INDIVIDUAL INCOME TAX IN CHINA

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The PRC tax law continues to be an area of dynamic legislative activity. After having substantially revised the PRC Corporate Income Tax framework in 2011 and in more recent years having abolished the PRC Business Tax and pushed forward the VAT reform, the PRC Standing Committee of the National People‘s Congress had implemented a new PRC Individual Income Tax Law (“**IIT Law**”) in late September 2018.

Certain of its stipulations became effective since 1 October 2018 (see Chapter I below), while the full IIT Law took full effect as of 1 January 2019 (see Chapter II below).

In addition, in late December 2018 the Implementing Regulations in the IIT Law (“**Implementing Regulations**”) and the Interim Measures for Special Additional Deductions for IIT (“**Deduction Measures**”) were promulgated and both became effective as of 1 January 2019, together with certain other related announcements issued by the State Tax Administration.

The major changes refer to a new categorization of income groups, a new annual accrual basis, new taxation tables, new personal deductions, new specific expense deductions, new rules on the duration of tax residency purposes and new anti-avoidance rules.

Hence, employers and employees need to review and adapt their labour arrangements or internal payroll and accounting processes in light of the new IIT legislation and are well advised to constantly monitor the current status of the IIT Law‘s implementation and to update payroll and accounting processes to ensure legal compliance.

CHAPTER I

Changes Applicable as of 1 October 2018

The following stipulations of the IIT Law are effective since 1 October 2018:

1. NEW TAX BRACKETS

Since 1 October 2018, the following tax brackets apply to income from salaries and wages (after personal deduction and specific deductions) and such income shall be taxed on a monthly basis:

Brackets (unchanged)	Monthly Taxable Income (after deductions) (RMB)	Tax Rate (%) / Quick Deduction (RMB)
1	≤ 3,000	3% / 0
2	3,000 ≤ 12,000	10% / 210
3	12,000 ≤ 25,000	20% / 1,410
4	25,000 ≤ 35,000	25% / 2,660
5	35,000 ≤ 55,000	30% / 4,410
6	55,000 ≤ 80,000	35% / 7,160
7	> 80,000	40% / 15,160

These tax brackets / rates are identical to the tax brackets / rates applicable to the Comprehensive Income (see below Chapter II Sec. 2. regarding the definition of Comprehensive Income) as of 1 January 2019.

Further, the following tax brackets / rates apply to income (after applicable deductions for costs, expenses and losses) derived from the production or business operation by self-employed industrial / commercial households, etc.:

Brackets	Annual Taxable Income (after deductions) (RMB)	Tax Rate (%)
1	≤ 30,000	5%
2	30,000 ≤ 90,000	10%
3	90,000 ≤ 300,000	20%
4	300,000 ≤ 500,000	30%
5	> 500,000	35%

These tax brackets/rates are identical to the tax brackets / rates applicable to the Operating Income as of 1 January 2019.

CHAPTER II

Changes Applicable as of 1 January 2019

1. TAX RESIDENCY

The taxation of IIT on an employee‘s income in China mainly depends on his/her tax residence status and the source of income. In general, individuals who have their domicile in the PRC are subject to IIT on their worldwide income. However, as the term “domicile” refers to “habitual residence”, which is a legal term rather than an actual place of residence, foreigners working for a limited period of time in the PRC will not be deemed to have established their “domicile” in the PRC. According to the IIT Law, the following considerations apply in terms of tax residency:

Tax residency: Any individual who has a domicile in the PRC or who has no domicile but has stayed in the PRC for 183 days or longer in a tax year (= calendar year) is a tax resident and shall pay IIT for any income sourced within and outside the PRC according to law.

Non-tax residency: Any individual who has no domicile and who does not stay within the PRC or who has no domicile but stays within the PRC for less than 183 days in a tax year is a non-tax resident and shall pay IIT for income sourced within the PRC according to law.

