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GMS Flash Alert

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People's Republic of China - More Guidance Implementing IIT Reform

The Ministry of Finance and the State Taxation Administration of the People's Republic of China (PRC) provided further guidance regarding the tax treatment of nonresidents and non-PRC-domiciled resident individuals on March 14, 2019.[1] Retroactively effective from January 1, 2019, Announcement No. 35 supplements the amended individual income tax (IIT) law and provides guidance on the following :

- Income-sourcing methods for calculating non-domiciled individuals' PRC-sourced assessable employment income;
- Methods for calculating non-domiciled individuals' PRC IIT;
- Application of Avoidance of Double Tax Agreements (DTA) for non-domiciled individuals;
- Rules on collection and administration of PRC IIT for non-domiciled individuals.

For prior coverage of guidance supplementing the IIT provisions, see GMS *Flash Alerts*: 2019-010 (January 23, 2019) and 2019-012 (January 25, 2019).

WHY THIS MATTERS

Announcement No. 35 clarifies various PRC IIT regulations for nonresidents and non-domiciled resident individuals, which differ from the pre-reform regulations. In particular, individual taxpayers and their withholding agents need to pay attention to the new method of determining what is PRC-sourced income and a different basis for calculating PRC IIT for non-domiciled individuals.

With the different IIT withholding methodologies for resident taxpayers and nonresident taxpayers, withholding agents need to assess and determine the residency status of their employees in order to withhold IIT properly.

Determining PRC-Sourced Income and PRC IIT Calculation Methods for Non-Domiciled Individuals

Determining PRC-Sourced Income

Announcement No. 35 clarified that the PRC-sourced employment income earned by non-domiciled individuals who are concurrently employed by domestic and overseas entities, or employed solely overseas, is determined based on the individuals' PRC work-days. Work-days in the PRC are calendar days spent in the PRC for business purposes. A stay in the PRC for less than 24 hours on a calendar day is counted as a half work-day.

Work-days in the PRC include calendar days physically spent in the PRC for business purposes, and public holidays, personal leave, and days spent in training that accrue to one's PRC employment, regardless of whether they are conducted inside or outside the PRC.

According to a non-domiciled individual's position and physical presence in the PRC, PRC-sourced employment income is calculated according to different formulas:

For a non-senior executive whose physical presence in the PRC does not exceed 90 days.

For a senior executive whose physical presence in the PRC does not exceed 90 days.

For a non-senior executive whose physical presence in the PRC exceeds 90 days but is less than 183 days.

For a senior or non-senior executive whose physical presence in the PRC exceeds 183 days but is less than six consecutive years.

After being a PRC tax resident for a period of six consecutive years, senior or non-senior executives will be subject to PRC IIT on worldwide income, except for individuals who have taken a single period of absence of more than 30 days within any calendar year of the six consecutive years concerned.

Further details, including formulas, can be found in the full March 2019 report.[2]

PRC IIT Calculation

Resident Taxpayer

Tax payable for annual comprehensive income = (annual salary income + annual independent personal services remuneration income + annual author's income + annual royalty income - deduction of expenses - itemised deduction - additional itemised deduction - other deductions stipulated by PRC IIT law) x applicable tax rate – "quick deduction."

Nonresident Taxpayer

Salary and wages earned by nonresident taxpayers are subject to monthly PRC IIT withholding at the rates outlined in the Appendix of the full March 2019 report after fewer deductions as stipulated by PRC IIT law.

Determining PRC-Sourced Income and PRC IIT Calculation Method for Bonus (Multiple-Month Performance Period) and Equity Income

PRC-Sourced Income

PRC-sourced bonus or equity income = bonus or equity income x corresponding work days in the PRC / corresponding calendar days of bonus or equity income's sourcing period.

PRC IIT Calculation

After determining the amount of income derived from the PRC, the tax amount for bonus and equity income for nonresidents is calculated as follows:

- For nonresident individuals who receive bonus amounts within a month, the tax payable is calculated separately from their monthly income, i.e., without combining it with wages and salaries in the same month, using the following formula:

  Tax payable for bonus = (bonus amounts ÷ 6) x applicable tax rate – "quick deduction" x 6

  In each calendar year, nonresident individuals can only apply this preferential tax treatment once.

- For nonresident individuals who receive equity income within a month, the tax payable is calculated separately from their monthly income, i.e., without combining it with wages and salaries in the same month, using the following formula:

  Tax payable for equity income for the current month = [(cumulative equity income in this calendar year ÷ 6) x applicable tax rate – "quick deduction"] x 6 – tax paid previously for equity income in this calendar year.

Application of Avoidance of Double Tax Agreement

Announcement No. 35 also clarifies that a non-domiciled individual who is defined as a tax resident of the country with which the PRC has a relevant DTA is eligible for the tax treatment of income from employment, independent personal services, or business profits as stated under the DTA, and is exempt from individual income tax in the PRC if all conditions are met.

When one of the following circumstances occurs for an individual who is a tax resident of a country which has a DTA with the PRC, the individual may elect to use the method for determining PRC-sourced employment income under the non-senior executives method instead of the method for senior executives:

- DTA concerned does not include the "director's fee" article; or

- The "director's fee" article is not applicable to the individual.

