

# A Study on the Legal Issues of Imposing an Exit Tax in China

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**Abstract:** With the acceleration of globalization, the emigration of high-net-worth individuals has become increasingly common. Some emigrants circumvent tax obligations and transfer assets by renouncing their nationality, leading to capital outflows and disputes over tax sovereignty. This paper defines the concept of exit tax and analyzes the necessity of imposing such a tax in China from three perspectives: curbing capital outflows, regulating tax avoidance, and safeguarding tax sovereignty. It also demonstrates the feasibility based on China's tax collection and management capabilities and legal foundation. Meanwhile, it identifies the shortcomings of China's existing "tax settlement upon deregistration of household registration" provisions, including their failure to tax unrealized capital gains, regulate overseas assets, and establish effective collection periods. Drawing on the extraterritorial experiences of the United States and Canada, this paper proposes institutional recommendations for China's exit tax system in terms of taxpayer definition, tax base, rate design, and collection procedures, providing a reference for improving China's tax system.

**Keywords:** Exit tax, Capital outflow, Tax sovereignty, Tax system construction

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## 1. Basic Overview of Exit Tax

### 1.1. Definition of Relevant Concepts

The exit tax, also known as the "exit charge" or "expatriation tax," refers to a one-time tax levied by a country on taxpayers who renounce their nationality, permanent residency, or domicile and leave the country, based on the appreciation of their global assets or specific assets at the time of renunciation. Its core purpose is to prevent taxpayers from circumventing domestic tax obligations through renunciation of nationality, thereby safeguarding national tax sovereignty and fiscal interests.

The target of an exit tax typically includes two categories: first, the unrealized capital gains on all assets (both domestic and foreign) held by the taxpayer at the time of renunciation, i.e., the difference between the fair market value of the assets and their acquisition cost; second, certain specific types of assets, such as gifted assets or trust interests. The scope of taxpayers is generally limited to individuals who voluntarily renounce their nationality or permanent residency to become non-residents, excluding cases where nationality or residency is lost involuntarily due to death, marriage, or other non-voluntary reasons.

### 1.2. Necessity of Imposing an Exit Tax in China

#### 1.2.1. Need to Curb Capital Outflows

In recent years, the emigration of high-net-worth individuals in China has shown an upward trend. Some emigrants transfer or conceal substantial capital overseas before renouncing their nationality, leading to domestic capital outflows. As of 2019, China became the world's third-largest source of emigrants, with an estimated 10.7323 million emigrants, including 16,000 millionaires.[1] Imposing an exit tax on the appreciation of assets at the time of renunciation would increase the cost of capital transfer, thereby effectively curbing unjustified capital outflows and

safeguarding national economic security.

#### 1.2.2. Need to Regulate Tax Avoidance

Some taxpayers exploit international tax differences and loopholes in various countries' tax systems to avoid their tax obligations in China through "renunciation – tax avoidance" schemes. For example, after significant asset appreciation, some high-net-worth individuals renounce Chinese nationality and acquire nationality of a low-tax jurisdiction, thereby evading tax on the appreciated portion of their assets. Such behavior not only undermines the principle of tax fairness in China but also results in the loss of fiscal revenue. Introducing an exit tax would fill this tax loophole and effectively deter tax avoidance through nationality renunciation.[2]

#### 1.2.3. Need to Protect China's Tax Sovereignty

Tax sovereignty is an integral part of national sovereignty, including the powers to legislate, collect, and benefit from taxes. Wealth accumulated and income obtained within China's territory should be subject to tax obligations in accordance with the law. Allowing taxpayers to easily evade tax by renouncing nationality would weaken the authority of China's tax sovereignty. Enacting an exit tax would clarify the taxpayer's tax responsibilities at the time of renunciation, ensuring that national tax sovereignty is not infringed upon.

