



## Individual income tax in China

*Individual income tax (“IIT”) is a complicated tax framework and many expatriates are confused about how to determine their tax liability in China. It is strongly recommended that SMEs do their research well in advance to assess personal tax situations and ensure compliance. This document outlines the determination of tax liability, calculation of tax and the tax filing procedure.*

### 1. What categories of income are subject to individual income tax (IIT)?

According to the Chinese taxation law the following categories of individual income are subject to IIT:

- Wages and salaries derived from employment, including wages, bonuses, allowances, any other income related to the employment;
- Remuneration for providing personal services as an independent contractor, including accounting, consulting, lecturing, translating, design, decoration, installation, drafting, testing, performances, technical services, brokerages, commissioned services;
- Income derived from publishing a manuscript(s) or article(s) in book, newspaper or periodical form;
- Partnership income: a partnership enterprise does not pay company tax on its income. It is the income received by the individual partners of the partnership enterprise that is subject to IIT;
- Royalty income for providing the right to use patents, trademarks, copyrights, non-patented technology, etc.;
- Interest income, dividends;
- Income derived from the leasing or renting of buildings, land use rights, machinery, equipment, vehicles, vessels and other property;
- Income derived from the assignment of securities, share rights, buildings, land use rights, machinery, equipment, vessels and other property.

### 2. Who is liable to pay IIT in China?

IIT is a residence-based tax. The key factors for determining whether a person is liable to individual income tax, and the extent to which he or she is liable, are

- whether the person is living in China;
- how long the person has been living in China, in case this person is an expatriate;
- the source of the income; and
- who bears the salary cost for this person.

#### 2.1. Individuals domiciled in China

An individual domiciled in China is liable to pay IIT on his/her worldwide income derived from sources both within and outside China. According to the Chinese taxation law an individual is regarded as being domiciled in China if he or she usually resides in China because of household registration, family or economic involvements.

In practice all PRC nationals are treated as tax residents in China and are consequently subject to paying IIT on their worldwide income without limitation of source.

## 2.2. Temporary visitors in China

Foreigners who live in China continuously or accumulatively not more than 90 days (or 183 days if tax treaty is applicable) only need to pay IIT on their employment income derived during their actual working period within China. In case the income is paid by an overseas employer and is not borne by any enterprise or establishment of the overseas employer in China, the income is exempt from Chinese IIT.

### Example

Ms Smith is a British citizen who works at a British company AAA. In 2010 she travelled regularly to China to work for the Chinese subsidiary of AAA (AAA Beijing). She stayed in China for a total of 150 days in 2010 and received her salary from AAA in Britain.

*Since Ms Smith stayed in China for less than 183 days in 2010 and her salary was paid by a foreign company without charging its Chinese subsidiary, according to the tax treaty between the UK and China Ms Smith should not be subject to Chinese IIT for the year of 2010.*

## 2.3. Expatriates living in China

### 2.3.1. Expatriates living in China for more than 90/183 days

Expatriates who have resided in China continuously or accumulatively for more than 90 days (or 183 days if tax treaty is applicable) but less than one year, are subject to paying IIT in China on the income derived from sources within China, regardless of whether the income is paid by a Chinese or foreign employer.

The following categories of individual income are regarded as being derived from sources within China irrespective of whether the payment has been made within China or not:

- wages and salaries received during actual working period within China;
- income derived from performing personal services as an independent contractor;
- income derived from the assignment of properties in China;
- income derived from leasing property for use within China;
- income derived from granting licensing rights for use within China;
- income derived from interest or dividends paid by enterprises or individuals within China.

### Example

Ms Smith is a British citizen who works at a British company AAA. In 2010 she travelled regularly to China to work for the Chinese subsidiary of AAA (AAA Beijing). She stayed in China for a total of 200 days in 2010 and received her salary from AAA in Britain.

*Since Ms Smith stayed in China for more than 183 days in 2010, according to the tax treaty between the UK and China Ms Smith should be subject to Chinese IIT for the income derived during the 200 days in China regardless of who paid her salary.*

### 2.3.2. Expatriates living in China for more than one year but less than five years

Strictly speaking expatriates who have lived in China for more than one year but not more than five years are also subject to paying IIT on their worldwide income in accordance with the Chinese taxation law. In practice, however, IIT is only levied on their income derived from China. The foreign sourced income is not taxable unless it is paid by individuals or enterprises in China.

Expatriates who have stayed in China for 365 days in a calendar year are regarded to have lived in China for one year. By calculating the days of residence in China the temporary absence will not be deducted. The term "temporary absence" means absence from China for not more than 30 days during a single trip, or not more than a cumulative total of 90 days over a number of trips, within the same year.

