China: Changes with significant impact to the taxation of non-China domiciled individuals

April 4, 2019

In brief

Notice on the Criteria for Determining Non-China Domiciled Individual’s Length of Residence (Notice [2019] No. 34) and Notice on Individual Income Tax Rules Concerning Non-Resident and Non-Domiciled Resident (Notice [2019] No. 35) were jointly released in March 2019 by the PRC Ministry of Finance and the PRC State Administration of Taxation. They introduce important changes and clarify matters relating to the taxation of non-China domiciled individuals under the new Individual Income Tax (IIT) Law.

In the past, tax rules concerning non-China domiciled individuals were stated in various circulars and notices issued by the PRC authorities. The introduction of the new IIT Law presents a good opportunity to provide clearer guidance on the taxation of non-China domiciled individuals, from the perspective of both domestic law and tax treaties.

In detail

China residence day vs. China work day

Notice [2019] No. 34 provides a major change to how days in China are counted. For the purpose of determining a non-China domiciled individual’s China tax residency under the domestic law, a day in which a non-China domiciled individual is in China for less than 24 hours is not counted as a day in China. However, for purposes of sourcing the income and calculating the IIT payable, physical presence less than 24 hours in China is still counted as a ½ work day in China.

As a result, a non-China domiciled individual who is employed by a foreign company or is concurrently employed by a foreign company and a Chinese company, needs to be mindful of these two different counting methods of days in China.

Additionally, Notice [2019] No. 35 reiterates that a China work day should include actual work days in China plus other days spent inside and outside China that are connected to a non-China domiciled individual’s China employment. This includes, for example, public holidays, annual leave, and training.

‘Six-year rule’

Implementation details for the new ‘six-year rule’ are set forth in Notice [2019] No. 34. The following is a brief summary of the main points:

- A non-China domiciled individual’s physical presence in China before 2019 can be excluded for purposes of the new ‘six-year rule’
• The ‘six-year’ count can be reset by spending more than 30 consecutive days outside of China during a calendar year.

• A non-China domiciled individual will be subject to IIT on worldwide income starting from the seventh consecutive year of having resided 183 days in China annually if there is no single absence of more than 30 consecutive days during a calendar year within the six previous years.

Pursuant to Notice [2019] No. 34, year 2019 is the first year of the ‘six-year’ count irrespective of a non-China domiciled individual’s physical presence in China before 2019. Although accumulated absence from China of more than 90 days during a year under the old ‘five-year rule’ is not an option for resetting the ‘six-year’ count, the new ‘six-year rule’ overall is more favourable to non-China domiciled individuals.

The chart below is an illustration of the new ‘six-year rule’:

Having resided 183 days in China for 6 consecutive years plus no absence from China of more than 30 consecutive days during any of these 6 years, worldwide taxation triggered by 7th year of residing 183 days in China

‘6-year’ count can be reset by residing less than 183 days in China or being out of China for more than 30 consecutive days during any year

Taxability assessment of non-China domiciled individual’s employment income

Assessing whether a non-China domiciled individual’s employment income should be subject to IIT is not a straightforward task. Besides the source of employment income, which entity or entities are paying and cost-bearing also must be considered.

The major change under the new IIT Law is the impact attributable to a non-China domiciled individual’s days in China as illustrated in the table below:
## Insights

<table>
<thead>
<tr>
<th>Non-China domiciled individual</th>
<th>Days in China</th>
<th>China source employment income (China work days)</th>
<th>Foreign source employment income (foreign work days)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>China payment</td>
<td>Overseas payment</td>
</tr>
<tr>
<td>Non-China tax resident</td>
<td>≤ 90 days</td>
<td>Taxable</td>
<td>Tax exempted</td>
</tr>
<tr>
<td></td>
<td>&gt; 90 days but &lt; 183 days</td>
<td>Taxable</td>
<td>Tax exempted</td>
</tr>
<tr>
<td>China tax resident</td>
<td>≥ 183 days (not exceeding 6 consecutive years)</td>
<td>Taxable</td>
<td>Tax exempted</td>
</tr>
<tr>
<td></td>
<td>≥ 183 days (exceeding 6 consecutive years with no single absence of more than 30 consecutive days during a year within these 6 years)</td>
<td>Taxable</td>
<td>Taxable</td>
</tr>
</tbody>
</table>

*As exemplified in Notice [2019] No. 35, taxability assessment of directors and senior management personnel’s employment income is complicated and requires consideration of the relevant facts and tax treaty articles.

### Changes in IIT time apportionment calculation method

Although there is basically no change to the taxation principle of non-China domiciled individuals’ employment income, the new changes to the IIT time apportionment calculation method are beneficial to those non-China domiciled individuals who have dual employments in China and outside China respectively, as well as those non-China domiciled individuals who travel to work in China temporarily.

Under the old IIT rules, IIT payable on the total monthly taxable employment income was the basis for applying time apportionment with reference to the number of China work days in the month concerned. With the release of Notice [2019] No. 35, there are now three different new IIT time apportionment calculation formulas. The common feature of these three formulas is that taxable employment income can be apportioned according to a non-China domiciled individual’s number of China work days in the month concerned before calculating the IIT payable.

Using a simple example of a non-China domiciled individual who has 15 China work days in the month of April, a comparison of the IIT payable under the old and new IIT rules is set out in the table below:
As illustrated in this simple example above, apportionment of employment income may lower the applicable marginal tax rate resulting in lower IIT payable.

