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Long-awaited Regulations on Pyramid and Direct Sales Issued

The Regulations Prohibiting Pyramid Sales (《禁止传销条例》); the “Pyramid Sales Regulations”) and the Regulations on Administration of Direct Sales (《直销管理条例》; the “Direct Sales Regulations”) were promulgated on August 23, 2005 by the State Council and take effect on November 1 and December 1, 2005, respectively.

The Pyramid Sales Regulations prohibit any form of pyramid sales (传销), which is defined as follows:

“an act by which an organizer or operator recruits persons, calculating and paying remuneration to the persons it recruits on the basis of the number of persons that person directly or indirectly recruits or on sales performance, or asks persons recruited to pay a certain fee for obtaining the qualification to participate, thereby seeking unlawful benefits, disturbing the economic order and affecting social stability.”

The effect of the Pyramid Sales Regulations is to prohibit, for the time being, in China multilevel marketing of the type widely engaged in by direct businesses in North America and elsewhere.

The Direct Sales Regulations define the term “direct sales” (直销) as a sales model that includes three basic elements: a sales enterprise (i) recruiting direct sales personnel (ii) to conduct product promotion away from a fixed place of business (iii) to the ultimate consumers of the products.

The Direct Sales Regulations permit direct sales to be undertaken in respect of specified categories of products that are manufactured

by the direct selling enterprise or by its parent company or its holding company in a single-level marketing type structure with commission-based compensation capped at 30 percent of personal sales. The categories of product eligible for direct sale will be determined and promulgated by the Ministry of Commerce (“MOFCOM”) and the State Administration for Industry and Commerce.

Both domestic and foreign-invested enterprises are permitted to engage in direct sales. However, the Direct Sales Regulations set high entry thresholds for direct selling enterprises. Among other things, to be eligible for the license to undertake direct sales, an enterprise must (1) have registered capital of not less than RMB 80 million and (2) pay a minimum bond of RMB 20 million plus 15 percent of monthly sales up to a maximum of RMB 100 million. The foreign investor of a foreign-invested direct selling enterprise must have at least three years’ experience in direct sales outside China.

The Direct Sales Regulations also require direct selling enterprises to establish service outlets where they exhibit their products and prices, and provide product refund and exchange services to customers. There is no limitation on the numbers of service outlets and direct selling enterprises may also set up branches.

Since promulgation of the Direct Sales Regulations, MOFCOM issued various draft implementing rules in October 2005 for public comment. These implementing rules, which include provisions governing the performance bond to be posted by direct sales enterprises, the training of direct sales personnel and other matters, are expected to be released in final form shortly. ■

Far-Reaching Amendments to the Company Law Promulgated Recently, Come into Effect January 1, 2006

Amendments to the *Company Law* 《公司法》, representing the most far-reaching reform of Chinese company law since the Company Law was first implemented in July 1994, were adopted at the 18th Session of the Standing Committee of the 10th National People Congress (the “NPC”) and promulgated on October 27, 2005, and will come into effect on January 1, 2006. We summarize a number of the significant amendments below.

RULES OF PIERCING THE CORPORATE VEIL

Article 20 of the Company Law, as amended, states that shareholders of a company must not abuse the company’s status as an independent legal person or its limited liability to harm the interests of creditors and makes those doing so jointly liable to the creditors.

SHAREHOLDERS RIGHTS ENHANCED

A number of the amendments involve either adding new provisions to or beefing up existing provisions of the Company Law relevant to shareholders’ rights. For example, Article 122 of the Company Law, as amended, provides that where a listed company within one year purchases or sells material assets or provides guarantee exceeding 30 percent of its total assets, approval of shareholders voting no less than two-thirds of voting rights must be obtained. Article 183 stipulates that where serious problems arise in the operation of a company causing serious harm to the interests of shareholders, if the company’s operations continue and the problems cannot be resolved through other means, shareholders representing no less than 10 percent of the voting rights may petition the court to dissolve the company. Article 75 provides that where a company that has been profitable for five consecutive years and fulfils Company Law conditions for being eligible to pay a dividend but does not do so, shareholders that voted against the resolution not to pay a dividend may request the company to repurchase their shares. If the company does not reach a purchase agreement

with the shareholders within 60 days of the resolution, the shareholders can institute a court action within 90 days of the resolution.

