Special tax regulations for foreigners: 6-year benchmark and short-term posting of employees to China

At the beginning of the year, a comprehensive reform of Chinese Income Tax Law ("IIT Law") came into force. The new rules under the IIT reform initially focused on the newly introduced special deductible expenses for Chinese citizen and the fundamental adjustment of the taxation system.

Now there are further implementation regulations that specify the taxation of foreigners. In particular, the conditions for the exemption of global income taxation for foreigners working long term in China are further detailed (see below 1). In addition, the rules for the taxation of short-term dispatch to China are also set out (see below 2). Relevant Announcements No. 34 and No. 35 of the Chinese Ministry of Finance and the State Taxation Administration (STA) will apply retroactively from January 1, 2019. Below we summarize the key points as follows:

1. Exemption from the taxation of world income: 6-year benchmark
The new term of residence (staying in China for more than 183 days cumulatively per calendar year) in the new IIT law has caused heated discussions in the last year.

a) New preconditions for the exemption
For foreigners working long-term in China, the so-called "5-year regulation" applied before the tax reform. Accordingly, foreigners were to be taxed for the first time on their global income after spending more than five (5) consecutive years in China. It could be avoided by taking a “tax break” within the 5 years, i.e. by staying outside of China for more than 30 days at a time or 90 days cumulatively within one calendar year.

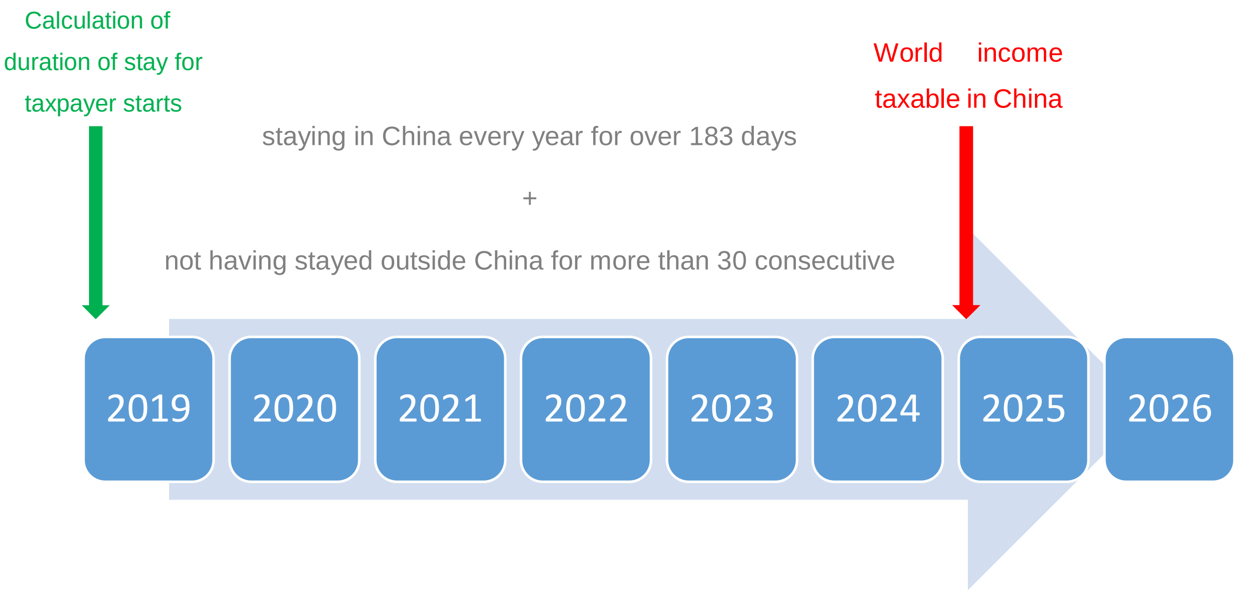
The new implementation provisions of the IIT Law have made it clear that this exemption will continue to apply to foreigners and that the exemption period is extended to 6 years provided certain conditions are met. That means that from a tax point of view, within a period of 183 days to 6 years is a foreigner resident in China, nevertheless is exempt from taxing world income.

Announcement No. 34 specifies as follows:

- From 2019 the time spent in China by taxable foreigners will be “reset to zero“, no matter how long they had actually been living in China.

- A foreign taxpayer may reset the calculation of time spent in China to zero at any time after 2019 by making a stay outside China for more than 30 consecutive days within a calendar year. Under the new scheme, a stay outside of China for a period of more than 90 days cumulatively within one calendar year will no longer be considered in the calculation of the length of stay.

A foreign taxpayer in China is subject to taxation of their worldwide income in China from the seventh calendar year if that person:
- spent more than 183 days in China each year for a period of six (6) consecutive calendar years since 2019; and
- has not stayed outside of China for more than 30 consecutive days within the six (6) years; and
- also spent more than 183 days in China in the seventh year.



