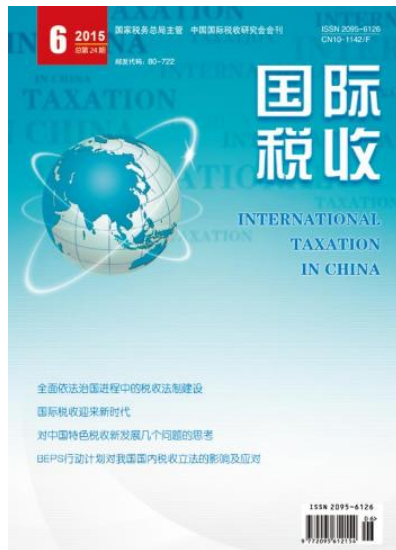


Controlled Foreign Company (CFC) rules and the latest development in the PRC

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Background

⑥ *Shandong Tax Bureau administrative ruling (Dec. 2014) involving application of CFC rule*



⑥ *Chapter 10 (CFC rule) of the revision draft of circular 2[2009] v. OECD BEPS Action Plan 3 – similarities and divergence?*

《特别纳税调整实施办法》征求意见稿

发布日期：2015年09月17日 来源：国家税务总局政策法规司

【字体：大 中 小】 打印本页

为进一步规范特别纳税调整工作，税务总局对《特别纳税调整实施办法》（国税发〔2009〕2号）进行了修订，起草了《特别纳税调整实施办法（征求意见稿）》，并拟以部门规章形式公布，现向社会公开征求意见。公众可通过以下途径和方式提出反馈意见：

