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Improving the Chinese General Anti-Avoidance Rule: A Comparative and Functional Approach

Seven years after its introduction in 2008 with the enactment of the new Chinese Corporate Income Tax Law, the Chinese general anti-avoidance rule (GAAR) has become a complex and incoherent piece of legislation. Despite its current shortcomings, the international impact of the Chinese GAAR is expected to grow significantly given China's increasingly proactive participation in the G20's fight against international tax avoidance and its embrace of the OECD's Base Erosion and Profit Shifting (BEPS) initiative. Against this background, this research takes a comparative-functional approach to analyse and evaluate the functioning and efficacy of the Chinese GAAR. The comparative-functional approach is used to critically compare the Chinese GAAR with the GAARs of the Netherlands and the United Kingdom. These jurisdictions were chosen for reasons that are both practical and theoretical, as the comparators both have a large amount of reliable and openly accessible literature and jurisprudence, and strike a balance between civil law jurisdictions and common law jurisdictions. The analysis reveals that for a number of legal, institutional and cultural reasons, the Chinese GAAR is not working as effectively, and is not as balanced, as it could be. On these grounds, the article puts forward some suggestions for reforms on a legal and administrative level that could lead to a more balanced application of the Chinese GAAR. The article does not advocate judicial reforms.

Contents

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1. Introduction

In recent years, tax avoidance has drawn a lot of media and political attention due to the lengthening list of global tax controversies. The uncovering of complex tax structures used by companies such as Google, Amazon and Apple to lower their corporate income tax liabilities has inspired numerous headlines and triggered public debate in many jurisdictions.[1]

On a national level, a number of initiatives have been developed in an attempt to deal with tax avoidance arrangements. These include the introduction of specific anti-avoidance rules (hereinafter SAARs), the enhancement of the exchange of information between national institutions and the imposition of higher penalties.[2] However, with the continuous evolution of avoidance arrangements, many countries have come to the realization that these measures alone are not sufficient to tackle tax avoidance behaviour. For this reason, many jurisdictions have resorted to introducing a general anti-avoidance rule (hereinafter GAAR) or fortifying existing ones.[3] Today, most tax systems have incorporated either a statutory GAAR or a GAAR developed in judicial doctrine based on similar principles to counteract abusive taxpayers' behaviour. Nevertheless, GAARs remain controversial, as they confer high amounts of discretion on the tax authorities, thereby disturbing the balance between the state and the taxpayers.[4]

In line with these international developments, China has also introduced a statutory GAAR with the enactment of the Chinese Corporate Income Tax Law (hereinafter CCITL) in 2008.[5]

1. *See*, for example, F. Norris, *The Corrosive Effect of Apple's Tax Avoidance* (New York Times, 23 May 2013), available at http://www.nytimes.com/2013/05/24/business/making-companies-pay-taxes-the-mccain-way.html and V. Bradford & G. Holt, *Google, Amazon, Starbucks: the rise of 'tax shaming'* (BBC, 21 May 2013) available at http://www.bbc.co.uk/news/magazine-20560359.
2. J.G. Gravelle, *Tax havens: International Tax Avoidance and Evasion* (DIANE Publishing 2010) p. 34 and p. 37.
3. Ernst & Young, GAAR Rising: Mapping Tax Enforcement's Evolution (2013) 2.
4. P. Rosenblatt, *General Anti-Avoidance Rules for Major Developing Countries* (Kluwer Law International 2014) 12.
5. *Zhonghua Renmin Gongheguo Qiye Suodeshui Fa* (中华人民共和国企业所得税法) (*Corporate Income Tax Law of the People's Republic of China*) (promulgated by the 5th Session of the Tenth National People's Congress, 16 Mar. 2007) available in English at http://en.pkulaw.cn/display.aspx?cgid=89382&lib=law.

However, although formulating the aim of combating tax avoidance might be straightforward, developing a GAAR that is both balanced in regard to the taxpayers' interests and the interests of the tax authorities, while effectively combating tax avoidance, is a more nuanced matter. The Chinese GAAR is general and vague and has been followed by a series of clarifications in the form of administrative regulations and rules.[6] Seven years after its promulgation, the Chinese GAAR has become a complex and incoherent piece of legislation. In addition, some of its key elements remain ambiguous, it harbours several discretionary elements and it is currently only applied in relation to cross-border indirect transfers.[7]

Given China's increasingly proactive participation in the G20's fight against international tax avoidance, and its embrace of the OECD's Base Erosion and Profit Shifting (hereinafter BEPS) initiative, it is expected that the international impact of the Chinese GAAR will equally grow in the near future.[8] This development is likely to affect the way enterprises operate not only in China, but will also have significant impact on Hong Kong and Singapore, which have traditionally been major hubs for cross-border transactions with mainland China. Against this background, and given the increased convergence and global cooperation on the matter, it is useful to analyse and evaluate the functioning and efficacy of the Chinese GAAR from an international perspective. The aim of this article is therefore to identify similarities and differences between the GAAR of China and the GAARs of selected countries, to understand the reasons for these differences, and – taking these reasons into account – to propose reforms that may further advance the development of the Chinese GAAR.

To achieve its purpose, the article takes a comparative-functional approach. The functional approach is premised on the idea that the functioning and design of local GAARs are the result of "tax-law in action" and must be understood not only in the light of the statutes and regulations, but also in the light of case law, scholarly opinions, and cultural and institutional differences.[9] The comparative-functional approach is used to analyse the Chinese GAAR on two levels within the ambit of this comparative research: "the legal level" and "the operational level." The analysis on a legal level focuses on comparing the common legal elements of the GAARs with the purpose of boiling down essential features in their design, and pointing out any differences. The analysis on an operational level compares the Chinese GAAR with the GAARs of selected countries in terms of the way the GAAR is given meaning and effect, the motivations behind their application, the problems they address and their procedural framework. On both levels, special attention will be given to understanding the reasons behind any differences that are encountered. This comprehensive approach will make the

6. These clarifications include art. 120 CITLIR, arts. 92 to 95 of Circular 2, the 2015 GAAR Measures and the recently released Notice 7, which will be discussed in sec. 2.3.

7. *See*, Z. Zhang, *What Is Needed To Perfect the Chinese GAARs?*, 68 Bull. Intl. Taxn. 1 (2014), Journals IBFD and C.J. Finnerty & B. Lai, *Strengthening Cross-Border Tax Enforcement and the Evolving General Anti-Avoidance Rule*, 18 Asia-Pac. Tax Bull. 5 (2012), Journals IBFD.

8. On 16 Nov. 2014, during the G20 Summit held in Brisbane, Australia, Chinese President Xi Jinping announced that "efforts should be made to reinforce the international collaboration on tax matters, to crack down on cross-border tax avoidance and evasion, and to help developing countries and low-income countries improve their capabilities of tax collection and administration." In addition, China is an active participator in the OECD's BEPS initiative. *See also* China's reply to the BEPS Questionnaire of the UN Subcommittee, available at http://www.un.org/esa/ffd/tax/Beps/CommentsChina_BEPS.pdf. According to the SAT, the GAAR is China's primary legal instrument to counter BEPS.

9. C. Garbarino, *Comparative Taxation and Legal Theory: The Tax Design Case of the Transplant of General Anti-Avoidance Rules*, (2010) 11 (2) Theoretical Inquiries in Law.

GAARs comparable despite (textual, cultural and institutional) differences and allows for a more balanced evaluation of the Chinese GAAR.

The article compares the Chinese GAAR with the GAAR of the Netherlands and the United Kingdom. These jurisdictions were chosen for reasons that are both practical and theoretical. From a practical standpoint, the comparators both have a large amount of reliable and openly accessible literature and jurisprudence on tax avoidance in general and on the GAAR more specifically. From a theoretical point of view, the comparators strike a balance between civil law jurisdictions and common law jurisdictions. Finally, the comparators respectively apply a GAAR developed in judicial doctrine and a statutory GAAR, making these jurisdictions well suited for a comparative study.

The article is organized into six sections. For the purpose of clarity, and given its influence on the Chinese GAAR, section 2. first provides some background on Chinese tax law and the CCITL. It will then discuss the current legal framework of the Chinese GAAR by consecutively discussing its application requirements, methodology and the legal consequences of its application. In addition, it will provide a selection of case examples in which the Chinese GAAR was applied. Section 3. sets the comparative basis of this article, by discussing the Netherlands and UK GAARs from the same perspectives. Section 4. will critically compare the Chinese GAAR with the Netherlands and UK GAARs. Section 5. will evaluate the outcome of the comparative analysis and propose some suggestions for reforms on a legislative and administrative level that may lead to a more balanced application of the Chinese GAAR. Section 6. concludes by giving a summary and evaluation of the most important findings.

2. The Chinese General Anti-Avoidance Rule

In China, the separation of powers is not as substantive as it is in the Western sense of the concept.[10] Although, in theory, the power to interpret the law is shared among the legislator, the judiciary and the executive organs, it is the Standing Committee of the National People's Congress (hereinafter SCNPC) that has the sole power to interpret the law.[11] Moreover, whereas in most Western jurisdictions the judiciary acts as a cushion to mitigate the power imbalance between the state and the individual, the Chinese judiciary only has a very limited role in interpreting the tax statutes and can only do so for the purpose of adjudicating cases.[12] Since the Chinese judiciary merrily applies the law, Chinese tax law is statutorily developed.

2.1. Chinese tax law

The framework of Chinese tax law can be described as a pyramid with three tiers. On the top is the primary tax legislation passed by either the National People's Congress (hereinafter NPC) or the SCNPC. A common feature of the primary tax law is that it is general and only contains broad principles, leaving the more detailed provisions to be dealt with by lower regulations.[13] The NPC has delegated some of its law-making powers to the State Council.[14] The

10. F. Vanistendael, *Taxation, Tax Avoidance and the Rule of Law*, 16 Asia-Pac. Tax Bull. 3 (2010), Journals IBFD.
11. Art. 67 (1) and (4) Chinese Constitution.
12. J. Li, *Development and Tax Policy: Case Study of China*, (2007) 3 (4) Comparative Research in Law and Political Economy, CLPE Research Paper 27/2007, p. 40.
13. Vanistendael, *supra* n. 10.
14. Art. 89 Chinese Constitution. *See*, for example, art. 59 CCITL which entitles the State Council to formulate Implementation Rules on the CCITL.

State Council is the highest organ of state power and state administration, and is empowered to adopt administrative measures and regulations to further direct and administer the tasks and responsibilities of the ministries.[15] The State Council exercises its power through setting out secondary legislation in the form of implementation regulations. Thus, on the second tier are the regulations of the State Council, which expound on the primary legislation. Further amplification of the primary tax law and of the implementation regulations of the State Council is given by the State Administration of Taxation (hereinafter SAT) in the form of administrative rules, also known as "circular letters" or "notices," constituting the third and final tier of the pyramid.[16]

2.2. The CCITL and the Chinese GAAR

The CCITL has been the latest Chinese effort to harmonize Chinese corporate tax laws with international standards and can be characterized as a hybrid of Chinese rules and international tax norms.[17] Compared to its predecessors, the CCITL is more detailed and sophisticated. In addition, it eradicated the difference previously seen in tax treatment between foreign enterprises and Chinese domestic enterprises.[18] Next to tax neutrality, another major policy objective of the new CCITL was the protection of the Chinese tax base.[19] Since the late 1990s, the Chinese government has become increasingly aware of the revenue loss caused by corporate tax avoidance.[20] From the perspective of the Chinese authorities, tax avoidance is objectionable because it facilitates capital flight from China. In addition, the loss of tax revenue undermines the purpose of encouraging foreign direct investments into China.[21] In reaction to past abusive avoidance practices, chapter 6 of the CCITL therefore introduced a number of specific anti-avoidance rules applicable to cross-border transactions, as well as a GAAR.[22]

15. F. Cao, *Corporate Income Tax Law and Practice in the People's Republic of China* (Oxford University Press, 2011) 2.
16. The SAT is a ministry of the State Council. The SAT frequently issues notices and circulars regarding the interpretation and implementation of existing tax laws.
17. J. Li & H. Huang, *The Transformation of the Enterprise Income Tax in China: Internationalization and Chinese Innovations*, 62 Bull. Intl. Taxn. 7, p. 275 (2008), Journals IBFD.
18. Z. M. Prebble, *Approaches to Tax Avoidance Prevention in Seven Asian Jurisdictions: A Comparison*, 15 Asia-Pac. Tax Bull. 1, pp. 28-29 (2009), Journals IBFD.
19. Prebble, *supra* n. 18. *See also* A. Ting & Xiliang Ge, *China's Enterprise Income Tax System: Policy Objectives and Key Design Features*, (2014) 29 Australian Tax Forum 621.
20. P.L.L. Mo, *Tax avoidance and Anti-Avoidance Measures in Major Developing Economies* (Greenwood Publishing Group 2003) pp. 78-79. China's total tax revenues as a percentage of its GDP has fluctuated between 10% to 12% throughout the 1990s, compared to 16% to 20% in other developing countries and the 30% seen in developed countries. Although the tax revenue as a percentage of GDP steadily increased in the early 2000s, China still lagged behind other countries, a difference that has mainly been attributed by the Chinese authorities to tax avoidance and tax evasion. *See also* D. Qiu, *Collecting Unpaid Tax Offshore: Caribbean Tax Havens and Foreign Direct Investment in China*, 68 Bull. Intl. Taxn. 12, p. 650 (2014), Journals IBFD.
21. C. Silvani, *GAARs in Developing Countries: IFA Research Paper* (2013) 21.
22. K. Holmes, *The People's Republic of China: A Comparative Look at Regulation of Corporate Tax Avoidance* (Springer Netherlands, 2012) 112 and P. Lampreave, *Anti-Tax Avoidance Measures in China and India: An Evaluation of Specific Court Decisions*, 67 Bull. Intl. Taxn. 1, p. 51 (2013), Journals IBFD.

2.3. The (evolving) application requirements of the Chinese GAAR

The Chinese GAAR is developed according to the same three-tier framework described in section 2.1. According to article 47 of the CCITL, if an enterprise conducts any other[23] arrangement without a reasonable business purpose that results in a reduction of the taxable income or revenue, the tax authority is authorized to make adjustments based on reasonable methods. Hence, at the core of the Chinese GAAR lies the interpretation of "without a reasonable business purpose."

Pursuant to article 120 of the Chinese Corporate Income Tax Implementation Regulations (hereinafter CITLIR), an arrangement is deemed "without reasonable business purpose" when the arrangement is conducted with the main purpose of achieving an exemption, reduction or deferral of the payment of taxes.[24] When reading article 120 of the CITLIR into article 47 CCITL, it becomes clear that the GAAR targets those arrangements whose main purpose is to exempt, reduce or defer taxes, resulting in a reduction of taxable income or revenue. Unfortunately, the question of how the "main purpose" of an arrangement can be identified as a tax purpose has been left unanswered by both the CCITL and CITLIR.

Following the Implementation Regulations of the State Council, the SAT promulgated Circular 2 containing additional guidelines on taxpayers' compliance with article 47 of the CCITL and its enforcement by the tax authorities.[25] According to article 92 of Circular 2, the local tax authorities will launch a general anti-avoidance investigation when it encounters arrangements that involve the abusive use of tax incentives, treaty shopping, abuse of the corporate organizational form, use of offshore structures in tax havens and other abusive arrangements that lack a bona fide business purpose. Circular 2 therefore seems to imply that these types of arrangements are deemed to have the main purpose of exempting, reducing or deferring taxes. Moreover, Circular 2 adds that the SAT will comprehensively consider the following factors when determining whether the GAAR applies to a particular arrangement:

- the form and substance of the arrangement;
- the duration of the arrangement;
- the implementation method of the arrangement;
- the steps that were taken to construct the arrangement;
- the financial effects on the parties involved in the arrangement; and
- the tax consequences.[26]

23. "Other" refers to other arrangements that do not involve transfer pricing, controlled foreign companies and thin capitalization arrangements. These issues are covered by SAARs. The Chinese GAAR of art. 47 CCITL must therefore be seen as a so-called catch-all provision aimed at covering those arrangements not covered by the SAARs of ch. 6 CCITL. *See also* H. Yang, *New Developments in the General-Anti-Abuse Rules and the Impact on International Tax Planning*, 15 Asia-Pac. Tax Bull. 3, p. 176 (2009), Journals IBFD.
24. *Zhonghua Renmin Gongheguo Qiye Suodeshui Fa Shishi Tiaoli* (中华人民共和国企业所得税法实施条例) (Implementation Regulations of Enterprise Income Tax Law of the People's Republic of China) (promulgated by Decree No. 512 of the State Council of the People's Republic of China on 6 Dec. 2007, effective from 1 Jan. 2008). Available in English at http://en.pkulaw.cn/display.aspx?cgid=100121&lib=law.
25. *Guojia Shuiwu Zongju Guanyu Yinfa Tebie Nashui Tiaozheng Shishi Banfa* (国家税务总局关于印发特别纳税调整实施办法) (Circular of the State Administration of Taxation on the Issuance of the Implementation Measures of Special Tax Adjustments) *Guoshuifa* (国税法) (2009) No. 2 Order (promulgated on 8 Jan. 2009, retroactively effective from 1 Jan. 2008). Available in English at http://en.pkulaw.cn/display.aspx?cgid=112360&lib=law
26. Art. 93 of Circular 2.

