Charltons - China News Alerts Newsletter - 28 July 2005

[online version](http://www.charltonslaw.com/china-news-alert-issue-112/)

# China News Alert Issue 112

## Headlines

### Rules on cross-border share exchanges to clarify red chip listing procedures

The consultation period for the proposed Rules on Cross-border Share Exchanges of Enterprises has now ended and it is foreseen that the final version of the Rules will be adopted this year. The Rules were jointly drafted by the State Administration of Industry and Commerce, the State Administration of Taxation and the State Administration of Foreign Exchange, and initiated by the Ministry of Commerce. The Rules will allow domestic enterprises to carry out cross-border share exchanges for overseas listing and financing (i.e. shareholders of an overseas companies may use their equity or shares in the overseas company as payment to acquire shareholder equity or shares in a domestic enterprise).

As domestic stock markets have slumped, many Chinese companies have sought overseas "red chip" listings on exchanges such as Hong Kong, the NASDAQ and Singapore by converting themselves into foreign investment holding companies. This is done through the following procedure:

1. the owner of a private enterprise establishes an overseas shell company in, for example, the British Virgin Islands or the Cayman Islands;
2. equity investment and assets from the mainland will be injected into the shell company to increase its share capital;
3. the shell company can then acquire the assets of other mainland enterprises;
4. the off-shore shell company can apply for "red chip" listing on, for example, the Hong Kong, Singapore or NASDAQ stock exchanges.

However, a Circular on improving foreign exchange administration relating to mergers and acquisitions (M&A) by foreign investors issued by SAFE earlier this year has acted to thwart many Chinese enterprises contemplating red chip listing through the above method.

According to the Circular, mainland residents wishing to invest directly or indirectly to establish and control an offshore enterprise must comply with the approval and registration procedures set out in the Measures for the Administration of Foreign Exchange of Offshore Investment. As a result, the owner of a private enterprise must seek SAFE approval for establishing the offshore enterprise in his personal capacity. Previously, the Measures applied to offshore investment by companies, enterprises and other economic entities registered in the mainland, but not to offshore investment by individuals.

While the main aim of the Circular has been to stem the outflow of mainland capital via third territories, to prevent the dissipation of state-owned assets, and to enhance the review by state authorities of red chip registration of overseas enterprises, capital injections and M&A of domestic assets, the practical effect of the measures has been to stymie many small and medium-sized enterprises with real overseas financing demands, and in particular to block overseas listings by private enterprises.

Following lobbying from a large number of companies, intermediary institutions and venture investment companies trying to secure overseas listings, the draft Rules were issued to clarify the standard approval procedures for red chip overseas listings. The Rules will allow a domestic enterprise to conduct cross-border share exchanges for overseas listing and financing: in other words, shareholders of an overseas company may use their equity or shares in the overseas company as payment to acquire shareholder equity or shares in a domestic enterprise. According to the Rules, a domestic enterprise may first register a shell company in a tax-free jurisdiction such as the BVI, then exchange shares to be issued by this company for equity of a domestic company. The shell company may the carry out a "back-door" listing on an overseas market.

In contrast to cash payments for M&A of assets of domestic enterprises, cross-border share exchanges do not result in an outflow of domestic enterprise capital. Accordingly, this process may avoid certain irregularities during the M&A process. The Rules establish two categories of company in respect of cross-border share exchanges:

1. overseas listed companies and
2. special purpose companies (or overseas shell companies).

Different regulations and approval requirements are proposed for the two categories of companies.

The Rules will contain a special provisions for special purpose companies for the overseas listing of domestic companies. The provisions define the term "special purpose company" to mean an overseas company established for the purpose of listing overseas by Chinese domestic enterprises or individuals. Such company may exchange its shares or issue additional equity for shareholder equity or shares of a domestic enterprise.

It is foreseen that the effect of the Rules may be particular importance to the venture capital industry. In China, many venture capital activities are conducted by registering off-shore institutions in places such as the Isle of Man. Statistics compiled by Beijing Qingke Co., Ltd., show that the total sum of domestic venture capital fell sharply in the first quarter of this year compared to the fourth quarter of last year, from US$285 million to US$165 million. Overseas back-door listings of small and medium-sized enterprises is one of the few effective exit channels for domestic venture capital, which channel has been blocked by the effects of the Circular issued by SAFE. It is foreseen that the clarifications provided by the Rules will help to encourage further venture capital activities.

