



GMS Flash Alert



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People's Republic of China - IIT Preferential Treatment: Preparing for Change

As the second quarter of 2021 approaches, the uncertainty over whether preferential individual income tax (IIT) policy in the People's Republic of China ("PRC") will be extended beyond 2021 continues. To aid companies and their employees with tax planning for tax year 2022, we analysed the possible financial impact and the relevant considerations should the preferential IIT policy cease to apply. In particular, this article discusses the PRC IIT treatment applicable for annual bonuses, equity-based incentives, and certain expatriate fringe benefits-in-kind under the prevailing PRC IIT regulations, and provides an analysis of the trend of preferential tax policies in the PRC.

WHY THIS MATTERS

While preferential IIT policy provisions that may be elected for tax year 2021 are clear, uncertainties remain with the application of the relevant calculation method for certain income to be derived in tax year 2022 and beyond. Companies and individual taxpayers should consider whether to elect the applicable preferential policies based on their personal circumstances in accordance with the prevailing PRC IIT law and regulations.

Background

On 27 December 2018, the Ministry of Finance and the State Taxation Administration jointly released Circular 164 entitled "Notice of issues concerning the transitional policies on preferential tax treatments under the amended PRC IIT law."¹ In this circular, preferential calculation methods for determining IIT payable on annual bonuses, equity-based incentives and certain expatriate fringe benefits-in-kind were outlined and are applicable until 31 December 2021. (For prior coverage, see [GMS Flash Alert 2019-12](#) (25 January 2019).)

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Context and Scenarios

Below is an overview of the potential financial impact to individual taxpayers, should the preferential IIT policy cease to apply at the end of December 2021.

Annual Bonus

Case study 1: Employee A, who is a non-PRC-domiciled individual, earns a monthly salary of RMB 100,000, and receives an annual bonus of RMB 300,000 in December.

PRC IIT treatment

Employee A's PRC tax residency in the year in which the income is received should be evaluated in advance based on contractual terms and the other factors, and the amount of tax payable should be calculated accordingly.

- The resident scenario

	2021	2022 and beyond
Applicable tax treatment	<p>Choose one of the two options:</p> <ol style="list-style-type: none"> 1. Tax on annual bonus is calculated without aggregating it with Employee A's regular salary, and based on the marginal tax rate applicable to 1/12 of the annual bonus amount (the marginal tax rate varies depending on the quantum of income, so this calculation approach lowers the marginal rate applicable) ; or 2. Annual bonus is aggregated with Employee A's regular salary for the month, and subject to PRC IIT at the marginal tax rate applicable for the aggregate value 	Annual bonus is aggregated with Employee A's regular salary for the month, and subject to PRC IIT at the marginal tax rate applicable for the aggregate value
Financial impact	If option 1 is adopted, PRC IIT on annual bonus is RMB 72,340 ²	<ul style="list-style-type: none"> • PRC IIT on annual bonus is RMB 135,000³ • PRC IIT increases by approx. 86% compared to 2021

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PRC IIT treatment

Employee A’s PRC tax residency in the year in which the income is received should be evaluated in advance based on contractual terms and the other factors, and the amount of tax payable should be calculated accordingly.

- The resident scenario

	2021	2022 and beyond
Applicable tax treatment	<ul style="list-style-type: none"> • PRC IIT is calculated on the bonus amount separately from the taxpayer’s other comprehensive income derived in the same month • Applicable formula: tax payable on = [(bonus amount ÷ 6) × applicable tax rate – quick deduction] × 6 • This method can be applied only once in a calendar year 	<ul style="list-style-type: none"> • To be clarified
Financial impact	<ul style="list-style-type: none"> • Tax payable on the bonus is RMB 63,540⁴ 	

Equity-based Incentives

Case 2: Employee B, who is a non-PRC-domiciled individual, obtained equity-based incentives in the value of RMB 300,000 in June and another lot of RMB 300,000 in December. The relevant criteria for preferential IIT policy are fulfilled.

PRC IIT treatment

Employee B’s PRC tax residency in the year in which the income is received should be evaluated in advance based on contractual terms and other factors, and the amount of tax payable should be calculated accordingly.

- The resident scenario

	2021	2022 and beyond
Applicable tax treatment	<ul style="list-style-type: none"> • PRC IIT is calculated on the equity-based incentives separately from Employee B’s other comprehensive income derived in the same month, 	<ul style="list-style-type: none"> • To be clarified

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	<p>and subject to tax at the applicable (annual) marginal tax rate</p> <ul style="list-style-type: none"> • If Employee B receives two or more lots of equity-based incentives in a tax year, the income received should be consolidated for tax calculation purposes 	
Financial impact	<ul style="list-style-type: none"> • PRC IIT on equity-based incentives derived in June is RMB 43,080⁵ • PRC IIT on equity-based incentives derived in December is RMB 84,000⁶ 	

- The non-resident scenario

	2021	2022 and beyond
Applicable tax treatment	<ul style="list-style-type: none"> • PRC IIT is calculated on the equity-based incentives separately from Employee B's other comprehensive income derived in the same month • Applicable formula: tax payable = [(total equity-based incentives derived in the current calendar year ÷ 6) × applicable tax rate – quick deduction] × 6 – tax already paid on equity-based incentive derived in the current calendar year 	<ul style="list-style-type: none"> • To be clarified
Financial impact	<ul style="list-style-type: none"> • Tax payable on income from equity-based incentives in June is RMB 63,540⁷ • Tax payable on income from equity-based incentives in December is RMB 115,500⁸ 	

Certain Expatriate Fringe Benefits-in-Kind

Case 3: A foreign individual who is a PRC tax resident earns a monthly salary of RMB 100,000 and spends RMB 30,000 on monthly rent, and RMB 300,000 on the individual's children's education every year. These expenses are reimbursed by the employer based on valid supporting documents.

