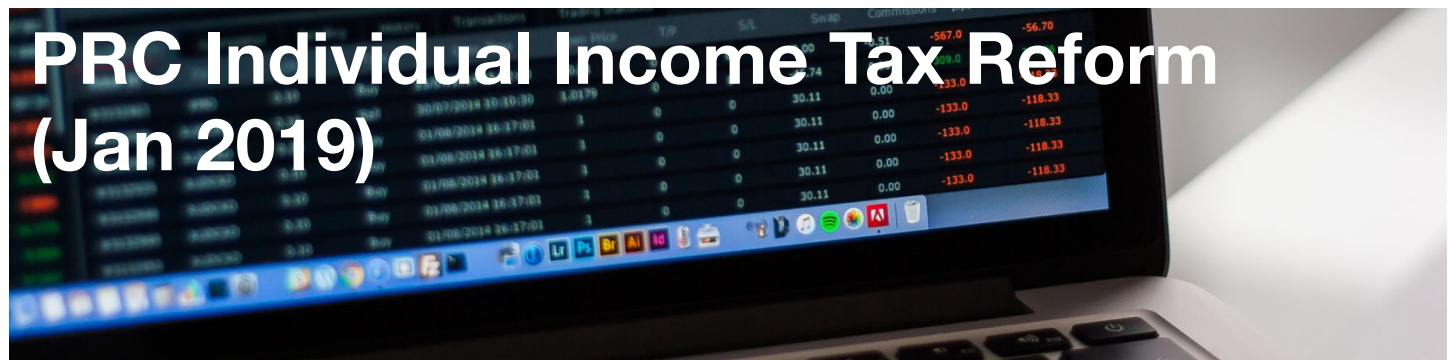


PRC Individual Income Tax Reform (Jan 2019)





Background

The Decision on the Revision of the PRC Individual Income Tax ("IIT") Laws was passed by the Fifth Session of the 13th Standing Committee of the National People's Congress on 31 August 2018 and shall be implemented with effect from 1 January 2019. The revised IIT Laws and IIT Implementation Rules as well as relevant circulars issued by the State Administration of Taxation ("SAT") have significant impacts on individual taxpayers.

Despite the fact that full implementation of the new IIT Laws shall be effective from 1 January 2019, it is worth noting that the revised IIT rates and the new standard personal deduction as well as other special deductions as introduced in the new IIT Laws (see 3 below for details) already took effect on 1 October 2018 for wages, salary, self-employed income from production and business operations, and income from contracted and leasing operations.

On 18 December 2018, the Ministry of Finance and State Administration of Taxation also issued the revised Implementation Regulations of the IIT Laws ("the new IR"), followed by a few other circulars, with the aim of clarifying the detailed rules for interpreting and implementing the new IIT Laws.

PRC Individual Income Tax Reform (Jan 2019)

Key Amendments

1. Determination rules of tax residents

The new IIT Laws redefine the concept of tax resident and non-tax resident. The rules for determination of tax residence are amended from the existing 1-year test to a 183-day test. Under the new test, individuals who do not have a domicile in the PRC but have resided in the PRC for 183 days or more cumulatively within a calendar year shall be deemed to be PRC resident individuals. The previous domicile test (i.e. where individuals who habitually reside in the PRC due to the household registration, family or economic interests shall be deemed to resident individuals) has been retained under the new IIT Laws.

The new IR has indicated that the previous 5-year resident concept still applies, with certain modifications being made thereto. In particular, the 5-year threshold has been lengthened to a 6-year threshold. In brief, an individual who is not a 6-year resident or who successfully breaks the 6-year rule may only pay IIT on income sourced or paid in the PRC. It is only when an individual becomes or is deemed to be a 6-year PRC resident that he/she will be subject to IIT on his/her worldwide income.

2. Taxation of service-related income

According to the new IIT Laws:-

- Wages and salaries derived by PRC resident individuals are subject to progressive IIT rates ranging from 3% to 45% calculated on an annual accumulative basis, while remuneration for personal services is subject to 20% to 40% IIT rates on a monthly or transaction basis.
- Income derived by PRC non-resident individuals, such as wages and salaries, remuneration for personal services, author's remuneration and royalties shall be consolidated and reported as "comprehensive income", to which one set of progressive IIT rates ranging from 3% to 45% shall apply when calculating the IIT payable on such income.
- Income derived from self-employed business operations shall be subject to another set of progressive IIT rates ranging from 5% to 35%.
- Interest income, dividends, income from property leasing and transfer of assets, and incidental income shall remain to be subject to a flat tax rate of 20%.

