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Reference: Cai Zi [2017] No. 24
Issuance date: 12 June 2017
Effective date: N/A

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

Potential impacts on businesses:
- Compliance risks due to regulatory uncertainties reduced

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Outbound investing SOEs required to upgrade investment evaluation procedures

On 12 June 2017, the Ministry of Finance (MOF) issued *Financial Administrative Measures for State-owned Enterprises Making Outbound Investment* (Cai Zi [2017] No. 24, referred to as the "Measures"). The Measures seek to upgrade the rigour with which Chinese state-owned enterprises (SOEs) evaluate their outbound investments and entered into force from 1 August 2017. The Measures are released in parallel with an increased role for SOE Communist Party committees in overseeing and managing key strategic decisions at SOEs. Updates to the articles of association of various overseas-listed SOEs to reflect this has recently been remarked upon in the international business media.

The "outbound investment" in scope of the Measures includes SOE activities related to acquiring ownership, control rights, or business management rights over incorporated or unincorporated entities or projects (e.g. property management service arrangements, construction project contracting) outside of China (including Hong Kong, Macau and Taiwan). This includes greenfield investment, mergers and acquisitions (M&A), joint ventures, and equity participations.

There are certain exclusions from the scope of the Measures, including outbound investment by financial SOEs, and less significant outbound investments (such as SOE representative offices outside China). Key points in the Measures are set out below:

Pre-investment	• Where outbound investments are made by way of M&A, joint ventures or equity participations, due diligence must be undertaken by the SOEs or hired intermediaries (e.g. Big 4 accounting firms). Macro-economic risks in the target countries need to be evaluated. • Financial feasibility studies must prepared internally by the SOE, and also by external intermediaries for large-scale projects. The extent to which these will be reviewed by the government bodies administering the SOEs (e.g. SASAC) has not been clarified in the Measures.

During investment process	• All relevant investment steps (e.g. merger, disposals, distributions, etc.) must be conducted in compliance with foreign laws. • Expenditures incurred by overseas invested enterprises, during the course of investment projects, on brokerage and service fees, etc. must be in compliance with foreign law. • Dividends from the overseas invested enterprises shall be distributed to SOE parent companies in China on time and in full, and be subject to both Chinese and foreign tax on distribution.
Performance review and financial supervision	• SOEs are required to assess their outbound investments at regular intervals, and poor performing operations should be disposed of or shut down. • On-site inspection or audit (by intermediaries) is required for defined 'high-risk' cases where the overseas invested enterprises (projects) have incurred heavy losses in one or several years. Losses are exempted from inspection or audit if their incurrence can be reasonably explained by: (i). Long projected payback period of certain projects; (ii). The invested enterprise solely conducts research and development (R&D). The exemption must be subject to internal approval by the SOE's decision-marking bodies, including the shareholders meeting, the SOE Communist Party committee, and the board of directors. • SOE groups must summarize financial information on their outbound investments on annual basis for submission to their in-charge administration for finance matters. This must be submitted before the end of April of the following year.

* In 2016, reports in the global business media opined that the Chinese government was looking exert more effective control over outbound capital flows from China, and that the State Council had considered issuing guidance to tighten limitations on outbound investment. The media reported that outbound merger and acquisition (M&A) transactions exceeding US$10bn (US$1bn if acquisition was outside the core business of the Chinese investor) would not be approved by MOFCOM and other relevant authorities. In addition it was reported that SOEs would not be allowed to invest more than US$1bn in a single overseas real estate transaction. In response, on 6 December 2016, the State Administration of Foreign Exchange (SAFE) along with other three authorities, including the National Development and Reform Commission (NDRC), MOFCOM, and the People's Bank of China (PBOC) clarified the supervision issues for China's outbound investment [See KPMG *China Tax Weekly Update (Issue 47, December 2016)* for details].

Furthermore, a 26 January 2017 SAFE circular clarified that, 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 [See KPMG *China Tax Weekly Update (Issue 6, February 2017)* for details].

