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Insights & Ideas

MOFCOM New Circular on Foreign-invested Enterprises Engaged in Sales Business through the Internet or Vending Machines (Author: Xiaolin TENG)

On 19 August 2010, the General Office of China's Ministry of Commerce ("**MOFCOM**") issued a *Circular on the Relevant Issues pertaining to the Administration of Approvals with Respect to Sales by Foreign-invested Enterprises through the Internet or Vending Machines* (Shang Zi Zi No. [2010]272) (the "**Circular**") The Circular simplified approval procedures for foreign-invested enterprises engaging in sales through the Internet or vending machines and seems to open a door for foreign-funded enterprises to operate online business which has been restricted for a long time. But the implementation of the Circular still needs to wait for relevant departments' further arrangement and cooperation.

Foreign Investors Engaging in Online Sales through Foreign-invested Manufacturing Enterprises or Foreign-invested Commercial Enterprises (FICEs) May be No Longer Restricted by the Proportion of Investment

According to Article 1.1 of the Circular, lawfully approved, established and registered foreign-invested manufacturing enterprises or foreign-invested commercial enterprises can directly engage in online sales. Online sales are counted as one form of value-added telecommunications services. Under the amended *Provisions on the Administration of Foreign-funded Telecommunications Enterprises* on September 10, 2008 (the "**Provisions**"), foreign investors providing telecoms services shall be in the form of Sino-foreign equity joint venture enterprises. The proportion of foreign investment in a foreign invested telecoms enterprise providing value-added telecoms services shall not exceed 50%. After the Circular became effective, foreign investors seems can directly engage in online sales through foreign-invested manufacturing enterprises or foreign-invested commercial enterprises with no restriction on the proportion of foreign investment. In practice, however, whether or not this is feasible is still unknown. Firstly, the Provisions is an administrative regulation issued by the State Council, its legal effect is greater than the Circular issued by MOFCOM, therefore, interpretation of the Circular shall not betray the principles of the Provisions. Secondly, according to the Provisions, foreign-funded telecoms enterprises will still need to apply for the license for providing telecoms services; without license, they can not provide telecoms services and the competent telecoms department reserves the final right of interpretation on this. Hence, the so-called directly engaging in online sales mentioned in the Circular seems hard to achieve in practice.

Approval Power for FICEs Engaging in Online Sales and Sales via Vending Machines Has Been Delegated Down

Though the approval power for most FICEs has been delegated down to provincial-level MOFCOM before issuance of the Circular, the approval power for FICEs engaged in sales via telephone, television, mail order, internet or vending machines still belongs to provincial-level MOFCOM. The Circular provides that application for establishment of foreign-invested enterprises ("**FIEs**") purely engaging in online sales or sales via vending machines or adding the content of sales via vending machine to existing FIEs' business scope shall be approved by provincial-level MOFCOM.

If an FIE Uses its Own Online Platform to Directly Engage in Sales of Products, No Value-added Telecoms License Would be Required

According to the Circular, if an FIE uses its own online platform to provide internet services for other trading parties, a value-added telecoms license from the Ministry of Industry and Information Technology ("**MIIT**") would be needed; but if such FIE uses its own online platform to engage in direct sales of products, the FIE would only need to record with local MIIT. This provision seems to open a door for FIEs to engage in online sales, however, it is still a question whether or not it can be carried out. Firstly, it is MIIT rather than MOFCOM which has jurisdiction to decide whether FIEs should apply for a value-added telecoms license or just need to record. Secondly, even if MITT admits such provision of MOFCOM, in practice, however, further interpretations shall be made so as to clarify what constitutes "using its own online platform to provide internet services for other trading parties" and "using its own online platform to engage in direct sales of product". In addition, the *Measures for the Administrative of Internet Information Service* effective 25 September 2000 has been using operational and non-operational as the criteria for drawing the line between getting a value-added telecoms license and recordation. In practice, the local telecoms departments hold different opinions about the criteria for operational and non-operational. And we still need to wait and see whether or not the issuance of the Circular will cause MITT to change the criteria and set up a new one by releasing detailed implementation rules.

In short, before the issuance of detailed implementation rules and interpretations regarding the Circular, we cannot make definite comments on other matters in this Circular except that the relevant approval power has been delegated down (as mentioned above). Attention shall be paid to local governmental authorities' approaches and attitudes in dealing with specific cases.

Legal Updates

1. MOFCOM Conditionally Approves the Acquisition of Alcon by Novartis (Author: Xiaolan CHEN)

On 13 August 2010, the Ministry of Commerce of the People's Republic of China ("**MOFCOM**") issued its conditional clearance decision on the anti-monopoly notification for the proposed acquisition of Alcon, Inc (**Alcon**) by Novartis AG (**Novartis**). Early on April 20, 2010, the MOFCOM received the anti-monopoly notification for the proposed transaction.

