TAX EXECUTIVES INSTITUTE, INC.

1 August 2014

Legal Department
State Administration of Taxation,
No. 5, Yangfangdian West Road,
Haidian District, Beijing
10039, P.R. China

Via Email: shuiwulaw@163.com

RE: Administrative Measures on the General Anti-Avoidance Rule (Trial) Discussion Draft Publicized on 3 July 2014

Dear Gentlemen:

On 3 July 2014, the State Administration of Taxation (SAT) released for public comment draft administrative measures on the General Anti-Avoidance Rule (GAAR) set out in Article 47 of the Corporate Income Tax Law of the People's Republic of China and its Detailed Implementation Regulations (DIR). The draft measures provide guidance on, among other things, when a tax avoidance case is present, policies and procedures on selection of GAAR cases by in-charge authorities, documents that may be requested from the taxpayer in connection with a GAAR examination, and the types of tax adjustments that may be made to deny tax benefits for transactions without reasonable business purpose. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the SAT's request for comments.

The draft measures are a welcome addition to the Chinese domestic law GAAR as they provide guidance to in-charge authorities that is absent in the existing law. We are concerned,

however, that the draft measures expand the GAAR to reach transactions outside the scope established in the DIR, unfairly subject taxpayers to two independent substance-based inquiries when special tax adjustment rules also apply to a transaction, and contain overly expansive document production requirements. Our comments focus on these and other aspects of the draft administrative measures that are important to our membership.

TEI Background

Tax Executives Institute was founded in 1944 by a group of fifteen corporate tax executives intent on creating an organization to exclusively serve the networking, educational and advocacy needs of in-house tax professionals, *i.e.*, professionals who perform the tax work for their business employers. A non-profit organization, which has tax-exempt status under the United States Internal Revenue Code, TEI has grown from its founding to become the preeminent organization of in-house professionals worldwide, comprising 55 chapters and over 7,000 members who work for over 3,000 of the largest corporations in Asia, Europe and North America. TEI is dedicated to promoting sound tax policy, as well as the fair and efficient administration of tax laws, at all levels of government around the world. In 2005, TEI established a chapter in Asia, which currently has over 120 members employed by 51 different companies with significant operations in China and throughout Asia.

TEI Comments

Article 4

Article 4 of the draft measures provides that the main characteristics of a "tax avoidance scheme" are:

1) the sole or main purpose, or one of the main purposes is to obtain a tax benefit;

2) the form of scheme is permitted in accordance with the tax rules, but the form is not consistent with its commercial substance.

By describing a tax avoidance scheme as an arrangement where "one of the main purposes" is to obtain a tax benefit, the draft measures materially widen the reach of the GAAR from the scope set out in Article 120 of the DIR and, in doing so, create an added layer of uncertainty and cost for taxpayers and the SAT.

Article 120 of the DIR extends the GAAR to arrangements in which the "***main purpose*** is reduction, exemption or deferral of tax payments [emphasis added]." The "one of the main purposes" standard introduced in the draft measures is not defined, but invites in-charge authorities to apply the GAAR to transactions that are undertaken primarily to achieve overriding commercial purposes but are also structured in a tax-efficient manner. Complex commercial transactions frequently have a main, non-tax commercial purpose but may also yield certain tax benefits. If adopted, the subjective and far-reaching "one of the main purposes" standard proposed in the draft measures would increase transactional costs and risks to businesses operating in China, result in disparate interpretations and uneven application by in-charge authorities, and ultimately lead to a proliferation of GAAR cases for the SAT to resolve.

TEI encourages the SAT to avoid the increased costs and uncertainties associated with the overly subjective "one of the main purposes" standard and to retain the more objective and easily administered "main purpose" standard set forth in Article 120 of the DIR.

Article 5

Article 5 of the draft measures clarifies the types of adjustments that may be made to disallow tax benefits arising from arrangements without reasonable commercial purpose. TEI commends the SAT for providing this much-needed guidance to in-charge authorities. To increase the certainty surrounding permissible adjustments and avoid unreasoned adjustments and abuse of the GAAR, TEI recommends that the draft measures specifically provide that special tax adjustments are intended only to disregard the artificial structure and deny the tax benefits arising therefrom. Such a change would clarify that special adjustments can be made only to the extent necessary to disallow inappropriate tax benefits and do not authorize in-charge authorities to reconstruct the arrangement in a manner that upsets other aspects of the transaction.

In addition, allowing in-charge authorities to make adjustments using "any other reasonable method" (*i.e.*, clause 4 under Article 5) is overly broad and invites abuse by in-charge authorities seeking a basis for an arbitrary adjustment. We recommend that the SAT clarify this provision by stating that the method must reflect the substance over form principle embodied in the GAAR.

To reflect the foregoing, TEI recommends the following changes to Article 5 of the draft measures:

> According to the principle of substance over form, tax authorities shall make special tax adjustments to the extent required to disregard the artificial structure and deny the tax benefits arising therefrom ~~by reference to other similar schemes with reasonable commercial purpose and economic substance~~. Adjustment methods including:
>
> 1) re-characterize part or whole of the scheme;
>
> 2) disregard the existence of a transaction party for taxation purposes or deem this transaction party and the other transaction party as the same entity;
>
> 3) re-characterize the relevant income, deduction, tax incentives, foreign tax credits, etc. or reallocate the split among the transaction parties; and
>
> 4) any other reasonable method that reflects what the tax effects of the scheme would have been if its form had followed its substance.

