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CHINA'S INDIVIDUAL INCOME TAX LAW FOR EXPATRIATES

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In recent times, many mainland Chinese are taking up employment or immigration opportunities outside China. With the accumulation of personal wealth in China, more of such movement of human capital can be expected. However, at the same time, the Chinese tax authorities are increasing their attempts to enforce Chinese law on Chinese working outside mainland China by requiring them to report overseas income and comply with China's Individual Income Tax Law. The threat of "double taxation" will inevitably affect the decisions of those who are looking for overseas employment opportunities and those who are currently working abroad. This article examines the tax consequences of both outbound and inbound cross-border employment from China's perspective. By comparing the income tax rules applicable to different groups of cross-border employees, the article will highlight the discriminatory treatment of Chinese cross-border employees and propose measures to better facilitate the cross-border movement of human resources.

I. Introduction

In mid-2020, a headline raised many eyebrows: "China starts taxing its citizens for global income". The story revealed that "China has started tracking down some of its citizens living abroad to collect taxes, surprising expatriates who never had to pay levies back home on overseas income".[1] Mainland Chinese[2] working abroad, in places where individual income tax rates are lower than China, may be required to repay any shortfall in their income tax liability under China's Individual Income Tax Law (IITL).[3] For example, the individual income tax (IIT) rate in mainland China is as high as 45% for top earners, while the current highest personal income tax rate is 22% in Singapore, the highest salaries tax rate is 17% in Hong Kong and a maximum rate of 12% is charged on personal income in Macau.[4] This news is not

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1 *Bloomberg News*, "China Starts Taxing Its Citizens for Global Income" <https://www.bloomberg.com/news/articles/2020-07-10/china-starts-taxing-its-citizens-global-income-for-first-time> (10 July 2020).

2 In this article, mainland China is defined as the geographical area of the People's Republic China (PRC) excluding Hong Kong, Macau and Taiwan, and mainland Chinese refer to nationals of the PRC who are not Hong Kong, Macau or Taiwan compatriots.

3 Individual Income Tax Law (People's Republic of China) (2018).

4 Inland Revenue Authority of Singapore, "Individual Income Tax Rates" <https://www.iras.gov.sg/taxes/individual-income-tax/basics-of-individual-income-tax/new-to-tax/individual-income-tax-rates>; "Tax Rates of Salaries Tax & Personal Assessment" <https://www.gov.hk/en/residents/taxes/

only bad for those currently working in Hong Kong, Singapore or elsewhere outside China, it also acts as a deterrent to those in mainland China who want to build a career abroad.[5]

The Chinese IITL sets out a worldwide tax system that taxes residents' domestic and foreign income, but the rule had not been strictly implemented in respect of foreign-sourced income. Whether mainland Chinese working abroad might be subject to the IITL depends on the specific circumstances. As more Chinese engage in cross-border employment or choose to reside overseas, the potential consequences of a change in enforcement policy affect a larger group of people. Furthermore, automatic exchange of information makes the taxation of Chinese tax residents' worldwide income more achievable than ever before.[6] China signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in August 2013, committing to the implementation of automatic exchange of information (AEOI), and also signed the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information in December 2015.[7] By the end of 2021, 102 jurisdictions had committed to delivering Chinese tax residents' common reporting standard information to China.[8] This will increase the information available to Chinese tax authorities and make the enforcement of income taxation on Chinese tax residents' foreign earnings more feasible.[9]

This article aims to examine the tax liability of Chinese tax residents involved in cross-border employment or migration, as well as the tax liability of foreigners in China. The article first introduces the key concepts that determine an individual's tax residence in China in Section II. Section III then examines a tax residency dispute dealt with by a Chinese tax authority. In Section IV, potential issues raised by

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taxfiling/taxrates/salariesrates.htm> (April 2022); PwC, "Macau SAR Individual - Taxes on Personal Income" <https://taxsummaries.pwc.com/macau-sar/individual/taxes-on-personal-income> (16 December 2022).

5 *Bloomberg News,* "Bankers Shocked by 45% China Tax Rate Mull Leaving Hong Kong", <https://www.businesstimes.com.sg/government-economy/bankers-shocked-by-45-china-tax-rate-mull-leaving-hong-kong> (15 July 2020).

6 HKWJ Tax Law, "Automatic Exchange of Information for Tax Purpose in Mainland China" <https://www.hkwj-taxlaw.hk/automatic-exchange-of-information-for-tax-purposes-in-mainland-china/> (6 May 2021); Xiaoqing Huang, "Automatic Exchange of Information and BRICS: Why and How Does It Affect Emerging Economies?" (2017) 23(4) Asia-Pacific Tax Bulletin; State Taxation Administration of the People's Republic of China, "Introduction to the Standards for Automatic Exchange of Tax-related Information on Financial Accounts" <http://www.chinatax.gov.cn/chinatax/aeoi_index.html>.

7 People's Republic of China State Taxation Administration, "Expanding Exchange of Information (EOI) Network" <http://www.chinatax.gov.cn/eng/c101270/c101275/c5157937/content.html>. To implement AEOI domestically, in May 2017, the Administration Measures on Due Diligence Procedures for Non-residents' Financial Account Information in Tax Matters was jointly issued by the State Taxation Administration, the Ministry of Finance, the Peoples' Bank of China, the China Banking Regulatory Commission, the China Insurance Regulatory Commission and the China Securities Regulatory Commission. The Measure took effect from 1 July 2017 and China started its first exchange of financial account information in 2018.

8 Organisation for Economic Co-operation and Development, "Activated Exchange Relationships for CRS information" <https://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/exchange-relationships/> (October 2022).

9 Zhe Chen & Bart Peeters, "A Study on the Protection of Taxpayer Rights in an Era of Enhanced Exchange of Information: How Can the Chinese Approach Be Improved?" (2022) 50(8) Intertax 579 at 578-579.

the Chinese tax residence rules are discussed, considering relevant rules in several other jurisdictions. Section V and VI examine the inflexibility and inequity of the IITL in relation to cross-border employment. The last section concludes the article.

II. Key concepts for deciding an individual's tax residence

A. *Tax residence in Mainland China*

The IIT scheme in China has gone through significant and consistent reforms over the past 40 years since formal IIT rules were first adopted in the early 1980s.[10] The latest reform, conducted in 2018 in relation to China's IITL, is regarded as one of the most significant reforms in decades.[11] Changes have been made in various aspects, including redefining the tax residence rule, adjusting rate structure, increasing deductions, revising the tax base and enhancing tax administration.[12] The 2018 reform to the IITL reflects the mandate pursued by the Chinese government to gradually raise the revenue share of direct taxation and enhance the redistribution role of the tax system.[13] However, to what extent the goal can be achieved is open to question.[14] Another purpose of the 2018 IITL reform is to level the playing field in respect of the tax treatment provided to foreign and domestic individuals.[15] The focus of this article is to examine the discrepancies of tax treatment between tax residents and non-residents, calling for future reform to reduce obstacles for cross-border movement of labour.

In the 2018 amendment of the IITL, the provision relating to tax residency status was amended by adopting the concepts of "resident" and "non-resident" in Article 1:

> A resident individual is an individual who is domiciled in China or who is not domiciled in China but has stayed in China in the aggregate for 183 days or more in a tax year. A resident individual shall, in accordance with the provisions of this Law, pay individual income tax on his or her income obtained inside and outside China.