Concerned Issues

MOFCOM focused its concerns about the competition issues in two relevant markets: (a) the market for ophthalmic anti-inflammatory and anti-infective products; and (b) the market for contact lens care products.

In terms of the products of ophthalmic anti-inflammatory and anti-infective, the combined global shares after the transaction will exceed 55% while the combined shares in China market will be over 60%. Currently, Alcon's market share in China is over 60%, whilst Novartis' market share is less than 1%. Although Novartis expressed they would withdraw from the global market including China market with regard to the ophthalmic anti-inflammatory and anti-infective products, MOFCOM was of the view that Novartis was still the competitor in China market and, if it took the withdrawal only as a strategic exit for this transaction, it may still have the capability of reentering the market after the transaction, and thus may result in the exclusion and restriction of competition in China after the transaction.

In the contact lens care products market, the merged entity will hold a global market share of nearly 60% and a share of around 20% in China, which will make the merged entity the second largest enterprise in China with respect to the contact lens care products. In 2008, the subsidiary of Novartis, Shanghai Ciba Vision Trading Co., Ltd. ("**Ciba Vision**") entered into a distribution agreement with Hydron Contact Lens Co., Ltd. ("**Hydron**") that is a subsidiary of the Taiwanese company Ginko International Co. Through said exclusive distribution agreement, the post acquisition entity may collude on pricing, quantity, sale geography and other issues with Hydron and consequently impose the impact of exclusion and restriction of competition. Hydron is now the biggest manufacturer and seller in China with over 30% market share. It is worth noting that this is the first time that MOFCOM imposes conditions on a proposed merger on the ground that the merger may have "coordinated effects" and thus have the effects of excluding or restricting competition in China.

Restriction Conditions

Specific to the issues of exclusion and restriction of competition, MOFCOM approved the transaction and stipulated the following requirements for Novartis and Alcon:

By the end of 2010, Novartis shall cease to supply Infectoflam in China. MOFCOM further stipulated that within a period of 5 years upon the effectiveness of the clearance decision, Novartis shall not supply Infectoflam, product of Infectoflam under a different product name, or ophthalmic anti-inflammatory and anti-infective products that were sold outside the territory of China prior to the closing of the transaction in China. During the five year period, Novartis shall report its performance of such requirements to MOFCOM on every anniversary after the effective date of the clearance decision.

Novartis shall terminate the distribution agreement between Ciba Vision and Hydron within the twelve months upon the effective date of the conditional clearance by MOFCOM and report the performance to MOFCOM within one week after the termination of such distribution agreement.

Conclusion

Since the effectiveness of the Law of the People's Republic of China on Anti Monopoly, MOFCOM has accepted around 140 anti monopoly filings and decided for the most cases. The Novartis/Alcon decision is only the sixth decision on which MOFCOM imposed conditions. The prior five conditional clearance were all specific to foreign companies. Although MOFCOM claimed that they apply the Anti Monopoly Law equally to foreign and domestic applicants, to date, among the published decisions in two years, only foreign companies have been issued clearance decisions with conditions.

2. China Allows Sino-foreign Joint Venture Travel Agencies to Operate Outbound Tourism Business (Author: Jiaxin LIU)

Background

Article 23 of the *Regulation on Travel Agencies* provides: "Foreign-invested travel agencies may not operate Chinese mainland residents' travel business abroad and to Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan region, unless it is otherwise decided by the State Council, or provided for by the free trade agreements signed by China and by the arrangements on establishing closer economic partnership between Mainland and Hong Kong/Macao." The *Interim Measures on Supervision and Administration of Pilot Operation of Outbound Tourism Business by Sino-foreign Joint Venture Travel Agencies*(the "**Interim Measures**"), which was jointly promulgated by China's National Tourism Administration(CNTA) and Ministry of Commerce on August 29, 2010, loosens the above restriction and provides that Sino-foreign joint venture

travel agencies that satisfy the application requirements and procedures set forth in the Interim Measures may, on a pilot basis, operate outbound tourism business of Chinese mainland residents after obtaining relevant permits. However, the Interim Measures also provides that the number of Sino-foreign travel agencies permitted to operate outbound tourism business will be subject to strict control of the State and determined by CNTA.

Application Requirements of Pilot Operation Qualifications

The Interim Measures provides that a Sino-foreign joint venture travel agency applying for pilot operation of outbound tourism business (the "**Applicant**") shall satisfy such requirements that it shall has obtained the tourism business permit for two years or more, and is not subject to any punishment more serious than fine by the administrative body due to its infringement upon the legitimate rights and interests of tourists.

