“Transforming from the Old IIT Regime to a New One” Series V - leverage policy essentials to attract talents amidst the release of new policy for non-China domiciled individuals

News Flash
China Tax and Business Advisory
March 2019
Issue 13

In brief

On 16 March and 17 March 2019, the Ministry of Finance and the State Taxation Administration jointly issued the *Public Notice Regarding Criteria for Determining Days of Residing in China for Non-China domiciled Individuals* (Public Notice [2019] No. 34, hereinafter referred to as "PN 34”）and the *Public Notice Regarding the IIT Policies for Non-Residents and Residents without a Domicile in China* (Public Notice [2019] No. 35, hereinafter referred to as "PN 35”), which clarifies the relevant individual income tax (“IIT”) policies for non-China domiciled individuals under the new IIT Law.

On the whole, the above two public notices have made comprehensive amendments and adjustments to the IIT policies for non-China domiciled individuals (hereinafter referred to as "non-domiciled individuals"), reflecting major changes in the new IIT Law and providing guidance on tax collection and administration. In this issue of China Tax and Business News Flash, we will share the main contents of these two public notices and their impacts.

In detail

Under the old IIT Law, tax policies related to non-domiciled individuals are stated in various circulars and notices. These two public notices, especially PN 35, systematically sorts out and integrates the IIT policies which were spread over more than ten relevant documents under the old IIT Law, and clarifies the IIT treatment for non-domiciled individuals under the new IIT Law from the perspective of both domestic laws and tax treaties.

These two public notices are rich in contents, among which, many of the tax policies for non-domiciled individuals that are not affected by the new IIT Law are directly adopted from documents under the old IIT Law, so as to maintain the consistency of tax policies. At the same time, major changes have also been made to some of the tax policies for non-domiciled individuals.

Day of residing in China vs China work day

The recent tax policies for Guangdong-Hong Kong-Macao Greater Bay Area that have attracted a lot of attention, called for a major change to how the days of residing in China are counted and proposed that if an individual is physically present in China for less than 24 hours in a day, that day should not be counted as a day of residing in China. The newly issued PN 34 confirms this new determination standard and adopts it as a national-level tax policy applicable to all non-domiciled individuals in China.

This means that under the new IIT Law, for the purpose of determining a non-domiciled individual’s China tax residency, a day in which a non-domiciled individual is in China for less than 24 hours is not counted as a day of residing in China. This is good news to non-domiciled individuals who make frequent cross border travels in and out of China. For specific analysis, please refer to PwC’s China Tax and Business News Flash, Issue 11, 2019.[1]

pwc 普华永道

It should be noted that this change in PN 34 is only applicable to the counting of days of residing in China for non-domiciled individuals. According to PN 35, for the purpose of determining the sourcing of income and calculating the IIT payable, physical presence of less than 24 hours in China in a day by non-domiciled individuals who hold dual-employment positions in both China and overseas, or are employed by overseas employers and required to travel to China should still be counted as a ½ work day in China, which is similar to that under the old IIT Law. That is, for non-domiciled individuals with dual employment in China and overseas or employed only by overseas employers, they should count their days of residing in China and China work days for the purpose of calculating IIT payable differently in accordance with the respective provisions of PN 34 and PN 35 as the two result would be different. In addition, special attention should be paid to the determination on a working period in China in PN 35.

