

Human resource & Tax alert

Tax regulations for non-domiciled individuals are released

Executive Summary

The Ministry of Finance (MOF) and the State Administration of Taxation (SAT) recently issued Announcement [2019] No. 34, which is an Announcement regarding the determination of the length of residence for non-domiciled individuals (hereinafter referred to as "Announcement 34") and Announcement [2019] No. 35, Announcement on individual income tax (IIT) policies for non-resident and non-domiciled individuals (hereinafter referred to as "Announcement 35"), which summarizes the IIT treatments on non-domiciled individuals under the new IIT law. The above regulations took effect from 1 January 2019.

This alert aims to elaborate on the detailed contents and implications brought about by the announcements.

Key Content

Announcement on the determination of length of residence for non-domiciled individuals

The rules in determining the length of residence for non-domiciled individuals are as below:

1. If a non-domiciled individual resides in mainland China ("China") for 183 days or more in a tax year, he will be subject to PRC IIT on both China and non-China sourced income provided that the individual resided in mainland China for 183 days or more in each of the preceding 6 years without being absent from China for more than 30 days consecutively in any of the preceding 6 years. If in any of the preceding 6 years, the individual resided in China for less than 183 days or was absent from China for 30 days consecutively, the non-China sourced income received in the tax year will be exempt from PRC IIT if it is paid by overseas enterprises, organizations or individuals.
 "Preceding 6 years" refers to the six consecutive years from the preceding year of the tax year to the preceding 6th year of the tax year, which is counted from 2019 and onwards.
2. A stay in mainland China of 24 hours shall be counted as a China day while a stay in mainland China of less than 24 hours shall not be counted as a China day.

Announcement on IIT policies for non-resident and non-domiciled individuals

1. Providing the rules to determine the source of income
 - 1) Announcement 35 provides the rules to determine the income source for wages and salaries, several-month bonus and equity income, remuneration received by member of board of directors, member of supervisory board and senior management, which are summarized below:

Income Type	Source of income
Wages and Salaries	China sourced wages and salaries refer to the wages and salaries earned by the individual attributable to China working periods
Several-month bonus and equity income	China sourced several-month bonus and equity income refer to the several-month bonus and equity income earned by the individual attributable to China working periods
Remuneration received by member of board of directors, member of supervisory board and senior management	For Individuals who act as members of board of directors, members of supervisory boards and senior management (hereinafter referred to as "Senior management") of a Chinese resident enterprise, the directors' fees, supervisors' fees, wages and salaries and other remuneration (hereinafter referred to as "Senior management remuneration," including several-month bonus and equity income) paid or borne by the Chinese resident enterprises, are China sourced income, regardless whether they are performing their duties in China

- 2) Announcement 35 also elaborates on the definition of “China working period,” non-China working period as well as how to determine China sourced income and non-China sourced income:
- ▶ A China working period is computed based on the number of working days in China, including actual working days in China as well as public holidays, annual leave and training days in and outside China, which are taken during the period working in China
 - ▶ For individuals who hold roles both inside and outside China or individuals who are only employed by foreign employers, if they stay in China for less than 24 hours in a day, half of the day will be counted as a China working day. In other words, the departure day from China and arrival day into China are both counted as a half day of China working day
 - ▶ For individuals who hold roles both inside and outside China or individuals who are only employed by foreign employers and work inside and outside China in the same period, the China sourced and non-China sourced income is apportioned based on the number of China or non-China working days over the total number of days in the relevant period respectively
- 3) In addition, the determination of income source for several-month bonus and equity income is as follows:
- ▶ Several-month bonus or equity income received by non-domiciled individuals when they performed duties in China for previous periods that were during non-China working periods are considered to be non-China sourced wages and salaries
 - ▶ Any several-month bonuses or equity income received by non-domiciled individuals after they have stopped performing duties in China and have left China but who have conducted work during previous periods that are listed as “China working periods” is considered as “China sourced wages and salaries.”
 - ▶ Calculation method: Total amount of several-month bonus or equity income times the number of China working days during the attributable period over the total number of days during the attributable period.
 - ▶ When a non-domiciled individual receives, in one month, a few several-month bonuses and equity income that are attributable to several different periods, China sourced income should be calculated for each single income and then aggregated to be the monthly total China sourced income

2. Elaborating on the calculation method for taxable wages and salaries for non-domiciled individuals:

- 1) Where a non-domiciled individual is not in senior management, the wages and salaries received by the individual shall be calculated based on the methods below:

