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CHINA’S AMENDED IIT LAW IMPLEMENTATION REGULATIONS – AREAS FOR CLARIFICATION

On 22 December 2018, the amended Implementation Regulations (the “Implementation Regulations”) of the Individual Income Tax Law (the “IIT Law”) of the People’s Republic of China (“China”) have been announced by the State Council. The revised Implementation Regulations have come into effect from 1 January 2019.

In our Tax Flash of October 2018 (<https://www.rsm.global/hongkong/service/tax-alerts>), we discussed some salient points in the consultation draft of the Implementation Regulations. Many comments and suggestions from the public were considered in updating and finalizing the Implementation Regulations.

In this Tax Flash, we highlight several key changes and areas pending further clarification:

- ✓ *Time to tax offshore income if an expatriate fails to take a single trip with*

absence from China of more than 30 days during six consecutive tax years;

- ✓ *Eligibility for Specific Deductions if non-resident employees in China have made social security contributions;*
- ✓ *Removal of some anti-tax avoidance provisions from the consultation draft may be too good to be true.*

“6-year” safe-harbour concession

As a concessionary policy to attract and facilitate more expatriate employees to work in China, the safe-harbour rule for IIT exemption on qualified offshore income has been retained and relaxed. As in the past, the safe-harbour concession only applies to “Resident by Stay” and not “Resident by Domicile”.

Please refer to Appendix 1 for the summary table about taxation of employees who are Non-resident, “Resident by Stay” and

“Resident by Domicile”, and their definitions in Note (2) of Appendix 1.

In brief, the important changes include:

- 5-year concession has been extended to 6-year;
- Exemption approval from tax authorities is simplified to record-filing with the tax authorities;
- It only needs one continuous absence of more than 30 days away from China in any year to re-count the 6-year residence period.

Prior to the amendment, if an individual stayed in China for 5 consecutive tax years, it was explicitly stated in the old Implementation Regulations that the offshore income of the individual would only be taxed in China from the 6th year, and there was no clawback taxation on offshore income for the past 5 years. Such provision is absent from the amended Implementation Regulations. It is not clear whether the offshore income of an individual who stays in China for 6 consecutive years should be taxed from the 7th or 6th year. Strictly speaking, it appears the tax authorities may also have ground to clawback the IIT from the 1st year. Hope this can soon be clarified.

If an individual has difficulties to take a more than 30-day absence from China during any year in 6 consecutive years, the tax authorities may be interested to know if the individual is “Resident by Domicile” rather than “Resident by Stay” indeed.

Non-resident employee’s eligibility for Specific Deductions

Article 6(1) of the IIT Law provides that in computing the taxable income of a Resident taxpayer, Basic Deduction, Specific Deductions (e.g. statutory contributions to basic endowment insurance, basic medical

insurance, unemployment insurance) and some other deductions as stipulated in the IIT Law can be taken.

Nevertheless, Article 6(2) of the IIT Law currently prescribes that Non-resident employees can only take Basic Deduction (i.e. RMB5,000 per month) in calculating the taxable income. In other words, in case Non-resident employees (e.g. expatriate executives of multinational groups seconded to China but still need to travel extensively outside China for more than 183 days in a year to fulfil their regional responsibilities) paid any social security contributions in China, no tax deductions of such contributions may be allowed. This needs to be fixed.

Please refer to Appendix 2 for the computations of taxable income of Residents and Non-residents.

Some anti-tax avoidance provisions deleted

Certain anti-tax avoidance provisions (e.g. deem and tax donation of property as deemed transfer of property, definitions of related parties and related transactions, restrictions on short-cut taxing methods for conduit entities controlled by individuals, detailed procedures in tax clearance before emigration of resident individuals, etc.) proposed in the consultation draft have yet been kept.

This does not mean the tax authorities will step backwards for anti-tax avoidance measures. Since the IIT Law has provided the necessary principles, arrangements set up by individuals without reasonable commercial purposes and obtain improper tax advantage will be combated by tax authorities. The detailed implementation rules may be easier to come as batches of tax circulars and announcements to be issued by State Administration of Taxation



(“SAT”) to facilitate timely updates to cope with new development in the future.

Late-payment surcharges

Since IIT on Comprehensive Income of tax residents are calculated and finalized on an annual basis, it seems that there may not be late-payment surcharges over the monthly provision payments if there is no deliberate intention to defer “timely” reporting and payment of IIT on Comprehensive Income.

Tax filing location

To avoid disputes over suitable tax filing location, further practice guidelines are expected in respect of there is a choice of more than one filing locations (e.g. when the individual receives taxable income from more than one sources).

In-charge tax departments

In the past, the Individual Income Tax Department of a Local Tax Bureau is the in-charge department of all IIT matters. Please note that in certain locations, it may not be the case. For example, in Shenzhen, while Individual Income Tax Department will handle most of the IIT work, the tax anti-avoidance work will be handled by International Tax Department. In other parts of Guangdong Province, the policies on IIT matters of resident individuals and non-resident individuals are now handled by Individual Income Tax Department and International Tax Department respectively. For cases involving the change from a non-resident into a resident or vice versa, both Departments will get involved. It is important to discuss specific IIT cases with appropriate in-charge tax department(s).

