

China Regulatory Updates

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1. Realization of Preferential Tax Treatments under Tax Treaties Will Be Subject to Tax Bureau's Scrutiny

The PRC State Administration of Taxation (“SAT”) has recently issued the *Trial Measures on the Administration of the Tax Treaty Treatments Enjoyed by Non-Residents* (the “Measures”), with a view to further regulating the procedures for non-residents to apply for tax treaty benefits and to combating illicit tax avoidance and treaty shopping. The Measures will take effect on October 1, 2009.

Pursuant to the Measures, non-resident taxpayers are required to secure approval from the competent tax authorities if they want to enjoy any tax treaty benefit for dividends, interests, royalties and asset gains that they receive from China. Non-resident taxpayers should file with the competent tax authorities for their entitlement of other types of tax treaty treatments (excluding those under the international transportation clauses) before the relevant tax liability arises or when it is reported. No tax treaty treatments may be granted unless such required approval or filing procedures are effectuated.

The Measures require non-resident enterprises applying for tax treaty treatments to report certain key information of their China investee companies for the PRC tax authorities to examine the adequacy of commercial substance of the underlying transactions and the reasonability for such non-resident enterprises to have the special purpose vehicle established in a tax-efficient jurisdiction (such as Hong Kong and Singapore) to hold their China investments.

To sum up, in order to enjoy the preferential tax treatments under the relevant tax treaties, foreign investors are advised to (i) take proper measures to fill their offshore SPVs with more “commercial substances”, such as active engagement in business operations, holding regular board meetings, and maintaining all regular books and records; and (ii) review and adjust their existing business arrangements and internal transactions with their Chinese affiliates.

2. Foreign Exchange Rules Applicable to QFIIs Will Soon Be Amended

On September 4, 2009, the PRC State Administration of Foreign Exchange (“SAFE”) released for public comments the *Draft Provisions on Administration of Foreign Exchange Related to Domestic Securities Investment by Qualified Foreign Institution Investors* (the “Draft Rules”). The purpose of the Draft Rules is to lift the restrictions on QFII investment quota and capital flow and to promote the opening progress of China’s capital market.

According to the Draft Rules, the maximum investment quota available to a single QFII is increased from US\$800 million to US\$1 billion. The lock-up periods for investment principals of QFIIs with long and medium investment cycles (such as pension funds, insurance funds and mutual funds) and qualified open-ended China funds launched by QFIIs are shortened from one year to three months, while the lockup period for other types of QFIIs remains one year. The qualified open-ended China funds mentioned above should have been launched by QFIIs through oversea public offering, with at least 70% capital to be invested into China’s securities market.

As part of the efforts to facilitate the operation of QFIIs, the Draft Rules for the first time allow the open-ended China funds launched by a QFII to remit in or out of China the net difference between the fund investor’s monthly redemption amount and subscription amount after the expiry of the lockup period for their investment principals. The approval authority over such remittance will be delegated to the local SAFE office where the QFII’s custodian is located.

3. Tax Calculation and Withholding Obligations Related to Stock Option Incentive Plans Further Clarified

SAT has recently promulgated the *Circular on Issues with Respect to Individual Income Tax Related to Stock Option Incentive Plans* (the “Circular”), clarifying the calculation methods of taxable amount related to the income from stock appreciation rights and restricted stocks.

The Circular reiterates that income obtained by individuals from stock appreciation rights and restricted stocks granted by their employers listed within or outside China should be respectively taxed under the names of salary income and income from stock options. The granting companies or their China operations will be responsible to withhold the relevant individual income tax according to applicable PRC tax law.

The Circular also specifies that all currently effective individual tax policies issued by SAT with respect to stock options should be similarly applicable to employees who work at listed companies (including their branches) or the subsidiaries under such companies' immediate or second-tier control, provided that such listed companies should hold at least 30% equity interest in the aforesaid subsidiaries.

4. Supreme People's Court Specifies Scope of Application of the New Insurance Law

On September 23, the Supreme People's Court of China released the *First Interpretations to Several Issues Concerning the Application of the PRC Insurance Law* (the "Interpretations") in a bid to ensure a smooth transition from the currently effective insurance law to the newly amended *PRC Insurance Law* (the "New Insurance Law") and to provide unified standards for judges at all levels to hear cases on insurance disputes. The six-article Interpretations will come into effect concurrently with the New Insurance Law on October 1, 2009.

Pursuant to the Interpretations, for disputes arising from insurance contracts that take effect on or after October 1, 2009, the New Insurance Law should apply. For disputes arising from insurance contracts taking effect before October 1, 2009, the then-effective laws should apply. However, if the activities or events related to such insurance contract (such as transfer of insured assets, the occurrence of insured incidents or the termination of an insurance contract by the insurer due to the insurance applicant's false representations) occur on or after October 1, 2009, the New Insurance Law should apply. If there is no applicable provision in the then-effective laws, the courts should hear such disputes with reference to the New Insurance Law.

The Interpretations have also specified the commencement dates of certain time periods under the New Insurance Law.

5. Futures Companies Subject to Category Specific Supervision

The China Securities Regulatory Commission has recently circulated the *Trial Provisions on the Supervision over Futures Companies on Category Specific Basis* (the “Provisions”), which have become effective on September 1, 2009. The Provisions classified futures companies into 5 categories and 11 sub-categories in terms of their risk management capacity, market influence and continuous compliance obligations. The classification of futures companies will serve as a basis for selection of qualified participants for any pilot new business and for determination of the contribution ratio to the futures investor protection funds, which currently ranges from 0.5% to 1% of the agency turnover of futures companies.

According to the currently effective *Catalogue for the Guidance of Foreign Investment Industries*, futures companies are restrictively open to foreign investments and should be controlled by Chinese shareholders. However, as of the date hereof, there are no detailed implementing rules issued with respect to the formation of futures joint ventures, except for a few clauses under the Closer Economic Partnership Arrangement (CEPA) between the mainland China and the HK SAR/Macau SAR.

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