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Insights & Ideas

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An Introduction to the Administration Regulations on the Registration of Permanent Representative Offices of Foreign Enterprises (Author: Li ZHANG)

On November 19th, 2010, the State Council promulgated *Administration Regulations on the Registration of Permanent Representative Offices of Foreign Enterprises* (hereinafter the "**New Regulation**"), which will come into effect on March 1st, 2011. The New Regulation is another important piece formulated by the State Council regarding the permanent representative offices of foreign enterprises (hereinafter "**Representative Office**") after the *Notice on Further Strengthening the Administration of Registration of Permanent Representative Offices of Foreign Enterprises* jointly issued by State Administration for Industry and Commerce (SAIC) and Ministry of Public Security in January this year and the *Provisional Measures for Taxation of Permanent Representative Offices of Foreign Enterprises* issued by State Administration of Taxation in February this year. The former *Measures on Registration of Permanent Representative Offices of Foreign Enterprises* (hereinafter "**Former Measure**") issued by the SAIC and approved by the State Council in 1983 will be annulled on the effective date of the New Regulation. The Former Measure is obviously inconsistent with the current social and economic practices and legal system, and the New Regulation has expressly and clearly provided for the establishment of the Representative Offices and every aspect of their business activities. Following please find more information:

Define the Nature and Business Scope of the Representative Offices

It is expressly provided in the New Regulation that Representative Office refers to the working body established by foreign enterprises in accordance with Chinese laws and regulations and engaging in non-profit activities related to the business of said foreign enterprises. Representative Office does not have the status of a legal person. Representative Office shall not engage in any profit-making activities unless provided otherwise in international treaties and conventions concluded or participated in by the People's Republic of China. The New Regulation also stipulates that in case a Representative Office conducts profit-making activities in violation of the New Regulation, the registration authority may order rectification, confiscate illegal gains, confiscate the tools, equipment, raw materials and products (commodities) used specially for profit-making activities and impose a fine of more than RMB50, 000 but less than RMB500, 000; in cases of gross violation, the registration certificate of the Representative Office may even be revoked.

The New Regulation defines the scope of business activities the Representative Offices may engage in, including market surveys, exhibitions and campaigns related to the products or

services of the foreign enterprise; and liaison activities in connection with sales of products, provision of service, domestic procurement and investment of the foreign enterprise. It is especially mentioned in the New Regulation that a Representative Office shall obtain relevant approvals for the business activities specified in the preceding paragraph, if required by laws, administrative regulations or provisions of the State Council.

Improve the Registration Administration System

It is specifically provided in the New Regulation that the SAIC and the local administrations for industry and commerce authorized by the SAIC are the competent authorities in charge of the registration and administration of Representative Offices (hereinafter the "**Registration Authorities**").

The New Regulation also sets forth the qualifications for the chief representative or representative of the Representative Offices. Pursuant to the New Regulation, a person involved in any of the following situations may not act as the chief representative or representative: a) a person who has records of being imposed with criminal penalties for harming China's national security or public interests; b) a chief representative or representative of a Representative Office of which the establishment registration has been cancelled or the registration certificate has been revoked in accordance with the laws, or which has been ordered to close down by relevant authorities in accordance with the laws, due to involvement in illegal activities such as harming China's national security or public interests, and it has been no more than five years from the date of such deregistration, revocation or order for closing down; c) other circumstances stipulated by the SAIC.

It is worth noticing that, to apply for establishment of a Representative Office, a foreign enterprise shall submit a certificate for good standing evidencing the existence of the foreign enterprise for at lease 2 years and a credibility letter issued by a financial institution having business transactions with such foreign enterprise. Moreover, pursuant to the *Notice on Further Strengthening the Administration of Registration of Permanent Representative Offices of Foreign Enterprises* jointly issued by SAIC and Ministry of Public Security in January, 2010, the afore-mentioned certificate and credibility letter should be notarized and authenticated by the national or local notary public of the state where the foreign enterprise is incorporated and the Chinese embassy or consulate thereof.

The New Regulation has also imposed some specific requirements on modification registration and deregistration of Representative Offices, prescribing that a Representative Office shall apply for modification registration or deregistration within 60 days upon the occurrence of the modification or deregistration events. If any changes occur to the authorized signatories, the

form of enterprise organization, the capital (assets), the business scope and the representatives of the foreign enterprise, the foreign enterprise shall file with the Registration Authority within 60 days from the date of occurrence of said changes. Representative Offices which failed to comply with the above requirements may be subject to fines imposed by the Registration Authority and their registration certificates may even be revoked in cases of gross violation. Moreover, the New Regulation requires foreign enterprises to publicize on the designated media about the formation and modification of the Representative Offices.

