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Insights & Ideas

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Key Points of the Administrative Measures for Registration of Foreign Debts and its Operational Guidelines (Authors: Shu WANG, Irene CAI, Xinfeng ZHANG)

The State Administration of Foreign Exchange ("**SAFE**") released *the Administrative Measures for the Registration of Foreign Debt* (Hui Fa [2013] No.19, the "**Administrative Measures**") and *the Operational Guidelines for the Administrative Measures* (the "**Operational Guidelines**") on April 28, 2013. The Administrative Measures and Operational Guidelines will significantly alter the current registration system and administrative methods for foreign debts[1], and will take effect on May 13, 2013.

Compared with the current registration system and administrative methods for foreign debts, the following points of the Administrative Measures and Operational Guidelines are worthy of attention.

Improves the Management Methods of Foreign Debts Registration

The Administrative Measures and the Operational Guidelines provide three different foreign debts registration methods for three types of debtors, which are financial departments, domestic banks and other domestic debtors:

a) Financial department debtors shall within the first 10 business days of each month submit all contract executions, drawings, settlement and purchase of foreign exchange, repayments and changes of accounts regarding foreign debts to SAFE on a case-by-case basis;

b) Domestic bank debtors shall submit the information of foreign debts through the relevant systems of SAFE on a case-by-case basis; and

c) Other debtors ("**Non-bank Debtors**") shall go through foreign debts contract-signing registration within 15 business days after execution of the relevant foreign debts contracts on a case-by-case basis.

The Operational Guidelines further clarify the requirements and scale of foreign debts for various enterprises (including ordinary foreign-invested enterprises, foreign-invested investment companies, foreign-invested rental companies and foreign-invested real estate companies), and specify that Non-bank Debtors shall conduct foreign debts registration for businesses of financing lease, financing leaseback and issuance of offshore bonds.

1 Foreign debts described herein shall refer to debt borrowed from international financial institutions, foreign governments, financial institutions, enterprises or other institutions outside the People's Republic of China by domestic organizations, enterprises or financial institutions, where the debtors are contractually obligated to repay in foreign currency. Foreign debt herein shall include international financial institution loans, foreign government loans, foreign bank and financial institution loans, buyer's credits, foreign enterprise loans, securities issued in foreign currency, international financial leases, and foreign debt in other forms.

Cancels Several Approvals for Foreign Debts and Simplifies the Procedures of Foreign Debts Management

The Administrative Measures repeal several approvals for foreign debts such as advances and payables under foreign goods or services trade, and foreign payables under financial asset deals other than foreign debt. Since these three types of businesses are not included in the foreign debts scale, foreign debts registration is not required. The Administrative Measures also specify that the opening of foreign debts accounts, settlement of foreign exchange, and repayment of principal and payment of interest shall be reviewed and handled by the designated foreign exchange banks directly, while the foreign debts registration shall be conducted by the local SAFE branch of the debtor.

Clarifies the Foreign Exchange Management for Foreign Guarantees under Domestic Loans

According to the Administrative Measures, qualified debtors can accept guarantees provided by foreign entities and individuals when borrowing money from domestic financial institutions ("**Foreign Guarantee under Domestic Loans**"). Foreign-invested enterprises may execute foreign guarantee contracts directly, while domestic companies must first apply for a guarantee amount with SAFE.

In principle, the management method for Foreign Guarantee under Domestic Loans is the "Creditor Assembly Registration", which means that the financial institution creditors shall within the first 10 business days of each month submit the data regarding Foreign Guarantee under Domestic Loans to SAFE. In case that the performance of a foreign guarantee occurs, the foreign guarantee shall become the foreign debts of the debtors, and the debtors shall go through the foreign debts registration procedures. Where the debtors are foreign-invested enterprises, the performed amount under the foreign guarantees shall be included into and controlled within the Investment Balance[2] or foreign debts scale.

Clarifies Foreign Exchange Management for the Foreign Transfer of Non-Performing Assets

The Administrative Measures and the Operational Guidelines provide that the foreign transfer of non-performing assets by domestic entities shall obtain prior approval from SAFE, and the offshore investors shall go through the filing for the foreign transfer of non-performing assets within 15 business days after obtaining approval. The Operational Guidelines also stipulate the procedures regarding the purchase and payment of foreign exchange for transfer revenues, and further provides that domestic guarantees already listed in the abovementioned filings will not constitute foreign guarantees solely due to the foreign transfer of non-performing assets.

