Outbound M&A tax planning for Chinese companies

2013 edition

Tax

A publication of Deloitte Tax Research Foundation

Contents

Introduction

With an ever-increasing number of Chinese enterprises engaging in business ventures abroad, China has rapidly emerged as a significant player in the overseas investment market. The heightening demand for expansion abroad from both state-owned enterprises and companies from the private sector follows close on the heels of rapidly growing economic power. Engaging in the outbound M&A market is undeniably a major shortcut to meeting this demand. Today's Chinese investors remain green in the international M&A market, with less experience than key international competitors. Complicated and unfamiliar international regulatory systems may leave many unaccustomed with such systems at a loss. In this context, a majority of the Chinese investors have jointly recognised the acute need for a thorough study of interrelated domestic and international policies prior to engagement. Only by understanding the cumulative effects of these relations can an integrated and concise M&A plan come to fruition. In discussing major M&A costs, tax expense planning emerges as one of the chain's most integral links. Proactive tax planning is necessary to not only help companies minimise tax risks, but also improve operational efficacy. This in turn also serves to help promote the realisation of a group's business goals. Approaching tax planning lightly or missing opportunities to plan for future tax obligations could raise total costs, directly obstruct M&A transactions, and even plague post-M&A business operations.

This publication offers Chinese investors a key to understanding tax planning for outbound M&A. Also included is a discussion of fundamental approaches to common technical issues. We hope you find this introduction both helpful and insightful in all your future M&A endeavours.

According to the statistics from China Enterprise Confederation/China Enterprise Directors Association, the top 100 Chinese companies with multinational operation scored an average of 12.93 percent Transnationality Index (TNI) rate in 2012, which is far below the average TNI of 62.25 percent of the top 100 multinational companies worldwide. Facing an era of high cost, the operating capacity of China's enterprises is still relatively weak, and most Chinese enterprises have not yet "gone global" or implemented global resource deployment.

Overview

Where do I start?

You should start by clearly thinking through how you intend to turn a profit on your investment.

A good place to start is to review your goods/ services (supply chain):

Supply chain planning aims at exploiting synergies within the company's supply chain in order to increase the profitability of your goods/services. In this regard, you should be clear on where the additional value will arise:

- Within the group you are acquiring, and/or
- In the current group.

If the additional value arises within the group you are acquiring, you may extract that value through a combination of any of the following:

1. Dividends (shares of the parent company of the group you are acquiring, or the acquisition company through which you are making the acquisition): receiving dividends.
2. Interest (debt - funds which you lend to the group you are acquiring, or the acquisition company through which you are making the acquisition): receiving interest, as well as the proceeds from the repayment of the debt.
3. Payment for the use of intellectual property (IP) (which you license to the group you are acquiring): receiving payments for the use of IP, which is currently owned by the group you are acquiring, and which you intend, post-acquisition, to extract out of the group.
4. Services (which you provide to the group you are acquiring, including technical services, payments which are not royalties): receiving payments for services you provide to the group you are acquiring.
5. Gain on exit (the sale of the shares of the parent company of the group you are acquiring, or the acquisition company through which you made the acquisition): receiving the proceeds from the sale of shares in excess of the amount you paid for them.

Each of the above "flows" has an impact on your pre-acquisition and post-acquisition considerations:

	Pre-acquisition considerations	Post-acquisition considerations
Dividends	Acquisition structuring: holding structure for shares acquired	Post-acquisition reorganisation to enhance tax efficiency
Gain on exit		
Interest	Financing structure: how to introduce debt into the group	Post-acquisition reorganisation to enhance tax efficiency; Funding structure for additional post-acquisition funding requirements
Payments for the use of intellectual property (IP)	IP holding structure	Post-acquisition reorganisation to enhance tax efficiency, often undertaken as part of supply chain planning
Services (including technical services)	Anticipation of post-acquisition considerations	Arrangements in respect of the provision of intra-group services
Goods/services (supply chain)		Supply chain planning: re-alignment of the overall supply chain, including transfer pricing. Often, IP considerations are key.

First, separately examine each of the considerations above in sequence, identifying the options which are available to you together with the costs, benefits and risks associated with each:

Timing	Consideration
Pre-acquisition	1. Acquisition structuring 2. (Debt) funding structure for acquisition 3. IP holding structure
Generally post-acquisition (although you should, during the acquisition stage, start to consider and keep in mind your post-acquisition strategies)	4. Supply chain planning 5. Arrangements for the provision of intra-group services 6. Other post-acquisition considerations

You should then review the results thereof and, from the tax perspective, select your course of action by measuring the respective tax-related costs, benefits, and risks against your own particular objectives and preferences. For example:

	Acquisition Structure 1	Acquisition Structure 2
Dividend	Withholding tax rate 10%	Withholding tax rate 5%
Gain on exit	Exempt	Taxed

If you were a strategic investor looking to derive most of your profits through dividends, you would prefer Acquisition Structure 2 to Acquisition Structure 1. If, however, you were a private equity investor looking to derive most of your profits through the sale in the medium term of your investment, you would prefer Acquisition Structure 1 to Acquisition Structure 2.

