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Reinvestment by Foreign Investors in the Post "Income Tax Law Unification" Era

By David Yu and Clare Lu

The Corporate Income Tax Law of the PRC for Foreign-invested Enterprises and Foreign Enterprises (the "Old CIT Law") stipulated that a foreign investor of a Foreign-invested Enterprise ("FIE") can be refunded CIT paid by the FIE on the reinvested amount, if such foreign investor reinvests its after-tax profit obtained from the FIE directly into the same FIE by increasing the FIE's registered capital, or uses the after-tax profit as capital investment to establish a new FIE. Since 1 January 2008, after the unification of CIT laws for domestic enterprises and FIEs, the CIT reinvestment refund preferential treatment provided to foreign investors has been cancelled by new Corporate Income Tax Law (the "New CIT Law") and its detailed implementation rules. This article aims to introduce the tax regulations regarding reinvestment by foreign investors in the post income tax law unification era.

Tax Regulations Regarding Reinvestment by Foreign Investors in the Post Income Tax Law Unification Era

Guo Shui Fa [2008] No. 23 ("Circular 23") stipulated that, a foreign investor may apply for reinvestment tax refund according to the Old CIT Law, if such foreign investor can complete after-tax profit reinvestment procedures by the end of 2007, including completing formalities of re-registration/registration with its competent Administration for Industry and Commerce (the "AIC").

Guo Shui Han [2010] No.69 ("Circular 69") reiterated that, the foreign investor of an FIE, who enjoys reinvestment tax refund based on the Old CIT Law, should return the refunded taxes if its reinvestment is withdrawn within less than five years from the investment.

Llinks Comments

- Time limitation on reinvestment tax refund

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Circular 23 and Circular 69 provided supplementary regulations regarding the tax refund on reinvestment by foreign investors within the transitional period. According to Circular 23 and Circular 69, foreign investor can be granted tax refund on reinvestment on the condition that all reinvestment procedures can be completed no later than 31 December 2007, including registration/registration with the AIC; and if such reinvestment is withdrawn within less than five years since its investment, the foreign investor should return refunded taxes. The after-tax profit that is eligible for reinvestment refund refers to the after-tax profit after being accrued "three kinds of reserves".

- Preferential tax treatments on reinvestment after 2008

In accordance with Cai Shui [2008] No. 1 ("Circular 1"), from 1 January 2008 to 31 December 2010, foreign investors of Integrated Circuits ("IC") manufacturing enterprises and encapsulation enterprises who conduct reinvestment in China (including using after-tax profit as capital of other IC manufacturing enterprises and encapsulation enterprises) can be refunded 40% of CIT paid by the FIE on the reinvested amount; and the domestic and foreign investors who make reinvestment in western China by establishing IC manufacturing enterprises, encapsulation enterprise or software manufacturing enterprises with after-tax profit as capital, can be refunded 80% of CIT paid on the reinvested amount. Similar to Circular 69, if such reinvestment is withdrawn within less than five years from the reinvestment, the refunded CIT will be clawed back. At current stage, it is uncertain as whether such preferential treatment will be prolonged in 2011.

Watch Out

- Follow-up supervision shall be noticed

In the post income tax law unification era, the industrial mergers and acquisitions ("M&As") and restructurings will continued. For instance, Guo Fa [2011] No. 4 encourages and supports the enhancement of industrial resource integration within software enterprises and IC enterprises; and the central and local level governments should provide support and guidance positively (with prohibitions on setting up obstacles) on cross-region M&As conducted by software enterprises and IC enterprises for the purpose of realizing resource integration and the industrial development. Thus, the investors who are still in the "five-year supervision period" shall still pay attention to the follow-up supervision.

- Space exists for tax planning

For the foreign investors that have established multi-level holding structures in China, they may consider using the existing FIEs as reinvestment vehicles, so as to simplify the administrative approving formalities and avoid additional tax burden. However, the feasibility of such planning shall be studied together with the enterprises' actual situation.

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