People’s Republic of China: 
Pilot Scheme of Individual Income Tax Deferred Pension Plan Expected to Roll Out in Shanghai

Summary

On November 24, 2011, the China Insurance Regulatory Commission Shanghai Bureau (SIRC) held a media conference and formally announced the issuance of the “Outline of the 12th Five-Year Plan for the Development of Shanghai Insurance Industry.” In the media conference, it was disclosed that the long-awaited individual income tax (IIT) deferred pension plan would be launched in Shanghai as a pilot scheme and would be further developed in the twelfth five-year period (year 2011 – year 2015).

Key implications

According to the recent news announcement, the pilot scheme will be rolled out in the form of commercial pension insurance products first and may be extended to other supplementary pension plans where appropriate.

In essence, under the proposed IIT-deferred pension plan, qualified individuals working in Shanghai will be eligible to claim IIT deduction for personal pension contributions with a monthly ceiling applied, and defer the IIT payment until receipt of the pension in retirement.

Currently, selected insurance companies in Shanghai are working closely with the SIRC to finalize the plan design. It is expected that there would be further announcements in regards to this early next year.

Deloitte’s view

The pilot IIT-deferred pension plan aiming to encourage personal contributions to supplementary pension plans is to a certain extent in line with prevailing international practices, such as the 401(k) plan and Individual Retirement Account (IRA) plan in the U.S., and Mandatory Provident Fund in Hong Kong, China.

On a general basis, the IIT-deferred pension plan may sacrifice current tax revenues for government authorities. However, in the long term, it could alleviate the growing financial burdens of the government related to pension obligations.

China’s pension system currently consists of three main parts including a basic pension plan guided by the government authorities, enterprise annuity initiated by employers, and personal commercial pension insurances funded by individuals. According to the prevailing PRC IIT regulations, individual contributions to basic pension plans can be claimed for IIT deduction, whereas individual contributions to enterprise annuity and commercial pension insurance are both nondeductible for IIT purposes.

In order to offer IIT incentives and attract personal contributions to supplementary pension plans, the proposed IIT-deferred pension plan has been under discussion for years. In 2008, the China State Council issued Circular 126 (Guobanfa[2008]126), which was the first time from a legislation perspective clearly encouraged research and exploration on IIT-deferred commercial pension insurance plans. The municipal government of Tianjin subsequently launched a pilot IIT-deferred pension plan in 2008, which was suspended later due to the high ratio of deductible income.

Shanghai has started the exploration of IIT-deferred pension plans for years as well. From the information available to the public in the recently designed plan, there will be a monthly ceiling applied of IIT deduction, which may have a less significant impact on the total tax revenue deferred. Once the pilot scheme is launched, it would not only benefit the participants, but also alleviate the pension burdens for the government in the long run.

Under the existing PRC IIT system, employment income is taxed on a monthly basis through the employers as withholding agents. From an implementation perspective, in order to achieve IIT deductions from the pilot pension plan, the employers will need to actively get involved and establish internal processes to ensure that IIT filing can be correctly reported. Because of the tax deferral attribute, the plan may be appealing to some employees. From an employer perspective, operating such a plan could bring benefits to its employees without extra expenses except for administrative costs. In view of the above, employers may want to consider having their employees participate on a voluntary basis. Though the details as to who will qualify for the pilot scheme and how it will be rolled out are not yet available, we would recommend companies to closely
monitor the development of the pilot IIT-deferred pension plan in Shanghai and establish internal policies where necessary so that employees can benefit from such a plan once it rolls out.

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