### 1.3. Feasibility of Imposing an Exit Tax in China

From a practical perspective, China already possesses the basic conditions for imposing an exit tax. First, in terms of legal foundation, China's Law on the Administration of Tax Collection and Individual Income Tax Law provide a basic framework for tax collection and management. The legal status and collection basis of an exit tax could be clarified by amending relevant provisions. Second, in terms of collection capacity, with the advancement of China's tax information technology, the Golden Tax Project Phase IV has achieved comprehensive monitoring of taxpayer information, enabling

effective identification and tracking of taxpayers' domestic and overseas asset positions. Meanwhile, China has signed tax treaties with over 100 countries and regions and established information exchange mechanisms, providing technical support for cross-border tax collection. Furthermore, in terms of social consensus, as public awareness of taxation increases, there is broad social recognition of the need to regulate tax avoidance through nationality renunciation, laying a solid social foundation for introducing an exit tax.

## **2. Deficiencies of the Current Tax System in Regulating Emigration and Renunciation of Nationality**

In China's current tax system, the provisions related to renunciation of nationality are mainly reflected in the "tax settlement upon deregistration of household registration" clauses of the Individual Income Tax Law and its implementing regulations. According to Article 24 of the Regulations for the Implementation of the Individual Income Tax Law, a taxpayer who emigrates abroad and cancels their Chinese household registration must settle their tax liabilities before deregistration. However, these provisions have notable deficiencies in practice and are insufficient to effectively regulate emigration and renunciation.

### **2.1. Failure to Tax "Unrealized Capital Gains"**

Unrealized capital gains refer to the book appreciation of assets that have not yet been sold or disposed of, such as the difference between the market value of stocks, real estate, or equity and their acquisition cost. Under China's current individual income tax system, tax is levied only on realized capital gains (i.e., gains obtained after the sale or disposal of assets). Therefore, if a taxpayer renounces nationality without selling the assets, the unrealized gains are not subject to tax. This creates room for taxpayers to avoid tax on unrealized gains by renouncing nationality. For example, suppose a taxpayer holds shares of a listed company with a purchase price of RMB 10 per share. At the time of renunciation, the share price has risen to RMB 50 per share, but the shares are not sold. Under current rules, the unrealized gain of RMB 40 per share is not subject to individual income tax.

### **2.2. Failure to Tax Overseas Assets Originating from China**

With the implementation of China's "Going Global" strategy, an increasing number of individuals hold overseas assets originating from China through overseas investments or the establishment of offshore companies, such as holding domestic enterprises through offshore companies or holding domestic real estate through overseas trusts. The current "tax settlement upon deregistration" provisions mainly target assets and income located within China and lack effective regulation over overseas assets that originate from China. Upon renunciation, taxpayers may transfer overseas assets to evade tax, thereby harming China's tax interests.

### **2.3. Failure to Extend Tax Collection Period After Renunciation**

The current "tax settlement upon deregistration" provisions require taxpayers to settle their tax liabilities before deregistering their household registration, but they do not specify a tax collection period after renunciation. Some taxpayers conceal or underreport assets before renunciation to

evade settlement. Once household registration is canceled, China's tax authorities face difficulties in subsequent recovery. Moreover, although current rules require individual income tax to be paid on income derived from China after renunciation (such as dividends, interest, and rental income), the actual collection rate is low due to the lack of effective enforcement measures.

## **3. Extraterritorial Experiences and Lessons on Exit Tax**

### **3.1. Extraterritorial Experiences**

#### **3.1.1. United States**

The United States is one of the earliest countries to impose an exit tax, with a relatively comprehensive system. Under Section 877A of the U.S. Internal Revenue Code, effective from 2008, an exit tax is imposed on individuals who meet the "covered expatriate" criteria. Covered expatriates include: individuals whose average annual net income tax for the five years preceding renunciation exceeds a certain amount (USD 192,000 in 2023); individuals whose net worth exceeds USD 2 million on the date of renunciation; and individuals who fail to certify compliance with all U.S. tax obligations for the preceding five years. The U.S. exit tax is based on the "deemed sale" of the taxpayer's worldwide assets on the date of renunciation, i.e., assuming that all assets are sold at fair market value on that date, and capital gains tax is levied on the resulting gain. Certain assets, such as qualified pensions and IRA accounts, are eligible for deferred taxation. Additionally, the U.S. has a tax tracking mechanism that continues to tax specific types of income (e.g., income effectively connected with a U.S. trade or business) received by covered expatriates within ten years after renunciation.[3]

