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China Alert

China Enhanced Individual Income Tax Administration of Share Transfers

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On 7 December 2014, the State Administration of Taxation ("SAT") in China issued the "Administrative Measures in relation to Individual Income Tax ("IIT") on Income Derived from Share Transfers (Trial)" ("Circular 67"), which has further strengthened the tax administration of share transfer transactions made by individuals. Circular 67 was effective from 1 January 2015.

This Alert briefly highlights the salient features of Circular 67 and sets out our points of view.

Applicability of Circular 67

Pursuant to Circular 67, the term "shares" refer to share or stock investments made by individual shareholders ("Individuals") in enterprises or organizations that are legally established in China ("Invested Enterprises"). Sole proprietorships and partnerships are excluded from such Invested Enterprises.

"Share transfers" as stipulated under Circular 67 refer to individuals transferring shares to other individuals or legal persons. Such activities include sales of shares; share repurchase made by a company; sales of shares by the shareholders of Invested Enterprises to investors during Initial Public Offering; mandatory share transfers ordered by judicial or administrative authorities; share transfers that are effected for the purpose of making capital contribution for investments or conducting non-monetary transactions; share transfers for the repayment of debts; and other share transfer activities.

Circular 67 does not apply to transfers of shares listed on Shanghai and Shenzhen Stock Exchanges by individuals provided that such shares are obtained through public offering or trading, transfers of restricted stock, or other share transfers that are governed by special regulations.

Calculation of Income derived from Share Transfers

According to Circular 67, the taxable income of the individual who engages in share transfers is calculated as follows: Taxable income = Income from share transfers – original value of shares – reasonable expenses

Taxable income derived from share transfers shall be subject to IIT under the category of "income from the transfer of property" which is taxed at 20%. The transferor shall be the IIT taxpayer while the transferee shall be the withholding agent.

It is worthy to note that Circular 67 sets out very detailed rules to define revenue from share transfers. Apart from cash, tangible goods, securities and other forms of economic benefits, other payments received by the transferor related to the share transfers (including penalties for breach of contract, compensation), other named payments, assets, interests and subsequent income received according to contract terms and upon fulfillment of contract conditions, shall all be considered as income from share transfers.

Circular 67 stipulates that the revenue received by an individual from a share transfer should be determined based on the fair transaction principle.

The tax authority could make an assessment of the revenue derived from share transfers if any of the following circumstances is met:

1. The reported revenue derived from share transfers is considerably low without any justifiable reason;
2. Failure to comply with the tax reporting requirements within the prescribed period, and does not rectify the non-compliance status within the timeline even after the receipt of filing order from the tax authority;
3. The transferor cannot provide or refuses to provide relevant information relating to the share transfers;
4. Other circumstances that necessitate an assessment on revenue arising from share transfers.

In the situation where the tax authority makes an assessment of the income derived by the transferor from the share transfer transaction, the original value of shares shall be determined as follows: original value of shares held by the transferee = reasonable taxes and other expenses arising from the share transfer + assessed income derived by the transferor from the share transfer as determined by the tax authority

Tax reporting obligations and payment deadline

According to Circular 67, the taxpayer, the withholding agent and the Invested Enterprise shall comply with the following tax reporting and payment obligations:

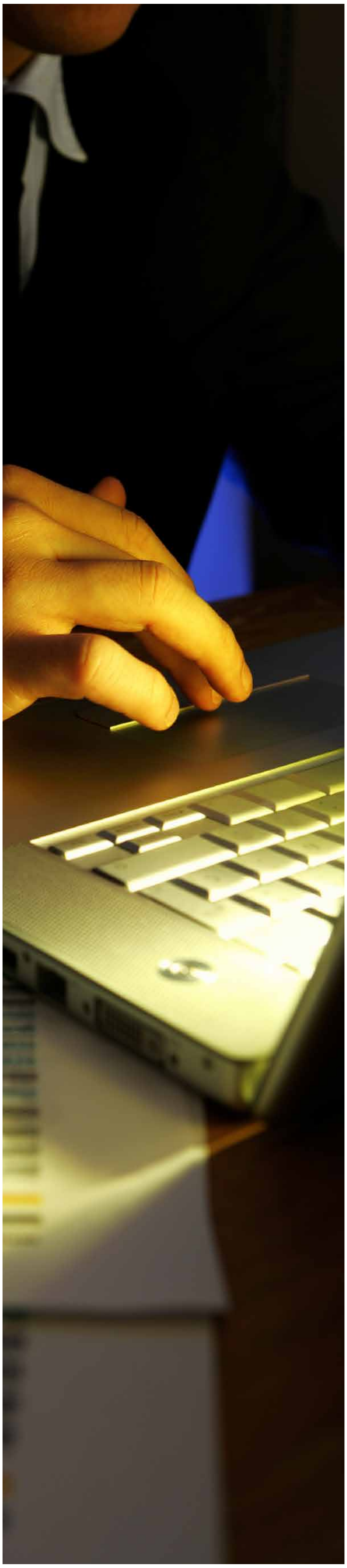
Tax reporting obligations of the withholding agent

The withholding agent must report the relevant information regarding the share transfer to the in-charge tax authority within 5 working days after the relevant share transfer agreement is signed.

Tax filing and payment

The withholding agent or the taxpayer should complete tax filing and pay tax to the in-charge tax authority within 15 days of the month subsequent to the month in which any of the following circumstances appeared:

1. The transferee has paid whole or part of the consideration for the share transfer;
2. The share transfer agreement has been signed and became effective;



3. The transferee has actually performed a shareholder's duties or enjoyed a shareholder's rights and interests;
4. The judgment, registration or announcement of the relevant government authorities became effective;
5. The relevant share transfers activity prescribed in article 20(5) of Circular 67 has been completed ;
6. Other evidence determined by the tax authority proved that the relevant share(s) has been transferred.

Tax reporting obligations of the Invested Enterprise

Invested Enterprise should submit documents of board meetings or shareholders' meetings, such as minutes and resolutions, related to the share transfer to the tax authority within 5 working days after the meetings are held.

Should there be changes in individual shareholders or changes in shareholding held by individual shareholders, the Invested Enterprise should submit the <Basic Information of Individual Income Tax (Form A)> and explanations of the circumstances regarding the change of shareholder to the in-charge tax authority within 15 days of the month following the month in which the change happened.

Our Comments

1. The release of Circular 69 is in line with the China tax authorities' commitment to further strengthen the tax collection and administration of share transfer transactions conducted by individuals. The Circular sets out comprehensive requirements to further elaborate the tax reporting obligations and tax assessment as stipulated under the Law of Administration of Tax Collection, thereby facilitating the monitoring and enforcement of IIT measures with respect to share transfer transactions.

2. Circular 69 further clarifies the assessment method of income arising from share transfers. It also confirms that various types of consideration derived by the transferor from the share transfer should be treated as share transfer income. In addition, Circular 69 provides clarifications in respect of the determination of original value of shares being transferred. Such clarifications in Circular 69 have significantly enhanced the regulatory certainty to monitor individual share transfer transactions.

3. It is worthy to note that Circular 67 sets out more detailed guidance with regard to the tax reporting obligations and responsibilities of Invested Enterprises. As compared with Guoshuihan [2009] No.285 which lays down reporting and disclosure requirements for enterprises with changes in individual shareholder ownership, Circular 67 provides clearer and more comprehensive provisions.

4. To conclude, the release of Circular 67 is consistent with the SAT's objectives to execute a series of tax administration and anti-avoidance measures in recent years. Circular 67 has brought about significant implications on various aspects including the investments of foreign investors in Mainland China, mergers and acquisitions, as well as the restructuring of Mainland enterprises for overseas listing, etc. It is recommended that both the investor and the operating party adhere to the relevant tax rules when conducting share transfer transactions, so as to properly manage and minimize the relevant tax risks.

For more information, please contact:

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