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PRC Individual Income Tax Reform

Latest update on tax arrangements for foreign individuals under the new PRC Individual Income Tax ("IIT") Law

4 April 2019

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Overview of PRC Individual Income Tax ("IIT") Reform

Overview of PRC IIT Reform

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2018.06.19
Draft amendments submitted to the 3rd Session of the Standing Committee of the 13th National People's Congress for deliberation

2

2018.06.29-07.28
Draft amendment released to the public for consultation

3

2018.08.31
The amendments approved by the 5th Session of the Standing Committee of the 13th National People's Congress

4

2018.10.01
Standard deduction increased to RMB5,000/month for salaries and wages, tax rate on comprehensive income applies

5

2018.10.20-11.04
The draft implementation rules to the amended PRC IIT law and the rules to the additional itemized deductions released for public consultation

6

2018.12.22
A series of documents such as the final implementation rules to the new IIT law and detailed rules to the additional itemized deductions were officially released

7

2019.01.01
The 7th amendment of the China IIT law takes full effect

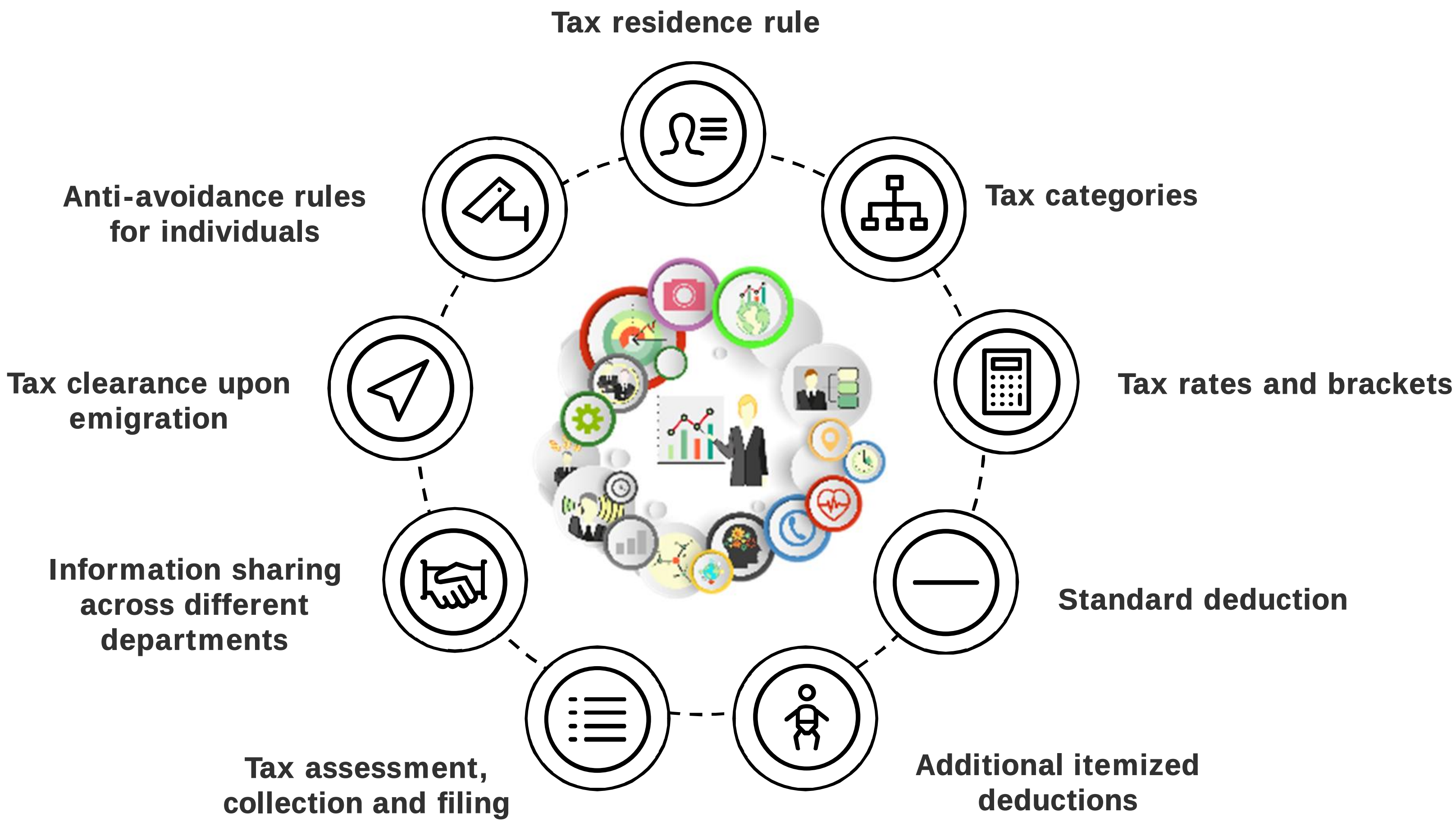
8

2019.02.02
The New IIT Return released

9

2019.03.16-03.17
Circulars 34 and 35 were released

Overview of PRC IIT Reform



Overview of PRC IIT Reform

The most significant reform in the history of PRC IIT Law has long-term and significant impacts on the PRC IIT system. The new IIT Law and relevant regulations have taken full effect on January 1, 2019. Individual taxpayers and withholding agents are recommended to have a good understanding on the new IIT Law and seek for professional advice when required.

Tax Resident Rule

- "183 days" replaces the "one year" rule
- Calculation of time spent within China

New withholding and reporting system

- Annual tax reconciliation requirement on comprehensive income of tax resident
- Tax reporting mechanism for non-resident individual
- Withholding agent should provide taxpayers with their income and withholding tax information

"Five-year rule" upgraded to "six-year rule"

