

CHINA UPDATE 2009

Squire, Sanders & Dempsey L.L.P.
April 2009

Inside

New Tax Regulations for Nonresident Companies	2
Seventh Amendment of the PRC Criminal Law Passed	5
State Council Announces Provisions for Travel Agencies	6
SAIC Introduces Share Investment Registration.....	7
China Adopts Food Safety Law	9
Articles, Publications and Other Media	12
Past Events	12
Upcoming Events	12

New Tax Regulations for Nonresident Companies

Key Points:

- ***“Withhold at source” rule adopted for income generated by nonresident companies***
- ***New contract filing requirement for Chinese payers***
- ***Numerous registration and filing requirements introduced for nonresident companies, withholding agents and PRC-resident contracting parties***
- ***Issue unresolved as to whether requirements apply to projects/services outside China requiring visits to China by nonresidents***

The State Administration of Taxation (“SAT”) recently issued two circulars: Tentative Measures for the Administration of Source Withholding of Corporate Income Tax for Nonresident Companies (Guo Shui Fa [2009] No. 3) and Tentative Measures for the Tax Administration of Contract Projects and Service Provisions for Nonresidents (Decree [2009] No. 19). These two regulations, which are targeted at nonresident companies, demonstrate the tax authority’s determination to strengthen the tax administration for nonresident companies in China.

Tentative Measures for the Administration of Source Withholding of Corporate Income Tax for Nonresident Companies (“Circular No. 3”)

China is adopting the “withhold at source” rule for income generated by nonresident companies: i.e., the Chinese payer must act as the withholding agent for nonresident companies and deduct any applicable tax from its China source income – such as dividend, interest, rent, royalties or capital gains derived from the disposal of property – before sending the payment out of China. In addition to this withholding obligation, Circular No. 3 introduces a new contract filing requirement for the Chinese payer. Within 30 days after the execution of the agreement by the PRC resident company and nonresident company, the PRC resident company (“PRC company”) must file a contract registration form, a copy of the agreement and other related documents with the tax bureau. If the agreement is subsequently amended, supplemented or extended, the PRC company must file the changes with the tax bureau within 30 days after the amendment, supplement or extension takes place. In addition, the PRC company should maintain a contract file and a separate account for recording the withholding information.

Circular No. 3 is significant because it officially clarifies that taxes should be paid by a nonresident company on capital gains derived from offshore transfer of equity interest in a PRC company. Under PRC tax law, capital gains derived from the sale of

shares of a PRC company are considered PRC source income and thus subject to withholding tax in China. This circular acknowledges that in this situation, the nonresident transferor is responsible for paying the tax. The target PRC company does not have a statutory obligation to withhold any tax on behalf of the nonresident transferor, and it should not be held liable if the nonresident transferor fails to pay the tax. The nonresident transferor must file the taxes either by itself or through a designated agent with the tax bureau where the target PRC company is located. However, the circular requires the target PRC company to submit the equity transfer agreement to the tax bureau when it files its application to change its tax registration. Although the circular indicates that the target company should assist the tax bureau in collecting taxes from the nonresident transferor, it fails to provide any details as to what kind of assistance the target company should provide.

According to Circular No. 3, if the PRC company and nonresident company agree that the Chinese payer will accept the tax liabilities of the nonresident company, the net income received by the nonresident company will be grossed up when calculating its tax liability; i.e., the tax borne by the PRC company will be considered taxable income for the nonresident company and thus subject to PRC tax.

Tentative Measures for the Tax Administration of Contract Projects and Service Provisions for Nonresidents (Decree [2009] No. 19) (“Decree No. 19”)

Decree No. 19, targeted at regulating nonresident contract project companies and service providers in China, introduces numerous registration and filing requirements not only for nonresident companies but also for withholding agents and PRC-resident contracting parties (“PRC companies”).

Nonresident companies contracting to provide project services including construction, installation, assembly, finishing or utility, or rendering other services in China, are now required to register with the tax bureau where the project is located or when they provide those services within 30 days after the execution of their agreement with the PRC company for which they are providing the service. They must also deregister with the tax bureau within 15 days of the completion of the project or service.