LIBERALIZATION OF CAPITALIZATION RULES

The amendments bring about a significant reduction in the minimum registered capital of limited liability and joint stock limited companies. The Company Law previously set the minimum registered capital of limited liability companies at different levels depending on the nature of the company’s business, ranging from RMB 100,000 to RMB 500,000. A single minimum figure for all limited liability companies of RMB 30,000 will apply in the future. The minimum registered capital of joint stock limited companies was reduced from RMB 10 million to RMB 5 million.

The amendments also allow capital contributions to be made over a two-year period (five years for investment companies), rather than as before in a single installment before issuance of the company’s business license.

The Company Law previously limited the contribution towards a company’s registered capital to cash; in-kind, intangible property and land use right and the maximum contribution of intangible property to 20 percent or 35 percent if it was a high-tech joint stock company. The amendments add the non-cash assets which can be evaluated and transferable as one kind of contributable assets and stipulate the cash contribution shall not be less than 30 percent of a company’s registered capital. As a result of that, equity interest can be one kind of contributable asset. Also, the contribution of intangible property may be up to 70 percent.

LIBERALIZED RULES GOVERNING INVESTMENTS BY COMPANIES

The Company Law previously restricted a limited liability company other than one established as a holding company

from investing up to 50 percent of its net assets in another company. The amendments eliminate such limitation. The amendments also stipulate that a limited liability company must not provide joint and several guarantees in relation to its invested companies' liabilities.

SINGLE SHAREHOLDER COMPANIES

The Company Law previously required a limited liability company other than a stated-owned limited liability company to have no fewer than two shareholders. The amendments permit a limited liability company to be incorporated with one shareholder.

CORPORATE GOVERNANCE

Under the current Company Law, if the chairman of the board of a company does not perform his or her duty to convene a meeting of the board, there was no mechanism for the other directors themselves to convene a meeting. Articles 48 and 111 of the Company Law, as amended, provide that in these circumstances, the vice-chairman may convene and preside at a board meeting and if the vice-chairman does not do so, directors elected by more than half of the directors may do so.

The amendments also provide for the first time for:

- Shareholder review of corporate guarantees;
- Shareholder rights to commence derivative actions; and
- Listed companies appointing independent directors.

Taken together with amendments to the Securities Law (also discussed in this issue of the China Law Bulletin), the amendments to the Company Law represent a significant effort on the part of Chinese legislators to promote a fair and efficient framework for raising investment funds and mediating the interests of shareholders and management of Chinese companies. ■

Securities Law Extensively Revised

On October 27, 2005, the Standing Committee of the 18th Session of the 10th NPC passed a series of amendments to the Securities Law (《证券法》; the "Securities Law Amendments"), which will come into effect on January 1, 2006.

The current Securities Law first came into effect on July 1, 1999. As the current Securities Law was promulgated at a time when most of Asia was struggling with the Asian financial crisis, it comes as no surprise that the predominant concern of the law was control of financial risks, at the cost of market efficiency. While proposals for amending the law appeared in China's media shortly after the Securities Law was promulgated, it was not until now that the Securities Law Amendments were finally passed by the NPC.

Key aspects of these changes involve an expansion in the powers of the China Securities Regulatory Commission (the "CSRC"). In cases of suspected illegal activity, the CSRC is now empowered to freeze or seal individual or corporate capital, securities, and bank accounts rather than being required to obtain a court order to freeze such assets. The CSRC also has the power to suspend for up to 15 days the trading activity of persons suspected of stock manipulation or insider trading. If the CSRC determines that a case qualifies as "complicated", it may suspend an individual's activities for more than 15 days. One concern in this respect is that the term "complicated" is not defined.

Counterbalancing these new powers, the CSRC must assign at least two people to an investigation. These investigators are required to present proper identification and notice of an investigation prior to commencing work. A company or individual may lawfully refuse to cooperate with an investigation if the CSRC fails to meet these requirements. If the CSRC determines to freeze assets, the head of the CSRC must approve the order.

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Securities Law Extensively Revised

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The amendments also now provide a clear definition of a “public offer” as an offering of securities (a) to the general public (as opposed to a specific group of people); (b) to more than 200 people in a particular group in aggregate; or (c) other types of offerings stipulated by law or regulation.

