“Going global” Chinese enterprises: How to manage the tax risk of outbound Chinese employees

July, 2020
Issue 18

In brief

Whether Chinese employees working overseas are obliged to report their overseas income and pay the relevant individual income tax (“IIT”) in China via annual reconciliation filing has aroused heated discussions lately. In recent years, with China’s further deepening of the "Belt and Road Initiatives" strategy, more and more Chinese enterprises are expanding business globally. Meanwhile, the global mobility is getting more frequent with increasing number of Chinese employees assigned to work overseas under different types of mobility arrangement. According to statistics released on "Going Global" public service platform of the Ministry of Commerce, in year 2019, around 487,000 contract workers were sent abroad under foreign labour cooperation projects and as of the end of 2019, there were around 992,000 contractors working abroad¹. Nevertheless, we have seen in our daily work that many "going global" Chinese enterprises as well as their outbound Chinese employees are not quite clear about their IIT compliance obligations associated with the outbound assignment.

"Outbound assignment" is the typical global mobility type adopted by most “going global” Chinese enterprises. We will take it as an example to walk you through the IIT compliance requirement for both the outbound Chinese assignees and their dispatching entities in China. We will also share our observations and suggested action plans for "going global" Chinese enterprises in terms of how to better manage onshore/offshore compliance requirement and strengthen cross-border tax risk management for outbound assignees.

In detail

Outbound Assignment - Typical global mobility type commonly adopted by “going global” Chinese enterprises

With the development of globalization and the widespread use of technologies such as the Internet and virtual remote technology, the global mobility type that adopted by multinational companies has become more and more flexible and diversified. However, according to our observations, outbound assignment, especially long-term assignment (with assignment period usually more than 1 year), is still commonly adopted by most “going global” Chinese enterprises.

The following diagram reflects a typical long-term outbound assignment model adopted by "going global" Chinese enterprises with a brief summary of the relevant onshore/offshore arrangements:
Under a direct outbound assignment model, outbound Chinese assignees will usually retain their employment relationship with the Chinese dispatching entities and continue their social security contributions in China. Outbound Chinese assignees usually prefer to keep their contributions to China statutory social security schemes and housing fund during the assignment period. In terms of salary and welfare arrangements, most Chinese companies adopt the “Home Country Based Balance Sheet” approach to formulate compensation and benefits for long term assignees. Under this approach, the company will pay additional assignment related allowances to outbound assignees in order to make up for the difference in cost of living between the home and host country. During the assignment period, outbound assignees are usually under split payroll arrangement and paid by home dispatching entity and host receiving entity respectively, while some companies may choose to process payroll solely in home or host entity. In terms of tax arrangements, “tax equalization” is still the mainstream tax policy adopted by most “going global” Chinese enterprises in the market. Under tax equalization policy, assignees will bear the tax burden had they remained in home country (i.e. China), which is commonly referred to as hypothetical tax, while the difference between actual tax burden and hypothetical tax is borne by the company.

Outbound Chinese Assignees – China tax residency status and tax compliance obligations

The above analysis indicates that, Chinese employees under a typical outbound assignment arrangement are assigned by the company to live and work abroad for a certain period of time (i.e. during the assignment period) due to specific reasons (i.e. work arrangements). They derive overseas income while working abroad and will return to China upon completion of the assignment. Therefore, China is their place of “habitual residence”. According to prevailing China IIT law and regulations, these outbound assignees are considered “China-domiciled” resident individuals, who shall be subject to IIT in China on income derived from sources within and outside China. It is worth noting that this “global taxation obligation” of resident individuals is consistent before and after the implementation of new IIT law effective from 1 January 2019.

In addition, there are Chinese nationals who are residing abroad due to reasons other than outbound assignment as mentioned above. For example, some individuals are employed outside China by overseas companies directly and have been residing overseas on a long-term basis. The determination of these individuals’ China tax residency status, the potential impact of double taxation treaties/arrangements as well as the applicable tax treatment, etc. are usually much more complicated and more factors will be required for further analysis case by case.

IIT Declaration for Outbound Assignees—— Annual reconciliation filing

The next step further to the determination of outbound Chinese assignees IIT obligations is the compliance requirement in relation to IIT declaration. On January 17th of 2020, the Ministry of Finance (“MOF”) and the State Taxation Administration (“STA”) jointly issued the Public Notice of Individual Income Tax Policy Concerning Foreign Income (the MOF and the STA Public Notice [2020] No. 3, PN 3). PN 3 sets forth the IIT polices on foreign income derived by individuals under the
new IIT regime and provides a clearer guidance for strengthening the management of tax declaration on foreign income and foreign tax credit ("FTC") claim going forward.

1. **Filing Period**

China resident individuals who receive overseas income shall declare and settle IIT within the period from March 1 to June 30 of the following year, which is the annual reconciliation filing period. That is to say, the latest 30 June 2020 was the deadline for those outbound Chinese assignees to declare overseas income received in year 2019 and settle the tax due, if any, according to PN 3.

2. **Filing Location**

For resident individual holding a position in or being employed by a Chinese entity, he/she shall perform the annual reconciliation IIT filing on overseas income with the in-charge tax authority of the Chinese entity. If the resident individual is no longer hired in China, he/she shall perform such filing with the in-charge tax authority of the location of his/her household registration ("Hukou") or habitual residence in China. For the individual whose place of household registration is not consistent with that of habitual residence in China, he/she shall choose to file in one of the locations. And for the individual with no household registration in China, he/she shall file with the in-charge tax authority of the location of his/her habitual residence in China.