The PRC company, for its part, must submit the registration form, agreement and tax registration certificate of the nonresident company within 30 days after the execution of its agreement with the nonresident company. It must also file a change application with the tax bureau within 10 days after any change in the agreement. Additionally, the PRC company must submit to the tax bureau a photocopy of the invoice it obtained from the nonresident company within 30 days after receipt.

Decree No. 19 further requires the nonresident company to file provisional corporate income tax quarterly and final corporate income tax annually except for certain situations for which it may obtain an exemption: for example, if the company worked on the contracted project or provided its services for less than one year, its work was completed before the end of the year and all relevant taxes have been fully paid, or it completed deregistration during the annual filing period.¹ If the nonresident company is responsible for paying the business tax or value added tax (VAT) and has a business establishment in China, it must report those taxes itself. If it does not have an established business in China, it may appoint an agent to report its tax; if it fails to designate an agent, the Chinese party must act as the withholding agent.

Decree No. 19 significantly increases the administrative burdens of the nonresident company as well as the PRC company. In addition to its tax registration requirement as imposed under the previous law, the nonresident company carrying out a contract project or providing services in China must submit a detailed project report when filing its tax return on which a great amount of information is requested, including date of entry into and exit from China, project or service period, work description, remuneration information and expense information.

In practice, it is difficult for most nonresident companies to keep track of this information, as they usually do not maintain records in China. As outlined above, Decree No. 19 also imposes a heavy responsibility on the Chinese contracting party by requiring it to submit information to the tax bureau during various stages of the project.

Nevertheless, Decree No. 19 leaves one important issue unanswered. The law stipulates the registration and filing requirements to which a nonresident company rendering services or conducting projects within China is subject. However, it is unclear whether these requirements apply in situations in which the entire project is to be completed, or the service rendered, outside China, but an individual or individuals from the nonresident company must visit China on a number of occasions in the course of the work. Subsequent regulations should clarify this outstanding issue.

– *Xu Qianrong (Sharon)*

¹ Notice on the Administrative Measures for Corporate Income Tax Annual Filing by Nonresident Companies (GuoShuiFa [2009] No. 6), issued on January 22, 2009 by the State Administration of Taxation

Seventh Amendment of the PRC Criminal Law Passed

Key Points:

- ***Extends potential charges of official bribery to relatives and friends of current and former state functionaries***
- ***Criminalizes illegal sale and unlawful disclosure of personal data by government entities in certain sectors***
- ***Revises tax evasion laws***

China has provided extensive news coverage related to the passage of the Seventh Amendment of the PRC Criminal Law on February 28, 2009. The following updates have been singled out for particular public attention.

Official Bribery

According to the Amendment, not only state functionaries may be convicted of official bribery, but also: (i) “close relatives” or persons otherwise having a “close relationship” with state functionaries and (ii) former state functionaries and their “close relatives” and persons otherwise having a “close relationship” with them. This update demonstrates the government is expanding its efforts to crack down on corruption of government officials.

PRC Criminal Law prohibits both the offering and acceptance of official bribery – bribery involving state functionaries – and non-official bribery, which involves non-official individuals and private entities.

Both criteria and penalties related to official bribery are more severe than for non-official bribery.

Personal Data Protection

The Amendment criminalizes as a “severe violation” the illegal sale or other unlawful disclosure of any citizen’s personal data by government entities or their officials and employees in the financial, telecommunications, transportation, education or medical sectors that such entities, officials or employees have obtained in the course of performing their duties or services. It is also a criminal offense for any person to obtain citizens’ personal data by theft or other unlawful means. Offenders may be subject to up to three years’ imprisonment.

One criticism of this provision is that its application is limited to the financial, telecommunications, transportation, education and medical sectors. Other entities that may have access to citizens’ personal data, such as stores and clubs, are excluded. Also, the provision is confusing in that it requires that there be present a prior confidentiality obligation or expectation, provided by other laws and regulations, in order for the sale or disclosure of personal data to qualify as “illegal” and thus trigger a criminal charge.

The criteria for determining whether a “severe violation” has been committed are expected to be clarified in future judicial interpretations by the

Supreme People's Court or the Supreme People's Procuratorate.

