

RECENT DEVELOPMENT ON CHINA'S OUTBOUND INVESTMENT APPROVAL / FILING REQUIREMENTS AND PREFERENTIAL TAX TREATMENT

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Legal Briefings - By **Karen Ip and Martha Wang**

The Chinese government recently published new regulations on outbound investment approval/filing requirements and preferential tax treatment which bring changes to the current regulatory regime for Chinese outbound investment and clarify queries and uncertainties brought about by the tightened control on capital outflow since November 2016.

IN BRIEF

The highlights of the new measures for Chinese outbound investment include:

- expanding the scope of projects subject to NDRC scrutiny;
- revising the scope of sensitive countries/regions and sensitive sectors;
- streamlining the approval and filing procedures; and
- enhancing post-approval and filing supervision.

The new Chinese policies on foreign income tax credits allow consolidation of tax credits and extend the tiers of overseas subsidiaries for tax credits.

CHINA PROMULGATES NEW REGULATIONS FOR OUTBOUND INVESTMENT

On 26 December 2017, the National Development and Reform Commission (**NDRC**), one of China's key regulators of outbound investment, issued new Measures for the Administration of Outbound Investment by Enterprises (New Measures). The New Measures will be effective on 1 March 2018, replacing the existing Measures for the Administration of Approval and Filing of Outbound Investment Projects issued by the NDRC in 2014 (Existing Measures).

The key features of the New Measures are summarised below:

EXPANDING THE SCOPE OF PROJECTS SUBJECT TO NDRC SCRUTINY

The Existing Measures capture outbound investment made by a China-incorporated entity, or by an offshore entity that is financed or guaranteed by a China-incorporated entity. The New Measures expand the scope to cover outbound investment made by a China-incorporated entity, or by an offshore entity controlled by China-incorporated entities or Chinese individuals (either by way of direct or indirect ownership or the ability to direct important matters), regardless of the source of funding or guarantee.

Notably, the New Measures specify that outbound investment covers the establishment of or participation in offshore equity investment funds and investment to gain control of overseas entities or assets through contractual or trust arrangements.

In respect of the entities making the outbound investment, the New Measures make it clear that both non-financial and financial entities are subject to the regime. This clarifies the existing uncertainty under the current regime as to whether outbound investment made by financial institutions should be subject to NDRC scrutiny.

REVISING THE SCOPE OF SENSITIVE COUNTRIES/REGIONS AND SENSITIVE SECTORS

Consistent with the current regime, outbound investment in sensitive countries/regions or sensitive sectors will continue to be subject to approvals as opposed to filings. However, the New Measures revise the scope of sensitive countries/regions and sensitive sectors. The major revisions in this respect are as follows:

- "Countries subject to international sanctions", which is regarded as a type of sensitive countries/regions under the Existing Measures, is changed to "countries and regions in which investment is restricted under international treaties to which China is a party";
- "Basic telecommunications operations, large-scale land development, main power

transmission lines and power grids", which are included in the sensitive sectors list in the Existing Measures, are replaced by "manufacturing and repair of weaponries";

- catch-all categories of "other sensitive countries and regions" and "sectors in which outbound investment is restricted under China's laws, regulations and macroeconomic policies" are added to the sensitive countries/regions list and the sensitive sectors list respectively; and
- the NDRC is authorised under the New Measures to separately issue a catalogue of sensitive sectors.

STREAMLINING THE APPROVAL AND FILING PROCEDURES

The New Measures make a number of changes that aim to streamline the approval and filing procedures. Highlights of the changes include:

