



*cutting through complexity*

# 2012 Annual China Tax Update Conference

November 2012



# Agenda

- **Introduction**
- **Latest Development of Laws and Regulations**
- **Case Studies**
- **Q&A**

# Introduction

- Current economic condition – risk of China / the world
- Overall increasing of tax revenue
- Increasing enforcement efforts by tax authority
- Expanding scope of VAT reform

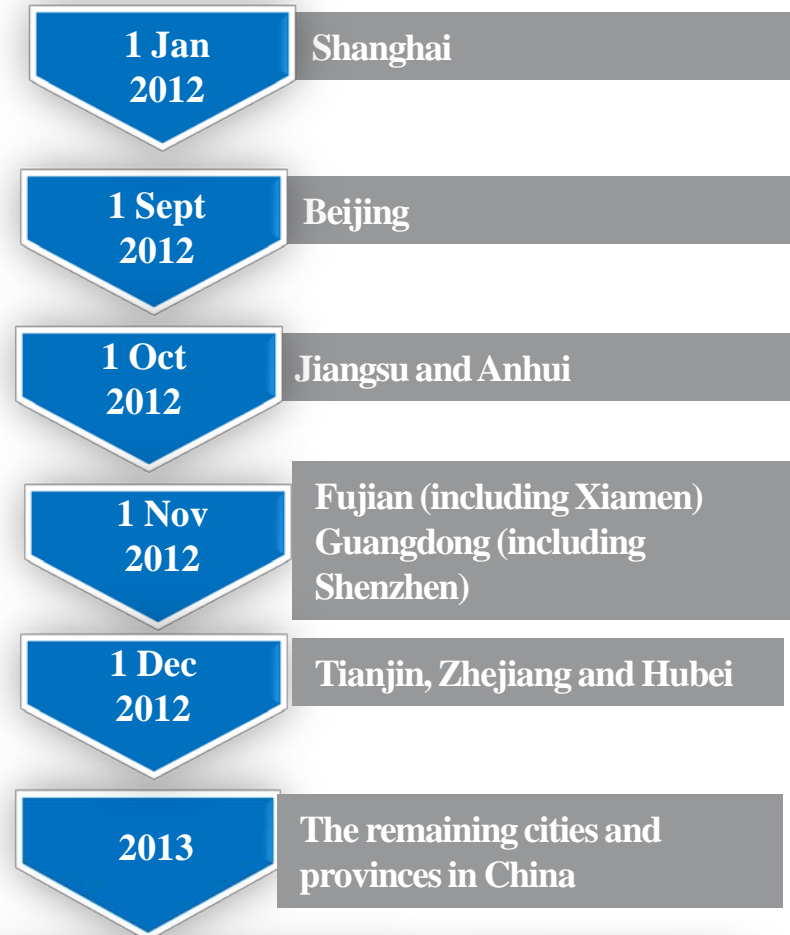
# Latest Development of Laws and Regulations



# Latest Development of Laws and Regulations

- **Turnover Tax**
  - Pilot Program for Value Added Tax Reform
  - Policy Change on VAT Refund/Exemption on export of goods and services
- **Corporate Income Tax**
  - Expense Deduction
  - Incentives for Western Regions
  - Corporate Income Tax for Non-Resident Enterprises
- **Individual Income Tax**
  - Individual Income Tax Incentives for Hong Kong and Macau Tax Residents
- **Administration of Collection**
  - Tax Compliance Agreement
  - Outlook for Advance Ruling Mechanism
- **Other**
  - Equity contribution as capital

# Value Added Tax Reforms

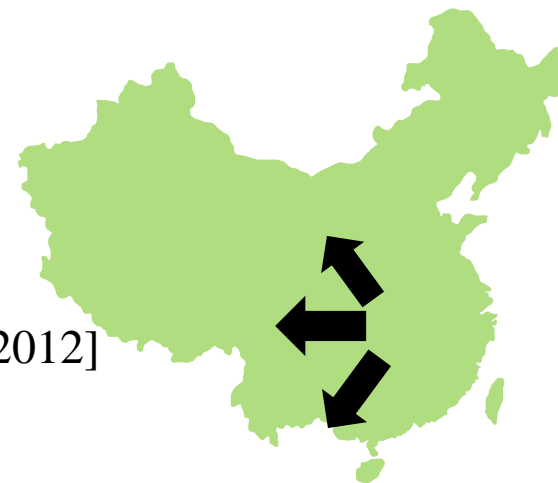


# Overview of Implications

## Expansion of VAT pilot program: key comparisons

### What will be the same?

- Same VAT rates as Shanghai
- Same industries as Shanghai
- Same pilot program rules as Shanghai (see Circular Cai Shui [2012] No. 71)



### What will be different?

- In Shanghai, State and local tax bureaus are together. In other locations, they are separate
- Different tax bureaus may have different interpretations
- In Shanghai, exemptions, concessions and other beneficial treatments under the BT regime continue to apply. However, in other locations, different tax officials may hold different views

# Our Experiences So Far

Industry	Tax burden impact	Complexity
Transportation	Increased	Very high
Logistics	Some increases	High
Asset leasing	Some increases	High
R&D and technical services	Some decreases	Medium
IT	Decrease	Medium
Cultural and creative services	Decrease	Medium
Consulting	Decrease	Low to Medium
Small scale taxpayers	Decrease	Low



# Key VAT Implications for Cross Border Services

## Export:

	Output VAT	Creditable input VAT
Zero - rating	No	Yes
Exempt	No	No

Maintain relevant documentations for the input VAT amounts and the associated allocation pertaining to various types of expenses

## Import:

	Output VAT	Creditable input VAT
Agent or service recipient	Withholding of VAT	Yes, if general VAT taxpayer

# Import of Services and Intangibles

## The Rules

VAT would apply to overseas entities or individuals providing services to taxpayers located in the pilot cities

If an overseas service provider has an establishment or place of business within China, such establishment or place of business shall be the VAT withholding agent

If such a business agent does not exist, the service recipient (including entity and individual) shall be the VAT withholding agent, even if the recipient is not a VAT payer (e.g., bank)

If the recipient is a VAT General Tax Payer (GTP) and it is able to provide the relevant supporting documents, the recipient is entitled to the input VAT credit



*Cai Shui [2011] No. 131  
Provisional Regulations of the People's Republic of China on Value Added Tax*



# The Rules – Export of Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
Leasing of tangible movable property		<ul style="list-style-type: none"> <li>Leasing of tangible movable property if the object of the lease is used outside China</li> </ul>
Transportation services	<ul style="list-style-type: none"> <li>Qualified international transportation</li> </ul>	<ul style="list-style-type: none"> <li>Unlicensed international transportation</li> </ul>
Research and development (R&D) and technical services	<ul style="list-style-type: none"> <li>R&amp;D and design services provided to overseas entities</li> </ul>	<ul style="list-style-type: none"> <li>Engineering as well as exploration services where the related project or mineral resources are located outside China</li> <li>Technology transfer, technology consulting, energy management services (except where the object of the energy management contract is located in China) provided to overseas entities</li> </ul>

# The Rules – Export of Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
Information technology (IT) services		<ul style="list-style-type: none"> <li>• Software services, circuit design and testing services, business process management services provided to overseas entities</li> </ul>
Cultural and creative services	<ul style="list-style-type: none"> <li>• Design services provided to overseas entities (except for design services in relation to immovable property located in China)</li> </ul>	<ul style="list-style-type: none"> <li>• Convention and exhibition services for events located outside China</li> <li>• Trademark and copyright transfer services, intellectual property services provided to overseas entities</li> <li>• Advertising services where the related advertisement is released outside China</li> </ul>

# The Rules – Export of Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
Logistics and ancillary service		<ul style="list-style-type: none"> <li>• Warehousing services where the location of the warehouse is outside China</li> <li>• Logistics and ancillary services provided to overseas entities (except warehousing services)</li> </ul>
Certification and consulting services		<ul style="list-style-type: none"> <li>• Certification, verification and consulting services provided to overseas entities (except for services in relation to goods or immovable property located in China)</li> </ul>



# Policy Adjustment for Export VAT Refund (Exemption)

## New changes in export VAT refund policy

- Definition of export enterprises
- Expanded scope of products deemed as self-manufactured
- The payment certificate issued by Customs can now be used for export VAT refund purposes
- Export VAT refund policy is adjusted for goods that a trading company consigns to other companies for processing, repair and replacement

## New changes in export VAT exemption policy

- For export sales which are not reported properly or the documents filed are not complete, change from levying tax to tax exemption
- New provisions for the export entrusted by non-export enterprises
- Adjustment of provisions for export of goods that are not deemed as self-manufactured by non-listed manufacturing enterprises
- Clarification of the tax refund (exemption) provisions for export of goods in special zones
- New provision to allow export enterprises to give up their tax exemption rights

## New changes in the VAT taxation policy for export

- Adjustment of the calculation method of output VAT for import processing business
- Clarification of provisions for the sales of imported materials by trading companies
- Addition of measures to strengthen the prevention of export tax fraud

Caishui [2012] No. 39  
SAT Announcement [2012] No. 24

# Further Clarification of Expense Deduction

- **General expense deduction**
  - Advertising and promotion expenses
  - Seasonal workers costs
  - Financing costs
  - Fees and commissions
  - Entertainment expenses during pre-operating period
  - Previously non-deducted expenses that should have been deducted
- **Stock compensation cost deduction**
  - Timing: Deductible upon exercise; not deductible during the lock-up period
  - Amount: (FMV of the stock at the time of exercise – exercise price) x number of shares
  - Nature: Wages and salaries

SAT Announcement [2012] No. 15

SAT Announcement [2012] No. 18

Caishui [2012] No. 48

# CIT Incentive for Western Regions

- **Announcement 12 clarifies the following implementation issues regarding CIT incentives for China's western regions**
  - The industrial catalogue used to determine the main operation of an enterprise
  - Approval procedures for the 15% preferential CIT rate
  - The grandfathering arrangement for the old “two-year-exemption, three-year-half-reduction” policy
  - How to apply the 15% preferential CIT rate for enterprises with branches both in and outside the western regions

SAT Announcement [2012] No. 12



# Supplement to Circular 601 – Announcement 30

- **SAT Announcement regarding the determination of “beneficial owners” in tax treaties** (SAT Announcement [2012] No.30)
  - Effective date: 29 June 2012
- **Key issues clarified by the supplement:**
  - Emphasize the comprehensive analysis of all factors listed in Circular 601
  - Clarify the supporting documents to refer to when analyzing the factors listed in Circular 601
  - Provisions for “safe harbor” rule
  - Tax refund issue
  - The authorities to be involved when rejecting the taxpayers’ applications
  - Consolidated result for the same taxpayer when the circumstances are comparable

# Supplement to Circular 698 – To Be Issued Soon

- **Plan to clarify:**

- Circular 698 is not applicable to internal reorganizations
- Simplified documentation requirements if certain conditions are met
- The tax authorities' duty to provide written confirmation
- Extended tax payment term
- Cost basis in calculating the capital gains

# Relevant Cases for Non-resident Enterprises

2012, Shanxi, the most significant tax payment for indirect share transfer

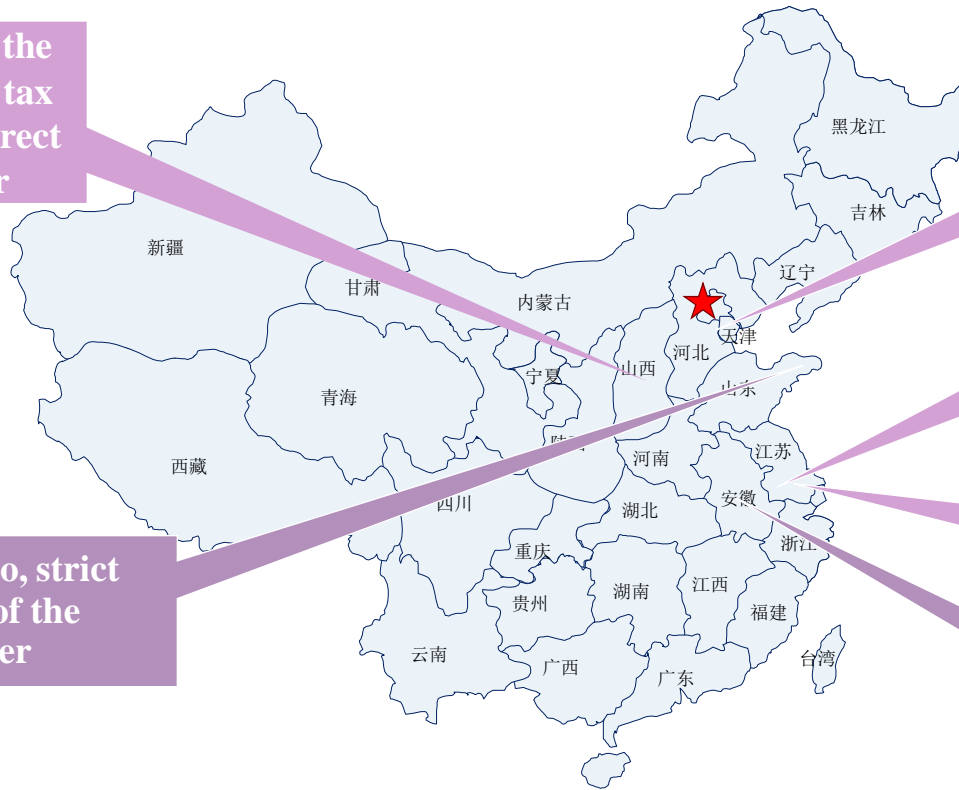
2011, Nanjing, taxation of indirect share transfer identified by an anonymous informant

2011, Kunshan, the first case of taxation of indirect share transfer

2012, Qingdao, strict identification of the beneficial owner

2011, Qidong, Taxation of indirect share transfer

2011, Anhui, Prevention of the abuse of tax treaties



# Tax Incentive for Hong Kong/Macau Tax Resident in Mainland China

- **Eligibility:**
  - Tax Resident of Hong Kong/Macau who is employed in Hong Kong/Macau, or it's under dual employment contract with a mainland Chinese entity and a Hong Kong/Macau entity
- **Measurement To Eliminate Double Taxation**
  - Preferential formula for determining Individual Income Tax liability
  - Administratively more feasible method for computing onshore and offshore working days
  - New rule for sourcing of bonus
- **Effective Date**
  - For salary received by qualified individuals on or after June 1, 2012

SAT Announcement [2012] No. 16

# Tax Compliance Agreement

Liaoning state and local tax bureaus signed "Tax Compliance Agreement" with 13 large enterprises on 31 March 2012

Jiangsu state tax bureau signed "Tax Compliance Agreement Regarding Export Tax Refund" with three large trading groups on 29 Oct 2012

Fuzhou state tax bureau signed "Tax Compliance Agreement" with 5 large enterprises on 24 April 2012

Shenzhen state and local tax bureaus signed "Tax Compliance Agreement" with 2 well-known enterprises on 28 April 2012

State Tax Bureau signed "Tax Compliance Agreement" with three designated contact enterprises on 12 Oct 2012

Sichuan state tax bureau signed "Tax Compliance Agreements" with 4 enterprises in May 2012

# Outlook for Advance Ruling Mechanism

## Applicable Area

Pilot program may be implemented among “large enterprises” with tax compliance agreements signed with tax authorities

