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**People's Republic of China – New Rules Aim to Encourage Retirement Savings**

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The People's Republic of China has issued new rules with respect to the taxation of participation in certain employer-sponsored retirement and pension plans.[1] The new rules under Circular 103 became effective on 1 January 2014.

The rules should apply to all employees (including expatriates) working in China and participating in the approved plans.

## Why This Matters

The new rules defer the point of taxation for voluntary employer contributions to the retirement plans and allow a tax deduction for voluntary employee contributions to approved plans. Prior to the change, individual income tax ("IIT") was due at the time contributions were made. Along with the deferral of that taxable event, this change may mean a lower individual tax liability.

The point of taxation is changed for individuals, so that rather than paying IIT on annuities when a contribution is made, they will be subject to tax on their contributions at the time of the pay-out. This could mean a lower tax burden for the individual.

The Circular also entails some new registration processes and withholding obligations on employers.

## Background

The Chinese pension insurance system was first established in the early 1990s and has been in place for over 20 years. It consists of savings insurance for basic pensions, supplementary pensions, and personal pensions.

### Impact of IIT Treatment of Annuity Plans after 1 January 2014

On the following page is a snapshot of the impact on the IIT treatment of annuity plans after 1 January 2014.

<table>
<tr><th>Events</th><th colspan="2">Pre-1 January 2014</th><th colspan="2">Post-1 January 2014</th></tr>
<tr><td rowspan="3">Contribution</td><td>Employer Contribution</td><td>Employee Contribution</td><td>Employer Contribution</td><td>Employee Contribution</td></tr>
<tr><td>Taxable as separate category of monthly salary</td><td>Non-deductible</td><td rowspan="2">Non-taxable</td><td rowspan="2">Deductible (up to 4% of the individual's contribution basis)<br>[Note 1]</td></tr>
<tr><td colspan="2">Quarterly, semi-annual or annual contributions cannot be attributed to the respective month for tax computation purposes</td></tr>
<tr><td>Fund Investment</td><td colspan="2">N/A</td><td colspan="2">Non-taxable</td></tr>
<tr><td>Pay-out</td><td colspan="2">N/A</td><td colspan="2">- Monthly pay-out: Taxable as salary for the month<br>-Quarterly or annual pay-out: equally allocated to the respective month and taxable as monthly salary for the respective month<br>[Notes 2 and 3]</td></tr>
</table>

**Notes:**

1. Contribution basis: Based on the employee's average monthly salary of the proceeding year, subject to a ceiling of 300% of the relevant city's monthly average salary for the preceding year.

2. Individuals who contributed to an approved plan prior to 1 January 2014, and that subsequently receive a lump-sum pay-out after implementation of Circular 103, will be taxed on the balance of their total contributions less any contributions which have been subject to IIT under the old rules. For individuals who receive their pay-out in installments, the same principle applies, and the contributions which have been subject to IIT under the old rules will be equally distributed to the periodic pay-out for IIT computation purposes.
3. For individuals or beneficiaries/legal heirs who receive a lump-sum annuity pay-out due to special circumstances (i.e., overseas migration or death), the IIT on the pay-out may be reported in equal instalments over a 12-month period.

## Tax Registration of Plans and IIT Withholding Obligations

Companies must register newly established plans or any revisions made to existing plans with the relevant local tax authorities within 15 days following the end of the month during which establishment or revision occurs. Documents that need to be submitted include all documents pertaining to the plans and the Letter of Registration Confirmation and Approval issued by the Ministry of Human Resources and Social Security in respect of the plans.

Companies that establish approved plans and custodians of the plans are obliged to withhold IIT at the time contributions are made/deducted and when pay-outs are distributed.

**KPMG Note**

Currently, individuals are obliged to pay IIT on annuities when a contribution is made. Given that individual taxpayers are likely to be subject to a lower marginal IIT rate when they receive pay-outs from a plan, the new rules under Circular 103 will not only defer the point of taxation of contributions made under a plan to the time of the pay-out, but may also lower the eventual IIT burden on employees to a certain extent. In view of this, Circular 103 is expected to play an important role in encouraging retirement savings, and provides for tax planning opportunities in the design and establishment of annuity plans.

Companies should set up proper mechanisms to review their current plans. They should also determine whether they are able to fulfill plan registration and tax withholding obligations as required by Circular 103.

*Footnote:*

1 *Notice on Issues Pertaining to the Collection and Administration of Individual Income Tax on Enterprise Annuities and Occupational Pensions*, issued by the Ministry of Finance, the Ministry of Human Resources and Social Security, and the State Administration of Taxation, Cai Shui [2013] No. 103.

Circular 103 provides for deferred IIT treatment of contributions made under annuity plans established in accordance with *Implementation Rules on Enterprise Annuity* (formerly known as "Notice 20") issued by Ministry of Human Resources and Social Security ("MHRSS") and *Provisional Implementation Rules on Occupational Pension Plans* (Guobanfa [2011] No. 37).

The release of Circular 103 also sees the nullification of Guoshuihan [2009] No. 694 and Public Notice [2011] No. 9 issued by the State Administration of Taxation, which provided less favorable IIT treatment of approved plans.

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