HONG KONG TAX ALERT

ISSUE 10 | June 2018

Proposed Individual Income Tax amendments signal significant changes to the taxation of individuals in China

Summary

On 19 June 2018, Mr Liu Kun, the Minister of Finance, explained to the Thirteenth National People's Congress the proposed draft amendments to China's individual income tax ("IIT") rules.

Mr Liu indicated that a number of changes have been included, with the most attention-grabbing proposals being the proposed change to tax residence and the introduction of a general anti-avoidance rule (GAAR).

The proposed amendments could have a significant impact on the taxation of foreign nationals in China and may indicate a general shift in the approach and attitude to IIT compliance and enforcement.

On 19 June 2018, during the third session of the Thirteenth National People's Congress of the People's Republic of China ("PRC"), Mr Liu Kun, the Minister of Finance, Ministry of Finance of the PRC, outlined the proposed amendments to China's individual income tax ("IIT") rules. Mr Liu confirmed that the draft amendments have been agreed by the State Council.

Mr Liu delivered two important messages about the coming PRC Individual Income Tax (IIT) reform, as follows:

- The IIT reform is intended to reduce the tax burden of the working class and deepen reform of the income distribution system by raising the IIT threshold, aggregating income in the similar nature for taxation and introducing additional special deductible expenses

- At the same time, the IIT reform will revise existing regulations that are not consistent with international practice to promote IIT reform, close existing loopholes and protect the integrity of the national tax base

Although a number of changes have been signalled, the most attention-grabbing proposals are the proposed change to tax residence and the introduction of a general anti-avoidance rule (GAAR) for IIT.

Tax residence changes: the end of expatriate tax breaks?

Mr Liu referred to modifying China's personal tax residence rule to a 183-day test. If introduced, a residence test based on 183 days of presence in China can be expected to have a profound impact on foreigners working in China.

Currently, foreigners working in China are only exposed to Chinese tax on worldwide income if they are resident in China for five full years. The five-year period of residence is commonly broken, and liability to tax on worldwide income prevented, by a period of absence, commonly referred to as a "tax break".

A tax break requires the expatriate to be absent from China for an aggregate of 91 days or more during a year, or for a single period of at least 31 days. If this is done, the five-year clock is reset. These rules have led to a common practice of foreigners working in China taking a tax break, i.e., an extended period away from China of 31 days or more, at least every five years.

Mr Liu was silent on whether the five-year concession will remain, or if China will align its residence rules with other countries that apply residence tests on an annual basis.

If the residence test is applied annually, foreigners will be subject to China tax on their worldwide income starting from their first year of tax residence in China. Even if the five-year concession remains, it will be much more difficult to manage residence through short tax breaks, as an absence of 183 days would be required.

These changes may cause those employed under a dual contract arrangement, commuters and business travellers to attract greater scrutiny. But, even if an employee is fully taxed on remuneration in China, becoming tax resident may extend China tax implications to previously untaxed personal investment income.

Any employer with expatriates / foreigners working in China should assess the implications and plan ahead to manage the consequences of these potential changes. These consequences could include the cost of additional tax passed on to employers, or implications for talent acquisition, mobility and retention, if the cost of tax is borne by the employee.

Budgets for projects, profitability of long term contracts and cost of foreign labour could all be impacted over time by these changes.

KPMG observations

General anti-avoidance rule: a shift in enforcement?

Mr Liu signalled that a general anti-avoidance rule will be introduced to combat loopholes in China's current individual income tax legislation.

General anti-avoidance rules are a feature of many jurisdictions' tax legislation. Such rules typically give broad powers to reconstruct, for tax purposes, arrangements that are considered by the tax authority to be abusive and to result in an inappropriate tax advantage.

While a GAAR for individual income tax is interesting in itself, it also prompts the question of whether this signals a shift in China's approach and attitude to compliance and enforcement of IIT obligations.