#### **3.1.2. Canada**

Canada's exit tax regime primarily targets "taxable Canadian property." Under Canadian tax law, non-resident individuals who dispose of taxable Canadian property are subject to capital gains tax. When an individual gives up permanent residency in Canada, they are deemed to have disposed of their taxable Canadian property and must pay tax on the appreciated portion. Taxable Canadian property includes: real estate located in Canada, shares of Canadian private companies, and shares of Canadian public companies (where the ownership percentage exceeds 10%). Canada provides certain exemptions, such as a tax-free threshold for gains below a certain amount (CAD 500,000 in 2023) and special treatment for a principal residence. Canadian tax authorities have also established extensive tax treaties and information exchange mechanisms with other countries to enhance cross-border asset monitoring.[4]

#### **3.1.3. Germany**

Germany imposes an "emigration tax" on individuals who renounce German nationality or residency. Under the German Income Tax Act, when a taxpayer renounces nationality or residency, if the assets held by the taxpayer generate taxable income within Germany, or if the transfer of assets would harm Germany's tax interests, the tax authorities may levy tax on the appreciation of those assets. The German emigration tax rate aligns with the individual income tax rate, which is progressive up to a maximum of 45%. Germany also has stringent filing and payment procedures, requiring taxpayers to report their asset status to the tax authorities before renunciation and pay the tax within a specified period.

## **3.2. Lessons from Extraterritorial Practices for China**

### **3.2.1. Define the Scope of Taxpayers and Tax Base**

Drawing on the U.S. experience, China could set criteria for "high-net-worth renunciators," limiting the taxpayer base to individuals whose net worth exceeds a certain amount or whose average annual tax payments in previous years meet a threshold, thereby avoiding excessive burdens on ordinary emigrants.[5] The tax base should include unrealized gains on the taxpayer's worldwide assets at the time of renunciation, applying the "deemed sale" principle, i.e., assuming that all assets are sold at fair market value on the date of renunciation and taxing the appreciation.

### **3.2.2. Design Reasonable Rates and Exemptions**

Tax rate design should balance fiscal revenue and fairness. It may refer to the proportional rate (e.g., 20%) applied to property transfer income under China's individual income tax, or adopt a progressive rate based on the amount of asset appreciation. Exemptions should be provided, such as tax-free or reduced-tax treatment for a principal residence and small-value assets, to reduce the tax burden on middle- and low-income emigrants.[6]

### **3.2.3. Improve Cross-Border Tax Collection Mechanisms**

Drawing on the experiences of Canada and Germany, China should strengthen tax cooperation with other countries and regions, expand the scope of tax treaties and information exchange, and establish a cross-border asset information sharing platform. At the same time, the tax collection period after renunciation should be extended, continuing to tax certain income derived by renunciators from China within a specified period and establishing effective recovery mechanisms.

## **4. Institutional Construction of an Exit Tax in China**

### **4.1. Scientifically Define the Tax Base and Core Elements**

Precise definition of the tax base is fundamental to the effective implementation of an exit tax system. A closed-loop system should be built around three core elements: "taxpayer," "tax base," and "tax rate."

**Definition of Taxpayer:** The system should focus on high-net-worth individuals and key stakeholders to avoid imposing excessive burdens on ordinary emigrants. Dual criteria are recommended: (1) asset size – a basic threshold of RMB 10 million in global net assets (individual and family) at the time of renunciation, consistent with the current distribution of high-net-worth wealth in China and the policy direction of using individual income tax to regulate high-income groups; (2) tax contribution and status – individuals whose average annual individual income tax payments exceeded RMB 500,000 in the five tax years preceding renunciation, or who have served as legal representatives, controlling shareholders, or de facto controllers of domestic enterprises, should also be included. The former reflects the "benefit-and-tax alignment" principle, while the latter targets key actors who might transfer enterprise control or avoid related-party transaction taxes through renunciation.[7]

