Individual income tax for expatriates working in China

by *Grace Lin*, *Cuatrecasas*, with *Practical Law China*

Practice notes | **Maintained** | China

This note provides an overview of Chinese individual income tax legislation applicable to expatriates working in China. It outlines tax implications by introducing the concepts of source of income and tax residency status and their interactions and includes summary tables on taxable income rules. It explains tax calculation methods, pre-tax deductions for expatriates, compliance obligations and foreign tax credit, and discusses the legal consequences for non-compliance and the tax risks associated with the commonly applied expatriation regimes.

Scope of this note

On 31 August 2018, *China* (PRC) released the *Law on Individual Income Tax 2018* (2018 IIT Law, with effect from 1 January 2019), which drew on international practice and, in many ways, transformed the country's existing IIT system. Afterwards, a series of supporting regulations were released to shed light on the implementation.

The changes in the law and its supporting regulations significantly impact the IIT rules applicable to foreign nationals working in China (expatriates), including, for the purposes of this note, residents of Hong Kong SAR, Macau SAR and Taiwan.

This note provides an overview of the changes and discusses:

- IIT implications for expatriates working in China.
- IIT calculation and compliance obligations.
- Legal consequences for non-compliance.
- Tax compliance risks under different expatriation regimes.

Main legislation

The following statutes govern China's revised IIT regime (all with effect from 1 January 2019):

- *2018 IIT Law*.
- *Regulations for the Implementation of the Individual Income Tax Law 2018* (2018 Implementation Regulations of IIT Law).
- *Interim Measures for Special Additional Deductions for Individual Income Tax 2018* (2018 IIT Deduction Measures).

These main statutes are supplemented by a large body of legislation issued by the *Ministry of Finance* (MOF) and *State Taxation Administration* (STA), including the following tax bulletins and circulars:

- *Operating Measures for Special Additional Deductions for Individual Income Tax (For Trial Implementation) 2018* (Tax Bulletin 60/2018).
- *Administrative Measures for Withholding and Declaration of Individual Income Tax (For Trial Implementation) 2018* (Tax Bulletin 61/2018).
- *Announcement of the STA on Issues of Self-declaration of Individual Income Tax 2018* (Tax Bulletin 62/2018).
- *Notice of the MOF and STA on Issues of Connection among Relevant Preferential Policies after the Revision of the Individual Income Tax 2018* (MOF/STA Joint Circular 164/2018).
- *Notice of the MOF and the STA on Preferential Policies of Individual Income Tax in the Guangdong-Hong Kong-Macau Greater Bay Area 2019* (MOF/STA Joint Circular 31/2019).
- *Announcement of the MOF and STA on the Criteria for Determining the Residence Period of Individuals without Domicile in China 2019* (MOF/STA Joint Bulletin 34/2019).
- *Announcement of the MOF and STA on Relevant Individual Income Tax Policies for Non-resident Individuals and Resident Individuals without Domicile 2019* (MOF/STA Joint Bulletin 35/2019).
- *Announcement of the MOF and STA on Relevant Individual Income Tax Policies for Foreign-sourced Incomes 2020* (MOF/STA Joint Bulletin 3/2020).
- *Notice of the MOF and STA on Individual Income Tax Policies for the Top-level and Urgently Needed Talents working in the Hainan Free Trade Port 2020* (MOF/STA Joint Circular 32/2020).
- *Announcement of the MOF and STA on Continuing the Implementation of the Preferential Policies for Individual Income Tax on Lump-sum Annual Bonuses and Others 2021* (MOF/STA Joint Bulletin 42/2021).
- *Announcement of the MOF and STA on Continuing the Implementation of the Preferential Policies for Individual Income Tax on Allowances and Subsidies for Foreign Individuals 2021* (MOF/STA Joint Bulletin 43/2021).

IIT implications for expatriates

IIT implications for expatriates working in China mainly depend on the following:

- Source of income, that is, China-sourced or foreign-sourced.
- Tax residency status, that is, non-residents, non-China-domiciled residents, or China-domiciled residents.
- Whether income is attributable to a permanent establishment (PE) in China as defined under the double taxation treaty (DTT).

Source of income

The source of employment income usually depends on the place where the work is performed, regardless of where the income is paid:

- The salary received by expatriates for work performed in China is considered China-sourced income.
- The salary received by expatriates for work performed overseas is considered foreign-sourced income.

(*Article 3*, *2018 Implementation Regulations of IIT Law*; *Article 1(1), MOF/STA Joint Bulletin 35/2019*; *Article 1, MOF/STA Joint Bulletin 3/2020*.)

However, expatriates who are appointed board directors, supervisors or senior management personnel in domestic resident companies (Senior Management) are subject to different treatment. Specifically, director fees, supervisor fees, salary or similar remuneration (including bonuses and equity incentive plans) paid or borne by domestic resident companies are considered China-sourced income, regardless of where the Senior Management perform their functions. Senior management personnel include a company's general manager, vice general manager, head or director of each functional department and similar roles. (*Article 1(3), MOF/STA Joint Bulletin 35/2019*.)

Expatriates may receive other types of income while working in China, and their source can be determined as follows:

- The following income is considered China-sourced income, regardless of where it is paid:
  - income from providing services in China;
  - rental income from leasing properties to a lessee for use in China;
  - royalty income from licensing the use of proprietary rights in China;
  - income from transferring real estate located in China and transferring other properties in China; and
  - interest and dividends received from domestic entities and resident individuals.

