# China Tax Alert

**Issue 26, August 2017**

## China to boost foreign direct investment -- Dividend WHT deferral for reinvestment

**Regulations discussed in this issue:**

- The Catalogue of Industries for Guiding Foreign Investment (2017 revisions) (NDRC MOFCOM Order No. 4), issued on 28 June 2017 by NDRC and MOFCOM, effective from 28 July 2017

### Background

On 28 July 2017, an executive meeting of the State Council outlined a series of measures to further boost foreign direct investment in China. One of the new State Council measures temporarily permits the deferral of dividend withholding tax (WHT), otherwise levied on the distributed profits of a foreign invested enterprise (FIE), where the relevant amounts are reinvested in 'encouraged' projects. In this Alert we consider relevant aspects of the new relief for foreign investors.

### Current tax treatment of China profit reinvestment

From 2008 onwards, with the introduction of the new Corporate Income Tax (CIT) Law, FIEs have been obliged to withhold 10% WHT on distributions to foreign investors, unless double taxation agreement (DTA) relief applies. Consequently, the recycling of China profits by foreign investors, into further China investments, involves tax leakage where conducted from overseas. To deal with this, some foreign enterprises have used onshore holding companies to recycle and reinvest China profits without tax leakage, as intra-corporate dividends in China are tax exempt.

Two structuring options have been available in this regard. A special China Holding Company (CHC) regime allows for an onshore holding company to be established, which can use cash equity and debt to make China equity investments. Alternatively, 2012 Ministry of Commerce (MOFCOM) guidance facilitates a foreign enterprise to contribute the equity of existing operating FIEs into a separate holding FIE, to create an onshore holding company. The CHC regime rules demand that the relevant foreign investor has global assets of at least USD400 million and its onshore holding company registered capital of more than USD30 million, limiting its usefulness. The second option, while more accessible for smaller enterprises, also involves certain regulatory challenges.

As such, the new State Council measure may be very useful and facilitate the use of offshore platforms, such as corporate regional hubs in Hong Kong and Singapore, for China profit consolidation and reinvestment.

## KPMG observations

It is noted that, at present, a number of uncertainties exist:

- Can a tax deferral-qualifying 'reinvestment' of distributed FIE profits be made in any FIE controlled by the foreign investor in China? For example, can a foreign investor receiving dividends from FIE A in Beijing reinvest these in FIE B in Shanghai, and obtain the relief?
- Must the relevant foreign investor control the FIEs in question, or can dividends received by minority foreign investors also qualify?
- Must the reinvestment be by way of injection of fresh registered capital in an FIE (or wholly local investor-owned company), or could a use of the distributed monies to acquire existing China equity from a foreign (or local) investor qualify as a 'reinvestment' in China?
- Investment in 'encouraged' projects may qualify for the relief. Is this limited to investment in sectors designated as encouraged in the June 2017 Catalogue of Industries for Guiding Foreign Investment [See KPMG *China Tax Alert (Issue 21, June 2017)*]?
- Are sectors designated as encouraged in other guidance (e.g. the Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions) also in scope of the relief?
- When must the deferred WHT ultimately be paid? Should the deferral relief be clawed back, and the WHT paid, when equity is disposed of in (i) the originally distributing FIE or (ii) the reinvested FIE? What if there is a partial disposal of the relevant equity interests? Who will bear withholding responsibilities?
- Which local tax authorities will collect the clawed back WHT – the registered tax authority for the originally distributing FIE, or the reinvested FIE?
- How will the new relief interact with DTA treatment?

Details are anticipated by September 2017, and KPMG China will follow up with further updates on the clarified relief.

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Other 28 July State Council meeting measures include:

- The foreign direct investment "Negative List" approach will continue to be rolled out and foreign investment laws improved.
- Pilot city CIT incentives for advanced technology services enterprises (ATSEs) will be expanded nationwide.
- Relaxes/ eliminates requirements for foreign investors to have Chinese co-investors for their China investments. Local governments are encouraged to promote the establishment of multinational enterprise ASPAC regional headquarters in China with local tax incentives, and efforts will be made to enhance the protection of foreign enterprise intellectual property rights.
- Further development of national (high tech) development zones with facilitation of land grants to foreign invested projects, and provision of financial support to technology and green projects in western and northeast China.
- Streamline the working permit/visa process for foreigner workers.

This is the second in a series of articles, titled "China to boost direct foreign investment", covering the announced policy changes from the 28 July State Council meeting. Further articles are to follow.

See the first article "Limits on foreign equity stake in Chinese enterprises to be lifted" in this series.

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