1. 登陆中国政府法制信息网

（网址：<http://www.chinalaw.gov.cn>），进入首页左侧的“部门规章草案意见征集系统”提出意见。

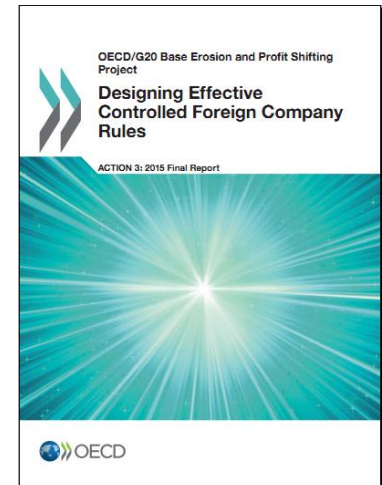
2. 登陆税务总局网站

（网址：<http://www.chinatax.gov.cn>），进入主页点击“《特别纳税调整实施办法》征求意见稿”提出意见。

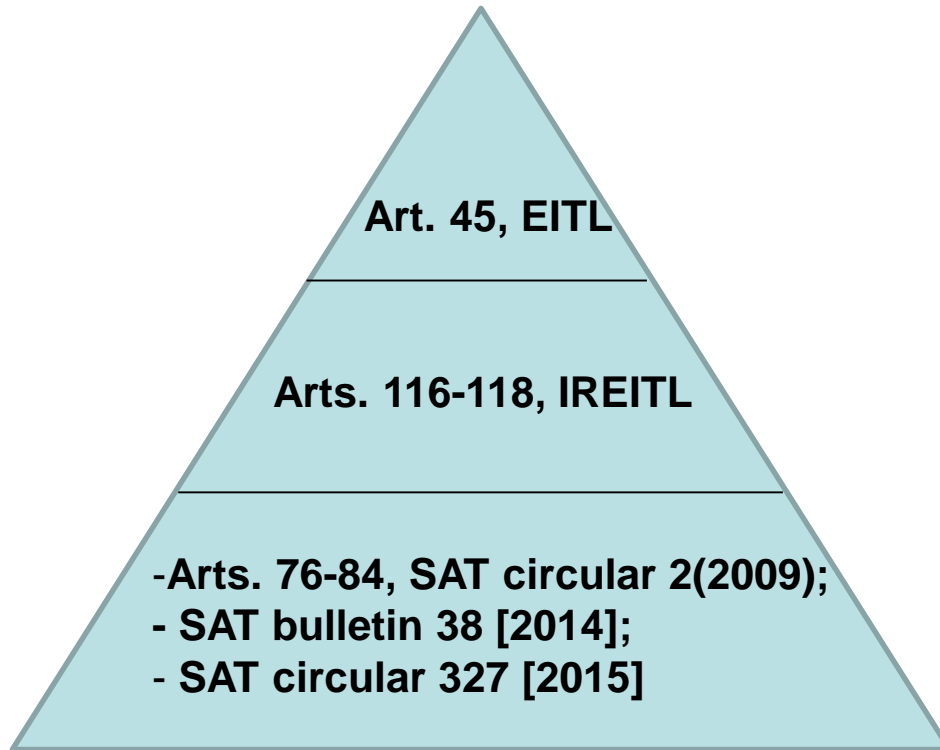
电子邮件：shuiwulaw@163.com

通信地址：北京市海淀区羊坊店西路5号国家税务总局政策法规司（邮编：100038）

意见反馈截止时间为2015年10月16日。



CFC rules in China



Legal and regulatory framework of CFC rules in China

Article 45, EITL

A PRC resident shareholder (including resident enterprise, or resident enterprise and resident individual) is subject to tax on undeclared profits kept **without reasonable business reasons** by a controlled foreign company (CFC) incorporated in a jurisdiction **with an effective tax rate** obviously lower than that of PRC.

Control: **Art. 117 of the IREITL**

China's outbound FDI

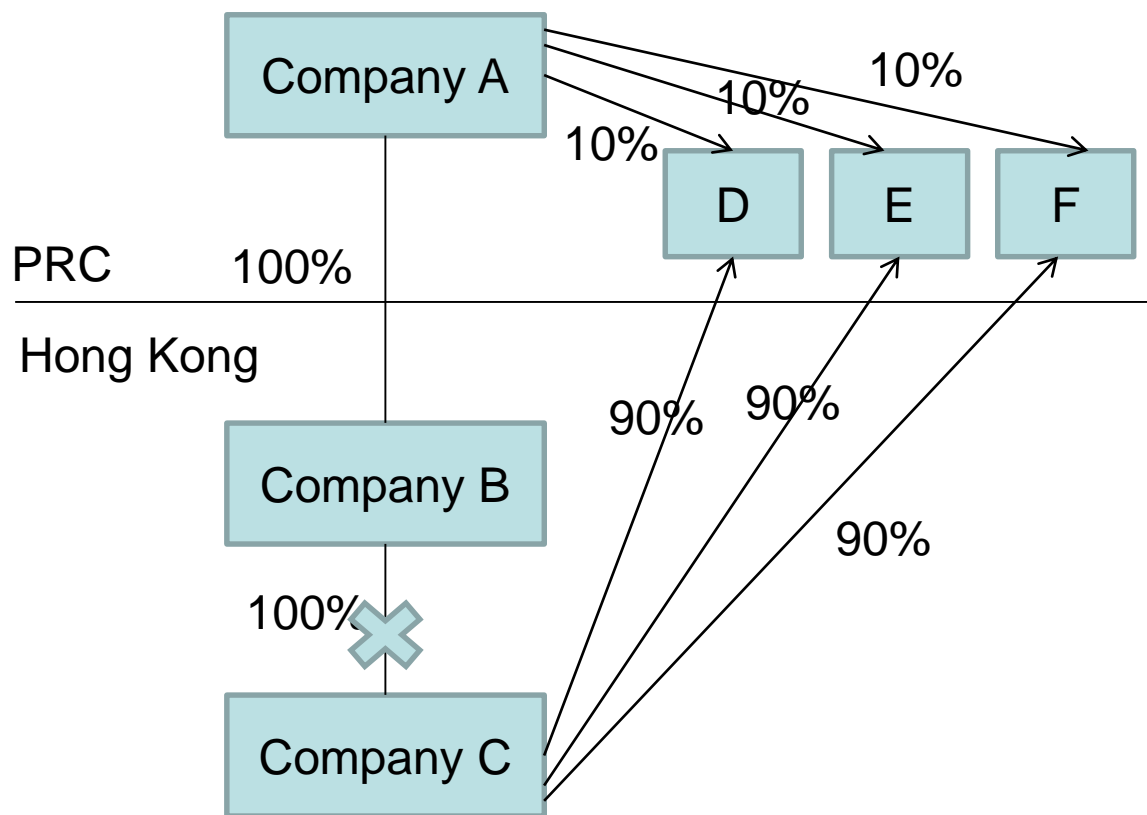
Top 3 jurisdictions/regions that has received the largest amount of FDI from China by the year of 2013

Destination of China's outbound FDI	Accumulative volume of FDI (billion USD)	Percentage
Hong Kong	377.09	57.1%
British Virgin Islands	42.32	6.4%
The Cayman Islands	33.90	5.1%
Total	453.32	68.6%

Statistic: MOFCOM & SAFE & National Bureau of Statistic, Statistic Bulletin of China's Outbound FDI, 2014.