## Applicable Item

Possible for prior and future transactions within the pre-agreed scope

## Time Frame

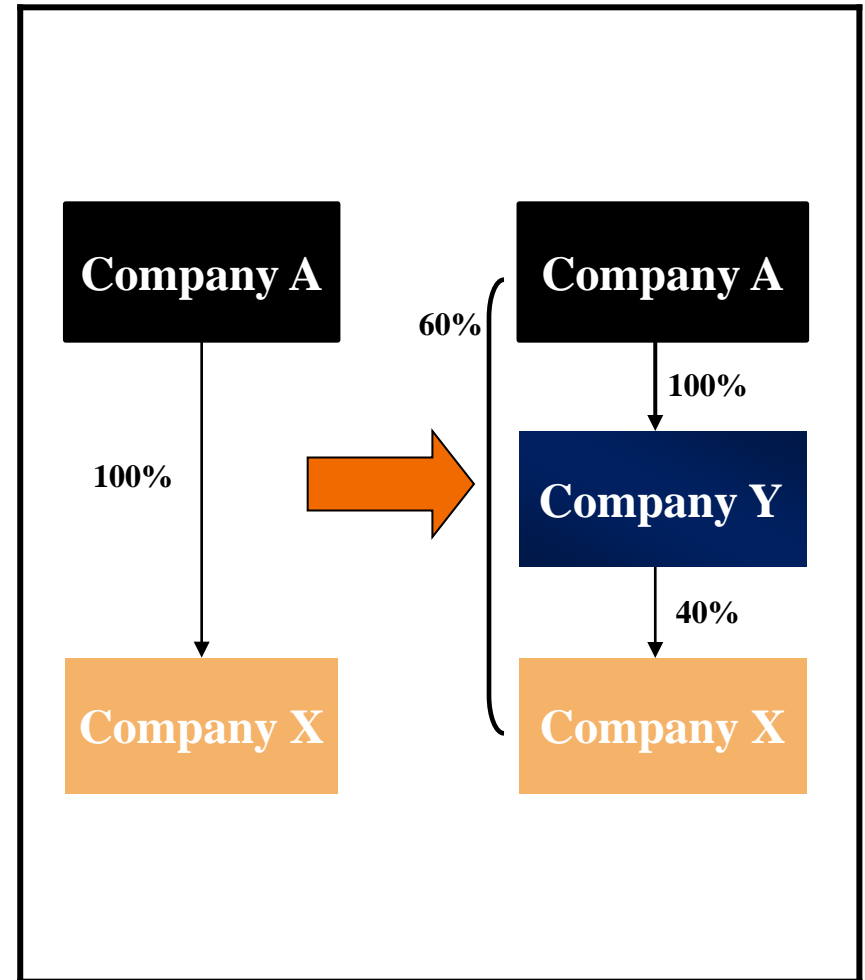
Conclusion by the tax authority potentially within 4 months after the submission of the application

## Administrative method

The conclusion may be disclosed on an anonymous basis

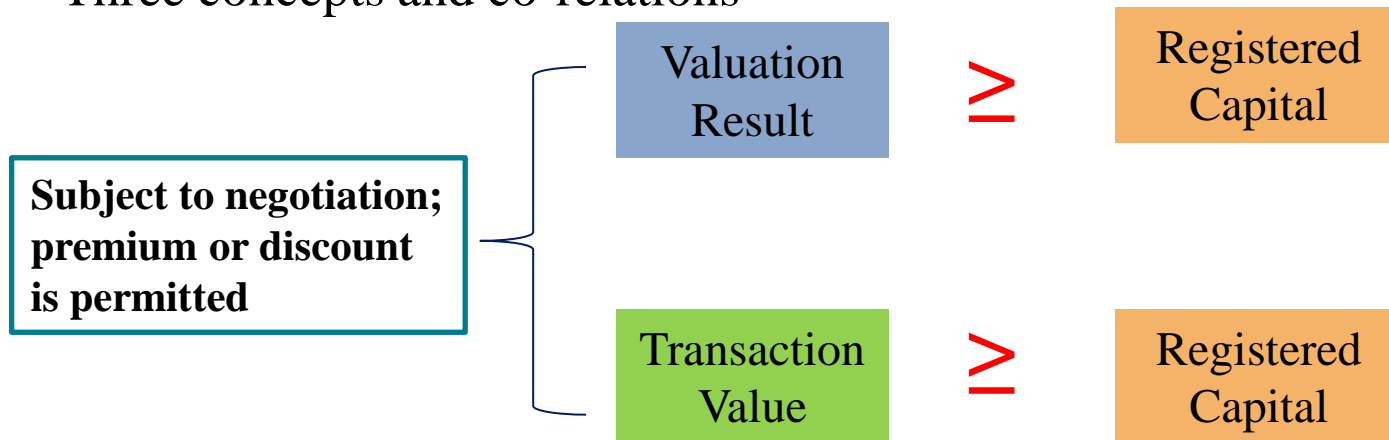
# Equity Contribution

- **“The Provisional Regulation for Capital Contribution using Equity Interest of Foreign Investment Enterprises” (Ministry of Commerce, Decree [2012] No 8)**
  - Effective October 22, 2012
- **Background of Decree No. 8**
  - *“The Administrative Measures Governing the Registration of Capital Contribution with Equity Interest”* (State Administration of Industry and Commerce, Decree [2009] No.39)
  - Issuance of various local equity contribution registration rules
  - Lack of specific guidance in capital contribution using Foreign Invested Enterprise equity interest



# Equity Contribution (Cont'd)

- **Criteria for equity contribution**
  - Equity interest of any real estate enterprise is prohibited
  - Meet the relevant foreign investment rules
- **Valuation and pricing of equity interest**
  - Valued by valuation firms **duly established in the PRC**
  - Three concepts and co-relations

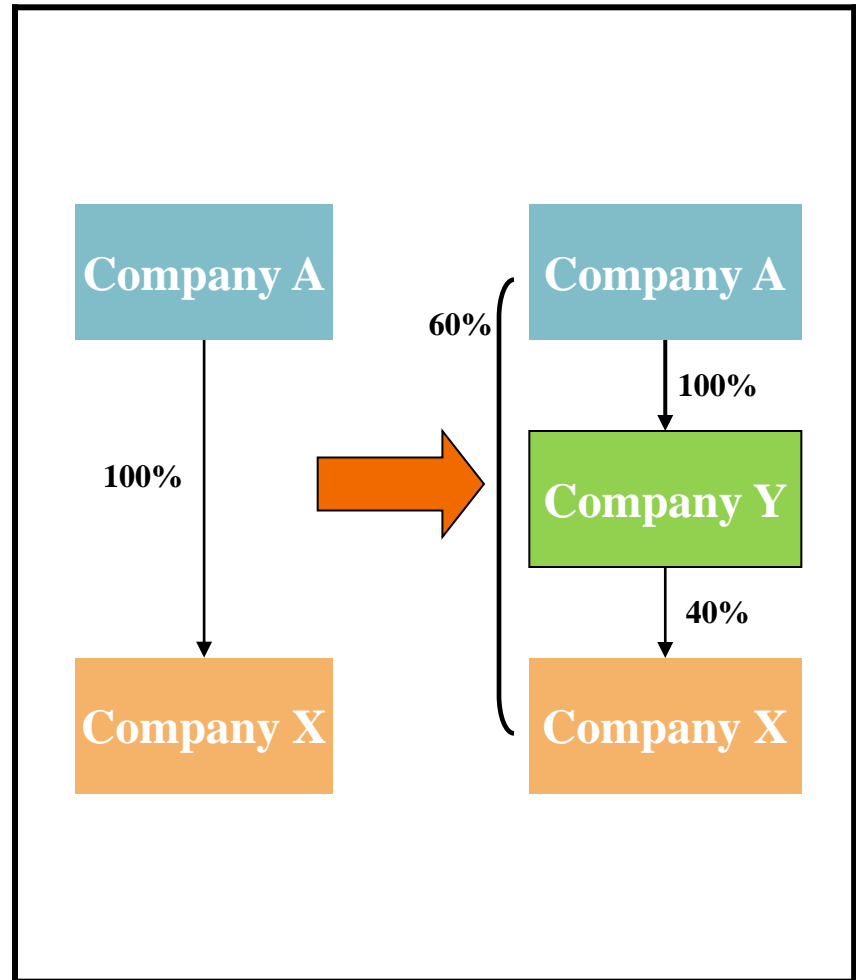




# Equity Contribution (Cont'd)

## Approval Procedures

- Step 1: Application submitted by Company A or Y to Company Y's relevant approving authority
- Step 2: Company Y's approving authority checks with Company X's Provincial level approving authority for comments
- Step 3: Company Y's approving authority issues conditional approval document with the note of "Capital contribution not made"
- Step 4: Company X applies for change of investor
- Step 5: Company Y applies for final approval document with the note of "Capital contribution fully contributed"



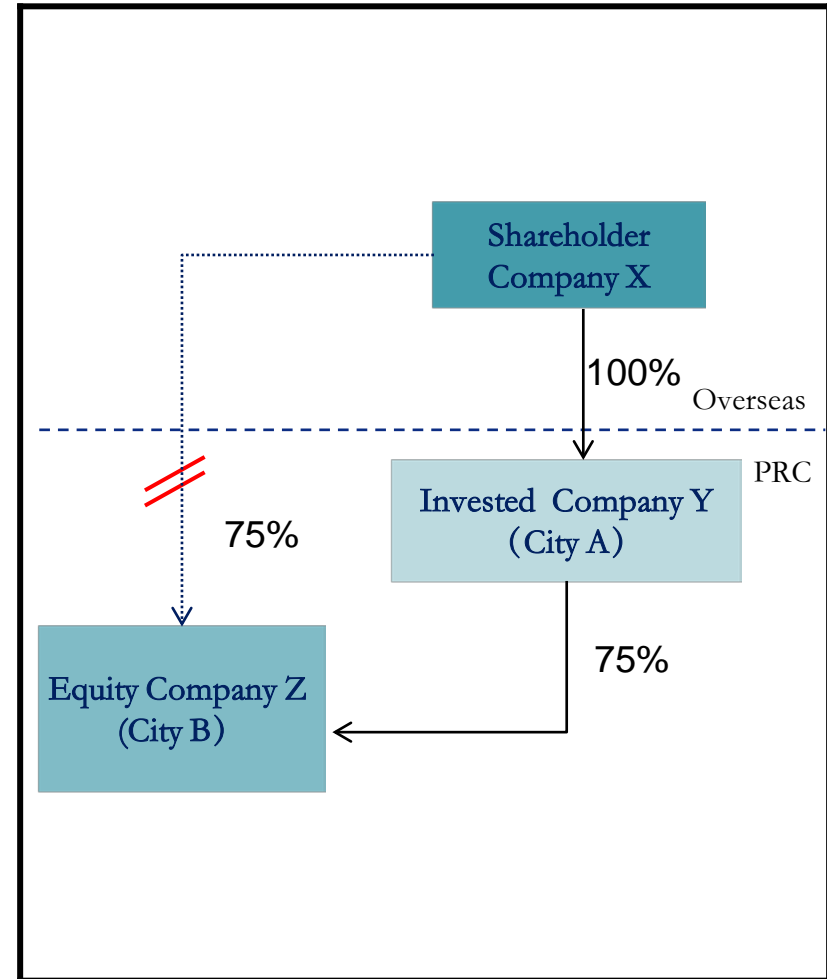
# Case Study - Capital Contribution with Equity Interest

## Case

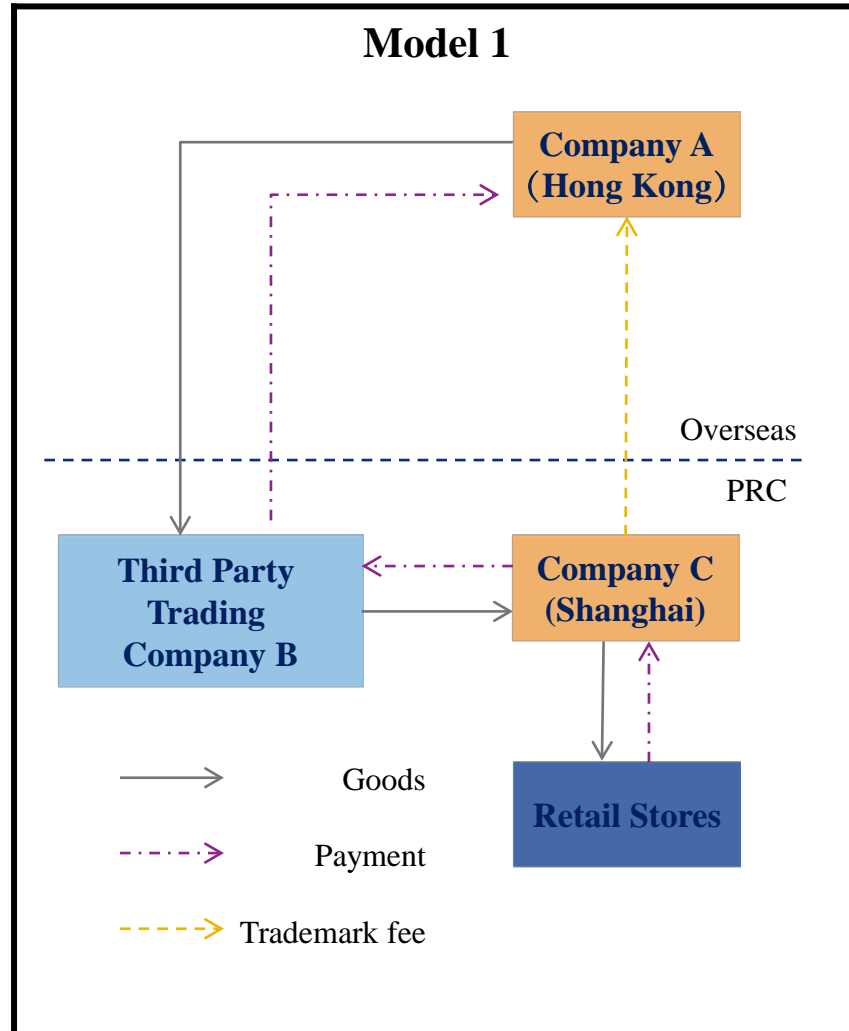
- Company X owned 75% Company Z. In 2010, Company X transferred 100% equity interest in Company Z to Company Y (100%) in the form of equity contribution.
- After the equity contribution, Company Y owns 75% equity interest in Company Z. Company Z retains as a WFOE.

## Issues

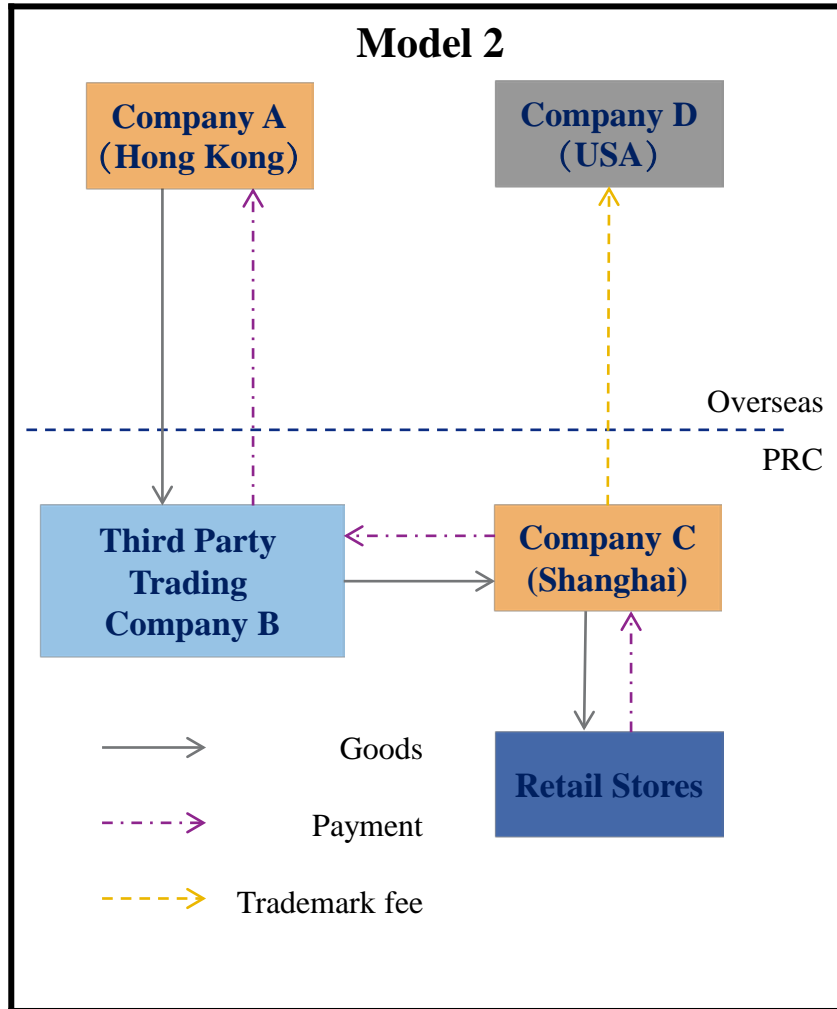
- Disagreement over the approving authority's sequential processing order for the equity transfer and the capital increase
- Valuation relating to registered capital contributed
- Tax treatment of the equity exchange



