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Global Employer Services

Global Rewards Update:
People's Republic of China (PRC) – Increased focus from tax authorities on equity awards

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Background

Tax and foreign exchange registration and reporting requirements have long been in place for companies that offer employee equity incentive plans in China. For example, companies must register equity plans with the relevant local tax bureau and report any new grants, vests or exercises. Further, if PRC nationals are participating in an equity plan offered by a foreign company, the employer is also subject to registration and ongoing reporting with the State Administration of Foreign Exchange (SAFE) or its local offices. Previously, not all of these requirements were strictly enforced in some cities or provinces. However, recent changes in practice, particularly in the Shanghai and Jiangsu provinces, signal an increased focus by the authorities on compliance with equity plan registration and reporting requirements.

Tax registration updates

Under the current tax regulations, all equity plans offered by an employing company in China must be registered with the company's in-charge tax bureau(s) before the plan is rolled out. Any ongoing award events (i.e. new grants, vests or exercises) must be reported to the tax bureau with the applicable time limits. Penalties may be imposed on the company for failure to comply with this and employees may be disqualified from the preferential individual income tax treatment applicable to equity-based salary income (i.e. if preferential treatment applies, such income may be spread over the vesting period (up to a maximum period of 12 months) for tax computation purposes, with the result generally being that a lower tax rate can be applied).

Shanghai

The Shanghai tax authorities have recently increased their enforcement of the reporting of equity plans, in an effort to streamline and improve the process. For example, reporting is now required into two categories: "grant information" and "vesting/exercise information" to facilitate compliance.

- It has been noted that, in a few cases in 2013, reporting later than the deadline set by the bureau has led to the denial of the preferential tax treatment.
- A few district-level tax bureaus in Shanghai have conducted special tax audits on equity plans. Companies that have reported equity-based income for employees on withholding returns in the last three to five years may be selected and reviewed. If a company is found not to have complied with the registration/reporting requirements, but the preferential tax treatment was

applied to the employee's income, the tax bureau will require the company to make a retrospective adjustment and pay the under-withheld individual income tax.

Jiangsu

- Employee equity plans also have become an audit target in Jiangsu. The tax bureau at the provincial level may conduct random tax audits in which the employing company will have to submit relevant supporting documents, including documents on vesting/exercise and an explanation of the tax calculation. Failure to do so may result in penalties.
- Companies in the Jiangsu province are generally required to submit an annual reporting form to the tax authorities for their expatriate employees/secondees. Any equity plan-related information has now been incorporated into this annual reporting requirement.

Foreign Exchange registration update

Shanghai

The SAFE Shanghai office recently amended the format of the initial registration form for companies operating multiple equity plans. Such companies now only have to complete a single form instead of separate forms for each plan.

Action

Given the increased focus from the authorities on equity plans, it is recommended that companies operating equity plans in China take the following steps:

- Review the implementation status of their plans and take immediate action on the initial tax registration if this has not already been done for existing plans;
- Set up an internal process to ensure ongoing compliance with the reporting requirements;
- Assess and manage potential individual income tax exposure if the company has adopted the preferential tax treatment on equity income but failed to make a timely registration; and
- Monitor local requirements to ensure that ongoing reporting obligations are aligned with any new processes from both tax and foreign exchange perspectives.

People to contact

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your usual Deloitte adviser or email us at **globalequity@deloitte.com**, and an adviser will contact you.

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