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# Newsletter

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## **The MOFCOM Issued Interim Measures on Investigating and Punishing Failure to Notify Concentrations between Business Operators in accordance with Law (Authors: Tracy ZHOU, Shen LIN)**

In November 2009, the PRC Ministry of Commerce (the “**MOFCOM**”) Anti-Monopoly Bureau (the “**Anti-Monopoly Bureau**”) released the “*Draft Interim Measures on Investigating and Punishing Failure to Notify Concentrations between Business Operators in accordance with Law*” (the “**Draft Interim Measures**”), and solicited for comments. This indicated that the Chinese government started to switch its role in anti-monopoly investigation of business concentrations from passive review to active investigation. After about two years of comments collections and amendments, on December 30, 2011, the MOFCOM promulgated the “*Interim Measures on Investigating and Punishing Failure to Notify Concentrations between Business Operators in accordance with Law*” (the “**Interim Measures**”), which came into force on February 1, 2012. Compared with the Draft Interim Measures, the Interim Measures provide more detailed and definite rules on entities subject to investigation, initiation of investigation, investigation authorities, investigation procedures and investigation results, etc. Therefore, this article will mainly elaborate in these aspects.

### **Entities subject to Investigation**

Article 2 of the Interim Measures provides that the Interim Measures apply to concentrations between business operators that reach the declaration thresholds<sup>1</sup> set forth in the *Provisions of the State Council on the Thresholds for Notification of Concentrations between Business Operators*, but are not notified to the MOFCOM. In addition, Article 5 of the Interim Measures provides further that entities subject to investigation refer to the business operators who have obligations to notify the concentrations as set forth in the *Measures on Notification of Concentration between Business Operators*<sup>2</sup>.

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<sup>1</sup> Article 3 of the *Provisions of the State Council on the Thresholds for Notification of Concentrations between Business Operators* provides that where a concentration of undertakings reaches any of the following thresholds, the undertaking(s) concerned shall file a prior notification with the MOFCOM, and no such concentration may be implemented without the clearance of the prior notification:

- (1) the aggregate worldwide turnover of all the business operators concerned in the preceding financial year is more than RMB 10 billion, and the nationwide turnover within China of each of at least two of the business operators concerned in the preceding financial year is more than RMB 400 million; or
- (2) the aggregate nationwide turnover within China of all the business operators concerned in the preceding financial year is more than RMB 2 billion, and the nationwide turnover within China of each of at least two of the business operators concerned in the preceding financial year is more than RMB 400 million.

The *Measures for Calculating the Turnover for the Notification of Concentrations of Business Operators in the Financial Industry* shall be applied to calculation of the turnover of banks, financial organizations, securities companies, futures companies, fund management companies and insurance companies.

<sup>2</sup> Article 9 of the *Measures for on Notification of Declaration for Concentration of Business Operators* provides that any concentration realized by means of combination may be declared by any undertaking participating in the acquisition; and any undertaking concentration realized by other means shall be declared by the undertaking that has the right to control or impose decisive influence on the acquired one and other undertaking(s) shall give assistance.

## **Initiation of Investigation**

According to the *Anti-Monopoly Law* and the Interim Measures, the MOFCOM may initiate investigations by itself or after receiving reports from any entity or individual. In case of any written report which include the basic information regarding the reporter(s) and the person(s) being reported against, relevant facts and evidences regarding the alleged concentration, the MOFCOM shall conduct necessary verification. As for the facts and evidences obtained from other sources, the MOFCOM may conduct necessary verification at its discretion.

## **Investigation Authorities**

Article 3 of the Interim Measures specifies that the MOFCOM is in charge of investigating and punishing violations of anti-monopoly notification obligations. Due to the frequency and geographic wideness of business concentrations, the Interim Measures also authorize the MOFCOM to entrust provincial administrations of commerce to assist in investigating violations within their respective jurisdictions.

