



THE POWER
OF BEING
UNDERSTOOD

RSM Tax Advisory (Hong Kong) Limited 羅申美稅務諮詢有限公司

Welcome to Tax Flash – RSM Tax Advisory (Hong Kong) Limited’s Newsletter Covering Technical Development in Taxation

CHINA’S AMENDED IIT LAW – PLANNING AHEAD FOR IMPLEMENTATION FROM 1 JANUARY 2019

On 20 October 2018, the following two important draft documents have been posted jointly by Ministry of Finance (“MOF”) and State Administration for Taxation (“SAT”) for public consultation before 4 November this year:

- Implementation Regulations of the Individual Income Tax Law (“IIT Law”) of the People’s Republic of China (中华人民共和国个人所得税法实施条例; the “Implementation Regulations”) and
- Interim Measures for the Supplementary Specific Deductions (“SSD”) for the Individual Income Tax (个人所得税专项附加扣除暂行办法; the “Interim Measures”).

These documents will be finalized soon after the consultation period for announcement to facilitate the new changes effective 1 January 2019.

This newsletter highlights some salient points for your proactive preparation for the changes:

- ✓ *New “5-year rule” to defer worldwide income taxation on Resident by Stay*
- ✓ *Donation of property may become taxable deemed transfer*
- ✓ *Anti-avoidance provisions to combat tax-driven transactions involving individuals and their related individuals and entities*
- ✓ *Restricted use of short-cut taxation methods on “conduit entities” of individuals*
- ✓ *Entity that has income information and control over the process of obtaining the income may become tax withholding agent*
- ✓ *Compulsory tax filing and clearance requirements before emigration*
- ✓ *SSD supporting information to be provided by third parties*
- ✓ *Statutory obligations on employers for SSD and related risks*
- ✓ *Foreigners may not be eligible for SSD unless they become tax residents.*

The Implementation Regulations

(1) New “5-year rule” concession

Having considered public consultation comments on amendment of the IIT Law, a modified “5-year rule” concession on taxation of overseas income of Resident by Stay (please refer to Note (2) of Appendix 1) is stipulated in the draft Implementation Regulations. It is anticipated the new “5-year rule” may be counted from 1 January 2019.

Please refer to our summary matrix in Appendix 1 for the proposed taxability on employment income derived by foreigners (including Hong Kong, Macau and Taiwan residents).

Record-filing requirements are introduced but the details of information and procedures are yet to be announced. Some foreigners may have practical difficulties and privacy concerns in furnishing overseas income information to tax authorities in China when the income is not taxable. Some expect that the tax authorities in China should have obtained the information through the Automatic Exchange of Financial Account Information in Tax Matters (“AEOI”) system first on those suspected IIT under-reporting cases instead of imposing responsibilities on all Residents by Stay and local tax bureaus to spend effort and resources to handle the on-going record-filings.

Nevertheless, failure in complying with the record-filing requirements may jeopardize the use of the “5-year rule” concessionary tax treatments.

(2) Deemed taxable transfer of assets

It is interesting to note that current draft Article 16 tries to deem and tax donation of property by an individual as “transfer of property”. There has been no deeming provision in IIT Law. For genuine donation, there is no consideration or income derived by the donor so it seems strange if cash donation is not a taxable event whilst donation in-kind is taxable.

If the donor cannot claim in-kind donation as tax deduction in IIT computation and the donation of property is deemed as a taxable transaction, it will be very unfair to the donor. The unexpected tax cost may be a hurdle for genuine donation of property (e.g. donation of R&D facilities, dormitories, computer servers and other goods and assets to schools or hospitals) by resident or non-resident individuals.

The development of this deemed taxable treatment may have significant impact to trust and wealth planning arrangements.

(3) Anti-avoidance provisions

Drawing on the experience of Enterprise Income Tax Law, the Implementation Regulations refine some anti-tax avoidance provisions and clarify the relevant concepts and criteria.

