In this issue:

People's Republic of China: Highlights of seventh draft amendments to the individual income tax law

Overview

A draft law (seventh draft amendments to the PRC individual income tax (IIT) law) containing broad changes to the IIT system was submitted to the Standing Committee of the National People's Congress for deliberation on June 19, 2018, and released to the public for consultation on June 29, 2018.

Although the IIT law has been amended six times since it was enacted in 1980, the seventh draft amendments are expected to bring about the most significant reform to the rules. Unlike some previous amendments that merely adjusted the standard deductions or modified the tax brackets for salaries and wages, the draft includes fundamental changes to the definition of a resident, the consolidation of various categories of income, the introduction of more itemized deductions and anti-avoidance rules, etc. The proposed changes aim to promote social fairness and justice by alleviating the tax burden, increasing personal income, and boosting consumption on the middle and lower income classes.

If the legislative authorities pass the draft, the new rules generally should become effective on January 1, 2019, although some measures, such as the increased standard deduction, would be effective as early as October 1, 2018.

Highlights of proposed changes

Definition of resident: The draft would introduce the internationally recognized "183-day" test for determining whether an individual is a China tax resident, which will make it much easier for a non-China-domiciled individual to be considered a Chinese resident for tax purposes. Under the current rules, a non-China-domiciled individual will be considered a Chinese tax resident only if he or she stays in China for a full tax year – *i.e.*, 365 days in the calendar year, with temporary trip(s) (one single trip of more than 30 days or multiple trips of more than 90 days) outside China not taken into account. The following table sets out how the new rules would operate:

	Definition	**Tax scope**
Resident	• China-domiciled individuals • Non-China-domiciled individuals who stay in China for 183 days or more in a calendar year	Worldwide income
Non-resident	Non-China-domiciled individuals who stay in China for less than 183 days in a calendar year	Only China-source income

Tax categories: The existing IIT law uses a typical scheduler system, according to which all taxable income is classified into 11 categories and the income under the different categories is taxed separately. The draft would consolidate four categories of income (*i.e.*, salaries and wages, remuneration for (independent) services, authors' remuneration, and income from royalties) into a single new tax category called "comprehensive income."

Tax rates and brackets: Salaries and wages currently are subject to progressive tax rates ranging from 3% to 45%, with seven tax brackets. According to the draft, the tax rates and brackets would be applied to compute tax on comprehensive income. The lowest three brackets (*i.e.*, 3%, 10%, and 20%) would be broadened considerably to benefit middle-/low-wage earners.

Standard deductions: According to the draft, the basic standard deduction that currently applies to salaries and wages also would apply to comprehensive income and would be increased from RMB 3,500 per month to RMB 5,000 per month (*i.e.*, RMB 60,000 per year). However, the draft would repeal the additional standard deduction of RMB 1,300 per month that currently applies to salaries and wages earned by foreign individuals working in China and China-domiciled individuals working overseas.

Additional itemized deductions: The existing IIT law provides for few itemized deductions, and those that are available normally are limited to statutory social security contributions. To promote the well-being of the population and reduce the cost of living, the draft would introduce additional itemized deductions, including deductions for children's education and continuing education expenses, medical expenses for critical illnesses, housing mortgage interest, and housing rent.

Tax assessment, collection, and filing: The draft would introduce new rules relating to tax compliance obligations.

For Chinese citizens having identification, such identification would be their tax ID; while, for those not having identification, tax authorities would assign a tax ID.

Comprehensive income derived by resident individuals would be assessed on an annual basis (currently, all individuals earning salaries and wages are assessed monthly). However, comprehensive income derived by nonresidents would be assessed on a monthly or transactional basis.

The IIT for resident individuals would be collected through advance tax payments withheld and remitted by the payer (if any) on a monthly or transactional basis, with a final settlement made by the taxpayer at the time the annual return is filed. The annual return must be filed between 1 March and 30 June of the year following the calendar year.

The draft also provides that if a taxpayer submits information relating to itemized deductions to an income payer (*i.e.*, the tax withholding agent) and requests the payer to deduct the relevant items to compute the advance tax payments to be withheld, the payer would not be able to refuse the request.

For nonresidents, an income payer could act as a withholding agent to withhold and remit the IIT on a monthly basis on behalf of the taxpayer by the 15th of the following month, and annual return would normally not be required.

Tax clearance upon immigration: Based on the draft, if a taxpayer plans to deregister his or her Chinese Hukou (household registration in China) in order to immigrate abroad, the taxpayer would be required to settle his or her Chinese IIT liabilities before the deregistration would be allowed.