This updated amendment is China's first successful legislative attempt to protect personal data at the national level. Within the past two years, several provinces and cities have taken independent local legislative measures to address Internet privacy concerns, and the draft Torts Liability Law, which has been subject to lengthy and heated debate, is also said to include potentially important privacy stipulations.

Tax Evasion

The Amendment revises the clause related to tax evasion that exempts first-time violators from criminal charges if they have since paid the taxes and received administrative penalties; however, violators who have received two administrative penalties or been held criminally liable in the last five years for tax evasion are not exempt. The Amendment also removes the threshold requiring evaded tax to equal a minimum amount in order for the evasion to qualify as a criminal violation, leaving more flexibility for the courts to decide whether the subject should be criminally liable. Nevertheless, it is specified that the court must rule on whether to lay criminal charges if the violator has evaded a minimum of 10% of due tax. – *Zijie Li (Lesley)*

State Council Announces Provisions for Travel Agencies

Key Points:

- **Special requirements for global companies seeking to invest in a travel agency in China eliminated**
- **Distinction between national and international travel agencies removed**
- **More details regarding payment of travel quality deposits**

With the goal of improving the administration of travel agencies and keeping the commitments outlined in China's WTO concessions, the State Council released its Provisions for Travel Agencies ("Provisions") on February 20, 2009 with an effective date of May 1, 2009.

Prior to the issuance of the Provisions, global companies seeking to invest in a travel agency in China faced a slate of special requirements. The necessary minimum registered capital was RMB2.5 million, and the outside investor was required to be a travel agency engaging in the travel business that had earned at least US\$500 million in the previous year.

To comply with the commitments made by China in its WTO concessions, the State Council passed Provisions to extend the same treatment to investors inside and outside China in canceling all special requirements for outside investors wishing to form a travel agency in China. Under the

Provisions, all applicants wishing to establish travel agencies are required to meet the same conditions, such as having fixed business venues, all the necessary equipment and minimum registered capital of RMB300,000. However, under the Provisions, except for Hong Kong/Macau outbound travel services provided by Hong Kong/Macau-invested travel agencies in Guangdong Province, no travel agency with investors from outside China is permitted to engage in outbound travel business unless otherwise provided for in the free trade agreement.

Under current provisions, two types of travel agencies exist in China: national agencies and international agencies. National travel agencies are permitted to conduct only in-China travel business, while an international travel agency may engage in inbound and outbound travel business in addition to domestic travel business. The Provisions no longer make such a distinction. Any travel agency may engage in both in-China travel business and inbound travel business. If a China-invested travel agency follows all applicable laws and regulations, it may apply for permission to offer outbound travel services within two years of its establishment.

In addition, the Provisions supply more detailed information on requirements for the payment of travel quality deposits. To protect tourists' interests and rights, previous provisions for establishment of travel agencies in China have required agencies to

establish travel quality deposits, which are managed by the China National Tourism Administration. However, under the new Provisions, a travel agency may present a letter of guarantee issued by a bank as an alternative to making a travel quality deposit. Furthermore, a travel agency may withdraw half of the quality deposit remaining in its designated bank account if it has not been fined for harming travelers' interests in the past three years. – Yao Meng-Jiang (Daniel)

SAIC Introduces Share Investment Registration

Key Points:

- ***Provides specific guidelines for use of equity interests or shares of a company as capital contributions under PRC Company Law***
- ***Provides alternative means of capital contribution intended to stimulate M&A market and investment activity***

The Administrative Measures on Registration of Capital Contribution With Equity Interests ("Measures"), officially promulgated by the State Administration for Industry & Commerce ("SAIC") this January and which took effect on March 1, provide specific guidelines for the use of equity interests or shares of a company as capital contributions under PRC Company Law. The Measures facilitate corporate restructuring by providing alternative means of capital contribution

and should stimulate China's M&A market and investment activities during the economic downturn.

Under the Measures, contributions of equity interests or shares must meet the following conditions:

1. The investments must be made to an onshore company ("Invested Company") by an investor using equity interests or shares in another onshore company ("Equity Company").

2. The investor is required to have clear and complete title to the equity interests or shares to be used for capital contribution and the equity interests or shares must be legally transferrable.

