

ACCLIME.



**Policy Briefing: Cancellation
of Tax Exemptions for Foreign
Nationals Working in China**

2021

1. Introduction

By the end of 2021, certain tax exemptions for foreign nationals working in China will come to an end. The future shape of the Individual Income Tax regime (IIT) is hereafter subject to rulings by local governments, and current allowances for housing, education, language training and other deductibles are not guaranteed in the future. There is likely to be a significant impact on foreign employees, and companies may need to consider covering certain costs personally to ensure they remain attractive to key foreign talent. The new policy is estimated to have a particular impact on high-income foreign workers with children.

This report will provide an overview of current IIT and a forecast for potential scenarios, in order to aid companies' and individuals' understanding of their options and the consequences of alterations to the IIT policy. The British Chamber of Commerce in China will continue to advocate for the replacement of the current IIT system to cover foreign national's core interests, including allowances for education and accommodation. The second headline recommendation of *the British Business in China: Position Paper 2021* raised the need to continue developing a global talent pool in China, and ensure that the new IIT regime adds to, rather than detracts from, the attractiveness of China as a destination for foreign talent.

The paper has already been presented to the State Council, the Ministry of Commerce, the Department for International Trade and other key stakeholders in the British and Chinese governments. Challenges around IIT will remain on the top of the agenda as the chamber continues to make its members' voices heard in its advocacy work for 2021.

2. Overview of current IIT deduction

A OVERVIEW OF CURRENT SITUATION

The Chinese government has rules on tax-free allowances applicable to foreign nationals working in the Chinese mainland. All foreigners and their employers should be aware of these rules, in order to optimise the IIT amounts paid, which have a direct bearing on the gross salaries companies must bear as a cost. According to the regulations currently in effect, the following items are tax-free, which allow foreign employees to minimise payable IIT:

Rent

- If in the form of non-cash (i.e. the rental contract is with the company, and the company remits rent directly to the landlord; or the rental contract is with the foreign national who applies for reimbursement of rent paid);
- Rent amount must be reasonable and supported by valid fapiao issued to the company or the individual.

Relocation

- If in the form of reimbursement to the foreign national;
- Expenses (e.g. flights, luggage, moving company etc.) must be real, reasonable and supported by valid fapiaos or receipts (if incurred outside the Chinese mainland);
- Fixed monthly relocation allowances are taxable.

Home Trips

- If in the form of reimbursement to foreign national;
- Expenses (e.g. flight, train, taxi) must be real, reasonable and supported by valid fapiaos or receipts (if incurred outside the Chinese mainland);
- Up to two round-trips per year;
- Travel must be between the city in the Chinese mainland where the foreign national works and the city where they / their spouse / their parents are from or currently live;
- Any allowance paid for the foreign national's family will be taxable.

School Fees

- Expenses must be reasonable and supported by valid fapiao and documents on school information;
- The school must be registered and located in the Chinese mainland;
- Other fees (e.g. meals, school bus fares, uniforms) are usually deemed taxable.

Meals, Groceries and Laundry

- Expenses must be real, reasonable and supported by valid fapiao;
- Expenses must have incurred in the Chinese mainland;
- Fixed monthly allowances for expenses are taxable.

Chinese Lessons

- Expenses must be reasonable and supported by valid fapiao;
- Language school must be located in the Chinese mainland;
- Language courses provided to the foreign national's family members are taxable.

The current IIT calculations are based on the following brackets:

Annual Taxable Income (CNY)	Tax Rate (%)	Quick deduction (CNY)
0 to 36,000	3	0
Over 36,000 to 144,000	10	2,520
Over 144,000 to 300,000	20	16,920
Over 300,000 to 420,000	25	31,920
Over 420,000 to 660,000	30	52,920
Over 660,000 to 960,000	35	85,920
Over 960,000	45	181,920

B OVERVIEW OF PROPOSED CHANGES:

a. Explanation of changes:

The IIT Law has been slowly modified over the past five years. The first wave of changes, proposed in 2018 and enacted in 2019, affected the take home pay for every employee and the payroll processing for every employer in China. With 2021 approaching, employees and employers alike are preparing for another round of modifications, which will mainly affect high earning foreign tax residents.

Income is taxed incrementally from 3%-45% depending, and until now, companies could attract foreign employees through large deductibles, that would lower the taxable salary and payments to the social insurance system.

b. Introduction of proposed changes:

As already mentioned, foreigners living in China currently qualify for a lower tax-rate due to the available deductions of living expenses such as rental and child education. The new changes to IIT, currently in draft form, will modify the previous legislation to impact foreigners, specifically those relying on deductibles as a part of their overall compensation package. Trial implementation will end the above tax exemption items for foreign nationals by end of 2021. Therefore, the new IIT deductions will be very likely unified to all taxpayers, even though reimbursement for such expenses as home leave and relocation are unclear.