Other important changes to the Securities Law include:

- The securities exchanges will take over the role previously played by the CSRC in connection with the review and approval of listing applications, and listings will be governed by listings agreements between the applicants and the relevant exchange;
- The minimum share capital of a company applying to list has been reduced from RMB 50 million to RMB 30 million;
- A sponsorship system has been implemented, pursuant to which public offers must have a sponsor, the qualifications of which are to be regulated under separate regulations to be issued by the CSRC;
- The Securities Law Amendments permit for the first time trading in derivative products, pursuant to separate regulations to be issued by the CSRC;
- The classes of person subject to liability for false or misleading disclosure have been widened and now include directors, supervisors, and senior managers of listed companies as well as the issuer and underwriters as before; and
- The use of mass media to publish misleading commentary on securities is prohibited and those publishing such information are liable to investors for the losses they suffer as a result. ■

Further Progress in the Regulatory Framework for the Sale of Non-Tradable Shares in Listed Companies

In the *July 2005 issue* [<http://www.mofo.com/news/updates/bulletins/bulletin02027.html>] of the *China Law Bulletin*, we reported on the issuance by the CSRC of the *Notice Relevant to Pilot Reform of the Segmented Share Structure of Listed Companies* (《关于上市公司股权分置改革试点有关问题的通知》; the “Pilot Reform Notice”) as part of the CSRC’s effort to encourage holders of non-tradable State-owned shares (“Non-Tradable Shares”) to list their shares on a domestic exchange.

A period of public consultation followed issuance of the Pilot Reform Notice and on September 4, 2005 the CSRC promulgated the *Administrative Measures for the Reform of the Segmented Share Structure of Listed Companies* (《上市公司股权分置改革管理办法》; the “Share Reform Measures”) and repealed the Pilot Reform Notice.

For the most part, the policies embodied in the Pilot Reform Notice have not changed with the promulgation of the Share Reform Measures. As was the case with the Pilot Reform Notice, the Share Reform Measures do not mandate a particular mechanism listed companies or their shareholders must adopt in order to convert Non-Tradable Shares into tradable shares and instead continue to allow individual companies to develop and present to shareholders plans for such conversion based on the particular circumstances of the company. The Share Reform Measures do however, set out by way of example a number of conversion schemes that may be adopted by listed companies, based on pilot conversions undertaken under the terms of the Pilot Reform Notice, including an increase of shareholdings by the controlling shareholders, a share repurchase, issue of warrants and

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Further Progress in the Regulatory Framework

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provision of an undertaking not to sell the converted State-owned shares at less than a specified price, etc.

The procedures and disclosure requirements in the Share Reform Measures are in principle the same as those stipulated in the Pilot Reform Notice but easier to follow. In the Share Reform Measures, the CSRC requires relevant intermediaries to supervise strict implementation of conversion plans adopted by shareholders.

The Share Reform Measures do however depart significantly from the Pilot Reform Notice insofar as the Share Reform Measures clearly confine share reform to the “A” share market, which is the market for tradable shares denominated in Renminbi traded between Chinese individuals and entities. Under the Share Reform Measures, only holders of “A” shares have an opportunity to participate in consideration of conversion proposals. Foreign, Hong Kong, Macanese, Taiwanese and overseas Chinese holders of “overseas” shares (including “B” shares, listed on a domestic exchange and “H” and “N” shares, listed, respectively, on the Hong Kong or an overseas stock exchange) are excluded. In contrast, the Pilot Reform Notice had required that conversion proposals be presented to a shareholders’ extraordinary general meeting for consideration, allowing all shareholders to participate. The

practical result of these provisions of the Rules is that State-owned Shares will not be converted into “overseas” shares.

This change is best understood in the context of a second regulatory development that followed promulgation of the Share Reform Measures. On October 26, 2005, MOFCOM and the CSRC jointly issued the *Notice on Administration of Foreign Investment Relevant to Reform of the Segmented Share Structure of Listed Companies* (《关于上市公司股权分置改革涉及外资管理有关问题的通知》; the “Notice”). The Notice permits foreign investors other than qualified financial institutions to purchase “A” shares as a strategic investor upon their conversion from being Non-Tradable Shares. Issuance of the Notice represents a significant new opening of the “A” share market to foreign investment.