3. Equity interests or shares may not be used as capital contributions under any of the following circumstances:

- if the registered capital of the Equity Company has not been paid in full;
- if the equity interests or shares are subject to a pledge;
- if the equity interests or shares have been frozen by the competent authority;
- if transfer of the equity interests or shares is prohibited by the Equity Company's articles of associations;

- if transfer of equity interests or shares is subject to governmental approval but such approval has not been obtained; or
- if any law, administrative regulation or decision of the State Council prohibits transfer of the equity interests or shares.

4. The total amount of in-kind capital contribution (including equity interests or shares contribution) should not exceed 70% of the Invested Company's total amount of registered capital, and the equity interests or shares must be appraised by a qualified appraiser.

5. The contribution is required to be made within one year after the establishment of an Invested Company.

The Measures also specify the procedures the Invested Company must make in registering the capital contribution with the appropriate local AIC. Invested Companies are required, in the course of applying for registration of incorporation, to register the names of investors contributing equity interests or shares as well as the values, forms and times of their investments. Investors contributing equity interests or shares to a newly incorporated company must fully contribute those equity interests or shares within one year after the incorporation of the Invested Company, which is then required to revise the notation of its paid-up capital on the registration form. – *Li Xin (Lily)*

China Adopts Food Safety Law

Key Points:

- **Establishes commission to streamline interagency coordination and eliminate gaps**
- **Ministry of Health and other government agencies to share responsibility for monitoring and testing food**
- **New rules for food additives, imports and foods making health claims**
- **Violation penalties sharply increased**

In light of growing unrest over food safety, China has made great efforts to strengthen regulations related to food, additives and other consumer products. The farthest reaching of these, the Food Safety Law of the People's Republic of China ("Food Safety Law"), officially adopted at the seventh meeting of the Standing Committee of the 11th National People's Congress on February 28, 2009 takes effect on June 1.

The Food Safety Law governs the manufacturing, processing and distribution of food, additives, food packaging materials, containers, detergent, disinfectants, tools and equipment in relation to food manufacturing or distribution. The summary below provides highlights.

Administration Authorities

Currently, approximately 10 government departments and ministries with overlapping duties monitor food

safety in China. In the absence of an effective coordination system, those authorities have been blamed for unresponsiveness to food safety problems.

Under the Food Safety Law, a Food Safety Commission ("FSC"), whose primary duty will be to streamline interagency coordination and eliminate administration gaps, will be established by the State Council. The Ministry of Health ("MOH") and its local counterparts will be responsible for appraising food safety risks, drafting food safety standards, disclosing food safety information and investigating food safety incidents. The General Administration of Quality Supervision, Inspection, and Quarantine ("AQSIQ"), the General Administration of Industry and Commerce ("AIC") and the State Food and Drug Administration ("SFDA") and their local counterparts will be responsible for overseeing food safety in accordance with their duties.

Active Monitoring System

A food safety monitoring system will be established to actively monitor the presence of hazardous ingredients in food, food-borne diseases and food contamination. The MOH and its local counterparts will develop a monitoring plan that, it is believed, will require government agencies to take action not only after food safety issues are uncovered through consumer complaints or exposed through media publicity, but also to carry out regular daily testing and supervision to detect safety risks.

Food Standards

The MOH will be required to review, screen and integrate various existing statutory food quality and hygiene standards at the farm level with compulsory industry standards and develop and issue unified national food safety standards. Such an approach will help eliminate conflicts among different standards and provide clearer guidance to food enterprises. Reportedly, MOH has placed a priority on drafting or amending standards pertaining to pesticide residue, hazardous and poisonous contaminants, food additives and milk products. The opinions of food manufacturers and distributors, as well as consumers, will be weighed in developing national standards. If there is no existing national or local standard for a specific type of food, its manufacturers will be permitted to work out their own standards, to be recorded with the local counterpart of the MOH.

Food Additives

Food additives will no longer be permitted unless they are both necessary and proven safe. Labels and instructions relating to food and food additives may not indicate that the food or additives prevent disease or have a therapeutic effect. These restrictions will make it difficult for food manufacturers to develop and sell new products using questionable health enhancement claims based on its additives.

