

China's New General Anti-Avoidance Rules: An Overview

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On December 2, 2014, the ***State Administration of Taxation (SAT)***, China's highest tax authority, issued the ***Administrative Measures for the General Anti-Avoidance Rules (Trial) (GAAR)***, which went into effect on February 1, 2015. Prior to this legislation, *China* had no specific GAAR, only a few general anti-avoidance principles in various regulations, such as the Enterprise Income Tax Law and its Implementation Rules (EIT laws) and the Measures for Special Tax Adjustments (Guo Shui Fa [2009] No. 2, or Circular No. 2). The new GAAR aims to provide taxpayers with more transparent administration procedures for GAAR cases while empowering tax authorities to adjust taxpayers' payments in accordance with clear rules.

Scope, Definitions and Adjustment Methods

The new GAAR applies to any tax avoidance arrangement by an enterprise that is without reasonable commercial purpose and is intended for the purpose of obtaining tax benefits. It does not apply to arrangements that are not related to cross-border transactions or payments, and is not intended to address tax-related illegal acts, such as tax evasion, evasion of overdue tax, tax fraud, refusal to pay taxes or issuance of false invoices, all of which are dealt with separately.

The new GAAR defines a tax avoidance arrangement as follows: the main or sole purpose of the arrangement is to reduce, secure exemption from or defer the payment of Enterprise Income Tax (EIT); and the arrangement meets the requirements for such reduction in, exemption from or deferral of EIT as a matter of legal form but not as a matter of economic substance.

By following the principle of "substance over form," Chinese tax authorities are authorized to counter tax avoidance arrangements by redetermining the nature of all or part of the transactions under the arrangement; negating the existence of a transaction party or deeming several transaction parties to be a collective whole; reallocating or redetermining the nature of income, deductions, tax preferential treatment or offshore tax credits among the transaction parties; and applying other reasonable methods.

Clarified Administrative Procedures

Previously, certain tax authorities in practice could initiate anti-tax-avoidance investigations at a local level unconstrained by specific protocols, although according to Circular No. 2, level-by-level

reporting to the SAT was required. The GAAR now mandates that examinations conducted by Chinese tax authorities follow the “Case Filing, Investigation, Case Conclusion, Dispute Resolution” procedures (CICD), and re-emphasizes the requirement of level-by-level reporting to the SAT. Under the CICD:

- Tax authorities may not start an anti-avoidance investigation until it is approved by the SAT, which should lead to more consistent tax examination procedures.
- If, during an investigation, a taxpayer is required to provide documents in its defense, it may now have up to 90 days to do so (60 days plus a 30-day extension upon application). This extended timeframe will allow taxpayers more time to prepare a comprehensive explanation or defense.
- Taxpayers under investigation are entitled to formulate their dissent from the conclusions made by tax authorities. Local tax authorities are required to revisit the conclusions reached in their investigations by taking into account comments from the SAT, and the final decision is subject to the SAT’s approval.
- In addition to regular avenues for dispute resolution, such as administrative reconsideration and litigation, the GAAR establishes a new mechanism to resolve disputes between taxpayers and local tax authorities over double taxation as a result of an anti-avoidance investigation, under which the SAT is to perform a coordinating function. It remains to be seen how exactly the SAT will implement this.

Relation to Other Tax Measures and China’s Bi-Lateral Tax Treaties

The new GAAR has been released against the backdrop of numerous existing tax measures governing such matters as transfer pricing, cost sharing, controlled foreign enterprises and thin capitalization, as well as China’s network of tax treaties (containing, among other things, specific anti-abuse measures, such as Limitation of Benefit clauses and beneficial ownership tests).

The GAAR makes it clear that such specific tax measures, as well as China’s tax treaties, are to be given priority over the GAAR if a tax arrangement of an enterprise being investigated falls within their scope. In other words, the GAAR is to serve as a supplement to other more specific applicable tax measures and effectively as a last resort by which a tax authority may seek to tackle perceived instances of tax avoidance.

Conclusion

The new GAAR increases transparency in local tax authorities’ anti-avoidance administrative activities and provides better guidance for multinational enterprises doing business in China. At the same time, as the GAAR provides more certain principles and procedures for examining potential tax avoidance arrangements, Chinese tax authorities may increase their scrutiny of such arrangements.

Enterprises—especially multinational enterprises with significant cross-border transactions—that have implemented tax savings strategies in China should review their positions in light of the enactment of the GAAR and determine if any adjustments to their strategies are warranted.

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