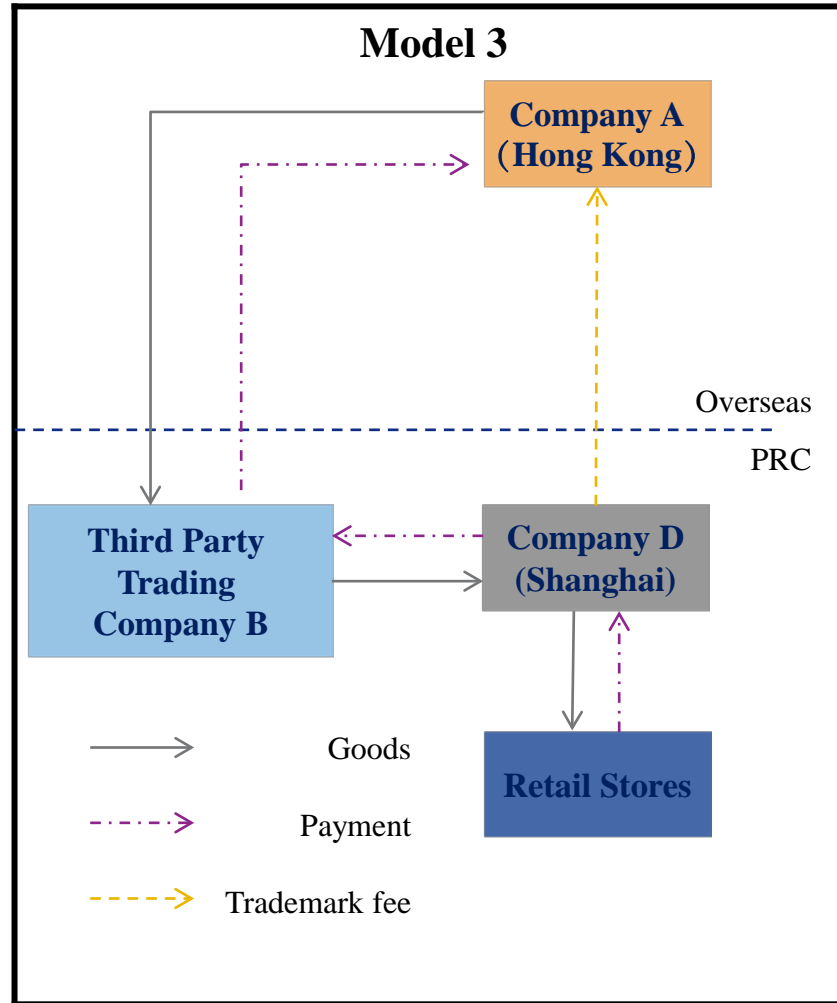
# Case Study - Royalty Fee



# Case Study - Royalty Fee (Cont'd)



# Case Study - Royalty Fee (Cont'd)



# Case Study - IIT for Hong Kong/Macau Tax Resident

## Case:

- Hong Kong resident A who is employed by a Hong Kong Company and is seconded to work for its subsidiary located in mainland China
- A only renders employment duties towards the mainland China Company
- A's family members still reside in Hong Kong. A travels to mainland China for work on every Monday and returns to Hong Kong every Friday (assuming A is physically present in mainland China for 209 days and in Hong Kong for 156 days during the 365 days of a calendar year)
- The monthly salary for A is RMB120,000 and the annual bonus is RMB240,000
- A bears his own PRC Individual Income Tax (“IIT”)

	<b>Before Announcement No.16 (single employment contract)</b>	<b>After Announcement (single employment contract)</b>
Total IIT on monthly salaries	460,020	460,020
IIT on annual bonus	<u>58,995</u>	<u>58,995</u>
Total	519,015	519,015

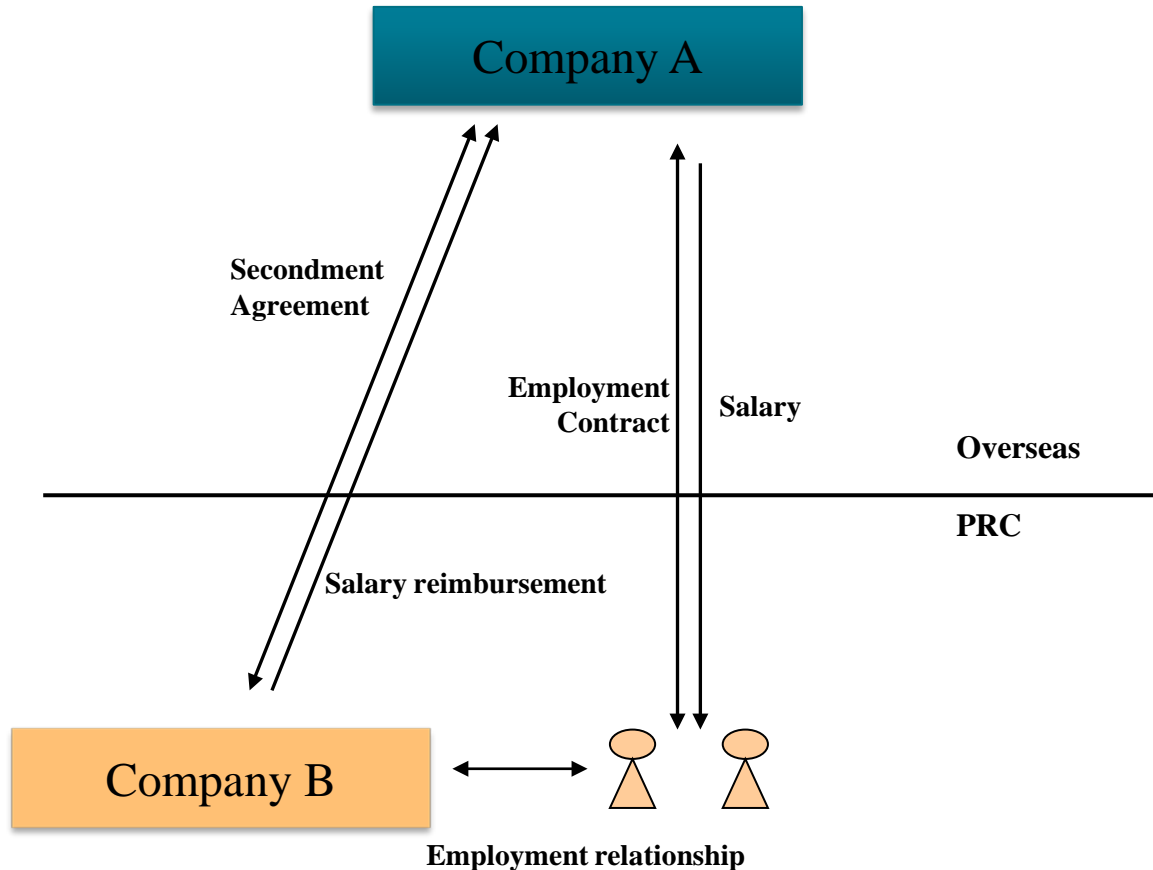
# Case Study - IIT for Hong Kong/Macau Tax Resident (Cont'd)

## Tax impact under Announcement 16

	Before Announcement No.16 (dual employment contract)	After Announcement No.16 (dual employment contract)
IIT on monthly salary for the calendar year	263,409	263,409
IIT on annual bonus	<u>58,995</u>	<u>33,781</u>
Total	322,404	297,190

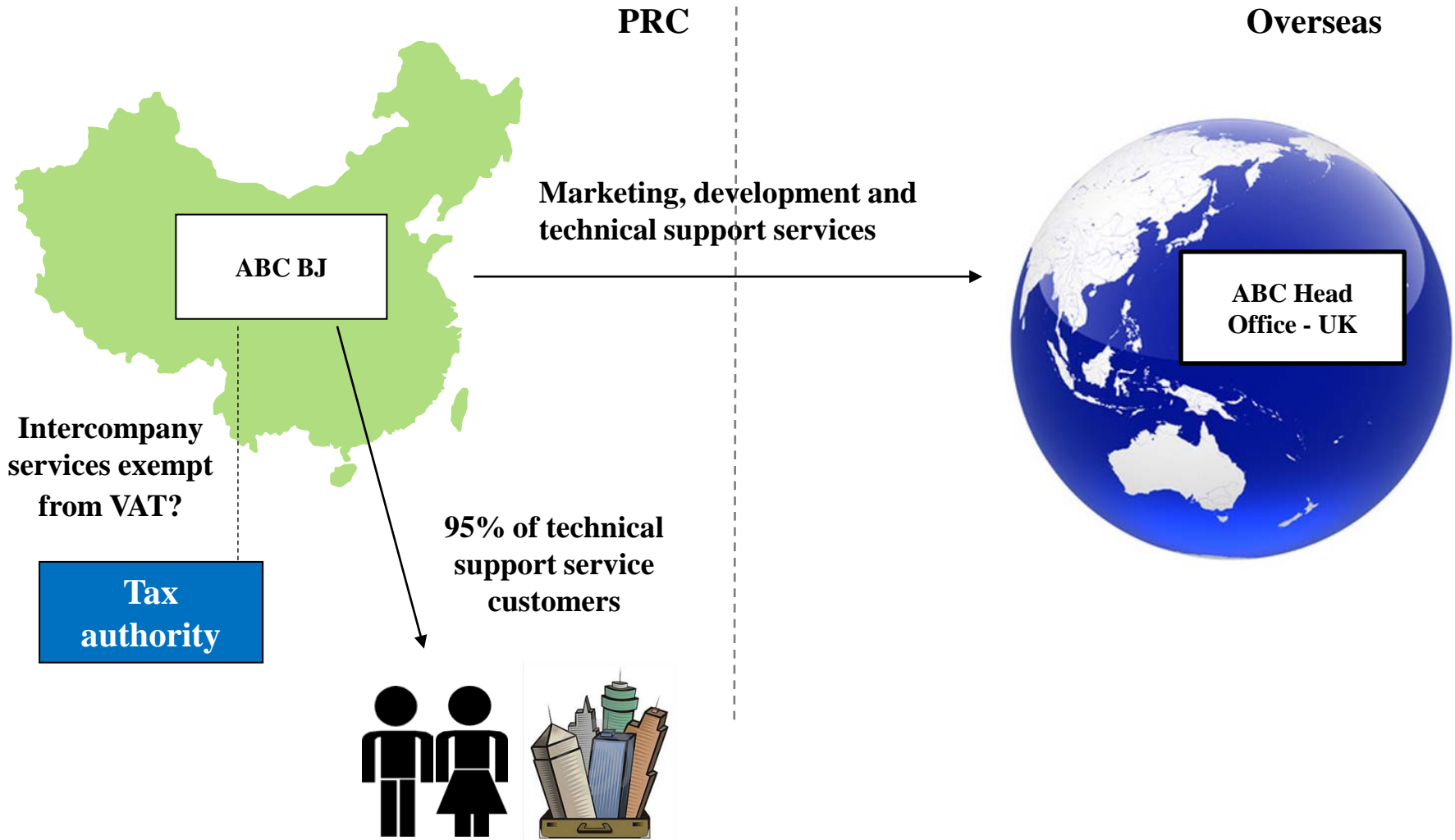
	Before Announcement No.16	After Announcement No.16
PRC IIT cost saving from dual employment arrangement as composed to secondment arrangement	196,611	221,825

# Case Study - Payment to Overseas for The Salary Reimbursement





# Background Facts



# Roadmap to Accessing VAT Concessions

## 4 step process for accessing VAT concessions:

Step	Issue	Reference
1	Do the services fall within the scope of the VAT pilot program (and within the geographical area)?	Caishui [2011] 111 and Caishui [2012] 71
2	Do the services meet the technical requirements for VAT exemption?	Caishui [2011] 131
3	Have the procedural requirements for obtaining VAT exemption been satisfied?	Various reference sources
4	Are the corresponding input creditable?	Caishui [2011] 111

# Requirements for Claiming VAT Exemption for Exported Services

(1)

**The following services are exempt if rendered to a foreign entity**

Logistics and ancillary services

**Technology transfer, technology consulting, energy management services**

**Software services, circuit design and testing services, information system services, business process management services**

Trademark and copyright transfer services, intellectual property services

(2)

**The following services are exempt if consumed outside China**

Unlicensed international transportation

Warehousing services where the location of the warehouse is outside China

Engineering and exploration services if the project /resources are outside China

Convention and exhibition services located outside China

Leasing of tangible moveable property where the object of the lease is being used outside China

(3)

**The following services are exempt if rendered to a foreign entity & consumed outside China**

Consulting services – the recipient must be overseas and the services must not relate to goods or real estate in China

Certification and verification services – the recipient must be overseas and the services must not relate to goods or real estate in China

Advertising services provided to an overseas recipient, and the related advertisement must be released outside China

# Conditions for Claiming Exemption for Services

ABC BJ has three contracts with ABC to provide the following intercompany services:

Type of services	Within scope of VAT pilot program	Conditions for VAT exemption	Conditions met
R&D and technical support services	✓	<ul style="list-style-type: none"> <li>Service recipient is a foreign entity</li> </ul>	✗ See next slide
R&D and technical services (software development)	✓	<ul style="list-style-type: none"> <li>Service recipient is a foreign entity</li> </ul>	✓
Verification and consulting services (marketing services)	✓	<ul style="list-style-type: none"> <li>Service recipient is a foreign entity</li> <li>Services must not relate to goods or real estate in mainland China</li> </ul>	✓ ✓

# Procedures for Claiming Exemption for Services

## Self assessment now available in some locations



The tax authorities in China have not yet published documentation requirements for claiming VAT exemption

In October 2012 Beijing tax bureau issued an urgent internal notice advising that taxpayers can now self-assess eligibility for VAT exemption on exported services

ABC BJ can self-assess eligibility for VAT exemption on its exported services (Beijing)

In Shanghai, Changning District has established procedures. In other locations in Shanghai, the experience is slowly being relaxed – many taxpayers now able to self-assess, whereas some still ineligible

ABC BJ should confirm with the in-charge tax official that it may proceed with self-assessment before filing its October 2012 VAT return

ABC BJ should retain the following documents which may be requested by the tax bureau:

- Contracts specifying the services ABC BJ provides to ABC;
- Requests for payment issued to ABC, fee note, commercial invoice;
- Foreign currency transaction records confirming payment received is made in a foreign currency by a foreign company;
- Bank statements

# Apportionment of Input VAT Credits

- Exemption from VAT means that input VAT on costs incurred in supplying exempt services (exported marketing services and software development services) may be denied
- ABC BJ needs to identify the costs it incurred in providing VAT exempt services to ABC, and classify them into three categories:

## Fixed assets and certain intellectual property rights

Input VAT credits do not need to be apportioned in relation to the purchase of fixed assets or certain intellectual property rights which are used, at least in part, in providing taxable services.

Full input VAT credits can generally be claimed.

## Direct costs

If ABC BJ incurs direct costs/outlays in providing services to ABC, it cannot claim input VAT credits on those costs

## General overhead costs

Many costs may not relate to specific services but are general overhead costs.

These costs which are subject to VAT (e.g. electricity, logistics costs) should be apportioned by ABC BJ each month according to the amount of taxable income as a percentage of total income.

ABC BJ should only claim input VAT credits corresponding to that percentage of general overhead costs.

