PRC Individual Income Tax Implementation Rules and related Circulars finalized

Mazars Newsletter - January 2019

Summary

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In the past month, the Chinese authority has issued various circulars detailing the new rules and regulations on the individual income tax ("IIT"). The final Implementation Rules (the "Implementation Rules") and the circulars are to implement the new IIT law passed by the Peoples' Congress in August, 2018.

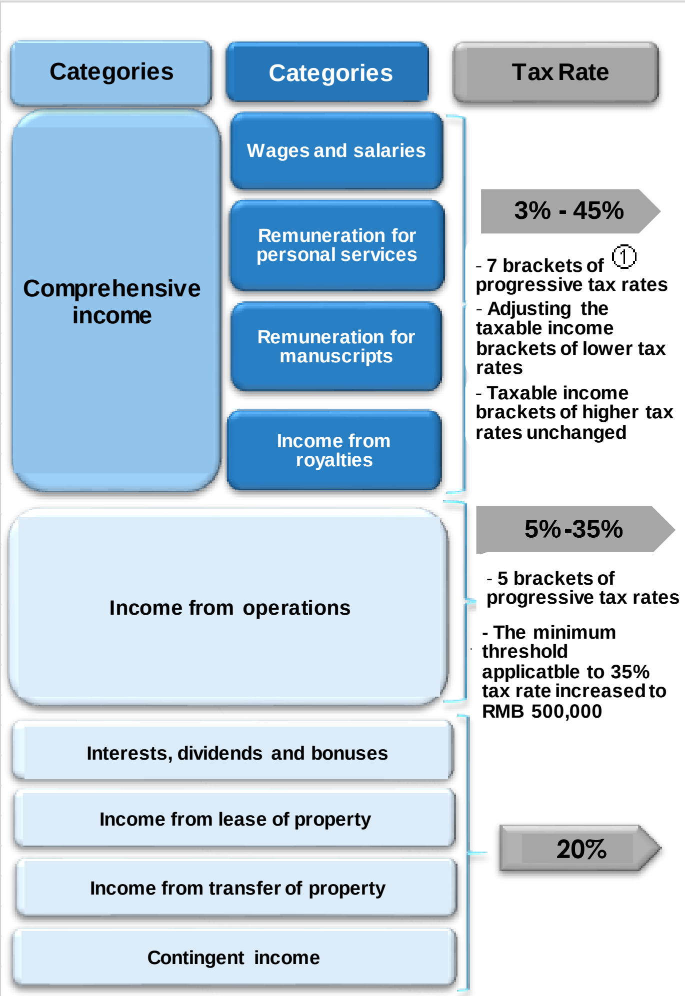
- On December 13, 2018, the State Council released the "Provisional Rules on the Specific Itemized Deduction for IIT purpose" (Guofa (2018) No. 41) ("Circular 41")
- On December 18, 2018, the State Council finalized and announced the Implementation Rules which would take effect on January 1, 2019.
- On December 21, 2018, the SAT issued Public Notice (2018) No. 60 ("PN 60") laying out the temporary measures dealing with the claiming of itemized deductions.
- On December 27, 2018, the Ministry of Finance and SAT jointly released the circular Caishui [2018] No. 164 to specify the new tax preferential policies.

We summarize below the main changes and implications for individuals.

HIGHLIGHTS OF MAJOR CHANGES IN IIT

New taxable income categories

The new IIT law has consolidated certain taxable income categories, namely income from salaries and wages, income derived from remuneration for personal services, income derived from remuneration for manuscript and income from royalties into a category called “Comprehensive income”.
The following table shows the details of the new tax rates at ① on the comprehensive income. The monthly rate is only for reference.



