DEZAN SHIRA & ASSOCIATES
Your Partner for Growth in Asia

China's New IIT Regime

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1. Welcome

Welcome

- On behalf of Dezan Shira & Associates, as well as the Italian Chamber of Commerce in China, we are pleased to welcome all participants to this presentation on China's new individual income tax (IIT) regime.

- Please refer to the next slide for an overview of the key topics which will be covered in this evenings presentation.

2. Introduction to new IIT law

Background

- A draft law containing broad changes to the IIT system was submitted by the Standing Committee of the National People's Congress for deliberation on June 19, 2018

- The draft amendments were then released for public consultation on June 29, 2018. The Public Consultation program closed on July 28, 2018. Thousands of comments were received.

- On 31 August 2018, the amendments to the new IIT law were passed by the Standing Committee during the fifth plenary session.

- October 1st, 2018 – December 31st: standard deduction increased to RMB 5,000/month, new tax tables apply to salaries & wages and income from operations.

- January 1st, 2019: The amendments take full effect.

- The recent changes are profound. Although the IIT law has been amended several times since being enacted in 1980, these latest amendments are the most significant, making changes in several areas.

Introduction to key changes and policy rationale

- The new IIT law impacts every taxpayer.

- The news laws include the following:
  - Changes to the definition of tax resident
  - Consolidation of different categories of income
  - Introduction or more itemized deductions
  - General anti avoidance rules (GAAR)

- The changes aim to:
  - Promote social fairness and justice by alleviating the tax burden
  - Increase personal income
  - Boost consumption for lower and middle income classes
  - Expansion of the taxation scope of foreign individuals in China, and the associated costs to their onshore and offshore employers
  - Increases scrutiny over High Net Worth Individuals' global investment strategy and the relevant tax compliance costs

Highlight of the amendments to IIT Law

1. Tax residence rules
2. Tax categories
3. Tax rates and brackets
4. Standard deduction
5. Additional itemized deductions
6. Tax assessment, collection and filing
7. Information sharing across different departments
8. Tax clearance upon emigration
9. Anti-avoidance rules for individuals

3. Key changes

3.1 Consolidation of Income Categories

Categories of Taxable Income (Old)

1. Employment Income: 7- tier progressive rate from 3% to 45%
2. Independent Service Income: 3-tier rate of 20%, 30%, 40%
3. Manuscripts income: 20% with a further 30% reduction of the tax payable
4. Royalty income: 20%
5. Production & business income derived by industrial and commercial households: 5-tier progressive rate from 5% to 35%
6. Income from contracted or leased operation of enterprises or institutions 5% to 35%
7. Interest, Dividends, profit distribution: 20%
8. Property rental income: 20%
9. Income derived from transfer of properties: 20%
10. Occasional income: 20%
11. Income from other sources specified as taxable by the department of finance under the State Council

The Scope of Comprehensive Income

1. Income from wages and salaries
2. Income from labor services
3. Income from author's remuneration
4. Income from royalties

Comprehensive Income
one-set progressive rates from 3% - 45%

Therefore, the classification of comprehensive income as well as the changes in IIT calculations could lead to a change in the IIT liabilities of self-employed individuals.

5. Income from production and business operations by individual industrial and commercial household

5% - 35% progressive rates (the min. threshold applicable to 35% tax rate increased to RMB 500,000

6. Income from interest, dividends and bonuses
7. Income from lease of assets
8. Income from transfer of assets
9. Contingent income

Unchanged
20%

10. Other income (removed in the final amendment)

3.2 New Tax Brackets

New IIT Rates for Employment Income

Tax Bracket	Annual Taxable Income (RMB)	Tax Rate	Quick Deduction (RMB)
1	≤ 36,000	3 %	0
2	36,000 to 144,000	10%	210
3	144,000 to 300,000	20%	1,410
4	300,000 to 420,000	25%	2,660
5	420,000 to 660,000	30%	4,410
6	660,000 to 960,000	35%	7,160
7	> 960,000	45%	15,160

Tax Table Comparison

Current IIT Law | **New IIT Law**

Monthly Taxable Income (MTI) (RMB)	Tax rate	Quick Deduction	Monthly Taxable Income (MTI) (RMB)	Tax rate	Quick Deduction
1,500	3%	0	Not exceeding 3,000	3%	0
1,501 – 4,500	10%	105	3,001 – 12,000	10%	210
4,501 – 9,000	20%	555	12,001 – 25,000	20%	1,410
9,001– 35,000	25%	1,005	25,001– 35,000	25%	2,660
35,001 – 55,000	30%	2,755	35,001 – 55,000	30%	4,410
55,001 – 80,000	35%	5,505	55,001 – 80,000	35%	7,160
Exceeding 80,000	45%	13,505	Exceeding 80,000	45%	15,160

Note:

- The tax brackets have been widened; 3%, 10% and 20%.
- The tax bracket for 25% has been narrowed.
- The 30%, 35%, and 45% tax brackets have been maintained/kept the same.