  (*Article 3, 2018 Implementation Regulations of IIT Law*.)
- The following income is considered foreign-sourced income:
  - income from providing services outside China;
  - author's remuneration paid and borne by foreign entities and other organisations;
  - royalty income from licensing the use of proprietary rights outside China;
  - operational income from carrying out manufacturing and operational activities outside China;
  - interest and dividends received from foreign entities, other organisations and non-resident individuals;
  - rental income from leasing properties to a lessee for use outside China;
  - income from transferring real estate located outside China, transferring equity interest in foreign entities and other organisations (except where over 50% of the fair market value of the assets in the invested entities or organisations directly or indirectly consists of real estate in China at any time during the three years, or 36 consecutive calendar months, before the transfer; and income arising from these transfers is considered China-sourced income) and transferring other properties outside China; and

- incidental income paid and borne by foreign entities, other organisations and non-resident individuals.

(*Article 1, MOF/STA Joint Bulletin 3/2020*.)

Tax residency status

The *2018 IIT Law* distinguishes between "resident" and "non-resident" individuals.

Individuals meeting one of the following criteria will qualify as tax residents in China:

- Those who are domiciled in China (China-domiciled residents). For this purpose, "domiciled in China" means habitually residing in China due to household registration (hukou), family, economic ties, and so on (*Article 2, 2018 Implementation Regulations of IIT Law*). This criterion usually applies to Chinese nationals.
- Those who are not domiciled in China but reside in China for 183 cumulative days or more in a tax year (non-China-domiciled residents). This criterion usually applies to expatriates to determine their residency status in China.

(*Article 1*, *2018 IIT Law*.)

Individuals who are not domiciled in China, and who do not reside in China or reside in China for less than 183 cumulative days in a tax year are not considered tax residents in China (non-residents).

For counting the cumulative days of residence in China of non-domiciled individuals (that is, expatriates), only the presence of full 24 hours for the day is considered (*Article 2*, *MOF/STA Joint Bulletin 34/2019*).

China's tax year is January 1 to December 31.

Expatriates' taxable income from employment

Generally, Chinese tax residents are subject to IIT in China on their worldwide income, and non-residents are only subject to IIT in China on their China-sourced income.

However, there are two exceptions:

- For non-residents who reside in China for up to 90 cumulative days in a tax year, the IIT exemption applies to their China-sourced income that is paid and borne by a foreign employer. Therefore, only their China-sourced income paid or borne by a domestic employer (including the domestic establishment or business place of a foreign employer) is subject to IIT in China. (*Article 5*, *2018 Implementation Regulations of IIT Law*.)
- For non-China-domiciled residents who reside in China for 183 cumulative days or more in a tax year for less than six consecutive tax years (that is, the individuals are tax residents in China for less than six consecutive years), after filing with the tax authorities, an IIT exemption applies to their foreign-sourced income paid and borne by a foreign payer (Six-year Rule). If any non-China-domiciled resident leaves China

for more than 30 consecutive days in any of those six years, the six-year period restarts. (*Article 4, 2018 Implementation Regulations of IIT Law*.)

The Six-year Rule became effective 1 January 2019. Therefore, the time spent in China before 1 January 2019, will not be considered when counting the six-year period. Consequently, for the 2019 to 2024 tax years, all non-China-domiciled residents can benefit from the IIT exemption granted by the Six-year Rule. (*Article 1, MOF/STA Joint Bulletin 34/2019*.)

Based on the above, the employment income of non-domiciled individuals (that is, expatriates) is subject to the below IIT treatment, depending on their source of income and tax residency status (see *Table one: expatriates' taxable employment income (ordinary employees)*).

Non-residents: annual stay of up to 90 cumulative days

Where non-residents reside in China for up to 90 cumulative days in a tax year, only their China-sourced income paid or borne by a domestic employer (including the domestic establishment or business place of a foreign employer) is subject to IIT in China; their China-sourced income paid and borne by a foreign employer is tax exempt.

The monthly salary income subject to tax in China is calculated as follows (Formula One):

> Monthly salary = worldwide salary x (China-paid salary/worldwide salary) x (days working in China in the month/calendar days of the month)

For this purpose, if a foreign company pays the salary of an expatriate working in China on behalf of a domestic employer, and then charges it back, which means the salary is borne by the domestic employer, this salary is considered China-paid salary, not foreign-paid salary, when applying the above formula.

Non-residents: annual stay over 90 but less than 183 cumulative days

Where non-residents reside in China for over 90 cumulative days but less than 183 days in a tax year, only their China-sourced income is subject to IIT in China; their foreign-sourced income is not subject to IIT in China.

The monthly salary income subject to tax in China is calculated as follows (Formula Two):

> Monthly salary = worldwide salary x (days working in China in the month/calendar days of the month)

Non-China-domiciled residents: minimum annual stay of 183 cumulative days for less than six years

When non-China-domiciled residents reside in China for 183 cumulative days or more in a tax year for less than six consecutive tax years, all their employment income, except for the foreign-sourced income paid and borne by a foreign payer, is subject to IIT in China; the foreign-sourced income paid and borne by a foreign payer is tax exempt under the Six-year Rule

The monthly salary income subject to tax in China is calculated as follows (Formula Three):

> Monthly salary = worldwide salary x [1 - (foreign-paid salary/worldwide salary) x (days working outside China in the month/calendar days of the month)]

Non-China-domiciled residents: minimum annual stay of 183 cumulative days for six years

Where non-China-domiciled residents reside in China for 183 cumulative days or more in a tax year for six consecutive tax years, and therefore, no longer qualify to apply the Six-year Rule, their worldwide salary income is subject to IIT in China.

