

China Regulatory Updates

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1. SAFE Softens Restrictions on Outbound Lending by Onshore Enterprises

The PRC State Administration of Foreign Exchange (“SAFE”) has recently released the *Circular on Relevant Issues Concerning the Administration of Foreign Exchange Related to Outbound Lending by Onshore Enterprises* (the “SAFE Circular”), which will become effective on August 1, 2009. The SAFE Circular is applicable to credit facilities provided by an onshore enterprise to its offshore investee enterprises.

With an aim of softening the restrictions over outbound lending by onshore enterprises, the SAFE Circular has:

- (a) broadened the scope of qualified lenders from multinational companies to all types of enterprises that meet certain requirements;
- (b) expanded the sources of funds and the lending quota of outbound lending. Foreign currency funds owned by the lender, converted from RMB or drawn from the foreign exchange capital pool as approved by SAFE can all be lent to the offshore borrower, provided that the outstanding amount of all loans made by the onshore lender to its offshore investee company should not exceed 30% of the lender’s ownership interest or the agreed and duly registered investment amount of the Chinese party, whichever is lower; and
- (c) simplified the relevant approval and remittance procedures. Matters related to outbound lending will be only subject to the examination and approval by relevant local SAFE offices.

It is worth noting however that for a multinational company, the SAFE Circular should apply if it lends money to its offshore investee companies. In the case of its lending money to its other offshore affiliates, the rules issued by SAFE in 2004, i.e., the *Circular on Issues Related to Internal Operation and Management of Foreign Exchange by Multinational Companies*, should apply.

2. Collection of Individual Income Tax on Equity Transfer Deals Strengthened

In order to further regulate the collection and administration of the individual income tax (“IIT”) on income from equity transfer deals, the PRC State Administration of Taxation (“SAT”) has lately promulgated the *Circular on Strengthening the Administration of Individual Income Tax Collection Related to Share Transfer* (the “IIT Circular”).

The most remarkable feature of the IIT Circular is that local offices of the PRC State Administration for Industry and Commerce (“SAIC”) are required to provide assistance in the collection of IIT levied on equity transfer income, i.e., no change of shareholders of the target company can be registered with the SAIC offices unless the tax payment receipt (or tax exemption certificate/non-taxable certificate) is issued by the competent tax authorities to relevant IIT payer in the equity transfer deal. However, as the IIT Circular is issued by SAT, it is not clear now whether such arrangement will be actively responded by SAIC.

In addition, the IIT Circular has also emphasized that the tax authorities should evaluate and check whether the equity transfer deal is conducted on a sensible, reasonably economic and an arm’s length basis. With respect to any unjustified taxable income that is declared to the tax authority and is obviously below the normal level (in such circumstances as cost-price selling or underselling), the tax authorities may determine the taxable income based on the net asset value per share or the net asset value *pro rata* to any individual shareholder’s shareholding in the target company.

3. Foreign-Invested Equity Investment Management Company for the First Time Permitted in Pudong New Area of China

The government of Pudong New Area, Shanghai released and effectuated on June 10, 2009 the *Trial Measures for the Establishment of Foreign-Invested Equity Investment Management Enterprise in Pudong New Area of Shanghai* (the “Measures”). According to the Measures, foreign equity investments will be permitted for the first time to be registered as “equity investment management company” in Pudong New Area if they meet certain requirements with respect to, among others, the minimum registered capital and the qualifications of investors as well as senior executives. The Measures, as an experimental step, will be effective for a period of one year.

As Shanghai is committed to making itself an international financial center, the Measures are widely deemed as a positive pilot move of Pudong New Area to attract international private equity funds and promote the development of foreign-related RMB funds. The implementation of the Measures is however facing the problems of the lack of central government's positive response and absence of supporting rules at the operating level. It is reported that the authorities of Pudong New Area are now contemplating feasibilities for foreign-invested equity investment management enterprises to serve as the general partner to RMB funds, or the feasibility for foreign private equity funds to set up onshore RMB funds. All these blueprints of course need explicit encouragement from the central level of administration (especially the PRC Ministry of Commerce and SAFE).

RMB funds are probably the hottest spot in China's private equity investment sector at present. However, in contrast to various rules and tax incentives released by local governments on foreign-related equity investment, the central government is moving slowly in respect of national legislation. The *Regulations on the Administration of Foreign Invested Venture Capital Investment Enterprises* issued in 2003 allow foreign investors to establish non-legal foreign-invested venture capital investment enterprises in China, but there is no regulation applicable to foreign-invested partnerships in China now and thus foreign investors cannot form RMB funds in the form of limited partnership as they usually do outside China at this moment. In addition, foreign-related RMB funds are now facing practical obstacles, such as foreign exchange surveillance, uncertain tax policies and unsmooth exit mechanism. In this sense, local governments' pilot endeavors in relation to RMB funds may, to some extent, play a role in pushing forward the central government's decision-making process with respect to foreign-related RMB fund legislation.

4. SAIC Issues Two Implementing Rules for Anti-Monopoly Law

SAIC has recently issued the *Provisions on Procedures for the SAIC Offices to Investigate and Sanction Monopoly Agreements and the Abuse of Market Dominant Positions* and the *Provisions on Procedures for the SAIC Offices to Prohibit the Abuse of Administrative Powers to Eliminate or Restrict Competition*, both of which became effective on July 1, 2009.

According to the PRC Anti-Monopoly Law, SAIC is responsible for the enforcement of the anti-monopoly rules against monopoly agreements (except for those related to price), the abuse of market dominant positions and the abuse of administrative powers to eliminate or restrict competition. The two aforesaid regulations, as the major supporting rules, will help to ensure the smooth implementation of the PRC Anti-Monopoly Law by the SAIC offices.

5. Certain PRC Enterprises' Outbound Investments to Be Subject to NDRC's Preliminary Review

On June 8, 2009, the PRC National Development and Reform Commission ("NDRC") promulgated the *Circular on Certain Issues Related to the Improvement of Outbound Investment Project Management*, requiring the enterprises concerned to submit an information report to it (with the relevant department in charge under the State Council being copied) before any material work related to their outbound investments is initiated. This circular is only applicable to offshore M&As and biddings that are subject to approval by NDRC or the State Council according to the *Catalogue of Investment Projects Subject to Government Approvals* released in 2004.

According to this circular, NDRC will issue a confirmation letter within seven business days upon its receipt of the project information report. If NDRC holds that the project has any obvious and material adverse factor, it will so indicate in the confirmation letter and strictly review the project if the same project is submitted to it for examination and approval in the future.

6. Transactions Involving PRC State-Owned Property Rights Further Regulated

On June 25, 2009, the PRC State-Owned Assets Supervision and Administration Commission ("SASAC") circulated the *Operating Rules on Transactions of State-Owned Property Rights Held by Enterprises*, which have taken effect since July 1, 2009. The Rules mainly cover the major steps related to the transactions involving PRC state-owned property rights, with an aim to unify and further regulate the transactions of state-owned property rights.



Compared to the draft of these rules released in March 2009 for public comments (*please refer to the April 2009 issue of Han Yi China Regulatory Updates for more details*), these rules have expanded the application scope and are applicable to all transactions conducted at all PRC property rights exchanges designated by the SASAC offices at provincial level or above. In addition, the mandatory requirement in the draft with respect to the membership system for the property rights exchanges has not been written into these rules.

For further information, please write us at inquiry@hanyilaw.com.

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