However, under the Rules, if a special purpose company is permitted to carry out overseas share exchanges, shares held by the company should be effective within 6 months of the issue of an operation license, and the latest revision prolongs this period to two years. But this period is still short for venture capital into start-up companies. The period for withdrawing invested venture capital is generally three to four years. The period restriction in the Rules may therefore affect project choices of venture capital. Back to top

### CSRC issues guidelines on the relationship between listed companies and investors

The CSRC has issued Guidelines on the Relationship between Listed Companies and their Investors, requiring companies to set up working relationships with investors and mechanisms for communicating important issues. In formulating schemes affecting the rights and interests of stockholders, various methods should be adopted to facilitate sufficient communication and negotiation between investors, and these communication methods should be both convenient and effective in order to facilitate investor participation.

According to the Guidelines, development of company/investor relations should be based on six basic principles: full information disclosure, information disclosure by compliance, equality of opportunity among investors, faithfulness, high efficiency, and mutual communication. The main bulk of communication consists of the company's development strategy, legal information disclosure and relevant information, legal disclosure of management operational information and other significant matters, including important investments of the company, assets restructuring, M&A, external cooperation, and significant lawsuits and arbitration.

In contrast to the current compulsory information disclosure of listed companies, the full information disclosure principle stipulated in the Guidelines requires that disclosure should be undertaken by companies on their own initiative, that disclosure channels be widened, and that the content and method of information disclosure be highlighted. In addition, companies should improve two-way communications with investors by encouraging interaction and reviewing investor feedback.

According to the CSRC, the improvement of the investor relations is of particular importance in the context of the current share redesignation reform. The experience of the first pilot scheme on share redesignation shows that that good management of investor relations has facilitated communication between holders of non-tradeable and tradeable shares and share redesignation reform. Back to top

### CDRC approves Valin Steel Tube & Wire equity transfer

The China Development and Reform Commission (CDRC) has granted approval to the Valin Group to transfer part of its state-owned corporate stock in Valin Steel Tube & Wire to the largest steel group in the world, Mittal Steel Company, and to establish the jointly invested Valin Steel Tube & Wire Co., Ltd. SASAC has also approved the equity transfer. The deal represents the first purchase of Chinese A stocks by foreign investment, with Valin Steel Tube & Wire becoming the first large-scale steel enterprise in China to enter the global steel industry through equity transfer.

In accordance with the requirements of the SASAC and CDRC of the State Council, Valin Steel Tube & Wire will remain state-controlled, with equity held by the Valin Group 1% higher than that of the Mittal Steel Company upon completion of the equity transfer. The total capital stock of the Valin Group is 1765.375 million shares, of which the Valin Group holds state corporate shares totaling 665.076875 million and accounting for 37.673% of the total capital stock, while the Mittal Steel Company holds non state-owned shares totaling 647.423125 million and accounting for 36.673%. With the exception of 30% of the RMB2.7915 billion capital submitted as financial capital, all the remaining capital will be used to restructure the Valin Group and readjust and upgrade the products of Valin Steel Tube & Wire.

Under the deal, Mittal Steel Company will transfer technology to the Valin Group. In March this year, Valin Steel Tube & Wire and the Mittal Steel Company executed a supplementary framework agreement for strategic cooperation, which provides that the Mittal Steel Company will provide Valin Steel Tube & Wire with six internationally advanced technologies, including the production technique for aluminium and zinc steel plating; the production technology for alloy spring steel and cutting high-intensity steel, such as refined wire and bar; the production technology for vessels using high-intensity and performance steel plate; the process technique for developing and producing electrical steel by CSP; the production technology for DRI; and the production technology for automobile deep drawing and cold-sheet rolling.

The Mittal Steel Company will also provide strong support for Valin Steel Tube & Wire in terms of purchasing, marketing and capital. Mittal Steel Company will integrate Valin Steel Tube & Wire into a global purchase plan by directly supplying 3 million tonnes of minerals to Valin Steel Tube & Wire and increasing this supply on a step-by-step basis according to productivity. Making use of this global distribution network to sell the products of Valin Steel Tube & Wire, this logistic advantage will be used to reduce logistic costs, provide Valin Steel Tube & Wire with the necessary capital support, and graft an advanced knowledge management system onto Valin Steel Tube & Wire's operations.

