SPECIAL TAX TREATMENTS ON SHARE ACQUISITION AND MERGER PURSUANT TO NOTICE 59[1]

(1) Special Tax Treatments under Notice 59

- Corporate restructuring transactions that qualify for special tax treatment can be carried out **without being subject to any capital gain tax**. Such special tax treatment however only applies to consideration made in shares or stock (i.e. share consideration).

- Parties to the corporate restructuring transactions have the option to elect to adopt the special tax treatment on the relevant corporate restructuring transaction.

- Parties to the corporate restructuring transactions (regardless of whether they qualify for special tax treatments) are still required to recognize any taxable gain or loss in relation to the non-share consideration as calculated below:

$$(\text{FMV of transferred assets} - \text{Tax basis of transferred assets}) \times \frac{\text{Non-share consideration}}{\text{FMV of transferred assets}}$$

(2) Conditions to be satisfied for special tax treatment under Notice 59

2.1 General requirements for special tax treatment (Article 5), including:-

(i) *Business purpose*: the corporate restructuring should have the reasonable business purpose, and its principal purpose is not for the reduction of, exemption from, or delay in the tax payment;

(ii) *Materiality*: the assets or equity percentage involved in the acquisition, merger or separation must meet the percentage requirements specified under Notice 59, which generally requires that no less than 75% of equity or assets to be purchased in case of share or asset acquisitions;

(iii) *Continuity of business enterprise (COBE)*: there must be no change in the original substantive operational activities of the reorganized assets within the continuous 12 months following the restructuring;

(iv) *Equity ratio*: the consideration for the restructuring in the form of share must meet the percentage requirements specified under Notice 59, which generally requires that no less than 85% of the total consideration must be in the form of share for all restructurings, other than the change of legal form or debt reorganization (please note that Notice 59 does allow for no consideration paid in a merger under the common control); and

(v) *Continuity of interest (COI)*: the original shareholders that obtain the share consideration for the restructuring cannot transfer their shares within the continuous 12 months following the restructuring.

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[1] *Notice on Several Issues Concerning Enterprise Income Tax Treatment of Enterprise Restructurings* (Cai Shui [2009] No. 59) (**"Notice 59"**) issued by the Ministry of Finance and State Administration of Taxation dated 30 April 2009 and retroactively effective from 1 January 2008.

2.2 Further requirements for cross-border share and assets acquisitions (Article 7), including:-

(i) *Foreign to foreign*: a non-resident enterprise (Transferor Company) transfers its equity interest in a PRC resident enterprise to another non-resident enterprise in which the Transferor Company has 100% direct ownership (Transferee Company), so long as (i) it would not result in a change of the withholding income tax liability on the gain arising from the subsequent transfer of the subject equity in the target PRC resident enterprise and (ii) the Transferor Company undertakes in writing to the PRC tax authority in charge that it will not transfer its equity in the Transferee Company within 3 years;

(ii) *Foreign to China*: a non-resident enterprise transfers its equity interest in a PRC resident enterprise to a resident enterprise in which the non-resident enterprise has 100% direct ownership;

(iii) *Offshore investment*: A resident enterprise uses its own assets or equity to invest in a non-resident enterprise in which the resident enterprise has 100% direct ownership;

(iv) *Other circumstances*: as approved by the Ministry of Finance and State Administration of Taxation.

(3) <u>Special Tax Treatments Applying to Share Acquisition and Merger under Notice 59</u>

3.1 Share Acquisition

Assuming the above conditions in 2.1 and 2.2 (for cross-border share acquisition) for the special tax treatment are satisfied, and the parties to the share acquisition elect to adopt such special tax treatment, and specifically,

- Shares purchased by the Seller is no less than 75% of the total shares of the Target; and
- Consideration paid in the form of share (i.e. share consideration) for the share acquisition represents no less than 85% of the total consideration,

the following special tax treatments (Article 6(2)) shall apply:

- Cost base of the Buyer's shares acquired by the Seller shall be the original cost base of the Target's shares.
- Cost base of the Target's shares acquired by the Buyer shall be the original cost base of the Target's shares.
- Cost bases for assets, liabilities and other income tax related particulars of the Buyer and Target shall remain unchanged.

Otherwise, the following general tax treatments (Article 4(3)) shall apply:

- Seller shall recognize any gain or loss from transfer of the equity interests or assets of the Target.

- Cost base of the Target's equity interests or assets acquired by the Buyer shall be the respective fair market value (FMV).
- Relevant income tax related particulars of the Target shall remain unchanged.

3.2 Merger

Assuming the above conditions in 2.1 and 2.2 (for cross-border share acquisition) for the special tax treatment are satisfied, and the parties to the share acquisition elect to adopt such special tax treatment, and specifically,

- Shares consideration obtained by the shareholders of the Post-Merger Entity is no less than 85% of the total consideration; or
- No consideration is required in a merger under common control.

the following special tax treatments (Article 6(4)) shall apply:

- Cost bases of the respective Merged Entities' assets and liabilities received by the Post-Merger Entity shall be the original cost bases of the respective Merged Entities' assets and liabilities.
- Outstanding income tax related liabilities in connection of the respective Merged Entities prior to the merger shall be assumed by the Post-Merger Entity.
- Cost base of the Post-Merger Entity's shares received by shareholders of the respective Merged Entities shall be the same cost base of the shares of the Post-Merger Entity after the merger.
- Limit of accumulated loss of the respective Merged Entities that can be utilized by the Post-Merger Entity = FMV of net assets of respective Merged Entities x Interest rate applying to the government bond with the longest term as of the end of the year during which the merger occurs.

Otherwise, the following general tax treatments (Article 4(4)) shall apply:

- Cost bases of the respective Merged Entities' assets and liabilities received by the Post-Merger Entity shall be ascertained on a FMV basis.
- The Pre-Merged Entities and their respective shareholders shall settle their income taxes in accordance with the relevant liquidation procedures.
- Losses of the respective Pre-Merged Entities are not allowed to be carried over to the Post-Merged Entity for future offsetting.