Reference: MOFCOM Order [2017] No. 2 / MOFCOM Announcement [2017] No. 37
Issuance date: 30 July 2017
Effective date: 30 July 2017

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

Potential impacts on businesses:
- Compliance risks due to regulatory uncertainties reduced

You may click the circular titles to access full content of the circulars.

FIE establishment and alteration rules clarified

On 30 July 2017, the Ministry of Commerce (MOFCOM) issued MOFCOM Order [2017] No. 2 with the revised Interim Measures for Filing Administration of Establishment and Alteration of Foreign-invested Enterprises (FIEs) (the "July 2017 Interim Measures". The July 2017 Interim Measures came into force from the date of issuance and take the place of the Interim Measures for Filing Administration of Establishment & Alteration of FIEs ("October 2016 Interim Measures") issued by MOFCOM in October 2016.

The October 2016 Interim Measures had provided that the set up of new FIEs and alteration of FIEs (e.g. name changes, registered capital increases, and transfer of FIE equity interests between foreign investors) would be subject to MOFCOM recordal filings rather than to MOFCOM pre-approval procedures, as was previously the case. This new treatment, applied nationwide, extended to FIEs in sectors which were not on the national 'Negative List" (which sets out sectors which are restricted/prohibited to foreign investment). For FIEs in restricted sectors the MOFCOM pre-approval process would still need to be followed.

Before the finalisation of the 2017 July Interim Measures, MOF solicited public comments on its draft in May 2017 [See KPMG *China Tax Weekly Update (Issue 22, June 2017)* for details]. Building upon the October 2016 Interim Measures, the July 2017 Interim Measures further provide that the following transactions will also transition from the pre-approval to the recordal process:

- M&A transaction resulting in domestically-owned companies becoming FIEs;
- Equity transactions through which a foreign-invested listed Chinese company gains a new foreign shareholder.

The transition to recordals for these transactions is subject to the Negative List caveat noted above, and requires also that the M&A transaction is not conducted between related parties. Otherwise pre-approvals still apply.

Simultaneous with the issuance of MOFCOM Order No. 2 and the July 2017 Interim Measures, MOFCOM also on 30 July 2017 issued Announcement [2017] No. 37 setting out the filing forms for FIE establishment and alteration (including through M&A transaction).

* Foreign investors investing into non-negative list industries in China simply make a recordal with MOFCOM (or local commerce departments) and may proceed with all of their other registrations (e.g. business registration, forex registration) in tandem. This differs from the old system which required MOFCOM FIE set up approval first, and then allowed the FIE to continue with all the other registrations, which made for a very time consuming process. The negative list covers sensitive industries for which the Chinese government still wants establishment and transfer of FIEs to be subject to a pre-approval process See [KPMG *China Tax Weekly Update (Issue 39, October 2016)* for details].

Reference: N/A
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: Enterprises, public institutions and other producers and business operators that discharge taxable pollutants into the environment directly
Relevant taxes: Environmental protection tax

Potential impacts on businesses:

- Get prepared for implementation of environmental protection tax

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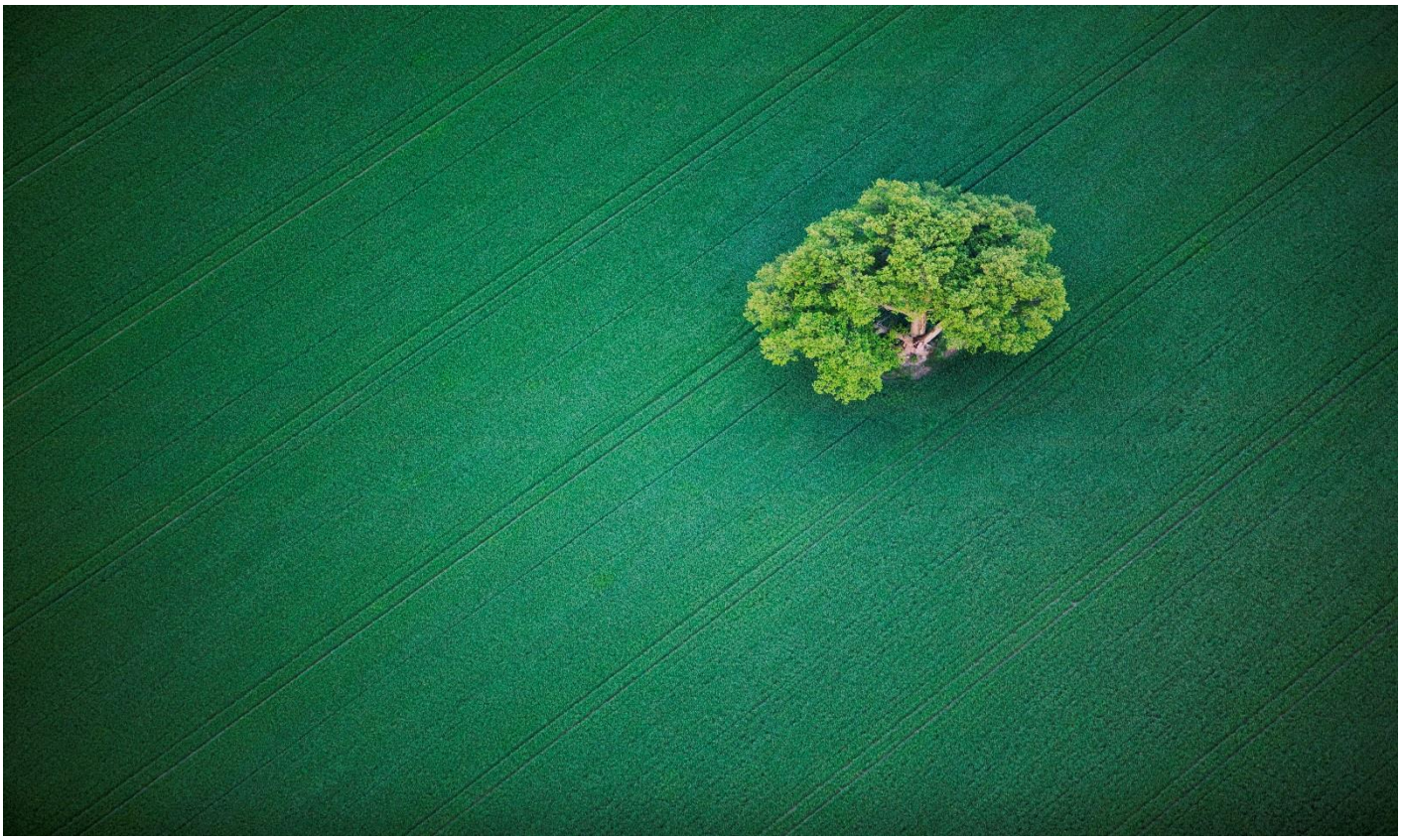
Environmental protection tax enforcement measures

On 25 December 2016, the Environmental Protection Tax Law was approved by the Standing Committee of the 12th National People's Congress, and it will apply from 1 January 2018. It is intended that the conversion from pollutant discharge fee to tax should not raise enterprise fiscal burdens. The law adopts the current standards for pollutant discharge fees as a lower range. Provincial level governments now have the authority to raise tax impositions above this level based on the environmental situation in their jurisdictions [See KPMG *China Tax Weekly Update (Issue 1, January 2017)* for details].

To facilitate the implementation of the law, in June 2017, MOF, the State Administration of Taxation (SAT) and the Ministry of Environmental Protection (MEP) jointly issued the draft *Implementation Regulations for Environmental Protection Tax Law* (the "Draft Regulations") to solicit public comments. The Draft Regulations noted that SAT will work with MEP to set up tax-related information sharing platform, and MEP will support SAT in conducting tax audit for environmental protection tax (EPT) [see KPMG *China Tax Weekly Update (Issue 26, July 2017)* for more details].

Furthermore, SAT and MEP on 31 July 2017 signed a cooperation memorandum on EPT collection. The memorandum clarifies that SAT and MEP will work together, inter alia, on the following:

- Publish the standards on EPT collection;
- Formulate EPT relief policy and its implementation rules; and
- Set up tax collection system and tax-related information sharing platform.