The Implementing Regulations state that individuals who are regarded as non-domiciled in the PRC and have not been a PRC tax resident for more than six consecutive years may claim an exemption for their foreign-sourced income paid overseas by performing a put-on-record filing with the tax authorities. For any year during which a non-domiciled person is away from the PRC for more than 30 continuous days, the six-year residence period will restart.

2. SOURCES OF INCOME, TAX CALCULATION AND TAX FILING

The IIT Law‘s income groups comprise nine (compared to previously 11) categories. Of these nine categories, the first four categories (i.e. salaries and wages, remuneration for personal services, author‘s remuneration, and royalties) gained by PRC tax residents are consolidated under one category (“Comprehensive Income”, see dark grey highlight in below table). For non-PRC tax residents, taxable income obtained from such four categories shall be calculated separately.

	Up to 31 December 2018:	As of 1 January 2019:
1	Salaries and Wages	Salaries and Wages (1)
2	Production or business operation by self-employed industrial/commercial households	Remuneration for personal services (4)
3	Contracted or leased operation of enterprises or institutions	Author's remuneration (5)
4	Remuneration for personal services	Royalties (6)
5	Author's remuneration	Operating income (2) (3)
6	Royalties	Interest, dividends and bonuses (7)
7	Interest, dividends and bonuses	Lease of property (8)
8	Lease of property	Transfer of property (9)
9	Transfer of property	Incidental income (10)
10	Incidental income	
11	Income from other sources specified as taxable according to law	

Comprehensive Income: For PRC tax residents, IIT on Comprehensive Income will be calculated on a consolidated basis for the tax year (= calendar year) and after the new personal standard deduction of RMB 60,000, specific deductions, itemized deductions for specific expenditures, and other deductible items (see Chapter II, Sec. 3 below) from the gross yearly income. Monthly provisional filings are still required; however, in addition an annual reconciliation filing must be made between 1 March and 30 June of the following year. For non-PRC tax residents, IIT on income on salaries and wages shall be taxed per month after the new personal standard deduction of RMB 5,000 from the gross monthly income. For income derived from personal services, author's remuneration and royalties, the taxable income is the amount received each time and shall be taxed accordingly each time. In regard to income derived from wages and salaries, personal service remuneration, author's remuneration and royalties, the withholding agent, if any, shall withhold and remit IIT on a monthly or per-time basis. The non-PRC tax resident does not have to conduct the annual reconciliation filing for IIT. If there is no withholding agent, taxpayers must file tax returns and pay IIT themselves.

The taxable income from **Lease of Property** is taxed on the single lease payment amount and based on the following formula:

- Single lease payment amounting to up to RMB 4,000 = [payment received] – RMB 800

- Single lease payment amounting to over RMB 4,000 = [payment received] – 20% for expenses

Income from **Transfer of Property** is taxed on each transfer based on the following formula:

- Taxable income = [proceeds from the transfer of property] – [original price of the property] – [reasonable expenses]

Income from **Interest**, **Dividends**, **Bonuses** and **Incidental Income** is taxed based on the following formula:

- Taxable income = amount received each time

All above income items received by a taxpayer are taxed for IIT purposes on a monthly or per-time basis. The withholding agent, if any, shall withhold and remit the IIT accordingly. There is no requirement for an annual reconciliation filing for these income items.

Operating Income: The taxable income is the gross income obtained in a single tax year after deduction of costs, expenses and losses and is taxed for IIT purposes on a yearly basis. The taxpayer shall file a provisional tax return for such Operating Income with the locally competent tax authority within 15 days after the end of each month or quarter. In addition, taxpayers then need to handle the final reconciliation settlement latest by 31st March of the following year.