Basic IIT Calculations

Monthly Taxable Income =
**Gross Income – **IIT Exemption Threshold*

IIT Payable =
Monthly taxable income x Applicable tax rate – *Quick Deduction

Note:
**Gross Income: after deduction of employee mandatory benefit*
***IIT Exemption Threshold: 5000 per month, 60,000 per year*

Scenario I: Salary Only

Monthly Income	Annual income	Tax payable (Before)	Tax payable (After)	(decreased) or increased	Flux (%)
5,000	60,000	540	0	(540)	(100%)
10,000	120,000	8,940	3,480	(6,460)	(61%)
50,000	600,000	134,340	109,080	(25,260)	(19%)
85,000	1,020,000	278,040	250,080	(27,960)	(10%)
100,000	1,200,000	359,040	331,080	(27,960)	（8.4%)

low and middle- income earners will benefit from it and boosting consumption for lower and middle income classes

Scenario II: Salary & Bonus

	Before	After
Annual bonus (RMB)	960,000	960,000
Applicable tax rate	35%	45%
Annual IIT	330,495	432,000

Note: it is not clear that is there any special tax treatment for Annual Bonus yet

3.3 Deductions

A new Comprehensive Deduction System

- **Standard basic deductions**
  - ➢ The new IIT law raises the personal deduction amount for Comprehensive Income to RMB60,000 per year (i.e. RMB5,000 per month) for residents and RMB5,000 per month/time for non-residents. personal deduction (i.e. RMB1,300 per month) for foreign nationals will no longer apply.
- **Specific additional deductions (draft)**
  - ➢ Education expenses for children;
  - ➢ Expenses for further self-education;
  - ➢ Healthcare costs for serious illness;
  - ➢ Housing loan interest;
  - ➢ Housing rent; and
  - ➢ Elderly care expense (*added in the final draft*)

Note: detailing specific scope and criteria, amount, supporting documents and timing of claim are still to be determined by the relevant departments of the State Council.

- **Specific deductions**
- **Other deductions**

3.4 New Concept of Tax Residency Status

New Definition for Tax Residence

Old law

- Foreign individuals who reside in China for less than one year will be taxed only on their China-source income.

- Foreign individuals who reside in China for more than one year but not more than five consecutive 'full' years will be subject to tax on both their China-source income and their foreign-source income. However, as a concession, foreign-source income is taxed only to the extent of income paid and/or borne by a China entity.

- Foreign individuals who reside in China for more than five consecutive 'full' years will be subject to IIT on their worldwide income from the sixth consecutive 'full' year onward.

New law

- An individual who is domiciled in China, or a non-domicile of China who resides in China for 183 days or more, is considered a resident and is liable to PRC IIT on their global incomes.