Frequently asked questions

In the remainder of this document, we address some frequently asked questions concerning "acquisition structuring", "debt funding for acquisition structures", and "impact of Chinese foreign tax credit regime on acquisition structure". Our answers are for general information only and are not intended to form the basis for decisions concerning transactions you intend to undertake.

1. Acquisition structuring

1.1. Why shouldn't I just directly acquire the parent company of the group I am acquiring?

Setting aside business considerations, from a tax perspective, there are broadly three reasons why you would choose an intermediate holding company to acquire the parent company of the group ("the Target") you are acquiring:

- Using an offshore intermediate holding company to acquire the Target may give a better tax result by reducing, or eliminating, withholding tax on dividends paid and/or the tax imposed on the gains arising on a future exit;
- Using an offshore intermediate holding company allows you to retain flexibility in respect of the timing when dividends, as well as gains on exit, are received by you in China from your underlying investments; and
- Effective "debt push-down" strategies (refer below) may require a new appropriately capitalised (from the debt/equity mix viewpoint) acquisition company to acquire the parent company of the group.

1.2. How does the use of an intermediate holding company reduce or eliminate withholding tax on dividends and tax on gains on exit?

Many countries, which levy withholding tax on dividends, have entered into double tax treaties ("treaties") under which the rate of withholding tax levied on qualifying dividends, received by taxpayers who are residents of the respective treaty partner, is reduced.

Further, the rates provided for in the treaties which a country has entered into vary from treaty to treaty. For example, the withholding tax on qualifying dividends paid by Swiss companies to Chinese companies is reduced to 10 percent (from 35 percent) under the China/Switzerland Double Tax Treaty. However, qualifying dividends paid by Swiss companies to Luxembourg companies are exempt from tax in Switzerland. Accordingly, it might well be advantageous to hold your Swiss investment through a Luxembourg holding company.

The same consideration applies in respect to gains on exit. For example, most foreign investments into India are held via Mauritius holding companies because, under the India/Mauritius Double Tax Treaty, gains on such investments would, subject to meeting qualifying conditions, be exempt from tax in India.

Contacts

For more information, please contact:

Danny Po
Partner - Asia-Pacific and China National Leader, Mergers and Acquisitions Tax Services
Tel: +852 2238 7333
Email: dannpo@deloitte.com.cn

Northern China
Kevin Ng
Partner
Tel: +86 10 8520 7501
Email: kevng@deloitte.com.cn

Eastern China
Vicky Wang
Partner
Tel: +86 21 6141 1035
Email: vicwang@deloitte.com.cn

Southern China
Danny Po
Partner
Tel: +852 2238 7333
Email: dannpo@deloitte.com.cn

For further information, visit our website at www.deloitte.com/cn

Authors:

Deloitte Touche Tohmatsu Certified Public Accountants LLP

Leonard Khaw
Tel: +86 21 6141 1498
Email: lkhaw@deloitte.com

Simon Tan
Tel: +86 21 6141 1033
Email: sitan@deloitte.com.cn

Qin Li China Lawyers

Hong Ye
Tel: +86 21 6141 1171
Email: hoyeqinli@qinlichinalawyers.com

Bill Ye
Tel: +86 21 6141 1261
Email: byeqinli@qinlichinalawyers.com

Note: Qin Li China Lawyers is part of Deloitte's global network.

Contact details for Deloitte's China Practice

Beijing
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Beijing Branch
8/F Deloitte Tower
The Towers, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, PRC
Tel: +86 10 8520 7788
Fax: +86 10 8518 1218

Chongqing
Deloitte & Touche
Financial Advisory Services (China) Limited
Room 8, 33/F International Financial Center
28 Ming Quan Road
YuZhong District
Chongqing 400010, PRC
Tel: +86 23 6310 6206
Fax: +86 23 6310 61700

Dalian
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Dalian Branch
Room 1503 Senmao Building
147 Zhongshan Road
Dalian 116011, PRC
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297

Guangzhou
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Guangzhou Branch
26/F Teemtower
208 Tianhe Road
Guangzhou 510620, PRC
Tel: +86 20 8396 9228
Fax: +86 20 3888 0119 / 0121