In a related development, on September 17, 2005, the State-owned Assets Supervision and Administration Commission (the “SASAC”) issued the *Notice on Issues Concerning the Approval Procedures for the Administration of State-Owned Shares During the Reform of the Segmented Share Structure* (《关于上市公司股权分置改革中国有股股权管理审核程序有关事项的通知》), which set out the procedure for SASAC’s approval of reform plans affecting State-owned shares proposed by listed companies. ■

Technology: State Council Issues New Rules Governing Internet News Information Services

The *Rules on the Administration of Internet News Information Services* (《互联网新闻信息服务管理规定》; the “News Rules”) were promulgated on September 25, 2005 by the State Council Information Office (the “SCIO”) and the Ministry of Information Industry (“MII”).

The News Rules appear to be an attempt to clarify the vagueness around the Internet Information Service (“IIS”)

provider regulations promulgated in 1999, which permitted various Chinese Internet companies to obtain IIS licenses under which they could re-transmit – sometimes with some editing – news and “current affairs” from licensed domestic news sources but not from overseas sources. Since IIS regulations permitted “editing,” Internet companies injected commentary as well in the guise of editing. There were also

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Technology: State Council Issues New Rules

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issues surrounding the almost instantaneous re-transmission of news from authorized news organizations that the Propaganda authorities subsequently decided should not be transmitted. This censorship mechanism did not work effectively with the rapid pace of online news publishing.

To address these issues, the News Rules establish three categories of Internet news providers:

- licensed news organizations planning to transmit current affairs information that is outside the scope of their licensed publications,
- non-licensed media organizations which that want to transmit news, and
- licensed news organizations planning to re-transmit news that they are already allowed to publish in another medium.

Clearly, the second category is the sensitive one, since this would encompass the structure used by existing Chinese Internet companies to transmit news.

Applicants for this new license must prove that they have established an “Internet management system”, have “qualified” editors, have proof of ownership of facilities, and evidence that their capitalization came from a “legal source”. Category 2 applicants must have at least two years’ experience in the field of providing Internet news, as well as having minimum capitalization of RMB 10 million. These requirements appear to be aimed at commonly used structures under which Internet companies that are not licensed as Internet Content Providers (“ICPs”) formally hand over their servers to data centers and sign “service” contracts with them, since under the former regulatory framework server ownership technically determined site ownership and responsibility. Additionally, all applicants that obtain licenses must accept regular “supervision.”

If a licensed and a non-licensed Chinese organization form a joint venture Internet news provider, provided the licensed news organization holds no less than 51 percent of the equity then the joint venture will be deemed Internet news provided

established by a licensed organization. If the licensed news organization holds less than 51 percent – or its equity holding subsequently drops – then the joint venture needs to be licensed as a non-licensed media organization.

The News Rules explicitly prohibit an Internet news provider being operated by a Sino-foreign joint venture, Sino-foreign cooperative joint venture, or a wholly foreign owned enterprise. Likewise, in response to many of the existing Internet structures, the News Rules also require all Internet news providers that “cooperate” either domestically or abroad with a foreign enterprise or a foreign invested enterprise to engage in activities relating to providing Internet news services must report to the SCIO and carry out a security evaluation.

The News Rules strengthen content controls, and specifically prohibit Category 2 Internet news providers from providing any news that they have gathered themselves, or have edited. They also require that all Internet news providers establish a self-censorship system. All Internet news providers are also required to maintain copies and posting/transmission logs of all news that they post online and maintain such information for at least sixty days.

We would note one additional interesting item in the News Rules, in that the SCIO arrogates a controlling role for itself in supervising Internet news providers. Although the News Rules are jointly issued by MII, MII is not even mentioned as a regulator in the text of the News Rules. While the SCIO has always held the ultimate approval and supervisory responsibility, we are not aware of the SCIO undertaking review proceedings on a regular basis. This appears, therefore, to be part of a new effort by the authorities to impose stricter content controls on the Internet. While there is a regulatory framework for ICPs, Internet companies have been the first private entities engaged in widespread content distribution in China that are not under the traditional control of the Chinese Communist Party’s Propaganda Bureau. The News Rules, therefore, give the SCIO, as the government body representing the Propaganda Bureau, a formal regulatory role supervising news distributed over the Internet. ■

SAFE Refines Approach To Overseas Investment By PRC Residents

On October 21, 2005 SAFE issued the *Circular on Relevant Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment through Offshore Special Purposes Vehicles* ("Circular 75"). At the same time Circular 11 and Circular 29 ceased to be implemented. Please see our Special Note covering key provisions of Circular 75 and what they mean to investors. [<http://www.mofo.com/news/updates/files/update02094.html>] ■

