Taxation of Hong Kong individuals working in mainland

24 June 2019

The new China individual income tax ("IIT") law fully came into effect, and a tax circular regarding the preferential IIT treatment for the Greater Bay Area ("GBA") talents was also released. Meanwhile, in Hong Kong, the "Inland Revenue (Amendment) (No. 6) Bill 2017" came into effect from the 2018/19 year of assessment. They introduce important changes for China IIT as well as Hong Kong salaries tax ("HKST") for Hong Kong individuals working in Mainland China ("China"). Such changes will be discussed in detail in this report.

China IIT

Hong Kong individuals' concerns with the new IIT law are more around whether the worldwide taxation exemption rule will continue to apply, the 90-day (based on domestic IIT law) or 183-day (based on HK-China double tax arrangement) exemption will be adjusted, and other preferential IIT treatments (such as time apportionment for specified circumstances, non-taxable benefits for expatriates, preferential tax treatments for bonus and equity income[1]) will continue to apply, etc. To answer these questions, we have to first determine whether or not the Hong Kong individuals are domicile in China under China IIT and / or tax resident in China under tax treaty.

1. Explanations on "domicile" and "tax residency" from the IIT perspective

"Domicile"

Whether an individual has a "domicile" in China is an important factor to determine his IIT obligations. A China domiciled individual is deemed to be a China tax resident and is liable to IIT on his worldwide income, regardless of where the income has derived or paid. A non-China domiciled individual is liable to IIT on his China sourced income only, regardless of the payment location. Meanwhile, the non-China domiciled individual can be exempted from IIT on worldwide income if the worldwide taxation exemption rule (i.e. the "6-year rule") can be met.

"Domicile" from the IIT perspective is not necessarily equal to an actual residential premise. Domicile refers to a habitual residence in China on account of household registration, family ties or economic interests. Habitual residence is a legal criterion whereby a taxpayer is defined and it does not refer to actual residence or residence of an individual for a particular period of time, but rather, a place where an individual will come back to reside after staying, working, visiting family, and touring in another place. There is no change on the "domicile" definition between the old and new IIT law.

The supplementary guidance released by the PRC Ministry of Finance ("MoF") and the PRC State Taxation Administration ("STA") in April 2019 has verified that foreign individuals (including Hong Kong, Macau and Taiwan individuals) residing in China for studying, working, visiting family and touring, etc., who will go back to reside in overseas (including Hong Kong, Macau and Taiwan) afterwards, are not China domiciled individuals even if they purchase a residential premise in China. This may ease some concern of those who are interested in investing in China's real estate market. However, the analysis may be different (and more complicated) if these individuals establish a permanent home in China. In this regard, the analysis of one's domicile status should be performed on a case by case basis, and communications with the local tax bureau in China may also be required.

[1] The preferential tax treatments for bonus and equity income will not be discussed in detail in this report, as they are quite complicated and professional tax advice should be sought in this regard.

Tax residency status

As mentioned above, a domiciled individual is deemed as China tax resident. As for a non-domiciled individual, his China tax residency status depends on whether he has resided 183 days or above in China in the calendar year concerned. Meanwhile, pursuant to the Notice on the Criteria for Determining Non-China Domiciled Individual's Length of Residence (Notice [2019] No. 34) issued by the MoF and the STA in March 2019, for the purpose of determining a non-China domiciled individual's China tax residency under the new IIT law, a day in which a non-China domiciled individual is in China for less than 24 hours (midnight to midnight) is not counted as a day of residence in China.

Relationship between "domicile" and tax residency status

Please refer to the table below for a summary of the relationship between "domicile" and tax residency status.

Non-China domiciled individual	Days of residing in China	China source employment income (China work days*)		Foreign source employment income (foreign work days)	
		China payment	Overseas payment	China payment	Overseas payment
Non-China tax resident	≤ 90 days	Taxable	Tax exempted	Tax exempted**	Tax exempted
	> 90 days but < 183 days	Taxable	Taxable	Tax exempted**	Tax exempted
China tax resident	≥ 183 days (not exceeding 6 consecutive years)	Taxable	Taxable	Taxable	Tax exempted
	≥ 183 days (exceeding 6 consecutive years with no qualified absence trip)	Taxable	Taxable	Taxable	Taxable
China domiciled individual	**Days of residing in China**	**China source employment income (China work days)**		**Foreign source employment income (foreign work days)**	
		China payment	**Overseas payment**	**China payment**	**Overseas payment**
China tax resident	Regardless of number of days	Taxable	Taxable	Taxable	Taxable

* China work days include actual work days in China plus other days spent inside and outside China that are connected to the China employment such as public holidays, annual leave, and training.

