

Human resource & Tax alert

China launches Individual Income Tax deferral on commercial pension in pilot areas

Executive summary

On 2 April 2018, the Ministry of Finance (MOF), the State Administration of Taxation (SAT), the Ministry of Human Resources and Social Security and other relevant departments jointly issued Caishui [2018] No. 22 - Notice on Individual Income Tax (IIT) deferral on the commercial pension in pilot areas (hereafter refer to "Circular 22") which provides pilot IIT deferral treatment on commercial pension. The pilot program will take effect from 1 May 2018 with a trial period of one year. The pilot areas include Shanghai, Fujian Province (including Xiamen) and Suzhou Industrial Park Zone.

This alert provides a summary of the key points and discusses the impacts brought about by Circular 22.

Key points

1. IIT treatments

1) Contribution of commercial pension

In pilot areas, individuals' contributions to qualified commercial pension plans through personal commercial pension fund accounts can be deducted from the taxable income within a cap. For individuals who receive salaries and continuous labor remuneration, the allowable deduction amount is capped by 6% of the monthly salary or continuous labor remuneration of the current month (or RMB1,000 a month; whichever is lower). Where self-employed industrial and commercial households, individual operators, sole proprietorship enterprises and individual partners of partnerships derive income from production and business operations or from contracting or leasing, the allowable deduction is capped by 6% of the annual taxable income of the current year (or RMB12,000 a year; whichever is lower).

Personal commercial pension fund accounts are special private accounts set up by individual taxpayers at commercial banks for the purpose of making contributions to IIT deferral commercial pension plans, collection of investment gains and other relevant payments. It is a close-ended account solely linked to the individuals' personal identifications.

2) Distribution of investment gains

When gains derived from the investment of commercial pension funds are distributed to individuals' accounts, no IIT will be imposed on such gains during the pension contribution period.

3) Distribution of commercial pension fund

Individuals who reach the retirement age set by the government can receive commercial pension funds on a monthly or yearly basis. In principle, the distribution of commercial pension funds lasts until the end of the person's lifetime (and/or covers at least 15 years). One-off withdrawal is possible in case of death, disability or critical illness (according to the specific terms of the plan).

Among the qualified distribution payments of the commercial pension fund, 25% of the distribution payment can be exempted from IIT and the remaining 75% will be subject to a tax rate of 10%. Therefore, the total effective tax rate is 7.5%. The distribution payment shall be reported under the category of "other income". When the individuals receive the distribution payments, the relevant IIT shall be withheld by the insurance companies.

2. Eligible individuals

Eligible taxpayers for the IIT deferral treatment refer to the individuals who receive salaries and continuous labor remuneration (i.e. the taxpayer provides labor services and receives remuneration from the same entity for at least six consecutive months or more), as well as self-employed industrial and commercial households, individual operators, sole proprietorship enterprises and individual partners of partnerships deriving income from production, business operation or contracting/leasing operations whose IIT withholding agent or whose actual operation is located in the pilot areas.

If an individual derives income from two places in the above pilot areas, he or she can only select one area to enjoy the favorable IIT deferral treatment.

3. Related administrative procedures

During the pilot period, the information platform established by China Insurance Information Technology Management Co., Ltd will be used. This information platform will be interfaced with the system of tax bureaus, commercial insurance companies and commercial banks. The information platform will also support account management, information checking, tax review, external supervision, etc.

Individual commercial pension products should focus on safety, consist of a majority of safe products and a minority of aggressive products. The detailed guidelines will be proposed by the China Banking Insurance Regulatory Commission and announced by MOF, the Ministry of Human Resources and the SAT after internal consultation.

Our observation

The trial will allow individuals working in the pilot areas to enjoy IIT deferral on commercial pension insurance contribution and investment gains until the distribution stage after retirement and enjoy an effective tax rate of 7.5%, which is good news. We expect that after the trial, the IIT deferral treatment will likely be expanded to other areas in China and the relevant policies may be adjusted and improved. It will be considered a positive supplement to the existing limited pension scheme.

Next Steps

It is suggested that relevant companies and individuals pay attention to the commercial pension insurance product guidelines and related regulations to be issued at a later stage in order to understand how to enjoy the IIT deferral treatment on commercial pension funds. If in doubt, please consult the local tax authorities or seek advice from professionals.



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