GMS Flash Alert

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People's Republic of China – Implementing IIT Reform and Supplementary Guidance

In order to implement the amended PRC Individual Income Tax ("IIT") law[1] accurately, a series of administrative measures[2] have been promulgated in the People's Republic of China ("PRC" or 'China") which aim to improve and streamline administration, delegate power, and enhance services.

The State Council and the State Administration of Taxation ("SAT") released the implementation rules ("Implementation Rules") and supplementary guidance notes, implementing the new IIT rules and providing important guidance on the following:

- Interim measures for administration of itemised deductions;
- PRC IIT withholding calculation methods applicable for resident and nonresident taxpayers;
- Requirements on IIT declarations;
- Tax treatment of foreign-sourced income derived by foreign individuals.

The Implementation Rules and guidance notes are effective from 1 January 2019.

In this GMS *Flash Alert*, we cover some of the salient points of the Circulars.

WHY THIS MATTERS

The scope of the changes is wide-ranging. For example, there is to be a significant change to the IIT withholding mechanism. The adoption of a cumulative withholding methodology will result in lower tax withheld in the earlier months and higher tax withheld in the later months during a tax year.

There are to be different IIT withholding methodologies for resident taxpayers and nonresident taxpayers. Withholding agents need to assess and determine the residency status of their employees in order to withhold IIT properly.

The onus will be on taxpayers to be responsible for the authenticity, accuracy, and completeness of the information provided for the itemised deductions they claim.

Individual Taxpayers and Their Employers

IIT Withholding Mechanism

Announcement 56 sets out the IIT withholding calculation methodologies for resident and nonresident taxpayers.

Resident Taxpayers

Comprehensive income derived by resident taxpayers is subject to tax withholding as summarised below.

Salary and Wages: Salary and wages earned by resident taxpayers are subject to PRC IIT withholding based on the cumulative withholding method, as follows:

> Tax to be withheld in current period = cumulative tax payable – cumulative tax withheld in previous period
>
> Cumulative tax payable = cumulative taxable income × withholding rate – quick deduction
>
> Cumulative taxable income = cumulative income (excluding tax-exempt income) – cumulative applicable deductions (including personal deduction, special deductions, itemised deductions and other applicable deductions).

Personal Services Income, Author's Remuneration, and Royalties: PRC IIT should be withheld separately in respect of personal services income, author's remuneration, or royalties. Personal services income is subject to withholding[3].

Author's remuneration and royalties are subject to a flat withholding rate of 20 percent.

Annual Reconciliation for Comprehensive Income: Resident taxpayers who derive comprehensive income that has not had the correct withholding tax applied at source during the tax year should perform an annual reconciliation filing. The annual reconciliation filing, to settle the tax due or claim a tax refund, should be performed between 1 March and 30 June following the tax year.

Nonresident Taxpayers

Salary and wages, personal services income, author's remuneration, and royalties derived by nonresident taxpayers are subject to tax withholding as summarised below.

Salary and Wages: Salary and wages earned by nonresident taxpayers are subject to monthly PRC IIT withholding[4] after the monthly personal deduction of RMB 5,000.

Personal Services Income, Author's Remuneration, and Royalties: Personal services income, author's remuneration, or royalties is subject to PRC IIT withholding separately and on an occurrence/monthly basis[5].

Itemised Deductions (Applicable to Resident Taxpayers Only)

The following are notable differences between the recently-issued Interim Measures and the Draft, which was reported on in GMS *Flash Alert* 2018-142 (31 October 2018). Also, see: "China Tax Alert" Issue 22, 24 October 2018.)

- Further education – academic education:
  - Only applicable to education received at institutions in the PRC;
  - A maximum period of deduction of 48 months is allowed for each degree.
- Serious illness medical fees:
  - Should be within the scope of PRC social medical insurance coverage;
  - Only applicable to self-paid medical fees in excess of RMB 15,000 per annum;
  - The deduction cap increased to RMB 80,000 per annum;
  - Deductible either by the patient him/herself or his/her spouse. If the patient is a juvenile, deductible by either of his/her parents.
- Mortgage interest:
  - Subject to a maximum period of deduction of 240 months;
  - Where a couple each take out a first mortgage before marriage, they can claim a deduction of either 50 percent for each or 100 percent for either.
- Housing rental:
  - For big cities, the deduction is increased to RMB 1,500 per month.
  - For other cities with populations over 1 million, the deduction is increased to RMB 1,100 per month.

Announcement 60 sets out the detailed administration requirements for itemised deductions including the timing of the claim, reporting requirements, and supporting documents from both individual taxpayers and their withholding agents.

- Individual taxpayers should:
  - provide the required claim information either directly to the tax authority via its website/mobile APP or by completing and submitting the information collection paper/electronic forms via their withholding agents or to the tax authorities directly;
  - confirm any changes to their itemised deductions for the following year to their withholding agents in December each year where continuing to claim deductions via their withholding agents;
  - take responsibility to help ensure the information provided for the purpose of the itemised deductions is authentic, accurate, and complete; and

- retain the Itemised Deduction Information Collection Forms and the relevant supporting documents for at least five years after completion of the annual reconciliation filing.

