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# China News Alert Issue 306

## Capital Markets

### Limits raised for QFII investors

China plans to raise the limits on inbound portfolio investments to bolster market sentiment and the renminbi's internationalisation.

The upper limit for individual institutions' quotas under the qualified foreign institutional investor (QFII) program will be raised to US$1 billion from US$800 million under the draft rules and the lockup period for some investors will be cut from one year to three months, the State Administration of Foreign Exchange (SAFE) said recently.

"Although the total holdings of QFII investors amount to only a small fraction of the A-share market, these liberalisations (and potentially an accelerated pace of approvals) may signal official efforts to stabilise the domestic equity market," said Jing Ulrich, chairwoman of China Equities and Commodities at JP Morgan.

The Shanghai Composite has dropped 18 per cent from its peak on 8th August following concerns that tighter capital requirements would curtail lending and derail a recovery.

"The draft rules are very encouraging for QFII. It is extremely good news if QFIIs invest in the Chinese A-share market, which has undergone a correction/fall of around 20 per cent in the last few weeks," said Hubert Tse, managing director with International Business Group Yuan Tai PRC Attorneys. "The changes will make it possible for large investors to channel more portfolio investments into China's capital markets," Tse said.

As of August, 87 qualified foreign institutional investors were permitted to invest a combined US$15 billion in local-currency stocks and bonds. However, the overall investment quota of US$30 billion will remain intact, as less than US$15 billion of that amount has been used so far, Chu Yumei, an official with SAFE, said.

SAFE also said it will shorten the lockup period for some medium- and long-term QFII funds, such as pension funds and insurance funds, to three months. Other QFII investors will still be subject to a one-year lockup.

The draft rules aim to encourage "medium- and long-term investment" and to make investment operations and risk control more "convenient", the currency regulator said.

"The new move is part of the renminbi's internationalisation," said Ha Jiming, chief economist with the China International Capital Corporation.

"The relaxed limitation on inbound portfolio investments could enhance cross-border circulation and raise efficiency. Looking ahead, the government might adopt measures to smooth the outflow of the renminbi in order to speed up its internationalisation."

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-09/05/content_8658520.htm) ([see archive](Limits_up_for_QFII_investors.pdf))

### PE/VC companies offer helping hand to GEB suitors

Private equity (PE) and venture capital (VC) firms are backing nearly 38 of the 94 startups that are likely to be listed on the NASDAQ-like Growth Enterprise Board (GEB), according to a report released by market research firm, Zero2IPO Group, recently.

Domestic venture capital firms are playing a lead role in most of the GEB investment, accounting for 70 per cent of the total investment, the report said.

"Since the GEB provides more exit avenues it has attracted PE and VC firms. It would be beneficial for these firms to carry out both the fundraising and exit opportunities in the domestic market," said Lin Wanting, an analyst at Zero2IPO Group.

The report shows that more than half of the VC/PE-backed companies are engaged in IT or traditional industries. Of the 94 companies that cleared the regulators' preliminary review, 70 per cent are in IT or traditional industries.

"We may see more energy-saving and healthcare companies backed by VC/PE firms, as the nation is encouraging alternative energy firms," said Lin.

According to Zero2IPO, of the 38 VC/PE-backed companies, six firms have received a second round of funding, while one firm is already in its third round of capital injection.

The first investment by a PE/VC firm was in Kindee International Software Group, which received funding from IDG Capital Partners in 1999 and was listed in Hong Kong in 2001. A subsidiary of Kindee is now seeking to list on the GEB.

The report revealed that most of these cases were conducted in the past three years, peaking in 2008. The average investment cycle is normally two to three years.

"According to international examples, it usually takes six to eight years for VC/PE firms to exit the invested companies," said Lin.

"The GEB's lower threshold has also attracted some companies that were earlier looking at a listing on the small and medium-sized enterprise (SME) board," Lin said.

The 38 VC/PE-backed companies are mainly located in 13 cities or provinces, including Beijing, Shenzhen, Zhejiang province and Hubei province. The 94 companies are mainly located in Beijing, Shenzhen, Zhejiang province, Sichuan province and 17 other provinces or cities, the report said.

