



China Legal Update – July, 2009

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New Laws:

1. Detailed Guidelines Issued on Favorable Tax Treatment for High-Tech Service Enterprises
2. Circular on Strengthened Measures for Collection of Individual Income Tax Arising from Equity Transfers
3. Circular on Administration of Foreign Exchange Regarding Offshore Lending by Domestic Enterprises

General News:

1. New Approval Procedures for Shanghai Construction Projects
2. First Cross-border RMB Trade Finance Transaction Conducted in HK
3. China's Economy Grows 7.9% in Q2

New Laws:

1. Detailed Guidelines Issued on Favorable Tax Treatment for High-Tech Service Enterprises

Authority: The Ministry of Commerce and the State Administration of Taxation

Date of Promulgation: 13/05/2009

Effective Date: 01/01/2009

The Ministry of Commerce and the State Administration of Taxation issued a Circular, which sets out the tax policies for high-tech service enterprises (Caishui [2009] No. 63, hereinafter as “Circular No.63”). Enterprises in 20 specified cities are entitled to a reduced rate of 15% reduction enterprise income tax and an exemption from business tax for income arising from offshore service outsourcing.

1. Scope of qualified “ high-tech services”

- Information Technology Outsourcing (ITO);
- Business Process Outsourcing (BPO); and
- Knowledge Process Outsourcing (KPO)

Circular No. 63 also includes an appendix which details the scope of activities for each service category.

2. Period for favorable tax treatment

1 January 2009 to 31 December 2013

Favorable tax breaks enjoyed by a high-tech service enterprise will be suspended if the enterprise fails to meet the required standards. Enterprises should monitor their business operations on an ongoing basis to ensure they meet the requirements at all times even after their high-tech service enterprise status is confirmed.

3. Recognition of high-tech service enterprise

- Employees with tertiary education or above of qualified companies should account for at least 50% of the total work force;
- Aggregate qualified offshore outsourcing income from a high-tech service business should account for at least 50% of the annual income; and
- Aggregate local high-tech service outsourcing income should account for at least 50% of the annual income.

2. Circular on Strengthened Measures for Collection of Individual Income Tax Arising from Equity Transfers

Issuing Authority: The State Administration of Taxation

Date of Promulgation: 28/05/2009

Effective Date: 28/05/2009

On May 28, 2009, the State Administration of Taxation issued the “Circular on Strengthened Measures for Collection of Individual Income Tax Arising from Equity Transfers” (the “Circular”), which sets forth the rules with respect to the collection of individual income tax arising from an equity transfer by individual

shareholders.

According to the Circular, after the execution of the equity transfer agreement by the parties and the closing of the transaction but before the registration of the equity transfer, the transferor or transferee who is under the obligation to pay or withhold taxes shall declare the taxes to the relevant tax authority, and subsequently register the equity transfer agreement at the relevant administration for industry and commerce (the “AIC”) by presenting the tax payment receipt or certificate for tax exemption or zero-tax-rate certificate issued by the relevant tax authority with respect to the personal income tax arising from the equity transfer.

Where the parties have executed the equity transfer agreement but have not completed the equity transfer transaction, the enterprise concerned shall complete a “Report on Change of Individual Shareholders” when registering the equity transfer at the relevant AIC, and submit the Report to the relevant tax authority.

The relevant tax authority in charge of the individual income tax arising from the equity transfer shall be the tax authority of the place where the enterprise concerned is registered. The taxpayer or the withholding agent shall complete the tax declaration and payment at the relevant tax authority. The tax authorities shall assess and examine the tax basis for income tax arising from the equity transfer. Where the declared tax basis appears low (such as transfer at a low price or a price equivalent to the transferor’s acquisition cost) and without legitimate reasons, the relevant tax authorities may assess the tax payable by reference to the net asset value of each share or the net asset value pro-rated against the shareholding of the individual shareholders.

