MOORE STEPHENS

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CHINA "TAX BREAK" PRINCIPLE FOR EXPATRIATES

MS Advisory

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What does “Tax break” stand for? What does the Individual Income Tax Law (IITL) state in China? What are the underlying rules and practices?

The “Tax Break” is not an official rule in the Chinese tax authority. It is a common practice based on the understanding of the Individual Income Tax Law (IITL), the Individual Income Tax Implementing Rules (IITIR) and the Caishuizi (1995) issued by the Ministry of Finance (MOF) and the State Administration of Taxation(SAT).

The five-year rule states that foreign nationals, who have lived in China for at least one full year, are subject to individual income tax on their worldwide income. However, if you have lived for no more than 5 consecutive years in China, individuals may only be taxed on the portion of his/her worldwide income effectively paid in China.

The definition of living in China for one full year is based on 365 calendar days without a “temporary absence” of more than 30 days or multiple “temporary absences” of more than 90 days in total.

Understanding the rules:

- Expatriates who have lived in China for more than 5 consecutive years are subject to individual income tax on their worldwide income paid within and outside China.
- Income tax on worldwide incomes are to be paid for each full year spend in China from the sixth year onwards.
- Income tax is to be paid on all worldwide incomes including earnings from dividends, capital gains, foreign interest, rental income, etc.
- An expatriate that leaves China for more than 30 days or more than 90 days in several times in one year did not live a full year in China. Important to note that travelling days with arrival or departure in China are not considered as days out of China.

The “tax break” principle:

- If, during a fiscal year within the five-year period, an expatriate travel out of China for more than 30 days consecutively or for cumulative periods of more than 90 days, he interrupts his five years' period in China and has to restart from zero.
- If the expatriate has been in China for five full consecutive years but does not spend a full year in China the sixth year onwards by traveling out of China for more than 30 days consecutively or for cumulative periods of more than 90 days during that fiscal year, he is not entitled to pay income tax on his worldwide incomes for that year. However, he needs to do the same every year onward.
- Additional to this practice, if, in any year commencing after the sixth year, the expatriate lives in China for less than 90 days, he is no more a subject to individual taxes in China and the five-year period will start again the year he lives again in China for more than 90 days.

Below you can find some examples to make the rule understandable:

Example 1: An expatriate has lived in China since January 2012 and only makes a short trip out of China for a period of 30 days maximum. In June 2016, he realizes that he will be in China for 5 years at the end of that year. He decides to spend more than 30 days out of China to clear his five years' period. He leaves China from August 1st and comes back on September 2nd. He stayed out of China for 31 days (without travelling days) so he has effectively interrupted his five-year period.

Example 2: An expatriate has lived in China since January 2012, but made one long stay out of China in 2014 from June 1st to June 30th and another in 2015 from October 10th to November 15th. Since his stay out of China in 2014 was less than 30 days (28 days without travelling days) he cannot claim he interrupted his five-year period in 2014. However, he left China in 2015 for more than 30 days (35 days, travelling days not included), meaning that he interrupted his five-year period in 2015.

Example 3: An expatriate has lived in China since January 2012 and he only makes a short trip out of China for a period of 30 days maximum. In February 2017, he realizes that he has lived in China for 5 years and should pay income taxes on his worldwide incomes starting of 2017. He can decide to spend more than 30 consecutive days out of China in 2017 but this will only avoid to pay income taxes on his worldwide revenues in 2017. In 2018 and any year onward living in China, he will need to do the same to avoid being taxed on his worldwide incomes. The only way for him to break this situation is to leave China for a full year.

Conclusion

If you are an expatriate and live in China for almost 5 years, make sure to spend at least 30 full days outside China within 1 fiscal year to reset your five-year count.