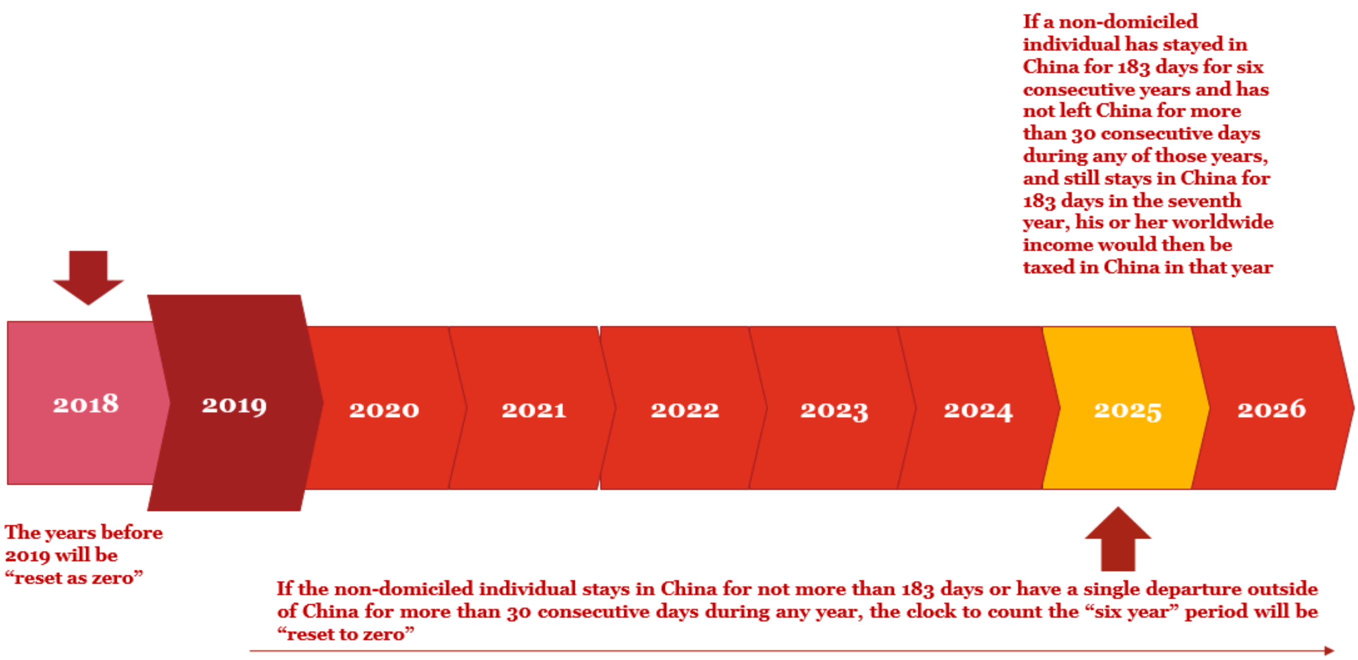
Clarifying the "six-year rule", setting the criteria for determining tax residency status and tax obligation

The new IIT DIR extends the "five-year rule" on tax exemption for non-domiciled individuals to "six-year rule". PN 34 clarifies the transition treatment from the old IIT policies to the new ones and specifies the practical application of the "six-year rule". The key points can be summarised as "zero zero seven" (007).

- A non-domiciled individual's physical presence in China before 2019 can be excluded, i.e **"reset as zero"**;
- From 2019 onwards, the "six year' count can be **"reset to zero"** if the non-domiciled individual spends more than 30 consecutive days outside of China during a calendar year;
- From 2019 onwards, for a non-domiciled individual who has resided in China for 183 days annually for six consecutive years and with no single absence of more than 30 consecutive days from China during any of those six years, if that individual still resides in China for more than 183 days in **"the seventh year",** he/she will be subject to IIT on his/her worldwide income in that seventh year.

From the policy transition perspective, starting from 2019, all non-domiciled individuals will commence to count the "six-year" period in accordance with the new regulations and 2019 is the first year of the "six-year" period under the new law irrespective of the status of residing in China in the previous years. Looking at the new policy, although the "cumulative absence from China of more than 90 days" condition under the old IIT Law to avoid being taxed on worldwide income is cancelled under this new policy, the condition of "a single absence from China of more than 30 consecutive days" still remains and the overall period of tax exemption is extended. Overall, the new policy can largely attract foreign investment and encourage foreign talents to work in China.