Special rules for Senior Management

However, if the non-domiciled individuals are appointed Senior Management of domestic resident companies, their employment incomes are subject to different IIT treatment when they are non-residents (see *Table two: expatriates' taxable employment income (Senior Management)*):

- Where the Senior Management resides in China for up to 90 cumulative days in a tax year, their income paid or borne by a domestic employer is subject to IIT in China; their income paid and borne by a foreign employer is not subject to IIT in China.
- Where the Senior Management resides in China for over 90 cumulative days but less than 183 days in a tax year, all their employment income, except for the foreign-sourced income paid and borne by a foreign payer, is subject to IIT in China. The above Formula Three is applicable in this situation.

(*Article 2, MOF/STA Joint Bulletin 35/2019*.)

In summary, under the new IIT regime, to calculate the expatriates' IIT amount payable on employment income, these formulas first determine the salary income subject to tax in China and then calculate the IIT amount payable accordingly.

Furthermore, for counting the days working in China in the above formula, it includes the actual working days in China, the public and personal holidays and trainings taken in China and overseas during the work assignment in China. Where non-domiciled individuals are employed by both domestic and foreign employers or only employed by a foreign employer while working both in China and overseas, their salary income is subject to time-apportionment according to the days working in and outside China. (*Article 1, MOF/STA Joint Bulletin 35/2019*.)

This is to say, where non-domiciled individuals are only employed by a domestic employer, regardless of where they perform the work, their overseas working days do not count when applying the formulas; instead all their working days will be deemed days working in China. (*Q&A from the MOF and STA on MOF/STA Joint Bulletin 35/2019*.)

Table one: expatriates' taxable employment income (ordinary employees)

Presence in China in a tax year	China-sourced		Foreign-sourced	
	China-paid	Foreign-paid	China-paid	Foreign-paid
≤ 90	Taxable	Non-taxable	Non-taxable	Non-taxable
90 days ~ 183 days	Taxable	Taxable	Non-taxable	Non-taxable
≥ 183 days (Six-year Rule applies)	Taxable	Taxable	Taxable	Non-taxable
≥ 183 days (Six-year Rule does not apply)	Taxable	Taxable	Taxable	Taxable

Table two: expatriates' taxable employment income (Senior Management)

Presence in China in a tax year	China-sourced		Foreign-sourced	
	China-paid	Foreign-paid	China-paid	Foreign-paid
≤ 90	Taxable	Non-taxable	Taxable	Non-taxable
90 days ~ 183 days	Taxable	Taxable	Taxable	Non-taxable
≥ 183 days (Six-year Rule applies)	Taxable	Taxable	Taxable	Non-taxable
≥ 183 days (Six-year Rule does not apply)	Taxable	Taxable	Taxable	Taxable

Interplay with DTT

Where the above domestic IIT rules conflict with the provisions of the DTT signed between China and a foreign country or region, the latter will prevail.

According to the DTT article on income from employment or dependent personal services, salary, wages and similar remuneration earned by a tax resident of a contracting state will be taxable only in that state, unless the work is performed in China. If the work is carried out in China, the remuneration earned may be taxed in China, provided any of the following conditions is met:

- The recipient is in China for a period or periods exceeding 183 days in any 12-month period starting or ending in the fiscal year concerned (or in the calendar year concerned, depending on the specific terms of the DTT).
- The remuneration is paid by, or on behalf of, an employer that is a resident of China.
- The remuneration is borne by a PE or a fixed base the employer has in China.

The above Formula One or Formula Two applies in this situation accordingly.

Further, if a tax resident of a contracting state is a member of senior management personnel, but the applicable DTT does not have the article on directors' fees, or it has the article but it does not apply to that individual (many DTTs only cover board directors or supervisors, not senior management personnel), then the remuneration received by this individual can benefit from the above DTT treatment for employment income and apply the IIT formula for ordinary employees (see *Table one: expatriates' taxable employment income (ordinary employees)*).

Permanent establishment

According to the above DTT provision, remuneration earned by a resident of a contracting state for work carried out in China will be taxable in China if the remuneration is borne by a PE or a fixed place that the employer has in China.

DTTs define a PE as a fixed place of business through which the enterprise wholly or partly carries out its business; a common example of what is treated as a PE in China is the *representative office* (RO) of a foreign company established in China. Therefore, for non-resident expatriates working for an RO, their remuneration is considered borne by the RO, regardless of where it is paid or how it is accounted; consequently, this remuneration is subject to IIT in China on a time-apportionment basis, without benefiting from the above 183-day relief granted by the DTT provision on income from employment.

