

China Tax Weekly Update

ISSUE 3 | January 2018

Reference: SAT
Announcement [2018] No. 3
Issuance date: 2 January
2018
Effective date: 1 January
2017

Relevant industries: All
Relevant companies: Foreign
investors
Relevant taxes: CIT

Potential impacts on
businesses:

- Operational costs reduced
- Compliance risks due to regulatory uncertainties reduced

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Guidance on reinvestment dividend WHT deferral scheme

On 28 December 2017, the Ministry of Finance (MOF), State Administration of Taxation (SAT), National Development and Reform Commission (NDRC), and Ministry of Commerce (MOFCOM) jointly issued [Cai Shui \[2017\] No. 88](#) ("Circular 88"). This sets out detailed guidance on the withholding tax (WHT) deferral incentive for profit reinvestment in China (see KPMG [China Tax Weekly Update \(Issue 1, January 2018\)](#) for details).

Subsequently, on 2 January 2018, SAT issued [SAT Announcement \[2018\] No. 3](#) ("Announcement 3"), setting out implementation rules for the WHT deferral incentive. The key contents of Announcement 3 include:

Encouraged projects

- Circular 88 sets out several qualifying conditions for the WHT deferral treatment. This includes that invested enterprises should be engaged in business activities listed in the '[Catalogue of Industries for Guiding Foreign Investment](#)' or '[Catalogue of Priority Industries for Foreign Investment in Central and Western China](#)', throughout the investment period.
- Announcement 3 further clarifies that the invested enterprises must carry on one or more of the following activities in connection with the 'encouraged' projects:
 - Producing products or providing services;
 - Research and development (R&D) activities;
 - Investing in construction projects or purchasing equipment; or
 - Other business activities.

Responsibilities of profit-distributing enterprises/for eign investors

- Circular 88 states that foreign investors should provide certain information, and supporting materials, to profit-distributing enterprises (i.e. the WHT agent) to allow confirmation that the foreign investors qualify for WHT deferral.

Announcement 3 further clarifies that the WHT agent must, on receipt of these materials, confirm that they are complete. It appears that the requirement on the WHT agent is solely that they perform a clerical review on the information and materials to see that they meet the Circular 88 and Announcement 3 content requirements; the WHT agent is not expected to investigate and verify the veracity of assertions by the foreign investor.

Once the clerical review is completed and satisfactory, the WHT agent may distribute the profits without application of WHT.

- If the profit-distributing enterprise fails to properly conduct the clerical review of documents, and inappropriately distributes profits without application of WHT, it may face consequences. The profit-distributing enterprise's in-charge tax authority may pursue the profit-distributing enterprise for penalties. Per the [Tax Collection and Administration Law](#), a fine of 50% to 300% of the tax which was not withheld may be imposed on the profit-distributing enterprise. However, the underpaid tax itself is, per Announcement 3, to be recovered from the foreign investor and not from the WHT agent.
- It should be noted that this is a different approach to underpaid WHT recovery from that set out in SAT Announcement [2017] No. 37, which provided that the tax authorities could either pursue the WHT agent or the foreign payee for underpaid WHT (see KPMG [China Tax Weekly Update \(Issue 42, November 2017\)](#) for details). Despite the wording of Announcement 3 one cannot discount the possibility that local tax authorities might look to invoke Announcement 37 and recover the WHT from the WHT agent.
- A separate rule applies where incorrect information has been provided by the foreign investor to the WHT agent, resulting in inappropriate application of the relief. In this case, the liability, including WHT, late payment surcharges (LPS) and penalties, shall be borne by the foreign investor. LPS shall be calculated from the date on which the relevant profits were paid out.

Tax treaties and WHT claw back

- Where WHT is to be set to be clawed back from a foreign investor, due to improper use of the relief or disposal of the reinvested equity, consideration needs to be given to any relevant double tax agreement ("DTA") with China. A DTA may potentially lessen the amount of WHT clawed back, but it is necessary that the DTA was in effect at the time at which the profit distribution was made.