The New Regulation has also established an annual report system of the Representative Office, providing that a Representative Office should submit annual reports to the Registration Authority between March 1 and June 30 each year, the contents of which should include such information as the status of legal existence of the foreign enterprise, business activities carried out by the Representative Office, and fees, revenues and expenditures audited by accountants etc..

The Premises and Duration Period of Representative Office

A Representative Office is allowed to choose its premises at its own discretion. The premises of the Representative Office shall be chosen by the foreign enterprise at its own discretion. However, based on the need of national security and public interests, relevant authorities may require a Representative Office to adjust its premises and inform the Registration Authority of said adjustment in a timely manner.

A Representative Office is allowed to choose it own duration period at its own discretion within the duration period of the foreign enterprise. The New Regulation does not include any provision stipulating a valid duration period of the registration certificate. Based on the current practices and the relevant provisions in the *Notice on Further Strengthening the Administration of Registration of Permanent Representative Offices of Foreign Enterprises*, the Registration Authority issues a one-year registration certificate to the Representative Office applying for establishment and extension.

Specify the Liabilities of Representative Office

With regard to the possible violations of the New Regulation by Representative Offices, including establishing Representative Offices or engaging in Representative Offices without authorization and registration; engaging in profit-making activities in violation of the New Regulation; or submitting false materials or concealing the truth by other fraudulent means in order to obtain a registration or filing; engaging in business beyond the business scope approved, the New Regulation has set forth the power of the Registration Authority to punish and methods of the punishment. The Registration Authority may order correction, order to cease the activities, impose fines, or annul the registration certificate in case of serious violation. For example, it is

provided in the New Regulation that in case a foreign enterprise establishes the Representative Office or conducts business activities of a Representative Office without authorization and registration, the Registration Authority shall order it to stop the activities and impose a fine more than RMB 50,000 but less than RMB 200,000. In case a Representative Office conceals the truth and practices frauds in the annual report, the Registration Authority shall order it to make rectifications and impose on the Representative Office a fine more than RMB 20,000 but less than RMB 200,000; in serious circumstances, the registration certificate shall be revoked.

1. People's Bank of China promulgated the Detailed Implementation Rules for the Measures for the Administration of Payment Services of Non-Financial Institutions (Author: Yuan LIN)

On December 1, 2010, the People's Bank of China (the "**PBOC**") officially promulgated the *Detailed* Implementation Rules for the *Measures for the Administration of Payment Services of Non-Financial Institutions* (the "**Rules**"), which became effective on the same day.

The Rules elaborate, modify, and delete certain provisions from the *Detailed Implementing Rules for the Measures for the Administration of Payment Services of Non-Financial Institutions* (*Draft for Comments*) released by PBOC on September 21, 2010 (the "**Draft**"). The major modifications of the Rules as against the Draft are as follows:

Delete All Provisions Related To Client Reserve Funds in the Draft

Compared with the Draft, one of the most noticeable changes in the Rules is that all the eleven explanatory provisions regarding client reserve funds are deleted.

The *Measures for the Administration of Payment Services of Non-Financial Institutions* (*Decree No. 2 [2010] of the People's Bank of China*) (the "**Measures**") does not define and explain "client reserve funds" clearly. It is provided in Article 26 of the Measures that "Where a payment institution accepts the reserve funds of a client, it shall open a special reserve deposit account at a commercial bank for depositing the reserve funds", in Article 23 that "Where a payment institution accepts reserve funds from a client, it shall only issue an invoice to the client based on the payment service fee it has charged from the client instead of the amount of such reserve funds", and in Article 30 that "The proportion of the paid-up monetary capital by a payment institution to the daily average balance of client reserve funds shall not be lower than 10%".

Later, the PBOC made a supplemental definition of "client reserve funds" in the Draft as "the monetary funds prepaid or reserved by the clients, which are held by the payment institution, and the monetary funds which are collected or paid by the payment institution on a commission basis", and also provided that "Where the clients use their reserve funds to pay for the payment service fees, the payment institution may open a non-bank settlement account exclusively for settling payment service fees, which shall only be used by itself", and that "Where a payment institution opens a non-bank settlement account for its clients, it shall guarantee that the monetary funds of the clients may be used immediately after they have entered the special reserve funds deposit account of the payment institution. A payment

institution shall not advance any monetary funds of the clients which have not entered its special reserve funds deposit account."

