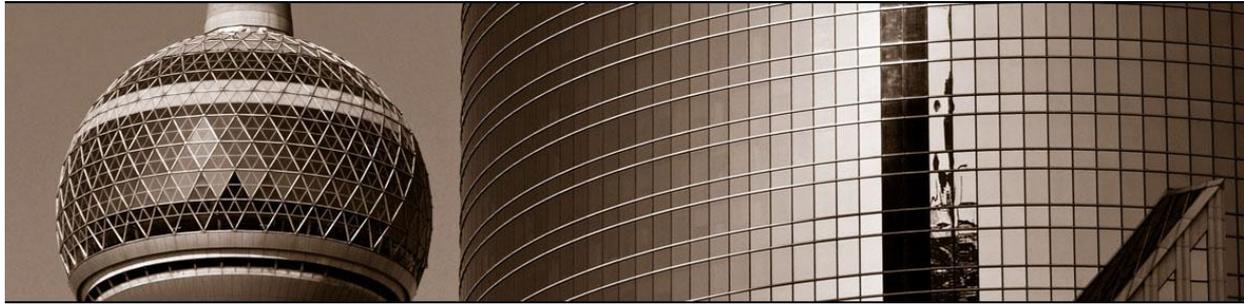


CUATRECASAS, GONÇALVES PEREIRA



LEGAL FLASH | SHANGHAI OFFICE

Special Edition 2012

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UPDATE ON TAX REGULATIONS 2012

Since the Chinese tax system was established in the 1980s, it has undergone major reforms aimed at adapting it to a changing economic environment. In 2012, China continued to modernize its tax system, implementing important developments, which we have reviewed periodically and some of which (the most relevant ones) we highlight in this special edition.

Clearly, the most significant reform relates to indirect taxation, with Shanghai implementing the **pilot program for replacing the business tax with VAT** for certain services, effective from January 1, 2012. Although the regulations governing the basic aspects of this reform were enacted at the end of 2011, it was only when the reform came into force in 2012 that the regulatory loopholes, which must be closed to ensure the new regime's completeness, became evident.

The main regulatory developments in 2012 relating to the pilot program were as follows:

- Extension of the pilot program to eight cities and provinces (including Anhui, Beijing, Fujian, Guangdong, Hubei, Jiangsu, Tianjin and Zhejiang).
- Approval of subsidies for Shanghai taxpayers affected by the reform.
- Rules on the application of the zero-rated system to certain services exports.
- Specific measures for services relating to international transport, the animation industry, and operating leases on moveable property acquired or produced before the pilot program came into force.

There were also important developments regarding VAT, such as the possibility for taxpayers with business units (i.e., headquarters with branches) in different districts of the same province to **consolidate VAT** provided they have the approval of the Ministry of Commerce and the corresponding tax authority.

Another focal point of the tax reforms in 2012 was **foreign trade, with a number of measures aimed at speeding up export processes**, making the tax and exchange obligations flexible. The relevant measures are established in Circular 39 and Bulletin 24 of the State Tax Administration, mainly dealing with the refund mechanism for export VAT. Below we summarize the main developments:

- The requirements that export products must meet for application of the refund mechanism have been relaxed.

- The deadline for requesting the refund has been extended until April 30th of the following year.
- The forms for exchange verification have been removed.
- The 12-month probation period for small- and medium-sized companies starting out in the export activity has been removed.
- The requirements for requesting an advance refund (before the export actually occurs) have been made flexible.

These measures are accompanied by other measures issued by the State Administration of Taxation together with the General Administration of Customs and the State Administration of Foreign Exchange, which are established in Announcement [2012] No. 1 of the State Administration of Foreign Exchange and Circular [2012] No. 38, all of which are aimed at **simplifying and speeding up the exchange information systems relating to international trade transactions.**

In the area of **non-resident taxation** we highlight the following: (i) Announcement [2012] No. 16 of the State Administration of Taxation, establishing specific rules for calculating the tax burden of cross-border workers between mainland China and Hong Kong, in line with the double tax treaty between the People's Republic of China and the Hong Kong Special Administrative Region; and (ii) Circular [2012] No. 30, also by the State Administration of Taxation, clarifying the concept of "beneficiary owner" for the purposes of Circular [2009] No. 601 by the same authority and, ultimately, interpreting that concept for the purposes of the double tax treaties to which China is party.

