

Research on the Tax Avoidance Regulation of Indirect Equity Transfer of Non-Resident Enterprises in My Country

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Abstract: Under the background of the accelerated development of economic globalization, the behavior of non-resident enterprises in my country to avoid taxes through equity transfer has seriously disrupted the market order of fair competition. In this regard, this paper introduces the method of indirect equity transfer of non-resident enterprises, and sorts out the promotion process of my country's tax law. Through the analysis of the Hangzhou Ring Expressway case, it finds out the defects of my country's tax law system and puts forward targeted suggestions.

Keywords: Non-Resident Enterprise; Indirect Equity Transfer; Tax Avoidance

1. Introduction

According to the United Nations Conference on Trade and Development, my country's total foreign direct investment (FDI) in 2020 reached 163 billion US dollars, ranking first in the world. The high tax burden of mainland enterprises in my country and the complicated procedures have made many investors indirectly transfer the equity of Chinese resident enterprises by setting up offshore companies in tax havens to avoid tax burdens. Regulation of such behaviors has become an important topic in anti-tax avoidance work of my country.

2. Related concepts

2.1 Non-resident enterprise

Chinese law stipulates that a non-resident enterprise refers to a company established in accordance with foreign (regional) laws and regulations and its actual management organization is not in China, but it has established an organization or place in China, or has not established an organization or place in China, but has sources from China.

2.2 Non-resident indirect equity transfer

Non-resident indirect equity transfer refers to the indirect transfer of equity of a resident enterprise by a non-resident through an overseas intermediary company to an overseas or domestic third party, which is divided into single-level transfer and multi-level transfer. In form, it transfers the equity of an overseas company in an attempt to evade my country's taxation rights. However, since most of the intermediary companies are conduit companies and do not have the nature of actual operation, the equity value is mostly derived from the equity of domestic resident companies. Based on the principle of substance over form, my country enjoys the actual tax right of equity transfer income by penetrating the intermediary company. Due to the concealment and complexity of indirect equity transfer, it is easier to achieve tax avoidance intentions. At present, the trend of equity transfer of overseas enterprises is to change from direct transfer to indirect transfer mode. The equity transfer trend chart is shown in figure 1.

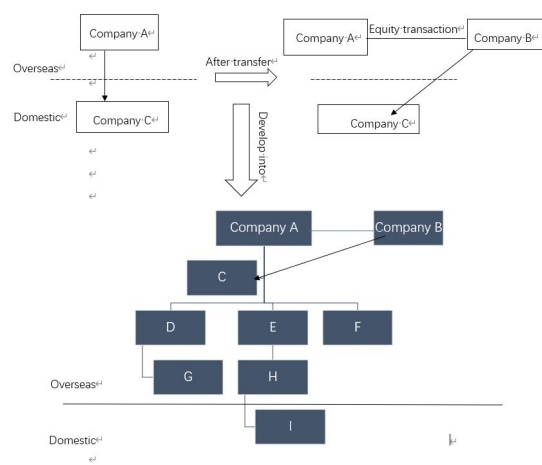


Figure 1 the equity transfer trend diagram

2.3 Related legislative process and restraint mechanism

The author believes that my country's tax law on indirect equity transfer of non-residents has gone through three stages: preliminary legislation, development and refinement, and gradual improvement. This is a process of decentralizing legislative power, replacing laws and regulations by departmental regulations, abstracting to concrete, and becoming more and more flexible. At present, the tax avoidance regulation on indirect equity transfer of non-residents mostly penetrates the intermediary enterprises with substance over form, and judges the reasonable commercial purpose and substantive nature of operation according to the regulatory documents such as No. 7, determines the taxation power and calculates the taxable amounts. The Legislative Process of Indirect Equity Transfer of Non-resident Enterprises in my country chart is shown in figure 2.

