

Tax Analysis

Individual Income Tax Reform: Guidance released on tax withholding under new IIT law

On 20 December 2018, China's State Administration of Taxation (SAT) published Bulletin 56 that provides guidance on the withholding of tax under the newly amended individual income tax (IIT) law that becomes effective on 1 January 2019.

The revised IIT law consolidates four previous categories of income (i.e. salaries and wages, remuneration for independent services, author's remuneration and income from royalties) into a single category called "comprehensive income."¹ Comprehensive income is subject to progressive tax rates ranging from 3% to 45% (there are seven tax brackets). The IIT on comprehensive income derived by residents is assessed on an annual basis, and is collected through the withholding of tax in advance, which is remitted to the tax authorities by the payer (i.e. withholding agent) on a monthly or transactional basis, followed by a final reconciliation and settlement by the taxpayer at the time he/she files the annual tax return. The IIT on comprehensive income derived by nonresidents is assessed on a monthly or transactional basis and is generally collected through the withholding of tax, which is remitted to the tax authorities by the payer.

Bulletin 56 provides guidance for businesses on how to compute the IIT to be withheld under the new IIT law.

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¹ See Deloitte Tax Analysis on the new IIT law:

<https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/tax/ta-2018/deloitte-cn-tax-tap2772018-en-180911.pdf>

<https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/tax/ta-2018/deloitte-cn-tax-tap2752018-en-180703.pdf>

Advance tax on comprehensive income of residents

For more information, please contact:

Salaries and wages

The advance tax to be withheld on salaries and wages is computed using a cumulative-salaries-based approach. The relevant computation formulas are as follows:

Advance tax to be withheld for the current period = (Cumulative taxable income of salaries to date x Advance withholding tax rate - Quick deduction) - Cumulative tax exemptions and reductions - Cumulative advance tax that has been withheld and remitted

Cumulative taxable income of salaries to date = Cumulative salaries to date - Cumulative tax-exempt salaries - Cumulative standard deductions - Cumulative itemized deductions - Cumulative additional itemized deductions - Cumulative other deductions

Notes:

- "Cumulative standard deduction" is RMB 5,000/month multiplied by the number of months the individual has worked for the employer in the current year.
- The advance withholding tax rate table is set out below (see Table I).

Examples

A resident individual earns a salary of RMB 40,000 per month, and makes a total monthly personal contribution to social security and the housing fund of RMB 3,000 (which are both itemized deductions) and is entitled to an additional itemized deduction of RMB 2,000:

- *Advance tax to be withheld in January 2019 = (40,000 - 5,000 - 3,000 - 2,000) x 3% = 900*
- *Advance tax to be withheld in February 2019 = (40,000 x 2 - 5,000 x 2 - 3,000 x 2 - 2,000 x 2) x 10% - 2,520 - 900 = 2,580*

Remuneration for independent services, author's remuneration and income from royalties

The advance tax to be withheld on other three types of comprehensive income are computed on a monthly or transactional basis. The computation formulas are as follows:

Advance tax to be withheld on remuneration for independent services = Taxable income for advance tax withholding purposes x Advance withholding tax rate - Quick deduction

Advance tax to be withheld on author's remuneration and income from royalties = Taxable income for advance tax withholding purposes x 20%

Taxable income for advance tax withholding purposes (for independent services and income from royalties) = Gross revenue - Deductible expenses

Taxable income for advance tax withholding purposes (for author's remuneration) = (Gross revenue - Deductible expenses) x 70%

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Notes:

- "Deductible expenses" are the higher of RMB 800 and 20% of "gross revenue."
- The advance withholding tax rate table is set out below (see Table II).

Example A

A resident individual earns gross independent service remuneration of RMB 40,000:

$$\text{Advance tax to be withheld} = (40,000 - 40,000 \times 20\%) \times 30\% - 2,000 = 7,600$$

Example B

A resident individual earns gross author's remuneration of RMB 40,000:

$$\text{Advance tax to be withheld} = (40,000 - 40,000 \times 20\%) \times 70\% \times 20\% = 4,480$$

It should be noted that the taxable income computation method and tax rate used for purposes of advance tax withholding are different from those used for the final tax calculation at year-end.

	Advance withholding		Annual reconciliation	
	Taxable income	Advance withholding tax rates	Taxable income	Tax rates
Remuneration for independent services	Gross revenue - deductible expenses (determined as the higher of RMB 800	Progressive tax rates ranging from 20% to 40%, with three tax brackets	Gross revenue x 80%; an additional 30% reduction is allowed for author's remuneration	Progressive tax rates ranging from 3% to 45%, with seven tax brackets
Income from royalties	and 20% of gross revenue); an additional 30% reduction is allowed for author's remuneration	20%		
Author's remuneration		20%		

Tax withholding on comprehensive income of nonresidents

The tax on comprehensive income of nonresidents is computed on a monthly or transactional basis and withheld by the payer. The computation formula is as follows:

$$\text{Tax to be withheld on comprehensive income} = \text{Taxable income} \times \text{Tax rate} - \text{Quick deduction}$$

Notes:

- "Taxable income" is determined as follows:
 - Gross revenue minus the standard deduction (i.e. RMB 5,000/month) for salaries and wages; and
 - 80% of gross revenue for remuneration for independent services, author's remuneration and income from royalties, with an additional 30% reduction allowed for author's remuneration.
- The tax rate table is set out below (see Table III).

