China Tax Regulation Update

October 2012

Circular Number	Issuance Date	Effective Date	Topic	What is new?
Ministry of Commerce Decree [2012] No. 8	2012-9-21	2012-10-22	Provisional Regulations on Capital Contribution by Means of Shares in Foreign Invested Enterprises	For various reasons, a foreign company holding direct shares in its Chinese subsidiaries may wish to transfer such shares to a Chinese entity ("Transferee Company"). In the past, such share transfer could be made in the form of a capital contribution only if the Transferee Company had a Chinese Holding Company ("Holdco") status. Otherwise, it had to be structured as a share transfer where the Transferee Company paid a share price to the foreign company. Under PRC tax law, such share transfer with cash payment will trigger PRC withholding tax of 10% on the capital gains arising from the share transfer. On 21 September 2012, the PRC Ministry of Commerce issued the Provisional Regulations on Capital Contribution by Means of Shares in Foreign Invested Enterprises ("the Regulations"), which took effect on 22 October 2012. The Regulations now generally allow domestic and foreign investors to contribute their shares in foreign invested enterprises ("FIEs") as capital contribution to a Chinese company (not limited to Holdcos). This may enable foreign investors to avoid the 10% withholding tax for the gains from the share transfer. Under the Tax Circular Caishui [2009] No. 59, the withholding tax is not payable if all of the following conditions are met: 1. The share transfer has its reasonable commercial purposes and is not conducted mainly for purposes

				of reducing, avoiding or postponing tax payments; 2. The transferred shares constitute no less than 75% of the shares in the target company; 3. More than 85% of the considerations for the share transfer are new shares in the transferee company; 4. The target company will continue its previous business operation for more than 12 months after the share transfer; 5. The transferor will not transfer its new shares in the transferee company within 12 months after the share transfer; 6. The Chinese transferee company is 100% directly held by the foreign transferor company.

For further information, please contact:

Charlie Sun
Head of Tax Practice Area Group — T +86 21 6289 6363
Charlie.Sun@cmslegal.cn — F +86 21 6289 0731