ADVANT Beiten

INDIVIDUAL INCOME TAX

The last substantial overhaul of the PRC Individual Income Tax Law („**IIT Law**") and related implementing regulations and other related measures became effective as of 1 January 2019. Some changes were provided to only be gradually phased in during a transitional period lasting until 31 December 2021, then later extended until 31 December 2023 ("**Transitional Period**"). With the expiration of the Transitional Period, employers and employees need to review their labour and payroll processes to ensure compliance with IIT legislation also after the Transitional Period ended. Likewise, they shall monitor new IIT-related measures which are expected to be published in the near future to deal with certain changes occurring after the Transitional Period ended.

1. Income Categories and Tax Filing

The IIT Law recognizes the below listed nine income categories. For PRC tax residents, income derived from the first four of these income categories are consolidated under the category "Comprehensive Income", while for non-PRC tax residents, income obtained from such four categories is taxed separately:

<table>
<tr><th></th><th colspan="2">As of 1 January 2019:</th></tr>
<tr><td>1</td><td>Salaries and wages</td><td rowspan="4">Comprehensive Income</td></tr>
<tr><td>2</td><td>Remuneration for personal services</td></tr>
<tr><td>3</td><td>Author's remuneration</td></tr>
<tr><td>4</td><td>Royalties</td></tr>
<tr><td>5</td><td colspan="2">Operating Income</td></tr>
<tr><td>6</td><td colspan="2">Interest, dividends and bonuses</td></tr>
<tr><td>7</td><td colspan="2">Lease of property</td></tr>
<tr><td>8</td><td colspan="2">Transfer of property</td></tr>
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1.1 COMPREHENSIVE INCOME

PRC tax residents: IIT on Comprehensive Income is calculated on a consolidated basis for the tax year (= calendar year) and after the personal standard deduction of RMB 60,000, specific deductions, itemized deductions for specific expenditures, and other deductible items from the gross yearly income.

Monthly provisional filings are required and in addition an annual reconciliation filing must be made between 1 March and 30 June of the following year.

Non-PRC tax residents: IIT on income from

- salaries and wages shall be taxed per month after the personal standard deduction of RMB 5,000 from the gross monthly income; and for

- personal services, author's remuneration and royalties, the taxable income is the amount received each time and shall be taxed accordingly each time.

IIT on wages and salaries, personal service remuneration, author's remuneration and royalties shall be withheld and paid on a monthly or per-time basis, either by the withholding agent or – if there is none – by the non-PRC tax resident himself/herself. Non-PRC tax residents must not file annual IIT reconciliation filings.

1.2 OPERATING INCOME

This is income derived from the production or business operation by self-employed industrial/commercial households. The taxable income is the gross income obtained in a single tax year after deduction of costs, expenses and losses and is taxed for IIT purposes on a yearly basis. The taxpayer shall file provisional tax return for such Operating Income with the locally competent tax authority within 15 days after the end of each month or quarter and make prepayment of the taxes. Taxpayers then need to handle the final reconciliation settlement latest by 31 March of the following year.

1.3 LEASE / TRANSFER OF PROPERTY, INTEREST, DIVIDENDS, BONUSES & INCIDENTAL INCOME

Property Lease: Taxable income is taxed on the single lease payment amount and based on the following formulas:

- Single lease payment amounting to up to RMB 4,000 = [payment received] – RMB 800;

- Single lease payment amounting to over RMB 4,000 = [payment received] – 20% for expenses.

Property Transfer: Taxable income is taxed on each transfer based on the following formula: Taxable income = [proceeds from the transfer of property] – [original price of the property] – [reasonable expenses].

Interest, Dividends, Bonuses & Incidental Income: Taxable income is taxed based on the following formula: Taxable income = amount received each time.

All above income items received by a taxpayer is taxed for IIT purposes on a monthly or per-time basis. The withholding agent, if any, shall withhold and remit the IIT accordingly. There is no requirement for an annual reconciliation for these income items.

2. IIT Rates & Brackets for Different Income Categories

IIT rates and deductions vary depending on the respective type of income and the tax residency status of the taxpayer.