Other guidance

Bulletin 56 confirms that a resident individual must make a final reconciliation and settlement at the time he/she files the annual tax return between 1 March and 30 June of the year following the tax year if the total IIT withheld is different from the final tax due. Bulletin 56 also contains the relevant reporting form with filing instructions.

Tax rate tables

*Table I - Advance withholding tax rates
(Salaries and wages derived by residents)*

Brackets	Cumulative taxable income of salaries to date (RMB)	Advance withholding tax rate (%)	Quick deduction
1	36,000 or less	3	0
2	Over 36,000 up to 144,000	10	2,520
3	Over 144,000 up to 300,000	20	16,920
4	Over 300,000 up to 420,000	25	31,920
5	Over 420,000 up to 660,000	30	52,920
6	Over 660,000 up to 960,000	35	85,920
7	Over 960,000	45	181,920

*Table II - Advance withholding tax rates
(Remuneration for independent services performed by residents)*

Brackets	Taxable income (RMB)	Advance withholding tax rate (%)	Quick deduction
1	20,000 or less	20	0
2	Over 20,000 up to 50,000	30	2,000
3	Over 50,000	40	7,000

*Table III - Withholding tax rates
(Comprehensive income derived by nonresidents)*

Brackets	Taxable income (RMB)	Withholding tax rate (%)	Quick deduction
1	3,000 or less	3	0
2	Over 3,000 up to 12,000	10	210
3	Over 12,000 up to 25,000	20	1,410
4	Over 25,000 up to 35,000	25	2,660
5	Over 35,000 up to 55,000	30	4,410
6	Over 55,000 up to 80,000	35	7,160
7	Over 80,000	45	15,160

Deloitte's view

Bulletin 56 should be welcome as it provides timely guidance for IIT withholding agents to understand how to compute the amount of tax to be withheld and remitted to the tax authorities.

The introduction of a cumulative-salaries-based approach to compute the advance tax to be withheld on salaries and wages earned by resident individuals is designed to minimize potential differences between the advance tax payments and final tax due. If a resident individual earns salaries and wages from only one source and no other comprehensive income is derived in a tax year, the use of this method could result in the taxpayer not owing any additional tax at the time he/she files the annual return or not having to request a refund of tax overpaid.

For other types of comprehensive income derived by resident individuals, the computation of the advance tax to be withheld is basically the same as that under the previous IIT rules, so withholding agents will be familiar with the process.

Recommendations

Withholding agents (employers)

- In view of the significant changes to the computation of monthly IIT withholding on salaries and wages (particularly that the relevant data of previous months must be taken into account to determine the amount of tax to be withheld for residents), employers should consider updating their financial and payroll systems and provide training to relevant personnel to correctly compute the IIT withholding under the new IIT law.
- Withholding agents should proactively communicate with employees and other relevant personnel about the implications of the new IIT law and help them understand the new IIT collection mechanism (i.e. advance withholding plus annual reconciliation). It is worth noting that the monthly take-home pay may fluctuate due to the new computation method, so employers should make employees aware of the situation and remind them to submit the information relating to additional itemized deductions (e.g. deduction of children education expenses, housing mortgage interest, etc.) in a timely manner.
- Resident employees may provide information on additional itemized deductions to their employers so that these items are deducted when computing the advance tax to be withheld. The information could be provided in such a flexible way that employees may claim deductions in relation to previous months (within the same calendar year) in the current month to compute the advance tax. Therefore, employers with large employee populations may need to consider technology solutions to automate the information collection and processing to improve efficiency and accuracy.
- Since residents and nonresidents are subject to different withholding tax rules, employers with a large population of foreign employees should pay close attention to the employees' tax residence status to apply the correct tax treatment. The government has not clarified on how to deal with the situation where the residence status cannot be determined at the beginning of a year; employers should keep monitoring the relevant regulatory development and seek guidance from tax authorities or professionals where necessary.

Taxpayers

- For resident individuals who receive salaries and wages from two or more sources, or receive both salaries and other types of comprehensive income, it is likely that their final tax on annual comprehensive income will be different from the total of advance tax withheld during the year, so an annual reconciliation will be required. These taxpayers should become familiar with the annual reconciliation and filing procedures.
- For resident individuals who do not derive salary income but only other types of comprehensive income, their additional itemized deductions can be deducted only at the time the annual tax return is filed. These taxpayers should properly collect and maintain the relevant supporting documents during the tax year to claim the relevant deductions via the annual reconciliation.
- Relevant individuals should self-assess their personal tax residence status appropriately and have the status confirmed with withholding agents so that the correct withholding rules could be applied.
- Taxpayers should seek professional assistance in complex situations.

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