



Tax News

Further to a series of tax laws and regulations including the *Regulation on the Implementation of the Individual Income Tax Law* ("New Regulation") which was collectively released by the end of 2018, the new version of *Individual Income Tax Law* ("New IIT Law") has been implemented in full scope as of January 1, 2019. This article will provide a summary of the updates mainly on the wages and salaries (as one of the comprehensive incomes) which have the most wide-ranging impact with respect to the expatriates of multinational companies.

1. Update on the identification of Chinese IIT Resident – from five-year rule to six-year rule

Pursuant to the Previous IIT Law, an individual without domicile in China (in practice usually an expatriate of a multinational company) but has stayed in China for a full calendar year shall be identified as a Basic Chinese IIT Resident; on top of that, an expatriate staying in China for five consecutive calendar years shall be construed as a full-scope Chinese IIT Resident (same as the native Chinese resident). As a legitimate means to evade full-scope Chinese IIT liability, a number of expatriates choose to leave China for more than 30 days in one single departure or for 90 days in aggregate during multiple departures within one calendar year in order to break the above-mentioned five-year rule.

Pursuant to the New IIT Law, however, an individual without domicile in China but having stayed for 183 days in aggregate within one calendar year in China shall be identified as a Basic Chinese IIT Resident, meaning that the timing for identifying Basic Chinese IIT Resident is shortened to half. It is thus more likely that an expatriate will become or choose to become a Chinese IIT Resident. The New Regulation further provides that the wages and salaries of a

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Basic Chinese IIT Resident under the 183-day rule borne and sourced overseas shall be exempt from IIT if said Basic Chinese IIT Resident has not stayed in China for six consecutive years or more, based on due registration with local tax bureau. This is the first time that the Chinese IIT system has adopted a six-year rule, a higher threshold for the full-scope IIT liability that appears to be more relaxed towards expatriates when compared against the five-year rule. Moreover, the New Regulation provides a more convenient mechanism to break the six-year rule on which such 6-year period shall be recalculated if there is one single departure for more than 30 days within any tax year, meaning that an expatriate may remain a Basic Chinese IIT Resident under the 183-day rule but never become a full-scope Chinese IIT Resident under the 6-year rule (which is impossible under the mechanism of the Previous IIT Law).

2. Update on the tax filing period – declaration by residents on an annual basis and non-residents on a monthly basis

The Previous IIT Law stated that all IIT payers ought to declare on a monthly basis, whilst the New IIT Law stipulates that a resident individual shall declare on the basis of a calendar year (normally by means of quarterly pre-filings and year-end final settlement within the period from March 1 to June 31 of the following year); on the other hand, a non-resident individual must declare on a monthly basis, foregoing the year-end final settlement. However, as the aforementioned 183-day rule may easily be met, it is expected that more than a few expatriates would pay their IIT on an annual basis as residents.

3. Deduction right and foreigners' optional right - transitional period from January 1, 2019 to December 31, 2021



Under the mechanism of the Previous IIT Law, foreigners enjoy the allowance deduction right which is different from that of the Chinese (nationality) residents, namely the housing subsidies, language training fees and children's education fees etc. incurred on a non-cash basis or a reimbursement basis are not taxable. The New IIT Law has introduced a new right of deducting special and additional fees, which is granted to the Chinese IIT Residents only, meaning that a foreigner who is domiciled in China for less than 183 days within one calendar year cannot enjoy such right under the New IIT Law. For a foreigner eligible as a Chinese IIT Resident, however, a concurrence of tax preferences may be applicable.

Previous IIT Law	Remarks	New IIT Law	Remarks
Comparative Items under the Previous and New IIT Law Respectively			
Housing subsidies	Normally the rent of foreign employees in China based on the rent invoices without a deduction cap	Housing loan interest or housing rent	Fixed deduction per family, i.e., RMB 1,000 per month for housing loan interest, RMB 800~1,500 per month for housing rent based on the ranking of the city
Language training fees	Based on the training invoices normally without a deduction cap	Expenditure for continuing education	Fixed deduction of RMB 400 per month during the education period and fixed deduction of RMB 3,600 in the year when the certificate is obtained



Children's education fees	Based on the invoices issued by the school normally without a deduction cap	Expenditure for children's education	Fixed deduction per family, RMB 1,000 per child per month
Non-Comparative Items under the Previous and New IIT Law Respectively			
Food allowance, laundry allowance	Based on invoices within a reasonable scope normally without a deduction cap	Medical care for serious disease	Deduction of the costs actually incurred capped at RMB 80,000 only when the individual burden exceeds RMB 15,000
Relocation fee for taking position into or away from China	Based on invoices normally without a deduction cap	Care for the elderly	Fixed deduction of RMB 2,000 per month which may be allocated among the siblings (if any) as agreed under a cap of RMB 1,000 for each
Allowance for transportation and accommodation	Based on invoices normally without a deduction cap		
Family visit fee	Normally based on the air tickets for the round trips between the dispatching country and China which shall be no more than two rounds within one year		



The New IIT Law provides a transitional period of 3 years with respect to the aforementioned preference concurrence, i.e. within the period from January 1, 2019 to December 31, 2021, foreign residents may decide which mechanism – the previous IIT Law or its updated version - is the best option, once decided, the applied mechanism shall remain the same within one calendar year.

Given the fact that the Previous IIT Law offers more deduction items which normally have no deduction cap, it is advisable for foreign residents to choose the deduction mechanism under the Previous IIT Law during the three-year transitional period.

It is also noteworthy that the New IIT Law provides that *“Since January 1, 2022, foreign individuals are no longer entitled to the preferential tax policies regarding housing subsidies, language training fees and children's education fees but shall have the right of deducting special and additional fees according to the provisions.”* The New IIT Law merely excludes the application of the three comparative items as addressed in the table above as of 2022; with respect to the non-comparative items mentioned thereto, it shall be subject to further clarification by the tax authorities as to whether they shall remain applicable after 2022.

4. Preferential treatment for annual bonus - transitional period from January 1, 2019 to December 31, 2021

The preferential treatment for annual bonus refers to the generally applicable treatment where the one-time annual bonus, unlike ordinary wages, shall be divided by twelve and subject to the corresponding tax rate (which is relatively low). As set forth in the New IIT Law, such preferential treatment shall continue



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to apply within the aforementioned transitional period before becoming obsolete in 2022. In other words, the annual bonus shall be included as part of ‘income’ alongside wages/salaries in the same tax year following the transition period’s culmination in 2022.

Should you have any further questions regarding the reform on the Chinese IIT Laws, please feel free to contact us.

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