Let us take a look at the impact of this tax policy over a longer time period spanning the old and new IIT Laws:



Taxability assessment of non-domiciled individual's employment income in China

Assessing whether the employment income of a non-domiciled individual who exercises his/her employment duty cross-border should be subject to IIT is relatively complicated. Besides determining the source of income, the entity or entities which are responsible to pay and bear the cost must also be considered. The determination of the tax obligation on employment incomes of non-domiciled individuals is adjusted based on the determination standards for tax residency status under the new IIT Law. Its general principles are consistent with the one under the old IIT Law. The major changes under the new IIT Law is the impact attributable to a non-domiciled individual's days in China as illustrated in the table below:

Non-domiciled individual	Days of residing in China	China source employment income (China work days)		Overseas source employement income (foreign work days)	
		China payment	Overseas payment	China payment	Overseas payment
Non-China resident individual	Days of residing in China ≤ 90	Taxable	Tax exempted	Tax exempted*	Tax exempted
	90 < Days of residing in China < 183	Taxable	Taxable	Tax exempted*	Tax exempted
China resident individual	183 ≤ Days of residing in China (for not more than 6 consecutive years)	Taxable	Taxable	Taxable	Tax exempted
	183 ≤ Days of residing in China (for over 6 consecutive years and no qualified absence outside China)	Taxable	Taxable	Taxable	Taxable

*The determination of the tax obligation of directors, supervisors and senior management personnel under PN 35 is complicated and requires a comprehensive analysis of the relevant facts and tax treaty articles.

The IIT time apportionment calculation method for non-domiciled individual's changes from "tax calculation before apportionment" to "apportionment before tax calculation"

Although there is basically no change to the taxation principle of non-domiciled individuals' employment income, there is a big change to the tax calculation method. For non-domiciled individuals with dual employment both in China and overseas or temporarily working in China for business purpose, if the "time apportionment" calculation method is applicable, under the old calculation method, the IIT payable on the total monthly taxable employment income from China and overseas would firstly be calculated, and then the IIT payable is apportioned based on the individual's working period in China for that month, that is the "tax calculation before apportionment" method.

In order to adapt to the changes in the new IIT Law, in calculating the IIT payable on the employment income received by the above-mentioned non-domiciled individuals, the total monthly taxable employment income would be apportioned first based on the actual working period in China before calculating the IIT payable based on the taxable income apportioned to the China working period, this is the so called "apportionment before tax calculation" method.

Let us use a simple example of a non-resident individual to illustrate the impact of the change in the tax calculation method. Assuming that, the individual has 15 China work days in April, a comparison of the IIT payable for his employment income for that month under the new and old IIT tax calculation methods is set out in the table below:

	Old IIT Calculation Method	New IIT Caculation Method
Total employment income sourced from China and overseas	100,000	100,000
New IIT calculation method: apportionment before tax calculation		100,000 x 15/30 = 50,000
Standard basic deductions	(5,000)	(5,000)
Taxable income	95,000	45,000
Applicable tax rate	45%	30%
Applicable quick deduction factor	(15,160)	(4,410)
Old IIT calculation method: tax calculation before apportionment	27,590 x 15/30 =13,795	
IIT payable	13,795	9,090

As illustrated in this simple example, although the two methods only differ in the order of apportionment, the method of "apportionment before tax calculation" will lower the applicable tax rate and reduce the actual tax burden accordingly; the shorter the China work period, the higher the extent of tax burden reduction.

PN 35 also clarifies the different tax calculation formulas to be used under the new IIT law based on different situations, such as, the China days and employment situation of a non-domiciled individual. All of these formulas reflect the principle of "apportionment before tax calculation".

At the same time, when applying the new method to determine the tax obligations and tax calculation method, it should be noted that, for non-domiciled individuals employed by enterprises in China, his or her China work period should include overseas vacation and training days connected with the China employment. This principle is consistent under both the old and new IIT Law.