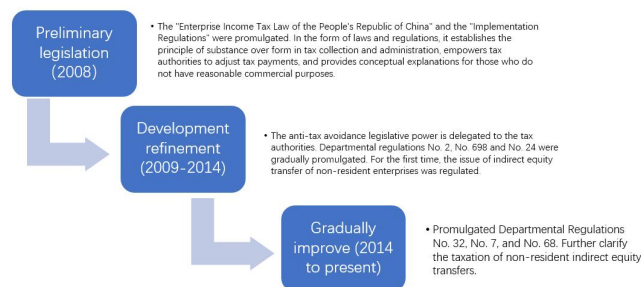


Figure 2 The Legislative Process of Indirect Equity Transfer of Non-resident Enterprises in my country

3. Case analysis and problems existing in my country's tax law system

3.1 Case introduction

The case taken in this paper is the children's investment master fund case, which is a typical case of indirect equity transfer of non-resident enterprises in my country. The case went through as follows:

Guoyi Road and Bridge Company is the main company established to complete the BOT (build-operate-transfer) project of Hangzhou Ring Road. Zhejiang Guoye Industrial Co., Ltd. holds 5% of the shares, and the remaining 95% is owned by Hong Kong Guohui Company, a wholly-owned subsidiary of CFC Company. The investors of CFC Company are Children's Investment Master Fund and Wide Faith Group Limited, which hold shares respectively. 26.32% and 73.68%, and actually control Guoyi Road and Bridge Company. The parties in this case (Children's Investment Fund), the intermediary company CFC and the transaction party Moscan are all registered in the international tax haven of the Cayman Islands. On September 9, 2011, the Children's Investment Master Fund sold its 26.32% stake in CFC to Moscan for US\$280 million, and reported the equity transaction to the State Taxation

Office of Xihu District, Hangzhou on October 9 of that year. After review and adjustment, the Xihu District State Taxation Bureau sent the "Notice of Tax Service" to the Children's Investment Fund on November 12, 2013, requesting it to pay 105 million yuan in additional tax. Children's Investment Fund applied for administrative reconsideration, and the court finally ruled that Children's Investment Fund's indirect transfer of Guoyi Road and Bridge Company's equity by transferring the equity of CFC Company did not have a reasonable commercial purpose, and rejected the appeal of the Children's Investment Fund. The changes in the shareholding structure of Guoyi Road and Bridge Company chart is shown in figure3.

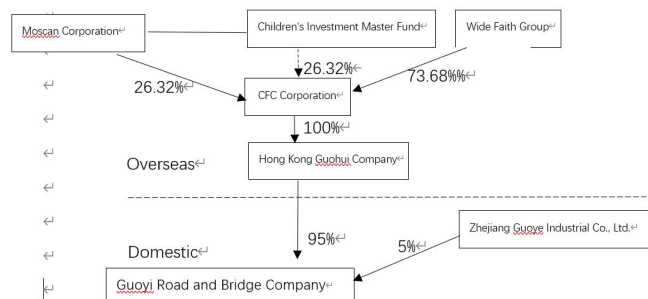


Figure 3 the changes in the shareholding structure of Guoyi Road and Bridge Company

3.2 Problems existed in the tax avoidance regulation of indirect equity transfer of non-resident enterprises

In this case, based on the principle of substance over form, the court finally ruled on that Children's Investment Master Fund had a tax avoidance problem and rejected its claim. But if we take a closer look at the cases, we see bunches of problems with the current tax system.

The first is the inadequacy of the tax system. In this case, the judiciary listed a large number of provisions in Document No. 698 and other documents that do not have reasonable commercial purposes, but did not explain the legal applicability of Document No. 698, and did not conduct compliance review of the regulations and provisions of these departments. It also did not elaborate on the key point that it does not have a reasonable commercial purpose, but directly affirmed the judgment of the tax authority. These documents are all formulated by the State Administration of Taxation, which are regulations of a nature, and their legal effect and level are not as good as laws and regulations. However, my country's Administrative Litigation Law stipulates that departmental regulations are only for reference, and court decisions must be in accordance with laws and administrative regulations. Therefore, the court's decision in this case was based on the rules formulated by the tax authorities, which actually transferred judicial power to the tax authorities. The tax authorities integrated legislation, law enforcement, and judiciary. The "Enterprise Income Tax Law of the People's Republic of China" and the "Implementation Regulations" only explain the general anti-tax avoidance measures, but it actually expand the discretionary power of tax authorities and personnel, which tends to encourage treasuryism and infringe the rights and interests of taxpayers.