# Tax Savings from Successful Outcome

**Business Tax (“BT”) regime**  
Exported services = 5% BT

**VAT pilot program**  
Certain exported services = 0% VAT

Intercompany services RMB	Transaction Amount (2012) RMB	BT under BT regime (5%) RMB	VAT under pilot program (0% or 6%) RMB
Technical support services	1,500,000	75,000	90,000*
Software development services	29,000,000	1,450,000	0
Marketing services	<u>35,000,000</u>	<u>1,750,000</u>	<u>0</u>
Total	65,500,000	3,275,000	90,000
Tax saving opportunity			3,185,000

\* ABC BJ is a general VAT taxpayer and will be able to claim input VAT credits for purchases in relation to the supply of technical support services

# Lessons Learned

Separate contracts for different types of services – if some services are exempt and others are not, then the exemption can still apply in part

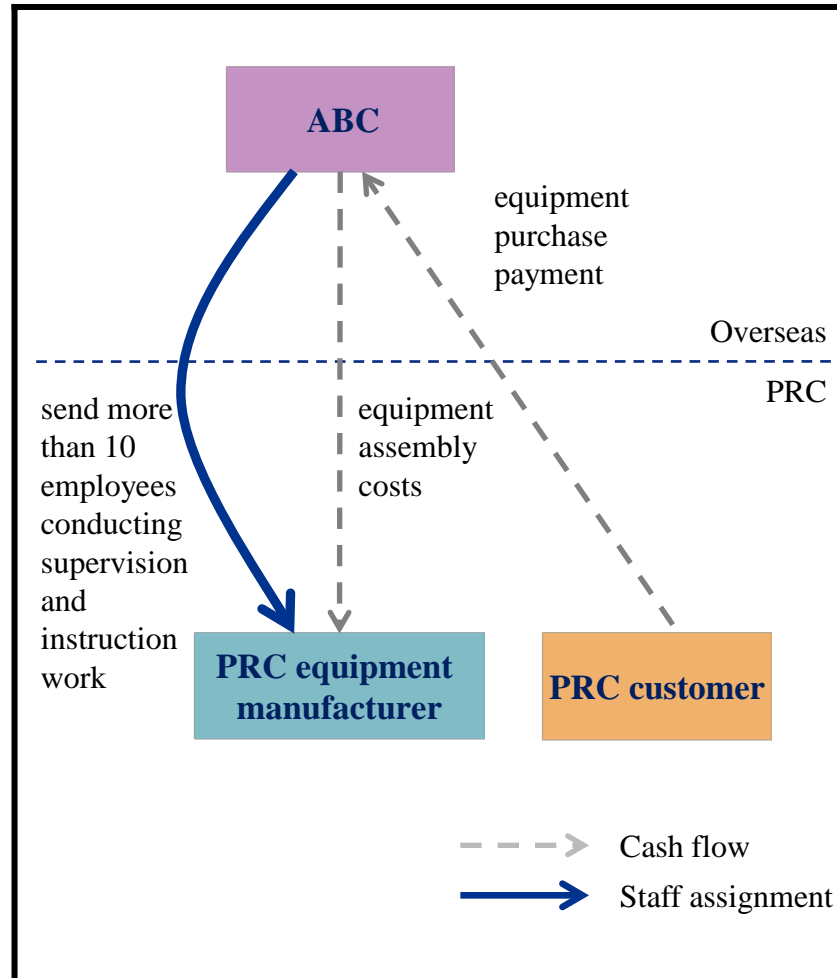
Need to negotiate the process with tax authorities – each tax authority has its own view which may differ from others

Identify the effective place of consumption – if in China, unlikely to get exemption even though it may appear to qualify based on Circular 131

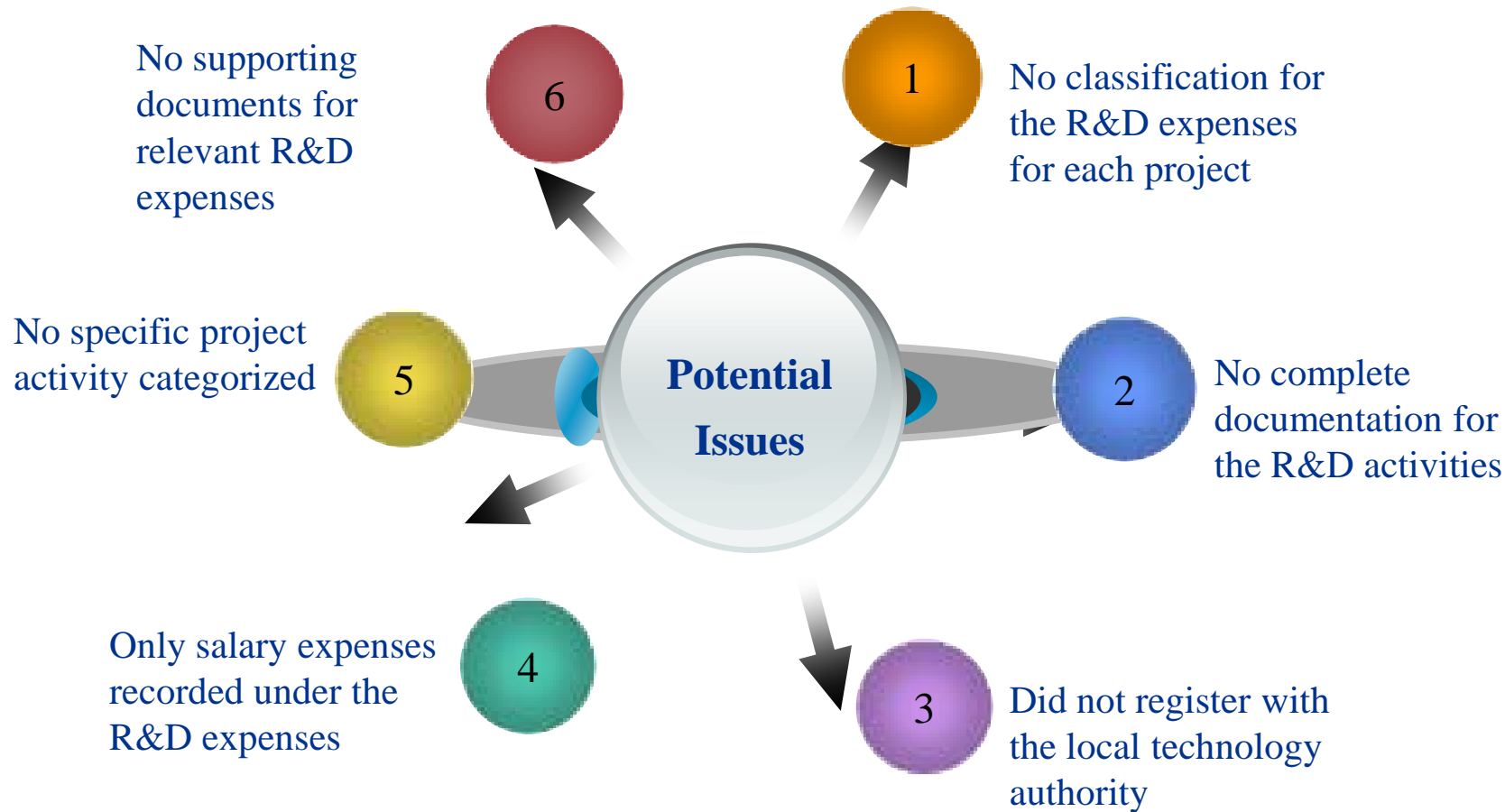
Need to apportion input VAT credits – tax officials expect this



# Case Study - Permanent Establishment

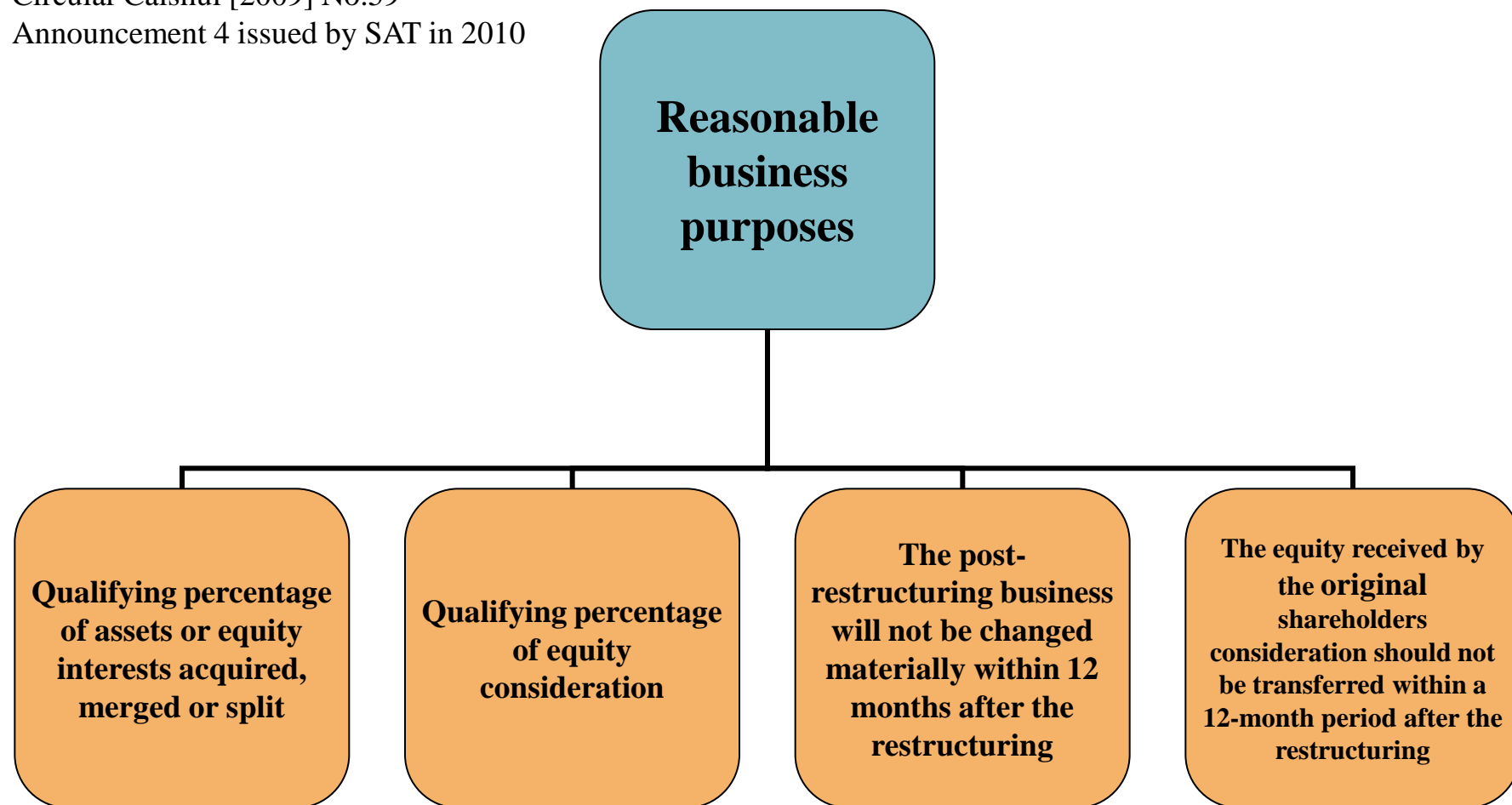


# Case Study – R&D Expense Bonus Deduction



# Overview of Circular 59 - General Conditions for Special Restructuring

Circular Caishui [2009] No.59  
Announcement 4 issued by SAT in 2010



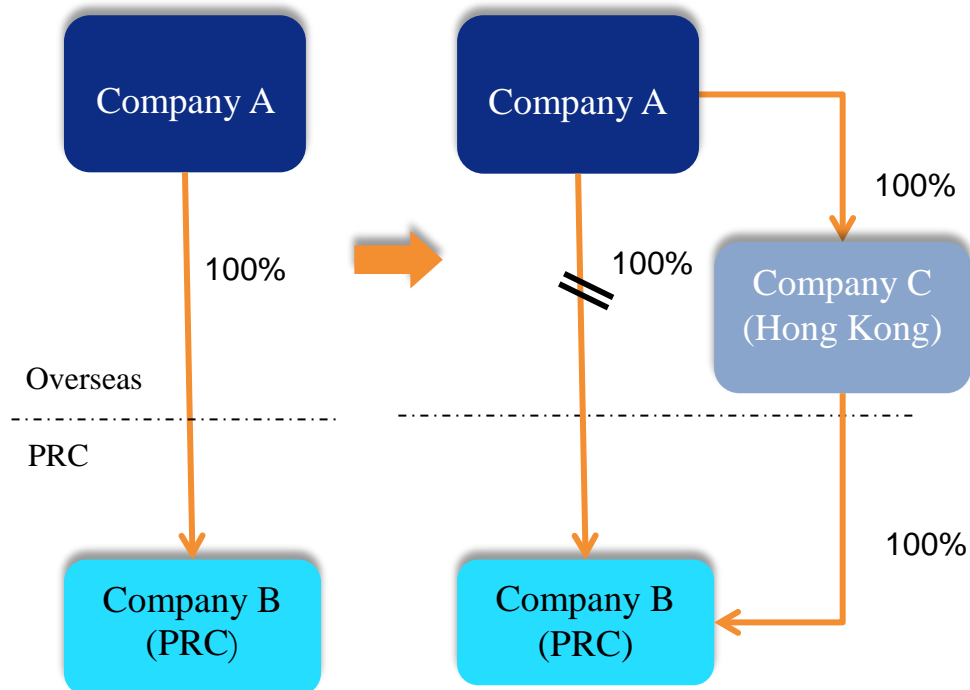
# Case Study - Cross-Border Restructuring

## Case

- Company A directly and indirectly owns a large number of PRC subsidiaries and accumulated substantial amount of undistributed profits after 2008.
- Company A will be subject to substantial amount of capital gain tax if the restructuring is done as an ordinary restructuring.
- Company A applies for the pre-approval for special restructuring before the equity transfer.

## Argument

- Whether the equity transfer has reasonable business purposes:
  - Is the transfer of the equity interest in Company B to Company C (Hong Kong) aiming at reducing the related WHT liability on dividends?
  - Proposed solutions by the SAT: ① Company B distributes all the dividends and pays the related WHT before the equity transfer ② Company B provides an affidavit certifying that it will not apply for the preferential WHT rate of 5% relating to dividend distribution of profit generated from 2008 to the year of equity transfer
  - Negotiation is in process.



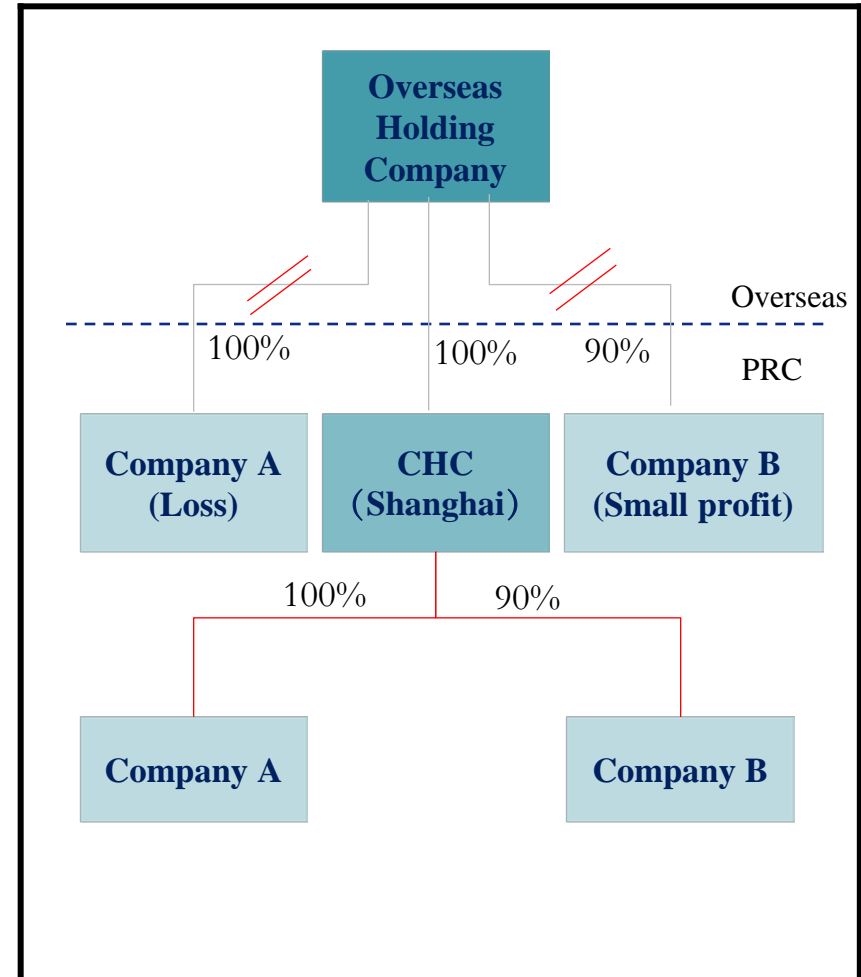
# Case Study - Cross-Border Restructuring (Cont'd)

