

PRC Individual Income Tax

Alfred K. K. Chan

Singapore

5th September 2006

1

PRC in IIT – Agenda

- PRC tax and Non-PRC tax resident
- 183-day exemption rules
- Dividing lines between residence & non-residence
- Tax rates
- Specific tax rules on: year-end bonus
- Deductions and exempted items
- Taxation on director's fee
- Withholding obligations

➤ Tax saving plan
www.china-tax.net

2

Tax rule on residence

- A PRC-domiciled individual is a tax resident for PRC IIT Law purpose.
- A non-PRC domiciled individual who physically stays and works in the PRC for 365 days in a calendar year is regarded as a tax resident in the PRC as well.

www.china-tax.net

3

What constitutes domicile?

- An individual is PRC-domiciled if he/she lives in the PRC because the individual has a household registration, family ties, or economic interests and relations in the PRC.
- <Article 2 of the Implementation Regulations of the PRC IIT Law>

www.china-tax.net

4

The tax liability on resident

- Resident employee is subject to tax on all of his/her employment income derived from employment inside and outside the PRC .
- No count is taken of any "temporary absence" in calculating the number of days under the 365-day rule.

www.china-tax.net

5

Temporary absence

- Temporary absence is a legal term, which is interpreted in a different way from the normal daily usage.
- The threshold for temporary absence is 30 days for a continuous absence in the tax year; or a total of 90 days in the calendar year if the absence is not continuous.
- <Article 3, Detailed Implementation Regulations>

www.china-tax.net

6

Temporary absence

- The IIT law deems the employee to stay inside the PRC national boundary in spite of the fact that the employee is physically absent in the PRC during the period of temporary absence.

PRC source rules in IIT

- Foreign nationals, employed by foreign company to exercise employment in the PRC, shall pay IIT irrespective of where he/she receives the income, in proportion to number of days he/she works in the tax year.
- Foreign national who enters into employment contract with an FIE should pay IIT irrespective of how long he/she works in the tax year.

The 183-day Exemption Rule

The 183-day exemption rule

If the employee stays in the PRC for a period not exceeding 183 days in a calendar year, the employee will not be subject to income tax subject to the following conditions being satisfied:

- (a) the salary is not borne by any entity inside the PRC; and
- (b) the salary is not paid by any entity inside the PRC.

The 183-day exemption rule

- The tax exemption period for foreign nationals who are residents of a non-PRC treaty country will be shortened to 90 days in a calendar year.
- The 183-day rule shall not apply to directors and employees holding senior positions in the FIE or a resident permanent establishment (PE).
- The directors or chief representative are subject to IIT throughout the period of their office or contract of services.

Example (1)

Scope of 183-day Rule

A foreign national holding a position as technical manager with a representative office, stays 80 days in the PRC. The RO is granted exemption from Chinese IT since it is not engaged in any business activities.

What is the tax position of the technical manager?

www.china-tax.net

13

Scope of 183-day Rule

A Japanese holding a position as technical manager with a representative office, stays 180 days in the PRC. The RO is subject to Chinese IT tax on a deemed profit basis.

What is the tax position of the technical manager?

www.china-tax.net

14

Deeming provision

- The salary is deemed to have borne by (charged to) the entity set up in the PRC if the entity is subject to Chinese IT on a deemed profit basis;
- The salary is deemed to have borne by (charged to) the entity set up in the PRC if the entity is exempted from Chinese IT.
- The deeming provision operates whether or not the salaries are recorded in the books of accounts.
- <Guo Shui Fa (1994) No. 148>

www.china-tax.net

15

Example (2A) Split Contract

Peter, who is an employee of a Hong Kong company, is required to work as the marketing manager in the Shanghai subsidiary of a Hong Kong Co. The monthly remuneration package including allowances is as follows:

- Peter will receive HK\$50,000 per month.
- HK\$30,000 is paid by Hong Kong Co, and RMB equivalent to HK\$20,000 is paid by SH Co.

www.china-tax.net

16

Example (2B) Split Contract

The position of his income tax will be as below:

- The amount of HK\$20,000 is taxable as it is borne by an entity in the PRC.

