



漢坤律師事務所
HAN KUN LAW OFFICES

Newsletter

China Practice

Global Vision



5th Edition of 2013



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Legal Updates

1. Nationwide Expansion of NTB Pilot Programs and Issuance of Specific Standards for Listing Conditions (Authors: Yixin LIN, Bin ZHI)

On June 19 2013, an executive meeting was held by the State Council that determined the policies and measures regarding “the nationwide expansion of the pilot programs of the Small and Medium-sized Enterprises (the “SME”) share transfer system”. The meeting determined that the New Third Boards (the “NTB”) pilot programs, which first began in National High-tech Parks in Beijing, Tianjin, Wuhan and Shanghai, will be expanded to nationwide. Due to the “convertibility” of the NTB, SMEs regard it as a means of access to the capital market. Currently NTB services are to be expanded into any nationally qualified SMEs, which will encourage further innovation and financial development of innovation-type SMEs, and accelerate their listing.

The Basic Guidelines of Stock Listing Conditions for the National Equities Exchange and Quotation (Trial) (the “Basic Guidelines”) was issued by the National Equities Exchange and Quotation Company on June 20 2013. The Basic Guidelines specifies the listing conditions set forth in the Business Rules of the National Equities Exchange and Quotation (“NEEQ”, also known as “NTB”) (the “Business Rules”). The National Equities Exchange and Quotation Company approves the listing application of any company which complies with the Basic Guidelines, and reviews and comments on whether the information disclosure of the company applying for stock listing meets the requirements, as well as whether the host dealer has preformed the required due diligence. The Basic Guidelines shall enter into force on the date of its promulgation.

In accordance with the Business Rules, any company applying for stock listing (the “Company”) shall meet the following requirements: (a) the Company has been legally established and has existed for at least two years; (b) the Company has a specific business scope and capacity for continuous operation; (c) the Company has efficient management mechanisms and operates in accordance with the relevant laws and regulations; (d) the equity ownership of the Company is clear, and the equity was issued and transferred in accordance with the relevant laws and regulations; (e) the listing of the Company was recommended and continuously supervised by the host dealer; (f) any other requirements provided by the National Equities Exchange and Quotation Company. The specific standards are as follows:

(a) The Company has been legally established and has existed for at least two years

As provided in the Basic Guidelines, being legally established includes that, the person or entity establishing the Company, the establishment process, the methods and proportion of shareholders’ contribution shall comply with the relevant laws and regulations, the approval documents for

establishing a special company such as state-owned company or a foreign invested company shall be issued by the competent authorities. Furthermore, the approval documents for establishing a joint-stock company prior to the amendment of the Company Law on January 1, 2006 shall be issued by the competent department authorized by the State Council or the provincial government.

As provided in the Basic Guidelines, existing for at least two years shall mean that the Company has existed for more than two accounting years, rather than 24 calendar months. Regarding a limited liability company that has been converted into a joint-stock company, the existing period of the new Company may be calculated upon the establishment date of the original limited liability company. The capital stock of the joint-stock company shall be equivalent to the net asset value of the limited liability company on the day from which the limited liability company begins to restructure its form (the “Base Day”). Neither the change in historic cost principles, nor the financial adjustment based upon the property assessment, is permitted. The latest closing date of reporting a financial statement shall not be earlier than the base day.

(b) The Company has a specific business scope and capacity for continuous operation

As required in the Basic Guidelines, a “specific business scope” shall mean that the Company is able to clarify its business, products, services, usages and business modes, clearly and specifically. The Company may engage in one or more than one business, each of which shall be conducted in compliance with the relevant laws, regulations and industrial policies, and shall obtain the corresponding qualification licenses. The critical resource factors shall have the capacity for input, process and output, matching the corresponding business contract, revenue, cost or expense of the Company.

The “capacity for continuous operation” requires that the Company: (a) has the continuous operation records, other than the occasional transaction or matter in the reporting period; (b) does not have any circumstance listed in the Auditing Standards No. 1324 of the Chinese Registered Certified Public Accountants - Continuous Operations, which adversely affects its capacity for continuous operation, and an Audit Report of standard clean opinions has been provided by the accountant firm; (c) does not have any circumstance of dissolution as provided in the Company Law, or any application of reorganization, conciliation, or bankruptcy received by the Court.

(c) The Company has efficient management mechanisms and operates in accordance with the relevant laws and regulations

In accordance with the Basic Guidelines, the Company shall have the shareholders’ meeting, the Board of Directors, the Board of Supervisors and organization structure composed of senior management, and formulate management regulations and operate it in accordance with regulations. The Board of Directors shall discuss and assess issues regarding the implement of management mechanisms in the reporting period.

