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Implementation of Scope Expansion of Deferred Withholding Tax Policy on Distributed Profits Reinvested by Foreign Investors for Direct Investment

Introduction

The Ministry of Finance, the State Administration of Taxation (“SAT”), the National Development and Reform Committee and the Ministry of Commerce have jointly released Cai Shui (2018) No. 102, *Circular on Expanding the Applicable Scope of the Policy of Temporarily Not Levying the Withholding Tax on Distributed Profits Used by Overseas Investors for Direct Investment* (“Circular 102”) to replace the previous Cai Shui (2017) No. 88, *Circular on Policy Issues concerning Temporarily Not Levying the Withholding Tax on Distributed Profits Used by Overseas Investors for Direct Investments* (“Circular 88”). In order to update the relevant implementation regulations, the SAT has published the Announcement of the SAT (2018) No.53, *Announcement of the SAT on Issues Concerning Expanding the Applicable Scope of the Policy of Temporarily Not Levying Withholding Tax on Distributed Profits Used by Overseas Investors for Direct Investments* (“Announcement 53”) to replace the announcement on the Implementation of the Policy of Temporarily Not Levying the Withholding Tax on Distributed Profits Reinvested by Foreign Investors for Direct Investment (“Announcement 3”). In response to the updated Circular 102, Announcement 53 has also expanded the application scope of the tax deferral policy on the reinvested profit distribution by foreign investors. Announcement 53 shall be effective from January 1, 2018, while Announcement 3 becomes ineffective from January 1, 2018.

1. Temporary Tax Benefit

In a nutshell, and on very general terms, Circular 88 introduced a temporary exemption on profits “distributed” by a foreign invested enterprise to its overseas investor, provided that the said profits were re-invested in China, under certain legal forms, and subject to certain conditions. In other word, the tax benefit is deferred withholding tax.

2. Expand Scope of Reinvestment

Announcement 53 has deleted the required business operation scope of the qualified investment under the encouraged category.

Circular 88	Announcement 3
<p>Article 2.4</p> <p>Direct investment of an overseas investor in <u>an investment project under the encouraged category</u> refers to <u>business activities</u> carried out by the invested enterprise under the scope listed below during the period when the overseas investor’s investment continues:</p> <ul style="list-style-type: none"> the category of industries to which foreign investors are encouraged to enter, as listed in the Catalog for the Guidance of Foreign Investment Industries; and the Catalog of Priority Industries for Foreign Investment in the Central-Western Region. 	<p>Article 1 defines the <u>business activities</u> mentioned in Article 2.4 of Circular 88 as follows:</p> <ul style="list-style-type: none"> Manufacturing products or offering services; Carrying out activities for the research and development purpose; Investing in construction projects or purchase of machinery or equipment; and Other business activities.

Circular 102	Announcement 53
<p>Article 1</p> <p>The policy under which profit received by an overseas investor from a resident enterprise in China will temporarily not be subject to the withholding tax, if such profit is used for direct investment in China, will be applicable to a larger extent, <u>covering not only the encourage category of foreign-invested projects but also all projects and fields from which foreign investments are not banned.</u></p>	Removed Article 1 in Announcement 3.

3. Qualified Scenario as Capital Increase

Announcement 53 has specified a scenario as qualified capital increase.

Circular 102	Announcement 53
<p>Article 2.1.1</p> <p>The direct investment made by an overseas investor may refer to directly increasing or increasing by transferring paid-in capital or capital reserves in an existing Chinese resident enterprise.</p>	<p>Article 1</p> <p>Where an overseas investor uses the distributed profits to make a supplementary payment for its registered capital subscribed in a resident enterprise in China or increase the paid-in capital or capital reserve, it shall fall under the circumstance of Article 2.1.1 of Circular 102.</p>

4. Qualified Scenario as Direct Payment

Announcement 53 has specified a scenario as qualified direct payment.

Circular 102	Announcement 53
<p>Article 2.3</p> <p>Where the direct investment is paid in cash, the said payment shall be directly made from the profit distributor into the account of the invested enterprise or the party that sells the equities. The cash payment shall not be paid into any other foreign or domestic account prior to the direct investment.</p>	<p>Article 2</p> <p>Where an overseas investor transfers the reinvestment funds to the invested enterprise or the account of the share transferor, through the special deposit account for RMB reinvestment established according to the regulations of the financial authorities (“Special Account”) on the same date of receiving such reinvestment funds in the Special Account from the profit distribution enterprise, it shall be deemed as meeting the requirements in Article 2.3 of Circular 102.</p>

5. Effective Period

Announcement 53 is effective from January 1, 2018. For the distributed profits received from January 1, 2017 to December 31, 2017, Circular 88 and Announcement 3 still prevail and the tax incentives are only applicable to the projects under the encouraged category.

Conclusion

Announcement 53 serves as the implementation guidance and supplementary explanation of Circular 102. It has further clarified certain conditions of qualified reinvestment and in consequence further expands the application scope of the tax deferral policy. Foreign investors are suggested actively consider the eligibility for the tax preferential policy for direct reinvestment and conform to the implementation regulations in the application of the tax incentives. At the same time, the investors need to keep a close contact with the in-charge tax authority to obtain a better understanding of the local practice of unclarified issues, such as the treatment of refunded tax from the reinvestment of dividend distribution, which in practice triggers many complexities.

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