3. TAX BRACKETS AND DEDUCTIONS

IIT rates vary depending on the respective type of income. **The Comprehensive Income** derived by a PRC tax resident in one tax year will be taxed according to the following tax brackets/progressive rates after deduction of personal deduction, specific deductions, itemized deductions for specific expenditures, and other deductible items determined by law:

Brackets (unchanged)	Annual Taxable Income (after deductions) (RMB)	Tax Rate (%) / Quick Deduction (RMB)
1	≤ 36,000	3% / 0
2	36,000 ≤ 144,000	10% / 2,520
3	144,000 ≤ 300,000	20% / 16,920
4	300,000 ≤ 420,000	25% / 31,920
5	420,000 ≤ 660,000	30% / 52,920
6	660,000 ≤ 960,000	35% / 85,920
7	> 960,000	45% / 181,920

The salaries and wages, remuneration for personal services, author's remuneration and royalties derived by a non-PRC tax resident will be taxed separately. Salaries and wages shall be taxed after the personal deduction of RMB 5,000, while the taxable income derived from for personal services, author's remuneration and royalties shall be the full amount after deductions of those items which can be deducted according to law.

The tax brackets / progressive rates applied to salaries and wages, remuneration for personal services, author's remuneration and royalties are as follows:

Brackets (unchanged)	Monthly Taxable Income (after deductions) (RMB)	Tax Rate (%) / Quick Deduction (RMB)
1	≤ 3,000	3% / 0
2	3,000 ≤ 12,000	10% / 210
3	12,000 ≤ 25,000	20% / 1,410
4	25,000 ≤ 35,000	25% / 2,660
5	35,000 ≤ 55,000	30% / 4,410
6	55,000 ≤ 80,000	35% / 7,160
7	> 80,000	45% / 15,160

Income from **Interest**, **Dividends**, **Bonuses**, **Property Lease / Transfer** and **Incidental Income** will be subject to an IIT rate of 20%.

Operating Income will be subject to IIT based on the amount of income after deduction of costs, expenses and losses in a tax year at the following progressive rates:

Brackets	Annual Taxable Income (after deductions) (RMB)	Tax Rate (%)
1	≤ 30,000	5%
2	30,000 ≤ 90,000	10%
3	90,000 ≤ 300,000	20%
4	300,000 ≤ 500,000	30%
5	> 500,000	35%

Personal Deduction: PRC tax residents receiving Comprehensive Income are entitled to a personal lump-sum deduction at a rate of RMB 60,000 / year. Non-PRC tax residents earning salaries and wages are entitled to a personal lump-sum deduction of RMB 5,000 / month.

Specific Deductions: In addition to the already existing specific deductions (i.e. basic pension insurance, basic medical insurance, unemployment insurance, housing fund), further deductions for specific expenditures for the following expenses can be deducted for IIT calculation purposes by PRC tax residents.

	Deduction Item	Deduction Amount/Cap	Taxpayer Entitled to Deduction
1	Children's Education (full-time academic education) in China	RMB 1,000/month per child	Parents (shared or individually)
2	Continuing Education in China	RMB 400/month for up to 48 months per academic degree RMB 3,600 during the year of obtaining the vocational qualification certificate	Student (or parents for bachelor degree or below)
3	Medical Costs in case of serious disease	Amount in excess of RMB 15,000 (after medical insurance reimbursement) up to RMB 80,000 per year	Patient or his/her spouse or either of parents for minor children
4	Housing Loan Interest (for first house only)	RMB 1,000/month up to 240 months	Home owner alone at 100% or with his/her spouse at 50/50%
5	Housing Rental	Between RMB 800 and 1,500/month depending on location	Lessee (either husband or wife if they reside in the same city)
6	Elderly Support for Parents aged 60 years or older	RMB 2,000/month/person	The only child or shared among the siblings (not exceeding 1,000 RMB/month per sibling)

Charitable Donations: Charitable donations not exceeding 30% of an individual's gross taxable income are allowable for tax deduction. Donations made to certain charities may not be subject to the 30% deductibility cap subject to approval by the State Council.