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[10] A brief account of the development of China's individual income tax system over the last 40 years is provided in Yan Xu & Zizheng Zhao, "International Tax Planning: China's New Regime for Taxing Expatriate Income: Tightening the Screws or Vintage Wine in a New Bottle?" (2021) 69(3) Can.Tax.J 953 at 956-960 [Yan Xu & Zizheng Zhao]. Also see Bingyang Lv and Zhaoqiang Zhang, "Reform of China's Taxation System: From Embedment in the Economy to Embedment in Society" (2022) 9(1) The Journal of Chinese Sociology 65 at 70-79.

[11] Adrian Sawyer, "Individual Income Tax Reform in China: An Evaluation Through a New Zealand Lens" (2020) 26(3) NZ J Tax L & Policy 315 at 315.

[12] Jingyi Wang & Wilson W.S. Chow, "The Reformed Individual Income Tax Law in China: A Move towards Equity?" (2021) 51(1) HKLJ 249 at 253-254.

[13] Peng Zhan, Shi Li & Xiaojing Xu, "Personal Income Tax Reform in China in 2018 and Its Impact on Income Distribution" (2019) 27(3) China & World Economy 25 at 26 and 30.

[14] Yan Xu & Zizheng Zhao, *supra* note 10 at 979; Jingyi Wang and Wilson W.S. Chow, *supra* note 12.

[15] Yan Xu & Zizheng Zhao, *supra* note 10 at 955.

> A non-resident individual is an individual who is neither domiciled in China nor stays in China or who is not domiciled in China but has stayed in the aggregate for less than 183 days of a tax year in China. A non-resident individual shall, in accordance with the provisions of this Law, pay individual income tax on his or her income obtained inside China.
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> Tax year means the Gregorian calendar year that runs from 1 January to 31 December.[16]

From Article 1, it can be seen that the tax jurisdiction over individuals includes both residence jurisdiction and source jurisdiction. When a person is regarded as a tax resident in China, he or she is subject to the IITL on his or her worldwide income. Non-residents are only liable for income sourced within China.

Article 1 sets out two grounds for determining if an individual is resident in China for tax purposes: domicile (*Zhu Suo*) and physical presence (the 183-day rule). These two kinds of tax resident are referred to as domiciled tax residents and 183-day tax residents respectively. Domiciled tax residents in mainland China are generally subject to IIT on their worldwide income, whereas 183-day tax residents are entitled to certain preferential treatment that is not available to domiciled tax residents.

In this section, several key concepts in understanding tax residency in China will be discussed, including domicile, habitual residence, and Overseas Chinese. As can be seen from the following discussion, it is difficult for domiciled Chinese tax residents leaving China to break their ties with China for tax purposes.

B. *Domicile and habitual residence*

The definition of domicile for tax purposes is found in Article 2 of the Regulation on the Implementation of the Individual Income Tax Law of the People's Republic of China:

> Article 2. For the purpose of the Paragraph 1 of Article 1 of the Individual Income Tax Law, "is domiciled in China" means habitually residing in China due to household registration, family or economic ties.

In a circular, "habitual residence" has been explained further as:

> individuals who live habitually within the territory of China because they have household [registration], family and relations of economic interests. The term

[16] IITL 2018, Article 1. Before 2018, "[a]n individual who has a domicile in the territory of China or who has no domicile but has stayed in the territory of China for one year or more shall pay individual income tax in accordance with the provisions of this Law for his income obtained in and/or outside the territory of China. An individual who has no domicile and does not stay in the territory of China or who has no domicile but has stayed in the territory of China for less than one year shall pay individual income tax in accordance with the provisions of this Law for his income obtained in the territory of China". The English translation of the regulations is quoted from <https://pkulaw.com>.

> "habitual residence" is used to determine whether the taxpayer is a resident or non- resident, not depending on the actual residence or the apartment in a particular period. For example, for individuals who live outside China due to study, work, visiting relatives or going on a tour, after the end of these activities, the reasons for them to live outside China no longer exist and therefore they must return to and live within China, China is the country of the taxpayer's habitual residence.[17]

As the tax domicile rule refers to the concept of habitual residence, domiciliation can be found without physical presence in China. Furthermore, as all Chinese nationals must be registered under the household registration (*hukou*) system,[18] it will be difficult for a Chinese national to establish that he or she is not domiciled in China. Therefore, there are special regulations regarding the residence of citizens living in the Hong Kong and Macau Special Administrative Regions (SARs):

> Any Hong Kong resident of Chinese descent who was born in the territory of China (including Hong Kong), or any other person who meets the requirements for Chinese nationality as prescribed by the Nationality Law of the People's Republic of China, is a Chinese national.[19]

However, although Hong Kong and Macau residents of Chinese descent are Chinese nationals, they are not automatically Chinese tax residents. The meaning of "resident" has been clarified in Guoshuifa [2010] No. 75, which states China's interpretation of the China-Singapore double tax treaty and applies to other treaties to the extent they contain the same provisions.[20] "Resident" in the context of a double tax treaty means:

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[17] People's Republic of China State Taxation Administration, Regulations on Some Issues Concerning the Levy of Individual Income Tax (Guoshuifa [1994] No. 89).

[18] Regulations of the People's Republic of China on Household Registration (1958), Article 2: Citizens of the People's Republic of China shall perform household registration in accordance with the provisions of these Regulations. Kam Wing Chan, "The Household Registration System and Migrant Labor in China: Notes on a Debate" (2010) 36(2) Population and Development Review 357 at 358.

[19] Hong Kong SAR Immigration Department, "Explanations of Some Questions by the Standing Committee of the National People's Congress Concerning the Implementation of the Nationality Law of the People's Republic of China in the Hong Kong Special Administrative Region" <https://www.immd.gov.hk/eng/residents/immigration/chinese/law.html>; a similar statement in relation to Macau is also provided in Macau (People's Republic of China), Standing Committee of the Ninth National People's Congress *Interpretation by the Standing Committee of the National People's Congress on Some Questions Concerning Implementation of the Nationality Law of the People's Republic of China in the Macau Special Administrative Region of the People's Republic of China*, 29 December 1988 at para 1, available at <http://www.npc.gov.cn/zgrdw/englishnpc/Law/2007-12/12/content_1383834.htm>.

[20] People's Republic of China State Taxation Administration, Interpretation of the Articles of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Protocol Guoshuifa [2010] No.75 (referred to as Circular No. 75). The applicability and relevance of Circular No. 75 is explained as follows:

> I. Where the provisions of the relevant articles of the agreements signed between China and foreign states are consistent with those of the articles of the Agreement between China and Singapore, the

(b) The criteria in domestic laws of China for determination of residents shall be as follows:

(i) Resident Individuals
In accordance with the relevant provisions of the Individual Income Tax Law of the People's Republic of China and the Regulation on the Implementation thereof, the resident individuals in China shall include:

(1) Chinese citizens and foreign expatriates who have a domicile within the territory of China, excluding Overseas Chinese who are Chinese citizens but live abroad instead of living in China's Mainland and Hong Kong, Macau and Taiwan compatriots.

From this explanation, it can be seen that Overseas Chinese and individuals living in Hong Kong, Macau and Taiwan do not become Chinese tax residents as a result of their Chinese nationality.