The meanings and standards of related parties, related relations, principle of independent transactions, controlled foreign enterprises, apparently low actual tax burden and reasonable commercial purposes are clarified in Articles 25 to 27.

The calculation of tax adjustment interest is stated in Article 28.

MOF and SAT are empowered to formulate the specific methods for tax adjustments.

In group restructuring of companies owned by founders and individuals for business expansion, pre-IPO, corporate succession and other commercial or family reasons, these new requirements should be considered to avoid tax surprises.

(4) Restricted use of short-cut taxing methods

To prevent individuals from using their “conduit entities” for tax avoidance purposes, local tax bureaus will no longer be allowed to use “fixed amount method”, “deemed profit method”, etc. for IIT reporting purpose in respect of individual businesses, sole-proprietor enterprises and partnerships with annual income exceeding certain threshold amounts to be stipulated by SAT.

Future profitability of the businesses may be affected, and prior years’ tax liabilities may be clawed back. Special consideration should be exercised in the valuation of the relevant entities for investment or acquisition discussions.

(5) More tax withholding agents (“TWA”)

TWA can be more than employers and payors of taxable income. SAT may designate an entity that possesses income information and control over the process of obtaining the income as TWA, and the statutory obligations of TWA will apply.

It is anticipated that SAT’s above power may be exercised in exceptional cases when both the primary TWA (i.e. payor of the taxable income) and the taxpayer have failed to cooperate in IIT filing or payment.

Financial institutions, business intermediaries and agents with general authorities, e-commerce/payment platform operators, etc. may wish to follow through the above development.

In Article 39, taxpayers (who need to do annual tax reconciliation and settlement on Comprehensive Income (please refer to Appendix 2)) may entrust TWA or other entities/individuals to handle the annual tax reconciliation and settlement. The role, required qualifications, legal responsibilities and protection on those “other entities/individuals” under the IIT Law or Tax Collection and Administration Law should be clarified.

(6) Tax clearance before emigration

Article 34 elaborates on the compulsory tax clearance filing information when a resident individual de-registers household registration in China for emigration abroad purpose, which includes:

- information about tax settlement of Comprehensive Income and business income for the year when the household registration is de-registered;
- information about tax settlement of other income for the above year;
- information about outstanding tax liabilities (if any) relating to prior years.

Stating these requirements explicitly in the IIT Law and the Implementation Regulations will improve voluntary filing and strengthen the statutory back up to handle non-compliance cases from next year.

(7) SSD information provided by third parties

Further to Article 15 of IIT Law, Article 44 of the Implementation Regulations elaborates that the entities and individuals

are obliged to provide or assist the tax authorities to verify the SSD of taxpayers include:

- relevant departments/offices of State Council's various Departments in charge of public security, banking, financial supervision and management, education, health, civil affairs, human resources and social security, housing and urban construction, natural resources, medical security, etc.
- other units and individuals related to the SSD information. This seems to be very broad and may include schools, medical organizations, professional organizations providing continuing professional development sessions, financial institutions, landlords, etc. These may increase the compliance costs and legal risks of these third parties, and the additional operating costs may be pushed down to taxpayers or others.

The Interim Measures

(1) Employer's obligations and risks

Over the past decades, employers have calculated and filed IIT withholding returns on their foreign employees and mainland Chinese employees slightly differently.

With the significant changes to the IIT Law, there will be more differences and the on-going tax filing work will become heavier and require closer attention, especially the tax computations and filings on residents who may now claim tax deductions on various allowable expenses.

Appendix 2 of the IIT Law highlights the different IIT filings by employers in respect

of resident employees and non-resident employees.

Article 11 of IIT Law requires that where a resident individual provides SSD information to TWA, the TWA shall deduct the SSD in the monthly withholding tax filings and payments, and the TWA cannot refuse to do so.

No doubt the SSD claims will increase the administration work and costs to employers. The IIT Law continues to provide that TWA will be paid a handling fee and the amount is still kept at 2% of the IIT withheld and paid.