#### Example

Ms Smith is a British citizen who was assigned the role of financial manager of a Chinese company (AAA Beijing) from January 1<sup>st</sup>, 2010. She travelled to the USA for 27 days and to Germany for 10 days. In total, she stayed in China for 328 days in 2010.

*The 37 days Ms Smith spent outside China during 2010 will be regarded as temporary absence and are not relevant for the calculation of her residence in China. As a result she stayed in China for a full year in 2010 and is subject to Chinese IIT on her full employment income (income from actual working period in China and also temporary absence).*

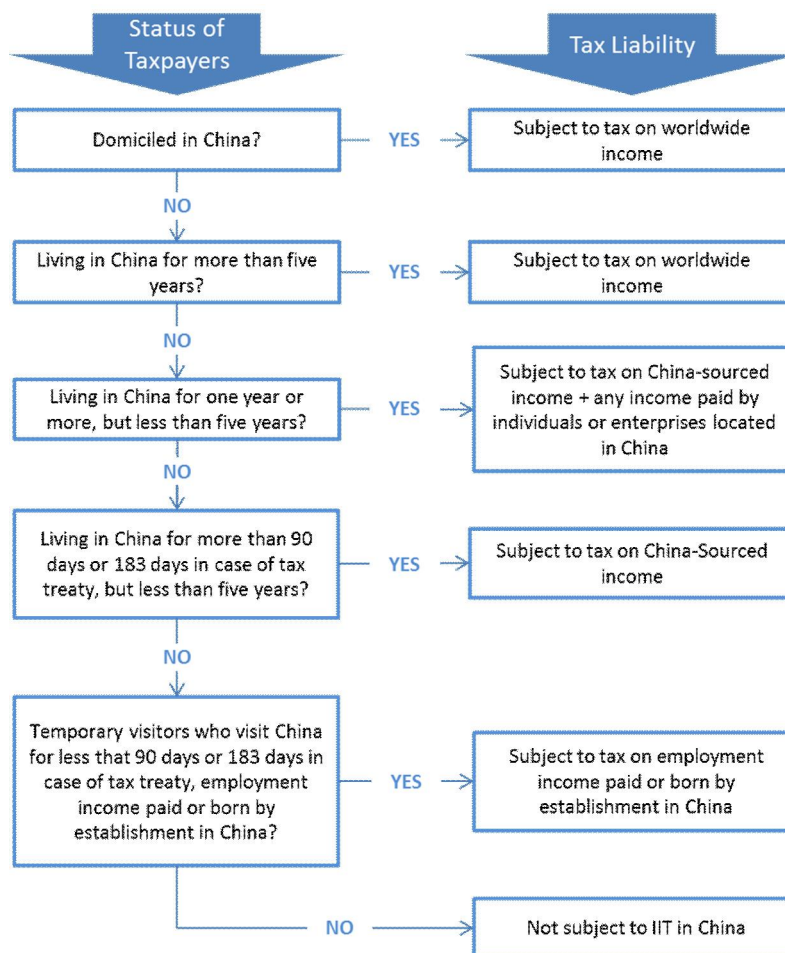
### 2.3.3. Expatriates living in China for more than five years

Expatriates who have lived in China continuously for more than five years are treated as tax resident and are subject to IIT on their worldwide income derived from sources within and outside China after the fifth year. This means that shall an expatriate living in China for more than five years have income elsewhere such as property rentals or interest, these shall also be declared to the Chinese tax authorities.

An expatriate is considered to have lived in China continuously for five years if he or she has been present in China consecutively for a full year in each of the past five years.

### 3. Interim summary

The income tax liability may be determined in accordance with the following flowchart:



#### Exceptional cases

##### 3.1. Chief Representatives and representatives

A Chief Representative or registered foreign representative of a Chinese representative office is not entitled to the 90-day (or 183-day) exemption rule. The employment cost of a Chief Representative or a Representative is deemed to be borne by the representative office.

In case the Chief Representative does not permanently reside in China and holds a post concurrently at the parent company, he or she will be regarded as so-called “part-time Chief Representative”. The part-time Chief Representative is subject to paying IIT in China on all his/her employment income derived from sources within and outside China on a prorated basis for the days spent in China.

##### 3.2. Senior management personnel

The tax relief available to expatriates who live in China for less than 90 or 183 days within a tax year does not apply to income received by a foreign senior manager of a Chinese enterprise from this enterprise. He or she is subject to paying IIT on all income derived from the Chinese enterprise

commencing from the date on which he or she assumes the post until the date on which the post is terminated, no matter whether he or she stayed in China and how many days he or she stayed in China for each calendar year.

The senior management personnel in a Chinese enterprise are defined as including:

- General Manager, deputy General Manager;
- persons occupying functional chief positions;
- chief supervisors;
- other persons occupying similar management level positions.