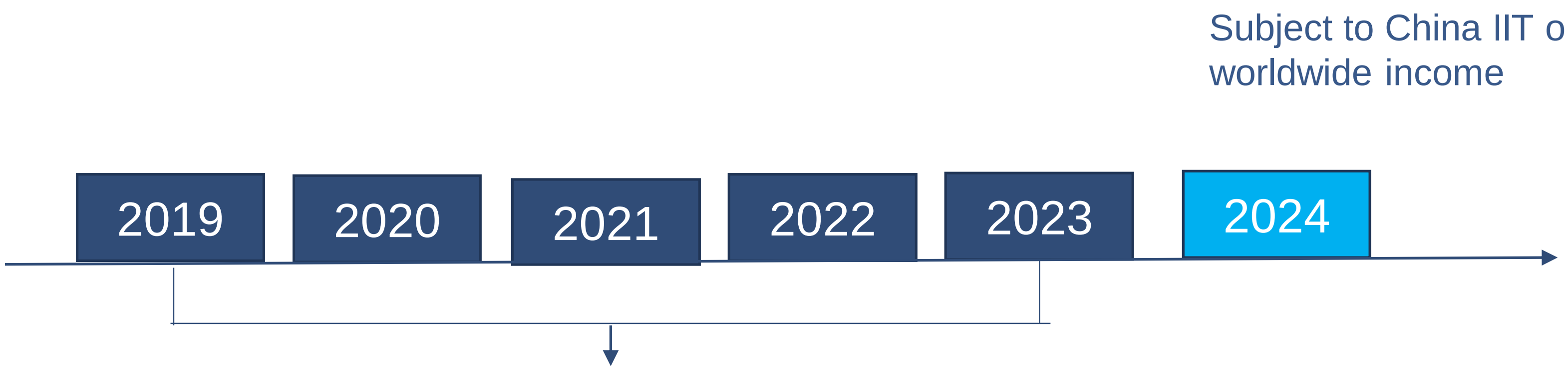
- A non-domicile of China who does not reside in China or who resides in China for less than 183 days is considered a non-resident and is liable to PRC IIT on their China sourced income only.

New Definition for Tax Residence

The previous five-year rule which is applicable to non-China-domiciled individuals remains effective with below two key changes:

1. the requirement for breaking the five-year chain changes to more than 30days out of China in one single trip

2. non-China-domiciled individuals who stay in China for 183 days or more in a calendar year would be considered as staying in China for one year for that calendar year



- Spending 183 days or more in china in every calendar year
- No absence of more than 30 days in a single trip five consecutive “full years”

3.5 General Anti Avoidance Rules

General Anti Avoidance Rules (GAAR)

- The new IIT law (Article 8) introduces anti-avoidance rules which allow the Chinese tax authorities to initiate tax adjustments and collect underpaid tax with overdue interest in following situations:

  - When transactions between an individual and his/her related parties do not comply with the arm's length principle.

  - When a resident individual controls a company established in a jurisdiction where the effective tax rate is significantly low and the company does not distribute profits or distributes less profits than it should without a reasonable business justification.

  - When an individual obtains improper tax benefits through an arrangement that lacks a reasonable business/commercial purpose.

Increases scrutiny over High Net Worth Individuals' global investment strategy and the relevant tax compliance costs

3.6 Compliance and Administration

Compliance

- **Tax Resident individuals**

  - Comprehensive income derived by resident individuals will be assessed on an annual basis.

  - The IIT for resident individuals will be collected through advance tax 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 must be filed between 1 March and 30 June of the year following the calendar year/year of assessment.

- **Non-Tax residents**

  - Comprehensive income derived by non-residents will be assessed on monthly or transactional basis.

  - For non-residents, an income payer can act as a withholding agent to withhold and remit IIT on a monthly basis on behalf of the taxpayer by the 15th of the following month, and annual return would normally not be required.

New taxpayer identification number (TIN)

- Each tax payer will have a unique personal TIN(纳税人识别号）based on their China ID card number
- Tax payer is required to provide their TIN to the withholding agent for tax withholding purpose
- Tax authority will assign a TIN to taxpayer who does not have a China ID card
- This TIN will be used for social security, CRS information exchange, immigration etc.

Phases

Phase 1: October 1st 2018
the new tax table will be implemented

Phase 2: January 1st 2019

Overall amendment will come into effect

Until March to June 2020

1st IIT annual reconciliation

4. Next steps

4.1 Two step implementation

- **The new IIT law will fully take effect from 1 January 2019.**

- **Prior to full implementation, the updated monthly personal deduction of RMB 5,000 and the adjusted tax rate bands which apply to the category of Comprehensive Income will be applied to salary and wages earned from 1 October 2018.**

4.2 Further guidance and DIR

- The new amendments released are broad in nature and not detailed/specific.

- Further guidance and detailed implementation rules (DIRs) are expected by December. These will be extremely important for a number of reasons, namely, they will hopefully outline and provide guidance on how the local tax bureaus should apply the new laws under certain scenario's.

- Will the 5 year rule continue? Will it be transitioned out?

- Will expats still be eligible to receive non-taxable benefits?

5. DSA’s observations

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Deductions

- The new law contains various measures to reduce the overall tax burden on individual taxpayers. Taxpayers in the middle to low income groups will benefit most.