[2] Investment Balance refers to the balance between the total investment amount and the registered capital of a foreign-invested enterprise.

Clarifies the Procedures for Foreign Debts Registration and Management

To refine the management requirements and procedures of foreign debts registration and related matters, the Operational Guidelines divide foreign debts management matters into 15 items, which consist of the following:

a) Non-bank Debtors to go through foreign debts contract-signing registration,

b) Financial departments and banks to go through foreign debts registration;

c) Banks to open and close foreign debts accounts for Non-bank Debtors;

d) Non-bank Debtors to file drawings in the form of non-funds transfer;

e) Non-bank Debtors to file repayment of principal and payment of interest in the form of non-funds transfer;

f) Banks to handle foreign exchange settlements under foreign debts for Non-bank Debtors;

g) Foreign debts cancellation registration;

h) Domestic enterprises to go through the procedures of foreign guarantee under domestic loans;

i) Financial institutions to handle the settlement and purchase of foreign exchange for performed amount under foreign guarantee;

j) Non-bank debtors to go through the procedures for foreign payment of the guarantee fees;

k) Approvals for receiving, payment and exchange of foreign exchange involved in foreign transfer of non-performing assets;

l) Filings by foreign investors of non-performing assets and approval for the purchase and payment of foreign exchange;

m) Banks to handle drawings in form of funds transfer under foreign debts for Non-bank Debtors;

n) Banks to handle repayment of principal and payment of interest in the form of funds transfer under foreign debts for Non-bank Debtors;

o) Banks to handle delivery performance under foreign debts hedging for Non-bank Debtors.

Repeals Several Regulations Related to Foreign Debts Management

SAFE announced its repeal of eight regulations in regard to foreign debts management including: *the Circular of SAFE on Issues Concerning the Improvement of the Administration of Foreign Debts* (Hui Fa [2005] No.74) and *the Circular of SAFE on Issues Concerning Management on Filings of Guarantees Involved in Transfer of Non-performing Assets by Financing Asset Management Companies* (Hui Fa [2011] No.13)..

Legal Updates

1. New Tax Rules on International Secondment Arrangement Released (Author: Fang JI)

On May 6, 2013, the State Administration of Taxation (the "**SAT**") issued *the Announcement on Issues Relating to the Collection of Enterprise Income Tax on Labour Services Provided by Personnel Dispatched by Non-resident Enterprises within the Territory of China* (SAT Announcement [2013] No. 19, **"Announcement 19"**), which clarifies the enterprise income tax treatment, tax filing procedures, principles for tax collection and administration as well as other tax-related matters for secondment arrangements. Announcement No. 19 will come into effect on June 1, 2013, and will apply to unsettled matters that have taken place prior to the effective date.

Background

It is quite common for non-resident enterprises (the "**Dispatching Entity**") to send personnel to take management, technical or other positions in Chinese enterprises (the "**Recipient Entity**"), especially foreign invested enterprises that are affiliated with the Dispatching Entity. The domestic Recipient Entity will pay the Dispatching Entity employment expenses of the seconded personnel, such as salaries/wages and bonuses. Since the implementation of the new Enterprise Income Tax Law on January 1 2008, the tax authorities have enhanced the tax collection and administration in respect of non-resident enterprises. However, due to the lack of clear and specific provisions as to whether such secondment arrangement constitutes, for the Dispatching Entity, offices or establishments under the Enterprise Income Tax Law, it has been difficult for tax authorities to determine the appropriate tax treatment. The uncertainty in tax treatment in turn makes it difficult for the domestic Recipient Entity to obtain the Tax Certificate for Outbound Remittance (the "**Tax Certificate**"). As a result, the Recipient Entity could not remit expenses, such as salaries and wages, of the seconded personnel to the Dispatching Entity, which also leads to a negative impact on the accounting and tax treatment of the Recipient Entity.

The Current Regulations

On July 26 2010, the SAT issued the *Interpretations on Clauses of the Agreement between the Government of the People's Republic of China and the Government of the Republic of Singapore for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and of the Protocol thereto* (Guoshuifa [2010] No.75, "**Circular 75**"). Although Circular 75 is an interpretation of the provisions of tax treaty on the basis of Tax Treaty between China and Singapore (hereinafter referred to as the "**Treaty**"), it applies to the interpretation and enforcement of all tax treaties between China and a foreign jurisdiction under which the relevant provisions are consistent with terms of the Treaty.