In December 2014, the SAT released The Administrative Measures on the General Anti-Avoidance Rule (hereinafter 2015 GAAR Measures), which are the latest set of rules regarding the implementation and application of the Chinese GAAR of article 47 of the CCITL.[27] Article 2 of the 2015 GAAR Measures excludes the following two scenarios from the scope of the measures: (1) all arrangements not involving cross-border transactions or payments;[28] and (2) all tax law violations, such as a refusal to pay tax and other forms of tax fraud.[29] According to article 4 of the 2015 GAAR Measures, the main characteristics of a tax avoidance arrangement are:

- the sole purpose or main purpose of the arrangement is to obtain a tax advantage;[30] and
- the tax advantage is obtained by using an arrangement that is technically compliant with tax laws but inconsistent with economic substance.

Although not mentioned in article 47 of the CCITL, the Chinese GAAR assessment therefore apparently consists of both a subjective test considering the purpose or intent of the taxpayer's arrangements and a more objective test following the substance-over-form principle to identify abusive arrangements.[31] The Chinese "purpose test" has been frequently revised over the past few years, without defining its guiding factors. A "lack of a reasonable business purpose" of article 47 of the CCITL was explained by the State Council as an arrangement with the main purpose of achieving an exemption, reduction or deferral of the payment of taxes. The 2015 GAAR Measures, however, have introduced a "sole or main purpose test" when determining whether an arrangement can be considered a tax avoidance scheme under the CCITL.

The more objective economic substance test is supposed to assist the tax authorities in their purpose test analysis.[32] Under the "substance test," Chinese taxpayers' activities are tested by reference to inconsistencies between the legal form of the arrangements and their economic substance, which is considered a hallmark of a tax avoidance arrangement insofar as the arrangement is structured to achieve a tax advantage. However, a tax advantage will not necessarily trigger GAAR application; if the economic substance of an enterprise in China satisfies the conditions for preferential treatment under the CCITL, the resulting tax advantage will not be subject to the Chinese GAAR.[33]

27. *Guojia Shuiwu Zongju Yiban Fan Bishui Guanli Banfa* (国家税务总局一般反避税管理办法) (Notice of the State Administration of Taxation regarding the Administrative Measures of the General Anti-Avoidance Rule) *Guoshuifa* (国税法) (2014) No. 32 Order. Available in English at http://en.pkulaw.cn/display.aspx?cgid=239563&lib=law.
28. *See* the SAT Q&A notes accompanying the 2015 GAAR Measures, available in English at http://www.chinatax.gov.cn/2013/n2925/n2957/c1396975/content.html. According to the SAT, the 2015 GAAR Measures exclude domestic transactions since they can cause double taxation within China. At this stage, the measures therefore solely focus on cross-border transactions leading to profit shifting.
29. Such acts are penalized under the Law on the Administration of Tax Collection. *See Zhonghua Renmin Gongheguo Suishou Zhengshou Guanli Fa* (中华人民共和国税收征收管理法) (Law of the People's Republic of China on the Administration of Tax Collection) (promulgated by the 27th Session of the 7th National People's Congress, 4 Sep. 1992, as revised and amended in 2001, 2013 and 2015). Available in English at http://en.pkulaw.cn/display.aspx?cgid=252598&lib=law.
30. According to art. 3 2015 GAAR Measures, a "tax advantage" refers to a tax reduction, tax exemption or tax deferral.
31. *See supra* n. 28. It must be noted that Circular 2 did not become invalid with the promulgation of the 2015 GAAR Measures. Circular 2, especially art. 93, therefore also remains relevant for current and future GAAR assessments.
32. Id.
33. Id.

2.3.1. Article 47 of the CCITL applied to international tax arrangements: Circular 698 and Notice 7

Although presented as a "general" anti-avoidance rule, the Chinese GAAR of article 47 of the CCITL is currently almost exclusively applied to cross-border indirect transfers.[34] These are transactions conducted outside China, but that are directly or indirectly linked to China. Until recently, Circular 698[35] provided guidelines for the application of the GAAR in relation to such indirect transfers. Circular 698 has since been partly replaced by Notice 7.[36]

Under the rules of the CCITL, capital gains on direct transfers of equity interest in a Chinese domestic enterprise and gains on direct transfers of movable and immovable property owned by an establishment or place in China are subject to Chinese withholding tax.[37] When a non-Chinese resident transfers his equity interest to another non-Chinese resident, it is a taxable event sourced in the state of residence of the company whose equity interest is transferred and any capital gains on the transfer (as well as any underlying assets) are therefore normally not subject to any withholding tax in China.

Article 1 of Notice 7, however, provides that when a non-Chinese resident company indirectly transfers assets[38] through an arrangement that serves no real business purpose but is mainly in place for the purpose of mitigating or avoiding Chinese tax liabilities, the Chinese tax authorities have the right to recharacterize the indirect transfer as a direct transfer in accordance with article 47 of the CCITL. Typically, an indirect transfer arises when a non-Chinese resident company transfers its equity interest in a non-Chinese resident holding company that directly or indirectly holds an equity interest in a Chinese resident company.[39]

According to article 3 of Notice 7, the following factors must be taken into account in order to determine whether or not the sole or main purpose of the indirect transfer of the taxable Chinese assets is to reduce, avoid or defer Chinese taxes:

- whether the equity value of the transferred non-resident company derives mainly, directly or indirectly, from taxable Chinese assets;

34. J. Li, *The Great Fiscal Wall of China: Tax Treaties and Their Role in Defining and Defending China's Tax Base*, 66 Bull. Intl. Taxn. 9 (2012), Journals IBFD; and Finnerty & Lai, *supra* n. 7.
35. *Guojia Shuiwu Zongju Guanyu Jiaqang Fei Jumin Qiye Guquan Zhuanrang Suode Zhengshou Qiye Suodeshui Guanli de Tongzhi* (国家税务总局关于加强非居民企业股权转让所得征收企业所得税管理的通知) (Notice of the State Administration of Taxation on Strengthening the Management of Enterprise Income Tax Collection of Proceeds from Equity Transfers by Non-Residents) *Guoshuihan* (国税函) (2009) No. 698 Order. Available in English at http://en.pkulaw.cn/display.aspx?cgid=125189&lib=law. Circular 698 and Notice 7 are more detailed implementations of the GAAR of art. 47 CCITL. It must be noted that the 2015 GAAR Measures apply next to Notice 7. *See* art. 11 of Notice 7.
36. *Guojia Shuiwu Zongju Guanyu Fei Jumin Qiye Jianjie Zhuanrang Caichan Qiye Suodeshui Ruogan Wenti de Gongao* (国家税务总局关于非居民企业间接转让财产企业所得税若干问题的公告) (Notice of the State Administration of Taxation on Issues regarding Indirect Transfers of Assets by Non-Resident Companies) (2015) Notice 7. Available in English at http://hk.lexiscn.com/law/announcement-of-the-state-administration-of-taxation-on-several-issues-concerning-the-enterprise-income-tax-on-the-indirect-transfers-of-properties-by-non-resident-enterprises.html.
37. *See* art. 7(3) CITLIR.
38. Assets are defined to mean movable property attributed to an establishment or place in China, immovable property in China and equity or equity-like interests in a Chinese resident company. These assets are collectively defined by Notice 7 as "taxable Chinese assets."
39. If the arrangement is found to lack a reasonable business purpose, the Chinese tax authorities will disregard the intermediate holding company and recharacterize the indirect sale of shares in the intermediate holding company as if it were a direct sale of shares in a Chinese resident company.

- whether the assets of the transferred non-resident company consist mainly, directly or indirectly, of Chinese investments or whether the income of the transferred non-resident company consist mainly, directly or indirectly, of Chinese-source income;
- whether the functions and risks undertaken by the transferred non-resident company and its direct and indirect subsidiaries justify the economic substance of the organizational structure;
- the length of time the organizational structure, the business model and the shareholders have been in place;
- whether the gains on the indirect transfer are subject to foreign withholding tax;
- whether the indirect investment in China could have been made through a direct investment and whether the indirect transfer could have been made through a direct transfer;
- whether there is an applicable tax treaty governing the indirect transfer; and
- other reasons as may be determined by the relevant tax authorities.[40]

2.4. Methodology

The Chinese GAAR is seen as a last resort, something only to be applied when all other anti-avoidance measures have failed to counteract the tax advantage sought by the tax avoidance arrangement.[41] The GAAR applies to all perceived tax avoidance arrangements and is not limited to specific transactions. Formally, it also does not distinguish between domestic and international transactions entered into by the companies involved. However, as illustrated by Circular 2 and Notice 7, it is clear that international arrangements involving the use of special purpose vehicles (hereinafter SPVs) in low-tax jurisdictions that have concluded tax treaties with China are a particular focal point for the Chinese tax administrators. Finally, the GAAR of article 47 of the CCITL does not have general effect and only applies to enterprises.

The SAT is authorized to enforce and regulate the GAAR. Any investigation into tax avoidance arrangements by the local tax authorities, or any resultant adjustment, is subject to approval of the central office of the SAT in Beijing.[42] According to the 2015 GAAR Measures, the GAAR investigation of the local tax authority should take no longer than nine months to complete after approval by the SAT.[43] The burden of proof that the requirements for the application of the Chinese GAAR have not been met lies with the taxpayer under investigation.[44] When the local tax authority suspects a tax avoidance arrangement, it will send out a written request for information to the enterprise.[45] The enterprise should, within sixty days after receiving the request, provide extensive documentation and other information that prove its arrangements do not involve tax avoidance, i.e. that the arrangements have

40. Circular 698 and Notice 7 thereby extend the substance-over-form approach of the Chinese GAAR to capital gains realized by non-residents upon indirect transfers of equity interest and indirect transfers of real properties.
41. *See supra* n. 28.
42. Art. 97 Circular 2 and arts. 8 and 9 2015 GAAR Measures.
43. Art. 16 2015 GAAR Measures.
44. H. Yang, *People's Republic of China: Tax Treaties and* Tax Avoidance*: Application of Anti-avoidance Provisions*, (2010) Vol. 95A, Cahiers de Droit Fiscal International 209-232.
45. Art. 95 of Circular 2 and art. 11 2015 GAAR Measures. There is no mandatory reporting requirement. Instead, an arrangement may be reported voluntarily by either party to the transaction, or the Chinese resident company whose shares are indirectly transferred or the local tax authorities may request relevant documentation from any of these parties.

been made for reasonable commercial reasons. According to 11 article of the 2015 GAAR Measures, the information that needs to be provided includes: the background of the arrangements, documents explaining reasonable business purpose, documents related to the internal decision making, transaction documents and communications between the taxpayer and other parties to the transaction, other materials that prove the arrangements do not involve tax avoidance and any other information regarding the arrangements as requested by the tax authorities. These general documentation requirements of the 2015 GAAR Measures have been further specified in Notice 7 for indirect transfers of taxable Chinese assets.[46] In special cases, an extension of thirty days may be given to individual taxpayers. Furthermore, the tax authority can require related parties, such as the taxpayer's tax adviser or attorney, or any other party that planned the tax avoidance arrangement, to provide relevant documents and materials.[47]

If the enterprise fails to provide the requested information within the specified period, the tax authority is authorized to assess the taxpayer's taxable income based on the available information. When the information provided fails to prove that the arrangements have been made for reasonable commercial purposes, the tax authority can make "reasonable adjustments" to the taxpayer's tax liability. The local tax authority will then prepare a preliminary adjustment notice, containing its opinion and a proposition for a preliminary adjustment scheme. The SAT must first approve both the preliminary opinion and adjustment scheme before the local tax authority can issue the notice to the taxpayer.[48] Upon receiving the preliminary adjustment notice, the taxpayer has seven days to appeal to the local tax authority for further determination by the SAT, after which the taxpayer will receive a final adjustment notice.[49]

2.5. Legal consequences

When the tax authorities uncover a tax avoidance arrangement, they have the right to make "reasonable adjustments." According to article 94 of Circular 2, "reasonable adjustments" mean that the tax authorities may recharacterize abusive arrangements according to the economic reality, and annul the tax advantage achieved by such arrangements.

The 2015 GAAR Measures have provided some further clarification on the adjustment measures available to the Chinese tax authorities. According to article 5 of the 2015 GAAR Measures, the tax authorities can adjust the tax consequences of a tax avoidance arrangement to match the tax consequences of similar arrangements with economic substance

46. According to arts. 9 and 10 of Notice 7, both parties to the transfer (the Chinese resident company whose shares are indirectly transferred and any third party advisors) may be required to submit the following materials to the competent tax authority: the share transfer agreement, the corporate organisation structure before and after the transfer, the financial statements of the transferred company and its subsidiaries of the past two financial years, evidence that the indirect transfer should not be recharacterized as a direct transfer, documents regarding the business operations and employees of the transferred company and its subsidiaries, an asset evaluation report to determine the value of the transferred shares, documents providing the foreign withholding tax that the transfer is subject to (if any), materials proving that a safe harbour rule applies and any other documents as required by the tax authorities. The materials must be provided to the local tax authority where the Chinese resident company is located.

47. Arts. 13 - 15 2015 GAAR Measures.

48. Although the 2015 GAAR Measures instruct the local tax authorities to complete the GAAR review process within nine months, there is no similar instruction for the SAT to make its approval decision on the opinion and preliminary adjustment scheme proposal of the local tax authorities.

49. Art. 17 2015 GAAR Measures.

and reasonable commercial purpose. For example, when one of the enterprises involved in the arrangement is a conduit company in a low-tax jurisdiction with little or no economic substance, and taking this enterprise into account would result in the avoidance of Chinese taxes, the enterprise can be disregarded for Chinese tax purposes. The tax authorities can make the following adjustments to annul the tax advantage achieved by abusive arrangements:

– recharacterize the whole or a part of the transaction;
– disregard a party to the transaction or treat the parties to the transaction as the same entity;
– recharacterize income, tax deductions, tax incentives, foreign tax credit, etc., or reallocate them among the parties to an abusive transaction; and
– any other reasonable methods.

2.6. Practical application of the Chinese GAAR: A selection of case examples

There are a limited number of case examples available that demonstrate the development and application of the Chinese GAAR. An analysis of these cases indicates that transactions involving cross-border indirect transfers of equity interests and cases involving treaty shopping have attracted the attention of the SAT in particular.

The *Chongqing* case

The *Chongqing* case[50] was the first anti-avoidance case after the CCITL became effective and serves as a prime example of the substance-over-form principle used in Chinese tax cases. The case concerned a Singaporean parent company which wholly owned a Singaporean SPV, which in turn held a 31.6% equity interest in a Chinese joint venture (hereinafter JV). The Singaporean parent company subsequently sold its equity interest in the Singaporean SPV to a Chinese resident company buyer for CNY 63.4 million.

The CCITL normally imposes a 10% withholding tax on any capital gains derived by non-residents on transfers of equity interest in a Chinese resident company.[51] The Singaporean parent company argued that since the transaction involved the transfer of equity in a non-Chinese resident company, any gains derived from this transaction did not qualify as Chinese-source income. Hence, the Chongqing tax authorities had no tax jurisdiction.[52] The tax authorities, however, argued that the Singaporean SPV did not carry out any substantial business activity other than holding a 31.6% equity interest in the Chinese JV. In addition, the SPV was low capitalized. According to the tax authorities, the transfer of the equity interest in the Singaporean SPV was, in substance, a transfer of the equity in the Chinese JV.[53] It therefore disregarded the Singaporean SPV for Chinese tax purposes and imposed a 10% withholding tax on the capital gains derived from the sale, treating the transaction as if the Singaporean parent company had directly transferred the equity in the Chinese JV under the domestic law of China and the China-Singapore tax treaty.

