

November 2018



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PRC Individual Income Tax Reform

On 1 January 2019, the new Individual Income Tax Law (the “**New IIT Law**”) of the People’s Republic of China (“**PRC**”) will come into effect.

The 5th session of the 13th National People’s Congress Standing Committee passed the revisions to the PRC IIT Law on 31 August 2018. The New IIT Law adopts a new tax system that introduces a comprehensive income category besides the existing individual income categories, and strengthens the existing tax law in various respects.

To facilitate implementation of the New IIT Law, the Ministry of Finance and the State Administration of Taxation announced on 20 October 2018 both the PRC IIT Law Implementing Regulations (Revised Draft Seeking Opinions) (“**Draft Seeking Opinions**”) and the IIT Specific Additional Deductions Provisional Measures (Draft Seeking Opinions) (“**Provisional Measures Draft Seeking Opinions**”) and initiated a solicitation of public opinions for a period of two weeks.

1 Key Amendments of the New IIT Law

1.1 Determination of “resident individual”

The New IIT Law introduces the concept of “resident individual” and “non-resident individual”. In the current law, taxpayers are denoted as “individual”, “natural person” or “foreign individual”; whereas the New IIT Law introduces the concept of “resident” and “non-resident”, such that the classification of taxpayer type is further clarified. The criterion for determining a “resident individual” is no longer based on whether the individual has lived in China for a full year, but adjusted to whether the individual has lived in China for an aggregate of 183 days within a tax year.

PRC IIT Law Article 1	
Existing IIT Law	New IIT Law
An individual who has a domicile in China or has no domicile in China but has stayed in China for one full year shall pay IIT as stipulated by this law on income derived inside and outside China.	An individual who has a domicile in China or has no domicile in China but has stayed in China for an aggregate of 183 days within one tax year is a resident individual . Resident individuals shall pay IIT as stipulated by this law on income derived inside and outside China.
An individual who has no domicile in China and does not stay in China or who has no domicile but has stayed in China for less than one year shall pay IIT as stipulated by this law on income derived inside China.	An individual who has no domicile in China and does not stay in China or who has no domicile in China but has stayed in China for an aggregate of less than 183 days within one tax year is a non-resident individual . Non-resident individuals shall pay IIT as stipulated by this law on income derived inside China.

1.2 Adjusting individual income categories to a combination of comprehensive income and individual income categories

- The New IIT Law has reduced the number of individual income categories on which tax must be paid from 11 (in existing IIT Law) to 9. This is achieved by revoking “income from contracting and leasing operations of enterprises and institutions” and replacing “income from production and business operations of individual industrial and commercial households” with “income from business operations”, and revoking “other taxable income as determined by the finance authorities of the State Council”.
- Four individual income categories – namely “salaries and wages”, “remuneration for personal services”, “author’s remuneration” and “royalties” – are consolidated as “comprehensive income”, and IIT is computed based on tax year (applicable only to resident individuals). In the case of non-resident individuals with income derived from these four items, IIT is computed on a monthly basis or on the occurrence of the income. The introduction of “comprehensive income” is a highlight of the New IIT Law.

Individual Income Category	
Existing IIT Law	New IIT Law
1. Salaries and wages	1. Salaries and wages
2. Income from production and business operations of individual industrial and commercial households*	2. Remuneration for personal services
3. Income from contracting and leasing operations of enterprises and institutions#	3. Author’s remuneration
4. Remuneration for personal services	4. Royalties
5. Author’s remuneration	5. Income from business operations
6. Royalties	6. Interest, dividends and bonuses
7. Interest, dividends and bonuses	7. Income from leasing of property
8. Income from leasing of property	8. Income from transfer of property
9. Income from transfer of property	9. Incidental income
10. Incidental income	For resident individuals who derive income from items 1 to 4 above (i.e. “ comprehensive income ”), the income categories are consolidated and IIT is computed based on tax year.
11. Other taxable income as determined by the finance authorities of the State Council#	For non-resident individuals who derive income from items 1 to 4 above, IIT is computed on a monthly basis or on the occurrence of the income.
	For taxpayers who derive income from items 5 to 9, IIT is computed separately on the basis of each income category in accordance with this Law.

* Income from this category replaced with "Income from business operations" under the New IIT Law.

