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TAX NEWS Further Information on Recent Changes to Individual Income Tax Filing Procedure in Beijing

TAX NEWS Individual Income Tax Issues for Hong Kong Residents in Hong Kong and China

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Circular of Beijing Local Tax Authority

"Provisional Administration Measure on IIT Filing" and "Provisional Administration Measure on Issuing IIT Receipt" *Jing Di Shui Ge* [2003] No. 590

Applicable taxpayers:

All withholding taxpayers and self-filing taxpayers who pay their individual income tax at the Beijing Local Tax Bureau.

Definition of "Self-filing taxpayers":

"Self-filing taxpayers" refers to those who fall into either of the following categories:

- 1) The taxpayer generates income from two or more resources.
- 2) The taxpayer receives, in more than one installments, one-off incomes such as remuneration for labor services, author's remuneration, royalties, and lease of property.
- 3) The taxpayer generates income and there is no withholding taxpayers to withhold IIT for that income.
- 4) The taxpayer receives income from a resource where relevant withholding taxpayers failed to

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withhold IIT.

5) The taxpayer receives incomes from overseas.

6) Other.

Filing:

Self-filing taxpayers should complete the IIT Self-filing Taxpayer Basic Information Form when they pay IIT for the first time. Any changes to the information provided should be communicated to the local tax authority within 30 days.

Withholding taxpayers should file "Withholding IIT Breakdown" form on a timely basis. Self-filing taxpayers should file "Self-filing IIT" form on a timely basis.

Taxpayers having difficulties in filing on time can postpone tax filing until the end of month.

Withholding taxpayers and self-filing tax payers can choose to file IIT via the internet.

Penalty Terms:

Withholding taxpayers and self-filing taxpayers who have failed to file their taxes in time are subject to a penalty up to RMB10,000.

Withholding taxpayers and self-filing taxpayers who are found guilty of tax evasion will be subject to a penalty from 50% to 500% of the evaded tax. Criminal charges may be applied if the amount is significant.

Tax agents:

Withholding taxpayers and self-filing taxpayers can entrust tax agents to handle all their tax affairs.

Effective date:

This circular becomes effective from 1st January 2004. The Beijing Local Tax Authority Provisional Measures Concerning Strengthening Tax Administration on Key Individual Income Taxpayers is abolished on the same date.

Issue of tax receipt:

Taxpayers can ask the local tax authority to issue tax receipts upon presentation of eligible identification.

TAX NEWS Individual Income Tax Issues for Hong Kong Residents Working in Hong Kong and China

Under "The Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income" ("the Arrangement"), a Hong Kong resident who exercises employment both in Hong Kong and the Mainland can be exempt from IIT in the Mainland if all the following three conditions are satisfied:

1) The Hong Kong resident stays in the Mainland for a period or periods not exceeding in the aggregate 183 days in the calendar year concerned, 2) the income is paid by, or on behalf of, an employer who is not a resident of the Mainland and 3) the income is not borne by a permanent establishment or a fixed base which the employer has in the Mainland.

In December last year, the Hong Kong Inland Revenue Department issued guidelines to clarify several issues concerning Hong Kong residents exercising employment both in Hong Kong and the Mainland.

增值税

"Zeng Zhi Shui"

(Value Added Tax)

营业税

"Ying Ye Shui"

(Business Tax)

They include the principle for counting the "period of stay" in the Mainland. According to the guidelines, a 2-tier test should be adopted in counting the "period of stay".

1) The period of stay in determining the taxing right

The first test is to calculate the "period of stay" for the purpose of determining which jurisdiction has the right to tax.

Under the Arrangement, one of the conditions for IIT exemption is that a Hong Kong resident must not stay in the Mainland for a period exceeding 183 days in a calendar year. In deciding whether the "period of stay" exceeds 183 days, the determination of the number of days of presence is critical. In this regard, a "day" includes any day on which a Hong Kong resident is physically present in the Mainland. This test is also referred to as the "N Day rule".

Suppose a Hong Kong resident is employed by a Hong Kong company but works full time in a factory in the Mainland and earns HK\$21,000 a month. The resident travels into the Mainland on Monday and comes back to Hong Kong on Friday every week and does not have any duty in Hong Kong.

Since the 183-day threshold is exceeded no IIT exemption is available and the whole amount of salary of HK\$21,000 is subject to IIT because it is entirely PRC sourced. The whole amount of salary of HK \$21,000 is exempt from Hong Kong Salaries Tax because no duty is performed in Hong Kong.

2) The period of stay in calculating tax liabilities

If a Hong Kong resident has stayed in the Mainland for more than 183 days in a calendar year under the "days of presence" rule, he or she is liable to IIT. In this regard, the second test is to determine the "period of stay" for the purpose of calculating the IIT liabilities in the Mainland. This second test is referred to as the "N-1 Day rule".

Suppose a Hong Kong resident is employed by a Hong Kong company but performs duties both in Hong Kong and the Mainland. The resident travels into the Mainland on Monday and comes back to Hong Kong on Friday every week and then works in Hong Kong every Saturday. The resident's monthly salary is HK\$21,000 and the amount of IIT due on HK\$21,000 is HK\$3,000.

Days of presence using "N-1 day rule" is: Number of days of presence in the Mainland each week:

5 - 1 days = 4 days

Number of days of presence in the Mainland in the month:

4 days per week x 4 weeks = 16 days

Since the 183-day threshold is exceeded no IIT exemption is available and the whole amount of salary of HK\$21,000 is subject to IIT, and then apportion on time basis because the Hong Kong resident has duties both in Hong Kong and the Mainland.

The IIT payable is calculated as follows:

HK\$3,000 x 16/ 30 = HK\$1,600

The whole amount of salary of HK\$21,000 is subject to Hong Kong Salaries Tax but the Hong Kong resident is eligible to claim an exclusion of salary on which IIT is paid.

The amount of salary subject to Hong Kong Salaries Tax is effectively calculated as follows:

HK\$21,000 x (1 - 16/ 30)

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