

China Business Series: Repatriation of Funds out of China

By Thomas M. Shoesmith, Woon-Wah Siu and Julian Zou

China imposes controls on the inflow and outflow of foreign exchange. Given the involvement of State Administration of Foreign Exchange and various other governmental agencies in the process, repatriating funds from China can be a trap for the unwary. Foreign investors should familiarize themselves with the approval requirements and procedures.

This advisory is one of a series prepared by Pillsbury's China Practice on questions frequently asked by our clients doing business in China. Here, we outline the general procedure for repatriating funds from a subsidiary in China upon (a) distribution of profits to an offshore parent company and (b) dissolution of the subsidiary. A list of the principal applicable regulations appears in the Appendix.

I. Background

The Chinese government still maintains foreign exchange control, although it has been gradually relaxing some of the restrictions. The State Administration of Foreign Exchange (SAFE) is the lead agency in foreign exchange control in China. Other agencies that are involved include the provincial branches of the State Tax Bureau, local tax bureaus and the Ministry of Commerce.¹

Typical ways of disposing profits accumulated by a subsidiary in China include distributing the profits out of China to the offshore parent company or re-investing the funds in China for the purpose of business expansion. If the profits are kept in China, the offshore parent may consider using entrusted loan services provided by some major banks in China as a way to lend money to other companies and to earn interest therefrom. In addition, the offshore parent company can repatriate before-tax profits through royalty fees, loan interests, overhead charges, management fees and other service charges, but the parent company may be subject to foreign enterprise income tax or business tax. In addition, certain inter-company charges may not be deductible by the Chinese subsidiary as expenses.

¹ For current-account transactions, SAFE has designated banks that sell foreign exchanges as gatekeepers to ensure that a remitting company has all the necessary approval documents. Current-account transactions and transactions related to loan or pledge are beyond the scope of this advisory.

What to do with profits generated in China generally is a commercial decision depending on the company's overall business strategy. Note, however, that under current law reinvestment is more tax efficient as the reinvested amount will not be subject to any withholding tax upon repatriation after five years. Subject to additional rules, reinvestment must have governmental approval before it can be eligible for the preferential tax treatment.

Distribution of profits and distribution upon dissolution are subject to approval and registration requirements, but the latter is subject to stricter legal requirements and is generally more time-consuming.

II. Repatriation of Profits

2.1 Calculation of Distributable Profits

Under PRC law, a foreign invested enterprise (FIE), including joint venture and wholly foreign-owned enterprises, can remit profits out of China after paying applicable PRC taxes. Although the procedure for repatriating profits is quite straightforward, calculation of distributable profits is sometimes complicated and is affected by other statutory requirements. We list below several factors that are often ignored by FIEs in China:

- (a) Whether the registered capital of the company has been fully contributed?

The registered capital of an FIE must have been fully contributed before any profits can be repatriated out of China.

- (b) Whether deficits incurred by the FIE in previous fiscal years have been fully offset by profits?

An FIE may not pay dividends unless profits are available for distribution. If the FIE has cumulative losses carried forward from previous fiscal years, the FIE has to offset the deficits fully against profits before distributing any profits out of China. For example, if the company was established in 2009, and in fiscal years 2009 and 2010, the company incurred deficits of US\$2,000,000 and US\$3,000,000, respectively, and then in fiscal year 2011, the company made a profit of US\$6,000,000, assuming no taxes are payable, the company can only distribute US\$1,000,000 out of China because it has to use US\$5,000,000 to offset the losses in fiscal years 2009 and 2010.

- (c) Whether the FIE has duly contributed the statutory surplus reserve?

According to PRC law, an FIE must set aside annually (i) no less than 10% of its after-tax profits for the reserve fund until the total amount of the statutory surplus reserve reaches 50% of the FIE's registered capital and (ii) specified percentages of its after-tax profits for the employee welfare and bonus fund and the enterprise expansion fund.

2.2 Repatriation Procedure

An FIE may repatriate distributable profits out of China by following the steps below.