Article 6

Article 6 of the draft measures provides ordering rules under which a transaction could be subject to scrutiny under a special tax adjustment rule (a SAAR) and then again under the GAAR with both investigations conducted pursuant to differing procedural rules. General anti-abuse rules, such as the GAAR, should not be invoked to adjust an aspect or element of a transaction that is also subject to a special anti-abuse rule. Further, subjecting a transaction to two levels of inquiry where both are based on the same substance-focused principles but have differing administrative measures is inefficient both for taxpayers and tax authorities.

Accordingly, TEI recommends that the SAT conform the administrative measures applicable to SAARs to the administrative measures applicable to the GAAR. In addition, TEI recommends that the SAT revise Article 6 to specifically state that when an arrangement is subject to a SAAR investigation, it shall not be subject to a separate GAAR investigation. This would save taxpayers and the SAT the time and expense necessary to resolve two substance-based

examinations. We suggest the following changes to Article 6 to implement this recommendation:

> For special tax adjustments in the areas of transfer pricing, cost sharing agreements, controlled foreign corporations or thin capitalization, etc. (SAARs), the relevant provisions in the ~~special tax adjustment rules~~ SAARs shall take priority.
>
> For the implementation of treaty treatments in the areas of beneficial ownership, limitation of benefit, etc. (Special Treaty Limitation Rules), the relevant ~~provisions~~ Special Treaty Limitation Rules in respect of the implementation of tax treaties shall take priority.
>
> If the aforementioned measures can appropriately address the tax avoidance of transactions, the GAAR should not be invoked. If the aforementioned measures are not appropriate to address the tax avoidance of a transaction, tax authorities can invoke the GAAR.
>
> If particular aspects of an arrangement are determined to have commercial substance under SAARs or Special Treaty Limitation Rules, those aspects of the arrangement shall be presumed to have "reasonable commercial purpose" under the GAAR, and the in-charge tax authority shall have the burden of establishing why those aspects of the arrangement should not be respected under the GAAR.

Articles 7-9

These articles of the draft measures set forth procedures that in-charge authorities wishing to conduct a GAAR investigation must follow before initiating the examination. The GAAR is a provision of last resort and should only be invoked to counteract abusive tax avoidance schemes that more specific tax statutes do not reach. It should not be widely invoked by in-charge authorities whenever a taxpayer is perceived to have taken a tax benefit. In this regard, it is critical that before invoking the GAAR, in-charge authorities distinguish transactions with tax benefits from inappropriate tax avoidance. Because the vast majority of transactions have a commercial purpose, GAAR investigations should be used sparingly, and it is important to have safeguards in place like those provided in Articles 7-9 to curb abuse of the GAAR.

Article 11

Article 11 of the draft measures provides welcome clarity surrounding the types of information that should be produced during the course of a GAAR investigation and the timeframes for making the production. It is unclear, however, how the 60-day time limit applies to information requests taxpayers receive after a Tax Investigation Notice is issued. TEI suggests adding a sentence to clearly explain that any subsequent information requests received shall also have a 60-day time limit from the date of receipt of such requests. In addition, it is important to recognize that in-charge tax authorities cannot compel taxpayers to produce documents that are protected from disclosure by an applicable privilege, such as attorney-client privilege or client-tax advisor confidentiality, or that pertain to transactions undertaken outside an applicable statute of limitations.

To reflect these two comments, we recommend the following changes to the introductory paragraph of Article 11:

> The enterprise being investigated shall, within sixty days upon receiving the "Tax Investigation Notice", provide information to prove that the scheme is not a tax avoidance scheme as specified under the Measures. If an enterprise receives an information request after receipt of the Tax Investigation Notice, the enterprise shall provide the requested information within sixty days upon receiving such information request. An enterprise being investigated is not obligated to produce information that is protected from disclosure by an applicable privilege, such as attorney-client privilege or client-tax advisor confidentiality, or information that pertains to periods outside the applicable statute of limitations.

Clauses 1 – 8 of Article 11 set forth the types of information that in-charge authorities can request. To ensure an efficient and productive examination, TEI recommends the following changes to these clauses.

Clause 3 provides that "email correspondences, etc." can be requested. Identifying and securing copies of relevant emails is an extremely time consuming and expensive endeavor. Further, email communications are often misleading, incomplete, and difficult to understand because of inevitable gaps in the chain of communication. TEI therefore recommends that the phrase, "email

correspondence, etc." be stricken from the list of documents and replaced with "external or internal written documentation concerning the arrangement."

Clause 5 includes "correspondence with tax advisors" as an item of information that can be requested. A generic request for correspondence is overly broad and is subject to differing interpretations. TEI recommends that clause 5 be limited to final versions of written legal and tax advice obtained from external tax advisors that are not protected from disclosure by attorney-client privilege or client-tax advisor confidentiality.