## Capital Markets

### CSRC develops series of policy measures for implementation

In order to further develop domestic securities market and facilitate the process of redesignation of non-tradeable shares, the China Securities Regulatory Commission (CSRC) has developed a series of policy measures, which have been approved by the State Council and are now being implemented by the related departments.

The implemented measures currently include:

* launching a second pilot scheme on share redesignation reform, including listed companies controlled by large state-owned enterprises and under the direct control of the State-owned Assets Supervision and the Administration Commission of the State Council;
* reducing income tax on bonuses and dividends of individual investors;
* refraining from collecting stamp tax and income tax on payments and gains from share redesignation;
* allowing listed companies to redeem floating shares and hold more floating shares after share redesignation reform;
* allowing fund management companies to use existing capital investments; and
* establishing clear policies and administrative provisions in respect of state-owned shareholders participating in share redesignation reform.

It is understood that following the end of the second share redesignation pilot scheme, there will be no further pilot scheme. On the basis of experience gained from these two pilot schemes, administrative methods for the comprehensive promotion of share redesignation reform will be studied and developed before receiving the approval of the State Council. The issuance of new shares will be suspended in the period prior to the implementation of the new share redesignation reform measures. Listed companies issuing shares after this period will implement the new measures for share redesignation; listed companies failing to complete share redesignation will suspend re-financing.

In order to promote the redesignation of non-tradeable shares, guidelines are being drafted on state-owned economy and industry shareholding proportions. Sponsors will be encouraged to apply innovative financial techniques in designing share redesignation schemes adapted to different listed companies, with securities exchanges and registration and settlement companies providing related technological support. A separate transaction board will be established for companies after share redesignation reform in order to study and develop related financial derivative products.

In tandem with the promotion of share redesignation, a series of guidelines on relating to listed companies, improvement of securities companies and the strengthening of institutional investors are also being developed.

Measures to enhance the listed company regime include the following:

* ensuring that shareholders who are major state-owned enterprises resolve the issue of misappropriation of capital of listed companies;
* promoting M&A test projects, such as increased issue of circulating shares, takeovers and mergers, guided by the direction of the market;
* utilising share redesignation reform to improve and restructure poorly performing listed companies and to deal with the issue of the misappropriation of capital of listed companies by large shareholders;
* accounting settlement provisions shall be developed for payments by shareholders of non-tradeable shares.

In relation to securities companies, the CSRC is aiming to enhance basic systems and to eliminate systematic risks in securities companies' management systems, to intensify supervision of high-level management and shareholders, to promote the integration of industry resources and to support high quality companies in order to encourage growth. In response to difficulties currently experienced by securities companies, liquidity support will be provided for pilot securities companies and sponsors involved in share redesignation reform. At the same time, in order to protect the legal rights and interests of investors, a protection fund for securities investors is being set up.

In respect of institutional investors, concrete measures include allowing fund management companies to finance through share mortgages, further promotion of pilots schemes of commercial banks initiating and establishing fund management companies, enhancing market entry of social insurance funds and state-owned insurance companies and studying and resolving issues such as postponement of financial examinations and accounting settlements of investment profit and loss.

At the same time, it is proposed that a further US$6 billion of Qualified Foreign Institutional Investor (QFII) investment quotas will be allocated in addition to the US$4 billion already granted. In addition, restrictive governmental provisions on stock market investment by state-owned enterprises is to be eliminated.

Finally, an overhaul of the securities laws regime is also and rules is also being carried out.

Related departments have organized special resources to study and implement the above measures. It is expected that these will then be successively published and implemented.

### Shanghai Securities Exchange releases circular imposing restrictions on first day prices of newly listed shares and other financial instruments

The Shanghai Securities Exchange has issued a Circular on Setting Declaration Price Restrictions on Categories of Transactions without Upper or Lower Limits. Under the Circular, first day transaction prices of newly listed shares will now be restricted. Additional share issues and first day transactions in respect of additional listings after share redesignation reform will be placed in the same category as first day transactions of newly listed shares, and therefore subject to the same pricing limitations.

