

CHINA TAX ALERT

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New foreign debt registration rules to shorten timeline for processing foreign currency settlement

Regulations discussed in this issue:

- State Administration of Foreign Exchange Announcement [2013] No. 19 - Announcement Regarding Administrative Measures for Foreign Debt Registration (Circular 19)

Background

On 28 April 2013, the State Administration of Foreign Exchange (SAFE) announced the release of Circular 19. Circular 19 seeks to simplify foreign debt registration procedures, which remove certain approval requirements. With the exception of registering foreign debt contracts, other actions such as opening foreign debt accounts and foreign currency settlements and repayments can now be handled directly by designated foreign exchange banks (collectively referred to as the 'banks'). We envisage that the timeline for processing foreign currency settlements on foreign debt should be shortened for many foreign investment enterprises (FIEs).

On the other hand, banks will be required to perform more compliance reviews of the foreign currency settlements application. Since the process and the required documentations may vary across different banks, FIEs should keep in regular contact with banks, prepare complete documentation supporting the usage of funds from foreign currency settlements.

Circular 19 became effective on 13 May 2013.

Main policy changes

1. Refining selected regulations and rules

In an effort to simplify regulations on the foreign debt that is so crucial to the operations of many FIEs in China, Circular 19 has clarified and refined the following rules:

- Circular 19 requires that the first round of capital investment be paid before FIEs are permitted to borrow foreign debts. Foreign debts obtained by FIEs are capped at the percentage of foreign capital injected multiplied by the difference between total investments and registered capital.

- Where enterprises have not registered foreign debt contracts before the applicable deadline and/or have violated provisions on foreign debts, the following options are available under Circular 19:
 - If the enterprise has not registered its foreign debt contract before the applicable deadline and has not yet drawn down the debt, the SAFE can continue to process the foreign debt contract registration in accordance with regular procedures, provided the enterprise can provide a reasonable explanation
 - If an enterprise has not registered its foreign debt contract in time and has already drawn down the debt, the enterprise must provide documentation supporting the foreign debt that has been undertaken. The foreign debt registration department of the SAFE will forward the case to the foreign exchange inspection department for investigation. The registration can be completed thereafter, where the amount of debt that will be registered could be the verified outstanding balance of the debt.
- In addition to the purchase of goods and services allowable under their permitted business scopes, enterprises can also use foreign debts to fund the following transactions:
 - When replacing old loans with new loans in debt restructuring
 - When using foreign debts to fund equity investments through the establishment of a new enterprise, provided that this is an allowable activity based on its business scope.

It is important to note that Circular 19 has not removed the restriction on the use of Renminbi funds from foreign currency settlements to repay Renminbi loans from domestic financial institutions. Rather, it specifically stipulates that foreign debt funds cannot be used to make loans to entities other than foreign invested leasing companies or small loan companies. This provision effectively means that foreign debt funds of China Holding Companies cannot be lent to invested companies down the chain.

- Enterprises in China (including FIEs) commonly apply for loans with domestic banks using guarantees from foreign organisations or individuals ('foreign-guaranteed domestic loans'). In this respect, Circular 19 requires that domestic debtors should satisfy the following in order to qualify for these loans:
 - The borrower belongs to an 'encouraged' industry of the PRC
 - The borrower has been in a profitable position for the past three years
 - The borrower has sound financial management and internal control systems
 - The borrower's net equity should be no less than 15 percent of its total capital
 - The borrower's total overseas borrowings plus remaining overseas guarantees should not exceed 50 percent of its net capital.

Circular 19 has reiterated that for FIEs, if the sum of the outstanding foreign loan principal created by foreign guarantees and other foreign debts exceeds the difference between total investments and registered capital, the SAFE may register the foreign debt first, and the foreign exchange department will subsequently forward the case onto the investigation department as excess foreign debts.

- Circular 19 has also clarified the documentation requirements with respect to the claiming of debt forgiveness or debt reduction for the following scenarios:
 - Claiming debt reduction or full debt forgiveness: Debt forgiveness notice from the creditor or other related supporting materials
 - Debt restructuring transactions, such as converting debt to equity: Confirmation letter from the creditor and an approval from the competent authority of commerce
 - Domestic/overseas guarantor honoring the guarantee: Relevant supporting material showing fulfilment of the guarantor's duty
 - Repaying debt and interest through debtor's overseas account: Materials supporting the repayment transaction.
- 2. Removal of the application procedure with the SAFE for foreign currency settlements for foreign debt

Circular 19 has removed the application procedure for foreign currency settlements for foreign debts. Instead, banks are now authorised to examine such settlements, and debtors can now directly apply for foreign currency settlements with banks by submitting the relevant supporting documentation. In addition, Circular 19 has also extended the time limit allowed for transferring the Renminbi received from the settlement to the recipient from two days to five days.

It is important to note that Circular 19 stresses that when examining applications for foreign currency settlements for foreign debt, banks should determine the scope and quantity of the supporting materials to be submitted based on the purpose that the debtor intends to use the funds for. Banks make this determination by reference to their understanding of the applicant, the purpose and intention of the funds, and the sum of the foreign currency settlement.

KPMG observations

After the policy adjustments, banks will be required to perform more compliance procedures and take on more risk regarding foreign currency settlements that may be inconsistent with policies. Since banks have different internal management systems and hold different attitudes toward risk, the process and the required documentations may vary across different banks during the preliminary execution stage of Circular 19. As such, FIEs should keep in regular contact with banks, prepare complete documentation supporting the usage of funds from foreign currency settlements, and make appropriate arrangements for using the funds for different trading activities.

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