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# RSM Tax Advisory (Hong Kong) Limited

## 羅申美稅務諮詢有限公司

Welcome to Tax Flash – RSM Tax Advisory (Hong Kong) Limited’s Newsletter Covering Technical Development in Taxation

### INDIVIDUAL INCOME TAX POLICIES ON INCOME DERIVED FROM OUTSIDE THE PRC

*The PRC Ministry of Finance (“MOF”) and the State Administration of Taxation (“SAT”) jointly issued Public Notice [2020] No.3 – “Announcement on the individual income tax policies on income derived from outside the PRC” (hereinafter referred to as “PN 3”) on 17 January 2020. PN 3 clarifies the definition, tax declaration and credit calculation of income derived by PRC individual tax resident<sup>1</sup> from outside the PRC. In this Tax Flash, we will illustrate the salient points of PN 3.*

#### 1. INCOME DERIVED FROM OUTSIDE THE PRC

PN 3 defines “income derived from outside the PRC” as follow: -

Income Categories	Conditions
Salary and wages (工资、薪金所得)	Obtained as a result of employment / service provided outside the PRC
Income from provision of independent personal services (劳务报酬所得)	
Author’s remuneration (稿酬所得)	Paid and borne by non-PRC enterprises / organizations
Royalties (特许权使用费所得)	Obtained as a result of licensing the use of IP right outside the PRC
Income from Operations (经营所得)	Obtained as a result of engaging in production and business activities outside the PRC
Interest Income, Dividends, Bonus (利息、股息、红利所得)	Obtained from non-PRC enterprises / organizations or non-resident individuals

<sup>1</sup> A PRC individual tax resident is defined as either (i) an individual domiciled in the PRC; or (ii) a non-domiciled individual who is in the PRC for 183 days or more in a calendar year.

Income Categories (Cont'd)	Conditions (Cont'd)
Income from Property Leasing (财产租赁所得)	Obtained as a result of renting property to lessee for use outside the PRC
Income from Transfer of Property (财产转让所得)	Obtained as a result of transfer of immovable property, equity assets <sup>2</sup> (e.g. stocks, equity or investments of non-PRC enterprises / organizations) or other property outside the PRC
Incidental Income (偶然所得)	Paid and borne by non-PRC enterprises / organizations or non-resident individuals

In case a PRC tax resident derives income from outside the PRC, he/she should report to the competent tax authority during the period from 1<sup>st</sup> March 1 to 30<sup>th</sup> June of the following year: -

Competent Tax Authority	
Taxpayer with PRC employer	The PRC employer's in-charge tax authority
Taxpayer with no PRC employer	The tax authority where taxpayer's household registration is located or his/her habitual place of residence

## 2. INDIVIDUAL INCOME TAX (“IIT”) CALCULATION

For PRC individual tax resident's IIT calculation, PN 3 clarifies that: -

- The comprehensive income<sup>3</sup> derived from and outside the PRC should be added up to calculate the amount of IIT payable.
- The income from operations derived from and outside the PRC should be added up to calculate the amount of IIT payable. However, for loss derived from outside the PRC (calculated in accordance with the PRC IIT Law and its Implementation Rules (“IRs”)), it cannot be used to offset against the income from operations derived from the PRC or other country (region). Instead, it should be carried forward to offset the income from operations derived from the same country (region) in the following years.
- The amount of IIT payable for other income categories (i.e. income from interest, dividends, property leasing, transfer of property and incidental income) derived from and outside the PRC should be calculated separately.

<sup>2</sup> If the fair value of the assets of the invested enterprise at any time within the three years (36 consecutive months) prior to the transfer is more than 50% directly or indirectly from immovable property in the PRC, the transfer proceeds will be deemed as derived from the PRC.

<sup>3</sup> “Comprehensive income” covers the following four types of income derived by a PRC individual tax resident:

- Income from salary and wages;
- Income from provision of independent services;
- Income from authors' remuneration; and
- Income from royalties