Ministry of Land and Resources Reforms Mineral Licensing System; Puts FIEs on Equal Footing with Domestic Exploration and Mining Companies

One of the more vexing problems for the Chinese government in promoting the orderly development of its mineral resources sector has been to assure that exploration and mining activities are undertaken only under the terms of a lawfully issued exploration permit or mining license. On September 30, 2005 the Ministry of Land and Resources ("MOLAR") issued the *Circular on Relevant Issues in Standardizing the Authorization to Grant Exploration Permits and Mining Licenses* in an effort to address these problems. One of the achievements of the circular is to place FIEs on the same footing as domestic mining companies in connection with applications for exploration permits and mining licenses. Prior to issuance of the circular with few exceptions, FIEs were obliged in every case to obtain exploration permits and mining licenses from MOLAR at the central level, while domestic companies were eligible to obtain licenses for certain types and sizes of deposits from provincial or local departments.

Please see our Special Note covering key provisions of MOLAR's circular. [<http://www.mofo.com/news/updates/files/update02087.html>] ■

OTHER RECENT DEVELOPMENTS

Distribution: Foreign Invested Companies in Free Trade Zones Permitted to Apply for Distribution Rights

MOFCOM and the General Administration of Customs issued the *Notice on Certain Issues Regarding Trade Management in Bonded Zones and Bonded Logistics Parks* (《关于保税区及保税物流园区贸易管理有关问题的通知》) on July 13, 2005.

Foreign invested enterprises ("FIEs") with operations in bonded zones or bonded logistics parks are granted trading rights and may apply for distribution rights. The Notice allows FIEs to engage in trading activities with enterprises and individuals located within China and outside the zones and parks. FIEs that acquire distribution rights may conduct distribution activities within China. FIEs based in free-trade zones ("FTZs") that conduct distribution activities will remain subject to tax and customs regulations used in the FTZs. ■

Foreign Direct Investment: Early Recovery of Investment from CJVs

The *Measures for Examination and Approval of Early Recovery of Investment from Sino-foreign Cooperative Joint Ventures by Foreign Investors* (《中外合作经营企业外国合作者先行回收投资审批办法》); the "Recovery Measures" were promulgated on June 9, 2005 by the Ministry of Finance ("MOF"), and came into effect as of September 1, 2005.

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Foreign Direct Investment: Early Recovery of Investment from CJVs

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Applicable rules permit the foreign investor to a Sino-foreign cooperative joint venture (“CJV”) to recover its investment during the term of operation of the entity, whereas in an equity joint venture the parties’ investment may only be recovered at the end of the term of operation upon liquidation of the entity. The most common method of achieving this is through distribution to the foreign investor of funds representing the depreciation of the CJV’s fixed assets. This makes CJVs a useful vehicle for financing of infrastructure and other projects. Applicable law makes any arrangement for the early recovery of investment subject to MOF approval and the Recovery Measures confirm requirements to obtain that approval.

The Recovery Measures set out various conditions that must be met for a CJV to qualify to make an early distribution of investment to its foreign investor. The conditions include the following:

1. Upon expiration of the CJV’s term of operations, following liquidation, all its fixed assets transfer to the

Chinese investor at no cost;

2. The CJV must issue a letter undertaking that it will settle its debts in priority to making an early distribution of investment to the foreign investor; and
3. The foreign investor must issue a letter of undertaking under which it assumes joint and several liability for the debts of the CJV to the extent of the investment to be recovered in advance.

Similar conditions were in fact contemplated in previous CJV regulations. The Recovery Measures clarify certain specific requirements as well as confirming procedures associated with applications to MOF. Following the practice in recent regulations issued by other agencies in China, the Recovery Measures provide a performance pledge with a time limit for regulatory review. MOF undertakes in the Recovery Measures to make a decision within 30 days on whether to grant approval of an application under the Recovery Measures. ■

Application Process for Foreign Invested Distribution and Retail Operations Clarified by MOFCOM

Application Process for Foreign Invested Distribution and Retail Operations Clarified by MOFCOM

MOFCOM issued the *Application Procedures for Foreign Investment in Commercial Projects* 《外商投资商业领域项目办理程序》, the *Application Materials for Foreign Investment in Commercial Projects* 《外商投资商业领域项目申报材料》 and the *Timeframes for Examining and Approving Applications for Foreign Investment in Commercial Projects* 《外商投资商业领域项目审批时限》 on August 16, 2005.