However, a PE does not have to be established in a physical form; it may also take a virtual form. According to the article in the DDTs on permanent establishment, PEs also include:

- A building site, construction, assembly, installation project or related supervisory activities, but only if that site, project or activities last more than a certain period (for example, six or twelve months), depending on the specific terms of the applicable DTT (commonly referred to as a construction PE).
- The provision of services, including consultancy services, by an enterprise through employees or other personnel who are present in China for that purpose, but only if these activities continue for the same or a connected project in China for more than a certain period (for example, 183 days in any 12-month period), depending on the specific terms of the applicable DTT (commonly referred to as a service PE).
- Where a person (other than an independent agent) is acting in China on behalf of an enterprise of a contracting state and habitually exercises in China an authority to conclude contracts in the name of the enterprise, that enterprise will be considered to have a PE in China for any activities that person carries out for the enterprise, unless those activities are limited to preparatory or auxiliary in nature defined under the DTT (commonly referred to as a dependent agent PE).

Once a PE is established in any form in China, the remuneration of any expatriate working for the PE is subject to IIT in China on a time-apportionment basis.

Dual contract arrangement

Where an expatriate assumes employment functions under a dual contract arrangement, the expatriate can benefit from a time-apportionment method for IIT calculation, provided the overseas functions are separate from the expatriate's employment functions in China.

Note if the expatriate is fully dedicated to working for a domestic employer, but the salary is paid through a split arrangement between the domestic employer and a foreign company in the same group, this is not in substance a dual contract arrangement.

The time-apportionment method is presented in the set of formulas (depending on how long the Expatriate has been in China) provided in *MOF/STA Joint Bulletin 35/2019* and also takes into account the DTT provisions mentioned in the above sections.

Expatriates' other income

Expatriates sometimes have other types of income from abroad when they work in China, for example, dividends distributed by a foreign company, rentals from a house located overseas, or gains from property transfers overseas.

This income is usually foreign-sourced income whose taxability depends on the individual's tax residency status. Where expatriates are non-residents, this foreign-sourced income is not subject to IIT in China; where expatriates are non-China-domiciled residents who qualify for the Six-year Rule, the foreign-sourced income paid and borne by a foreign payer is tax exempt.

IIT calculation

Article 2 of the *2018 IIT Law* divides personal income into the following nine categories:

- Salary and wages, including basic salary, pay increases, bonuses, incentive plans, cash allowances, severance pay, and any other income related to employment.
- Service income.
- Author's remuneration
- Royalties.
- Operational income.
- Interest and dividends.
- Property rental income.
- Property transfer income.
- Incidental income.

For resident taxpayers, the income in the first four categories received in a tax year (collectively "Comprehensive Income") is consolidated to calculate the IIT for a tax year, applied with a progressive scale of tax rates ranging from 3% to 45%. For non-resident taxpayers, the income in these four categories is calculated separately for the IIT on a monthly basis or every time a payment is made, with the converted monthly progress scale of tax rates for Comprehensive Income.

For both resident and non-resident taxpayers, the income in rest five categories is calculated separately for the IIT. Operational income is applied with a progressive scale of tax rates ranging from 5% to 35%; other income categories are taxed at 20%.

Resident taxpayers: monthly cumulative withholding method plus annual self-declaration

For resident taxpayers, Comprehensive Income can subtract the following items to determine the taxable amount:

- Statutory deduction of RMB60,000.
- Special deductions, that is, taxpayers' contributions to the basic social security and housing fund.
- Special additional deductions (see *Special additional deductions*).

- Other qualified deductions under the law (including payments for qualified enterprise annuities and occupational annuities, expenditures for purchasing qualified commercial health insurance and tax-deferred commercial pension and other items specified by the State Council).
- Qualified donations to public welfare and charity (Qualified Donations).

(*Article 6(1) and (4), 2018 IIT Law*; *Announcement of the STA on Matters Concerning Personal Income Tax Comprehensive Income Final Settlement and Payment in 2021*.)

Only resident taxpayers can apply these special deductions, special additional deductions and other qualified deductions (*Article 6(1), 2018 IIT Law*).

For tax declarations, a monthly cumulative withholding method is applied to resident taxpayers, combined with an annual self-declaration.

Monthly cumulative withholding method

When paying salary and wages, employers must withhold and prepay IIT monthly by applying the following cumulative withholding method:

> Cumulative taxable income = cumulative income – cumulative tax-exempt income – cumulative statutory deduction – cumulative special deductions – cumulative special additional deductions – cumulative other qualified deductions

> Tax to be withheld and prepaid for the current period = (cumulative taxable income x withholding tax rate – quick deduction) – cumulative tax deduction and exemption amount – cumulative tax withheld and paid

(*Article 6, Tax Bulletin 61/2018*.)

When resident taxpayers receive salary and wages, they can choose to deduct Qualified Donations during monthly cumulative withholding or at annual self-declaration (*Article 4(1), Announcement of the MOF and STA on Individual Income Tax Policies for Donations to Public Welfare and Charity 2019*).

When receiving other types of incomes, the payer, as the withholding agent, must also withhold and repay or pay IIT monthly or every time the payment is made, where applicable.

Annual self-declaration

Comprehensive Income must be assessed yearly by conducting an annual settlement with the tax authorities between March 1 and June 30 in the following year to claim a tax refund or pay additional tax (*Article 11, 2018 IIT Law*).