## **Investigation Procedures**

The Interim Measures provide the following procedures for investigating suspected violations:

- 1) Case filing: if there are preliminary facts and evidences indicating possible failure to notify concentrations of business operators, the MOFCOM shall file the case and notify the business operators being investigated in writing;
- 2) Submission of documents: The business operators shall, within 30 days following receipt of the case filing notice, submit to the MOFCOM all documents and materials regarding whether the transaction under investigation constitutes a concentration of business, whether the concentration reaches the notification thresholds, whether the transaction has been undertaken without prior notification etc..
- 3) Preliminary investigation: The MOFCOM shall, within 60 days following receipt of the documents and materials submitted by the business operators, complete its preliminary investigation on whether the transaction under investigation constitutes a concentration of business operators that shall be notified but is not notified. If the preliminary investigation finds there is violation of anti-monopoly notification obligations, the MOFCOM shall conduct a further investigation and notify the business operators in writing; otherwise, the MOFCOM shall render a decision of no further investigation and notify the business operators under investigation in writing;
- 4) Further investigation: when the MOFCOM decides to conduct further investigation, the business operators under investigation shall suspend the concentration, and shall submit to the MOFCOM all relevant documents and materials in accordance with the notification requirements set forth in the *Measures on Notification of Concentration of Business Operators*

within 30 days upon receipt of the further investigation notice. Within 180 days upon receipt of the above documents and materials, the MOFCOM shall complete the evaluation about whether the transaction under investigation has or may have effect of excluding or restraining competitions.

In order to implement relevant investigations, the *Interim Measures* also specify that if any business operator under investigation refuses to provide relevant materials or information, or provides false information, or conceals, destroys or transfers evidence, or otherwise refuses or obstructs the investigation, the MOFCOM may sanction such business operator under Article 52 of the *Anti-Monopoly Law*<sup>3</sup>.

### **Investigation Results**

Article 13 of the *Interim Measures* provides that if it is established the business operators under investigation undertook the concentration of business without prior notification, the MOFCOM may impose a fine of no more than RMB500,000, and may order these business operators to (i) stop the concentration; (ii) dispose shares or assets by a specific deadline; (iii) transfer the business by a specific deadline and (iv) take other necessary measures, in order to resume to the pre-concentration status. In addition, the *Interim Measures* also provide that the MOFCOM shall take account of considerations such as the nature, severity and duration of the failure to make declaration, and the result of the evaluation of its anti-competitive effect of in the further investigation.

According to information released by the MOFCOM, from the implementation of the *Anti-Monopoly law* on August 1, 2008 to the end of 2011, the MOFCOM had reached the verdict of 382 cases of business concentrations, among which only one case was blocked and ten were conditionally approved, and the remaining cases were approved unconditionally. Although the *Anti-Monopoly Law* imposes legal liabilities on violations of notification obligations, the MOFCOM has noted that some business operators may have failed to notify their concentrations in accordance with the law. The promulgation of the *Interim Measures* indicates that in the future the MOFCOM will pay more attention on investigating and punishing violations of notification obligations. Mr. Shang Ming, the Minister of the MOFCOM, emphasized for many times that it is mandatory to notify business concentrations, and failure to notify the business concentrations that reach the declaration threshold is a violation of law. After the implementation of the *Interim Measures*, notification of business concentrations shall be considered in every merger and acquisition project.

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<sup>3</sup> Article 52 of the *Anti-Monopoly Law* provides Where, during the review and investigation conducted by the authority for enforcement of the Anti-monopoly Law, a unit or individual refuses to provide relevant materials or information, or provides false materials or information, or conceals, or destroys, or transfers evidence, or refuses to submit to or obstructs investigation in any other manner, the authority for enforcement of the Anti-monopoly Law shall instruct it/him to rectify, and a fine of not more than 20,000 shall be imposed on the individual and not more than 200,000 on the unit; if the circumstances are serious, a fine of not less than 20,000 but not more than 100,000 shall be imposed on the individual and not less than 200,000 but not more than one million on the unit; and if a crime is constituted, criminal liability shall be investigated for in accordance with law.