Other developments relate to **enterprise income tax** (e.g., rules on the deductibility of certain expenses, others aimed at promoting employee remuneration through participation company's equity and rules on calculating pre-payments for small businesses, among others) and **individual income tax** (such as the taxation on dividends received from listed companies). There have also been **sector-related developments** to promote technology (incentives for software companies and integrated circuit companies), the national iron and steel industry, and certain cultural activities.

Finally, in 2012, the State Administration of Taxation issued the second annual report on the advanced pricing agreements, which includes statistics for the 2005-2010 period, and which is a clear indication of China's growing concern to establish a solid transfer pricing system.

UPDATE ON LEGAL REGULATIONS 2012

In 2012, the Chinese authorities enacted and amended a series of laws, regulations and rules, many of which aim to facilitate trade and foreign investment. In this special edition of our newsletter, we briefly highlight issues concerning laws, regulations and rules on foreign investment, intellectual property, labor, foreign-exchange control, contracts and procedures. For a detailed analysis and more information, please refer to our monthly newsletters.

On December 24, 2011, the National Development and Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM") amended the **Industry catalog for guiding foreign investment** ("2011 Industry Catalog"), effective from January 30, 2012. The 2011 Industry Catalog continues to guide foreign investment by categorizing industries as "encouraged," "restricted" and "prohibited," while considering those not listed within these categories as "permitted." Reflecting the focus of the policies highlighted in China's 12th Five-Year Plan, the 2011 Industry Catalog (i) transfers a number of projects from other categories to "encouraged," mainly relating to high-end manufacturing industries, new- and high-technology industries, new-energy industries, energy-efficient and environmental-protection industries, and modern-service industries; (ii) lifts restrictions on the ratio of foreign capital equity in several industry fields; and (iii) transfers many projects from the "restricted" and "prohibited" categories to the "permitted" category. Meanwhile, it establishes new prohibitions in certain industries, including domestic courier services, and building and running villa developments.

Many regulations and rules regarding foreign invested enterprises ("FIE") were issued during 2012, including the **Interim provisions on equity contributions to FIEs** ("Interim Provisions"), which formally establish a sound legal basis for share-for-share contributions involving FIEs. Investors contributing equity interests to FIEs must ensure that these are transferable and free from any encumbrances, and meet the conditions established by the Interim Provisions. Equity contributions, together with other non-monetary capital contributions, must not exceed 70% of the registered capital of the invested FIEs. The Interim Provisions enable investors to restructure their assets and relieve their cash-flow burden, although the contributed equity must be excluded from the registered capital when calculating total investment, which has implications such as the reduction of the FIE's foreign-debt quota.

The Trademark Law of the People's Republic of China ("PRC") is currently under revision, mainly aiming to facilitate trademark application and tackle trademark squatting and other acts of unfair competition. Regulations, rules, judicial interpretations and policies on intellectual property ("IP") protection have been issued, mainly aiming to tackle IP rights infringement and counterfeit. The **Opinions on issues concerning fully leveraging the role of intellectual property trials in promoting culture and economic development**, issued by the Supreme People's Court, point out the role of the courts in protecting trademarks in China, including rules on tackling trademark

squatting, determining the similarity of trademarks, protecting well-known trademarks and applying affirmative defense of prior use. It is widely believed that judicial protection of IP rights, in addition to administrative and customs protection, will play a major role in this field.

