

Amendment of the Chinese Income Tax Act in 2022: Impact on personnel strategy in China

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With the new Chinese income tax regime coming into effect in January 2022, this marks the end of non-Chinese employees in China benefitting from tax-free benefits and allowances. From a tax law perspective, this means equal treatment for both local and foreign workers, which could, however, have significant income-related consequences for the latter.

(Cumulative) Income Tax in China – As of 2021

Annual Income (in CNY)	Tax Rate	Tax Deduction (in CNY)
Up to 36.000	3%	0
36.000 – 144.000	10%	2.520
144.000 – 300.000	20%	16.920
300.000 – 420.000	25%	31.920
420.000 – 660.000	30%	52.920
660.000 – 960.000	35%	85.920
Above 960.000	45%	181.920

Source: JP contagi

What Will Change in 2022?

Allowances such as rent and tuition fees, which are usually offered to foreign employees by their company in China and have been tax-free until now, will be added to the salary from next year and will be subject to income taxation. Starting from 2022, everyone is entitled to only monthly allowances, which is, for example, CNY 1,000 tuition fee per child and a maximum of CNY 1,500 for rent.

Higher Cost for the Company – Income Reduction for the Employees

A company that wants to continue employing a foreign employee beyond 2022 will have to accept the higher costs. The existing employment contracts, which do not regulate which party assumes this additional tax burden, must be renegotiated on this matter. If employees and employers cannot reach an agreement, then there is a risk of unilateral termination of the employment contract. The employer must also plan for a higher budget when recruiting foreign staff in the future.

On the other hand, a foreign worker whose employer is unwilling to accept or compensate for the higher tax burden must adjust to a reduction in net income. Especially for employees living with a partner and school-age children in China, the question arises as to what extent it is still worthwhile to work in China under these circumstances. As a result, this will not only reduce the willingness but also the attractiveness of working in China.

Example:

A company in Shanghai employs a foreign manager, Mr. M, who also lives in Shanghai with his family (two school-age children). In addition to a gross annual salary of CNY 1 million, the company also pays the rent (CNY 300,000 p.a.) and the school tuition fees for the manager's two children (CNY 400,000 p.a.).

Impact for Mr. M

Assumption: Mr. M's employer refuses to accept or compensate for Mr. M's higher tax burden.

			2021	2022
①	Gross Annual Salary		1.000.000	1.000.000
②	Individual Income Tax	①*45% minus Tax Deduction	268.080	268.080
③	Annual Net Salary	①-②	731.920	731.920
④	Annual Allowances (e.g., Rent, Children's Tuition Fees, Continuing Education)		700.000	700.000
⑤	Taxation on the Allowances	④*45% minus Tax Deduction	0	273.000
⑥	Annual Allowances (Net)	④-⑤	700.000	427.000
⑦	Total Net Income (Year)	③+⑥	1.431.920	1.158.920

Source: JP contagi

Compared to the previous year, Mr. M's net income will be reduced by CNY 273.000 (approx. 19%) in 2022.

Impact for Mr. M's Employer

Assumption: The employer would like to maintain Mr. M's employment and decides to fully take over the higher income tax burden from Mr. M in 2022.

			2021	2022
①	Salary Payment (Year)		1.000.000	1.000.000
④	Annual Allowances (e.g., Rent, Children's Tuition Fees, Continuing Education)		700.000	1.272.727
⑤	Taxation on the Allowances	④*45%	0	572.727
⑧	Company Costs / Year	①+④	1.700.000	2.272.727

Source: JP contagi

In order to provide Mr. M with the same net income in 2022, the costs for the employer will increase by CNY 572.727 (approx. 34%) compared to 2021.

Impact on the Local Labor Market

Foreigners must anticipate that their search for well-paying jobs will become increasingly more difficult from 2022 onwards, especially in cities such as Shanghai, Beijing, and Guangzhou, where well-trained/skilled local staff are now available.

Nevertheless, there will be an ongoing demand in the Chinese labor market for those with relevant qualifications and experience. However, foreigners must be aware that the duration of their employment could be shorter than they desired. After their term of employment has concluded, they may be replaced by a local employee who is already being established for this purpose during their employment.

Companies, on the other hand, must be prepared for the fact that the employment of foreigners in China will become costlier. Due to the growing cost pressure, they will have to weigh, even more meticulously, the added value that a foreign employee can generate. The local human resource strategy will increasingly focus on the early recruitment and development of local staff.

If a company cannot or is not willing to forfeit foreign staff, factors such as the size of the household, and especially the number of school-age children, will become more relevant in the selection of candidates.

Overview of the Advantages and Disadvantages of Different Types of Candidates in China

Candidate Types	Advantages	Disadvantages
Expatriates	<ul style="list-style-type: none"> ① Knowledge and experience that the local market has limited available talents (e.g., R&D) ② Better access to the subsidiary company ③ Communication with the parent company 	<ul style="list-style-type: none"> ① High cost ② Lack of market knowledge & culture ③ Language barrier ④ Temporary employment (typically, 3 +2 year) ⑤ Risk of premature termination as well as the return to the parent company
Local Foreigners <i>(foreigners working in China with local employment contracts)</i>	<ul style="list-style-type: none"> ① Communication with the parent company ② Western understanding of business with local market expertise ③ Long-term solution 	<ul style="list-style-type: none"> ① High cost ② Language barrier ③ Creation of a "Glass Ceiling" for local employees.
Overseas Chinese <i>(from HK, SG, TW, etc.)</i>	<ul style="list-style-type: none"> ① Knowledge of the local culture & language ② Familiar in dealing with Westerners and Chinese Management ③ Familiar with Western & local values 	<ul style="list-style-type: none"> ① Often missing market knowledge ② Problem of acceptance by local employees
Chinese Returnees <i>(from abroad)</i>	<ul style="list-style-type: none"> ① Local / culturally rooted with knowledge of Western culture & values 	<ul style="list-style-type: none"> ① High ambitions & expectations ② High willingness to change jobs
Local Chinese <i>(without or limited international experience)</i>	<ul style="list-style-type: none"> ① Best knowledge of the Chinese market ② Predestined for certain functions (e.g., Sales) 	<ul style="list-style-type: none"> ① Culture & linguistic barriers ② High willingness to change jobs

Source: JP contagi

In addition, a new group of talents that are gradually entering into the labor market due to the ongoing cultural hybridization, should be taken into account. These are children who were born in China in a (partly) foreign household. They grew up with Chinese as an additional mother tongue and were able to familiarize themselves with local culture from an early age.

A Glimmer of Hope for Foreign Workers in China

Currently, several foreign chambers of commerce in China are engaged in dialogue with both the Chinese government and local governments to secure adjustments or an extension of the previous regulation. It remains to be seen what specific changes will occur starting from 2022. Nevertheless, it is recommended that companies in China and their foreign employees prepare early for possible changes to the IIT law, and work on solutions together.

Conclusion

- The upcoming reform of income tax law will help to revitalize the trend of localization in human resource policy in China, which has already been accelerated by the pandemic, in the coming year.
- Legal tax-optimized income models, which particularly benefit foreigners, will no longer be possible, or will only be possible to a limited extent, according to the current interpretation of the law starting from 2022.
- It will be more difficult for foreign employees to gain a professional foothold in China, not least because the personnel strategy of companies will be increasingly geared towards localization of personnel.
- Adjustments to the provisional regulation of income taxation in 2022, even a further postponement of this reform, are possible. Nevertheless, all parties involved should plan and prepare for changes.

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