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INDEX

DRAFT CYBER SECURITY LAW（《网络安全法（草案）》）

The Legislative Affairs Commission of the Standing Committee of the National People's Congress recently issued the Draft Cyber Security Law (the "Draft") aiming at safeguarding China's cyber sovereignty.

The Draft's main highlights:

- It establishes the government's leading role in network building, operation, maintenance, security and use.

- It establishes a supervision mechanism for security protection within China, under which network operators (i.e., network owners and managers and network service providers that use networks owned or managed by third parties to provide services) have a monitoring role that includes the following obligations:

    1) To formulate internal management and operating procedures for network security protection, determining the people in charge.

    2) To adopt technical measures to prevent computer viruses and other activities endangering network security.

    3) To adopt technical measures to record and track network operation status and to monitor and record network security incidents.

    4) To implement important data classification, backup and encryption measures.

    5) To verify user identity when managing network access or domain name registration services.

    6) To formulate emergency response plans for network security incidents and to manage system loopholes, computer viruses, network intrusions and attacks and any other security risks in a timely manner.

- Key network equipment and specialized network security products must be certified or tested by licensed security institutions before accessing the market to ensure compliance with relevant national and industry standards.

- Key information infrastructures –broadly defined to cover media, energy, water resources, transportation, finance, public services, military and government affairs, and network service providers with large numbers of users- will be protected through the following mechanisms:

    1) Operators will enter into a security and confidentiality agreement with suppliers of network products and services.

    2) Network products or services that may give rise to national security and public social order concerns will be subject to a security review by the relevant governmental authorities.

    3) Personal information and other important data obtained will be stored in China, and any disclosure overseas for business purposes will be subject to review in accordance with the standards set out by the State Council.

    4) Operators will carry out annual security reviews and adopt proper measures for security risk mitigation.

- The Draft reiterates the importance and requirements of personal data protection, the need to obtain consent to collect user information and the need to inform users of the purposes, method and scope of information collection.

- The Draft establishes various non-compliance liabilities, from warnings to penalties for network operators and those directly responsible for them.

The Draft, if approved, will be the first law promulgated by the highest Chinese legislative bodies that comprehensively addresses and may raise significant challenges to existing network operators, as they will be subject to greater scrutiny and administrative control.

Date of issue: July 6, 2015. Deadline for public comments: August 5, 2015.

THE SUPREME PEOPLE'S COURT OFFICIALLY CLARIFIES THE JURISDICTIONAL ISSUES ARISING OUT OF CHINA'S INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION SPLIT

Since late 2012, when the two former sub-commissions of China's International Economic and Trade Arbitration Commission ("CIETAC") in Shanghai and South China announced they were splitting up and changed their names respectively to Shanghai International Arbitration Center ("SHIAC") and Shenzhen Court of International Arbitration ("SCIA"), serious concerns and jurisdictional disputes over the application and validity of agreements providing for CIETAC arbitration have surfaced.

As analyzed in our January and March 2015 legal flashes, recent civil rulings have confirmed that SHIAC and SCIA had jurisdiction over disputes on arbitration clauses that respectively designate the Shanghai Sub-Commission and South Sub-Commission of CIETAC. Although they were not binding, they indirectly reflected the Supreme People's Court ("SPC") view on the matter.

On July 15, 2015, the SPC published its Reply to the Request Made by Shanghai's High People's Court and Others in Relation to Judicial Review of the Arbitration Awards Issued by CIETAC and its Former Sub-Commissions (the "Reply"), which officially endorses the recent civil rulings and sets out binding guidance for future disputes.

The Reply mainly clarifies the following issues regarding arbitration clauses referred to CIETAC's former Sub-Commissions:

1. If the arbitration agreement was entered into before the official name change to SHAIC (on April 8, 2013) or SCIA (on October 22, 2012), SHIAC/SCIA will have jurisdiction over any disputes. Applications to invalidate the arbitration agreement, set aside or resist enforcement of an arbitral award on the grounds of SCIA/SHIAC having no jurisdiction will not be supported by the court.