**Tax Base:** The tax base should cover unrealized capital gains on worldwide assets, applying the "deemed sale" principle – treating the taxpayer as if they had sold all assets at fair market value on the date of renunciation, thereby

calculating the appreciation. Specific assets include domestic and foreign real estate, listed company shares, unlisted company equity, fund shares, bonds, intellectual property, trust beneficial interests, and other asset types. Special attention should be given to bringing under regulation domestic assets held through offshore companies and Chinese-sourced assets held through overseas trusts, filling the gap left by the current "tax settlement upon deregistration" provisions regarding overseas-related assets. The determination of fair market value requires diversified approaches: for publicly traded assets like stocks and funds, the closing price or net value on the renunciation date should be used; for non-publicly traded assets like real estate and unlisted company equity, a valuation report from a qualified asset appraisal institution is required, and the tax authorities have the right to review and adjust the appraisal.

**Tax Rate Design:** The tax rate should balance fiscal revenue and fairness, adopting a "base rate plus excess surtax" model. Referring to the 20% rate on property transfer income under China's individual income tax, the base rate for exit tax is set at 20%, ensuring coherence with the current tax system. Additionally, for asset appreciation exceeding RMB 100 million, an excess surtax of 5% applies (i.e., a total of 25%). This differentiated rate structure avoids a one-size-fits-all approach for different wealth levels and uses the progressive rate to encourage high-net-worth individuals to treat renunciation more responsibly, thereby reducing unjustified capital outflows.

### **4.2. Establish Flexible Exemption and Collection Mechanisms**

Exemption provisions should balance tax rigidity with livelihood needs, avoiding an undue impact on taxpayers' basic living and reasonable rights.

**Principal Residence Exemption:** For a taxpayer's only residence, a tiered exemption applies: appreciation up to RMB 5 million is fully exempt; any appreciation exceeding RMB 5 million is taxed at half of the base rate (i.e., 10%). This protects basic housing rights while preventing tax avoidance through multiple properties.

**Social Security Assets:** Assets such as balances in individual pension, medical insurance, and unemployment insurance accounts, as well as social security fund investment returns, are fully exempt. These assets are directly related to taxpayers' basic living security, and their exemption aligns with the policy objective of "ensuring livelihoods and promoting fairness."

**Charitable Donations:** Donations made within three years before renunciation to domestic public welfare causes (such as education, healthcare, poverty alleviation, etc., as defined under the Public Welfare Donation Law) are deductible from taxable income up to 30% of the taxable income amount. This encourages charitable giving and provides reasonable tax planning opportunities.

**Collection Procedures:** A full-chain management process of "pre-application – review – post-renunciation recovery" ensures tax collection.

**Filing:** Taxpayers must file an "Exit Tax Return" with the competent tax authorities within 30 days before applying to cancel household registration, along with supporting documents including asset lists, asset appraisal reports, tax payment certificates for the last five years, and proof of ownership of overseas assets. For overseas assets, notarized official valuation certificates or third-party appraisal reports

from the asset's jurisdiction are required.

**Review:** Tax authorities should complete a review of the completeness and authenticity of the submitted documents within 20 days, focusing on the relationship between overseas and domestic assets and the compliance of appraisal reports. If necessary, the authorities may interview the taxpayer or verify information with financial institutions or appraisal agencies in the asset's jurisdiction. For cases with discrepancies, the review period may be extended to 45 days with written notice.

**Payment:** Taxpayers may choose a lump-sum payment or installment payment. Those experiencing difficulties in making a lump-sum payment may apply for installment payments for a maximum period of three years, subject to providing adequate security (e.g., domestic asset mortgage, third-party guarantee). Interest will be charged at the prevailing Loan Prime Rate (LPR) during the installment period.

**Post-Renunciation Recovery Mechanisms:** These are key to preventing tax evasion. Two core rules are essential: (1) Extended collection period – A 10-year statute of limitations for tax recovery after renunciation. For assets concealed or misreported at the time of renunciation, or assets transferred through related-party transactions or offshore structures, the tax authorities may recover taxes within 10 years, with daily late payment penalties (0.05% per day) accruing from the date the tax became due. (2) Look-through verification – Income obtained by the taxpayer after renunciation through overseas related parties that is indirectly derived from China (e.g., dividends, interest, rental income, royalties) is deemed income sourced from China and remains subject to individual income tax under Chinese law, ensuring that tax interests are not lost after renunciation.

