Strategic Regions Tax Newsletter

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China

MOF and SAT issue new VAT reform rules Individual income tax deferred on enterprise annuity

(1) Summary

China's State Administration of Taxation, the Ministry of Finance, and the Ministry of Human Resources and Social Security (MHRSS) jointly issued guidance on 6 December 2013 (Circular Cai Shui [2013] No. 103), that provides for the deferral of individual income tax (IIT) on an "enterprise annuity." Circular 103 applies from 1 January 2014.

Enterprise annuity is a supplementary pension plan that Chinese companies may establish according to a decree issued in 2004 (Decree No. 20 of the Ministry of Labor and Social Security (the predecessor of MHRSS)). Under a typical enterprise annuity, both the employer and employee make monthly contributions to the annuity fund, although the annual employer contribution may not exceed 1/12 of its total salary expenses of the preceding calendar year. Before Circular 103, both the employer and employee contributions were taxable at the time the contribution was made. Circular 103 shifts the taxation point to the time the funds are withdrawn from the annuity fund.

(2) Key implications

1) An employer's contribution is exempt from IIT in the hands of the employee provided the contribution is made within the limits set by the relevant regulations.

2) An employee's contribution of no more than 4% of his/her salary tax base is deductible from the employee's salary for IIT purposes. The salary tax base is the employee's average monthly salary of the preceding calendar year, but is capped at three times the local average monthly salary of the preceding calendar year.

3) The allocation of the fund earnings to the employee's individual account is exempt from IIT.

4) After an employee reaches the statutory retirement age, the monthly withdrawal of the annuity fund from his/her individual account will be subject to IIT as wages and salary, at tax rates ranging from 3% to 45%. If the withdrawal is made on a quarterly or an annual basis, it will be spread evenly over the relevant period and taxed monthly.

5) A lump-sum withdrawal due to the employee's immigration abroad or death will be spread evenly over 12 months and taxed monthly. However, a lump-sum withdrawal for any other reason will be treated as a separate monthly salary—no spread will be allowed.

6) The employer must register with competent tax authorities within the first 15 days of the month following the month an annuity plan is set up and the following documents must be submitted to the authorities: the annuity plan, the letter of filing, the confirmation letter issued by the MHRSS (or its local branches), and any other documents required by the tax bureau. If a change is made to an annuity plan, the trustee, the custodian, etc., relevant documents must be submitted to the competent tax authorities within the first 15 days of the month following the month in which the change is made.

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