# Mobility: tax alert

September 2018

# China

## China individual income tax reform effective 1 January 2019

**Executive summary**
On 29 June 2018, China's National People's Congress (NPC) published a draft amendment of the Individual Income Tax Law (IIT). Details of the Draft Amendment were covered in EY's alert issued in July.

On 31 August 2018, the NPC passed the Draft Amendment to the People's Republic of China (PRC) IIT Law, with the amendments becoming effective from 1 January 2019.

**Key issues**
**More stringent criteria of "resident" determination**
The new IIT Law introduces the definitions of "resident" and "non-resident". Under the new Law, individuals who are domiciled in mainland China, or non-domiciled and have resided in mainland China for 183 days or more within a calendar year, are considered as China tax residents and are subject to IIT on their worldwide income.

The current IIT Law considers whether a non-domiciled individual (usually referred to as "foreigners and Hong Kong, Macau and Taiwan residents") has resided in mainland China for one year in order to determine the individual's residency status. The new criteria for satisfying the physical presence test of 183 days in a calendar year is more stringent than the current law.

This change is expected to significantly impact foreigners and Hong Kong, Macau and Taiwan residents in terms of their tax position and employment arrangements in mainland China. These individuals have a concern whether they will trigger China tax filing obligations on their worldwide income if their physical presence in mainland China reaches or exceeds 183 days in a calendar year.

It is important to note that the current China tax implementation rules has a "Five-year rule" for foreigners and Hong Kong, Macau and Taiwan residents. This rule provides that non-China sourced income (e.g. dividends derived from overseas entities and income from transferring overseas property) may be exempt from China taxation if the individual resides in mainland China for no more than five consecutive full years unless such income is paid by Chinese companies or organizations.

If the new IIT Implementation Rule to be issued still maintains the "Five-year rule" for foreigners and Hong Kong, Macau and Taiwan residents who are considered as China tax residents but are not China tax residents for more than five full consecutive years, they may still be exempt from tax in China on their non-China sourced income. However, this is yet to be clarified by the new implementation rule. Notwithstanding, compared to the existing five-year rule, it will be much more difficult for a non-Chinese national to stay for less than 183 days in mainland China during one of five calendar years than to stay in mainland China for less than a full year under the existing rule (i.e. stay outside of mainland China for more than 30 days in a single trip or more than 90 cumulative days in one of five calendar years).

**Establish a comprehensive-categorized tax system and simplify income categories**
The new IIT Law consolidates four types of labor income including wage and salary, remuneration for personal services, author's remuneration and royalty, into one category (hereafter referred to as "consolidated income"). Remuneration for personal services and royalty can be deducted by 20% to calculate the taxable income. In particular, author's remuneration can be deducted by 44% to arrive at the taxable income.

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Meanwhile, income derived from individual industrial, commercial production and operating activities, and income derived from contracting or leasing operations by any enterprise or institution are consolidated to income derived from business operations.

The tax rate tables for consolidated income and income derived from business operations remain the same as those mentioned in our tax alert of July 2018.

**Establish tax exemption for consolidated income mechanism, increase tax exemption threshold amount and introduce specific additional tax deductions**
The new IIT Law also:
- Increases the standard tax deduction for consolidated income to RMB60,000/year
- Introduces specific additional tax deductions including caring for the elderly, children education, continued education, medical expenses for serious illness, housing loan interest or housing rent.

The scope, standard and procedures will be regulated by the State Council and filed with the NPC Standing Committee for record.

The details under "Proposal to revise certain tax filing deadlines", "Proposal to add certain clauses for anti-tax avoidance" and "Increased collaboration among relevant parties" remain the same as those mentioned in our tax alert of July 2018.

**Effective date**
The effective date of the new IIT Law is 1 January 2019. From 1 October 2018 to 31 December 2018, salaries and wages income can be deducted by the monthly exemption amount of RMB5,000 along with other specific deductions and allowance deductions by the Law.

**Next steps**
Both employers and employees should prepare for the challenges brought by the new IIT Law and pay close attention to the upcoming new Implementation Rule and revisions to other tax regulations. EY will continue to provide updates in due course.

If you require any assistance in relation to this, please contact your local EY advisor or one of the contacts below.


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