3. Circular on Administration of Foreign Exchange Regarding Offshore Lending by Domestic Enterprises

Issuing Authority: The State Administration of Foreign Exchange

Date of Promulgation: 09/06/2009

Effective Date: 01/08/2009

The State Administration of Foreign Exchange (“SAFE”) issued the “Circular on Administration of Foreign Exchange Regarding Offshore Lending by Domestic Enterprises” (the “Circular”) on June 9, 2009. The Circular will take effect on August 1, 2009.

“ Offshore lending” under the Circular means the direct lending by domestic enterprises other than financial institutions (the “Lender”) to its offshore wholly-owned subsidiaries or partially-owned affiliates (the “Borrower”) and within the approved limit. The Circular stipulates the sources of fund for offshore lending. The domestic enterprises may use foreign currency held by themselves, foreign currency funds purchased in RMB, and funds from foreign currency pools approved by SAFE as the source of funds for their offshore lending to the Borrower.

The Circular also provides the conditions that must be satisfied by the Lender and the Borrower:

- (i) both the Lender and the Borrower must be duly incorporated and have their registered capital fully contributed;
- (ii) both the Lender and the Borrower must maintain a continuous record of good standing with a sound financial system and internal controls, and have no record of violation of foreign exchange regulations in the last three years;

- (iii) the Lender's direct offshore investments over the past years have been approved by the relevant domestic authorities and have been registered with the SAFE, and have obtained a rating of Level 2 or above in the last joint annual inspection on offshore investment (except for those Lenders that have been incorporated for less than one year); and
- (iv) the Lender who has been approved to engage in offshore lending business has acted in its ordinary course of business and has committed no violations in its last offshore lending transaction.

News Items:

1. New Approval Procedures for Shanghai Construction Projects

New regulations for the approval of construction projects have been issued in Shanghai. These will facilitate the process of getting construction projects approved by the authorities.

The current nine approval procedures will be simplified, including the procurement of land use rights, endorsement of design schemes, inspection of design documents and final approval of the construction.

The whole process should now take no more than 50 days to complete - 30 days for the Shanghai Construction and Transport Commission to examine the various safety and environmental aspects of the proposed project and 20 days for its final acceptance if project permits are applied for immediately after obtaining the approvals. This should help construction companies shorten their project timelines and stimulate the industry.

The above changes have been introduced in Pudong New Area and the districts of Changning and Minhang, and will be extended to the rest of Shanghai from October 2009 onwards. The total output of the construction industry in Shanghai was 45 billion USD in 2008, an increase of about 22% over the previous year. Construction spending in China is expected to grow by about 8% annually through 2013.

2. First cross-border RMB trade finance transaction conducted in HK

Bank of China (Hong Kong) announced on 14 July that it had successfully conducted the first cross-border RMB trade finance transaction.

The move marks the official launch of Hong Kong's RMB trade finance business after the RMB trade settlement transaction started in the city on July 6.

To tie in with the launch of the RMB trade settlement and finance services, the bank also announced that it had introduced a range of offers, covering instant opening of RMB account, a handling fee waiver for RMB remittances as well as preferential exchange rates.

In addition, the bank has automatically extended the existing trade finance facility of its corporate customers to RMB trade transactions to better meet their business needs.

4. China's economy grows 7.9% in Q2

China's economy grew 7.9 per cent in the second quarter of 2009, the government says, in a startling turnaround for the Asian powerhouse fuelled by a massive stimulus package.

"The economy is rebounding and the strength of the recovery is increasing." National Bureau Spokesman Li Xiaochao said at a media briefing to release the data on 16 July.

"China's second quarter GDP growth beat market expectations," said Lu Zhengwei, a Shanghai-based economist with the Industrial Bank.

"It means the country's economy has achieved a very strong rebound thanks to continued expansionary fiscal policies and the central government's stimulus measures."

Lu said China's economy would likely grow by 8.0 per cent in 2009, in line with the government's target.