C. *Overseas Chinese*

The term Overseas Chinese (*Hua Qiao*) has a particular meaning, which is explained in Guoshuifa [2009] No. 121.[21] Overseas Chinese refers to Chinese citizens who reside in foreign countries, specifically:

a. A Chinese citizen who resides in a foreign country means that he has acquired long-term or permanent residence in the country, has resided in the country for two consecutive years and has stayed in the country for a total of 18 months or more in the two years.

b. A Chinese citizen who has not acquired long-term or permanent residence in the foreign country where he resides but has acquired the qualification for legal residence in the country for five or more consecutive years and has stayed in the country for a total of 30 months or more in the five years shall be defined as an Overseas Chinese.

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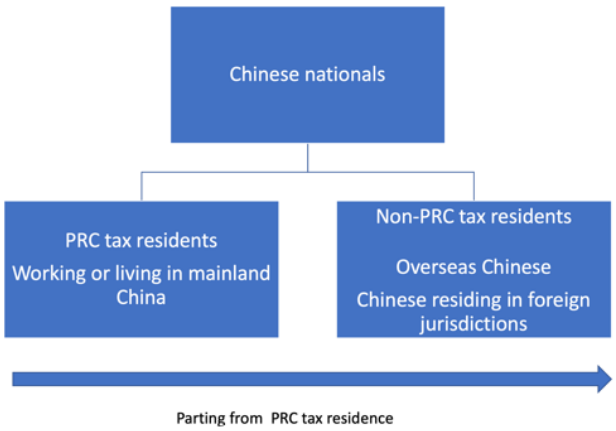
provisions of the Interpretation of the Articles of the Agreement between China and Singapore shall also apply to the interpretation and implementation of the same Articles of other agreements;

II. If there is any discrepancy between the Interpretation of the Articles of the Agreement between China and Singapore and the interpretation and implementation documents of the relevant tax agreements issued heretofore, the Interpretation of the Articles of the Agreement between China and Singapore shall prevail.

[21] People's Republic of China Overseas Chinese Affairs Office of the State Council, Notice on Issuing the Provisions on Defining the Identity of Overseas Chinese, Chinese of Foreign Nationality, Returned Overseas Chinese and Their Family Members (No. 5 [2009]); People's Republic of China State Taxation Administration, Notice on Clarifying Several Issues Concerning the Implementation of Individual Income Tax Policies (Guoshuifa [2009] No. 121).

c. A Chinese citizen shall not be defined as an Overseas Chinese during the period when he studies abroad (either at the expense of the government or his own) or when he works in a foreign country on business (including the assignment of labour forces to foreign countries).

Figure 1: Changing tax residency status of Chinese nationals



From the above policies, it can be seen that certain Chinese nationals abroad are clearly regarded as non-resident in China for tax purposes. Therefore, a Chinese national employed abroad faces one of three different situations: he or she will be regarded as a Chinese tax resident only; he or she becomes a dual resident; or he or she is a non-resident from the perspective of China. However, it seems that it is not possible for a Chinese person to be domiciled in China and recognised as a non-resident; the person would have to leave China for at least five years or acquire a foreign permanent residence permit to cease to be a Chinese tax resident. This means that Chinese nationals involved in cross-border activity who are not Overseas Chinese or who have left China for less than five years have a tax status that is most interesting and uncertain.

A typical example of this uncertain situation is a domiciled Chinese resident involved in cross-border employment working outside mainland China, such as a person from mainland China working in Hong Kong on an employment visa. If the visa expires as a result of quitting the job or completing the contract, the person has to return to China without having become a permanent resident in Hong Kong. This person is likely to be regarded as habitually residing in China through the period he or she worked in Hong Kong and therefore the income he or she earned in Hong Kong will still be subject to taxation in China. There would be "double taxation"[22]: the income would be taxed in Hong Kong as it is considered Hong Kong sourced income as well as taxed in China on the basis of the individual's tax residence. In this case, the cross-border employee will have to pay the higher rates imposed by China's IITL.

[22] As the tax charged in Hong Kong will be relieved by the tax credit provided in mainland China, there will typically be no actual double taxation.

D. *Double tax treaty: income from employment*

When the cross-border employee is only involved in a temporary job outside China, the treatment of employment income can be seen in Article 15 of the double tax treaty between mainland China and Singapore:

> 1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
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> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
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> (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days within any twelve-month period; and
>
> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
>
> (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.[23]

According to Article 15, employment income should be primarily subject to taxation in the person's home state, *i.e.,* where the individual is tax resident. If a person is regarded as a Chinese tax resident, his or her employment income should be taxed in China. The other state may only tax that income when the employment is exercised in that other state. But if the employment performed in the other state meets the conditions in paragraph 2, the taxing right is reserved solely for the residence state. This means that if a Chinese state-owned enterprise (SOE) employee is seconded to Singapore or another overseas branch for less than 183 days and is paid by the Chinese SOE, the income earned during the overseas secondment will only be taxed in China.

If the employment does not meet the conditions laid down in paragraph 2 of Article 15,[24] a person employed in the other jurisdiction may be taxed on that income in that other jurisdiction. As mentioned above, a person employed abroad who has not yet qualified as Overseas Chinese will still be considered a Chinese tax resident. Thus, their employment income will be subject to the IITL, even if it is already being taxed in the state where the employment is performed. In order to

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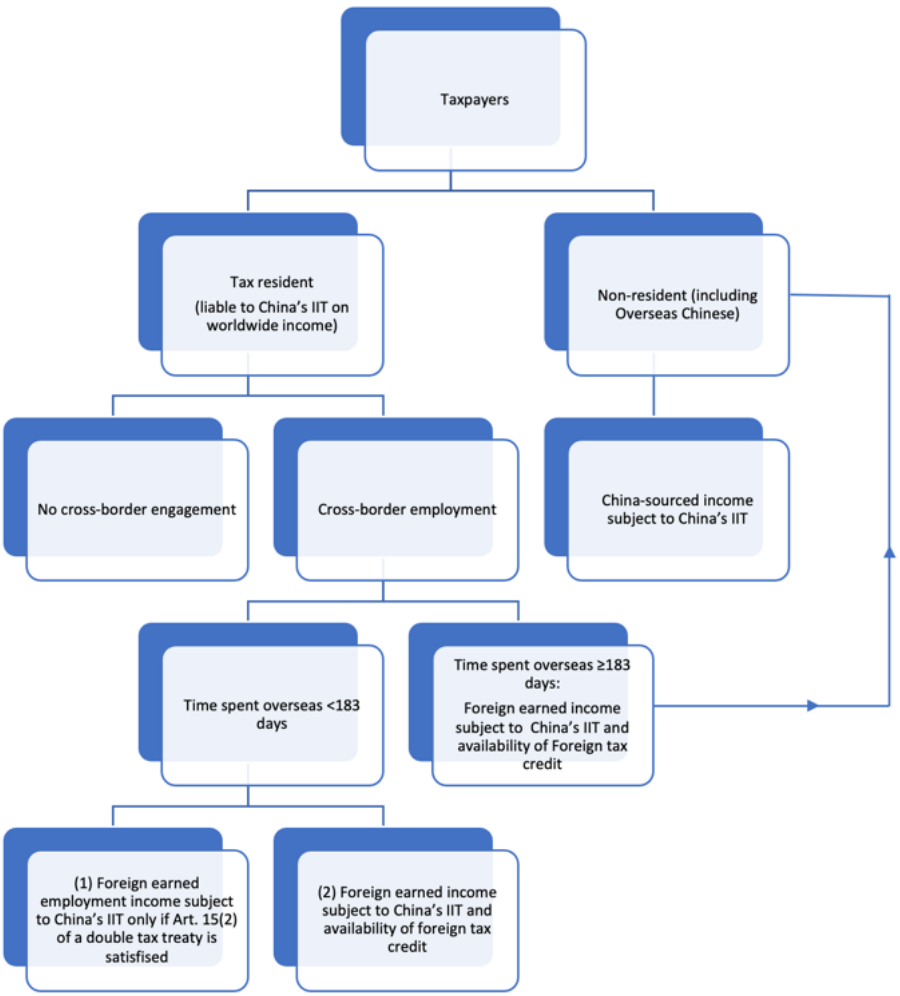
[23] Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (2008), Article 15.

