GMS Flash Alert

Global Compensation Edition

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People's Republic of China – Extension of Tax Preferences for Equity Compensation, Gains

Certain tax-preferential policies have been extended for one year, until 31 December 2023, according to the Chinese government, namely:

- Employees' equity income from participation in equity plans 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").

This extension is pursuant to the *Announcement on the Continuation of the Implementation of Preferential Individual Income Tax Policies* ("Announcement [2023] No. 2") jointly released on 16 January 2023 by the Ministry of Finance and the State Administration of Taxation of the People's Republic of China ("China" or "PRC").

WHY THIS MATTERS

The extension of preferential IIT policies is good news for both companies and individuals. It provides some degree of certainty and consistency in terms of expectations, policies and processes, and compliance. The extension also helps keep tax costs tied to such forms of compensation/reward low, which is welcome in terms of companies awarding such forms of compensation, and the employees on the receiving end.

In Brief: Background of Preferential Policies and Statutory Sources

Equity Incentives of Public Companies

- Cai shui [2018] No.164

  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 plans.[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 was 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.

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 through 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 INSIGHTS

For companies, offering equity incentives with tax advantages can help facilitate motivation and support recruitment, loyalty, and retention of employees. Individuals are entitled to preferential tax treatment – as long as certain conditions are 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 should be borne in mind that these preferential tax policies are only extended for one year until 31 December 2023, while it remains uncertain for 2024 and beyond.

KPMG INSIGHTS continued:

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. At KPMG in China, we have observed that the tax bureau has been tightening its inspection into IIT of equity incentive income since 2021. When it is noticed through big data analysis and comparison that the declared equity incentives income in the IIT filing system does not match with tax registration information, the tax bureau may conduct further IIT investigation.

For Consideration

In this regard, in addition to benefiting from the preferential tax policies for equity compensation, companies should properly complete the tax registration of equity incentive plans in a timely manner, so as to respond to potential "visits" by the tax authorities, who, as we noted above, are enhancing their scrutiny.

If companies and their employees have questions or concerns about their record-keeping, properly submitting tax registration information, their exposure to investigation, and reviewing their compliance policies and procedures, they should contact their qualified global reward professional or a member of the Global Reward Services team with KPMG in China (see the below Contact Us section).

FOOTNOTES:

1 Resident individuals participate in the equity incentive plan that is implemented by a listed company, which directly or indirectly holds 30-percent interest 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 the equity incentive plan and other documentation 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.).

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Contact us

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