Tax calculation methods for multiple-months bonuses and employee equity incentives plan income of non-resident individuals are clarified

It is worth noting that, according to PN 35, the taxable income for multiple-months bonuses or employee equity incentives plan income received by non-domiciled individual should be determined based on the actual China work days during the relevant income period. Under the old IIT Law, for non-domiciled individuals using the "time apportionment" tax calculation method, the taxable income of multiple-months bonuses obtained is determined on a monthly basis, that is, as long as the individual works in China for 1 day in a month within the income period, the share of bonuses for that month should be fully treated as taxable income. Therefore, the change to this new tax calculation method for bonuses and employee equity incentives plan income is relatively more reasonable for non-domiciled individuals, especially for those with dual China and overseas employment or travelling to China temporarily.

Non-resident individuals cannot use the new method of annual comprehensive income taxation, nor can they use the preferential tax treatment available to resident individuals who receive annual one-off bonuses and employee equity incentive plans income stipulated in Caishui [2018] No 164. PN 35 specifically provides a new set of tax calculation rules for multiple-months bonuses and employee equity incentive plans income received by non-resident individuals, i.e., "taxed separately from monthly employment income, no deduction, spreading the income over six months to determine the applicable marginal tax rate by using the monthly tax rate table". The above tax calculation method can only be used once per year for bonuses.

At the same time, Caishui [2018] No 164 specifies a three-year transitional period for the preferential taxation treatment relating to the annual one-off bonus of resident individuals, while PN 35 does not have a similar time limit on the taxation method for bonuses and equity incentives plan income of non-resident individuals. This means that the preferential policy applicable to non-resident individuals will be permanent.

For example, if a non-domiciled individual with dual employment in China and overseas receives an annual bonus of RMB 365,000 in 2019 from the overseas employer, the IIT payable under the old and new IIT calculation methods is compared as below:

	Old tax calculation method	New tax calculation method (tax resident)	New tax calculation method (non-tax resident)
2019 annual bonus (January to December)	365,000	365,000	365,000
China work days	Having China work days in every single month	240 days of working in China within a year (Resident individual)	120 days of working in China within a year (Non-resident individual)
Taxable income - Old tax calculation method	365,000		
Taxable income - New tax calculation method		365,000 x 240/365*=240,000	365,000 x 120/365=120,000
Applicable tax rate	25% (Apply the old preferential taxation method, determine the applicable tax rate after dividing the taxable income by 12)	20% (Apply the taxation method in Circular No. 164, exclude the taxable bonus income from the annual comprehensive income and determine the applicable tax rate after dividing the taxable income by 12)	20% (Apply the taxation method in PN 35, calculate the tax after spreading the taxable income over a 6 months period)
Applicable quick deduction factor	(1,005)	(1,410)	(1,410)
Tax payable	90,245	46,590	15,540

* With the bonus fully paid by overseas employer in the example, the apportionment ratio is calculated as

[1-365,000/365,000 X (365-240)/365].

As illustrated by the above example, for non-resident individuals who actually do not have too many China work days, the above-mentioned new tax calculation method is more reasonable and may reduce the China tax burden of income which is for several months, such as multiple month bonuses.

In addition, as the standard for determining the source of income varies among the domestic tax law of different countries, some non-domiciled individuals (such as US or Hong Kong tax residents) who receive multiple-months bonuses may face double taxation under the old tax calculation method. The above-mentioned method for determining the taxable income of bonuses and employee equity incentives plan income received by non-resident individuals can, to a certain extent, effectively solve the double taxation problem of non-residents with dual employment both in China and overseas or working temporarily in China.

Details on non-domiciled individuals applying tax treaties as well as relevant collection and administration

PN 35 provides an integrated policy explanation on how treaty articles may be applicable to non-domiciled individuals. For the purpose of assessing and applying the tax treaty articles, non-domiciled individuals should also consider other relevant factors such as physical days of presence permanent establishment, economic employers and other related issues.