## Legal Updates

### 1. Introduction of Newly-Issued RQFII Rules (Authors: James WANG, Kelvin GAO, Sheldon CHEN)

On December 16, 2011, China Securities Regulatory Commission (“**CSRC**”), the People’s Bank of China (the “**PBOC**”) and State Administration of Foreign Exchange (“**SAFE**”) jointly released the *Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the “**Pilot Measures**”), a move showing that after deliberation for more than two years, RQFII, another measure to accelerate the backflow of offshore RMB funds as well as to push forward the internationalization of RMB, has been formally launched, in which case offshore RMB funds are generally permitted to invest in domestic securities market. Thereafter, CSRC, the PBOC and SAFE respectively promulgated its own implementing rules (i.e., the *Implementing Rules for the Pilot Measures on Domestic Securities Investment by RMB Qualified Foreign Institutional Investors for Fund Management Companies and Securities Companies* (the “**CSRC Implementing Rules**”), *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 “**SAFE Circular**”) and *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 “**PBOC Circular**”, together with the CSRC Implementing Rules and the SAFE Circular, collectively, the “**Supporting Regulations**”), which specified the relevant issues of the Pilot Measures.

The promulgation and implementation of the Pilot Measures and its Supporting Regulations have provided detailed guidelines for launch of the pilot program of domestic securities investment by RQFII (the “**RQFII Pilot Program**”), which will play a significant role in the acceleration of the backflow of offshore RMB funds, the internationalization of RMB as well as the development of domestic capital market. We set out below the general introduction and analysis of the Pilot Measures and the Supporting Regulations.

#### **Applicant and Qualifications Applicable to RQFII Pilot Program**

Pursuant to the Pilot Measures, so far only the Hong Kong subsidiaries of domestic fund management companies and securities companies are allowed to apply for RQFII (the “**HK Subsidiary**”).

The Pilot Measures also specifies the following qualifications of RQFII for a HK Subsidiary to invest in domestic securities market with RMB funds raised in Hong Kong shall satisfy the following conditions: (i) it has obtained the asset management business license (i.e., Type 9 License) issued

by the Hong Kong securities governmental authority and has already operated the asset management business with stable and healthy financial conditions and good credit; (ii) it has effective corporate governance and internal control and its staff meet such qualification requirements as required in Hong Kong; (iii) both of such Hong Kong Subsidiary and its domestic parent company have been legally operating their business and neither of them is subject to any serious penalties imposed by the local competent governmental authorities in the past 3 years; (iv) its domestic parent company has obtained the license for securities asset management business; and (v) any other conditions required by CSRC based on principle of prudence.

### **Governmental Authorities in Charge of RQFII Pilot Program and Their Respective Responsibilities**

Pursuant to the Pilot Measures and its Supporting Regulations, CSRC, the PBOC and SAFE are the main governmental authorities in charge of the RQFII Pilot Program, among which, CSRC shall be mainly responsible for the supervision and administration of domestic securities investment by Hong Kong Subsidiaries, while the PBOC for the administration of opening domestic RMB bank accounts by Hong Kong Subsidiaries and SAFE for investment quota administration on Hong Kong Subsidiaries. In addition, the PBOC, together with SAFE, will also monitor and administer capital inflow and outflow.

### **Approval Procedures for RQFII**

According to the Pilot Measures, a Hong Kong Subsidiary shall (i) apply with CSRC for the qualification of RQFII Pilot Program; and (ii) apply with SAFE for its investment quota.

#### **1) Approval for RQFII Qualification**

In order to apply for the RQFII qualification, a Hong Kong Subsidiary should submit such application documents to CSRC as set forth in Article 7 of the Pilot Measures. Within 60 days upon receipt of the completed application documents, CSRC will then decide whether or not to grant the RQFII qualification. If granted, CSRC should issue the approval letter in writing as well as the operating permit for securities investment (the “**Operating Permit**”).

