



China Tax Newsletter (2020 June)

New IIT Regime: First Annual Individual Income Tax Filing on Comprehensive Income

The new Individual Income Tax ("IIT") regime officially came into effect starting from 1st January 2019. Under the new IIT regime and its Implementation Regulations, a taxpayer is subject to IIT annual filing if certain criteria are met, and taxpayers have been looking forward to the practical guidelines and the first annual IIT filing.

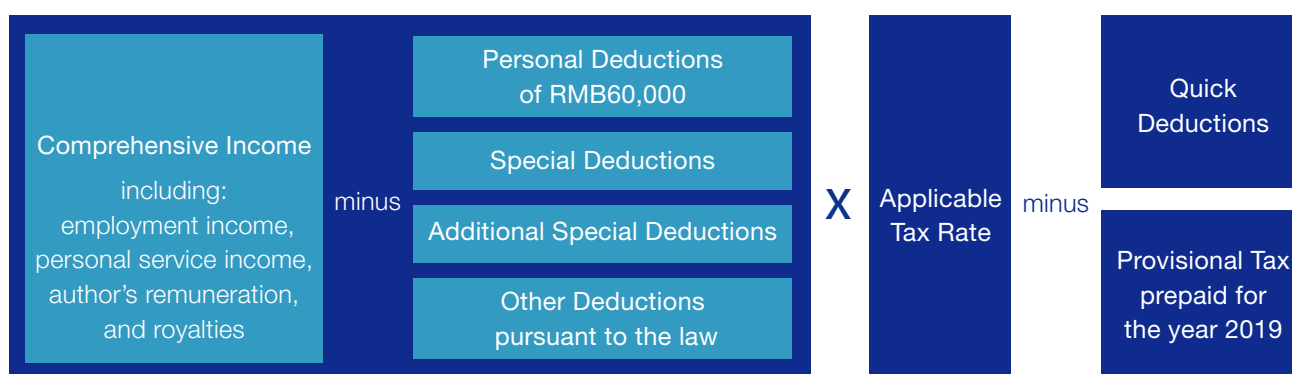
On 31st December 2019, the State Administration of Taxation issued the "Announcement on IIT annual filing policies for the year 2019 regarding comprehensive income" in order to provide implementation guidelines and policies for taxpayers in respect of their first IIT annual filing.

As the deadline for IIT annual filing on **comprehensive income** for the year ended 31st December 2019 is approaching (i.e. 30th June 2020), we wish to remind you the deadline and also summarize the key points regarding the IIT annual filing on comprehensive income as below:-

What is IIT annual filing for comprehensive income?

Comprehensive income refers to the four types of income earned by a Chinese resident taxpayer within a tax year, which includes **employment income, personal service income, author’s remuneration, and royalties**. Taxable comprehensive income is calculated by subtracting allowable expenses and deductions from the annual comprehensive income. The annual comprehensive income tax rate table will then be applied to the taxable comprehensive income to calculate the total IIT payable for the relevant year. The difference between the total IIT payable for the relevant year and the IIT prepaid previously during the year is the amount of additional tax or refundable tax to be reported to the Chinese tax authority.

For IIT annual filing for comprehensive income for the year 2019, the estimated additional tax payable/ tax refund could be calculated based on the following formula:-



Please note that the following items are not included in the comprehensive income:-

- Interest, dividend, property leasing, property transfer and contingent income, etc.;
- Annual one-off bonus, one-off compensation for employment termination or retirement, income from exercising equity incentives of listed companies, corporate annuity, occupational annuity, etc.

Why IIT annual filing is required?

Under the new IIT regime, for the four types of comprehensive income, the withholding mechanism on monthly basis/ for each payment is retained. However, the nature of these payments has become similar to prepaid tax or provisional tax. After the end of the year, the taxpayer shall consolidate their comprehensive income and allowable expenses and deductions by using the calendar year (i.e. from 1st January to 31st December of the same year) as a calculation basis to calculate their annual tax payable, so as to include any previously omitted taxable items or deductible items, and to calculate any additional tax payable or tax refund on an annual basis.

IIT annual filing facilitates taxpayers with high income, various income sources or unstable income to consolidate their annual comprehensive income to determine the applicable tax rate and tax payable, which would help to smooth out the tax burden caused by inconsistent tax treatments for different incomes and the fluctuation of income in certain months.

Also, by performing the IIT filing on an annual basis, the taxpayers can make more accurate calculations or reconciliations regarding their allowable expenses and deductions for the relevant year. This is especially beneficial for those who have incurred unforeseeable expenses and under-claimed certain deductions during the year.

Who should perform the IIT annual filing?

Individuals who fulfill all the following criteria **are required** to perform IIT annual filing:-

- a tax resident as defined in the China tax law (an individual who has a domicile in China, or do not have a domicile in China but resided in China for 183 cumulative days or more within a calendar year);
- earned at least one type of income from employment income, remuneration for personal services, author's remuneration and royalties; and
- going to claim for a tax refund (except for those who give up the tax refund voluntarily), or need to settle the additional tax payable after the annual comprehensive income tax calculation plus one of the following situations exists:
 - (i) the annual comprehensive income is more than RMB120,000 and additional tax payable is more than RMB400; or
 - (ii) the withholding agent does not withhold IIT according to the tax laws when the taxpayer receives income.

