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Human resource & Tax alert

China releases the full text of draft amendment of the Individual Income Tax Law and solicits public opinion

Executive summary

On 29 June 2018, China's National People's Congress (NPC) published a draft amendment of the Individual Income Tax (IIT) Law ("the Draft Amendment") on its website, soliciting public opinion. It is open for public comment until 28 July 2018.

This tax alert aims to elaborate on the detailed contents and discuss the major changes brought about by the Draft Amendment.

Key issues

1. Propose to consolidate certain income for taxation and revise current tax rate table

(1) The Draft Amendment may consolidate four types of labor income including wage and salary, remuneration for personal service, author's remuneration and royalty into one category (hereinafter referred to as "consolidated income") and impose unified progressive tax rates. In addition, the Draft Amendment proposes to replace the existing "Table 1 for IIT Rates" (Applicable to income of wages and salaries) with "Table 1 for IIT Rates" (Applicable to consolidated income).

The "Annual Taxable Income" as mentioned in this table refers to the balance after deducting RMB60,000 from the annual income and any specific tax deductions, specific additional tax deductions and other tax deductions pursuant to the relevant IIT rules and regulations. Specific tax deductions include mandatory individual social security contributions such as basic pension, medical, unemployment and housing funds. Specific additional tax deductions include child education, continued education, medical expenses for serious illness, housing loan interest and housing rent. The relevant scope, standard and procedures shall be formulated by the financial and tax department of the State Council and other relevant departments.

Non-residents receiving consolidated income shall calculate IIT on a monthly basis after converting the annual taxable income into the monthly taxable income according to the tax rate table.

We have summarized the major differences by comparing the tax rates of consolidated income as announced in the Draft Amendment with the prevailing tax rates of income of wages and salaries as follows:

Converted monthly taxable income according to the Draft Amendment（RMB）	Monthly taxable income according to the existing IIT Law（RMB）	Tax rate （%）
0 – 3,000	0 – 1,500	3
3,000 – 12,000	1,500 – 4,500	10
12,000 – 25,000	4,500 – 9,000	20
25,000 – 35,000	9,000 – 35,000	25
35,000 – 55,000	35,000 – 55,000	30
55,000 – 80,000	55,000 – 80,000	35
> 80,000	> 80,000	45

As shown above, the tax brackets of the income applicable to tax rates between 3% and 25% are adjusted to allow recipients to enjoy lower tax rates while those of the tax rates from 30% to 45% remain unchanged.

(2) The Draft Amendment proposes to replace the existing “Table 2 for IIT Rates” (Applicable to income derived from individual industrial, commercial production and operating activities and income derived from contracting or leasing operations by any enterprise or institution) with “Table 2 for IIT Rates” (Applicable to income derived from business operations). The "Annual Taxable Income" as mentioned in this table refers to the balance after deducting the costs, expenses and losses from the total revenue of each tax year.

We have also summarized the major differences by comparing the tax rates of income derived from business operations as announced in the Draft Amendment with the prevailing tax rates applicable to income derived from individual industrial, commercial production and operating activities and income derived from contracting or leasing operations by any enterprise or institution as follows:

Annual taxable income according to the Draft Amendment（RMB）	Annual taxable income according to the existing IIT Law（RMB）	Tax rate （%）
0 – 30,000	0 – 15,000	5
30,000 – 90,000	15,000 – 30,000	10
90,000 – 300,000	30,000 – 60,000	20
300,000 – 500,000	60,000 – 100,000	30
> 500,000	> 100,000	35

As shown above, proper adjustments are made to the respective tax brackets to lower taxes.

2. Introduce the definition and determination of residents and non-residents

An individual who has a domicile in China or who is non-domiciled but has resided in China for 183 days or more in a tax year will be deemed as a tax resident, and shall pay IIT for all income derived in and outside China according to the provisions of the IIT Law.

Any individual who has no domicile and does not reside in China or who has no domicile and has resided in China for less than 183 days in a tax year will be deemed as a non-resident. They shall pay individual income tax on income derived from China according to the provisions of the IIT Law.

3. Propose to introduce annual reconciliation for consolidated income

Tax residents shall calculate IIT on consolidated income on a yearly basis, however, for tax residents who have withholding agents, the tax payable shall be withheld and prepaid by the withholding agent on a monthly basis or based on the occurrence of the income. By the end of the year, annual reconciliation can be performed if there is additional tax due or any overpayment. In the event of a tax resident providing information of specific additional tax deductions, the withholding agent shall not refuse to deduct the relevant amount while prepaying the monthly IIT.

