On 2 January 2018, China’s State Administration of Taxation (SAT) released SAT Public Notice [2018] No. 3 (PN 3) to clarify the implementation details of the withholding tax deferral treatment on direct reinvestment that is provided under Caishui [2017] No. 88 (Circular 88). PN 3 is retroactively effective as of 1 January 2017. PN 3 clarifies but is not limited to the following:

- Scope of eligible operational activities
- Filing procedures and document requirements
- Responsibilities of foreign investors, withholding agents and tax authorities
- Application of treaty benefits

Circular 88 requires eligible reinvestments to be made into one of the designated encouraged industries listed under the Foreign Investment Industrial Guidance Catalogue and/or the Catalogue of Priority Industries for Foreign Investments in the Central and Western Regions. PN 3 further clarifies the eligible operational activities as one or more of the following economic activities:

- Manufacture of products or provision of services
- Research and development
- Investment in construction projects or acquisition of equipment
- Other operational activities
Under Circular 88, a Chinese distributing company is required to assess whether the information provided by a foreign investor supports the eligibility for the withholding tax deferral treatment. PN 3 provides that the assessment should include whether:

- Information provided by the foreign investor is complete.
- Actual dividend payment flow is consistent with the information provided by the foreign investors.
- Information reported on the form related to the Chinese distributing company is correct and accurate.

After the withholding agent is satisfied with the assessment, the withholding agent should submit the required documents to the tax authorities within seven days of the actual dividend distribution. Failure to properly assess the eligibility will subject the withholding agent to underwithholding tax penalties, ranging from 50% to 300% of the underpaid taxes. The foreign investors however will be required to pay the underwithheld tax to the tax authority.

If the foreign investor obtains the withholding tax deferral treatment by filing improper or incorrect information, the foreign investor is subject to late filing interest.

When the foreign investor applies for the deferral treatment but repays the underwithheld tax to the withholding agent due to improper or incorrect information, the foreign investors may still apply for a reduced treaty withholding tax rate for a dividend.

When the foreign investor partially disposes its equity interest in the Chinese subsidiary where the equity was invested with dividends under both the deferral and non-deferral treatments, the disposal will first be applied against the deferral treatment, triggering the claw-back provision.

Endnote

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