# Position Paper on Cancelation of Non-Taxable Allowance for Foreign Employees

## *INTRODUCTION*

On January 1, 2022, China will cancel non-taxable allowances for foreign employees. Foreign employees will no longer be able to claim a tax exemption on certain Benefits in Kind (BIK), including housing, school tuition, food and language training.

AmCham Shanghai conducted a survey of 102 companies from March 23 to March 26 to assess the impact of the taxable allowance cancelation on members. Survey results, highlighted in detail below, showed that the impact on companies and their foreign employees will be profound and is causing companies to reconsider Shanghai as the location of their headquarters or other operations. Foreign experts employed at these companies are also likely to leave Shanghai if these changes are implemented.

For example, it is estimated that a company paying 960K RMB in BIK to a tax equalized foreign individual will now pay an additional 785K RMB in taxes, making it significantly more expensive to retain foreign staff. We have based the below scenarios on typical costs for housing and school tuition. Furthermore, many foreign employees will move into higher tax brackets, with many companies and individuals paying the maximum 45% in personal income tax.

## Tax Scenarios

| | Scenario 1 – One Child | | Scenario 2 – Two Children | | Scenario 3 – Three Children | |
|---|---|---|---|---|---|---|
| **Group** | **Expatriate Assignee** | **Local Hired Foreign Employee** | **Expatriate Assignee** | **Local Hired Foreign Employee** | **Expatriate Assignee** | **Local Hired Foreign Employee** |
| Tax Policy | Tax Borne by the Company | Tax Borne by the Employee | Tax Borne by the Company | Tax Borne by the Employee | Tax Borne by the Company | Tax Borne by the Employee |
| Housing Rental | 300,000/year | 300,000/year | 360,000/year | 360,000/year | 420,000/year | 420,000/year |
| Children's Tuition | 300,000/year | 300,000/year | 600,000/year | 600,000/year | 900,000/year | 900,000/year |
| TOTAL Non-taxable BIKs | 600,000/year | 600,000/year | 960,000/year | 960,000/year | 1,320,000/year | 1,320,000/year |
| Applicable Tax Rate | 45% | 45% | 45% | 45% | 45% | 45% |
| Extra Cost to the Company (Tax Borne by the Company) | 490,090 | - | 785,455 | - | 1,080,000 | - |
| Extra Cost to the Employee (Tax Borne by the Employee) | - | 270,000 | - | 432,000 | - | 594,000 |

One CFO at a large multinational said that "The initial results show a clear benefit in terms of cost and tax to move to Singapore. If we do so, our expatriates will move but all local associates working for our Asia Pacific HQ will lose their jobs as we would hire locally in Singapore."

Another CFO of a mid-sized multinational said: “In addition to the very high international school costs, rental costs are roughly 420,000 RMB per annum for each family; with the additional tax this will then exceed 750,000 RMB per annum. Unless Shanghai implements measures to offset these significant tax costs, we will have to relocate all our foreign talent to regions with globally competitive tax policies, such as the Guangdong-Hong Kong-Macau Greater Bay Area and will downsize or close completely our Shanghai operations.”

The impact on Shanghai’s role as China’s primary business hub should not be underestimated, nor the financial impact on local communities in Shanghai, such as Jinqiao and Hongqiao, where many expatriates live and spend their earnings.

Furthermore, one of the hardest hit sectors will be international schools, which hire large numbers of expatriates and face a steep increase in taxes. These schools will not be able to absorb the costs and will subsequently pass them on to parents, many of whom pay school fees on their own.

According to one school, “184 of our 291 employees are expatriates who require housing and many have family members who require tuition benefits. We estimate the proposed BIK taxation will increase our costs by 30 million RMB. We will need to increase our student tuition fees at least 10% to adjust for this increased cost. In addition, if the social insurance fees for expatriates begin in Shanghai on August 15 as per the current regulations, this will cost an additional 20 million RMB and cause an additional fee increase of 8%.”

## *SURVEY HIGHLIGHTS*

- 38.9% of companies with annual Shanghai revenues above $100 million said they will consider moving all or part of their Shanghai offices/facilities to another China location with a more favorable tax regime if the non-taxable allowance is canceled.

- 36.1% of companies with annual Shanghai revenues above $100 million said they will consider moving all or part of their Shanghai offices/facilities to a foreign country if the non-taxable allowance is canceled.

- 69.6% of companies believe the Individual Income Tax regime change will make it more difficult to attract highly qualified foreign talent to work in Shanghai.

