

China Released Interpretation on the Application Scope of Withholding Tax Deferral Policy on Dividends Reinvestment

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EMA TADA

ADVISORY DEPARTMENT
JAPANESE CORPORATE BANKING DIVISION
FOR ASIA

T +852-2823-6091
EMA_TADA@HK.MUFG.JP

MUFG Bank, Ltd.

A member of MUFG, a global financial group

On 19 November, the State Administration of Taxation (SAT) promulgated The Announcement on The Application Scope-related Issues Regarding The Provisional Withholding Tax Exemption Policy on Direct Investment with Dividends by Foreign Investors (SAT Announcement 2018, No. 53, hereinafter "The Announcement"). The Announcement clarified a few points upon the implementation of dividends withholding tax deferral policy. The development and the content of dividends withholding tax deferral policy is introduced in this article.

1. The Development of The Policy

Under the existing Corporate Income Tax Law, tax is withheld from dividends paid by Chinese resident to non-resident companies. Dividends withholding tax was imposed not only at profit repatriation but also at reinvestment in China¹. However, aiming at further developing Chinese economy by expanding foreign investment in China, the authority introduced a provisional deferral policy to exempt dividends withholding tax at making domestic reinvestment in 2017. Circulars explaining the policy have been promulgated thereafter to enable its smooth implementation.

Circulars	Date of Publication	Date of Implementation	Contents
(1) Notice on The Provisional Withholding Tax Exemption Policy on Direct Investment with Dividends by Foreign Investors (Caishui [2017] No. 88) (Invalidated by the publication of (3))	21 Dec 2017	1 Jan 2017	• The introduction of withholding tax deferral policy at making direct investment with dividends
(2) Announcement on the Implementation of The Provisional Withholding Tax Exemption Policy on Direct Investment with Dividends by Foreign Investors (Guoshuifa [2018] No. 3) (Invalidated by the publication of The Announcement)	2 Jan 2018	1 Jan 2017	• The publication of implemental details

¹ Dividends withholding tax rate is nominally 20%. However, the rate can be reduced by tax treaties to 10% (in case of Sino-Japan tax treaty) or 5% (in case of Sino-Hong Kong tax agreement)

(3) Notice on Expanding The Application Scope Regarding The Provisional Withholding Tax Exemption Policy on Direct Investment with Dividends by Foreign Investors (Caishui [2018]No. 102)	29 Sep2018	1 Jan 2018	• The expansion of the application scope from Caishui [2017] No.88
(4) The Announcement on The Application Scope-related Issues Regarding The Provisional Withholding Tax Exemption Policy on Direct Investment with Dividends by Foreign Investors (The Announcement)	19 Nov 2018	1 Jan 2018	• The interpretation on issues related to the application scope of the policy

The content of respective circulars is introduced below.

2. The Content of The Circulars

(1) The introduction of withholding tax deferral policy on dividends reinvestment (Caishui [2017] No. 88)

China introduced withholding tax deferral policy on dividends reinvestment for the first time under this circular. Effective from 1 Jan2017, foreign investors that make certain forms of direct investment on operational activities² in the subject industries with dividends received from Chinese resident companies, may enjoy withholding tax deferral treatment.

[Concept and Content]

Dividends	<ul style="list-style-type: none"> Refers to interest earnings such as interest, dividends, and those derived from the retained profit actually distributed by the Chinese resident companies to their offshore investors Including retained profit generated before 1 Jan., 2017 but distributed after the date. Companies entitled the tax deferral benefit may apply for tax refund up to 3 years, if the withholding tax on dividends has been paid at making direct investment
Subject Industries	<ul style="list-style-type: none"> Encouraging industry on 「Catalogue of Industries for Guiding Foreign Investment」 Industry specified on 「The Catalogue of Priority Industries for Foreign Investment in Central and Western China」
Certain Forms ³	<ul style="list-style-type: none"> Additional capital injection, transfer of capital reserve to capital fund of Chinese resident companies New investment on Chinese resident companies and establishment of Chinese resident companies Obtaining stock from non-related Chinese resident companies Others forms permitted by the Ministry of Finance, SAT
Direct Investment	<ul style="list-style-type: none"> Direct remittance of cash dividends from the profit distributing company to the invested business Direct transfer of dividends-in-kind from the profit distributing company to the invested business
Time to Pay Tax Deferral	<ul style="list-style-type: none"> Within 7 days after the collection of fund by transfer, buyback or liquidation of the invested business Continuous enjoyment of tax deferral is possible if special intergroup restructuring occurs, which qualifies the foreign investor as a subject of special tax treatment

² The concept of operational activities is explained as a supplement in Guoshuifa [2018] No. 3.