Although MOFCOM issued the *Measures on the Management of Foreign-Invested Commercial Enterprises* (《外商投资商业领域管理办法》, Notice No. 8) on April 16,

2004, there was considerable uncertainty as to how such measures were to be applied. These three new documents, provide implementing guidelines for the measures and clarify procedures for (1) investors to establish new foreign-invested commercial enterprises (“FICEs”), (2) existing FICEs to open retail stores, and (3) existing foreign-invested enterprises (“FIEs”) to expand their business scopes to include distribution and retail operations.

These new documents clarify that provincial authorities are responsible for conducting initial reviews of applications. In most cases, the provincial authorities will only have the authority to preliminarily approve an application, although

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Application Process for Foreign Invested Distribution and Retail

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some may be authorized by MOFCOM to directly approve an application. Inter-provincial coordination is an important component of the review process if an FIE intends to engage in distribution beyond the province where it is registered. The effectiveness of this coordination is critical to FICEs trying to establish regional and national distribution and retail networks. One key concern for applicants is that authorities in a FICE's home province must approve branch stores or distribution offices both inside and outside the province, which will impose significant additional work on these authorities and possible delays in the application process.

The application materials for establishing new FICEs has not changed, but there has been a relaxation of the application process for existing FICEs applying to open additional retail stores, in that they no longer need to submit a feasibility study, an audit report, their joint venture contract (in the case of joint ventures), or their articles of association. Other documentation requirements remain unchanged. The new documents stipulate that provincial-level authorities have one month to review and approve an application, after which MOFCOM has three more months to review and approve such an application. ■

Taxation: New Tax Preference Measures

The Administrative Measures for the Reduction and Exemption of Tax (《税收减免管理办法(试行)》; the "Tax Preference Measures") were recently issued by the PRC State Administration of Taxation ("SAT") and took effect on October 1, 2005. The Tax Preference Measures consolidate, and provide for standardized procedures for obtaining reductions of, and exemptions from, various Chinese taxes, which were previously regulated in separate rules specific to the particular tax.

As well as consolidating relevant rules, the Tax Preference Measures streamline relevant procedures. The Tax Preference Measures classify tax reductions and exemptions into those obtained by way of approval and those obtained by way of registration. An approval process governs those tax

reductions and exemptions in respect of which the tax authorities review and determine a tax payer's eligibility on a case-by-case basis. For other reductions and exemptions, when specified requirements set forth by the law are met, the taxpayer simply completes a registration procedure without prior review by the tax authorities.

The Tax Preference Measures include provisions governing how income and revenue eligible for reductions and exemptions should be segregated from ineligible income and revenue. They also provide a specific mechanism so that taxpayers can obtain tax refunds if they failed to take into account applicable reductions or preferences. It is also notable that the Tax Preference Measures eliminate the annual examination of tax reductions and exemptions. ■

Individual Income Tax

The Amendments to the *Individual Income Tax Law* (《个人所得税法》; the "IIT Amendments") were adopted at the 18th Session of the Standing Committee of the 10th NPC, promulgated on October 27, 2005 and will come into effect on January 1, 2006.

The most publicized feature of the IIT Amendments increases taxpayers' basic deduction amount from RMB 800 to RMB 1,500. This is the first increase in the basic deduction since the law was promulgated in 1994 and addresses significant

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Individual Income Tax

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cost of living increases over the intervening 11 years. The tax withholding provisions of the law have also been amended.

The Notice of the Ministry of Finance and the State Administration of Tax Concerning Individual Income Tax Policy on Dividends and Bonus Shares (《关于股息红利个人所得税有关政策的通知》), effective June 13, 2005, states that individual investors that receive dividend and bonus income from listed companies may exclude 50 percent of such amount from their taxes. A second circular issued June 24, 2005 confirms that the term “listed companies” means companies listed on the Shanghai or the Shenzhen exchanges.