## Case analysis

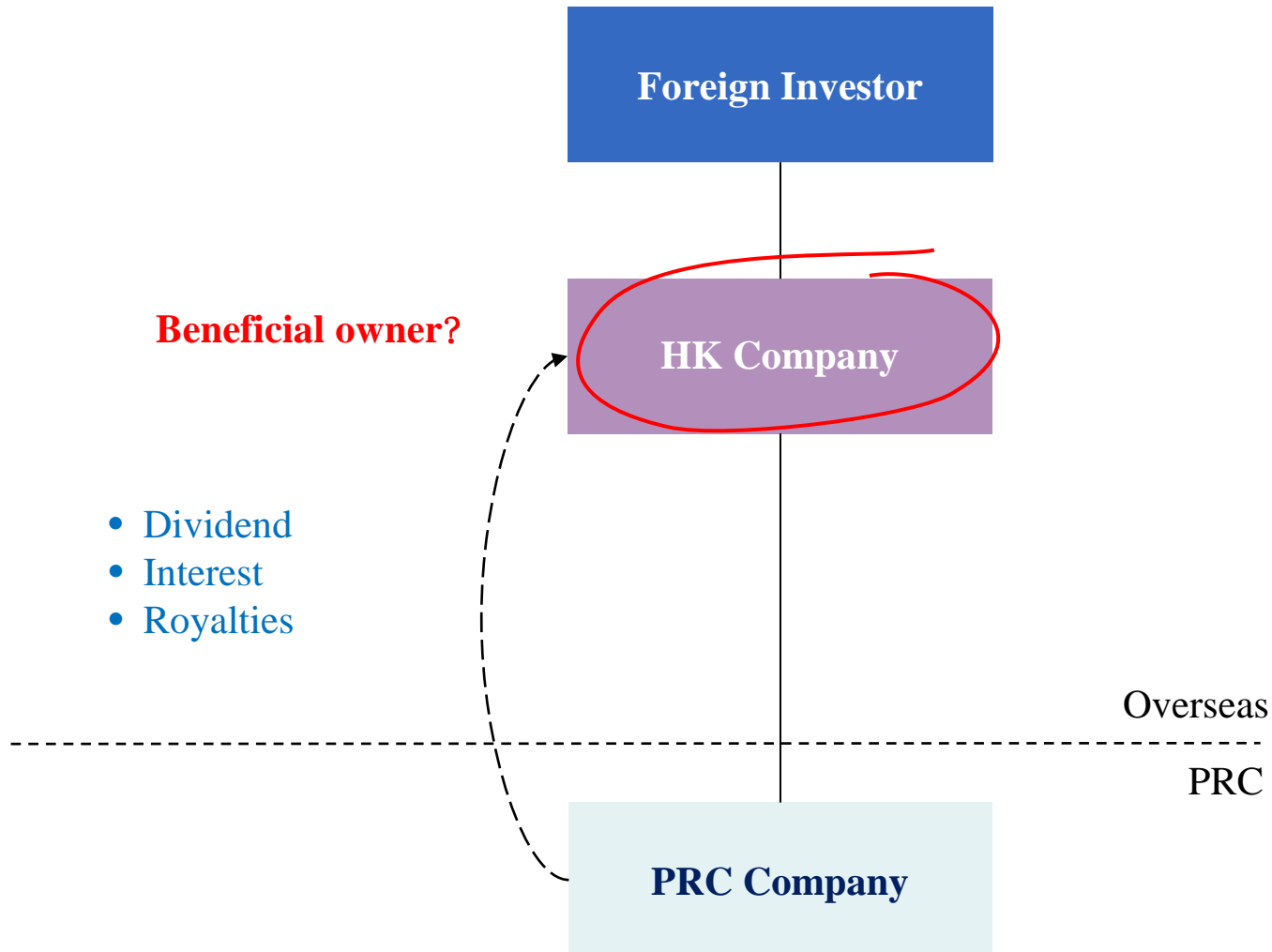
- The overseas holding company plans an internal restructuring by transferring the equity interests of several PRC subsidiaries outside Shanghai to the CHC in Shanghai.
- Advanced discussion with the relevant tax authorities about special restructuring tax treatment is made based on Circular 59 and Announcement 4.

## Issues to consider

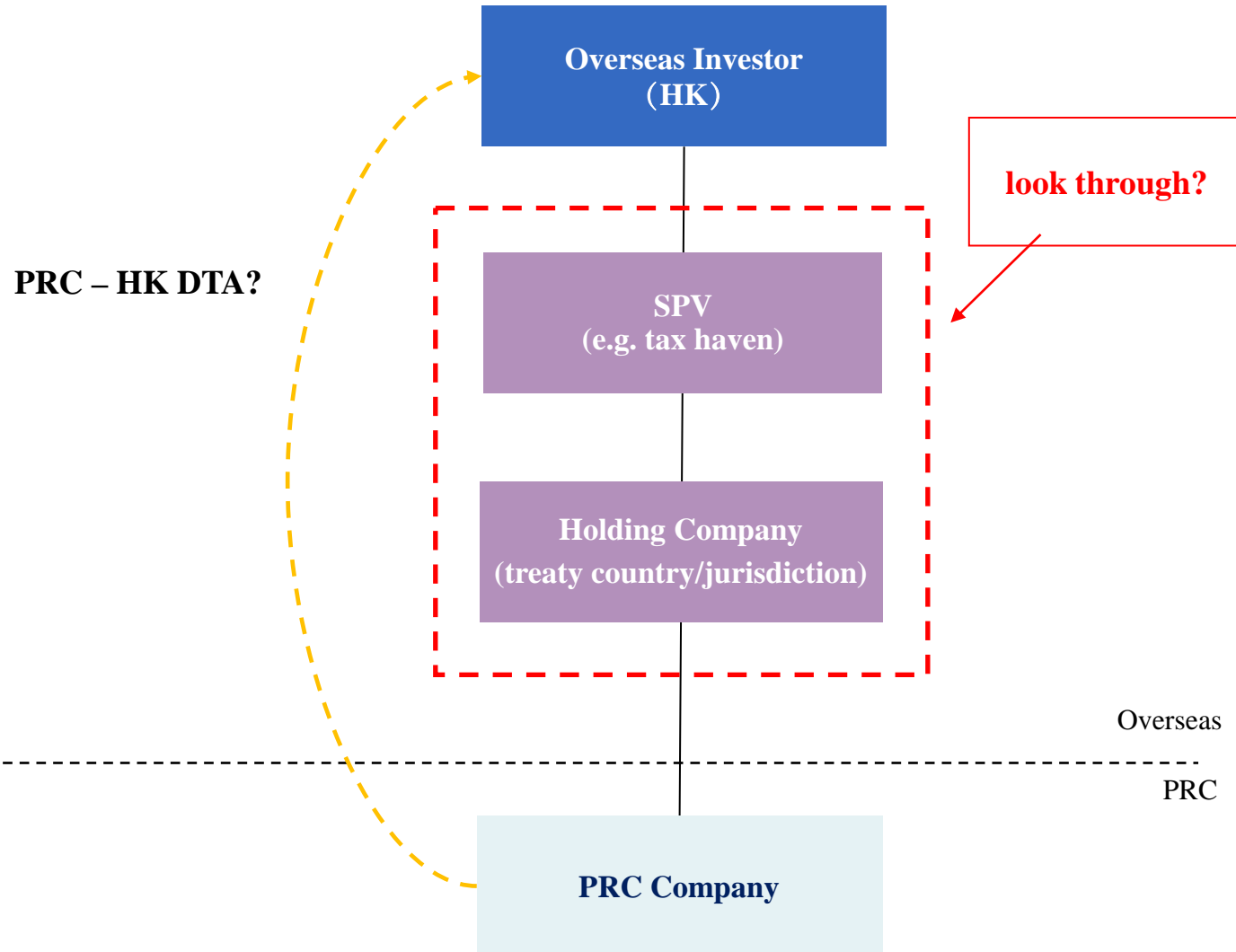
- Approval of special restructuring?
- How to coordinate among the various government authorities on the approvals and registration changes before the approval of special restructuring?
- Is ordinary restructuring an alternative?



# Circular 601 - Beneficial Ownership Test

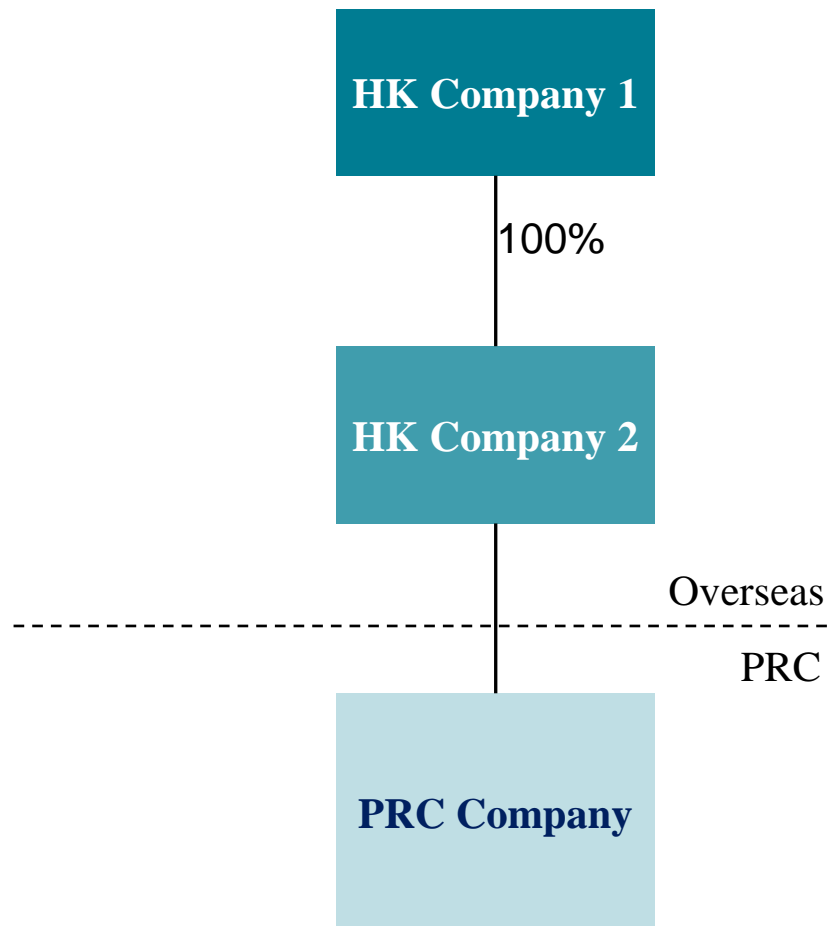


# Circular 601 - Beneficial Ownership Test (Cont'd)

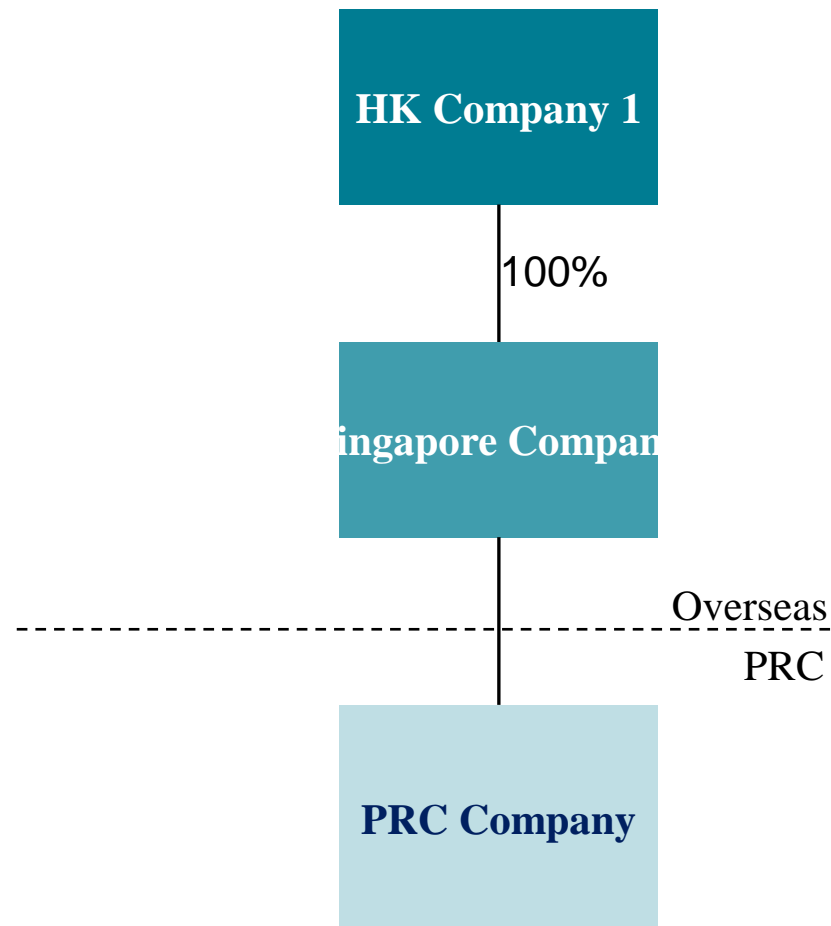


# Announcement 30 – Safe Harbour

## Same county/ jurisdiction



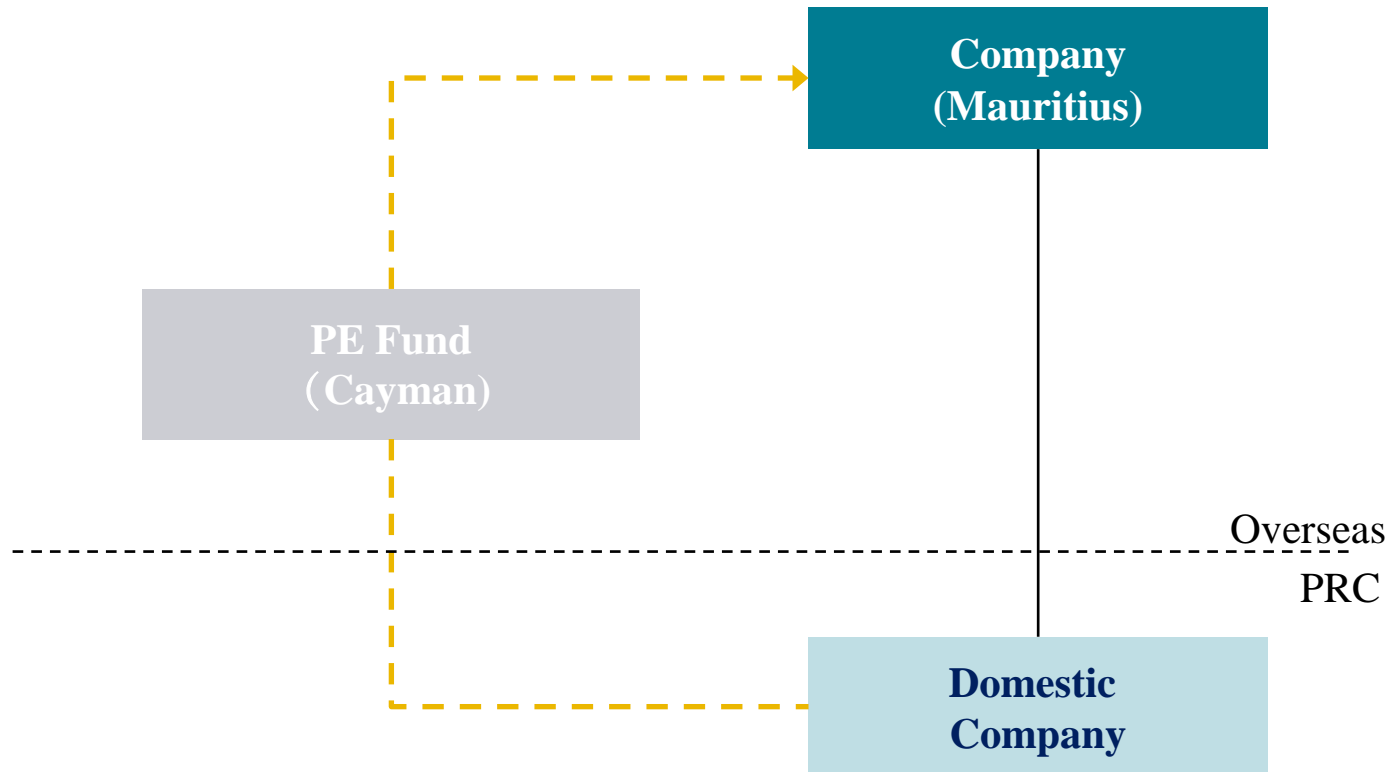
## Identical treaty treatment relief?



