NIKKEI Asia

WEALTH MANAGEMENT

Inside China's data-driven hunt for taxes on overseas gains

Rich told to self-assess and pay up, boosting local coffers but risking exodus

Chinese tax authorities are harnessing the power of big data to step up enforcement and collect levies on offshore gains. (Nikkei montage/Source photo by Akira Kodaka)

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HONG KONG -- China is prodding its citizens to pay taxes on overseas investment gains, as authorities harness the power of big data to close gaps in enforcement.

Individuals profiting from a range of financial investments offshore -- including insurance policies, family trusts and foreign stock trading -- are receiving texts and notices from local tax offices asking them to conduct self-assessments on overseas capital gains over the past two years and settle any unpaid amount, multiple people familiar with the matter told Nikkei Asia.

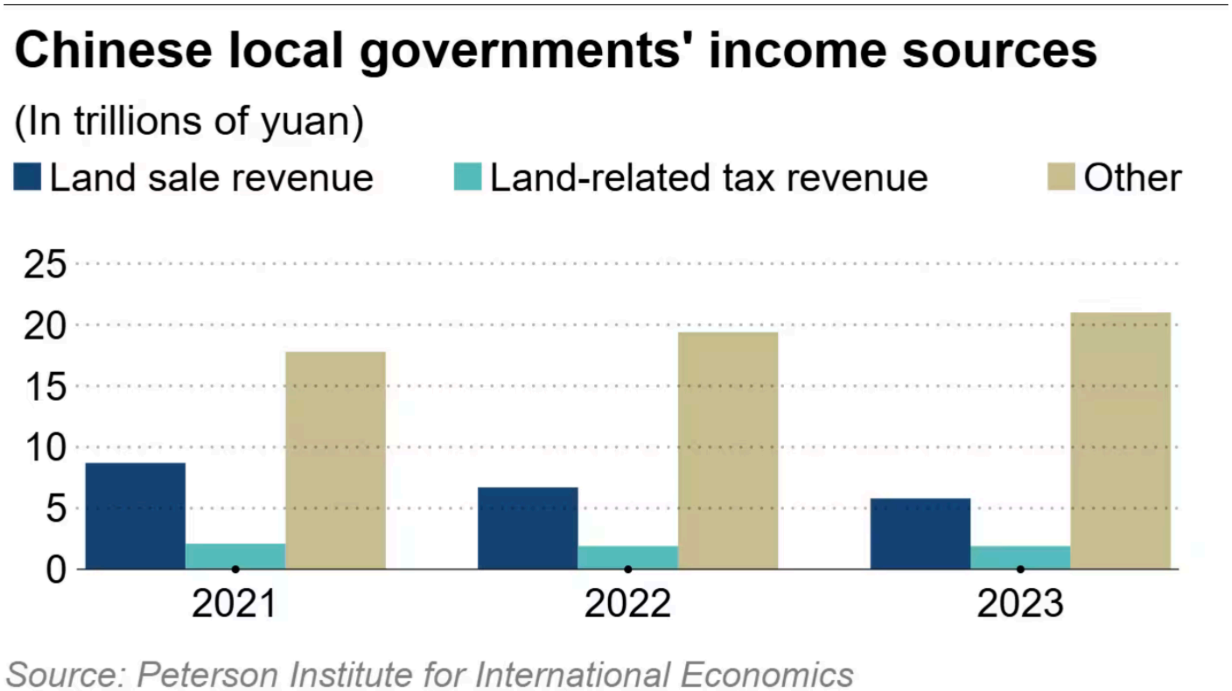
China has been gathering such data since 2017 under the Common Reporting Standards (CRS), which help participating jurisdictions catch tax evasion. But the people said authorities only started wide implementation earlier this year, as it took time to build up a database and share the information with local tax officials. The COVID-19 pandemic also delayed the process.

The drive comes amid a painful decline in tax revenue for local governments following the epic downturn in China's real estate sector. The decline has forced authorities to seek new sources of income apart from land sales, and the resulting hunt is highlighting how China is increasingly using big data and artificial intelligence to monitor the finances of businesses and individual taxpayers.

China levies up to 20% on citizens' offshore income. Stricter enforcement, however, could be a double-edged sword, with some experts warning that it risks accelerating an exodus of wealthy Chinese.

China's tax bureau is instructing individuals to "carefully examine" whether they obtained income from abroad during 2022 and 2023 and to "correct the personal income tax report truthfully," according to a notice seen by Nikkei Asia. Bloomberg previously reported that rich Chinese were being targeted for taxes on offshore assets.

China's State Taxation Administration did not reply to requests for comment.



The stepped-up scrutiny, which began around April, covers a range of targets including shareholders of Hong Kong-listed companies that issued dividends and Chinese passport holders who serve as executives at private companies, sources said.

Some senior executives at overseas-listed Chinese technology companies have been summoned by the tax authorities in recent months to assess their overseas gains, according to one person with knowledge of the matter.

A senior executive at a wholly owned subsidiary of a Hong Kong-listed Chinese real estate company also received such a notice, another person added. Notices have been sent to people who reaped gains trading shares of U.S.- and Hong Kong-listed companies through online brokerage platforms including Futu Holdings and Tiger Brokers as well, the source added.

Tiger Brokers did not respond to requests for comment, while a spokesperson for Futu said it had not received reports from users or clients regarding this matter.

Yin Zhe, group CEO of Noah Holdings, one of China's top third-party wealth managers, said he has observed an uptick in inquiries from mainland clients seeking advice about the tax prodding.

"China didn't have an established system [for collecting taxes on offshore gains] in its development history," Yin said. But now, increased communication with other countries, pressures in different economies and geopolitics all mean that countries start to prioritize "thinking about themselves."