[24] *Ibid.*

Figure 2: Tax liability and tax residence in China



avoid this double taxation, a possible solution might be to become a tax resident in the other state by applying the treaty tie-breaker rule (if available).

The following section analyses a dual-residence dispute dealt with by a Chinese tax authority to demonstrate the implementation of the tie-breaker rule in mainland China.

III. Case analysis: tie-breaker rule in the double tax arrangement between China and Hong Kong SAR

This case illustrates the factors that were considered by Chinese tax authorities in deciding the status of an individual tax resident. Although changes were made to the residence rule in the 2018 amendments to the IITL, many key concepts in relation to a taxpayer's residence status have been carried forward. This case, adjudicated

before 2018, is still of relevance in understanding the position of the Chinese tax authorities.[25]

In 2013, Mr Y signed a non-fixed-term labour contract to become chief operating officer with Company C located in City X in China. The contract stipulated that his main work location was City X.

From 2014, Mr Y served concurrently as the executive director of Company D, a subsidiary of Company C in Hong Kong, and also performed his duties in Hong Kong.

Mr Y applied for a refund of the income tax he paid in China in 2014 and 2015, during which time he considered himself tax resident in Hong Kong. He provided his Hong Kong identity card as a non-permanent resident and the Hong Kong tax resident certificate issued by the Hong Kong Inland Revenue Department (IRD) for 2014 and 2015.

However, this was not accepted by the Chinese tax authority in charge of Mr Y's tax affairs, which determined that Mr Y had maintained his Chinese tax residency throughout the period when he worked in Hong Kong.

The mainland tax authority made the decision after applying the tie-breaker rule included in the double tax arrangement (DTA) between China and Hong Kong. The reasons were as follows:

(1) Mr Y was a domiciled tax resident in mainland China
From 2014 to 2015, Mr Y spent two years in Hong Kong on secondment, meaning he was expected to return to China after the secondment was over. Mr Y was only a non-permanent resident in Hong Kong and his household registration was in the mainland. He was regarded as habitually residing in the mainland during those two years. For these reasons, Mr Y was recognised as a domiciled Chinese tax resident. As Mr Y was issued a Hong Kong tax resident certificate, the tie-breaker rule included in the DTA between China and Hong Kong was applied.

(2) Application of the tie-breaker rule

Mr Y was not entitled to a tax refund because the Chinese tax authority decided that Mr Y had been a Chinese tax resident during his stay in Hong Kong.

As mentioned above, in order to support his tax refund claim, Mr Y obtained a Hong Kong tax resident certificate from the IRD for 2014 and 2015. The IRD suggests that a Certificate of Resident Status is a document issued to a Hong Kong resident who requires "proof of resident status for the purpose of claiming tax benefits under the Comprehensive Double Taxation Agreements/Arrangements".[26] The IRD indicates that the Certificate of Resident Status should constitute sufficient proof of the residence status of a Hong Kong resident and issues the certificate to help the applicant receive DTA tax benefits. Nevertheless, the IRD acknowledges

[25] People's Republic of China State Taxation Administration International Taxation Department (ed), *Cases of the Implementation of Tax Treaties* (China Taxation Press 2019) (in Chinese), 1–4.

[26] Hong Kong SAR Inland Revenue Department, "Certificate of Resident Status" <https://www.ird.gov.hk/eng/tax/dta_cor.htm>.

Table 1: Tie-breaker rule in the DTA between mainland China and Hong Kong

DTA between mainland China and Hong Kong, Article 4 (2)	***Circular No. 75* Interpretation**	**Connection with Mainland China**	**Connection with Hong Kong**
(a) Permanent home He shall be deemed to be a resident only of the State in which he has a permanent home available to him.	*According to Circular No. 75, a permanent home includes any form of abode, such as a house or apartment rented by an individual and a rented room, but the abode must be permanent, that is, the individual plans to live in it on a long-term basis instead of temporarily (such as during travel and business tours).*	Mr Y owned three properties in City X. Mr Y lived in one of the properties before he moved to Hong Kong and when he travelled back to City X during his secondment in Hong Kong. The property could be regarded as his permanent home in the mainland.	Mr Y rented and lived in a residential property when he worked in Hong Kong, which could also be regarded as a permanent home.
Therefore, Mr Y has permanent residence in both China and Hong Kong. As Mr Y's residence status could not be resolved by applying the permanent home test, the next step was to identify his centre of vital interests.			
(b) Centre of vital interests If he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer.	*According to Circular No. 75, the centre of vital interests shall be comprehensively determined by referring to the family and social relations of the individual, occupational, political, cultural and other activities, business places, the place of management of property and other factors. Special attention shall be paid to the individual's behaviour, that is, the State where the individual has been living and working, and has a family and property is usually the place where the centre of vital interests is situated.*	Mr Y was employed by Company C and served as the executive director for Company D in Hong Kong. His salary was paid by Company C, which also paid for his social insurance and housing provident fund, and Company D did not buy insurance for Mr Y in Hong Kong. In 2014, he stayed in China for 220 days, and in 2015 he stayed in China for 160 days. According to third-party information, most of Mr Y's relatives lived in China and had stable social relationships in the mainland. His family assets were mainly concentrated in the mainland, including deposits, stocks, cash, vehicles, and three properties.	In Hong Kong, Mr Y had only one rented house and one car. Both Mr Y's wife and daughter obtained non-permanent Hong Kong resident status; his wife was a housewife and his daughter studied at a secondary school in Hong Kong.
After considering all the relevant factors, the Chinese tax authority decided that Mr Y's tie with China was closer and therefore his centre of vital interests was in China. He was determined to be a Chinese tax resident after applying the tie-breaker rule.			

that whether the certificate holder can actually claim the DTA benefits depends on the decision of the treaty partner.[27]

According to the IRD, an individual can apply for a Certificate of Resident Status if he or she:

i. ordinarily resides in Hong Kong in that year of assessment or
ii. stays in Hong Kong for a period or a number of periods amounting to more than 180 days during that year of assessment or for a period or a number of periods amounting to more than 300 days in two consecutive years of assessment, one of which is the year of assessment (part of a day spent in Hong Kong is counted as one day).[28]

An individual "ordinarily resides" in Hong Kong if he or she has a permanent home in Hong Kong where the individual or the individual's family lives.[29]

Mr Y seemed to meet these two requirements: he rented a property in Hong Kong, lived there together with his wife and daughter, and stayed in Hong Kong for more than 300 days in two consecutive years of assessment. Nevertheless, his ties with China were regarded as stronger by the Chinese tax authority. Mr Y did not ask the IRD or the Chinese tax authority to initiate the mutual agreement procedure (MAP) but accepted their decisions. As the MAP was not launched, the tax authorities from mainland China and Hong Kong enforced their own decisions and Mr Y had to comply with the requirements from both sides.