Food with a Health Care Function

The Food Safety Law stipulates that any food product for which health claims are made be subject to strict oversight. Labels and instructions for preparation or use of such foods must specify the name and amount of their ingredients and who can safely consume the product.

Food Inspections and Tests

As expressly stipulated in the Food Safety Law, no food can be exempted from safety inspections and tests.

Imported Foods

For imported foods to which no existing PRC national food safety standard applies, and additives and food products being imported for the first time, importers are required to submit import applications and materials for safety appraisal. The MOH should organize their safety appraisal within 60 days of acceptance of the import application and determine whether to grant the import permit following the appraisal.

AQSIQ is required to issue an alert or take controlling actions regarding any food safety incidents that occur abroad but that may have a bearing on food safety in China, as well as any serious food safety problems detected in imported food, and report them to other appropriate PRC authorities.

Overseas exporters and their agents that export food to China, as well as overseas food manufacturers exporting food to China, are required to register with AQSIQ, which will periodically publish an updated list of recorded exporters and agents and registered overseas manufacturers.

Liability

The Food Safety Law sharply increases violation penalties, compared to the PRC Food Hygiene Law it replaces. The maximum penalty assessed could equal 10 times the monetary value of the products

involved. In addition, if market and fair sponsors and renters of counter space used for selling takeaway food fail in their obligations to monitor the safety of the food they sell, they will be subject to joint and several liability for any food safety incidents taking place at their market, food counter or fair. This joint and several liability will also apply to any social entity or individual recommending food to consumers via fraudulent advertising.

– *Chen Changshun (Ryan)*

Articles, Publications and Other Media

Amy L. Sommers, national partner in our Shanghai office, was quoted on Feb. 19 by the *China Herald* regarding proposed land use right reforms in China.

James M. Zimmerman, partner in our Beijing office, is author of *China Law Deskbook, Second Edition (2005): A Legal Guide for Foreign-Invested Enterprises*. More information on the *China Law Deskbook* is available on the ABA website:

<http://www.abanet.org/abastore/index.cfm?section=main&fm=Product.AddToCart&pid=5210139>

Past Events

Daniel F. Roules, partner in our Shanghai office; **LaRhonda J. Brown-Barrett**, associate in our Shanghai office; and **Li Zijie (Lesley)** and **Chen Dongying (Doris)**, consultants in our Shanghai office, were presenters on topics relevant to doing business in China during Squire Sanders' China Business Immersion Trip, hosted by China Centric Associates, LLC at China Centric's new facility in Shanghai on March 16.

James M. Zimmerman presented "How to Reduce the Existing and Prevent New Barriers to Foreign Investment" at the Joint Session of the United Nations Development Program GTI Consultative Commission and Business Advisory Council on March 24 in Ulaanbaatar, Mongolia and "Business Outlook for the GTI Region" at the Second United Nations Development Program GTI Investment Forum, Greater Tumen Initiative: Gateway to North-East Asia, on March 25 in Ulaanbaatar, Mongolia.

Daniel F. Roules and **Jia Weiheng**, associate in the Shanghai office, hosted a roundtable seminar, "Grappling with Layoffs and Reductions in Force," at our Shanghai office on March 26.

Upcoming Events

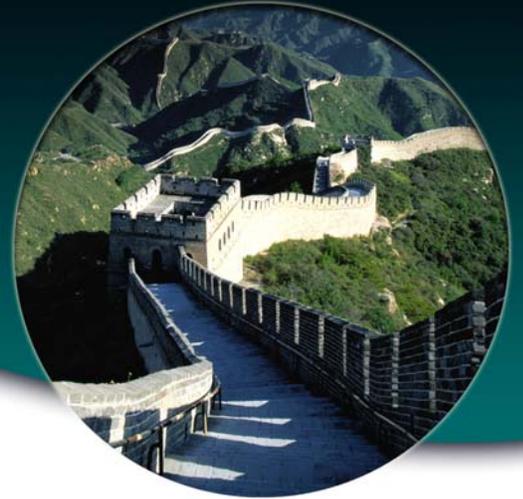
James M. Zimmerman will give the presentation "China's Current Business Climate: Economic Stimulus Programs, Anticipated Growth, and Protectionist Pressure in 2009" on April 6 in Singapore. He will present an overview on the current business climate in China; discuss the government's economic stimulus programs and policies to encourage economic growth; outline trends and prospects in 2009 for growth and investment; and provide insight on the ongoing pressure on policymakers to engage in protectionist and trade-restricting activities that may affect outside investors. For more information, contact our Beijing office.

