A man and a woman in business attire are looking at a tablet together. The woman is on the left, wearing a dark blazer over a light blue shirt, and the man is on the right, wearing a dark suit, white shirt, and blue tie. They are both looking down at the tablet held by the man. The background is a solid grey color.

## Navigating the 'Five Year Tax Rule' for Expatriates in China

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## Navigating the 'Five Year Tax Rule' for Expatriates in China

### Background

The China Five Year Tax Rule threshold and its application is a pertinent and often misunderstood issue that affects all expatriates (including Hong Kong, Macao and Taiwanese nationals) residing in the People's Republic of China ("PRC"). There have been many questions raised about the 'Five Year Tax Rule' concerning its application. The key ones that are usually asked include:

- What does the 'Five Year Tax Rule' actually mean?
- Whom does it affect?
- How will it impact an expatriate's tax liability if not adhered to?
- How can an expatriate avoid being subject to China Tax on Worldwide Income?

Since the requirement for expatriates to file an annual tax return was introduced in 2006, the authorities are now better equipped to work backwards to trace an expatriate's Individual Income Tax ("IIT") footprint. With the China Local Tax Bureau ("LTB") stepping up its policy of collection in order to meet government imposed targets, and expatriate tax being an area of particular interest, it is important for expatriates to review their past, current and future tax position, from both a tax compliance and a planning perspective.

In terms of putting in place a compliant tax strategy as an expatriate living in China, it is important to have a clear understanding of the Five Year Tax Rule, what China Tax Residency entails and the Individual Income Tax liabilities applied to an expatriate residing and working in the People's Republic of China ("PRC").

This short guide will illustrate the best practices for ensuring that as an expatriate from an IIT perspective, tax liabilities can be planned and clarifies the key points of understanding concerning China Tax Residency.

### Definition of a China Tax Resident

In practice, a China Tax Resident can be defined as a foreign national living and working in China for more than 5 years (including Hong Kong, Macao and Taiwanese nationals). Residing in China for a period of 365 consecutive days in the fiscal calendar year from 31st December to 1st January (also termed 'Tax Year') is acknowledged as having lived in China for the full one year duration.



## How is a 'Full Year' Defined?

To be counted as a full year residing in China, an expatriate throughout this period does not leave China for a consecutive period of 30 full days or a total of 90 full days throughout the calendar year. Days travelling inbound or outbound from the PRC are classed as days spent inside China's borders, so therefore if you were to take a 7 day business trip to New York, departure and arrival days from China included, this would mean that 5 full days were spent outside of China's borders.

## What could be Taxable for an Expatriate under the Five Year Rule?

Exceeding the 'Five Year Tax Rule' can substantially increase an expatriate's tax burden and therefore if the period of the 'Five Year Tax Rule' is not interrupted, subsequently an expatriate could incur IIT tax liability with the Local Tax Bureau ("LTB") on worldwide income from the sixth year onwards for every consecutive year forthwith. IIT would therefore apply to all PRC and Non – PRC sourced income specified by law. Ideally, an expatriate would want to avoid this scenario being applied to their IIT liability.

## How can I avoid being taxed on Worldwide Income under the Five Year Tax Period?

To break the five-year period at any point and reset tax residency, an expatriate should leave China for a period of more than 30 full days consecutively in one trip or a total of 90 full days within a 'Tax Year'. This will in effect reset the clock back to zero in tax years and the following year would become year 1. The process can then be repeated every five years, therefore enabling an expatriate to remain exempt from tax on worldwide Non-PRC sourced income.

However, an expatriate can also break the five-year residence in China only if they spend less than 90 days inside China any one-year after the sixth year, or whereby the expatriate becomes a tax resident in another jurisdiction which has a double tax treaty with China, the conditions noted in the tax treaty would apply. (You should check carefully the specific terms concerning Tax treaties between China and your country of nationality.)