The secondment arrangement of multinational corporations was mentioned by Circular 75 in its interpretation of the permanent establishment clause. Circular 75 sets out the criteria to determine whether such secondment arrangement constitutes a permanent establishment for the non-resident dispatching enterprise. Pursuant to Circular 75, the determination of whether the seconded personnel work for the dispatching parent company or the recipient domestic company should be established based on their roles in respect of: the direction of the work of the seconded personnel; assumption of the responsibility and risk of the seconded personnel's work; determination of the standard and quantity of such personnel; sharing of the salary cost of such personnel as well as whether the parent company makes profit from dispatching personnel to the subsidiary to conduct business. If the seconded personnel are deemed to work for the parent company and the parent company has constituted a permanent establishment in China, the Chinese tax authorities have the power to impose an enterprise income tax on the fees that the parent company collected from its subsidiaries for the abovementioned secondment activities.

Circular 75 for the first time explicitly provides for the enterprise income tax treatment under the international secondment arrangement after the implementation of the new Enterprise Income Tax Law. However, as Circular 75 provides interpretations of tax treaties, it is silent on the tax treatment in situations where the non-resident enterprise does not constitute a permanent establishment, but has a place/establishment of business under the Enterprise Income Tax Law. Furthermore, Circular 75 does not state the tax filing and payment method of non-resident enterprises or the coordination of tax collection and issuance of tax certificates.

New Tax Rules for Secondment Arrangements

Announcement 19 further clarifies the tax treatment for the international secondment arrangements.

(a) Situations where a Place/Establishment of Business or Permanent Establishment is Constituted

In accordance with Circular 19, if the following conditions are both satisfied, the Dispatching Entity should generally be deemed to have a place/establishment of business in China through which services are provided as a result of the provision of services by the seconded personnel in China:

- the Dispatching Entity assumes some or all responsibilities and risks of the outcome of the work conducted by the seconded personnel, and
- the Dispatching Entity assesses the work performance of the seconded personnel under normal circumstances.

If the Dispatching Entity is a tax resident in a jurisdiction that has concluded a double tax treaty with China, and its place/establishment of business through which services are provided is relatively fixed and permanent, such place/establishment of business shall be regarded as a permanent establishment of the Dispatching Entity in China.

However, the Dispatching Entity, as a shareholder of the Recipient Entity, may dispatch its personnel to provide services in China for the sole purpose of exercising its shareholder's rights and/or protecting its legitimate rights and interests as shareholder. For instance, the seconded personnel may provide investment advice to the Recipient Entity, or attend the shareholders' meetings or board meetings on behalf of the Dispatching Entity. In such situations, the Dispatching Entity shall not be deemed as having a place/establishment of business or a permanent establishment in China, even though such activities take place in the business premise of the Recipient Entity.

(b) Factors to be Considered and Documents to be Reviewed

The following factors shall be taken into account when making the judgement of whether the Dispatching Entity has a place/establishment of business or a permanent establishment in China. Please note that in principle, if the secondment arrangement falls within the situation as described above where a place/establishment of business or permanent establishment should be deemed to exist, and any of the following conditions are met, it can be concluded that a place of business/establishment or permanent establishment has been constituted.

- The Recipient Entity makes payments in the nature of management fees or service fees to the Dispatching Entity;
- The payment made by the Recipient Entity to the Dispatching Entity exceeds the salaries and wages, social security premiums and other costs actually paid by the Dispatching Entity;
- The Dispatching Entity retained a portion of the payment received from the Recipient Entity instead of disbursing it in full to the seconded personnel;
- Individual income tax is not paid on the entire amount of salaries and wages borne by the Dispatching Entity; and
- The number of dispatched personnel as well as their qualifications, remuneration criteria and place of work in China are determined by the Dispatching Entity.

The tax authorities will focus on reviewing the following documents in relation to the secondment arrangement for tax administration purposes:

- Contracts or agreements between the Dispatching Entity, the Recipient Entity and the seconded personnel;
- Management rules or regulations of the Dispatching Entity or the Recipient Entity for the seconded personnel, including provisions on their responsibilities, job descriptions, performance appraisal and risk-sharing;
- Payments made by the Recipient Entity to the Dispatching Entity and relevant accounting treatments, as well as individual income tax filing and payment documents for the seconded personnel; and

- Whether there is any hidden payment arrangement in relation to secondment activity, such as offsetting transactions, waiver of claims and related-party transactions.