- "Five-year rule" has now been upgraded to "six-year rule";
- "6-year" is counted from 2019 for every non-China domiciled individual
- Record-filing with the tax authorities for "six-year rule"

Source of Income and Tax Calculation

- Determination of source for wages and salaries, bonus, equity awards, remuneration to senior executives
- Tax calculation for non-domiciled individuals;
- "Income-apportionment" on wages and salary derived by individual under dual employment

Intensified Tax Enforcement

- Declaration for tax residency and uncertain tax position;
- New rules for withholding tax reporting for income paid by non-China affiliates;
- Application and provision for treaty exemption

IIT Preferential Tax treatment

- Preferential tax treatment during transition period
- Additional itemized deduction for China tax resident
- New rules for non-resident's bonus equity award
- Tax subsidy in the Greater Bay Area

Interpretations on new Circulars for non-China domiciled individuals

Definition of "resident" for IIT purpose

Old IIT Law		Current IIT Law	
No clear definition of "resident" and "non-resident" for tax purposes		Introduces the definition of "resident" and "non-resident" for tax purposes	
		Resident	**Non-resident**
China-domiciled individuals	Non-China-domiciled individuals	China-domiciled individuals	Non-China-domiciled individuals
Non-China-domiciled individuals who reside in China for one "full" year	Non-China-domiciled individuals who reside in China for less than one "full" year	Non-China-domiciled individuals who stay in China for **183 days** or more in a calendar year	Non-China-domiciled individuals who stay in China for less than **183 days** in a calendar year
Both China sourced and non-China sourced income are subject to IIT	Only China sourced income is subject to IIT	Both China sourced and non-China sourced income are subject to IIT	Only China sourced income is subject to IIT

- An individual is considered as having domiciled in China if he habitually resides in China due to his household registration (or hukou), family, or economic ties.
- If a non-domiciled individual has spent less than 24 hours a day in China, it will not be counted as a China day.

