

China withholding tax deferral program

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In brief

- » China's Ministry of finance (MOF), State Administration of Taxation (SAT), National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) had jointly issued Caishui [2017] No. 88 ("Circular 88") to introduce the withholding income tax (WHT) program on reinvestment of profits by foreign investors.
- » Foreign investors can enjoy WHT deferral treatment on direct reinvestment of profits distributed from Chinese tax resident enterprise into Chinese encouraged projects.
- » The new treatment would be effective retrospectively from 1 January 2017, and tax payments already settled on eligible reinvestment can be refunded

Feedback

WTS – strong presence in about 100 countries / regions

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In detail

Dividends derived from Chinese enterprise to overseas are subject to a WHT at 10%. To support China's economic growth, the Chinese government releases a WHT deferral program to motivate further foreign investment in China.

However, foreign investors must meet all criteria listed below to enjoy this WHT deferral treatment:

1. Criteria 1: direct reinvestment

It must be a direct equity investment by foreign investors using the profits distributed from a Chinese enterprise, in any of the following manner:

- » Increase of capital or capital reserve in an existing Chinese company to invest;
- » Establishment of a new Chinese enterprise;
- » Equity acquisition of a Chinese enterprise from third parties; or
- » Other types of investment stipulated by MOF and SAT.

Circular 88 has excluded investments into listed companies, except for investments meeting the requirement of "strategic investment" by MOC Order [2005] No. 28 (*Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors*).

2. Criteria 2: nature of distributed profits

The distributed profits refers to equity investment income distributed by a Chinese enterprise to their foreign investors, such as dividends or profit distribution, etc.

3. Criteria 3: direct payment

All distributed profits, either in the form of cash or non-cash, have to be directly transferred to the Chinese enterprise (the new investee). Any forms of indirect investment will not qualify for the WHT deferral treatment.

4. Criteria 4: encouraged projects

Reinvestment must be made to encouraged projects which are designated in the "Industrial Guideline for Foreign Investments" and in the "Industrial Guideline for Priority Foreign Investments in Central and Western Region".

Circular 88 further sets out the procedures for a record filing:

» Record filing procedure

The Chinese profit distributing enterprise, as the withholding agent, should perform record-filing procedure with their tax bureau in charge for WHT deferral treatment if believing that its foreign investor is eligible to the benefit.

However, if the tax authority considers the foreign investor not eligible for the WHT deferral treatment in a later review, the deferred WHT will be clawed back plus interests.

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» Deferred WHT repayment

If the foreign investor has withdrawn their investment through such means as equity transfer, equity buyback, or liquidation of projects which have already enjoyed deferred WHT treatments, the investor should report and pay back the deferred WHT to the tax authority in charge within seven days upon receiving their investment fund.

The said WHT claw-back does not apply to the case of special restructuring tax treatment, in which case, the foreign investor can continue to enjoy the WHT deferral treatment.

» Retrospective effectiveness

Circular 88 specifies that the dividends received by foreign investors on or after 1 January, 2017 are eligible for the WHT deferral treatment and a refund for the WHT already paid can be applied for within three years since the WHT payment date.

Therefore, foreign investors interested in this WHT deferral incentive should check whether the dividends they received can fulfill all the four aforementioned criteria.

WTS observation

This WHT deferral program will help incentivize additional investments by the existing foreign-owned subsidiaries in China. Foreign investors are urged to review their China profit distribution plan so as to enjoy this WHT deferral incentive.

Further, the WHT deferral incentive applies only to encouraged projects listed. It sends a clear signal that the focus is on manufacturing sectors and is an echo to the “*Made in China 2025*” and “*Belt and Road*” initiatives.

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