The tax authorities will determine the enterprise income tax liability of the non-resident Dispatching Entity based on the above documents as well as the economic essence and the implementation status of the secondment arrangement.

(c) Tax Payment and Calculation for Non-resident Dispatching Entities

The Dispatching Entity that is deemed to have a place/establishment of business or permanent establishment in China should perform tax registration with the in-charge tax authorities at the place of the projects (which is usually the locality of the Recipient Entity) within 30 days after the project contracts or agreements are signed pursuant to the *Interim Administrative Measures for the Taxation of Contracting Construction Projects and Providing Services of Non-Resident Enterprises* (Order of the State Administration of Taxation No.19).

In principle, the Dispatching Entity should itself make tax filings and declarations. The Dispatching Entity should calculate its income and declare and pay enterprise income taxes on an accurate and truthful basis. If the Dispatching Entity is unable to make tax filings and payments on an actual basis, tax authorities are entitled to assess and collect enterprise income taxes on a deemed-profit basis in accordance with the *Administrative Measures for the Assessment and Collection of Income Tax against Non-resident Enterprises* (Guoshuifa [2010] No. 19, **"Deemed-profit Measures"**). Pursuant to the Deemed-profit Measures, where a non-resident enterprise is taxed on the deemed-profit basis, the taxable income will be converted based on a pre-determined deemed profit rate and any of the gross income, costs or expenditures of the non-resident enterprises that can be accurately accounted. According to the Deemed-profit Measures, the deemed profit rate for consulting services is between 15% to 30%, the deemed profit rate for management services is between 30% to 50% and the deemed profit rate for other services should be no less than 15%.

Announcement 19 further stipulates that, in addition to assessing the enterprise income tax treatment for the secondment arrangement, the in-charge tax authorities should also promote the exchange of information with tax authorities responsible for the collection of individual income taxes and business taxes that may be triggered by the secondment arrangement.

(d) Foreign Exchange Remittance

Moreover, tax authorities are required under Announcement 19 to timely handle the foreign exchange payment formalities for the Dispatching Entity or the Recipient Entity pursuant to the relevant regulations when determining the tax treatment of secondment arrangements. This requirement mainly refers to the issuance of a tax certificate. In accordance with the relevant regulations, when making remittance of certain service trade items, such as the payment of service incomes to foreign entities or remunerations for personal services, a tax certificate issued by the tax authorities should be obtained if a single payment amounts to more than USD 30,000 (or the

equivalent in other foreign currencies). As such, the tax authorities should promptly arrange to issue the tax certificate after ascertaining whether taxes should be imposed on the Dispatching Entity as a result of the secondment arrangement.

Our Observations and Recommendations

As compared to Circular 75, Announcement 19 sets out more detailed provisions in respect of the determination of the existence of a place/establishment of business or permanent establishment under secondment arrangements. However, there are still some open issues. For example, when the seconded personnel holds senior management positions, they usually have to report their work to the corporate headquarters (i.e., the Dispatching Entity), and the corporate headquarters would bear the responsibilities and risks of their work to certain extent. In this case, it remains unclear as to whether the Dispatching Entity would be regarded as having a place/establishment of business or permanent establishment in China even if the Recipient Entity reimburses the Dispatching Entity at cost, and the individual income tax is paid in full for the entire amount of salaries and wages of the secondment personnel.

In addition, pursuant to Announcement 19, if a Dispatching Entity is deemed to have a place/establishment of business or permanent establishment in China, the Dispatching Entity is obliged to perform tax registration and fulfill tax filing and payment obligations on its own. However, there may be certain practical difficulties for a non-resident Dispatching Entity to pay taxes directly in China. The source of RMB funds to settle tax payments would be one of the difficulties faced by the Dispatching Entity. In practice, assistance of the Recipient Entity with regard to the tax payment may be necessary.