- (a) The FIE must submit the following documents:

- (1) Board resolution approving the distribution of profits or dividends to the offshore parent company and specifying the amount to be distributed and the period in which the profits to be distributed are generated² (Profit Period)
 - (2) Audit reports by an accounting firm on the Profit Period and the interim audit report for the current fiscal year unless the current fiscal year is the Profit Period
 - (3) Financial statements of and books of accounts for the Profit Period
 - (4) Capital verification report by an accounting firm confirming that the requisite capital contribution has been made
 - (5) Tax registration certificate of the FIE
 - (6) Foreign exchange registration certificate of the FIE
 - (7) Articles of association of the FIE
- (b) Tax Review and Payment of Taxes
- (1) Tax Rate and Preferential Treatment

The tax imposed upon repatriated profits is enterprise income tax,³ Foreign investors who receive repatriated profits are liable for enterprise income tax on the repatriated profits received.⁴ The FIE must withhold tax from the amount to be distributed. The applicable withholding tax rate will depend on the period in which the profits are generated.

(i) Profits Generated Before January 1, 2008

Any accumulated and undistributed profits generated by the FIE before January 1, 2008 are exempted from withholding tax upon repatriation. The FIE should file a tax exemption application in the tax review process discussed below.

(ii) Profits Generated On or After January 1, 2008

For profits generated on or after January 1, 2008, there is a 10% withholding tax imposed on the profits to be distributed,⁵ If the foreign investor is a resident of a country with a bilateral tax treaty with China, the withholding tax rate may be lower.

² The requirement to specify the Profit Period is due to the tax preference which foreign investors can enjoy (an FIE can repatriate distributable profits generated before January 1, 2008 to its foreign parent without tax withholding) and which preference will cease eventually.

³ If the foreign investor of an FIE is a natural person and not an entity, any profits distributed to such investor, regardless when such profits are generated, will be exempted from withholding.

⁴ If the foreign investor of an FIE is a natural person and not an entity, any profits distributed to such investor, regardless when such profits are generated, will be exempted from withholding.

⁵ Although the standard income tax rate after 2008 is 20% for profits generated by an FIE, the Implementing Rules to the Enterprise Income Tax Law reduced the rate to 10%.

(2) Tax Review

The FIE must apply for tax review in order to determine the amount of taxable income, applicable tax rate, and possible preferential tax treatment that might apply. The FIE has to submit the following documents for tax review purposes:

- (i) Board Resolution
- (ii) Audit Reports
- (iii) Financial statements and books of account for the Profit Period
- (iv) Tax Registration Certificate of the FIE
- (iv) Articles of Association of the FIE
- (v) Tax Return for the Profit Period, as approved by the tax authority (税务机关汇算清缴后的有关年度所得税申报表)
- (vi) Income Tax Clearance Certificate (所得税完税凭证) of the FIE covering the Profit Period as evidence that the FIE has paid income tax for profits generated in the Profit Period
- (vii) Any other documents that may be requested by the tax authority from time to time

Tax Review will take approximately 16 business days, and the tax authority will issue a Review Letter (服务贸易等项目对外支付税务核定通知书) to the FIE indicating the applicable tax rate and whether the FIE enjoys any preferential tax treatment under applicable bilateral tax treaties.

The FIE is required to pay withholding tax based on the tax rate in the Review Letter, after which the tax authority will issue a Withholding Tax Clearance Certificate (完税证明) relating to payment of the withholding tax.

(3) Tax Certificate for Repatriating Profits

The two Tax Clearance Certificates mentioned in Step 2.2(b)(2) above are merely internal documents for use within the tax authority. The FIE may be required to apply for a Tax Certificate (税务证明) before proceeding to Step 2.2(c) below. If the profits to be repatriated exceed US\$30,000, the FIE has to obtain this Tax Certificate. If the profits to be repatriated is US\$ 30,000 or less, the FIE can proceed to Step 2.2(c) below.

The following documents need to be submitted to the tax authority to apply for the Tax Certificate:

- (i) Application Form (which is a standard form that can be obtained from the tax authority)

- (ii) Review Letter
- (iii) Income Tax Clearance Certificate
- (iv) Tax Return for the Profit Period, as approved by the tax authority
(税务机关汇算清缴后的有关年度所得税申报表)
- (iv) Approval and Implementation Statement of Preferential Tax Treatment of Non-Residents under Bilateral Tax Treaties
(非居民享受税收协定待遇审批执行情况报告表), if any
- (v) Any other documents that may be requested by the tax authority

It takes approximately one business day after submitting the application and all necessary documents for the FIE to obtain the Tax Certificate.

