Deloitte. 德勤

Tax
Issue P275/2018 – 3 July 2018

Tax Analysis

Individual Income Tax Reform: Draft amendments released for public consultation

Authors:

Beijing
Huan Wang
Partner
Tel: +86 10 8520 7510
Email: huawang@deloitte.com.cn

Shanghai
Irene Yu
Partner
Tel: +86 21 6141 1277
Email: iryu@deloitte.com.cn

Beijing
Mandy Kang
Senior Manager
Tel: +86 10 8512 5412
Email: makang@deloitte.com.cn

Christine Liu
Senior Manager
Tel: +86 10 8520 7612
Email: christliu@deloitte.com.cn

Shanghai
Tiffany Li
Senior Manager
Tel: +86 21 6141 1335
Email: tiffli@deloitte.com.cn

A draft law (7th Draft Amendments to the PRC Individual Income Tax Law) containing broad changes to the individual income tax (IIT) system was submitted to the Standing Committee of the National People's Congress for deliberation on 19 June 2018 and released to the public for consultation on 29 June.

Highlights of proposed changes

Definition of resident

A China-domiciled individual, or a non-China-domiciled individual who stays in China for a full calendar year normally is considered a Chinese resident for tax purposes, with the individual's China- and non-China-source income subject to Chinese IIT pursuant to the IIT Law. The "full year" test looks at whether the individual stays in China for 365 days in the tax year, with temporary trip(s) (i.e., a single trip of more than 30 days or multiple trips of more than 90 days) outside China not taken into account.

The draft law would introduce the internationally recognized "183-day" test for determining whether an individual is a Chinese tax resident, which will make it much easier for a non-China-domiciled individual to be considered a Chinese resident for tax purposes. The proposed definition is set out below:

	Definition	Tax scope
Resident	• China-domiciled individuals; and • Non-China-domiciled individuals who stay in China for 183 days or more in a calendar year	Both China- and non-China source income
Non-resident	• Non-China-domiciled individuals who stay in China for less than 183 days in a calendar year	Only China-source income

Tax categories

The existing IIT law uses a typical schedular system, according to which all taxable income is classified into 11 categories and the income under the different categories is taxed separately.

The draft would consolidate four categories of income (i.e., salaries and wages, remuneration for (independent) services, authors' remuneration, and income from royalties) into a single new tax category called "comprehensive income."

Tax rates and brackets

Salaries and wages currently are subject to progressive tax rates ranging from 3% to 45%, with seven tax brackets. According to the draft, the tax rates and seven brackets would remain and be applied to compute tax on comprehensive income. The lowest three brackets (i.e., 3%, 10%, and 20%) would be broadened considerably to benefit middle-/low-wage earners.

Standard deductions

According to the draft, the basic standard deduction that currently applies to salaries and wages also would apply to comprehensive income and would be increased from RMB 3,500 per month to RMB 5,000 per month (i.e., RMB 60,000 per year).

Meanwhile, the draft would repeal the additional standard deduction of RMB 1,300 per month that currently applies to salaries and wages earned by foreign individuals working in China and China-domiciled individuals working overseas.

Additional itemized deductions

The existing IIT law allows only a few itemized deductions that normally are limited to statutory social security contributions. To promote the well-being of the population and reduce the cost of living, the draft would introduce additional itemized deductions, including deductions for a child's education and continuing education expenses, medical expenses for critical illnesses, housing mortgage interest, and housing rent.

Tax assessment, collection, and filing

The draft would introduce new rules relating to tax compliance obligations. The key points are summarized below:

Tax ID: Chinese citizens' ID numbers would be used for tax purposes; the tax authorities would assign a tax ID to persons that do not have Chinese ID numbers (notably foreign nationals).

For more information, please contact:

Global Employer Services National & Southern China Leader
Hong Kong
Tony Jasper
Partner
Tel: +852 2238 7499
Email: tojasper@deloitte.com.hk

Northern China
Beijing
Huan Wang
Partner
Tel: +86 10 8520 7510
Email: huawang@deloitte.com.cn

Eastern China
Shanghai
Irene Yu
Partner
Tel: +86 21 6141 1277
Email: iryu@deloitte.com.cn

Western China
Chongqing
Frank Tang
Partner
Tel: +86 23 8823 1208
Email: ftang@deloitte.com.cn

Tax period: Comprehensive income derived by resident individuals would be assessed on an annual basis (currently, salaries and wages are assessed monthly). However, comprehensive income derived by nonresidents would be assessed on a monthly or transactional basis.

Comprehensive income of residents: The IIT for resident individuals would be collected through advance payments withheld and remitted by the payer (if any) on a monthly or transactional basis, with a final settlement made by the taxpayer at the time the annual return is filed. The annual return is due between 1 March and 30 June of the year following the calendar year.

The draft also provides that if a taxpayer submits information relating to itemized deductions to an income payer (i.e., the tax withholding agent) and requests the payer to deduct the relevant items to compute the advance tax payments to be withheld, the payer would not be able to refuse the request.

