

New rules on the PRC Individual Income Tax ("IIT") treatments

Nov 2009



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Recently the PRC State Administration of Taxation has issued a tax circular Guoshuifa [2009] 121 ("Circular") clarifying certain IIT treatments which may have implications for taxpayers and their withholding agents.

The Circular addresses several issues as follows:-

- 1) Elimination of the practice of treating "Double Pay" as separate monthly income for computing IIT purpose
- 2) Director fees and salaries fee income received by the same executives should be combined and taxed under the "Salaries and Wages" head of charge
- 3) Clarification of definitions of "overseas Chinese" and the IIT implications
- 4) IIT exemptions for transfer of real estates to spouses under divorce settlements.

We would focus our discussions on the first two items.

Elimination of the practice of treating "Double Pay" as separate monthly income for computing IIT purpose

Under the tax circular Guoshuihan [2002]629, "Double Pay" or the 13th monthly salary could be separately accounted as one single month salary for computation of IIT. As IIT adopts progressive tax rates, the higher the income, the higher applicable tax rates is adopted. By allowing separate computation, the IIT payable would be in general lower than combining the "Double Pay" with the normal monthly salary.

Subsequently, the SAT issued Guoshuifa [2005] 9 which provides a basis for preferential IIT treatment for annual bonus.

Since then, there had been some variations in IIT treatments among some local level tax bureaus. For some employees who were paid "Double Pay" and annual bonus in different months, certain tax bureaus viewed that the "Double Pay" as additional bonus and that such "Double Pay" should be combined with normal monthly salaries for computation of monthly IIT. It appeared they considered that Guoshuifa [2005] 9 had superseded Guoshuihan [2002] 629.

However, there were also some tax bureaus which allowed treatment for “Double Pay” in line with Guoshuihan [2002] 629 while at the same time permitted preferential treatments for annual bonus in accordance with Guoshuifa [2005] 9.

With the issue of this Circular, the tax treatment has now been unified. Employers may consider adjusting the timing of paying ‘Double Pay’ and annual bonus in order to reduce IIT liabilities of their employees.

Combination of director fees and salaries fee income received by the same executives for IIT computation under ‘Salaries and Wages’ head of charge

Currently, director fee and salaries income are subject to IIT under different heads. For director fee, it is under the head of labour services. The progressive rates are in the range of 20% to 40%. As to salaries income, it is under the head of salaries and wage. The progressive rates are in the range of 5% to 45%.

As such, if the individuals have these two types of income, they may manipulate the allocation of director fee and salaries in order to achieve their tax saving objectives.

The change appears to plug this loophole. Please note that the combination treatment is not restricted to those situations where the executives receive both salaries and director fee income from the same enterprise. It also applies to the situations where the executive receive salaries from one enterprise and director fee from related enterprises.

In this regard, the executives concerned should ensure that correct amount of IIT be withheld in case they have both director fee and salaries fee income.

This change in treatment does not affect the IIT treatment for those persons who only have director fee income. To them, their director fee income will still be subject to IIT under the head of labour services.

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