We expect SAT will announce further rules to elaborate on some of the above interpretation and filing matters soon.

If you have any questions on the above or if you wish to prepare for the above significant changes, please consult your professional China tax advisors.

A brief summary of China IIT Implications on Employment Income of Foreigners (including Hong Kong, Macau and Taiwan Residents)

| Tax residency of foreigners | Source of employment income | | | |
|---|--|---|---|--|
| | Services rendered in China | | Services rendered outside China | |
| Non-resident staying in China for less than 183 days in aggregate in a calendar year | Remuneration is paid or borne by a Chinese employer | Remuneration is paid and borne by non-resident employer | Remuneration is paid or borne by a Chinese employer | Remuneration is paid and borne by non-resident employer |
| | <i>For no more than 90 days or longer period if relevant DTA applies</i> | Taxable | Exempt | Not taxable |
| <i>Resident due to staying in China for 183 days in aggregate or more in a calendar year (“Resident by Stay”) and continues for less than 6 consecutive years (note: For any year during which a Resident by Stay is away from China for more than 30 continuous days, the 6-year residence period will restart.)</i> | Taxable | | | Possibly not be taxed provided that record-filing requirements have been fulfilled |
| Resident by Stay for 6 consecutive years or longer | | | | Taxable |
| Resident due to domicile in China (“Resident by Domicile”) | Taxable | | | |

Notes:

- (1) In line with the international practice, the amended IIT Law defines “residents” and “non-residents” for tax purpose. In principle, residents are taxed on their worldwide income and non-residents are usually taxed on their China-sourced income.
- (2) For tax residents, there are two categories:
 - an individual who has a domicile in China (“Resident by Domicile”);
 - an individual who does not have a domicile in China but has stayed in China for 183 days in total in a tax year (“Resident by Stay”). Prior to the IIT Law amendments this time, it was “one full year” and the time threshold has been shortened after the change.Domicile refers to habitual residence in China on account of domiciliary registration (“household registration”), family ties or economic interests.
- (3) If an individual is a tax resident of more than one jurisdiction, the residency status shall be determined in accordance with the relevant Agreement/Arrangement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (“DTA”).
- (4) Please note that in some DTAs, the requirement may be “not exceeding in the aggregate 183 days within any twelve-month period” instead of “not exceeding in the aggregate 183 days in a calendar year”.
- (5) According to Article 2 of IIT Law, taxable income includes income from employment, labour services, article publication, royalties, business operations, interests, dividends, profit sharing, property leasing, property transfer and occasional income. Income from employment, labour services, article publication and royalties are collectively categorized as Comprehensive Income for IIT purpose.
- (6) Senior management employees of companies and Chief Representatives of representative offices of overseas companies may be subject to additional rules on taxation of overseas employment income.

IIT Computations for Resident and Non-resident Employees

Resident individuals

- Employment income, labour service income, article publication income and royalty income are taxed together as Comprehensive Income on the same tax filing.
- Final amount of IIT on Comprehensive Income is computed on an annual basis. Monthly estimated payments are withheld and pre-paid by the tax withholding agent. Annual tax filing is required for tax reconciliation and settlement during March to June of the year following the relevant tax year.
- Pursuant to Article 6(1) of IIT Law, taxable income from Comprehensive Income is calculated as follows:

Comprehensive Income

- Employment income
- Labour service income
- Article publication income
- Royalty income

Less: Basic Deduction

- RMB60,000 per taxpayer per annum (RMB5,000 per month)

Less: Specific Deductions

- Contributions to (1) basic endowment insurance, (2) basic medical insurance, (3) unemployment insurance and (4) housing fund paid by individuals in accordance with the scope and standards stipulated by the central government

Less: Supplementary Specific Deductions

- SSDs include expenditure on (1) children's education, (2) continuing education, (3) medical care for serious illness, (4) home mortgage interest (5) housing rent and (6) support for designated elderly family members

Less: Other Approved Deductions stipulated in relevant national laws

- Including (1) Commercial health insurance, (2) personal tax deferred commercial endowment insurance, (3) enterprise annuity and (4) occupational annuity.

Taxable income

- Specific Deductions, Supplementary Specific Deductions and Other Approved Deductions are limited to the amount of taxable income for the relevant tax year, and the unrelieved amounts cannot be carried forward to the following tax year.

Non-residents individuals

- Comprehensive Income arrangements do not apply such that IIT on employment income and other categories of income continues to be calculated and filed separately.
- Monthly tax filings and payments should be done by withholding agent or taxpayers.
- In general, employment income of non-resident employees is still calculated as follows:

Employment income

- Excluding tax-exempt fringe benefits (e.g. qualified children's education fee, language training fee, housing rent subsidy, home leave expense reimbursement)

Less: Basic deduction

- RMB5,000 per month (increased from RMB4,800)

Taxable income

- Neither Article 6 of IIT Law nor the Implementation Regulations have mentioned tax deduction treatments in case non-resident employees are required to pay social security contributions in China.

RSM Tax Advisory (Hong Kong) Limited

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- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
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