#### **2) Approval for Investment Quota**

The Hong Kong Subsidiary obtaining the RQFII qualification (the “**RQFII Pilot Institution**”) will need to submit the application documents to SAFE as set forth in Article 8 of the Pilot Measures to apply for its investment quota. Within 60 days upon receipt of the completed application documents, SAFE will then decide whether or not to grant the investment quota. If approved, SAFE should issue the approval letter in writing as well as the registration permit. It is reported that the total amount of investment quota for RQFII Pilot Program will be RMB20 billion at the early stage.

## **Domestic Investment by RQFII Pilot Institutions**

The Pilot Measures and its Supporting Regulations have provided the following specific rules to govern the investment activities in domestic securities market by RQFII Pilot Institutions:

### **1) Type of Securities Allowed for Investment**

It is provided under the CSRC Implementing Provisions that an RQFII Pilot Institution is allowed to invest, within its approved investment quota, in stocks, bonds, warrants, securities investment funds listed or traded in stock exchanges and such other securities as permitted by CSRC and the PBOC.

### **2) Investment Portfolio Requirement**

Pursuant to the CSRC Implementing Rules and the PBOC Circular, an RQFII Pilot Institution will need to meet the following requirements on its investment portfolio: within its approved investment quota, the funds for investment in stock or stock securities investment funds should be no more than 20% of the total amount of the funds raised, while the funds for investment in fixed-income securities (including various kinds of bonds and fixed-income securities investment funds) should be no less than 80% of the total amount of funds raised. CSRC and the PBOC may have the right to adjust such investment portfolio requirement based on principle of prudence.

### **3) Information Disclosure**

According to the Pilot Measures and CSRC Implementing Rules, when conducting investment in domestic securities market, an RQFII Pilot Institution should be in compliance with the general rules under applicable PRC laws and regulations with respect to shareholding ratio and information disclosure as well as other regulatory requirements (e.g., in the event that the domestic securities investment by an RQFII Pilot Institution triggers the information disclosure requirements, as the obligor of information disclosure, it should submit the contents of information disclosure to stock exchange).

In addition to the above-mentioned compliance requirement on information disclosure, an RQFII Pilot Institution shall report to CSRC, the PBOC and SAFE in the event of any change of its onshore custodian and chair person, shareholding restructuring, increase or decrease of its registered capital, merger or consolidation with any other institution, involvement in any material litigations and any other major event, being subject to any serious penalty overseas and any other circumstance specified by CSRC, the PBOC and SAFE.

It is noteworthy that each of CSRC, the PBOC and SAFE may require an RQFII Pilot Institution, its onshore custodian, securities companies and other institutions to provide the relevant materials with respect to such RQFII Pilot Institution, and conduct necessary inquiry and examination.

#### 4) Entrustment of Securities Companies

Pursuant to the Pilot Measures and the CSRC Implementing Rules, an RQFII Pilot Institution is required to entrust domestic securities companies for securities trading. Each RQFII Pilot Institution may entrust no more than 3 domestic securities companies in Shanghai Stock Exchange and Shenzhen Stock Exchange respectively for securities trading. Additionally, an RQFII Pilot Institution may also entrust domestic fund management companies and securities companies to manage its domestic securities investment.

### **Asset Custody**

#### 1) Custodian

It is required under the Pilot Measures that an RQFII Pilot Institution should entrust a domestic commercial bank with the custodian qualification for qualified foreign institutional investors (the “**Custodian**”) to deal with the asset custody. The main duties of the Custodian include: (i) to maintain all assets entrusted by RQFII Pilot Institutions; (ii) to supervise the operation of RQFII Pilot Institutions in domestic securities investment; (iii) to deal with capital inflow and outflow for RQFII Pilot Institutions; (iv) to make statistics declaration of the payment balance in accordance with relevant provisions; (v) to submit relevant business reports and statements to CSRC, the PBOC and SAFE; and (vi) to perform other duties specified by CSRC, the PBOC and SAFE based on principle of prudence.