"Five-year rule" upgraded to "six-year rule"

Non-China sourced income of non-domiciled individual not borne by or recharged to China entity / individual is exempt from China IIT

- Reside in China for **more than 183 days for no more than 6 consecutive years**; or stay outside China for more than 30 days in one single trip in any tax year during the 6-year period AND
- **Record-filing** with the tax authorities

How to break the 6-year rule during the 6-year period

- Reside in China for **not more than 183 days** in any tax year during the 6-year period; OR
- Stay outside China for **more than 30 days** in a single trip in any tax year during the 6-year period

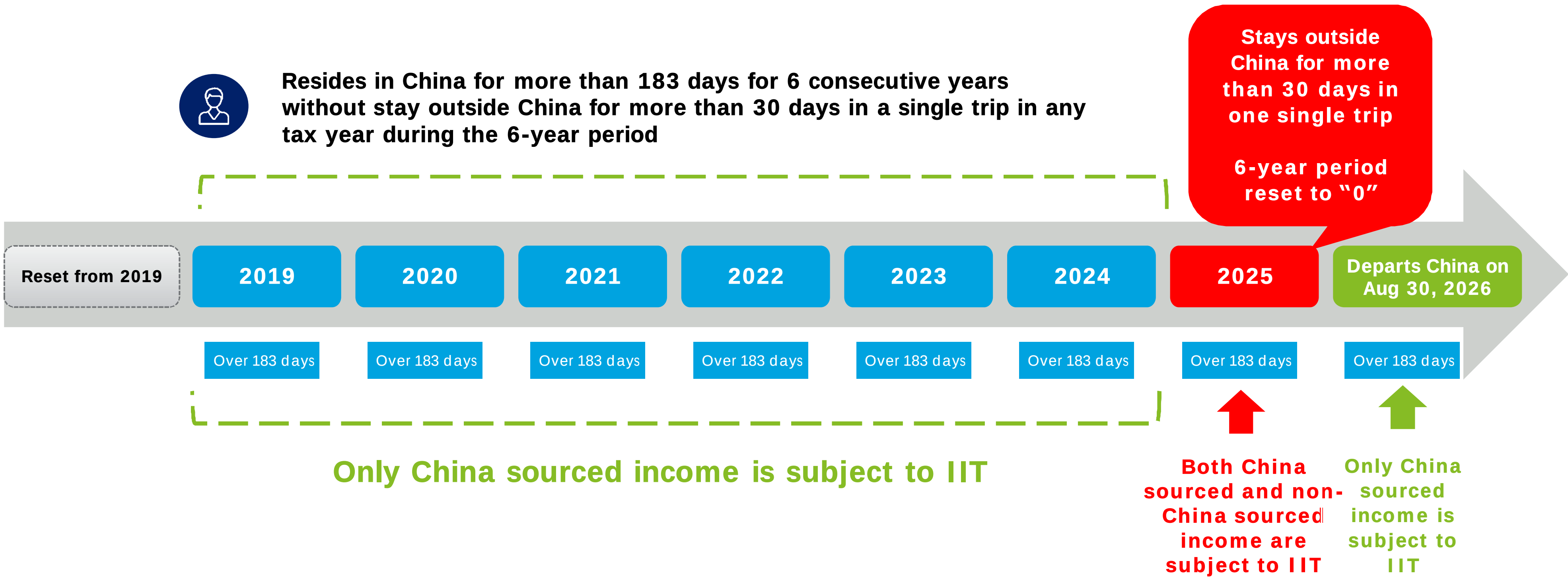
Both China-sourced and non China sourced income of non-China-domiciled individual are subject to PRC IIT

- Reside in China for more than 183 days and **have not stayed outside China for more than 30 days in a single trip in any tax year during the preceding 6-year period**;
- *"6-year" is counted* ***from 2019 for every non-China domiciled individual***

"Five-year rule" upgraded to "six-year rule"

Case study

- Mr. Cheung is a Hong Kong resident who started to work in Shenzhen since January 1,2013. He returns to Hong Kong for work from August 30, 2026;
- He stays in Shenzhen all along the above period except for the business trip to Hong Kong from February 1, 2025 to March 15, 2025; and
- The non-China-sourced income is NOT borne by any China entity or individual.



