



# THE PRC LAW ON INDIVIDUAL INCOME TAX ( “IIT” ) AMENDMENTS APPROVED

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## Background

On 31 August, the Standing Committee of China's National People's Congress formally approved the Amendments to the PRC Law on IIT (the "Amendments").

## In brief

The key changes that will affect individual expatriates and their employers include:

- Revising the criteria for determining tax residency status;
- Implementing a mixture of aggregate and scheduler taxation system to replace the old scheduler taxation system;
- Amending the tax rates and taxable income brackets;
- Increasing the standard basic deduction and introducing additional specific deductible items;
- Introducing a unique taxpayer identification number; and
- Introducing an anti-tax avoidance rule.

The Amendments are indeed signifying an overhaul of the IIT system.

## In details

Salient points of the Amendments are set out below:



# 01

## Salient points of the Amendments

## 1. New definition for tax residency

In determining the tax residency status of individuals without domicile or factual residency in China, the physical presence threshold would be tightened from 'one full year' to '183 days spent in China'.

Under the old IIT law, when an individual is not usually or habitually resident in China, i.e. not being a factual resident in China, he would be considered as a Chinese resident when his physical presence in China is one full year. Under the new IIT law, that individual would be considered as a resident in China in a particular tax year if he has spent 183 days or more in China during the relevant tax year.

As a resident in China, he would be liable for IIT on their worldwide income for that relevant year.

Nevertheless, under the existing Detailed Implementation Rules of the IIT law ("Implementation Rules"), individuals without domicile in China will not be subject to IIT on the worldwide income until after they have resided in China for five consecutive full years. It is unknown at this stage how this "5-year rule" may be affected by this change to the definition of tax residence. It remains un-clear until further amendments to the Implementation Rules are introduced. Amendments to the Implementation Rules would be introduced by the State Council, without the need for approval from the National People's Congress.

## 2. New tax system

The Amendments have consolidated certain taxable income categories, namely income from wages and salaries, income derived from remuneration for personal services, income derived from remuneration for manuscripts and income from royalties into a category called "Comprehensive income". For the first time, PRC tax residents can deal with the tax filings on the various income included as comprehensive income on an annual basis.

Under the old IIT law, income derived from contractual or leasing operations of enterprises or institutions was under a separate taxable income category. This category of income has been removed with the relevant income incorporated into comprehensive income or business operation income respectively. Also being removed is the category called "other income".

Thus, for an individual who is receiving salaries from one employer and director fee from another separate enterprise, instead of having the salaries and the director fee taxed separately, the two incomes would be combined as comprehensive income and taxed accordingly.

The new categories are listed in the following table.

OLD IIT LAW		THE AMENDMENTS	
CATEGORIES	TAX RATES	CATEGORIES	TAX RATES
Income from wages and salaries	3%-45% 7 brackets of progressive tax rates	Comprehensive income	<ul style="list-style-type: none"> <li>3%-45% 7 brackets of progressive tax rates</li> <li>Adjusting the taxable income brackets of lower tax rates (i.e., 3%, 10%, 20% and 25%)</li> <li>Taxable income brackets of higher tax rates unchanged (i.e., 30%, 35% and 45%)</li> </ul>
Income derived from remuneration for personal services	20%-40% 3 brackets of progressive tax rates		
Income derived from remuneration for manuscripts	20%		
Income derived from royalties	20%		
Income derived from production and business operations by individual industrial and commercial households	5%-35% 5 brackets of progressive tax rates	Business operation income	<ul style="list-style-type: none"> <li>5%-35% 5 brackets of progressive tax rates</li> <li>The minimum threshold applicable to 35% tax rate increased to RMB 500,000</li> </ul>
Income derived from contractual or leasing operations of enterprises or institutions	5%-35% 5 brackets of progressive tax rates	Category removed with relevant income incorporated into comprehensive income or business operation income respectively	
Income from interest, dividends and bonuses	20%	Unchanged	
Income from lease of property	20%		
Income from transfer of property	20%		
Contingent income	20%		
Other income	20%	Removed	

### 3. Monthly Standard Deductions and Other Specific Deductions

The monthly standard deduction has been unified for all taxpayers and increased to RMB 5,000.

In addition, other specific deductions are listed in the following. These specific deductions are only deductible for comprehensive income. These are:

- Child education expenses
- Continuing education expenses
- Medical expenses for chronic diseases
- Mortgage interest expenses for residential homes
- Rental expenses for residential homes and
- Support expenses for parents
- Social security payments

The actual scope and specific procedures to claim these deductions shall be announced by the State Council in due course.

It remains to be seen as to specific deductions available to expatriates under the old IIT law.

For income derived from personal services, income derived from manuscripts and royalty income, there would be a further notional deduction equal to 20% of the income. For income derived from manuscripts, there is an addition 30% deduction, thus making effectively only 56% of income derived from manuscripts to be included in comprehensive income subject to IIT.

In addition, donations to charities are also allowed as deduction up to 30% of taxable income for IIT purposes.

### 4. The New Tax Rates

The table below highlights the main changes to the taxable income brackets, especially for those taxpayers subject to an applicable tax rate of 25% or lower.