Comprehensive income of nonresidents: An income payer could act as a withholding agent to withhold and remit the IIT on a monthly or transactional basis on behalf of a nonresident by the 15th of the following month, and an annual return normally would not be required.

Tax clearance upon emigration

Based on the draft, if a taxpayer plans to deregister his or her Chinese Hukou (household registration in China) to emigrate abroad, the taxpayer would be required to settle his or her Chinese IIT liabilities before the deregistration would be allowed.

Cooperation among government agencies and collection of tax compliance records

To ensure that the tax authorities are equipped with necessary data for tax collection purposes, other government agencies would be obliged to assist the tax authorities in providing relevant information. For example, the public security bureaus, the People's Bank of China and financial regulatory bodies would have to provide information to the tax authorities in relation to taxpayers' ID and bank accounts; and government agencies in charge of education, healthcare, housing, etc. would have to provide information to the tax authorities in relation to the various itemized deductions.

The tax authorities also would be required to provide IIT compliance records of taxpayers and withholding agents to credit rating systems.

Anti-avoidance rules

The draft would introduce anti-avoidance rules (similar to those that apply for enterprise income tax purposes), and would allow the Chinese tax authorities to initiate tax adjustments and collect underpaid tax with overdue interest in the following situations:

- When transactions between an individual and his or her related parties do not comply with the arm′s length principle and the noncompliance cannot be justified;
- When a resident individual controls (or jointly controls with other resident individuals/companies) an enterprise established in a jurisdiction where the effective tax rate is significantly low and the enterprise does not distribute profits or distributes less profits than it should without a reasonable business justification; and
- When an individual obtains improper tax benefits through an arrangement that lacks a reasonable business purpose.

Effective date

Based on the proposed schedule in the draft, the new measures may come into effect on 1 January 2019 at the earliest, although some measures, such as the increased standard deduction, may be effective as early as 1 October 2018.

Deloitte's View

The proposed changes to the IIT system aim to promote social fairness and justice by alleviating the tax burden, increasing personal income and boosting consumption by the middle and lower income classes. Unlike some previous amendments that merely adjusted the standard deductions or modified the tax brackets for salaries and wages, the draft includes fundamental changes to the definition of a resident, it provides for the consolidation of various categories of income, the introduction of more itemized deductions and anti-avoidance rules, etc. After the draft comes into effect, these changes could have a profound impact on Chinese IIT landscape.

Domestic individuals

The draft introduces various measures (e.g., increasing the basic standard deduction, the introduction of more itemized deductions, and the expansion of the scope of the lower tax brackets) to reduce the overall tax burden on individual taxpayers, with the middle- and/or low-income groups probably receiving the most benefits.

The existing annual filing requirement for individuals whose annual income exceeds RMB 120,000 ("current annual filing") is expected to be replaced by the annual filing requirement applicable to comprehensive income derived by resident individuals ("new annual filing"). A wider group of individuals may be subject to the new annual filing requirement, as the current annual filing requirement applies only to individuals whose annual income exceeds RMB 120,000. Also, in many situations, the current annual filing requirement only involves an information return and normally no annual tax settlement is needed, since most taxable income (other than those derived from business operations) is taxed on a monthly or transactional basis. However, an annual tax settlement could become more standard after the new annual filing requirement is introduced, given that the tax on comprehensive income would be computed on an annual basis for resident individuals and the new comprehensive income category covers more income sources with more itemized deductions. To carry out the new annual filings, resident individuals may need to pay more attention to information gathering relating to the income and deductions, and seek professional assistance where necessary.

At the same time, the introduction of more itemized deductions would involve a large volume of personal data. Therefore, the government is expected to place more effort in building a database of individuals' income and property information, as well as enhancing information-sharing mechanisms among government agencies. The inclusion of IIT compliance records in the credit rating system would further encourage tax compliance in the future.

Foreign individuals in China

Practically, most foreign individuals working in China are considered non-China domiciled individuals for IIT purposes. The new 183-day test will make it easier for a non-China-domiciled individual to be considered a Chinese resident so that the individual's worldwide income could be subject to Chinese IIT.

It remains unclear whether the "five-year" test (i.e., whether a non-China domiciled individual has not stayed in China for five full consecutive tax years) currently offered to non-China domiciled individuals to shield certain foreign-source income from Chinese taxation will be repealed. If it is repealed, such individuals may have to resort to the tiebreaker rule under relevant tax treaties (if applicable) to determine their residence status and then seek treaty relief if the individual is considered a resident of the counterparty for the treaty purposes. If the individual is considered a Chinese tax resident, he or she would be subject to Chinese IIT on worldwide income. Potentially affected taxpayers may need to review their residence status under the draft law, and identify any risk of double taxation and eligibility for tax treaty relief.

