Human resource & Tax alert

New Individual Income Tax calculation methods

Executive summary

The State Administration of Taxation (SAT) issued SAT Announcement [2018] No. 56, Announcement on several transitional matters concerning tax collection and administration for fully enforcing the new Individual Income Tax (IIT) Law (hereinafter referred to as "Announcement 56") on 19 December 2018. Announcement 56 provides new pre-withholding/withholding IIT calculation methods on income from wages and salaries, remuneration for personal service, authors' remuneration and royalties received by PRC tax residents and non-residents, which will take effect from 1 January 2019.

This alert aims to elaborate on the detailed contents and implications brought about by Announcement 56.

Key Content

1. Pre-withholding method for PRC tax residents

1) When a withholding agent pays wages and salaries to PRC tax residents, cumulative pre-withholding calculation methods shall be adopted to perform monthly full withholding declarations for all individuals. The formulae are as shown below:

- Pre-withholding tax payable for the current month = (cumulative pre-withholding taxable income × pre-withholding tax rate - quick reckoning deduction) - cumulative tax exemptions - cumulative pre-withheld tax
- Cumulative pre-withholding taxable income = cumulative income - cumulative non-taxable income - cumulative standard deduction - cumulative special deductions - cumulative specific additional tax deductions - cumulative other deductions as stipulated by laws and regulations
- Cumulative standard deduction: calculated by multiplying RMB5,000/month by the number of months from the first month to the current month during which the employee is employed by the current employer
- Pre-withholding tax rates: pre-withholding tax rates and quick reckoning deduction on wages and salaries for PRC tax residents are as shown below:

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Band	Cumulative pre-withholding taxable income (RMB)	Pre-withholding tax rate (%)	Quick reckoning deduction
1	0 – 36,000	3	0
2	36,000 – 144,000	10	2,520
3	144,000 – 300,000	20	16,920
4	300,000 – 420,000	25	31,920
5	420,000 – 660,000	30	52,920
6	660,000 – 960,000	35	85,920
7	> 960,000	45	181,920

2) When a withholding agent pays remuneration for a personal service, or an author's remuneration or royalty, the individual income tax shall be pre-withheld accordingly every time or every month.

- Pre-withholding taxable income: Pre-withholding taxable income refers to the balance of income from remuneration for personal service, an author's remuneration or royalty minus deductible expenses. Pre-withholding taxable income for an author's remuneration is calculated at 70% of the remuneration.

- Deductible expense: If the income is from remuneration for a personal service, and if an author's remuneration or royalty does not exceed RMB4,000 per time, the deductible expense shall be RMB800; if the income exceeds RMB4,000, the deductible expense shall be calculated at 20% of the income.

- Pre-withholding tax payable on income from remuneration for a personal service = pre-withholding taxable income × pre-withholding tax rate - quick reckoning deduction

- Pre-withholding tax payable on income from author's remuneration or royalty = pre-withholding taxable income × 20%

- Pre-withholding tax rate: 20%-40% of the progressive pre-withholding tax rates below shall apply to income from remuneration for a personal service:

Band	Cumulative pre-withholding taxable income (RMB)	Pre-withholding tax rate (%)	Quick reckoning deduction
1	0 – 20,000	20	0
2	20,000 – 50,000	30	2,000
3	> 50,000	40	7,000

2. Withholding methods for non-residents

When a withholding agent pays wages and salaries, remuneration for a personal service, an author's remuneration or royalty to non-residents, who reside in mainland China for less than 183 days accumulatively in a calendar year, the following withholding method shall be applied to calculate withholding tax each time or on a monthly basis:

- Taxable income: Taxable income from wages and salaries of non-resident individuals shall be the balance of monthly employment income minus standard deduction of RMB5,000; Taxable income from remuneration for a personal service, an author's remuneration or royalty equals to the income amount received per time, which is the income from remuneration for a personal service, an author's remuneration and royalty deducted by 20% of deductible expense. Meanwhile, the income for an author's remuneration is calculated at 70% of the remuneration.

