

Tax Analysis

PRC Tax

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SAFE simplifies rules on administration of foreign exchange for direct investment

China's State Administration of Foreign Exchange (SAFE) recently issued guidance that simplifies and relaxes the rules governing the foreign exchange administration of both inbound and outbound investment (*Notice on Further Improving and Adjusting Foreign Exchange Administration Policies for Direct Investment* (Huifa [2012] No. 59, ("Circular 59"))). Circular 59 eliminates the advance approval required for many foreign direct investment (FDI) activities, such as setting up a foreign exchange bank account, transferring foreign exchange capital funds to certain accounts, etc., so that banks can directly handle investors' requests. In addition to simplifying the administrative burdens on the SAFE (for more than 40 types of activities), Circular 59 is also expected to benefit foreign investors by relaxing the foreign exchange rules. Circular 59 applies as from 17 December 2012.

Highlights of Circular 59

1. The following administrative procedures for FDI are abolished:
 - SAFE approval for certain foreign exchange accounts (i.e. opening, deposit of funds, buying, selling and remitting foreign exchange);
 - SAFE approval for domestic transfers of foreign exchange funds for routine business purposes;
 - SAFE approval for reinvestment by foreign investor using legitimate income generated from Mainland China;
 - Verification by SAFE for a reduction of capital; and
 - Foreign exchange registration and capital verification for reinvestment in China by foreign-invested Chinese holding companies (CHCs).
2. Controls on the utilization of funds are relaxed as follows:
 - The restrictions on the number of foreign exchange accounts and the setting up of foreign exchange capital accounts in places other than where a foreign-invested entity (FIE) is incorporated are abolished;

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- The restriction on the purchase and remittance of foreign exchange by an FIE in places other than where it is incorporated are abolished; and
- Domestic entities can use foreign exchange loans obtained domestically to extend loans offshore, and FIEs can grant loans to their overseas parent companies.

3. The following foreign exchange procedures for FDI are simplified:

- The categories of foreign exchange accounts;
- Foreign exchange administrative procedures for domestic reinvestment by foreign-invested CHCs;
- SAFE confirmation procedures for verification of the capital of an FIE;
- Foreign exchange registration procedure for foreign investors in equity acquisitions from Chinese shareholders; and
- Conversion of foreign exchange capital to RMB by an FIE.

The following compares the pre- and post-Circular 59 foreign exchange policies:

FIE establishment and capital verification

	Pre-Circular 59	Post-Circular 59
Account opening	<p>To establish an FIE, a foreign investor could set up a special foreign exchange account with a domestic bank to pay expenses relating to incorporation, but this was subject to SAFE's approval.</p> <p>Approval also was required to set up a foreign exchange capital account after the FIE was established.</p>	<p>SAFE approval is not required to set up a special foreign exchange or capital account. The bank can directly open an account using the investor's registration information in the SAFE e-system.</p>
	<p>An FIE generally was not allowed to open a foreign exchange capital account in places other than where it was incorporated. The number of foreign exchange capital accounts by an FIE was strictly controlled and a ceiling was set for each capital account.</p>	<p>An FIE can open one or more foreign exchange capital accounts, and there are no restrictions on the location of the accounts. Instead of setting a ceiling for each capital account, SAFE will set a limit on the total capital inflow for the FIE.</p>
Capital verification	<p>Accounting firms were required to submit documents in hard copy to the local SAFE to obtain written confirmation of a capital injection or reduction.</p>	<p>Accounting firms may apply for and obtain the confirmation electronically through the SAFE e-system. No confirmation is required for a capital reduction.</p>

Domestic reinvestment

	Pre-Circular 59	Post-Circular 59
Domestic reinvestment by foreign investors	<p>SAFE approval was required where a foreign investor made reinvestment (i.e. newly established an FIE or increased the capital of an existing FIE) with legitimate income generated in China, or where an FIE converted its registered foreign debt to capital.</p>	<p>SAFE approval is not required.</p>

Domestic reinvestment (continued)

	Pre-Circular 59	Post-Circular 59
Domestic reinvestments by foreign-invested CHCs ²	All FIEs had to register for foreign exchange purposes, regardless of whether they were invested by a foreign investor or a foreign-invested CHC.	FIEs established by a foreign-invested CHC are not required to register for foreign exchange purposes, unless they are jointly established by the CHC and a foreign investor(s). If registration is required, a foreign-invested CHC will be considered a Chinese shareholder.
	A foreign-invested CHC had to obtain SAFE approval to remit its foreign exchange capital to its domestic-invested entity for capital injection purposes.	SAFE approval is not required. The bank can process the remittance after reviewing the relevant materials. However, the bank must register the information in the SAFE e-system after the remittance is processed.