Determining the source of income for non-domiciled individuals

Salaries and wages attributable to time spent in China is subject to China IIT

Salaries and Wages

Dual employment or under non-China employment

AND

Work in and outside China at the same time

Apportion based on day-in-day out basis to determine the source of income that is attributable to time spent inside and outside China

Bonus and Equity Awards

Non-China sourced income

The portion of bonus and equity awards that is attributable to non-China service period

China-sourced income

The portion of bonus and equity awards, notwithstanding that it is received upon departure or cessation of service, that is attributable to the China service period

Compensation for Directors and Senior Executives

Any director's fees, salaries, and other remuneration equivalent (including bonus and equity awards) derived by Directors/Senior Executives of a China resident enterprise is considered as a China-sourced income if the remuneration is borne by a China resident enterprise, regardless of the location of service rendered.

Determination of taxable salaries and wages for non-domiciled individuals

From "Tax Apportionment" to "Income Apportionment"

Abolishing the previous practice of apportioning tax payable and now adopt income apportionment. This aligns with the international practice and potentially reduces the effective tax rate.

Are you applicable?

§ Employed by non-China entity AND perform services inside and outside China

Are you Senior Executives?

- Senior executives refer to individuals who serve as directors, supervisors and senior management positions of a China enterprise;
- Senior Management includes the enterprise's Chief officers, Directors, General Manager, Assistant General Manager, and other equivalent capacities.

NO

YES

Non-senior Executives

Determine the source of salaries and wages based on the time spent in China and outside China over the calendar days

Senior Executives

Regardless of the location of service rendered, remuneration paid or borne by a China resident entity is considered as China-sourced income (except for situation where tax treaty applies)

Determination of taxable salaries and wages for non-domiciled individuals (Domestic Rule)

Non-Senior Executives

Status	Accumulated days in China	Days spent in China		Days spent outside China	
		Paid or borne by China enterprise	Paid or borne by non China enterprise	Paid or borne by China enterprise	Paid or borne by non China enterprise
Non-Resident	< 90 days	√	×	×	×
	> 90 days but <183 days	√	√	×	×
Resident	> 183 days but less than 6 years	√	√	√	×
	> 183 days and more than 6 years	√	√	√	√

NOTE: The above is based on the China domestic tax law only. Application of income tax treaty may need to be considered under certain circumstances.

Determination of taxable salaries and wages for non-domiciled individuals (Domestic Rule)

Senior Executives

Status	Accumulated days staying in China	Days spent in China		Days spent outside China	
		Paid or borne by China enterprise	Paid or borne by non China enterprise	Paid or borne by China enterprise	Paid or borne by non China enterprise
Non-Resident	< 90 days	✓	×	✓	×
	> 90 days but <183 days	✓	✓	✓	×
Resident	> 183 days but less than 6 years	✓	✓	✓	×
	> 183 days and more than 6 years	✓	✓	✓	✓

NOTE: The above is based on the China domestic tax law only. Application of income tax treaty may need to be considered under certain circumstances.

Withholding and reporting system of non-China domiciled individuals

Resident

Monthly withholding

Salaries and wages:

- Calculate accumulative taxable income by accumulative IIT withholding calculation method
- On monthly withholding basis

Remuneration for (independent) services, income from royalties and authors' remuneration:

- Taxable income is the net of gross income minus deductible expenses
- Tax withheld on a monthly basis according to applicable tax rate by each category

Annual tax reconciliation

Annual tax reconciliation for comprehensive income:

Annual comprehensive taxable income =

(annual salaries and wages + annual remuneration for (independent) services + annual authors' remuneration + annual income from royalties – cumulative deductible expenses - cumulative itemized deductions- cumulative additional itemized deductions - other cumulative deductions in accordance with the law) × applicable tax rate - quick deduction

Non-resident

Monthly withholding

Salaries and wages:

- Calculate taxable income on monthly basis
- On monthly withholding basis

Remuneration for services, income from royalties and authors' remuneration:

- Taxable income is the net of gross income minus deductible expenses
- Tax withheld each month/each transaction according to the monthly comprehensive income rates

Annual tax reconciliation

Annual tax reconciliation is NOT required

Transition of foreign individuals tax-free fringe benefits

Tax-free fringe benefits	Additional itemized deductions
Housing Benefit	Rental expense
Child Education Expenses	Child Education
Language Training	Continuous Education Expense
Home Leave	Home Loan Mortgage Interest
Meal and Laundry	Medical Expenses for Serious Illness
Relocation Expense	Expenditure on Dependent Parent

Transition

2019.01.01 - 2021.12.31

- Foreigners can choose to enjoy either deduction for additional itemized deductions, or continue to enjoy the current tax exemption policy for the benefits-in-kind with no double benefits claim.
- Cannot switch within the same tax year once elected.

From 2022.01.01

- Foreign individuals will no longer enjoy tax-free fringe benefits such as housing benefit, language training, child education expense and etc.
- Foreign individuals to enjoy itemized deductions (if any available).

Preferential treatment – Bonus / equity-based compensation

Resident

2019.01.01 - 2021.12.31 | **From 2022.01.01**

Bonus

Annual bonus:

2019.01.01 - 2021.12.31:

- Taxpayer could choose to include annual bonus as comprehensive income; or
- Divide the annual bonus by 12 and apply monthly tax rate and quick deduction to assess separately

From 2022.01.01:

Include as comprehensive income

Equity-based Compensation

Equity-based compensation from the listed company:

2019.01.01 - 2021.12.31:

- If the equity-based compensation is in compliance with the relevant tax regulations, assessed separately from other comprehensive income;
- Equity-based compensation received in the same tax year should be aggregated for tax calculation.

From 2022.01.01:

Details to be announced

Non-resident

From 2019.01.01

Bonus

Periodic bonus:

- Divide the periodic bonus by 6 and apply monthly tax rate and quick deduction (without deductible expenses) to assess separately from other salaries and wages
- Preferential tax calculation method only applicable once in a tax year

Taxable amount of periodic bonus = [(Bonus÷6)× applicable tax rate – quick deduction]×6

Equity-based Compensation

Equity-based compensation from the listed company:

- Divide the equity-based compensation by 6 and apply monthly tax rate and quick deduction (without deductible expenses) to assess separately from other salaries and wages
- Equity-based compensation received in the same tax year should be aggregated for tax calculation

Taxable amount of equity-based compensation on monthly basis = [(Cumulative equity-based compensation in a tax year÷6)×applicable tax rate – quick deduction]×6 - tax previously paid for equity-based compensation in that tax year

Tax collection measures for non-China domiciled individuals

Pre-assessment of tax residency status

Pre-assessment for residency status → **Year-end – Final result for residency status**

Non-resident → Meet 183 days threshold →

Resident

- Monthly withholding method not to change within a tax year
- Annual reconciliation tax return required for any adjustment
- If leaving China during the year, filing of annual reconciliation tax return applicable for departure year

Resident → Do not meet 183 days threshold →

Non-resident

- Amended monthly tax return required
- Individual should report to the tax authorities, recalculate the taxable amount according to the non-resident individual rule and declare the tax already paid from the date which the individual confirms he/she cannot become resident to the 15 days after year end
- No interest surcharge if observing the due date. If a tax refund is required, it shall be handled in accordance with the tax regulations

Estimated staying in China for not more than 90 days (or 183 days if DTA applicable) → Staying for more than 90 / 183days →

Year-end - staying in China for more than 90 days (or 183 days if DTA applicable)

- Backlog monthly tax return required
- Individual should report to the tax authorities, calculate the taxable amount according to salaries and wages obtained for previous months within 15 days after the month of reaching 90 / 183 days and settle tax payment
- No interest surcharge if observing the due date

