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## Change affecting tax calculation on bonus

The State Administration of Taxation issued *Guoshuifa (2005) No.9* on 21 January 2005 regarding the adjustment of calculation of individual income tax on yearly bonuses. "Yearly bonus" refers to a one-off bonus paid to employees based on each employer's economic results and the individual's performance.

### Yearly or annual bonus

For both expatriates and locals, the following treatment applies on yearly bonuses:

- 1) Where the employee's normal salary in the current month of payment is higher than or equal to the statutory personal deduction, tax payable equal to:

Bonus x applicable rate on bonus/12 – quick deduction

E.g. Assume bonus = RMB 60,000

Rate applicable on RMB 5,000 (60,000 / 12) is 15%
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Quick deduction = RMB 125

Tax payable = RMB [60,000 x 15%] – RMB125 = RMB 8,875

- 2) Where the employee's normal salary in the current month of payment is lower than the statutory personal deduction, tax payable equal is to:

[Bonus – (personal deduction – normal salary)] x applicable rate on net bonus after deduction of the difference between normal salary and personal deduction /12 – quick deduction

### Other bonuses

Other bonuses such as semi-yearly bonus, quarterly bonus, overtime bonus, attendance bonus, are to be added to the monthly normal salary and the individual income tax calculated on the aggregated amount. However, in the case of frequent travellers who are taxed on a days-in-days-out basis, such bonuses are taxed as a separate source from the normal pro-rated monthly salary. The bonus is taxed in whole (not pro-rated based on the number of days in China during the month).

### Implications

Prior to the issuance of *Guoshuifa (2005) No.9*, all kinds of bonuses were taxed as a separate source of salary, without the personal deduction, and were not added to the normal salary for the month. As the tax rates were on a progressive basis, the individual's effective tax rate would be reduced with multiple bonuses paid throughout the year rather than as a single yearly bonus.

With this change in treatment, employees with multiple bonuses will now be at a disadvantage. Employers will need to reconsider the payment of a yearly bonus rather than multiple bonuses, especially if this is consistent with global policy.

*Guoshuifa (2005) No.9* is effective from 1 January 2005.

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