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China Published New Individual Income Tax Law

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I. Introduction

On 31 August 2018, the new Individual Income Tax Law of the People`s Republic of China ("New IIT Law") was released and will come into effect on 1 January 2019. The newly drafted Implementation Regulations for the Individual Income Tax Law of the People's Republic of China (hereinafter referred to as "New Implementing Regulations"), were released on 20 October 2018 and are now open to the public for comments. The public can make comments until 4 November 2018. Compared to the current Individual Income Tax Law of the People`s Republic of China ("Old IIT Law") released on 30 June 2011 and in force since 1 September 2011, the New IIT Law will reform the individual income tax collection system in the People`s Republic of China ("PRC" or "China"), for instance, as it now explicitly defines the concept of resident and non-resident taxpayer, changes the tax threshold and tax rates, deletes the deduction preferential regulations on foreigners and includes anti-avoidance rules.

II. Significant Changes

The significant changes in the New IIT Law in comparison to the Old IIT Law are as follows:

1 Introduction of the Concept of Resident and Non-Resident Taxpayer

(1) Current Situation

(a) Worldwide income

Pursuant to Art. 1 para. 1 Old IIT Law, individuals who have a domicile in China shall be taxed on their worldwide income.

According to Art. 1 para. 1 Old IIT Law and Art. 6 of its corresponding Implementation Regulations for the Individual Income Tax Law of the People`s Republic of China ("Old Implementing Regulations") released on 19 July 2011 and in force since 1 September 2011, an individual who does not have a domicile in China will become taxable on worldwide income only when he/she has stayed in China for more than five years. Temporary trips out of China each year are not deducted, namely stays of up to 30 days single trip or stays of up to 90 days cumulatively over multiple trips each year will not affect the application of such rule.

(b) Income derived within and outside China

According to Art. 4 Old Implementing Regulations, income derived within China shall mean income sourced from China; income derived outside China shall mean income sourced outside China.

An individual who has no domicile in China, but has stayed in China for one to five years shall pay individual income tax ("IIT") on the part of his/her income which is sourced outside China and paid in China (see Art. 6 Old Implementing Regulations"). In addition, the individual`s income sourced from China will also be taxed.

This means that if a Swiss individual receives one part of his/her income from the Swiss mother company`s branch in China (income within China) and another part of income from the Swiss mother company directly (income outside China by working in China), the first part is taxed in China since it is paid for working in China by a Chinese company and the second part can be exempted in China upon approval of the Chinese tax authority.

(c) Only income derived within China

Income derived within China will be all the time subject to IIT in China.

However, when an individual who has no domicile in China but has stayed in China for not more than 90 days consecutively or cumulatively in a tax year, his/her income sourced in China and paid by an overseas employer shall be exempted from IIT in the PRC (Art. 7 Old Implementing Regulations).

(2) New IIT Law

The New IIT Law introduces a new criterion of "183-days" to determine whether the individual shall be regarded as a resident in the PRC or not. Art. 1 of the New IIT Law stipulates: "Individuals who have a domicile in China, or individuals who do not have a domicile in China but have stayed in China for 183 days or more cumulatively within a tax year, shall be deemed as resident individuals." As already mentioned in the Old Implementing Regulations, having domicile in China means habitually residing in China due to household registration, family or economic interests (see Art. 2 New Implementing Regulations).

(3) How Will the New IIT Law Impact Foreigners

This is the first time for the Chinese legislator to expressly define the concept of resident and non-resident, which determines a resident or a non-resident by