Based on the available information, Mr Y's case appears disputable.[30] Although Mr Y had assets, relatives and other connections with the mainland, he performed his job duties mainly in Hong Kong and his immediate family lived in Hong Kong. In some other jurisdictions, living with family or the location of a spouse is regarded as one of the key factors in determining a person's place of residence.[31]

In Mr Y's case, the place of signing his employment contract, the receipt of a salary from Company C and the temporary nature of his work in Hong Kong may have been the deciding factors considered by the Chinese tax authority. When Company C paid his salary, it also withheld income tax for Mr Y and remitted this money to the Chinese tax authority. Therefore, if other conditions were the same, and Mr Y was directly employed by a Hong Kong company and paid by the Hong Kong employer, it is possible that Mr Y would have succeeded in insisting that he was only resident in Hong Kong during those two years.[32]

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[27] *Ibid*.

[28] *Ibid*.

[29] Hong Kong SAR Inland Revenue Department, "Information on Residency for Tax Purposes—Hong Kong, China" <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/Hong-Kong-Residency.pdf>.

[30] Although the Chinese tax authority's position was within the generally understood and accepted parameters of centre of vital interests to hold as it did, the Chinese tax authority's position was aggressive.

[31] Lynne Oats, *Principles of International Taxation,* 8th edn (Bloombury Professional, 2021) at section 3.12, Canada and section 3.17, Germany [Oats]; Government of Canada, "Determining your residency status" <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/determining-your-residency-status.html>.

[32] Ayesha Macpherson Lau & Michael Olesnicky, *Hong Kong Taxation: Law and Practice, 2018–19 Edition* (The Chinese University of Hong Kong Press, 2019) at 425 [Lau & Olesnicky].

As Mr Y's case shows, however, the issue with the tie-breaker rule in the DTA is that although he regarded himself as solely tax resident in Hong Kong, this did not stop the Chinese tax authorities from determining that he was tax resident in China. Without launching the MAP, the tax authorities on both sides had no opportunity to exchange opinions and possibly resolve the dispute.[33]

IV. Inflexibility of the Chinese tax residency rule: domicile v. residence

Domiciliation for Chinese tax purposes does not emphasise the subjective intentions of a person recognising a place as his or her permanent home. As indicated by the IITL Implementation Rules, domiciliation for Chinese tax purposes is determined largely by objective factors, not the individual's subjective intent. Thus, even if the individual intends to remain abroad indefinitely, this will not be considered.

This understanding of "domicile" is consistent with the meaning adopted in other areas of Chinese law. For example, according to the Civil Code, Article 25:

> The domicile of a natural person shall be his or her place of residence recorded in the household registration or any other valid identity registration; but if his or her habitual residence is different from the domicile, the habitual residence shall be deemed his or her place of domicile.[34]

The domicile for deciding tax residence purposes in China is equated with habitual residence, whereas in many jurisdictions, "domicile" and "habitual residence" are two distinct concepts.[35] The concept of a domicile can be traced back to the Roman Empire and means "the place in which a person had made his permanent home".[36] It is therefore used as the major connecting factor to determine the personal law of an individual.[37]

"Domicile" in the traditional sense "focuses upon the taxpayer's intent to return to the taxing state and his permanent allegiance to that state, rather than his immediate

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[33] Under Article 4 of the Arrangement between China and Hong Kong, if a taxpayer has a habitual abode in both sides or in neither of them, the competent authorities of both sides shall resolve by mutual agreement. As a matter of fact, individuals rarely invoke the MAP.

[34] Civil Code of the People's Republic of China (2020), Article 25.

[35] Hong Kong (People's Republic of China), The Law Reform Commission of Hong Kong, *Rules for Determining Domicile* (April 2006) at 26.

[36] *Ibid* at 1, quoting *Mason v Mason* (1885) EDC 330, at 337.

[37] Jonathan Schwarz, *Booth and Schwarz: Residence, Domicile and UK Taxation*, 20th edn (Bloomsbury Professional, 2018) at 343 [Schwarz]; *Ibid* at 1. There are usually five principles of domicile: (1) No one shall, at any time, be without a domicile; (2) No one can simultaneously have more than one operative domicile; (3) Domicile must relate to a territory subject to a single system of law, whether or not the limits of that territory coincide with national boundaries; (4) An existing domicile is presumed to continue until it is proved that a new domicile has been acquired, *ie* a change of domicile may never be presumed; and (5) Domicile must be determined according to one jurisdiction's domestic law, as different jurisdictions may adopt different meanings of domicile.

physical presence in the state".[38] Due to its subjective and fact-intensive nature, "domicile" has either been significantly limited or supplemented by statutory residence tests for tax purposes.[39] The subjective aspect of "domicile" means that the determination of an individual's tax residency status should be flexible and take into account his or her intention. As "domicile" in the Chinese tax context is explained as habitual residence and mainly relies on a person's household registration, the Chinese definition of domicile lacks flexibility. Taking into account all the rules mentioned above, the effect of Article 1 of the IITL is that, with a few exceptions, citizenship and household registration are the primary connecting factors to determine a person's tax residence in mainland China.

According to a news report, in June 2020, China Resources Group, Industrial and Commercial Bank of China (Asia), China CITIC Bank, China Merchants International, Bank of China (Hong Kong) and other Chinese-funded companies in Hong Kong issued internal notices requiring employees from China who hold work visas or come to Hong Kong through the Quality Migrant Admission Scheme to pay IIT on their Hong Kong income in China.[40] These employees were mainly seconded from their group companies in China. The report noted that even some mainland Chinese who were directly hired by these Hong Kong companies were required to comply with the IITL.[41] A common feature of these companies is that they are funded by mainland China-based sibling or parent companies; employees from the mainland working for companies local to Hong Kong seem to not have been affected so far. This suggests that Chinese employees seconded to other jurisdictions by China-based companies might also be targeted in future, for example, Chinese working in overseas branches or subsidiaries of SOEs.[42]

Given the criteria for becoming an Overseas Chinese, acquiring permanent residence or staying in a foreign jurisdiction for a substantial period would be regarded as proof of having a new place of domicile.[43] This suggests that there is almost no possibility for a Chinese to be domiciled in China and be considered non-resident. The inflexibility of the Chinese domicile rules can be changed by inserting a special test considering the employment status of Chinese expatriates. In the following section, the full-time employment test used in the United Kingdom (UK) and Japan will be considered.

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[38] Edward A. Zelinsky, "Defining Residence for Income Tax Purposes: Domicile as Gap-Filler, Citizenship as Proxy and Gap-Filler" (2017) 38(2) Mich.J.Int'l L at 271-272.

[39] *Ibid* at 272.

[40] Shu Yuan, "Mainlanders Working in Hong Kong Required to Pay Mainland Tax" <https://www.hk01.com/社會新聞/495637/在港工作內地人需繳內地稅-中資公司發公告催申報-稅率遠超本港> (9 July 2020).

[41] *Ibid*.

[42] Employees seconded by Chinese SOEs to foreign jurisdictions are usually not allowed to acquire permanent resident status by the SOE through special employment arrangements.

[43] To be specific, Guoshuifa [2009] No. 121 (Circular 121), as shown in section 2.3, mentions that there are two different groups of Oversea Chinese that are regarded as non-residents. The first group has obtained long-term or permanent residence in a foreign country, while the second group has not acquired such permanent residence yet. For both groups to maintain the status of non-residents, they need to be physically present in the foreign countries for sufficient time as outlined in Circular 121. This means beyond the required time, they can stay in mainland China for some time as well.