Reference: N/A
Issuance date: N/A
Effective date: N/A

Relevant industries: All
Relevant companies: MNEs
Relevant taxes: CIT

Potential impacts on businesses:
- Risks of being challenged due to cross-border tax avoidance arrangement increased

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OECD branch mismatch rules under BEPS Action 2

22 August 2016, the Organisation for Economic Cooperation and Development (OECD) invited public comments on a discussion draft on tax measures to counteract branch mismatch structures. This is an extension of the work completed in 2013-2015 under Action 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) of the BEPS Action Plan [See KPMG China Tax Weekly Update Issue 33, August 2016 for more details].

On 27 July 2017, the OECD released the final report (2017 report) which sets out recommendations for branch mismatch rules that would bring the treatment of these structures into line with the treatment of hybrid mismatch arrangements as set out in the 2015 BEPS Action 2 Report.

Branch mismatches arise where the ordinary rules for allocating income and expenditure between the branch and head office result in a portion of the net income of the taxpayer escaping the charge to taxation in both the branch and residence jurisdiction. Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch. The 2017 report identifies five basic types of branch mismatch arrangements, including:

- Disregarded branch structures – arising where the branch is not within the definition of a permanent establishment and does not have any other taxable presence in a jurisdiction;
- Diverted branch payments – arising where a jurisdiction recognizes the existence of the branch but the payment made to the branch is attributed to the head office in that jurisdiction, while the jurisdiction of the head office exempts the payment from tax because it was made to the branch;
- Deemed branch payments – arising where the branch is deemed to make a notional payment resulting in mismatch in tax outcomes under the rules of the residence and branch jurisdictions;
- Double deduction branch payments – where the same items of expenditure creates a tax deduction under the laws of both jurisdictions; and
- Imported branch mismatches – arising where the payee offsets income from a deductible payment against a deduction arising under a branch mismatch arrangement.

This report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches. It also includes targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

As a non-OECD member China's tax authorities are not bound to follow the OECD recommendations for branch mismatch. The recommendations, however, may be referred to by China's tax policymakers in the development of China's domestic hybrid mismatch rules. It is understood that work on the Chinese domestic rules in this space is under way. There is anticipation that progress on these rules may be made by late 2017/early 2018.

Contact Us

For any enquiries, please send to our public mailbox: taxenquiry@kpmg.com or contact our partners/directors in each China/HK offices.

Khoonming Ho
Head of Tax,
KPMG Asia Pacific
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Lewis Lu
Head of Tax,
KPMG China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Beijing/Shenyang
David Ling
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Tianjin
Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Qingdao
Vincent Pang
Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Shanghai/Nanjing/Chengdu
Anthony Chau
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Hangzhou
John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Guangzhou
Lilly Li
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen
Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Shenzhen
Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong
Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

David Ling
Head of Tax,
Northern Region
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Cheng Chi
Tel. +86 (10) 8508 7606
cheng.chi@kpmg.com

Conrad TURLEY
Tel. +86 (10) 8508 7513
conrad.turley@kpmg.com

Milano Fang
Tel. +86 (532) 8907 1724
milano.fang@kpmg.com

Tony Feng
Tel. +86 (10) 8508 7531
tony.feng@kpmg.com

John Gu
Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Rachel Guan
Tel. +86 (10) 8508 7613
rachel.guan@kpmg.com

Helen Han
Tel. +86 (10) 8508 7627
h.han@kpmg.com

Michael Wong
Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Josephine Jiang
Tel. +86 (10) 8508 7511
josephine.jiang@kpmg.com

Henry Kim
Tel. +86 (10) 8508 5000
henry.kim@kpmg.com

Li Li
Tel. +86 (10) 8508 7537
li.li@kpmg.com

Lisa Li
Tel. +86 (10) 8508 7638
lisa.h.li@kpmg.com

Thomas Li
Tel. +86 (10) 8508 7574
thomas.li@kpmg.com

Larry Li
Tel. +86 (10) 8508 7658
larry.y.li@kpmg.com

Alan O'Connor
Tel. +86 (10) 8508 7521
alan.oconnor@kpmg.com

Vincent Pang
Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Naoko Hirasawa
Tel. +86 (10) 8508 7054
naoko.hirasawa@kpmg.com