2. If the arbitration agreement was entered into after the official name change, or on that same date but before July 17, 2015, CIETAC will have jurisdiction over any disputes, unless the claimant submits the disputes to SHIAC/SCIA, and the respondent does not raise any objections. Subsequent applications to set aside or resist enforcement of an arbitral award on the grounds of SCIA/SHIAC having no jurisdiction will not be supported by the court.

3. If the arbitration agreement was entered into on or after July 17, 2015, CIETAC will have jurisdiction over any disputes.

The Reply also clarifies that it will not have retrospective effects (i.e., it will not affect disputes accepted by CIETAC, SHIAC or SCIA before July 17, 2015).

Date of issue: July 15, 2015. Effective date: July 17, 2015.

NOTICE OF THE STATE ADMINISTRATION OF TAXATION ON WORKING PROCEDURES FOR ENTERPRISE INCOME TAX ON INDIRECT PROPERTY TRANSFER BY NON-RESIDENT ENTERPRISES (TRIAL) (SHUI ZONG FA [2015] No.68) (国家税务总局关于印发《非居民企业间接转让财产企业所得税工作规程（试行）》的通知)

In February 2015, the State Administration of Taxation ("SAT") issued Announcement 7[1] to introduce a new enterprise income tax ("EIT") regime for offshore indirect transfers of Chinese property by non-resident enterprises (please see our February 2015 legal flash for detailed information on Announcement 7).

Following the issue of Announcement 7, on May 13, 2015, the SAT released Shui Zong Fa [2015] No. 68 ("Circular 68"), providing internal procedural guidelines to be followed by local tax authorities when analyzing this type of transactions and aiming at uniform application and management of the new regime.

The main highlights of Circular 68 are:

1. Department responsible for handling indirect property transfers

Non-resident taxation departments of local tax authorities at all levels are in charge of collecting EIT on indirect Chinese property transfers by non-resident enterprises.

[1] Announcement [2015] No. 7 on issues concerning enterprise income tax on indirect property transfers by non-resident enterprises, issued by the SAT on February 3, 2015.

2. The local tax authorities must issue a receipt of acceptance of voluntary report

When a party to an indirect property transfer (or the Chinese resident enterprise being indirectly transferred) voluntarily reports the transfer to the tax authorities, the tax authorities must issue a receipt of acceptance.

The receipt of acceptance can be used by the reporting parties as proof of reporting and date to be able to benefit from the interest markup waiver or the penalty reduction and waiver.

3. Voluntary report of indirect property transfer is welcomed and encouraged

Although Announcement 7 only provides for voluntary reporting, Circular 68 still urges the local tax authorities to guide and encourage the parties to report taxable indirect transfers.

Circular 68 also encourages the local tax authorities to collect information on indirect property transfers through various channels, including the annual EIT declaration, tax assessment, transfer pricing documentation, crossborder related-party payments, equity transfer administration, application of the double taxation treaty, news reports and listed company announcements.

4. Investigation of indirect property transfer should follow a general anti-avoidance investigation

Announcement 7 specifies that investigations of indirect property transfers must be carried out under the General Anti-Avoidance Rule procedures set out under Decree 32[2] (please see our December 2014 legal flash for detailed information on Decree 32).

Circular 68 also states that the selection and conclusion of an indirect Chinese property transfer case is subject to SAT's approval, via examination of the report and relevant materials provided by the tax authorities when they

[2] Decree No. 32 on Administrative Measures on the General Anti-Avoidance Rule ("GAAR") (Trial), issued by the SAT on December 2, 2014.

suspect a transaction lacks commercial purposes. Upon receiving SAT's approval, the tax authorities have nine months to verify and assess the information submitted by the taxpayer during the investigation, and they may ask the parties, their advisors and the resident companies involved for further information and documents to determine whether the taxpayer is subject to a tax adjustment. If so, the tax authorities must report a preliminary adjustment proposal with their opinion and reasoning for SAT's approval to close the case. All open cases are closed when the tax authorities issue a notice, either for conclusion or for preliminary tax adjustment.

Circular 68 also introduces a panel review mechanism for significant cases that includes setting up a panel of at least five members and nominating a SAT coordinator to conduct the review.

