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GES NewsFlash

People's Republic of China (PRC) – Intensified PRC Individual Income Tax (IIT) Administration on High-Income Individuals

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Summary

The State Administration of Taxation ("SAT") issued Circular Guoshuifa (2011) No. 50 ("Circular 50") in April 2011. Circular 50 applies the spotlight directly on "high income individuals" as tax collection and administration targets and signals the tax bureaus' ongoing and intensifying efforts on strengthening the reporting, collection, and administration of the PRC IIT on high-income individuals and high-income industries.

Key implications

Intensified enforcement on IIT administration in respect to nonemployment income derived by high-income individuals

Under Circular 50, local tax bureaus are required to further strengthen the administrative efforts with a focus on the following types of **unearned income**:

- Income from transfer of properties
  This includes the transfer of equity holdings by individual shareholders and the transfer or auction of real estate properties.

- Income derived from equity investments, such as interest and dividend income
  Local tax authorities are required to conduct in-depth investigations on interest, dividends, and equity investments income from a withholding perspective, especially for companies that have continuously made profits, yet failed to distribute any dividends.

- Individual income from business operations

  Tax audits on accounting books are required to focus on large-sized sole proprietorships, partnerships, and business owners for tax collection purposes. If there are practical difficulties in implementing a tax audit on accounting books, a deemed profit method may be applied for tax purposes. The circular also sets out various areas that the tax authorities may focus on during the audit.

Strengthening the IIT administration on high-income industries and high-income individuals

- Intensifying the IIT administration and collection on individuals who mainly receive unearned income, especially the individuals who hold a large number of company stock or receive a huge amount of investment income, and who are engaged in the following "high income industries":
  - Real estate
  - Mineral resources investment
  - Private equity
  - Trust investment, etc.

- Enhancing the IIT administration and collection on employment income received by individuals in high-income industries, with a focus on bonuses, allowances, and equity incentives received by the senior management

- Improving administration on sizable service income

- Strengthening the tax collection on high-income foreign national individuals; this includes a focus on the reporting of income paid both onshore and offshore, enhancing the tax collection for individuals who have resided in the PRC for more than five full consecutive tax years, and more strict supervision on remuneration borne by permanent establishments or fixed bases (of foreign enterprises) with a view to avoid the abuse of treaty protections

Establishing an integrated tracking and monitoring system on taxable income for high-income individuals and conduct tax audit

The tax bureaus are required to make better use of the internal and external resources to identify and track taxable activities conducted by the high-income individuals and high income industries and intensify tax collection accordingly.

The tax bureaus are also required to conduct more proactive communications and information sharing between relevant government agencies (e.g., public security bureaus, banks, securities brokerages, housing centers, foreign exchanges) to ensure enhanced administrations.

Deloitte's view

Circular 50 is issued in the context of the proposed PRC individual income tax reform. The IIT reform aims at reducing the tax burden for lower-income groups and moderately increasing the tax on high-income groups and high-income industries.

The proposed IIT reform includes the increase of the exemption threshold and reduction of the number of tax brackets from nine to seven under the progressive tax rates for employment income.

With the rapid economic growth, the source of personal wealth is increasingly diversified. Employment income increasingly may not be the dominant source of income for wealthy individuals. Circular 50 indicates an emerging awareness and a policy-level shift towards a focus on nonemployment income as well as employment income and calls for special attention on expatriates and PRC individuals who receive significant amount of unearned income derived from transfer of properties, interests, dividends and equity investments, and business operations.

In fact, some enforcement actions have already been taken by the tax authorities early this year, where the SAT issued Circular GuoShuiFa [2010] No.111 regarding the statistics collection of exempt and reduced taxes administrated by the tax authority. The key items affecting the expatriates working in the PRC is the amount of IIT exempted on qualifying nontaxable benefits. Although, at the time, the stated objective of this exercise is to facilitate the tax authorities' data collection, we anticipate that in the long run, the tax authorities may use such data collected for cross-checking and benchmark purposes to ensure correct reporting on nontaxable benefits. We understand that in response to Circular 50, Beijing Local Tax Bureau has announced that a tax audit will be launched soon on high-income earners. We anticipate that more tax audits on IIT are expected to be launched in other key locations of China.

In view of the above, we would recommend companies to take the following actions:

1. Review current human resources policy, tax planning ideas, and tax reporting procedures for employees — especially senior executives of companies in high-income industries, as well as high-income expatriates and local PRC nationals to make sure relevant documentation and reporting are in line with the prevailing tax regulations. Professional assistance may be required.

2. Make sure relevant registrations as required by the local tax bureaus are properly performed and proper documentations are substantiated (i.e., equity plans implemented in China and nontaxable benefits offered to expatriate employees).

3. For expatriate individuals who are not domiciled in the PRC but have not yet stayed in the PRC for more than five full consecutive tax years, consider adopting a tracking and planning system so that the five-year threshold is not inadvertently crossed. Similarly, closely monitor expatriates who are working in the PRC on a project basis to ensure PRC IIT is properly reported.

4. Review equity transactions and other investment-related transactions/income to seek proper tax planning and mitigate tax exposures and risks.

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