The “Operates in accordance with relevant laws and regulations” requires that the Company and its controlling shareholders, directors, supervisors, senior management personnel thereof shall conduct all business activities in accordance with the relevant laws and regulations, and do not have any serious violation of such laws and regulations, including:

- i) The Company, the controlling shareholders and the actual controller thereof, have been not been sentenced to any criminal penalty or any administrative penalty due to any serious violations of the laws and regulations, or suspected of a crime which do not have a clear conclusion but have been put on file for investigation and prosecution by the judicial authorities, in the past 24 months.
- ii) The directors, the supervisors and the senior management personnel qualified in accordance with the Company Law have not been penalized by the China Securities Regulatory Commission or taken measures of prohibiting from entering the securities market in the past 24 months.
- iii) The shareholders of the Company, including the controlling shareholders and the actual controller, or affiliates thereof have not occupied the capital, assets or any other resources of the Company in the reporting period, or such occupy was corrected or returned prior to the application for listing.
- iv) The Company has an independent financial department conducting independent financial accounting. The accounting policies faithfully represent the financial situations, operating results and cash flows of the Company.

(d) The equity ownership of the Company is clear, and the equity is issued and transferred in accordance with the relevant laws and regulations

Pursuant to the Basic Guidelines, the “clear equity ownership” shall mean the Company has qualified shareholders (special shareholders shall comply with the special provisions provided in the relevant laws), and a clear, authentic and definite equity structure, and does not have any dispute or potential dispute regarding the equity held by shareholders.

“The equity was issued and transferred in accordance with the relevant laws and regulations” shall mean that the share issuance and transfer of the Company, its holding subsidiaries and any other company consolidated in its financial statements is conducted in accordance with the relevant laws and regulations, and the transfer does not violate sales restrictions, and does not engage the following conducts:

- i) Any public offering or disguised public offering that has not been approved by the competent authorities in the past 36 months.
- ii) Any foregoing offering conducted prior to 36 months, nonetheless, it continues existing (excluding the Joint-Stock Company, which has more than 200 shareholders,

established prior to the implement of the Non-listed Public Company Supervision and Management Measures and otherwise acknowledged by the China Securities Regulatory Commission).

(e) The listing of the Company was recommended and continuously supervised by the host dealer

In accordance with the Basic Guidelines, the Company shall execute the Recommended Listing and Continuous Supervision Agreement with the host dealer. And the host dealer shall complete the due diligence and internal examination, and provide independent comments on whether the Company satisfies the listing conditions, and recommendation report.

In addition to the foregoing conditions, the National Share Transfer System Company does not require any other condition in respect of the listing application of the Company.

2. SAT Issues Announcement on EIT Applicable to Legal Person Partners of Limited Partnership Venture Capital Enterprises in Suzhou Industrial Park (Authors: Evan ZHANG, Lu RAN, Mengzhu LIU)

In the light of the *Circular of the Ministry of Finance and the State Administration of Taxation on the Pilot Policies for Enterprise Income Tax on Legal Person Partners of Limited Partnership Venture Capital Enterprises in Suzhou Industrial Park* (“**Cai Shui [2012] Document No. 67**”) and relevant regulations, the State Administration of Taxation (the “**SAT**”) released the *Announcement on Issues Concerning the Administration of Pilot Collection Policies of Enterprise Income Tax on Legal Person Partners of Limited Partnership Venture Capital Enterprises in Suzhou Industrial Park* (SAT Announcement [2013] No.25) (the “**Announcement**”) on May 24, 2013, to further enhance the administration on pilot collection of enterprise income tax (“**EIT**”) in Suzhou Industrial Park.

The major issues regarding the Announcement are as follows:

(a) Specify the subject qualifications

The *Circular of the Ministry of Finance and the State Administration of Taxation on Issues Concerning the Income Tax Levied on Partners of A Partnership Enterprise* (“**Cai Shui [2008] Document No. 159**”) Article 2 specifies that for a partnership enterprise, every partner shall be a taxpayer and where a partner of a partnership enterprise is a natural person, individual income tax shall be paid. Where a partner is a legal person or any other organization, EIT shall be paid, which treats a partnership enterprise as a tax transparent entity. Therefore, the subject to the pilot policy is limited to legal persons and other organizations with EIT liability. The Circular requires that “the legal person partner of limited partnership venture capital enterprises registered in Suzhou Industrial

Park” (the “**legal person partner**”) regulated in Cai Shui [2012] Document No. 67 is subject to the following requirements: 1) the limited partnership venture capital enterprise shall be a limited partnership enterprise organized in Suzhou Industrial Park under the *Partnership Enterprise Law of the People's Republic of China* and *Interim Administrative Measures for Venture Capital Investment Enterprises* and shall be specialized in venture capital investment; 2) the legal person partner shall be a limited partnership enterprise regulated by the *Law of the People's Republic of China on Enterprise Income Tax, Implementing Regulations of the Law of the People's Republic of China on Enterprise Income Tax* and *Circular of the State Administration of Taxation on Issues regarding Verification Collection of Enterprise Income Tax* (Guo Shui Han [2009] No. 377) and shall be taxed on an actual profit basis.