Disposal of reinvestment equity holdings

- Announcement 3 deals with the case where a foreign investor made a reinvestment (out of distributed profits) in a Chinese enterprise, and enjoyed the WHT deferral relief, and subsequently holds 'two types' of equity in the invested enterprise; part financed out of distributions that received the WHT relief, and part acquired without the benefit of any such relief. Announcement 3 sets out an 'ordering rule' for disposals of equity; the incentivized equity is deemed to be disposed of prior to the non-incentivized equity, with implications for the WHT claw back.

For example, a foreign company holds RMB100 of equity in a Chinese enterprise. RMB40 of this was an incentivized reinvestment of distributed profits and RMB60 was acquired without any such incentive. Where RMB50 of equity is disposed of, it is regarded that the full RMB40 of incentivized equity was disposed of first, and the WHT relief clawed back. If RMB30 of equity is disposed of then, similarly, this will be regarded as a disposal of incentivized equity; the subsequent RMB10 of disposed of equity will also be regarded to be disposed of out of the remainder of the incentivized equity.

Announcement 3 also clarifies the documentation requirements for the foreign investors, including:

- Documentation sent to the profit-distributing enterprise to use the WHT relief.
- Retroactive application for WHT relief to the tax authority of the profit-distributing enterprise.
- Documentation sent to the tax authority of the profit-distributing enterprise prior to disposal of re-invested equity holdings.

* For a more detailed analysis and interpretation of Circular 88, you may read the following KPMG publication:

□ [*China Tax Alert: WHT Deferral Incentive for Profit Reinvestment in China \(Issue 35, December 2017\)*](#)

Reference: SAT
announcement [2017] No. 54
Issuance date: 29 December
2017

Effective date: 2017 CIT
annual filing and onwards

Relevant industries: All
Relevant companies: All
Relevant taxes: CIT

Potential impacts on
businesses:

- Actual tax burden
reduced

You may click [here](#) to access
full content of the circular.

Enhancement to Corporate Income Tax (CIT) Filing Forms

On 29 December 2017, SAT issued [SAT Announcement \[2017\] No. 54](#) ("Announcement 54"), revising the corporate income tax (CIT) annual filing forms to facilitate use of CIT preferential policies. The new forms are to be used for the 2017 annual filing (i.e., in May 2018) and onwards.

The new CIT annual filing consists of 37 forms and improvements include:

- **Incentives:** Revise 10 filing forms for incentives covering, inter alia, donations, R&D expenses, high and new technology enterprises (HNTEs), software and integrated circuit (IC) enterprises, dividend distribution between resident enterprises.
- **Basic deductions:** Abolish 4 filing forms covering, inter alia, accelerated fixed asset depreciation and tax deductions for asset losses.
- **Taxpayer information:** Adjust 7 filing forms covering, inter alia, basic enterprise information; asset depreciation and amortization schedules; asset losses.
- **Information requirements:** Clarify the data requirements for 8 filing forms, such as for foreign tax credits (FTCs).

* Some new policies in respect of which the CIT forms have been altered are as follows:

- ❑ Enhanced China foreign tax credit rules (see KPMG [China Tax Weekly Update \(Issue 1, January 2018\)](#) for details)
- ❑ An amendment has been made to Article 9 of the existing CIT Law, which sets out rules governing the tax deductibility of corporate charitable donations (see KPMG [China Tax Weekly Update \(Issue 8, March 2017\)](#) for details)
- ❑ A new incentive treatment for venture capital (VC) enterprises and individual 'business angel' investors (See KPMG [China Tax Alert \(Issue 15, May 2017\)](#) for details)
- ❑ New administrative guidelines for recognition of HNTEs (KPMG [China Tax Alert \(Issue 19, July 2016\)](#) for details)



Other recent regulatory and tax circulars:

- ❑ [State Council's decision on temporarily adjusting certain laws and rules in pilot free trade zones](#) (Guo Fa [2017] No. 57, issued on 25 December 2017)
- ❑ [SAT's announcement on consumption tax collection and administration on refined oil](#) (SAT Announcement [2018] No. 1, issued on 2 January 2018)
- ❑ [SAT's notice on promoting 'packaged' tax services to new taxpayers](#) (Shui Zong Han [2017] No. 564, issued on 28 December 2017)
- ❑ [Q and A on promotion of abbreviated tax categories and codes for commodities and services by SAT](#) (released on 9 January 2018)

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