Shirley Shen
Tel. +86 (10) 8508 7586
yinghua.shen@kpmg.com

Joseph Tam
Tel. +86 (10) 8508 7605
laiyiu.tam@kpmg.com

Joyce Tan
Tel. +86 (10) 8508 7666
joyce.tan@kpmg.com

Jessica Xie
Tel. +86 (10) 8508 7540
jessica.xie@kpmg.com

Cynthia Xie
Tel. +86 (10) 8508 7543
cynthia.py.xie@kpmg.com

Christopher Xing
Tel. +86 (10) 8508 7072
christopher.xing@kpmg.com

Irene Yan
Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Jessie Zhang
Tel. +86 (10) 8508 7625
jessie.j.zhang@kpmg.com

Sheila Zhang
Tel: +86 (10) 8508 7507
sheila.zhang@kpmg.com

Tiansheng Zhang
Tel. +86 (10) 8508 7526
tiansheng.zhang@kpmg.com

Tracy Zhang
Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Eric Zhou
Tel. +86 (10) 8508 7610
ec.zhou@kpmg.com

Central China

Anthony Chau
Head of Tax,
Eastern & Western Region
Tel. +86 (21) 2212 3206
anthony.chau@kpmg.com

Andy Chen
Tel. +86 (21) 2212 3298
andy.m.chen@kpmg.com

Yasuhiko Otani
Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Johnny Deng
Tel. +86 (21) 2212 3457
johnny.deng@kpmg.com

Cheng Dong
Tel. +86 (21) 2212 3410
cheng.dong@kpmg.com

Marianne Dong
Tel. +86 (21) 2212 3436
marianne.dong@kpmg.com

Chris Ge
Tel. +86 (21) 2212 3083
chris.ge@kpmg.com

Chris Ho
Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Henry Wong
Tel. +86 (21) 2212 3380
henry.wong@kpmg.com

Jason Jiang
Tel. +86 (21) 2212 3527
jason.jt.jiang@kpmg.com

Flame Jin
Tel. +86 (21) 2212 3420
flame.jin@kpmg.com

Sunny Leung
Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Michael Li
Tel. +86 (21) 2212 3463
michael.y.li@kpmg.com

Karen Lin
Tel. +86 (21) 2212 4169
karen.w.lin@kpmg.com

Christopher Mak
Tel. +86 (21) 2212 3409
christopher.mak@kpmg.com

Henry Ngai
Tel. +86 (21) 2212 3411
henry.ngai@kpmg.com

Ruqiang Pan
Tel. +86 (21) 2212 3118
ruqiang.pan@kpmg.com

Amy Rao
Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Wayne Tan
Tel. +86 (28) 8673 3915
wayne.tan@kpmg.com

Tanya Tang
Tel. +86 (25) 8691 2850
tanya.tang@kpmg.com

Rachel Tao
Tel. +86 (21) 2212 3473
rachel.tao@kpmg.com

Janet Wang
Tel. +86 (21) 2212 3302
janet.z.wang@kpmg.com

John Wang
Tel. +86 (571) 2803 8088
john.wang@kpmg.com

Mimi Wang
Tel. +86 (21) 2212 3250
mimi.wang@kpmg.com

Jennifer Weng
Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

Grace Xie
Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Bruce Xu
Tel. +86 (21) 2212 3396
bruce.xu@kpmg.com

Jie Xu
Tel. +86 (21) 2212 3678
jie.xu@kpmg.com

Robert Xu
Tel. +86 (21) 2212 3124
robert.xu@kpmg.com

Yang Yang
Tel. +86 (21) 2212 3372
yang.yang@kpmg.com

William Zhang
Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

Hanson Zhou
Tel. +86 (21) 2212 3318
hanson.zhou@kpmg.com

Michelle Zhou
Tel. +86 (21) 2212 3458
michelle.b.zhou@kpmg.com

Southern China

Lilly Li
Head of Tax,
Southern Region
Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Penny Chen
Tel. +1 (408) 367 6086
penny.chen@kpmg.com

