is defined as a general manager, deputy general manager, technical director, department head or its equivalent.

Under most tax treaties, directors’ fees paid by a Chinese company are normally subject to tax on the full amount irrespective of physical presence of the individual director in China. The tax rate is 20%. If an individual is both a senior management executive and a director, the salary and directors’ fees received would be taxed in accordance with the respective rules for salaries and director’s fees. However, some of China’s tax treaties (e.g. Canada, Sweden and Thailand) expand the definition of directors’ fees to include the salaries of senior management executives. In that case, the salary or director’s fees of an individual who is both a senior management executive and a director would be subject to tax without the benefit of the “day in/day out” rule. However, the respective tax rates for salaries (5% to 45%) and directors’ fee (20%) still would be applicable.

New Permanent Residence Regulations Could Have Tax Consequences

By:  Gus Kang, Tax Director – Beijing
     April Liao, Tax Manager – Beijing

Further to the Ministry of Public Security’s announcement in 2001 that China would introduce an international permanent residence ("green card") system, the government issued regulations, entitled "Management procedures for permanent residence for foreigners living in China," on 15 August 2004.

According to the regulations, foreigners that qualify under one of the following categories may obtain a green card in China:

- Foreigners who hold senior management positions in businesses that promote China's economic, scientific and technological development or social progress;
- Foreigners who have made a "relatively large direct investment" (as defined) in China;
- Foreigners who have made outstanding contributions or are of special importance to China; or
- Foreigners who come to China to be with family (e.g. husband and wife, minors dependent on their parents and senior citizens dependent on their relatives).
A "senior management position" is defined as a position equal to or above deputy general manager, deputy plant manager, deputy professor or deputy senior researcher. Tenure in such a position must be at least four years.

A "relatively large direct investment" is defined as follows:

- Investments over USD 500,000 in encouraged industries in the western provinces or in remote areas;
- Investment exceeding USD 1 million in the central regions; and
- Cumulative investments exceeding USD 2 million in China.

To obtain a green card, the individual must file an application with the municipal public security authorities. The authorities are required to make a decision within six months of receipt of the application and issue a green card within 30 days after approving the application.

There is no limit on how long a green card holder may stay in China; however, the card is valid for five years for minors and 10 years for adults. To enter and leave the country, a foreigner only needs a valid passport and the green card. The green card also may be used as a legal identity document during the foreigner’s stay in China. To maintain a green card, foreigners must be present in China for at least three months in any calendar year.

**Tax Implications for Green Card Holders**

Since the issuance of the green card regulations, questions have arisen regarding the individual income tax ("IIT") treatment and social security obligations of green card holders. The Chinese government has not yet released any guidance on these issues.

PRC IIT and social security tax obligations are different for Chinese nationals and foreigners. Therefore, the tax treatment of green card holders depends on whether the individual is deemed to be domiciled in China or whether the individual is deemed to be a foreigner. In the former case, an individual is subject to PRC IIT on his/her worldwide income and is required to participate in the PRC social security system.

Worldwide income includes income from the following sources:

- Employment income;
- Investment income;
- Business income;
- Royalty and copyright income;
- Contingency income; and
- Other income specified as taxable income by the Chinese authorities.

PRC social security taxes include:

- Pensions;
- Unemployment insurance;
- Medical insurance;
- Work injury insurance; and
- Housing funds.

Green card holders must also take into consideration the possibility of inheritance tax liability. If the Chinese government adopts the inheritance tax law, green card holders could be subject to PRC inheritance tax on their worldwide assets.

If an individual holding a green card is deemed to be a foreigner, PRC tax liability depends on how long the individual has been physically present in China, the source of the income and the party assuming the cost of compensation.

Foreigners contemplating taking up residence in China should consider the tax and legal implications before making any decision regarding a green card.
SAT Issues Simplified Export Refund Procedures

By: Kevin Ng, Tax Partner – Tianjin
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The State Administration of Tax (“SAT”) issued a circular, Guoshuifa [2004] No. 64, in late May 2004 which provides guidance on the export rebate scheme. During the 2004 export rebate conference, the SAT urged the tax authorities in charge of export refunds to expedite the process and requested cooperation from all enterprises involved.

The new circular provides for the following requirements:

- When claiming an export rebate, exporting enterprises should provide the following documents together with the application form:
  - Manufacturing enterprises using the “exempt, credit and rebate” method should provide export invoices, and trading enterprises should provide the special VAT invoice or general invoice, without providing a tax payment certificate or a split form of tax completion for goods exported, which were requested before;
  - Custom declaration forms for export rebate purposes; and
  - A foreign exchange verification certificate for export.

However, trading enterprises that purchase and export goods that are subject to consumption tax or that purchase goods from small-scale VAT payers should provide a tax payment certificate or a split form of tax completion for goods exported.

- When claiming an export rebate, exporting enterprises should provide the foreign exchange verification certificate for export. In case payments on exported goods have not yet received, exporting enterprise should provide the foreign exchange verification within 180 days (except long-term payment contract), to support the rebate.

