China issues circular to encourage corporate restructuring

In response to China’s State Council Circular Guofa [2014] No. 14 (Circular 14) issued on 7 March 2014, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued Circular Caishui [2014] No. 109 (Circular 109) to relax and clarify corporate income tax (CIT) treatment on certain equity and assets acquisition. This Alert summarizes Circular 109’s favorable changes.

Reduction of acquired equity or assets threshold for tax deferral treatment

- Equity acquisition: minimum equity interest acquired reduced to 50% of the target’s equity interest from the previous threshold of 75% for acquisition of equity interest.
- Asset acquisition: minimum assets acquired changed to 50% of the target’s total assets from the previous threshold of 75% for acquisition of assets.

The provision is applicable to both domestic and cross-border transactions. A domestic or nonresident transferor would be eligible for tax deferral if certain conditions, including the acquired equity or assets threshold are satisfied. However, types of cross-border restructuring transactions that may be eligible for tax deferral treatment are still limited to specific scenarios under Article 7 of Circular Caishui [2009] No. 59.
Tax deferral on business restructuring of Chinese tax resident companies

A domestic transferor is eligible for tax deferral treatment if all of the following conditions are satisfied:

- Transferor and transferee are:
  - Parent and 100% owned subsidiary, or
  - Brother-sister companies that are 100% owned by the common Chinese tax resident parent company or the group of Chinese tax resident companies. The common Chinese tax resident parent company or the group of Chinese tax resident companies may be held by a foreign common parent.
- The transaction is effected at net book value.
- Neither the transferor nor the transferee recognizes gain or loss on the transferred asset or equity under China GAAP.
- The transaction is based on valid business purposes and its primary objective is not tax avoidance, reduction or!d different.
- The nature of the business activities associated with the transferred equities or assets must remain unchanged for 12 months following the transfer.

Circular 109 is effective retroactively as of 1 January 2014 and applies to transfers that are still pending.

Endnotes


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