whether he/she has stayed in China for a period of 183 days or more cumulatively within a tax year.
However, the New Implementing Regulations include in its article 4 a corresponding time span as the five-years-rule in Art. 6 Old Implementing Regulations, in which the taxpayer has to pay tax on income first within China and second sourced outside China and paid in China. The main difference is that the starting point for this time span is from 183 days having stayed in China rather than from one year having stayed in China within a tax year. Thus, the time span of five years to be the starting point for the worldwide income of a foreigner being taxed in China remains the same. Another difference is that the New Implementing Regulations do not mention anymore that multiple temporary trips outside of China of not more than 90 days cumulatively are not to be deducted from the time of stay in China, as stipulated in Art. 3.2 Old Implementing Regulations. However, the 30-days-rule for single trips outside of China remains the same (see Art. 4 New Implementing Regulations). In conclusion, now pursuant to Art. 4 New Implementing Regulations individuals who have stayed in China for a total of 183 days per year (and therefore are resident taxpayers) in a row for five consecutive years, and individuals who have stayed in China for five years in full without a single departure for more than 30 days, if have stayed in China for a total of 183 days in the 6th year, shall pay IIT on worldwide income.
Furthermore, a non-resident taxpayer who does not have a domicile in China and who has stayed in China for less than 183 days cumulatively in a tax year shall only pay IIT on income derived within China.

The New Implementing Regulations in its article 5 also include the same exception as in Art. 7 Old Implementing Regulations for foreigners having stayed in China for not more than 90 days in total in a tax year.

The new regulation of “183 days” will mainly influence expatriate workers who receive their income from abroad and also within China. Swiss employees working in China or receiving income from China will still be exempted from double taxation according to the *Agreement between the Government of the People`s Republic of China and the Swiss Federal Council for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital* (“Bilateral Tax

Treaty") in force since 27 September, 1991 and its amended version in force since November 15, 2014.

Foreign employees in China cannot avoid paying taxes in China based on the Bilateral Tax Treaty. Pursuant to Article 4, Article 15 and Article 24 paragraph 1 Item a Bilateral Tax Treaty, "［w］here a resident of China derives income from Switzerland, the amount of tax on that income payable in Switzerland, in accordance with the provisions of this Agreement, may be credited against the Chinese tax imposed on that resident." However, a foreigner, who receives his/her income partly from abroad and partly in China, shall only pay taxes in China, as "［s］alaries, wages and similar remuneration received by a resident of a Contracting State from employment shall be taxable only in that State" (see Art. 15 para. 1 Bilateral Tax Treaty). This means that the foreigner only pays taxes in the State where he/she is resident. The term "resident" means "any person who, under the laws of that Contracting State, is liable to tax therein by reason of his domicile, residence, place of head office (place of effective management) or any other criterion of a similar nature" (see Art. 4 Bilateral Tax Treaty). Thus, foreigners, who have been residing in China for at least 183 days and therefore have to pay taxes in China, are regarded as "resident" according to PRC Law or rather the New IIT Law. If the Swiss employee is also regarded as resident in Switzerland according to Swiss law, he/she shall be deemed to be a resident of the Contracting State in which he has a habitual abode (see Art. 4 para. 2 lit. b Bilateral Tax Treaty). "Habitual abode" means the place in which he/she lives for a long period of time, even if this period is limited in advance (see Art. 20 para. 1 lit. b Swiss Private International Law Act). In conclusion, foreigners who have been residing in China for at least 183 days are considered as resident in China and therefore need to pay taxes according to New IIT Law even though they might only stay for a limited period of time.

2 Amendment of Tax Threshold and Tax Rates

(1) Current Situation

According to Old IIT Law Article 2 and 3, taxable incomes are classified into five tax rate categories:

(1) Income from wages and salaries;

(2) Income from production and business operations of individual industrial and commercial households and income from contracted and leasing operations of enterprises and institutions;

(3) Income from author's remuneration;

(4) Income from remuneration for personal services; and

(5) Income from royalties, income from interest, dividends and bonuses, income from lease of property, income from transfer of property, contingent income and other income.

The various categories are taxed separately according to different tax rates. Salaries and wages were previously subject to progressive tax rates ranging from 3% to 45%, with seven different tax grades. The tax threshold was RMB 3`500 per month (see Article 6(1) Old IIT Law).

