

# Legal & Tax Feature

## Ready for salary cut?

### Tax honeymoon for expatriates ending on 31 Dec 21

1 January 2022 will be the date when the three major allowances (housing rental, child education and language training) for expatriates working in China will cease to be exempted from China individual income tax (IIT) – instead they will be replaced by six other deductions which are unfortunately capped at a very low level. This will result in a drastic cut to take-home pays (see two examples on the right).

On the same date, the IIT benefit for annual bonus is also clicking for an ending for all tax residents including expatriate staff in China.

Rumor has it that an extension could be granted by the Chinese tax authority. No matter what the decision is, both employers and employees are advised to prepare for the worst.

WTS China and Bird & Bird have jointly responded to the FAQs below to shed light on some major considerations in China legal and tax regimes – for employers and employees to note.

### FAQs on IIT policy change

#### Q: How should employers cope with the policy changes?

A: Employers need to revisit the employment contracts, adding proper 2021-2022 transition clauses, e.g. how a salary (take-home pay) should be adjusted, or how much of the tax cost should be borne by the employer. Most of the current employment contracts have not addressed how to deal with the salary cut due to the policy changes.

#### Q: Does it matter to staff stability?

A: Very much. Some expatriates may find it hard to accept or continue a China assignment if their take-home pay will drop drastically, and would expect employers to tackle the issue upfront. They are observing how you care about them, and their interests. No matter what, a solution has to be sought on a case-by-case basis. It will also take time to seek professional opinions when contracts are concerned.

#### Q: What could be the legal impacts if there are labour dispute due to the policy changes?

A: Employers may worry that affected expatriates may lodge a labour arbitration against the company on the ground of insufficient payment of allowance, if noting that they are receiving less than what is agreed in their employment

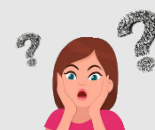
### Case 1



Mr. Fort has been working as a general manager for a Shanghai company on a three-year contract, from 1 Jan 20 to 31 Dec 22. He rents an apartment for RMB 20,000 a month, and bears an international school fee of RMB 200,000 a year for his two kids. Due to the cancellation of the IIT exemption to his two allowances, he is astonished to see that he will suffer extra RMB 131,300 tax after 2022, which means a 14.5% cut to his salary (see calculation below).

	2020 & 2021	2022
Annual salary	1,000,000	1,000,000
Deductions	(actual amounts)	(limitation)
Rental	240,000	18,000
Child education	200,000	24,000
IIT cost	97,080	228,380
After-IIT salary	902,920	771,620
Take home pay cut		131,300 (14.5% cut)

### Case 2



Ms. Cooper, a sales manager of a Chinese company, has been earning her remuneration mostly in the form of an annual performance bonus. She is very upset to see that her take-home pay will be cut by 2% when the current tax benefit for her bonus is removed due to the new IIT policy.

	Now	Since 2022
Annual salary	500,000	500,000
Annual bonus	500,000	500,000
IIT cost	224,670	241,080
After-IIT salary	775,330	758,920
Take home pay cut		16,410 (2% cut)

agreements. Unlike a case law system, however, it is commonly accepted in China that the contractual arrangement shall be subject to and adapt to legislation or policy changes from time to time. In this regard, the employer is unlikely to be held accountable if it is the change of law that renders the contract impossible to perform or implement as agreed. Nevertheless, it is highly recommended to notify this change to the affected expatriate staff in advance (e.g. 90 days or the notice period agreed in the contract, if any) in order to leave adequate time for negotiating new clauses and signing off the amendment to the employment contract.

**Q: When should I start the preparation?**

**A:** ASAP. Not too late. Some employment contracts require a six-month notice, or longer for any amendments. Anyway, early planning and communication can advocate transparency and avoid disputes. We have seen some employer-employee negotiations developing into disputes due to poor communication. Many others have not even any agreement clause to deal with the changes.

**Q: Would the IIT benefits be renewed beyond 2022?**

**A:** It was announced that IIT exemption for rental, child education and language training will be gone by the end of 2021. It has not mentioned other allowances (e.g. home leave, relocation expense, meal, laundry) – which may continue to be tax free.

**Q: How serious the tax burden will hike up after 2022?**

**A:** We are talking about 10% ~ 30% salary cut. The higher the allowances, the larger the cut – when the IIT exemption is cancelled (as announced already). Otherwise, one can keep the finger crossed that an exceptional extension will be offered. Alternatively, employers have to explore if any alternative way of tax calculation can offer a better saving. For example, for those earning a living by getting a large bonus or sales commission, they can consider combining the bonus with all their other income for IIT calculation, instead of taxing the bonus alone. It may achieve an overall tax saving.

**Q: What to note in the course of amending employment contracts?**

**A:** Per PRC labour laws, any amendment to the employment contract shall be made in a written form and subject to mutual consent of both parties.

Although there is no statutory notice period on making amendments, the contractual obligation shall be taken into account, depending on individual cases.

Considering the travel restrictions due to the Covid-19 pandemic, it may be difficult to obtain wet signatures from the expatriate staff who are currently outside of China. Using an electronic signature platform is legally acceptable in China. However, do please bear in mind to choose a right platform as not any e-signature platform is recognised by the people's court, if a dispute arises.

**Q: Will the employer be allowed to early terminate the expats if no agreement on the allowance change is reached?**

**A:** It depends on locality. Indeed, PRC Employment Contract Law allows the employer to terminate an employee by providing 30 days prior notice if two parties cannot reach an agreement to amend the labour contract which is not performable because the objective circumstance where the contract was concluded has materially changed. However, as commonly recognized, PRC labour laws remain very local and each city may have its own understanding and practices on this clause. You may consult your legal adviser for professional advice before terminating any expat relying on this provision.

**■ What Bird & Bird can help?**

- **Suggestions on employment contract amendments and improvements**
- **Handling employer-employee negotiation or disputes**
- **Reviewing legal compliance for any contractual arrangements for the transition**

**■ What WTS China can help?**

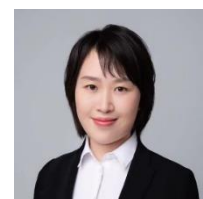
- **Tax cost simulation for employers / employees**
- **Remuneration re-structuring for tax optimization**
- **Tax clauses amendment for employment contracts**

**Bird & Bird**



**Ying Wang**  
ying.wang@twobirds.com

**wtsChina**



**Ened Du**  
ened.du@wts.cn