January 2022

Human resource & Tax alert

China extends certain favorable Individual Income Tax (IIT) treatment from 1 January 2022

Executive summary

Based on Caishui [2018] No. 164 (Notice on several transitional rules concerning favorable IIT treatments under the new IIT regime), the favorable tax treatment on annual bonus, non-taxable benefits for foreign nationals and equity income from listed companies is applicable until 31 December 2021. As such, companies and individuals have been very concerned about the relevant tax treatment after 2022.

On 31 December 2021, the Ministry of Finance (MOF) and the State Taxation Administration (STA) jointly issued MOF/STA Announcement [2021] No. 42 and MOF/STA Announcement [2021] No. 43 (hereinafter referred to as "Announcement 42" and "Announcement 43"). The two circulars extend the favorable tax treatment on annual bonus, non-taxable benefits for foreign nationals and equity income from listed companies, etc.

Main content

Items	Expiration Date	Favorable tax treatment
Annual bonus	31 December 2023	Resident employees may choose to not combine the annual bonuses with consolidated income and the bonuses can be divided by 12 to determine the applicable monthly tax rate and quick reckoning deduction: Tax liability = annual bonus income x applicable tax rate – quick reckoning deduction Or they can be combined with consolidated income and apply annual tax rate table to compute tax liability.
Equity-based awards from listed companies	31 December 2022	Equity income, if qualified for certain conditions, should not be combined with consolidated income, and the applicable annual tax rate shall be adopted for China tax residents: Tax liability = equity income x applicable tax rate – quick reckoning deduction Equity income received twice or more shall be aggregated to determine the applicable tax rate, compute tax liability, and perform a reconciliation.
Non-taxable benefits for foreigners	31 December 2023	Foreign nationals who qualify as China tax residents (Note) can choose to enjoy applicable specific additional tax deductions or the non-taxable benefits policy including subsidies on housing, language training and children education, but they cannot enjoy both at the same time. Once selected, the selection cannot be changed within a tax year.
Exemption of China annual tax reconciliation requirement	31 December 2023	A China tax resident may be exempted from China annual tax reconciliation filing if he/she meets one of the following conditions: - The taxpayer has underpaid tax liability on consolidated income, but his/her annual consolidated income is no more than RMB120,000; OR - The underpaid tax liability on consolidated income does not exceed RMB400 If the tax withholding agent fails to withhold tax on consolidated income properly, the tax resident cannot be exempted from annual tax reconciliation filing requirement.
Incentives received by in-charge persons of central enterprise	31 December 2023	Deferral annual performance bonuses or incentives received by in-charge persons of central enterprise can apply the tax treatment on annual bonus as long as certain conditions are met.

Note：Non-domiciled Individuals who reside in mainland China for 183 days or more in a calendar year is regarded a China tax resident.

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Our observation

1. Annual bonus

Following China Individual Income Tax reform in 2019, relevant tax regulations stipulated that the favorable tax treatment on annual bonus was applicable by end of 2021. There has been a great deal of public interest on whether such favorable tax treatment can be extended after 2021. As the favorable tax treatment has been prolonged for another two years, companies shall revisit the internal policy and compensation structure to enjoy the tax incentives brought by the new regulation.

2. Equity-based awards from listed companies

Unlike the tax treatment on annual bonus, the favorable tax treatment on equity-based awards from listed companies is prolonged for one year based on Announcement 42.

Based on our observation, the tax authorities would like to collect and analyze the relevant information of the companies implementing equity incentive plans. After the expiration of the one-year grace period for equity-based awards, it is expected that the tax authority may issue new regulations to stipulate the tax treatment on equity-based awards in the future.

It is noteworthy that existing tax regulations have imposed certain reporting and registration requirements for companies implementing equity plans. According to Caishui [2005] No.35 ("Circular 35"), equity plans of listed companies shall be registered with the local tax bureaus. Caishui [2016] No.101 ("Circular 101") requests companies to fulfill registration requirement for the equity plan implemented by non-listed companies which are eligible for tax deferral treatment. In addition, STA issued Shuizongzhengkefa [2021] No. 69 ("Circular 69") in October 2021, which further emphasizes the information reporting requirement in terms of equity plans. In view of the above, companies implementing equity plans shall strictly follow the registration/reporting requirement based on relevant tax regulations. It is suggested for the companies to understand the key content and the application of relevant tax regulations and get prepared.

3. Non-taxable benefit for foreigners

Based on the current market practice, we noticed that most companies are providing certain non-taxable benefits to foreign employees. If such favorable tax treatment is eliminated, it will create a significant impact on most foreign employees working in China. Previously, EY has been involved in discussions with Business Chambers, enterprises and tax advisors with the tax authorities on the impact brought by the tax regulations on non-taxable benefits. The extension of the favorable treatment provided by Announcement 43 is good news to both foreign individuals and companies.

According to our observation, the tax authorities are strengthening the tax collection and administration with respect to non-taxable benefits for foreigners in these years. Companies shall review the current non-taxable benefits arrangements and the supporting documents to meet the compliance requirement when enjoying the favorable tax treatment.

4. Tax treatment for foreign nationals

The latest regulations prolonged the favorable tax treatment on annual bonus and equity-based awards for residents. Where foreign nationals are concerned, depending on their residency status, i.e. China tax residents vs. non-residents, the tax calculation method on special compensation items such like annual bonus and equity awards are different. It is suggested for the companies and individuals to understand the relevant tax regulations and take the correct tax positions in this respect. For example, care shall be taken in the determination of residency status and the application of the tax calculation methods.

Next steps

At the beginning of the new year of 2022, the extension of relevant preferential tax policies is a gift to companies and individuals provided by the government. In view of the new tax regulations, companies shall conduct proper employee communication and training for relevant personnel in due course. In the meantime, in order to enjoy the favorable tax treatments, companies shall fully understand the relevant compliance requirements and assess the feasibility to adopt the favorable tax treatment.

If any question, please consult local tax authorities or contact our EY professionals.

Contact information

Our aim is to provide an integrated approach that delivers added-value to your organization. We welcome the opportunity to make a positive contribution to your continuing success.

Let us help your organization achieve its potential by turning complexity into competitive advantage. This is how EY People Advisory Services in Greater China makes a difference. Please do not hesitate to contact your local EY professionals or any of the following individuals:

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