Application procedures, Application Time Limits and Approval Procedures of Pilot Operation Qualifications

According to the Interim Measures and the *Notice on Acceptance of Application for Pilot Operation of Outbound Tourism Business by Sino-foreign Joint Venture Travel Agencies* (the "**Notice**") posted by CNTA on its official website on September 7, 2010, the Applicant shall apply by submitting the following materials to the provincial-level tourism administration of its domicile during the period from the promulgation date of the Notice (i.e., September 7, 2010) to September 30, 2010:

- Application report on pilot operation of outbound tourism business;
- Photocopies of the Tourism business permit, approval certificate of foreign-invested enterprise and the business license;
- Brief report of the operation performance since establishment of the Applicant.

After reviewing the submitted application materials, the provincial-level tourism administration will issue a written certification to a qualified Applicant certifying the Applicant's satisfaction of the prescribed application requirements and report to CNTA in official documents. CNTA will choose from the Applicants and issue to the qualified agency an Approval Opinion on Operation of Tourism Business by Foreign-invested Travel Agencies.

The qualified agency shall then apply for business scope alteration registration with the commerce departments with the said approval opinion, the agreement executed by its investors and its articles of association. The commerce departments shall determine approval or disapproval of the said application according to relevant laws and regulations. In

the case of approval, the commerce departments shall issue an updated approval certificate of foreign-invested enterprise to the qualified agency and notify the qualified agency to obtain a new tourism business permit from CNTA; in the case of disapproval, the commerce departments shall notify and explain the reasons to the qualified agency. After receiving approval from the commerce department, the agency shall process business scope alteration registration with the competent administration of industry and commerce.

Subsequent Formalities and Assessment After Obtaining a Pilot Operation Qualification

Besides, the Interim Measures requires that the Sino-foreign joint venture travel agency which has obtained the pilot operation qualification of outbound tourism business (the "**Pilot Travel Agency**") shall increase its quality bond by RMB 1.2 million and submit the relevant evidence materials to CNTA within 3 working days upon obtaining the new tourism business permit.

The Pilot Travel Agency shall provide the following materials to CNTA every half year during the three years after obtaining the qualification: (a) the number and person-trips of the outbound tour groups as organized and attended by the Pilot Travel Agency; (b) the business volume of outbound tourism business; (c) the experiences and results achieved. Meanwhile, according to the Interim Measures, CNTA will annually review and assess the achievements of the pilot program and may adjust the said pilot program and the number of the Pilot Travel Agencies according to the assessment results during the three years after implementation of the Interim Measures.

3. A Conspicuous Landmark in the Development of PRC Double Taxation Agreements (Author: Bing XUE)

On 2 September 2010, the State Administration of Taxation (the "**SAT**") initially released the *Notice of the Interpretation Notes on the China-Singapore Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* (Circular Guoshuifa [2010] No. 75) (the "**Circular 75**"). Although the Circular 75 was only released to the public on 2 September 2010, the issuance date of Circular 75 is marked as 26 July 2010.

Through Circular 75, the SAT for the first time comprehensively stated technical positions and practice guidelines with respect to the implementation of tax treaties/agreements (the "**DTA**"). The most eye-catching point is the application of Circular 75 has been extended to other DTAs concluded by China while the provisions of the relevant stipulations in those DTAs are the same as those in the China/Singapore DTA.

As introduced by the SAT, since the conclusion of China-Japan DTA (in 1983) which is the first DTA concluded by China, to date China has concluded DTAs with more than 90 countries and 2 Special Administrative Regions (i.e. Hong Kong SAR and Macau SAR). From the international taxation perspective, the DTA issue has become a hotspot in both PRC companies' outbound investment and foreign companies' investment in China.

During the implementation of DTAs, the local tax authorities have been taking different views and practices in the past, despite the SAT has from time to time issued more than twenty guidelines regarding the interpretation. In the past year 2009, we noted the SAT devoted to providing guidelines on certain fundamental issues with respect to the implementation of DTAs, including the interpretation of Dividend and Royalty issues, and the compliance requirements for claiming treaty benefits, etc. In addition, the International Taxation Department of SAT issued the Notice regarding the Interpretations on DTAs (Circular Jibianhan [2009] No.47) in 2009.

The Circular 75 has provided taxpayers, especially the cross-border investors, with valuable guidelines in enjoying the DTA benefits. We believe in that the Circular 75 will be a conspicuous landmark in the development of PRC DTAs.

Important Announcement

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