

China implements new measures on General Anti-Avoidance Rules



On December 12 2014, the Chinese State Administration of Taxation (SAT) issued Decree 32 on the general anti-avoidance rules, that shall pertain to special tax adjustments made to companies' tax avoidance arrangements.

Though certain kind of anti-avoidance rules were already included in the law as from 2008, they were way too general and hence not that efficient.

The globalization of the markets and the opening of China to the western business community have required a significant review of the domestic legislation in this respect.

By any evidence, it represents another step to an approach that other big economies have been adopting for long time now. The global debate on measures to avoid multinational groups reduce their tax liabilities by taking advantage of certain countries' ad-hoc tax schemes is indeed reaching practical results. The G20 activated the OECD to put in place effective action plans to fight the Base Erosion and Profit Shifting (BEPS).

And properly in the context of the Ninth G20 Leaders' Summit held on 16 November 2014 in Australia, the Chinese President Xi Jinping stated "efforts should be made to reinforce the international collaboration on tax matters, to crack down on cross-border tax avoidance and evasion, and to help the developing countries and low-income countries improve their capabilities of tax collection and administration".

Such speech on an official context as the G20 was certainly a sign of change that would have led to major detailed procedures for the benefit of the tax administration but also of the taxpayer.

Via the new GAAR, the taxpayer's rights over a dispute resolution are clarified. As a matter of practice, in order to fit with the already existing measures, the new GAAR shall be invoked only after the already in use measures would have been tried.



The content of the measures

Pursuant to Decree 32, the competent tax authority shall have the power to request any relevant information and supporting documentation to those entities which would have provided tax planning services to the investigated taxpayers in respect of the arrangement in question.

The competent tax authority shall have 9 months to complete the investigation.

According to article 47 of the Enterprises Income Tax Law (EIT) the SAT has the right to adjust an enterprise's arrangement that has no sufficient business purpose. Pursuant to article 120 EIT, the business purpose would be deemed as lacking in case the arrangement has been put in place with the main intention of reducing, avoiding or deferring tax payments.

The Decree indicates also a prescription term for the investigation and the subsequent adjustment. The SAT has the power to intervene up to 10 years of the date the arrangement occurred.

Another point that approaches China to the OECD principles is the concept of economic substance. The Decree specifies that besides the effective tax benefits the taxpayer might have achieved, should the economic substance of the transaction lack, the arrangement shall be adjusted, and regardless the fact said arrangement is perfectly correct as from a legal form perspective.

Methods adopted by the SAT

By applying the principle of substance over form, the special tax adjustments the tax authorities shall operate will be *inter alia*, (i) the recharacterization of part or all of the arrangement; (ii) the recharacterization of income, deductions, preferential tax treatment; (iv) reallocation of income deductions and preferential tax treatment between the parties.

In terms of regulation hierarchy, should an arrangement imply other specific existing regulations (e.g. transfer pricing), such specific regulations shall prevail over the new GAAR.

The Decree discloses a detailed list of information and documents that might be requested to the taxpayer in the context of the investigation.

In terms of procedures, once terminated the investigation, the competent tax authority must submit its remarks on the special tax adjustment to the SAT that after review and approval shall allow the competent tax authority to notify the taxpayer. In case of disagreement with the investigation's output, the taxpayer might seek legal relief at an administrative court.



Conclusions

By any evidence, China is quite rapidly maturing in respect of tax and regulatory principles.

This confirms its exposure to the international business community and the interest generated to big multinational groups that hence require a more efficient tax system.

China is paving its way to a durable future of business opportunities for both domestic and foreign players.

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