

China Tax Weekly Update

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Reference: Hui Fa [2017] No. 3

Issuance date: 26 January 2017

Effective date: 26 January 2017

Relevant industries: All
Relevant companies: All
Relevant taxes: N/A

Potential impacts on businesses:

- Compliance risks due to regulatory uncertainties reduced

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China clarifies forex administrative rules for cross-border trade and financing

As highlighted in KPMG *China Tax Weekly Update* ([Issue 48, December 2016](#)) and ([Issue 47, December 2016](#)), the international business media has increasingly reported that the Chinese forex authorities have been tightening limitations on outbound flows of investment from China, on profit remittances by foreign-invested enterprises (FIEs) from China, and on servicing of cross-border financing. The view has been expressed in these media reports that China's measures against capital flight are having the consequence of undermining China's cross border trade.

In response, on 6 December 2016, the State Administration of Foreign Exchange (SAFE) along with three other Chinese government authorities clarified supervision arrangements for China's outbound investment. At the same time, SAFE made a statement that no new restrictions had been imposed on profit remittances out of China. In addition, SAFE further stated on 25 January 2017 that no new restrictions had been imposed on cross-border trade finance. Most recently, on 26 January, the SAFE issued Hui Fa [2017] No. 3 ("Circular 3"), effective from that date. This sets out 9 measures grouped in 3 categories, clarifying how effective forex supervision is to be reconciled with improved checks on the authenticity of the cross-border trading transactions purported to underpin them. Categories 1, 2 and 3 are set out below.

1. Facilitate trade and investment

- ❑ Loans in foreign currencies, offered by Chinese banks to enterprises registered in China, are allowed to be converted into RMB. Such loans must be for the purposes of supporting goods export activity (e.g. the RMB funds are used to buy the goods which are then exported). The loans must be repaid using the forex funds obtained through export transactions, rather than using additional forex funds purchased in the domestic market.
- ❑ Allow the transfer, into China, of borrowed funds received by Chinese companies overseas from foreign banks, where the loan is secured with guarantees made, or collateral located, in China. The Chinese term "nei bao wai dai" is used for such arrangements.

(Under the earlier relevant regulation, issued by SAFE in 2014, the transfer, into China, of borrowings obtained through "nei bao wai dai" arrangements, was subject to restrictions. After the funds were transferred into China, they were not allowed to be used for lending, equity investment or securities investment within China without the approval of SAFE. Circular 3 now removes the requirement for SAFE approval. However, it remains unclear to what extent such transferred funds can be used for other forms of investment in China.)

- ❑ The maximum amount of the deposits, received via the international foreign exchange funds principal account of a domestic bank, that can be used by the domestic banks within China (e.g. make new loans) has been increased. It has been lifted to 100% (previously 50%) of the daily average deposits balance in the preceding 6 months, held with the bank in question;
- ❑ Allow foreign enterprises in pilot free trade zones to convert their foreign currency holdings, in their domestic forex accounts, in China into RMB.
(Previously, without the specific approval of the bureau or foreign exchange control department of the SAFE at the foreign enterprises' place of registration, the funds in such foreign exchange accounts could not be converted to RMB);

2. Authenticity and compliance verification for outbound remittances

- ❑ When handling an outbound remittance of profits earned by a FIE, with a value of more than US\$50,000, the banks shall conduct a review of the submitted documents, including the internal directors' dividend distribution resolution, the tax filing form and the audit financial statements. It is explicitly provided that the accumulated profit reserve, out of which profits can be distributed, needs to fully reflect losses incurred in prior years, such that the remittances out of China do not deplete the capital of the enterprise.
- ❑ When a domestic enterprise investor conducts a registration with a local forex authority in relation to an outbound direct investment (ODI), and plans to transfer funds out of China to pay for the ODI, it must state both the source of its investment funds and the purpose of the outflow (utilization plan). The enterprise must submit the resolution of its board of directors in relation to the outbound investment, the investment contract, and other proof of investment authenticity, to the bank concerned. This is in addition to submitting the usual documentation required for bank verification

(Circular 3 adds these requirements for supplementary materials alongside the pre-existing documentation requirements).

3. Ensure proper reporting of Chinese enterprise RMB/foreign currency holdings overseas/loans from China and compliance with relevant regulations

- ❑ Reporting rules are clarified for the case where a domestic enterprise retains, in an overseas bank account, its earnings from exports of goods or services and does not immediately transfer these earnings back to China. Where the enterprise has previously failed to conduct the required forex control registration and filing formalities set out in Hui Fa [2012] No. 38 and Hui Fa [2013] No. 30, it must now take the initiative to report the relevant information. Reporting must be made within one month from the issuance of Circular 3 (i.e. 26 Feb 2017) to the forex authority in the place where the enterprise is located.
- ❑ For a domestic enterprise granting loans abroad, the total amount of its outbound loans balance in RMB and its outbound loans balance in foreign currency shall not exceed 30% of the enterprise's owner's equity per its audited financial statements for the previous year

(Per a 2014 SAFE regulation, it is stated that the outbound loans balance of an enterprise, funded in a foreign currency, shall not exceed 30% of the enterprise's owner's equity. Circular 3 now adds that the outbound loans balance denominated in RMB must also be included in this calculation. Under the revised rules, the total amount of outbound loans balance in RMB and foreign currency must not exceed the calculated upper limit.)