Failure to do so may result in forfeiture of the rebate and the tax authorities may claw back previously rebated VAT or reject a claim for a VAT rebate on exported goods.

- Exporting enterprises should claim the rebate within 90 days after the export declaration is filed with the customs office. Unless otherwise approved by the competent tax authorities, failure to comply with the 90-day deadline will result in denial of a rebate. Manufacturing enterprises that fail to meet the deadline will be treated as domestic sellers and, hence, be subject to VAT on exports.

In the case of deemed exported products, such as bidding products or domestic equipment purchased by a foreign investment enterprise, etc., an export rebate should be claimed within 90 days after the issuance of a VAT invoice.

If the required documents contain incorrect information or are not filed properly, the exporting enterprise should apply to the competent tax authorities for an extension of the deadline, which may be extended for an additional three months, upon approval.

- The due date for claiming an export rebate for goods declared for export before 31 May 2004 is 30 September 2004.

- The tax authorities are required to process an export rebate claim in a timely manner and may not reject an application that is supported by complete documentation on the grounds that electronic information may be inconsistent, etc.

The tax authorities clearly are attempting to become more efficient in processing export rebate claims but this will also require the cooperation from exporting enterprises as to improve their internal procedures.

Since custom offices and local administrations regulating foreign exchange are involved in export rebate scheme and may have different degree of inefficiency, exporting enterprises should work closely with these authorities to obtain all necessary documentation in a timely manner with a view to lodging the refund applications in time.
Beijing Issues Deemed Stamp Duty Rules

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On 22 May 2004, the Beijing Local Tax Bureau (BLTB) issued a tax circular (Jingdishuidi [2004] No. 256) that may require certain taxpayers to pay stamp duty on a deemed basis.

In general, the following documents are subject to stamp duty under the 1988 Provisional Rules of the People's Republic of China on Stamp Duty:

1. Contracts for purchases and sales, processing, project construction, property leasing, commodity transportation, storage and custody of goods, loans, property insurance, technology as well as other documents of a contractual nature;
2. Documents relating to the transfer of title to property;
3. Accounting books;
4. Rights or licenses; and
5. Other documents as determined by the Ministry of Finance.

The amount of stamp duty, which ranges from 0.005% to 0.2% of the contract value, or RMB5 per taxable document, depends on the nature of the taxable documents. To strengthen the tax administration, the SAT issued a Circular in January 2004 (Guoshuihan [2004] No. 150), which requires that:

1) Taxpayer retain taxable documents for 10 years;
2) Upon approval, taxpayers may pay stamp duty on a periodic basis;
3) A stamp duty audit should be carried out on a regular basis; and
4) The local tax authorities may adopt a deemed tax basis method for stamp duty collection in certain special cases.

As a follow-up to Circular No. 150, the BLTB has issued Circular Jingdishuidi [2004] No. 256 to implement a deemed tax method in Beijing in the following cases:

1) If the taxpayer fails to create records of taxable documents as required or fails to report and keep the taxable documents properly;
2) If the tax basis reported by the taxpayer is obviously and unreasonably low;
3) If a taxpayer that is permitted to pay stamp duty on a periodic basis fails to submit the required stamp duty report to the tax authorities or under-reports its duty or if issues are discovered in tax audit; and
4) If a taxpayer is unable to provide all taxable documents, it can voluntarily apply to pay stamp duty under the deemed tax basis method.

The deemed taxable amount depends on the type of taxpayer and documents involved. The deemed percentage may be summarized as follows:

<table>
<thead>
<tr>
<th>Industrial enterprises</th>
<th>Purchase and sales contracts</th>
<th>70% of total sales and 60% of raw material purchases</th>
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<tbody>
<tr>
<td>Commercial enterprises</td>
<td>Purchase and sales contracts</td>
<td>30% of total commodities sales and purchases</td>
</tr>
<tr>
<td>Printing, advertising, repair and spare parts replacement enterprises</td>
<td>Processing contracts</td>
<td>100% of revenue from the main operation</td>
</tr>
<tr>
<td>Construction and installation enterprises</td>
<td>Construction and installation project contracts</td>
<td>80% of revenue; 50% of raw material purchases or project cost</td>
</tr>
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For example, if the deemed tax basis method is implemented for an industrial enterprise and its total sales and purchases is RMB100 million and RMB60 million, respectively, the stamp duty would be:

\[(RMB \ 100 \ million \times 70\% + RMB \ 60 \ million \times 60\%) \times 0.03\% = RMB \ 31,800\]
As a result of the implementation of Circular No. 150 issued by SAT and Circular No. 256 issued by BLTB, taxpayers may be required to pay additional stamp duty on a deemed basis. Other local tax bureaus outside of Beijing may follow suit and implement the deemed tax method. In this respect, it is important for taxpayers to maintain adequate records and documents to avoid paying additional stamp duty that may be imposed under the deemed method.
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