According to the Circular, the restriction by Shanghai Securities Exchange on declaration prices of securities transaction varieties formerly without upper or lower limits will be based on the closing prices of the previous transaction day; or, if no such prices are available, it will be calculated on issuance prices:

* National debt and corporate bonds:
* upper limited:
closing prices of the previous transaction day x (1+30%);
* lower limit:
the closing prices of the previous transaction day x (1-30%);
* Convertible bonds:
* upper limit:
closing prices of the previous transaction day x (1+100%);
* lower limit:
closing prices of the previous transaction day x (1-50%);
* Funds:
* upper limit:
closing prices of the previous transaction day x (1+100%);
* lower limit:
closing prices of the previous transaction day x (1-50%);
* Shares:
* upper limit:
closing prices of the previous transaction day x (1+100%).
* lower limit:
closing prices of the previous transaction day x (1-50%).

There are no restrictions on bond redemption declaration prices.

### SAC approves 6 new sponsors for share redesignation work

The Securities Association of China (SAC) announced a list of 6 further sponsoring institutions available to assist companies in involved in the second pilot scheme on share redesignation reform, thus increasing the number of securities companies engaged in such work to 51.

The 6 newly added securities companies are United Securities, Haiji Dahe, Hualong Securities, Hengtai Securities, Xinjiang Securities, and Zhongguancun Securities.

The SAC stated that it will intermittently adjust and publish the name list of sponsoring institutions available to assist with share redesignation reform.

The full list of approved sponsors is as follows:

GF Securities, Guangda Securities, Guosen Securities, Merchants Securities, Guotai Junan, Huatai Securities, China International Capital Corp, and CITIC Securities

Orient Securities, Donghai Securities, CHANGJIANG BNP PARIBAS. PEREGRINE, China Euro Securities, Southwest Securities, Hong Yuan Securities, Shenyin & Wanguo, Great Wall Securities

Industrial Securities, Founder Securities, Tebon Securities, Bank of China International, First Capital Securities, Central China Securities, Golden Sun Securities, Century Securities, and Guolian Securities

Daton Securities, Huaan Securities, Bohai Securities, Jin Yuan Securities, CITIC WT Securities, Hongta Securities, Ping An Securities, Northeast Securities, and Guoyuan Securities

Jinxin Securities, West China Securities, Dongguan Securities, MINSHENG. Securities, GuoHai Securities, Shanxi Securities, Dongwu Securities, China Securities, Galaxy Securities

Beijing Securities, United Securities, Haiji Dahe, Hualong Securities, Heng Tai Securities, Xinjiang Securities, and Zhongguancun Securities

### SGIS Songshan share redesignation scheme

SGIS Songshan announced a share redesignation scheme on 11 July, becoming the first company involved in the pilot share redesignation scheme to establish a share price lower than net assets per share.

SGIS Songshan will implement a payment scheme presenting 3 shares for every 10 shares, and introduce an equity incentive plan. The formulation of the scheme has not been affected by the fact that corporate share prices fall below net assets per share and are not linked to net assets, but rather are calculated according to the principle that the market value of non-tradeable shares should be less than the market value of such shares prior to reform. In addition to undertaking not to reduce the share price to the net asset value of each share, the only shareholder of SGIS Songshan holding non-circulated shares иC SGIS иC has also stated that it will take the opportunity to input capital of not less than RMB0.2 billion in order to hold capital stock of not less than 5% through centralized bidding within two months from the implementation of reform, in case the share price of SGIS Songshan is lower than the net assets per share of the latest term or according to the fluctuation of SGIS Songshan share prices.

Meanwhile, SGIS Songshan has engineered to implement equity incentive measures in respect of senior and middle management by making 67.056 million shares available for circulation 12 months after the implementation of reform (accounting for 5% of the capital stock after the presentation of 6 shares for every 10 shares). The exercise price will be the net assets value per share of the latest term.

### SASAC supports share redesignation reform of state-owned listed companies

Li Rongrong, the director of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) has that the SASAC supports large- and medium-sized state-owned listed companies improving share redesignation reform, optimizing capital structure and enhancing the general quality of such companies. The SASAC also supports qualified, large state-owned companies going public overseas by means of standardized restructuring and achieving the complete listing of their main businesses.

