中國稅務及投資顧問有限公司
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# PRC Individual Income Tax

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1

## Relevant Legal Rules

1. Tax treaties（税收协定）
2. PRC Law for Individual Income Tax（法律）
3. Implementation Regulations of the PRC IIT Law（行政法规）
4. Circulars of the Ministry of Finance and the State Administration of Taxation（部门规章）

The legal authority ranks in descending order

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## Tax items in the IIT Law

1. incomes from wages and salaries;
2. incomes of private industrial and commercial households from their productions and business operations;
3. incomes from contracting or leasing enterprises and institutions;
4. incomes from remuneration for labor services;
5. incomes from authors' remuneration;
6. incomes from royalties;
7. incomes from interest, stocks dividends and bonuses;
8. incomes from lease of property;
9. incomes from transfer of property;
10. occasional incomes; and
11. other incomes specified as taxable by the department of the State Council for finance.

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## Determining the source of employment income

➢Where the employee works in China for less than 365 days in a calendar year, he/she is a non-tax resident.

➢The source of his income is determined as below:

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## Source of employment income (I)

The foreign nationals hired by Non-PRC Co to perform duties in China, in the absence of tax exemption, shall pay IIT with reference to the No. of days he works in China, irrespective of where he gets paid.

Source rule: Place where he exercises the employment, not the place where he gets paid (outside of China).

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## Source of employment income (II)

Where a foreign national is hired by a resident entity or permanent establishment, the income is taxable in China, irrespective of how long he/she works in China.

Source rule: Payment borne by resident entity or P.E.

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## Source of employment income (III)

Deemed income rules:

The foreign national has not entered into any employment contract with a resident entity (or PE), and the resident entity / PE does not have any record for the salaries, but he/she is deemed to have derived the income.

Deemed income rules apply where the resident entity/PE is exempted from income tax (i.e. chamber of commerce), or the entity / PE is taxed on a deemed profit rate basis.

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7

| Period of stay | Tax status | PRC Source Income | | Non-PRC source income | |
|---|---|---|---|---|---|
| | | Paid inside | Paid outside | Paid inside | Paid Outside |
| < 183 days | Non-resident | v | Exempt | x | x |
| => 183 days but < 365 days | Non-resident | v | V | x | x |
| 1~ 5 years | Resident | v | v | v | Exempt |
| Over 5 years | Resident | v | v | v | v |

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8

## Tax obligation – non tax residents

- Work inside China for < 183 days (possible exemption); or
- Work inside China for >183 days but <1 year

## Tax obligation – tax resident

- Work in China between 1 year and 5 years (possible exemption); and
- Work in China for over 5 years

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9

## 183-day exemption rule

Employee who works in China for less than 183 days in a year is exempted from income tax if the following conditions are satisfied:

1. The salary is not paid or borne by resident entity; or

2. The salary is not paid or borne by a permanent establishment set up in China

- Note: the provision for deeming rules

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10

## Determination of resident status

1. days of temporary absence is not included
2. "temporary absence" : stay outside China for < 30 days; or stay outside for an aggregate of < 90 days
3. The day of arrival or departure is counted as one day.

Note that the legal meaning differs from normal usage for captioned purpose.

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11

## Counting the No. of days in China

If the employee, who does not have residence in China, concurrently holds position a in resident entity and non-resident entity, or he/she only holds position in a non-resident entity, his day of arrival or departure is counted as half day.

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12

## Tax-exempt income (foreign employee)

- The employer bears the expenses and the service provider issues a tax invoice to the employee

| | | |
|---|---|---|
| 1. Meals | 2.Language training | 3.Laundry |
| 4. Rental | 5.Child education | 6.Transport |

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## Statutory Deduction

1. Basic deduction:RMB3500/month（RMB3,500 applying to locals, effective 2011-9-1）
2. Additional deduction:RMB1,300/month (applicable to foreign nationals)
3. Social security contributions (within statutory limits) See SAT document（2006）No.10.

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## Example 1: tax obligation

Q: A Japanese employee works as technical manager for a representative office. He stays in China for 140 days in the year. His salary is paid by the non-resident employer. The RO is taxed on a deemed profit rate basis. Is the employee required to pay tax?

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## Example 1: tax obligation

A: The employee is deemed to have derived income from China if the RO he works is taxed on a deemed profit basis. It is so even if there is no record of his salary in the books of the RO.

See SAT documents (1994) No. 148.