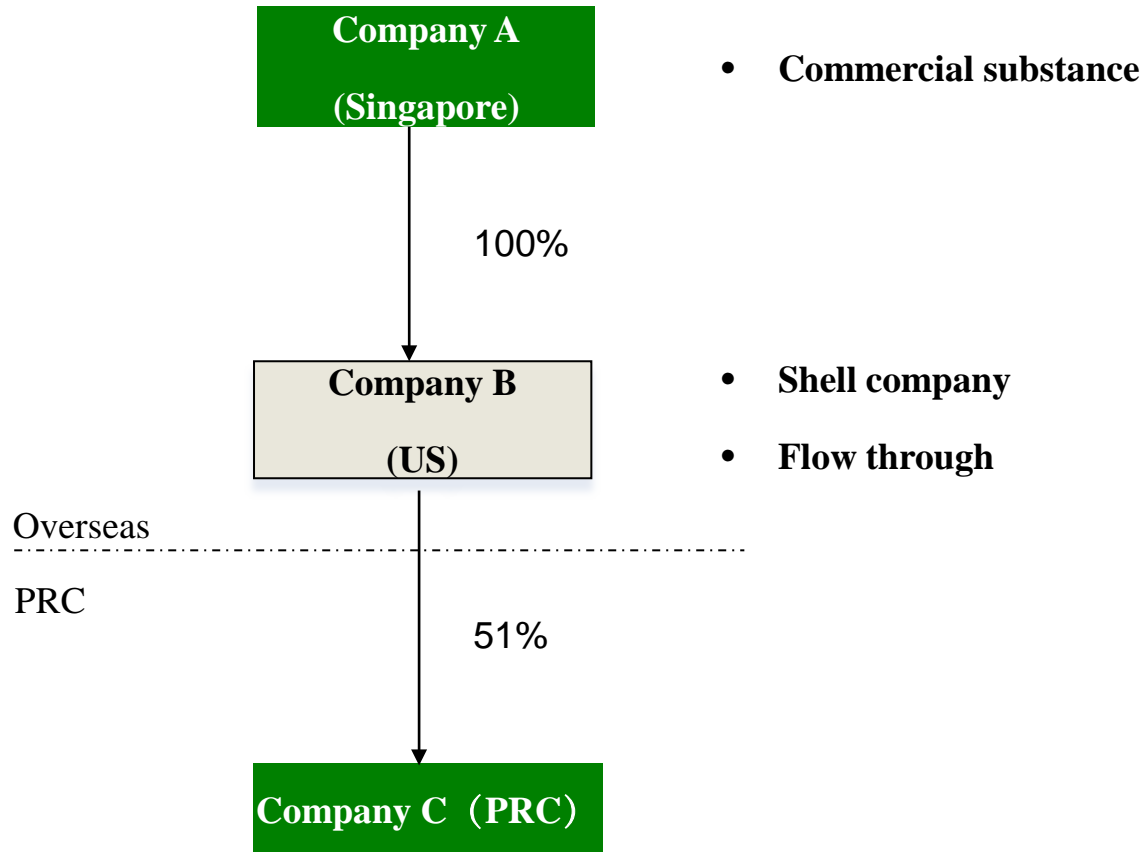


# Safe Harbour– An Agent

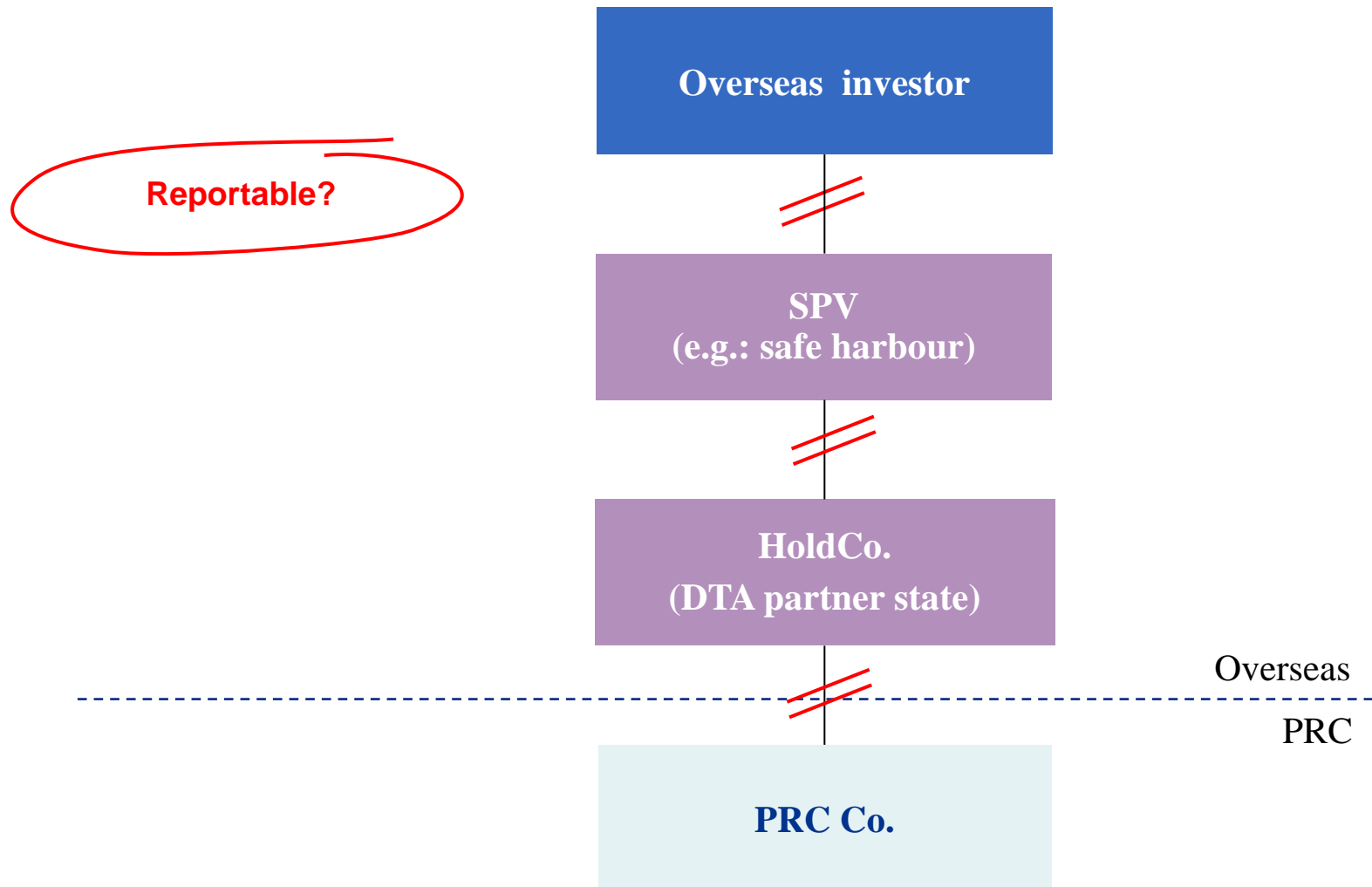
Where an agent or a designated payee receives the income



# Case Study - “Beneficial Owner”



# Review of Circular 698



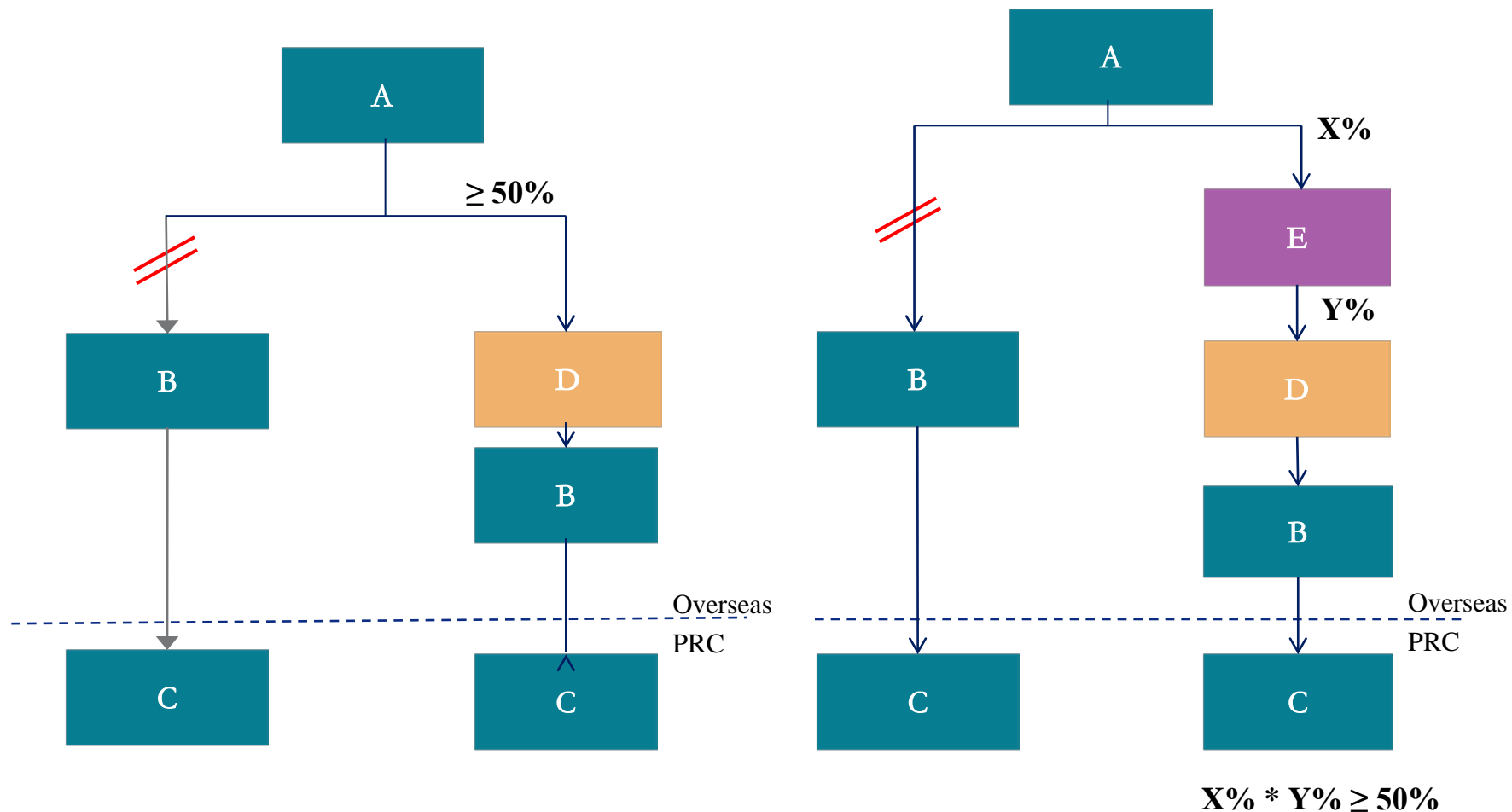
# Supplement Rule to Circular 698 (Draft)- Intra-group Reorganization

**Indirect transfer of equity interest of PRC resident enterprise could be viewed as not being subject to Circular 698 where all of the following conditions are fulfilled**

- Equity ownership requirement of transferor and transferee  $\geq 50\%$  direct or indirect shareholding
  - 3 scenarios
- The total equity interest in the PRC resident enterprise indirectly held by the ultimate shareholder remains unchanged
- No change in actual tax burden on capital gains from disposal of the equity interest

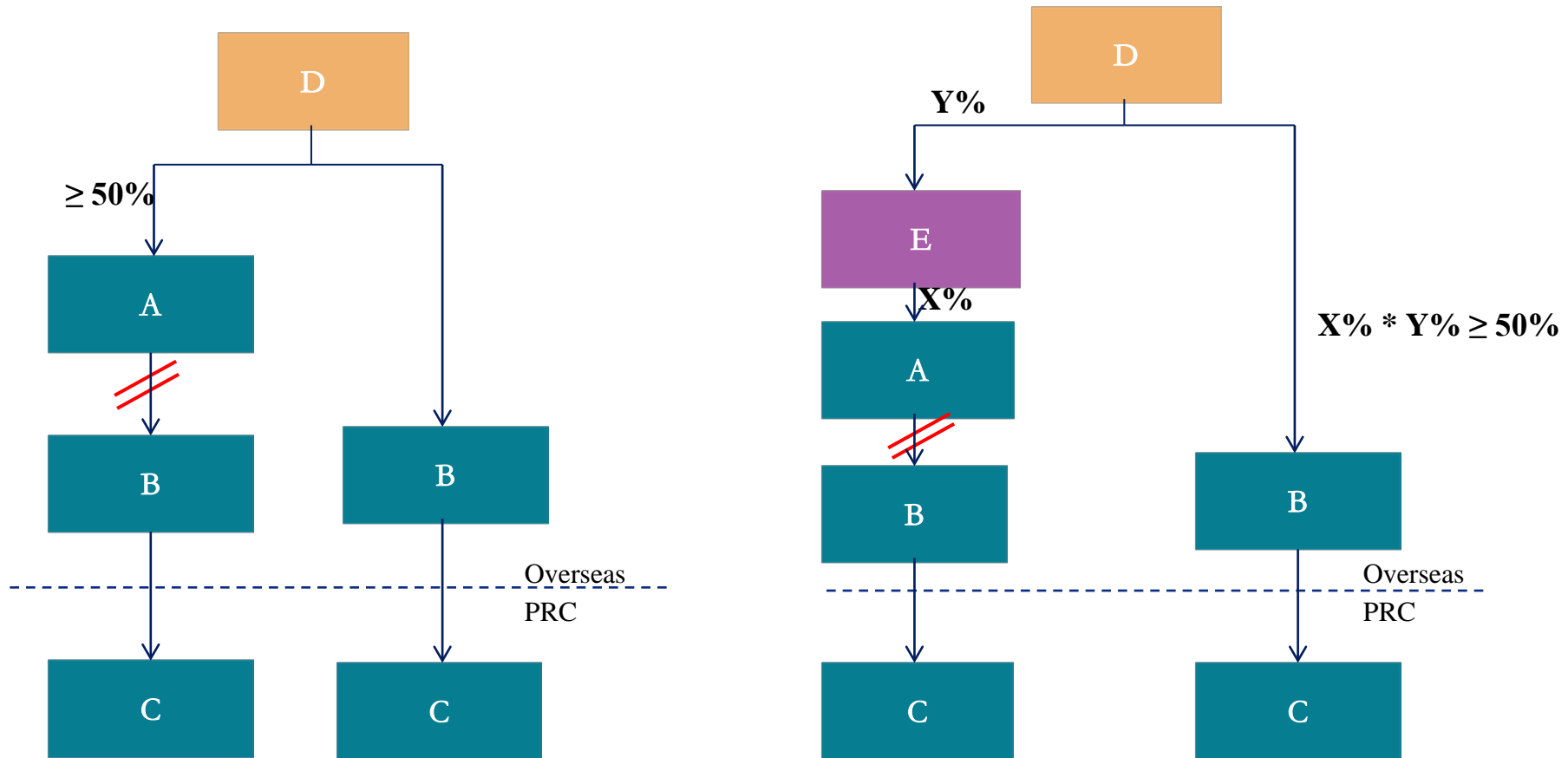
# Intra-Group Reorganization

Scenario I – The transferor directly or indirectly holds 50% (or more) interest in the transferee



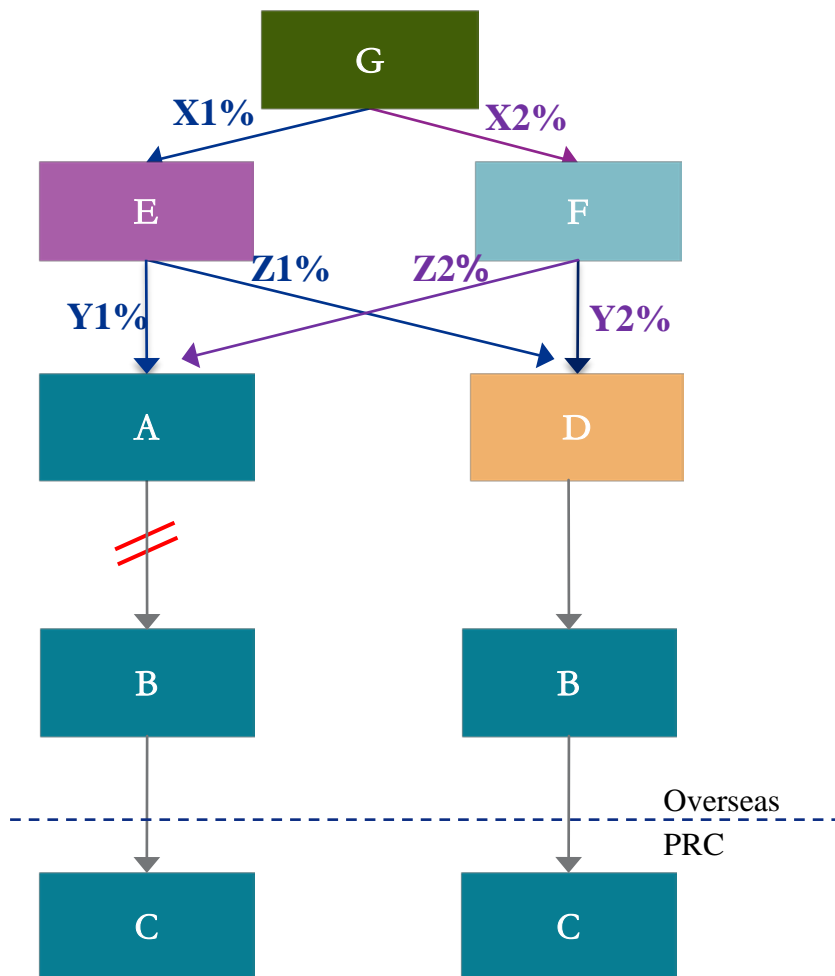
# Intra-Group Reorganization (Cont'd)