Taxation on non-residents

- The news laws are set to have a substantial impact on foreigners living in China. Under the new tax residents test, more foreigners will be regarded to be tax residents of China. The Five-year rule remains for expatriates, but with change.
- The removal of the RMB1300 additional standard deduction applicable to foreigners also signals the Chinese governments intention to treat PRC nationals and foreigners on a more equal playing field.

5. DSA's observations

Compliance

- The new laws provide for a taxation system which includes both monthly withholding of salary and wages as well as an annual reconciliation.
- The new laws confirm the requirement of withholding agents to withhold IIT per month/per payment.
- However, withholding agents should not refuse to deduct any specific allowable deductions being claimed by taxpayers on a monthly basis, provided the relevant information is provided by the employee. The claiming of these deductions can be done monthly and the employee doesn't have to wait until he end of the year. This may increase the tax withholding agents responsibility and the complexity of the work involved, especially where a large number of employees are hired.

GAAR

- Individuals with cross border arrangements and overseas assets should consider reviewing their overall tax compliance status and put in place measures to mitigate any potential risks.

6. Key points from the Draft Implementation Rules

6. Key Points from the Draft Implementation Rules

- The ‘Five-year Rule’ will remain for expatriates, but with changes
- Expatriates will remain eligible for most of their current tax-exempt benefits
- Expatriates’ domicile assessment criteria will remain unchanged
- High net-worth tax payers have new general anti-avoidance rule compliances
- Overseas emigrants need to file prior to cancelling household registration
- Resident taxpayers have new documentation requirements
- No clarity on tax treatment of severance pay as of yet

7. How can DSA help you

7. How DSA can help you

- Tax advice for individuals and companies.
- Policy updates.
- Implementation guidance.

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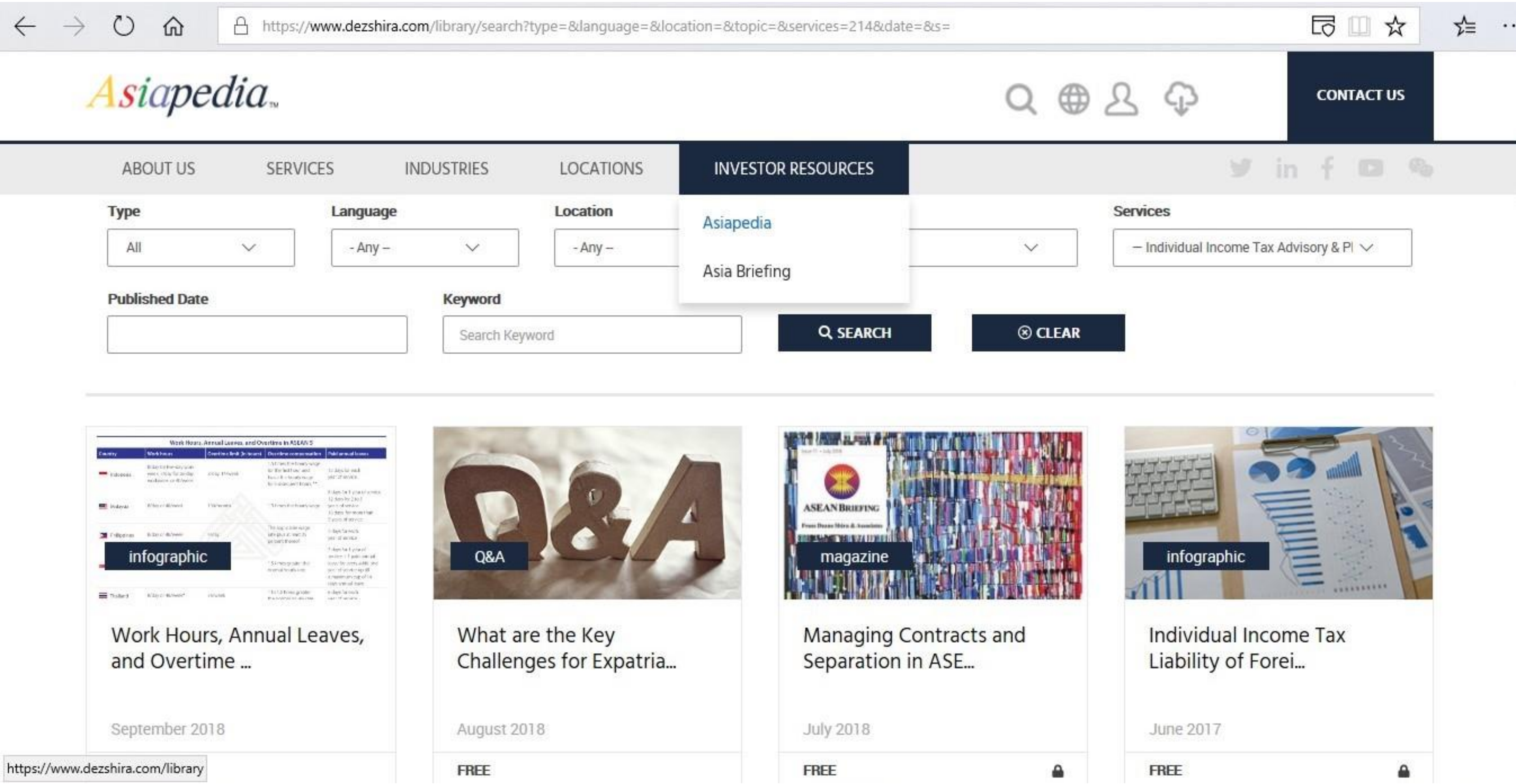