Clauses 6 and 7 are similarly overbroad and subject to differing interpretations. TEI recommends striking these items from the list or making them more detailed so the required information is clear to both taxpayers and in-charge authorities, such as providing a list of specific examples similar to the list provided in clause 4.

Clause 8 is a generic "catch-all" provision that has no stated boundaries. Given the breadth of specific information included in the prior clauses, the catch-all clause is unnecessary and will inevitably serve as a basis for unprincipled information requests that will lead to disputes. Accordingly, we urge the SAT to remove clause 8 from the draft measures.

TEI appreciates the acknowledgement in the draft measures that taxpayers may not be able to comply with the sixty-day time period for providing requested information. To avoid disagreements over the circumstances that warrant an extension, the SAT may consider providing examples of the types of "exceptional circumstances" that should give rise to an extension.

Article 12

Article 12 of the draft measures provides that the in-charge tax authority shall make adjustments if the enterprise refuses to provide the required information or the information provided is "false or incomplete." The word "incomplete" is vague and open to broad interpretations that may lead to disagreements between the taxpayer and in-charge authorities. Accordingly, TEI recommends that the concept of incomplete information be stricken from the provision. Alternatively, clarity could be added to the draft provision by using a more objective standard, such as "materially incomplete."

Article 13

Article 13 provides that when conducting a GAAR investigation, the in-charge tax authority may request the "planner" of the scheme to provide "any relevant information." The meaning of the word planner is unclear, as there may be multiple parties involved in assisting a taxpayer implement a transaction. Providing a definition of what is meant by planner would assist with the administration of and compliance with this provision.

In addition, use of "any relevant information" is overly broad, subjective, and subject to differing interpretations by taxpayers and in-charge authorities. TEI suggests that the provision specifically identify the types of information that may be requested from the "planner," for example written memos or opinions obtained from the planner that are not otherwise privileged.

Article 14

Article 14 addresses the issuance of Tax Investigation Notices to third parties involved in a transaction under investigation. In many instances, such third parties are domiciled offshore and are from countries that have neither a tax treaty nor an exchange of information agreement with China. TEI recommends adding a provision to address how Tax Investigation Notices will be issued in these circumstances, as well as a provision providing additional details on the procedural process of accessing this information.

Article 15

Article 15 provides that the in-charge tax authority may also require the enterprise under investigation to provide a ***notarized*** copy of the relevant information concerning overseas related parties. Not all information or documents can be notarized or certified. Further, for documents that may potentially be notarized, the process is quite time consuming, and some information may be subject to relevant privacy laws in the offshore locations. TEI recommends that the SAT obtain such information through the normal government-to-government information exchange channels and remove this notarization requirement from Article 15.

Article 16

GAAR investigations frequently involve secret and/or commercially sensitive information. To protect taxpayers' privacy and confidential information, TEI suggests adding a provision to Article 16 that prohibits in-charge tax authorities from disclosing to third parties any information related to the GAAR case investigation or using such information for any purpose other than the GAAR investigation.

Article 17

Article 17 requires a taxpayer to raise an objection to a Preliminary Special Tax Investigation Adjustment Notice within seven working days of receipt. TEI recommends that the timeframe for providing a general objection to the notice be revised to a period of "14 working days" and that taxpayers be granted an additional 30 working days from the date the general objection is submitted to submit a more detailed objection providing reasons the case should not be a GAAR case. This expanded procedure will allow time for thoughtful consideration of the notice and result in a more efficient review process.

Article 20

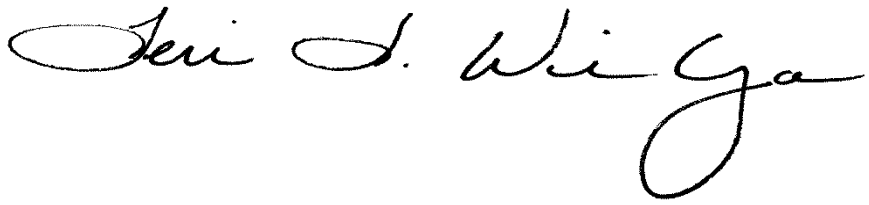
Article 20 provides that where GAAR adjustments made by in-charge tax authorities result in domestic double taxation, the SAT "shall conduct the coordination and provide solutions." TEI recommends amending the provision to state that the SAT shall conduct "all necessary" coordination and provide "reasonable solutions to ensure no double taxation will arise for the taxpayer." These changes will provide more assurance to taxpayers that the SAT will use its best efforts to eliminate double taxation.

Conclusion

TEI appreciates the opportunity to comment on the SAT's proposed administrative measures on the GAAR. These comments were respectfully prepared by TEI-Asia Chapter board members and the TEI Asia Tax Committee, whose Chair is Lisa Zheng. If you have any questions about the submission, please contact Ms. Zheng at (65) 8181 4364, zheng.li.3@pg.com, or Patrick Evans of the Institute's legal staff, at +1 (202) 638 5601, pevans@tei.org.

Sincerely yours,

TAX EXECUTIVES INSTITUTE, INC.



Terilea J. Wielenga
International President