CFC administrative ruling

⊗ *Shandong ruling – China's first CFC case*



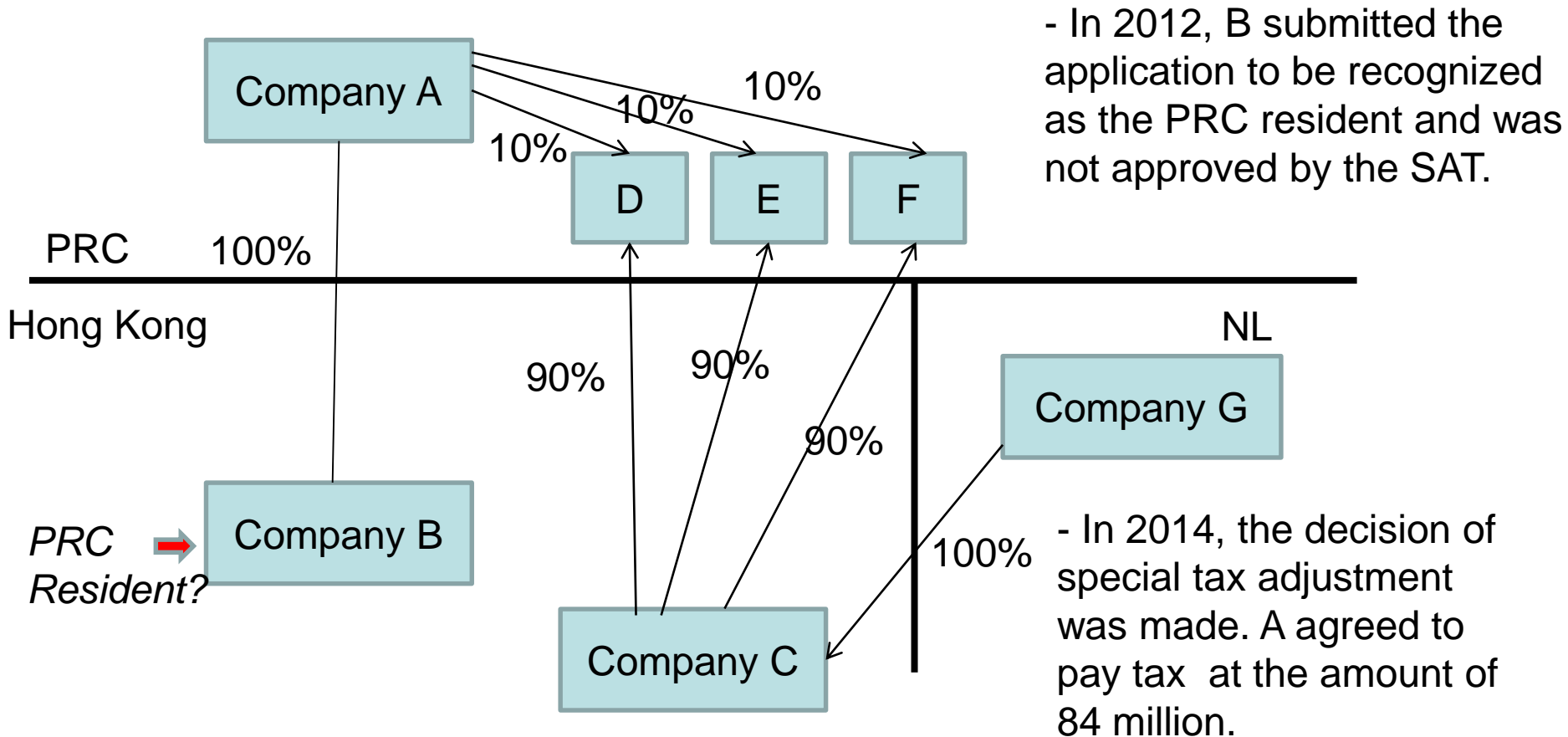
-In June 2011, B was established in Hong Kong with the registered capital at the amount of 3.1 million USD.