China days in a tax year for the non-domiciled individual	Taxable Income	Calculation formula for current-month wages and salaries
No more than 90 days	Wages and salaries paid or borne by domestic employer attributable to China working period	<p>Formula 1:</p> $\text{Current month wages and salaries} = \frac{\text{Current month China sourced and non-China sourced wages and salaries}}{\frac{\text{Current month wages and salaries paid in China}}{\text{Current month China sourced and non-China sourced wages and salaries}}} \times \frac{\text{China working days in the current month}}{\text{Total days in the current month}}$
More than 90 days but less than 183 days	Wages and salaries attributable to China working period	<p>Formula 2:</p> $\text{Current month wages and salaries} = \frac{\text{Current month China sourced and non-China sourced wages and salaries}}{\frac{\text{China working days in the current month}}{\text{Total days in the current month}}}$
No less than 183 days but less than 6 consecutive years of residency	All wages and salaries, except for the portion paid by overseas employer or individual and attributable to non-China working period	<p>Formula 3:</p> $\text{Current month wages and salaries} = \frac{\text{Current month China sourced and non-China sourced wages and salaries}}{\left[1 - \frac{\text{Current month wages and salaries paid outside China}}{\text{Current month China sourced and non-China sourced wages and salaries}} \right] \times \frac{\text{Non-China working days in the current month}}{\text{Total days in the current month}}}$
No less than 6 consecutive years of residency, and	All China sourced and non-China sourced wages and salaries	All China sourced and non-China sourced wages and salaries are subject to PRC IIT.

2) Where a non-domiciled individual is in senior management, the wages and salaries received by the individual shall be computed based on the methods below:

China days for the non-domiciled senior management (in a tax year)	Taxable Income	Calculation formula for current-month wages and salaries
No more than 90 days	Wages and salaries paid or borne by domestic employer	Current month wages and salaries refer to the wages and salaries paid or borne by domestic employer.
More than 90 days but less than 183 days	All wages and salaries, except for the portion not paid or borne by domestic employer and attributable to non-China working period	Formula 3: $\text{Current month wages and salaries} = \text{Current month China sourced and non-China sourced wages and salaries} \times \left[1 - \frac{\text{Current month wages and salaries paid outside China}}{\text{Current month China sourced and non-China sourced wages and salaries}} \times \frac{\text{Non-China working days in the current month}}{\text{Total days in the current month}} \right]$
No less than 183 days but less than 6 consecutive years of residency	All wages and salaries, except for the portion paid by overseas employer or individual and attributable to non-China working period	Formula 3: $\text{Current month wages and salaries} = \text{Current month China sourced and non-China sourced wages and salaries} \times \left[1 - \frac{\text{Current month wages and salaries paid outside China}}{\text{Current month China sourced and non-China sourced wages and salaries}} \times \frac{\text{Non-China working days in the current month}}{\text{Total days in the current month}} \right]$
No less than 6 consecutive years of residency	All China sourced and non-China sourced wages and salaries	All China sourced and non-China sourced wages and salaries are subject to PRC IIT.

3. Defining the rules to compute tax liability for non-domiciled individuals

1) Rules to compute tax liability for resident individuals

- ▶ Where a non-domiciled resident individual receives consolidated income, individual income tax shall be computed on an annual basis after year end. Where there is a withholding agent, the withholding agent shall perform pre-withholding on a monthly basis or per time. Where an annual reconciliation is required, the annual reconciliation shall be performed in accordance with relevant provisions and annual consolidated income shall be computed based on the formula below (Formula 4):

Annual consolidated income = (annual wages and salaries + annual income from remuneration for personal services + annual author's remuneration + annual royalties - deductible expenses - special deductions - specific additional tax deductions - other deductions stipulated by laws and regulations) x tax rate - quick reckoning deduction

- ▶ Where a non-domiciled resident individual is a foreign individual and the eight types of tax-exempt benefits, such as housing subsidies, children education, language training, etc. have been excluded from the taxable wages and salaries before 1 January 2022, special additional tax deductions cannot be claimed at the same time.

