In this issue:

India:
High Court: Allowance paid to employees deputed abroad construed as personal expenses and taxable as perquisite; employer liable to deduct taxes

Background / facts

- M/s Sun Outsourcing Solutions Private Limited (Sun India / applicant), a private limited company with its office in Hyderabad and branch office at London, UK (Sun UK), deputed employees from India to work in its branch office, besides employing Non-Resident Indians (NRIs) in the UK.
- The employees continued on India payroll, received salaries in India and were paid lump-sum boarding and lodging allowances in the UK. The salary payments for the NRIs were also paid in the UK.
- Sun India operated withholding taxes on the salary paid in India. However, taxes were not withheld on allowances paid in the UK and salary payments made to NRIs employed overseas.
- Sun India was charged with taxes besides penal interest on the allowances paid to employees in the UK by the jurisdictional tax officer, which was upheld by the appellate authorities. The matter was further referred to the High Court.

- The matter put up before the High Court was to decide whether the lump-sum allowances were in the nature of personal benefit and thus liable to tax or whether such allowances were exempt from tax being incurred in the performance of duties of an employer. The High Court was also requested to decide whether the allowances were subject to withholding tax.

Ruling of the High Court

The High Court upheld the ruling of the appellate authorities that the allowances paid were chargeable to tax, and hence the employer should have deducted taxes on the same through the withholding mode. Further, failure to deduct taxes would attract interest. The court highlighted certain principles derived from earlier rulings on the subject while laying down few others based on the specific facts of the case.

Principles derived by the Andhra Pradesh HC from the earlier decisions:

- Where any personal advantage is derived from payment, it falls within the definition of perquisite;
- A mere reimbursement or necessary disbursement does not fall within the explanation of perquisite;
- Any allowance paid to the employee in order to meet his personal expenses at the place where the duties of his or her office are ordinarily performed, is not exempt under the Act; and
- For an allowance to be exempt, it should specifically be wholly granted in performance of duties.

Ruling pronounced based on the specific facts of the case

- Lump-sum payments made to the employees confer additional advantage of personal nature and cannot be treated as having been incurred in connection with discharge of duties.
- In agreement with the findings of the appellate authorities listed below:
    - The applicant made lump-sum payment as allowances, which included payments made to few employees after they returned to India and no evidence was available or obtained by the applicant for the expenditure incurred by the employee in London;
    - In absence of any log book or vouchers, there is no reimbursement of expenditure but lump-sum payments; and
    - The applicant is legally bound to deduct taxes in absence of any certificate for lower deduction or no deduction of taxes obtained from employee and exemption if valid, can be claimed by the employee on submission of necessary evidences before the tax officer.

Source: I.T.T.A. Nos. 211, 212, 213 and 214 of 2005; I.T.T.A. No. 211 of 2005 dated December 27, 2017

Deloitte's view

This High Court ruling contradicts the principles established in the case of Symphony Marketing Solutions India Pvt. Ltd.11 (and other Tribunal rulings) wherein it was held that verification of actual expenditure by the tax authority is not required, subject to the allowance being reasonable and the employer satisfying themselves that all conditions for claiming exemption under the act are satisfied.

The ruling has now placed the onus on the employer to prove that the payments are in the nature of reimbursements. This would necessitate a review of the documentation and process followed for disbursements of such payments by the employer.

— Anis Chakravarty (Mumbai)
Partner
Deloitte India
anchakravarty@deloitte.com

People’s Republic of China:
Pilot program launched for tax-deferred commercial pension insurance

Overview

On April 12, 2018, China’s Ministry of Finance published Circular 22 that officially launched a pilot program for tax-deferred commercial pension insurance in Fujian, Shanghai, and Suzhou Industrial Park beginning May 1, 2018. Individuals in pilot areas who purchase qualified commercial pension insurance may enjoy a favorable tax deferral treatment (*i.e.*, the insurance premium paid may be pretax deductible) and income tax will be triggered only when the individual withdraws from the pension account.

Further guidance has been issued by government departments to clarify the implementation details and the criteria for commercial insurance products to qualify for the pilot program.

Highlights

1. Who may enjoy the tax-deferral policy under the pilot program?

1.1 Pilot areas

The program is being piloted in Fujian (including Xiamen), Shanghai, and Suzhou Industrial Park for one year.

1.2 Eligible participants

1. Individuals who receive wages and salaries, or recurring remuneration for consecutive independent services (where the individual provides independent services to the same entity for no less than six consecutive months) from parties that act as the income tax withholding agents and are located in pilot areas; and
2. Private business owners (*e.g.*, owners of individual industrial and commercial households, investors in sole proprietorships, individual partners of partnerships, etc.) who derive income from business activities conducted in pilot areas.

