4.3 Avoidance of Double Taxation between Hong Kong and the Chinese Mainland

In the levying of tax on incomes derived by individuals and FIEs from sources outside the territory of China, there may be cases where such incomes have already been taxed in the source country or region. Based on the principle of avoidance of double taxation, China offers appropriate exemptions and reductions for that part of the incomes that has already been taxed outside the country when levying tax on incomes derived by individuals and FIEs in China.

4.3.1 Provisions for Avoiding Double Taxation on Individual Income Tax

(a) Mainland Regulations on Avoidance of Double Taxation

- Hong Kong residents who reside within the territory of China (in the context of China's Tax Law, "the territory of China" does not include Hong Kong, Macau or Taiwan) consecutively or accumulatively for less than 183 days in a tax year are exempt from individual income tax in China if their wage or salary is not paid or borne by an employer in China nor by the resident establishment or permanent venue of their employer in China, but they have to pay salary tax in Hong Kong. (Those who draw director's fees or salaries as directors or senior executives of enterprises in China are required to declare and pay individual income tax even if they discharge their duties outside China.)
- Hong Kong residents who reside in China consecutively or accumulatively for more than 183 days but less than one year in a tax year are required to pay individual income tax in China on wages and salaries paid by employers inside and outside China during their residence in the Chinese mainland. Income from wages and salaries derived from work outside China (including that part paid by employers in China) is exempt from individual income tax (with the exception of director's fees and wages or salaries for directors and senior executives of enterprises in China).

The formula for computation is as follows:

Tax payable = taxable income of the current month x number of days actually residing in China in the current month / number of days of the current month

- Hong Kong residents who have resided in China for more than one year but less than five years are required to declare and pay individual income tax on income derived from wages and salaries paid by employers both inside and outside China during their duration of work in the Chinese mainland. During their temporary absence from China, they are required to declare and pay tax only on that part of income paid by employers in China.
- For Hong Kong residents who have resided in China for five years, starting from the sixth year they are required to declare and pay individual income tax every year on income derived from sources both inside and outside China if they have resided in China for the whole year, but those who have resided in China for less than one year after the five-year period are exempt from individual income tax on wages and salaries obtained during their duration of work outside China.
- If a taxpayer has already paid individual income tax abroad on the income derived from sources outside China, the amount actually paid may be deducted from the individual income tax payable in China. However, the amount to be deducted may not exceed the tax payable (i.e. the deductible limit) on the income derived from sources outside China calculated in accordance with China's Tax Law. If the amount of individual income tax paid outside China exceeds the deductible limit, deduction can only be made up to the limit for the current year and the excess portion may be deducted in the following five years.

(b) Hong Kong Regulations on Avoidance of Double Taxation

- Hong Kong employees are exempt from salaries tax if they do not work in Hong Kong for a whole year in any tax year.

- Hong Kong employees are exempt from salaries tax if they stay in Hong Kong for less than 60 days in any tax year
- Hong Kong employees may apply for deduction for individual income tax paid in China when filing their salaries tax return in Hong Kong, but they must provide evidence of tax payments and of their dates of entry and exit.

(c) Example of Tax Deduction for Income Derived Outside China

- A taxpayer has derived taxable income from countries A and B in the same tax year. He works for a company in country A and is paid an annual salary of Rmb60,000 (or an average monthly income of Rmb5,000). He has also received a lump sum of Rmb30,000 from royalty for a patented technology. He has to pay individual income tax of Rmb5,200 on these two items of income in country A. At the same time, he has received Rmb15,000 in author's remuneration (royalty) for publishing his works in country B and paid Rmb1,720 in individual income tax in country B for that income. The method for computing the deductible items is as follows:
- Individual income tax payable in China on income derived in country A:
  - For wages and salaries: Under China's Tax Law, tax payable is computed at an applicable tax rate of the 9-level progressive rates after making monthly deductions of Rmb4,000:
    Monthly tax payable: (Rmb5,000 – Rmb4,000) x 10% (tax rate) – Rmb25 (allowable deduction) = Rmb75
    Yearly tax payable: Rmb75 x 12 (number of months) = Rmb900
  - For royalties: Under China's Tax Law, 20% will be deducted for expenses and the remaining amount will be taxed at a rate of 20%:

- Tax payable: Rmb30,000 x (1 – 20%) x 20% (tax rate) = Rmb4,800
- Deductible limit for country A: The sum of the above two payable items, that is, Rmb5,700.
- Outstanding amount: Since the actual amount of individual income tax paid by the taxpayer in country A is Rmb5,200, which is lower than the deductible limit of Rmb5,700, he can claim full deduction but has to pay the difference of Rmb500 in tax.

- Individual income tax payable in China on income derived in country B:

  - For author's remuneration: Under China's Tax Law, 20% will be deducted for expenses and the remaining amount will be taxed at a rate of 20% with an additional 30% deduction:
    Tax payable: [Rmb15,000 x (1 – 20%) x 20% (tax rate)] x (1 – 30%) = Rmb1,680
  - Deductible limit: Rmb1,680
  - Tax deduction: This taxpayer has already paid Rmb1,720 in individual income tax in country B, which is Rmb40 above the deductible limit. Hence, he can only claim deduction for Rmb1,680 but may make claims for the remaining Rmb40 in the following five years.

- This taxpayer has to pay Rmb500 in individual income tax for income derived from sources in countries A and B in the current year.

(d) Points to Note

- A taxpayer applying for income tax deductions in China must provide original copies of tax payment receipts issued by the tax authorities outside China.

- Tax payable should be computed separately for income derived from sources inside and outside China.

- Apart from the above provisions, China has also signed agreements on the avoidance of double taxation with certain countries and regions. The provisions of these agreements will apply where necessary.

4.3.2 Provisions for Avoidance of Double Taxation on FIEs and Foreign Enterprises

(a) Tax Exemption and Reduction

- According to China's Tax Law, FIEs are required to pay corporate income tax on all incomes derived from sources inside and outside China.
- If an FIE has already paid abroad corporate income tax on the income derived from sources outside China, the amount paid may be deducted from the corporate income tax payable in China. However, the amount to be deducted may not exceed the deductible limit.
- The deductible limit is the amount of tax payable computed in accordance with China's Tax Law on incomes derived from sources outside China.
- If the amount of corporate income tax paid abroad by an FIE is lower than the deductible limit, the actual amount of tax paid outside China may be deducted; if the amount of the corporate income tax paid abroad by the FIE equals the deductible limit, the full amount may be deducted; if the amount of corporate income tax paid abroad by the FIE exceeds the deductible limit, deduction can only be made up to the deductible limit for the current year and the excess portion may be deducted in the following five years.

(b) Points to Note

- When applying for tax deductions, an FIE must provide original copies of tax payment receipts for the current year issued by the tax authorities outside China. Photocopies or payment receipts for other years will not be accepted.
- In computing corporate income tax in accordance with China's Tax Law, the applicable tax rate of 33% instead of the preferential tax rates shall be used.