As part of the new IIT law, a "Tax Break" in one of the following forms is acceptable:

- Staying outside of China for more than 30 days at a time; or
- Stay within China for less than 183 days in a calendar year.

After six years, the taxation on worldwide income can only be avoided if the taxpayer stays in China for less than 183 days in the seventh (7th) calendar year. An exit for 30 days can then no longer set the count to "zero".

b) Calculation of length of stay

For the purpose of determining the exact length of stay in China, the day that the person is in China less than 24 hours does not count.

Example "Mr. Cheung":

Mr. Cheung comes from Hong Kong and works in Shenzhen (Mainland China).
In 2019, Mr. Cheung commutes between Hong Kong and Shenzhen every week, on Monday he goes to Shenzhen and on Friday he returns to Hong Kong.
Since Mr. Cheung is less than 24 hours in Mainland China on Monday and Friday, his length of stay is 3 days per week.

Accordingly, Mr. Cheung's tax status would be assessed as follows:

Assuming Mr. Cheung is working in China for a total of 52 weeks in 2019, his stay in China will be 156 days in that calendar year. Thus Mr. Cheung is not a resident in China for tax purpose.

To do for foreigners and their employers:
- Annual review on length of stay in China
- If necessary, timely plan "Tax Break".

2. Short-term dispatch to China: permanent establishment (PE) and split positions
If the posting of an employee requires a stay of less than 183 days in China, he/she will not be a resident for tax purposes. Important cases of short-term dispatch are the posting of a foreign employee to a so-called permanent establishment (PE) as well as the assumption of a part-time position in China in addition to a position abroad (so-called split positions). The two different situations will be addressed respectively below.

a) New calculation method of the tax
The calculation method of the tax for above cases will be changed in the future as follows.

Before 2019: Splitting the tax according to the stay in China

Previously, the tax payable in China was calculated as follows: First, the total amount of the tax was calculated on the basis of the total monthly salary. The actual tax payable was then proportionally calculated according to actual working days in China (tax in China = total tax amount * working days in China / calendar days of each month).

From 2019: Splitting the income before tax calculation

From 2019, the salary from Chinese sources will firstly be calculated according to the working days in China (salary from Chinese sources = total income * working days in China / calendar days of the respective month). Based on the pro rata salary from Chinese sources, the income tax is then calculated.

Example "Mr. Schmidt":

Mr. Schmidt is not a tax resident in China and has been sent by his employer in Germany in October 2018 to a PE in Beijing for 3 days per month.

	Calculation before 2019	Calculation from 2019
Gross Income in April	50.000 RMB	50.000 RMB
Tax Exempt Amount	5.000 RMB	5.000 RMB
Taxable Income in China	45.000 RMB *(50.000 – 5.000 = 45.000 RMB)*	0 *(50.000 * 3/30 – 5.000 = 0 RMB)*
Tax Rate	30%	/
QCD	4410	/
Tax	909 RMB *[(45.000* 30% - 4410) * 3/30 = 909 RMB]*	0

According to the new calculation formula, Mr. Schmidt no longer needs to pay tax in China for his work and stay here.

b) Calculation of working days in China

For tax purposes, the calculation of working days in China is different from the calculation of residency (see above example of "Mr. Cheung" under 1.). When calculating the working days, the day is counted as half a day (0.5 day) when the person is in China less than 24 hours.

In the example of Mr. Schmidt, his working time in China would be 3 days if he arrives in Beijing on a Monday and flies back to Germany on the Thursday of the same week (Monday and

Thursday as days of arrival and departure in each case 0.5 days + Tuesday and Wednesday 2 full working days in China).

To do for foreigners and their employers:
- Adjust tax calculation formula for short-term dispatch.

3. Tax return

A person without a domicile in China must choose to make a tax declaration as a tax resident (more than 183 days) or a non-resident (less than 183 days) from the date of the first tax declaration in China from 2019.

If a person declares himself as a non-resident, but is considered a resident after the end of the calendar year (e.g. the stay lasts longer than planned), he has to declare the difference in the following year (March to June). If this person will leave China within the respective calendar year and will not re-enter China, the tax settlement can also be carried out prior to departure. However, the taxation method within the respective calendar year remains unchanged, regardless of the status change.

If a person, declared himself a resident, has finally turned out a non-resident due to staying shorter than anticipated in China, that person must declare the difference to the tax authority for the purpose of reimbursement after verification of his status as a non-resident, and at the latest within the first 15 days of the following calendar year

To do for foreigners and their employers:
- Well planning of the work calendar before the employee dispatch to China
- Ongoing monitoring of taxpayers’ status in China
- Timely declaration upon change of status in China