Answer-to-Question- 1

Before 2016: ACO clearly is a UK tax resident than ca benefit from the provisions of the treaty, unless there is a suspsition of treaty abuse, transfer pricing provisiones or anti-avoidance rules.

In 2016, many transactions ocurr, for example the incorporation of BCO.
- Ownership relationship of Aco to BCO, the latter being based in china.
- BCO is considered a WOFE, wholly owned foreign enterprise which is relatively better than a joint venture, though, it is supposed to be used for special sectors, like high technology or innovation, rather than a mere distribution activity.
- Hopefully, BCO is goinG to be used to produce medicinal products, probably because of location specific advantages, and then sell them to ACO.
- This strategy inmmediatly should trigger the compliance with Transfer Pricing rules, at minimum, the Arm´s length principle (ALP), because BCO will resell this to ACO. A simple cost plus method could be applicable.

Secondly, in 2016 also, it is expected that the products stay in China, after being sold to ACO at a ALP price. This operations could be considered not very reasonable, because if the first selling price is not ALP, the second sale could be considered a second opportunity to "export" income, which will be apparently an offshore sale, not taxable in China. Therefore this double sale structure could be deemed unreasonable and subject, firt to Transfer Pricing rules, and subsequently, if applicable, GAAR rules.

Third. BCO, as a sole agent of ACO has been assigned to accept order on ACO´s behalf. This is related to what´s indicated in the previous parragrah. It seems clear that it´s not an independent agent but an exclusive one, and it has the power to accept order on behalf of ACO. This means that it has some autonomy to contract, which gives certainty of a place of busines in ACO in china. This also could mean that BCO is the actual manufacturer and real seller of the medicinal product, and not ACO, so the revenue from that sale should be assigned to BCO rather than been declared UK domain. This view can be supported by SAT´s and OECD view, action plan 7, that the value creation is in the china and not in the UK,

Fourth, as for the secondment of a product manager (PM), which is UK resident, it may be considered a China tax resident for the purpose of this operation because it will stay more than 183 days, but, normally, it is not expected to be taxable for its UK income, only it chinese

income. However, BCO is not paying directly to him but to ACO, and the case doesn´t indicate how much ACO is witholding to the PM. To sum up, it doesn´t seem to be a full chinese worker because it reports periodically to ACO rather than BCO. Thus PM is likely to be considered a PM, specially if its provides know how, and its payment will be subject to withholding tax. It doesn´t seem necessary to determine a PE status because the incomes from the main activity will be allocated to BCO. Though, what can be adjusted is the amount paid (CPM) that has to be reasonable and has a direct impact on the amount of the tax withheld. The DTA cannot change this situation, but may offer a tax credit to the PM for the tax paid in china.

Fifth, as for the license and rent of equiment, it triggers inmmediately a intangible property and use of property transfer pricing issue. Though, the case doesn´t specify how much BCO pays for that, but it seems that it´s using the PM salary to obtain the alleged income from it. Therefore the cost plus, as well as the 10% of such payment should be totally revisited, as it may contain the hidden revenue of the license and renting. In other word, this is sort of similar a contract split case. And, the respective withholding taxes shall apply.

Finally, in 2017, the distribution of profit from ACO to BCO, may require, previously some adjustment to the expenses such as licence and know how services, that may increase the chinese profit overall, a thus increase the Enterprise Income Tax that BCO will have to pay, prior to sending the dividends to ACO.

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Answer-to-Question- 2

GAAR under chinese law

1) Legal framework

The basic legal framework of GAAR has been already input in the Enterprise Income Tax Law and it regulations, complemented by circular 698/2009 (Guoshuif) and lately announcement 7 from SAT.

In addition, tax treaty now include GAAR provisions, according to BEPS, OECD´s ACTION 7, as well as the multilateral instrument that is expected to rule this.

As a special note, it is likely that the principal purpose test, suggested by the OECD, is going to be included in the following tax treaties, given the interpretation of ´prevention of fiscal evasion ´in the title of such treaties that hasn´t been clear enough and the abundance of tax treaty abuse.

2) Content of basic rules

There many guidelines about GAAR but one the main ideas is the concept of Substance over Form argument, which has been used many decades ago in the U.S. jurisdictional cases.

To be more precise, this substance is related to the economic or business reality of an operation or activity, aside the formalities or visible corporate structures that lacks workers or working capital to create value.

Therefore, one of the main goals of GAAR is to identify, by all means, where the real value is being created and if the resident company or the offshore company are making operations or establishing structures to take away that value from china, without paymet the so-called ´fair share of taxes´. This corresponds to the criteria of the Source of Income, applicable as a complement of the residence criteria to determine taxable income.