Deemed Expense Deduction: Deemed expenses in an amount of RMB 800 will be allowed for tax deduction for income from provision of personal services, income from author's remuneration and income from royalties if the income on per-payment basis does not exceed RMB 4,000. The deemed expense shall be calculated at 20% of the income if the income on a per-payment basis exceeds RMB 4,000. IIT on an author's remuneration will be assessed on 70% of the net income after deducting the deemed expenses.

4. WITHHOLDING AGENT, TAX PAYER AND TAX ID

The term withholding agent refers to the entity making the income payment while the term taxpayer refers to the respective income earner.

Withholding agents must provide IIT withholding statements including information of IIT withheld and other relevant information to the taxpayers to allow them to file accurate annual tax reconciliation returns. Further, withholding agents shall furnish details of the amount of IIT withheld, and other relevant information to individual taxpayers. Taxpayers must notify their tax ID (PRC ID Card number in case of PRC nationals; for foreigners, the tax authorities will allocate tax IDs) to their withholding agents.

If there is a withholding agent who does not withhold /remit IIT when due, the taxpayer shall pay IIT latest by 30 June of the year following the year in which the income was received (if the tax authority notifies of another time limit, such time limit prevails). PRC tax residents must file tax returns for income received from outside the PRC between 1 March and 30 June of the year after the year such income is received. Non-PRC tax residents receiving wages and salaries from two or more PRC sources must file tax returns within the first 15 days of the month after the month the income is received.

5. THREE YEAR TRANSITIONAL POLICIES ON PREFERENTIAL TAX TREATMENTS UNDER THE IIT LAW

Certain tax preferential treatments which existed under the abolished tax laws will be extended from 1 January 2019 for a period of three years until including 31 December 2021 ("**Transitional Period**") for the following types of income:

ANNUAL BONUS

Annual bonus shall refer to a one-off bonus paid to the employee by the employer according to its economic returns and comprehensive evaluation on the employees' working performance during a given calendar year.

Under the previous IIT regime, one way to tax-optimize the benefits package for employees would be to pay part of the salary as an annual bonus. Basically, annual bonuses will not be combined for IIT calculation purposes with the regular monthly salary, but will be treated as an extra reward. The applicable tax rate is then determined based on the 1/12 of the annual bonus which will lower the IIT burden of the taxpayer. This calculation method can be used by each individual only once in a calendar year.

For the Transitional Period, taxpayers and their withholding agents can elect to apply either of the following methods to calculate IIT on annual bonus payments:

- Continue to apply the above described existing preferential tax treatment; or
- Aggregate the bonus with other Comprehensive income derived during the same year.

TAX-EXEMPT BENEFITS FOR FOREIGN EMPLOYEES

Foreign employees who are PRC tax residents may elect to either:

- Claim the specific itemized deductions under the new IIT regime (see above Chapter II. 3); or

- Continue to claim tax exemption on certain fringe benefits as prescribed under Guoshuifa [1997] No 54 which provides as follows:

The following benefits may be considered as non-taxable benefits for foreign employees and are exempt from IIT upon meeting certain criteria:

Housing Allowance: A foreign employee's reasonable housing allowance either paid directly by the employer to the landlord or on a reimbursement basis with support of the valid tenancy agreement together with the official tax receipt (a so-called "Fapiao") is regarded as non-taxable compensation.

Meal and Laundry Allowances: Food allowances in cash are taxable for individuals. However, reasonable meal / laundry allowances paid by the employer directly or on a reimbursement basis with appropriate official receipts may be exempt from IIT.

Relocation Allowance: Reasonable relocation allowances paid by the employer on a reimbursement basis upon commencement and cessation of an employment assignment in the PRC may be exempt from IIT. However, if the relocation allowance is paid by the employer in a lump sum or on a monthly or fixed term basis, the allowance will be treated as salary and shall therefore be subject to IIT.