Individuals who fulfill any of the following criteria **are not required** to perform IIT annual filing:-

- a non-tax resident as defined in China tax law;
- required to pay additional tax but the annual comprehensive income is less than RMB120,000;
- the additional tax payable is less than RMB400; or
- the prepaid tax for the year is the same as the annual tax payable or the taxpayer is not going to apply for tax refund.

Allowable deductions for IIT annual filing

According to Article 6 of the IIT law, the taxable income of a tax resident's comprehensive income equals to the annual comprehensive income less the standard personal deduction of RMB60,000 plus various deductible items. Generally, the deductible items for the purpose of calculating comprehensive income for IIT annual filing include the following:-

- personal deduction of RMB60,000;
- special deductions (social security and housing fund);
- additional special deductions (please refer to the Appendix for details);
- other deductions pursuant to the law, including corporate annuity and occupational annuity paid by individuals which fulfill relevant requirements, expenses for commercial health insurance paid by individuals which fulfill relevant requirements; and
- personal charity donations for education, poor and helpless, etc.

Please note that the special deductions, special additional deductions and other deductions pursuant to the law shall be capped at the taxpayer's taxable income for the relevant year. If those deductions are not fully utilized in one basis year, the unutilized deductions shall not be carried forward to the next basis year.

Timing for IIT annual filing

Chinese resident taxpayers should complete their IIT annual filing between 1st March to 30th June every year, unless the abovementioned exemptions apply. For individuals without a domicile in China, he/ she should complete the IIT annual filing before departure if the departure date is before 30th June of the following year in which the taxpayer earned the reportable comprehensive income.

IIT annual filing procedures

Taxpayers can make their IIT annual filing by:

- 1) Self-reporting via IIT annual filing APP or online tax filing system;
- 2) Appointing the withholding agent to handle his/ her IIT annual filing obligation; or
- 3) Engaging a service provider to handle his/ her IIT annual filing obligation.

Please note that if a taxpayer appoints a withholding agent to handle his/ her annual filing obligation, a written confirmation shall be obtained before 30th April 2020. Otherwise, the taxpayer shall make his/her own IIT annual filing before 30th June 2020. Taxpayers can also make the filing by online tax system, by mail or on-site filing.

Consequence for false or erroneous filing

Taxpayers shall be responsible for the truthfulness and accuracy of the IIT annual filing. If a taxpayer fails to perform the IIT annual filing in accordance to the relevant laws and regulations, he/ she may be liable to administrative penalty and have a bad record in his/ her personal tax credit file. According to Article 63 of the Tax Administration Law, if a taxpayer evades tax payment by concealing income or fabricating tax deductions, the tax authority shall recover the unpaid or underpaid taxes together with late payment fees, and levy 50% to 500% of unpaid tax or underpaid tax as the penalty. If the event constitutes a crime, criminal proceedings may be taken against the taxpayer.

PKF Hong Kong's Observation

The IIT annual filing is one of the focal points of China's IIT tax reform. Going forward, IIT will be calculated on a yearly basis, whereas a monthly basis was used prior to the tax reform. This change seeks to reduce situations of tax inequity. For example, in the past, two taxpayers with the same total amount of annual comprehensive income may not have the same amount of tax due, since the old tax system's calculation of IIT was on a monthly basis and there were varying tax rates depending on the nature of the income. The new tax reform would play a major role in smoothing out the tax burden of individuals in China and would be in line with the IIT annual filing practice adopted by most countries in the world.

The tax system was overhauled in the spirit of the national policy of reducing Chinese individuals' tax and financial burdens. In particular, the IIT annual filing system would provide tax relief via full IIT tax exemptions for individual tax residents in China whose annual comprehensive income does not exceed RMB120,000 or whose additional tax due does not exceed RMB400.

In order to maintain a positive credit level and eligibility to enjoy the wider range of tax deductions to reduce their financial burdens, Chinese tax resident individuals should observe the relevant regulations and complete their IIT annual filings by June 30th accordingly.

Appendix – Summary of additional special deductible items

Deduction Items	Deduction Details	Deduction Basis (RMB)	Who claims the deduction	Supporting Documents
Child Education	<ul style="list-style-type: none"> Preschool education (at least 3 years old and before entering primary school) Full-time education (compulsory education, high school education and higher education) 	1,000 per month per child	50% for each parent / 100% for single parent	Admission letter for overseas education, etc.
Continuing Education	Continuing education	400 per month (up to 48 months)	Parent / Self	-
	Vocational qualification education (skilled personnel, professional technical personal)	3,600 for the year when the certificate is issued	Self	Admission letter, certificate, etc.
Medical Expenses for Serious Illness	Portion of payment exceeding 15,000	80,000 per year	Self / spouse	Medical certificate, invoice, etc.
Housing Mortgage	Interest expenses of your own or spouse's first housing mortgage	1,000 per month (up to 240 months)	50% for each spouse / 100% for one	Lease contract, interest payment record, etc.
Housing Rent	Municipality, provincial capital (capital), other city confirmed by the State Council	1,500 per month	Couple live in same city: for one	Lease contract, rent payment record, etc. (Note: The basic condition of housing rent deduction is that the taxpayer does not own property in the main working city.)
	Other city (Population > 1 million)	1,100 per month	Couple live in different cities: for each	
	Other city (Population ≤ 1 million)	800 per month		
Support for the Elderly	Children who have obligations to support the parents (60 year old or above) and grandparents whom all children have passed away	Only child: 2,000 per month	Self	-
		Not only child: not exceeding 1,000 per month per person	Average allocation or agreed allocation	Allocation agreement, etc.

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Mainland China

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- Annual EIT certification report
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