#### 2) Opening Bank Accounts

Pursuant to the PBOC Circular, an RQFII Pilot Institution will need to select a domestic commercial bank (the “**Custody and Settlement Bank**”) with custodian qualification for both qualified foreign institutional investors and settlement agent qualification for inter-bank bond market concurrently to open a foreign institution RMB basic deposit account (the “**Basic Deposit Account**”) and a foreign institution RMB special deposit account (the “**Special Deposit Account**”). Unless otherwise provided by the PBOC, a RQFII Pilot Institution is not allowed to open ordinary deposit accounts or non-temporary deposit accounts.

With respect to the Special Deposit Account, an RQFII Pilot Institution can open three types of Special Deposit Accounts in a Custody and Settlement Bank for the purpose of stock trading, inter-bank bond trading, stock exchange bond trading, respectively. Transfer of funds is allowed among such three types of Special Deposit Accounts. However, fund transfer is forbidden between any Special Deposit Account and the Basic Deposit Account, and no cash can be drawn from any Special Deposit Account.

The scope of incomes under the Special Deposit Accounts of an RQFII Pilot Institution generally cover investment principal remitted from outside of China by an RQFII Pilot Institution, capital gain



by selling securities, cash dividend, interest income and other income provided by the PBOC, the scope of payment under the Special Deposit Accounts of an RQFII Pilot Institution generally cover funds used to buy securities, principal and capital gain and other payments provided by the PBOC.

Besides, it is also provided under the PBOC Circular that if an RQFII Pilot Institution sets up open-ended securities investment funds, each such open-ended securities fund should open a separate Special Deposit Account.

### **Administration of Foreign Exchange**

According to the SAFE Circular, SAFE adopts balance administration for RQFII's investment quota. The aggregate amount of RMB funds remitted into China by an RQFII Pilot Institution should be capped at its approved investment quota, and such quota should not be transferred to any other institution or individual.

In addition, it is specified in the SAFE Circular that an RQFII Pilot Institution should entrust its Custodian to proceed with the capital inbound and outbound remittance as well as purchase of foreign exchange. Meanwhile, the Custodian should review the authenticity and compliance on the corresponding capital remittance as well as collection and payment of funds, and submit relevant statements to SAFE in accordance with the requirements under the SAFE Circular.

### **Other Noteworthy Issues**

Pursuant to the Pilot Measures and its Supporting Regulations, an RQFII Pilot Institution failing to submit the investment quota application to SAFE within 1 year after obtaining the Operating Permit should return the Operating Permit to CSRC. Further, if an RQFII Pilot Institution fails to effectively use its investment quota within 1 year upon approval of the investment quota, SAFE is entitled to adjust or reduce the investment quota or even revoke the quota based on the then-applicable circumstances.

### **Conclusion**

The promulgation and implementation of the Pilot Measures and its Supporting Regulations will make domestic capital market more open, stimulates the development of international business by domestic securities institution, optimizes the backflow mechanism of RMB funds, and further push forward the internationalization of RMB. However, for the purpose of protecting the domestic capital market from the adverse impact to be caused by the huge inflow of overseas hot money and other factors, the governmental authorities took a prudent attitude towards RQFII's scale, investment scope and portfolio. The total amount of initial investment quota for RQFII Pilot (i.e., RMB20 billion) equals to approximately 3.2% of the RMB deposits in Hong Kong which is RMB 627.3 billion as stated by Hong Kong Monetary Authority as of November 2011. Furthermore,

compared with the A-Share market with a total market value of RMB25 trillion and an average daily turnover of RMB174.4 billion in 2011, the funds permitted to invest in stock market (i.e., no more than RMB4 billion) based on portfolio requirement (i.e., 20% of the total investment quota) is negligible. Comparatively, the current total investment quota for qualified foreign institutional investors (“QFII”) is USD21.6 billion (or RMB136 billion), among which approximately 40% has been invested in stock market. It can be foreseen that there is a huge room for RQFII’s future development.

