



GAAR

CHINA'S LEGISLATION AND PRACTICE

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Fourth IMF-Japan High-Level Tax
Conference

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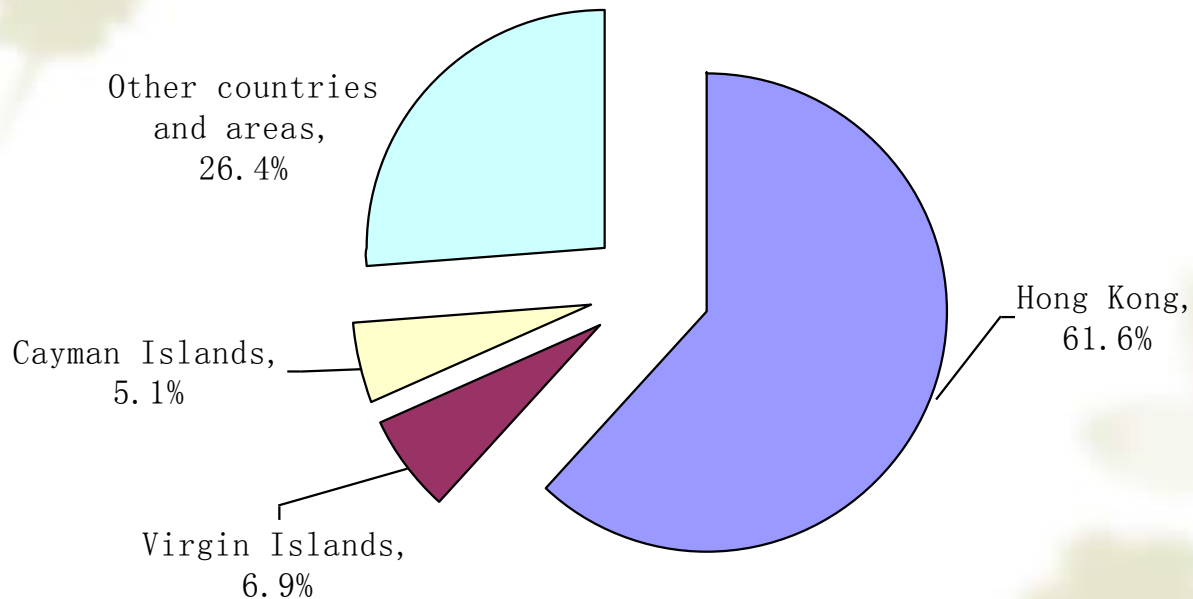
Background

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Background

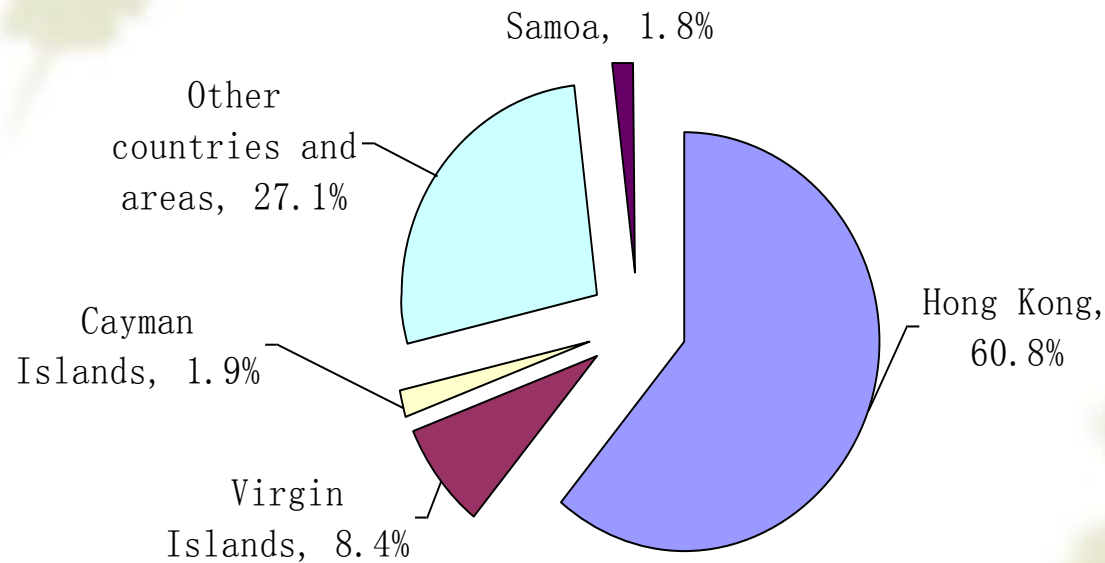
- ❖ Tax avoidances are severe in China
 - Multinational companies
 - Domestic companies
- ❖ International Legislation and Demand
 - OECD: Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
 - UN: Practical Manual on Transfer Pricing for Developing Countries
 - G20 Summit: Take actions to non-compliant tax havens
- ❖ Opportunity
 - In 2008, China unified the Foreign CIT and Domestic CIT and added the content of anti-avoidance into the new law.