The following situations require annual self-declaration:

- Where a taxpayer receives Comprehensive Income from two or more sources, and after subtracting special deductions, the remaining amount of Comprehensive Income exceeds RMB60,000.
- Where a taxpayer receives one or more types of income from service income, author's remuneration and royalties, and after subtracting special deductions, the remaining amount of Comprehensive Income exceeds RMB60,000.
- The tax withheld and prepaid during a tax year is lower than the tax amount payable.
- The taxpayer can claim a tax refund.

(*Article 25, 2018 Implementation Regulations of IIT Law*.)

Therefore, when a resident taxpayer only has one source of salary income, and the employer correctly withholds and prepays IIT during the tax year, the taxpayer does not need to submit an annual self-declaration.

For Comprehensive Income received in each of the tax years from 2019 to 2023, resident taxpayers are exempt from submitting an annual self-declaration if any of the following occurs:

- Their annual Comprehensive Income is no more than RMB120,000 (unless there is tax refund to claim).
- The additional tax to be paid through the annual self-declaration is no more than RMB400, provided the tax withheld and prepaid during the tax year is done according to the law.

IIT rate table applicable to resident taxpayers' annual Comprehensive Income

Resident taxpayers' annual Comprehensive Income is applied with progressive tax rates from 3% to 45% (*Schedule 1, 2018 IIT Law*):

> Annual taxable income = annual Comprehensive Income – the statutory deduction of RMB 60,000 – special deductions – special additional deductions – other qualified deductions – qualified donation

> Annual IIT payable = annual taxable income x applicable tax rate – quick deduction

Annual taxable income (RMB)	Tax rate (%)	Quick deduction (RMB)
0 to 36,000	3	0
Over 36,000 to 144,000	10	2,520
Over 144,000 to 300,000	20	16,920
Over 300,000 to 420,000	25	31,920
Over 420,000 to 660,000	30	52,920
Over 660,000 to 960,000	35	85,920
Over 960,000	45	181,920

Special additional deductions

Resident taxpayers are entitled to seven categories of special additional deductions when calculating the IIT on Comprehensive Income (*2018 IIT Deduction Measures*; *Circular of the State Council on Establishing Special Additional Deductions for Individual Income Tax for the Care of Infants and Young Children Under Three Years of Age 2022* (国务院关于设立3岁以下婴幼儿照护个人所得税专项附加扣除的通知)).

Deductible amount for each category is set out in the table below.

Deduction category	Deductible amount (RMB)
Children's education	1,000/month/child for pre-school or academic education
Continued education	400/month (capped at 48 months) for academic education or 3,600/year for vocational qualification education
Medical treatment for serious illness	Up to 80,000/year and only applicable to the self-paid medical expenses that are related to basic medical insurance and more than the cumulative 15,000.
• Interest on mortgage for first property	• 1,000/month within the repayment period (capped at 240 months)
• Housing rental	• 1,500/month for directly controlled municipalities, provincial capital cities, cities specially designated in the state plan and other cities specified by the State Council. • 1,100/month for cities other than those under the first bullet with a registered population over 1 million. • 800/month for cities other than those under the first bullet with a registered population below 1 million.
Support for the elderly	• Where the taxpayer is a single child, 2,000/month. • Where the taxpayer has siblings, 2,000/month shared among them, and up to 1,000/month/person.
Care for children under three years old	1000/month/child

From 1 January 2019 to 31 December 2023, expatriate tax residents in China can choose to claim the above special additional deductions, or they can continue applying the tax-exempt benefits accessible to all expatriates. Once the choice is made, it cannot be changed in a tax year. From 1 January 2024, expatriates will no longer benefit from the tax-exempt allowances for housing, language training and children's education; instead, they must claim special additional deductions accordingly, the same as Chinese citizens. (*Article 7, MOF/STA Joint Circular 164/2018*; *MOF/STA Joint Bulletin 43/2021*.)

Considering the tax-exempt benefits for expatraites do not limit the amount, as long as they are reasonable, opting for that regime is considered more favorable for expatriates during the transition period.

Tax-exempt benefits for expatriates

The following benefits received by expatriates in a non-cash form or through reimbursement are tax-exempt:

- Housing allowance.
- Meal allowance.
- Laundry allowance.
- Relocation expenses when starting and ending an assignment in China.
- Business travel allowance in or outside China.
- Home leave allowance (up to two round trips in a calendar year for expatriates only).
- Allowance for language training in China.
- Allowance for children's education in China.

(*Article 2, Circular of the MOF and STA regarding Several Policies concerning Individual Income Tax 1994* (财政部、国家税务总局关于个人所得税若干政策问题的通知).)

The tax-exempt benefits must be substantiated with valid supporting documents such as official invoices (*fapiao*) and agreements (for example, leasing agreement), and Chinese tax authorities may require employers to submit these documents for review when the monthly IIT declaration is filed. To increase enforcement in this area, Chinese tax authorities have been applying stricter standards to the exemption.

Apart from the above, other benefits received by expatriates while working in China (for example, social security contribution in the expatriates' home country, medical or dental insurance, cash living allowance) should be added to the monthly salary income for IIT calculation.

Although *MOF/STA Joint Circular 164/2018* and *MOF/STA Joint Bulletin 43/2021* were not clear on the fate of the five allowances other than housing, language training and children's education, it is widely expected that all the above tax-exempt benefits will fully expire by 31 December 2023.