The Shenzhen Stock Exchange said recently that it plans to test the GEB network on 12th September and 10th October, indicating that investors could buy shares of GEB-listed companies by as early as the fourth quarter of this year.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-09/03/content_8649551.htm) ([see archive](PEVC_companies_offer_helping_hand_to_GEB_suitors.pdf))

## Corporate & Commercial

### The State Post Bureau regulates express delivery businesses

Recently the State Post Bureau released the ‘Administrative Measures for Express Delivery Businesses' (the Measures).The Measures provide details for licensing express delivery businesses based on the Postal Law.

Beginning from 1st October, any engagement in the express delivery business is subject to prior approval. Existing express delivery companies are required to submit their applications within one year.

Under the Measures, enterprises carrying out their business in a single province should have a registered capital of RMB 500,000, and those conducting business across different provinces should have a minimum registered capital of RMB 1 million. This will present a great threat to existing private businesses as 80 per cent of them do not meet the standards.

The delivery business license expires after five years and a new license needs to be obtained to continue the business.

In recent years the express delivery business in China has developed rapidly. However, the quality of services is not guaranteed and there have been many safety problems. The express delivery business involves client privacy as well as national safety and social stability. The Measures aim to solve such problems.

[Source: Stock Star](http://news.stockstar.com/info/darticle.aspx?id=SS,20090907,30030617&columnid=4003) ([see archive](The_State_Post_Bureau_regulates_express_delivery_businesses.pdf))

### China pledges more financial aid for outsourcing industry

The Chinese government has pledged more aid from the country's financial institutions to boost its outsourcing industry, a circular on the website of the country's central bank said recently.

The circular asked banks to develop more policies and credit products tailored to the outsourcing business, especially for firms in the 20 pilot cities for the industry, which include Beijing, Tianjin, Chongqing and Shanghai.

Insurance companies were also ordered to improve policies and create more insurance products for outsourcing firms.

Outsourcing companies were encouraged to list in equity markets both at home and abroad to raise fund to increase their competitiveness.

Local financial authorities should roll out and implement measures in line with their local situation by the end of September, according to the circular.

The statement was jointly issued by the People's Bank of China, the Ministry of Commerce, the China Banking Regulatory Commission, the China Securities Regulatory Commission, the China Insurance Regulatory Commission and the State Administration of Foreign Exchange.

As of June this year, China had 6,673 outsourcing firms employing 1.215 million people, Lin Zheying, director of the department of treaty and law at the Ministry of Commerce, said at a conference recently in Xiamen, Fujian province.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-09/10/content_8677523.htm) ([see archive](China_pledges_more_financial_aid_for_outsourcing_industry.pdf))

### China to tighten supervision over lip-synching

As of October 2009, all singing and instrument playing in commercial performances in China will be recorded and observed to avoid lip-synching, an instruction posted on the Ministry of Culture's website said recently.

Performance organisers who stage shows without recording them will face a fine of up to 3,000 yuan (US$439), said the announcement.

Lip-synching is the matching of a singer's lip movements to a recording. Taped music use in commercial performances will also be supervised.

"The act of lip-synching and faking the playing of a musical instrument is a gross violation of regulations and laws", said Tuo Zuhai, adding that it not only infringes on the rights and interests of consumers but harms the reputation of the singer or player.

Lip-synching during the opening ceremony of the Beijing Olympic Games caused controversy when a girl who touched millions of viewers with a moving song was later found to be miming.

The Ministry of Culture has also recently released a circular to further open up the domestic performance market. The Circular specifies the establishment procedures for Hong Kong or Macao wholly owned performance brokers and provides a sound environment for investment.

Regular performances involving foreigners in recreational places, scenic spots, amusement parks, theme parks, hotels, restaurants and bars require approval by provincial cultural departments. Performances with actors from both the mainland and Hong Kong or Macao may be approved by provincial cultural departments.

[Source: Xinhua](http://news.xinhuanet.com/english/2009-09/03/content_11992385.htm) ([see archive](China_to_tighten_supervision_over_lip-synching.pdf))

### China to allow foreign-invested companies to list

China will gradually reduce limits on the proportion of equity in investments from overseas companies, allowing qualified foreign-invested enterprises to list in the country's stock market, Chen Deming, Minister of Commerce, said recently.

The move aims to expand cooperation between China and foreign countries, opening investment avenues and optimising foreign investment structures, Chen said at the 13th China International Fair for Investment and Trade (CIFIT) in Xiamen, southeastern Fujian Province. Chen did not say when this will take effect.