Scenario II – The transferee directly or indirectly holds 50% (or more) interest in the transferor



# Intra-Group Reorganization (Cont'd)

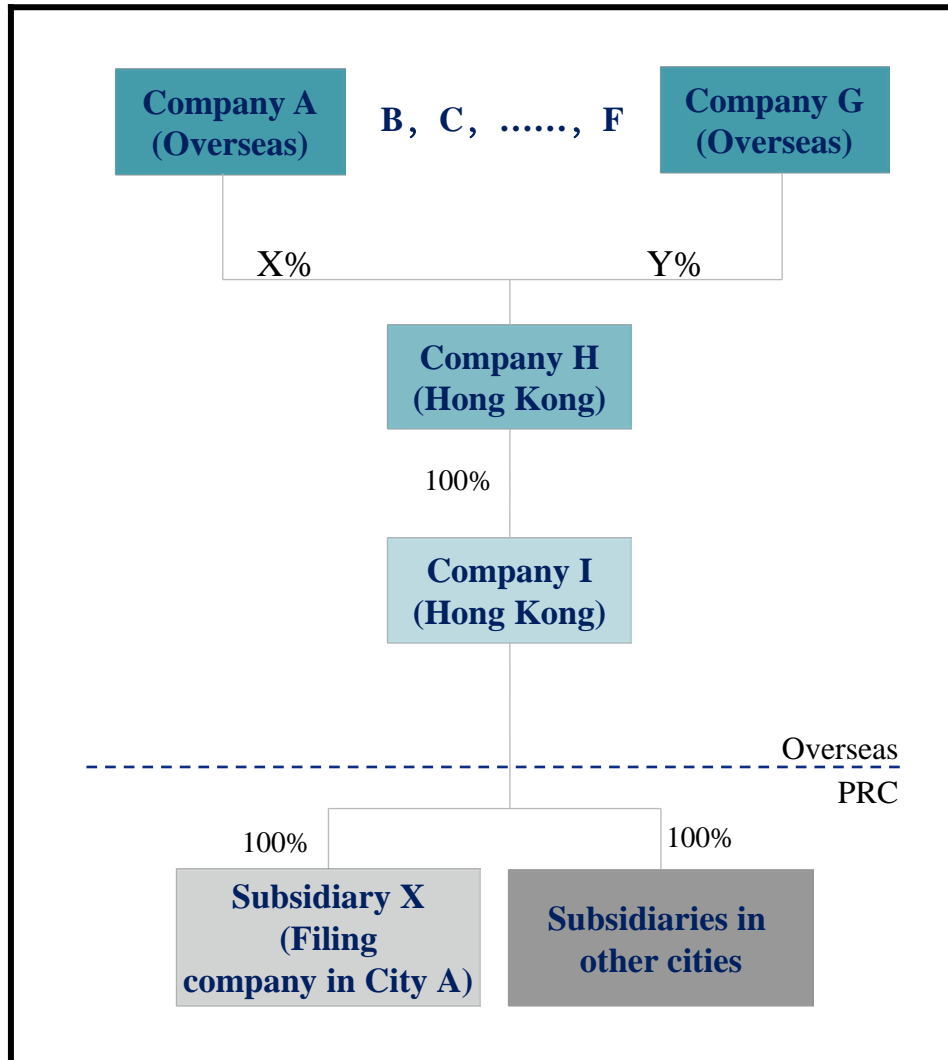
Scenario III – One or several parties directly or indirectly hold 50% (or more) interest in both the transferor and the transferee



$$X1\% * Y1\% + X2\% * Z2\% \geq 50\%$$

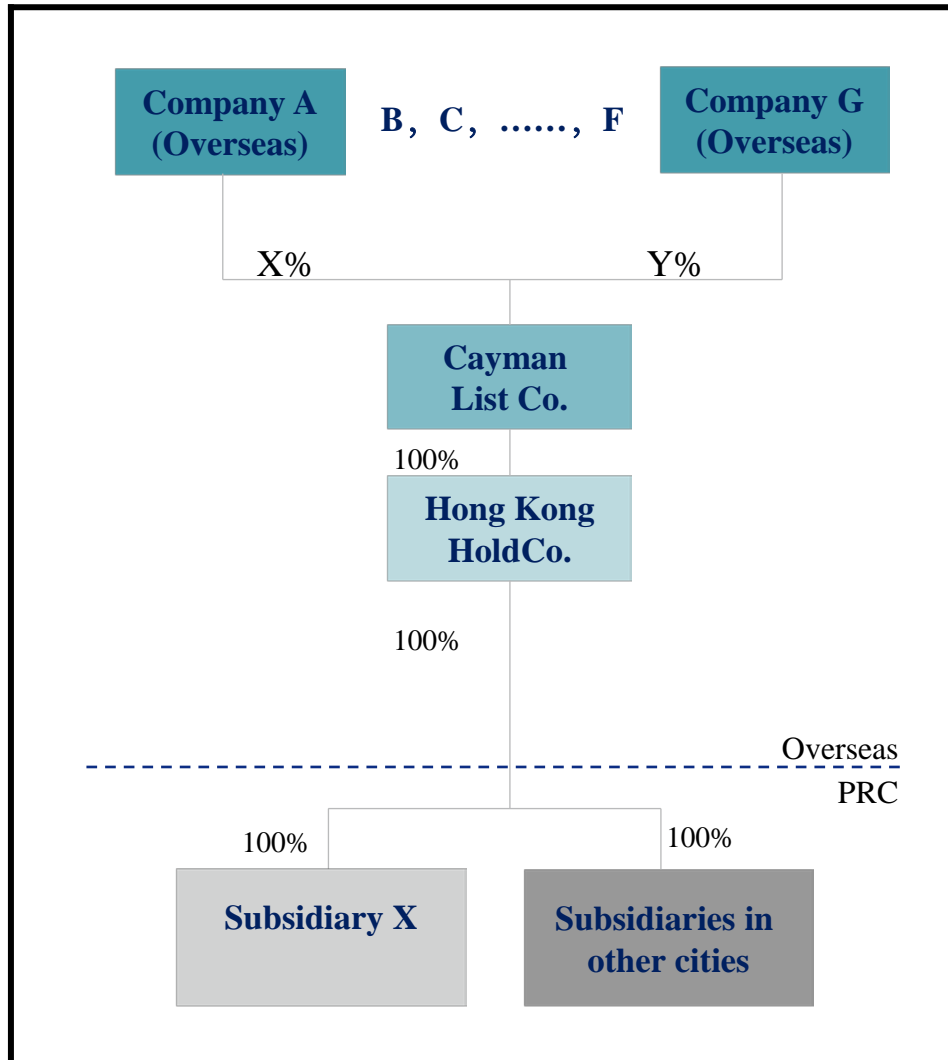
$$X2\% * Y2\% + X1\% * Z1\% \geq 50\%$$

# Circular 698 – Case Analysis



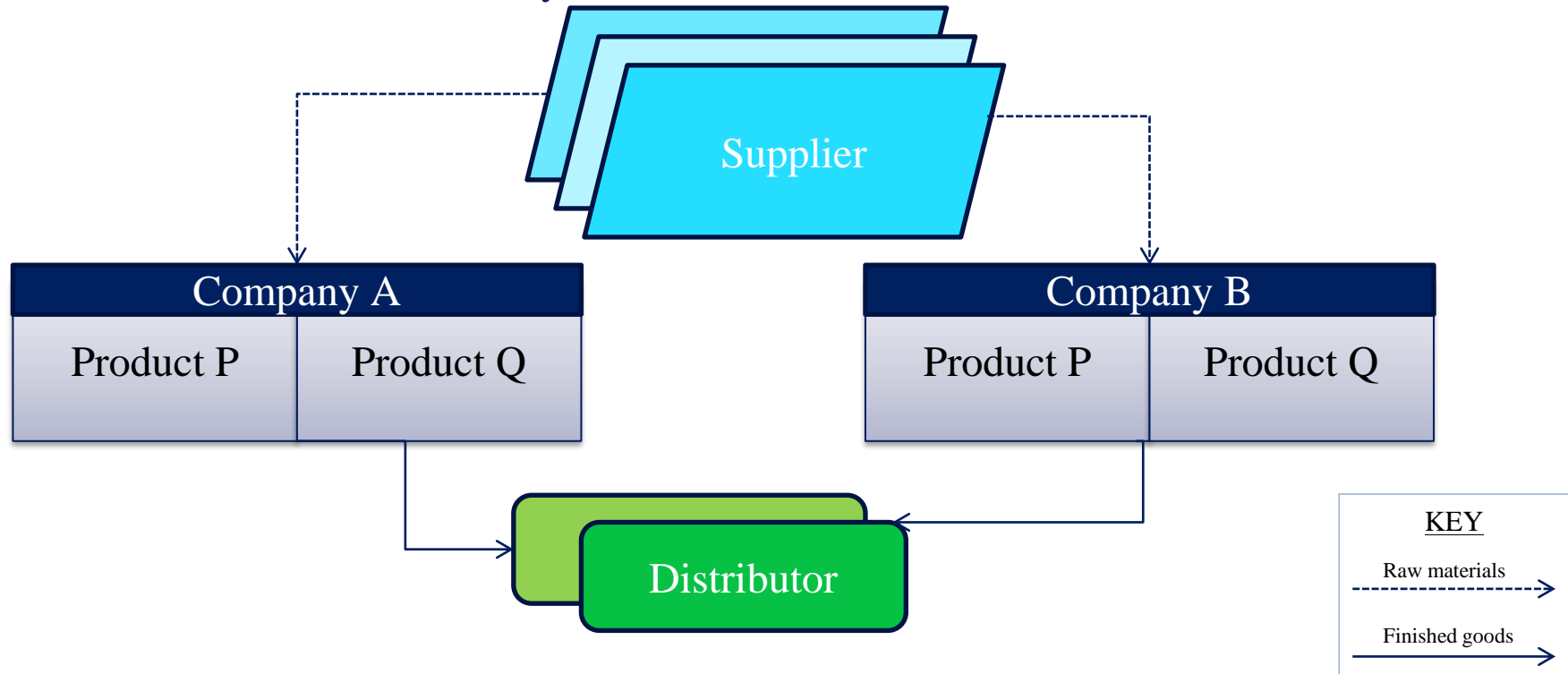


# Circular 698 – Case Analysis (Cont'd)



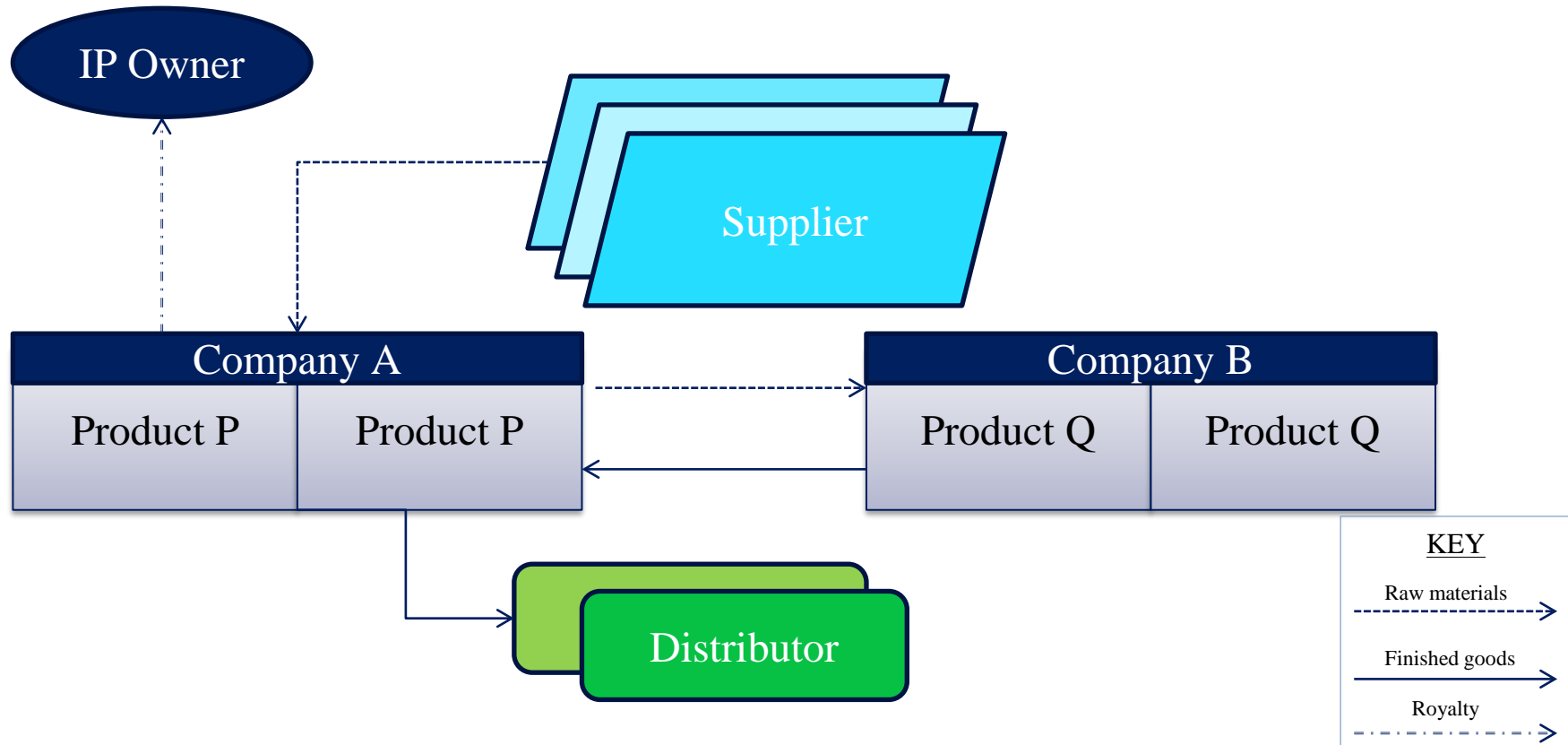
# Case Study – Transfer Pricing

- European multinationals with two legal entities in China: A and B
- Both were joint ventures converted to wholly owned recently
- Both produce product P and product Q
- Significant overlapping in suppliers and distribution channels
- A has been granted a high-tech status as such enjoying a corporate income tax rate of 15%; B is taxed at the statutory rate of 25%



# Case Study– Transfer Pricing (Cont'd)

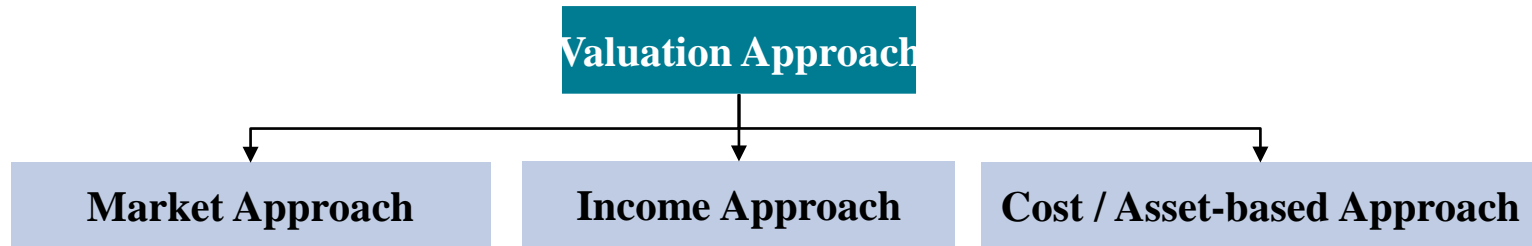
- Duplicative business functions
- Confusion amongst channel and customers
- Lack of consolidation of purchasing power
- Failure to pay royalty to overseas IP owner



# Case Study - Recent Case of Transfer Pricing Adjustment on Related Party Equity Transfer

City	Date	Additional Tax Payment (RMB in ten thousands)	Tax Authority Treatment / Opinion
Chengdu	2012.6	2,387	Make adjustment to the price of equity transfer that is lower than the book value
Taiyuan	2012.5	158	Adopt the income approach to tax the capital gains arising from the offshore transfer of equity interest
Kunshan	2012.4	672.23	Identify a case of equity transfer without mark-up by using “Tax Risk Identification Model of Income Tax Arising from Equity Transfer”
Tianjin	2011.9	401	Identify the impact on capital gains arising from the implied related party relationship in an equity transfer between unrelated parties
Xiamen	2011.3	131	Tax on the capital gains derived by the offshore transfer of equity interest based on the fair market value of the net assets stated in the valuation report issued by local valuator
Nanjing	2011.1	2,310.2	Deny the reason of equity transfer without mark-up proposed by the taxpayer
Dalian	2010.12	1,100	Adopt the “income approach” to make anti-tax avoidance adjustment of equity transfer
Suqian	2012.9	997	Identify a case of equity transfer without mark-up during a special tax audit of capital transaction, and adopt Transactional Net Margin Method to make tax adjustment
Suzhou	2012.5	2,114	Adopt Comparable Uncontrolled Price Method to make adjustment to the price of equity transfer between related parties

# Case Study - Valuation of Related Party Equity Transfer



## Common approach of transfer pricing on related party equity transfer applied by taxpayers

- Registered capital?
- Book value of the equity (net assets)?
- Valuation by cost/asset-based approach?