For non-residents deriving consolidated income and in the case which there is a withholding agent, the tax payable shall be prepaid by the withholding agent on a monthly basis or based on the occurrence of the income, and no annual reconciliation is required. If there is no withholding agent, self-declaration is to be performed within 15 days in the following month upon receiving the income.

4. Propose to revise certain tax filing deadlines

(1) A taxpayer who derives consolidated income is required to perform annual reconciliation, should submit the annual IIT reconciliation return between 1 March to 30 June of the following year after receiving the income.

(2) Any taxpayer, who receives taxable income but in the case which the withholding agent fails to withhold the tax payment, shall pay IIT before 30 June of the following year. In the event that tax authorities request to settle the tax payment within a given timeline, IIT shall be paid accordingly.

(3) A taxpayer who derives income overseas should file tax return and settle the tax payment between 1 March to 30 June of the following year after the occurrence of the income. Deadline has been as extended as compared with the prevailing filing due date as of 31 January of the following year.

(4) Any taxpayer who cancels his household registration in China due to migration abroad shall complete tax clearance before the cancellation of the household registration. This is a new requirement which was not stated in the existing IIT Law.

5. Propose to add certain clauses for anti-tax avoidance

Where any of the following circumstances applies, the tax authority shall be empowered for tax adjustment, the collection of tax underpayment and interest surcharge resulting from tax remediation:

(1) Where the business deals between an individual and his related parties are in violation of the arm's length principle (ALP) and are unreasonable
(2) Where the enterprise, which is controlled by an individual, or jointly controlled by an individual and resident enterprise, is set up in a state (region) that obviously has lower actual tax burden and has no profits-sharing or reduced profits-sharing on that which should be attributed to the individual, without reasonable business needs
(3) Where an individual obtains improper tax benefits from other unreasonable commercial arrangements

6. Collaboration among relevant parties

Relevant parties such as the Ministry of Public Security, the People's Bank of China and Financial Supervision department should assist the tax authorities to ascertain taxpayer's ID and bank account information. The Ministry of Education, Ministry of Health, Healthcare, Ministry of Civil Affairs, Ministry of Human Resources and Social Security, Ministry of Housing and Urban-Rural Development, the People's Bank of China and financial supervision departments should provide the tax authority with relevant information related to the specific additional tax deductions such as child education and continued education, medical expenses for serious illness, housing loan interest and housing rent.

7. Proposed effective date for the IIT Draft Amendment

According to the Draft Amendment, the proposed effective date is 1 January 2019. Before that, it is proposed that the monthly standard deduction of RMB5,000 on salaries and wages can be deducted to calculate the taxable income and relevant parties can use the "Table 1 for IIT Rates" discussed above to calculate their monthly IIT during the period from 1 October 2018 to 31 December 2018. In the meantime, the "Table 2 for IIT Rates" would be applied to calculate relevant IIT - "income derived from individual industrial, commercial production and operating activities" - during this period.

Our observation

According to the Draft Amendment, the monthly standard deduction will be increased to RMB5,000 and after the deduction of child education, medical expenses for serious illness, housing loan interest and housing rent, IIT may be reduced - which is especially relevant for lower and middle income earners.

It is expected that the existing annual tax filing for individuals with an annual income of more than RMB120,000 will be replaced by the annual reconciliation tax filing. The due date will be extended from 31 March of the given year to the period between March and June of the following year.

Terms have been added to the Draft Amendment and requests have been made for the relevant parties to collaborate and take actions on anti-tax avoidance. This should mean that China will strengthen the information exchange among relevant parties and this should see the enhancement of the IIT administration.

According to the existing IIT Implementation Rule, foreign nationals who stay in China for more than five full consecutive tax years will be subject to IIT on his or her worldwide income. In light of the fact that the Draft Amendment may introduce the 183-day period to determine the status of a tax resident, attention should be paid to any proposed changes to the above Five-Year rule. If any changes are made, it may exert great influence on relevant foreign nationals.

Unlike the terms for residents, it appears that specific tax deductions and specific additional tax deductions will not be available for non-residents. However, those non-residents who stay in China for less than 183 days during a year may also need to pay certain expenses such as mandatory social security contributions which shall be considered as specific tax deductions.

Next steps

The public can log on to www.npc.gov.cn to raise their comments to the Draft Proposal by 28 July 2018.

We recommend that companies and individuals to closely monitor the news regarding the IIT reform. We will also share updates on the IIT reform. If in doubt, please consult local tax authorities or seek advice from professionals.

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