China's used foreign direct investment (FDI) has declined for ten consecutive months since October 2008 as a result of the global economic downturn. The country's FDI dropped by 20.4 per cent year-on-year to US$48.4 billion in the first seven months of 2009, data from the Ministry of Commerce showed.

China will promote the opening-up of the service industry and speed up the construction of economic and technological development zones, in a bid to enhance mutual investment and contribute a dynamic force to the shrinking global economy, said Chen.

It will encourage foreign companies to develop high technology industries, promote the outsourcing industry, and support investment in clean technology, energy saving and environmental protection industries.

The country will also create sympathetic laws and policy for mutual investment, gradually granting foreign-funded enterprises the same treatment as their Chinese counterparts, Chen said.

The 13th CIFIT opened recently. This year's fair has attracted 13,000 overseas businesspeople. Launched in 1997, CIFIT has become one of China's most influential international platforms for the promotion of investment.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-09/09/content_8669965.htm) ([see archive](China_to_allow_foreign-invested_companies_to_list.pdf))

### China issues regulation to curb cement overcapacity

The Ministry of Industry and Information Technology (MIIT) issued a draft regulation on the access threshold for the cement industry to curb the industry's overcapacity, the China Business News reported.

New cement production lines in provinces where clinker output capacity exceeds 1,000 kg per capita will close, the regulation said. This means provinces like Anhui and Zhejiang will no longer approve new cement production lines.

According to statistics, in the first seven months of this year, investment in the cement industry totaled 88.16 billion yuan (US$12.91 billion), up 66 per cent year-on-year. It is estimated that about 100 new production lines will be put into use by the end of this year and approximately 200 more in 2010, according to the industry portal, chinacements.com.

The regulation also suggests the reconstruction of cement enterprises and the lifting of requirements on cement producers in new production.

The draft regulation calls for comments by 20th September.

Some industry insiders said provinces in Northwest China do not have overcapacity problems in the cement industry. In Guangdong province about 30 to 40 per cent of the old production lines are to be abandoned so there is still some development space for new production lines.

[Source: People's Daily](http://english.people.com.cn/90001/90776/90884/6751682.html) ([see archive](China_issues_regulation_to_curb_cement_overcapacity.pdf))

## Taxation

### Import tariff policy adjusted to encourage innovation

China's government is adjusting its policies on imported technological equipment with the purpose of boosting domestic innovation and greater industrial restructuring and upgrading.

Key components and raw materials imported by domestic enterprises for manufacturing major technological equipment and products are exempted from import tariffs and value-added tax (VAT) as of 1st July this year, according to a joint communiqué issued by the Ministry of Finance and five other ministries recently.

Tariff exemption for imported complete sets of machinery and equipment will be revoked, according to the communiqué.

To ensure a smooth transition, preferential policies for items which currently can not be wholly supplied domestically will be gradually phased out.

Major State-backed key technological equipment includes clean energy power generating systems and nuclear power generating units of above a million kilowatts.

In March China's central government announced an expenditure of 20 billion yuan (US$2.94 billion) for this year, from a 908 billion yuan public sector budget, to help enterprises upgrade technology, energy efficiency and innovation.

It also unveiled a three-year plan in May to stimulate the equipment-manufacturing industry, which lacked the ability to innovate and had underdeveloped technology.

But experts said lack of funding and cooperation among research institutes still restrains China's technological transition.

[Source: China.org](http://www.china.org.cn/government/central_government/2009-09/05/content_18469220.htm) ([see archive](Import_tariffs_policy_adjusted_to_encourage_innovation.pdf))

### SAT clarifies the levy of individual income tax on equity incentives

The State Administration of Taxation (SAT) on 2nd September 2009 released a circular to clarify the levy of individual income tax (IIT) on equity incentives in the wake of salary payment reform and the implementation of equity incentive measures by an increasing number of listed companies, both those listed domestically and overseas.

Under the Circular, listed companies or their domestic subsidiaries should determine and calculate IIT on income gained from stock appreciation rights and restricted stock during the employment period under the category of “income of wages and salaries”. Such taxes should be withheld and paid on behalf of employees.

Stock appreciation right, according to the Circular, refers to the cash paid by listed companies to employees for the difference in stock price on the grant day and exercise day multiplied by the number of shares held.