2.1 The **Comprehensive Income** derived **by a PRC tax resident** in one tax year shall be, after deduction of personal deduction of RMB 60,000, specific deductions, itemized deductions for specific expenditures, and other deductible items determined by law, taxed according to the following tax brackets/progressive rates:

Brackets	Annual Taxable Income (after deductions) (RMB)	Tax Rate (%)/ Quick Deduction (RMB)
1	≤ 36,000	3%/0
2	36,000 ≤ 144,000	10%/2,520
3	144,000 ≤ 300,000	20%/16,920
4	300,000 ≤ 420,000	25%/31,920
5	420,000 ≤ 660,000	30%/52,920
6	660,000 ≤ 960,000	35%/85,920
7	> 960,000	45%/181,920

2.2 The **salaries and wages**, **remuneration for personal services**, **author's remuneration and royalties** derived **by a non-PRC tax resident** shall be taxed separately. Salaries and wages shall be taxed after the personal deduction of RMB 5,000, while the taxable income derived from personal services, author's remuneration and royalties shall be the full amount received each time after deduction of those items which can be deducted according to law. The tax brackets/progressive rates applied to salaries and wages, remuneration for personal services, author's remuneration and royalties are as follows:

Brackets	Monthly Taxable Income (after deductions) (RMB)	Tax Rate (%) / Quick Deduction (RMB)
1	≤ 3,000	3% / 0
2	3,000 ≤ 12,000	10% / 210
3	12,000 ≤ 25,000	20% / 1410
4	25,000 ≤ 35,000	25% / 2660
5	35,000 ≤ 55,000	30% / 4410
6	55,000 ≤ 80,000	35% / 7160
7	> 80,000	45% / 15,160

2.3 **Operating Income** shall be subject to IIT based on the amount of income after deduction of costs, expenses and losses in a tax year at the following progressive rates:

Brackets	Annual Taxable Income (after deductions) (RMB)	Tax Rate (%)
1	≤ 30,000	5%
2	30,000 ≤ 90,000	10%
3	90,000 ≤ 300,000	20%
4	300,000 ≤ 500,000	30%
5	> 500,000	35%

2.4 Income from **Interest**, **Dividends**, **Bonuses**, **Property Lease / Transfer** and **Incidental Income** shall be subject to a flat IIT rate of 20%.

3. Deductions Applicable to Calculation of Taxable Income for IIT Purposes

Personal Deduction: PRC tax residents receiving Comprehensive Income are entitled to a personal lump-sum deduction at a rate of RMB 60,000/year. Non-PRC tax residents earning salaries and wages are entitled to a personal lump-sum deduction of RMB 5,000/month.

Specific Deductions: In addition to the already existing specific deductions (i.e. basic pension insurance, basic medical insurance, unemployment insurance, housing fund), further deductions for specific expenditures for the following expenses can be deducted for IIT calculation purposes by PRC tax residents.

	Deduction Item	Deduction Amount / Cap	Taxpayer Entitled to Deduction
1	Children's education (full-time academic education) in China	RMB 1,000 / month per child	Parents (shared or individually)
2	Continuing education in China	RMB 400 / month for up to 48 months per academic degree RMB 3,600 during the year of obtaining the vocational qualification certificate	Student (or parents for bachelor degree or below)
3	Medical costs in case of serious disease	Amount in excess of RMB 15,000 (after medical insurance reimbursement) up to RMB 80,000 per year	Patient or his / her spouse or either of parents for minor children
4	Housing loan interest (for first house only)	RMB 1,000 / month up to 240 months	Home owner alone at 100% or with his / her spouse at 50 / 50%
5	Housing rental	Between RMB 800 and 1,500 / month depending on location	Lessee (either husband or wife if they reside in the same city)
6	Elderly support for parents aged 60 years or older	RMB 2,000 / month / person	The only child or shared among the siblings (not exceeding 1,000 RMB / month per sibling)

Charitable Donations: Charitable donations not exceeding 30% of an individual's taxable income are allowable for tax deduction. Donations made to certain charities may not be subject to the 30% deductibility cap subject to approval by the State Council.