2. What is the tax-deferral policy under the pilot program?

As from May 1, 2018, the following rules apply to eligible participants who have purchased qualified commercial pension insurance:

- The insurance premium payment is deductible for individual income tax purposes, subject to a cap that is determined as:
  - 6% of the monthly salaries/service remuneration or CNY 1,000, whichever is lower for individuals in 1.2 i; and
  - 6% of the annual taxable revenue or CNY 12,000, whichever is lower for individuals in 1.2 ii.
- No income tax is imposed when investment income is credited to the individual’s personal commercial pension account.
- 75% of withdrawals from a commercial pension account will attract a 10% income tax, with the remainder being tax-exempt.

3. How can an eligible individual enjoy tax-deferral under the pilot program?

3.1 Qualified commercial pension insurance products

The tax-deferral policies under the pilot program apply only to eligible individuals who purchase qualified commercial pension insurance products; tax deferral is not available for nonqualified products. The Chinese Banking and Insurance Regulatory Commission has released guidance (*i.e.*, Yin Bao Jian Fa [2018] No. 20) to insurance companies on the criteria for a commercial pension insurance product to qualify for the tax deferral. The regulators will maintain and publish a list of qualified products.

3.2 Designated account and centralized information platform management

To enjoy the tax-deferral treatment, an eligible participant must appoint a bank account to handle the commercial pension insurance matters (*i.e.*, payment of insurance premiums, receiving investment income, withdrawals). The bank account will have to be linked with the individual's Chinese ID number and registered on the information platform developed by the China Insurance Information Technology Management Co., Ltd. (the "CIITC Platform"). The CIITC Platform is interconnected with the systems of tax bureaus, insurance firms, and banks, and will be responsible for issuing a certificate to the individual for claiming the deduction for the insurance premium.

4. What obligations must each party fulfill under the pilot program?

4.1 Payment of insurance premiums

- For individuals in 1.2 i: The individual must provide the certificate to the withholding agent and notify the agent in a timely manner if there is any change to the insurance premium, or if the insurance policy is cancelled or not renewed.

  After receiving the certificate, the withholding agent must deduct the relevant premium from the gross income to calculate the tax to be withheld and complete an information form. When the agent is preparing the reporting form of withholding tax, the deductible premium must be included in "Other (deductible) items," marked "tax-deferral pension insurance."
- For individuals in 1.2 ii: The individual must, when filing his/her annual income tax return, include the deductible premium in "Other deductible expenses," marked "tax-deferral pension insurance," and complete an information form. The individual must notify the competent tax authorities in a timely manner if there is any change to the insurance premium or if the insurance policy is cancelled or not renewed.

- Individuals that receive income from two or more sources in the pilot areas may only claim the deduction of premiums from one source.

4.2 Withdrawal

After an individual fulfills the prescribed conditions (*e.g.*, reaching the statutory retirement age) to withdraw from the pension account, the insurance firm will withhold and report the individual income tax on behalf of the individual for each withdrawal to the competent tax authorities where the insurance firm is located.

5. What is the time period for the tax-deferral policy? Can individuals enjoy the policy retroactively?

The policy under the pilot program applies for one year from May 1, 2018. Where insurance premiums for the previous periods were not deducted because the individual did not provide a certificate in a timely manner, the withholding agent is allowed to make retroactive adjustments for the previous periods in the month the certificate is received by the agent; overpaid tax for the previous periods may be used to offset the future tax payable or be refunded.

Deloitte's view

The tax-deferred commercial pension insurance policy is considered an important supplement to the government-sponsored basic pension fund and employer annuity plans. Although similar tax-deferral treatment is granted for annuity plans, tax-deferred commercial pension insurance could provide more flexibility for individuals since they are free to choose the insurance product in the market that best suits their needs. In addition, the regulators have indicated that a qualified pension insurance product will have low premiums and broad coverage. In view of this, the pilot program has attracted considerable attention from the public, and the tax- deferral pension insurance business is expected to grow rapidly in the pension market. It also is worth noting that the government has rolled favorable treatment out nationwide that allows individuals to claim a deduction for qualified commercial health insurance premiums. The tax-deferral treatment for qualified commercial pension insurance also is expected to be expanded nationwide.

The launch of the pilot program may aim to test the waters before more deductions are introduced, as the government has expressed its intention to introduce further deductions for living expenses (*e.g.*, child education expenses and medical expenses) in the next step of the reform of the individual income tax. The CIITC Platform and its interconnection with systems of the tax authorities, insurance firms, and banks will enable the Chinese tax authorities to gain experience in the construction of infrastructure to better address the challenges that the reform may bring to the administration of taxes.