Income from this category revoked under the new IIT Law.

1.3 Widening income tax brackets for lower-level tax rates

The tax brackets will be adjusted for the lower-level tax rates of 3%, 10% and 20%, so as to reduce the tax burden on taxpayers with a comprehensive income and income from business operations as defined above.

Monthly Taxable Income			
Level	Existing IIT Law	New IIT Law	Tax Rate
1	≤ ¥1,500	≤ ¥3,000	3%
2	> ¥1,500 - ¥4,500	> ¥3,000 - ¥12,000	10%
3	> ¥4,500 - ¥9,000	> ¥12,000 - ¥25,000	20%
4	> ¥9,000 - ¥35,000	> ¥25,000 - ¥35,000	25%
5	> ¥35,000 - ¥55,000	> ¥35,000 - ¥55,000	30%
6	> ¥55,000 - ¥80,000	> ¥55,000 - ¥80,000	35%
7	> ¥80,000	> ¥80,000	45%

For income from interest, dividends and bonuses, income from leasing and transfer of property, and incidental income, the tax rate is 20%, which is the same as in the existing tax law.

Please refer to the Appendix for tax rate tables.

1.4 Adjusting standard deductions and establishing specific additional deductions

- **Standard deductions**

The standard deductions for comprehensive income will be raised to ¥5,000 per month (i.e. ¥60,000 per year) under the New IIT Law. Taxpayers without a domicile in China and who have earned salaries and wages inside China (such as foreign nationals employed in China) will apply the same amount for standard deductions. The current ¥1,300 per month additional deduction for foreign nationals will be abolished.

The changes will be implemented in two phases.

1st phase: from 1 October 2018 to 31 December 2018

Taxpayers will apply the standard deductions to salaries and wages received from 1 October 2018 onwards (1 October inclusive) at a rate of ¥5,000 per month and adopt the new comprehensive income tax rate table. For income from business operations, the new tax rate table for income from business operations will be adopted.

2nd phase: from 1 January 2019

Full implementation of the New IIT Law.

- **Specific additional deductions for comprehensive income category**

While retaining the current (i) standard deductions, (ii) special deductions (such as social insurance and housing fund paid in accordance with state regulations and standards) and (iii) other deductions as defined by law (such as tax incentive type commercial health insurance, individual contributions to corporate annuities, tax-deferred commercial pension insurance, etc.), the New IIT Law introduces several specific additional deductions for the comprehensive income category. This marks an important first step in the setting up of a deduction mechanism for the comprehensive income category in IIT. The specific additional deductions include expenses for children's education, continuing education, medical treatment of major illnesses, housing loan interest or rental expenses, payments in support of the elderly, etc.

1.5 Taxable income

The New IIT Law has different stipulations for assessing the taxable income of resident individuals and non-resident individuals.

- **For resident individuals**

For resident individuals, comprehensive income is consolidated on an annual basis. Taxable income is derived after various deductions. Of these, 20% can be deducted from income earned from personal services, author's remuneration and royalties, with the balance as taxable income. In other words, 80% of the total earnings of these income categories are counted as comprehensive income. On top of that, an additional 30% deduction can be enjoyed on the income earned from author's remuneration, which means that actually only 56% of the income earned from author's remuneration is counted as comprehensive income.

- **For non-resident individuals**

For non-resident individuals, the taxable income from salaries and wages is calculated on the basis of monthly earnings after ¥5,000 deduction. For income from personal services, author's remuneration and royalties, the taxable income is the income on each occurrence.

For individual income that is not considered as comprehensive income, the assessment of taxable income is basically the same as in the current regulations.

1.6 Introduction of anti-tax avoidance provisions

From time to time, individuals may use various tactics to avoid paying IIT. To block the loopholes in tax collection and protect the national interest, the New IIT Law has made reference to the relevant anti-tax avoidance regulations in the Corporate Income Tax Law. It targets individuals who transfer property without complying with the arm's length principle, evade taxes through overseas tax havens, or secure improper tax benefits through unreasonable commercial arrangements. With the New IIT Law, the tax authorities are empowered to make adjustments to tax liability in a rational manner under the above circumstances. It can be anticipated that high net worth individuals and their affiliated companies would have to adhere to the arm's length principle, and the structures that hold financial accounts through offshore companies might no longer be feasible.