** Taxability assessment of directors, supervisors and senior management personnel's employment income is complicated and requires consideration of the relevant facts and tax treaty articles.

2. IIT arrangements for a non-China domiciled and non-resident individual (i.e. reside in China for less than 183 days in the calendar year)

90-day IIT exemption

Based on the new IIT law, a non-China domiciled individual could be exempted from IIT if he resides in China for not more than 90 days in a calendar year, his remuneration is paid by, or paid on behalf of, an employer who is not a resident of China, and his remuneration is not borne by a permanent establishment ("PE") or a fixed base which the employer has in China.

Compared to the old IIT law in which "presence" days were used, the 90 "residence" days are easier to avoid. For example, a Hong Kong individual enters China on Monday and departs on Friday of the same week, his "presence" days under the old IIT law are 5 days, but his "residence" days under the new IIT law are only 3 days (both the arrival and departure days are not residence days as the individual spends less than 24 hours in China). This could be more favorable from the IIT perspective for Hong Kong individuals who travel frequently to China, especially the ones who have same-day trip to Southern China.

However, does it mean if a Hong Kong individual commutes daily between China and Hong Kong, his income is exempt from IIT as his "residence" days in China is zero? Please note that besides the residence days requirement, other requirements should also be fulfilled in order to have IIT exemption. For example, the individual should hold an offshore position in an offshore company only, and his remuneration cost should be paid and borne by the offshore entity. It should be noted that when such individual stays in China for more than a certain number of days during a certain period, or performs certain duties in China, the offshore company may be regarded as having created a China PE (and therefore the individual is regarded as an employee of a China PE) – in such cases, the 90-day exemption will no longer be applicable for the individual, and this China PE may also be exposed to corporate income taxes in China. Cases involving cross-border employees are generally more complicated and analyses from both IIT and China corporate income tax perspectives may be required.

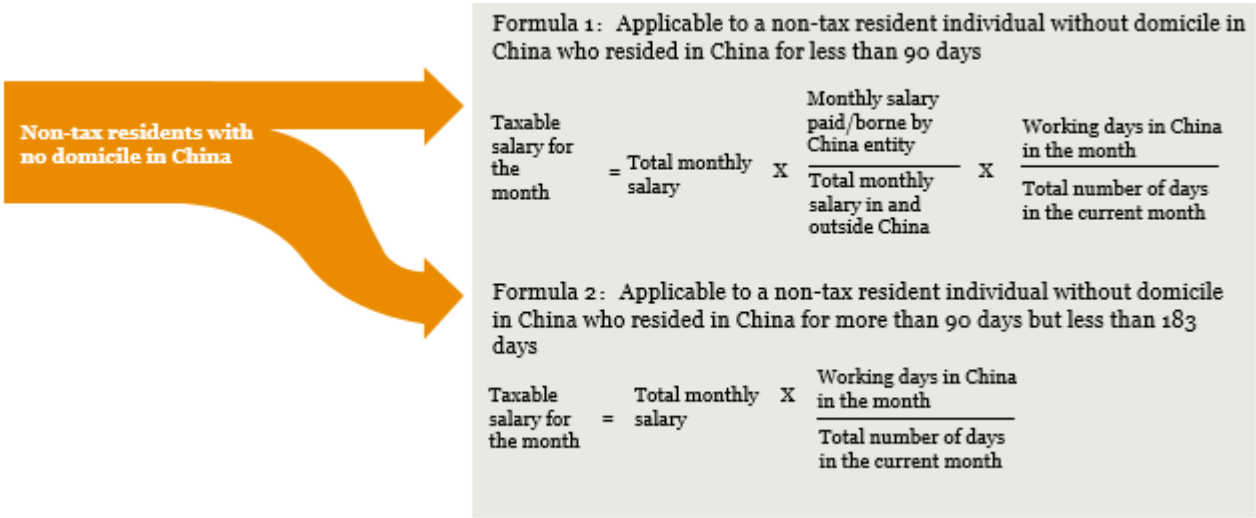
Time apportionment method to calculate IIT

Many Hong Kong individuals now working in China are under dual employment positions in China and Hong Kong, or single Hong Kong employment. Time apportionment may be applied to calculate the IIT for these individuals.

