



## Tax Newsflash

China

Deloitte Tohmatsu Tax Co.

January 14, 2015

### Guidance Issued to Facilitate Corporate Reorganizations

China's Ministry of Finance and the State Administration of Taxation (SAT) published two circulars (i.e. Caishui [2014] No. 109 and 116) on 8 January 2015 that relax the requirements for reorganizations to qualify for special tax treatment (i.e. no gain or loss will be recognized on the date of reorganization for enterprise income tax purposes, but will be deferred to the time of a subsequent taxable disposition) and to grant a maximum five-year period to pay tax by installment on gains realized when a nonmonetary asset is contributed for equity. The circulars apply retroactively as from 1 January 2014, as well as to any transaction whose tax treatment has not been finalized.

The circulars are a response to a notice issued by the State Council in March 2014 asking the government to expand the scope of transactions eligible for special tax treatment and to make improvements to the relevant tax policies.

#### (1) Background

Corporate reorganizations normally result in the taxable transfer of shares or assets, although in certain cases, an enterprise may elect for special treatment to effectively achieve a deferral of enterprise income tax if all of the following conditions are satisfied in a domestic share or asset acquisition (additional requirements must

be met in cross-border reorganizations):

- The transaction has a bona fide business purpose and the primary purpose of the transaction is not to reduce, avoid or defer the payment of tax;
- At least 75% of the total equity of the target company, or the total assets of the transferor, is transferred in the acquisition ("minimum acquisition threshold");
- There is no change in the original business operating activities of the target business for 12 months after the reorganization;
- At least 85% of the total consideration received by the transferor is in the form of equity; and
- The major transferor does not transfer the acquired equity for 12 months after the acquisition.

#### (2) Circular 109

Circular 109 reduces the minimum acquisition threshold from 75% to 50% for a share or an asset acquisition to qualify for the special tax treatment and introduces a new form of special tax treatment for an intragroup "assignment" of shares or assets between resident enterprises. The new form of special tax treatment will apply if all of the following conditions are satisfied:

- The assignment of shares or assets are between resident enterprises that have a 100% direct control relationship, or that are both under the 100% direct control of the same resident enterprise or same group of resident enterprises;
- The assignment of shares or assets is based on the net book value (NBV);
- The transaction has a bona fide business purpose and the primary purpose of the transaction is not to reduce, avoid or defer the payment of tax;
- There is no change in the original business operating activities in relation to the shares or assets in concern for 12 months after the assignment; and
- Neither the transferring nor the transferee enterprise has recognized any profit or loss for financial accounting purposes.

If the qualifying parties elect for this special tax treatment:

- Neither the transferor nor the transferee enterprise will be required to recognize taxable income;
- The tax basis of the shares or assets received by the transferee will be determined based on the NBV in the hands of the transferor; and
- For tax depreciable assets assigned to the transferee enterprise, the tax depreciation will be calculated based on the NBV in the hands of the transferor.

### **(3) Circular 116**

Where a resident enterprise contributes nonmonetary assets for equity in another resident enterprise, it normally must recognize the fair market value of the assets over its tax basis as a taxable gain. However, Circular 116 now allows the taxpayer to spread the gain over a period of up to five years for enterprise income tax purposes and pay the relevant tax in installments. The tax basis of the acquired equity

will step up according to the taxing schedule of the gain. The installment treatment has been piloted in the China (Shanghai) Pilot Free Trade Zone and now is rolled out nationwide.

Circular 116 also allows a taxpayer to elect to apply special tax treatment (provided the contribution of nonmonetary assets satisfies the relevant conditions) instead of the five-year installment treatment.

### **(4) Deloitte Comments**

Businesses generally have welcomed the issuance of Circulars 109 and 116 because the circulars will allow share or asset acquisitions to be carried out in a more tax-efficient manner. The new form of special tax treatment, which appear somewhat similar to income tax relief for intragroup share transfers under the pre-2008 Foreign-invested Enterprise Income Tax regime (i.e. Circular 207), may help facilitate intragroup reorganizations under which tax deferral will be granted regardless of the percentage of shares/assets acquired and the form of the consideration. Unfortunately, however, the new form of special tax treatment do not apply to intragroup cross-border reorganizations or transfers of the shares of a resident company as a result of the intragroup restructuring (e.g. merger, division, liquidation, etc.) of its foreign parent company.

The SAT is expected to issue further guidance that contains details on the implementation of the two circulars and clarifies certain aspects (e.g. definition of "assignment"). Affected taxpayers should evaluate and explore the possibilities to enjoy tax deferral of M&A deals, closely monitor the regulatory and practice development, and seek professional advice where necessary.

## Newsletter Archives

To see past newsletters, please visit our website.

[www.deloitte.com/jp/tax/nl/ao](http://www.deloitte.com/jp/tax/nl/ao)

## Contacts

Jennifer Zhang, Partner [jenzhang@deloitte.com.cn](mailto:jenzhang@deloitte.com.cn)

Vicky Wang, Partner [vicwang@deloitte.com.cn](mailto:vicwang@deloitte.com.cn)

## Issued by

### Deloitte Tohmatsu Tax Co.

#### HQ・Tokyo Office

Shin-Tokyo Building 5F, 3-3-1, Marunouchi, Chiyoda-ku, Tokyo 100-8305, Japan

T E L : +81-3-6213-3800

email: [tax.cs@tohmatu.co.jp](mailto:tax.cs@tohmatu.co.jp)

URL : [www.deloitte.com/jp/en/tax](http://www.deloitte.com/jp/en/tax)

All of the contents of these materials are copyrighted by Deloitte Touche Tohmatsu Limited, its member firms, or their related entities including, but not limited to, Deloitte Tohmatsu Tax Co. (collectively, the "Deloitte Network") and may not be reprinted, duplicated, etc., without the prior written permission of the Deloitte Network under relevant copyright laws.

These materials describe only our general and current observations about a sample case in accordance with relevant tax laws and other effective authorities, and none of 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. The opinions expressed in the materials represent the personal views of individual writers and do not represent the official views of Deloitte Network. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

Deloitte Touche Tohmatsu (Japan Group) is the name of the group consisting of member firms in Japan of Deloitte Touche Tohmatsu Limited (DTTL), a UK private company limited by guarantee. Deloitte Touche Tohmatsu (Japan Group) provides services in Japan through Deloitte Touche Tohmatsu LLC, Deloitte Tohmatsu Consulting Co., Ltd., Deloitte Tohmatsu Financial Advisory Co., Ltd., Deloitte Tohmatsu Tax Co., and all of their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu (Japan Group) is among the nation's leading professional services firms and each entity in Deloitte Touche Tohmatsu (Japan Group) provides services in accordance with applicable laws and regulations. The services include audit, tax, consulting, and financial advisory services which are delivered to many clients including multi-national enterprises and major Japanese business entities through nearly 7,800 professionals in almost 40 cities of Japan. For more information, please visit Deloitte Touche Tohmatsu (Japan Group)'s website at [www.deloitte.com/jp/en](http://www.deloitte.com/jp/en).

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 and territories, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's more than 200,000 professionals are committed to becoming the standard of excellence.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a more detailed description of DTTL and its member firms.