New IIT rates		
	Annual Taxable Income	**Tax Rate**
1	Not exceeding 36,000	3%
2	Exceeding 36,000 to 144,000	10%
3	Exceeding 144,000 to 300,000	20%
4	Exceeding 300,000 to 420,000	25%
5	Exceeding 420,000 to 660,000	30%
6	Exceeding 660,000 to 960,000	35%
7	Exceeding 960,000	45%
	Monthly Taxable Income	**Tax Rate**
1	Not exceeding 3,000	3%
2	Exceeding 3,000 to 12,000	10%
3	Exceeding 12,000 to 25,000	20%
4	Exceeding 25,000 to 35,000	25%
5	Exceeding 35,000 to 55,000	30%
6	Exceeding 55,000 to 80,000	35%
7	Exceeding 80,000	45%

The basis of the taxable income is based on the net salary after deduction of individual social contributions, additional itemized deduction (see next page) and CNY 5000 on monthly basis.

Based on the new rules, resident individual taxpayers who receive salaries and wages are withheld IIT on accumulated basis per month. If it is found that they pay IIT in excess at year end, they would apply for tax refund.

Additional itemized deduction

One of the highlights of the IIT amendments is the addition of six itemized specific deductions. Details are in the following table.

Amount in RMB

Deduction category	Annual	Monthly	Criteria
Child education (per child)	12,000 *	1,000	Eligible for parents with child (from 3 years old to higher education)
Continued education	4,800* (1)	400	Academic education
	3,600	N/A	Vocational education
Serious illness	Incurred amount between 15,000 and 80,000 (2)	N/A	Expenses borne by taxpayer with substantiation. Expense can be claimed for taxpayers themselves, their spouses and their non-adult children.
Rental cost	18,000	1,500	Municipalities directly under the Central Government, capital cities or other cities listed separately
	13,200	1,100	Cities with population above 1 million
	9,600	800	Cities with population below 1 million
Mortgage interest	12,000 * (3)	1000	For self-owned first property only and under commercial mortgage or housing fund
Elderly support	24,000	2000	To be divided by the supporting children

Maximum amount in a tax year

(1) The academic education has to be in China. The program cannot be longer than 48 months and if it is for under graduate education, the deduction can be claimed by the parents.

(2) The deduction can be claimed by the taxpayer for himself, his spouse, or his non-adult child.

(3) The maximum deduction period is 240 months.

EXPATRIATES’ TAX PREFERENTIAL POLICY AMENDED

End of the preferential tax calculation on the so called “bonus or 13th month” from 1 January, 2022

IIT on bonus payment before the amendment of IIT law is calculated out of the normal monthly salary and thus the individual can benefit a preferential tax calculation method. This rule will be maintained until December 31 2021. Starting from **1 January**, **2022**, the bonus will be integrated into the IIT calculation on the annual salary.

Change of tax calculation on the stock option derived from listed companies

From 1 January 2019 until 31 December 2021, the IIT on stock option will be calculated separately in full amount applying the 7 brackets of progressive rate for comprehensive income. The policy after 1 January, 2022 is not clear yet and will clarify in the future.

Expatriates’ tax preferential policy

Six-year rule

Under the new IIT laws, an individual who would normally be considered as a non-resident of China due to absence of residential ties, could be deemed to be a Chinese tax resident in a particular year if he has spent 183 days or more in China during the relevant tax year. The individual would then be subject to IIT on his worldwide income in that tax year.

Under the Implementation Rules, for individuals who do not have residential ties in China but is deemed to be a Chinese tax resident under the 183 days presence test, he would not be subject to IIT on his worldwide income, as long as these “deemed tax residency” years would not be continuous and exceed 6 years, and during the 6 year period, the individual has been outside China for a single period of more than 30 days. In order to obtain the tax exemption on non-China source income, the individual needs to file with the relevant tax authority for records. The 6-year period would start from any one year during which the individual has been outside China for a single period of more than 30 days. For example, if the individual has not been outside China for a single period of more than 30 days until the 6th consecutive year, not only that he should be subject to the 6-year rule exemption for the preceding five years, but also for the subsequent five years.

It is an extension of one year from the previous 5-years exemption in the exposure draft of Implementation Rules issued in October 2018. The measure is to encourage expatriates to work in China.

The Implementation Rules also defines “ordinarily resident” as an individual having Chinese domicile, family ties in China and economic ties in China and because of these ties, has been habitually living in China.