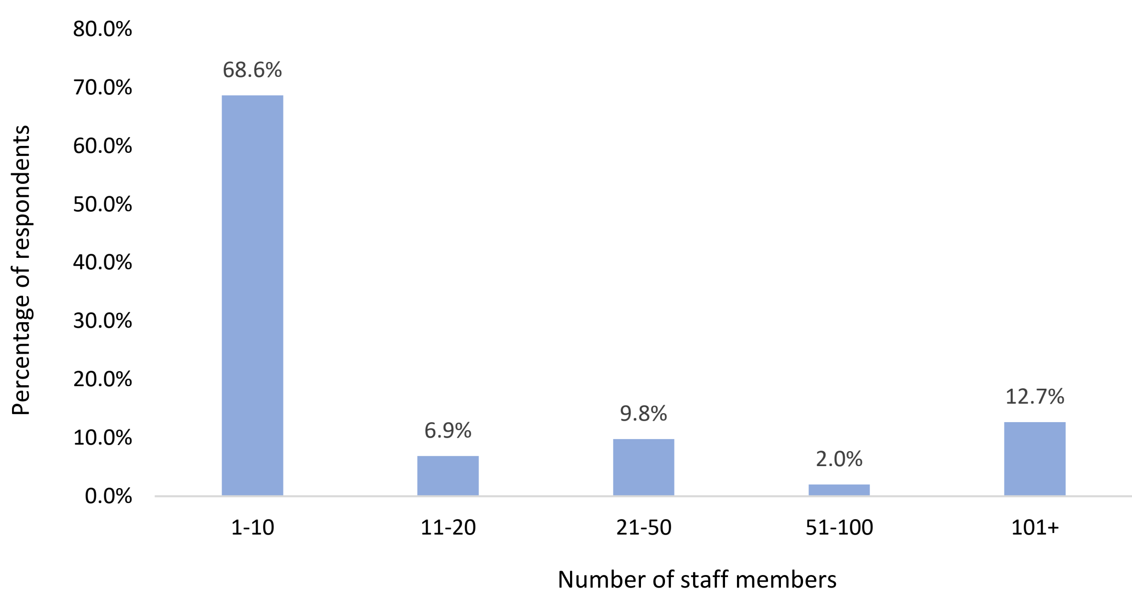
## *RECOMMENDATIONS*

- **For the central government:**
  1. Maintain non-taxable allowances.
  2. Delay the implementation of the new rules for 3 to 5 years to allow companies and foreigners to adjust to the new regulations.
  3. Regardless of whether the government will implement, delay or cancel the rules, a final decision on its implementation should be publicized 6 months prior to allow companies the time needed for adjustments.
  4. If it is not possible to delay or cancel the new rules, we suggest that the government provide clearer definitions and information on the implementation of the rules that allow for more flexibility on BIK. For example:
     - **a.** Raise the BIK for Chinese and foreign employees.
     - **b.** Differentiate between categories of foreigners. Allow certain categories of foreigners (highly skilled expatriates, teachers, etc.) to continue to have non-taxable status for BIK.

- **For the Shanghai government:**
  1. Provide subsidies to companies to compensate for the increased costs caused by the new regime. Provide tax rebates to individuals that would compensate for increased costs.
  2. Develop a high-skilled talent program that uses tax subsidies to keep individual income tax at 15% for qualifying individuals, similar to tax subsidies used in Shenzhen, Guangzhou and Hainan. (Corporate tax incentives are also available in these locations to attract businesses and talent.) Many foreigners could move to these cities for lower taxes and simply fly to Shanghai when needed, instead of living in Shanghai and actively contributing to the local economy and culture. The loss to Shanghai's existing tax income and economic spending from foreigners could be substantial.
  3. If rebates are not possible, cap school fee taxes at 10% or 15% and create a further reduction for a second or third child.
  4. Connected to the BIK issue, some of our members are concerned that the requirement for foreign nationals to make social insurance contributions could also lead to greater costs. Most foreigners do not use the local medical insurance or receive benefits from the program. We recommend that companies have some flexibility on this issue.

