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Human resource
& Tax alert

China clarified favorable Individual Income Tax treatments

Executive summary

The Ministry of Finance and the State Administration of Taxation (SAT) issued Caishui [2018] No. 164, which is a Notice focusing on several transitional rules concerning favorable individual income tax ("IIT") treatments after the amendment of IIT Law (hereinafter referred to as "Circular 164") on 27 December 2018. Circular 164 provides transitional rules on favorable tax treatment after the implementation of the new IIT Law, which will take effect from 1 January 2019.

This alert aims to elaborate on the detailed contents and implications brought about by Circular 164.

Key content

Below is a summary of favorable tax treatments:

Favorable income items	Favorable tax treatment	Applicable tax rate	Transition period and follow-up management
Annual bonus (PRC tax residents)	▸ Before 31 December 2021, as with the current treatment, not combined with consolidated income, annual bonuses will be divided by 12 to determine the applicable monthly tax rate and quick reckoning deduction: Tax liability = annual bonus income × applicable tax rate – quick reckoning deduction ▸ Or they can be combined with consolidated income to compute tax liability	Monthly tax rate table / Annual tax rate table for consolidated income	From 1 January 2022, annual bonuses shall be combined with other consolidated income received in a year to compute tax liability
	The above favorable tax treatment can also be applied to deferred annual performance bonuses and awards for leaders of state-owned enterprises	Monthly tax rate table / Annual tax rate table for consolidated income	Tax treatment after 1 January 2022 will be stipulated separately
Equity income from listed companies (PRC tax residents earn income from eligible stock options, stock appreciation rights, restricted stocks, stock awards, etc.)	▸ Before 31 December 2021, similar to the current treatment, not combined with consolidated income, use the applicable annual tax rate: Tax liability = equity income × applicable tax rate – quick reckoning deduction ▸ Equity income received twice or more shall be aggregated to determine the applicable tax rate, compute tax liability and make a reconciliation	Annual tax rate table for consolidated income	Relevant treatment after 1 January 2022 will be stipulated separately

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Favorable income items	Favorable tax treatment	Applicable tax rate	Transition period and follow-up management
Commission fee for insurance salesmen and securities brokers	► Commission fee for insurance salesmen and securities brokers shall be categorized as remuneration for personal service. Taxable income will be the remaining amount of commission fee excluding value-added tax deducts 20% deductible expenses, business expenses and additional taxes. It should be added with other consolidated income to compute tax liability. Business expenses are computed at 25% of the remaining amount of commission income excluding VAT minus 20% deductible expenses ► Cumulative pre-withholding calculation method shall be adopted	Annual tax rate table for consolidated income	No transition period is stipulated, and there should be no transitional period
Enterprise annuity and occupational annuity	Enterprise annuity and occupational annuity received by individuals who reach the statutory retirement age shall not be combined with consolidated income, but IIT will be computed separately: Monthly withdrawal	Use applicable monthly tax rate	No transition period is stipulated, and there should be no transitional period
	Quarterly withdrawal	Divided evenly into monthly income and use applicable monthly tax rate	
	Yearly withdrawal	Use applicable annual tax rate for consolidated income	
Severance payment upon termination of employment relationship, upon early retirement and upon internal retirement	Severance payment upon termination of employment relationship within three times of average annual salary of the preceding year in the city is exempt from individual income tax; the excessive amount beyond the three times shall not be combined with consolidated income, but IIT will be computed separately	Annual tax rate table for consolidated income	No transition period is stipulated, and there should be no transitional period
	Severance payment upon early retirement shall be apportioned according to the actual number of early retirement years between the year of early retirement and the statutory retirement year to apply tax rate and quick reckoning deduction: Tax liability = {[(severance payment ÷ actual number of early retirement years) – standard deduction] × applicable tax rate – quick reckoning deduction} × actual number of early retirement years	Annual tax rate table for consolidated income	No transition period is stipulated, and there should be no transitional period
	The individual income tax treatment on severance payment upon internal retirement remains unchanged		No transition period is stipulated, and there should be no transitional period
Selling houses to employees at lower price	If companies sells residential properties to employees at a price lower than the actual purchase price or the actual construction costs, the difference shall not be combined with consolidated income, it will be divided by 12 to determine the applicable tax rate and quick deduction: Tax liability = the difference × applicable tax rate – quick reckoning deduction	Monthly tax rate table	No transition period is stipulated, and there should be no transitional period
Tax-exempt benefits for non-Chinese nationals (including foreign nationals, and citizens of Hong Kong, Macau and Taiwan)	Non-Chinese nationals who qualify as PRC tax residents can choose to enjoy applicable specific additional tax deductions or the existing tax-exempt benefits including subsidies of housing, language training and children education, but they cannot enjoy both at the same time. Once selected, they cannot change it within a tax year		From 1 January 2022, tax-exempt benefits for subsidy of housing, language training and children education will no longer be available to non-Chinese nationals. They shall enjoy specific additional tax deductions

The provisions relevant to the above favorable tax treatments in the prevailing tax regulations shall be abolished at the same time. Except for those specified in the above, other favorable IIT treatments shall continue to be effective based on relevant tax regulations.

Our observation

1. Tax-exempt benefits for non-Chinese nationals

1) During the three-year transition period, we expect that most non-Chinese nationals will choose to continue to enjoy the current tax-exempt benefits since the amount of specific additional tax deductions are quite low

2) From 1 January 2022, tax-exempt benefits on subsidies of housing, language training and children's education will no longer be available to non-Chinese nationals, and they can only claim the low specific additional tax deductions. Since housing rent and children's education are very expensive in China, there will be significant impact on foreign investment enterprises and non-Chinese national employees. Under the same level of gross employment income and welfare, the IIT liability of these employees will significantly increase and their net after-tax income will decrease accordingly. If the employer would like to maintain the same level of the employees' after-tax income, they need to raise the total gross income of the employees, and this will increase the company cost. Therefore, multinational companies need to pay attention to and analyze China IIT costs of their non-Chinese employees starting from 2022 and plan ahead. Literally speaking, the remaining tax-exempt benefits for non-Chinese nationals including meals and laundries, home leave and relocation may still be available after 2022, but attention needs to be paid as to whether there will be any changes on this point

2. Annual bonus

Recently, a lot of attention is being paid to whether the favorable tax treatment on annual bonus will continue to be available or not from 2019. It is good news to taxpayers that it will still be available during the three-year transition period. However, it should be noted that it will not be available from 2022 and from then annual bonus shall be combined with consolidated income for IIT calculation purpose. It is not mentioned in the circular whether non-resident individuals can enjoy this favorable tax treatment.

3. Equity income from listed companies

Under the transitional rules, eligible equity income from listed companies received by PRC tax residents no longer need to be divided by the stipulated number of months to determine the applicable tax rate and quick reckoning deduction number, but apply annual tax rate table for consolidated income to compute tax liability. Equity income received by PRC tax residents twice or more in a year shall be aggregated to compute tax liability. This is very similar to the existing treatment. It is not mentioned in the circular whether non-resident individuals can enjoy this favorable tax treatment.

Next Steps

As withholding agents, companies need to become familiar with the relevant favorable tax treatments specified in the circular. If in doubt, please consult the local tax authorities. You are also welcome to contact EY professionals.

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