Under the new IIT Laws, individuals liable to PRC IIT will need to perform IIT filing on a monthly or annual basis depending on their actual circumstances. Employers in the PRC will also have the obligations to withhold and report the IIT payable by their employees.

PRC Individual Income Tax Reform (Jan 2019)

Key Amendments

3. Computation of taxable comprehensive income, revised personal deduction and introduction of special deductions

The progressive IIT rate tables for the abovementioned comprehensive income and income from business operations have been revised. Please refer to Appendix 1 for the new progressive IIT rate tables.

Under the new IIT Laws, the amount of personal deduction (i.e. personal allowance) for comprehensive income will be raised to RMB5,000 per month or RMB60,000 per year and such amount will be the same for both PRC resident individuals and non-PRC resident individuals.

Furthermore, the new IIT Laws have also introduced special additional deductions for certain categories of expenses incurred by individuals, such as children education, continuing education, medical expenses for serious illness, mortgage interest or housing rent, support for the elderly, etc. The SAT proposes to impose standard deduction amounts for most deduction categories rather than based on actual expenses incurred by the taxpayers. Please refer to Appendix 2 for the deduction amounts and general criteria for each type of special deductions.

4. Anti-avoidance rules for individuals

A significant impact of the new IIT Laws is the introduction of the general anti-avoidance rules ("GAAR"), transfer pricing and controlled-foreign-company ("CFC") rules, pursuant to which the PRC tax authority is empowered to adjust the taxable income of individuals based on any reasonable methods under any of following situations:-

- Transactions between individuals and their related parties do not comply with the arm's length principle, and as a result of which the amount of tax payable by the individuals or their related parties is reduced without any proper reason.
- An enterprise which is set up in a country (or jurisdiction) with a significantly low effective tax rate, and which is controlled by PRC resident individuals or jointly controlled by PRC resident individuals together with PRC resident enterprises, has earned profits but for no valid business reasons does not distribute or reduces distribution of profits which are attributable to the PRC resident individuals.
- Individuals who have obtained improper tax advantages through the carrying out of any arrangements without reasonable business purposes.

When the PRC tax authority decides to make tax adjustments by invoking the above anti-avoidance rules, the PRC tax authority shall levy an additional tax and charge interest thereon pursuant to the relevant laws.

PRC Individual Income Tax Reform (Jan 2019)

PKF comments - Impacts of the new PRC IIT Laws

1. Tightening of taxation on foreign individuals

The modification of the rules for determination of tax residence from the existing 1-year test to a 183-day test shows the PRC government's alignment to the popular 183-day test adopted by many countries. Under the new IIT Laws, foreign individuals are more likely to be deemed to be PRC tax residents, and it is increasingly difficult for foreign individuals to break the 6-year rule when compared to the previous IIT Laws because multiple trips outside the PRC for more than 90 days in any calendar year can no longer reset the counting.

In this relation, foreign individuals should seek professional advice and plan carefully in advance to avoid becoming or being deemed to be a 6-year tax resident who will be subject to IIT on their worldwide income. As there are numerous modifications introduced by the new IIT Laws and the new IR, foreign individuals should make an effort to understand the interaction between the new IIT Laws and the old IIT circulars, review their current IIT status and clarify whether their previous IIT planning is still reasonable and feasible.



2. Reducing the tax burden for labour workers

Under the previous IIT tax rates for wages and salary, the IIT burden in the PRC is arguably heavy for the middle and low-income groups. The new IIT Laws, by adjusting the tax brackets and tax rates, raising personal deduction and allowing special additional deductions for taxpayers who earn comprehensive income, shall significantly reduce the IIT burden for the middle and low-income groups.

PRC Individual Income Tax Reform (Jan 2019)

PKF comments - Impacts of the new PRC IIT Laws

3. Introducing and broadening anti-avoidance rules

It is the first time for the PRC tax authority to introduce the GAAR concept and codify anti-avoidance provisions into the IIT Laws. These new provisions empower the PRC tax authority to make tax adjustments to related party transactions carried out by individuals if the tax authority views that such transactions are not conducted on an arm's length basis, or other arrangements and transactions involving tax avoidance by using offshore CFCs or deriving tax benefits without reasonable business purposes.

