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CHINA TAX ALERT

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New policy on PRC Individual Income Tax on dividends of listed companies was promulgated to encourage long-term investments

Regulation discussed in this issue:

- *Notice on Issues Relating to Differentiated Individual Income Tax (IIT) Policies for Dividends Derived from Listed Companies*, Cai Shui [2015] No.101 (Circular No.101), issued by the Ministry of Finance, the State Administration of Taxation and the China Securities Regulatory Commission on 7 September 2015 and effective 8 September 2015.

Background

The Ministry of Finance, State Administration of Taxation, and China Securities Regulatory Commission jointly issued "*Notice on Issues Relating to Differentiated IIT Policies for Dividends Derived from Listed Companies*" (Cai Shui [2015] No.101, "Circular No.101") to suspend IIT on dividends for long-term individual investors who obtained shares of listed companies via public offerings and market transfer and held for more than one year, which is formulated on top of the preferential IIT treatment as prescribed in the "*Notice on PRC IIT Collection Policy for Dividends Derived from Listed Companies* " (Cai Shui [2012] No. 85, "Circular No. 85") and "*Notice on Issues Concerning the Implementation of Differentiated IIT Policies for Dividends Distributed by Quoted Companies on the National Equities Exchange and Quotations*" (Cai Shui [2014] No. 48, "Circular No. 48").

The stock market in China has gone through an extremely turbulent June in 2015 and since then a series of bailout measures and supporting policies have been introduced to boost individual investors' confidence in the stock market. Circular No.101 was issued with the intent of reasserting the role of tax policy in encouraging individuals engaging in value investments by holding value-oriented stocks in the long run, curb short-term speculation, and promote long-term stability and robust development of the capital market.

Circular No. 101 became effective 8 September 2015.

Main content

Circular No.101 stipulates that, from 8 September 2015, dividends derived from the shares held by individuals for more than one year shall temporarily be exempt from IIT.

The table below illustrates the effective IIT rates on dividends under the former and new rules:

Holding period	Effective IIT rate (Before 8 September 2015)	Effective IIT rate (From 8 September 2015)
≤ 1 month	20%	20%

> 1month and ≤ 1 year	10%	10%
> 1 year	5%	**Temporarily exempted**

In addition, upon dividend distribution, listed companies shall temporarily not withhold IIT. For individuals whose holding period of shares does not exceed one year (including one year), the China Securities Depository and Clearing Corporation Limited (CSDCC) shall compute the tax payable based on the holding period at the time of share transfer by the individual, the security brokerage companies shall deduct the tax from the individual's fund account and transfer to the CSDCC, the CSDCC shall transfer the tax to the listed company within five working days of the following month, and the listed company shall declare and pay the tax to the tax authorities in charge within the statutory declaration period of the current month.

- **Scope of application**

The new rules apply to dividends derived by individuals from the following investment holdings:

✓ Dividends derived from shares of listed companies[1] which are acquired through IPO or market transfer;
✓ Dividends derived from desterilised restricted shares[2] of listed companies;
✓ Dividends to securities investment funds derived from listed companies;
✓ Dividends distributed by quoted companies[3] on the national equities exchange and quotations.

- **Holding period**

The calculation method of holding period of shares remains unchanged in Circular No. 101. The holding period starts from the date when an individual acquires the shares to the date immediately preceding the date when the individual transfers such shares. When an individual transfers his/her shares, the holding period shall be computed using the principle of "first-in-first-out". For desterilised restricted shares, the holding period commences from the desterilisation date.

Holding of shares for one year means the continuous holding of shares from a date in the prior year to the date immediately preceding the same date in the current year; Holding of shares for one month means the continuous holding of shares from a date in the prior month to the date immediately preceding the same date in the current month.

KPMG observations

It is worth noting that relevant authorities and regulators have made strenuous efforts to boost investors' confidence. Circular No.101 aims to further reduce individuals' tax burden on long-term investments, and encourage individual investors to be "shareholders" through long-term holdings, instead of "short-sighted speculators" to promote long-term stability and healthy development of China's capital market. This further indicates the tax reform trend of "structural tax cuts" in China over recent years.

The new policy will be welcomed by individual investors who intend to make long-term investments in China's stock market, and to them, companies with higher dividend pay-out will become increasingly attractive. The new policy may also encourage listed companies to pay dividends to investors regularly, and therefore the interests of small and medium investors can be better protected.

[1] Listed companies refer to the companies listed on Shanghai Stock Exchange and Shenzhen Stock Exchange.
[2] Dividends derived before destabilisation continue to be subject to the actual IIT rate of 10%, regardless of holding period.
[3] A quoted company refers to an unlisted public company whose shares are quoted on the national equities exchange and quotations (NEEQ) for public transfer.

Circular No.101 suspends the former requirements for the listed companies to calculate and withhold IIT upon dividend distribution. The management functions of CSDCC will be further developed and embodied in the tax calculation and collection process. From the perspective of management operations, the new withholding requirements will effectively ease the administrative burden on listed companies. The close involvement and cooperation of the listed companies, CSDCC, and security brokerage companies are also required to ensure tax compliance.

Individual investors are also recommended to understand thoroughly the new differentiated IIT policy for dividends and ensure that the amounts of incomes and IIT liabilities are correctly captured in the annual IIT returns. In addition, despite the role of CSDCC in computing the tax payable, listed companies, as the withholding agent that is responsible for tax withholding and reporting, still need to check the amount of tax payable based on the relevant documents and data provided by the CSDCC to ensure full compliance.

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