The Circular reinforces the requirement that domestically listed companies engaging in share option schemes and stock appreciation right schemes should submit documentation according to the relevant rules. Domestic subsidiaries of overseas listed companies are required to file with the competent tax authority, Chinese (foreign language) documents relating to the equity incentive schemes offered by the overseas listed company.

[Source: State Administration of Taxation](http://www.chinatax.gov.cn/n8136506/n8136548/n8136748/9245804.html) (Link no longer active)

### SAT regulates non-resident tax treaty benefits

The State Administration of Taxation recently released the ‘Administrative Measures for Non-residents Enjoying Tax Treaty Benefits (for trial implementation)' (the Measures) which shall come into force as of 1st October. This will strengthen taxation rules for non-resident enterprises.

The Measures provide details for application procedures, examination and implementation of tax treaty benefits, and the legal liabilities arising thereof. The Measures specify regular or irregular checks on the benefits enjoyed by non-residents to prevent tax evasion.

The Measures further protect residents investing overseas. Chinese enterprises may apply to relevant authorities for the prevention of double taxation.

After the amendment to the Corporate Income Tax Law, the number of non-resident enterprises applying for tax treaty benefits has greatly increased. The Measures aim to specify and regulate the taxation on such enterprises.

[Source: Net Ease](http://money.163.com/09/0907/10/5IJPTI1R00252G50.html) ([see archive](SAT_regulates_non-resident_tax_treaty_benefits.pdf))

## Other

### SPC clarifies preemption right of tenants

'The Judicial Interpretation Concerning Trial of Disputes on Urban House Tenancy Agreements'(the Interpretation) was issued by the Supreme People's Court (SPC) and came into force on 1st September. The Interpretation clarifies uncertainties previously existing regarding disputes over tenancy agreements and the preemption right of tenants.

According to one official from No. 1 Civil Tribunal of the SPC, housing decoration and fittings and fixtures issues with tenancy agreements have caused many debates and difficulties in judicial trials. Therefore, the Interpretation provides that decoration and fittings implemented by the tenant without the prior consent of the landlord constitutes a tort and the tenant should bear liabilities for such infringements. Where the landlord agrees to the decoration, different methods shall be adopted under differing circumstances.

The Interpretation further clarifies situations under which a tenancy agreement is null and void:

1. a tenancy agreement for illegal constructions;
2. a sublet period longer than the remaining lease term; and
3. a sublet agreement not agreed to by the landlord.

Where the tenancy agreement does not meet the necessary conditions, the court shall recognise the agreement as long as the relevant conditions under the laws and regulations are satisfied before the closing of court debate in the first trail.

The Interpretation protects the preemption right of tenants. The preemption right is defined as a right of claim under the Interpretation. Tenants are not entitled to claim the ineffectiveness of sale and purchase agreements entered into by the landlord and a third party based on the preemption right.

[Source: QQ.com](http://hb.qq.com/a/20090901/000242.htm) ([see archive](SPC_clarifies_preemption_right_of_tenants.pdf))

### Special courts built to manage public appeals

China's Supreme People's Court (SPC) recently set up two special courts to deal with case-related appeals from the public in an attempt to regulate court work and ensure people's rights.

According to the SPC, one of the courts, named "Court One for Registry", is responsible for accepting public appeals, examining the procedure of appeals for retrial and managing the flow of all cases managed by the SPC.

The other, named "Court Two for Registry", will receive cases with jurisdictional disputes and carry out investigations in cases dealt with by courts at lower levels whose judgment is questioned by the public.

The second court is also responsible for legal aid and drafting judicial explanations.

Zhou Zemin, an official with the SPC, said both courts are the windows of the Supreme Court and every word and deed by staff will affect the court's entire image in people's minds.

"Registry judges communicate with ordinary people everyday... Only with a positive attitude, civilized behaviour and precise work can we manage every letter and case well and leave every visitor with a good impression," said SPC Vice President Su Zelin.

Su added that the SPC would continue to make trial procedures transparent and open, and ensure the rights of people involved in cases to the best of their ability.

[Source: China.org](http://www.china.org.cn/government/central_government/2009-09/10/content_18496667.htm) ([see archive](Special_courts_built_to_manage_public_appeals.pdf))

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