



China Regulatory Updates

December 2009

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- › Standardization
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Foreign Investment

Supreme People's Court Issues Specific Rules Governing Lawsuits Involving FIEs

On November 23, 2009, the PRC Supreme People's Court ("SPC") released for public comments the draft *Provisions on Several Issues Concerning the Hearing of Foreign-Invested Enterprises Cases (I)* (the "Draft Provisions"), in an effort to provide unified standards for the hearing of cases related to foreign invested enterprises ("FIEs") and to better safeguard the legitimate interests of foreign investors. The Draft Provisions are designed to offer clarifications and guidance to courts at all levels with respect to FIE-related issues not otherwise fully addressed by the current legislations, and to ensure the consistency among various laws and regulations applicable to FIEs.

Some of the highlights of the Draft Provisions include:

(a) Government Approval's Effect on Joint Venture Contract's Validity. If a joint venture contract ("JVC") is void or revocable according to applicable law but has been duly approved by government authorities, the people's court should revoke such contract or hold such contract revocable. Moreover, if the parties enter into any supplementary contract modifying certain clauses of the original JVC that has been approved but fail to apply for approval of such amendments, the courts should not invalidate such supplementary contract for the absence of government approval, unless such supplementary contract has materially or substantially amended the original JVC.

(b) Exercise of Right of First Refusal in Equity Transfer. Where any shareholder transfers its equity interest in a Sino-foreign joint venture to any outside party and the other shareholders claim to revoke the relevant equity transfer agreement that

has been approved by reason of violation of their right of first refusal, the court should support such claim, unless such other shareholders did not claim their right of first refusal within the statutory 30-day period or other time period as set forth in the relevant JVC or the articles of association upon their awareness of such transfer.

(c) Effectiveness of Equity Pledge Agreement. The equity pledge agreement between the shareholders of an FIE and their creditors should take effect as soon as it is duly executed, except as otherwise provided in applicable laws and regulations, or such equity pledge agreement. Whether such equity pledge is registered or not will not affect the underlying agreement's validity. However, the equity pledge is not valid and enforceable until it is registered with the competent authority.

(d) Effectiveness of Entrusted Shareholding. The entrusted investment agreement between the actual investor and the nominee shareholder of an FIE will be generally deemed legal and binding by court if it does not violate or evade the governance of the mandatory provisions in PRC laws and regulations. Nevertheless, the actual investor may only request the nominee shareholder to perform its obligations under the entrusted investment agreement (such as profit distribution), but can not assert any shareholder's right in the FIE.

(e) Governing Law of Joint Venture Contract between Foreign Investors. With respect to a wholly foreign owned FIE, any dispute arising from the contract regarding the establishment of such FIE should be exclusively governed by PRC law.

Foreign Companies and Individuals Are Permitted to Establish Partnership Enterprises in China

On November 25, 2009, PRC State Council released the *Measures on the Administration of the Establishment of Partnership Enterprises by Foreign Enterprises or Individuals in China* (the "FIP Measures"), with an aim to providing a formal and general legal basis for the establishment of foreign

invested partnership ("FIPs"). The FIP Measures will come into effect as of March 1, 2010.

Similar with the current practice in FIE areas, foreign companies and individuals will be able to, together with domestic entities and individuals or

otherwise, set up FIPs in the form of green field investment or through M&As. However, no MOFCOM approval is needed for the establishment of an FIP. Foreign investors are only required to file with local offices of SAIC (or PRC State Administration for Industry and Commerce) and submit a confirmation letter with respect to its compliance with the Chinese market entry policies for foreign investments, provided that for FIPs that will invest in projects that are subject to governmental approvals, such approvals should be obtained in advance. The operation and management of FIPs are generally subject to the

PRC Partnership Enterprise Law.

Please note that the FIP Measures are still subject to other national-level regulations applicable to partnership enterprises with investment as their primary business. It is expected that following the issuance of the FIP Measures, government authorities (such as SAIC, SAFE and SAT) will promulgate supporting rules to further remove the existing regulatory barriers and facilitate at the operational level the establishment and operation of FIPs.

M&As

Rules on Declaration for Concentration of Business Operators Finalized

On November 27, 2009, the PRC Ministry of Commerce (“MOFCOM”) released the *Measures on the Declaration for Concentration of Business Operators* (the “Declaration Measures”), which will take effect as of January 1, 2010. The Declaration Measures are substantially the same as its draft version which was circulated for public comments earlier this year.