Royalties or Technical Services Fee

Income from royalties or technical services obtained by non-domiciled individuals may be subject to PRC IIT at the tax rate stipulated in the relevant DTA. For example, according to PRC IIT domestic law, a 20-percent tax rate is usually applied to royalties. However, under the DTA the PRC has concluded with certain countries, royalties may be taxed at a tax rate of 10 percent.

Tax Collection and Administration of PRC IIT

Determining Physical Presence in the PRC for Non-Domiciled Individuals

Non-domiciled individuals filing tax for the first time during a tax year will estimate their physical presence in the PRC for the tax year based on the relevant contractual agreement and personal circumstances to decide if they will be tax resident or nonresident and pre-pay the monthly IIT accordingly. If the actual situation differs from the initial estimate, the tax filing should be adjusted according to a summary table provided in the full March 2019 report.

Domestic Employer's Reporting Obligation for Non-Domiciled Individuals

Domestic employers in the PRC with non-domiciled individuals being paid PRC-sourced employment income by an overseas affiliated company must file a report with the tax bureau. The non-domiciled individual can self-report the PRC-sourced employment income or authorize the domestic employer in the PRC to assist with the monthly IIT reporting and withholding payment. If not authorized by the non-domiciled individual, the domestic employer is required to report the following relevant information to the local tax bureau within 15 days after the end of each month:

Work arrangement of the non-domiciled individual;

Overseas payments made to the non-domiciled individual;

Non-domiciled individual's contact details.

KPMG NOTE

Determining Source of Income

The new method of determining PRC-sourced income effectively reduces the probability of double taxation for non-domiciled individual. It also serves to reduce the tax costs for enterprises and individuals, and better aligns with current international practices.

Practical challenges remain in determining whether days when an individual is on holiday should be counted as part of the working period in the PRC. However, the tax bureau may be stricter in enforcing the reporting and counting of the number of days a non-domiciled individual is working in the PRC.

- Bonus (multiple-month performance period) and equity incentive income for non-tax residents and non-domiciled tax residents can be sourced to PRC according to the work-days spent in the PRC. This should reduce the likelihood of double taxation occurring due to the different sourcing rules of each country.

It remains unclear if similar rules can be applied to other special items, such as severance payments received by non-tax residents and non-domiciled tax residents.

More Reasonable Basis for Calculating PRC IIT for Non-Domiciled Individuals

The new PRC IIT calculation method should result in a more reasonable amount of income being included for PRC IIT for non-domiciled individuals, thus reducing their overall effective tax rates.

- Employers should adjust the PRC IIT withholding tax calculation for non-domiciled individuals. And, if after recalculating the taxes paid for January and February 2019, seek refunds from the local tax bureau or pay additional taxes in accordance with Announcement No. 35 in a timely manner.

Practical Implications Due to Change in Tax Residency in a Tax Year

While non-domiciled individuals are expected to do additional reporting and pay any unpaid taxes or seek relevant refunds, the procedures for doing this remain unclear. Thus, further clarifications are expected.

- It is important to closely track the travel patterns to the PRC of individuals on dual employment (DE) contracts to ensure that the relevant calculation methods for PRC IIT can be applied to achieve the intended tax savings.

Requirement for Non-Domiciled Individuals to Do Self-Reporting Will Reduce PRC IIT Withholding Obligations for Domestic Employers and Enhance Tax Compliance

Announcement No. 35 also abolished the obligation of domestic employers to withhold wages and salaries paid to their employees by their overseas affiliates. It is recommended that domestic employers communicate with and encourage the non-domiciled individuals (especially for those who are eligible for tax equalization policy, and whose PRC IIT is paid by the employer) to authorize them to assist with PRC IIT tax reporting and payment. This will help to reduce the risk of individual non-compliance.

Even absent authorization, it is important for employers of non-domiciled individuals to timely report the relevant information to the local tax bureaus.

Application of DTA

"Measures for the Administration of the Treatment for Nonresident Taxpayers by Tax Agreements" (Announcement No. 60 of the State Taxation Administration in 2015) is still valid after the release of Announcement No. 35, which also means that non-domiciled individuals can still enjoy the treatment under the DTA concluded provided that they meet all the relevant conditions, complete the required reporting, and provide the required information to the tax bureau in accordance with the requirements of Announcement No. 60.

For prior coverage, see GMS *Flash Alert* 2019-012 (January 25, 2019), which includes a table showing the IIT rate bands on monthly comprehensive income.

KPMG will continue to pay close attention to relevant regulations regarding the reform of individual income tax. All enterprises and taxpayers are welcome to contact the KPMG International member firm in the PRC for the latest developments in the reform of individual taxation in the PRC.

FOOTNOTES:

1 Announcement No. 35 of the State Taxation Administration, Ministry of Finance, 2019 (referred to hereinafter as "Announcement No. 35").

2 See "Supplementary guidance on tax treatment of nonresidents and non-PRC-domiciled residents are announced" in *China Tax Alert* (Issue 11, March 2019), a publication of the KPMG International member firm in the People's Republic of China.

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RELATED RESOURCE:

This article is excerpted, with permission, from "Supplementary Guidance on Tax Treatment of Nonresidents and Non-PRC-Domiciled Residents Are Announced," in *China Tax Alert* (Issue 11, March 2019), a publication of the KPMG International member firm in the People's Republic of China.

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