

China Tax Alert

Issue 31, December 2018

Transitional provisions for PRC Individual Income Tax preferential tax treatment

Regulations discussed in this issue:

- Caishui [2018] No. 164 - Notice of issues concerning the transitional policies on preferential tax treatments under the amended IIT law ("Circular 164")

The Ministry of Finance and the State Administration of Taxation have jointly released Circular 164 entitled "Notice of issues concerning the transitional policies on preferential tax treatments under the amended PRC IIT law".

Following on from the new IIT Law which came into force on 1 January 2019, Circular 164 sets out transitional measures for the application of preferential tax treatment for tax-exempt benefits for foreign employees, annual bonuses, equity based compensation and severance payments.

Three-year transitional policy

The tax preferential treatments which existed under the previous tax regime will be extended from 1 January 2019 for a period of three years on the following types of income:

➤ Tax-exempt benefits for foreign employees

Foreign employees who are PRC tax residents (i.e. reside in China for 183 days or more during the calendar year concerned) may elect to either:

- Claim itemised deductions under the new IIT regime; or
- Continue to claim tax exemption on certain fringe benefits as prescribed under Guoshuifa [1997] No 54 ("Circular 54").

➤ Annual bonuses

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

- Continue to enjoy the existing preferential tax treatment (i.e. divide the bonus by 12 for determination of the applicable tax rate and quick deduction based on the tax rate bands in Appendix 1); or
- Aggregate the bonus with other Comprehensive income derived during the same year.

➤ **Equity based compensation**

- Qualified equity based compensation income can be treated as a separate source of income from Comprehensive income for IIT calculation purposes.
- The IIT rate bands in Appendix 2 will apply for IIT calculation purposes.
- Multiple instalments of equity based compensation derived during the same year must be aggregated for the purpose of applying the preferential tax treatment.

Amendment to certain preferential tax treatments

➤ **Withdrawals from qualified enterprise annuity**

- Withdrawals can be treated as a separate source of income from Comprehensive income for IIT calculation purposes.
- With respect to withdrawals which are paid on a monthly basis, the rates in Appendix 1 will apply.
- Withdrawals which are paid on a quarterly basis will be divided by 3 for determination of the applicable IIT rate, based on the rates in Appendix 1.
- For withdrawals paid on an annual basis or due to reasons such as emigration or upon death, the IIT rates in Appendix 2 will apply.

➤ **Severance payments**

- Qualified severance payments in excess of 3 times of the prior year's local average wages will be treated as a separate source of income, and the rates in Appendix 2 will apply.
- 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. The rates in Appendix 2 will apply.

Other IIT preferential treatments remain intact under the new PRC IIT regime.

KPMG Observations

The release of Circular 164 is in line with the government's recent strategy to retain the stability of governmental policies and to ensure the overall reduction of tax burdens for individual taxpayers.

In applying these preferential treatments, individual taxpayers and their withholding agents need to consider the following:

- For preferential tax treatments which are subject to the three-year transitional period, companies should pay close attention to regulatory updates. They should analyse the new rules when preparing their tax cost forecasts, and review their talent retention strategies and policies as well as their tax reimbursement policies.
- Whilst the preferential tax treatment for annual bonuses will be retained during the transitional period, the "inefficient payment of annual bonus" issue remains. We recommend that companies review their bonus payment schemes in advance of payment in order to mitigate unnecessary costs.
- In applying any preferential tax treatment, individual taxpayers and their withholding agents should familiarise themselves with the relevant qualifying conditions, including reporting requirements.
- Where an election is available, individual taxpayers and their tax withholding agents should plan for elections to be made in advance of the payment.

KPMG will continue to pay close attention to the relevant circulars to be promulgated under the new IIT regime and to share our observations. Please contact us for the most updated news in relation to IIT reform and other tax regulations.

Appendix 1: IIT rate bands on monthly Comprehensive income

Level	Taxable Income	Tax Rate (%)	Quick Deduction
1	not in excess of RMB3,000	3	0
2	RMB3,000 to RMB12,000	10	210
3	RMB12,000 to RMB25,000	20	1,410
4	RMB25,000 to RMB35,000	25	2,660
5	RMB35,000 to RMB55,000	30	4,410
6	RMB55,000 to RMB80,000	35	7,160
7	in excess of RMB80,000	45	15,160

Appendix 2: IIT rate bands on annual Comprehensive income

Level	Cumulative Taxable Income	Withholding Rate (%)	Quick Deduction
1	not in excess of RMB36,000	3	0
2	RMB36,000 to RMB144,000	10	2,520
3	RMB144,000 to RMB300,000	20	16,920
4	RMB300,000 to RMB420,000	25	31,920
5	RMB420,000 to RMB660,000	30	52,920
6	RMB660,000 to RMB960,000	35	85,920
7	in excess of RMB960,000	45	181,920

The background of the image is a high-angle aerial shot of a coastal road. The road is a two-lane asphalt path with white dashed lines, running parallel to a rocky shoreline. The ocean to the left is a deep turquoise color with white-capped waves crashing against the rocks. To the right of the road is a steep, rocky hillside with sparse green vegetation. The overall scene is a mix of natural beauty and human-made infrastructure.

If you have any questions on the above, KPMG will be pleased to assist and provide relevant guidance and assist accordingly.

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