(2) New IIT Law

In the New IIT Law, taxable incomes are classified into three tax rate categories:

(1) Consolidated income, which includes wages and salaries, income from remuneration for personal services, authors' remuneration, and incomes from royalties;

(2) Income from business operation; and

(3) Income from interest, dividends and bonuses, income from lease of property, income from transfer of property and contingent income.

The tax threshold is RMB 60`000 per year for resident taxpayers and RMB 5`000 per month for non-resident taxpayers (see Article 6(1) New IIT Law).

Please find the comparison of tax categories in the below chart:

Current IIT Law		New IIT Law	
Categories	**Tax Rates**	**Categories**	**Tax Rates**
Wages and Salaries	3%-45% (7 grades progressive tax rates)	Wages and Salaries	3%-45% (7 grades progressive tax rates)
Production and Business Operations ; Contracted and Leasing Operations	5%-35% (5 grades progressive tax rates)	Business Operation	5%-35% (5 grades progressive tax rates)
Authors' Remuneration	20% and a 30% tax deduction shall be	Author's Remuneration	20%

	applied to the amount of tax payable.		
Remuneration for Personal Services	20%. However, If a single payment of remuneration for labor service is excessively high, an additional proportion of tax may be levied thereon.	Remuneration for Personal Services	20%
Royalties, Interest, Dividends, Bonuses, Lease/Transfer of Property, Contingent Income and Other	20%	Royalties, Interest, Dividends, Bonuses, Lease/Transfer of Property, Contingent Income	20%

Below please find the comparison of the detailed tax rates:

Old IIT Law			New IIT Law	
Grade	**Annual (Monthly) Taxable Amount (RMB)**	**Rate**	**Annual (Monthly) Taxable Amount (RMB)**	**Rate**
1	No more than 18`000 (1`500)	3%	No more than 36`000 (3`000)	3%
2	18`000-54`000 (1`500-4`500)	10%	36`000-144`000 (3`000-12`000)	10%
3	54`000-108`000 (4`500-9`000)	20%	144`000-300`000 (12`000-25`000)	20%
4	108`000-420`000 (9`000-35`000)	25%	300`000-420`000 (25`000-35`000)	25%
5	420`000-660`000 (35`000-55`000)	30%	420`000-660`000 (35`000-55`000)	30%
6	660`000-960`000 (55`000-80`000)	35%	660`000-960`000 (55`000-80`000)	35%
7	More than 960`000(80`000)	45%	More than 960´000(80`000)	45%

(3) Will the New Tax Rates Reduce or Raise the Tax?

Compared to the New IIT Law, the tax rates remain seven grades and they will be applied to calculate the tax on consolidated income. Middle-/low-wage earners

seem to benefit from lower taxes according to the New IIT Law. For taxpayers with annual taxable amounts between RMB 18`000 and RMB 36`000, they will pay only 3% tax instead of 10%; taxpayers with annual taxable amounts between RMB 54`000 and RMB 108`000 will pay 10% instead of 20%; taxpayers with annual taxable amounts between RMB 108`000 to RMB 300`000 will pay 20% instead of 25%; taxpayers with annual taxable amounts more than RMB 300`000 or less than 18`000, the tax rates for them stay the same.

Although the New IIT Law will only be effective upon 1 January 2019, the abovementioned tax rates are already applicable now since 1 October 2018 according to the Notice on Applicable Expense Deductions and Rates for Individual Income Tax in the Fourth Quarter of 2018.

3 Tax Preferential

(1) Current Situation

The Old IIT Law provides a deduction for foreign employees. According to Old IIT Law Article 6.3 and Old Implementing Regulations Article 26 to 28, the foreign taxpayers who do not have a domicile in China but receive income from China or taxpayers who have a domicile in China but receive income outside China, may enjoy additional deduction of expenses on the basis of his/her average income level, living standard and fluctuations in exchange rates. According to Old Implementing Regulations Article 28, such additional deduction will be applied to:

(1) Foreign personnel working for foreign investment enterprises and foreign enterprises in China;

(2) Foreign experts employed by enterprises, institutions, social groups and State organs to work in China;

(3) Individuals who have a domicile in China and derive income from wages and salaries in relation to tenure of office or employment outside China; and

(4) Other personnel determined by the finance department and tax department of the State Council.

