

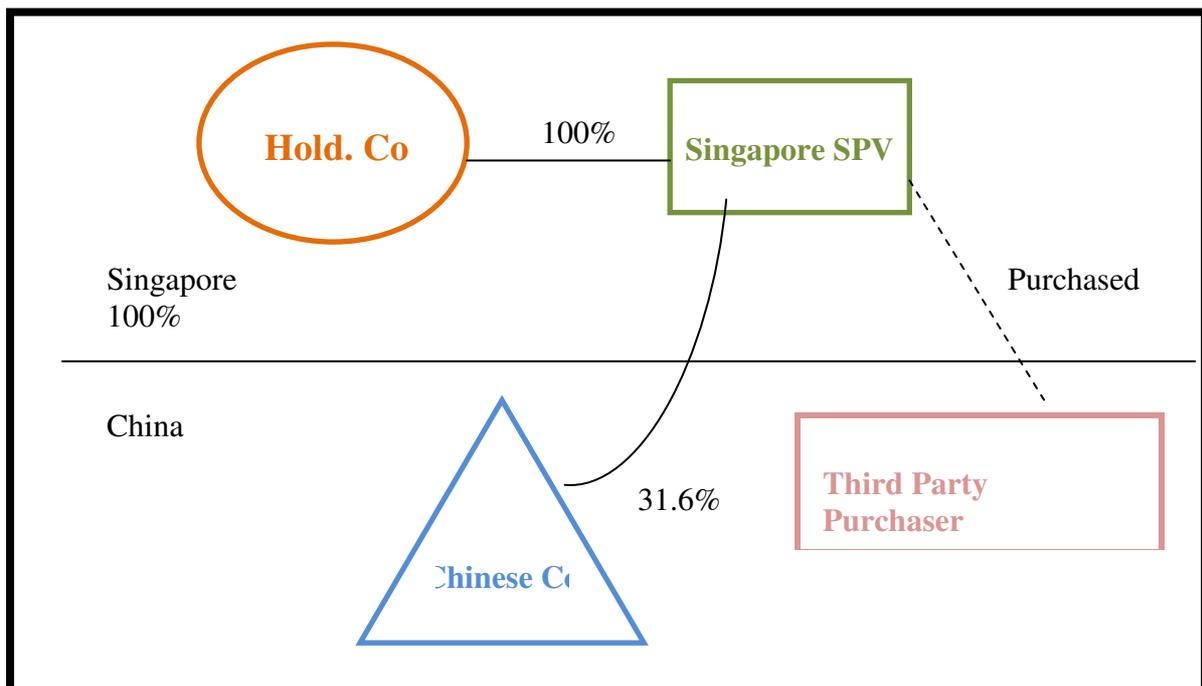


China gets Serious on Anti-avoidance.

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The 2008 Enterprise Income Tax Law (“EITL”) introduced a general anti-avoidance provision into China’s taxation laws for the first time. Article 47 of the EITL provides Chinese tax authorities with the power to make adjustments ‘through a reasonable method’ where an enterprise enters into an arrangement ‘not for any reasonable business purpose’. The tax authorities have a ten year statute of limitations in which to make an adjustment for non-arm’s length principle transactions or any arrangement that does not have any reasonable business purpose. Yet, until recently it was not clear whether the authorities would utilize the broad powers, and to what extent, conferred on them under the new Law and Regulations. Recent events appear suggest that the State Administration of Taxation (SAT) will make serious attempt to eliminate avoidance practices.

Firstly, in late 2008 a tax case was issued by the State Tax Bureau in the Chongqing Yuzhong district which has substantial consequences for how many companies have traditionally structured their operations in China – through the use of offshore SPVs. In this particular case the tax authorities found that a Singapore holding company was liable to taxation in China for the sale of its shares in a Singapore based subsidiary, which itself held a 31.6% equity stake in a Chinese company. The authorities deemed the sale of the subsidiary to be a sale of the interest in the Chinese company and accordingly imposed withholding tax on the holding company.



The Xinjiang SAT issued also issued a similar decision in a case involving a Barbados SPV. Importantly, this was a case where the PRC tax authorities rejected the application of the China-Barbados tax treaty on the basis that the SPV did not have any operations of substance in Barbados and according was not entitled to protection under the treaty.

Further, on 8 January 8 2009 the State Administration of Taxation released the *Implementation Regulations for Special Tax Adjustments (Trial)* (the “Regulations”) which clarify the operation of Article 47 of the EITL. In particular, Article 92 provides that the tax authorities may initiate a general avoidance audit where an enterprise engages in one of the following:

1. Abuse of tax incentives;
2. Abuse of tax treaties;
3. Abuse of a company's legal form;
4. Tax avoidance through a tax haven; and
5. Other arrangements without bona fide commercial purpose.

Article 93 of the Regulations outlines matters that the authorities should take into account in determining whether there is a tax avoidance arrangement. These are the (1) form and substance of the arrangement; (2) the conclusion time and the execution period of the arrangement; (3) implementation method of the arrangement; (4) relationship between each step or part of the arrangement; (5) changes in the financial performance of each party involved in the arrangement; and (6) the tax consequences of the arrangement.

Finally, on 31 March 2009 the SAT held a seminar where the issue of the operation of its anti-avoidance tax policy was discussed. The SAT’s overall commitment reducing tax avoidance through the use of the general anti-avoidance law was confirmed. The SAT specifically indicated that they would take stronger efforts in relation to obtaining information, including through the exchange of the information with treaty partners. The SAT also indicated a specific commitment to employ 500 officials in a specialized anti-avoidance team.

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