In addition, the Implementation Rules also states that for an individual without residential ties in China in a particular tax year, if his stays in China are in aggregate for 90 days or less, his employment income is paid by an overseas employer and the compensation would not be charged back to a Chinese entity or a permanent establishment of the foreign employer, the compensation would not be subject to China IIT.

Pay Exempt	Income derived from China		Income derived out of CHINA	
	Income borne by China entity	Income borne by Overseas entity	Income borne by China entity	Income borne by overseas entity
Less than 90 days/183 days				
More than 183 days for each year in less than 6 years in a row or 6 years or more in a row with a single trip of more than 30 days outside China				
More than 183 days for each year in 6 years or more without a single trip of more than 30 days outside China				

Obligation to declare the tax status

Based on the above status, expatriates through its bank or through the tax payer agent must declare his/her individual tax status to the authorities in January 2019 in order to take into account in the IIT system from the tax bureau for the computation of the IIT.

End of tax deductible items for expatriates:

The regulations mentioned that from 1st January until December 2021, expatriates can still enjoy these additional tax deductibles items listed below or choose to the specific itemized deductions, but not both.

- Housing rental
- Child education
- Language learning
- Home Travelling
- Meal & Laundry
- Relocation

Starting from **1 January 2022**, the above items cannot be deductible anymore. Expatriates should follow the specific deduction rules which are applicable to mainland Chinese taxpayers.

Anti-avoidance rules

The new IIT laws introduce anti-avoidance rules on individuals which empowers the tax bureaus to make tax adjustments to combat tax avoidance under the following circumstances:

- Transfer Pricing - transactions between the individual taxpayer and related parties are not independent and not at arm's length; and

- Profits are not allocated properly between the individual taxpayer and an related off-shore corporation which is set up in a low tax jurisdiction without reasonable and commercial needs, and the corporation is controlled by resident individuals or jointly controlled by resident enterprises;
- Inappropriate tax benefits derived through arrangements without reasonable commercial reason.

Under the draft Implementation Rules, the definitions on independent arm's length principles, related parties, commercial reasons, control, and low tax are predominately consistent with the anti-avoidance rules for corporations. With respect to related parties' transactions, it added to the definition of related parties to include husband and wife, immediate family, brothers and sisters, and anyone maintained or supported by the individual.

Under the final Implementation Rules, the above detailed explanations were removed. Nevertheless, it should be pointed out that the anti-avoidance rules applicable to individuals are now part of the legislation. It is expected that future circulars would be issued in this regard.

TAX AUTHORITY MOBILE APPLICATION

The tax authorities have launched the mobile app to collect taxpayers’ information. If you are under conditions of the additional itemized deduction, you can declare your authentic information through the website and app, and update any change of your information in time.
The mobile app can be downloaded now as following pictures.

The collection of the information can either be done through the above application, or by the company HR department.

MAZARS' VIEWS

The new IIT laws and the Implementation Rules also enforce the use of anti-avoidance rules related to individuals, even though there had already been few cases previously whereby the Indirect Transfer rule, one of anti-avoidance measures, were imposed on individuals.

In conjunction with the information collected through enhanced information sharing between departments and the automatic exchange of financial assets information under the Common Reporting Standard (CRS), it is becoming very clear that there would be tighter rules and greater enforcement of tax obligation in China. Take for example, the recent high profile case of the famous Chinese actress evading tax through the use of two contracts (so-called "yin-yang" contracts) is an indication of the tax authority's determination to enforce compliance. The Implementation Rules, Circular 41 and PN 60 provide helpful guidance to the application of the new IIT laws. Taxpayers should review their tax arrangements and ensure they understand their compliance obligations. Businesses should also consider the implications of the new rules and the withholding requirements, and devise policies that would fit for the purpose of maintaining talents.

HOW MAZARS CAN HELP YOU?

- Providing a dedicated payroll system tool for your HR department to help to collect the information and manage payroll, if you required.

- Assessing your company and yourself the possible implications of those changes from short term and long term perspectives.

- Assisting your company and yourself in the compliance obligations arising from those changes.

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