Home Leave Allowance: Travel costs incurred by foreign employees in respect of their home leave between the PRC and the location of the employees' families (including spouse's or parent's place of residence) for up to two round-trips per year, either paid directly by the employer to the travel agent or on a reimbursement basis with support of valid official receipt, is regarded as non-taxable compensation. However, reimbursements of travel costs for the employees' spouses and / or other family members are considered taxable for IIT purposes.

Business Trip Allowance: Business trip allowance for domestic and overseas travel obtained by the expatriate according to reasonable standards may be exempt from IIT with the supporting documents of the transportation expense, accommodation expense or the travel plan of the employer.

Language Training Fees and Children's Education Fees: Reasonable language training fees for foreign employee incurred within the PRC are exempt from IIT if the expenses are paid by the employer directly or on a reimbursement basis supported by valid official receipts. Reasonable tuition fees for foreign employees' children incurred inside the PRC are exempt from IIT if the expenses are paid by the employer directly or on a reimbursement basis supported by valid official receipts.

The above allowances will be subject to IIT if they are paid to the foreign employees in cash on a non-reimbursement basis. The employer shall keep all supporting documents and valid official receipts in case of tax audit, to prove that the allowances are reasonable and the tax treatment is in compliance with relevant tax regulations. There is no clear guidance to which extent the allowances are considered reasonable, which is to be determined by the in-charge tax official by reference to the individual's total remuneration package, job position as well the local cost of living.

STOCK OPTIONS (EQUITY BASED COMPENSATION)

Qualified stock option income may be treated as separate income source from the Comprehensive Income for IIT calculation purposes and the IIT rates applicable to annual Comprehensive Income tax assessment shall apply in such case. If such qualified stock option income gained during one year is not paid in one but several installments during the calendar years, the installments paid during one calendar year shall be combined applying the preferential IIT treatment / calculation.

6. CHANGES TO PREFERENTIAL TAX TREATMENTS UNDER THE IIT LAW

Certain tax preferential treatments which existed under the abolished tax laws will be revised as follows:

ENTERPRISE ANNUITY WITHDRAWALS

Any withdrawals from qualified enterprise annuities may be treated as separate income source from the Comprehensive Income for IIT calculation purposes. In case of monthly / annual withdrawals the IIT rates applicable to monthly / annual Comprehensive Income tax assessment shall apply respectively. In case of quarterly withdrawals, the amount withdrawn shall be divided by three to determine the applicable IIT rate based on the IIT rates applicable to monthly Comprehensive Income tax assessment.

SEVERANCE PAYMENTS

Qualified severance payments up to three times of the prior year's local average wages will be IIT exempt.

Qualified severance payments in excess of three times of the prior year's local average wages will be treated as a separate source of income from the Comprehensive Income for IIT calculation purposes and the IIT rates applicable to annual Comprehensive Income tax assessment shall apply in such case.

One-off compensation for early retirement can be treated as a separate source of income from Comprehensive Income and amortised over a period equal to the number of years between the date of early retirement and the mandatory retirement date for IIT calculation purposes and shall be taxed based on IIT rates applicable to annual Comprehensive Income tax assessment.

7. ANTI-AVOIDANCE RULES

The IIT Law introduces general anti-avoidance rules similar to those already introduced under the PRC Corporate Income Tax Law. Chinese tax authorities have the right to assess IIT on individuals who are involved in transactions such as asset transfers which are not at arm's length, tax avoidance by use of offshore tax havens or deriving inappropriate tax benefits through unreasonable commercial arrangements, etc.

If IIT is assessed in reliance on the above measures, not only IIT, but also late payment surcharge are collected by the tax authorities. Late payment surcharge often outweighs the actual IIT amount.

China concluded anti-tax avoidance agreements with over 100 countries and regions worldwide and implemented the Common Reporting Standards ("**CRS**"), bilateral Competent Authority Agreements and activated bilateral exchange relationships with close to 80 countries and regions (including e.g. Germany and most of the European countries). China will strengthen compliance and utilization of automatic exchange of financial account information under CRS to increase IIT collection.

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