



Differences between the new and old Individual Income Tax Law

Source: JFU

9 November 2018

The new Individual Income Tax Law (IITL) was enacted on 31 August 2018 (“IITL 2018”) to replace the old law (“IITL 2011”). This note highlights the major changes.

- 1. Determination of tax residence.** A Chinese tax resident is subject to tax on worldwide income; whereas a non-resident of China, is taxed only on income sourced in China. IITL 2018 stipulates that any person having a home in China or without a home but residing in China for 183 days or more in a year, is a Chinese tax resident for that year. Under the old IITL 2011, a person without a home in China is regarded as a Chinese tax resident only if that person resides in China for one year or more. This change is to align China’s IITL with international practice in determining who is a tax resident.
- 2. Adoption of a balanced comprehensive and schedular personal income tax system.** Income requiring the exertion of personal effort including wage and salary, service fee, writer’s fee, and royalty are combined in determining an individual’s income tax on his annual comprehensive income. The schedular system applies to business profits and “unearned” investment income including interest, dividend, profit sharing, rental, capital gain and incidental windfall. Comprehensive income is subject to tax at progressive rates between 3% and 45%; business profits, between 5% and 35%, and unearned income all at a flat rate of 20%. This change of income classification and rates structure is more rational in that it helps income redistribution, yet preserves incentive for building personal savings, and hence improves capital formation for society.
- 3. Adoption of a comprehensive system of personal allowances.** The standard monthly deduction of RMB 3,500 (local) / 4,800 (expatriate) that only applies to wage and salary under the old IITL has been replaced by a unified comprehensive system of personal allowances including a standard allowance of RMB 60,000/year or RMB 5,000/month and additional allowances to address an individual’s personal circumstances including child education, self-continuing education, medical cost of illness, mortgage interest or rental cost, and elderly relatives. This change brings about a more humanistic and socialistic approach to income redistribution.

4. **Adoption of the anti-avoidance principles.** The application of an arm's length principle and business rationale test, already adopted under the corporate income tax law, is now extended to IITL. This change provides the tax administration with technical definitions to apply toward tax avoidance behavior, and supports formulation of appropriate tax adjustments. IIT has been an area strewn with arbitrary practices. This policy change, together with the publicity of a few high-profile evasion cases involving top celebrities, signifies the administration's determination to bring this area of tax practice to order.

5. **Tax administration.** The TIN (tax identification number) is now based on the PRC identity card number. PAYE (pay as you earn) applies, although comprehensive income is filed and assessed annually. Withholding agents, typically employers, have to file the payment by the 15th of the following month. Additional allowances apply in determining a PAYE payment, provided that details are provided to the withholding agent. This change has the potential of improving the compliance rate of taxpayers and increasing government tax revenue.