KPMG

GMS Flash Alert

2019-012 | January 24, 2019

People's Republic of China - Transitional Provisions for IIT Preferential Treatment

Following on from the new Individual Income Tax ("IIT") Law which came into force on 1 January 2019, a new Chinese Circular sets out transitional measures for the application of the preferential tax treatment for tax-exempt benefits for foreign employees, annual bonuses, equity-based compensation, and severance payments.[1] (For prior coverage of the IIT reform, see GMS *Flash Alert* 2019-010, 23 January 2019.)

The Ministry of Finance and the State Administration of Taxation of the People's Republic of China ("PRC" or "China") have jointly released Circular 164 entitled "Notice of issues concerning the transitional policies on preferential tax treatments under the amended PRC IIT law."

WHY THIS MATTERS

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

Moreover, the new rules will affect companies' tax cost forecasts and possibly their talent retention strategies and policies, as well as their tax reimbursement policies.

Taxpayers should bear in mind that for preferential tax treatment there are qualifying conditions and reporting requirements.

Three Year Transitional Period

Tax-Exempt Benefits for Foreign Employees

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 types of income noted below.

Foreign employees who are PRC tax residents (i.e., who reside in the PRC 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 from a qualified enterprise annuity can be treated as a separate source of income from comprehensive income for IIT calculation purposes.
- With respect to withdrawals that are paid on a monthly basis, the rates in Appendix 1 will apply.
- Withdrawals that 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 NOTE

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. The KPMG International member firm in China recommends 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.

Next Steps

KPMG will continue to pay close attention to the relevant circulars to be promulgated under the new IIT regime and to share our observations with GMS *Flash Alert* readers. Please feel free to contact us for the most recent news in relation to the IIT reform and other tax regulations.

Appendix 1：IIT rate bands on monthly comprehensive income

Level	Taxable Income	Tax Rate（%)	Quick Deduction (RMB)
1	not in excess of RMB 3,000	3	0
2	RMB 3,000 to RMB 12,000	10	210
3	RMB 12,000 to RMB 25,000	20	1,410
4	RMB 25,000 to RMB 35,000	25	2,660
5	RMB 35,000 to RMB 55,000	30	4,410
6	RMB 55,000 to RMB 80,000	35	7,160
7	in excess of RMB 80,000	45	15,160

Source: KPMG in the People's Republic of China

Appendix 2：IIT rate bands on annual comprehensive income

Level	Cumulative Taxable Income	Withholding Rate (%)	Quick Deduction (RMB)
1	not in excess of RMB 36,000	3	0
2	RMB 36,000 to RMB 144,000	10	2,520
3	RMB 144,000 to RMB 300,000	20	16,920
4	RMB 300,000 to RMB 420,000	25	31,920
5	RMB 420,000 to RMB 660,000	30	52,920
6	RMB 660,000 to RMB 960,000	35	85,920
7	in excess of RMB 960,000	45	181,920

Source: KPMG in the People's Republic of China

FOOTNOTE:

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

* * * * *

RELATED ARTICE

This article is excerpted with permission from "Transitional Provisions for PRC Individual Income Tax Preferential Tax Treatment," published in *China Tax Alert* (Issue 31, December 2018) a publication of the KPMG International member firm in the People's Republic of China).

RMB 1 = EUR 0.130
RMB 1 = USD 0.147
RMB 1 = GBP 0.113
RMB 1 = TWD 4.55

Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in the People's Republic of China:

Michelle Zhou
Partner
Tel. +86 (21) 2212 3458
Michelle.b.zhou@kpmg.com

Vincent Pang
Partner
Tel. +86 108 508 7516
Vincent.pang@kpmg.com

Murray Sarelius
Partner
Tel. +852 3927 5671
elius@kpmg.com

The information contained in this newsletter was submitted by the KPMG International member firm in the People's Republic of China.

www.kpmg.com

kpmg.com/socialmedia

Flash Alert is a GMS publication of KPMG LLP's Washington National Tax practice. To view this publication or recent prior issues online, please click here. To learn more about our GMS practice, please visit us on the Internet: click here or go to http://www.kpmg.com.