(2) Foreigners' eligibility for SSD

Article 28 of the Interim Measures mentions that foreigners may be eligible for SSD claims on expenses of children's education, continuing education, home mortgage interest or housing rent. However, the eligible foreigners may be confined to those who have become tax residents (Resident by Domicile or Resident by Stay) in China.

Under the current IIT rules, tax-exempt employment fringe benefits of foreigners include qualified children's education fee, language training fee and housing rent subsidy. Going forward, eligible foreigners can elect either tax-exempt employment income on these items or SSD claims on them. If SSD claim is elected, the corresponding employment fringe benefits will become fully taxable.

Due to the relatively low annual/monthly deduction limits for SSD and the additional reporting procedures, it seems that foreigners may still elect for the non-



taxable income treatment. The election may complicate the employer's tax equalization computations for expatriate employees.

Send in your Questions and Suggestions

- Please consider submitting your comments and suggestions on the consultation drafts before 4 November 2018:
http://www.gov.cn/hudong/2018-10/20/content_5332913.htm
http://www.gov.cn/hudong/2018-10/20/content_5332914.htm .
- If you have any questions on the above or if you wish to prepare for the above significant changes, please consult your professional China tax advisor.

High-level Illustration of Possible China IIT Implications on Employment Income of Foreigners (including Hong Kong, Macau and Taiwan Residents)

(Subject to the finalized Implementation Regulations)

Tax residency of foreigners	Source of employment income			
	Services rendered in China		Services rendered outside China	
Non-resident staying in China for less than 183 days in aggregate in a calendar year	Remuneration is paid or borne in China	Remuneration is paid and borne by non-resident employer	Remuneration is paid or borne in China	Remuneration is paid and borne by non-resident employer
	<i>For no more than 90 days or longer period if relevant DTA applies</i>	Taxable	Exempt	Not taxable
Resident due to staying in China for 183 days in aggregate or more in a calendar year (“Resident by Stay”)				
<i>Less than 5 consecutive years</i>	Taxable			Possibly not be taxed provided that record-filing requirements have been fulfilled
<i>For 5 years but with a single departure from China for more than 30 days during the period</i>				
<i>For 5 years and without any single departure from China for more than 30 days during the period</i>				Taxing from the 6 th year (with stay(s) for 183 days or more in China in the year)
Resident due to domicile in China (“Resident by Domicile”)	Taxable			

Notes:

- (1) In line with the international practice, the amended IIT Law defines “residents” and “non-residents” for tax purpose. In principle, residents are taxed on their worldwide income and non-residents are usually taxed on their China-sourced income.
- (2) For tax residents, there are two categories:
 - an individual who have domicile in China (“Resident by Domicile”);
 - an individual who does not have domicile in China but has stayed in China for 183 days in total in a tax year (“Resident by Stay”). Prior to the IIT Law amendments this time, it was “one full year” and the time threshold has been shortened after the change.Domicile refers to habitual residence in China on account of domiciliary registration (“household registration”), family ties or economic interests.
- (3) If an individual is a tax resident of more than one jurisdiction, the residency status shall be determined in accordance with the relevant Agreement/Arrangement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (“DTA”).
- (4) Please note that in some DTAs, the requirement may be “not exceeding in the aggregate 183 days within any twelve-month period” instead of “not exceeding in the aggregate 183 days in a calendar year”.
- (5) According to Article 2 of IIT Law, taxable income includes income from employment, labour services, article publication, royalties, business operations, interests, dividends, profit sharing, property leasing, property transfer and occasional income. Income from employment, labour services, article publication and royalties are collectively categorized as Comprehensive Income for IIT purpose.
- (6) Senior management employees of companies and Chief Representatives of representative offices of overseas companies may be subject to additional rules on taxation of overseas employment income.