## Funds

### Regulations on trading open-ended funds issued

With the approval of the CSRC, the Shanghai and Shenzhen Stock Exchanges have issued regulations and detailed rules on purchasing and redeeming open-ended funds. Shanghai Securities Exchange Funds will be available on the Exchange and six Listed Open-Ended Funds (LOFs) of Shenzhen Securities Exchange will take the lead opening on-floor purchases and redemptions.

Shanghai Securities Exchange Funds have been developed using core technology from the Shanghai Securities Exchange and will conduct the specialized underwriting, purchasing and redemption of open-ended funds through a transaction system connected with the existing member system of the Exchange. The equity funds of securities investments of Yinhua Funds Management Co., Ltd. will be the first open-ended funds listed on the Shanghai Securities Exchange through Shanghai Securities Exchange Funds.

The Rules issued by the Shenzhen Securities Exchange provide that open-ended funds are purchased and redeemed on the floor and that fund managers shall submit applications to and acquire confirmation from the Exchange. Members of the Exchange who are regarded by the CSRC as authorized commission agents and who comply with risk control requirements can handle purchases and redemptions.

## Foreign Investment

### Foreign direct investment in China remains small-scale

Chen Jian, minister of the Ministry of Commerce, stated in a press release conference held by the State Council Information Office on the July12, that China has attracted US$21.3 billion of foreign direct investment (FDI). There is no large-scale foreign investment in China, although foreign investment has continued to increase in recent years.

Chen Jian indicated that although China has in total used more than US$560 billion of foreign investment since the reform and opening-up of Chinese markets, when factors such as the number of foreign-invested enterprises which have closed down or ceased operations, and the depreciation of assets and the repatriation of capital are taken into account, China attracted US$21.3 billion of FDI, accounting for less than 1% of the global FDI.

Additionally, the percentage of FDI to China's Gross Domestic Product (GDP), and fixed-assets investment and FDI per capita, are lower than the world average. In 2003, FDI stood at 3.8% of GDP and FDI per capita at only USD41; far less than those of developed countries (US$530) and per capita world average (US$107).

## Corporate & Commercial

### SAIC issues circular malpractice in monopolised industries

The State Administration of Industry and Commerce (SAIC) has issued a circular relating to malpractice in monopolised industries (such as the power, water supply, gas supply, transportation and postal sectors), in order to reinforce the investigation and punishment of illegal actions and protect monopolised markets from unfair competition.

The Circular has made the following findings in respect of certain monopolised sectors:

* the power supply department obliges users to buy electricity meters, wires, electrical switch boxes, transformers and other electrical equipment which the power supply department is supposed to provide, to make advanced payments and deposits for power supply, to buy power insurance and unnecessary goods, and to pay a minimum power usage fee;
* the water supply department requires users to purchase water pumps, valves and pipelines of designated operators, to buy water meters or change water meters, to buy unnecessary water cards, to accept a designated water project construction service, and to pay a minimum water charge;
* the gas supply department obliges users to buy or use gas cooking utensils provided by them, to purchase unnecessary goods, to purchase accidental injury insurance and to pay a minimum gas charge, etc;
* the transportation department requires users to accept the extended service provided by designated operators, to buy insurance and accept insured transport service, and to buy tickets and pay fees at appointed sale sites;
* the postal service department obliges users to buy EMS, etiquette and gift services, post cards, value insurance, stamp albums and other goods, to use packaging provided by the postal service department rather than those produced by other operators regardless of user requirements, to join postal savings schemes, to subscribe to newspapers and magazines and to purchase its goods when the user withdraws money.

### SAWS issues Circular on application procedures for safety production licenses of coal mines

The State Administration of Work Safety (SAWS) has issued an urgent circular on the examination and verification of safety production licenses and to rigorously enforce issuance procedures and discipline. The Circular also sets out measures to crack down on illegal production activities.

Under the Circular, all coal mining enterprises and all production mineral wells must meet production safety conditions and submit applications to the relevant administrative departments to issuing coal mine safety production licenses at the provincial level.

