

Asia Pacific Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

China

March 29, 2012

Clarifications on RMB reinvestments by Chinese Holding Companies

In our newsalert issued on [August 17, 2011](#), we mentioned that on March 29, 2011, the State Administration of Foreign Exchange ("SAFE") set out a new requirement in Circular Huizhihan [2011]No. 7 ("Circular 7"). Under this requirement, Chinese Holding Companies ("CHCs") must convert their legitimate RMB proceeds to registered capital by applying for a capital increase before using the same RMB to reinvest in their Chinese subsidiaries. As such, a CHC would be deemed to distribute dividends to its foreign investor, and the investor may be concerned that it would consequently be subject to China's withholding income tax ("WHT").

Recently, the Ministry of Commerce ("MOFCOM") and the SAFE jointly released Circular Shangzihan [2011] No.1078 ("Circular 1078") to clarify the requirements set out in Circular 7.

In this newsalert, we summarize the key aspects of Circular 1078 as well as our observations.

Key points of Circular 1078

- A CHC may reinvest its legitimate investment-related RMB income derived from China, including profits, early investment repatriations, liquidation proceeds, share transfer proceeds and reductions of capital, directly in China. Such reinvestments are subject to approval by SAFE.



- Echoing the requirement of Circular 7, the CHC's foreign investors may use the aforementioned income as capital contributions to the CHC if the CHC's capital has not yet been paid up, or as additional capital to increase the existing CHC's registered capital.
- Circular 1078 also stated that a CHC may not use domestic loans for investing in China.

Observations

- Circular 1078 clarifies that a CHC is not required to apply for a capital increase or capital contribution before using its investment-related RMB income derived by the CHC from Chinese portfolio companies for reinvesting. This effectively mitigates any adverse tax implications on the CHC and its foreign investors.

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