50. Yuzhong District State Taxation Bureau of Chongqing City (27 Nov. 2008). *See also* Lampreave, *supra* n. 22, p. 53 and C.J. Finnerty & B. Lai, *supra* n. 7.
51. Art. 3 CCITL and art. 7 CITLIR.
52. According to art. 3 CCITL and art. 7 of its Implementation Regulations, the source of income from a share transfer is determined by the place of residence of the transferred company. Since the place of residence of the transferred company was in Singapore, the Singapore parent company argued that any capital gains derived from this transaction were not subject to Chinese withholding tax.
53. D.K.C. Cheung, *An Update on General Anti-Tax Avoidance Rules in China* (2012), 38 (1) International Tax Journal 36.

The *Xinjiang* case

In the *Xinjiang* case,[54] the tax authorities did not allow a Barbadian SPV to enjoy the benefits of the China-Barbados tax treaty. The case involved the purchase and sale-back of an equity interest in a Chinese JV. In 2006, a Barbadian SPV owned by a US parent company paid USD 33.8 million to acquire a 33.32% equity interest in a Chinese resident company from one of its two Chinese shareholders. The Chinese resident company was subsequently converted into a JV. Following the transaction, the selling Chinese shareholder injected the share purchase price (USD 33.8 million) into the JV, increasing its registered capital. Less than a year after the original transaction, the Barbadian SPV transferred its equity interest in the JV back to the original shareholder, deriving a capital gain of USD 12.17 million.

Under the rules of the CCITL, this capital gain was sourced in China and therefore subject to a 10% withholding tax.[55] However, under the China-Barbados tax treaty, the exclusive right to tax capital gains is allocated to Barbados when the selling company is a Barbados resident company. Therefore, if the transaction would be successful, the capital gain of USD 12.17 million would not be subject to corporate income tax in China.

To receive the benefits of the China-Barbados tax treaty, the Barbadian SPV argued that it was a resident of Barbados. The Xinjiang tax authorities, however, ruled that the Barbados SPV was not a Barbados tax resident and denied the benefits of the China-Barbados tax treaty. Their decision was based on the following facts: firstly, all of the SPV's directors were US citizens with US residential addresses, indicating that the place of management could not be considered to be in Barbados. Secondly, the Barbadian SPV had purchased the equity interest in the Chinese JV only one month after the company was formed. Thirdly, the subsequent transfer of equity back to the original shareholder was the result of an earlier contractual arrangement between the two parties. Finally, the Barbadian SPV did not provide its tax residency certificate. The Chinese tax authorities therefore concluded that the Barbadian SPV was not entitled to the protection of the China-Barbados tax treaty. As a result, a 10% withholding tax was imposed on the capital gain of USD 12.17 million.[56]

The *Fujian* case

The *Fujian* case[57] involved an equity transfer in a Chinese listed company by a Hong Kong holding company. A wealthy Hong Kong individual indirectly held 38.09% of the equity in a Chinese listed company through two wholly-owned Hong Kong resident companies (Hong Kong Holdco A and Hong Kong Holdco B). Hong Kong Holdco A and Hong Kong Holdco B respectively held a 15.6% and 22.49% equity interest in the Chinese listed company. During 2009 and 2010, Hong Kong Holdco A gradually sold part of its equity interest in the Chinese listed company on the Shanghai stock exchange, realizing a capital gain of CNY 3.5 billion. Hong Kong Holdco A argued that this capital gain was exempt from Chinese taxes under the China-Hong Kong tax treaty, since the treaty allocates the right to tax capital gains to Hong Kong as long as the Hong Kong seller's equity interest in a Chinese subsidiary does

54. The *Xinjang* case was officially published by the SAT through the Notice regarding the Correct Handling of a Case Involving the Abusive Application of Treaty Benefits *Guoshuihan* (国税函) (2008) No. 1076 Order. *See also* Lampreave, *supra* n. 22, p. 54 and Yang, *supra* n. 23.
55. Art. 3 CCITL and art. 7 CITLIR.
56. The *Xinjiang* case is exemplary on how the SAT has dealt with treaty abuse and how it is likely to deal with treaty abuse in the future. The GAAR is the primary legal instrument under the BEPS Action Plan and China will continue to aim for a broad and international scope of application of its domestic GAAR. For example, the Chinese tax treaties concluded before 2006 do not allow for the use of the domestic GAAR to counter treaty abuse. Since 2007, however, the domestic GAAR has been incorporated in a number of tax treaties. Nevertheless, as illustrated by the cases discussed hereafter, the lack of a GAAR article in the tax treaty will not mean that the SAT will not rely on the GAAR. Herein lies the danger of double taxation, especially when the treaty partner state does not agree with the Chinese point of view. *See also* J. Li, *China and BEPS: From Norm-Taker to Norm-Shaker*, 69 Bull. Intl. Taxn. 6/7 (2015), Journals IBFD.
57. S. Ma, *Tax Arrangement between China (People's Rep.) and Hong Kong – Fujian Tax Authority Denies Application of Art. 13(5) that Capital Gains from Disposal of Minority Holdings Taxable Only in Hong Kong* (7 July 2010), News IBFD and D. Qiu, *China's Capital Gains Taxation of Non-residents and the Legitimate Use of Tax Treaties*, (2010) (60) 8 Tax Notes International. This case will be discussed in more detail in sec. 4.2.2.

not surpass a 25% threshold. The Fujian tax authority, however, disregarded the argument of Hong Kong Holdco A, arguing that it had only been in place to avoid Chinese taxes and imposed Chinese individual income tax on the Hong Kong individual.[58]

The *Jiangsu* case

The *Jiangsu* case[59] concerned a US resident seller and a US resident purchaser that transferred an equity interest in a Hong Kong holding company, which, in turn, held a 49% equity interest in a Chinese JV. The US resident seller sold its equity interest in the Chinese JV to the subsidiary of a US resident company for USD 350 million. The US resident seller argued that, since both the transferring company and the purchasing company were non-Chinese residents, and the equity transferred was that of a Hong Kong resident company, any capital gains derived from the transaction should not be subject to Chinese withholding tax. Nevertheless, the Jiangsu tax authorities disagreed and argued that Circular 698 had to be applied. Based on the equity transfer agreement and the publicly available information on the transfer, the Jiangsu tax authority concluded that the Hong Kong holding company had no employees, no other investments and no substantial business operations other than its shareholding in the Chinese JV. Since there was no noteworthy economic substance, the Jiangsu tax authorities concluded to disregard the Hong Kong holding company and recharacterized the transaction as a direct transfer of 49% of the equity interest in a Chinese company. It imposed Chinese withholding tax accordingly.

The *Shenzhen* case

The *Shenzhen* case[60] involved a Hong Kong individual with a Hong Kong holding company. The Hong Kong holding company had registered a Chinese resident company in Shenzhen. The Shenzhen company was involved in the logistics and transportation business, and had purchased significant warehouse facilities to support its operations. Over the course of a decade, the value of these warehouses increased dramatically in the wake of the Chinese real estate market upsurge. In 2010, the Hong Kong individual sold his equity interest in the Hong Kong holding company to a Singaporean resident company for CNY 200 million. From the standpoint of the Hong Kong individual, this transaction merely involved the transfer of equity in a Hong Kong resident company and therefore had to be regarded as a Hong Kong domestic transaction. Hence, the capital gains derived from the equity transfer fell outside of China's tax jurisdiction. The Shenzhen tax authorities, however, argued that, given the value of the Chinese warehouse facilities, the real essence of the deal involved the Shenzhen company and not the Hong Kong holding company whose equity was transferred. In addition, it found that the deal structure gave rise to suspicions of tax avoidance. Since there is no anti-avoidance rule in China's Individual Income Tax Law (hereinafter CIITL), the Shenzhen tax authorities consulted the SAT for guidance. The SAT confirmed that the GAAR of the CCITL could not be applied in this case.[61] However, it found that the share transfer agreement included the assets of both the Hong Kong holding company and the Chinese resident company. For this reason, any income derived from the transfer of the Chinese resident company's assets in China is deemed to be Chinese-source income and should be subject to Chinese individual income tax. The Shenzhen tax authorities imposed individual income tax accordingly.[62]

58. This case will be discussed in more detail in sec. 4.2.2.
59. *Jiangsu Case Reports* (China Taxation News, 6 June 2010). *See also* Cheung, *supra* n. 53, p. 41, Qiu, *supra* n. 57 and B.T. Kelly, *Taxation of Indirect Equity Transfers*, 17 Asia-Pac. Tax Bull. 2 (2011), Journals IBFD.
60. *The Shenzhen Tax Authority Collected CNY 13,680,000 Tax Payment from Abroad* (China Taxation News 3323, 8 June 2011). This case will be discussed in more detail in sec. 4.2.2.
61. J.S. Pu, *The Lack of Anti-Avoidance Rules in the Chinese Individual Income Tax Law: A Loophole for Indirect Transfer of Shares by Non-Resident Individuals*, 20 Asia-Pac. Tax Bull. 3 (2014), Journals IBFD.
62. It is unclear how the SAT reached this conclusion as it does not appear to make sense that an agreement to transfer shares could include the assets of the companies. A more detailed discussion of the *Shenzhen* case will follow in sec. 4.2.2.

3. The General Anti-Avoidance Rule of the Netherlands and the United Kingdom

3.1. The Netherlands GAAR

The Netherlands had a statutory GAAR as early as 1925.[63] The Netherlands GAAR was introduced to promote the rightful levying of direct taxes and was aimed at curbing the increased use of tax avoidance arrangements at the time.[64] Article 31 of the Netherlands General Tax Act (*Algemene wet inzake rijksbelastingen*) provides that juridical acts are not taken into account for tax purposes if:

- these juridical acts[65] do not aim to result in an actual change of the factual situation; or
- when based on other facts and circumstances, it can be assumed that these juridical acts would not have been undertaken except to make the future levying of taxes wholly or partly impossible.

According to article 32 of the General Tax Act, the tax authorities can only apply the GAAR after approval of the Ministry of Finance. Until the 1980s, such approvals were regularly given and the GAAR has been used intensively for multiple decades.[66] In 1984, however, the Netherlands Supreme Court ruled that that the application requirements of the Netherlands statutory GAAR and the (judicially developed) *fraus legis* doctrine, also known as the abuse of law doctrine, were materially the same.[67] Since application of the *fraus legis* doctrine is much simpler, and its scope of application is wider than that of the statutory GAAR, the Ministry of Finance decided to promote the use of *fraus legis* and has not given approvals to apply the statutory GAAR since 1987.[68] As a result, the Netherlands statutory GAAR has become obsolete, even though the GAAR is still included in the General Tax Act. Since currently only *fraus legis* is being applied in the Netherlands, the next paragraphs will discuss the GAAR developed in judicial doctrine by the Netherlands Supreme Court.

3.1.1. The application requirements of the Netherlands GAAR

According to the Netherlands Supreme Court, the following conditions must be met to apply *fraus legis*:

- the primary motive, or by far the most important motive, of the taxpayer to enter into a juridical act, or a set of juridical acts[69] is to prevent the levying of Netherlands taxes; and
- the tax effects of the juridical act, or set of juridical acts, are contrary to the intent and purpose of the tax law.[70]

63. Act of 25 Apr 1925, Stb. 171. The statutory GAAR was later transferred from art. 31 to art. 36 General Tax Act 1959 (*Algemene Wet inzake Rijksbelastingen* 1959).
64. S. Hemels, *General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World? The Netherlands* (Paper for the Rust conference July 2014) 2 http://ssrn.com/abstract=2448616.
65. A "juridical act" is a civil law term that refers to a lawful act or expression of will intended to have legal consequences. For example, entering into a purchase agreement is an example of a juridical act.
66. R.E.C.M. Niessen, *Fraus legis in de 21e eeuw*, (2011) 4 (6) NTFR Beschouwingen 5-10.
67. HR 21 Nov. 1984, no. 22 092, BNB 1985/32.
68. Resolution of the Netherlands Ministry of Finance, 10 Aug. 1987, DB87/4966, V-N 1987/1842.3.
69. Also, the Supreme Court refers to a "juridical act, or a set of juridical acts" rather than transactions or arrangements. The definition "juridical act, or a set of juridical acts" has a very wide scope. It is hard to imagine any transactions or arrangements of a taxpayer that will not fall under this definition. For example, a transfer of shares through a share transfer agreement requires a set of judicial acts to complete. Another example of a juridical act is the establishment of a company.
70. HR 21 Nov. 1984, no. 22 092, BNB 1985/32 and HR 10 Aug. 2001, no. 35.890, BNB 2001/399.

The first requirement focuses on the intention of the taxpayer and is of a more subjective nature. In principle, a taxpayer has the right to choose between several legal paths to reach a certain tax result. The taxpayer will only risk application of *fraus legis* when he has chosen a way with the primary purpose of frustrating the levying of Netherlands taxes. In its jurisprudence, the Netherlands Supreme Court has formulated a number of indications from which it can be derived that the primary motive of the taxpayer has been to prevent the levying of Netherlands taxes. An indication can be that the arrangement leads to a foreseeable commercial disadvantage if the tax advantage is not taken into account or when the commercial result is so low that this cannot justify the arrangements of the taxpayer.[71] Other indications are the artificial character of the arrangements or that the arrangement did not achieve any factual change (for example, with circular transactions).[72]*Fraus legis* does not apply when the arrangement has been made for (substantial) commercial purposes, i.e. the decisive reason or most important reason underlying the arrangement is of a non-tax nature. When fiscal motives did play a role in the execution of the arrangements, other non-tax motives that are of more than ancillary motives must underlie the arrangements to prevent that *fraus legis* is applied.[73]

The second requirement is more objective in nature.[74] Even if the primary purpose of the arrangements of the taxpayer was to achieve a tax advantage, *fraus legis* will nevertheless not apply if the chosen arrangement cannot be considered to be contrary to the intent and purpose of the tax law.[75] The court will determine the intent and purpose of the law by reference to the legislative history of the provision and the overall system of the tax law.[76] This means, for example, that when the legislator has both foreseen and accepted certain avoidance possibilities, but has failed to amend the law accordingly, these arrangements cannot be tackled with *fraus legis*.[77] This will, for example, be the case when the avoidance possibility has arisen because of a conscious choice by the legislator or when the avoidance possibility is so obvious that the legislature should have reasonably considered it.[78]

Again, the "intent and purpose" criterion does not prevent taxpayers to choose the tax framework most favourable to their transactions and activities. According to the Netherlands Supreme Court, the arrangements of the taxpayer will usually go against the intent and purpose of the tax law if the taxpayer, with tax avoidance as his primary motive, has chosen an

71. HR 22 Jul. 1982, no. 20.953, BNB 1982/243.
72. HR 6 Oct. 1999, no. 33.971, BNB 2000/19. In evaluating the artificial character of an arrangement, the period of time in which the transactions were made can be an important indicator. For example, when certain transactions are made shortly before a taxable event and they are undone afterwards, there is a strong presumption that the transactions have been of an artificial nature. However, the artificiality or complexity of the arrangements is not a separate condition. It can merely be an indication of the tax motives behind a particular arrangement.
73. HR 21 Sept. 1983, no. 22 060, BNB 1983/316.
74. Hemels, *supra* n. 64.
75. HR 10 Feb. 2012, no. 09/03203, BNB 2012/128. However, it must be noted that when the arrangement serves no other purpose than tax avoidance, the arrangement will often also be contrary to the intent and purpose of the law. *See* J.J. van Dam, *Schijnhandeling, Fiscale Herkwalificatie en Fraus Legis in de Directe Belastingen* (2013) TFO 125 (1) 6.
76. M. Chin-Oldenziel & M. Belkaid-Koubia, *Fraus legis, het normvereiste geanalyseerd*, (2013) 1492 WFR.
77. HR 8 Jan. 1986, no. 23 031, BNB 1986/127.
78. HR 11 May 1988, no. 24 918, BNB 1988/289, HR 11 May 1988, no. 25 006, BNB 1988/290 and HR 11 May 1988, no. 25 231, BNB 1988/291.

option that is artificial in nature and with no real economic consequence or purpose.[79] Other indications that the arrangements of the taxpayer go against the intent and purpose of the law are that they can be repeated arbitrarily, providing an opportunity to reduce the tax base at will, or when there is no compensating levying of tax on a certain tax advantage. In the Netherlands, a taxpayer will generally risk application of *fraus legis* when the taxpayer has different options to arrange his taxes but tries to combine two or more beneficial rules, or when he tries to achieve a tax advantage using a detour.[80]

3.1.2. Methodology

Similar to China, the Netherlands GAAR serves as an *ultimum remedium*. *Fraus legis* is only to be applied when an arrangement is not covered by a legal provision and methods of legal interpretation and other SAARs have failed to bring the arrangement under the desired norm that would lead to a taxation in accordance with the intention and purpose of the Netherlands tax law.[81] The *fraus legis* doctrine applies to all perceived tax avoidance arrangements and is not limited to specific transactions or taxes. In addition, the Netherlands GAAR has general effect and can apply to the arrangements of both individuals and enterprises. However, the Netherlands Supreme Court makes a distinction between domestic and international transactions entered into by the companies or individuals involved, as the Netherlands Supreme Court is very reluctant to apply domestic anti-avoidance rules in international situations, specifically under tax treaties.[82] From a Dutch perspective, the proper way of securing international effect of its domestic anti-avoidance measures is to make proper arrangements in its tax treaties.[83]

Since *fraus legis* has been developed by the judiciary, there is no statutory procedure in the law for its application. To justify the infringement on the principle of legal certainty, however, the initial burden of proof that the requirements to apply *fraus legis* have been met lies on the tax authorities.[84]*Fraus legis* can be invoked at any stage, from the initial assessment by the tax authorities to when the case is before the court. When the tax authorities can make it plausible, based on the factual evidence, that the decisive reason for a certain arrangement has been to avoid Netherlands taxes, the burden of proof will shift to the taxpayer.[85] The taxpayer will then have to convince the court that the arrangements have been made for a commercial purpose and that the fiscal motive for the arrangements has only been of an ancillary nature.[86] Finally, Netherlands taxpayers are not required to disclose arrangements that could potentially fall under the *fraus legis* doctrine.

