China alert

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# Update on Administration of Foreign Exchange for Direct Investment

**Regulations discussed in this issue:**

- Further adjustments for Foreign Exchange Administration Measures on Direct Investment ( Huifa [2012] No. 59 )

## Background and KPMG observations

On the 19 November, 2012, the State Administration of Foreign Exchange (SAFE) announced the circular 'Further Adjustments to Measures for the Administration of Foreign Exchange for Direct Investment' ("Circular 59"). In the circular, 35 administrative approvals are removed, 14 administrative approvals are simplified, and most pre-approvals for routine operations are downscaled. This circular becomes effective on 17 December 2012.

Generally, Circular 59 is for the purpose of simplifying administrative procedures, increasing efficiency, cutting costs and improving the domestic investment environment. However, although control measures have been changed from approvals to registration, enterprises must still provide relevant documents for registration purposes. In other words, there is no substantive change in terms of foreign exchange ('forex') control on direct investment.

Moreover, banks will undertake more responsibilities for documentation review, business data and information reporting. Owing to differing risk appetities and internal control requirements, banks may have varying procedures during the initial implementation phase. Therefore, enterprises may spend more time dealing with banks whose risk control is relatively weak or who are conservative in this regard.

## Main adjustments

We summarise the three major changes below:

1) Removes approval for account opening, cash remittance, and forex conversion, as well as purchase and remittance in direct investment by foreign investors. Removes approval for domestic transfer of forex in routine operations. Removes approval on reinvestment by foreign investors with income obtained by legal means in China. Removes capital

verification confirmation (CVC) procedures for capital reduction. Removes CVC and registration requirements when a Chinese holding company (CHC) reinvests in China.

2) Reduces the types of forex accounts relating to direct investment. Simplifies management procedures for forex capital conversion. Simplifies CVC procedures and SAFE registration requirements for share transfer by foreign investment enterprises (FIEs) and the corresponding forex collection.

3) Enables more accounts to be opened, and allow accounts to be opened in locations other than business registration under direct investment. Relaxes the restrictions on forex purchases and remittances for direct investment from different locations. Expands capital sources for overseas lendings, which allows overseas lending sourced from a domestic forex loan.

## Impacts on enterprises

### Administration measures changing from approval to registration

Circular 59 shifts forex control from an approval system to a registration system.

Previously:

- Enterprises applied to their local SAFE
- The local SAFE issued an approval certificate
- Banks executed the remaining procedures.

Following the issuance of Circular 59, the procedure is now:

- enterprises submit required documents to their local SAFE
- SAFE sets the quota on cross-border cash transfer and forex convention via its Direct Investment Forex Information System ("DIFIS")
- banks execute their handling procedures and update related information using DIFIS
- SAFE conducts "off-site supervision" using DIFIS information.

Please note that enterprises still need to submit the relevant documents for registration with SAFE. Therefore, when dealing with relevant operations, enterprises shall follow the instructions of Circular 59's appendixes, i.e., 'Operation Manual for Forex on Direct Investment (SAFE Version)' and 'Operation Manual for Forex on Direct Investment (Bank Version)'.

### Reinvestment through CHC

Before the issuance of Circular 59, according to Shang Zi Han [2011] No. 1078, a CHC could reinvest RMB profits distributed by its Chinese subsidiaries. Both the CHC and the proposed investee were required to apply for reinvestment approval/perform CVC and registration procedures with their local SAFE, respectively.

After the policy adjustment, the proposed investee should register its reinvestment by CHC with its local SAFE. Following registration, its bank can open a reinvestment account and transfer funds using DIFIS registration information.

**Relaxed controls on lending overseas**

According to a previous circular Hui Fa [2009] No. 24, a PRC enterprise could only provide loans to its overseas subsidiaries. After the policy adjustment, an FIE is allowed to provide a loan to its overseas parent company. Meanwhile, capital sources for overseas lending have been expanded, and overseas lending sourced from a domestic forex loan by PRC banks is allowed. In such instances, an FIE may remit the 'undistributed profit' to its overseas parent company in the form of a loan. In this way, the FIE will only be subject to 5 percent business tax and 25 percent corporate income tax on the interest income, which to some extent defers the PRC tax liabilities to be imposed on 'dividend' repatriation.

Nevertheless, Circular 59 still requires that the approved overseas lending be limited to the overseas parent company's share of profit in the Chinese subsidiary, which is the sum of the subsidiary's dividends payable and undistributed profits. Hence, FIEs making losses or breaking even, including those with excess cash, still lack the practical means to finance foreign related parties with excess domestic cash.

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