Close Relationship Between Companies and Tax Havens



Until 2011, China's direct investment stocks to Hong Kong, Cayman Islands and Virgin Islands have accounted for 73.6% of total China's outward direct investment stock.

Close Relationship Between Companies and Tax Havens



In 2011, China's FDI from Hong Kong, Cayman Islands, Samoa and Virgin Islands have accounted for 72.6% of total China's FDI.

Purposes of GAARs

- ❖ The GAARs are introduced to tackle tax avoidance arrangements without reasonable commercial purposes, such as:
 - Abuse of preferential tax treatments
 - Abuse of tax treaties
 - Abuse of corporate legal form
 - Use of tax havens
 - Other arrangements without reasonable commercial purposes.

Fruits of China's Anti-Avoidance

- ❖ From 2006–2010, average payment of tax underpaid in anti-avoidance cases had increased from 3.8 million yuan to 14.6 million yuan.
- ❖ During these 5 years, there have been 155 cases, of which the payment of tax underpaid was over 10 million yuan, and 12 cases, of which the payment was over 100 million yuan.
- ❖ In 2011, anti-avoidance contributed 23.9 billion yuan to tax revenue increase.
- ❖ Increased the compliance level of taxpayers. After special tax adjustment on some foreign companies, the whole profit level of that industry increased from less than 1% in 2004 to 5.6% in 2008.

Legislation

Legislation of GAARs

❖ Corporate Income Tax Law of the PRC

- Article 47: “When the taxable income or amount of income of an enterprise is reduced as a result of arrangements with no reasonable commercial purposes implemented by the enterprise, the tax authorities have a right to make adjustments according to a reasonable method.”

Legislation of GAARs

- ❖ No reasonable commercial purposes
 - Article 120 of Regulations for Implementation of the law of the CIT: “No reasonable commercial purposes, ..., means that the main purpose is to reduce, exempt or postpone tax payments.”

Legislation of SAARs

	Article of CIT	Provision
TP	Article 41, 1st item	Where a business transaction between an enterprise and its affiliate disobeyed the principle of the arm's length with reducing the taxable income, the taxation authority shall have the right to make adjustment in a reasonable manner.
APA	Article 42	An enterprise may make suggestions to the taxation authority as to the principle of pricing and the method of calculation for the transactions between itself and its affiliate. The taxation authority and the enterprise may, after consultation and confirmation, reach an advance pricing agreement.
CSA	Article 41, 2nd item	The cost incurred by an enterprise and its affiliate in joint development or transfer of intangible assets, or in joint provision or acceptance of labor services shall be shared by them under the principle of arm's length.