According to the information recently released by CSRC, RQFII Pilot Program develops smoothly as of the date hereof. 9 fund management companies and 12 securities companies have been granted the RQFII qualification as well as the investment quota. In addition, the relevant governmental authorities are considering further expanding the scale of RQFII Pilot Program, trying to achieve breakthroughs in the areas of institution forms, investment scope and investment portfolio. Meanwhile, CSRC is actively researching the feasibility of RQFII Pilot Institutions to issue RMB-denominated A-Share ETF products as well as the issuance of RMB-denominated bonds and stocks by H-Share companies. We will continue to keep an eye on the latest development of RQFII Pilot Program and other RMB cross-border investment and will give you an update in a timely way.

## **2. Brief of the Amended Catalogue of Industries for Guiding Foreign Investment (Authors: Gloria XU, Bing XUE and Lan LI)**

Upon approval of the State Council, on December 24, 2011, the PRC National Development and Reform Commission (“NDRC”) and the PRC Ministry of Commerce (“MOFCOM”) jointly published the amended *Catalogue of Industries for Guiding Foreign Investment* (the “2011 Catalogue”), which became effective on January 30, 2012 and superseded its previous version released in 2007 (the “2007 Catalogue”). Compared with the 2007 Catalogue, the 2011 Catalogue has the following key amendments:

### **Major Changes on Industry Policies**

#### **1) Further loosen the restrictions on foreign investment**

The 2011 Catalogue has 473 items, including 354 encouraged items, 80 restricted items and 39 prohibited items. Compared with the 2007 Catalogue, in the Catalogue 2011, 3 items have been added to the encouraged category, 7 items have been removed from the restricted category, and 1 item has been removed from the prohibited category. Meanwhile, the 2011 Catalogue has removed the equity ratio limit to foreign investment in certain industries.

#### **2) Promote the transformation and upgrade of manufacturing industry**

The 2011 Catalogue encourages foreign investments in high-end manufacturing industry and calls

for foreign investors using new technology, new process, new material and new equipment to facilitate the transformation and upgrade of the traditional manufacturing industry.

### 3) Cultivate strategic emerging industries

The 2011 Catalogue encourages foreign investments in strategic emerging industries, such as energy conservation and environmental friendly industry, new generation of information technology, biology and high-end equipment manufacturing, new energy resources, new material and new energy vehicles, etc.

### 4) Encourage the development of services industries

Nine items in the services industries are added to the encouraged category in the 2011 Catalogue, including vehicle charging stations, venture capital investment, intellectual property services, marine oil pollution cleaning services, occupational skills training, etc.

## **Amendments in Specific Industry Sectors**

### 1) Vehicle manufacturing

To ensure the sound development of vehicle industry, the 2011 Catalogue has downgraded the vehicle manufacturing from encouraged category to permitted category. For the purpose of cultivating strategic emerging industries, the 2011 Catalogue encourages the manufacturing of key parts and components of vehicle and research and development of key technology in such sector as well as the manufacturing of key parts and components of new energy vehicles. As to manufacturing business of energy vehicle power battery, the 50% shareholding restriction on foreign investment shall be noted.

### 2) Real estate

To further regulate the high-class real estate industry, the development and operation of villa projects are prohibited under the 2011 Catalogue.

### 3) Wholesale and retail

- The sales of vehicle and medicine are removed from the restricted category and fall under the permitted category. Among others, the sale of vehicle is no longer subject to the restriction that “a chain store company having more than 30 stores and selling products of different varieties and brands from multiple suppliers should be controlled by domestic PRC shareholders”; even though the restriction of controlling shareholders on sale of medicine has been removed from the 2011 Catalogue, the currently effective Measures for the Administration on Foreign Investment in Commercial Fields still imposes the 30-stores restriction on chain store companies selling medicines. Thus further regulations are expected to be released by competent authorities to clarify whether drugstore companies are still subject to the above restriction in practice;

- Franchise, entrustment operation, business management and commodity auction have been re-categorized from restricted category to permitted category;
- Construction and operation of large-scale agricultural products wholesale market has been downgraded from permitted category to restricted category;
- Direct sales, mail orders and online sales are retained in restricted category.