- Tax payable = taxable income × tax rate – quick reckoning deduction

- Tax Rates: The following tax rates shall apply to income from wages and salaries, remuneration for a personal service, an author's remuneration and royalty received by non-residents:

Band	Taxable income (RMB)	Tax rate (%)	Quick reckoning deduction
1	0 – 3,000	3	0
2	3,000 – 12,000	10	210
3	12,000 – 25,000	20	1410
4	25,000 – 35,000	25	2660
5	35,000 – 55,000	30	4410
6	55,000 – 80,000	35	7160
7	> 80,000	45	15160

3. Implementation and administration

When a withholding agent pays income from wages and salaries, remuneration for personal service, author's remuneration or royalty to PRC tax residents, they shall submit the "Individual Income Tax Withholding Return" to the in-charge tax authorities. Announcement 56 provides a template of "Individual Income Tax Withholding Return", which applies to monthly full pre-withholding/withholding declaration for all resident and non-resident individuals when paying wages and salaries, remuneration for personal service, author's remuneration and royalty, as well as when paying interest and dividend income, income from the leasing of property, capital gain and incidental income.

If the pre-withholding tax payment amount for a year is not the annual tax liability, PRC tax residents shall perform the annual reconciliation on the consolidated income with the tax authorities from 1 March to 30 June of the following year, to settle the additional tax liability or to apply for a tax refund.

Our observation

Tax-resident employees

- Employees can enjoy specific additional tax deductions in the monthly pre-withholding; Unused deductions for previous months within a same tax year can be carried forward to and used in a current month or future months.

- If one employee receives wages and salaries from one source with no other consolidated income items, has used the special additional tax deductions in monthly tax filing, and is not eligible to enjoy the specific additional tax deduction items of continued education for skilled personnel/professional and technical personnel, and medical expenses for serious illness that need to be claimed during the annual reconciliation, he or she will probably pay accurate tax by December of the year and will not need to perform annual reconciliation. It is expected that many employees will fall under this situation. Hence, the introduction of the cumulative pre-withholding method will minimize the workload of employees and the tax authorities.

- For employees with a similar amount of monthly wage and salary, their monthly IIT liability should also be similar each month before the IIT reform. However, effective from 1 January 2019, since the annual tax rates will be applied to the monthly pre-withholding, the monthly IIT liability of employees should normally increase gradually each month and the net after-tax monthly income should normally decrease gradually. This change should have a positive impact on employees' cash flow, and the employees should have an overall idea of their monthly net income during a year.

Non-resident employees

- Non-resident employees can only enjoy the monthly standard deduction of RMB5,000 and they cannot enjoy the specific additional tax deductions.

Individuals receiving other consolidated income items

- For individuals receiving income from remuneration for a personal service, an author's remuneration and royalty, specific additional tax deductions are not allowed in the monthly pre-withholding but the deductions can only be claimed in the annual reconciliation.

- As the old tax rates will be used in the pre-withholding for tax resident individuals, such individuals shall apply the new annual tax rates for the consolidated income in the annual reconciliation.

Companies

- As the monthly pre-withholding method on wages and salaries is very different from the current monthly tax withholding method, companies should modify and update their finance and payroll systems.

- Companies should be well prepared in areas of technology and human resources etc. to deal with the additional burden of collecting information of specific additional tax deductions from employees, calculating monthly IIT liabilities and net income for employees.

- Companies need to get familiar with and correctly apply the tax rates to withhold IIT on income from remuneration for a personal service, an author's remuneration and royalty. For foreign employees, companies need to assess whether they are residents and non-residents in order to apply the appropriate tax rates and tax calculation methods.

- For employees who join companies in a month during a calendar year, it is expected that the employer can perform the monthly IIT pre-withholding based on the wages and salaries the employees have received from the same employer, and the employer does not need to obtain the information of the employees' wage and salary and IIT paid by the previous employer during the same year.

Next Steps

As withholding agents, companies need to familiarize themselves with the new pre-withholding IIT calculation methods on different categories of income for tax residents and non-residents. If in doubt, please consult the local tax authorities. You are also welcome to contact EY professionals.

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