Although Announcement 19 does not explicitly refer to the application for tax treaty benefits by the Dispatching Entity, the policy interpretation (the "**Interpretation**") released simultaneously by the SAT with Announcement 19 confirms that the Dispatching Entity may enjoy tax treaty benefits. The Dispatching Entity should make a filing to the in-charge tax authority in accordance with the relevant regulations. If the materials submitted evidences that the Dispatching Entity does not have a permanent establishment in China, the Dispatching Entity would not be subject to enterprise income tax in China.

Furthermore, Announcement 19 requires the tax authorities to promote the foreign exchange remittance procedures after ascertaining tax liabilities of the Dispatching Entity. The reiterates that if the application form and other materials for foreign exchange remittance purposes submitted by domestic institutions are complete and appropriate, the tax authorities shall issue the tax certificates on the spot. Tax authorities shall not delay or hinder the normal foreign exchange remittance of enterprises on the ground of difficulties in determining the tax liability. We hope that this provision can be effectively implemented in practice, as it may reduce the time required for foreign exchange remittance.

Enterprises that implement secondment arrangements should review the relevant contracts or agreements, personnel management regulations and the individual income tax treatment of seconded personnel in light of Announcement 19. In order to avoid the judgement of constituting a place/establishment of business or permanent establishment in China, enterprises should be ensure that:

- The seconded personnel enter into employment contract with the Recipient Entity;
- The employment contract, personnel management regulations and other relevant documents (such as a joint venture contract) specify that the Recipient Entity is responsible for determining the qualifications, quantity and place of work for the seconded personnel, assuming responsibilities and risks of the seconded personnel's work, and be responsible for the performance appraisal of the seconded personnel;
- The Recipient Entity reimburse the Dispatching Entity at cost for the salaries and wages, social insurance premiums and other employment related payment made to the seconded personnel;
- The salaries and wages of the seconded personnel are taxed to the individual income tax in full (i.e., for the seconded expatriate employees, their individual income tax should not be reduced based on the days of their actual presence in China).

2. Introduction of New RQFII Implementing Regulations (Authors: James WANG, Sheldon CHEN)

On March 6, 2013, the China Securities Regulatory Commission released the *Measures for the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New RQFII Rules**"). Thereafter, the State Administration of Foreign Exchange ("**SAFE**") and the People's Bank of China **(**the "**PBOC**") respectively promulgated their own implementing rules (i.e., *the Circular of the State Administration of Foreign Exchange on Issues Concerning the Pilot Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New SAFE Circular**") and *the Circular of the People's Bank of China on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors* (the "**New PBOC Circular**", together with the New SAFE Circular, the "**New Implementing Regulations**"), which specify and clarify relevant issues of the New RQFII Rules.

At the end of 2011, following the promulgation of *the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the "**RQFII Pilot Measures**"), SAFE and the PBOC released *the Circular of the State Administration of Foreign Exchange on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund*

Management Companies and Securities Companies (the "**Old SAFE Circular**") and *the Circular of the People's Bank of China on the Relevant Issues Regarding the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the " **Old PBOC Circular**"), respectively.[3] The following contains an introduction to the New Implementing Rules with a focus on the comparison to the Old SAFE Circular and the Old PBOC Circular.[4]

Introduction of New SAFE Circular

The New SAFE Circular specifies the supervision over investment quotas, application procedures, the inward and outward remittance of capital and the verification mechanism, which are in most parts consistent with the Old SAFE Circular. For example, the rules regarding application materials for investment quotas, the restrictions on the transfer, re-sale and effective use of investment quotas, permitted types of remittance of capital and exchange as well as the receipt and payment of capital under the New SAFE Circular are consistent with the Old SAFE Circular. However, there are certain differences between the New SAFE Circular and the Old SAFE Circular.

(a) Combination of Balance Administration and Administration by Amount Incurred

Pursuant to the Old SAFE Circular, SAFE conducts balance administration for investment quotas of all kinds of RQFII products, while the New SAFE Circular conducts a different type of administration for open-ended and non open-ended funds. Under the New SAFE Circular, open-ended funds shall be administered under balance administration and the cumulative net inward remittance of RMB capital by an open-ended fund shall not exceed its approved investment quota. In addition, products and funds other than open-ended funds shall be administrated by the amount incurred, and the cumulative inward remittance of funds shall not exceed the investment quota approved by SAFE.

Furthermore, products and funds other than open-ended funds shall have their investment principal remitted within six (6) months from the date of each investment quota's approval, and without approval no inward remittance beyond the time limit can be made. The lock-up period for the investment principal shall be one (1) year.

