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China Law Update

Individual Income Tax for Expatriates in China

For foreigners lured into China labor market, there are many things for them to ponder over before heading to China soil. One of the critical things that need to be clearly addressed is the tax implication of working in China, namely, whether you need to pay individual income tax in China, and how and how much you need to pay China individual income tax.

For those expats who have been working in China, it has probably been a period of caution after China started strengthening its administration of taxation on foreigners in 2010. We have been approached for advice by expats who are being audited in respect of their individual income tax records by local tax authority.

We hereby summarize the basic legal framework governing expats individual income tax liabilities in respect of their salaries, wages and similar remuneration for their employment carried out in China. Individual income tax liabilities in respect of other types of income derived from property sale, royalty or other activities other than employment are not covered herein. We will at your request provide related information.

No.	Time period of stay in China by expats	Income sourced inside China		Income sourced outside China	
		paid or borne by domestic entity	paid and borne by foreign entity	paid or borne by domestic entity	paid and borne by foreign entity
1.	Less than 90 or183 days	Yes	exempted	No	No
2.	More than 90 or183 days but less than 1 year	Yes	Yes	No	No
3.	More than 1 year but less than 5 years	Yes	Yes	Yes	exempted
4.	More than 5 years	Yes	Yes	Yes	Yes

- "**Yes**" means China government will collect the individual income tax; "**Exempted**" means you don't have to pay the tax though you are legally obliged to; "**No**" means you are not subject to such tax.
- "**Less than**" shall not include the number immediately following after it; "**more than**" shall include the number immediately following after it.

I Basic Terms

Before moving to explain the table above, I would like to introduce some basic concepts that are essential to understand individual income tax implications in China.

➢ Resident Taxpayer

According to China Individual Income Tax Law (the "**Law**"), a resident taxpayer refers to a person who is subject to Chinese individual income tax to the fullest extent by reason of his domicile within China or by reason of his stay in China for a prescribed period.

According to the Implementation Rules for the Law (the "**Implementation Rules**"), a foreigner may be deemed to have a domicile in China if he or she habitually resides in China by reason of household registration (*hukou* in Chinese), family, economic interests and etc.. But in practice, it is never clear to determine whether a foreigner should be considered a Chinese resident, even though the foreigner with their family may have bought a home and lived in China for many years.

Though without a domicile in China, a foreigner who has lived in China consecutively for more than five years (inclusive) shall be treated as a resident under the Law, provided however that he or she lives in China for a full calendar year (to be explicated later) in each of these consecutive five years.

➢ China Sourced Income

Literally, China Sourced Income means that the income is derived from China or is deemed to arise in China. Pursuant to the Implementation Rules, in the case of income of salaries, wages and other similar remuneration paid for employment exercised in China, ***regardless of where the employment is established and where such salaries and wages are paid, inside or outside China***, such income shall be deemed as China sourced income.

This is a critical point in analyzing an expat's liability for China individual income tax, as China sourced income will be always subject to China income tax, unless clearly exempted, even though such income may be physically paid to the employee in a foreign country. On the other hand, income sourced outside China shall be taxed by Chinese authority only in certain circumstances (to be elaborated below).

This is also the case in Sino-foreign income tax treaties. For example, if you look at Article 14 (dependant personal service) and Article 22 (elimination of double taxation) in the China-USA income tax treaty, you will arrive at the same conclusion.

II Explanation of the Table above

The table above sets out the basic legal framework of Chinese individual income taxation on salaries and wages derived by expats in China. For a complete understanding of table, the following points shall be taken into account.

1. When calculating the days of stay in China, the days on which the foreigner enters or exits China shall be computed as one whole day.

   In some cases, it is required to calculate the actual working period of an expat in China, the days on which the foreigner enters or exits China shall be computed as half a working day.

2. In the table, the 90-day period applies where the person in question is a national of a country which does not have a bilateral income tax treaty with China, and 183-day period applies when there is such

a bilateral income tax treaty. China has concluded such tax treaties with nearly forty countries worldwide including USA, Japan, South Korea, Australia, and major European countries like Germany, France, UK, Italy and Holland.

3. In the case of an expat staying in China less than 90 or 183 days (as the case may be), if the entity in which the expat works does not have revenue and therefore is not subject to enterprise income tax or its income tax is imposed based on assessed profits (as opposite to profits computed according to corporate financial books), the salaries and wages received by the expat during the working period in China, regardless of whether such income is recorded in the accounting books of the entity, shall be deemed as paid or borne by such Chinese entity, and therefore shall not be eligible for tax exemption.

