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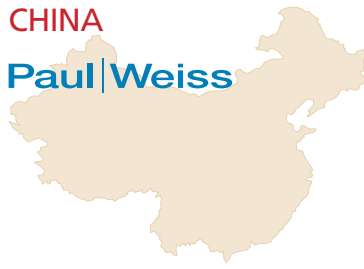


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New Regulations on Corporate Income Tax on Gains from Transfers of Equity Interest by Non Resident Enterprises

In an attempt to strengthen regulation of corporate income tax (“CIT”) on gains from transfers (“Transfers”) by non-tax resident enterprises (“NREs”) of equity interest in tax resident enterprises (“CTREs”), on December 10, 2009, the State Administration of Taxation issued Guoshuihan [2009] No. 698 (the “Notice”). The Notice focuses on Transfers that potentially could be viewed as structured by NREs to avoid CIT in China and grants Chinese tax authorities power to conduct substantive review of, and adjust CIT on, such Transfers.

Among other things, the Chinese tax authority (the “Authority”) will review indirect Transfers in which the offshore holding company whose equity interest is being transferred (the “Intermediary”) is subject to an effective tax rate of less than 12.5% in its jurisdiction of establishment. If a Transfer is found to be an abuse of organizational form arranged by the NRE to avoid CIT and have no reasonable commercial purpose, the Authority may re-characterize the nature of the Transfer based on its economic substance and disregard the existence of the Intermediary. Moreover, for Transfers by an NRE to its related parties, if the transfer price is found to be inconsistent with the arm’s length principle and results in reduction in CIT, the Authority may adjust such transfer price pursuant to reasonable methodologies.

The Notice imposes substantial disclosure burden on NREs and does not specify what level of detail is required. Also, the standard for review by the Authority is subjective and vague. For example, it is unclear what the tests are for determining “abuse of organization form” or the “arm’s length principle.” Neither does the Notice

give any explanation for “reasonable methodologies” that sometimes could be applied to adjust relevant transfer prices in, and ultimately, CIT on, a Transfer. The test for “arm’s length principle” is particularly problematic because it is questionable whether the Authority should be involved in the substantive review of valuation of the relevant CTREs. In addition, no time limit for review and determination by the Authority or procedures for follow-up requests is provided in the Notice.

The Notice poses challenges to Transfers by increasing uncertainties over structuring, pricing and execution of such transactions. On any Transfer, NREs should carefully consider issues such as structure, allocation of any additional CIT which may be imposed by the Authority, and communication with the relevant Authority in executing such transactions.

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