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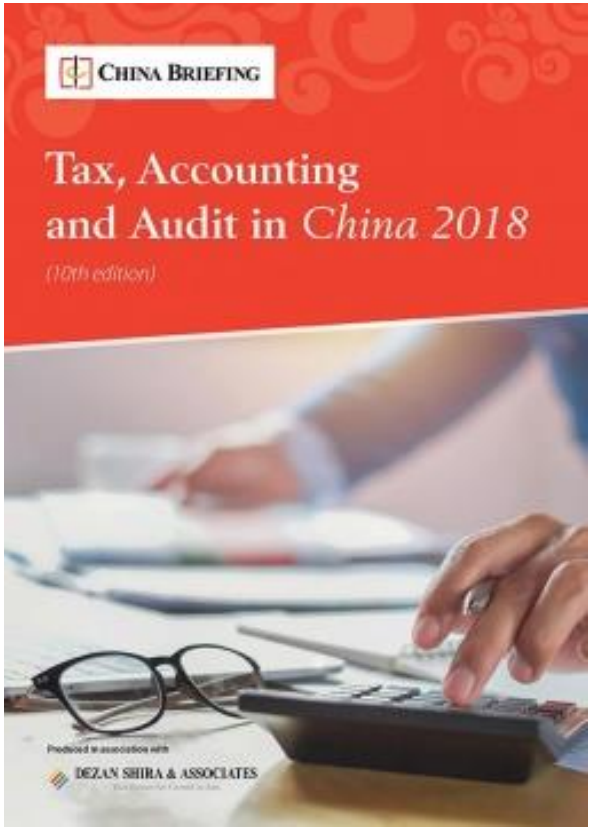