Vivian Chen
Tel. +86 (755) 2547 1198
vivian.w.chen@kpmg.com

Sam Fan
Tel. +86 (755) 2547 1071
sam.kh.fan@kpmg.com

Joe Fu
Tel. +86 (755) 2547 1138
joe.fu@kpmg.com

Ricky Gu
Tel. +86 (20) 3813 8620
ricky.gu@kpmg.com

Fiona He
Tel. +86 (20) 3813 8623
fiona.he@kpmg.com

Angie Ho
Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Aileen Jiang
Tel. +86 (755) 2547 1163
aileen.jiang@kpmg.com

Cloris Li
Tel. +86 (20) 3813 8829
cloris.li@kpmg.com

Jean Li
Tel. +86 (755) 2547 1128
jean.j.li@kpmg.com

Sisi Li
Tel. +86 (20) 3813 8887
sisi.li@kpmg.com

Mabel Li
Tel. +86 (755) 2547 1164
mabel.li@kpmg.com

Kelly Liao
Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Patrick Lu
Tel. +86 (755) 2547 1187
patrick.c.lu@kpmg.com

Grace Luo
Tel. +86 (20) 3813 8609
grace.luo@kpmg.com

Ling Lin
Tel. +86 (755) 2547 1170
ling.lin@kpmg.com

Maria Mei
Tel. +86 (592) 2150 807
maria.mei@kpmg.com

Eileen Sun
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Michelle Sun
Tel. +86 (20) 3813 8615
michelle.sun@kpmg.com

Bin Yang
Tel. +86 (20) 3813 8605
bin.yang@kpmg.com

Lixin Zeng
Tel. +86 (20) 3813 8812
lixin.zeng@kpmg.com

Hong Kong

Curtis Ng
Head of Tax, Hong Kong
Tel. +852 2143 8709
curtis.ng@kpmg.com

Ayesha M. Lau
Tel. +852 2826 7165
ayesha.lau@kpmg.com

Chris Abbiss
Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern
Tel. +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Tel. +852 2847 5108
yvette.chan@kpmg.com

Lu Chen
Tel. +852 2143 8777
lu.l.chen@kpmg.com

Wade Wagatsuma
Tel. +852 2685 7806
wade.wagatsuma@kpmg.com

Natalie To
Tel. +852 2143 8509
natalie.to@kpmg.com

Matthew Fenwick
Tel. +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Tel. +852 2143 8821
sandy.fung@kpmg.com

Charles Kinsley
Tel. +852 2826 8070
charles.kinsley@kpmg.com

Stanley Ho
Tel. +852 2826 7296
stanley.ho@kpmg.com

Becky Wong
Tel. +852 2978 8271
becky.wong@kpmg.com

Barbara Forrest
Tel. +852 2978 8941
barbara.forrest@kpmg.com

John Kondos
Tel. +852 2685 7457
john.kondos@kpmg.com

Kate Lai
Tel. +852 2978 8942
kate.lai@kpmg.com

Travis Lee
Tel. +852 2143 8524
travis.lee@kpmg.com

Irene Lee
Tel. +852 2685 7372
irene.lee@kpmg.com

Alice Leung
Tel. +852 2143 8711
alice.leung@kpmg.com

Ivor Morris
Tel. +852 2847 5092
ivor.morris@kpmg.com

Benjamin Pong
Tel. +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Tel. +852 2684 7472
malcolm.j.prebble@kpmg.com

David Siew
Tel. +852 2143 8785
david.siew@kpmg.com

Murray Sarelius
Tel. +852 3927 5671
murray.sarelius@kpmg.com

John Timpany
Tel. +852 2143 8790
john.timpany@kpmg.com

Lachlan Wolfers
Tel. +852 2685 7791
lachlan.wolfers@kpmg.com

Steve Man
Tel. +852 2978 8976
steve.man@kpmg.com

Daniel Hui
Tel. +852 2685 7815
daniel.hui@kpmg.com

Karmen Yeung
Tel. +852 2143 8753
karmen.yeung@kpmg.com

Erica Chan
Tel. +852 3927 5572
erica.chan@kpmg.com

Adam Zhong
Tel. +852 2685 7559
adam.zhong@kpmg.com

kpmg.com/cn