## Evaluation on related party equity transfer by tax authorities

- Income approach is preferred
- Market approach?
- Encourage cross-check by more than two approaches

## Common adjustment factors

- Control premium(or discount for lack of control)
- Discount for lack of marketability

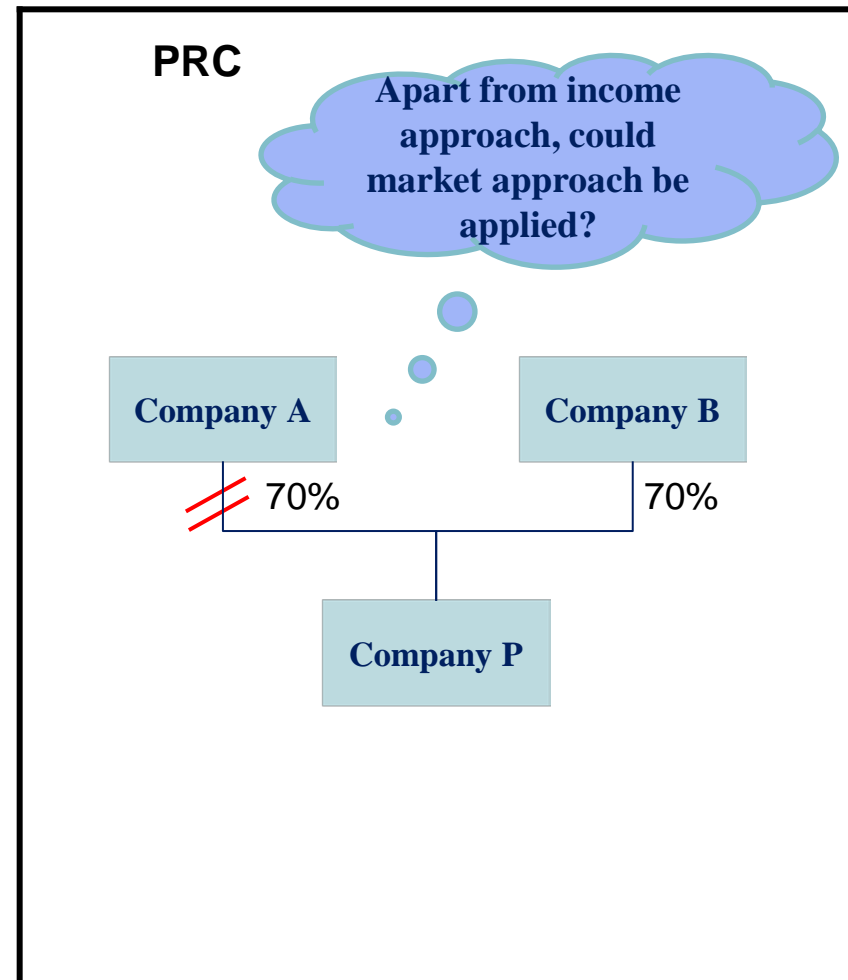
# Case Study – Transfer Pricing

## Background

- Company P is an unlisted company. On June 30, 2012, due to the group restructuring, Company A, as the shareholder of Company P, decided to transfer its 70% equity interest in Company P to its related party Company B.
- On June 30, 2012, the book value of Company P's net assets is RMB 100 million.
- Company B intended to value the 70% equity interest in Company P based on the arm's length principle as of the Valuation Date (June 30, 2012).

### Additional information:

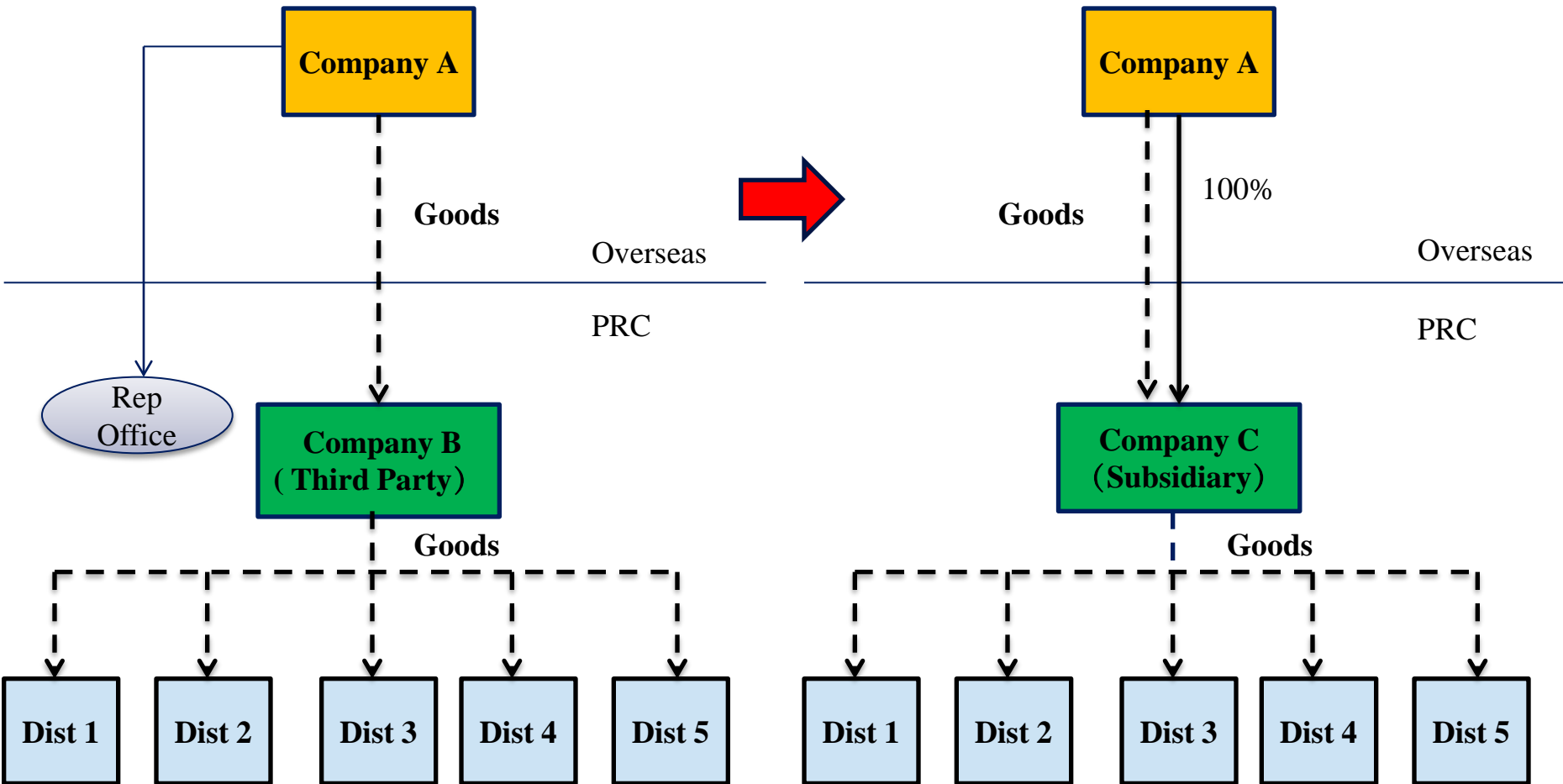
- Q is a company engaged in similar business operations in the same region of Company P. C and D are the shareholders of Company Q and originally own 60% and 40% of Company Q respectively. Company C and D are unrelated parties.
- On June 15, 2012, D acquired 60% share of Company Q from Company C at a price of RMB 120 million. The book value of the transferred equity is RMB 80 million.



# Case Study – Business Model Change

## Indirect Operation

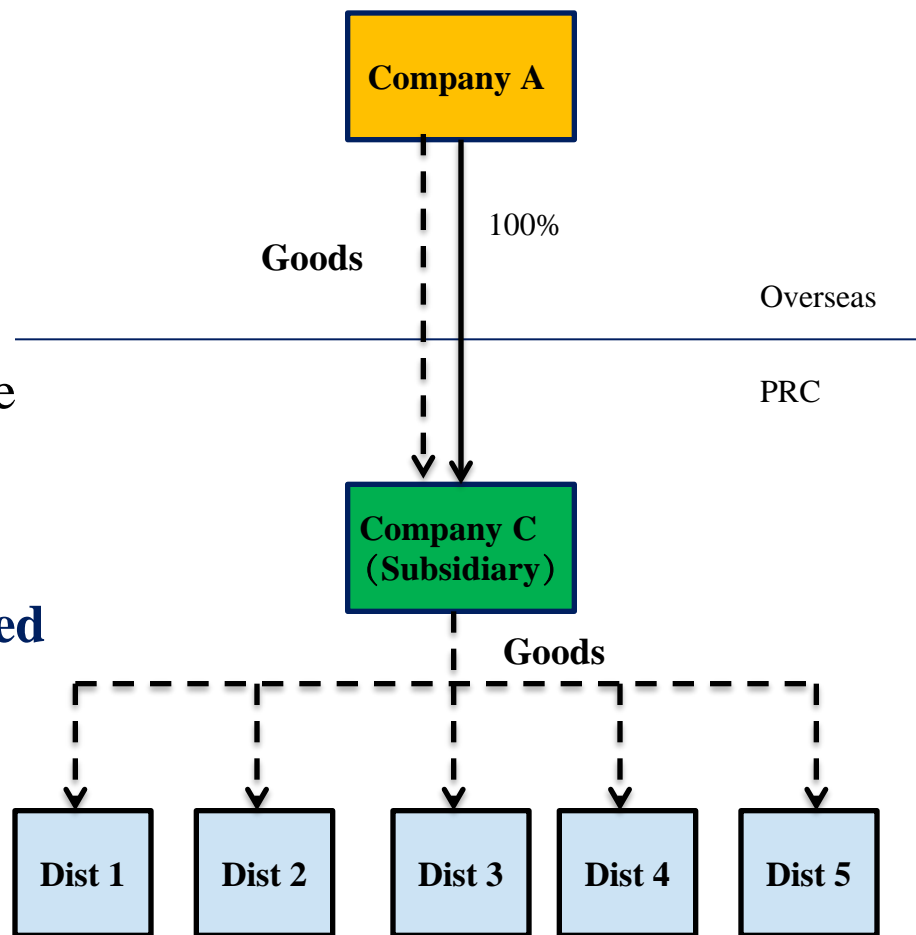
## Direct Operation



# Case Study – Business Model Change (Cont'd)

## Common exposure under new business model

- **Importing Company changed from third party to Company C**
  - Transfer Pricing risk
  - Customs valuation risk caused by the import price fluctuation
- **Compensation dispute (business model change may lead to disgruntled former agent)**
- **Necessary to keep the existing Rep office?**





# Tax Risk Management – Background

SAT established the “Large Enterprise Taxation Management Division”

Guoshuihan [2008] No.1064: the designated contact enterprise list

Guoshuifa [2009] No.90: “Large Enterprise Tax Risk Management Guidance (Provisional)”

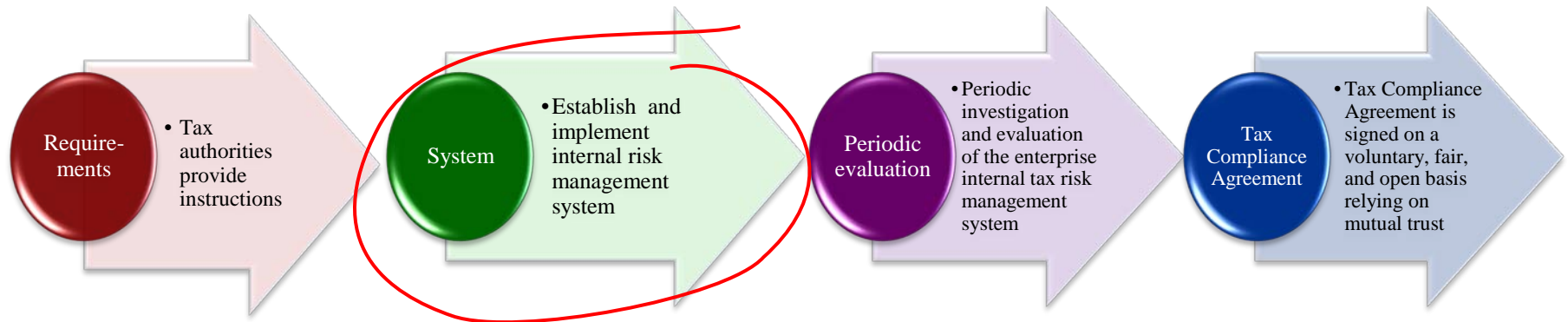
Guoshuifa[2011] No. 71: “SAT Large Enterprise Taxation Service and Management Rules (Provisional)”

Tax authorities across the country establish “Large Enterprise Taxation Management Division”

Local tax authorities issue large enterprise list in different jurisdictions (e.g., Guangdong, Shandong, Jiangsu, Xiamen, Hangzhou, Tianjin, Dalian, Ningbo)

Local tax authorities maintain dialogue with, and raise relevant requirements, to large enterprises

# Tax Risk Management – Potential Issues and Risks



## Potential Issues

## Potential Risks

No documented internal control system for tax	No clear goal to be accomplished
No designated tax risk management group or positions	Unclear division of responsibilities and no segregation of duty
No tax risk recognition and evaluation system	Potential tax risks may not be detected in due course
Incomplete tax risk control and responding mechanism	Ineffective tax risk control
No documented tax information management system and communication mechanism	Ineffective communication of information and issues cannot be detected and addressed by the management team in due course
No systematic supervision and implementation mechanism	Unable to evaluate the effectiveness of tax risk management and optimize the process
Non-standardised tax internal control system for various subsidiaries' tax policies and management team.	Inconsistent policies and practices adopted by each department/subsidiary

# Tax Risk Management

Risk management  
methodologies and tools

Management Framework  
Objectives  
Risk identification and  
assessment  
Risk controls  
Information management  
Monitoring

Tax Risk  
Management

Tax registration  
Invoice management  
Return filing  
Transfer pricing  
Tax incentive application  
Tax planning  
Tax audit and inspection

Tax aspects of normal  
business operations

# Tax Risk Management (Cont'd)

## Effective tax risk management

### Step 1

Understand the existing corporate structure, business models and tax strategies

### Step 2

Identify the applicable taxes and understand the current processes to manage tax risks

### Step 3

Identify the inherent tax risks and assess their respective implications on the business operations

### Step 4

Evaluate the effectiveness and adequacy of existing tax risk controls and consider improvements

### Step 5

Prepare tax risk management manual to confirm the processes and responsibilities

### Step 6

Arrange workshops to communicate the tax risk management system to all parties

### Step 7

Carry out periodic monitoring process to test the effectiveness of the controls

# Tax Risk Management (Cont'd)

## Benefits for tax risk management

### Internal

- Reduction of tax exposures and related tax costs
- Lower tax audit risk and compliance costs
- Management to be able to better understand the company's tax strategies and positions
- Management to be able to better gauge tax implications of the operations
- Enhancement of overall corporate governance

### External

- Build up a trusted and transparent relationship with tax authorities
- Establish an effective communication platform with the tax authorities, and increase efficiency
- Facilitating the signing of Tax Compliance Agreement with the tax authorities
- Higher likelihood to obtain “advance tax ruling” for major business transactions
- Avoidance of “surprises” which may adversely affect business' reputation



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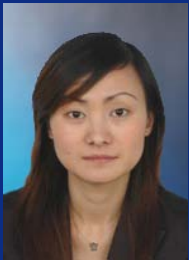
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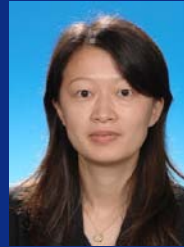
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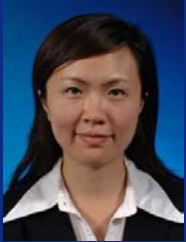




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*cutting through complexity*

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