From July 14, all enterprises failing to submit license applications, or failing to receive application approval after examination and verification, must halt production pending verification. The coal mine safety supervisory authority will withdraw business, coal production and mining licenses, and maintain a list of all coal mines under suspension orders.

### NDRC issues new catalogue of drug prices

The National Development and Reform Commission (NDRC) has issued the new NDRC Catalogue of Priced Drugs to adjust the range, form and authorization of drugs priced by government. The Catalogue will take effect on August 1.

The number of drugs priced by the government has increased from about 1,500 to approximately 2,400 in the revised Catalogue. Besides 2,100 drugs designated as basic medical care, for which reimbursement is available, there are also around 300 other drugs covering anesthetic, psychoactive, immune and contraceptive functions.

The NDRC has stated that the national catalogue of basic medical care increased the number and variety of drugs for which reimbursement is available from about 1,300 to approximately 2,100 in September 2004. The range of government priced drugs thus requires a corresponding adjustment.

In accordance with the provisions of the Implementation Regulations of Drug Management, the drugs covered in the national catalogue of basic medical care must implement the government's guiding price. Drugs priced by the government are divided into two categories: in the first category, sellers cannot adjust government prices without authorization; in the second category, sellers may decrease government guiding prices without limitation. The prices of reimbursable prescription drugs are determined by the Central Government. In line with the actual conditions of purchase and sale, localities may decrease the highest retail price of drugs subject to government guiding prices, and non-prescription drug prices shall be determined by the government.

### MOR issue Circular on transportation of dangerous goods

The Ministry of Railways (MOR) has issued the Circular on Strengthening Safety Management of the Transportation of Dangerous Goods, to ensure the safety management of the transportation of dangerous goods.

The Circular requires that the condition of dangerous goods safety technology such as packaging and transportation vehicles must be carefully examined, and that those conditions not in compliance with requirements will be rejected. Dangerous goods that are excessively sensitive and may spontaneously react shall not be handled. Goods sections must be systematically divided according to the characteristics of dangerous goods, which shall not be piled up in awnings or in the open air.

The Circular stipulates that transporters of dangerous goods must implement a signature system for accepting the carriage, truck loading, transportation, escorting, grouping and isolation of dangerous goods. Responsibility systems for convoy sections of essential dangerous goods such as liquefied gas, explosives, severe toxins and ammonium nitrate must be implemented.

## Insurance

### Chinese insurance institutions permitted to invest in financial products

Wei Yingning, vice-chairman of the China Insurance Regulatory Commission (CIRC) has stated that Chinese insurance institutions may invest in financial products such as short-term financing bills, international development RMB bonds and assets, in addition to deposits, securities, funds and shares, and may also indirectly invest in the national infrastructure construction projects.

Wei Yingning expressed these statements to the CIRC and the international seminar on the management system of insurance assets jointly held by the AXA Group. He stated that China's insurance market has developed rapidly in recent years and that available assets were continuously increasing. As of the end of May, overall assets of the insurance industry has reached RMB1,352.8 billion, increasing 14.1% from the beginning of the year, and the balance after the application of funds is RMB1,213.5 billion, increasing 13.4% from the beginning of the year.

Wei Yingning also revealed that in addition to risk prevention, the CIRC will strengthen system construction by establishing more than 10 focus groups to systemically study and develop rules on management and supervision. Draft regulations are currently being discussed and revised and will be implemented in the second half of the year.

Wei Yingning stated that the CIRC will make efforts to establish a relatively complete, basic management system structure for insurance assets within two or three years in order to further regulate policy implementation and investment operations for the whole industry and enhance the self-control and profits capability of insurance companies.

## Taxation

### STA levies income tax on secondary house

A press spokesman at the State Taxation Administration (STA) has made it clear that the levying of income tax on secondary housing transaction (i.e. sales of second-hand houses) does not represent a new policy and that tax departments of various levels should levy income tax together with deed tax and sales tax.

According to the provisions of the tax law and policies, the following taxes are to be levied on individuals transferring houses in China: deed tax, operation tax (adding town maintenance and construction tax and additional education tax), income tax, land VAT, stamp duty tax etc. The macro control policy implemented this year emphasizes operation tax, while other tax policies remain the same.