79. HR 13 Mar. 2009, no. 43 946, BNB 2009/123. This will usually be the case when the arrangements cannot be justified by any other reason than for the purpose of reducing or avoiding Netherlands tax.
80. H. Vermeulen, *Cursus Belastingrecht, Formeel Belastingrecht*, 7.4.3.B.f .
81. HR 10 Aug. 2001, no. 35 890, BNB 2001/399. *See also* Niessen, *supra* n. 64 and Vermeulen, *Cursus Belastingrecht, Formeel Belastingrecht*, 7.4.1.
82. HR 15 Dec. 1993, BNB 1994/259. *See also* F.G.F Peters and A. Roelofsen, *The Netherlands: Tax Treaties and Tax Avoidance: Application of Anti-avoidance Provisions* (2010) Vol. 95A Cahiers de Droit Fiscal International 551-574.
83. Id.
84. Chin-Oldenziel & Belkaid-Koubia, *supra* n. 76.
85. HR 13 Dec.1995, no. 29931, BNB 1996/89 and HR 10 Aug. 2001, no. 35 890, BNB 2001/399.
86. HR 21 Sept. 1983, no. 22 060, BNB 1983/316.

3.1.3. Legal consequences

When the court finds that the arrangements of the taxpayer meet the requirements for application of *fraus legis*, the arrangements can either be ignored or substituted by its closest taxable equivalent. Application of the *fraus legis* doctrine can therefore not only lead to the (partial) elimination of facts and legal actions, but it can also substitute the actual facts and legal actions to the closest equivalent that would achieve a taxation in line with the intention and purpose of the tax law.[87] In other words, the abusive arrangement is not taxed according to the actual applicable law, rather according to the law the taxpayer tried to avoid.[88] The deficient amount of tax is calculated by the court (or by the tax authorities if the case has not been brought to the court) based on the new circumstances and reflects the amount that the legislator intended to tax.[89]

3.1.4. Practical application of the Netherlands GAAR: A selection of case law

A large quantity of Netherlands jurisprudence exists on *fraus legis* in the context of tax law. For this reason, this section has made a selection of two landmark cases. The cases discussed below illustrate that the application requirements of *fraus legis* are strongly intertwined. When applying *fraus legis* to a particular fact pattern, the Netherlands Supreme Court applies the two requirements as a whole.[90] In addition, they illustrate that the application of the GAAR in the Netherlands is complex and that a heavy responsibility lies on the judiciary to achieve a fair and just application of the GAAR.

HR 10 August 2001, no. 35 890, BNB 2001/399

HR 10 August 2001, no. 35 890, BNB 2001/399 involved a dividend payment to a parent company (Company A) located in the Netherlands Antilles by one of its subsidiaries (Company B) located in the Netherlands. However, Company B did not actually pay the dividend to its parent company, but remained indebted to Company A to pay the dividend. Thus, an interest deduction was created at the level of Company B that lowered its taxable profits, while the corresponding interest income at the level of Company A was taxed at a substantially lower rate in the Netherlands Antilles. Following this transaction, Company A lent the proceeds of this dividend payment to Company C, a subsidiary of Company B, which was also located in the Netherlands. As Company B and Company C formed a fiscal unity[91] under Netherlands tax law, the latter transaction was not recognized, since Company B and Company C were treated as one entity for Dutch tax purposes. Hence, the combination of transactions described above eroded the Netherlands tax base (at the level of the fiscal unity), while the corresponding interest income was taxed at a lower rate in the Netherlands Antilles.

In its judgment, the Netherlands Supreme Court ruled that such practices are, in principle, allowed. After all, although the interest is deducted from the profits of the fiscal unity, the corresponding proceeds are taxed on the level of the shareholders. It continued, however, that such an interest deduction cannot be allowed when the main purpose of the transactions is to prevent the levying of Netherlands taxes, and under circumstances that are in conflict with the intent and purpose of the law.

In this case, the Netherlands Supreme Court found that the indebted dividend payment of Company B

87. Id.
88. HR 10 Feb. 2012, no. 08/05317, BNB 2012/127.
89. Hemels, *supra* n. 64.
90. Chin-Oldenziel & Belkaid-Koubia, *supra* n. 76.
91. The Netherlands fiscal unity regime allows groups of companies to consolidate their tax return. Since the group is treated as one taxpayer, the losses and profits of one company in the group can be set off against the profits and losses of the other companies in the group. Also, transactions between these group companies, like intercompany loans, are not recognised for tax purposes.

to Company A and the subsequent loan for the same amount to Company C for this transaction had no real commercial reason other than to prevent the levying of Netherlands taxes. The debts created by these transactions did not contribute to the business financing of Company A's subsidiaries. Therefore, allowing the deduction of interest at the level of the fiscal unity would go against the intent and purpose of the tax law, since the legislator did not intend to allow an interest deduction on artificial loans that do not have a function in the financing of the enterprise of the taxpayer, especially when the corresponding interest income is taxed at a substantially lower rate. Since the debts were merely created to lower the Netherlands tax liability, the Netherlands Supreme Court disallowed the interest deduction at the level of the fiscal unity and the arrangements were taxed without taking these deductions into consideration.

HR 15 March 2013, no. 11/05609, BNB 2013/151

HR 15 March 2013, no. 11/05609, BNB 2013/151 was a case in which the question arose as to whether the legislator had both foreseen and accepted a certain avoidance possibility. The case concerned taxpayer A and taxpayer B, who each owned various real estate properties respectively. To avoid the payment of real estate transfer tax, they became registered partners for one day. After the transaction was completed, they broke their partnership. It was not disputed that the sole motive for this transaction was to avoid the Netherlands real estate transfer tax. In a previous instance, the court had ruled that this possibility to avoid real estate transfer tax was pointed out to the legislator during the legislative process, but since the legislator did not amend the proposed legislation, there was no conflict with the intent and purpose of the law. The Netherlands Supreme Court, however, ruled that fraus legis applied to the above arrangement. Although the legislator had foreseen the possibility to avoid real estate transfer tax during the legislative process, this does not mean, according to the Supreme Court, that the legislator also explicitly accepted the avoidance possibility.[92] Since the registered partnership was for such a short period of time that it had no real practical significance, it came into conflict with the intent and purpose of the real estate transfer tax law. As a result, the registered partnership was disregarded and the real estate transfer tax was levied accordingly.

3.2. The UK GAAR

Before the introduction of the statutory GAAR, the UK courts appeared to be developing a judicial anti-avoidance doctrine.[93] This development commenced with a series of cases, most notably the decision of the House of Lords in the Case *W.T. Ramsay Ltd v. IRC*.[94] It appeared that when there was a preordained set of transactions that had no commercial purpose other than to achieve a tax advantage, the courts could view the arrangements as a whole for tax purposes and tax the arrangements on the basis of the overall result.[95] However, this apparent rule began to be strained as taxpayers started to rely on its wording and argued that their arrangements were not fully preordained or that the transactions all had a commercial purpose.[96] After taxpayers won some important cases, the courts revisited their approach and asserted that there had never been a general rule that allowed the court to disregard transactions in tax avoidance schemes, but rather the courts had applied a form of statutory interpretation.[97]

92. Chin-Oldenziel & Belkaid-Koubia, *supra* n. 76.
93. J. Freedman, *GAAR as a Process and the Process of Discussing the GAAR* (2012) 57 (1) British Tax Review 22-27.
94. *W.T. Ramsay Ltd v. IRC* (1982) AC 300.
95. *Furniss v. Dawson* (1984) A.C. 474.
96. J. Freedman, *Designing a General Anti-Abuse Rule: Striking a Balance*, 20 Asia-Pac. Tax Bull. 3 (2014), Journals IBFD.
97. *See*, for example, *MacNiven v. Westmoreland* (2001) UKHL 6 and *McLaughlin v. IRC* (2012) UKFTT 174. L. Cohen & J. Bryant, *The Effect of 'Social Evils' on Trustees' Decisions* (2014) 20 (9) Trusts & Trustees 882-890.

Due to the subsequent uncertainty surrounding the case law, it was proposed to introduce a statutory GAAR in 1998.[98] However, the proposal was rejected, partly because the wording of such a statutory GAAR could not be agreed upon and partly because taxpayers argued for an advance clearance procedure while the tax authorities did not want to provide such a service. Thus, the uncertainty surrounding the so-called Ramsay "principle" remained.

After many years of political debate and growing concerns about the number of complex and aggressive tax schemes being carried out, the government finally agreed to set up a study group in 2011 to investigate the desirability of a statutory anti-avoidance rule in the United Kingdom.[99] The report recommended the government to implement a moderate and targeted general anti-abuse rule aimed at curtailing tax avoidance through mainstream tax planning. Two years later, the United Kingdom introduced its statutory GAAR with the promulgation of the Finance Act 2013 (FA). It is thereby a relative latecomer to this form of legislation.[100]

3.2.1. The application requirements of the UK GAAR

The purpose of the UK GAAR is to counteract tax advantages that arise from 'abusive tax arrangements'.[101] Under section 207 FA, tax arrangements are broadly defined. Tax arrangements are any arrangements of which it would be reasonable to conclude that the obtaining of a tax advantage[102] was the main purpose, or one of the main purposes.[103] Whether obtaining a tax advantage has been the main purpose, or one of the main purposes, of a certain arrangement should be determined objectively, having regard to the facts and circumstances of the individual case.[104] This is a deliberately wide definition, and allows the GAAR to cover a vast range of arrangements.[105] The broad nature of the GAAR is considered to be balanced by the fact that the arrangements must also be "abusive."[106] The tax arrangements are abusive if they cannot reasonably be considered as a reasonable course of action in relation to the

98. Freedman, *supra* n. 93.
99. G. Aaronson, *GAAR Study: A Study to Consider Whether a General Anti-Avoidance Rule Should Be Introduced into the UK Tax System* (11 Nov. 2011) available at http://webarchive.nationalarchives.gov.uk/20130129110402/http:/www.hm-treasury.gov.uk/d/gaar_study_supp_report_250612.pdf.
100. In contrast, several British Commonwealth countries, such as Australia, Canada and New Zealand, have had a statutory anti-abuse rule in place for many years.
101. The UK GAAR can be found in secs. 206 to 215 UK Finance Act 2013. The current UK GAAR cannot be read without also considering the official UK GAAR Guidance, which serves as an additional aid to its interpretation and application. *See* Her Majesty's Revenue and Customs (HMRC) General Anti-Abuse Rule Guidance (GAAR Guidance), approved by the advisory panel with effect from 15 Apr. 2013. Available at https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules.
102. Sec. 208 FA defines "tax advantages" as a relief or increased relief from tax, repayment or increased repayment of tax, avoidance or reduction of a charge to tax or an assessment to tax, avoidance of a possible assessment to tax, deferral of a payment of tax or advancement of a repayment of tax, and avoidance of an obligation to deduct or account for tax.
103. Sec. 207 (1) FA.
104. According to the GAAR Guidance, the main purpose of the arrangement is to obtain a tax advantage when, for example, the arrangement would not have been carried out were it not for the opportunity to obtain a tax advantage. To determine whether one of the main purposes of the arrangement has been to obtain a tax advantage, whether the arrangements which would otherwise have occurred have been reshaped in order to significantly change the tax results must be established, and the tax result itself is a substantial objective of the arrangements. *See* GAAR Guidance, *supra* n. 101, at C3.4 to C3.6.
105. GAAR Guidance, *supra* n. 101, at C3.8. *See also* K.A. Parillo, *News Analysis: HMRC Official Explains U.K. GAAR* Proposal (2012) 133 (1) Worldwide Tax Daily available at http://www.sbs.ox.ac.uk/sites/default/files/-Business_Taxation/Events/conferences/summer_conference/2012/news-analysis-hmrc-official-explains-uk-gaar-proposal.pdf.
106. D. Roxburgh, *General Anti-Abuse Rule (GAAR)*, 54 Eur. Taxn. 2-3 (2014), Journals IBFD.

relevant tax provisions (the so-called "double reasonableness test").[107] The "reasonableness" of the arrangements must be determined with regard to all the circumstances of the case, including the following:

- whether the substantive results of the arrangements are consistent with any principles and policy objectives of the relevant tax provisions;
- whether the arrangements involve one or more contrived or abnormal steps; and
- whether the arrangements are intended to exploit any shortcomings in the relevant tax provisions.[108]

Non-exhaustive indications that the taxpayer's arrangements are abusive are that:

- they result in an amount of income, profits or gains that is significantly less than the amount for economic purposes;
- they result in deductions or losses that are significantly more than the amount for economic purposes; and
- they result in a claim for the repayment or crediting of tax (including foreign tax) that has not been and is unlikely to be paid.[109]

However, each of these cases will only amount to abuse if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted. Another indication that the arrangements are not abusive for the purposes of the GAAR is when the arrangements are in accordance with established practice of the tax authorities at the time the arrangements were entered into.[110]

According to the United Kingdom's official GAAR Guidance, the "double reasonableness test" does not ask whether entering into or carrying out the arrangements was a reasonable course of action in relation to the relevant tax provisions, but rather whether there can be a reasonably held view that entering into or carrying out the tax arrangements in question was a reasonable course of action, having regard to the purpose of the GAAR and the factors it requires to be taken into consideration.[111] In broad terms, the GAAR only comes into action when the tax arrangements of the taxpayer aim to achieve a favourable tax result, something that the British Parliament did not anticipate when it introduced the applicable tax provision, and that those arrangements cannot reasonably be considered to be a reasonable course of action, i.e. when they are considered to be abusive for the purposes of the GAAR.[112]

3.2.2. Methodology

The UK GAAR is seen as a last resort, only coming into action if the tax law is not effective in counteracting the advantageous tax result achieved by the abusive arrangements. This is only different when the tax arrangements of the taxpayer are of such an abusive nature that the tax authorities feel it is necessary to immediately invoke the GAAR without waiting to see if the tax code can appropriately counteract the tax advantages sought.[113] The GAAR applies to all tax arrangements perceived to be abusive and is not limited to specific transactions or

107. Sec. 207 (2) FA.
108. Id.
109. Sec. 207 (4) FA.
110. Sec. 207 (5) FA.
111. GAAR Guidance, *supra* n. 101.
112. GAAR Guidance, *supra* n. 101, at B11.1.
113. Roxburgh, *supra* n. 106, at 114.

