

China Business Expenses and Reimbursement: What WFOEs Need to Know

Dan Young Business Consultancy — www.danyoungcpa.com
Unofficial English translation prepared for reference only. The official Chinese text prevails.

Contents

The Fapiao Requirement 1

The Reimbursable Expense Categories 1

The Entertainment Expense Limitation 2

The Travel Expense Policy 2

The Approval Process 2

The Documentation Retention 2

A WFOE's expense reimbursement policy is one of those documents that nobody reads until there's a problem — and then everyone argues about what it says. In China, the expense reimbursement policy is also a tax compliance document, because expenses that are reimbursed without proper documentation are not deductible for corporate income tax purposes. A poorly designed expense policy costs the company tax deductions it should have gotten.

Here's what the policy should cover and how to make it work in China.

The Fapiao Requirement

The fundamental principle of China expense compliance is that every expense must be supported by a fapiao — a Chinese tax invoice. A foreign company's expense report that's supported by an overseas receipt, a credit card statement, or a handwritten note is not acceptable to the Chinese tax authorities. The expense must be supported by a fapiao that meets the fapiao requirements — the correct fapiao type, the correct fapiao content, and the correct fapiao issuing entity.

The fapiao should be issued in the company's name — the fapiao header must show the company's full Chinese name and the company's tax registration number. A fapiao that's issued to an individual employee rather than to the company may not be accepted as a company expense, and the company loses the deduction.

The fapiao content must match the expense — a fapiao that says "office supplies" but the expense was for client entertainment is a mismatch, and the tax authorities may disallow the deduction. The fapiao should describe the goods or the services accurately, and the description should be consistent with the company's business.

The Reimbursable Expense Categories

The expense policy should define the categories of expenses that are reimbursable — and the categories that are not. The standard categories are travel expenses — airfare, train fare, hotel, local transportation — business entertainment — meals with clients, business gifts — communication expenses — mobile phone

charges, internet charges — and office expenses — stationery, printing, postage.

Each category should have a spending limit — a maximum amount per event, per day, or per month — and a documentation requirement. A meal expense with a client might be limited to 300 RMB per person, and the documentation must include the fapiao, the names of the attendees, the purpose of the meal, and the business discussed. A travel expense might be limited to economy class for domestic flights and premium economy for international flights, and the documentation must include the fapiao, the boarding pass, and the travel itinerary.

The Entertainment Expense Limitation

Business entertainment expenses in China are subject to a tax deductibility limitation — only 60% of the entertainment expense is deductible, and the deduction is further limited to 0.5% of the company's annual sales revenue. A company that spends 100,000 RMB on client entertainment can deduct only 60,000 RMB — and only if the company's annual sales revenue is at least 12 million RMB ($60,000 / 0.5\%$). The limitation applies regardless of whether the expense is supported by a fapiao, and the non-deductible portion is a permanent tax cost.

The entertainment expense limitation makes business entertainment an expensive way to build client relationships. A company that can convert entertainment expenses to meeting expenses — a business meeting with a client at the company's office rather than a restaurant — avoids the entertainment expense limitation because meeting expenses are fully deductible.

The Travel Expense Policy

The travel expense policy for a China WFOE should address the specific travel patterns of the company. Domestic business travel in China is extensive — the staff travel to visit customers, to attend trade shows, to inspect suppliers — and the travel expense policy should define the travel class, the hotel standard, the daily meal allowance, and the local transportation allowance.

The daily meal allowance is typically a fixed amount per day — 100 RMB, 150 RMB, or 200 RMB depending on the city — and the allowance doesn't require a fapiao because it's a fixed allowance, not a reimbursement. The tax authorities accept the daily meal allowance as a deductible expense without fapiao support, as long as the allowance is reasonable and is based on the company's written policy.

The Approval Process

The expense reimbursement should be subject to an approval process that's documented in the policy. The employee submits the expense report with the supporting fapiao, the employee's supervisor approves the expense as a valid business expense, and the finance department verifies that the fapiao are compliant with the fapiao requirements and that the expense is within the policy limits. The approved expense is reimbursed to the employee through the company's bank account.

The approval process should be designed to catch the common fapiao problems before the expense is recorded in the accounting system — the fapiao that's issued to the wrong company name, the fapiao that's expired, the fapiao that's for a non-reimbursable category. A fapiao that's recorded in the accounting system and later rejected by the tax authorities creates a tax adjustment that's more expensive to fix than the original expense.

The Documentation Retention

The expense documentation — the expense reports, the fapiao, the supporting documents — should be retained for the statutory retention period, which is generally ten years for tax purposes. The documentation is the evidence that the expense was a valid business expense, and it's the company's defense in a tax

audit.

The documentation should be organized by period and by expense category, and the organization should allow the tax authorities — or the company's auditor — to trace a specific expense from the expense report to the fapiao to the accounting entry to the tax return. A documentation system that's disorganized — the fapiao are in a shoebox, the expense reports are in a filing cabinet — makes the tax audit more difficult and increases the risk that the tax authorities will disallow the expense because the documentation can't be produced.