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## Individual Income Tax
## （the employee bears the tax）

| Taxable income | Rate | Quick deduction |
|---|---|---|
| <= 1500 | 3% | 0 |
| 1501-4500 | 10% | 105 |
| 4,501-9,000 | 20% | 555 |
| 9,001-35,000 | 25% | 1005 |

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## Individual Income Tax
## （the employee bears the tax）

| Taxable income | Rates | Quick deduction |
|---|---|---|
| 35,001-55,000 | 30% | 2,755 |
| 55,001-80,000 | 35% | 5,505 |
| ＞80,000 | 45% | 13,505 |
| | | |
| | | |

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## Individual Income Tax
(the employer bears the tax)

| Taxable income | Rate | Quick deduction |
|---|---|---|
| Less than1455 | 3% | 0 |
| 1,456-4,155 | 10% | 105 |
| 4,156-7,755 | 20% | 555 |
| 7,756-27,255 | 25% | 1005 |



## Individual Income Tax
(the employer bears the tax)

| Taxable income | rate | Quick deduction |
|---|---|---|
| 27,256-41,255 | 30% | 2,755 |
| 41,256-57,505 | 35% | 5,505 |
| Over 57505 | 45% | 13,505 |
| | | |
| | | |



## Example 2: Computation

An employee is assigned to work in Guangzhou. His monthly salary is HK$30,000 (RMB26,000 including RMB3,000 rental allowance). The employee is paid in Hong Kong.

The employee rents a flat in Guangzhou, paying a rental of RMB3,000 each month.



## IIT computation (employee bears tax)

➢Taxable income

= Salary - deduction – Tax exempt income

➢Tax payable

= Taxable income x rate* - quick deduction*

* Tax rate and quick deduction is dependent on income level



## Tax computation (employee bears tax)

Taxable income = RMB26,000 - RMB4,800 - RMB3,000 = RMB18,200 (each month)

Tax payable = RMB18,200 x25% -1005

=RMB3,545



## Tax computation (employer bears tax)

Taxable income = (salary – Statutory deduction – tax exempt income – quick deduction) / (1 - rate)

Tax payable = taxable income x rate* - quick deduction*

* Tax rate and quick deduction is dependent upon taxable income.

Tax computation (employer bears tax)

Taxable income = (RMB26,000 - RMB4,800 - RMB3,000 - 1,005) / (1 - 25%) = RMB22,926.67 (monthly)

Tax payable = RMB22,926.67 x 25% - 1,005

= RMB4,726.67



## Example 3: Bonus computation

The HK employee gets a year-end bonus of HK60,000 (RMB52,000), the IIT payable is：

The amount of bonus is divided by 12 months. RMB52,000 / 12 = RMB4,333.33， and then using the quotient to determine the applicable rate and quick deduction



## Tax computation for year-end bonus (employee bears tax)

Taxable income

= Bonus (no statutory deduction)

= RMB52,000



## Tax computation for year-end bonus (employee bears tax)

Tax payable = Taxable income x rate * - quick deduction *

= RMB52,000 x 10% - 105 = RMB5,095

* Tax rate and quick deduction very with taxable income



## Tax computation for year-end bonus (employer bears tax)

Taxable income = (bonus – quick deduction * ) / (1 – tax rate * )

Tax payable = taxable income x tax rate – quick deduction



## Example 4: Determine taxable income

Mr. A who works for a HK Co is sent to work in Shanghai as general manager. His salary is HK$70,000 / month. HK$40,000 is paid in HK, and the equivalent amount of RMB is paid in China. His tax position is as follows:

Source rule: income derived from exercise of employment inside China is PRC-source income.



 

## Determining taxable income(1)

Mr. A's HK30,000 is fully taxable in China. The tax position of the other HK$40,000 depends on the following:

Source rule: payment borne by resident entity is PRC source Income.



## Determining taxable income(2)

Scenario 1:

If A stays outside China for period not exceeding 30 days (or for period aggregating > 90 days), then A is tax resident. Accordingly, his other HK$40,000 is taxable in China.



## Determining taxable income(3)

Scenario 2

If he works in SH for less than 183 days in a year, then he gets tax exemption for the amount he receives outside China.



## Determining taxable income(4)

Scenario 3

If he works Say 200 days (It is over 183 days but less than 275 days (i.e.365-90)), then his taxable income is determined by reference to the no. of days he stays in China. That is 200/365 x 40,000 = HK$21,918, to be converted into RMB.



## Example 5: lawful way of avoiding worldwide tax

Q: How can the employee who already worked in China for 5 years avoid paying tax on non-PRC source income?

A: In the fifth year of stay, the employee can leave China for a continuous period of 30 days, or leave for 90 days if the absence from China is not continuous.

The employee will be exempt from non-PRC source income (not received in china). 5-year period will start again the 6$^{th}$ year.