taxes.[114] In addition, the GAAR contains provisions to ensure its international effect. Hence, the GAAR applies where there is a tax treaty in place, although it was noted that it can only be applied with difficulty to tax arrangements with an international element.[115] In the United Kingdom, taxpayers are also required to disclose aggressive tax avoidance arrangements.[116]

The initial burden of proof lies on the tax administrators.[117] When the tax authorities believe that a tax advantage has arisen from an abusive arrangement, a specialist tax officer will send out a written notice to the taxpayer that sets out the reasons for this believe and the counteraction that the tax authority considers ought to be taken.[118] The taxpayer will then have forty-five days to respond to the notice.[119] When no representations were made or when the specialist officer is still convinced that the tax advantage needs to be counteracted upon receiving the representations of the taxpayer, he must refer the case to the GAAR advisory panel.[120] All potential GAAR cases must be brought before the advisory panel if they are to proceed. The taxpayer can directly make representations to the advisory panel within twenty-one days of receiving notice of the referral by the specialist tax officer.[121]

The primary role of the GAAR advisory panel is to consider whether or not entering into the tax arrangements in question was a reasonable course of action under the GAAR, or that, based on the available materials, it is not possible to give an adequate opinion on the matter. As one might have noticed, the advisory panel only considers one aspect of the "double reasonable test." This is intended to reflect that the advisory panel is not acting in a judicial capacity.[122] Both the taxpayer and the specialist tax officer can be invited to supply additional information. The final decision of the advisory panel regarding whether the tax advantage is to be counteracted, and, if necessary, the steps that need to be taken to counteract the benefit, will be communicated to the taxpayer in writing. It is expected that when any member of the GAAR advisory panel considers that the tax arrangements are a reasonable course of action, the tax authority will not proceed with counteracting the arrangements; it will only do so when the advisory panel is unanimous.[123]

When the taxpayer disagrees with the final decision of the advisory panel, the matter can be brought to a court or tribunal. Again, the tax authorities will have the burden of proof that the arrangements of the taxpayer are abusive tax arrangements for the purposes of the UK GAAR and that the adjustments made to counteract the tax advantages arising from the said

114. *See* GAAR Guidance, *supra* n. 101. According to the GAAR Guidance, the GAAR applies to income tax, corporation tax and any amount treated as corporate tax, capital gains tax, petroleum revenue tax, inheritance tax, stamp duty land tax and annual tax on enveloped dwellings.
115. However, it must be noted that the GAAR cannot override the tax treaty. The provisions of the tax treaty must still be applied, taking into account any adjustments made under the UK GAAR. In addition, the mere fact that a certain tax arrangement allows an enterprise to benefit from the treaty provisions does not mean that this arrangement also amounts to abuse.
116. The Disclosure of Tax Avoidance Schemes legislation contained in Finance Act 2004 part 7 as amended and supplemented.
117. Sec. 211 (1) FA.
118. Sec. 43 FA.
119. Id. This period can be extended on request.
120. Id.
121. Id.
122. *See* GAAR Guidance, *supra* n. 101, at C6.5.11.
123. Id. However, since the GAAR advisory panel does not exercise a judicial role, the UK tax authorities also remain free to proceed with counteracting the arrangements when they disagree with the final decision of the advisory panel.

arrangements are just and reasonable.[124] Another procedural safeguard is that the court must take the GAAR Guidance into account when considering a GAAR case.[125]

3.2.3. Legal consequences

Similar to China, when the tax authority believes that application of the GAAR to a certain arrangement is justified, the tax authorities can make just and reasonable adjustments to counteract the tax advantages that would otherwise arise from the abusive arrangements. This means that the tax authority may impose or increase the taxpayer's tax liability.[126] However, the alternative transaction that should replace the original arrangements should not necessarily be the one that results in the highest tax charge.[127]

3.2.4. Practical application of the UK GAAR: A selection of case examples

There have been no reported GAAR cases before the UK courts at the time this article was written. This section will therefore discuss a selection of case examples described in Part D of the GAAR Guidance.

Barclays Mercantile Business Finance Limited v. Mawson case

The *Barclays Mercantile Business Finance Limited* (hereinafter BMBF) case[128] involved a complicated set of arrangements that the court found to comply with the law and did not regard as abusive. The *BMBF* case involved a set of leasing transactions entered into in 1993. The Barclays Bank leasing subsidiary (i.e. BMBF) had claimed capital allowances in a case where it had purchased a natural gas pipeline. The pipeline was purchased from an Irish company (Company A) to which it was subsequently leased back. Company A, in turn, had subleased the pipeline to its subsidiary (Company S). Company S operated the pipeline and charged fees to Company A that it used to meet the lease rents.

BMBF claimed capital allowances as the actual owner of the equipment under section 24 of the CAA 1990. The tax authorities challenged this claim, arguing that BMBF was not the actual owner of the equipment. In addition, it argued that BMBF did not take any financial risk on the financial lease agreement nor did it provide the lessee with actual finance. Usually, sale and lease-back arrangements are used to raise finance. However, Company A did not actually raise finance from the transaction. Company A had assumed full liability to BMBF to pay the rent under the head lease and had secured its obligations in advance to BMBF with a cash deposit, equal to the amount of the purchase price, to BMBF's parent company, Barclays Bank. This security deposit was indirectly sourced by the purchase price received from BMBF for the natural gas pipeline. BMBF had, in turn, borrowed the purchase price for the pipeline from its parent company, Barclays Bank.[129] Therefore, it could be argued that the purchase price ultimately moved in a circle through Barclays Bank and that the lessee did not actually receive the purchase price.

The GAAR Guidance follows with a GAAR analysis of the above facts.[130] It concludes that the substantive results of the arrangements are consistent with the principles and policy objectives of the relevant tax law, as (tax-based) financial leasing has been a long standing practice in the United Kingdom. Section

124. Sec. 211 (1) FA.
125. Sec. 211 (2) FA.
126. Sec. 209 (1) – (6) FA.
127. GAAR Guidance, *supra* n. 101, at B13.3. In many cases, the adjustments on a particular arrangement will be straightforward. For example, when the arrangements are designed to achieve a deductible loss while the economic reality does not reflect that loss, that loss will be ignored for tax purposes.
128. *Barclays Mercantile Business Finance Limited v. Mawson* (2004) UKHL 51, (2005) 1 A.C. 684.
129. The reason Company A entered into these transactions was to allow access to cheaper funding and to obtain a timing benefit, as the financial lease allows it to write off the costs of the equipment for tax purposes before the lease fees would be accrued.
130. GAAR Guidance, *supra* n. 101, at D7.

24 of the CCAA 1990 did not require the owner of the equipment to also be the economic owner of the equipment or to take any credit risk or to provide actual finance to the lessee. Also, the tax results did not involve contrived or abnormal steps since the transactions were in line with common financial lease standards. Furthermore, the arrangements do not intend to exploit shortcomings in the relevant tax provisions, since there are no specific provisions on financial leasing. Finally, there were no other indicators of abusiveness in the sense of section 207 (4) of the FA, also because BMBF's income was ultimately brought into account for tax purposes. It can therefore be concluded that the leasing transactions were a reasonable course of action under the UK GAAR.

***Blumenthal v. HMRC* case**

Blumenthal v. HMRC[131] involved a reorganization of share capital in which a taxpayer exchanged his shares in a company for loan notes classed as non-qualifying corporate bonds (hereinafter NQCB), which he would later convert into qualifying corporate bonds (hereinafter QCB). Under the UK tax law, any capital gain present in these shares is rolled over to the new NQCB. However, when the NQCB is converted into a QCB, this transaction is exempt from capital gains tax under UK law. Under the scheme, the conversion would only take place after the market value of the corporate bonds was artificially and temporarily decreased to create a loss. This was achieved by a deed of variation, which provided that the issuer could redeem the loan notes at 3% of their par value within a month if they were held by a person other than the original holder. However, the original note holder could still redeem them at par value. It was therefore argued that since any potential buyer of the loan note would risk the loan notes being redeemed at 3% of par, their actual market value would also be 3% of par value. The "passed" capital gain from the shares was then calculated with reference to this low market value, creating a loss for tax purposes.

According to the GAAR Guidance, the substantive results of the arrangements are inconsistent with the principles and policy objectives of the relevant tax law. The UK legislator intended that the gain or loss inherent in the original shares be "frozen" until the gain or loss is eventually realized when the QCB is redeemed or sold. In addition, some of the transaction steps are of a contrived or abnormal nature, given the (artificial) temporary reduction in value of the loan notes. Furthermore, the arrangements are solely in place for tax purposes with the aim being to generate a tax loss by exploiting shortcomings in the relevant tax provisions, specifically the calculation of the "passed" over capital gain. Finally, there are indicators of abusiveness in the sense of section 207 (4) of the FA. By redeeming the QCB, an economic gain is realized on the original shares, yet the taxpayer claims a loss for tax purposes. It can therefore be concluded that it cannot reasonably be argued that the transactions were a reasonable course of action under the UK GAAR.

4. The Chinese GAAR: A Legal and Operational Comparison

The second part of this article focuses on implementing the comparative-functional analysis of the Chinese GAAR. It will first provide a legal comparison, after which there will be an operational comparison of the Chinese GAAR. Each part will give a short introduction in which the criteria are explained for the comparison to follow.

4.1. The Chinese GAAR: A legal comparison

As mentioned in the introduction of this article, analysis on a legal level focuses on comparing the legal elements of the GAARs with the purpose of boiling down essential features in their design and pointing out any differences. Since there are inevitable differences in the language used, the legal comparison will not specifically focus on the (differences in) linguistics of the domestic GAARs, but instead on comparing their legal elements.

131. *Blumenthal v. HMRC* (2012) UKFTT 497.

As the previous discussions have shown, all GAARs – whether statutory or case law based – share several common characteristics. Essentially, the GAARs share the following primary features: all GAARs use a broad description of relevant transactions, consider the tax advantage achieved by the arrangements and have developed some form of purpose test. Secondly, the GAARs have incorporated a secondary test to distinguish between acceptable tax avoidance and unacceptable tax avoidance. However, the manner in which these common elements are given shape differs. This research identifies the manner in which the Chinese GAAR's purpose test is given shape, as well as its strong focus on the substance-over-form doctrine, as the main differences between the Chinese GAAR and the Netherlands GAAR and UK GAAR.

4.1.1. Determining the threshold: The Chinese GAAR's unclear purpose test

The purpose test is the first significant step when applying the GAAR to a particular arrangement. The Chinese GAAR defines tax avoidance arrangements as "arrangements of which the sole purpose or main purpose is to obtain a tax advantage."[132] The UK GAAR describes tax arrangements as "arrangements of which it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes,"[133] while the Netherlands GAAR speaks of "arrangements of which the primary motive, or by far the most important motive of the taxpayer, is to prevent the levying of Netherlands taxes."[134]

Although at first glance the UK and Netherlands purpose test may appear to be subjective in nature, both purpose tests are, in fact, rather objective. Since it is impossible to obtain evidence of the taxpayer's state of mind when conducting the tax avoidance arrangements, the subjective intentions of the taxpayer are not of importance. The purpose of the arrangements needs to be derived from an objective evaluation of all the relevant facts and circumstances.[135] According to the United Kingdom's GAAR Guidance, for example, the main purpose of the arrangement is to obtain a tax advantage when the arrangement would not have been carried out were it not for the opportunity to obtain a tax advantage or where any non-fiscal motive was clearly secondary to obtaining a tax advantage.[136] To determine whether one of the main purposes of the arrangement has been to obtain a tax advantage, it must be established whether the arrangements which would otherwise have occurred have been reshaped in an obvious and contrived way in order to significantly change the tax results, and if the tax result itself is a substantial objective of the arrangements.[137] The guidance of the Netherlands Supreme Court on whether the primary motive, or by far the most important motive, of the arrangements has been to prevent the levying of Netherlands taxes has been given shape in a number of (similar) objective indications. These include the artificiality of the arrangements and whether or not the arrangements would lead to a negative commercial result if the tax advantage is not taken into account. On the other hand, the Netherlands GAAR will not apply when the decisive reason or the most important reason underlying the arrangement is

132. *See* sec. 2.3., p. 7.
133. *See* sec. 3.2.1., p. 25.
134. *See* sec. 3.1.1., p. 18.
135. In practice, it will be hard to imagine that after an objective evaluation of all the relevant facts and circumstances, the obtaining of a tax advantage appears to be one of the main purposes of the arrangement, while subjectively, the taxpayer did not, in fact, have such an aim.
136. GAAR Guidance, *supra* n. 101, at C3.5.
137. GAAR Guidance, *supra* n. 101, at C3.6.

of a non-tax nature.[138] Similarly, the UK GAAR will not apply if only commercial purposes underlie the arrangements of the taxpayer. Hence, without providing a clear definition, both the Netherlands and UK GAAR provided taxpayers with some important guidance on the purpose test so that taxpayers can (to some extent) assess and avoid the consequences of GAAR application.

In contrast, the question on how the "sole purpose" or "main purpose" of an arrangement can be identified as a tax purpose has been left completely unanswered by the CCITL and CITLIR.[139] Also, Circular 2 and the 2015 GAAR Measures did not elaborate on these definitions. Rather than elaborating on what makes the sole or main purpose of an arrangement fiscally orientated, the SAT regulation only elaborates on its focus on the economic substance of arrangements to identify their abusiveness.[140] Even less clear is whether non-tax motives, or "business purposes," can save a particular transaction or arrangement from GAAR application. In various published case examples, possible economic purposes for a given arrangement, such as using an SPV for introducing co-investors, group financing purposes and ring-fence liability were regarded as less important by the Chinese tax authorities.[141]

4.1.2. The Chinese GAAR's strong emphasis on substance-over-form: A critique

To distinguish between what can be considered acceptable tax avoidance and unacceptable tax avoidance, most GAARs have incorporated an additional requirement next to the purpose test. The Netherlands GAAR requires the actions of the taxpayer to also be contrary to the intent and purpose of the law to determine the abusiveness of the arrangements, while the UK GAAR uses a "double reasonableness test" that operates more or less to the same effect. The Chinese GAAR assessment, on the other hand, focuses strongly on the "economic substance" of arrangements.

In essence, the substance-over-form doctrine tries to apply the tax law to match the real transactions of the taxpayer. More specifically, the "substance test" tests whether the transaction, apart from its tax consequences, had economic reality.[142] The substance-over-form doctrine therefore goes beyond the plain text of the statutes, permitting to ignore the legal text of the tax law on the basis of economic principles.[143] The substance-over-form approach brings up a few questions: How should the taxpayers' "real transaction" be determined? Does the real transaction refer to its economic consequences? Or are other characteristics also of importance? How should the real transaction of the taxpayer be distinguished from its legal form?

138. *See* sec. 3.1.1.

139. G. Zhao, *Ying jian guoji jingyan jianshe woguo "yibin fan bishui" zhidu* (借鉴国际经验建设我国"一般反避税"制度) (Establishing China's General Anti-Avoidance Rule by Referring to International Experiences) International Taxation in China (2013) 10 available at www.cnki.net.

140. *See* the SAT Q&A notes, *supra* n. 28. According to the GAAR's Q&A notes, the purpose test calls for "a comprehensive consideration based on the specific facts of each individual case with a key focus on evaluating the economic substance of such an arrangement."

141. KPMG, *Guidance on Chinese General Anti-avoidance Rule Published for Public Comment* (2014) 19 available at www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/ChinaAlerts/Documents/China-tax-alert-1407-19-Guidance-on-Chinese-GeneralAnti-Avoidance-Rule.pdf.

142. L. Lederman, *W(h)ither Economic Substance?* (2010), 95 Iowa Law Review p. 435 available at SSRN: http://ssrn.com/abstract=1345388.

143. A. D. Madison, *The Tension Between Textualism and Substance-Over-Form Doctrines in Tax Law* (2003), 43 Santa Clara Law Review 701.