The above provisions in the Draft purported to protect the safety of clients' funds put into possession of relevant payment institutions. However, it can also cause the effect of occupying payment institutions' funds, which may force payment institutions to face greater market pressure.

Deletion of said provisions regarding client reserve funds would allow payment institutions more flexibility in the use of the client reserve funds, thus will provide more favorable capital environment which will reduce the costs of enterprises and enhance efficiency of capital use. However, we cannot exclude the possibility that the regulatory authorities will enact detailed regulation for the administration of the client reserve funds separately in the future.

Elaborate the Scope of Anti-money-laundering Measures

Compared with the Draft, the Rules elaborate the anti-money-laundering measures in more details. With respect to the connotation of the anti-money-laundering measures in the Measures, Article 4 of the Rules provides: "'Anti-money laundering measures' mentioned in Item (5) of Article 8 of the Measures shall include the measures for preventing money laundering, terrorist financing, and other financial criminal activities, such as internal control of anti-money laundering, client identity identification, suspicious transaction reporting, preservation of client identity materials and transaction records." By contrast, Article 8 of the Draft only mentioned the basic policies of anti-money-laundering, the setting-up of anti-money-laundering positions and the detection system of suspicious transactions.

According to media report, certain payment institutions have refined their anti-money-laundering measures pursuant to the provisions of the Draft, for example, to set up special position for anti-money-laundering, to establish working standards of anti-money-laundering on Internet.

Specify Qualifications for Capital Contributors of Applicant.

The Rules explicitly provides the qualifications for capital contributors of an applicant. Article 8 of the Rules provides that "Capital contributors that hold the actual controlling right of an applicant institution" mentioned in Article 10 of the Measures shall include: a) Capital contributors that directly hold more than 50% equity interest in the applicant institution; b) Capital contributors who directly and indirectly hold more than 50% equity interest in the applicant institution on an accumulative basis; and c) Capital contributors who directly and indirectly hold less than 50% equity interest in the applicant institution on an accumulative

basis, but are entitled to the voting rights which are sufficient to exert significant impact on the resolutions of the shareholders' meeting and general meeting of shareholders.

Miscellaneous

The Rules delete a provision from the Draft which stated that "a payment institution shall not carry out business activities in the name of a financial institution". However, the purpose of doing so may be only to entitle the payment institutions to engage in payment business, rather than implicitly permitting payment institutions to provide financial services.

Besides, the Rules modify the qualification requirements for senior management personnel in the Draft:

- The "senior management personnel" mentioned in the Rules only includes "the general manager, deputy general managers, principal of financial affairs, principals of technical affairs, or personnel that actually perform the aforesaid duties and responsibilities", which delete from the Draft "the directors, chief compliance manager, chief risk management manager, marketing manager, system maintenance manager and principals of branch companies".

- Compared with the Draft, the Rules loosen the qualification requirements of senior management personnel. Article 3 of the Rules provides: "Having at least five senior management personnel familiar with the payment services" mentioned in Item (4) of Article 8 of the Measures shall mean that an applicant institution shall have at least five senior management personnel satisfying the following conditions: a) Having a university degree or above or having a middle rank technical title in fields such as accounting, economics, finance, computer science, electronic communications, information security; b) Having engaged in the payment settlement business or financial information processing business for two years or more or having engaged in the work of accounting, economics, finance, computer science, electronic communications, information security for three years or more.

Note: For more details, please refer to the treatise China's Central Bank Released Draft Implementation Rules on Administration of Payment Services of Non-financial Institutions in the 9th Edition of 2010 of Han Kun Newsletter (the 43rd Issue for the total).

2. Brief of the "Administrative Measures on Investment by Mainland Enterprises in Taiwan Region" (Author: Jiaxin LIU)

To promote the investment cooperation between Mainland and Taiwan Region, the *Administrative Measures on Investment by Mainland Enterprises in Taiwan Region* (hereinafter referred in as the "**Administrative Measures**") were promulgated by the National Development and Reform Commission ("**NDRC**"), Ministry of Commerce ("**MOFCOM**") and State Council Taiwan Affairs Office ("**SCTAO**") on November 9, 2010 and came into force on the same date. The *Notification on the Relevant Regulation for Administration on Investment Projects by the Mainland Enterprise in the Taiwan Region* (Fa Gai Wai Zi [2008] No.3503) promulgated by the NDRC and the SCTAO, and the *Notification of Relevant Matters for Investment or Establishment of the Non-enterprise Legal Person by Mainland Enterprises in Taiwan Region* (Shang He Fa [2009] No.219) promulgated by the MOFCOM and the SCTAO, were abolished at the same time. The main contents of the Administrative Measures are as follows:

Conditions for Investment by Mainland Enterprises in Taiwan Region

In accordance with the Administrative Measures, the mainland investment bodies that intend to invest in Taiwan Region shall meet the following conditions: a) being legal persons legally incorporated and operating in Mainland; b) having the according industry background, capital, technology and management qualifications for the applied projects to be invested; c) being beneficial to peaceful development of cross-strait relationships without harms to national security and unity.