1.7 Method for reporting IIT

- **For resident individuals**

The method of reporting IIT is changing into a combination of the withholding agent withholding and paying tax into the State Treasury and self-reporting by the resident individual. The corresponding tax risk that traditionally was borne principally by the withholding agent is now to be shared by the self-reporting individual and the withholding agent.

The IIT on the comprehensive income earned by resident individuals is to be calculated on an annual basis. Before the 15th of the month following the month when the income was paid, the withholding agent must pay the withheld tax amount into the State Treasury on a monthly basis or on the occurrence of the income, and provide the taxpayer with the income statement and withheld tax information. From 1 March to 30 June of the following year, the resident individual must complete the final settlement and payment of the annual income tax.

Whether the resident individual receives multiple income payments through various organizations or a single payment through one organization, annual settlement and payment of IIT is required.

During the monthly tax filing, if information on specific additional deductions has not yet been provided to the employer, or the amount deducted from the withholding tax is insufficient or in excess, the taxpayer could apply for settlement of the underpaid tax or tax refund at the time of the final settlement and payment of the annual income tax.

It is clear that under the New IIT Law, the main duty of withholding agents is (i) to withhold and pay tax into the State Treasury on a monthly basis or as income occurs; (ii) to withhold and report the full withheld amount for all taxpayers dealt with; and (iii) to provide each taxpayer with information about the income and the amount of tax withheld. For the taxpayers, the main duty is to process the final settlement and payment of the annual income tax.

- **For non-resident individuals**

The tax payable on income derived by non-resident individuals shall still be withheld and paid by withholding agents on a monthly basis or as the income occurs, and is not subject to final settlement and payment of annual income tax.

1.8 New requirement to settle tax on leaving China

Taxpayers who will emigrate and cancel their household registration in China must settle and pay their annual income tax before they leave China. As such, Chinese citizens who will emigrate must ensure full compliance with the New IIT Law on a regular basis so as not to be adversely affected by the inability to complete the final settlement and payment of their annual income tax in a timely manner before leaving China.

2 Soliciting Public Opinions on Draft Implementation Details of New IIT Law

The Draft Seeking Opinions is an explanation of policy geared towards the implementation of the New IIT Law. Its main content includes the following:

- Further clarification of the tax liability of non-resident individuals
- Clarification of rules regarding sources of income
- Inclusion of basic elements of the tax system such as the scope of various taxable incomes
- Improved regulations on tax collection and administration
- Improved regulations on anti-tax avoidance measures, information sharing and such other rules

The Provisional Measures Draft Seeking Opinions refines the policy for specific additional deductions. For each additional deduction, the draft clearly defines requirements such as the scope of use, the standard for deduction, the requirements for restrictions, the deduction time points as well as the supporting documentation.

Specific provisions regarding implementation details and the IIT Specific Additional Deductions Provisional Measures will be further explained at a later stage.

3 Challenges of the New IIT Law

- 3.1** The tax preferential treatment of annual bonuses could be revoked. Current compensation and benefit packages and current tax planning measures might no longer be effective. Enterprises and institutions would need to make corresponding adjustments to their employee incentive remuneration structure, incentive mechanisms and employment modes.
- 3.2** The compliance requirements of the final settlement and payment of annual income tax are becoming more complex.
- 3.3** The complexity of reporting comprehensive income and the management of specific additional deductions would increase the cost of compliance incurred by enterprises and institutions. In addition, it would impose new requirements on the internal remuneration, finance and tax personnel.
- 3.4** The follow-up filing requirements for individuals without a domicile in China would add to the administration of employees that are foreign nationals for enterprises and institutions

It is clear that compliance with the new IIT Law, with its further refinement of the tax collection and administration system and regulatory measures, is of utmost importance. Enterprises and institutions need to fully understand the contents and requirements of the New IIT Law and make appropriate adjustments to their current remuneration structure, internal tax management procedures, etc., in a timely manner so as to avoid unnecessary increase in tax costs arising from non-compliance. Individuals also need to pay close attention to IIT policies to meet the requirements of the annual settlement. Both enterprises and individuals need to seek timely advice from professional organizations so as to ensure they are in full compliance with the New IIT Law.

