An update on Re-structuring FDI in China
By Alfred Chan
China Tax & Investment Consultants Ltd
www.china-tax.net

(1) On 30th April 2009, the Ministry of Finance and State Administration of Taxation jointly issued a guideline Cai Shui (2009) No. 59 (the Guideline) setting out the tax treatments on company re-structuring transactions involving companies incorporated within and outside China.

(2) The Guideline makes a distinction between general re-structuring and special re-structuring transactions. Different tax treatment shall apply depending on the above classification of the company re-structuring transaction. The special tax treatment in company re-structuring shall apply where all of the following conditions are satisfied:

(a) The re-structuring transaction has a sound commercial motive and it is not primarily intended to reduce or avoid the tax liability;
(b) The relative ratio of assets or equity that is the subject of acquisition, merger or spin-off shall be in conformance with what is stated in the Guideline;
(c) The taxpayer shall not change the substance of the business activities within a continuous period of 12 months after the company re-structuring transaction;
(d) The ratio of equity payment as settlement to the total consideration shall conform to what is prescribed in the Guideline;
(e) The acquiring company shall not dispose of the shares acquired within 12 months from the acquisition date.

(3) The Guideline also provides that the ratio of equity payment as a percentage to the total consideration for the equity acquisition shall be no less than 85%, and the equity transfer as a percentage to the total equity capital in the acquired entity shall be no less than 75%.

(4) Where the acquisition transactions involves the transfer of equity and assets located within and outside China (including Taiwan, Hong Kong and Macau), and the taxpayer would like to receive the special tax treatment, the following criterion should be met in addition to the above five conditions as mentioned above: a non-resident company transfers to its 100% owned non-resident subsidiary the equity interest of a resident company (transfer having no impact on income tax on the capital gain in future), the transferor shall give to the PRC tax authority a written undertaking that it shall not dispose of its interest in the above-mentioned non-resident subsidiary within a period of 3 years. In other words, the jurisdiction of the PRC tax authority is extended to the non-resident companies: the immediate holding company and its holding company one level up the company structure, unless any China's double tax agreement provides otherwise.

(5) A comparison for different legal rules is set out in the following table:

	Types of rules	Mandatory requirement for cash in the composition of capital	% of equity stock vs. cash in composition of consideration
I	Accounting rules	Not mandatory	Not applicable
II	Income tax rules per Cai Shui (2009) 59	Mandatory; but cash is no more than 25% of the acquired capital	Consideration consisting of 85% equity and 15% cash
III	Administrative rule issued by State Administration of Industry and Commerce	Mandatory; cash is no less than 30% of the registered capital of acquired company	Not applicable