Pursuant to the Declaration Measures, the turnover of a single business operator in the concentration should include the turnover of, among others, (i) the company directly participating in the concentration; and (ii) affiliates that directly or indirectly control such company or directly or indirectly under such company’s control, excluding the turnover derived from transactions among such affiliates. The Declaration Measures have not defined the term “*control*” though. This ambiguity will inevitably

bring more uncertainties to the declaration results.

The Declaration Measures provide that if the same business operators conduct multiple rounds of concentration deals within two consecutive years while none of such deals has reached the statutory declaration threshold, MOFCOM may deem these deals as a one single concentration transaction and sum up all turnovers in such serial deals.

For concentrations that do not cross the statutory threshold of anti-monopoly declaration, the relevant participants may also declare to MOFCOM at their own will. But MOFCOM is not empowered to automatically initiate any anti-monopoly investigation against any concentration of business operators that falls short of the statutory declaration threshold.

Banking & Insurance

Commercial Banks May Invest in Insurance Companies on Trial Basis

Recently, the China Banking Regulatory Commission has circulated the *Measures on the Administration of Pilot Equity Investment by Commercial Banks in Insurance Companies* (the “Trial Measures”), allowing in principle commercial banks to invest in insurance companies. The Trial Measures set out specific requirements with respect to qualifications, application procedures, risk control, supervision and administration, and

other aspects. The highlights of the Trial Measures are as follows:

- (a) With respect to corporate governance, the bank’s board is required to undertake the ultimate management duties, e.g., the bank’s board should establish a complete fire wall system and appoint one non-executive director to supervise the operation of the fire

wall to ensure the effective isolation between the bank and the insurance company. In addition, the bank's board should include persons that are familiar with business operation and risk control of insurance business.

- (b) In order to control risks arising from related party transactions, the banks should appoint one non-executive director to supervise the related party transactions and may not extend any credit facility (off-balance-sheet or otherwise) to the insurance companies invested by them as well as such insurance companies' affiliates and clients guaranteed by them. The Trial Measures also include detailed rules for the insurance companies' purchase of various securities issued by their

shareholder banks.

- (c) With respect to the consolidation of financial statements, the Trial Measures require that banks should consolidate the insurance companies invested by them into their financial statements while exclude their capital investment in the insurance companies for the purpose of calculating the capital adequacy rate of the relevant bank.
- (d) With respect to business cooperation, the Trial Measures provide that the business cooperation between banks and the insurance companies invested by them should be conducted on an arm's length basis and no unfair competition is allowed.

Information Disclosure Obligations for Insurance Companies Specified

The China Insurance Regulatory Commission ("CIRC") has recently released for public comments the draft Measures on the Administration of Information Disclosure by Insurance Companies (the "Draft Measures"). The Draft Measures have set out the minimum requirements for information disclosure of insurance companies in a bid to further protect legitimate interests of policy holders and the insured. Insurance companies are required to establish and file with CIRC its information disclosure management policies.

Pursuant to the Draft Measures, insurance companies should disclose information with respect to their basic information, financial and accounting data, risk control, operation of insurance products, solvency, material related transactions, major matters, and other aspects as required to be disclosed by CIRC. In particular, transaction details, assessment of the transaction and independent director's opinion in respect of any related-party transaction should be specifically disclosed.

Tax

Pass-Through Special Purpose Vehicles Being Denied Tax Treaty Benefits

Further to its series of rules on non-resident taxpayer's entitlement under tax treaties, the State Administration of Taxation ("SAT") has recently released the *Circular on How to Interpret and Identify the "Beneficiary Owner" under Tax Treaties* (the "Circular"). The Circular requires an applicant to submit relevant materials evidencing its status as the "*beneficial owner*" when claiming for tax treaty benefits. The relevant tax authorities will carefully render their decisions based on the "substance-over-form" principle and in line with the purpose of relevant tax treaties.

According to the Circular, non-resident taxpayers will be less likely to be identified as a beneficiary owner under the following circumstances:

- (a) The taxpayer is obligated to pay or distribute all or substantial part (e.g., more than 60%) of its income to a third country resident within a prescribed time (e.g., within 12 months after the receipt date thereof);
- (b) The taxpayer has few business activities other than holding the assets or rights from which it obtains income;

- (c) For corporate taxpayer, its assets, size, and staffing are too small to fit its income;
 - (d) The taxpayer has few rights to control or dispose of the income or relevant assets and rights, and assumes few risks; or
 - (e) The taxpayer's home country does not levy or levy tax at rate of a fairly low level over such income.
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For further information, please write us at inquiry@hanyilaw.com.

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