Reference: Guo Ban Fa [2017] No. 6
 Issuance date: 4 February 2017
 Effective date: to be launched before 30 June 2017

Relevant industries: All
 Relevant companies: All
 Relevant taxes: N/A

Potential impacts on businesses:

- Operational costs reduced

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Simplification of social security contributions system

On 25 December 2016, the Standing Committee of the National People's Congress authorized the State Council to carry out a pilot program to merge the social security contributions made by employees and employers under the maternity insurance and employees' basic medical insurance schemes (hereinafter referred as the "two public insurance schemes") in 12 cities*. Both of maternity insurance and basic medical insurance are mandatory contributions in China.

On 4 February 2017, with the issuance of Guo Ban Fa [2017] No. 6, the State Council released the detailed plan for the said pilot program, which will start from the end of June 2017, and last for one year. The plan highlights:

- Employees who participate in basic medical insurance schemes, simultaneously participate in maternity insurance schemes.
- The maternity insurance fund is to be merged with the employees' medical insurance fund and will be collected and paid together.
- The new premium that employers will pay for employees will be the sum of the two insurance premiums. An individual need not pay the maternity insurance premium. (Individual, under the current regime, pays the medical insurance premium but not a maternity insurance premium (only the enterprise does)).
- The service that maternity insurance funds finance for urban residents will not be cut after the reform.

* 12 pilot cities include: Handan (Hebei province), Jinzhong (Shanxin province), Shenyang (Liaoning province), Taizhou (Jiangsu province), Hefei (Anhui province), Weihai (Shandong province), Zhengzhou (Henan province), Yueyang (Hunan province), Zhuhai (Guangdong province), Chongqing, Neijiang (Sichuan province), Hunming (Yunnan province).



Reference: GAC
Announcement [2017] No. 9
Issuance date: 3 February
2017
Effective date: 3 February
2017

Relevant industries: All
Relevant companies: FIEs
Relevant taxes: N/A

Potential impacts on
businesses:

- Compliance risks due to regulatory uncertainties reduced

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FIE customs registrations clarified

As highlighted in KPMG [China Tax Weekly Update \(Issue 35, September 2016\)](#) and [\(Issue 39, October 2016\)](#), China has been in the process of revising its inbound investment rules. Following various pilot programs in certain localities, a new nationwide system for the administration of foreign investment approvals is being rolled out. Whereas previously, all foreign investment into China needed pre-approval by the Ministry of Commerce (MOFCOM), the new system generally allows for simple recordals to be made for investments in industries where foreign investment is encouraged/permitted, with pre-approvals limited to industries where investment is restricted. This is the so-called "Negative List" system (under the "special administrative measures for foreign investment access") and it is effective from 1 October 2016. Accordingly, establishment and alteration of foreign invested enterprises (FIEs) that are not included in the "Negative List" shall be subject to recordals, and the recordal procedure with MOFCOM would remain unchanged. Upon completion of recordals, FIE may obtain a "Filing Acknowledgement for Establishment of Foreign Investment Enterprise" or a "Filing Acknowledgement for Change Matter of Foreign Investment Enterprise".

To implement this foreign investment administration reform from the customs angle, on 3 February 2017, the General Administration of Customs (GAC) issued Announcement No. 9, effective from the date of promulgation. This clarifies that the documentation requirement for an FIE's registration with Customs, i.e., copies of the MOFCOM filing acknowledgement, can be submitted to Customs. This would be done for an FIE which handles the registration formalities for consignor/consignee for imports/exports.

(Currently, an FIE may provide (i). registration form for filing of foreign trade business operator or (ii). its "Approval Certificate for Foreign Investment Enterprise" for the registration, however, with issuance of Announcement No. 9, any of the said three documents (i.e., (i) or (ii) or MOFCOM filing acknowledgement), can be submitted. There is now more flexibility on which documents can be filed.)

Reference: GAC
Announcement [2017] No. 8
Issuance date: 3 February
2017
Effective date: 3 February
2017

Relevant industries: All
Relevant companies:
Enterprises engaged in
import and export trade
Relevant taxes: Import and
Export Customs Duty / VAT /
Consumption Tax

Potential impacts on
businesses:

- Compliance costs reduced

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Paperless customs clearance expanded

On 3 February 2017, the GAC issued Announcement [2017] No. 8 (Announcement No. 8). Pursuant to this announcement, paperless customs clearance shall be expanded and be applicable to all enterprises regardless of their customs credit rating, effective from date of promulgation.

Prior to this, the paperless customs clearance was only applied to enterprises with a customs credit rating of category B and above (This is a measure of the enterprise's customs compliance history/capability). The earlier arrangements provided that an agreement for electronic data application would be entered into between an enterprise, a customs office (subordinate to the GAC) where the enterprise handles its customs clearance, and a third-party authentication institution (i.e., China E-port Data Centre) – with these arrangements in place the paperless customs clearance could be applied, but only for the customs office entering into the agreement.

With the issuance of Announcement No. 8, paperless customs clearance now will now be applied to enterprise customs clearance activity across the whole country, no matter with which individual customs office the agreement was signed.

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