There are no real answers to these questions. There are many approaches available to determine the real transaction, all of which have their own difficulties and particularities.[144] Notwithstanding these different approaches to determine the "real transaction" (and their issues), in GAAR practice, the real transaction or economic reality usually refers to the conclusion that the economic consequences of a particular arrangement determine the outcome in a potential GAAR case.[145] However, even when assuming that the substance-over-form doctrine refers to the belief that economic consequences have priority over the legal form of the arrangements, there are still grounds for criticism.[146] Under normal circumstances, taxation depends on the legal form of the transaction and not on its economic consequences.[147] Even when applying the substance-over-form doctrine, whether the arrangement of the taxpayer should be taxed according to its legal form or its economic consequences still depends partly on the correct interpretation of the underlying tax provisions and partly on the circumstances of the case. The case examples of the United Kingdom and the Netherlands discussed earlier in this article illustrate that economic outcomes will only sometimes trump legal forms, while at other times they will not. Hence, the principle does not prescribe how the conflict between form and reality should be resolved.

Given these grounds, the Netherlands and UK GAAR, in contrast to the Chinese GAAR, do not largely focus on "substance-over-form" but consider the abusiveness of an arrangement in a matter in which economic substance *may* be relevant.[148] The economic reality of a transaction can only be one indication of its abusiveness. Neither the legal form of the arrangements nor their economic reality holds the answer in an individual case.[149] Beyond the conclusion that economic reality should be accorded considerable weight in the GAAR assessment, the substance-over-form principle in itself does not offer any direction for solving individual cases.

The problems of the substance-over-form doctrine are clearly reflected in the Chinese GAAR. Although the SAT has stressed that Chinese taxpayers' activities are tested by reference to inconsistencies between the legal form of the arrangements and the economic substance of the arrangements, the current legal framework does not offer any prescription as to how the conflict between the legal form and economic reality of the transaction should be resolved, i.e. how to distinguish the real transaction of the taxpayer from its legal form. Circular 2 refers to the "form and substance of the arrangements" and the "economic and tax consequences" of the arrangements as factors that should be considered without going into detail. Also, Notice 7, although it provided a list of specific factors that need to be

144. Id. pp. 435-437. E.g. the economic reality can be determined by an objective evaluation of the change in the taxpayer's economic position or by an objective evaluation of the change in the taxpayer's economic position while *also* considering the benefit to the taxpayer. A third approach is to determine the economic reality of the transaction by an objective evaluation of the taxpayer's reasonably expected profits. However, the issue with all of these approaches is that they can be manipulated, as they test for hypothesized transactions and outcomes.
145. B. Banoun, *Tax Avoidance Rules in Scandinavian and Anglo-American Law*, 56 Bull. Intl. Taxn. 8 (2002), pp. 485-492, Journals IBFD.
146. Id.
147. Madison, *supra* n. 143.
148. Moreover, in both the Netherlands and the UK GAAR assessments, economic substance will not be of relevance if the underlying purpose of the avoided tax provision was not to tax based on economic substance.
149. P. Samtani and J. Kutyan, *GAAR Revisited: From Instinctive Reaction to Intellectual Rigour* (2014) 62 (2) Canadian Tax Journal p. 420 and Banoun, *supra* n. 145.

considered when reviewing indirect transfers of taxable Chinese assets, it did not give additional guidance on this matter. Notice 7 arguably added to the uncertainty. Confusingly, the factors mentioned in article 3 of Notice 7 seem to be relevant for both the purpose test and the substance test. For example, the references to the overseas tax implications and the time examination of the organizational structure seem to be related to the purpose test, while the first two factors seem to be in place only to determine the transaction's relation to China. Furthermore, Notice 7 raises questions regarding the application of these factors, in particular the weight the tax authorities will give to these factors relative to the substance of the arrangement. Although the SAT GAAR Q&A notes that the tax authority's key focus will be on evaluating the economic substance, only the third factor mentioned in article 3 of Notice 7 focuses on the real business activities of the transferee.[150] It seems reasonable to assume that all factors will be collectively considered and that no factor is of conclusive importance. Since the tax authorities do not look at the "substance" factor in absolute terms, but also in relative terms, Circular 2 and Notice 7 are not clear on what is deemed as sufficient substance in a particular case.

Given the apparent issues of using the substance-over-form doctrine as a standalone to determine the abusiveness of arrangements, and its undefined meaning in the Chinese Implementation Rules, the SAT has given taxpayers little guidance to determine their tax position under the Chinese GAAR.

4.2. The application of the Chinese GAAR: An operational comparison

Although the legal comparison reveals some key differences between the GAARs, they are overall quite similar. The greatest divergence between the Chinese GAAR and the GAARs of the comparators can be found in their procedural frameworks and overall functioning. This part will subsequently discuss the way in which the GAARs are given meaning and effect, their application and the avoidance issues they address, as well as their procedural frameworks. Since the functioning of a GAAR is the result of "tax-law in action,"[151] this section will give special attention to the institutional and cultural reasons behind any differences encountered.

4.2.1. The role of the SAT and its influence on taxpayer interactions

The application of the GAAR in China, the Netherlands and the United Kingdom differs greatly in regard to how the GAAR is given meaning and effect. In both the Netherlands and the United Kingdom, the application of the GAAR involves the tax authorities and the judiciary. The tax authorities will first invoke the GAAR, but its effectiveness will ultimately depend on the judicial interpretation of the fact pattern. The tax authorities have no formal role in the interpretation of the tax law. When a dispute arises, the tax authorities and the taxpayer will have equal status before the court. The taxpayer will mostly not agree to GAAR application, leaving the matter in the hands of the courts, who, in turn, will not always judge in favour of the tax authorities. This requires the tax authorities to make a very balanced assessment of the success of a potential GAAR investigation. As a result, the effective scope of the application of the Netherlands and UK GAARs is narrower in practice than on paper.

150. *See* the SAT Q&A notes accompanying the 2015 GAAR Measures, *supra* n. 28.
151. Garbarino, *supra* n. 9.

In China, the opposite is likely true. The Chinese GAAR begins and ends with the SAT.[152] The ultimate effectiveness of the GAAR does not depend on judicial interpretation. China has no case law tradition and the judicial mechanism inhibits independence of the judges.[153] The power to interpret tax provisions has been predominantly exercised by the SAT, whereas the legislature and judiciary play very limited roles.[154] Although the SCNPC has the sole power to interpret tax laws, it has published very few interpretations on the tax law and has delegated its law-making powers to the State Council and the SAT.[155] The reasons for the strong position of administrative organs in the development of Chinese tax law date back to the 1980s when the Chinese government was building a legal system from the ground up. Given this daunting task and the limited competence of the legislature, the NPC was forced to delegate part of it legislative powers to fill up the legal void in order to match the changing policies at the time.[156] Since the NPC and the SCNPC have been largely absent from tax legislative work, the development of Chinese tax law is dominated by administrative organs rather than by the legislature. In practice, however, given the limited participation of the State Council, the SAT enjoys a near monopoly status in legislating and interpreting the tax law and its interpretations have a *de facto* legislative nature.

In addition, the highly centralized powers of the SAT can be explained by China's cultural heritage. In Confucian tradition, civilians shall be unconditionally submissive to their governors. In turn, the governors, taking on multiple roles, will take good care of the civilians.[157] The SAT, in their role as "tax governors," take on the role of judge, tax administrator and law-maker in order to both administer and protect the taxpayers. The tax officials should be respected and are entrusted with great discretionary powers since a failure to fulfil their obligations towards the taxpayer would lead to a moral accusation.[158] Hence, it is "mutual obligations" rather than the western notion of "rights" that define the relationship between the taxpayer and the tax authority.

One implication of all of this is that there is relatively little independent interpretation of tax law by Chinese taxpayers. In the United Kingdom and the Netherlands, taxpayers have traditionally used a variety of tools to interpret the tax law in unfamiliar situations, such as the legislative history and parliamentary discussions, official publications and scholarly writing. Also, judicial decisions form an important tool in legal interpretation. In China, judicial decisions are very rare in the field of tax law and there are few other tools available to assist taxpayers with interpreting unclear rules.[159] In the absence of legislative and scholarly guidance, the closely interwoven interpretative work of the SAT with its legislative powers and

152. J. Li, *Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian* GAAR (2010) 11 (2) Theoretical Inquiries in Law.
153. J. Weidong, *The Judicial Reform in China: The Status Quo and Future Directions* (2013), 20 (1) Indiana Journal of Global Legal Studies 189 and Qiu, *supra* n. 20, p. 654.
154. D. Qiu, *Interpretation of Tax Law in China: Moving Towards the Rule of Law?* (2014), 44 (2) Hong Kong Law Journal available at http://ssrn.com/abstract=2487911.
155. Arts. 89 and 90 Chinese Constitution.
156. Qiu, *supra* n. 154, p. 6.
157. M. Zhang, *The Socialist Legal System with Chinese Characteristics: China's Discourse for the Rule of Law and a Bitter Experience* (2010), 24 Temple International & Comparative Law Journal.
158. By extension, aggressive tax planning is perceived as defying the authority of the tax law and the tax authorities.
159. W. Cui, *Two Paths for Developing Anti-Avoidance Rules in China*, 17 Asia- Pac. Tax Bull. 1 (2011), Journals IBFD, available at http://ssrn.com/abstract=1962157.

the influence of Chinese cultural heritage, Chinese taxpayers choose extensive interaction with the tax authorities over the more presupposing independent interpretation of the law as seen in the United Kingdom and the Netherlands.[160] As will be discussed in more detail in the next paragraph, this mode of operation has created an uneven playing field between the taxpayers and tax authorities in which the tax authorities may require taxpayers to follow a state preferred interpretation of the tax law, or even impose an interpretation of the law on the taxpayers that goes beyond what is implied by the tax law.

4.2.2. Application of the Chinese GAAR

All jurisdictions discussed in this article consider certain types of tax avoidance arrangements to be unacceptable. However, the motivations for applying the GAAR are different. The main target of the Chinese GAAR is cross-border transactions.[161] The case examples discussed earlier illustrate that in overseas indirect equity transfers, the use of tax havens and cases involving treaty shopping are the main concerns for the Chinese tax authorities. Specifically, indirect transfers through holding companies located in jurisdictions that have concluded tax treaties with China, but have no substantial economic activities, are perceived to be most harmful to the Chinese tax base and are actively targeted by the GAAR. The general perception in China seems to be that only multinational companies are engaged in aggressive tax planning to avoid Chinese taxes.[162] This focus on cross-border transactions by international enterprises is further illustrated by the fact that the Chinese GAAR currently only applies to enterprises and not to individuals.[163] In contrast, the Netherlands GAAR and the UK GAAR are far more "generally" applied and do not target specific entities or transactions. The Netherlands case law discussed earlier illustrates that creating artificial debts and interest deductions with no real commercial purpose were of the biggest concern for the Netherlands judiciary and legislator.[164] Nevertheless, as we have seen in *HR 15 March 2013, no. 11/05609, BNB 2013/151*, *fraus legis* is not limited to enterprises but applies equally to companies and individuals. Similarly, there is no clear line, or "typical" GAAR case to be discovered in the pre-GAAR UK case law and the discussion of "GAAR cases" in the UK GAAR Guidance. Also, the UK GAAR applies equally to companies and individuals.

The lack of a universal anti-avoidance rule that applies equally to both companies and individuals has led to an interesting conflict between the Chinese tax law and the SAT's practice, and has created a difference in the tax treatment of non-resident individuals and enterprises.[165] An example of this conflict can be seen in the *Shenzhen* case.[166] Furthermore, the case illustrates the problems that arise from the high centralization of power and the lack of external checks on the SAT in the application of the Chinese GAAR. For the purposes of clarity, please refer to section 2.6. for a short summary of the case facts.

160. Vanistendael, *supra* n. 10.
161. Li, *supra* n. 152.
162. K.B. Brown, *A Comparative Look at Regulation of Corporate Tax Avoidance* (Springer Science & Business Media 2012) at 111.
163. *See* art. 47 CCITL. The CIITL does not contain an anti-avoidance rule.
164. *See* sec. 3.3.4.
165. Pu, *supra* n. 61.
166. *See supra* n. 60.

The *Shenzhen* case was a surprising decision since, in absence of a GAAR in the CIITL, the SAT found that the share transfer included the assets of the underlying company. The first question to be answered when analysing this case is whether the CIITL provides for a legal basis to impose individual income tax on a cross-border indirect sale of shares. According to the rules of the CIITL, China can exercise source jurisdiction over non-resident individuals, even when the place of payment is outside of China, when the source of income is derived from sources inside China.[167] In the case of a transfer of immovable property, the place where the immovable property is located is identified as the source of income. The source of income of movable property, on the other hand, is the place where the transfer is carried out. Thus, whether China can exercise tax jurisdiction on any capital gains realized on a share transfer of a Hong Kong individual depends on whether the share transfer takes place within China. The SAT recognized that this was not the case and confirmed that the rules of article 47 of the CCITL did not apply. Therefore, it seems that the indirect transfer issue did not come into consideration.

The SAT, however, exercised jurisdiction based on the fact that the share transfer of the Hong Kong holding company included the transfer of the assets of the Shenzhen company. At the time of the *Shenzhen* case, it was unclear how the SAT reached this conclusion, since Circular 698 only covered share transfers. In addition, the subject of a share transfer generally only includes the shares of a company, and not the underlying assets of the company or any of its subsidiaries. The promulgation of Notice 7 has shed some light on the SAT's reasoning. Notice 7 has expanded the subject of indirect transfers to include both equity interests in Chinese resident companies and real properties located in China. However, since Notice 7 only applies to the indirect transfers of taxable Chinese assets by non-resident enterprises, and not individuals, the Notice did not correct the flaws in the SAT's reasoning in this particular case. The current rules of the CIITL provide no legal basis for China to exercise tax jurisdiction on the capital gains of non-resident individuals from an indirect cross-border transfer of shares or assets. Furthermore, the CIITL does not contain an anti-avoidance rule on the basis of which an indirect transfer of shares could, in substance, be viewed as a direct transfer of Chinese immovable assets.[168]

Another example of this conflict can be found in the *Fujian* case, a summary of which is located in section 2.6.[169]

Similar to the *Shenzhen* case, it is not clear how the Fujian tax authorities came to this conclusion. One possible explanation is that the tax authorities invoked the revised China-Hong Kong tax treaty.[170] According to article 13 of the China-Hong Kong tax treaty, China can exercise jurisdiction on capital gains derived from the sale of equity interests if the recipient of the gain, directly or indirectly, held at least a 25% equity interest in a Chinese company in the 12 months before the transfer of the equity interest. The crux here is the interpretation of "recipient of the gain," which refers to the transferring party receiving the income. Hence, in this case, the recipient of the gain was Hong Kong Holdco A and not the Hong

167. *See* art. 1 (2) CIITL and art. 5 of its Implementation Regulations.
168. In contrast, if the transferor had been a Hong Kong resident company instead of an individual, China could have exercised jurisdiction on the basis of art. 3 CCITL and art. 7 CITLIR, which determines that transfers of shares by non-resident companies are subject to corporate income tax.
169. *See supra* n. 57.
170. Silvani, *supra* n. 21, p. 28.

Kong individual. It appears that the Chinese tax authorities read "beneficial owner" instead of "recipient of the gains."[171] Therefore, the equity interest in the Chinese company was calculated through the Hong Kong individual and not through Hong Kong Holdco A. This is a deviation from the text of the revised China-Hong Kong treaty, which does not speak of "beneficial owner" in the context of capital gains. Another explanation is that the tax authorities applied the GAAR of article 47 of the CCITL. However, it must be concluded again that the GAAR should not be extended to individuals, since article 47 only applies to enterprises.

The *Shenzhen* and *Fujian* cases illustrate that the lack of a universal anti-avoidance rule did not constitute a major hurdle for the Chinese tax authorities to exercise tax jurisdiction in these cases. The resulting difference in the tax treatment of non-resident individuals and enterprises has created a degree of uncertainty for foreign individual investors in China, even though in practice, individuals may still be subject to Chinese taxation. In addition, the cases exhibit the problems that arise from the high centralization of power at the SAT and the lack of effective checks. Since the SAT enjoys an effective monopoly to legislate, implement and interpret the GAAR, and because of an ineffective dispute resolution system (as will be discussed in section 4.2.3.), the relationship between the taxpayers and the tax authorities is defined by extensive interactions and does not overly rely on legal argumentation or use of litigation.[172] Since extensive interaction with the tax authorities is the norm in daily Chinese tax compliance, prevention of tax avoidance has become a matter of negotiation rather than of law enforcement. Under these circumstances, taxpayers exert a relatively high level of tolerance and are willing to except the *ultra vires* interpretation as seen in the *Fujian* and *Shenzhen* cases. Thus, even though there seems to be no legal basis for the tax authority to exercise jurisdiction, in both cases the taxpayers eventually settled with the tax authorities.[173]

4.2.3. Disputes upon GAAR application: Lack of effective remedies

As mentioned earlier, in the Netherlands and the United Kingdom, the application of the GAAR is greatly influenced by the approaches and interpretation of the courts, who act as a balancing mechanism between the arbitrary exercise of state power and the protection of the taxpayers' rights. In these countries, the application of the GAAR is a dynamic process that usually starts with the introduction of a tax provision that taxpayers will subsequently apply or interpret in a manner that minimizes their tax liability. The tax authorities on the other hand will often challenge the beneficial interpretation of the taxpayer and bring the fact pattern before a judge, who may sometimes rule in favour of the taxpayer. In these jurisdictions, the courts' decisions not only reflect the judicial attitude towards tax avoidance, but also influence the nature of the GAAR itself.