	2021	2022 and beyond
Applicable tax treatment	<ul style="list-style-type: none"> • A foreign individual that is considered a PRC tax resident can choose to either claim additional itemised deductions or enjoy preferential IIT policy to exempt reimbursement received for actual expenses incurred on housing rental, language training, or children’s tuition as tax-exempt for PRC IIT purposes • Once the choice is made, it cannot be changed within the same tax year 	<ul style="list-style-type: none"> • From 1 January 2022 onwards, the tax-exemption treatment on reimbursement for housing rental, language training, or dependent children’s tuition, may no longer be available. In that case, additional itemised deductions could be claimed if applicable. • It remains unclear at this stage whether: <ul style="list-style-type: none"> ○ reimbursement for expenses incurred on home leave, relocation, meals and laundry etc. will continue to be tax-exempt; ○ standard deduction amount for additional itemised deductions will be reviewed in consideration of an expatriate’s incremental living costs in China
Financial impact	<ul style="list-style-type: none"> • The foreign individual electing the preferential IIT policy on tax-exempted housing rental or dependent children’s tuition pays less tax • Reimbursement received for housing rental and dependent children’s tuition are tax-exempt 	<ul style="list-style-type: none"> • Taxpayer may claim standard deduction amount prescribed for housing rental and dependent children’s tuition • PRC IIT on reimbursement received for housing rental and dependent children’s tuition is RMB 283,500⁹

KPMG NOTE

While KPMG in the PRC anticipates that the Chinese authorities will announce policies or guidance in relation to the tax treatment of certain employment remuneration items discussed in this article in the coming months, we recommend that companies and individual taxpayers consider the following well in advance in preparation for tax year 2022:

- Keep abreast of policy updates to help ensure appropriate company and personal budgeting are performed on a timely basis;
- Perform a cost analysis based on policy updates, review and adjust the company policies to facilitate talent attraction and retention;
- Communicate with employees in a timely manner on regulatory changes, potential financial impact to foster workforce stability;
- Review and assess eligibility for existing financial subsidy programmes (such as preferential IIT policies for attracting highly-skilled talent to work in the Greater Bay Area, Shanghai Free Trade Zone Lingang New Area, and Hainan Free Trade Port) and apply accordingly to effectively minimise financial burden which may arise from cessation of preferential IIT policy.

In view of the complexity and technicality of tax-related matters, companies and individual taxpayers may also consider seeking support from professional institutions to make sure that they fulfil their obligations accurately and in a timely manner and avail themselves of the preferential policies they are eligible for.

We will monitor the latest developments in preferential IIT policies and discuss policy trends and practical cases with local tax authorities. Companies and individuals interested in learning more about the latest developments and hot topics are welcome to get in touch with us.

FOOTNOTES:

1 Caishui [2018] No. 164 - Notice of issues concerning the transitional policies on preferential tax treatments under the amended IIT law ("Circular 164").

2 Tax payable on bonus = RMB 300,000 x 25% - RMB 2,660 = RMB 72,340 (tax is borne by the individual).

3 Tax payable on bonus = RMB 300,000 x 45% = RMB 135,000 (tax is borne by the individual).

4 Tax payable on bonus = (RMB 300,000 / 6 x 30% - RMB 4,410) x 6 = RMB 63,540 (tax is borne by the individual).

5 Tax payable on equity-based incentives derived in June = RMB 300,000 x 20% - RMB 16,920 = RMB 43,080 (tax is borne by the individual).

6 Tax payable on equity-based incentives derived in December = (RMB 300,000 + RMB 300,000) x 30% - RMB 52,920 - RMB 43,080 = RMB 84,000 (tax is borne by the individual).

7 Tax payable on equity-based incentives derived in June = (RMB 300,000 / 6 x 30% - RMB 4,410) x 6 = RMB 63,540 (tax is borne by the individual).

8 Tax payable on equity-based incentives derived in December = [(RMB 300,000 + RMB 300,000) / 6 x 45% - RMB 15,160] x 6 – RMB 63,540 = RMB 115,500 (tax is borne by the individual).

9 Tax payable on reimbursement received for housing rent and dependent children's tuition = (RMB 30,000 x 12 + RMB 300,000 – RMB 1,500 x 12 (special additional deduction for rent currently applicable to taxpayers in Shanghai) – 1,000 x 12 (special additional deductions for children's education currently applicable)) x 45% = RMB 283,500 (tax is borne by the individual).

RMB 1 = EUR 0.13

RMB 1 = USD 0.15

RMB 1 = GBP 0.11

RMB 1 = TWD 4.31

RELATED RESOURCE:

This article is adapted, with permission, from "Current main preferential policies and changing trends of China's personal income tax" in *China Tax Alert* (Issue 5, February 2021), a publication of the KPMG International member firm in the People's Republic of China.

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