Preferential tax treatment for annual bonus

Before 31 December 2023, resident taxpayers can choose to separate the annual bonus from Comprehensive Income and calculate IIT independently by applying the current preferential tax treatment (that is, the annual bonus is divided by 12 for the applicable tax rate in the converted monthly progressive tax rates applicable to Comprehensive Income) or, alternatively, add the annual bonus to the Comprehensive Income to calculate IIT (*Article 1, MOF/STA Joint Circular 164/2018*; *MOF/STA Joint Bulletin 42/2021*).

From 1 January 2024, all resident taxpayers' annual bonus must be consolidated into Comprehensive Income to calculate IIT.

Non-resident taxpayers: monthly declaration

For non-resident taxpayers, IIT is calculated separately for each category of income. The payer, as the withholding agent, must withhold and pay IIT monthly or every time the payment is made, where applicable. In other words, the consolidation and annual self-declaration of Comprehensive Income do not apply to non-resident taxpayers. (*Article 6*, *2018 IIT Law*.)

The monthly taxable income from employment is the monthly salary income minus the statutory monthly deduction of RMB5,000, to be applied with the converted monthly progressive tax rates ranging from 3% to 45% to calculate the monthly IIT payable (*Article 6(1) and Schedule 1, 2018 IIT Law*).

Monthly IIT payable = (monthly taxable income × applicable tax rate) – quick deduction

IIT rate table applicable to non-resident taxpayers' monthly salary income

Monthly taxable income (RMB)	Tax rate (%)	Quick deduction (RMB)
0 to 3,000	3	0
Over 3,000 to 12,000	10	210
Over 12,000 to 25,000	20	1,410
Over 25,000 to 35,000	25	2,660
Over 35,000 to 55,000	30	4,410
Over 55,000 to 80,000	35	7,160
Over 80,000	45	15,160

Where an expatriate is uncertain about whether the person will become a tax resident in China in a tax year, the employer, as the withholding agent, may treat the expatriate as a non-resident taxpayer and withhold IIT accordingly during the tax year. Once the expatriate becomes a tax resident, the individual should inform the withholding agent of the change of the residency status and submit an annual self-declaration as a resident taxpayer following the end of the tax year.

Tax-exempt policy for expatriates working in the Guangdong-Hong Kong-Macau Greater Bay Area

For expatriates working in the Guangdong-Hong Kong-Macau Greater Bay Area who are qualified as top or urgently needed talents, the subsidies granted to them, based on the difference in the IIT burden between the mainland and Hong Kong, are tax exempt (*MOF/STA Joint Circular 31/2019*).

Tax preferential policy for the top-level and urgently needed talents working in the Hainan Free Trade Port

From 1 January 2020 to 31 December 2024, for the top-level or urgently needed talents working in the Hainan Free Trade Port, IIT burden over 15% for Comprehensive Income, operational income and subsidies recognized by the Hainan Province is tax exempt (*MOF/STA Joint Circular 32/2020*).

Foreign tax credit

Where resident taxpayers obtain foreign-sourced income, they can claim foreign tax credit by deducting the tax paid overseas under the tax laws of the source country from their IIT liability in China (*Article 7*, *2018 IIT Law*).

The foreign tax credit deductible in a tax year is limited to the tax amount that the foreign-sourced income pays under Chinese laws and regulations. The foreign tax credit limit of a country is the sum of the limit calculated for each category of income sourced from that country. The foreign tax credit exceeding the limit can be carried forward for five tax years. (*Articles 3 and 6, MOF/STA Joint Bulletin 3/2020*.)

To apply to Chinese tax authorities for the foreign tax credit, resident taxpayers must provide the tax certificates, tax payment receipts or records issued by overseas tax authorities. If the taxpayers cannot provide these documents, they can submit overseas tax returns (or notices of tax payment confirmed by overseas tax authorities) and bank payment receipts. (*Article 10, MOF/STA Joint Bulletin 3/2020*.)

Legal consequences

Failing to pay or withhold IIT may result in administrative and criminal liabilities to both taxpayers and withholding agents.

Administrative liabilities

Where taxpayers fail to pay the taxes due, or withholding agents fail to remit the withheld taxes by the deadline established by law, the tax authorities will order them to pay the taxes before a specific deadline and impose a late payment surcharge of 0.05% per day on the tax due amount from the day of default (*Article 32*, *Law on the Administration of Tax Collection 2015* (2015 Tax Collection Law)).

Where taxpayers fail to pay or underpay the taxes due by forging, altering, concealing or, without authorisation, destroying accounting books or vouchers, overstating expenses or failing to state or understating income in the accounting books, refusing to declare taxes after being notified by the tax authorities to do so or filing false tax returns, it will be considered tax evasion. In the case of tax evasion, the tax authorities will recover the unpaid or underpaid taxes plus the late payment surcharge and impose a penalty ranging from 50% to five times the unpaid or underpaid taxes; if a crime is committed, criminal liabilities will be investigated according to the law. (*Article 63, 2015 Tax Collection Law*.)

Likewise, if withholding agents fail to remit or under-remit the withheld taxes by the means listed above, the tax authorities will recover the unremitted or under-remitted taxes plus the late payment surcharge and impose a penalty ranging from 50% to five times the unremitted or under-remitted taxes; if a crime is committed, criminal liabilities will be investigated according to the law (*Article 63, 2015 Tax Collection Law*).

