

**Commentary On The 5-Year Tax Break For Temporary Residents****Source: JFU****13 November 2018**

The Chinese Ministry of Finance (“MOF”) and State Administration of Taxation (“SAT”) have provided the public with an exposure draft of Individual Income Tax Implementation rules (“IITR 2018”) for comments, following the promulgation of the Individual Income Tax Law (“IITL 2018”) in August 2018. The IITR is meant to provide clarification and details regarding the implementation of the new IITL.

One controversial subject following the enactment of IITL 2018 is the scope of the IIT charge on temporary residents; specifically, temporary residents who stay in China for 183 days or more.

A tax resident is subject to tax on worldwide income, according to the IITL. A person without a home in China but who has stayed therein for 183 days or more in a tax year is regarded as a tax resident for that year. Strictly, therefore, such a temporary resident is subject to tax in respect of his worldwide income. Such an exposure has been considered too harsh for expatriates on temporary assignments, and counterproductive from a national development perspective.

A 5-year tax break has been proposed under the IITR 2018 to mitigate the exposure. This tax break is actually an extension of a concession already available under the old IITR, where the worldwide income basis of taxation only applies to a temporary resident in the 6th year of his temporary tax residency in China.

Thus, in effect, temporary residents will continue to enjoy the 5-year tax break, exempting foreign sourced income.

There is a further concession in the draft IITR according to the way in which the 5-year break is determined. According to the draft rules, the break starts anew each time an expatriate leaves China for a period exceeding 30 consecutive days. A similar recounting rule has been in existence in the past under the old IITR. Most expatriates would capitalize on the rule by taking a month-long vacation at least once within a 5-year period to ensure that their foreign income would not be subject to IIT.

Thus, with the proposed recounting rule, a perpetual tax holiday is granted to temporary residents on the condition that they take a continuous vacation exceeding 30 days at least once every five years.

The IITR 2018 basically retains this 5-year tax break and the recounting rule to keep foreign talent happy to stay and work in China. This concession is welcome and fair as long as it only applies to individuals who do not maintain a home to habitually reside in China. Those who have a home and habitually reside in China should be treated as fully-fledged citizens entitled to full social privileges, bearing full tax responsibilities.

This limitation will not be unnecessarily harsh for those expatriates who normally need to keep a permanent home back in their home countries, as they can rely on the tie-breaker rule that is normally available in tax treaties.