2) Rules to calculate tax liability for non-resident individuals

- ▶ Wages and salaries received by non-resident individuals for the current month shall be calculated in accordance with the provisions in the announcement, and the monthly standard deduction of RMB5,000 should be deducted to reach the taxable income. Monthly tax rate table shall be applied to calculate the tax liability.
- ▶ When a non-domiciled individual receives a several-month bonus, China sourced income should be calculated based on this announcement and PRC IIT should be calculated separately from their regular monthly salary. No deductions are allowed; it should be evenly divided into six instalments and IIT should be calculated using the monthly tax rates. This method should be used once a year and the formula (Formula 5) is as shown below:

Tax payable on several-month bonus received in a month = [(several-month bonus ÷ 6) × tax rate - quick reckoning deduction] x 6

- ▶ When a non-domiciled individual receives equity income, China sourced income should be computed based on this announcement and PRC IIT should be computed separately from their regular monthly salary. No deductions are allowed; it should be evenly divided into six instalments and IIT should be computed using the monthly tax rates. This method should be used once a year and the formula (Formula 6) is as shown below:

Tax payable on equity income received in a month = [(aggregated equity income in the calendar year ÷ 6) × tax rate - quick reckoning deduction] x 6 - tax already paid on equity income in the calendar year

4. Elaborating the rules on the application of double tax treaties for non-domiciled individuals

Based on “Resident Clause” in the agreements for the avoidance of double taxation and arrangements for the avoidance of double taxation with Hong Kong and Macau (hereinafter referred to as “double tax treaties”), where an individual is a resident of the other contracting state,

the individual can choose to receive relevant treaty benefits in accordance with the double tax treaty and other provisions stipulated by MOF and SAT or choose not to receive the relevant treaty benefit when computing tax liability.

Provisions are summarized below for non-domiciled individuals to enjoy tax treaty treatments:

Relevant clauses	Provisions in the double tax treaty	Relevant Provisions in the Announcement
Dependent personal services	Treaty benefit on overseas dependent personal services income	
	Non-China sourced dependent personal services income received by a resident of that other contracting state can be tax exempt in China.	<ul style="list-style-type: none"> ▶ Where a non-domiciled individual is a resident of that other contracting state, wages and salaries can be tax exempt in China if treaty benefit on overseas dependent personal services income is applied. The individual can enjoy the treaty benefit at the time of pre-withholding (for resident individuals) or when the income is received (for non-resident individuals). ▶ Formula 2 shall be adopted in computing taxable income of wages and salaries.
	Treaty benefit on domestic dependent personal services income	
	Where a resident of that other contracting state resides in China for no more than 183 days in the contracting period based on the double tax treaty, China sourced dependent personal services income can be tax exempt in China if it is not paid or borne by the domestic resident employer or a permanent establishment.	<ul style="list-style-type: none"> ▶ Where the non-domiciled individual is a resident of that other contracting state, wages and salaries can be tax exempt in China if treaty benefit on domestic dependent personal services income is applied. The individual can enjoy the treaty benefit at the time of pre-withholding (for resident individuals) or when the income is received (for non-resident individuals). ▶ Formula 1 shall be adopted in computing taxable income of wages and salaries.
Independent personal services	Independent personal services income received by a resident of that other contracting state can be tax exempt in China if he meets the conditions stipulated in the double tax treaty.	Where the non-domiciled individual is a resident of that other contracting state, income from remuneration for personal services can be tax exempt in China if treaty benefit on independent personal services income is applied. The individual can enjoy the treaty benefit at the time of pre-withholding (for resident individuals) or when the income is received (for non-resident individuals).
Directors' fees	Directors' fees or senior management remuneration received by a resident of that other contracting state can be taxed in China in accordance with relevant provisions for wages and salaries or income from remuneration for personal services if he meets the conditions stipulated in the double tax treaty.	<ul style="list-style-type: none"> ▶ Where a resident of that other contracting state is a member of board of directors while the relevant double tax treaty doesn't include the clause for directors' fees, the senior management remuneration shall apply relevant provisions in the above clauses for dependent personal service and independent personal services or business profits. ▶ Where a resident of that other contracting state is a senior management but not a member of board of directors while the clause for directors' fees in the relevant double tax treaty doesn't include provisions for senior management, the senior management remuneration shall apply relevant provisions in the above clauses for dependent personal service and independent personal services or business profits. ▶ Where a resident of that other contracting state is a senior management, if the senior management remuneration can be taxed in China based on the clause for directors' fees in the double tax treaty, it shall be taxed in accordance with provisions in 2-2) in the announcement.

