

# HR & Tax Alert



*Quality In Everything We Do*

## **China – Notice issued clarifying the procedures for the Individual Income Tax Self-Declaration Trial**

**November 2006**

### **Executive summary**

Until now taxpayers have not been required to file self declaration tax returns in the People's Republic of China. However, recent legislation has introduced a filing requirement for certain categories of taxpayer. On 6 November 2006 the State Administration of Taxation ("SAT") issued a notice entitled "Procedures for Individual Income Tax ("IIT") Self Declaration (Trial)". The purpose of the notice was to clarify and introduce the new IIT procedures relating to those taxpayers who are required to complete self-declaration tax returns for income derived during the year. The Notice details the different categories of taxpayers who must comply with the regulations to assist the SAT in their efforts to combat tax evasion.

### **Overview of the notice**

#### ***Taxpayers required to complete self-declaration tax returns***

The Notice has detailed that there is a mandatory self-declaration tax filing requirement for those taxpayers who fall within the following 5 categories:

1. Annual income exceeding RMB120,000 (Approximately £8,000, €9,900, US\$ 15,250)
2. Wages and salaries received from two or more different sources in China
3. Income from sources outside China
4. Taxable income received without withholding
5. Other situations specified by the State Council

According to the Notice, taxpayers with an annual income of RMB120,000 or more but who are not domiciled in China and who are not in China for one full year of presence without interruption during that calendar year, will be exempt from this requirement.

On the other hand, taxpayers with income sources outside China shall include those individuals who are domiciled in China and those who are domiciled outside China but have resided in China and are continuously present throughout that calendar year.

In determining periods of continuous presence in China, absences of less than 30 consecutive days or cumulative periods of absence which in aggregate do not exceed 90 days are ignored. Tax years are considered independently. Where an individual arrives in or departs from China partway through the tax year and as a result spends less than 275 days in China during that tax year he is not continuously present in China for that calendar year. As such there is no filing requirement for that calendar year even if it makes up part of a period of continuous presence exceeding 12 months.

The Notice clarifies that the combination of sources of income that make up the "annual income" for the purposes of the RMB120,000 self declaration threshold whether received inside or outside of China are as follows :

- i. Wages and salaries
- ii. Income from production or business conducted by self-employed industrial and commercial households
- iii. Income from contracted or leased operation of enterprises or units
- iv. Remuneration for providing personal services
- v. Income from author's remuneration
- vi. Income from royalties
- vii. Income from interest, dividends and bonuses
- viii. Income from the lease of property
- ix. Income from transfer of property
- x. Incidental income
- xi. Other income as determined by Finance Section of State Council

It is further clarified in the Notice that the following sources of income shall be excluded when calculating the income for the RMB120,000 self declaration threshold. It is not clearly clarified in the Notice whether the sources of income listed below should be declared in the Individual Income Tax return despite being excluded from the RMB120,000 calculation.

1. Categories of income specified in Article 4 of the PRC IIT Law, such as insurance indemnities, military severance pay and demobilization pay and monetary awards granted by provisional People's Governments etc.
2. Income derived outside the territory of China which is exempt from PRC IIT in accordance with Article 6 of the Implementation Rules of PRC IIT Law.
3. Contributions to pensions, medicals, unemployment benefits and housing funds made by the employer and employees in accordance with the government statutory requirement as stipulated in Article 25 of the Implementation Rules of PRC IIT Law.

#### **Completion of the self declaration tax return**

Those taxpayers who fall under the 5 categories stipulated in the Notice are required to complete the self-declaration tax return designed by the SAT and submit it to the relevant local tax bureau within the specific deadlines.

The Notice specifies that for those taxpayers with taxable income over RMB120,000 in a calendar year and the regulations shall take effect from 1 January 2006. In

the other words, the 2006 self-declaration annual tax return filing will be due on or before 31 March 2007.

On the other hand, those taxpayers who fall under categories 2 to 4 as detailed above, the regulations shall take effect from 1 January 2007. At the same time, the "Interim Notice for Individual Income Tax Declaration" issued in 1985 will be repealed.

The duly completed self-declaration tax return can be submitted by courier, electronic filing, in person or other method as determined by the relevant local tax bureau. Individual taxpayers may engage a third party consultant to prepare and submit the tax returns on their behalf. If the taxpayers fail to complete the self-declaration tax return filing within the stipulated period, a fine up to RMB10,000 can be imposed in accordance with Article 62 of the Administration Law of the PRC on the Levying and Collection of Taxes. Notwithstanding, an extension may be granted upon an approval of the relevant local tax bureau.

#### **Implications for companies and/or taxpayers**

Obviously, the Notice will have significant impact to those high income taxpayers with annual taxable income over RMB120,000 and those individuals who are under categories 2 to 4. As high income taxpayers, it is likely that most foreign employees will have to complete and submit the self-declaration tax return. Although this is the individual's obligation, foreign employees assigned to work in China will likely ask the company for help in complying with this self-declaration requirement. As a result, the administrative burden on the company may increase.

We have discussed with a Section Chief of the SAT and he verbally confirmed that foreign individuals who reside in China for more than one year but less than 5 years would only need to report their income that is taxable in China. However, as it has not been specifically stipulated in the Notice, it still remains uncertain at this stage whether the foreign individual's worldwide income is required to be declared in the self-declaration tax return even though the related income is not subject to tax in China. We are following up with the relevant authority to seek further clarification. In the meantime, companies may wish to begin preparing internal communications to advise those employees who may be impacted (both local and expatriate) on how this Notice will affect them.

For further information please contact your local Ernst & Young Human Capital professional, or in China:

Paul Wen (Hong Kong)  
Christina Li (Hong Kong)  
Stacy Kwok (Beijing)  
Norman Yu (Shanghai)  
Michael Fischer (Shanghai)  
Sam Pang (Shenzhen)  
Even Feng (Guangzhou)

Tel: +852 2629 3876  
Tel: +852 2629 3664  
Tel: +86 10 5815 3382  
Tel: +86 21 2405 2287  
Tel: +86 21 2405 2179  
Tel: +86 755 2502 6160  
Tel: +86 21 2405 2858

E-mail: paul.wen@hk.ey.com  
E-mail: christina.li@hk.ey.com  
E-mail: stacy.kwok@cn.ey.com  
E-mail: norman.yu@cn.ey.com  
E-mail: michael.fischer@cn.ey.com  
E-mail: sam.pang@cn.ey.com  
E-mail: Even.feng@cn.ey.com

The *Ernst & Young Human Capital HR & Tax Alert* is a periodic newsletter designed to communicate current developments in the 'human capital' area. It is not intended to serve as legal, immigration or tax advice. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. No member firm of Ernst & Young Global Limited ("EYGL") or Ernst & Young International Limited ("EYI") or EYGL or EYI accept responsibility for any loss arising from any action taken or not taken by any person in reliance on this publication.