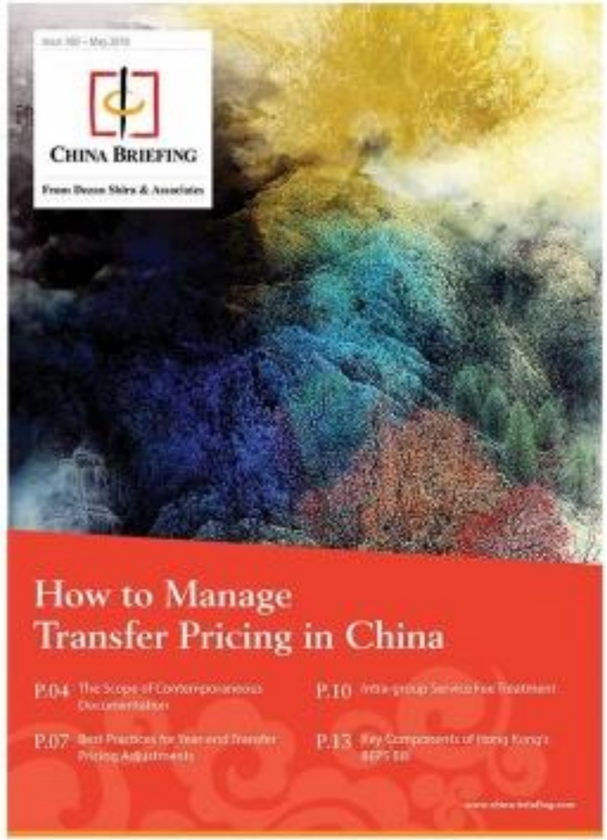

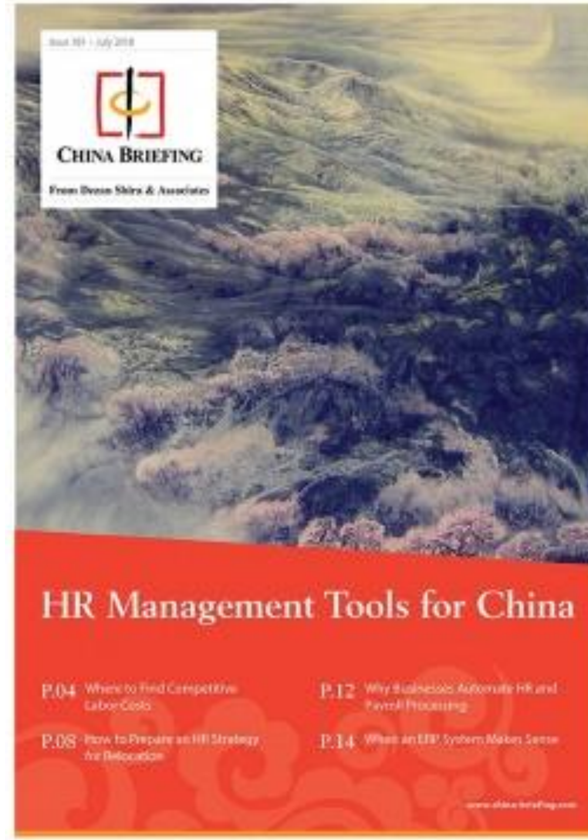

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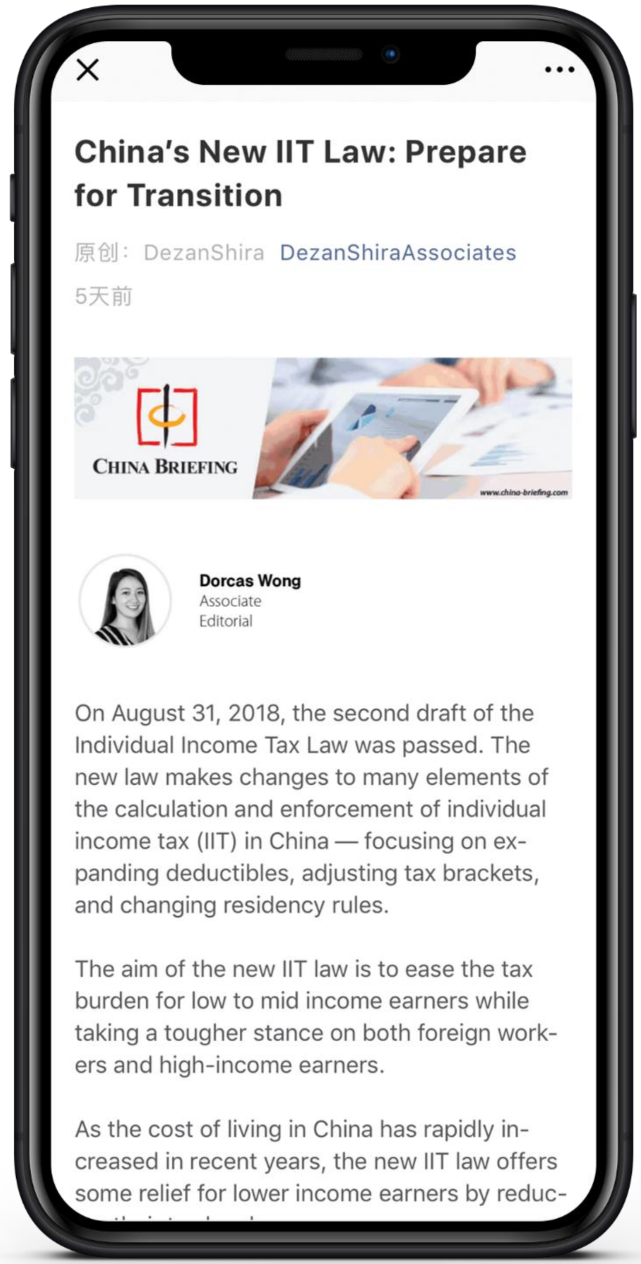

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