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TAX

Brief of the Announcement on Issues Concerning Assessing and Determining the Basis of Calculating Individual Income Tax on Incomes Derived from Equity Transfer

On December 14, 2010, the State Administration of Taxation (SAT) published the *Announcement on Issues Concerning Assessing and Determining the Basis of Calculating Individual Income Tax on Incomes Derived from Equity Transfer* (SAT Announcement [2010] No. 27, "**Announcement No. 27**"), clarifying relevant issues concerning the individual income tax calculation basis where a natural person obtains incomes from transferring the equity (shares) he/she holds in an enterprise ("Equity Transfer", excluding the transfer of shares of listed companies). Announcement No. 27 became effective on January 14, 2011.

In May 2009, the SAT issued *Notice of the State Administration of Taxation on Strengthening the Administration of Individual Income Tax on Incomes from Equity Transfer* (Guoshuihan [2009] No. 285, "**Circular 285**"), setting out the framework and rules for individual income tax collection with respect to Equity Transfer. However, there remained quite a number of unclear issues, both technical and procedural, in Circular 285.

As a result, both taxpayers and PRC tax authorities encountered difficulties in adopting and complying with the relevant tax regulations as per Circular 285, which resulted in compliance risks to both sides. Obviously, the SAT was aware of such undesirable situation and issued Announcement No.27 to clarify some policy-type issues arising from tax administration practice. We set out below salient points of Announcement No.27.

Tax Calculation Basis: Fair Trade Price

If the tax calculation basis is significantly low and without justifiable reasons, the competent tax authority may adopt the following methods to determine the incomes derived from Equity Transfer:

- making reference to the net asset value per share or the share of the net assets corresponding to the equity ratio the taxpayer is entitled to (if the aggregate of intellectual property rights, land use rights, real estate, right of prospecting, right of mining and equity accounts for more than 50% of the total assets of the target enterprise, then the value of net assets of the target enterprise should be assessed by a third-party valuator);
- making reference to the Equity Transfer prices of other shareholders or the same shareholder within the same enterprise under the same or similar conditions;
- making reference to the Equity Transfer prices of enterprises within the same industry under the same or similar conditions;
- if the taxpayer disagrees with the determination method adopted by the competent tax authority, he/she shall provide relevant evidence to support his/her argument. The competent tax authority may adopt other reasonable determination methodology if the evidence is verified and accepted by the tax authority.

Reasonable Testing Methods on Determining Tax Calculation Basis

- According to Announcement No.27, when characterized by any of the following situations without justifiable reason, the tax calculation basis may be deemed as significantly low:

    (a) the filed Equity Transfer price is lower than the initial investment cost or lower than the payments paid for obtaining this equity plus relevant fees and taxes;

    (b) the filed Equity Transfer price is lower than the corresponding share of net assets; or

    (c) he filed Equity Transfer price is lower than the Equity Transfer price of other shareholders or the same shareholder within the same enterprise under the same or similar conditions; or

    (d) the filed Equity Transfer price is lower than the Equity Transfer price of enterprises within the same industry under the same or similar conditions; or

    (e) other situations as may be provided by the competent tax authority.

- Announcement No.27 also provides that there may be justifiable reasons for a low price. Examples given include:

    (a) target is in a loss position for more than three (inclusive) consecutive years; or

    (b) the investor is selling equity at an artificially low price due to an adjustment of state policy; or

(c) as part of a family re-structuring (i.e. where the equity-holder transfers equity to a spouse, parent, child, grandparent, grandchild, sibling or any relative that has a direct obligation to raise or support the transferor); or

(d) other justifiable reasons as may be provided by the competent tax authority.

Tax Calculation Basis for Previous Equity Transfer

Where a taxpayer transfers the equity acquired by him/her, the Equity Transfer cost shall be the trade price of the previous transfer plus the relevant fees and taxes paid by the buyer.

If you have any questions regarding the foregoing, please feel free to contact us. Thank you!

Important Announcement

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