5. Defining the rules on the tax collection and management for non-domiciled individuals

1) Rules on the anticipated China days

▶ When a non-domiciled individual performs tax filing for the first time in a tax year, the individual can estimate China days in the tax year and in the period stipulated by double tax treaties based on the terms in the employment contract, etc. and compute tax liability based on the estimated situation. If the actual situation differs from the estimated situation, the following provisions shall apply:

- a) Where a non-domiciled individual is pre-determined as a non-resident but becomes a tax resident due to extended China presence, the withholding method will remain unchanged during the tax year. The individual should perform annual reconciliation filing after year end in accordance with relevant provisions for resident individuals. However, if the individual leaves China and is not expected to enter into China in the tax year, the annual reconciliation filing can be performed before he leaves China.
- b) Where a non-domiciled individual is pre-determined as a tax resident but becomes a non-resident due to shortened China presence, the individual shall report to the in-charge tax authority and re-calculate tax liability based on the provisions for non-resident individuals from the day he will not qualify as a resident to the 15th day after year end. The underpaid tax liability shall be settled and no interest surcharge will be imposed. If tax is overpaid, he can apply for tax refund.
- c) Where a non-domiciled individual is pre-determined as non-resident and the China days is anticipated to be no more than 90 days in a year or 183 days in the contracting period based on the double tax treaty, the individual shall report to the in-charge tax authority and re-calculate tax liability on the wages and salaries for the previous months within 15 days after the end of the month when the actual China days exceeds 90 days or 183 days. The underpaid tax liability shall be settled and no interest surcharge will be imposed.

2) Rules on domestic employers reporting wages and salaries paid by overseas related parties

▶ Where a non-domiciled individual earns China sourced wages and salaries during employment in China, if the domestic employer is related with an overseas entity or individual and the wages and salaries that should have been paid by the domestic employer are partly or wholly paid by the overseas related parties, the non-domiciled individual can file the tax liability on the overseas portion via self-declaration or authorize the domestic employer to file the tax liability. If the domestic employer is not authorized by the non-domiciled individual, the employer shall report relevant information to the in-charge tax authority within 15 days after the end of the month in which the income is paid, including the non-domiciled individual's working arrangement made by the domestic employer and the overseas related parties, overseas payments and contact information of the non-domiciled individual, etc.

3) Non-resident individuals who receive income after 1 January 2019 and have overpaid tax liability according to the old rules, they can apply for tax refund according to relevant laws and regulations. The existing tax rules relevant to the above announcements are abolished at the same time.

Our observation

1. Under the new IIT law and regulations, the 6-year exemption rule is counted freshly from 2019 while the years of 2018 and prior years are not counted. In this regard, Year 2024 will be the 6th year for the first time. In addition, the clock for the 6-year period will be reset if an individual leaves mainland China for more than 30 consecutive days or resides in mainland China for less than 183 days in any calendar year. As a consequence, it will be easier for foreign individuals working in China to meet the conditions for tax exemption on non-China sourced income.
2. Starting from 2019, the method to calculate China days becomes different. Under the old regulations, both the departure day and arrival day were counted as China days even when the stay in mainland China was shorter than 24 hours in these days in determining whether the individual resides in China for more than 90 days or 183 days or more. Under the new regulations, both the departure day and arrival day will not be counted as China days because the stay in mainland China is shorter than 24 hours in these days. In this regard, attention should be paid when determining whether a non-domiciled individual will become a China tax resident and when counting consecutive 30 days to break the 6-year period. Overall speaking, the new rule is more generous.
3. Based on the new provisions, several-month bonus and equity income received by non-domiciled individuals are proportioned based on the number of China working days over the total days in the attributable period. It is different from the previous rule when the apportionment is based on the number of China working months, and the new method is more reasonable.
4. With the introduction of consolidated income, the time apportionment method is applied on the income rather than on the tax liability for non-domiciled individuals who hold a foreign role. However, the concept of calculation formulas and allocation method generally remains the same.
5. When a non-domiciled individual performs tax filing for the first time in a tax year, he can estimate China days based on the terms of the employment contract, etc. to pre-determine whether he will be a resident individual for the tax year and compute monthly tax liability based on different rules. Since the withholding method for non-resident individuals shall remain unchanged in the tax year and different tax treatments are applied to resident and non-resident individuals respectively, we suggest that the company and taxpayer should carefully determine the tax residency status at the beginning of each year.
6. It was stipulated in Caishui [2018] No. 164 that only resident individual can enjoy favorable tax treatments on annual bonus and equity income from listed companies. Announcement 35 elaborates the calculation method for several month bonus and equity income for non-resident individuals and companies shall pay attention to the different rules for tax residents and non-residents when computing tax liability for them.

Next steps

Companies and taxpayers need to get familiar with relevant provisions in the announcements. If in doubt, please consult the local tax authorities. You are also welcome to contact EY professionals.

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