3. **IIT calculation and FTC claim**

PN 3 has provided a set of clear guidance in terms of the sourcing rules of overseas income, the method of IIT calculation and FTC claim (with the principle of "one country/region limitation and carry forward of unutilized FTC"), etc. including some practical highlights, such as the situation where the tax year of the source country/region is not on calendar year basis. Foreign tax credit claim covered by PN 3 is the key method to eliminate double taxation for resident individuals. For detailed interpretation of PN 3, please refer to Issue 3 of our 2020 China Tax and Business Advisory News Flash with the subject of "Latest individual income tax policy on foreign income: impact on resident individuals "going abroad" and foreign individuals investing in China".

**Chinese Dispatching Entities’ Withholding and Reporting Obligation**

Following the issuance of PN 3, the enforcement of IIT collection and administration on overseas income and the consistency of implementation will enhance accordingly.

- **PN 3 requires the domestic dispatching entity to perform provisional IIT withholding if it continues to pay or bear the cost of the remuneration for outbound employees.**

- **In the case where the overseas receiving subsidiaries or related entities paying the remuneration without deducting the provisional IIT for the outbound employees, the domestic dispatching entity is required to perform information reporting on outbound employees by 28 February of the following year.**

**The takeaway**

**Our observations and proposed action plan**

- **We have seen in our daily work that many “going global” Chinese companies and outbound Chinese assignees are lack of awareness about what they are obliged to do from China tax perspective as well as the associated impact and potential risks for both the entity and the individual. PN 3 reiterates that, non-compliance of the taxpayers (i.e. outbound Chinese assignees) or withholding agents (Chinese dispatching enterprises), such as failure to declare, pay/withhold IIT on overseas income or to perform information reporting, will be treated in accordance with the relevant law and regulations including the Tax Collection and Administration Law, the IIT Law and its Detailed Implementation Regulations, etc. Such noncompliance record will also be included in the individual tax credit management system, so the individual’s personal credit will be adversely affected.**

- **Taking a glance at the current tax administration environment globally, we have seen the trend that countries all over the world are paying more and more attention to the tax administration related to income derived by resident individuals from cross-border activities. Domestically, relevant IIT rules and regulations have been released with further deepening of the IIT reform, the big-data based tax management system, i.e. Golden Tax III, has been launched and upgraded nationwide, and the unified Individual Taxation System (“ITS”) is now up and running. All the above measures provide strong support for the enhancement of IIT administration. In addition, China has officially adopted the Common Reporting Standards (CRS) to exchange tax and financial information with more than 100 countries in the world on September 1, 2018, which may provide Chinese tax authorities access to information on**
overseas income and assets of China tax residents in a more effective and transparent way. "Going global" Chinese enterprises as well as outbound Chinese assignees should be aware of the above development and its implications to the IIT compliance in China.

- We suggest that the following immediate actions be taken by the “going global” Chinese companies and outbound Chinese employees:
  ✓ Revisit the company’s current outbound mobility status as soon as possible, identify outbound Chinese assignees who might be delinquent with the 2019 China IIT annual reconciliation filing;
  ✓ Review the existing onshore/offshore compliance arrangements for outbound assignment, including the company’s payroll arrangements, tax policies, tax withholding and payment status, information reporting arrangements, etc.;
  ✓ Seek professional support if needed.

Endnotes

1. This data only includes contracted workers assigned overseas under foreign labour cooperation and contracting projects with record filing with the Ministry of Commerce.

2. According to Article 2 of The Detailed Implementation Regulations of the IIT Law: “having a domicile in China” shall mean habitually residing within the territory of China by reason of permanent residence or family or economic interests.

3. According to Article 1 of the IIT Law: Individuals who have a domicile in China or individuals who do not have a domicile in China but have resided in China for an aggregate of 183 days or more within a tax year shall be considered resident individuals. Income derived by resident individuals from inside and outside China shall be subject to individual income tax in accordance with the provisions of this Law.


5. According to Article 11 of PN 3: For resident individuals assigned to work overseas by domestic enterprises, units, or other organizations (hereinafter referred to as dispatching entities), if their wages and salaries or compensation for labour services are paid or borne by the dispatching entities or other domestic entities, the dispatching entities or other domestic entities shall withhold and pay the provisional IIT in accordance with the provisions of the IIT Law and its Detailed Implementation Regulations.

Where resident individuals assigned to work overseas by a domestic dispatching entity receive wages and salaries or compensation for labour services paid or borne by the overseas receiving entities, if the overseas receiving entity is a Chinese institution for which the individuals hold a position or are employed outside China (hereinafter referred to as a “Chinese institution”), the Chinese institution can withhold the IIT and entrust the domestic dispatching entity to declare and pay to the competent tax authority in China. If the Chinese institution does not withhold or the overseas receiving entity is not a Chinese institution, the dispatching entity shall report the information of the outbound Chinese assignees to the competent tax authority before 28 February of the following year. The information to be reported includes: name, type of ID and ID number, position, country/region assigned to, name and address of overseas receiving entity, assignment period, income and tax payment at home and abroad, etc.
Let’s talk

For a deeper discussion of how this impacts your business, please contact PwC’s Global Mobility Service Team:

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