(b) Differences in Inward and Outward Remittance Procedures

According to the Old SAFE Circular, for open-ended funds, the custodian may complete on its behalf the corresponding formalities for the inward remittance of RMB funds on a daily basis upon the occurrence of net subscriptions in view of the net offset balance of daily subscription or redemption, and complete on its behalf the corresponding formalities for the outward remittance of RMB or

[3] Introduction of Newly-Issued Rules on the Pilot Program of Domestic Securities Investment by RMB Qualified Foreign Institutional Investors (http://www.hankunlaw.com/backuser/picinfo/20122317218.pdf)

[4] For the avoidance of doubt, the RQFII Pilot Measures, the Old SAFE Circular and the Old PBOC Circular have been superseded by the New RQFII Rules, the New SAFE Circular and the New PBOC Circular.

purchased foreign exchange funds on a daily basis upon the occurrence of net redemptions. The New SAFE Circular has loosened the inward and outward remittance procedures for open-ended funds. The custodian may complete on its behalf the corresponding procedures of capital remittance in or out or of purchasing foreign exchange and remitting abroad based on subscription or redemption, which gives the custodian more discretion. Moreover, it is worth noting an important advantage of the RQFII regime over the QFII one, i.e., pursuant to the relevant QFII rules, RMB capital of open-ended QFII funds may be remitted inward and outward by the custodian only on a weekly basis as opposed to a daily basis for open-ended RQFII funds.

Furthermore, the New SAFE Circular provides that for funds and products other than open-ended funds, the custodians shall distinguish between the principal and income in the capital remittance. Outward remittance that constitutes return of principal may not be remitted inward again and the investment quota shall be decreased accordingly. In addition, in the case of outward remittance of investment income, audit reports and relevant tax certificates issued by domestic accounting firms are required to be submitted to the custodian.

(c) Clarification on Penalties for Violations

Pursuant to the Old SAFE Circular, if the RQFII and its custodian violate any of the requirements of the Circular, SAFE shall take appropriate regulatory measures and impose administrative penalties thereon according to relevant laws and regulations. The New SAFE Circular further clarifies the penalties for different types of violation:

(i) RQFIIs that obtain investment quotas through the transfer or re-sale to make investments shall be ordered to take appropriate remedial actions by the relevant foreign exchange administrative authorities and be subject to a fine of up to 30% of the relevant amount involved in the violation. Where the circumstances of the case are aggravated, a fine of between 30% and 100% of the illegal amount involved shall be imposed on the RQFII concerned. In addition, depending on the gravity of the case, SAFE may revoke the investment quota of the transferring or re-selling RQFII;

(ii) RQFIIs that fail to go through relevant filing formalities for account opening shall be ordered to take appropriate remedial actions by the relevant foreign exchange administrative authorities and be subject to a fine of up to RMB300,000;

(iii) Where a custodian fails to verify the authenticity and compliance of the remittance and exchange as well as the receipt and payment of the capital of the RQFII, the relevant foreign exchange administrative authorities shall order it to take appropriate remedial actions within a specified period of time, confiscate any illegal income, and impose a fine of between RMB200,000 and RMB1,000,000. Where the circumstances of the case are aggravated or no remedial action has been taken within the specified period of time, the foreign exchange administrative authorities shall order the custodian to cease its operation of relevant business.

Introduction of New PBOC Circular

Compared with the Old PBOC Circular, no material modifications have been made under the New PBOC Circular except for the following:

(a) Adjustment for Three Categories of Special Deposit Accounts

According to the Old PBOC Circular, RQFIIs may open three categories of special deposit accounts used for capital settlement in inter-bank bond market transactions, exchange bond market transactions, and stock market transactions, respectively. The New PBOC Circular instead provides for the three categories of special deposit accounts opened by RQFIIs to be used for exchange market transactions, inter-bank bond market transactions, and stock index futures margins, respectively. The special deposit accounts used for stock index futures margins shall be opened with a futures margin deposit bank.

(b) Adjustment for Income and Expenditure Scope of Special Deposit Accounts

In addition to the scope of special deposit accounts as provided by the Old PBOC Circular, the scope of income under the New PBOC Circular also includes funds remitted from other special deposit accounts. The scope of expenditure under the New PBOC Circular also includes funds remitted to other special deposit accounts.