(b) Specify the period for qualified enterprises to enjoy pilot policies

With regard to the duration of the pilot policies, the Announcement makes it clear that where limited partnership venture capital enterprises fulfill the requirements specified in Article 3 of Cai Shui [2012] Document No. 67 and conduct equity investment in unlisted small and medium-sized high-tech enterprises for 24 months within the pilot period, the legal person partner thereof is entitled to enjoy the preferential treatment.

(c) Specify the issues on deduction of amount invested and EIT calculation

In practice, a legal person partner may invest in various qualified venture capital enterprises and since the investment activities of those venture capital enterprises are subject to inherent risk, investment return and allocation may not be secured or unified. If the deductible investment amount is limited to the allocated taxable income in the corresponding venture capital enterprise, the margin left in overall deductible investment amount shall weaken the efforts of Cai Shui [2012] Document No. 67. The Circular stipulates that for a legal person partner, 70% of the investment amount shall be deducted when calculating the taxable income and for all competent venture capital enterprises in Suzhou Industrial Park, the deductible investment amount and allocated taxable income shall be calculated in total. Where the investment amount is not enough to be deducted for the current year, such amount may be retained until the following tax years. Where the investment amount for the current year is in excess after deduction, EIT may be calculated and paid pursuant to the relevant tax regulations.

(d) Specify issues on EIT calculation of venture capital enterprises and equitable distribution

Article 4 in the Announcement clarifies that during the policy pilot process Cai Shui [2008] Document No.159 shall be the governing regulation on collection management, and insists the principle of "division before taxation" for the production and management income and other income of a partnership enterprise.

(e) Specify liabilities of the competent tax authorities in Suzhou Industrial Park

The Announcement sets a three month declaration term, for which, the venture capital enterprises shall submit the relevant materials regarding tax declaration within three months upon the end of the year (for the year 2012 only, the materials may be submitted within five months upon the end of the year). This provision is in compliance with the declaration term of individual income tax in normal partnership enterprises, and ensures that a legal person partner may deliver the materials regarding tax declaration promptly when conducting annual EIT remittance and declaration before May 31st.

In addition, the Announcement defines the materials regarding tax declaration and requires the venture capital enterprises to submit the filing materials set in Article 4 of the *Circular of the State Administration of Taxation on Issues Concerning the Enterprise Income Tax Incentives on Joint Ventures*, Schedule on the Deduction of Taxable Income of Legal Person Partners of Limited Partnership Venture Capital Enterprises and the capital verification report of venture capital enterprises.

According to the Announcement, during the examination and verification process, the competent tax authorities in Suzhou Industrial Park shall pay attention to the annual taxable income of the venture capital enterprises, the allocation ratio of the legal person partners, the taxable income of the legal person partners, the deductible investment amount of the legal person partners, etc. The responsibilities and duties of administration are made clear to the local tax authorities.

(f) Specify procedures for filing applications

Since the competent tax authorities of the venture capital enterprises differ from those of the legal person partners of such enterprises, a legal person partner should attach the following documents for the reference of the competent tax authorities of legal person partners when applying: 1) Schedule on the Deduction of Taxable Income of Legal Person Partners of Limited Partnership Venture Capital Enterprises sealed by the competent tax authority in Suzhou Industrial Park and 2) the capital verification report of the venture capital enterprises.

In addition, the Announcement entitles the competent tax authorities an objection right. Where the competent tax authorities of legal person partners have an issue with the relevant application materials, they may seek external confirmation from the competent tax authorities in Suzhou Industrial Park or check on the website of such tax authorities in Suzhou Industrial Park and the competent tax authorities are obliged to give an professional response to the confirmation letter.

(g) Promote positive feedback

Pursuant to the Announcement, the tax authorities in Suzhou Industrial Park shall conduct a professional assessment regarding the effectiveness of the policies and issue timely responses. This provision helps to find and resolve various questions that may occur during the pilot program

and further popularize the pilot.

(h) Specify effective date thereof

Article 8 stipulates that since the validity period for the policy pilot program approved by the State Council is two years, from January 1st, 2012 to December 31st, 2013, the Announcement should enter into force on January 1, 2012.

Important Announcement

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