The introduction of the GAAR and relevant anti-avoidance provisions into the IIT Laws signifies the PRC government's further alignment with the international taxation standards and the development of anti-tax avoidance efforts over the world (e.g. the Common Reporting Standard). The new IIT Laws close the existing grey areas and secures the national tax base's integrity. As their impacts on individuals are significant, it is advisable for individual taxpayers to seek professional advice and to review their previous or future investment structures and transactions. Some examples which may be affected by the new IIT Laws are set out below:

- In the past, without the anti-avoidance provisions in the IIT Laws, it was argued that foreign individuals indirectly disposing of PRC assets should not be governed by any anti-avoidance rules or the Announcement [2015] No.7 under the PRC Enterprise Income Tax Law, and therefore should not be subject to PRC IIT. As the new IIT Laws confirm the applicability of anti-avoidance rules on individuals, any indirect disposals of PRC assets by foreign individuals should be carefully reviewed for any IIT implications or reasonable methods to mitigate the IIT risks.
- As the previous IIT Laws do not contain any CFC rules, there was a belief that the earning accumulated in offshore companies held by PRC resident individuals (where those companies are established in low tax jurisdictions) should not be subject to any potential PRC IIT liability. With the new IIT Laws becoming effective, resident individuals should revisit their outbound investment structures to avoid or reduce the PRC tax risks.

The enactment of the new PRC IIT Laws marks a significant step forward on the IIT reform. There are still many uncertainties about how the PRC tax authority will implement the new IIT Laws and the new IR in conjunction with the old circulars and whether the modifications of the IIT regime will lead to any further amendments or revocation of the past detailed regulations under the old IIT circulars. Both local and foreign individuals should pay attention to the IIT reform and keep an eye on any further amendments of the new IR or other IIT circulars to avoid non-compliance with the new IIT Laws, to reduce relevant tax risks in a reasonable and legal manner, and to develop proper tax and business planning for their inbound and outbound investments as well as employee secondment or other commercial arrangements involving the PRC.

PRC Individual Income Tax Reform (Jan 2019)

Appendix 1 – Progressive IIT rates table

1) Salary and wages for residents

Annual (RMB')

Grade	Tax rate (%)	Previous		New	
		Taxable Income	Quick Deduction	Taxable Income	Quick Deduction
1	3	≤18,000	0	≤36,000	0
2	10	Amount exceeding 18,000 and up to 54,000	1,260	Amount exceeding 36,000 and up to 144,000	2,520
3	20	Amount exceeding 54,000 and up to 108,000	6,660	Amount exceeding 144,000 and up to 300,000	16,920
4	25	Amount exceeding 108,000 and up to 420,000	12,060	Amount exceeding 300,000 and up to 420,000	31,920
5	30	Amount exceeding 420,000 and up to 660,000	33,060	Amount exceeding 420,000 and up to 660,000	52,920
6	35	Amount exceeding 660,000 and up to 960,000	66,060	Amount exceeding 660,000 and up to 960,000	85,920
7	45	≥960,001	162,060	≥960,001	181,920

Note: Annual taxable income refers to the amount of income derived by a tax resident in a year of assessment, after the deduction of personal deduction (RMB 5,000 times the number of relevant months), specific deductions, numerous deductions of specific expenditure and other allowable deduction items as determined by law.

PRC Individual Income Tax Reform (Jan 2019)

Appendix 1 – Progressive IIT rates table

2) Personal service income for residents

Each transaction or monthly (RMB')

Grade	Tax rate (%)	New	
		Taxable Income	Quick Deduction
1	20	≤20,000	0
2	30	Amount exceeding 20,000 and up to 50,000	2,000
3	40	≥50,001	7,000

Note: Taxable income refers to the income derived by a tax resident after the deduction of expense. Where the income does not exceed RMB4,000, the deductible expense shall be RMB800. For income exceeding RMB4,000, deductible expense shall be calculated at 20% of the income.

PRC Individual Income Tax Reform (Jan 2019)

Appendix 1 – Progressive IIT rates table

3) Comprehensive income for non-residents

Monthly (RMB')

Grade	Tax rate (%)	Previous		New	
		Taxable Income	Quick Deduction	Taxable Income	Quick Deduction
1	3	≤1,500	0	≤3,000	0
2	10	Amount exceeding 1,500 and up to 4,500	105	Amount exceeding 3,000 and up to 12,000	210
3	20	Amount exceeding 4,500 and up to 9,000	555	Amount exceeding 12,000 and up to 25,000	1,410
4	25	Amount exceeding 9,000 and up to 35,000	1,005	Amount exceeding 25,000 and up to 35,000	2,660
5	30	Amount exceeding 35,000 and up to 55,000	2,755	Amount exceeding 35,000 and up to 55,000	4,410
6	35	Amount exceeding 55,000 and up to 80,000	5,505	Amount exceeding 55,000 and up to 80,000	7,160
7	45	≥80,001	13,505	≥80,001	15,160

Note: Monthly taxable income refers to the amount of comprehensive income derived by non-tax resident monthly, after the deduction of personal deduction of RMB 5,000, specific deductions, numerous deductions of specific expenditure and other allowable deduction items as determined by law.