(c) Strengthening of Capital Transfer among Different Accounts

In addition to the prohibition of capital transfers between special deposit accounts and basic deposit accounts as well as the prohibition of drawing from special deposit accounts, the New PBOC Circular also prohibits capital transfers between special deposit accounts and other accounts and capital transfers among different open-ended fund accounts.

(d) Removal of Restrictions on Investment Proportion

The New PBOC Circular has removed the restrictions on the proportion of investments in equity and fixed income securities previously imposed by the Old PBOC Circular.

(e) Extension of Time Limit for Reporting

According to the Old PBOC Circular, the custody and settlement agency bank shall, within one (1) working day upon occurrence of business, submit the following to the RMB cross-border receipt and payment information management system: information regarding the opening and cancelling of the RMB bank settlement account, information regarding the approved investment quota, capital raised and cross-border transfer of capital by the pilot institution and general information regarding asset allocation of security investment within the territory of China by the pilot institution. The New PBOC Circular extends the time for such reporting to five (5) working days after the occurrence of the relevant event.

In conclusion, the New RQFII Implementing Rules, which were released following a relatively long period of time of implementation of the RQFII pilot program, are more sensitive to the market, and the supervision hereunder is more effective. It can be expected that the New RQFII Implementing Rules will play an important role in the RQFII's further development.

3. New SAFE Rules Further Simplify FDI Foreign Exchange Administration (Authors: Leia ZHANG, Irene CAI, Jiaxin LIU, Xinfeng ZHANG)

On May 10, 2013, the State Administration of Foreign Exchange (together with its branches, "**SAFE**") released the *Foreign Exchange Administrative Rules on Foreign Direct Investment by Foreign Investors* (the "**Administrative Rules**"), the *List of Abolished Laws and Regulations of Foreign Exchange Administration on Foreign Direct Investment* (the "**List of Abolished Laws and Regulations**") and the *Operational Guidelines for Foreign Direct Investment Businesses* (the "**Operational Guidelines**"). Based on the *Circular on the Further Improvement and Amendment of Foreign Exchange Administrative Policies on Direct Investment (Hui Fa [2012] No.59*, "**Circular 59**"*)* which adjusted the foreign exchange administrative policies on foreign direct investment by foreign investors[5] ("**FDI**"), the Administrative Rules further simplify and integrate the operational steps and regulations on FDI foreign exchange administration, including foreign exchange registration, account opening and use, receipt and payment of funds, and settlement and sales of foreign exchange, etc. The rules and regulations under the List of Abolished Laws and Regulations were repealed on May 10, 2013, and the Administrative Rules and the Operational Guidelines took effect on May 13, 2013.

Compared with the previous FDI foreign exchange administration system, the following points of the Administrative Rules, List of Abolished Laws and Regulations and Operational Guidelines are worthy of attention.

Further Clarify the Foreign Exchange Registration Matters

The Administrative Rules establish that the principal administrative model for FDI is foreign exchange registration. The Administrative Rules clarify the matters under FDI that need to be registered with SAFE, which include the following:

- Remittance of up-front fees and related funds by foreign investors;
- Newly-established foreign-invested enterprises;
- Capital contribution by foreign investors to foreign-invested enterprises, or payment of the

[5] FDI shall refer to foreign investors setting up foreign-invested enterprises or projects through a new establishment or acquisition, and obtaining ownership, control, management rights and other rights and interests.

purchase price by foreign investors for the acquisition of the shares of domestic companies;

- Capital increase, capital decrease, transfer of shares, other capital changes, and deregistration of foreign-invested enterprises;
- Transfer of shares, domestic reinvestment and related businesses involved in domestic direct investment by domestic and foreign institutions and individuals.

In order to implement the abovementioned registration matters, the Operational Guidelines stipulate in detail the operating requirements for nine types of businesses, which include the following: "registration of the basic information of up-front fees", "registration of the basic information of newly-established foreign-invested enterprises", "registration of the basic information of foreign-invested enterprises established through the acquisition of a domestic company by foreign investors", "changing registered matters or deregistration of foreign-invested enterprises", etc.

