China Tax Alert

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China strengthens tax management for equity incentives

Summary：

- Recently, the Ministry of Finance and the State Taxation Administration issued the Announcement on Individual Income Tax Policies Relating to Equity Incentives of Listed Companies (Announcement 1), which extends the individual income tax (IIT) payment period for equity incentives, e.g. stock options, restricted stocks, etc. granted by domestic listed companies.
- At the beginning of 2024, the State Taxation Administration issued the Announcement of the State Taxation Administration on Annual IIT Reconciliation on Comprehensive Income for 2023 (Announcement 2), which emphasises the tax reporting and filing requirements for equity incentives.

Background

In recent years, local tax authorities have been increasingly enforcing the administration and collection of IIT. On 17 April 2024, the State Taxation Administration (STA) and the Ministry of Finance (MOF) issued Announcement 1 to allow the deferral of IIT payment on eligible equity incentives of domestic listed companies to 36 months following the taxable event. It also emphasises that one of the qualifying conditions for the application of tax deferral treatment of equity incentives is full compliance on plan registration with the competent tax authority. Announcement 2 which was issued by the STA on 31 January 2024 highlighted the tax reporting and registration requirements of employer equity incentive plans, and emphasised that taxpayers who receive multiple equity incentives from one or more employer(s) in the same tax year should consolidate all instalments for tax computation and remittance purposes.

KPMG observations

Announcement 1 stipulates that the IIT payment period for equity incentives[1] could be deferred to up to 36 months. This provision is applicable if:

- The equity incentive granted is the stock of a company that is listed on the Shanghai Stock Exchange, the Shenzhen Stock Exchange or the Beijing Stock Exchange;
- The equity incentive plan has been registered with local in-charge tax authority;
- Income from the equity incentives are derived (i.e. stock options exercised or restricted shares (units) vested) between 2024 and 2027;
- Income from the equity incentives are derived after 1 January 2023 but IIT has not been paid in full (IIT instalment payment commences from the date of exercise/vest).

1. Exercise of stock options, vesting of restricted stocks or access to equity incentives

In addition, the announcement clarifies that taxpayers who terminate their employment during the extended IIT payment period should pay the IIT in full before their employment is terminated. This requirement enables tax withholding agents to fulfill their IIT withholding obligation in order to support individual taxpayers to settle the IIT timely.

The provision regarding the 12-month period of deferral of tax payment on IIT due on certain equity incentives previously stipulated in Circular Caishui [2016] 101[2] was abolished, as Announcement 1 came into force.

Announcement 2 underpins the tax reporting and registration requirements of employer equity incentive plans, and emphasised that taxpayers who receive multiple equity incentives from one or more employer(s) in the same tax year should consolidate all instalments for tax computation and remittance purposes. Specifically:

- The provisions apply to equity incentives granted by domestic listed companies to their employees, as well as equity incentives granted to domestic employees by overseas listed companies;
- The announcement reaffirms the requirements for tax reporting and filing in accordance with Circular Caishui [2005] 35[3];
- It also emphasises that if a taxpayer obtains multiple equity incentives from the same employer within a tax year, the employer should calculate and withhold relevant IIT on a consolidated basis;
- Where multiple equity incentives from different employers are derived within a tax year, the taxpayer can:
  - Provide information on the equity incentives derived from the previous employer to the current employer, which should then calculate and withhold the IIT on a consolidated basis; or
  - Lodge an annual individual income reconciliation tax return to report the consolidated equity incentives received within the year, between 1 March and 30 June of the next year.

KPMG suggestions

Given that equity incentives are widely adopted in the talent market, the MOF and the STA explicitly extended the effective period of the preferential IIT treatment (i.e. separating from regular salary) on equity incentive to 31 December 2027 in their Announcement [2023] 25[4]. Announcement 1 further deepens the preferential treatment by extending the IIT payment period for equity incentives of eligible domestic listed companies for employees from 12 months to 36 months.

However, with the abolishment of the extended tax payment period (12 months) stipulated in Circular Caishui [2016] 101, no such extension is now available for equity incentives granted to domestic employees by overseas listed companies. In this regard, relevant overseas listed companies and/or their domestic subsidiaries should take the following measures as soon as possible:

- Understand the potential impact due to regulatory changes;
- Estimate and simulate the potential cost implications of the policy changes, and actively communicate with employees;
- Continue to meet relevant tax information reporting and filing requirements.

At the same time, for companies currently applying preferential IIT treatment on equity incentives during the monthly IIT withholding process, local tax authorities have carried out tax inspections since 2023 to audit whether consolidated tax computation methodology has been applied to employees who derived multiple equity incentives in a tax year retroactively from 2019. To date, companies who have been selected for such inspection have been requested to perform amended IIT withholding filings in respect of the equity incentives and pay the tax shortfall, where consolidated tax computation methodology was not applied. Announcement 2, which was issued at the beginning of this year, also clearly emphasises tax administration requirements, including tax declaration, registration, and consolidated taxation of equity incentives. Going forward, tax administration of equity incentives is expected to become more stringent.

2. Item 1 of Article 2 of the Notice of the Ministry of Finance and the State Taxation Administration on Improving Income Tax Policies Relating to Equity Incentives and Provision of Technology in Exchange for Shareholding

3. Notice of the Ministry of Finance and the State Taxation Administration on Issues Relating to the Levy of Individual Income Tax on Personal Income from Stock Options

4. Announcement on the Continued Implementation of Individual Income Tax Policies Relating to Equity Incentives of Listed Companies

We have also observed that, in order to implement the requirements of Announcement 2 in situations where a taxpayer derives multiple equity incentives from one or more employers in a tax year, the IIT filing system has introduced a module tilted "consolidated tax filing for multiple equity incentives", which individual employees can use to perform consolidated tax filings between 1 March and 30 June after the close of the tax year. However, it is worth noting that the current module still has room for improvement. If a taxpayer derives multiple equity incentives from the same employer in a tax year, and the company has withheld IIT on a consolidated tax computation basis, the module will automatically aggregate a taxpayer's equity incentive income which has been reported in monthly withholding filing system, and duplicating assessable income and result in excessive IIT being calculated. Concerned companies and taxpayers should therefore verify the data when making relevant declarations on the IIT filing system. Meanwhile, we will continue to monitor the working of such module and keep you up-to-date on any optimisations that are made to it.

In conclusion, as tax authorities continue to strengthen the tax management of equity incentives, we recommend that relevant companies:

- Proactively carry out health checks on the tax treatment for employees' equity incentives;
- Adjust the tax treatment if a taxpayer has obtained multiple equity incentives in a tax year but has not performed consolidated tax filing;
- If an employee has received equity incentives from his/her previous employer, but has not provided relevant information to the current employer for consolidated tax filing, companies should communicate with the employee and provide necessary guidance to ensure that the equity incentive income in the tax year is correctly filed within the period for the annual reconciliation filing.

KPMG will continue to pay close attention to local tax authorities' detailed rules on the implementation of the IIT payment period extension stipulated in Announcement 1, as well as to the progress in resolving the tax base issue affecting the module for Announcement 2. If you have any questions, please do not hesitate to contact us.

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