The STA has stated that income tax on secondary house transactions has been specifically provided for by earlier regulations and that tax institutions had been levying it during this time. However, the individual secondary house transactions market has been inactive and has therefore attracted little attention. In addition, some regional tax institutions did not enforce the income tax levy policies strictly so that the intensification of the levy in some regions has created misconceptions among the public.

The STA reiterated the provisions concerning income tax levy methods upon individual house sales that were promulgated by three state ministries and commissions in December, 1999, as follows:

* the first situation concerns individuals selling self-owned houses, with the exception of public-owned houses. In this situation, income tax shall total 20% of the income accrued from the transaction after subtracting the original purchase price and reasonable expenses paid during the sale of the property;
* the second situation concerns individuals selling public-owned houses which have been bought earlier. In this situation, income tax shall be calculated on the selling price after subtracting
	+ the standard economic price of a house of such surface area;
	+ the difference between the original price paid for the house and the standard economic price;
	+ profits paid to the financial institution or original property right institution; and
	+ other reasonable fees levied by tax laws; and
* the third situation concerns employees selling houses built with raised funds, houses for low-income urban residents, affordable housing (i.e. affordable housing provided by the PRC government for low income citizens) and houses allocated after the demolition of original houses which were brought at the standard price. In this situation, the taxable income shall be calculated according to that of state-owned houses.

Favorable individual income tax policies shall be granted in two different situations:

* income tax shall be exempted when the only house of a family that has been owned for more than 5 years is transferred to an individual;
* taxpayers selling their existing house with the intention of buying another house according to market prices within one year of the sale shall pay income tax on the house sale as a deposit to the tax authorities. In instances where the house purchase price is more than or equal to the original selling price, the deposit shall be returned in its entirety. In instances where the purchase price is less than the selling price, the returned deposit shall be computed according to the proportion of the purchase price to the original selling price and the balance will be retained by Treasury.

## Other

### Circular on the regulation of notary charges

The Ministry of Justice (MOJ), the Supreme People's Prosecutions (SPP), the State Development Planning Commission (SDPC) and the China Banking Regulatory Commission (CBRC) have issued a circular to regulate legal service procedures for notarization and to prevent unfair competition,. The Circular requires that public notary offices and notaries strictly implement provisions on administration charges for notary services, to refrain from enlarging the scope of deductions and exemptions from notarization charges at random and to refrain from paying, requesting and collecting fees and profits as rebates.

The Circular highlights the existence of unfair competition practices in the notarization business, such as the adoption of low charges or the granting of rebates. Some agents have requested rebates on charges or other profits..

The Circular specifies that public notary offices and notaries must adhere to the Measures for the Administration of Notarization Service Charges. Public notary offices must adopt specific item charges, standard charges and measures for deducting and exempting charges. Public notary offices must collect charges in accordance with the stipulated standard charges, issue fee documents and refrain from enlarging the scope of deductions and exemptions from notarization charges at random when providing notary services. Notaries may not collect charges by themselves without approval.

The Circular provides that public notary offices and notaries may not grant rebates on charges and other profits under the guise of notary work, including introduction fees, assisting fees, communication fees and information fees. Groups or individuals may not request rebates on charges and other profits, either directly or indirectly, from public notary offices and notaries.

The Judicial Administration and the China Notaries' Association is responsible for the inspection and supervision of public notary offices. Departments engaged in overseeing notarization charges shall enhance the supervision of charges and prosecute illegal charges according to the law. Financial banking institutions and their staff discovered requesting rebates on charges and profits shall be urged to take disciplinary measures and punishments against directors, senior management officers directly in charge and other persons directly responsible, and financial banking institutions and their staff shall be investigated and issued with administrative penalties by banking regulatory administrations. Cases which constitute criminal activity shall be delivered to the judicial authorities to be dealt with according to the law.

**This newsletter is for information purposes only.**

Its contents do not constitute legal advice and it should not be regarded as a substitute for detailed advice in individual cases.

Transmission of this information is not intended to create and receipt does not constitute a lawyer-client relationship between Charltons and the user or browser.

Charltons is not responsible for any third party content which can be accessed through the website.

If you do not wish to receive this newsletter please let us know by emailing us at unsubscribe@charltonslaw.com

**Charltons - China News Alerts Newsletter - Issue 112 - 28 July 2005**