



Tax News

Since 1 January 2019, the new *Individual Income Tax Law* and its implementation regulations (“New IIT Law” and “New Regulation”) have been fully implemented. In the past months, discussions about how to allocate the domestic and overseas remuneration and corresponding calculation mechanism of wages and salaries earned by expatriates of multi-national corporations working in China have been a supreme topic. On 14 March 2019, the Ministry of Finance (“MOF”) and the State Administration of Taxation (“SAT”) promulgated jointly the Announcement No. 35 of 2019 (“Announcement No. 35”) to provide guidance on the aforementioned. This Newsletter will provide an overview of the highlights of Announcement No. 35.

1. New classification of expatriates

Announcement No. 35 divides expatriates into “non-residents” and “residents with no domicile”. Non-residents are further divided into those who have stayed in China for no more than 90 days and those for more than 90 days but less than 183 days in a taxation year. Residents with no domicile refer to those who have stayed in China for over 183 days in China in a taxation year.

Expatriates		
Non-residents		Residents with no domicile
Expatriates stayed in China for no more than 90 days. ("Class 1")	Expatriates stayed in China more than 90 days but less than 183 days. ("Class 2")	Expatriates lived in China for more than 183 days. ("Class 3")

Monthly IIT filing for Class 1 and Class 2. Yearly IIT filing for Class 3 with monthly pre-filings.

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It is still worth mentioning that, if an expatriate has been staying in China for six consecutive taxation years, and has never been absent from this country at a time for more than 30 days in any taxation year in said period, he/she then will be recognized as a tax resident in China with tax filing obligations for income received globally. However, Announcement No. 35 limits the scope of tax liability for such expatriate (which is extremely rare in practice), i.e. his/her tax filing obligation is limited to his/her wages and salaries (under the prior IIT regime, all sorts of his/her income would be subject to IIT).

2. Dual position in China and overseas still necessary for income allocation

Announcement No. 35 stipulates that domestic and overseas sourced income of expatriates shall still be corresponding to their actual working period inside and outside of China, with the same prerequisite that such expatriates hold dual positions in and outside of China (this stipulation is the same when compared to the prior IIT regime; thus, it is necessary for group companies to prepare documentation demonstrating positions held by the expatriates in and outside of China). For said working period, Announcement No. 35 introduces the new concept of “24 hours” to regulate the so-called “airport day”, i.e. if an expatriate stays in China for less than 24 hours on a certain day (measured by Beijing Time), then such day shall be recorded as half a day in China.



3. Formula for income apportionment

1) Formula one: for Class 1

Wage and salary in a given month = Total onshore and offshore wages and salaries in such month * (wages and salaries paid onshore in such month / total wages and salaries paid onshore and offshore in such month) * (days working in China in such month / total days in such month)

2) Formula two: for Class 2

Wage and salary in a given month = Total onshore and offshore wages and salaries in such month * (days working in China in such month / total days in such month)

3) Formula three: for Class 3

Wage and salary in a given month = Total onshore and offshore wages and salaries in such month * (1 - wages and salaries paid offshore in such month / total wages and salaries paid onshore and offshore) * (days working abroad in such month / total days in such month)

4. Special regulations for senior management

Senior management includes director, supervisor, general manager, deputy general manager, head of departments, chief inspector and other similar management positions within a domestic resident enterprise.



1) Senior management under Class 1

The amount of wage and salary in a given month is the wage and salary paid or borne in China in said month. It is noteworthy that this amount NOT subject to the summation of wages and salaries paid in China and outside of China with further apportionment, which is considered a significant new concept in Announcement No. 35.

2) Senior management under Class 2 and Class 3

Formula three applies.

5. Overlap between Announcement No. 35 and tax treaties

The tax treaty OECD template generally adopts “183-day rule” as a tax exemption precondition for residents from the other contracting state, i.e. if an expatriate stays in China for no more than 183 days in a given calendar year (or 12 consecutive months, depending on specific treaties with different countries) and his/her wage and salary are not borne by the domestic enterprise, he/she then does not pay IIT in China. Since the abovementioned three formulas also contain certain tax benefits, there is an overlap between the international treaty and domestic law. Announcement No. 35 grants expatriates option to choose between the tax benefits stipulated in international treaty and domestic law.

Since Class 1 and Class 2 are regarded as the same class under the definition of tax treaties (under the benchmark of 183 days), Announcement No. 35 stipulates that Formula one shall apply (preferential treatment for Class 2) if the tax treaty benefit is chosen. Formula two shall apply for Class 3 (preferential treatment) if the tax



treaty benefit is chosen. Generally, Class 2 and Class 3 shall opt for applying the tax treaty benefit.

6. Miscellaneous

1) Exemption of annual settlement for Class 3

Theoretically, Class 3 is a Chinese tax resident and annual settlement shall be performed. However, Announcement No. 35 stipulates that, expatriates with monthly withholding agent (domestic company in normal cases) could be free from the annual settlement. Therefore, expatriates of Class one, Class two and Class three would all be free from the annual settlement.

2) Pre-assessment on expatriates' classification

When an expatriate conducts IIT filing for the first time in China, the working-time in China shall be pre-estimated in accordance with his/her labor contract or expatriation agreement, and IIT shall be paid based on such estimation. In case that the pre-estimated working time is discrepant from the actual situation, it is allowed by Announcement No. 35 to make IIT reconciliations per the actual situation without late payment surcharge in normal cases.

3) Director fee

If a director (one sort of senior management) obtains director fee that is eligible for the relevant clause of "Director Fee" in relevant tax treaty, his/her tax filing obligation shall be handled according to Point 4 of this tax news update. On the contrary, if such director fee is not



eligible for the relevant clause in such tax treaty (different tax treaties may define the “Director Fee” clause differently), his/her tax filing obligation shall be handled according to Formula one and Formula two (preferential treatment) set forth in Point 5 of this tax news instead of Point 4.

For expatriates from Canada and Thailand, given the particularity of the clause of “Director Fee” in Sino-Thailand and Sino-Canada tax treaties, the above mechanism is applicable to the wages and salaries of other senior management.

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

Kind regards,

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