The Approval and Filing Procedures of the Investment by Mainland Enterprises in Taiwan Region

- In case of investment in Taiwan Region by mainland enterprises, local enterprises shall apply to the local development and reform commission at provincial level (hereinafter referred in as the "**PDRC**"). After the preliminary review made by the PDRC, the PDRC shall submit to the SDRC for examination and approval. On the other hand, central enterprises shall apply directly to the SDRC for examination and approval. While seeking comments from the SCTAO, the SDRC exams and approves the investment projects according to the *Interim Administrative Measures on the Examination and Approval on Outbound Investment Projects* (the SDRC Order No.21), and shall copy the approval documents to the MOFCOM, the SCTAO and other relevant institutions.

- If mainland enterprises intend to establish enterprise or non-enterprise legal persons in Taiwan Region, it shall be subject to examination and approval of the MOFCOM. Local enterprises shall apply to MOFCOM after preliminarily reviewed by local administration for commerce at provincial level. On the other hand, central enterprises shall submit application to the MOFCOM directly. MOFCOM will invite for the opinions from the

SCTAO after receipt of the applications (except where the investment projects are already examined and approved by the SDRC). With the consent of the SCTAO, MOFCOM examines and approves the application according to the *Administrative Measures on Outbound Investment Projects* (the MOFCOM Order 2009 No.5), and then issues a Certificate of Overseas Investment or a Certificate of Overseas Organization.

- With the approval documents on investment projects and incorporation of enterprise (including organizations), Certificate of Overseas Investment or Certificate of Overseas Organization as issued by relevant administrations, Mainland enterprises shall go through the examination and approval procedures on relevant personnel's going to Taiwan, foreign exchange registration and other relevant formalities.

- Mainland enterprises shall submit the relevant registration documents to the SDRC, the MOFCOM and the SCTAO for archival filing within 15 working days after the invested enterprises or non-enterprise legal persons complete local registration in Taiwan Region.

- For investment in Taiwan Region through offshore enterprises, mainland enterprises shall duly go through the approval procedures with the SDRC and the archival filing formalities with the MOFCOM.

Relevant Preferential Policies

According to the Administrative Measures, mainland enterprises are entitled to supports of relevant state policies on the approved investment in Taiwan Region with the approval documents and Certificate of Overseas Investment or Certificate of Overseas Organization. In addition, in case of receiving the relevant certifications, such as certifications of service providers, mainland enterprises can enjoy the treatments under relevant agreements entered into by and between Mainland and Taiwan Region.

3. Two Ministries Jointly Released New Circular on Further Standardizing the Administration of House Purchase by Foreign Organizations and Individuals (Author: Kaiying WU)

On November 4, 2010, the Ministry of Housing and Urban-Rural Development (the "**MOHURD**") and the State Administration of Foreign Exchange (the "**SAFE**") released the *Circular on Further Standardizing the Administration of House Purchase by Foreign Organizations and Individuals* [Jian Fang (2010) No. 186] (the "**Circular**"). The Circular reflects the above two ministries' intention to implement the *Circular of the State Council on Resolutely Curbing the Housing Price in Certain Cities From Rising Too Fast* [Guo Fa (2010) No. 10], and to further implement the *Opinions on Regulating the Entry and Administration of*

Foreign Investment into the Real Property Market [Jian Zhu Fang (2006) No.171]. The main points of the Circular are highlighted as follows:

Clarifying the Purchase Limit

The Circular clarifies, a foreign individual who complies the corresponding qualifications may purchase only one house unit for his/her own residential use; a foreign organization who owns domestic branches or representative offices may purchase non-residential housing for its own office use in the city where the domestic branch(es) or office(s) are registered, unless otherwise provided by laws and regulations.