## What happens if I miss the Five Year Tax Threshold?

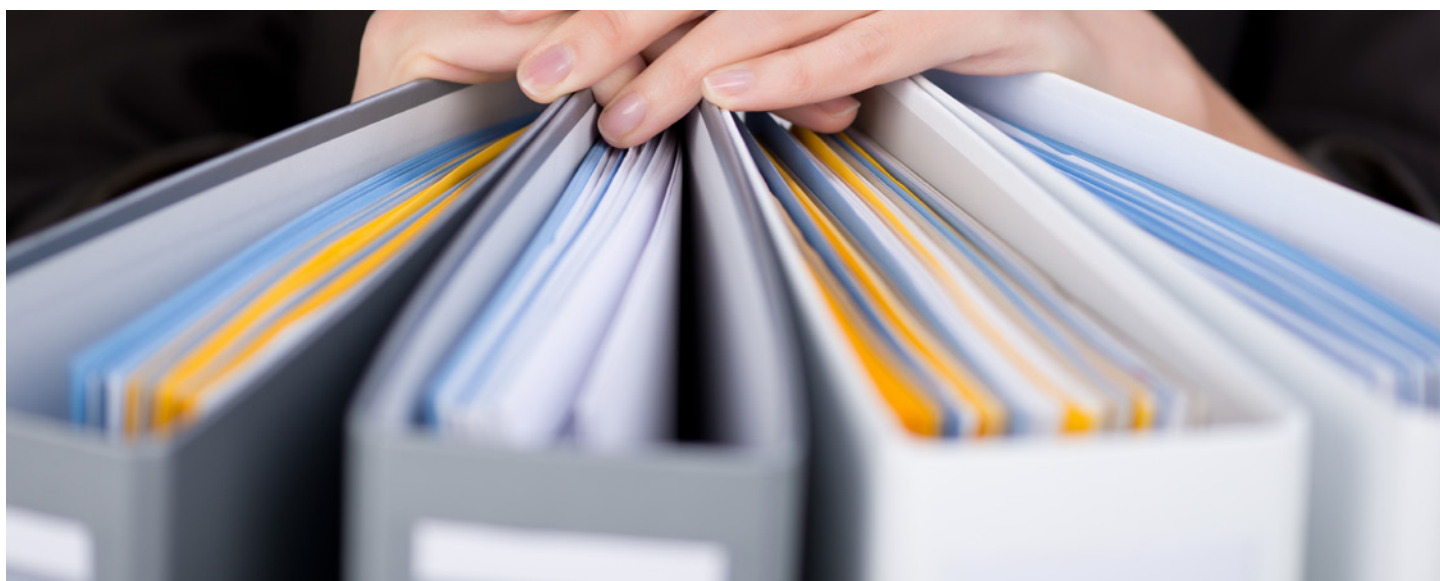
If the Five Year Tax threshold is missed (i.e., an expatriate does not exit the PRC for the required time period during the five year period) and tax residency is carried on into the sixth year, an expatriate can still avoid being liable for China IIT from the seventh year onwards. In order to do this however, they would need to exit China for the stated period (30 full days consecutively, or a total of 90 full days) for every calendar year onwards. The sixth year though would still be subject to IIT in theory.

## Final Thoughts

While the 'Five Year Tax Rule' has not been directly applied to expatriates residing in China on any specific case to date, it is a regulation that is hovering in the background. Should the Chinese tax authorities decide to impose the Five Year Tax Rule, it would be prudent to have complied with the policy set out by exiting China for the specified period during each Five Year Tax residence. Therefore, it is advisable to pay attention to your duration of stay in China, plan to take 30 consecutive full days outside of China within a 5 Year period or 90 full cumulative days annually and keep track of the period spent both inside and outside of China's tax jurisdiction.

LehmanBrown can assist both individuals and companies to better optimise their tax structures in the case of expatriates. For more information of the Five Year Tax Rule or to learn more about how we can support you, please contact us.





## About Us

Founded in 2001, LehmanBrown is a China-focused accounting, taxation and business advisory firm, operating in Beijing, Shanghai, Hong Kong, Macau, Shenzhen, Guangzhou and Tianjin. Our firm also manages an extensive affiliate network, providing service throughout China and reach across the globe.

Combining years of international expertise with practical Chinese experience and knowledge, LehmanBrown offers expert advice and support to both local and international clients. Within the mid - tier, we are regarded as a market leader and our clients enjoy access to a combination of senior and experienced counsellors from both China and abroad.

At LehmanBrown we recognise that you are unique, that you have unique requirements and we are committed to providing individually tailored financial solutions. LehmanBrown is dedicated to providing personalised service by working closely with our clients to understand your individual business needs. This enables us to offer the most up-to-date and expert advice.

## 关于我们

雷博国际会计成立于 2001 年，是一家获得许可，主要从事有关中国范围内会计、税务和财务咨询服务的公司，在北京、上海、香港、澳门、深圳、广州和天津设有专门办事机构，正积极在全国范围内建立广泛的联合专业服务网络。

综合多年的国际经验和对中国市场的深刻理解和实践体验，我们向广大国内外的客户提供高质量的专业服务和意见帮助。在雷博国际会计的服务过程中，我们作为市场中的佼佼者，您将得到来自中国本土以及其它国家的高级资深专家热忱的咨询帮助。

我们深刻认识到每一位客户都是独一无二的，并都有其独特的业务需求。雷博国际会计承诺将根据客户的不同业务需求，为客户提供个性化的财务解决方案。我们的专业人员将密切与您合作，以充分了解您独特的业务需求，从而提供满足您所需要的高时效、高质量的专业服务。



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US GAAP Audit

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For further information about how we can add value and support your individual or business needs, please contact us.

如需为个人或企业获取更多的增值服务及业务协助信息，请与我们联系。

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