A. *The UK statutory residence test*

The UK tax residency test is designed to "ensure that resident individuals cannot become and remain non-resident without significantly reducing the extent of their connection with the UK", and it is much harder to "become non-resident when leaving the UK after a period of residence than it is to become resident when an individual comes to the UK."[44] This underlying rationale sounds similar to the one used in the Chinese context. Nevertheless, the UK residency tests are designed to accommodate different specific situations.[45]

UK residence can be decided by applying the hierarchical statutory residence test, starting with the automatic overseas tests, followed by the automatic UK residence test and lastly the sufficient ties test.[46] The automatic tests consider four factors: physical presence in the UK; having and using a home in the UK; full-time work either in the UK or overseas; and death.[47] If a living individual is not physically present in the UK at all in a tax year, he or she will not qualify as a UK resident, whereas if a person spends 183 days or more in a tax year in the UK, he or she will be a UK resident, thus satisfying the first automatic UK test.[48] If a person wants to meet the UK automatic overseas test, depending on his or her residence status in the UK in the three tax years preceding the year in question, the number of days the person could be present in the UK is very limited, either less than 16 days or less than 46 days.[49]

Having and using a home in the UK for a sufficient period of time during the tax year will mean that the person satisfies the second automatic UK test, while working full-time in the UK or overseas will qualify the person as a UK resident or a non-resident, respectively.[50]

The full-time work overseas test means a UK-resident individual leaving the UK to work abroad full-time will be regarded as a non-resident during his or her time working overseas, regardless of their other connections with the UK (subject to certain exceptions).[51] An individual working full-time abroad will be regarded as conclusively non-resident if he or she:

(1) works sufficient hours overseas, as assessed, over the tax year;
(2) has less than 31 days in the year on which he does more than three hours' work in the United Kingdom;

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44 Schwarz, *supra* note 37 at 95.

45 Claire Weeks and Emma-Jane Weider, "The Statutory Residence Test and Covid-19" (2020) 5 P.C.B. 279; Aparna Nathan, "Section 218 and Schedule 45: the Statutory Residence Test" (2013) (4) B.T.R. 516.

46 Schwarz, *supra* note 37 at 96; Oats, *supra* note 31 at section 3.21 United Kingdom.

47 Schwarz, *supra* note 37 at 98.

48 *Ibid* at 98.

49 *Ibid* at 97. The first automatic overseas test: residence in the United Kingdom for one or more of the three tax years preceding the year and less than 16 days in the year in the United Kingdom; the second automatic overseas test: residence in the United Kingdom for none of the three tax years preceding the year and spending less than 46 days in the year in the United Kingdom.

50 *Ibid* at 97.

51 *Ibid* at 115.

(3) spends less than 91 days a year in the United Kingdom; and
(4) there are no significant breaks from overseas work during the year.[52]

Sufficient hours working overseas will be determined by applying a relatively complicated five-step formula.[53] One of the essential factors is to disregard days on which the person does more than three hours of work in the UK, even when the person also performs work abroad on the same day.[54] In contrast, an individual working full-time in the UK will be regarded as conclusively resident in the UK, irrespective of their other connections.[55]

Domicile is used mainly as the connecting factor for determining a taxpayer's liability to inheritance tax.[56] The UK statutory residence rule provides an analysis framework for dealing with different personal situations: on the one hand, the framework protects UK taxing rights over tax residents, and on the other hand, it releases those qualifying as non-residents from UK income tax on their foreign-earned income.

B. *Japan*

Japan also takes into account employment status when deciding an individual's tax residence.[57] The general rule in Japan, similar to that in China, has two residence tests: domicile and physical presence. When an individual has an occupation which normally requires residing in Japan continuously for one year or more, this individual will be presumed to be domiciled in Japan; when an individual has an occupation which normally requires residing abroad continuously for one year or more, this person will be presumed to not be domiciled in Japan.[58]

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[52] *Ibid* at 115.

[53] *Ibid* at 115–116.

[54] *Ibid* at 116.

[55] *Ibid* at 117. The conditions are: (1) works sufficient hours in the United Kingdom, as assessed, over a period of 365 days, all or part of which fall within the tax year; (2) does more than three hours' work in the United Kingdom on more than 75% of the total number of days in that period in which the individual does more than three hours' work; (3) does more than three hours' work in the United Kingdom on at least one day which is both in that period and the tax year; and during that period, there are no significant breaks from UK work.

[56] *Ibid* at 70.

[57] Japan National Tax Agency, "2021 Income Tax and Special Income Tax for Reconstruction Guide" <https://www.nta.go.jp/english/taxes/individual/pdf/a-4.pdf>; "Japan - Information on Residency for Tax Purposes" <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/Japan-Tax-Residency.pdf> [Japan Information on Residency for Tax Purposes]; KPMG, "Japan: Thinking Beyond Boarders for Japan" <https://home.kpmg/xx/en/home/insights/2021/08/japan-thinking-beyond-borders.html> (January 2021).

[58] Japan Information on Residency for Tax Purposes, *supra* note 57. According to the Order for Enforcement of the Income Tax Act (Japan) (1965), Article 15, an individual who falls under any of the following cases is presumed to not have their domicile in Japan: (i) an individual has an occupation which normally requires residing abroad continuously for one year or more (ii) it cannot be sufficiently presumed that an individual will return to Japan and mainly reside in Japan in light of the circumstances, such as whether the person has foreign nationality or permanent residency and does not support his or her relatives who reside in Japan, or whether the person does not have his or her occupation and assets in Japan.

The consideration of employment status in a foreign jurisdiction makes the residence rules flexible and taxpayer-friendly, reducing both compliance and administration costs. Cross-border employees do not need to worry about complying with two sets of different IIT liabilities, and they will be more willing to comply with any other tax liabilities that may occur due to income or gains sourced in their home jurisdictions (this would be true especially when the two tax systems operate as mirror images).

C. *United States*

Apart from the special consideration of full-time employment to reduce double taxation, the approach used in the United States (US) is also worth considering. In the US, the general rule is to tax its citizens on their worldwide income, with several special polices: those expatriates subject to US income tax on their worldwide income are entitled to both US foreign tax credit for taxes paid abroad and exemption from US income tax on part of their foreign earnings.[59] The maximum foreign-earned income that can be excluded is adjusted annually for inflation.[60] In 2021, the maximum excludible amount was US$108,700.[61] Besides the foreign-earned income exclusion, under some circumstances, an individual may also claim an exclusion or a deduction from gross income for his or her foreign housing costs.[62]

To be eligible for these benefits, a person needs to have foreign-earned income, his or her tax home must be in a foreign country, and the person needs to meet either the *bona fide* residence test or the physical presence test.[63]

According to this US Internal Revenue Service (IRS) explanation, a person will not automatically meet the *bona fid*e residence test by living in a foreign country or countries for one year. Rather, the determination is based on factors such as the individual's intention or purpose for being in the foreign country, his or her activities in the foreign country, and whether he or she paid taxes in the foreign country.[64] A person may be regarded as establishing such *bona fide* residence by setting up permanent quarters for his or her family in a foreign country, even though the person may intend to return to the US eventually.[65]

By providing a tax-free amount, the overall tax liability of these US expatriates is further reduced, alleviating the situation where a US citizen or resident alien living elsewhere might be subject to full US income taxation. However, the obligation to file tax returns remains (unless the individual does not earn enough income to be required to file a tax return).

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59 Reuven S. Avi-Yonah, "Tax Symposium: Introduction" (2017) 38(2) Mich.J.Int'l L 161.