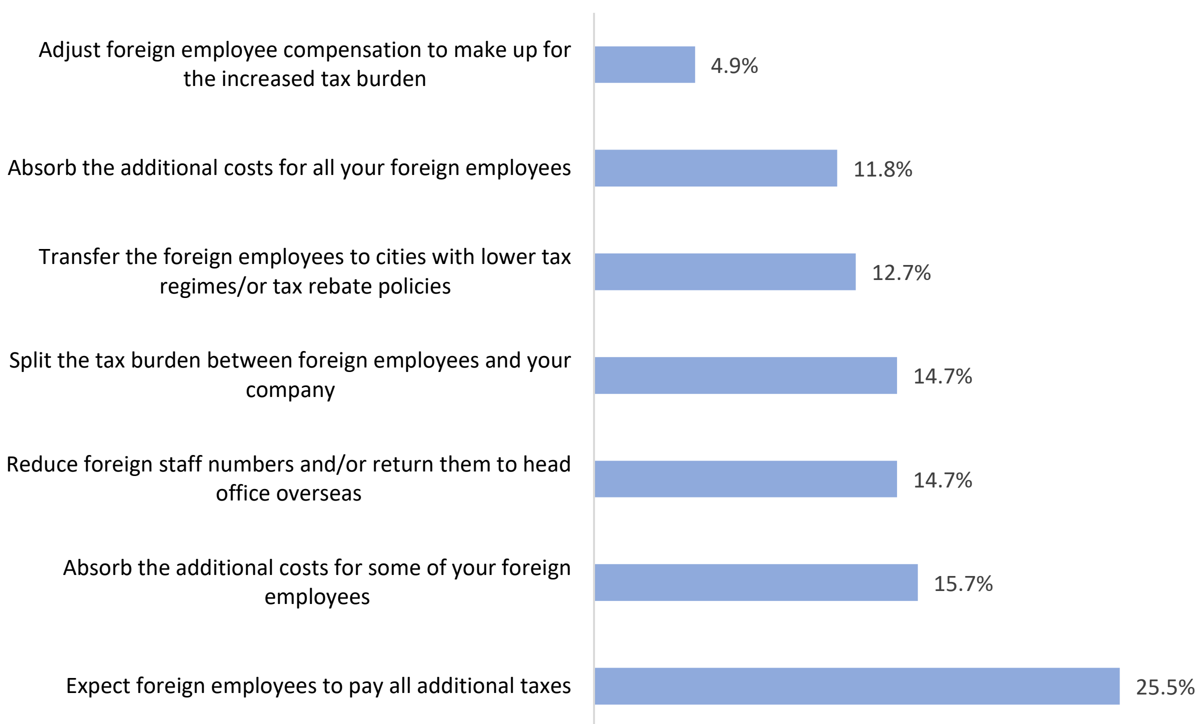
## *SURVEY RESULTS*

1. How many of your staff are currently enjoying the tax exemption on benefits in kind?

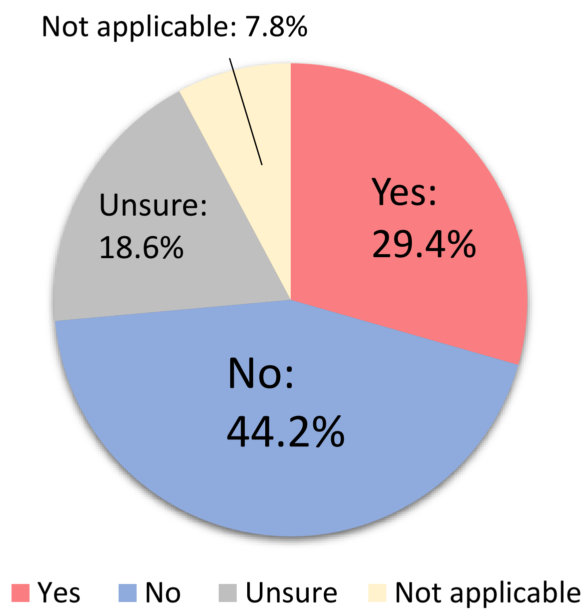


**2.** If your company will NOT compensate foreign employees for the increased tax burden, what percentage of your foreign employees do you expect to leave Shanghai?

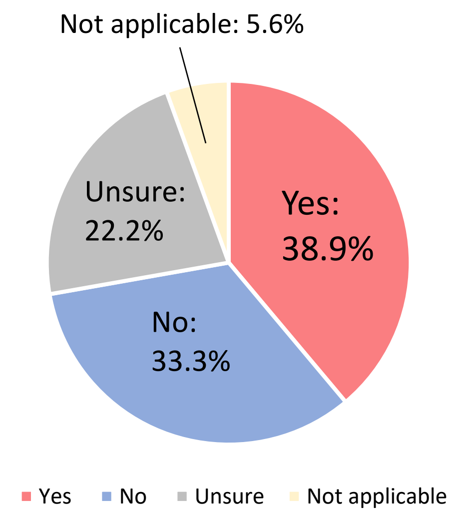

**3.** If the changes to foreign employee taxation are implemented, what will be your company's primary strategy?



**4.** If the Individual Income Tax (IIT) change is implemented, will your company consider moving, in whole or in part, its Shanghai office/facility to another China location with a more favorable tax regime (e.g., Hong Kong, Hainan Island, Shenzhen)?