In practice, there are several specific test that can help to identify where is the actual value creation by identify where are the actual resources, human or non-human, that facilitate such creation. One example is the location of main activities, or the place of effective management or the location or residency or, even nationality, of the beneficial owner of an income. Therefore, the fact that a company placed in another company pays an income in other country different from china is no longer a reason not to pay taxes in china, if the source of the income and/or the value creation was in fact in China. The SAT has succesfully obtain a compliance on this matter byt cases like, quaungji case, fouzhu case, jiandu case, vodafone case and zhouzu cases.

Finally, one basic rule for the SAT, or even the local tax authority, is to identify it the structure or the transaction create a situation which a company will pay no taxes, reduce its tax burden or deffer the payment of taxes, complemented with the reasonable business purpose test.

3) The Applied scope is as follows:
- GAAR Rules shall not be applicable to china residents, normally, nor to illegal behavior.
- Specific or target rules for anti-avoidance must be applied before GAAR.
- GAAR rules aim to company exit strategies that don´t watn to pay taxes, or reduce or deferrel without reasonable business purpose or negative value creation in china.
- GAAR rules can help to create any presence of the Foreign Company in China as a Permanente establishment or, as nowadays, as Tax Resident by adminsitrative decision.
- In general GAAR applies to all operations, structures o even reestructuring tha lacks or reasonable business or commercial purpose
- Recently, GAAR was intensively used to determine taxes on Indirect alienation of shares or assets, as well as fully offshore equity investment transfer, than by a literal interpretation of the law, might be exempted from tax in chine.
- Thus, a widely application of GAAR is also capital gains, and not only dividends, salaries, interests, among other types of income that could escape from tax audit by a technical arm´s length pricing.
- Finally, local tax autohirities must coordinate with SAT the application of a GAAR investigation prior to the determination of a avoided tax burden.

4) Special tax adjustments which may potentiale be made by tax authorities, as follow.
- recharacterization of contracts and arrangements
- Recharacterization of interest as dividends
- Aplication of withholding tax superseding current rules.
- Limitation of benefits of treatys, and even exclusion from benefits of treatys. i.e., the case of barbados treaty and jiandu case.
- The refusal of tax incentives, such as, but not limited to, restructuring [from special to ordinary]

5) Relationship with other domestic anti avoidance regimes an tax treaties
- Again, there has to be coordination between SAAR and TAAR, those should be implemented first.
- While the circular 698 seemed clear and wider enough, it has been clarifed by annoucements in 2013 to 2017, which, in opinion to SAT has clarified the concepts that are taxed, but at the same time, has been wider in those cases.

- Normally, a tax treay could bypass the GAAR, but nowaday, the mutual agreement procedure can help to show that this rules are reasonable to the other contracting state, and therefore allow taxation in china.
- The multilateral intrument, in contection to beps action 7 as well as the notes on the oecd´s model tax treaty has been progresively adapted to include GAAR background ideas which could be characterize as softlaw arguments in favour of GAAR, but which are being internalized by China with the help of its annoucements and circulars.
- Finally, there has to be a sort of connection with the transfer pricing principal, for instance in the case of related party loans, which trigger thin capitalisation rules, with possible dividends, from interest, and related to the actual interest rate. The final position is that the transfer pricing rule comes first and then the thin capitalisation rule, for example.

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Answer-to-Question- 3

1) before 2015
CCO is clearly a tax resident of UK, as well as the directors and consultants.

2) However in 2015 and on, with the joint partnerthip of DCO, which forces to be resident in china, suggests that DCO will implement value creation activites there. This is expected, given the fact that both are manufacturing companies, so the creation of this partnerships seems to be alligned with a reasonable purpose.

3) The problem arises with the contents of the agreement, that may differ from the expected preliminary analysis of the corporate structure and activites, that is 3 directors and 2 tech consultates will go to DDCO for 3 years (less tha 5years).

4) While the directoRs are members of government board, only board meeting, so they cannot be considered as workers in china, only representatives of CCO for its sole interest. Notwitstanding, any fees paid will be subject to transfer pricing and might not be deductible for the partnership, specially if one of the directors is also a partner. This can be arguably be considered as a

secondment.

5) To the contrary, the consultants design, assistance in production, testing, technology are considered a know how intangible service, which is likely to be subject to withholding tax, in the first 183 days, for the part of the management fee that is applicable to them.

6) But, a problem arises, because of their duration of stay. It is possible for them to be considered chinese tax residents and then to be taxed from a chinese wages and salaries taxation, instead of the management fees. That will be the real nature of the contract. Notwitstanding, it is also possible to be exempt from the world wide income rule, because their period of stay is less than 5 years, in case they have other sources of income in the UK.