#### 4) Services industries

- Venture capital investment, intellectual property services, logistics information consulting services and home services are classified into encouraged category for the first time;
- Financial lease companies are upgraded from restricted category to permitted category.

#### 5) Medical institutions

The 2011 Catalogue re-categorizes medical institution from restricted category to permitted category which could be viewed as implementation of the principle of gradually removing restriction over the proportion of equity held by overseas capital as introduced by the *Opinions of Further Encouraging and Guiding Non-government Funding for Medical Institutions* (Guo Ban Fa [2010] No. 58).

#### 6) Publication industry

- Remove the restriction of Chinese controlling shareholding requirement to distribution of audio & video products (excluding movies);
- Permit foreign investment to conduct import business of books, newspapers, periodicals, audio & video products and electronic publications.

#### 7) Express delivery

Express delivery business of mail is listed in the prohibited category.

#### 8) Education

- Occupational skills training is added to the encouraged category for the first time and without restriction on foreign investment ratio;
- Ordinary senior high schools are still listed in the restricted category, while the equity joint venture formation for ordinary senior high schools has been removed, thus foreign investors are only permitted to establish ordinary senior high schools in the mode of cooperative joint venture.

#### 9) Public facilities management

Construction and operation of pipeline networks for gas, heat, water supply and sewage in large cities are taken from restricted category to permitted category and the restriction of Chinese controlling shareholding requirement has been removed.

## **Transitional Arrangement between the 2011 Catalogue and the 2007 Catalogue**

According to NDRC official's public Q&A, foreign investment projects approved after January 30, 2012, when the 2011 Catalogue became effective shall be processed pursuant to the Catalogue 2011, whereas projects obtaining approval prior to the effective date shall follow the 2007 Catalogue. With respect to the items which are newly added to the restricted and prohibited categories, foreign investment companies which have been established and are under operation prior to January 30, 2012, shall be subject to the then effective policies upon approval, while any capital increase, share transfer or overseas listing of such companies shall be subject to the Catalogue 2011.

## **Expected Amendment to the Catalogue of Priority Industries for Foreign Investment in Central and Western China**

According to NDRC official's public Q&A, the NDRC is contemplating to revise the *Catalogue of Priority Industries for Foreign Investment in Central and Western China (Revised 2008)* (No. 4, Order of the NDRC and the MOFCOM) with reference to the principles set forth in the "Outline" of the 12th Five-Year-Plan, putting a special focus on increasing labor intensive categories, encouraging foreign investments in environmental friendly labor intensive industries in central and western China, as well as incorporating certain of the encouraged categories removed by the Catalogue 2011.

### **3. Brief of Circular on Strengthening Cooperation between the Taxation Authorities and the Industry and Commerce Authorities to Realize Sharing of Information on Equity Transfer (Authors: Bing XUE, Jiaxin LIU, Chu LIU)**

On December 22, 2011, the State Administration of Taxation ("**SAT**") and the State Administration for Industry and Commerce ("**SAIC**") jointly issued the *Circular on Strengthening Cooperation between the Taxation Authorities and the Industry and Commerce Authorities to Realize Sharing of Information on Equity Transfer* (Guoshuifa [2011] No.126, the "**Circular 126**"), aimed at promoting information sharing between the taxation authorities and the industry and commerce authorities (the "**Information Sharing**") and strengthening tax collection and administration in connection with equity transfer. Circular 126 took effect on January 1, 2012.