PN 35 also provides policy guidance on some important collection and administration issues for non-domiciled individuals, including:

- Pre-determination and change of resident/non-resident status

PN 35 allows non-domiciled individuals to do a reasonable preliminary determination of their China tax residency status at the beginning of a tax year so to ascertain their tax withholding and calculation methods. If a non-domiciled individual's China tax resident status changes during the year, the individual is required to complete the reconciliation filing, reporting, settlement of additional tax due or tax refund claim, etc. within the prescribed time period. PN 35 specifically stipulates that if any overdue tax is paid within the prescribed time period, no surcharge will be imposed.

- Income from wages and salaries paid by overseas affiliates

To fully reflect the "principle of the legal power of tax legislation", PN 35 no longer mandatorily requires domestic enterprises to withhold taxes for employment income of non-domiciled individuals that are disbursed by their overseas affiliates. At the same time, for income paid overseas, non-domiciled individuals may choose to perform self-reporting, or ask their employment entities in China to handle the IIT filing and payment for them. However, even if they do not ask their employment entities to handle the IIT reporting, the employment entities are still required to provide the relevant information on such overseas paid employment income to their in-charge tax authority every month.

These regulations set out higher compliance requirements for domestic companies, which need to consider the tax impacts on non-domiciled individuals from a more comprehensive and long-term perspective to ensure a timely and accurate fulfilment of their obligations and to control the tax risks.

The takeaway

Under the new IIT Law, changes relating to the determination China tax residency, the counting of days of residing in China, the "six-year rule" for tax exemption and the tax calculation methods under different situations, etc. would have a significant impact on the taxation of non-domiciled individuals. Enterprises and foreign individuals need to pay special attention to the followings:

- Effectively monitoring and counting the number of days a foreign individual is in or outside China;
- Understanding correctly the criteria for determining the China tax residency status and the requirements to apply tax treaties;
- As resident individuals and non-resident individuals are subject to different tax calculation methods and the tax calculation methods for bonuses and employee equity incentives plan incomes vary significantly, enterprises should carefully review the secondment arrangement of foreign individuals to China;
- Under the new IIT Law, the overall tax burden of foreign individuals is affected by many factors, making it difficult to make a simple determination. In that respect, more detailed estimates and analysis are required to conduct a comprehensive assessment;
- Enterprises need to be familiar with the tax filing, reporting and other obligations related to non-domiciled individuals, as well as their prescribed time periods, fully understand the importance of pre-planning the assignment/employment arrangements including estimate of travel schedule, remuneration structure and payment arrangements, etc.

With the full implementation of the new IIT Law, the complexity level of IIT is also increasing. Individuals and enterprises should, when in need, seek the help of professionals to improve their compliance level and reduce tax risks while optimising their tax cost.

Endnote

1. Please refer to China Tax & Business News Flash [2019] Issue 11 for details.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact a member of **PwC's Global Mobility Services Team:**

Central China

Jacky Chu
+86 (21) 2323 5509
jacky.chu@cn.pwc.com

North China

Edmund Yang
+86 (10) 6533 2812
edmund.yang@cn.pwc.com

South China

Louis CS Lam
+852 2289 5528
+86 (20) 3819 6308
louis.cs.lam@hk.pwc.com

In the context of this News Flash, China, Mainland China or the PRC refers to the People’s Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PwC's client service team or your other tax advisers. The materials contained in this publication were assembled on 19 March 2019 and were based on the law enforceable and information available at that time.

This China Tax and Business News Flash is issued by the **PwC's National Tax Policy Services** in China and Hong Kong, which consists of a team of experienced professionals dedicated to monitoring, studying and analysing the existing and evolving policies in taxation and other business regulations in China, Hong Kong and Singapore. They support the PwC's partners and staff in their provision of quality professional services to businesses and maintain thought-leadership by sharing knowledge with the relevant tax and other regulatory authorities, academies, business communities, professionals and other interested parties.

For more information, please contact:

Matthew Mui
Tel: +86 (10) 6533 3028
matthew.mui@cn.pwc.com

Please visit PwC’s websites at http://www.pwccn.com (China Home) or http://www.pwchk.com (Hong Kong Home) for practical insights and professional solutions to current and emerging business issues.

www.pwccn.com