Pursuant to Old Implementing Regulations Article 29, the deduction shall be RMB 1`300 per month in addition to the monthly deduction of RMB 3`500 based on Article 6(1) Old Implementing Regulations.

(2) New IIT Law

The New IIT Law does not include the above deduction. However, new "special additional deductions" are stipulated by the New ITT Law Article 6.4 for resident taxpayers, which includes but not limited to contributions to the basic pension insurance, basic medical insurance, unemployment insurance and other social security premiums, as well as housing provident fund, expenses towards children education, continuing education, major illness medical treatment, housing loan interest or housing rent, support for elderly etc.

(3) Consequence

As the deduction rules for certain individuals are deleted, certain foreign individuals as included in the Old Implementing Regulations Article 28 cannot enjoy "super preferential tax policies" any more. However, they may benefit from other tax deductions stipulated in the New IIT Law, especially from the "special additional deductions" as stipulated in Art. 6.4 New IIT Law.

4 Anti-Avoidance Measure

(1) Tax Number

The New IIT Law includes a new tax declaration obligation. The key point is "one taxpayer, one tax ID number". Stipulated by Article 9 of the New IIT Law, the ID card number will be the tax Identity Number for Chinese citizens, and an Identification Number will be given by the tax authority to other taxpayers. Such measure provides a better control over the tax collection.

(2) Tax Adjustment

New IIT Law Article 8 introduces new tax payment adjustments to the current rules, which allows the Chinese tax authorities to initiate and collect underpaid tax together interest according to the law in the following situations:

(1) When transactions between an individual and his or her related parties do not comply with the independent transaction principle;

(2) 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

(3) When an individual obtains inappropriate tax benefits through an

arrangement that lacks a reasonable business purpose.

The tax adjustment rule used to be an anti-avoidance measure for enterprise income tax law. Now, the New IIT Law adopts it to have more control over the individual income tax collection, which means China's tax authorities are becoming stricter.

(3) How Can Chinese Authorities Find out Foreigners' Income outside of China?

Besides several bilateral co-operations to release the conflicts between States on taxation, there are stringent treaties to coordinate the global cooperation to avoid tax evasion.

The Common Reporting Standard ("CRS") developed by the Organization for Economic Co-operation and Development ("OECD") in 2014, is currently the most famous information standard for the automatic exchange of information regarding bank accounts on a global level between tax authorities. Both Switzerland and China have rectified the CRS. Furthermore, the tax authorities of Switzerland and China started to launch due diligence to collect information on the financial accounts held by the tax residents on their own territories from 1 January 2018 and will start the information exchange concerning such due diligence from 1 January 2019.

Besides, in 2013 China and Switzerland both signed the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*, which provides methods in mutual assistance, such as exchange on request, spontaneous abroad tax examinations, simultaneous tax examinations and assistance in tax collection.

III. Conclusion

Undoubtedly, the New IIT Law will have significant impact on the tax collection system in China. Foreign individuals, who work in China, should pay special attention to the new taxation rules since the new 183-day rule changed the previous 1-year rule and makes foreign individuals resident taxpayers in China. However, the 5-years-rule as starting point for being taxed on worldwide income in China remains the same. Although the New Implementing Regulations have only been released for public opinion, which means the draft version is still not final and subject to change, there is a very small probability for additional change, as such exposure drafts are usually not changed after public opinions have been gathered.

Thus, foreigners who have been residing and working in China for a long time can breathe a sigh of relief. The income tax rates for middle-/low-income groups are already lowered now since 1 October 2018. China’s tax authorities will take more control over the individual income tax collection which will be especially important to control their income derived within China from abroad and in order to examine their worldwide income.

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