Deemed Expense Deduction: Deemed expense in amount of RMB 800 shall be allowed for tax deduction for income from provision of personal services, income from author's remuneration and income from royalties if the income on per-payment basis does not exceed RMB 4,000. The deemed expense shall be calculated at 20% of the income if the income on per-payment basis exceeds RMB 4,000. IIT on an author's remuneration shall be assessed on 70% of the net income after deducting the deemed expenses.

4. Tax Residency

The taxation of IIT on an employee's income in China mainly depends on his/her tax residence status and the source of income. In general, individuals who have their domicile in the PRC are subject to IIT on their worldwide income. However, as the term "domicile" refers to "habitual residence", which is a legal term rather than an actual place of residence, foreigners working for a limited period of time in the PRC will not be deemed to have established their "domicile" in the PRC. According to the IIT Law, the following considerations apply in terms of tax residency:

Tax residency: Any individual who has a domicile in the PRC or who has no domicile but has stayed in the PRC for 183 days or longer in a tax year (= calendar year) is a tax resident and shall pay IIT for any income sourced within and outside the PRC according to law.

Individuals who are regarded as non-domiciled in the PRC and who have not been a PRC tax resident for more than six consecutive years (counting from 1 January 2019, even if they stayed in China before such date) can be exempted from IIT in China for their non-China-sourced income by record filing with the tax authorities. For any calendar year during which a non-domiciled individual stays outside China for more than 30 consecutive days, the aforesaid six-year period will restart from zero.

Non-tax residency: Any individual who has no domicile and who does not stay within the PRC or who has no domicile but stays within the PRC for less than 183 days in a tax year is a non-tax resident and shall pay IIT for income sourced within the PRC according to law.

5. Withholding Agent, Tax Payer and Tax ID

Withholding agent refers to the entity making the income payment while the term taxpayer refers to the respective income earner.

Withholding agents must provide IIT withholding statements including information of IIT withheld and other relevant information to the taxpayers to allow them to file accurate annual tax reconciliation returns. Further, withholding agents shall furnish details of the amount of IIT withheld, and other relevant information to individual taxpayers. Taxpayers must notify their tax ID (PRC ID Card number in case of PRC nationals; for foreigners, the tax authorities will allocate tax IDs) to their withholding agents.

If there is a withholding agent who does not withhold/remit IIT when due, the taxpayer shall pay IIT latest by 30 June of the year following the year in which the income was received (if the tax authority notifies of another time limit, such time limit prevails). PRC tax residents must file tax returns for income received from outside the PRC between 1 March and 30 June of the year after the year such income is received. PRC tax residents can either file such tax returns by him/herself or authorize the withholding agent to file the tax returns on his/her behalf. Non-PRC tax residents receiving wages and salaries from two or more PRC sources must file tax returns within the first 15 days of the month after the month the income is received.

6. Preferential Tax Treatments under the IIT Law

6.1 ENTERPRISE ANNUITY WITHDRAWALS

Any withdrawals from qualified enterprise annuities may be treated as separate income source from the Comprehensive Income for IIT calculation purposes. In case of monthly/annual withdrawals the IIT rates applicable to monthly/annual Comprehensive Income tax assessment shall apply respectively. In case of quarterly withdrawals, the amount withdrawn shall be divided by three to determine the applicable IIT rate based on the IIT rates applicable to monthly Comprehensive Income tax assessment.

6.2 SEVERANCE PAYMENTS

Qualified severance payments up to three times of the prior year’s local average wages shall be IIT exempt. Qualified severance payments in excess of three times of the prior year’s local average wages shall be treated as a separate source of income from the Comprehensive Income for IIT calculation purposes and the IIT rates applicable to annual Comprehensive Income tax assessment shall apply in such case.

One-off compensation for early retirement can be treated as a separate source of income from the Comprehensive Income and amortized over a period equal to the number of years between the date of early retirement and the mandatory retirement date for IIT calculation purposes and shall be taxed based on IIT rates applicable to annual Comprehensive Income tax assessment.

6.3 ANNUAL BONUS

Annual bonus shall refer to a one-off bonus paid to the employee by the employer according to its economic returns and comprehensive evaluation on the employee's working performance during a given calendar year.

Until 31 December 2023, one option to tax-optimize the benefits packages for employees is to use the preferential IIT treatment for one-off annual bonuses. Under this regime – which can be used once every year – annual bonuses are not combined for IIT calculation purposes with the regular monthly salary, but treated as an extra compensation item and the bonus amount is divided by 12. The applicable IIT rate is then the rate applicable to such 1/12 of the annual bonus.