#### 4. How to calculate IIT?

It is to be noted that taxable income must be calculated in CNY. If the income is paid in a foreign currency it will be taxed on the equivalent amount converted into CNY according to the foreign exchange rate quoted by the People's Bank of China.

Different deductions and tax rates apply to the various categories of taxable income. The tax calculation for the wages and salary income and personal service income is set out in the following paragraphs.

##### 4.1. Tax on wages and salaries

###### 4.1.1. Deductible items

###### a) Social security benefits for expatriates

###### - *Contributions to Chinese social security*

The new Chinese Social Insurance Law was promulgated on October 28, 2010 and came into effect on July 1, 2011. It is generally provided therein that foreign individuals working in China may participate in social insurance schemes in accordance with this Law. This is the first time in China that foreign individuals working in China are included into the Chinese social insurance system by Chinese national law. The current attitude and practice of different local governments on the issue of including foreign individuals working in China in the Chinese social insurance system may vary from one city to another. Contributions to Chinese social security are tax deductible.

###### - *Contributions to social security in home country*

According to the Circular Guo Shui Fa [1998] No. 101, the Chinese taxation law exempts the social security payment paid or borne by the employer according to the legal obligations imposed by the law of the home country. Circular No. 101 was cancelled by the Public Notice No. 2 issued by the State Administration of Taxation in 2012. As a result, a foreign employer's mandatory contributions made to the social welfare schemes in his home country, such as social security and medicare, should be treated as taxable income. This requirement took effect from January 2011.

###### b) Employment benefits

The following items received by expatriates at a reasonable amount are not taxable:

- Housing allowance, meal allowance, relocation allowance and laundry expenses;
- Allowances for home visits (normally cost for two flights maximum);
- Language training expenses and children's education expenses.

Please note: such benefits must be provided in a non-cash form or on a reimbursement basis. That means:

- the employees pay up-front, then ask for reimbursement from the company;
- the company pays the expenses directly.

Documentation requirements in order to secure the exemption treatment for the abovementioned allowances may vary from city to city and are to be checked with the relevant tax bureau in advance to

confirm proper treatment. Usually official tax invoices for such expenses and the employment contract with provisions on such benefits therein may be required.

#### 4.1.2. Tax rates

Monthly taxable income	Tax rate (%)	Quick Calculation Deduction (QCD)
≤ 1,500 CNY	3	0
> 1,500 CNY, ≤ 4,500 CNY	10	105
> 4,500 CNY, ≤ 9,000 CNY	20	555
> 9,000 CNY, ≤ 35,000 CNY	25	1005
> 35,000 CNY, ≤ 55,000 CNY	30	2755
>55,000 CNY, ≤ 80,000 CNY	35	5505
> 80,000 CNY	45	13505

#### 4.1.3. Monthly taxable income

Monthly taxable income of an expatriate is his/her monthly income from salaries or wages less a fixed deduction of CNY 4,800 and other deductible items of income as mentioned above.

#### 4.1.4. Calculation formula

Formula for calculating the IIT payable on wages and salaries is as follows:

Tax payable = (monthly taxable income x applicable tax rate) – QCD

#### Example

Ms Smith is an expatriate subject to the Chinese IIT. Her salary from December 2010 is EURO 5,000. Assuming the exchange rate on December 31<sup>st</sup>, 2010 is 1 Euro = 9 CNY. Her IIT of January is calculated as follows:

Taxable income = 5,000 Euro x 9 – 4800 = 39,600 CNY

Tax payable = 39,600 x 25% - 1375 = 8,525 CNY

#### 4.1.5. Annual bonus

An annual bonus qualifies for beneficial tax treatment. The bonus may be calculated separately from other taxable salary income in the month of receipt.

There will be no standard deduction offset against the bonus. The bonus should be divided by 12 to determine the applicable tax rate.

Within a calendar year, the method of calculating IIT on an annual bonus mentioned above may only be adopted once for each taxpayer. The expatriate's bonuses other than annual bonus, such as monthly bonus, quarterly bonus, half year bonus, etc., shall be combined with other salary income in the relevant month for payment of IIT.