Legislation of SAARs

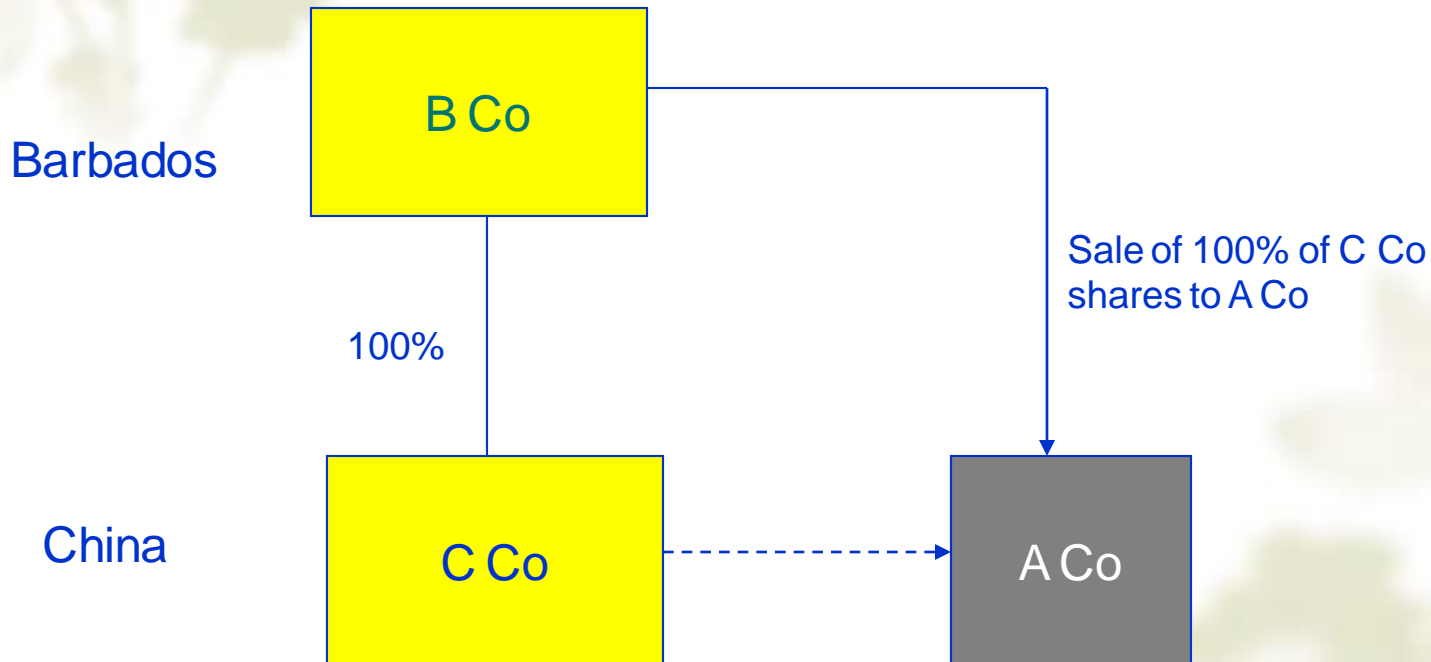
	Article of CIT	Provision
CFC	Article 45	For an enterprises which is controlled by a resident enterprise or by both a resident enterprise and a Chinese resident, but established in another country where the actual tax burden is obviously lower than the tax rate specified in the law, if it does not distribute its profits or distributes the profits at a reduced rate for reasons other than reasonable business needs, the portion of the aforesaid profits that should go to the said resident enterprise shall be included in the income of the current period in that enterprise.
TC	Article 46	The expenses incurred by an enterprise for payment of interest, due to the fact that the ratio of the bond or equity investment it receives from its affiliates is in excess of the prescribed norm, may not be deducted when it calculates the amount of its income taxable.

Relationship between GAARs and SAARs

- ❖ GAARs, as the last resort, we use it in the situation that an anti-avoidance arrangement exists but the SAARs cannot work well. General anti-avoidance provisions are to supplement or compensate the lack of special anti-avoidance provisions to help enhance compliance. In general, GAARs are not applied to a transaction that can be and should be dealt with through SAARs.

Case Study

Case Study



Case Study

- ❖ B Co is the resident enterprise of Barbados, non-resident enterprise of China.
- ❖ According to the tax treaty between Barbados and China in 2000, enterprise, which sell assets including shares, only pay tax in resident country.
- ❖ B Co asked tax exemption for the sale of 100% of C Co shares to A Co.

Case Study

- ❖ With the help of JITSIC, Chinese tax authority discovered the nature of this share transaction: B Co is an illusive parent company. It is the abuse of tax treaty.
- ❖ In December 2012, B Co agreed with the tax adjustment and paid tax of 40 million yuan.

The End

Thank you for your attention.

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