Appendix

Individual Income Tax Rate Tables

Table 1: Applicable to taxation of comprehensive income

Level	Annual Taxable Income	Tax Rate (%)
1	≤ ¥36,000	3
2	> ¥36,000 - ¥144,000	10
3	> ¥144,000 - ¥300,000	20
4	> ¥300,000 - ¥420,000	25
5	> ¥420,000 - ¥660,000	30
6	> ¥660,000 - ¥960,000	35
7	> ¥960,000	45

Table 2: Applicable to taxation on income from business operations

Level	Annual Taxable Income	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

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This TechNews is not exhaustive and only highlights the key amendments of PRC's Individual Income Tax Law. Please refer to the website of the State Administration of Taxation of the PRC Government at <http://www.chinatax.gov.cn/> for relevant information.

Please contact a Tricor executive or email info@cn.tricorglobal.com for assistance or enquiries.

OTHER OFFICES

AUSTRALIA

Tricor ChewandDormers Pty Ltd
info@au.tricorglobal.com

BARBADOS

Tricor Caribbean Limited
Caribbean Corporate Services Limited
info@bb.tricorglobal.com

BRITISH VIRGIN ISLANDS

Tricor Services (BVI) Limited
info@bvi.tricorglobal.com

BRUNEI

Tricor (B) Sdn Bhd
info@bn.tricorglobal.com

CAYMAN ISLANDS

Tricor Services (Cayman Islands) Limited
info@ky.tricorglobal.com

INDIA

SKP Tricor Corporate Services Pvt Ltd
skpt.info@skptricor.com

INDONESIA

PT Amalgamated Tricor
info@id.tricorglobal.com

IRELAND

MBSL Limited
info@ie.tricorglobal.com

JAPAN

Tricor K.K.
info@jp.tricorglobal.com

KOREA

International Outsourcing Inc.
info@ioikorea.com

LABUAN

Tricor Trustco (Labuan) Limited
info@my.tricorglobal.com

MACAU

Tricor Services (Macau) Limited
tricor@macau.ctm.net

MALAYSIA

Tricor Services (Malaysia) Sdn Bhd
info@my.tricorglobal.com

SINGAPORE

Tricor Singapore Pte Ltd
info@sg.tricorglobal.com

TAIPEI

Tricor Services (Taiwan) Limited
info@tw.tricorglobal.com

THAILAND

Tricor Outsourcing (Thailand) Limited
Tricor Executive Recruitment Limited
info@th.tricorglobal.com

UNITED KINGDOM

Tricor Services Europe LLP
info@uk.tricorglobal.com

VIETNAM

Tricor Vietnam Company Limited
contact@tsvservices.com



Tricor operating companies that provide core services in China & Hong Kong:

TRICOR SERVICES LIMITED
TRICOR INVESTOR SERVICES LIMITED
TRICOR CONSULTANCY (BEIJING) LIMITED

Tricor Key Contacts

CEO – China & Hong Kong Executive Director

Natalia Seng
Tel: (852) 2980 1688
natalia.seng@hk.tricorglobal.com

Deputy CEO – China

Hailiang Zhang
Tel: (86) 21 6391 5128
hailiang.zhang@cn.tricorglobal.com

Director - China Services

Betty Tang
Tel: (852) 2980 1220
betty.tang@cn.tricorglobal.com

Cecilia Lam
Tel: (852) 2980 1186
cecilia.lam@cn.tricorglobal.com

Desmond Lau
Tel: (852) 2980 1682
desmond.lau@hk.tricorglobal.com

Associate Director - China Services

Grace Guo
Tel: (86) 21 6391 5028
grace.guo@cn.tricorglobal.com

Grace Jin
Tel: (86) 21 6391 5226
grace.jin@cn.tricorglobal.com

Rebecca Fu
Tel: (86) 10 8587 6817
rebecca.fu@cn.tricorglobal.com

Shirley Sung
Tel: (86) 10 8587 6815
shirley.sung@cn.tricorglobal.com

Susan Peng
Tel: (86) 10 8587 6819
susan.peng@cn.tricorglobal.com

Yvonne Lam
Tel: (86) 755 8246 0282
yvonne.lam@cn.tricorglobal.com

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