- **Abolishing the "road pass" regime:** Under the Existing Measures, if an outbound investment is US\$300 million or more and is carried out through a competitive bidding or acquisition process, the Chinese investor must first submit a "project information report" to the NDRC before executing any binding agreement, making any binding offer or submitting any formal bidding documents. The NDRC will then issue a confirmation letter if it considers that the relevant project is consistent with the national policies for outbound investment. This project information reporting requirement is sometimes referred to as the "road pass" regime and has historically given the NDRC the discretion to determine which Chinese investor is best placed to pursue a particular transaction, as the NDRC typically issues only one road pass for a particular transaction. The "road pass" regime brings unwanted uncertainty and government interference to a transaction and often disadvantages Chinese bidders participating in competitive bids. The New Measures have now abolished this regime.
- **Simplifying the review process for transactions requiring approval of or filing with the central NDRC:** Under the current regime, a local enterprise must first submit its application to the relevant local NDRC for review, and the local NDRC will then forward the application to the central NDRC. In practice, this two-layer review can substantially prolong the approval or filing timeline. The New Measures now provide that where the central NDRC is the final decision-making authority, a local enterprise may submit its application directly to the central NDRC for approval or filing without first going through the local NDRC.
- **Clarifying the deadline for obtaining approval or filing:** The Existing Measures require that Chinese investors obtain the necessary NDRC approval or fulfil the filing obligations before signing the definitive agreements, or make obtaining such approval or completing the filing a "condition to effectiveness". In practice, there has been uncertainty as to whether "condition to effectiveness" means a condition precedent to

closing or a condition precedent to the effectiveness of the definitive agreement. The New Measures clarify that the deadline for obtaining the necessary approval or completing the required filing shall be before the implementation of the investment, i.e., before the investor actually contributes assets or interests or provides finance or guarantee to the project.

ENHANCING POST-APPROVAL AND FILING SUPERVISION

The New Measures introduce a number of measures to enhance supervision by the NDRC of outbound investment projects after approvals are granted or filings are made. The NDRC will work closely with other government bodies to set up new platforms to supervise outbound investment projects by way of online monitoring, conducting interviews, issuing written enquiries, conducting spot checks and so forth. Chinese outbound investors are also required to report online on the completion of, and any material adverse changes to, the projects. A "name and shame" system will be established to publicise any non-compliance of the New Measures by Chinese outbound investors.

CHINA ADOPTS NEW POLICIES ON FOREIGN INCOME TAX CREDITS

On 28 December 2017, the Ministry of Finance and the State Administration of Taxation of China issued the Notice on Improving Foreign Income Tax Credits Policies for Enterprises (**Tax Credit Notice**) which was implemented on 1 January 2017.

The Tax Credit Notice introduces two major improvements:

1. **Consolidation of tax credits:** Previously, the limit of tax credits was calculated based on income from overseas sources by country (region). Where a Chinese outbound investor did not use up its limit of tax credits in one country (region), the balance could not be used on its taxable income sourced from other countries (regions). However, under the Tax Credit Notice, a Chinese outbound investor may choose to enjoy consolidated tax credits based on the aggregated amount of its total taxable income from all overseas sources.
2. **Expanding the tiers of overseas subsidiaries for tax credits:** Before the implementation of the Tax Credit Notice, only tax paid by three tiers of overseas enterprises, of which more than 20% of direct and indirect shareholding was held by a Chinese outbound investor, was eligible for tax credits. The Tax Credit Notice extends the tiers of overseas enterprises to five tiers enabling Chinese outbound investors with complex overseas investment structures to better enjoy tax credits and to eliminate double taxation.

COMMENTARY

China's outbound investment has slumped by more than 40% in the past twelve months largely due to the government's tightened control on capital outflow in an effort to stabilise the depreciation of the Renminbi and its crackdown on "irrational" and "non-genuine" outbound transactions.

The 19th National Congress of the Communist Party of China concluded in October 2017 with mixed signals: China will still be buying, but selectively, carefully and with due attention to long-term goals. The New Measures appear to strike a balance between encouraging outbound investment to support China's Belt and Road Initiative and other macroeconomic policies on one hand, and restricting "irrational" and "non-genuine" outbound deals on the other.

The Tax Credit Notice is one of the tax supporting policies required under the Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment to encourage the outbound investment of Chinese companies.

In sum, with more clarity and certainty in China's regulatory approach to outbound investment, it is expected that there will be a cautious uptick of outbound transactions from China in 2018.

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