60 US Internal Revenue Service, "Figuring the Foreign Earned Income Exclusion" <https://www.irs.gov/individuals/international-taxpayers/figuring-the-foreign-earned-income-exclusion>.

61 *Ibid*.

62 US Internal Revenue Service, "Foreign Housing Exclusion or Deduction" <https://www.irs.gov/individuals/international-taxpayers/foreign-housing-exclusion-or-deduction>.

63 *Ibid*.

64 US Internal Revenue Service, *Bona Fide* Residence Test, *supra* note 64.

65 *Ibid*.

Table 2: The *bona fide* residence test and the physical presence test

Test	Persons covered	Requirement
The *bona fide* residence test[66]	1) US citizen, or 2) US resident within the meaning of Internal Revenue Code section 7701(b)(1)(A) who is a citizen or national of a country with which the United States has an income tax treaty in effect.	"If you are a *bona fide* resident of a foreign country or countries for an uninterrupted period that includes an entire tax year. During your period of *bona fide* residence in a foreign country, you may leave that foreign country for brief or temporary trips to the United States or elsewhere so long as you clearly intend to return to your foreign residence or to a new foreign *bona fide* residence without unreasonable delay."[67]
The physical presence test[68]	1) US citizens, or 2) US residents within the meaning of Internal Revenue Code section 7701(b)(1)(A)	"You meet the physical presence test if you are physically present in a foreign country or countries 330 full days during any period of 12 consecutive months including some part of the year at issue. The 330 qualifying days do not have to be consecutive."[69]

The approach used in the UK and Japan can be called a non-resident method, while the US approach can be described as a foreign income exclusion method.[70] The effect of both methods is similar in terms of exempting expatriates from the taxation of the home state on their foreign-earned income.[71] The Chinese mechanism is more like the non-resident approach. However, it is much harder to satisfy than Japan's or even the UK's overly complicated regime.

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66 US Internal Revenue Service, "Foreign Earned Income Exclusion - *Bona Fide* Residence Test" <https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion-bona-fide-residence-test> [US Internal Revenue Service, *Bona Fide* Residence Test].

67 *Ibid*.

68 US Internal Revenue Service, "Foreign Earned Income Exclusion - Physical Presence Test" <https://www.irs.gov/individuals/international-taxpayers/foreign-earned-income-exclusion-physical-presence-test>.

69 *Ibid*.

70 What is worth mentioning is that the US approach is necessitated by the fact that it is impossible for a US citizen or permanent residence to change his or her tax residence unless he or she relinquishes his or her citizenship or immigration status. This is not the case in the Chinese regime, where it is possible to lose residency status for tax purposes without relinquishing Chinese citizenship or *hukou* under certain circumstances.

71 The similar effect only applies to reduced compliance burden to the expatriates in respect of their foreign-earned income. There are still some differences between the US and UK approaches: even if there is no US tax liability, the US individual abroad will still have to file a return and may have to pay tax; the UK non-resident will not have to file a return at all.

V. Inequity in PRC tax residence rules

Determination of Chinese tax residence status mainly relies on two tests: domicile (habitual residence) and physical presence. As the habitual residence test does not require actual physical presence in China, it becomes very hard to break the tie for domiciliary Chinese nationals when they start to work abroad. This is similar to the basic premise adopted in the UK residency test discussed above. However, 183-day tax residents are entitled to make use of the foreign income exclusion rule, while non-residents can easily maintain their non-resident status even though they may work full-time in the mainland because of the generous way days are counted.

A. *183-day tax resident: partially liable*

A person who stays in China for no fewer than 183 days in a tax year will become a tax resident for IIT purposes (a 183-day tax resident) and is liable for income earned inside and outside China only after the six-year rule is met.[72] The six-year rule requires that a non-domiciled individual: (1) stays in China for at least 183 days in a tax year, (2) has already stayed in China no fewer than 183 days in each of the six consecutive years immediately before the tax year in question, and (3) has not left China for more than 30 days in a single trip in any of the six years.[73] After meeting all the requirements, the 183-day tax resident will become fully liable on all income earned in and outside China.[74] But if in any of the previous six years, the person stayed fewer than 183 days or left China for more than 30 days in a single trip, the income sourced outside China and paid by overseas entities or individuals is exempt from Chinese taxation.[75]

This means a non-domiciled individual will become a full tax resident only in the seventh year and only after meeting the 183-day test for that year and each of the previous six years. If a person wants to break the six-year rule, he or she need only not stay in China more than 183 days in one year or exit China for at least 30 consecutive days. The counting of the six years is reset to start from 2019.[76]

As shown in the above table, it is relatively easy to maintain entitlement to the Chinese foreign-sourced income exemption. Either way, the six-year period will be reset. The get-out clause is to attract foreign investors, including those from Hong Kong, Macau and Taiwan.

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[72] Hong Kong SAR Constitutional and Mainland Affairs Bureau, "Taxation of Hong Kong Individuals Working in Mainland" <https://www.bayarea.gov.hk/filemanager/en/share/pdf/Tax_arrangement.pdf> (24 June 2019) [Taxation of Hong Kong].

[73] People's Republic of China Ministry of Finance and State Taxation Administration, Standards for Determining the Period of Residence of an Individual Who Has No Domicile in China, (Announcement No. 34 [2019]) [Announcement No.34 [2019]].

[74] *Ibid*.

[75] Taxation of Hong Kong, *supra* note 72.

[76] Announcement No.34 [2019], *supra* note 73.

Table 3: Tax liability of non-residents and non-domiciled residents (183-day residents)

Days spent in the mainland	Tax residency status	Income sourced in China		Income sourced outside China	
		Income paid by Chinese employers	Income paid by foreign employers	Income paid by Chinese entities or individuals	Income paid by foreign entities or individuals
Fewer than 90 days (or 183 days where there is a double tax treaty)	Non-resident	Taxable	Non-taxable	Non-taxable	Non-taxable
More than 183 days in a tax year up to six consecutive years	Resident	Taxable	Taxable	Taxable	Non-taxable
More than 183 days in a tax year after more than six consecutive years (without more than 30-day trip abroad in any of the previous six years)	Resident	Taxable	Taxable	Taxable	Taxable

B. *Ease of maintaining non-resident status*

According to the Ministry of Finance and the State Taxation Administration Public Announcement [2019] No. 34,[78] when calculating the number of days in China, only days when a person spends a full 24 hours in China are counted; days when a person spends less than a full 24 hours will not be counted.[79]

This approach is definitely welcomed by many cross-border commuters from Hong Kong or Macau. As long as they carefully monitor how many days they stay in the mainland, any income earned outside mainland China would also be free from Chinese taxation. This day-counting rule is very generous. For example, the US substantial presence test treats an individual as present in the US on any day he or she is physically present in the country at any time during the day.[80]

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[77] The rules applicable to employment income earned by directors, supervisors and senior management personnel are different. *Ibid.*

[78] *Ibid.*

[79] An example was provided by a State Taxation Administration official to explain the application of the rule: Mr Li is a Hong Kong resident who works in Shenzhen. He comes to work in Shenzhen every Monday morning and returns to Hong Kong every Friday night. On Mondays and Fridays, he stays less than 24 hours, so these two days, plus Saturdays and Sundays, will not be counted. Thus, the number of qualifying days in a week that can be counted is only three. Given 52 weeks in a year, the number of days Mr Li stays in the mainland in the whole year is 156, which does not exceed 183 days. He does not constitute a tax resident. All the overseas income obtained by Mr Li can be exempted from personal income tax in mainland China. International Taxation Department of State Taxation Administration of PRC Income Tax Department, "Conference on Questions Regarding 183-Day Residence Rule" <http://www.chinatax.gov.cn/n810341/n810760/c4148935/content.html> (16 March 2019).