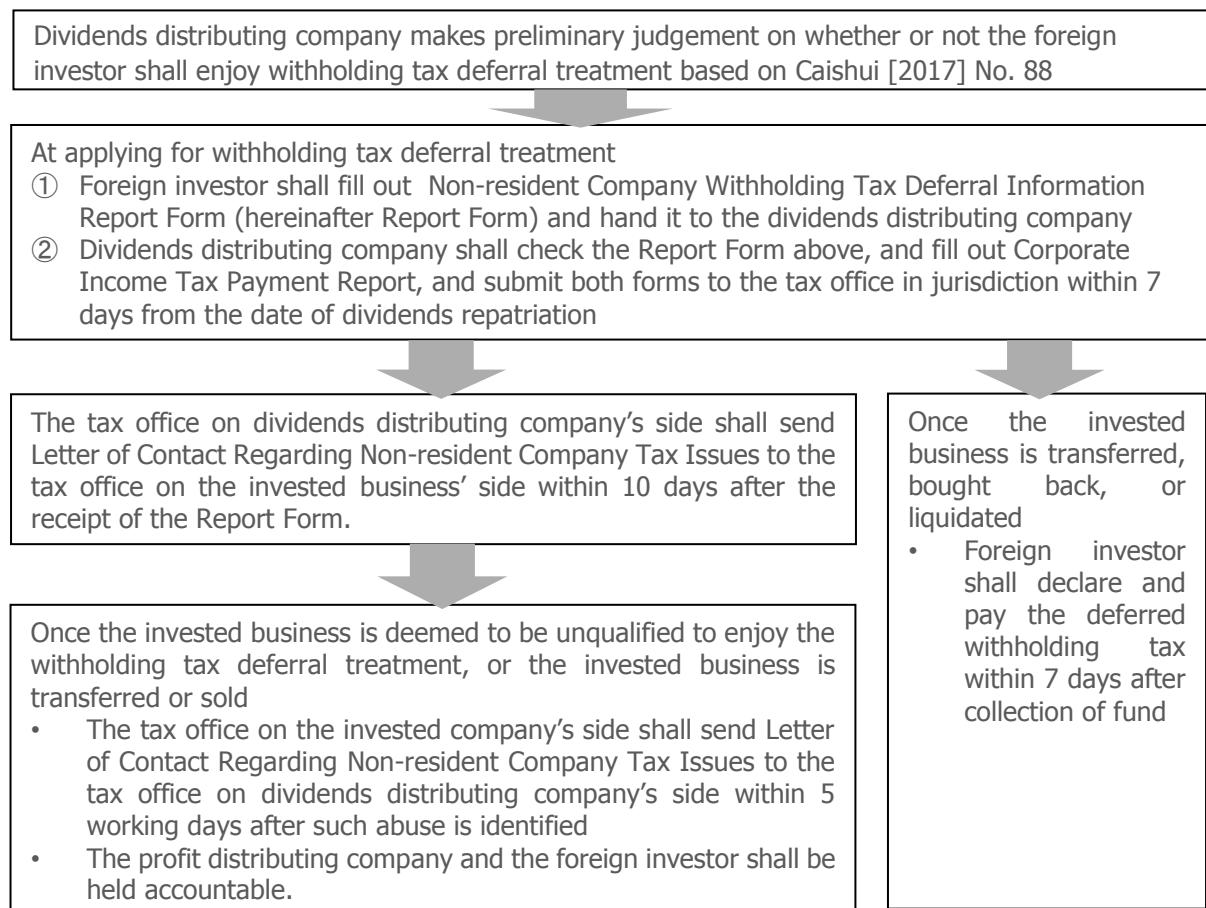
³ Unless the strategic investment in accordance with Ministry of Commerce, China Securities Regulatory Commission, State Administration for Industry and Commerce, SAT and State Administration of Foreign Exchange 2005 No. 28 Decree, dividends reinvestment in a listed company in forms of additional capital injection, capital reserve transfer and stock purchase is not entitled to the withholding tax deferral treatment.

(2) The implemental details of the tax deferral policy (Guoshuifa [2018] No. 3)

To promote the implementation of Caishui [2017] No. 88, this circular has clarified the documentation requirement and reporting obligation of foreign investors, dividends distributing company and invested business respectively when applying withholding tax deferral policy. In addition, as a supplement to Caishui [2017] No. 88, operational activities that qualifies the application of withholding tax deferral are specified as product manufacturing, service provision, project undertaking, equipment purchase and etc.

Please note that this circular has been invalidated along with the promulgation of The Announcement.

[The Application Workflow of Withholding Tax Deferral]



(3) The expansion of the application scope to the tax deferral policy

(Caishui [2018] No. 102)

This circular expands the scope of industries that the withholding tax deferral treatment may apply from the encouraging industries to all non-restricted industries for foreign investment, creating a wider range of opportunities for foreign investors to reinvest with own dividends in China. In addition, Caishui [2017] No. 88 was invalidated along with the enforcement of this circular.

(4) The interpretation on issues related to the application scope of the tax deferral policy (The Announcement)

The Announcement specified the implemental details of Caishui [2018] No. 102, which has expanded the application scope on withholding tax deferral policy. In addition to the contents and workflow published by the previous circulars, it interpreted the following points.

- ① Dividends reinvestment that makes up for unpaid registered capital, and resulted in actual capital increase or the increase of capital reserve is recognized as a proper investment activity that withholding tax deferral benefit can be enjoyed
- ② Transfer of dividends from the account of the profit distributing company to the account of the invested business via the foreign investor's Domestic Reinvestment Special RMB Account⁴ on the same day is recognized as a proper form of direct investment that withholding tax deferral benefit can be enjoyed

The Announcement goes into effect as of 1 Jan., 2018. However, a qualified applicant that have paid dividends withholding tax during 2017 may apply for tax refund in accordance with Caishui [2017] No. 88 and Guoshuifa [2018] No. 3, despite that both of which have been invalidated.

3. Comment

Under the circumstances, withholding tax deferral policy on dividends reinvestment is gradually optimized, and its feasibility is improved accordingly. However, it is necessary to pay close attention to the future trend as practical uncertainties still remain, such as the obligation to declare the further deferral of tax payment in the case of special tax treatment, and the procedure at the State Administration of Foreign Exchange when capital funds being remitted between two domestic companies. In addition, since the effect of tax incentives on the expansion of foreign investment is limited, it is also expected that China shall attract more foreign investment by continuously opening up the market and improving investment environment.

(End)

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⁴ Regulations to open and use a Domestic Reinvestment Special RMB Account are specified by PBOC [2011] No. 23 Announcement and Yinfa[2012] No. 165 Notice