



## **Hong Kong and Macau tax residents may be taxed favourably in mainland China**

### **Regulation discussed in this issue:**

- Announcement [2012] No. 16 issued by the State Administration of Taxation (Announcement 16)

The State Administration of Taxation (SAT) issued Announcement [2012] No. 16 (Announcement 16) on 26 April 2012 to address the double taxation issues that are encountered by Hong Kong and Macau tax residents who exercise their employment duties in mainland China. Announcement 16 will come into effect on 1 June 2012 and is applicable to employment income derived from this date.

### **Background**

With the increasing number of Hong Kong and Macau residents exercising employment duties in mainland China in recent years, double taxation due to the differing income sourcing rules being adopted by mainland China and Hong Kong /Macau has become an emerging issue, which has caught the attention of the State Administration of Taxation (SAT). Announcement 16 was issued to address some of these issues, which may otherwise affect residents of Hong Kong and Macau.

### **Measures to eliminate double taxation**

Announcement 16 attempts to eliminate double taxation for tax residents of Hong Kong and Macau who exercise employment duties in mainland China, by introducing:

- More favourable formula to determine PRC individual income tax (IIT)
- Practical ways of counting workdays for IIT purposes
- New rule for sourcing bonus payments.

- **Application of time apportionment formulae**

The following two tax calculation formulae were introduced in Announcement 16, which may be applied to employment income derived by eligible tax residents of Hong Kong and Macau from 1 June 2012:

Formula I

*IIT on total monthly income x (No. of days physically present in mainland China/total no. of days in the month)*

Formula II

*IIT on total monthly income x (No. of days physically present in mainland China/Total no. of days in the month) x (Income paid or borne by mainland China for the month/Total monthly income)*

According to The Announcement, it would appear that Formula I would be the default formula for eligible tax residents of Hong Kong and Macau who exercise employment duties in mainland China. However, the more favourable formula II may be applicable when the remuneration cost of the individual can be effectively allocated between the Hong Kong/Macau employer and a resident company or permanent establishment in mainland China. In order to ascertain how each of these formulas would be practically applied, further consultation with the in-charge tax authority may be required.

- **Counting of workdays**

Announcement 16 provides a practical solution to day-count for tax residents of Hong Kong and Macau in determining their PRC IIT by allowing them to only account for the number of days they are physically present in mainland China.

- **Sourcing of bonus**

The method for sourcing bonuses for PRC IIT purposes has also been reviewed for tax residents of Hong Kong and Macau, and a new approach to source bonuses based on one's physical presence in mainland China over the performance period is introduced in Announcement 16. Where applicable, the cost allocation ratio of the bonus between the Hong Kong/Macau employer and a resident company or permanent establishment in mainland China may also be adopted to reduce the PRC IIT burden on the bonus.

This table outlines the sourcing methodology under the existing regulations and Announcement 16.

	Pre 1 June 2012	1 June 2012 and beyond
<b>Sourcing rule</b>	<ul style="list-style-type: none"> <li>Bonuses attributable to the calendar months over the performance period where the individual is physically present in mainland China for any number of days is deemed to be sourced from mainland China duties.</li> </ul>	<ul style="list-style-type: none"> <li>Bonus attributable to one's physical presence in mainland China over the performance period will be deemed to be sourced from mainland China duties.</li> </ul>
<b>Applicable formula (assuming the individual is physically present in mainland China for 50 percent of the time during the performance period, and has spent at least one day in each of the calendar months)</b>	<ul style="list-style-type: none"> <li>100 percent of the bonus is deemed to be sourced from mainland China duties and taxed in mainland China</li> <li>IIT on 100 percent of the bonus</li> </ul>	<p><b>Formula I:</b></p> <ul style="list-style-type: none"> <li>IIT on 100 percent of the bonus x (No. of days physically present in mainland China during the performance period/Total no. of days of the performance period)</li> </ul> <p><b>Formula II:</b></p> <ul style="list-style-type: none"> <li>IIT on 100 percent of the bonus x (No. of days physically present in mainland China during the performance period/Total no. of days of the performance period) x (portion of bonus paid or borne by mainland China /Total bonus)</li> </ul>

The new bonus sourcing rule is in line with the sourcing rule currently being adopted by Hong Kong and Macau, and therefore effectively eliminates the potential double taxation issue for tax residents of Hong Kong and Macau.

### Eligibility

According to Announcement 16, tax residents of Hong Kong and Macau would be eligible to apply for the favourable tax treatment if they are:

- Employed in Hong Kong or Macau and travel to mainland China to exercise employment duties
- Employed in Hong Kong/Macau and mainland China concurrently and exercise employment duties in mainland China.

In addition, individuals who are eligible must also comply with the 'put-on-record' filing each time any of the favourable tax treatment is applied. Whilst no further details was provided in Announcement 16 on the procedural rules with respect to the 'put-on-record' filing for adopting the favourable tax treatment, it is anticipated, when submitting the tax return, which adopts the favourable tax treatment, that the individual or the employer

will need to enclose a declaration to state that the relevant conditions for applying the treatment have been met.

## **Recommendations**

With the introduction of favourable tax treatments for tax residents of Hong Kong and Macau, companies that currently have, or intend to send, tax residents of Hong Kong and Macau to work in mainland China should:

- Review the existing employment of these individuals to ensure that the employment structure reflects the working arrangement of the individuals
- Apply the favourable tax treatment for those who are eligible
- Comply with the 'put-on-record' filing when filing tax returns adopting the favourable tax treatment.

It is also imperative that when reviewing the employment structure of these mobile employees, companies also review the relevant permanent establishment implications of the working arrangement of these employees as well as an effective cost allocation structure for the employee's remuneration, in order to address and mitigate the associated corporate and personal income tax exposure.

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