Unless additional legislation would be put into place before 31 December 2023, this preferential treatment for bonuses will cease as of 1 January 2024 and the bonus would then be aggregated with the Comprehensive Income items during the same calendar year.

6.4 TAX-EXEMPT BENEFITS FOR NON-PRC EMPLOYEES

Until 31 December 2023, non-PRC employees can enjoy IIT exemptions on certain reasonable fringe benefits such as e.g. allowances for housing, meal and laundry, relocation, home flights and children's education, provided they can be proven by valid written documents (tax receipts, contracts etc.).

Once this preferential treatment for non-PRC employees on certain reasonable fringe benefits will no longer apply, the specific itemized deductions listed above under Chapter 3 "Deductions" will become applicable to non-PRC national tax residents in China. Case may however be that the Chinese government may come forward with additional incentives for non-PRC employees in China for IIT preferential treatment before 31 December 2023, so this would have to be monitored closely.

7. Anti-Avoidance Rules

China concluded anti-tax-avoidance agreements with over 100 countries and regions worldwide and implemented the Common Reporting Standards ("**CRS**"), bilateral Competent Authority Agreements and activated bilateral exchange relationships with close to 80 countries and regions (including e.g. Germany and most of the European countries). China will strengthen compliance and utilization of automatic exchange of financial account information under CRS to increase IIT collection.

Chinese tax authorities have the right to assess IIT on individuals who are involved in transactions such as asset transfers which are not at arm's length, tax avoidance by use of offshore tax havens or deriving inappropriate tax benefits through unreasonable commercial arrangements, etc. If IIT is assessed in reliance on the such measures, not only IIT, but also late payment surcharge are collected by the tax authorities. Late payment surcharge often outweighs the actual IIT amount.

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Contacts

Susanne Rademacher
Rechtsanwältin | Partner
ADVANT Beiten
Susanne.Rademacher@advant-beiten.com

Dr Jenna Wang-Metzner
Juristin | Partner
ADVANT Beiten
Jenna.Wang@advant-beiten.com

Kelly Tang
Juristin | LL.B. | LL.M.
ADVANT Beiten
Kelly.Tang@advant-beiten.com

ADVANT Beiten in Beijing
Suite 3130 | 31st Floor
South Office Tower
Beijing Kerry Centre
1 Guang Hua Road
Chao Yang District
100020 Beijing, China
T: +86 10 85298110
www.advant-beiten.com

Our offices

BEIJING
Suite 3130 | 31st floor
South Office Tower
Beijing Kerry Centre
1 Guang Hua Road
Chao Yang District
100020 Beijing, China
beijing@advant-beiten.com
T: +86 10 85298110

DUSSELDORF
Cecilienallee 7
40474 Dusseldorf
PO Box 30 02 64
40402 Dusseldorf
Germany
dusseldorf@advant-beiten.com
T: +49 211 518989-0

HAMBURG
Neuer Wall 72
20354 Hamburg
Germany
hamburg@advant-beiten.com
T: +49 40 688745-0

BERLIN
Luetzowplatz 10
10785 Berlin
Germany
berlin@advant-beiten.com
T: +49 30 26471-0

FRANKFURT
Mainzer Landstrasse 36
60325 Frankfurt/Main
Germany
frankfurt@advant-beiten.com
T: +49 69 756095-0

MOSCOW
Turchaninov Per. 6/2
119034 Moscow
Russia
moscow@advant-beiten.com
T: +7 495 2329635

BRUSSELS
Avenue Louise 489
1050 Brussels
Belgium
brussels@advant-beiten.com
T: +32 2 6390000

FREIBURG
Heinrich-von-Stephan-Strasse 25
79100 Freiburg im Breisgau
Germany
freiburg@advant-beiten.com
T: +49 761 150984-0

MUNICH
Ganghoferstrasse 33
80339 Munich
PO Box 20 03 35
80003 Munich
Germany
munich@advant-beiten.com
T: +49 89 35065-0

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EDITOR IN CHARGE:
Susanne Rademacher

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