"So they would step up doing tax checks on their own tax residents," Yin said, which prompts some to consider their tax residencies.

One tax adviser who declined to be named said his firm had received around 20 related inquiries so far this year. Individuals with at least $30 million in net assets or with the bulk of their assets overseas were more likely to be targeted.

The adviser said that individuals who receive the self-assessment orders are often confused about how much they must reveal. In one case, a person who reported only what was in his offshore bank accounts was told that he did not treat the audit seriously enough, the adviser said.

Nikkei Asia could not determine the scale of the inspection program, but one source said so far it has been focusing on wealthy individuals in large cities including Shanghai, Beijing and Guangzhou.

China's growing trove of tax intelligence is key to the initiative.

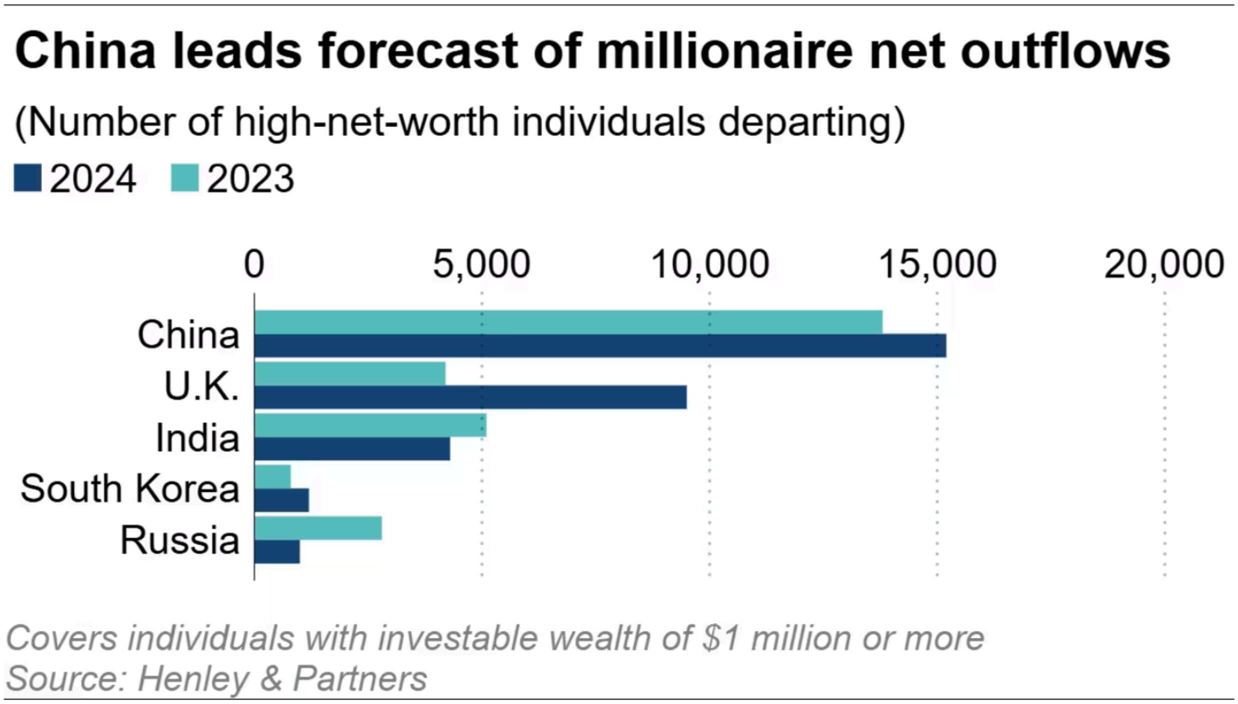
Data gathered through CRS includes extensive details on Chinese citizens' overseas assets, including year-end balances, interest income and stock transaction records, according to a person familiar with the system. This has been used to bolster what is known as the Golden Tax System, a collection and payment framework that helps authorities tighten oversight.

Some analysts say better tax enforcement is long overdue, as Chinese law subjects citizens to levies on their worldwide incomes similar to the situation in the U.S. and other developed economies. Chinese tax authorities have also increased efforts to crack down on tax evasion in recent years, including imposing hundreds of millions of dollars in fines on actors and live-streamers.

Increased collection of unpaid taxes promises to help local governments offset declining revenue.

Land sales and collection of land-related taxes generated about 27% of local governments' fiscal revenues in 2023, down from 38% in 2021, before Beijing started to deflate its real estate bubble, according to an estimate by the Peterson Institute for International Economics, a Washington-based think tank. China's fiscal revenue dropped by 1.3% on the year in the first 10 months of this year, official data shows.

"This is another structural way of improving local government finances so they can rely less on selling land to sponsor the growth policy," said Kelvin Lam, an economist at Pantheon Macroeconomics.



Insiders see potential to expand the dragnet.

Companies set up in low-tax jurisdictions by Chinese nationals could be subjected to individual tax inspections if there is no "necessary" operational reason to be there, according to China's tax law. Since it is common for Chinese onshore companies to set up British Virgin Islands-incorporated entities for the purpose of receiving payments, tax authorities could also go after the shareholders of these corporate structures, a trust adviser said on condition of anonymity.

There are concerns, however, that more stringent enforcement could push even more wealthy individuals toward the exits. With the Chinese economy mired in a downturn, a record 15,200 Chinese millionaires were already expected to leave the country this year, up 10% from 13,800 in 2023, a report by Henley & Partners estimated.

Leon Wu, founder and CEO of Ostrom Financial, a New York-based wealth and investment management consultancy, said he expects Chinese entrepreneurs and rich individuals to be more cautious when investing overseas and hire professionals to set up offshore structures.

"In a worst-case scenario," he said, "they can renounce their Chinese citizenship."

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