Hangzhou
Deloitte Business Advisory Services
(Hangzhou) Company Limited
Room 605, Partition A
EAC Corporate Office
18 Jiaogong Road
Hangzhou 310013, PRC
Tel: +86 571 2811 1900
Fax: +86 571 2811 1904

Harbin
Deloitte Consulting (Shanghai)
Company Limited
Harbin Branch
Room 1618, Development Zone Mansion
368 Changjiang Road
Nangang District
Harbin 150090, PRC
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056

Hong Kong
Deloitte Touche Tohmatsu
35/F One Pacific Place
88 Queensway
Hong Kong
Tel: +852 2852 1600
Fax: +852 2541 1911

Jinan
Deloitte & Touche
Financial Advisory Services Limited
Jinan Liaison Office
Unit 1018, 10/F, Tower A, Citic Plaza
150 Luo Yuan Street
Jinan 250011, PRC
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068

Macau
Deloitte Touche Tohmatsu
19/F The Macau Square Apartment H-N
43-53A Av. do Infante D. Henrique
Macau
Tel: +853 2871 2998
Fax: +853 2871 3033

Nanjing
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Nanjing Branch
11/F Golden Eagle Plaza
89 Hanzhong Road
Nanjing 210029, PRC
Tel: +86 25 5790 8880
Fax: +86 25 8691 8776

Shanghai
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
30/F Bund Center
222 Yan An Road East
Shanghai 200002, PRC
Tel: +86 21 6141 8888
Fax: +86 21 6335 0003

Shenzhen
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Shenzhen Branch
13/F China Resources Building
5001 Shennan Road East
Shenzhen 518010, PRC
Tel: +86 755 8246 3255
Fax: +86 755 8246 3186

Suzhou
Deloitte Business Advisory Services
(Shanghai) Limited
Suzhou Branch
23/F Building 1
Global Wealth Square
88 Su Hui Road, Industrial Park
Suzhou 215021, PRC
Tel: +86 512 6289 1238
Fax: +86 512 6762 3338 / 3318

Tianjin
Deloitte Touche Tohmatsu
Certified Public Accountants LLP
Tianjin Branch
30/F The Exchange North Tower
189 Nanjing Road
Heping District
Tianjin 300051, PRC
Tel: +86 22 2320 6688
Fax: +86 22 2320 6699

Wuhan
Deloitte & Touche
Financial Advisory Services Limited
Wuhan Liaison Office
Unit 2, 38/F New World International Trade Tower
568 Jianshe Avenue
Wuhan 430022, PRC
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032

Xiamen
Deloitte & Touche
Financial Advisory Services Limited
Xiamen Liaison Office
Unit E, 26/F International Plaza
8 Lujiang Road, Siming District
Xiamen 361001, PRC
Tel: +86 592 2107 298
Fax: +86 592 2107 259

About the Deloitte Tax Research Foundation

The Deloitte Tax Research Foundation was established in 2006 by Deloitte China Tax to promote education, research and innovation in the field of taxation within Chinese Mainland, Hong Kong SAR and Macau SAR. It supports an array of national and local programmes aimed at benefiting higher education students, academic institutions and the business community. Its key initiatives include the annual Deloitte China Tax Championship, publication of research papers on current topics, and holding conferences to provide a forum for interchange of ideas among tax professionals, business people, academics and government officials.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/cn/en/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

About Deloitte in Greater China

We are one of the leading professional services providers with 21 offices in Beijing, Hong Kong, Shanghai, Taipei, Chongqing, Dalian, Guangzhou, Hangzhou, Harbin, Hsinchu, Jinan, Kaohsiung, Macau, Nanjing, Shenzhen, Suzhou, Taichung, Tainan, Tianjin, Wuhan and Xiamen in Greater China. We have nearly 13,500 people working on a collaborative basis to serve clients, subject to local applicable laws.

About Deloitte China

In the Chinese Mainland, Hong Kong and Macau, services are provided by Deloitte Touche Tohmatsu, its affiliates, including Deloitte Touche Tohmatsu Certified Public Accountants LLP, and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is a member firm of Deloitte Touche Tohmatsu Limited (DTTL).

As early as 1917, we opened an office in Shanghai. Backed by our global network, we deliver a full range of audit, tax, consulting and financial advisory services to national, multinational and growth enterprise clients in China.

We have considerable experience in China and have been a significant contributor to the development of China's accounting standards, taxation system and local professional accountants. We provide services to around one-third of all companies listed on the Stock Exchange of Hong Kong.

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

©2013 Deloitte Touche Tohmatsu Certified Public Accountants LLP
HK-001ENG-13

This is printed on environmentally friendly paper