One important point to bear in mind is that Notice [2019] No. 35 states that China work days of a non-China domiciled individual employed by an entity in China should include overseas vacation and training days connected with the China employment.

**Taxation of non-China tax resident’s multiple-months bonus and employee equity incentive plan income**

Pursuant to Notice [2019] No. 35, sourcing of a non-China domiciled individual’s multiple-months bonus and employee equity incentive plan income can be based on the actual number of China work days during the relevant periods. In comparison with the old IIT rules under which only a month with no China days could be excluded for sourcing purposes, the new change may minimize double taxation.

The annual comprehensive income tax rates table and the preferential tax treatments available to annul bonus and employee equity incentive plans income under Circular [2018] No. 164 jointly issued by the PRC Ministry of Finance and the PRC State Administration of Taxation are not applicable to non-China tax residents.

Notice [2019] No. 35 specifically provides a new set of rules for non-China tax residents: Taxed separately from monthly employment income, no deduction, dividable by six months for purposes of determining the applicable marginal tax rate in the monthly tax rates table.

Similar to the annual bonus preferential tax treatment that can be enjoyed by China tax residents, this new set of rules available to non-China tax residents can be applied only once per year. However, there is no stipulation of the ‘three-year’ transition limit imposed on the preferential tax treatments applicable to China tax residents.

Example: A non-China domiciled individual receives a 2019 annual bonus; this person has dual employments in China and outside China respectively. The table below is a comparison of the IIT payable under the old IIT rules and the new IIT rules:
<table>
<thead>
<tr>
<th></th>
<th>Old rules</th>
<th>New rules (tax resident)</th>
<th>New rules (non-tax resident)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019 annual bonus</td>
<td>RMB 365,000</td>
<td>RMB 365,000</td>
<td>RMB 365,000</td>
</tr>
<tr>
<td>(Jan - Dec)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China work days</td>
<td>China work day in</td>
<td>240 China work days (tax</td>
<td>120 China work days (non-</td>
</tr>
<tr>
<td></td>
<td>every single month</td>
<td>resident)</td>
<td>tax resident)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable amount</td>
<td>365,000</td>
<td>365,000 x 240/365 =</td>
<td>365,000 x 120/365 =</td>
</tr>
<tr>
<td>(old tax rules)</td>
<td></td>
<td>240,000</td>
<td>120,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Applicable tax rate</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Applicable quick</td>
<td>(1,005)</td>
<td>(1,410)</td>
<td>(1,410)</td>
</tr>
<tr>
<td>deduction factor</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IIT payable</td>
<td>90,245</td>
<td>46,590</td>
<td>15,540</td>
</tr>
</tbody>
</table>

**Tax treaty articles applicable to non-China domiciled individual**

Notice [2019] No. 35 includes consolidated stipulation on how tax treaty articles may be applicable to non-China domiciled individuals. In addition to the tax treaty article’s own stipulated conditions, other factors that should be considered when assessing how the tax treaty article may be applied include physical presence, deemed permanent establishment, and economic employer.

**Other highlights**

Notice [2019] No. 35 requires non-China domiciled individuals to make a preliminary assessment of their China tax residency status for determining the applicable tax withholding / payment method and tax calculation methods at the beginning of a tax year. If there is any change to the China tax residency status during the year, the required reconciliation tax filing and tax settlement due dates stated in Notice [2019] No. 35 should be followed. Therefore, it is important for non-China domiciled individuals to reassess their China tax residency after the end of a tax year or before their final departure from China, whichever is earlier.

Another change stated in Notice [2019] No. 35 is that an employing entity in China is no longer mandatorily required to withhold the IIT payable on a non-China domiciled individual’s employment income disbursed by its overseas affiliate; instead, it is the non-China domiciled individual’s own responsibility. Non-China domiciled individuals can either perform their own monthly IIT filings or ask their employment entity in China to handle the IIT filing and payment for them.

Moreover, employing entities in China are required to provide the relevant information to their in-charge tax authority if their non-China domiciled employees choose to handle the reporting of the employment income received outside China and the settlement of the IIT payable thereon by themselves.

**The takeaway**

Under the new IIT Law, there are major changes to taxation of non-China domiciled individuals in terms of China tax residency assessment, counting of days in China, worldwide taxation, and IIT calculation methods such as the new time apportionment formulas. Because of these changes, IIT rules are more complicated and more difficult to apply. Some important considerations for companies and individuals may include:

- effective planning of China assignment and monitoring of days in China, including an accurate understanding of China tax residency assessment criteria and
how tax treaties may be applied, so as to achieve overall tax efficiency

- proper understanding of the ‘six-year rule’ for determining worldwide income subject to IIT
- effective use of the different tax preferential treatments available for the annual bonus and employee equity incentive plan income of China tax residents and non-China residents to minimize IIT payable
- understanding the tax filing and payment requirements so as to avoid non-compliance consequences, such as late payment interest.

Now that Notice [2019] No. 34 and Notice [2019] No. 35 have provided the additional parameters and clarification, companies and individuals may want to review their current arrangements from a compliance perspective and also identify any changes required for more efficient tax planning. In some cases, the new changes and clarification may trigger a need to adjust January 2019 and February 2019 monthly IIT filings.

Let’s talk
For a deeper discussion of how the new IIT Law might affect your business, please contact your PwC Global Mobility Services engagement team or one of the following team members:

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