In China, the influence of the judiciary on the (application of) the GAAR is limited. When a Chinese taxpayer disagrees with the assessments made by the tax authorities, he can appeal to the higher ranking tax authority for administrative review. Alternatively, he may appeal

171. Qiu, *supra* n. 57, p. 620.
172. J. Li, *Dare You Sue the Tax Collector? An Empirical Study of Administrative Lawsuits Against Tax Agencies in China* (2013) 23 (1) Pacific Rim Law & Policy Journal pp. 12-14 available at http://ssrn.com/abstract=2256021.
173. Qiu, *supra* n. 57, p. 619. Although there appears to be no legal basis for the decision of the tax authorities, the Hong Kong individual of the Shenzhen case eventually settled to pay a tax liability of CNY 13,680,000. The Hong Kong taxpayer in the *Fujian* case eventually settled by paying CNY 379,000,000 to the Fujian tax authorities.

to the Chinese People's Court.[174] However, the decisions of the SAT are rarely appealed. Despite the low litigation costs, in 2011 only 405 cases were filed against the tax authorities, most of them ending in settlement.[175]

There are a number of cultural, legislative and institutional reasons for the lack of judicial influence in the operation of the Chinese GAAR. Firstly, taxpayers are reluctant to initiate proceedings against the tax authorities.[176] There is a strong cultural tradition against government litigation under the impacts of Confucianism.[177] Furthermore, there is a widely-shared understanding that once the taxpayer decides to litigate and obtains a favourable ruling from the court, he will face challenges in enforcing the ruling, since there is only a low risk of punishment for the tax authorities when delaying or refusing to comply with the ruling. In addition, taxpayers may face retaliation by the tax authorities.[178] Local tax officials have a wide discretion in implementing the tax law and disguised retaliation could be very costly for the taxpayer plaintiff. For example, the tax authorities may cause excessive delays in processing any requests by the taxpayer or may overassess profits and revenues. Moreover, taxpayers will first have to go through the process of administrative review *and* pay any overdue taxes or fines before any judicial remedies become available.[179] The combination of these factors thus reduces the probability of a tax dispute arising in the first place.

Secondly, when a taxpayer does decide to initiate proceedings against the tax authority, the taxpayer will find himself at a further disadvantage. Under the existing laws, the court's jurisdiction is restricted to hearing administrative cases that involve the validity of specific administrative misconducts by tax officials, rather than substantive tax issues.[180] In addition, courts normally lack the (financial) strength and independence to impartially adjudicate administrative law suits against the local tax authorities. As a result, the Chinese courts are hesitant to hear tax cases. Judges consider the potential impact of any adverse ruling and will often dodge difficult cases.[181] Finally, China does not have a tradition of special tax courts and judges lack the necessary tax knowledge and expertise. As a result of the lack of tax competency among judges, they will often be inclined to take the opinion of the tax administration as authoritative.[182]

In summary, the potential high costs of retaliation combined with the limited scope of the administrative litigation process, the lack of judicial independence and state favouritism explain the low level of administrative lawsuits filed each year by Chinese taxpayers against the Chinese tax authorities.

174. J. Eichelberger, B. Kelly & A. Ling, *Tax Litigation*, 18 Asia-Pac. Tax Bull. 2 (2012), Journals IBFD.
175. Supreme People's Court, Summary of First Instance Administrative Lawsuits in China (2011) available at http://www.court.gov.cn/qwfb/sfsj/201206/P020120628451878418099.xls.
176. Li, *supra* n. 172.
177. Qiu, *supra* n. 154, p. 13.
178. Eichelberger, Kelly & Ling, *supra* n. 174 and Li, *supra* n. 172, pp. 12-14.
179. Id.
180. Art. 2 Administrative Litigation Law. In general, Chinese tax officials must have clearly violated the law. *See* B. Tran-Nam, *The Chinese and Australian Tax Systems: a Comparative Overview* (2002), Atax Discussion Paper No. 11 available at http://ssrn.com/abstract=623645.
181. Li, *supra* n. 172, p. 13.
182. Zhang, *supra* n. 7 and Qiu, *supra* n. 154, p. 17.

As a result, tax disputes are mostly resolved through either initial negotiations with the taxpayer or through the administrative review process.[183] According to articles 2 and 6 of the Chinese Administrative Review Law, any person, legal person or other organization who considers that their lawful rights and interests have been infringed upon by a specific administrative act may apply for administrative review to an administrative organ.[184] However, there are several obstacles for the administrative review process to serve as an effective remedy for tax disputes. Firstly, the procedure lacks independence. The application for review is referred to the higher-ranking tax authority; thus, the tax dispute will be reviewed within the same system. Since the higher-level tax authorities will have the same objectives and also apply a similar interpretation of the tax rules, it is unlikely that the outcome of such a review will differ much from the original opinion of the local tax authorities. Nevertheless, the SAT has made efforts to make the review process more independent by establishing an administrative review panel.[185] The administrative review panel can participate and advise in difficult review proceedings and consists of sixteen SAT officers and eight external experts. Given the fact that SAT officers are still largely in the majority, the introduction of a limited number of external experts cannot be considered enough to ensure an independent review process.

Another problematic feature of the administrative review process is its application process. Before a taxpayer can apply for administrative review, the taxpayer will firstly have to pay any overdue taxes and fines in advance or meet any other guarantees set by the SAT.[186] Although this was designed to prevent taxpayers from abusing the administrative review process to defer taxes, it inherently presents an obstacle for taxpayers to apply for administrative review.

It can therefore be concluded that neither of the dispute settlement systems is working as effectively as intended. Both the administrative review procedure and the administrative litigation process face challenges to provide taxpayers with an effective dispute settlement mechanism in GAAR controversies.

5. Improving the Chinese GAAR: Finding a Balance

Legal and operational analysis suggests that the Chinese GAAR is not working as effectively (nor is it as balanced) as could be the case. This section explores some possible reforms from a legislative and administrative perspective that may lead to a more balanced application of the Chinese GAAR. For reasons that are to be discussed later in section 5.3., this article does not propose reforms on a judicial level.

5.1. Legislative improvements

Despite its current shortcomings, the current legal framework provides a relatively adequate platform to apply the GAAR. In recent years, the SAT has made efforts to provide a

183. Eichelberger, Kelly & Ling, *supra* n. 174 and K. Holmes, *The People's Republic of China: A Comparative Look at Regulation of Corporate Tax Avoidance*, Springer Netherlands (2012), pp. 105-122.
184. *Zhonghua Renmin Gongheguo Xingzheng Fuyi Fa* (中华人民共和国行政复议法) (Administrative Review Law of the People's Republic of China) (promulgated by the 9th Session of the 9th National People's Congress, 29 Apr. 1999, revised and amended on 27 Aug. 2009). Available in English at http://en.pkulaw.cn/display.aspx?cgid=167114&lib=law.
185. *Shuiwu Xingzheng Fuyi Guize* (税务行政复议规则) (Rules for Tax Administrative Review) *Guoshuifa* (国税法) (2010) No. 21 Order. Available in English at http://en.pkulaw.cn/display.aspx?cgid=127354&lib=law.
186. *See supra* n. 29, art. 88.

clearer description of the GAARs application requirements, its legal consequences and its administrative framework. However, the previous discussions have shown that the work on its overall legal framework is still unfinished. To ensure a more responsible and balanced application of the Chinese GAAR, and to ensure that the interests of the taxpayer are better protected, this article favours additional guidance in regard to the "purpose test" and the "substance test." In addition, this section calls for a universal and integrated GAAR to ensure its application in a legal and uniform manner.

5.1.1. Additional guidance on the purpose test

From the perspective of the taxpayer, the case for a clear purpose test is easily made. Clear definitions will provide certainty for the taxpayer and will more clearly define the relationship between the taxpayers' rights and the interests of the tax authorities. The tax authorities, on the other hand, will prefer a more flexibly operating GAAR to effectively tackle current and future avoidance schemes. This is especially true within the Chinese context, where the tax authorities traditionally enjoy wide discretion.

One argument in favour of a clearly defined purpose test is that application of a GAAR to a particular arrangement is in clear breach of the principle of legal certainty, since it sets aside the formal application of the law and replaces or ignores the actual fact pattern for tax purposes.[187] From the perspective of legal certainty, it is therefore important that taxpayers can assess and avoid the (severe) consequences of the GAAR's application to some extent. In addition, local tax authorities should not be able to use broad and ambiguous wording to stretch the purpose test in order to treat a very wide range of arrangements as tax avoidance arrangements. On the other hand, however, GAARs are by nature broad and generally defined since they are intended to operate on a general basis. In addition, a GAAR can never be expected to give absolute certainty to taxpayers on the tax consequences of their transactions.[188] Thus, a balance must be found.

Regardless of the terms chosen, the purpose test should be flexible while at the same time providing sufficient guidance to taxpayers as to when the tax-saving aspects (purposes) of a certain transaction reach such a level that they will potentially trigger the GAAR (i.e. the threshold). The question may then be asked as to what constitutes an adequate description of the threshold. Reference to the "sole purpose" and "main purpose" of the arrangements only represents one side of the coin; such references make it clear that both tax purposes and non-tax purposes are relevant for the purpose test. Since transactions will combine tax purposes and non-tax purposes in varying degrees, the purpose test requires a balance of these purposes that must be weighted according to their relevance to determine the dominant purpose of a particular arrangement.[189] The biggest challenge, of course, lies in identifying and weighing tax purposes and non-tax purposes, especially considering that transactions have a multitude of purposes. With regard to the contents and weight of these "non-tax purposes," substantive commercial purposes usually carry greater weight than formal corporate law purposes in the

187. R. Prebble and J. Prebble, *Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law - A Comparative Study* (2010), 55 Louis ULJ 21.
188. C. Atkinson, *General Anti-avoidance Rules: Exploring the Balance Between the Taxpayer's need for Certainty and the Government's Need to Prevent Tax Avoidance*, (2012) 14 J. Austl. Tax'n 9-11.
189. Rosenblatt, *supra* n. 4, p. 72.

Netherlands and the United Kingdom. Also, artificial and abnormal arrangements will be more easily covered by their respective GAARs.

Even with these indications in place, it will not be possible to provide a clear description of the threshold.[190] This is neither necessary nor appropriate. The Netherlands and UK anti-avoidance rules do not clearly define their purpose tests, but have provided criteria for balancing the different purposes behind transactions in order to protect arrangements where a tax advantage is only ancillary. Without giving strict definitions, both the Netherlands and UK GAAR have painted the outlines of their respective purpose tests.

Future amendments to the Chinese GAAR should also provide relevant indications for the outcome of the purpose test, including the recognition that non-tax purposes are indeed relevant for the purpose test. In that way, the interests of the taxpayer are better protected, while the fact that they are merely relevant indications ensures that the GAAR remains flexible. A future amendment could, for example, provide that an indication of the main purpose of an arrangement being to obtain a tax advantage is that the arrangement would not have been carried out at all were it not for the opportunity to obtain a tax advantage or when non-tax motives would have clearly been secondary motives. Another indication that obtaining a tax advantage would have been the main purpose of the arrangement would be that the arrangements consist of artificial and atypical transactions.

5.1.2. Substance-over-form and other factors

The previous section explained that beyond the indication that economic substance considerations should be accorded considerable weight in a comprehensive factual GAAR investigation, the substance-over-form principle by itself does not offer any solutions to individual cases. As illustrated by the Chinese GAAR, the strong focus on the economic reality of the arrangements creates an impression that the interpretation is simple and automatic, even when this is not the case. Therefore, this section calls for an additional list of illustrative (non-exhaustive) indicia that are typical for Chinese avoidance arrangements, such as whether the arrangements involve one or more contrived steps, the accommodation of third parties or round trip financing.

5.1.3. The case for a universal and integrated Chinese GAAR

In practice, the Chinese GAAR is almost entirely governed by administrative regulations.[191] It is an unwritten rule of Chinese tax policy meaning that matters of tax policy left open by the NPC and State Council are to be further defined and implemented by the SAT.[192] In the context of the Chinese GAAR, the SAT has made extensive use of this authority. However, pursuant to the Chinese Legislation Law,[193] not only should the levying of taxes be regulated by national (primary) law but also only State Council regulations and ministerial regulations

190. J. Cassidy, *The Holy Grail: The search for the optimal GAAR*, (2009) 126 (4) South African Law Journal p. 775.
191. *See* sec. 2.3.
192. Nevertheless, this unwritten rule has been implicitly acknowledged in numerous regulations. For example, art. 20 CCITL, which states that: "the specific scope and criteria and deductions are to be determined by the SAT." Also, the CITLIR (the Chinese Corporate Income Tax Implementation Regulation of the State Council) has delegated law-making authority to the SAT.
193. *Zhonghua Renmin Gongheguo Lifa Fa* (中华人民共和国立法法) (Legislation Law of the People's Republic of China) (promulgated at the 3th Session of the Ninth National People's Congress, 29 Apr. 2000, amended 15 Mar. 2015) available in English at http://en.pkulaw.cn/display.aspx?cgid=245693&lib=law.

have force of law.[194] Even though they purport to contain generally applicable rules, the SAT circulars and notices are not ministerial regulations and thus lack formal force of law. In addition to their dubious legal position, the administrative regulations of the SAT have gone beyond mere interpretation and have expanded the scope of the original legislation several times, thereby materially affecting the taxpayers' rights and obligations.[195] For example, article 47 of the CCITL only mentions the "lack of a reasonable business purpose" as the main application requirement of the Chinese GAAR, while the administrative regulations of the State Council and the SAT have explained that the lack of a reasonable business purpose is only one element of the GAAR review process.[196] Secondly, according to article 47 of the CCITL, the GAAR only aims to target arrangements without a bona fide commercial purpose that result in a "reduction of the taxable income or revenue." However, according to article 120 of the CITLIR, a reduction of the taxable income or revenue is only one example of a tax advantage.[197] From a legal point of view, it can thus be argued that, even by using broad and general wording, the basic elements of the GAAR, such as its application requirements, the definition of a tax advantage and the legal consequences, should be integrated into article 47 of the CCITL and not into administrative rules and regulations.[198]

To improve the legal authority of the Chinese GAAR, this article therefore suggests that with the incorporation of the amendments proposed in sections 5.1.1. and 5.1.2., article 47 of the CCITL should be translated into a comprehensive and universal anti-avoidance rule that covers both the individual and enterprise income tax, as well as other taxes.[199] A universal Chinese GAAR based on a clear and comprehensive legal framework would solve the current conflict between the law and the SAT's practice, and eliminate the difference in tax treatment between foreign individuals and enterprises, while also ensuring that the GAAR is applied in a legal and uniform manner.

5.2. Administrative improvements

Although legislative reforms will go some way to ensuring a more balanced and consistent application of the Chinese GAAR, such reforms entail the danger of being empty reforms if they are not combined with administrative improvements. As previously discussed, the main hurdle towards implementation of the rule of law in China in the field of tax law is the near monopoly status of the SAT in legislating, interpreting and administering the law.