Under the new IIT law, the time apportionment method used to calculate IIT has been changed to "allocation before taxation (i.e. apportion the total income based on actual China workdays and calculate the final tax on China sourced income)" as opposed to "taxation before allocation (i.e. calculate the final tax on total income first and apportion the final tax based on actual China workdays)" under the old IIT law. With the new time apportionment method, taxable income could be effectively reduced to achieve a lower tax rate in the progressive tax system, and thus may result in a lower final tax liability (compared to the old method).

Please note that for the calculation of IIT liability under time apportionment method, a day which an individual spends less than 24 hours in China will be counted as a 0.5 China work day.

You may refer to the calculation formulas below:



Example: Assume a non-China domiciled individual has 15 China work days in April, a comparison of the IIT payable under the old and new time apportionment methods is set out below:

	Old rules	New rules
Total employment income	100,000	100,000
Apportionment of employment income		100,000 x 15/30 = 50,000
Standard basic deduction	(5,000)	(5,000)
Taxable income	95,000	45,000
Applicable tax rate	45%	30%
Applicable quick deduction factor	(15,160)	(4,410)
Apportionment of IIT payable	27,590 x 15/30 = 13,795	
IIT payable	13,795	9,090

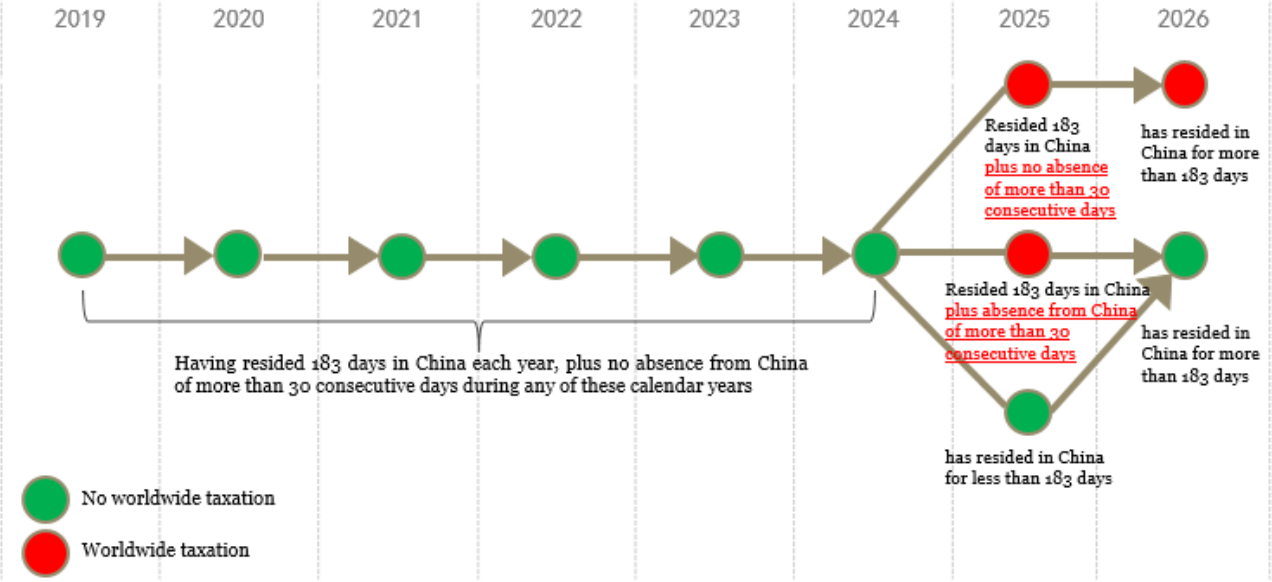
As seen from the example above, the new method is more favorable.