In addition, the repeal of the additional standard deduction (i.e., RMB 1,300 per month), which currently is available to salaries and wages earned by non-China-domiciled individuals working in China and China-domiciled individuals working overseas, signals the Chinese government′s intention to follow the principle of national treatment. It is unclear whether the tax exemption for certain benefits-in-kind that currently are offered only to foreign individuals will be repealed as well and replaced by the additional itemized deductions.

Employers' obligations

It is worth noting that an employer's IIT withholding obligation will not be eliminated or mitigated under the draft; e.g., an employer still would be required to withhold advance IIT on salaries and wages received by resident individuals on a monthly or transactional basis. In addition, if a taxpayer submits information relating to itemized deductions to an employer (which is a withholding agent) and requests that the agent deduct the relevant items to compute the advance tax payments to be withheld, the tax withholding agent would not be able to refuse the request. This requirement could complicate the situation, as it is unclear whether the employer has an obligation to verify the authenticity of such information.

Employers also may face challenges in assisting employees with their annual tax filings. It is common for businesses (notably multinational companies that have many expatriates or locally hired foreign individuals) to provide support for their employees to meet their IIT compliance obligations, and facilitate their annual filings and initial tax registration, which may be required to apply for a tax ID. Companies may need to review or set up new policies and processes in this regard.

Anti-avoidance measures

The introduction of IIT anti-avoidance rules, together with the coming financial account information exchange under the common reporting standard rules, would significantly improve the Chinese tax authorities' ability to handle IIT avoidance cases. High-net-worth individuals with assets in China and cross-border business arrangements should consider reviewing their overall tax compliance status and assess the sustainability of their tax positions at home and abroad to manage any potential risk.

Final amendments to the IIT law are expected to be announced during 2018 and more follow-up measures will be introduced to support the IIT reform. Individuals and companies should monitor developments closely and start planning for changes. We will continue to follow the progress of the proposed tax reform and corresponding supporting measures, and share further updates as needed.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Beijing
Andrew Zhu
Partner
Tel: +86 10 8520 7508
Fax: +86 10 8518 1326
Email: andzhu@deloitte.com.cn

Harbin
Jihou Xu
Partner
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056
Email: jihxu@deloitte.com.cn

Shenyang
Jihou Xu
Partner
Tel: +86 24 6785 4068
Fax: +86 24 6785 4067
Email: jihxu@deloitte.com.cn

Chengdu
Frank Tang / Tony Zhang
Partner
Tel: +86 28 6789 8188 / 8008
Fax: +86 28 6500 5161
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Hong Kong
Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Shenzhen
Victor Li
Partner
Tel: +86 755 3353 8113
Fax: +86 755 8246 3222
Email: vicli@deloitte.com.cn

Chongqing
Frank Tang / Tony Zhang
Partner
Tel: +86 23 8823 1208 / 1216
Fax: +86 23 8859 9188
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Jinan
Beth Jiang
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: betjiang@deloitte.com.cn

Suzhou
Kelly Guan
Partner
Tel: +86 512 6289 1328 / 1297
Fax: +86 512 6762 3338
Email: kguan@deloitte.com.cn

Dalian
Jihou Xu
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: jihxu@deloitte.com.cn

Macau
Raymond Tang
Partner
Tel: +853 2871 2998
Fax: +853 2871 3033
Email: raytang@deloitte.com.hk

Tianjin
Bill Bai
Partner
Tel: +86 22 2320 6699
Fax: +86 22 8312 6099
Email: bilbai@deloitte.com.cn

Guangzhou
Victor Li
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: vicli@deloitte.com.cn

Nanjing
Frank Xu / Rosemary Hu
Partner
Tel: +86 25 5791 5208 / 6129
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn
roshu@deloitte.com.cn

Wuhan
Gary Zhong
Partner
Tel: +86 27 8526 6618
Fax: +86 27 6885 0745
Email: gzhong@deloitte.com.cn

Hangzhou
Qiang Lu / Fei He
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn
fhe@deloitte.com.cn

Shanghai
Eunice Kuo
Partner
Tel: +86 21 6141 1308
Fax: +86 21 6335 0003
Email: eunicekuo@deloitte.com.cn

Xiamen
Jim Chung / Charles Wu
Partner / Director
Tel: +86 592 2107 298 / 055
Fax: +86 592 2107 259
Email: jichung@deloitte.com.cn
chwu@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre ("NTC") was established in 2006 to continuously improve the quality of Deloitte China's tax services, to better serve the clients, and to help Deloitte China's tax team excel. The Deloitte China NTC prepares and publishes "Tax Analysis", "Tax News", etc. These publications include introduction and commentaries on newly issued tax legislations, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research studies and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre
Email: ntc@deloitte.com.cn

National Leader

Southern China (Hong Kong)
Ryan Chang
Partner
Tel: +852 2852 6768
Fax: +852 2851 8005
Email: ryanchang@deloitte.com

Northern China
Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Eastern China
Kevin Zhu
Partner
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

Southern China (Mainland / Macau)
German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Western China
Tony Zhang
Partner
Tel: +86 28 6789 8008
Fax: +86 28 6317 3500
Email: tonzhang@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.