

China Insight



How Employers can Prepare for the Changes of Individual Income Tax ("IIT") Policies on Foreigners

Dear Sir or Madam,

Starting from 1 January 2022, the preferential Individual Income Tax ("IIT") policies granted to foreigners in the PRC for almost three decades will be cancelled. This will bring substantial impacts on the incomes of foreigners working in China. Please find below an overview on how employers can prepare for the changes.

Kind regards,
CMS, China

After three years' grace period, it is expected that starting from 1 January 2022, the preferential IIT policies which have been granted in the PRC to foreigners for almost three decades will be cancelled. This will bring substantial impacts on the incomes of foreigners working in China.

What are the changes?

According to the *PRC Individual Income Tax Law* which has been effective since 1 January 2019 and will also be applicable to foreigners working in China in the future, there are the following changes on foreigners' paying IIT in China:

1. A foreigner working in China is no longer able to enjoy IIT exemption of housing allowances provided by the employer. Instead, if a foreigner is an individual who has domicile in China or does not have domicile in China but stays in China for no less than 183 days within a tax year ("PRC tax resident"), same as other Chinese individuals, he/she can deduct housing rental as a special extra deductible item ("SEDI") from his/her comprehensive incomes for IIT purposes. The deductible amount is RMB 1,500, RMB 1,100 or RMB 800 per month, depending on the level and the population of the city where he/she resides.
2. A foreigner working in China is no longer able to enjoy IIT exemption of Children's education allowances which are usually provided by the employer as benefits. Instead, if a foreigner is a PRC tax resident, he/she can deduct children's education costs of RMB 1,000 per month as a SEDI, from his/her comprehensive incomes for IIT purposes when his/her children receive pre-school education (from 3 years old to primary school entry) or full-time degree education (from primary school entry to doctoral degree) in China.
3. A foreigner working in China is no longer able to enjoy IIT exemption of language training allowances. But if a foreigner participates in continuing educational programs, he/she can deduct the costs, as SEDI, of RMB 400 per month and RMB 3,600 at the year in which the educational qualification certificate is obtained from his/her comprehensive incomes for IIT purposes.
4. A foreigner working in China may still be able to enjoy IIT exemption for meal and laundry allowances, home leave allowances (usually two round trips between China and the individual's home country per year for the foreigner himself/herself) and relocation allowances in a certain amount.

Further, if a foreigner is a PRC tax resident, same as Chinese individuals, he/she can deduct the following SEDIs from his/her annual comprehensive incomes for IIT purposes:

- Housing loan interest: RMB 1,000 per month for the first resident house within China bought by him/her or his/her spouse through commercial housing loans or housing fund loans;
 - Medical treatment costs: the medical treatment costs actually incurred if the costs minus the compensation from the insurances exceed RMB 15,000 within one tax year. The deductible uncompensated medical treatment cost is capped at RMB 80,000;
 - Costs for support of elderly dependent(s): RMB 2,000 per month if he/she has to support elderly dependent(s) of 60 years of age or above.
5. In addition, a foreigner working in China is no longer able to enjoy preferential IIT policy for his/her annual bonus which used to be taxed separately from other incomes for IIT purposes. Instead, the annual bonus will be included in one's comprehensive income together with other incomes for IIT purpose.

In the past, because of the old preferable IIT policies, most foreign employees working in China received around 30% of their entire remunerations as benefits so that they do not need to pay IIT for that part of income. However, due to the changes, some benefits in comparatively large amounts such as housing allowances and Children's education fees can no longer be deducted from the taxable individual income of a foreigner. Although compared with the past, additional deductible items are added, however, since the deductible amounts are small and some of them are not relevant to foreigners, therefore, the amounts of costs which can be deducted from the taxable income of foreigners will be greatly reduced. This will significantly increase the tax burden of foreigners and impact their net incomes.

Actions to be taken by the employer

In common practice, employees normally bear the individual income taxes incurred for the remuneration and benefits provided by the employer. However, since the change of IIT policies on foreign employees will substantially affect the policies on involving and retaining foreign employees in Chinese business in the future, many foreign companies pay great attention to the changes. Some Chambers of Commerce in China have been lobbying the Chinese governments on cancellation of implementing new IIT policies, however until now there is no result yet. Although there is still half a year left until the implementing date, for preparation, foreign invested companies may consider taking the following actions:

- Evaluate the potential impacts of the new IIT policies on foreign employees working in China, communicate with them on potential changes in a timely manner and manage their expectations of net income;
- Adjust the remuneration structure to reduce the overall tax burden, if necessary;
- Re-visit the company's overall compensation policy and make corresponding adjustments according to changes in regulations;
- Pay close attention to the development of policies and seek effective tax solutions.

Change of employment documents

No matter whether foreign employees are seconded from overseas to work in China or hired locally, in case any remuneration structure of the employee needs to be changed, under PRC law, a written employment contract or amendment agreement must be concluded between the employee and his/her employer accordingly. In any case, the potential promulgation of the lobbying result, no matter whether good or bad, will only be close to the end of this year, and it will be too late for companies to adjust the employees' benefit policies and to reach acceptable solutions with foreign employees, if necessary. We thus suggest that relevant measures may be considered in advance.

In case you have questions or for further information, please contact:



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