Shanghai, September 3rd, 2018

The New Chinese Individual Income Tax Law

Dong (Stanley) Liu, Senior Consultant Tax & Legal

With the amendment draft to the law on individual income tax being approved by the Standing Committee of the People's Congress of the PRC on Aug 31th, the new individual income tax law was officially unveiled, after major repairs for 7 times. What are the benefits we can expect and what are the most important changes we must know?

1. **The definition of a "resident" might bring a huge influence to foreign individuals in China, and super national treatment for foreign individuals might be ended.**

As written in the new amendment draft to the **1st article** in the Chinese individual income tax law:

> "Any individual who has a domicile within the territory of China or who has no domicile but has stayed within the territory of China for 183 days or longer in a single tax year is considered as a resident individual and shall pay individual income tax for any income sourced within and outside the territory of China according to the provisions of this Law.
>
> Any individual who has no domicile and does not stay within the territory of China or who has no domicile but has stayed within the territory of China for less than 183 days is considered as a non-resident individual and shall pay individual income tax for any income sourced within the territory of China according to the provisions of this Law."

Actually in the current individual income tax law there is no clear concept as "resident".
Instead, the tax liability of an individual was determined by 2 criteria: **domicile** and **time stayed in China**. The amendment introduced the concept of **"resident" individual** and **"non-resident" individual** to the individual income tax law for the first time.

Additionally, it was stipulated in the amendment that an individual who **stayed in China for 183 days or longer** in a single tax year will be recognized as a resident.
This might have a huge impact on foreign individual tax payers in China, because as of now, foreigners who stayed in China for **less than 5 years** are in fact enjoying a **tax liability immunity for the income they generate outside of China**.

A departure from China once every 4 years - to evade the 5-years limitation - has become a popular tax planning method for foreign individuals, but this might be changed now. Under the new tax law, when a foreign individual stays in China for 183 days or longer in a single tax year, he/she will be recognized as a "resident" and **generate the tax liability** for the income he gets not only from China, but also his **income from all over the world**. Those changes will influence international companies' global dispatch arrangement policies and costs.

2. **With the consolidation of various income categories, the Chinese individual income tax system is historically reforming from a classified system to classify synthesize system.**

In the new Chinese tax law, “Wage and salary”, “labor remuneration”, “author remuneration” and “royalties” are consolidated referred to as “general income” for individuals. For individually-owned business, several income items are also consolidated referred to as “business income”.

Currently the income tax of individuals is calculated on a monthly basis. However, under the new tax law, individual income tax of the “general income” will be calculated by the tax year for resident individuals. (For non-resident individuals will still be on an item-by-item basis by month or by time).

These changes indicate that the Chinese individual income tax is historically reforming from a classified system to classify synthesize system. This reform will bring Chinese individual income system closer to the main stream of the world, and it can also build a foundation for a family declaration system in the future.

3. **The revision to the tax rate and deduction quota and new special extra deductions will bring benefits to widespread individual income tax payers.**

According to the new appendix 1 of the Chinese individual income tax law the **amended Individual Income Tax Rates** are:

Level	Annual Taxable Income	Tax Rate (%)
1	if not exceeding CNY36,000	3
2	for the part exceeding CNY36,000 but no more than CNY144,000	10
3	for the part exceeding CNY144,000 but no more than CNY300,000	20
4	for the part exceeding CNY300,000 but no more than CNY420,000	25
5	for the part exceeding CNY420,000 but no more than CNY660,000	30
6	for the part exceeding CNY660,000 but no more than CNY960,000	35
7	for the part exceeding CNY960,000	45

Comparing to the current tax rates, the annual taxable income range for tax rates below **25%** are expanded. Also, the **annual deduction quota** will be increased from CNY42,000 to CNY60,000. (The implementation of new annual deduction quota and tax rates will start from Oct, 2018)

Except for the special deduction items which cover social insurances and etc., **special extra deductions** items are introduced for the first time. Special extra deductions include expenses for **children's education, continuing education, medical expenses for serious diseases, interest of mortgages, house rents, expenses for supporting the elderly** etc.

These new changes will bring benefits to widespread individual income tax payers especially in the middle-income group and individuals with children to educate or elderly to support.

---

4. General Anti Avoidance Rules (GAAR) for individual income tax will be officially built.

The new **paragraph 8** of the Chinese individual income tax law stipulates that under any of the following circumstances, the tax authorities have the right to make tax adjustments based on reasonable methods:

> "(1) Business between an individual and his or her affiliated parties is not carried out under the arm's length principle, without any justifiable causes;
>
> (2) An enterprise established in a country (region) where the actual tax is obviously lower, which is controlled by a resident individual or jointly controlled by a resident individual and a resident enterprise, does not distribute profits that belong to such resident individual or distributes such profits in a smaller amount, without reasonable business needs;
>
> (3) An individual makes other arrangements, without justifiable business purposes, to seek unjustified tax benefits."

The introduction of General Anti Avoidance Rules in the new tax law implies that the **Chinese tax authority will step by step build an anti-tax avoidance system** for individual income tax. With the implementation of tax information exchange with financial bank accounts in the future, the Chinese tax authority will have **stronger control over tax avoidance behaviors** in terms of individual income tax. Although it takes time for the system to build up and more detailed regulations to be introduced, people should have the consciousness to examine their tax compliance at an early stage.

The new individual income tax law will be implemented on Jan 1st, 2019. The amendment to the tax law is just the beginning of a tax reform and a lot of detailed articles and regulations are waiting to be introduced. We will continue to pay attention to the implementation and further development in the Chinese individual income tax law and inform you accordingly.

If you have any questions, please contact or offices in Shanghai, Moscow and Waldshut at info@artax-rufil.cn

Dong (Stanley) Liu,

Senior Consultant for Tax & Legal,

Artax Rufil Consulting, Shanghai