3. IIT arrangements for a non-China domiciled and tax resident individual (i.e. reside in China for 183 days or more in the calendar year)

6-Year Rule

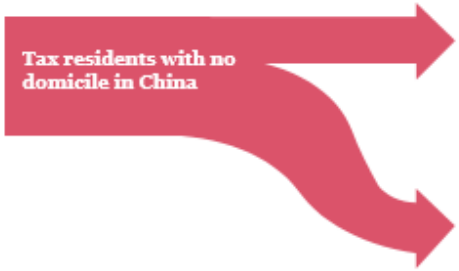
According to the new IIT law, non-China domiciled individuals would not be subject to IIT on their worldwide income if they have not resided 183 days or more in China for 6 consecutive years, or have resided for 183 days or more in China for 6 consecutive years but also have spent more than 30 consecutive days outside China during one of the aforesaid six calendar years AND have completed the required record filing with the in-charge tax bureau. Pursuant to Notice [2019] No.34, year 2019 is the first year of the "6-year" count irrespective of a non-China domiciled individual's physical presence in China before 2019. Although accumulative absence from China of more than 90 days during a year under the old "5-year rule" is not an option anymore for resetting the "6-year" count, the new "6-year rule" overall is more favourable to non-China domiciled individuals.

Please refer to the diagram below which shows how the 6-year is counted, and how the 6-year could be broken. Please note, although IIT on worldwide income is applied for year 2025 where the individual has resided in China for 183 days or more in the previous 6 years, as long as a single absence of more than 30 consecutive days can be satisfied, the "6-year" can still be reset in the following year (i.e. year 2026).



Time apportionment method to calculate IIT

For non-domiciled tax resident individuals who work in China under dual employment positions in China and Hong Kong, or single Hong Kong employment, time apportionment method applies to calculate IIT and the calculation formula is set out below:



Formula 3: Applicable to a non-domiciled individual who has resided in China for more than 183 days every year for no more than six consecutive years

$$\text{Taxable salary for the month} = \text{Total monthly salary} \times \left[1 - \frac{\text{Monthly salary paid/borne by the non-China entity}}{\text{Total monthly salary in and outside China}} \times \frac{\text{Working days outside of China in the month}}{\text{Total number of days in the current month}}\right]$$

A non-domiciled individual who has resided in China for six consecutive years and does not qualified for exemption under the 6-year rule, should be subject to IIT on his/her worldwide employment income.

Non-taxable benefits for non-China domiciled individuals

During a three-year transitional period from year 2019 to 2021, the non-taxable benefits for non-China domiciled individuals under the old IIT law will continue to be applicable (with an option to substitute for the overlapping additional itemized deductions). From year 2022 onwards where the overlapping non-taxable benefits are abolished, if a non-domiciled individual is qualified as China tax resident, the additional itemized deductions will still be applicable. Please see the table below for reference:

Existing non-taxable benefits applicable to foreign nationals	Additional itemized deduction	Year 2019 to 2021	Year 2022 and onwards
Child education	Child education	√ (either or)	Additional itemized deduction applies if individual fits the criteria as China tax resident
Rental expense	Mortgage interest or rental expense		
Language training	Continuing education		
Home leave	Major medical expense	√	
Relocating moving expense	Elderly care		
Meals and laundry			

4. Preferential IIT treatment for the GBA talents

The MoF and ST issued the Notice Regarding Preferential IIT Treatment for the GBA (Caishui [2019] No. 31) in March 2019, which clarified the scope of IIT rebate policy in 9 cities in the Guangdong Province of the GBA, i.e. from years 2019 to 2023, Guangdong Province and Shenzhen Municipality will provide IIT rebates to overseas (including Hong Kong, Macau and Taiwan) high-end talents and talents in short supply who work in the GBA based on the difference in individual income tax burden between China and Hong Kong. The rebate itself is exempt from IIT too.

At the moment, the relevant implementation rules, including talents identification catalogue and IIT rebate measures are yet to be released. Please also note that the IIT rebate policy previously implemented in Qianhai and Hengqing were abolished on 1 January 2019.