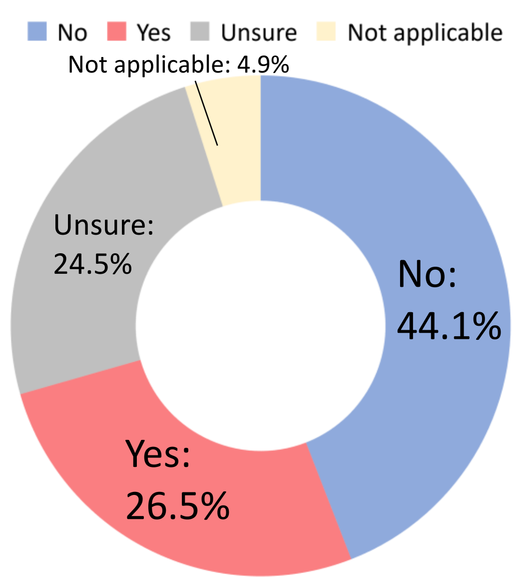



Total respondents: 102




Companies with revenue greater than $100 million: 36

**5.** If the IIT change is implemented, will your company consider moving, in whole or in part, its facilities/offices to foreign locations with more favorable tax regimes?

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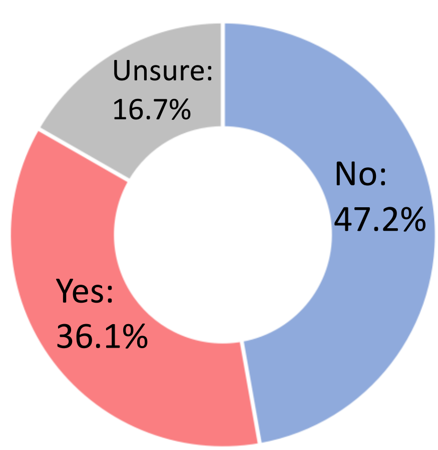
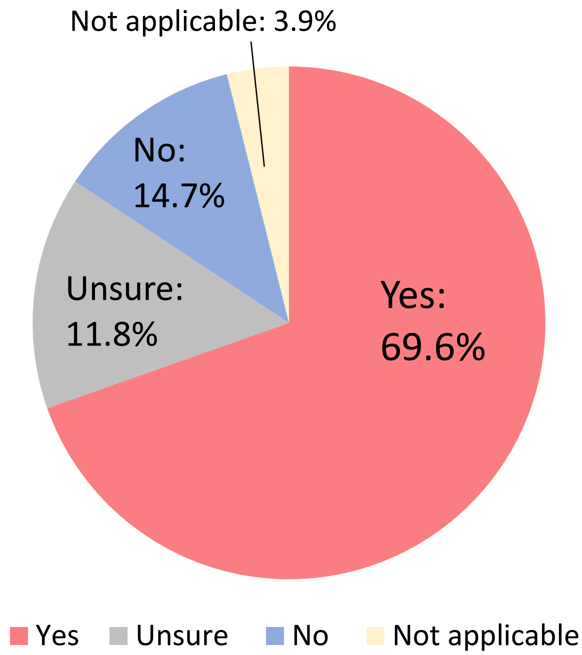
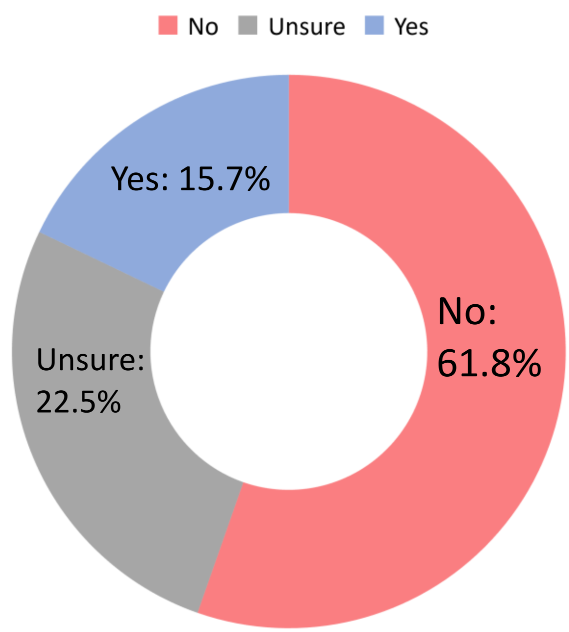