Refining the Examination Requirements

To ensure the above limits for purchase can be effectively implemented, the Circular particularly introduces the documents to be examined by local real estate administration authorities when they deal with the pre-sale contract recordation and property right registration for a foreign organization or a foreign individual. It states that except for examining the documents required by the *Measures for the Management of Pre-Sale of Urban Commercial Houses* and the *Measures for the Registration of Houses*, and verifying the house-holding situation of the purchaser, local real estate administration authorities shall further examine:

- Where the purchaser is a foreign individual: a) a certificate issued by related authorities to prove that the foreign individual (other than residents of Hong Kong, Taiwan, Macao and overseas Chinese) has been working within the territory of China for more than one year; or a certificate to prove that he/she has been working, studying or residing within the territory for residents of Hong Kong, Taiwan, Macao and overseas Chinese; b) a written undertaking which assures that he/she owns no other house in mainland China.

- Where the purchaser is a foreign organization: a) the approvals and registration certificates issued by related authorities for establishing its branches or representative offices; b) a written undertaking which assures that the house to be purchased is for actual office use purposes.

Strengthening the Administration of Foreign Exchange Settlement

The Circular emphasizes, in case a foreign organization or individual applies for settlement of foreign exchange for house purchase purposes, it shall strictly follow the procedures as set forth in the *Circular on Regulating the Administration of Foreign Exchange in Real Estate Market* [Hui Fa (2006) No. 47]. Designated foreign exchange banks shall strictly examine

the application materials submitted by foreign organizations or individuals when dealing with the settlement of foreign exchange for house purchase purposes. For those qualified, such banks shall make an instant record registration in the foreign exchange management information system for direct investment in accordance with related regulations, after the procedures for settlement of foreign exchange have been completed.

Finally, the Circular also requires local real estate authorities, foreign exchange administration authorities to actively propagate relevant laws and policies, and urges the above authorities to cooperate more effectively, communicate information timely, and work together to further tighten and regulate the administration of house purchase by foreign organizations and individuals.

4. Three Authorities Jointly Released Supplementary Circular of Individual Income Taxation Concerning Individual Transfers of Restricted Shares of Listed Companies (Author: Bin XUE)

Three authorities including the Ministry of Finance (MoF), the State Administration of Taxation (SAT) and the China Securities Regulatory Commission (CSRC) jointly released *Supplementary Circular of Individual Income Taxation Concerning Individual Transfers of Restricted Shares of Listed Companies* (Caishui [2010] No. 70, Circular 70) to further clarify the tax administration policy on individual transfers of listed companies' restricted shares as set forth in *Circular of Individual Income Taxation Concerning Individual Transfers of Restricted Shares of Listed Companies* (Caishui [2009] No. 167, Circular 167) jointly promulgated by the aforesaid three authorities on December 31, 2009.

Seven-category Taxable Restricted Shares

Under Circular 70, the taxable restricted shares shall include: a) the restricted shares as stipulated by Circular 167, i.e. restricted shares due to the reform of non-tradable shares of listed companies and restricted shares due to Initial Public Offerings; b) the restricted shares which an individual purchases from the institutions or other individuals; c) the restricted shares which an individual inherits or obtains from the division or assignment of a family estate; d) the restricted shares which are transferred to Main Board, Small and Medium Enterprise Board (SME Board) or ChiNext from Stock Transfer Agent System; e) in consolidation by merger of a listed company, the shares which are converted to equity shares of the merging company from restricted shares of the merged company owned by individual shareholders; f) in separation of a listed company, the shares which are converted to equity shares of the separating company from restricted shares of the separated company owned by individual shareholders; and g) other restricted shares.

Nine-type Taxable Transfers

Circular 70 further stipulates that conditions under which individual income tax is payable include: a) when an individual transfers restricted shares through the centralized trading system or block trading system of the stock exchange; b) when an individual uses restricted shares to subscribe or apply for exchange traded fund (ETF) shares; c) when an individual uses restricted shares in tender offer acceptance; d) when an individual exercises his/her cash option to transfer restricted shares to the third party offering the cash option; e)when an individual transfers restricted shares under a personal agreement; f) when the restricted shares held by an individual are deducted by the judiciary; g) when an individual inherits or obtains the ownership of restricted shares from the division or assignment of a family estate; h) when an individual uses restricted shares to repay the majority shareholders of a listed company who, in the course of stock equity distribution reform, have paid the tradable share holders on his/her behalf; and i) other transactions involving the de facto transfer of restricted shares.

Explicit Taxation Administration Policy

Pursuant to Circular 70, for restricted shares undergoing multiple transfers before the lockup expiration date, the transferor must pay individual income tax on the income derived from each transfer. As stipulated in the Circular 167, the transferor of the restricted shares will be subject to individual income tax on 20 percent of the gains derived from such transfer, in accordance of the category “gains from disposal of assets” since January 1, 2010.

Important Announcement

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