— Tony Jasper (Hong Kong)
Partner
Deloitte People's Republic of China
tojasper@deloitte.com.hk

Huan Wang (Beijing)
Partner
Deloitte People's Republic of China
huawang@deloitte.com.cn

Irene Yu (Shanghai)
Partner
Deloitte People's Republic of China
iryu@deloitte.com.cn

Global Rewards Updates:
New Zealand: Employee share scheme reporting

Key points to know

New Zealand Inland Revenue have changed the way they would like employee share scheme ("ESS") benefits to be reported, effective 1 April 2018.

Uncertainty exists with respect to payroll systems and the harmonization with prior ESS reporting procedures.

Reporting deadlines are dependent on whether the employer has opted for payday reporting.

Background

Last year, the Inland Revenue introduced mandatory reporting and voluntary Pay As You Earn ("PAYE") withholding of ESS benefits through the employer monthly schedule. Employers were required to disclose the ESS benefit value as "gross earnings" and disclose this as "earnings not liable for ACC" on the employer monthly schedule.

Main changes

Effective 1 April 2018, the Inland Revenue have changed the way they would like ESS benefits to be reported and have introduced a new ESS tax code.

The Inland Revenue now require ESS income to be reported on a separate line detailing:

- The employees' name;
- Their IRD number;
- The tax code (of "ESS"); and
- The taxable value of the ESS benefit as "earnings and/or schedular payments not liable for ACC earners' levy".

Deducting PAYE on the benefit remains optional and there are no changes to the Commissioners Statement issued in April 2017 (CS 17/01 – valuation of employee share schemes) that provides guidance on how employers can value employee share benefits. As a reminder, ESS benefits are not subject to KiwiSaver or ACC earners levy. However, if an employer opts to deduct PAYE on an ESS benefit it will be necessary to account for other deductions such as student loan and child support deductions.

It is not entirely clear whether payroll systems will allow employers to report employee data for the same employee on a separate line. Uncertainty also exists as to whether this will overcome an Inland Revenue system limitation that required employers who do not account for PAYE on ESS benefits to submit a list of employees receiving ESS benefits prior to filing the employer monthly schedule to reduce the number of errors. More details are expected to follow.

When to report?

Employers who have opted for payday reporting: Employers who have opted for payday reporting from 1 April 2018 will report the ESS benefit based on a "20-day rule". There are two options as follows:

Option 1:

- If the 20th day after receiving the ESS benefit falls between the 1st and 15th of a month, the information must be reported as if the 15th was the payday.
- If the 20th day after receiving the ESS benefit falls between the 16th and the end of a month the information must be reported as if the last day of the month is the payday.

Option 2: Alternatively, an employer can choose to treat the 20th day after receiving the ESS benefit as the payday. The following Inland Revenue example illustrates how the two options apply:

"Sam's employer provides him with an ESS benefit on 13 December 2018. The 20th day after Sam receives the benefit falls between the 1st and 15th of January 2019.

Under Option 1, Sam's employer can report the taxable value of the ESS benefit within 2 working days of 15 January 2019.

Under Option 2, Sam's employer can choose to report the value of the ESS benefit as part of employment information which is due 2 working days from the 2 January 2019"

Employers who have not opted for payday reporting: There is no change to the timing of reporting for employers who have not opted for payday reporting (noting this will be mandatory from 1 April 2019). As a reminder, for large employers (that have annual withholding obligations under the PAYE system of $500,000 or more) the ESS benefit is reported as follows:

- ESS benefits received by the employee in the first half of the month (1st to the 15th) is shifted to the second half of the month. This is reported by the employer in the employers' monthly schedule for that month; and
- ESS benefits received by the employee in the second half of the month (16th to end of the month) is shifted to the first half of the following month. This is reported in the employers' monthly schedule for that following month.

This is best illustrated by way of example: If the ESS benefit vests on 25 March 2018, the employer will record the benefit in the employer monthly schedule for April, which is due on 5 May 2018. Tax on the benefit (if the employer opts to deduct PAYE) is paid in the PAYE payment period due 20 April (as the ESS benefit is shifted to the period 1 April 2018 to 15 April 2018)

Deloitte's view

The changes further illustrate the enhanced disclosure requirements associated with ESS benefits and the need for accurate and timely reporting, even if the relaxation to account for PAYE continues to exist. Employers should familiarize themselves with the new requirements and determine the appropriate reporting deadline based on the company's payday reporting structure.