5. Consolidation of voluntary report for an indirect transfer involving properties located in two or more provinces or cities

Announcement 7 abolished the practice provided in the former regulation of allowing taxpayers to choose between tax authorities for reporting purposes if the transfer involved at least two Chinese resident enterprises located in different provinces or cities.

Circular 68 reinstated this practice for voluntary reporting purposes (but not for payment purposes). This should be beneficial to both the reporting parties, by saving compliance costs, and to the tax authorities, by making better use of administrative resources.

Circular 68 took effect on the date of issue, i.e., May 13, 2015, and it will be applied to the unsettled offshore equity transfers taking place before that date, including those that have already been submitted to the SAT.

Date of issue: May 13, 2015. Effective date: May 13, 2015.

NOTICE OF THE ZHEJIANG PROVINCE STATE TAX AUTHORITY ON WORKING GUIDELINES FOR TAX RISK MANAGEMENT OF FEES RESIDENT ENTERPRISES PAY TO RELATED PARTIES OVERSEAS (浙江省国家税务局关于印发《企业向境外关联方支付费用税收风险管理工作指引》的通知)

In March 2015, the SAT released Announcement 16[3] to formalize its position on fees resident enterprises pay to related parties overseas (please see our March 2015 legal flash for detailed information on Announcement 16).

Following the release of Announcement 16, the Zhejiang Province State Tax Authority was the first at provincial level to issue its Working Guidelines on Tax Risk Management of Fees Resident Enterprises Pay to Related Parties Overseas (the "Guidelines").

Guidelines' main highlights:

1. They point out the main tax risks on which the tax authorities should focus when monitoring crossborder related-party payments from the perspective of resident enterprises, providing examples and key aspects to consider:

    a) Fees paid to related parties without substantial business activities, especially payments to related parties registered in tax havens and royalties paid for intangible assets with no residual value.

    b) Fees paid to related parties for services that do not entail a direct or indirect economic benefit for the resident enterprise.

    c) Fees paid to related parties for incidental interests or fringe benefits, including benefits for belonging to a group, shareholder activities, benefits from financing or listing activities through an overseas holding or financing company.

    d) Unreasonably priced fees paid to related parties when compared to fees paid to independent third parties, i.e., failing to follow the arm's length principle.

[3] Announcement [2015] No. 16 on enterprise income tax on fees resident enterprises pay to related parties overseas, issued by the SAT on March 18, 2015.

2. They also point out the main tax risks associated to crossborder related-party payments from the perspective of non-resident enterprises:

   a) Evading taxes in China by claiming services are provided offshore.

   b) Evading taxes in China by treating royalties as provision of services.

   c) Evading taxes in China by deliberately avoiding a permanent establishment in China.

   d) Evading taxes in China by offsetting receivables and payables with related parties.

3. The Guidelines specify the use of a six-test approach to evaluate whether a resident enterprise uses related-party payments to shift profits and erode its tax base in China: (i) authenticity test, (ii) necessity test, (iii) benefit test, (iv) value creation test, (v) duplicity test, and (vi) remuneration test.

The Guidelines provide administrative measures that the local tax authorities may adopt, and they especially address what relevant information, divided into five categories, the local tax authorities may request from taxpayers. It is expected that tax authorities in other regions will take similar action to manage crossborder related-party payments. As local tax authorities have strengthened their work in this area and stepped up their assessment of resident enterprises, resident enterprises should prepare themselves to be able to address this type of procedure properly.

Date of issue: June 30, 2015. Effective date: June 30, 2015.

CHINA RATIFIES MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS (《多边税收征管互助公约（经 2010 年议定书修订）》)

On July 1, 2015, the National People's Congress ratified the Council of Europe and the OECD's Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the "Convention"), as amended by a 2010 protocol that it had already signed on August 27, 2013.

The Convention seeks to combat tax avoidance and evasion, and as of June 30, 2015, all G20 countries and a total of 87 countries and regions have become members to it.

From a practical point of view, ratification of the Convention reflects China's effort to further integrate and open up its taxation system to the international community, and it implies that China will share information with other members of the Convention regarding all types of Chinese taxes, except for customs duties, after the signed agreement enters into force.

Date of ratification: July 1, 2015.

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