A number of labor regulations and rules were also issued in 2012, of which we highlight the Supreme People's Court ***Interpretations IV on issues relating to the application of law to the hearing of labor dispute cases (Draft for Comments)*** ("Draft Interpretations"). Although the Draft Interpretations have not yet been formally issued, we believe that they are of vital importance to labor law compliance. They address various issues that have arisen from labor-dispute trials since China's Labor Contract Law was implemented on January 1, 2008, including issues relating to court jurisdiction, severance pay, internal rules and regulations of employers, non-compete clauses, modifications to labor contracts, the requirement to notify the trade union of an employer's unilateral termination under relevant Articles of the Labor Contract Law, an employer's unilateral termination in the form of "vitality curve," and issues relating to foreigners working in mainland China without work permits. We also highlight the ***Special provisions on labor protection for female employees*** (the "Special Provisions") issued by the State Council on April 28, 2012, introducing changes relating to maternity leave under various circumstances and maternity allowance.

Throughout 2012, the State Administration of Foreign Exchange ("SAFE") issued a series of circulars to deregulate control over trade in goods and foreign direct investment ("FDI"). The two most important circulars are the ***Circular on issues concerning laws and regulations in relation to foreign exchange administration on trade in goods*** (effective from August 1, 2012) and the ***Circular on improving and adjusting the foreign exchange administration on FDI*** (effective from December 17, 2012). The first circular removes the deregistration procedure in export, and enormously facilitates the foreign exchange settlement of trade in goods, while the second circular aims to loosen SAFE's control over FIEs to facilitate FDI, putting emphasis on the banks' compliance with SAFE rules instead of imposing approval requirements on FIEs. The second circular has had the following effects: (i) the opening of various foreign exchange accounts related to FDI activities and reinvestments carried out by FIEs in China no longer require pre-approval from SAFE; (ii) the foreign exchange administration on reinvestment by foreign invested investment companies, the capital verification confirmation procedures of FIEs, and the foreign exchange registration procedures for foreign investors acquiring equity interests from Chinese companies are considerably simplified; (iii) control over FIEs lending funds to their overseas shareholders is loosened; and (iv) foreign exchange controls over (a) bank transfers within China if related to FDI activities and (b) purchases and outbound payments related to FDI activities are removed.

We also refer to the Supreme People's Court ***Interpretations on the application of law in the trial of cases of disputes over sales and purchase contracts***, which were made based on 12 years' judicial experience since China's Contract Law was

promulgated in 1999 and following opinions of leading scholars. These interpretations cover the issues of formation and validity of contract, delivery of goods, transfer of title, passing of risks, quality inspections, remedies for breach of contract, retention of title, and special arrangements regarding sales and purchase contracts, including sample sales and trial-use-based sales.

In 2012, the National People's Congress amended the ***Criminal Procedure Law of the PRC*** ("Criminal Procedure Law") and the ***Civil Procedure Law of the PRC*** ("Civil Procedure Law"). Although these two laws do not immediately affect foreign investors, it is worth highlighting that the amended Criminal Procedure Law has explicitly introduced provisions on respecting and safeguarding human rights, which is considered a major breakthrough in China, and the Civil Procedure Law has introduced a wide range of changes such as introducing the "public interest litigation" and "small claim litigation", improving summary procedures, allowing third parties to file separate lawsuits to challenge court judgments concerning their rights and interests, updating territorial jurisdiction rules, allowing "electronic data" as a main type of evidence in civil litigation, updating evidence rules, allowing pre-filing evidence preservation, and expanding the scope of interim measures and their application.

The China International Economic and Trade Arbitration Commission ("CIETAC"), the leading arbitration institute in China, issued its new arbitration rules ("*CIETAC Arbitration Rules 2012 Edition*"), effective from May 1, 2012. These aim to reflect the new trends in international arbitration, allowing greater party autonomy, including choice of place of arbitration, language of arbitration, arbitration rules, arbitrators and governing laws. They introduce changes to procedures, including the determination of jurisdiction, triggering of summary procedures, suspension of arbitration proceedings, consolidation of arbitrations, ordering of interim measures, and rendering of conciliation statements. Although with the issuance of the new rules, disputes over jurisdiction between CIETAC, the CIETAC Shanghai sub-commission and the CIETAC South-China sub-commission have been confusing, it is believed that CIETAC will continue to be a major player in international arbitration.

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