Companies with revenue greater than $100 million: 36

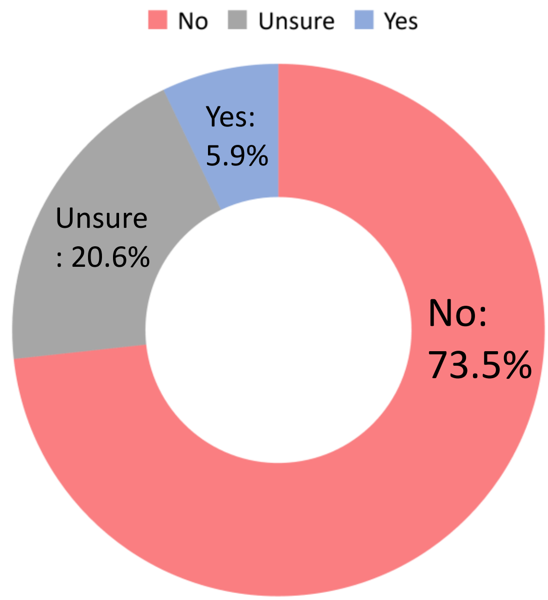
**6.** Will the IIT regime change make it more difficult for your company to attract highly qualified foreign talent to work in Shanghai?



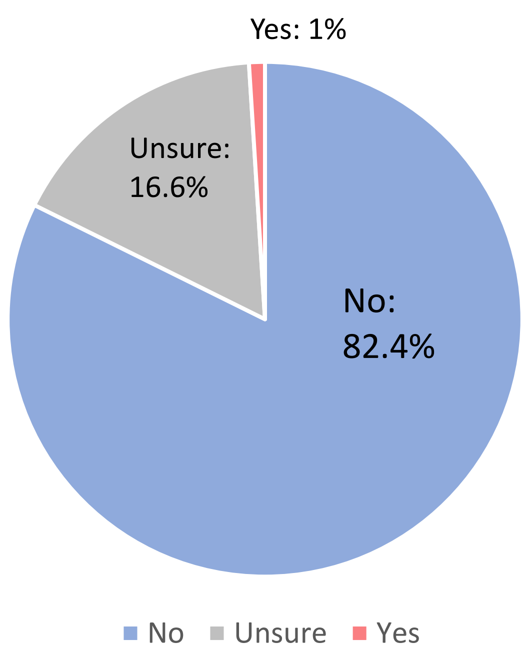

**7.** Has your company expressed concern about the new tax rules to your district government?



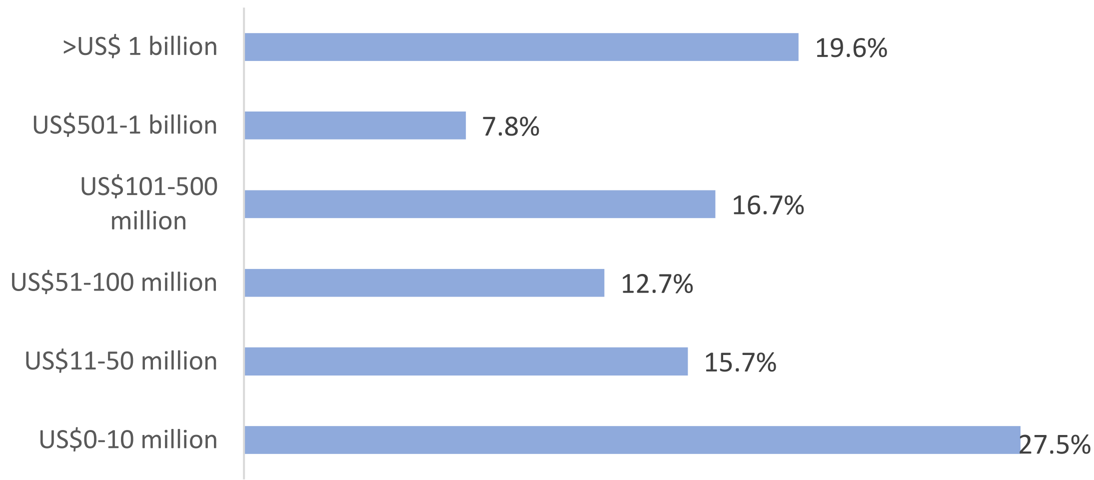
**8.** Has your company received any enquiries from district- or city-level tax officials about how the ITT changes could impact your business?




**9.** Has your local district provided (or offered to provide) your company with tax benefits to make up for the expected extra costs?



**10.** What are your company's annual China revenues?




**11.** What are your company's annual revenues generated from business in Shanghai?