Where taxpayers fail to file a tax declaration, resulting in unpaid or underpaid taxes, the tax authorities will recover the unpaid or underpaid taxes plus the late payment surcharge and impose a penalty ranging from 50% to five times the unpaid or underpaid taxes (*Article 64, 2015 Tax Collection Law*).

It has always been a controversial issue whether the intent of the parties concerned is an element to constitute tax evasion. However, it has been recently clarified that no administrative penalty should be imposed if the parties concerned have sufficient evidence to demonstrate a lack of intent, unless otherwise provided by laws and regulations. That means, intent is an element to be taken into account when constituting tax evasion, and the burden of proof lies with the parties concerned, not the tax authorities. (*Article 33(2), Law on Administrative Penalties 2021*.)

Where withholding agents fail to withhold taxes, the tax authorities will recover the taxes due from the taxpayers and impose a penalty on the withholding agents ranging from 50% to three times the under-withheld taxes (*Article 69, 2015 Tax Collection Law*).

According to Articles 32 and 69 of the 2015 Tax Collection Law, in the case of an employer, as withholding agent, failing to withhold IIT for an employee according to the law, the tax authorities will recover the taxes due from the employee who is the taxpayer and impose a penalty on the employer who is the withholding agent. However, in the spirit of the 2015 Tax Collection Law, the tax authorities should not impose a late payment surcharge on either the taxpayer or the withholding agent (unless the employer agrees to bear IIT on the employee's salary, in which case the IIT will be considered withheld by the employer who fails to remit it to the tax authorities). This understanding is also reflected in the *Reply of the STA on Issues Regarding the Un-withheld Individual Income Tax by the Administrative Authorities 2004* (国家税务总局关于行政机关应扣未扣个人所得税问题的批复), which states that no late payment surcharge should be imposed on either the taxpayer or the withholding agent on the under-withheld taxes. However, in practice, sometimes the local tax authorities have a different interpretation and refuse to waive the late payment surcharge, and the employer, fearing a severe penalty, may choose to pay the late payment surcharge instead.

Another aspect to consider is that the employees may have an annual self-declaration obligation. In that case, if they fail to pay additional tax as they are supposed to do in this process, a late payment surcharge will be imposed on the taxes due following the annual self-declaration deadline.

Criminal liabilities

Where taxpayers or withholding agents make a false declaration or do not declare by using fraudulent or concealed measures, evading a tax payment of a relatively large amount (that is, over RMB10,000) and corresponding to over 10% of the taxes due, they will face criminal liabilities for tax evasion (*Article 201, Criminal Law 2020*, with effect from 1 March 2021).

However, if, after being notified by the tax authorities, the taxpayers or the withholding agents have paid the taxes due, the late payment surcharge and the penalty, the tax authorities will not pursue criminal liabilities, unless the taxpayers have been penalised for criminal liabilities or had administrative penalties imposed twice for tax evasion in five years.

Tax compliance risks under different expatriation regimes

Foreign companies normally send expatriates to work in China through:

- International secondment to a group company in China.
- Onshore service provision to Chinese resident companies.

These two expatriation regimes meet different needs of foreign companies operating in China and are associated with different tax compliance risks.

For detailed discussions on engaging foreigners working in China, see *Practice notes, Engaging foreign employees in China* and *Secondment of foreign employees: China*.

International secondment to a group company in China

Under an international secondment arrangement, the expatriate remains the employment relationship with the foreign company outside China and is seconded to work at a group company in China for a fixed period of time. The substantive employment contract with the foreign company remains in place and is unaffected or suspended for the duration of and on return of the secondment. The expatriate is provided with a secondment letter detailing any temporary deviation from current employment terms applicable during the secondment as well as the terms and conditions of the secondment. A local employment contract may be signed for this purpose.

Under this regime, foreign companies may choose different ways to arrange the cost of the expatriation, that is, entirely paid by the Chinese company, split between the Chinese and the foreign companies, or entirely paid by the foreign company; in the latter two cases, the foreign company will charge the cost back to the Chinese company.

The tax compliance risks associated with the foreign-paid expatriation cost are:

- Under the secondment arrangement, the employment income is attributable to the expatriates' work performed in China, that is, a China-sourced income, and it is paid or eventually borne by the Chinese company, making it fully taxable in China.

  Due to a lack of knowledge on tax laws and regulations, the Chinese company may only withhold IIT on the salary it has paid, without adding the overseas salary paid by the foreign company. This results in the IIT for the expatriates being under-withheld.

- Considering the expatriates remain in the employment relationship with the foreign company in the home state, and when the employment cost is not paid by the Chinese company, it is often questionable whether the assigned expatriates are employees of the foreign company providing services in China, or employees of the Chinese company performing employment services.

  Therefore, the foreign company may also have a PE risk in China, meaning Chinese tax authorities may consider the assigned expatriates are employees of the foreign company, and that the secondment arrangement constitutes a PE in China in the form of fixed place of business by the foreign company, exposing the foreign company to taxation in China.

