



# GMS Flash Alert

Global Compensation Edition

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## People's Republic of China - New IIT Law and Trailing Liabilities for Equity Compensation

As we reported in April,<sup>1</sup> the Ministry of Finance and the State Taxation Administration of the People's Republic of China (PRC or China) issued Announcement No. 35 to provide further guidance on the application of the recent reform of China's Individual Income Tax (IIT) law. The Announcement supplements the amended law and provides guidance on income-sourcing methods for calculating non-domiciled individuals' PRC-sourced assessable employment income and methods for calculating non-domiciled individuals' PRC IIT, along with other clarifications.

Along with the guidance provided by Announcement 35 it was noted that Guoshuihan [2000] Circular 190 (Circular 190) was rescinded, which is an important consideration for the taxation of equity compensation for former PRC residents and is the primary focus of this *GMS Flash Alert*.<sup>2</sup>

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### WHY THIS MATTERS

Many taxpayers may have relied upon Circular 190 to exempt from taxation equity compensation received by a PRC nonresident attributable to services performed in China during the vesting period of the individual's award where the compensation expense was not borne by the local PRC entity. Now that the Circular has been rescinded, this exemption is no longer supported.

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## Background

The taxation of equity compensation for an employee in the PRC is usually taxed based on the amount of income sourced to the PRC during the vesting period of the award. Circular 190 provided for the tax-exemption of certain trailing equity-based compensation derived by non-PRC domiciled individuals after they permanently departed the PRC. Specifically, the type of equity-based compensation which was eligible for the tax exemption treatment had to meet the following criteria:

- The compensation accrued to a period or periods of time during which the non-PRC-domiciled individual rendered services in the PRC;
- The compensation was derived after the individual had permanently departed the PRC; and
- The cost of the compensation was not borne by any entity or permanent establishment in the PRC.

## What New Law Means for Trailing Liabilities

The release of Announcement 35 and the rescinding of Circular 190, which is effective retroactively from 1 January 2019, in effect removes the tax exemption treatment which was provided for this trailing liability. As a result, non-PRC-domiciled individuals will be taxable on all of their PRC-sourced equity-based compensation, irrespective of when the income is derived or whether the cost of the equity compensation is determined to be borne by the PRC entity, either directly or indirectly.

As a result of Circular 190 being rescinded, domestic employers in the PRC with non-domiciled individuals being paid PRC-sourced employment income by an overseas affiliated company will have the obligation to make a report to the tax bureau. The non-domiciled individual can do self-reporting for the PRC-sourced employment income or authorize the domestic employer in the PRC to assist with the monthly IIT reporting and withholding payment. If not authorized by the non-domiciled individual, the domestic employer is required to report the following relevant information to the local tax bureau within 15 days after the end of each month:

- Work arrangement of the non-domiciled individual;
- Overseas payments made to the non-domiciled individual;
- Non-domiciled individual's contact details.

## Determining PRC-Sourced Income

Announcement No. 35 clarified that the PRC-sourced employment income derived by non-domiciled individuals who are concurrently employed by domestic and overseas entities, or employed solely overseas, shall be determined based on the individual's PRC work-days. Work-days in the PRC are calendar days that are spent in the PRC for business purposes. A stay in the PRC for less than 24 hours on a calendar day is counted as a half work-day.

Work-days in the PRC include calendar days physically spent in the PRC for business purposes, and, public holidays, personal leave and days spent in training which accrue to one's PRC employment, regardless of whether they are conducted inside or outside the PRC.

PRC-sourced employment income shall be calculated using a formula that applies to the position which a non-domiciled individual holds (e.g., a senior or non-senior executive), and his or her physical presence in the PRC.

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## KPMG NOTE

Under the new PRC IIT regime, the method of determining what is PRC-sourced income first before applying the applicable tax rates, effectively reduces the probability of double taxation for non-domiciled individual. It also serves to reduce the tax cost for enterprises and/or individuals as well as being closer to current international practices.

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## FOOTNOTES:

1 For related coverage, see GMS [Flash Alert 2019-063](#) (April 1, 2019).

2 Announcement No. 35 of the State Taxation Administration, Ministry of Finance, 2019 (referred to hereinafter as "Announcement No. 35").

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