   This issue arises in the case of foreign companies' representative offices in China that are very often subject to enterprise income tax based on profits assessed by tax authority, and also in the case of some construction projects whose profits are assessed rather than calculated according to accounting records.

4. In the case of expats staying in China more than 90 or 183 days (as the case may be) but less than 1 year, the salaries and wages derived from work performed outside China shall not be subject to China taxation even though such income may be paid by Chinese enterprises.

5. In the case of expats staying in China for 1 full year, salaries and wages received for work performed out of China and paid by foreign employers are exempted from China individual income tax.

   Here, 1 full year means residency in China for 365 days in a given calendar year. Temporary absence in China will not affect the computation of such a full year. Temporary absence means residing outside the PRC for more than 90 days cumulatively each calendar year or 30 consecutive days within a single calendar year.

6. The 5 years period in the table shall mean the foreigner has been residing in China for 5 years with a full year residency in each calendar year. An expat having resided in China for more than 5 years shall declare any and all income derived from employment and other economic activities to Chinese tax authority.

   However, if from the sixth year on, the expat resides in China for less than 90 or 183 days in a calendar year, such 5 years period shall be recalculated from the next full year.

III Tax Base and Tax Rate

Individual Income Tax Base/Taxable Income

Tax base of China individual income tax, or taxable income, for expats is calculated as the difference of your total amount of salaries and wages minus RMB 4800.

The total amount of salaries and wages include any year-end bonuses, profits distributed as reward of employment, allowances and subsidies and other remuneration resulted from employment or taking up positions. Salaries and wages may take the forms of cash, goods, securities and other economic interests.

In practice, social security insurances premiums contributed by the employers for employees are exempted from individual income tax, and the part of social insurance premiums contributed by employees out of their salaries and wages are to be deducted in computing tax base.

Very often, employees may receive certain amount of economic compensation from employers upon termination of labor contracts under China Labor Contract Law or pursuant to company policies. Such compensation is however also subject to individual income tax. Such compensation will be taxed as follows: the compensation will be divided by the number of years of employment, and the quotient thereof will be deemed as the monthly salary which income shall be taxed in accordance with general rules.

Individual Income Tax Rate

China has adopted a progressive tax rate system for individual income taxation.

Tax Grade	Monthly Taxable Income (RMB)	Rate
1	RMB ≤1500	3%
2	1500 < RMB ≤ 4500	10%
3	4500 < RMB ≤ 9000	20%
4	9000 < RMB ≤ 35000	25%
5	35000 < RMB ≤ 55000	30%
6	55000 < RMB ≤ 80000	35%
7	RMB > 80000	45%

IV Special Rules for Directors and Senior Management Personnel

China has been treating foreigners holding director, supervisor and other senior managerial positions in Chinese enterprises differently in respect of individual income tax.

Expats who serve as directors or other senior managerial positions in Chinese enterprises (including foreign invested enterprises), ***regardless of the length of holding of such positions and regardless of where, inside or outside China, they have performed their duties***, shall be subject to China individual income tax liability in respect of their director fees or salaries and wages ***paid by such Chinese enterprises*** during the period commencing from their taking up of such positions and ending on their removal or dismissal from such positions. Meanwhile, salaries and wages ***paid to such persons by foreign enterprises outside China*** shall be taxed in accordance with general rules described in the table above.

Rules regarding director fee shall also apply to supervisors. Senior management personnel shall encompass general manager or deputy general manager, chief officers of different functional departments such as CFO.

It shall be particularly noted that director fee is in nature a different type of income from salaries and wages. Director fee is deemed as income derived from independent personal service, subject to a flat tax rate of 20%, while salaries and wages are income derived from dependant personal service, subject to progressive tax rates set out above.

THE END

Expat individual income taxation is a very complicated legal and financial issue. There is much more to be discussed, such as questions relating to tax credit offered by bilateral income tax treaties, which will require a whole separate article to explain.

You are welcome to contact the author for legal advice relating to China individual income tax issues.

If you have any question about the discussion set out above, please contact the author, **Jason Tian**, in our Shanghai Office, at his email: doroto@163.com, OR, tianjie@zhongyinlawyer.com or give him a call at: +8621-68871787*8058, or +86-13816548421(MP) (Beijing Time)

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