



Over 230,000 responses to exposure draft highlight fundamental issues in IIT reform

Regulation discussed in this issue:

- Draft Amendment to the Individual Income Tax Law of the PRC, preliminarily examined by the 11th Standing Committee of the National People's Congress (NPC), released via their website for public opinions on 25 April 2011.

Background

The 11th Standing Committee of the National People's Congress (NPC) preliminarily examined and released the Draft Amendment to the Individual Income Tax (IIT) Law of the PRC ("Draft Amendment") via the website of the NPC on 25 April 2011 calling for public opinions. The Draft Amendment has attracted extensive attention from the public and the NPC has received more than 230,000 responses as at 31 May 2011, which was the deadline for submission.

The salient points of the Draft Amendment and our comments on them are set out below:

1. Standard monthly deduction on employment income to be increased from RMB 2,000 to RMB 3,000

There have been two rounds of adjustments to the standard monthly deduction since the promulgation of the IIT Law in 1980 i.e. the initial increase from RMB 800 / month to RMB 1,600 / month starting from 1 January 2006 and the subsequent increase from RMB 1,600 / month to RMB 2,000 / month starting from 1 March 2008. The Draft Amendment has further increased the tax threshold on employment income by RMB 1,000 to RMB 3,000 in view of the constant increase of per capita non-productive expenditure.

It is worth noting that the Draft Amendment does not address the issue as to whether the standard monthly deduction for expatriates will be increased by the same extent. In March 2008, when the monthly standard deduction for local employees increased from RMB 1,600 to RMB 2,000, the threshold for expatriates remained unchanged. It is interesting to note that the unified Corporate Income Tax (CIT) Law, which has taken effect from 1 January 2008,

has removed the incentives specifically available to foreign invested enterprises. On the contrary, the reliefs currently available to foreign nationals (including higher tax threshold on employment income) appear to be intact for the time being. However, it is unlikely that further relief will be granted to foreign nationals.

2. Number of tax brackets reduced from nine to seven with the 15 percent and 40 percent brackets being eliminated

In the Draft Amendment, the IIT rates applicable to employment income have been revised as follows:

Bracket	Monthly taxable income (Existing)	Monthly taxable income (Proposed)	Tax rate (%)
1	RMB 500 or less	RMB 1,500 or less	5%
2	Income in excess of RMB 500 to RMB 2,000	Income in excess of RMB 1,500 to RMB 4,500	10%
3	Income in excess of RMB 2,000 to RMB 5,000		15%
4	Income in excess of RMB 5,000 to RMB 20,000	Income in excess of RMB 4,500 to RMB 9,000	20%
5	Income in excess of RMB 20,000 to RMB 40,000	Income in excess of RMB 9,000 to RMB 35,000	25%
6	Income in excess of RMB 40,000 to RMB 60,000	Income in excess of RMB 35,000 to RMB 55,000	30%
7	Income in excess of RMB 60,000 to RMB 80,000	Income in excess of RMB 55,000 to RMB 80,000	35%
8	Income in excess of RMB 80,000 to RMB 100,000		40%
9	Income in excess of RMB 100,000	Income in excess of RMB 80,000	45%

This follows that Chinese nationals with a monthly income of less than RMB 19,000 will find their tax burden reduced while those with a monthly income exceeding RMB 19,000 will suffer a greater tax burden. For foreign nationals, the break-even point will be RMB 16,800 due to the difference in the tax threshold.

3. Adjustment to progressive scale on income of sole traders from production or business operation and income from contracting or leasing activities

The Draft Amendment has revised the IIT rate table for sole traders in respect of the income from production or business operation and income from contracting or leasing activities as follows:

Bracket	Annual taxable income (Existing)	Annual taxable income (Proposed)	Tax rate (%)
1	RMB 5,000 or less	RMB 15,000 or less	5%
2	Income in excess of RMB 5,000 to RMB 10,000	Income in excess of RMB 15,000 to RMB 30,000	10%
3	Income in excess of RMB 10,000 to RMB 30,000	Income in excess of RMB 30,000 to RMB 60,000	20%
4	Income in excess of RMB 30,000 to RMB 50,000	Income in excess of RMB 60,000 to RMB 100,000	30%
5	Income in excess of RMB 50,000	Income in excess of RMB 100,000	35%

4. IIT filing deadline to be extended from within seven days to within 15 days of the following month

Under the current IIT regime, taxpayers and withholding agents shall file the returns and settle the tax due for a month within seven days starting from the first day of the following month. The Draft Amendment has extended the filing deadline from seven days to 15 days so as to make it consistent with the filing deadlines of other taxes such as CIT, Value Added Tax and Business Tax.

KPMG observation

The reasonableness of the proposed standard monthly deduction of RMB 3,000 has always been the hottest topic for discussion since the Draft Amendment was released on 25 April 2011. There is a widespread concern that given today's rising inflation and high housing prices, a monthly deduction of RMB 3,000 can hardly keep pace with the ever increasing living costs.

In addition to the tax threshold, the public opinions collected on the Draft Amendment also include the following:

- Is it feasible to have a consolidated annual IIT filing system to replace the current system of taxing income under separate and distinct categories?
- Is it possible to grant exemptions for the dependents of tax payers as part of the consolidated annual IIT filing system?

The Chinese government has set out various objectives with regard to the IIT reform in its 12th Five Year Plan (5YP), which include the establishment of a consolidated annual IIT filing system. The pooling of income from different sources should better reflect the total income of individuals. Actually, the Chinese tax authority has already made attempts to introduce the consolidated filing concept. The annual IIT return for qualified individuals with an annual income exceeding RMB 120,000, which was introduced in 2006, is commonly viewed as a preparatory step towards establishing a consolidated annual IIT filing regime. Taxpayers are required to disclose their different categories of income in the annual IIT returns. We understand that categories of income that are now subject to IIT at progressive rates i.e. employment income, business income from self-employment, income from contracting or leasing to enterprises or institutions, and independent personal services income, may become subject to consolidation under the new IIT regime. Other categories of income that tend to take the form of fixed and periodic payments to asset owners, such as royalties and rental income, may also be included in the consolidated IIT calculation.

- Is it appropriate to replace the current 15 percent and 20 percent tax rate applicable to employment income with a single rate of 20 percent?

The individuals that fall within 15 percent and 20 percent brackets are principally middle-income earners in China. As mentioned in Point 2 above under the Draft Amendment, the taxpayers with an income exceeding RMB 19,000 shall suffer a higher tax burden. Such an adjustment does not seem consistent with the theme of IIT reform under the 12th 5YP i.e. to reduce the IIT liability of low- and middle-income earners and increase the IIT liability of high-income individuals.

KPMG and the International Tax Review have jointly published a series of articles under the broad banner “China-Looking Ahead”¹ which analyse and comment on the tax implications of China’s 12th 5YP. One of the articles, “Re-dividing the pie”, analyses the development of China’s IIT reform as well as the impacts of the changes on businesses and individuals. A link to the publication is available [here](#).

¹ Only an English version of the report is available now.

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