The divergence between China, the Netherlands and the United Kingdom on this point brings up the question as to whether or not the tax administration has a role in interpreting and legislating the tax law. From a purely legal perspective, the Netherlands and UK tax authorities are only empowered to levy taxes based on the literal wording of the law rather than by means of a more purposive approach. However, also in the Netherlands and in the United Kingdom, the tax authorities effectively play a limited role in interpreting the

194. *See supra* n. 193, arts. 8-11.
195. Qiu, *supra* n. 154.
196. *See* art. 120 CITLIR, Circular 2 and the 2015 GAAR Measures. Next to the "purpose test," there is an "objective test" following the substance-over-form principle.
197. According to art. 120 CITLIR, a "tax advantage" means achieving exemption, reduction or deferral of the payment of taxes.
198. Zhang, *supra* n. 7.
199. Such a universal GAAR could, for example, be included in a future revision of the Law on the Administration of Tax Collection.

tax law. As a result of their enforcement activities, they are the first point of contact for taxpayers engaged in tax avoidance schemes. Similarly to China, the majority of the cases that potentially involve unacceptable tax avoidance do not end up in court since most disputes are resolved through negotiation between the tax authority and the taxpayer. Also, the tax authorities in these jurisdictions have some degree of (extra statutory) law-making capacity.[200] In this context, the comparison between the SAT circulars/notices and the UK GAAR Guidance is an interesting one. As discussed earlier, the Chinese GAAR is currently almost entirely governed by informal documents known as "circulars" or "notices." Despite their dubious legal position, the SAT circulars and notices are intended to have a legislative nature and not merely an interpretative nature, and are also applied as such.[201] Although not as extreme as in the Chinese case, generally applicable rules that do not have full force of law are also found in other tax systems. The UK GAAR Guidance, for example, has a higher status than other extra-statutory HMRC guidance.[202] It was drafted by HMRC but has been approved by the GAAR advisory panel and any court or tribunal *must* take it into consideration when reviewing the possible application of the GAAR.[203] In this way, the UK GAAR has also given some discretionary powers to HMRC. However, the UK GAAR Guidance differs from the SAT's circulars/notices in the fact that the GAAR Guidance does not have a legislative nature and does not contain substantive tax rules. Despite its higher status, it is intended to function as an aid to the (uniform) interpretation and application of the UK GAAR.[204]

The real question, therefore, is not if the tax administration has a role in interpreting and legislating the tax law, but how far the powers of the tax administration to interpret and legislate the tax law should reach. Some authors have argued that the increasing technical complexity of the arrangements involved, the continuous ingenuity of taxpayers and the existence of loopholes in the tax law demand a more active role on the part of the tax authorities in the operation of the GAAR.[205] It is not always possible in China to provide timely and effective remedies against tax avoidance activities due to the slow and cumbersome nature of its legislative process. Under these circumstances, they argue that it may be justifiable for the Chinese SAT to carry out a more purposive role in applying the GAAR to counter (new) tax avoidance arrangements.

Although a more discretionary application of the GAAR seems appropriate in China, safeguards should be in place against misuse. Fuelled by the ambiguous wording of the law, in practice, the SAT has often taken a rather simplistic approach to equate the application of the GAAR with the fact that a taxpayer derives a tax advantage, without considering whether the main purpose of his arrangements is a tax purpose or just tax related.[206] The new GAAR approval process implemented by the 2015 GAAR Measures, which demands any GAAR investigation and according adjustment to be approved by the central office of the SAT, goes

200. *See* the UK GAAR Guidance. In the Netherlands, the tax authorities are empowered to issue policy resolutions.
201. W. Cui, *What is the 'Law' in Chinese Tax Administration?*, (2011) 19 (1) Asia Pacific Law Review p. 90. available at http://ssrn.com/abstract=1687781. According to Cui, the prevalent belief among tax practitioners in China is that the SAT circulars and notices "are the law."
202. J.C. Leblanc-Leduc, *Radical Proposals for a General anti-Abuse Rule in the UK*, (2012) 23 Int'l Tax Rev. 36.
203. GAAR Guidance, *supra* n. 101, at para. A4.
204. *See* sec. 211 (2) FA and GAAR Guidance, *supra* n. 101, at para. A4.
205. W. Xiong & C. Evans, *Towards an Improved Design of the Chinese General Anti-Avoidance Rule: A Comparative Analysis*, 68 Bull. Intl. Taxn. 12 (2014), Journals IBFD.
206. Qiu, *supra* n. 154.

some way towards enhancing consistency in local GAAR practice. In addition, the approval process should limit overzealous application of the GAAR by local tax authorities. However, even with these amendments in place, at times taxpayers may still have to compromise and accept the decisions of the Chinese tax authorities due to the ineffective dispute resolution system and the lack of neutral external checks on the SAT.[207] For this reason, this section identifies the introduction of a neutral external check and extended training of tax officials as essential for the future development of the Chinese GAAR.

Similarly to the United Kingdom, the external check on the operation of the GAAR could come in the form of a GAAR advisory panel.[208] GAAR advisory panels are common practice in other jurisdictions.[209] From an organizational perspective, the advisory panel is on a par with the tax authority and is, to some degree, independent of them. They are ancillary to the tax authorities, providing an external opinion on the application of the GAAR, thereby ensuring the protection of the taxpayers' rights. However, the advisory panel's decisions are binding to neither the tax authority nor taxpayer.[210] To ensure its effectiveness in China, such a panel should consist *equally* of independent experts and members of the tax authority. A GAAR advisory panel consisting of both non-tax authority members and tax authority members could provide for some checks on any overstretch in the application of the GAAR, as well as assist in finding an efficient way to solve complicated avoidance cases.[211] They could provide a forum in which all members could reach a common position on whether application of a GAAR is justified in a given case. This will limit the discretionary power of the tax administrators, ensure a more consistent application of the GAAR and provide a more appropriate balance between the protection of the taxpayers' rights and the interests of the tax authorities.

In addition, since detection of tax avoidance arrangements still largely depends on local tax authorities, further developing resources for local tax authorities and enhancing coordination with other countries' tax authorities could encourage greater efficiency and consistency at the provincial levels.[212] Enhancing the SAT's national educational programmes would also aid in ensuring that the GAAR is applied responsibly and uniformly.[213] However, this training does not have to go as far as to provide extensive training to every tax official to deal with potential GAAR cases. As noted by Freedman, enormous sophistication of the entire workforce of the tax authority is not necessary.[214] It is sufficient that a small group of local specialists is educated in recognizing potential GAAR cases. By extension, further efficiency and consistency could be achieved by concentrating local expertise through the establish-

207. Zhao, *supra* n. 139.
208. *See* SAT, *Working Regulations on Joint Hearing in Major Cases Concerning Special Tax Adjustment (Trial)*, Mar. 2012. Such practice is already in use in China, although to a very limited extent. The joint hearings are internal, apply to a limited amount of cases and tax authority members far outnumber the external experts.
209. For example, in Australia, Canada, France and the United Kingdom, the GAAR is operated with the participation of these GAAR advisory panels.
210. A. Olesińska, *The General Anti-Avoidance Rule Consultative Committees*, (2014) 16 Comparative Law Review. Available at http://apcz.pl/czasopisma/index.php/CLR/article/view/CLR.2013.018.
211. Id.
212. R. Miller Bird & M. Casanegra de Jantscher, eds., *Improving Tax Administration in Developing Countries* (Washington DC: International Monetary Fund 1992) and J.L. Ho, *How to Train a Toothless Dragon: Finding Room for Improvement in China's Transfer Pricing Regulations* (2013) 54 Va. J. Int'l L. 437.
213. Id.
214. Freedman, *supra* n. 96, p. 173.

ment of specialized branches for anti-avoidance cases, as is already the case in the provinces of Beijing, Shanghai and Jiangsu.[215]

5.2.1. Procedural safeguards: Burden of proof

In China, the burden of proof essentially lies on the taxpayer. Upon receiving an information request, the taxpayer is required to provide extensive information within sixty days that his arrangements do not amount to tax avoidance.[216] In order to give the taxpayer a fair chance to defend himself against any GAAR investigation, one important requirement of the Netherlands and UK GAARs is that the tax authorities should provide the taxpayer with the detailed reasons for any potential GAAR assessment, including its elements and the possible tax consequences. Only after receiving such a statement should the taxpayer be invited to represent themselves before the tax authority to prove that his arrangements do not amount to abusive tax avoidance. This is, first of all, an important operational safeguard against potential abuse and overuse of the GAAR. Secondly, it is a measure to justify the breach of the principle of legal certainty.

The burden of proof is a controversial issue in GAAR design and is, to some extent, an extension of the general procedures in tax cases.[217] It must be noted that different jurisdictions take different approaches and it is hard to learn general lessons across jurisdictions.[218] Nevertheless, it is a policy issue that requires careful consideration since it contributes to the effectiveness of the GAAR. In the Chinese context, however, it seems excessive to place the burden of proof essentially on the taxpayer, especially considering the relatively weak position of the Chinese taxpayers compared to the tax authorities and the fact that effective remedies for taxpayers are limited.

5.3. Judicial improvements

In Western jurisdictions, the tax administrative litigation system serves as a balancing mechanism between the arbitrary exercise of state power and the protection of taxpayers' rights. Due to a combination of legislative, institutional and cultural factors, the Chinese tax administrative litigation system does not function as a balancing mechanism, resulting in few administrative lawsuits being filed each year against the Chinese tax authorities.[219] In addition, there are no specialized tax courts. Although improving the professional and technical tax knowledge of judges will undoubtedly improve their ability to deal with complex tax matters, such a process will take years before results can be measured. Nevertheless, this will not affect the courts limited space for tax law interpretation. Moreover, improving the judiciary and using courts and legal arguments to resolve tax disputes is not an end in itself. Every legal system is influenced by institutional and cultural backgrounds and, given these backgrounds, it is understandable that Chinese taxpayers with access to the legal system

215. X. Wang, *Shiying xingshi fazhan jiakuai woguo fan bishui fang kong tixi jianshe* (适应形势发展 加快我国反避税防控体系建设) (Follow the Trend and Accelerate the Development of the Prevention and Control System of Anti-tax Avoidance in China) International Taxation in China (2014) 10. Available at www.cnki.net. *See also* Y. Zhang, *The State Administration of Taxation's Efforts towards Anti-Avoidance*, 18 Asia-Pac. Tax Bull. 6 (2012), Journals IBFD for an overview of the SAT's (other) anti-avoidance efforts.
216. Art. 95 of Circular 2 and art. 11 2015 GAAR Measures.
217. *See* Ernst & Young, *supra* n. 3.
218. Id.
219. *See* sec. 4.2.3.

often choose not to use it. Even when substantial improvements are made to the judiciary, to the point that the tax administrative litigation system does function as an effective balancing mechanism, Chinese taxpayers cannot be forced to use the legal system. Since cultural and institutional legacies will only change over time, the Chinese courts will most likely continue to play a passive role in the application and interpretation of the GAAR.[220] In relation to the GAAR, judicial improvements, as well as improvements to the overall legal infrastructure, should therefore be considered to be long-term goals.

6. Conclusion

Although the approaches towards tax avoidance by the three jurisdictions discussed in this article differ, many common themes have emerged. All of the jurisdictions share the same basic aim to combat tax avoidance and have the legal or judicial framework in place to do so. However, although formulating the aim of combating tax avoidance might be straightforward, developing an approach that is both balanced in regard to the taxpayers' interests and the interests of the tax authorities, while effectively combating tax avoidance, is a more nuanced matter; a balance must be achieved.

The article has highlighted the distinctive features of the Chinese GAAR, i.e. the persisting inconsistencies between – and ambiguity of – the statutory provisions in both the CCITL and the secondary legislation, the near monopoly of the SAT to administer, interpret and implement the Chinese GAAR and the absence of neutral external checks. In this context, the possibility to develop and implement the GAAR in a structured and well-balanced manner is restricted, and one of the core values of the GAARs in the Netherlands and the United Kingdom, i.e. the balancing of the rights of the taxpayer versus the interest of the tax authorities, is easily overlooked. Specifically, the uncertainty surrounding the purpose test, the focus on the vague substance-over-form doctrine, the large discretionary powers of the SAT and the lack of effective remedies continue to add to the uncertainty for Chinese taxpayers when planning their tax affairs and have created an uneven playing field in taxpayer and tax authority dialogues in China.

Using the lessons learned from the Netherlands and UK GAARs, this article has proposed some suggestions for reforms on both legislative and administrative levels that may further advance the development of the Chinese GAAR. On a legislative level, the GAAR would benefit from additional guidance on the functioning of the purpose test. By providing some relevant indications for the outcome of the purpose test, such as the recognition that non-tax purposes are indeed relevant for the purpose test, the interests of the taxpayer will be better protected. On the other hand, the fact that they are merely relevant indications will ensure that the GAAR remains flexible. Similarly, it was suggested that additional guidance should be provided on the substance test. In addition to (a lack of) economic substance, possible indications of the abusiveness of the arrangements could be: large discrepancies between the income and loss of a company compared to its business results, whether the arrangements involve one or more contrived steps or reference to the intention and purpose of the under-

220. Minzner has even suggested that China has been moving *against* the rule of law in recent years. *See* C. F. Minzner, *China's turn against law*, (2011) The American Journal of Comparative Law pp. 935-984 and C.F. Minzner, *Legal Reform in the Xi Jinping Era*, (2015) 20 (1) Asia Policy pp. 4-9. *See also* K.G. Turner, ed., *The Limits of the Rule of Law in China* (University of Washington Press 2015) for a more general discussion on the rule of law in China.

lying tax law. In that way, taxpayers can more clearly determine their Chinese tax position. Again, the fact that these factors are merely relevant indications will not limit the scope of the GAAR and ensure its flexibility against future arrangements.

In addition to further guidance on the Chinese GAAR's ambiguous elements, from a legal point of view, it is necessary that the current array of secondary rules and legislation is integrated into article 47 of the CCITL. In practice, the Chinese GAAR is almost entirely governed by administrative regulations, with low legal authority. In addition, there are inconsistencies between the primary law and the administrative regulations. Integration of the current secondary legislation into a comprehensive and universal anti-avoidance rule in national law that covers both the individual and enterprise income tax, as well as other taxes, would increase the legal authority of the Chinese GAAR and solve the current conflict between the law and the tax authority's practice. The legislative improvements combined should aid taxpayers in defending their transactions on the basis of their reasonable business purposes.

However, legislative improvements alone are not enough to ensure that the GAAR is applied legally, uniformly and responsibly. Much will depend on the manner in which these improvements are implemented by the local tax authorities. In China, the main hurdle towards implementation of the rule of law in the field of tax law is the near monopoly status of the SAT in legislating, interpreting and administering the law. As there are currently no effective safeguards in place against any misuse in China, and since it is likely that the position of the Chinese judiciary will remain feeble in the interpretation of tax law, it was suggested that a GAAR advisory panel be introduced. To ensure the protection of the taxpayers' rights, such a panel should consist equally of independent experts and members of the tax authority. A GAAR advisory panel consisting of both non-tax authority members and tax authority members could provide for some checks on any overstretch in the application of the GAAR, and assist in finding an efficient way to solve complicated avoidance cases. In addition, since tackling tax avoidance is a global effort, much can be achieved by increasing coordination with other countries' tax authorities and providing effective GAAR training for local tax authorities.

This article does not see much point in suggesting judicial improvements to ensure a more balanced application of the Chinese GAAR. Due to a combination of legislative, institutional and cultural factors, the Chinese tax administrative litigation system does not function as a balancing mechanism between the arbitrary exercise of state power and the protection of taxpayers' rights. This is unlikely to change in the near future. Moreover, given the cultural and institutional background of China, it is highly understandable that Chinese taxpayers with access to the legal system often choose not to use it. Since cultural and institutional legacies only change over time, the Chinese courts will most likely continue to play a passive role in the application and interpretation of the GAAR. Judicial improvements and improvements to the overall legal infrastructure should therefore be considered long-term goals.

Nevertheless, it is clear that as of 2015, China more than ever has a legal framework in place through which the tax authorities can combat tax avoidance. However, given China's increasingly proactive stance in the G20's anti-tax avoidance debate, its full support for the OECD's BEPS initiative and its intention to use the domestic GAAR as the primary legal instrument to counter BEPS, the need for a more appropriate and balanced legal framework through which tax avoidance can be countered is increasingly imminent for both the

Chinese government and international taxpayers. The suggestions provided in this research could give some perspectives to further advance the development of the Chinese GAAR. The legislative and administrative improvements combined could aid taxpayers in defending their transactions on the basis of their reasonable business purposes, while at the same time providing a more clear and comprehensive legal framework. As international developments have been moving quickly in recent times, it will be interesting to see how the Chinese legislator and the SAT will balance the prevention of tax law manipulation with the protection of the taxpayers' right to plan their affairs with sufficient certainty in the near future.