IIT Computations by Employers in the Amended IIT Law

(Subject to the finalized Implementation Regulation)

Resident individuals

- Employment income, labour service income, article publication income and royalty income are taxed together as Comprehensive Income on the same tax filing.
- Final amount of IIT on Comprehensive Income is computed on an annual basis. Monthly estimated payments are withheld and pre-paid by TWA. Annual tax filing is required for tax reconciliation and settlement during March to June of the year following the relevant tax year.
- Pursuant to Article 6(1) of IIT Law, taxable income from Comprehensive Income is calculated as follows:

Comprehensive Income

- Employment income
- Labour service income
- Article publication income
- Royalty income

Less: Basic Deduction

- RMB60,000 per taxpayer per annum (RMB5,000 per month)

Less: Specific Deductions

- Contributions to (1) basic endowment insurance, (2) basic medical insurance, (3) unemployment insurance and (4) housing fund paid by individuals in accordance with the scope and standards stipulated by the central government

Less: Supplementary Specific Deductions

- SSDs include expenditure on (1) children's education, (2) continuing education, (3) medical care for serious illness, (4) home mortgage interest (5) housing rent and (6) support for designated elderly family members

Less: Other Approved Deductions stipulated in relevant national laws

- Including (1) Commercial health insurance, (2) personal tax deferred commercial endowment insurance, (3) enterprise annuity and (4) occupational annuity.

Taxable income

- Special Deductions, Special Deductions and Other Approved Deductions are limited to the amount of taxable income for the relevant tax year, and the unrelieved amounts cannot be carried forward to the following tax year.

Non-residents individuals

- Comprehensive Income arrangements do not apply such that IIT on employment income and other categories of income continues to be calculated and filed separately.
- Monthly tax filings and payments should be done by TWA or taxpayers.
- In general, employment income of non-resident employees is still calculated as follows:

Employment income

- Excluding tax-exempt fringe benefits (e.g. qualified children's education fee, language training fee, housing rent subsidy, home leave expense reimbursement)

Less: Basic deduction

- RMB5,000 per month (increased from RMB4,800)

Taxable income

- Neither Article 6 of IIT Law nor the Implementation Rules have mentioned tax deduction treatments in case non-resident employees are required to pay social security contributions in China.

RSM Tax Advisory (Hong Kong) Limited

RSM Hong Kong's dedicated and experienced tax specialists can:

- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

The aim of Tax Flash is to alert readers to recent developments. The information is general in nature and it is not to be taken as a substitute for specific advice. Accordingly RSM Hong Kong accepts no responsibility for any loss that occurs to any party who acts on information contained herein without further consultation with us. If you have any comments or require further information please contact:

Mr. Dicky To
T +852 2508 2863
E dickyto@rsmhk.com

Mr. Eric Chen
T +852 2583 1259
E ericchen@rsmhk.com

Ms. Lilian Poon
T +852 2583 1241
E lilianpoon@rsmhk.com

Mr. Samuel Chan
T +852 2583 1242
E samuelchan@rsmhk.com

Mr. Patrick Ho
T +852 2583 1258
E patrickho@rsmhk.com

Mr. Caesar Wong
T +852 2508 2851
E caesarwong@rsmhk.com

Ms. Catherine Tsang
T +852 2583 1256
E catherinetsang@rsmhk.com

Mr. Chan Ka Ho
T +852 2583 1249
E khchan@rsmhk.com

Ms. Joanna Lee
T +852 2583 1317
E joannalee@rsmhk.com

RSM Tax Advisory (Hong Kong) Limited

29th Floor, Lee Garden Two
28 Yun Ping Road
Causeway Bay, Hong Kong

T +852 2598 5123
F +852 2598 7230
E tax@rsmhk.com

www.rsmhk.com

RSM Tax Advisory (Hong Kong) Limited is a member of the RSM network and trades as RSM. RSM is the trading name used by the members of the RSM network.

Each member of the RSM network is an independent accounting and consulting firm, each of which practices in its own right. The RSM network is not itself a separate legal entity of any description in any jurisdiction.

The RSM network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 50 Cannon Street, London EC4N 6JJ.

The brand and trademark RSM and other intellectual property rights used by members of the network are owned by RSM International Association, an association governed by article 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

© RSM International Association, 2018