Anti-avoidance rules: The draft would introduce anti-avoidance rules (similar to those that apply for enterprise income tax purposes), and would allow the Chinese tax authorities to initiate tax adjustments and collect underpaid tax with overdue interest in the following situations:

- When transactions between an individual and his or her related parties do not comply with the arm's length principle and the noncompliance cannot be justified;
- When a resident individual controls (or jointly controls with other resident individuals/companies) an enterprise established in a jurisdiction where the effective tax rate is significantly low and the enterprise does not distribute profits or distributes less profits than it should without a reasonable business justification; and
- When an individual obtains improper tax benefits through an arrangement that lacks a reasonable business purpose.

Deloitte's view

- The existing annual filing requirement for individuals whose annual income exceeds RMB 120,000 is expected to be replaced by the rules that would apply to comprehensive income derived by resident individuals. Affected taxpayers may need to ensure that the relevant data and information (*e.g.*, with respect to additional itemized deductions) is appropriately collected and documented, to facilitate the annual personal filing.
- The draft includes various measures (*e.g.*, increasing the basic standard deduction, the introduction of more itemized deductions, and the expansion of the scope of the low tax brackets) to reduce the overall tax burden on individual taxpayers, with the middle- and/or low-income groups probably receiving the most benefits.
- The draft could have a substantial impact on foreign individuals working in China, who may be more likely to be considered China tax residents. At this stage, it is unclear if the "five-year" test (*i.e.*, whether a non-China domiciled individual has not stayed in China for five full tax years consecutively) currently offered to non-China domiciled individuals to protect their certain foreign-source income from being taxed in China will be repealed. If it is repealed, such individual may have to resort to the tie-breaker rule under the relevant tax treaty (if applicable) to determine his or her tax resident status and then seek treaty relief in case he or she is considered a resident of the counterparty for the treaty purposes after applying for the tie-breaker rule. In addition, the repeal of the additional standard deduction (*i.e.*, RMB 1,300 per month), which currently is available to foreign individuals, signals the Chinese government's intention to follow the principle of national treatment. It's also unclear whether the tax exemption for certain benefits-in-kind that are currently offered only to foreign individuals will be repealed as well and replaced by the additional itemized deductions applicable to all taxpayers.
- It is worth noting that an employer's IIT withholding obligation will not be eliminated or mitigated under the draft. In fact, businesses – in particular, multinational companies that employ many expatriates, locally hired foreign employees, and Chinese senior management employees – may need to provide additional support for their employees to meet their new IIT compliance obligations, and facilitate their annual filing and initial tax registration, which may be required in order to apply for a tax ID. Companies may need to set up new policies and processes to help their employees in this regard.
- Considering the potential introduction of the anti-avoidance rule, high-net-worth individuals with cross-border business arrangements and overseas assets should consider reviewing their overall tax compliance status and assess the sustainability of their tax positions at home and abroad to manage any potential risk.
- Although the draft is in the public consultation phase, final amendments are expected to be announced during 2018 and more follow-up measures will be introduced to support the IIT reform. Individuals and companies should monitor developments closely and start planning for changes. We will continue to follow the progress of the proposed tax reform and corresponding supporting measures, and share further updates as needed.

— Tony Jasper (Hong Kong)
Partner
Deloitte People's Republic of China
tojasper@deloitte.com.hk

Huan Wang (Beijing)
Partner
Deloitte People's Republic of China
huawang@deloitte.com.cn

Irene Yu (Shanghai)
Partner
Deloitte People’s Republic of China
iryu@deloitte.com.cn

Hong Kong:
Updates on newly proposed tax-deductible items

Overview

In April 2018, the Hong Kong Special Administrative Region Budget (the “Budget”), which was announced in February 2018, includes a proposal to relax the personal assessment (PA) requirement for married people.

PA is a relief option for taxpayers who are subject to profits tax and/or property tax, with or without employment income subject to salaries tax – an option for taxpayers to choose to assess their income from all sources together.

At present, when a married person and his or her spouse have income assessable under the Inland Revenue Ordinance (IRO), and both are eligible to elect for PA, that person can make an election only when his or her spouse also does so.

In order to provide married taxpayers with greater flexibility in tax assessment, the Budget proposed to relax the requirement by allowing married persons the option to elect PA separately.

The proposed amendment bill for the above was published in the Hong Kong Government Gazette (the “Gazette”) in June 2018, and it has been introduced to the Legislative Council for review. Once the Legislative Council approves it, the proposed measure aims to commence from the year of assessment 2018/19.

Deloitte’s view

The proposed relaxation of separate PA election by married taxpayers may further reduce the taxpayers’ tax burden, as the tax liability of a couple could be lower if each person is assessed separately.

Deloitte applauds the proposal, as the public has long-requested this change that will provide greater flexibility to taxpayers.

The Legislative Council must still approve the budget measures.

— Tony Jasper (Hong Kong)
Partner
Deloitte People’s Republic of China
tojasper@deloitte.com.hk

Irene Yu (Shanghai)
Partner
Deloitte People’s Republic of China
iryu@deloitte.com.cn

Huan Wang (Beijing)
Partner
Deloitte People’s Republic of China
huawang@deloitte.com.cn