- On July 26, 2011, B transferred all its shares in C to a Dutch company at the price of 450 million RMB (gains: 300 million).

- Gains were subject to withholding tax in China (30 million).

CFC administrative ruling

⊗ *Shandong ruling – China's first CFC case*



CFC administrative ruling

⊗ Unanswered question

- Whether capital gains tax paid by Company B was credited against the tax paid by Company A for the CFC income?

⊗ Some takeaway

- ⊗ Round-trip scheme: residence rules v. CFC rule (outbound investment) and tax on indirect transfer (inbound investment) → if company A had known the potential tax risks, would the business scheme be designed differently?

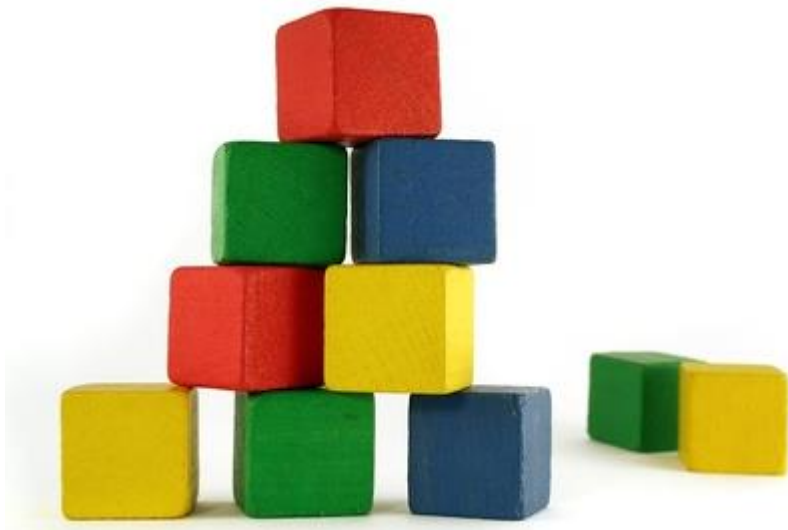
*Where are the CFC
rules in China heading
for?*

OECD BEPS Action 3

Designing Effective Controlled Foreign Company Rules (2015 Final Report)

Six building blocks

- Definition of a CFC;
- CFC exemptions and threshold requirements;
- Definition of income;
- Computation of income;
- Attribution of income; and
- Prevention and elimination of double taxation



China's CFC rules

Substantive rules that are still taking shape

	Revised circular 2 [2009] (draft)
Definition of a CFC	Art. 114 (“ foreign enterprises controlled by resident enterprise or resident enterprise and individuals”); Arts 115-116 (“ control ”).
CFC exemptions and threshold requirements	Art. 117 (“ the effective tax rate ”); Art. 120 (enlarged scope of CFC exemption)
Definition of income	Art. 119 (“attributable income”)
Computation of income	No mention of offsetting the CFC loss
Attribution of income	Arts.121 - 124
Prevention and elimination of double taxation	Arts. 125 -126 (it does not address the exemption of gains on the disposition of CFC shares from taxation)

China's CFC rules

⊗ **Substantive rules that are still taking shape**

• Article 119

In determining whether CFC income is 'includable' as taxable income of a Chinese taxpayer, one needs to analyze

- (i) whether the employees of the CFC have made a substantial contribution to the income earned by the CFC;
- (ii) whether the CFC is the entity which would be most likely to own particular assets, or undertake particular risks, if the entities were unrelated;
- (iii) whether the CFC had the necessary number of employees with the requisite skills in the CFC jurisdiction to undertake the majority of the CFC's core functions.

China's CFC rules

◎ Take-away

- BEPS action 3 has been used as an important reference for the SAT to upgrade the CFC rule.
- Chinese companies that invest abroad via the offshore market/low tax regimes will be exposed to higher tax risks and costs in China.