(c) Remittance of Profits

Once the FIE has obtained the Tax Certificate (unless it is not required to obtain one because the amount to be repatriated is US\$30,000 or less), it can then directly apply with a qualified bank (i.e., a bank authorized to engage into foreign exchange businesses) to remit the profits out of China. The FIE has to submit the following documents:

- (1) Tax Certificate (or Withholding Tax Clearance Certificate if the amount to be repatriated is US\$30,000 or less)
- (2) Audit Reports
- (3) Board Resolution
- (4) Foreign Exchange Registration Certificate of the FIE
- (5) Capital Verification Report
- (6) Other information as may be required by the SAFE

III. Repatriation of Funds Upon Dissolution

When a foreign investor dissolves an FIE it owns in China, the process for repatriation of funds will be more complicated. The funds to be repatriated consist of two parts: the original contributed registered capital by the foreign investors into the FIE, and any accumulated and undistributed profits. In some circumstances, there might also be shareholder loans from the offshore parent company. When applying for repatriating funds with competent government authorities, the FIE must be aware of the different treatment, especially the tax treatment, imposed on different types of funds.

A detailed discussion of the procedure for dissolution of a company in China is beyond the scope of this advisory, but we provide a brief summary here to help you gain a general understanding. Winding up an FIE in China is a lengthy process, which includes pre-approval, notification to creditors and public announcement, tax clearance, and deregistration. Distributable profits upon dissolution should be after

payment of any loans, employees' salaries, mandatory social security contributions related to employees, taxes, fees, costs and expenses by the FIE.

3.1 Tax Clearance and Deregistration

As discussed above, the FIE needs not withhold tax from distributions of profits generated before January 1, 2008 but must withhold 10% (or such lesser rate pursuant to applicable bilateral tax treaty) of profits distributed that were generated on or after January 1, 2008.

Step 2.2(b) also applies to dissolution of an FIE. In the case of dissolution, the tax authority will determine the taxable amount (total amount of funds minus the amount of contributed registered capital), and the applicable withholding tax. After paying the withholding tax, the FIE can then apply for deregistration with the tax authority by submitting the following documents:

- (1) Application Letter
- (2) Liquidation Report as approved by competent government authority (typically the original approving authority of the FIE)
- (3) Board Resolution adopted by the FIE regarding the dissolution and tax deregistration
- (4) Tax Registration Certificate
- (5) Income Tax Clearance Certificate
- (6) Audit Report on Dissolution
- (7) Financial statements and books of accounts
- (8) Other documents as may be required by the tax authority

The tax deregistration process will take approximately two business days, and a Tax Deregistration Certificate will be issued by the tax authority to the FIE at the conclusion of this step.

3.2 Approval by State Administration of Foreign Exchange

An additional step for repatriating funds upon dissolution is obtaining approval from the SAFE or its local branch. This process will take approximately 20 business days, and the FIE has to submit the following documents for examination by the SAFE:

- (1) Application Letter
- (2) Foreign Exchange Registration Certificate
- (3) Approval Letter regarding the dissolution issued by the original approving authority of the FIE (Dissolution Approval Letter)

- (4) Resolution adopted by the Liquidation Committee, which must have been formed at the beginning of the dissolution process for the purpose of supervising and conducting the liquidation
- (5) Capital Verification Report
- (6) Audit Report on Dissolution
- (7) Foreign Exchange Bank Account Opening Notice (外汇账户开户通知书)
- (8) Bank Statement for the foreign exchange bank account as of the closing date of the liquidation (清算结束日外汇账户对账单)
- (9) Tax Deregistration Certificate
- (10) Other documents as may be required by the SAFE

SAFE will issue an approval letter at the end of this step.

3.3 Repatriation of Funds

The FIE can then apply to remit funds out of China with a qualified bank by submitting the following documents:

- (1) Foreign Exchange Registration Certificate
- (2) Liquidation Committee resolution
- (3) SAFE approval letter
- (4) Dissolution Approval Letter
- (5) Audit Report on Dissolution
- (6) Other documents as may be required by the bank on a case-by-case basis

For further information on this or any other topic relating to doing business and investing in China, please contact our China Team.