## Example 6: director's remuneration

The director of a wholly foreign owned enterprise receives a director's fee of RMB80,000. He is subject to tax at progressive rates:
Taxable income = RMB80,000 – (1– 20% statutory deduction) = RMB64,000
Tax payable = RMB64,000 x 20% = RMB12,800;
(50,000 – 20,000) x 20% x 50% = 3,000;
(64,000 – 50,000) x 20% x 100% = 2,800;
Total: 12,800 + 3,000 + 2,800 = 18,600

## Tax rates and income brackets (Applicable to provision of services)

| | Brackets | rate | Quick ded'n |
|---|---|---|---|
| 1 | Not exceeding 20,000 | 20% | 0 |
| 2 | Between 20,000 and 50,000 | 30% | 2,000 |
| 3 | Over 50,000 | 40% | 7,000 |

Tax payable = [80,000 x (1-20%) =64,000] x 40% - 7,000 = 18,600

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## Example 7: director's remuneration

Q: If the director only visits China for a few days in the year, what is his tax position?

A: The director's fee is PRC-source income. According to SAT document (1994) No.148, the income can be taxed on a time apportioned basis.

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## Directors and Senior managers

- The 183-day rule shall not apply
- Income is ascertained by reference to the No. of days he/she stays in China

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## Example 8: tax on share options

1. Gain arising from difference between market price and exercise price on the exercise day falls under scope of salary income.
2. Profit from transferring the option right is salary income.
3. Dividend received from owning the shares: dividend income.
4. Gain from disposal of shares(selling price – purchase price): gain from disposal of properties

Income from item 1 and 2 can be apportioned by reference to the No. of days the employee works in China.

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## Computation method: gain on exercise of option rights

Taxable income = (Market price - price payable by employee) x No. of shares

Tax payable＝Taxable income x tax rate – quick deduction

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## Example 9: Computing share option income

A listed Company grants a senior employee an option to acquire 100,000 shares in 5 year's time with an exercise price of RMB1.00 each share. In the 3rd year, the market price of the Company's share is RMB5.5. The employee exercises the right and sell all the shares in the market, making a profit of 4.5 each share.

According to document CaiShui (2005) No. 35, the taxable income is RMB450,000 = 100,000 x (5.5 –1)

Per tax table, the applicable rate is 45% and quick deduction co-efficient is 13,505, the taxable income is 450,000×45％ - 13,505 = 188,995.

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## Employer's Legal Obligation

- Withholding at source
- Scope of withholding: employee's remuneration, director's remuneration, payment to independent contractors
- Other deductions: employee's Social security contributions, court's payment order）

Tax exemption: compensation paid in Company's liquidation is exempt, but is capped at a level equal to 3 times' average annual salary in the city.

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## Self-declaration

- Scope: self-declaration shall apply to following individuals

1. Annual income exceeding RMB120,000
2. Receiving salaries or bonuses from two or more entities in China
3. Deriving income from outside China
4. Deriving PRC-source income without a withholding agent

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## Self-declaration

- Those who have the obligation to pay IIT: having a permanent home, or having lived for one year in China for those without a permanent home.
- Exemption: excluding those who do not have a permanent home in China and those who do not stay in China for one year in a tax year.

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## Scope of declaration

1. incomes from wages and salaries;
2. incomes of private industrial and commercial households from their productions and business operations;
3. incomes from contracting or leasing enterprises and institutions;
4. incomes from remuneration for labor services;
5. incomes from authors' remuneration;
6. incomes from royalties;
7. incomes from interest, stocks dividends and bonuses;
8. incomes from lease of property;
9. incomes from transfer of property;
10. occasional incomes; and
11. other incomes specified as taxable by the department of the State Council for finance.

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## Location and time to Declare

- Deadline: 3 months after end of tax year.
- Place: (I) the tax authority in charge of the company for which the employee works. If there are two or more employers, just choose one to declare; (2) Those earning with income from non-PRC company shall declare to tax authority in the city in which the employee has the household registration (户籍). If the household registration is different from the city where the employee usually lives, declare to the tax authority in the second-mentioned city.
- Way to declare: electronic filing (retain hardcopy), mail, declaring in person or by the tax agent
- Legal responsibility: RMB2,000 to RMB10,000 for non-compliance.

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## Example 10: Tax equalization plan

- A HK Co assigns an employee to work in China's representative office for 2 years. The excess portion of tax payable over the HK tax he would have paid if he had worked in HK is borne by the HK Company. Show (i) how to compute the hypothetical tax and (ii) how the employee pays the tax.
- the Company should declare the IIT in China as follows: Salaries after deducting hypothetical tax x exchange rate. Then the amount is converted into taxable income using a formula, according to SAT document (1994) No. 89 and (1996) No. 199,

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## Example 10: Tax equalization plan

- Next, the HK Company should deduct the hypo tax from the gross pay of the employee in HK. The hypo tax is computed with reference to HK tax rules.
- The employee works in China, but he pays tax as if he is still working in Hong Kong.

Note the limitation in Tax Equalization Plan

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49

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**Thank you**

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50