Further Clarify Foreign Exchange Matters Conducted by Banks

In 2012, Circular 59 repealed the approval for foreign exchange account opening, account entry, purchase and payment of foreign exchange under FDI, and the prior filing procedures for the special settlement of foreign exchange capital funds of foreign-invested enterprises. Currently, the Administrative Rules reemphasize that banks will be responsible for the opening of up-front fees account, capital accounts and assets realization accounts and other FDI accounts, as well as the settlement of capital funds of foreign-invested enterprises.

In addition, where foreign-invested enterprises need to remit money abroad due to capital decrease, liquidation, withdrawal of investment, distribution of profits, etc., they may purchase foreign exchange and make outbound payments in banks after completing the relevant registration with SAFE. Where outbound remittance is needed due to the acquisition of the shares of foreign investors, the domestic transferee may purchase foreign exchange and make outbound payments in banks after the foreign-invested enterprise has completed the relevant registration with SAFE.

Further Simplify the Administrative Procedures for FDI Foreign Exchange Formalities

The Operational Guidelines stipulate the requirements for nine foreign exchange registration matters, including "registration of the basic information of up-front fees", as well as the requirements for fourteen businesses conducted by banks directly, which include the "opening of up-front fees account, account entry and use". The Operational Guidelines further integrate and simplify the procedural rules for FDI foreign exchange businesses under Appendix I of Circular 59, the Operation Rules for Direct Investment Foreign Exchange Business under Capital Account (SAFE Version), and Appendix II of Circular 59, the Instructions on Direct Investment Foreign Exchange Business under Capital Account (Bank Version).

Strengthen Statistical Supervision on Fund Flows under FDI

Pursuant to the Administrative Rules, banks shall conduct relevant businesses according to the registered information of SAFE, open accounts for entities, and submit information of account opening, account change, receipt and payment of funds, and settlement and sales of foreign exchange to SAFE in accordance with the relevant rules and regulations. SAFE shall conduct statistical supervision on cross-border fund payments, settlements and sales of foreign exchange, changes in rights and interests of foreign investors under FDI through registration, bank reports, annual inspections on foreign-invested enterprises, sample surveys, etc. in accordance with the relevant rules and regulations.

Repeal Several Normative Documents Related to FDI Foreign Exchange Administration

The List of Abolished Laws and Regulations repeals 24 normative documents of FDI foreign exchange administration, including the *Circular of the State Administration of Foreign Exchange on Distributing the Interim Measures for Foreign Exchange Registration of Foreign invested enterprises ([96] Hui Zi Han Zi No. 187),* the *Circular of the State Administration of Foreign Exchange on Reforming the Administrative Mode of the Foreign Exchange Settlement of Capital Funds of Foreign-invested Enterprises (Hui Fa [2002] No.59)*, the *Circular of the State Administration of Foreign Exchange on Issues Concerning Improving the Foreign Exchange Annual Inspection of Foreign-invested Enterprises (Hui Fa [2004] No.7)*, the *Circular of the State Administration of Foreign Exchange on Printing and Distributing on the Operating Rules for Foreign Exchange Administration with Respect to the Financing and Round-tripping Investment of Domestic Residents via Overseas Special Purpose Companies (Hui Fa [2011] No.19*, "**Circular 19**"*)*.

It is worth noting that Circular 19 was the main operational guideline for the foreign exchange registration (including without limitation to the foreign exchange registration of overseas special purpose companies of domestic residents) under the *Circular of the State Administration of Foreign Exchange on Issues Concerning the Regulation of Foreign Exchange in Equity Finance and Return Investments by Domestic Residents through Offshore Special Purpose Vehicles (Hui Fa [2005] No. 75,* "**Circular 75**"*)*. Since Circular 75 is still in effect, we understand that the nullification of Circular 19 would not influence foreign exchange registration under Circular 75. After Circular 19's repeal, the foreign exchange registration under Circular 75 is currently being conducted in accordance with the guidelines under Items 2.10, 2.11, 2.13 and 2.14 in Appendix 1 of Circular 59 "Operation Rules for Direct Investment Foreign Exchange Business under Capital Account (SAFE version)". These items include the following: "Foreign Exchange Registration for Overseas Special Purpose Companies of Domestic Residents", "Foreign Exchange Amendment Registration of Overseas Special Purpose Companies of Domestic Residents", "Foreign Exchange Deregistration of Overseas Special Purpose Companies of Domestic Residents" and "Foreign Exchange Supplementary Registration for Overseas Special Purpose Companies of Domestic Residents Overseas" respectively.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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