Could the introduction of a GAAR, coupled with the commencement of automatic exchange of financial account information under the OECD-led common reporting standard (known as CRS), signal an increase in enforcement of China's taxation of offshore assets that are beneficially owned by Chinese tax residents?

If these issues could impact you or your employees, please contact one of our Global Mobility Services contacts below.

Contact us:

Lewis Y. Lu
National Head of Tax
Tel: +86 21 2212 3421
lewis.lu@kpmg.com

Curtis Ng
Head of Tax, Hong Kong
Tel: +852 2143 8709
curtis.ng@kpmg.com

Corporate Tax Advisory

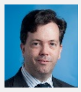
Chris Abbiss
National Head of Real Estate Tax
Tel: +852 2826 7226
chris.abbiss@kpmg.com

Matthew Fenwick
Partner
Tel:+ 852 2143 8761
matthew.fenwick@kpmg.com

Stanley Ho
Partner
Tel: +852 2826 7296
stanley.ho@kpmg.com

Charles Kinsley
Partner
Tel: +852 2826 8070
charles.kinsley@kpmg.com

Alice Leung
Partner
Tel: +852 2143 8711
alice.leung@kpmg.com



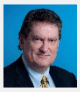
Ivor Morris
Partner
Tel: +852 2847 5092
ivor.morris@kpmg.com

John Timpany
Partner
Tel: + 852 2143 8790
john.timpany@kpmg.com

Eva Chow
Director
Tel: +852 2685 7454
eva.chow@kpmg.com

Elizabeth de la Cruz
Director
Tel: +852 2826 8071
elizabeth.delacruz@kpmg.com

Natalie To
Director
Tel: +852 2143 8509
natalie.to@kpmg.com



Michael Olesnicky
Special Advisor
Tel: +852 2913 2980
michael.olesnicky@kpmg.com

Deal Advisory, M&A Tax

Darren Bowdern
Head of Financial Services Tax, Hong Kong
Tel: +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Partner
Tel: +852 2847 5108
yvette.chan@kpmg.com

Sandy Fung
Partner
Tel: +852 2143 8821
sandy.fung@kpmg.com

Benjamin Pong
Partner
Tel: +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Partner
Tel: +852 2685 7472
malcolm.j.prebble@kpmg.com

China Tax

Daniel Hui
Partner
Tel: +852 2685 7815
daniel.hui@kpmg.com

Adam Zhong
Partner
Tel: +852 2685 7559
adam.zhong@kpmg.com

Travis Lee
Director
Tel: +852 2143 8524
travis.lee@kpmg.com

US Tax

Wade Wagatsuma
Head of US Corporate Tax, Hong Kong
Tel: +852 2685 7806
wade.wagatsuma@kpmg.com

Becky Wong
Director
Tel: +852 2978 8271
becky.wong@kpmg.com

Global Transfer Pricing Services

Karmen Yeung
Head of Global Transfer Pricing Services, Hong Kong
Tel: +852 2143 8753
karmen.yeung@kpmg.com

Lu Chen
Partner
Tel: +852 2143 8777
lu.l.chen@kpmg.com

John Kondos
Partner
Tel: +852 2685 7457
john.kondos@kpmg.com

Irene Lee
Director
Tel: +852 2685 7372
irene.lee@kpmg.com

Indirect Tax & Tax Technology

Lachlan Wolfers
National Head of Indirect Tax & Tax Technology; Asia Pacific Regional Leader, Indirect Tax
Tel: +852 2685 7791
lachlan.wolfers@kpmg.com

Alexander Zegers
Director, Tax Technology
Tel: +852 2143 8796
zegers.alexander@kpmg.com

Global Mobility Services

Murray Sarelius
National Head of Global Mobility Services
Tel: +852 3927 5671
murray.sarelius@kpmg.com

Barbara Forrest
Partner
Tel: +852 2978 8941
barbara.forrest@kpmg.com

David Siew
Partner
Tel: +852 2143 8785
david.siew@kpmg.com

Kate Lai
Director
Tel: +852 2978 8942
kate.lai@kpmg.com

kpmg.com/cn