**Example**

Ms Smith is an expatriate subject to the Chinese IIT. Her salary from December 2010 is EURO 5,000. She received an annual bonus of EURO 20,000 for the year of 2010 in December 2010. Assuming the exchange rate on December 31<sup>st</sup>, 2010 is 1 Euro = 9 CNY. Her IIT for December is calculated as follows:

**1. Salary**

Taxable income = 5,000 Euro x 9 – 4800 = 39,600 CNY  
 Tax payable on salary = 39,600 x 25% - 1375 = 8,525 CNY

**1. Bonus**

Bonus x exchange rate ÷ 12 = 20,000 EURO x 9 ÷ 12 = 15,000 CNY  
 Therefore applicable tax rate is 20%  
 Tax payable on Bonus = 20,000 EURO x 9 x 20% - 375 CNY= 35,625 CNY

**4.1.6. Tax planning**

Tax planning in respect of IIT is not only an important topic for employees but also for employers. A remuneration package could be structured in such a way that the employee will receive the best value for his work while complying with the taxation laws. As highlighted in the previous paragraph, a reasonable amount of some of the benefits in kind provided to an expatriate can be excluded from IIT. Using benefits can be an important part of tax planning. Furthermore, the tax rule applying to annual bonuses is relatively generous and appropriate structuring to maximise the potential of this tax relief can result in substantial savings.

**4.2. Tax on income from personal services****4.2.1. Tax rates**

Taxable income of each payment	Tax rate (%)	Quick Calculation Deduction (QCD)
≤ 20,000 CNY	20	0
> 20,000 CNY, ≤ 50,000 CNY	30	2,000
> 50,000 CNY	40	7,000

**4.2.2. Taxable income of each payment**

IIT is levied on each payment of personal services income received by an independent contractor. Furthermore, the personal service income is also subject to Chinese business tax amounting to 5% and currently a surcharge which is variable depending on the location (10% in Beijing for instance).

Taxable income of each payment is the gross amount of each payment less the business tax, surcharge, and a fixed deduction of CNY 800, or 20% of each payment, whichever is higher.

Please note: the fixed deduction of CNY 4,800 and other deductions applicable to income derived by expatriates from employment does not apply to personal service income.



### 4.2.3. Calculation formula

Formula for calculating the IIT payable on personal service income is as follows:

Tax payable = (taxable income of each payment x applicable tax rate) - QCD

#### Example

Ms Smith is an expatriate subject to the Chinese IIT. Her income for one personal service in December 2010 is EURO 5,000. Assuming the exchange rate on December 31<sup>st</sup>, 2010 is 1 Euro = 9 CNY. Her IIT payable for December is calculated as follows:

Taxable income = 5,000 Euro x 9 x (1 - 20%) = 36,000 CNY

Tax payable on such personal service = 36,000 x 30% - 2000 = 8800 CNY

## 5. How to pay IIT?

### 5.1. Withholding agent

IIT is generally reported and paid on a withholding basis. Any individual, enterprise or institution that pays taxable income to a taxpayer is deemed to be a “withholding agent” and is required to withhold and remit the tax payable by the taxpayer to the tax authorities. The withholding agent must:

- remit the tax to the tax authorities in a timely manner, normally fifteen days after the end of each relevant month;
- make and keep records for future reference.

### 5.2. Self-reporting by taxpayer

An individual is required to pay tax personally in the following circumstances:

- where non-China sourced income is received;
- where taxable income is received but there is no withholding agent;
- where wages or salaries are received from two or more employers;
- other cases as specified by the State Council.

Self-reporting taxpayers should pay tax to the tax authority in the location where they have derived the taxable income. Individuals who receive income from more than one location within China may choose a location for payment of tax. Where income is received outside China, a tax return should be lodged with the taxation authorities at the taxpayer’s place of permanent or ordinary residence.

Self-reporting taxpayers are normally required to pay the tax due to the competent authority within seven days of the end of each month.

### 5.3. Annual income tax filing

Since January 1<sup>st</sup> 2006, individuals with an annual income of over CNY 120,000 are required to file an annual PRC IIT return with their local tax authority before March 31<sup>st</sup> of the year after they have earned the income. The annual filing is solely the individual’s obligation, even if taxes have been duly withheld and paid on a monthly basis.

The return, together with a copy of the individual’s valid personal identification document, may be filed electronically online, by registered mail, or in person at the local tax bureau. Filing requirements



differ depending on the location. For example, Beijing's local tax bureau encourages individual taxpayers to perform annual filings online; Shanghai's local tax bureau encourages individual taxpayers to perform annual filings by registered e-mail or in person at the local tax bureau.

However, if a foreign national does not stay in China for one full year, he does not have a PRC IIT annual filing obligation in that year.



**Contact the Centre at:**

Room 910, Sunflower Tower  
37 Maizidian West Street  
Chaoyang District  
Beijing, 100125

T: +86 10 8527 5300  
F: +86 10 8527 5093

[www.eusmecentre.org.cn](http://www.eusmecentre.org.cn)  
[enquiries@eusmecentre.org.cn](mailto:enquiries@eusmecentre.org.cn)

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**Date:** August, 2012



The EU SME Centre is a project funded by the European Union.