The second is the disadvantage of post-adjustment. My country's current collection and management of non-resident indirect equity transfer is an post- adjustment mechanism. The lawsuit between the Children's Investment Fund and the Xihu District Internal Revenue Service took 4 years to complete. During this period, a lot of manpower, material and financial resources were spent. There are still many cases like this. If it is adjusted afterwards like this every time, it will undoubtedly cause a great waste of social resources.

4. Suggestions on improving the anti-tax avoidance of indirect equity transfer of non-resident enterprises in my country

My country's anti-tax avoidance process generally goes through four steps: discovering problems, exploring problems, identifying problems, and solving problems. Among them, the discovery and exploration of problems depend on the improvement of the information mechanism, while the identification and solution of problems require the support of a sound legal basis . The Anti-tax avoidance flow chart is shown in figure4.



Figure 4 the Anti-tax avoidance flow

4.1 Improve the information communication mechanism

Information is the prerequisite for decision-making. If the tax authorities do not have sufficient information, they will not be able to timely detect the tax avoidance of non-resident indirect equity transfer, let alone make adjustments. Therefore, my country should strengthen the information sharing and communication mechanism among various departments, establish a database, and use big data technology to screen and locate abnormal equity changes or transactions, and increase the sensitivity to information [9]. In addition, referring to the information sharing mechanism between the US government and financial institutions, key financial institutions are required to disclose company account information and improve the information communication mechanism with enterprises.

4.2 Improve the legislative system

In order to prevent the abuse of power, we should divide and balance power. European and American law systems emphasize the separation of powers and the neutrality of the judiciary, while the continental law system also pays attention to the checks and balances of power, but pays more attention to the responsibilities of legislation, emphasizing that legislative loopholes are discovered and improved through the process of legislation, law enforcement and justice. my country's tax law also belongs to the category of the civil law system. It should pay attention to the function of legislation and properly check and balance power. At present, my country's National People's Congress has delegated the legislative power to the tax authorities for tax avoidance regulation, which adapts to the rapid development of my country's economy and is conducive to solving the lag of laws. Dominance, tax authorities and personnel enjoy too much discretion, which is prone to power rent-seeking and breeds extreme treasuryism. In contrast to the complicated departmental regulations, there is the lack of higher-level laws. The entire tax law system is in the shape of a pyramid, which makes it difficult for judicial trials to have a corresponding legal basis and make it difficult to make fair judgments. The author believes that the legislative responsibility of the National People's Congress should be strengthened, and the legislative work of the higher law should be strengthened, so that the anti-tax avoidance work can be legally abided by, and the legality of the departmental regulations should be reviewed, and the regulations of each department should be properly restrained and regulated. The relationship between legislation, law enforcement, and the judiciary is shown in figure5.

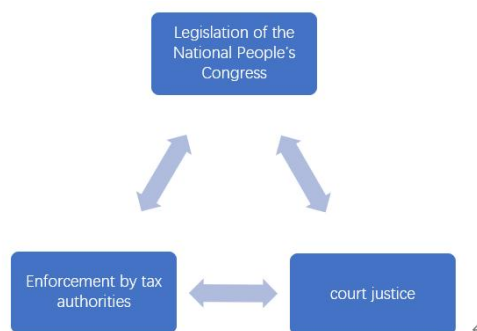


Figure 5 the relationship between legislation, law enforcement, and the judiciary

4.3 Improve tax information exchange between countries

With the improvement of my country's comprehensive national strength, my country has signed tax agreements with more than 110 countries or regions in the world, which effectively avoids multinational companies from conducting cross-border tax avoidance. However, there is still room for further improvement in the number of agreements, and tax information exchange is usually carried out on a regular basis, which has a certain lag. It is recommended to combine active information exchange and regular exchange, and

establish a database to exchange key tax avoidance information, which is to improve the quality of information and improve the efficiency of anti-tax avoidance work.

4.4 Improve tax information exchange with tax havens

The essence of anti-tax avoidance among countries is the competition and balance of tax sources. Due to the disadvantages of their natural resources, tax havens often attract the registration of multinational companies through tax incentives, and have established strict financial and confidentiality systems. It is not easy to sign tax agreements with tax havens. My country can refer to OECD countries to provide material and technical assistance to international tax havens in exchange for the exchange of tax information, and to effectively regulate the establishment of offshore companies in tax havens to avoid tax .

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