The Squire Sanders [Pharmaceutical Industry Roundtable](#), on April 16 at our Shanghai office, will explore how the geographic scope of operations for pharmaceutical and life sciences companies has widened so that practices and developments occurring around the world have a potential immediate impact on local operations. **Maureen Bennett**, partner in our San Francisco office, whose practice focuses on advising and counseling life sciences companies in the conduct of global clinical trials including key commercial and regulatory issues and with particular emphasis on trials in developing markets, will describe emerging issues in the field. **Zhaoyang (Paul) Li**, partner in our San Francisco and Los Angeles offices, whose practice focuses on intellectual property with an emphasis on patent law, will speak on how dates of invention and publication may affect your company. **Mark C. Goodman**, partner in our San Francisco office, whose practice focuses on commercial litigation, will address the topic of emerging liability for pharmaceutical companies in clinical trial and consumer injury cases. A continental breakfast will be served. There is no fee to attend, but space is limited. RSVP by April 14 to [Di \(Deborah\) Hu](#) to let us know if you will attend.

Rainer Burkardt, national partner in our Shanghai office, will give the presentation “Protection and Enforcement of Intellectual Property Rights” on April 22 in Hannover, Germany during the one-day event “China’s Role as Sourcing Market During Times of Economical Crises,” hosted by Germany’s Association Materials Management, Purchasing and Logistics (AMMPL), *Bundesverband Materialwirtschaft, Einkauf und Logistik* (BME). For more information, contact our Shanghai or Frankfurt offices.

This newsletter provides free information on the influence of certain aspects of the Chinese legal environment and does not constitute legal advice.

©Squire, Sanders & Dempsey L.L.P.
All rights reserved
2009



CHINA UPDATE APRIL 2009

Squire Sanders Contacts

BEIJING

[Sungbo Shim](#)
[James M. Zimmerman](#)

Squire, Sanders & Dempsey L.L.P.
25th Floor, North Tower, Suite 2501
Beijing Kerry Centre
1 Guanghua Road
Chaoyang District
Beijing 100020
People's Republic of China

+86.10.8529.6998

HONG KONG

[James S. Tsang](#)
[Nicholas Chan](#)
[Francis Li](#)

Squire, Sanders & Dempsey
24th Floor, Central Tower
28 Queen's Road Central
Central, Hong Kong
Hong Kong SAR, China

+852.2509.9977

SHANGHAI

[Daniel F. Roules](#)
[Amy L. Sommers](#)
[Rainer Burkardt](#)

Squire, Sanders & Dempsey L.L.P.
Suite 1207, 12th Floor
Shanghai Kerry Centre
1515 Nanjing Road West
Shanghai 200040
People's Republic of China

+86.21.6103.6300

TOKYO

[Steven S. Doi](#)
[Ken Kurosu](#)

Squire Sanders
Gaikokuho Kyodo Jigyo Horitsu Jimusho
Ebisu Prime Square Tower, 16F
1-1-39 Hiroo
Shibuya-ku, Tokyo 150-0012
Japan

+81.3.5774.1800

NORTH AMERICA

Cincinnati
Cleveland
Columbus
Houston
Los Angeles
Miami
New York
Palo Alto
Phoenix
San Francisco
Tallahassee
Tampa
Tysons Corner
Washington DC
West Palm Beach

LATIN AMERICA

Bogotá[†]
Buenos Aires[†]
Caracas
La Paz[†]
Lima[†]
Panamá[†]
Rio de Janeiro
Santiago[†]
Santo Domingo
São Paulo

EUROPE

Bratislava
Brussels
Bucharest[†]
Budapest
Dublin[†]
Frankfurt
Kyiv
London
Moscow
Prague
Warsaw

ASIA

Beijing
Hong Kong
Shanghai
Tokyo