Equity acquisition from a Chinese party

	Pre-Circular 59	Post-Circular 59
Special foreign exchange account opening and fund receipt by Chinese seller	<p>The Chinese seller had to set up a special foreign exchange account with the approval of SAFE in order to receive and retain the sales proceeds from the foreign investor in foreign exchange.</p> <p>SAFE approval was required when the proceeds were deposited in the account.</p>	SAFE approval is not required to set up a special account or to receive the proceeds from the acquisition. The bank can directly process the funds using the registration information in the SAFE e-system.
Foreign exchange registration by the foreign acquirer	After the consideration was paid, the foreign acquirer had to complete certain registration formalities with the local SAFE office where the Chinese seller was located.	<p>Where the consideration is paid through inbound remittances in foreign exchange, registration will be completed automatically through the SAFE e-system.</p> <p>Where the consideration is paid in other forms, registration formalities will need to be completed by the target company with its local SAFE office.</p>

Equity or real estate disposal to a Chinese party

	Pre-Circular 59	Post-Circular 59
Remittance of purchase consideration by the Chinese buyer	Where a domestic entity or individual purchased shares from a foreign party, SAFE approval was required for the Chinese buyer to purchase and then remit the foreign exchange to the foreign seller.	SAFE approval is not required. The bank can directly process the purchase and remittance of foreign exchange using the registration information in the SAFE e-system.

² According to Circular 59, foreign invested equity investment enterprises and venture capital investment enterprises also may be considered foreign-invested CHCs for foreign exchange administration purposes.

Equity or real estate disposal to a Chinese party (continued)

	Pre-Circular 59	Post-Circular 59
Remittance of proceeds from the sale of real estate by a domestic branch of a foreign company	Where a domestic branch of a foreign company (generally a representative office) disposed of its real estate in China, SAFE approval was required for the branch to convert the RMB proceeds to foreign exchange and then remit it to the head office.	SAFE approval is not required. The bank can directly process the proceeds after reviewing the relevant materials submitted by the branch.

Offshore loans

	Pre-Circular 59	Post-Circular 59
Offshore borrowers	<p>Offshore borrowers generally were limited to the lender's wholly owned subsidiaries or shareholding enterprises legally established abroad.</p> <p>For a foreign-invested multinational with a Chinese member entity fulfilling regional investment/management functions, the group's domestic member entities were allowed to make loans in foreign exchange to offshore members of the group, provided the loan balance did not exceed the total of dividends distributed (but not paid) in the preceding year and the foreign investor's share of retained earnings of the lender.</p>	No particular restriction is imposed on the qualification of borrowers. Domestic entities are specifically allowed to make loans to their overseas parent companies, with the loan balance not exceeding the overseas parent's share of dividends receivable and retained earnings.

Conversion of foreign exchange capital to RMB

	Pre-Circular 59	Post-Circular 59
Exceptional cases	For exceptional cases not specifically covered by the foreign exchange administration rules, but where the entity had valid business needs to convert foreign currency into RMB, the bank could handle the conversion as requested after reviewing the relevant documents, but documentation had to be filed with the local SAFE.	The bank can handle the conversion in exceptional cases after verifying the validity of the business needs. It is no longer necessary to submit documentation to SAFE.

Summary

Circular 59 removes a number of SAFE approval requirements, thus allowing banks to directly facilitate and process the relevant foreign exchange transactions. The new rules also replace certain paper submission requirements by providing public access to SAFE's e-system. These measures will reduce public costs, facilitate direct investment and benefit economic development of the country. It is worth noting, however, that Circular 59 specifically asks banks to enhance compliance awareness, which reflects the SAFE's concern about violations of the foreign exchange rules and could be interpreted to mean that SAFE supervision will continue, albeit with a change of administrative emphasis.

Note: Contents discussed in this Tax Analysis pertains to Deloitte Global Business Tax Services.

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