KPMG

China Tax Alert

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Two preferential individual income tax policies are further extended

Summary：

Pursuant to the Announcement on the Continuation of the Implementation of Preferential Individual Income Tax Policies ("Announcement [2023] No. 2") jointly released by the Ministry of Finance and the State Administration of Taxation on 16 January 2023, the following preferential policies are extended for one year until 31 December 2023:

- Employee's equity income from participation of equity plan of public companies is subject to preferential tax treatment;
- Gains from investments by mainland individual investors through the Shanghai-Hong Kong Stock Connect, the Shenzhen-Hong Kong Stock Connect and from the trading of Hong Kong fund units under the mutual recognition of funds are temporarily exempted from individual income tax ("IIT").

Highlights

We have analysed the preferential policies for the appropriate application of the treatment:

➢ **Equity incentives of public companies**

- Cai shui [2018] No.164
  - ❑ The eligible equity income[1] received by resident individuals, before 31 December 2021, is taxed as **a separate source of income from the employee's employment income and the annual comprehensive income tax rate is applied**.
- Shui Zong Zheng Ke Fa [2021] No.69
  - ❑ Tighten the administration of IIT on equity incentives, and further standardise the information reporting requirements for companies implementing equity incentive plan[2].
- Notice of the Ministry of Finance and State Taxation Administration [2021] No. 42
  - ❑ The preferential tax policy for equity incentives granted by public companies is extended to 31 December 2022.
- Announcement [2023] No. 2
  - ❑ The preferential policy on equity incentives granted by public companies has been extended to 31 December 2023.

1. Resident individuals participate in the equity incentive plan that is implemented by a listed company, which directly or indirectly holds 30% interests in the shares of the individual's employer, and the plan must meet all necessary reporting and documentation requirements.
2. A company that implements equity incentives should submit a Report on Equity Incentives to the tax authorities within the 15 days of the month following the implementation of equity incentives plan and other documentations as required (including but not limited to equity incentive plans, award agreements, grant notices, vesting/exercise notice, details relating to the shares received or transferred by individuals, and shares subscribed, etc.).

- **Mainland individual investors: Gains from investments**
  - Notice of the Ministry of Finance [2019] No. 93
    - ❑ Gains from investments derived by mainland individual investors through the following channels are temporarily exempted from IIT for the period 5 December 2019 and 31 December 2022:
      - Investments in stocks listed on the Stock Exchange of Hong Kong Ltd.(“SEHK”) through the Shanghai-Hong Kong Stock Connect or the Shenzhen-Hong Kong Stock Connect;
      - Trading of Hong Kong fund units under the mutual recognition of funds.
  - Announcement [2023] No. 2
    - ❑ Application of the above preferential IIT policy is now extended to 31 December 2023.

KPMG observations

The extension of preferential IIT policies is good news for both companies and individuals. For companies, offering equity incentives with tax optimisation effects facilitates the motivation and retaining of employees. For individuals, they are entitled to preferential tax treatment with certain conditions met where they are participating in the equity incentive plans of a listed company or participating in the trading of shares of Hong Kong listed companies or Hong Kong fund units, and thereby their tax burden is reduced. It is worth noting that these preferential tax policies are only extended for one year until 31 December 2023, while it remains uncertain for 2024 and beyond.

In the meantime, it is expected that the tax authorities will continue to focus on the collection and administration of IIT on equity incentives in the future. We have observed that the tax bureau is tightening the inspection on IIT of equity incentive income since 2021. When it is noticed through big data analysis and comparison that the declared equity incentives income in IIT filing system does not match with tax registration information, the tax bureau may conduct further IIT investigation. In this regard, in addition to benefiting from the preferential tax policies for equity incentives, companies should properly complete the tax registration of equity incentive plans in a timely manner, so as to respond to the increasing future supervision from the tax authorities.

KPMG China will continue to closely monitor the regulatory updates and welcome companies and individuals to contact us, should you encounter any difficulties.

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