### 4.3. Strengthen Cross-Border Cooperation and Supporting Institutional Support

Cross-border cooperation is essential to address the challenges of monitoring overseas assets and recovering taxes. It requires breakthroughs in three areas: information sharing, treaty coordination, and joint enforcement.

**Information Sharing:** Expand the scope of tax information exchange to include exit-tax-related asset information and transaction records. Especially, enhance the frequency of information exchange with popular emigration destinations such as the United States, Canada, Australia, Hong Kong (China), and Singapore, establishing a "monthly special reporting" mechanism. Leverage the Golden Tax Project Phase IV to build a "Cross-Border Asset Monitoring Platform," integrating data from the State Administration of Foreign Exchange on cross-border fund flows, customs declarations on asset outflows, and financial institutions' reports on overseas account openings, enabling real-time monitoring of changes in taxpayers' domestic and overseas assets.[8]

**Tax Treaty Coordination:** Include exit tax provisions in bilateral or multilateral tax treaties, clarifying the nature of the exit tax and the allocation of taxing jurisdiction to avoid double taxation or double non-taxation. First, when negotiating or revising tax treaties with other countries, add an "exit tax clause" providing that if a taxpayer has paid exit tax in China, the country of residence may grant a foreign tax credit for the same appreciation, limited to the amount of tax payable under the other country's law. Second, for countries or regions with preferential tax regimes that encourage

renunciation, use treaty provisions to limit the tax avoidance effect of "tax havens," for example, by requiring that if a taxpayer becomes a resident of a treaty country within a short period (e.g., three years) after renunciation and a substantial portion of their assets still originate from China, the treaty country shall notify Chinese tax authorities to jointly prevent treaty shopping.[9]

**Supporting Institutional Support:** Simultaneously advance legal improvements and public guidance.

**Legal amendments:** Revise the Individual Income Tax Law to add a dedicated "Exit Tax" chapter clarifying its legal status, scope, and collection procedures. Revise the Law on the Administration of Tax Collection to strengthen penalties for exit taxpayers who evade tax, e.g., treating the concealment of overseas assets resulting in underpayment of tax as "tax evasion," punishable by fines ranging from 50% to five times the amount of tax underpaid or not paid, and criminal liability where applicable.

**Public guidance:** Publish an "Exit Tax Policy Interpretation Manual" through the tax authorities' official website, the "Individual Income Tax" app, and mainstream media, using case-based, scenario-based explanations (e.g., "Example of Asset Reporting and Tax Payment for High-Net-Worth Individuals Renouncing Nationality") to help taxpayers intuitively understand the calculation methods and filing procedures. Conduct training in conjunction with professional associations (e.g., Institute of Certified Public Accountants, Asset Appraisal Association) to enhance the capacity of professional institutions to understand and implement the exit tax policy, assisting taxpayers in compliant filing and reducing misinterpretation.

## 5. Conclusion

With China's rapid economic development and deepening globalization, tax issues arising from the emigration and renunciation of nationality by high-net-worth individuals have become increasingly prominent. The existing "tax settlement upon deregistration" provisions are insufficient to effectively regulate tax avoidance through renunciation. Imposing an exit tax has become a necessary measure to protect China's tax sovereignty, curb capital outflows, and promote tax fairness. By drawing on the extraterritorial experiences of the United States and Canada, and considering China's actual conditions, a scientific and reasonable exit tax system can be constructed in terms of taxpayer definition, tax base, tax rate design, and collection procedures, effectively filling loopholes in China's tax system and improving the overall system. At the same time, cross-border tax cooperation and collection capacity must be strengthened to ensure the smooth implementation of the exit tax system. In the future, as China's rule-of-law-based tax system continues to advance, the exit tax regime will further mature, providing strong support for high-quality economic development in China.

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