- Withholding agents should assist their employees in claiming itemised deductions either:

  - based on the information shared by the tax authority, where the information is submitted by the employees to the tax authority directly; or

  - by submitting the information collection forms received from the employee to the tax authority via the tax filing system electronically and printing out two copies of the forms (one for the employer and another for the employee) endorsed with the employee's signature and company chop (official seal of the company) – these forms need to be retained for at least five years following the year of the withholding filings.

Foreign Individuals

"Six-Year Rule"

The Implementation Rules sets out that individuals who are regarded as non-domiciliaries of China and have not been tax resident of China for more than six consecutive years may claim exemption on their foreign-sourced income paid overseas by performing a "put-on-record filing" with the tax authorities.

For any year during which a non-domiciliary of China is away from China for more than 30 continuous days, the six-year residence period will restart.

High Net-Worth Individuals

The Implementation Rules and the supplementary guidance notes did not provide any details on the General Anti-Avoidance Rules ("GAAR") and removed certain clauses which were introduced by the Draft implementation rules, such as the "deemed transfer rule," tax collection, and administration rules on partnerships.

KPMG NOTE

With these measures, the government aims to strengthen tax collection and administration, while trying to reduce individual taxpayers' tax burdens and their withholding agents' administration costs.

However, some areas remain still unclear, such as detailed implementation rules on GAAR. These are expected to be clarified in another batch of circulars to be released. Individual taxpayers and their withholding agents need to pay attention to the following:

Individual Taxpayers and Their Employers

- The cumulative withholding methodology marks a significant change to the IIT withholding mechanism. Adopting a cumulative withholding methodology will result in lower tax withheld in the earlier months and higher tax withheld in the later months during a tax year. Individual taxpayers and their employers should familiarize themselves with the relevant calculation, as well as reporting and administration requirements.

- Announcement 56 provides different IIT withholding methodologies for resident taxpayers and nonresident taxpayers. Withholding agents need to assess and determine the residency status of their employees in order to withhold IIT properly.

KPMG NOTE (cont'd)

- Announcement 60 requires taxpayers to be responsible for the authenticity, accuracy, and completeness of the information provided for the claim of itemised deductions. If claims which are false or have errors are discovered during the administrative process, withholding agents should remind their employees to correct the claims and they should notify the tax authority if the individual concerned refuses to make the corrections. Withholding agents play a key role in collection and administration of itemised deductions for their employees.

- Withholding agents should review and make necessary adjustments to their existing tax filing systems, as well as internal tax and HR policies and administrative procedures in view of the Implementation Rules and the supplementary guidance notes.

Foreign Individuals

With respect to the Six-Year Rule, further clarifications are expected regarding the commencement of the "six years" and the details of the put-on-record filing required to claim a tax exemption on the foreign-sourced income derived by non-domiciled individuals.

High Net-Worth Individuals

As mentioned in our previous reports, GAARs were introduced under the new IIT regime. Detailed implementation rules on the GAAR have not been included in the above-mentioned Implementation Rules and supplementary guidance notes and are expected to be introduced in separate circulars.

Next Steps

The KPMG International member firm in China will continue to pay close attention to the relevant circulars to be promulgated under the new PRC IIT regime and share our observations. Please feel free to contact us for the most recent news in relation to IIT reform and other tax regulations.

FOOTNOTES:

1 For prior coverage of the reform of China's IIT, see GMS *Flash Alert* 2018-142 (31 October 2018).

2 SAT Announcement [2018] No. 56 - Announcement of the State Administration of Taxation ("SAT") on Transitional measures pertaining to Tax Collection and Administration for Enforcement of the Individual Income Tax Law ("Announcement 56").

Order No. 707 of the State Council - Implementation Rules for the Individual Income Tax ("IIT") Law of the People's Republic of China ("Implementation Rules").

Guofa [2018] No. 41 - Notice of the State Council on Interim Measures for Administration of Itemised Deductions ("Interim Measures").

SAT Announcement [2018] No.59 - Announcement of the SAT on Matters Concerning the Identification Number of Individual Taxpayers ("Announcement 59").

SAT Announcement [2018] No.60 - Announcement of the SAT on Administrative Measures for IIT Itemised Deductions (Trial Implementation) ("Announcement 60").

SAT Announcement [2018] No.61 - Announcement of the SAT on Trial administrative measures for individual income tax withholding ("Announcement 61").

SAT Announcement [2018] No.62 - Announcement of the SAT on Matters concerning self- declaration of individual income tax ("Announcement No.62").

3 For the withholding rate tables for residents' salary and wages and personal services income, as well as for nonresidents, see "Implementation Rules of the Amended PRC IIT Law and the Supplementary Guidance Notes Issued," in *China Tax Alert* (Issue 29, December 2018, updated January 2019) a publication of the KPMG International member firm in the People's Republic of China.

4 Ibid.

5 Ibid.

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For a full report on the Implementation Rules and Supplementary Guidance from the KPMG International member firm in the People's Republic of China, see "Implementation Rules of the Amended PRC IIT Law and the Supplementary Guidance Notes Issued," in *China Tax Alert* (Issue 29, December 2018, updated January 2019).

Contact us

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