### 3. FOREIGN TAX CREDIT (“FTC”)

- For foreign tax paid<sup>4</sup> on income derived by a PRC individual tax resident from outside the PRC during a tax year, the individual is eligible to claim FTC (within the credit limit) to offset his/her IIT payable.
- The following items, according to PN 3, are not eligible for FTC: -
  - foreign tax that should not be levied under the tax laws of the country of origin (e.g. foreign tax levied by omission / error);
  - foreign tax that should not be levied in accordance with the double tax agreement signed by the PRC government;
  - interest and penalty imposed on late/under payment of foreign tax;
  - tax rebate or compensation obtained from the overseas tax authority; and
  - foreign tax paid on income which is tax-exempted in accordance with the PRC IIT Law and IRs
- FTC is calculated based on the principle of "country (region)": -

$$\text{FTC for income derived from the same country (region)} = \text{FTC for comprehensive income derived from the same country (region)} + \text{FTC for income from operations derived from the same country (region)} + \text{FTC for other income categories derived from the same country (region)}$$

and the credit limit is calculated as follow: -

Income Category	Foreign Tax Credit Limit	
Comprehensive income	IIT Payable for Comprehensive income derived from and outside the PRC	$\times \frac{\text{Comprehensive income derived from the same country (region)}}{\text{Comprehensive income derived from and outside the PRC}}$
Income from operations	IIT Payable for income from operations derived from and outside the PRC	$\times \frac{\text{Income from operations derived from the same country (region)}}{\text{Income from operations derived from and outside the PRC}}$
Other income categories	IIT Payable for that income categories derived from the same country (region)	

- If the amount of foreign tax paid is higher than the FTC limit of the country (region), the excess can be carried forward for five tax years.
- For income derived from a foreign country (region) that can enjoy tax relief in accordance with the foreign tax laws, the tax relief amount will be deemed as an individual’s “actual” foreign tax paid for FTC calculation if such relief is covered by the “tax sparing credit” provision of the double tax agreement concluded by the PRC government and the foreign country (region).
- Taxpayer should provide supporting documents such as tax payment certificates or tax contribution records issued by the foreign tax authority to support his/her FTC claim. In case the above supporting documents are not available, taxpayer should provide to the tax authority his/her foreign income tax return (or tax assessment notice issued by the foreign tax authority) and the corresponding bank payment advice.
- If an individual tax resident declared his/her foreign sourced income to the PRC tax authority but did not elect for FTC claim, he/she may, within 5 years, retroactively to claim FTC in the tax year to which the foreign income is earned.

<sup>4</sup> The foreign tax paid should be of similar nature as PRC IIT and in accordance with the tax laws of that country.

#### 4. DISPATCH ARRANGEMENT

If a PRC enterprise (or organization) dispatches an individual tax resident to work overseas, PN 3 stipulates that: -

- if the individual's remuneration is paid or borne by the PRC enterprise (or organization), IIT should be withheld by the PRC enterprise (or organization) in accordance with the PRC IIT Law and IRs;
- if the individual's remuneration is paid or borne by an overseas unit which is a PRC institution<sup>5</sup>, the overseas unit may withhold the individual's IIT and then entrust the PRC enterprise (or organization) to report and pay IIT to the competent tax authority;
- if the PRC institution does not withhold tax or if the overseas unit is not a PRC institution, the PRC enterprise (or organization) shall report the following information to the competent tax authority by 28<sup>th</sup> February of the following year: -
  - Name of the employee;
  - Type of identity document and number;
  - Name and address of the overseas work unit;
  - Job title;
  - Dispatch period;
  - Details of his/her PRC and foreign sourced income; and
  - Tax payment status, etc.

#### 5. OTHERS

- If the foreign country (region) adopts a tax year other than calendar year, the foreign tax year in which the overseas income is obtained ending within the calendar year would be the corresponding PRC tax year for the overseas income.
- If, within the five years from which the overseas income is obtained, the actual amount of foreign tax paid is more or less than the amount stated in the tax payment certificate issued by the foreign tax authority, the individual's IIT payable will be recalculated. No penalty (in case of underpayment) nor interest (in case of tax refund) will be imposed.

#### POINTS TO NOTE

PN 3 makes it clear that taxpayers (and the dispatching unit) who fail to declare foreign income and report the relevant information shall be dealt with in accordance with the PRC Tax Collection and Administration Law and the IIT Law. PRC enterprises with employees working overseas and taxpayers who have obtained overseas income should be familiar with the specific contents of PN 3 and fulfill the relevant declaration requirements accordingly.

For further information on the above subject and to discuss the potential impact on your company and employees, please feel free to contact us.

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<sup>5</sup> "PRC institution" refers to the overseas branches/subsidiaries/representative offices/embassies of PRC enterprises, institutions, other economic organizations and PRC government authorities.

## RSM Tax Advisory (Hong Kong) Limited

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- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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