The Administrative Measures for Individual Income Tax Law (《个人所得税管理办法》), issued by SAT on July 6, 2005, took effect on October 1, 2005. The measures address a number of challenges in individual income tax collection, especially in relation to high-income taxpayers and those with more than one source of income. The new measures contemplate creating individual taxpayer filing records, requiring withholding agents to provide detailed tax reports, and establishing a system of dual filing by taxpayers and withholding agents. ■

State-Owned Enterprises: State Asset Valuation Measures Revised

The loss of State-owned assets through improper deals has been an ongoing problem accompanying China's reforms. This was due, in part, to the fact that State-owned assets were administered by three different agencies, and existing regulations had many ambiguities which were exploited for private gain. SASAC was established in 2003 to centralize the administration of State-owned assets, and to ensure that the disposition of those assets was handled professionally. SASAC has promulgated the *Interim Measures for the Administration of Valuation of State-owned Assets of Enterprises* (《企业国有资产评估管理暂行办法》); the “Valuation Measures”) on August 25, 2005 and they came into force as of September 1, 2005.

The Valuation Measures attempt to eliminate ambiguities in the existing State-owned asset valuation regulations. They follow the approval and recordation systems set up by MOF, but now clarify that SASAC and its local branches have responsibility for the approval and record of State-owned asset valuations.

The Valuation Measures stipulate thirteen kinds of economic acts of a State-owned enterprise that are subject to state-assets valuation requirements, including: (1) entirely or partially restructuring into a limited liability company or joint stock

limited company; (2) investing outside China using in-kind assets; (3) merging, splitting-up, declaring bankruptcy or dissolving; (4) changing the proportion of equity holdings of State shareholders in a non-listed company; (5) assigning property rights; (6) assigning or swapping assets; (7) renting all or part of assets to a non-State-owned entity; (8) repaying a debt in-kind; (9) engaging in asset-related litigation; (10) purchasing the assets of a non-State-owned entity; (11) accepting in-kind contributions from a non-State-owned entity; (12) accepting a non-State-owned enterprise's in-kind assets to offset a debt; and (13) any other matters addressed by other laws or regulations. Exceptions to the requirement for an asset valuation include transactions that (1) involve the entire or partial allocation without consideration of a State-owned enterprise's assets that is approved by the local government or the local SASAC bureau, or (2) involve the merger, swap of assets, or the allocation without consideration of assets from a wholly State-owned enterprise to its wholly owned subsidiary, or between the subsidiaries of a wholly State-owned enterprise.

The Valuation Measures also provide that if a contract price is less than 90 percent of the appraisal results, the transaction must be suspended until the original approval authority for the transaction issues specific approval for that price. ■

Financial Services: Launch of National Personal Credit Database in China

The Interim Measures for the Administration of the Basic Data of Individual Credit Information (《个人信用信息基础数据库管理暂行办法》; the “Data Measures”) were promulgated on August 18, 2005 by the People’s Bank of China (“PBOC”) and took effect on October 1, 2005.

The Data Measures were promulgated by the PBOC to create a uniform regulatory environment across China for the administration and protection of personal credit information. They follow the local Shenzhen and Shanghai personal credit measures that were issued in 2002 and 2003, and incorporate many of the same elements on a national scale.

A key element of the Data Measures is the creation of a central database of all individual loans and credit histories, which is to be directly administered by the PBOC. All of China’s commercial banks, urban credit cooperatives, rural credit cooperatives, and other loan-issuing financial organizations are mandated to submit information on individual loans and credit histories to the database. Although the Data Measures do provide for administrative penalties for misuse of personal credit information, the penalties are minimal. Of greater concern, however, is the fact that the Data Measures are vague and create additional risks by centralizing so much personal credit information with minimal safeguards for individuals’ confidentiality.

Financial institutions, after obtaining written consent from an individual, can obtain personal credit history information from the database. This consent may be incorporated into a credit application. Individuals who believe their credit history contains mistakes can apply to the local PBOC branch to correct them.

While the Data Measures are a first step towards the creation of a national credit reporting system, their intent appears to keep such system under the control of the government. They specifically prohibit financial institutions from providing credit information to any organization that is not licensed by the “credit information authorities”, and impose penalties for violations. While it may foreshadow the government licensing private entities to provide credit reporting services, it is likely that it is targeted at various private foreign credit reporting firms that are already talking about the possibility of setting up in China.