## COMPREHENSIVE INCOME

Current IIT rates		New IIT rates		
	Annual (Monthly) Taxable Income	Tax Rate	Annual (Monthly) Taxable Income	Tax Rate
1	Not exceeding 18,000 (Not exceeding 1,500)	3%	Not exceeding 36,000 (Not exceeding 3,000)	3%
2	Exceeding 18,000 to 54,000 (Exceeding 1,500 to 4,500)	10%	Exceeding 36,000 to 144,000 (Exceeding 3,000 to 12,000)	10%
3	Exceeding 54,000 to 108,000 (Exceeding 4,500 to 9,000)	20%	Exceeding 144,000 to 300,000 (Exceeding 12,000 to 25,000)	20%
4	Exceeding 108,000 to 420,000 (Exceeding 9,000 to 35,000)	25%	Exceeding 300,000 to 420,000 (Exceeding 25,000 to 35,000)	25%
5	Exceeding 420,000 to 660,000 (Exceeding 35,000 to 55,000)	30%	Exceeding 420,000 to 660,000 (Exceeding 35,000 to 55,000)	30%
6	Exceeding 660,000 to 960,000 (Exceeding 55,000 to 80,000)	35%	Exceeding 660,000 to 960,000 (Exceeding 55,000 to 80,000)	35%
7	Exceeding 960,000 (Exceeding 80,000)	45%	Exceeding 960,000 (Exceeding 80,000)	45%

## BUSINESS INCOME

Current IIT rates		New IIT rates		
	Annual (Monthly) Taxable Income	Tax Rate	Annual (Monthly) Taxable Income	Tax Rate
1	Not exceeding 15,000 (Not exceeding 1,250)	5%	Not exceeding 30,000 (Not exceeding 2,500)	5%
2	Exceeding 15,000 to 30,000 (Exceeding 1,250 to 2,500)	10%	Exceeding 30,000 to 90,000 (Exceeding 2,500 to 7,500)	10%
3	Exceeding 30,000 to 60,000 (Exceeding 2,500 to 5,000)	20%	Exceeding 90,000 to 300,000 (Exceeding 7,500 to 25,000)	20%
4	Exceeding 60,000 to 100,000 (Exceeding 5,000 to 8,333.33)	30%	Exceeding 300,000 to 500,000 (Exceeding 25,000 to 41,666.67)	30%
5	Exceeding 100,000 (Exceeding 8,333.33)	35%	Exceeding 500,000 (Exceeding 41,666.67)	35%

## **5. Special Treatments to Stock Options and Annual Bonus**

It is not known how stock options and annual bonus would be treated under the Amendments. Currently, the IIT treatments would be split into 12 months at maximum. Taxpayers should closely monitor further announcements from SAT.

## **6. Unique taxpayer identification number**

There will be unique taxpayer identification numbers assigned to taxpayers. If taxpayers are holders of PRC resident identity cards, the ID card numbers shall be the taxpayers' identification numbers. Otherwise, a new taxpayer identification number would be assigned by PRC tax bureau.

## **7. Additional anti-tax avoidance measures**

The PRC tax bureau would be empowered to adjust taxable income if they consider that those arrangements are tax driven and not commercial realistic. It also introduces CFC rules which have currently been adopted in corporate income tax law.

## **8. The implementation phases**

The new Amendments shall be effective from 1 January 2019. However, monthly deduction allowance and relevant tax rates shall be applied from 1 October 2018 onwards



# 02

**Un-certainty items  
to be clarified**

## Un-certainty items to be clarified

As mentioned above, currently expatriates who reside in China for more than 1 year but less than 5 years shall be exempted from IIT on their non-China sourced income. Up to now, whether this so called 5-year rule would be abolished or amended is not clear.

Will time basis claim in computing IIT for expatriates (including residents from Hong Kong, Macau and Taiwan) for those rendering services in both in China and outside China still be applied because of the change in definition of resident?

Also mentioned previously, it is still uncertain about the IIT treatments on stock options and annual bonus.

We expect that more circulars from SAT would be issued to clarify the Amendments. We would follow up with those developments in due course.



# 03

## Mazars ' Observations

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For expatriates, attention should be drawn to the change in the concept of tax resident. Under the Amendments, expatriates who stay in China for more than 183 days shall be considered as tax residents and are subject to worldwide income technically. Even if the so called 5-year rules still applies (it is not certain now), this change in the concept of tax residency would certainly make expatriates much easier to breach such rules.

Although it is good news that the Amendments provide more specific deductions, it is expected that the amounts of specific deductions are not particularly high. We expect that the total specific deductions would be around RMB 2,000 per month. However, tax bureaus would likely require taxpayers to provide sufficient detailed documentations to claim those expenses. We strongly advise taxpayers and their employers (as the case may be) to gather and collect relevant documents in due course.

Employers as withholding agents for most of their employees would face new challenges in employment management systems. For enterprises with a large number of expatriate employees it could bring influence on the employee costs of foreign employee and international dispatch plans.

*The content of this newsletter is only for general guidance on matters of interest and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Readers are advised to consult their tax advisors before making any business decisions.*

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