7) Given the fact that DCO is the payer of the fee, and thus this will represent a reduction in the profits (though, the case doesn´t how low or high the accounting profits are), then it is likely that the transfer pricing adjustment will be applied first to reduce the amount of the paid feed for tax purposes. A simple cost plus method could be suggested in this case.

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Answer-to-Question- 5

First of all, if UKCO is UK tax resident (UKTR) then it is possible to obtain a tax treaty relief, as long as the activites are not qualified as totally Chinese income, or in that case, the proper tax credit could be applied.

Transaction1, establishment of RO in China
- RO, formally, is not a separate entity of UKCO
- RO has limitated activities, and cannot contract.
- RO can advice on sales
- Though a RO can be redefined as a PE in case of significant activities that generate chinese income.
- In that case TP-SAAR rules or GAAR rules may apply

Transaction2, contracting an PRC-TR and a UK-TR

Transaction3, Salary payment to PRC-TR and salary payment to UK-TR
- Salary is 500K & Paid by the RO
- Salary is 1MB & Paid by head office
- substantially lower than the chinese resident, which can trigger a reasonable test.
- If the UK-TR is more qualified and/or has a superior job status, then it could be justified
- If not, there could be an adjustments.

Transaction4, other expenses by the RO in 2016 for 2MM
- Marketing services, may be doubtful in case of local marketing advantanges as well as local special advantages, that made UKCO put a RO in the first place.
- This doubt may arise if the total marketing expenses are higher than the total wages and salaries, even if the head office pays the respective salary of the UK-TR
- Though, unless a anti-avoidance rule or TP rules is put in place, no correction should be made.
- On the other hand, the provisionf of liaison, as well as marketing services should be reasonable, a could be in this case a percentage of the revenue.
- However, that revenue is not visible in this case, which increases the reasonability of the transactions.

Transaction5, earning and revenues
- No evidence has been provided about the revenues that has been made due to the placement of the RO.
- In such case, SAT seems to be unable to determine wheter there was a significant business made in china or not.
- The absence of such information as well has other revenues from the UKCO, can generate a practical rule to deem profit to the RO.

In conclusion, given the lack of information, and the high expenses that the RO has, it can be considered as a PE of UKCO. However, based on Circular 18/2010 (Goushufa), this be a case of deemed income (expenses over (1-deemed profit rate) or profit taxation, done by SAT.

In that case, a cost plus method should be applicable or a deemed profit method, where the minimium profit should 15% of total revenues. This tax should generate a tax credit for the

UKCO based on the treaty.

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Answer-to-Question- 7

1) The Tax Benefits of being considered a tax resident
- Tax residents are not used to be in the scope for tax audit by the tax administration, unless that residency is fraud and lack of activities or reasonable business purpose.
- No withholding tax for payments done between tax residents
- No PE nor Non-Resident-Enterprise status
- Dividends between hkco and xco will be exempt from taxes
- No deemed income between both
- No investigation for Indirect alienation of shares or assets, normally.
- Less risks in restructuring business.
- Tax rate in china is less than HK.
- it could be easier to qualify for a preferential tax treatment
- Less costs on technical advisors related on the possibility of uncertain tax liabilities.
- Possible to deduct many expenses related to the business
- Finally, it could defer the distribution of dividend without limitations.

2)Argument from HCKO

HKCO declared itself as TR IN china, because of it place of effectivament management (PEM), related presumably to the number of directors in china. Also, however the case doesn´t say so, it seems that one of the directors or another third person might be the CEO and it may be located in china, which could suppor the PEM argument.

However, this seems to be weak relationship with china, because the day-to-day managment, the actual o real management, is responsibilidad of a manager located in hong kong.

In this case, the argument should have been that the value creation is in china, thus the main activites are there, the sources of income. In addition HKCO should have said that even though there might be benefit from the tax residency, it doesn´t exclude the possibility of tax audit by transfer pricing, or future gains of operations. And that its presence in china would turn easier to audit any transfer of share to overseas companies.

3) The SAT argues that HKCO is a CFC controlled by XCO, and therefore it cannot be considered a resident in china. Having HKCO a large profit and being considered a CFC, it triggers a deemed distribution of dividends which will be taxable in china at the 25% rate, as pasive income of XCO.

In this case, SAT is right because the majority of directors are not in china but in HK, which presumably the corporate documents are also there, as well as the above mentioned daytoday mangement.

In addition, to be considered a resident in HK and not china, also supports the taxation by withholding taxes to all payments made by the china resident to its offshore related party.

To sum up, the SAT´s position is in accordance to the recent trend that has increase the taxation of foreign entities, because of the different more strict and rigourus taxation.