[80] US Internal Revenue Service, "Determining an Individual's Tax Residency Status" <https://www.irs.gov/individuals/international-taxpayers/determining-an-individuals-tax-residency-status>; "United States - Information on Residency for Tax Purposes" <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/United-States-Tax-Residency.pdf>.

C. *Subsidies afforded to "talent"*

The methods discussed above help to reduce Chinese tax liability on foreign-sourced income. There are also certain measures available to foreigners working in the mainland to reduce Chinese taxes on Chinese source income.

In Caishui [2019] No.31,[81] a special IIT rebate is provided to foreign (including Hong Kong, Macau and Taiwan) highly skilled professionals (including "high-end talent" and "talent in short supply") who work in the Guangdong-Hong Kong-Macau Greater Bay Area (the 'Greater Bay Area'). It is designed to offset these professionals' high IIT liability as a result of working in the mainland. The subsidy compensates for the relatively high mainland IIT rates compared to Hong Kong, Macau or Singapore, and reduces the effective tax rate to around 15%, equalising the income tax liability regardless of whether these workers are employed in Hong Kong or the mainland. This policy is commonly known as *Gang Ren Gang Shui*, or "Hong Kong taxation for Hong Kongers". In order to enjoy the tax subsidy, a qualifying person has to apply to the relevant local government. Similar treatment is available in the Hainan Free Trade Port (FTP) and is simplified by waiving any tax liability above 15% for high-end and urgently needed employees working there between 1 January 2020 and 31 December 2024.[82]

VI. Refinement of PRC tax residence rules

It is clear that China's IIT regime in relation to cross-border employment lacks neutrality and fairness. The inflexibility and unfairness of the PRC tax residence rules will discourage individuals planning to work overseas and encourage those currently working abroad to obtain permanent residence permits as soon as they can and possibly relinquish Chinese nationality. This could lead to "round-trip employment": after a person acquires foreign permanent resident status or foreign nationality, he or she could take up a job in mainland China (for example in the Greater Bay Area or Hainan FTP) and enjoy a much lower IIT liability.

Following the practices adopted in other jurisdictions, such as the UK and the US, current PRC tax residence rules could be modified to keep up with the development that there are more Chinese citizens either seconded to or directly hired by Chinese-funded or local companies in foreign jurisdictions.

The first change that could be considered is to adopt an automatic overseas test: Chinese citizens who work abroad full-time and stay in mainland China for less than 183 days will be regarded as non-residents.

A relevant question to be considered here is the source of employment income: is it the place where the employee does the work that earned the income, or where the employment itself was located? Different jurisdictions adopt different approaches to this question. For example, the Australian tax authority relies on the former

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[81] People's Republic of China Ministry of Finance and State Taxation Administration, Notice Regarding Preferential IIT Treatment for the Greater Bay Area (Cai Shui [2019] No. 31).

[82] C H Poon, "The Hainan Free Trade Port (1): Policy Update" <https://research.hktdc.com/en/article/OTI0NzczNTMz> (13 December 2021).

location, while the UK test focuses on the latter.[83] The Hong Kong IRD follows a two-tier approach to decide the source of employment.[84] The first step is to consider the following three factors:

(1) the place where the contract of employment was negotiated and entered into and is enforceable;
(2) the place of residence of the employer; and
(3) the place of payment of the remuneration.[85]

The IRD will treat a person's employment as being located in Hong Kong if any of the above three factors is in Hong Kong. However, even if all three factors are outside Hong Kong, the IRD may apply the totality of facts approach to decide whether it is a genuine non-Hong Kong source employment.[86]

Where an individual has employment that is not considered Hong Kong-based, only payment for services rendered in Hong Kong, including leave pay attributable to such services, will be subject to salaries tax in Hong Kong.[87] In the above case, although Mr Y was recognised as tax resident in Hong Kong, by looking into the three factors, Mr Y's employment was judged to be in the mainland rather than Hong Kong. The remuneration attributable to his services in Hong Kong were taxable in Hong Kong.

Will there be a situation where the income earned by a Chinese employee seconded to a foreign jurisdiction is regarded as "arriving in or derived from" an employment in the mainland and therefore becomes taxable in mainland China, even though the person working abroad has become a non-resident? Fortunately, under China's domestic IIT rule, there is no similar test for deciding the source of employment; income from the provision of labour services outside China due to holding an office, employment or performing contracts will be regarded as foreign-sourced.[88] Therefore, if an automatic overseas test is adopted, new non-residents will not be taxed on their foreign-earned employment income even if they are seconded by a mainland Chinese company.

Alternatively, a second approach is to adopt a US-style foreign-earned income exclusion rule for Chinese tax residents earning income in other jurisdictions, even though taxpayers are generally entitled to foreign tax credit. This measure saves the trouble of having a new category of non- residents. As in the US, a *bona fide* resident test or physical presence test could be used to determine whether a person is entitled to the foreign income exclusion rule.

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83 Lau & Olesnicky, *supra* note 32 at 425.

84 Patrick Kin-wai Ho and Kelvin Po-lung Mak, *Hong Kong Taxation and Tax Planning*, 19th edn (Pilot Publishing Company Ltd, 2020) at 105 [Ho & Mak].

85 Lau & Olesnicky, *supra* note 32 at 425.

86 Ho & Mak, *supra* note 84 at 105. There is no time-apportionment for taxable income from a Hong Kong source employment.

87 Lau & Olesnicky, *supra* note 32 at 431.

88 People's Republic of China Ministry of Finance and the State Taxation Administration on Relevant Individual Income Tax Policies for Overseas Income, (Announcement No. 3 [2020]).

VII. Conclusion

China's IIT regime was significantly updated in 2018, accompanied by strengthened enforcement. Before the 2018 reform, taxation on worldwide income was not strictly implemented. Although to date reported enforcement selectively targets employees working for Chinese-funded companies, it signals a tightened administration manner towards Chinese tax residents' foreign-sourced income. Voluntary compliance by taxpayers may be low; after China establishes a strong information exchange network, the enforcement of China's IIT on cross-border employment-related income will be more practical and feasible.

By analysing the key concepts in determining a person's tax residency in mainland China, including domicile, habitual residence, and the Overseas Chinese rule, the article reveals how difficult it is for domiciled Chinese to obtain non-resident status even after they have worked abroad for several years; they may become dual-tax residents, subject to double taxation. This article also examines the inequity and unfairness that exists in China's IIT regime, which treats 183-day residents and tax non- residents very generously.

The analysis of this article shows that China makes it much more difficult to shed tax residency than to acquire it. Many other jurisdictions, including the UK and the US, do the same. What should be acknowledged is that such discrimination (in the neutral sense) is not problematic conceptually as individuals domiciled in China and Chinese nationals have a greater connection to China than inbound expatriates. However, the approaches adopted in the UK, Japan and the US are fairer, more reasonable, flexible and taxpayer-friendly than the treatment provide in China.

The approaches used in the UK, Japan, and the US take into account different personal situations and allow residents working and living abroad to either take up non-resident status or make use of a generous foreign-earned income exemption rule. This article proposes that in order to improve the fairness and efficiency of China's IIT regime relating to cross-border employment, the approach used in the UK or the US should be considered as a way of modifying the existing inflexible domiciled tax residence rule.