

## Global Rewards Update: China

June 2009

### **NEW RULES REGARDING STOCK COMPENSATION OFFERED TO SENIOR EXECUTIVES**

#### **Background**

The Ministry of Finance and State Administration of Taxation (SAT) jointly issued a new circular (Circular Cai Shui [2009] 40) dated May 4, 2009 and released to general public late May 2009. The Circular provides for Individual Income Taxes (IIT) due on stock compensation income for senior executives to be paid on an installment basis where there may be restrictions as a result of PRC Company Law or Securities Law on how many shares realized under a plan may be sold or restrictions on when shares can be sold.

#### **Key Implications**

- The new circular applies to senior executives (directors of the board, members of the supervisory board, and senior management) of listed companies bound by Chinese Company Law or Securities Law who have earnings from stock options or other equity plans.
- The Circular confirms that the PRC IIT on the stock option income should still be calculated in accordance with Cai Shui [2005] 35 (Circular 35) and Guo Shui Han [2006] 902 (Circular 902). In other words, no change is made to the taxation for stock options.
- The Circular recognizes that in certain circumstances, some senior executives may find it difficult to pay a large tax bill on equity compensation in one installment where PRC Company Law or PRC Securities Law restrictions limit the amount of shares that may be disposed or restrict the timing of share sales. The Circular states that, subject to the approval from the local tax authority in charge, the PRC IIT payable on stock option income may be settled in multiple installments within a period of no more than six months from the exercise date.
- The above circular also applies to other equity plans.

## Deloitte's View

The circular re-emphasizes the growing importance of stock incentives in the China market, and a growing need to offer such plans locally to remain competitive in recruitment and retention of key executives in China by removing some of the practical challenges presented by current rules on timing of the tax payment on share-based compensation.

Focused on domestic-listed companies it is not clear the extent to which these provisions apply to overseas plans where restrictions on subsequent sale of shares may be driven by home country laws rather than PRC Company Law or Securities Law. Preliminary guidance indicates that the provisions apply only to senior executives of Chinese domestic-listed companies.

Companies, both domestic and non-Chinese multinational companies, should continue to monitor their compensation strategies in China to ensure that they remain competitive. Those companies considering operating equity plans in China should also ensure that plans introduced are compliant with local Chinese tax and exchange control regulations as well as ensuring they review the legal issues that arise from the use of equity plans in China.

## ACTION

- China-listed companies should inform their senior executives, who have stock compensation, about these new provisions so that they can settle their taxes accordingly.
- Foreign-listed companies should await further guidance as to whether the new rules can apply to their senior executives in China.

## People to Contact

For assistance in this matter or any other issue related to the operation of your global rewards plans, please contact your local Deloitte global rewards consulting services advisor or email us at: [globalequity@deloitte.com](mailto:globalequity@deloitte.com) and a global rewards consultant will contact you.

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