PRC Individual Income Tax Reform (Jan 2019)

Appendix 1 – Progressive IIT rates table

4) Business operation income

Annual (RMB')

Grade	Tax rate (%)	Previous		New	
		Taxable Income	Quick Deduction	Taxable Income	Quick Deduction
1	5	≤15,000	0	≤30,000	0
2	10	Amount exceeding 15,000 and up to 30,000	750	Amount exceeding 30,000 and up to 90,000	1,500
3	20	Amount exceeding 30,000 and up to 60,000	3,750	Amount exceeding 90,000 and up to 300,000	10,500
4	30	Amount exceeding 60,000 and up to 100,000	9,750	Amount exceeding 300,000 and up to 500,000	40,500
5	35	≥100,001	14,750	≥500,001	65,500

Note: Annual taxable income refers to the amount of income after deductions of cost, expenses and losses in the year of assessment.

PRC Individual Income Tax Reform (Jan 2019)

Appendix 2 – Special deduction

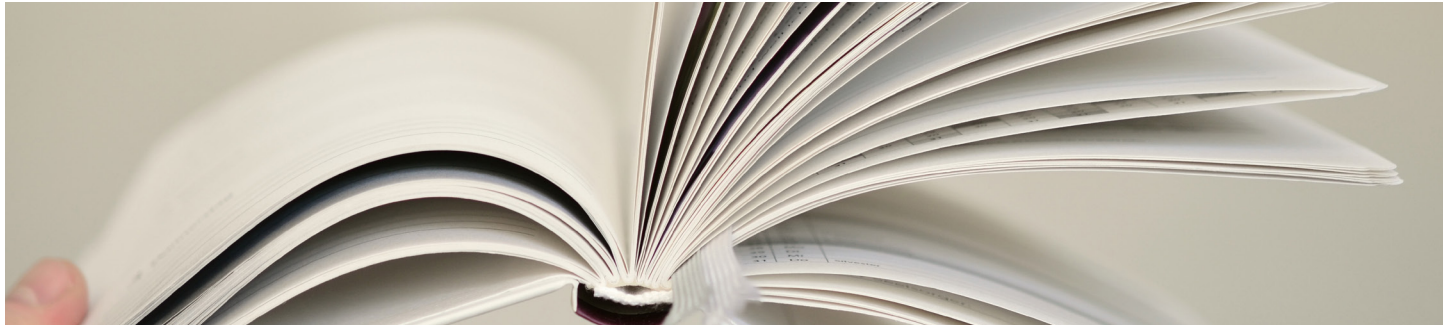
Standard amount of special deduction (RMB')

	Category	Deduction for annual calculation	Deduction for monthly calculation	
1	Child education	12,000 per child	1,000 per child	Includes eligible pre-school education and compulsory education, high school education and higher education.
2	Continuing education	4,800	400	<ul style="list-style-type: none"> Applies to eligible academic education and vocational education. However, the annual deduction amount for vocational education is RMB3,600 instead.
3	Medical expenses for serious illness	Up to 80,000 on an actual basis	N/A	The first RMB15,000 medical treatment expense borne by the taxpayer in the relevant year is not deductible.
4	Housing mortgage interest	12,000	1,000	Applies to the first residential property.
5	Housing rent	9,600 / 13,200 / 18,000	800 / 1,100 / 1,500	Different deduction amounts would apply to rental units in different types of cities for eligible individuals.
6	Support for the elderly	24,000	2,000	<ul style="list-style-type: none"> Applies to parents or other eligible dependents. The deduction amount shall be divided among the children if there is more than one child claiming for such deduction.

Note: The above contents are for general reference only. Taxpayers would need to meet certain relevant requirements when claiming for each type of deductions as mentioned above. Employers in the PRC should also understand the deduction rules for withholding of IIT payable by their employees. If you would like to know more details, please contact our tax consultants for professional assistance.

PRC Individual Income Tax Reform (Jan 2019)

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