Hong Kong Salaries Tax

5. Impact of "Inland Revenue (Amendment) (No. 6) Bill 2017"

According to the Inland Revenue Ordinance, if an individual visits Hong Kong for more than 60 days and renders services in Hong Kong in a year of assessment, his income should be fully reported for HKST purpose.

Before the year of assessment 2018/19, if the aforesaid individual renders services in another jurisdiction (e.g. China) and pays income tax in that jurisdiction (e.g. IIT), he could apply for double tax relief to seek for exemption of income that has been reported for income tax and such tax is paid, to mitigate double taxation.

From the year of assessment 2018/19 onwards whereby Inland Revenue (Amendment) (No. 6) Bill 2017 is in effect, the above-mentioned double tax relief is no longer available to claim income exemption in relation to jurisdictions where double tax agreement or arrangement is signed with Hong Kong. In this regard, such Hong Kong individual who works in China and pays IIT can no longer be eligible for double tax relief, and has to rely on the Hong Kong-China double tax arrangement to lodge a tax credit claim, under the condition that this individual is qualified as a Hong Kong tax resident. In this regard, if a Hong Kong individual spends most of his time working in China (or even relocates to China for living), he may no longer be qualified as a Hong Kong tax resident and thus is not eligible for the tax credit claim in Hong Kong – i.e. no matter whether he is taxed on partial (due to dual roles) or full income in China, he may still be fully taxed in Hong Kong. If he is not eligible for tax credit claim in China for the HKST paid at the same time, he may be double taxed. This matter shall be communicated between the tax authorities in China and Hong Kong to seek for a resolution.

Summary

From income tax perspective, there are significant impacts to Hong Kong individuals working in China due to the new China IIT law, especially the introduction / major changes on tax residency, day counting method, worldwide taxation and different IIT calculation methods such as the new time apportionment formulas. IIT rules are more complicated and more challenging to analyze and apply after the changes were made. Although the IIT rules between non-domiciled tax resident and non-resident have been summarized in Appendix 3, professional tax advice should be sought on how the rules should be applied and implemented.

The amendment bill in Hong Kong has also brought challenges against mitigation of double taxation for Hong Kong individuals working in China who pay IIT. Companies and individuals may consider reviewing their current arrangements from a compliance perspective and also identity any changes required for more efficient tax planning, in which tax professionals may be consulted.

Appendix 1

Tax rate taxable under new IIT law

Bracket	*Annual (monthly) taxable income*	*(%)*
1	Not over 36,000 (Not over 3,000)	3
2	Over 36,000 to 144,00 (Over 3,000 to 12,000)	10
3	Over 144,000 to 300,000 (Over 12,000 to 25,000)	20
4	Over 300,000 to 420,000 (Over 25,000 to 35,000)	25
5	Over 420,000 to 660,000 (Over 35,000 to 55,000)	30
6	Over 660,000 to 960,000 (Over 55,000 to 80,000)	35
7	Over 960,000 (Over 80,000)	45

Appendix 2

China Residence Day vs. China Work Day

Appendix 3

Comparison of IIT rules between tax resident and non-resident

	Non-China domiciled individuals	
	Tax resident	Non-tax resident
Tax collection	Comprehensive (annual basis) + category (monthly basis)	Category (monthly basis)
Withholding method	(Cumulative) Provisional tax withholding + Tax withholding	Tax withholding
Tax rate	Provisional tax rate is annual tax rate, and may differ from the actual applicable annual tax rate	Monthly tax rate
Special deductions	The social securities expense is deductible	The social securities expense is non-deductible
Special additional tax deductions	Applicable	Not applicable
Tax-exempt benefits	For foreigners (three-year transition, choose either policy)	For foreigners (three-year transition)
Taxation of annual bonus/ Multiple-months bonus	Annual bonus / 12; Applicable to the monthly tax rates table; Could be taxed with comprehensive income; Applicable to the 'three-year' transition period	Multiple-month bonus/6 and applicable to the monthly tax rates table
Taxation of employee equity incentive plan income	Applicable to the annual comprehensive income tax rate table and the 'three-year' transition period	Employee equity incentive plan income/6 and applicable to the monthly tax rates table
Reconciliation tax filing of comprehensive income	Required	Not required

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