Q : What is the IIT liability for the amount of \$30,000 paid by Hong Kong?

A : It depends on whether Peter is a tax resident or non-resident.

www.china-tax.net

17

Scenario One

- Peter is a tax resident if stays in the PRC throughout the year.
- The whole amount of \$20,000 paid by the Shanghai company will be taxable.

www.china-tax.net

18

Scenario Two

➤ Peter is a non-tax resident if he stays in the PRC for the a period of less than 365 days

(a) Period of stay < 183 days in a calendar year

➤ \$30,000 will be exempted from tax.

Scenario Two (continued)

(b) Period of stay => 183 days in a calendar year (say 200 days)

➤ the \$30,000, converted into RMB, will be liable to IIT in proportion to the number of days he stays in the PRC.

➤ Taxable income = \$30,000 x 200 / 365 = \$16,438

Period of stay	Tax Status	PRC-source		Non-PRC source	
		Paid in PRC	Paid outside	Paid inside	Paid outside
< 90 days (or 183 days)	Non-resident	✓	exempt	x	x
=> 90 days (or 183 days)	Non-resident	✓	✓	x	x
1 ~ 5 years	Resident	✓	✓	✓	x
Over 5 years	Resident	✓	✓	✓	✓

Defining Residence

➤ Scope of application: non-PRC domiciled individual staying in the PRC

➤ Counting of days: day of arrival, and day of departure shall be counted as one day respectively

➤ Purpose: to determinate residence or non-residence status

➤ See <Guo Shui Fa (2004) 097>

Determination of working days

➤ Scope of application: Non-PRC domiciled individual who holds positions both in the PRC Co and overseas Co, or who only holds position in overseas Co

➤ Counting of days: day of arrival, and day of departure shall be counted as half day respectively.

➤ See <Guo Shui Fa (2004) 097>

Determination of Period of Stay

Types of employer	Days to be counted
If employed by entity in the PRC	Rest days, annual leaves, days receiving training
If employed by entity outside the PRC	Rest days only

See SAT document Guo Shui Han Fa (1995) No. 125

Tax Rates

PRC Income Tax Rates and Brackets (In RMB):

Tax Borne by Employee	Tax Borne by Employer	Tax Rate	Quick Deduction
Less than 500	Less than 475	5%	0
501-2,000	476-1,825	10%	25
2,001-5,000	1,826-4,375	15%	125
5,001-20,000	4,375-16,375	20%	375

PRC Income Tax Rates and Brackets (In RMB):

Tax Borne by Employee	Tax Borne by Employer	Tax Rate	Quick Deduction
20,001-40,000	16,376-31,375	25%	1,375
40,001-60,000	31,376-45,375	30%	3,375
60,001-80,000	45,376-58,375	35%	6,375
80,001-100,000	58,376-70,375	40%	10,375
Over 100,000	Over 70,375	45%	15,375

Computation of IIT (1)

An employee is assigned to work in Guangzhou. Monthly salary is HK\$25,000 (=RMB26,000, including housing allowance of RMB3,000). Company pays salary outside the PRC

The employee rents a flat in GZ, and obtains a tax invoice from the landlord.

IIT Computation - Employee bears tax

Taxable income
= Salary – Standard deduction – tax-exempt income

IIT payable
= taxable income x tax rate – quick deduction *

* Tax rate and quick deduction vary with different income brackets.

IIT Computation - Employee bears tax

Taxable income
= RMB26,000 - RMB4,800 - RMB3,000
= RMB18,200

Tax payable = RMB18,200 x 20% - 375
= RMB3,265 per month

IIT Computation – Employer bears tax

Taxable income
= (Income – standard deduction – tax-exempt
income – quick deduction) / (1 – tax rate)

IIT payable
= Taxable income x tax rate – quick deduction

www.china-tax.net

31

IIT Computation – Employer bears tax

$$TI = (\text{RMB}26,000 - \text{RMB}4,800 - \text{RMB}3,000 - 1,375) / (1 - 25\%)$$

$$= \text{RMB}22,433.33$$

IIT payable = $\text{RMB}22,433.33 \times 25\% - 1,375$
= $\text{RMB}4,233.33$

www.china-tax.net

32

Taxation on Year-end Bonus

www.china-tax.net

33

IIT computation - Year-end bonus

The employee is paid a year-end bonus of HK\$50,000 (RMB52,000). The liability for IIT is computed as below:

Dividing the bonus by 12, then the quotient is used to determine the tax rate and quick deduction.
 $\text{RMB}52,000 / 12 = \text{RMB}4,333.33$

www.china-tax.net

34

IIT computation - Year-end bonus

Taxable income
= Year-end bonus (No standard deduction)
= $\text{RMB}52,000$

Note that the standard deduction $\text{RMB} 4,800$ shall not apply here.

www.china-tax.net

35

IIT computation - Year-end bonus

IIT payable
= taxable income x tax rate – quick deduction
= $\text{RMB}52,000 \times 15\% - 125^*$
= $\text{RMB}7,675$

* Tax rate and quick deduction is based on 4,333.33

www.china-tax.net

36

Statutory deduction & Items exempted from IIT

Statutory Deduction

- Standard deduction RMB1,600 <Article 27 of the Implementation Regulations of PRC IIT Law>
- Addition deduction RMB3,200 < Article 29 of the Implementation Regulations of the PRC IIT Law >
- Social security contributions within prescribed limits <Guo Shui Fa (2006) No. 10>

Exempted Items

The following items with supporting tax invoices, See SAT document Guo Shui Fa (1997) No. 54

- Housing allowance
- Meal subsidies
- Removal expenses (taking up or finishing assignment)

Exempted Items (Continued)

- Laundry expenses
- Reasonable business travel expenses within and outside PRC
- Home passage (once in a year)
- Language training fees
- Child education fees

Directors' Fee

Taxation on directors' fee

Directors' fee and remuneration of senior staff, is subject to tax as an independent service provider <Guo Shui Fa (2004) No. 097>

- Standard deduction (SD): 1,600 for income not exceeding 4,000
- SD: 20% for income of 4,000 or above

Tax Rates (Independent Services)

	Income brackets	Tax rates (in %)	Quick Deduction
1	Not exceeding 20,000	20	0
2	20,000 to 50,000	30	2000
3	Over 50,000	40	7000

www.china-tax.net

43

Illustrated Example

The director of an FIE receives a fee of RMB80,000 in the year.

$$\text{Taxable income} = 80,000 - (1 - 20\%) = 64,000$$

$$\begin{aligned} \text{IIT payable: } & 64,000 \times 20\% = 12,800 \\ & (50,000 - 20,000) \times 20\% \times 50\% = 3,000; \text{ and} \\ & (64,000 - 50,000) \times 20\% \times 100\% = 2,800 \\ & 12,800 + 3,000 + 2,800 = 18,600 \end{aligned}$$

www.china-tax.net

44

Illustrated Example

Alternatively, the computation can be done by using the quick deduction as below:

$$\text{IIT payable} = 64,000 \times 40\% - 7,000 = 18,600$$

www.china-tax.net

45

Withholding Obligation

IIT Withholding Obligation

- Resident employer is under legal obligation to withhold IIT from before-tax income <Article 8, IIT Law>
- Resident employer should submit IIT declarations and pay IIT within 7 days after end of each month. <Article 9, IIT Law>

www.china-tax.net

47

Deduction from Wages/Salaries

The following items are deductible from wages and salaries:

1. Individual Income Taxes;
2. Social Security Contributions;
3. Payment Order Issued by People's Court (Payment of Alimony, etc);
4. Other Items as Provided under Law
<Payment of Wages Tentative Rules, Lao Bu Fa (1994) No. 489, PRC Ministry of Labor & Social Securities>

www.china-tax.net

48

Tax Saving Plan

- 183-day Rules
- Remuneration package includes non-taxable items (housing allowance, etc)
- Taking advantage of temporary absence provision to avoid tax on worldwide income after working in PRC over 4 years.
- Tax equalization schemes; employee can pay tax as if working at home
- Employment contract vs. service agreement

www.china-tax.net

49

Thank You

alfred@china-tax.net

Tel : 852-2374-0067

Website: www.china-tax.net

50