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If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Thomas M. Shoesmith **(bio)**
Silicon Valley
+1.650.233.4553
thomas.shoesmith@pillsburylaw.com

Woon-Wah Siu **(bio)**
Shanghai
+86.21.6137.7924
woonwah.siu@pillsburylaw.com

Julian Zou **(bio)**
Silicon Valley
+1.650.233.4057
julian.zou@pillsburylaw.com

APPENDIX
Applicable Laws and Regulations

- 1 *Enterprise Income Tax Law* (企业所得税法), promulgated by the National People's Congress on March 13, 2007 and took effect on January 1, 2008.
- 2 *Implementing Rules to the Enterprise Income Tax Law* (企业所得税法实施条例), promulgated by the State Council on December 6, 2007 and took effect on January 1, 2008.
- 3 *Notification concerning Several Preferential Policies on Enterprise Income Tax* (关于企业所得税若干优惠政策的通知), promulgated by the Ministry of Finance and the State Administration of Taxation on February 22, 2008.
- 4 *Notification on Several Issues Relating to the Settlement of Enterprise Income Tax upon Liquidation* (关于企业清算业务企业所得税处理若干问题的通知), promulgated by the Ministry of Commerce and the State Administration of Taxation on April 30, 2009.
- 5 *Guidance on Dissolution and Liquidation of Foreign Invested Enterprises* (关于依法做好外商投资企业解散和清算工作的指导意见); promulgated by the Ministry of Commerce on May 5, 2008.
- 6 *Notification on Several Issues relating to the Dissolution and Deregistration of Foreign Invested Enterprises* (关于外商投资企业解散注销登记管理有关问题的通知), promulgated by the State Administration of Industry and Commerce and the Ministry of Commerce on October 20, 2008.
- 7 *Notification on Several Issues relating to the Repatriation of Profits and Dividends with Designated Foreign Exchange Banks* (关于外汇指定银行办理利润、股息、红利汇出有关问题的通知), promulgated by the State Administration of Foreign Exchange on September 22, 1998.
- 8 *Notification on Several Issues relating to Submission of Tax Certificate during the Process of Outbound Payment under Service Trade* (关于服务贸易等项目对外支付提交税务证明有关问题的通知), promulgated by the State Administration of Foreign Exchange and the State Administration of Taxation on November 25, 2008 and took effect on January 1, 2009.
- 9 *Notification on Several Issues relating to Foreign Exchange Payment by Transnational Companies under Non-Trading Transactions* (关于跨国公司非贸易售付汇管理有关问题的通知), promulgated by the State Administration of Foreign Exchange on June 29, 2004 and took effect on August 1, 2004.
- 10 *Notification on Further Clarification of Submission of Tax Certificate during the Process of Outbound Payment under Service Trade* (关于进一步明确服务贸易等项目对外支付提交税务证明有关问题的通知), promulgated by the State Administration of Foreign Exchange and the State Administration of Taxation on November 6, 2009.
- 11 *Notification on Foreign Exchange Business relating to Equity Transfer and Liquidation of Foreign Invested Enterprises* (办理外商投资企业转股、清算外汇业务的通知), promulgated by the State Administration of Foreign Exchange on December 22, 1999.

- 12 *Administration Rules on Foreign Loan of Foreign Invested Banks* (境内外资银行外债管理办法), Promulgated by the National Development and Reform Commission, People's Bank of China, and the China Banking Regulatory Commission on May 27, 2004 and took effect on June 27, 2004.
- 13 *Administration Rules on Borrowing International Commercial Loans by Domestic Entities* (境内机构借用国际商业贷款管理办法), promulgated by the State Administration of Foreign Exchange on September 24, 1997 and took effect on January 1, 1998.
- 14 *Tentative Rules on Administration of Foreign Loans* (外债管理暂行办法), promulgated by the National Development and Reform Commission, the Ministry of Finance, and the State Administration of Foreign Exchange on January 8, 2003 and took effect on March 1, 2003.
- 15 *Tentative Rules on Supervision of Foreign Loans* (外债统计监测暂行规定), promulgated by the State Administration of Foreign Exchange on August 27, 1987.
- 16 *Administration Rules on Income Tax Review and Levy of Non-Resident Enterprises* (非居民企业所得税核定征收管理办法), promulgated by the State Administration of Tax on February 20, 2010.
- 17 *Administration Rules on Foreign Exchange Income and Payment of Resident Individuals and Payment of Foreign Exchange under Non-Trading Transactions* (非贸易售付汇及境内居民个人外汇收支管理操作规程), promulgated by the State Administration of Foreign Exchange on March 18, 2002 and took effect on May 1, 2002.

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