The following allowances are expected to be equally applied to foreign and Chinese nationals from 2022:

- Children's education
 - CNY 1,000 per child per month
- Healthcare costs for serious illnesses
 - Medical expenses between CNY 15,000 to CNY 80,000 annually
- Housing mortgage interest
 - CNY 1,000/month, up to 240 months
- Elderly support
 - CNY 2,000/month shared equally with siblings
- Housing rent
 - Up to CNY 1,500/month in first-tier cities

3. Examples of foreign employees

Example 1.

Ms. Bell works for an international school as a teacher:

- Her total monthly gross income is CNY 27,000.
- Her monthly rental fee is CNY 5,000.

Her tax calculations for 2021 and 2022 are as below:

	Monthly 2021	Annually 2021	Annually 2022
Gross salary	27,000	324,000	324,000
Rent deduction – tax free before 2022	5,000	60,000	18,000
Fixed monthly deduction	5,000	60,000	60,000
Taxable income	17,000	204,000	246,000
IIT rate	20%	20%	20%
Quick Deduction	1,410	16,920	16,920
Payable IIT	1,990	23,880	32,280

Due to no longer being able to deduct her full rent from her taxable income, Ms. Bell has to pay CNY 8,400 more IIT annually.

Example 2.

Mr. Burton is a locally-hired foreign executive:

- His monthly gross salary is 100,000.
- He has three school children with a tuition fee of CNY 120,000 per child per year, a yearly total of CNY 360,000.
- His monthly rental fee is CNY 20,000.

	Monthly 2021	Annually 2021	Annually 2022
Total gross salary, incl. benefits	150,000	1,800,000	1,800,000
Rent deduction – tax free before 2022	20,000	240,000	18,000
Children’s education - tax free before 2022	30,000	360,000	36,000
Fixed monthly deduction	5,000	60,000	60,000
Taxable income	95,000	1,140,000	1,686,000
IIT rate	45%	45%	45%
Quick Deduction	15,160	181,920	181,920
IIT	27,590	331,080	576,780

As he is paying a total tuition fee of CNY 360,000 tuition fee per year and CNY 240,000 in rent per year, his annual taxable income is CNY 1,140,000. According to this (simplified) calculation, he will end up paying 74% more in taxes in 2022 than in 2021, lowering his net salary and benefits by CNY 245,700.

4. BritCham China's Advocacy Work on IIT

The British Chamber of Commerce in China will continue to advocate on this issue on behalf of our members across the Chinese mainland. Developing an innovative, dynamic and 'high-quality' economy is a core policy aim for the Chinese government. The chamber maintains that this cannot be achieved unless market conditions attract foreign talent and allow them to easily settle in China. However, foreign employees are often required to bear additional costs that their local colleagues are not, such as around education. IIT exemptions help manage these costs. There is a risk that, should future IIT policies fail to cover critical areas, foreign talent will find other destinations more attractive, shrinking the talent pool available to China. Having access to the broadest possible range of talent is vital for companies to innovate and grow.

Many of our member companies are strongly committed to the China market and wish to see it continue to develop into a truly global commercial centre. As such, concerns around the need to maintain an IIT regime attractive to foreign talent have been consistently featured in every edition of our annual *British Business in China: Position Paper*, which forms the basis of our engagement with the Ministry of Commerce and other key regulators. We have also organised briefings on changes to IIT to share information with our member companies. As replacements develop, we will continue to work with the Ministry of Commerce, our sister British chambers and other foreign chambers of commerce in China in order to make our members' voices heard.

5. About the British Chamber of Commerce in China & Acclime

Acclime China is a part of the Acclime Group – an Asia-focused premier corporate services specialist. Our regional network of grass-root experts is pushing the corporate services sector with bold, innovative solutions that are seamlessly delivered to the highest global standards. We are a regional expert provider of accounting, tax, consulting and corporate services and helps clients to seamlessly advance their businesses and interests in China.

The British Chamber of Commerce in China is a membership organisation with a focus on providing advocacy, business support and networking opportunities for British businesses in China. We operate as an independent, not-for-profit organisation with a strong and diverse membership, representing British companies across the country from our office in Beijing and our broader network across Shanghai, Guangdong and Southwest China. With decades' worth of business experience in China, we bring the British business community together and help them thrive in one of the world's fastest growing markets.