Tax collection measures for non-China domiciled individuals

China-sourced income paid outside China for non-domiciled individuals

For individuals who are employed in China or received China-sourced income, if the remuneration is fully/partially paid by the associated non-China entities:

Before Circular 35

Salaries and wages paid by overseas affiliate of the China entities

Circular 35

Domestic China enterprises shall, in accordance with the provisions of the tax regulations, compile and declare the relevant information and be responsible for withholding and paying IIT on behalf of the individual

IIT reporting and withholding obligation

IIT reporting and withholding obligation

Option 1 – Self-reporting performed by the individual

Option 2 - Withholding by China employer under individual's authorization

Reporting obligation

If an individual fails to authorize a China domestic employer to withhold and pay taxes on his behalf, the domestic employer shall report the relevant information (including the work arrangements, income payment arrangements of the overseas employer and the contact details of the individual, etc.) to the tax authority within 15 days after the end of the month in which the relevant income is paid

IIT subsidy in the Greater Bay Area

IIT subsidy in the Greater Bay Area

Preferential tax incentives in Greater Bay Area

Qualified individuals

Available to foreign individuals (including Hong Kong/Macao/Taiwan residents) who are high-end talents or talents in high demand

Further details and guidance to be issued by the Guangdong province and Shenzhen municipal governments

Subsidy

Tax-free IIT subsidy to be offered by the municipal governments in the Greater Bay Area to align the amount of tax that people would have paid if they worked in Hong Kong.

The subsidy is exempt from China IIT.

Covered Area

Available in all 9 Mainland cities in the Guangdong province in the Greater Bay Area including Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing.

Enforcement date

From Jan 1, 2019 to Dec 31, 2023

Potential impacts to enterprises and foreign individuals under the new PRC IIT Law

Potential impacts

- New definition of China tax resident and the impact on resident/non-resident tax withholding obligation and reporting requirements
- Income sourcing principles and the preferential tax treatment for bonus and equity-based compensation for non-China domiciled individuals
- Compliance requirement under the new "6-year rule"
- More complicated annual tax reconciliation requirement
- China domestic employer's obligation for reporting non-China domiciled individuals' personal information and salaries and wages paid by overseas affiliate
- The establishment of information exchange system between different government agencies and social credit information system creates a more stringent compliance environment

- Tax residents' after-tax income varies every month due to accumulative IIT withholding calculation method
- Impacts on employment or assignment cost for foreign employees due to changes of preferential tax treatment for foreign individuals tax-free fringe benefits
- New definition of China tax resident requires well-structured internal reporting, control and communications by employer
- The new requirements for annual tax reconciliation and self-reporting system indicates the enhancement of IIT collection by the tax authorities
- Non-compliance may affect the individual's record in the social credit information system

The Way Forward

Review tax residency status and ensure tax reporting and withholding are in compliance

Monitor and keep travel records for the number of days spent in China. Proper reporting to tax authorities for the "6-year rule" purpose

Understand different income sourcing principles and categories of China-sourced and non-China-sourced income for international assignees appropriately

Review the current IIT arrangement of international assignees and assess the impact on tax liability, retain supporting documents for income apportionment purpose

Review and update of the current company policies where applicable (e.g. C&B policy, tax withholding policy). Establish and improve the internal risk management and control process for foreign employees' tax reporting

Engage tax professionals for assistance when needed

Updates on Hong Kong Salaries Tax and Employer's Returns Filings

Hong Kong Salaries Tax

Employer's Filing Obligations

	Commencement	Active Employee as at March 31	Cessation	Departure
Form to complete	Form I.R.56E	Form BIR56A and Form I.R.56B	Form I.R.56F	Form I.R.56G
Statutory time limit	Within 3 months after commencement	Within 1 month of issuance of Form BIR56A	No later than 1 month before cessation	No later than 1 month before departure and withholding requirements
Reference in the Inland Revenue Ordinance	Section 52(4)	Section 52(2)	Section 52(5)	Sections 52(6) & 52(7)

Hong Kong Salaries Tax
Personal Assessment

Treatment of Married Couple under Personal Assessment

For the year of assessment up to 2017/18:

If you are married and are not living apart from your spouse, and both of you have income assessable to tax, election for personal assessment must be jointly made by you and your spouse. Separate taxation for husband and wife is not applicable under personal assessment for a year of assessment up to 2017/18.