Prior to Circular 126, on July 2, 2003, the SAT and the SAIC jointly issued the *Circular on Issues Concerning the Exchange and Sharing of Industry and Commerce Registration Information and Taxation Registration Information* (Guoshuifa [2003] No. 81, "**Circular 81**") and set down basic rules on Information Sharing. By reviewing recent years' tax collection and administration practices and considering the complexity of sources of income received by high net worth groups and the variety

of transaction modes, the Information Sharing mechanism laid down in Circular 81 did not play an effective role in the tax collection and administration on equity transfer.

We set forth below the key points of Circular 126 and address potential impacts it may have on the tax collection and administration on equity transfer.

### **Scope of Information Sharing**

Circular 126 defined the scope of Information Sharing:

- (1) Information to be provided by the industry and commerce authorities to the taxation authorities
  - The information pertaining to the equity transfer by limited liability companies that has been registered with the competent industry and commerce authorities, including: business license registration number, company name, domicile, names of shareholders, type(s) of identity certificates of shareholders, identity certificate numbers of shareholders, capital subscription by shareholders, contribution ratio and registration date.
- (2) Information to be provided by taxation authorities to the industry and commerce authorities
  - The tax-related information provided to the taxation department by enterprises in connection with equity transfer by shareholders thereof, including the business license registration number, enterprise name, taxpayer identification codes, names of shareholders, and types and serial numbers of the identity certificates of the shareholders of such enterprises.
  - The tax collection information obtained by the taxation authorities from the industry and commerce authorities after the share transfer, including the business license registration number, taxpayer's name, identification code of taxpayer, the category of tax, taxation period and amount of the tax collected.

Please kindly note that the collection of information related to the levy of taxes on equity transfer may help the tax authorities further strengthen tax collection and administration related to equity transfer.

### **Method of Information Sharing**

According to Circular 126, the Information Sharing related to equity change registration shall be conducted through the information sharing platform and exchange mechanism established by the SAT and the SAIC. All local offices of the state taxation authorities and local taxation authorities at provincial levels and below shall consult with the respective industry and commerce authorities at the same level with respect to information exchange. Computer networks shall be fully used in information exchange to gradually establish an information-technology-based information exchange mechanism.

## **Schedule of Information Sharing**

Pursuant to Circular 126, as of January 1, 2012, all local offices of the state taxation authorities, local taxation authorities and industry and commerce authorities at all levels shall complete the exchange of eligible information generated in each month, which is required to be exchanged, within 15 days following the end of the month. The exchange of eligible information between January 1, 2011 and December 31, 2011 shall be completed prior to June 30, 2012. The exchange of eligible information generated between January 1, 2010 and December 31, 2010 shall be completed prior to September 30, 2012.

It is worth noting that the aforesaid schedule of Information Sharing may bring all the share transfer transaction consummated since 2010 into the administration system of the tax authorities, in other words, such transactions may be reviewed by the competent tax authorities again.

## **Enhancement of Information Sharing**

All local offices of the state taxation authorities of all provinces (autonomous regions, municipalities directly under the Central Government and the cities specifically designated in the State plan) shall, in conjunction with local taxation authorities and the industry and commerce authorities, formulate specific local operation measures for information exchange and sharing in accordance with Circular 126, which shall be filed to the SAT and the SAIC for record prior to the end of February 2012.

## **Intensified Supervision of Taxation Administration and Collection on Share Transfer**

The SAT has continuously strengthened the supervision of taxation administration and collection in connection with share transfer, especially the share transfer concluded by individual shareholders. During the past years, the SAT successively issued circulars like Notice on Strengthening the Administration of Individual Income Tax on Income from Equity Transfer (Guoshuihan [2009] No. 285) and Announcement on Issues Concerning Assessing and Determining the Basis of Calculating Individual Income Tax on Income Derived from Equity Transfer (SAT Announcement [2010] No. 27) to strengthen tax administration, while those circulars were not carried out consistently at various localities due to the lack of cooperation from other authorities.

The joint issuance of Circular 126 is expected to unify and strengthen the tax administration approaches. We will monitor the developments in this area and share our insights with you in due course.

## **Important Announcement**

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