  Announcement of the STA on the Levy of Enterprise Income Tax on Labour Services Provided within Mainland China by Personnel Dispatched by Non-resident Enterprises 2013 (Tax Bulletin 19/2013) gives a more elaborate interpretation of this issue. Where a non-resident company (Dispatching Company) dispatches its employees to provide services to a group company in China (Dispatched Company), if the Dispatching Company:

  - assumes part or all of the responsiblities and risks associated with the work results of the dispatched employees; and

  - regularly assesses the work performance of the dispatched employees,

  (collectively, the "Principal Factors")

  the Dispatching Company should be considered as having an establishment or a place in China to provide services. If the Dispatching Company is a resident of a contracting state under the DTT, and the establishment or place for service provision is relatively fixed and permanent as interpreted under the *Notice of the STA on Issuing the Interpretations on the Clauses of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and of the Protocol thereto 2010* (Tax Bulletin 75/2010) (国家税务总局关于印发〈中华人民共和国政府和新加坡共和国政府关于对所得避免双重征税和防止偷漏税的协定及议定书条文解释〉的通知), the establishment or place will consitute a PE in China under the DTTs.

Based on the above, when determining which company is the de facto employer of the dispatched employees, Tax Bulletin 19/2013 looks beyond the legal form of the employment relationship and applies the "substance-over-form" principle.

Also, Tax Bulletin 19/2013 lists the following factors to consider (collectively, the "Reference Factors"):

- The Dispatched Company pays management fees or service fees to the Dispatching Company for the disptached services.
- The amount the Dispatched Company pays the Dispatching Company exceeding the salaries, wages, social security expenses and other expenses advanced or paid by the Dispatching Company for the dispatched employees.
- The Dispatching Company does not distribute all of the associated expenses received from the Dispatched Company to the dispatched employees (meaning the Dispaching Company retains a portion of the payment for itself).
- The salaries of the dispatched employees borne by the Dispatching Company are not fully declared for IIT in China.
- The Dispatching Company determines the number of employees to be dispatched, their qualifications, remuneration criteria and their work place in China.

Together with the above Principal Factors and the Reference Factors, Tax Bulletin 19/2013 tackles the determination of a PE under crossborder secondment arrangements from two perpsectives:

- Whether the Dispatching Company is the *de facto* employer of the dispatched employees (the Pricipal Factors).
- Whether the Dispatching Company makes a profit from the secondment arrangement (the Reference Factors).

The Reference Factors are presented in parallel situations; therefore, the Principal Factors, accompanied with one of the Reference Factors, can determine whether a PE is constituted in China under a secondment arrangement.

Article 5 of Tax Bullentin 19/2013 also provides that the tax authorities should review the following documents to determine the tax liabilities of the Dispatching Company in China:

- The contract or agreement signed by the Dispatching Company, the Dispatched Company and the dispatched employees.
- The management guidelines of the Dispatching Company or the Dispatched Company, including the specific rules governing the job responsibilities, description, performance review and risks assumed.
- Information on the payments made by the Dispatched Company to the Dispatching Company, the accounting treatments and the Chinese IIT declaration and payment for the dispatched employees.
- Information indicating situations where the Dispatched Company makes hidden payments related to the secondment through:
  - offsetting transactions;

- waiving creditor's rights;
- conducting related-party transactions; and
- other forms of concealed payments.

Therefore, foreign companies must properly design its international secondment structure and prepare the relevant documents to avoid the secondment arrangement being perceived as their PE in China.

Finally, Article 2 of Tax Bulletin 19/2013 provides an exception, that is, the Dispatching Company will not be considered to have a PE in China if it only assigns personnel to provide services in China to enable it to exercise its shareholder rights or to safeguard its lawful shareholder interests in the Dispatched Company, including attending shareholders meetings or board meetings, or providing investment advice relating to the Dispatched Company (commonly known as shareholders' activities). In the meantime, the Dispatching Company must not charge the expenses related to these activities to the Dispatched Company from a transfer pricing perspective; otherwise, the Dispatched Company will not be able to deduct these expenses before taxation in China.

Onshore service provision to Chinese resident companies

Foreign companies often assign their employees to provide services in China under a service agreement entered with a group company or a third-party resident company in China. As a consideration, foreign companies charge the Chinese service recipient a service fee using the "cost plus mark-up" method.

Under this regime, foreign companies often send their employees to work in China on a specific project or to perform centralised intra-group services. Within the same company group, the employees assigned to work in China remain in an active employment relationship with the foreign companies in the home state and only work for the group company in China for the specific work covered by the relevant service agreement.

The focus of this regime is to monitor the duration of the services provided in China and identify whether the activities constitute a PE in China under the DTT (see *Permanent establishment*).

Once a PE is created, the profit obtained by the foreign companies attributable to the PE (usually by applying a deemed profit rate to the service fee) will be subject to *enterprise income tax* (EIT) in China; meanwhile, the employment income attributable to the employee's work in China will be subject to IIT in China.

The tax compliance risk associated with this regime is that, without properly monitoring the activities, foreign companies may not realize they are creating a PE in China, or they declare EIT under a PE to process outbound payments, but do not declare IIT for their employees working in China under that PE. In the past, EIT and IIT collections were managed by different branches of the tax authorities that did not share information properly, so the IIT collection under a PE was often overlooked. However, with the integration of Chinese tax authorities (see *Practice note, Understanding the 2018 government institutional reform: China: Tax administration*), this issue may be better managed in the future.

The income tax paid in China can usually be recovered through foreign tax credit or exemption in the home state to avoid double taxation, provided it is accurate and within the limit established under the DTT and domestic regulations. It is crucial that taxation under a PE is handled properly in China to avoid unnecessary tax burdens for foreign companies in the home state.

END OF DOCUMENT