There are several ambiguous matters in the Data Measures. The first is that the China Banking Regulatory Commission, China’s banking regulator, is not mentioned and it is not clear what role it will play in this important financial regulatory field. Additionally, while the Data Measures indicate that they are to cover all bank accounts, they are silent as to whether they will apply to foreign residents. ■

EAR TO THE GROUND

Construction: Draft Regulations on Administration of Construction Engineering Enterprise Qualification Issued

The Ministry of Construction (“MOC”) issued the draft *Regulations on Administration of Construction and Engineering Enterprise Qualification* (《建设工程企业资质管理规定的草稿》; the “Draft Regulations”) on August 9, 2005, which

were available for public comment until August 23, 2005.

The Draft Regulations reflect MOC’s attempt to consolidate the fragmented existing regulations dealing

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Construction: Draft Regulations on Administration

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with construction, construction survey and design and construction supervision enterprises into a comprehensive and integrated qualification system.

The Draft Regulations divide each major class of construction enterprise -- namely construction, construction survey, construction design, and construction supervision -- into "general" and other categories and into several grades.

The Draft Regulations streamline the existing qualification approval process, for example by shortening relevant approval and review periods. The authorities are required within five days after receiving the application documents

to notify the applicant whether additional documents are required to be submitted. The preliminary review must be finished within 20 working days after the acceptance of the application and the approval process must be completed within 20 working days. The Draft Regulations also contemplate that the previous annual review of the qualification certificates will be cancelled.

The Draft Regulations does not specify the standards to be used to assess qualification applications. MOC will establish such standards after consultations with relevant government authorities. ■

Environment: Draft Sustainable Economy Law Proposed

Earlier this year Mr. Pan Yue, Vice-minister of the State Environmental Protection Agency ("SEPA"), publicly announced that a *Sustainable Economy Law* (《循环经济法》) is being drafted and may be promulgated this year. The announcement indicated that the draft Sustainable Economy Law has an ambitious scope aimed at strengthening the regulatory framework to protect the environment and achieve a balance between consumption of natural resources and economic development. At this point, however, a draft of the Sustainable Economy Law is not available to the public.

A notable feature of the draft Sustainable Economy Law is the establishment of an "Environmental Index" that will become an additional measure of the government's achievements. As such, when government officials make decisions favoring economic development, they must also

consider the usage of natural resources in order to reach a balance between these two competing priorities.

The draft Sustainable Economy Law also provides for the establishment of an assessment system of "Green GDP", so that the impact of economic activities on the environment can be assessed. This is meant to enhance the visibility of the economic value of environment protection and to encourage investment in environmentally friendly projects and products.

It is also proposed that an ecological compensation system will be implemented in order to offset the consumption of natural resources. Manufacturers consuming natural resources will be required to contribute to this system, presumably in the form of environmental tax payments. New technologies for re-using industrial and consumer waste will also be encouraged. ■

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Non Profit Organizations: Revision of Administrative Regulations Concerning Registration of Social Organizations

The current *Administrative Regulations Concerning Registration of Social Organizations* (《社会团体登记管理条例》) were promulgated on October 25, 1998 by the State Council. These regulations do not contemplate the establishment of charitable and other not-for-profit organizations by foreigners, leaving a regulatory vacuum for those foreign not-for-profits that operate in China.

We understand that the Ministry of Civil Affairs (“MOCA”) is revising the current regulations. The revised regulations will introduce guidelines for the registration of social entities and representative offices formed by foreign not-for-profits in China. According to reports, revised regulations will be promulgated later this year or early next year.

Based on news and our discussion with MOCA officials, we understand that the revised regulations will address the following key issues:

1. Foreign natural persons, legal persons and social organizations may form social organizations in China. Foreign social organizations may also set up representative offices in China.

2. If a social organization is established by Chinese and foreign parties, either party may apply for registration of the organization. If the Chinese party makes the application, the organization will be deemed to be a domestic social organization and the person in charge must be a Chinese national, and foreign nationals would be prohibited from taking leadership positions. If the foreign party makes the application, the entity will be deemed to be a foreign formed social organization, which will subject it to a higher degree of operational restrictions.

3. A social organization will be subject to two registration requirements, one with the competent authority responsible for the sector in which the social organization will be operating, and another with the relevant provincial branch of MOCA or with the MOCA itself.

4. The current working capital requirement (currently RMB 30,000 for a local social organization and RMB 100,000 for a national level social organization) might be abolished. ■