From the year of assessment 2018/19 and onwards:

A married person may elect for personal assessment separately from or jointly with his/her spouse. If you elect for personal assessment jointly with your spouse, both of you and your spouse must have income assessable to tax. If you and your spouse are jointly assessed under Salaries Tax, election for personal assessment must be made by you and your spouse jointly.

Hong Kong Salaries Tax
Personal Assessment

<u>**For the year of assessment up to 2017/18:**</u>

An individual may elect Personal Assessment if :

(1) he/she is 18 years of age or over, or under that age if both of his/her parents are dead; and

(2) the elector is or, if he/she is married, his/her spouse is ordinarily resident in Hong Kong or a temporary resident.

<u>**From the year of assessment 2018/19 and onwards:**</u>

An individual may elect for personal assessment if:

(1) he/she is 18 years of age or over, or under that age if both of his/her parents are dead; and

(2) the elector is either ordinarily resident in Hong Kong or a temporary resident.

Treatment of Married Couple under Personal Assessment

Hong Kong Salaries Tax
Personal Assessment

For the purpose of Personal Assessment :

(1) A person will be regarded as "ordinarily resident in Hong Kong" if he /she resides in Hong Kong voluntarily and for a settled purpose (such as for education, business, employment or family etc.) with sufficient degree of continuity. Such person should habitually and normally reside in Hong Kong apart from temporary or occasional absences of long or short duration, and is living in Hong Kong as an ordinary member of the community for all the purposes of his/her daily life. Whether a person ordinarily resides in Hong Kong will ultimately depend on the facts of the case.

(2) "temporary resident" means the elector or his/her spouse who stays in Hong Kong for a period or a number of periods amounting to more than 180 days during the year of assessment in respect of which the election is made or for a period or periods amounting to more than 300 days in 2 consecutive years of assessment, one of which is the year of assessment in respect of which the election is made.

Hong Kong Salaries Tax

Section 8(1A)(c) claim and Foreign Tax Credit ("FTC")

For individuals provide services in both Hong Kong and overseas, and paid overseas tax

	Old rules	New rules (effective April 1, 2018)
Section 8(1A)(c)	Eligibility to the exemption is not limited by the location in which the individuals render services	Does not apply in relation to income derived by a person from services rendered by the person in a territory if- (a) the territory is a DTA territory; and (b) under section 50, tax payable in the territory by a Hong Kong resident person in respect of income derived from services rendered by him or her in the territory is to be allowed as a credit against tax payable in Hong Kong by the Hong Kong resident person in respect of that income.
FTC	FTC is only available to HK resident individuals who render services and are liable to pay tax in a location that has a DTA in place with HK	No changes to eligibility.

Hong Kong Salaries Tax

Tax Deductions for Annuity Premiums and Mandatory Provident Fund (MPF) Voluntary Contributions

From the year of assessment 2019/20:

Taxpayers are entitled to tax deductions under salaries tax and personal assessment for-

(i) premiums paid to qualifying deferred annuities; and

(ii) contributions made to tax deductible MPF voluntary contribution accounts.

The maximum tax deductible limit is HK$60,000 each year per taxpayer, and is an aggregate limit for qualifying deferred annuity premiums and tax deductible MPF voluntary contributions.

List of Qualifying Deferred Annuity Policies Eligible for Tax Deduction:

https://www.ia.org.hk/en/qualifying_deferred_annuity_policy/Online_register_of_QDAP.html

List of MPF schemes offering tax deductible MPF voluntary contribution accounts:

http://www.mpfa.org.hk/eng/mpf_system/system_features/tvc/tvc_scheme_list.jsp

Q & A

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