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Executive Summary

MOFCOM Delegates Authority for FICE Approval (p.2)

In a recent Circular, the Ministry of Commerce has delegated the authority to approve foreign-invested commercial enterprises engaged in wholesale, retail, agency or franchising, to authorities at provincial level for most such enterprises. This will most likely facilitate approval procedures, although implementation remains unclear.

Author: Mr. Maarten Roos

Personal Income Tax on Property Transactions – Guangzhou Leads the Way (p.3)

Guangzhou is among the first major cities to have clarified how income tax on property transactions will have to be calculated. The governments of Beijing and Shanghai are expected to follow soon.

Author: Ms. Vivian Chen

Feature Article: Looking Back at 2005 (p.5)

The Editors take a final look at developments in China, in Chinese law, and at Wang Jing & Co., and wish everyone a happy and successful 2006.

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MOFCOM Delegates Authority for FICE Approval

China's regime for foreign-invested commercial enterprises (FICE's) – those foreign-invested enterprises (FIE's) engaged in wholesale, retail, agency or franchising – continues to be subject to much attention from legislators at the Ministry of Commerce (MOFCOM) and from authorities at local (provincial and municipal) level. Many foreign-invested enterprises, especially small- and medium-sized enterprises (SME's), are eager to take advantage of this still relatively new opportunity to enter the China market as a trading company.

While statistics are scarce, according to one report during the first year of implementation of the *Administrative Regulations on Foreign-invested Commercial Enterprises* (effective 11 December 2004 for wholly foreign-owned enterprises), from Shanghai alone over 300 applications were approved by the MOFCOM out of a total 500, including from many SME's who established wholesale trading companies with limited registered capital.[1] For the whole country, MOFCOM officials have reported 1,000 approvals out of 1,400 applications between 1 June 2004 and December 2005.

Delegation of Approval Authority

Until now, the number of approvals seems to have been limited partially due to the heavy workload of the relevant department at the Ministry of Commerce, which had sole authority to approve applications (after preliminary review and approval by local and provincial authorities). In anticipation of a further drastic increase of applications from all over the country, to facilitate the handling of such applications the MOFCOM on 9 December 2005 issued the "Circular on Issues Regarding the Delegation of Approval Authority for Foreign-invested Commercial Enterprise to Local Authorities". According to this Circular, from 1 March 2006 approval authorities for most kinds of FICE's will be delegated to MOFCOM authorities at provincial level – the Department of Foreign Trade and Economic Cooperation (DOFTEC) of provinces (e.g. Guangdong DOFTEC), or the Administrative Committee of Economic and Technological Development Zones (ETDZ) (e.g. Shenzhen Administrative Committee) directly under the State Council.

The Circular clarifies that the following may from 1 March 2006 be approved by relevant authorities at provincial level:

(a) New FICE establishments except where MOFCOM approval is still required (see below)
(b) Expansion of business scope of existing FIE's to include commercial activities
(c) Application for amendment of registration for existing FICE's
(d) Establishment of retail shops in the same municipality / province / ETDZ if under one of the following conditions:
    i) The single store area does not exceed 300 sq.m.
    ii) The single store area does not exceed 3,000 sq.m., the total number of stores in the same municipality / province / ETDZ does not exceed 5 and the total number of stored established in China through this FICE does not exceed 50; or
    iii) The single store area does not exceed 5,000 sq.m., the total number of stores in the same municipality / province / ETDZ does not exceed 3, and the total number of stored established in China through this

[1] *Implementation of Administrative Measures for Foreign-Invested Commercial Enterprises in Shanghai*, Issue 12, 2005 (01 December), www.tdctrade.com

FICE does not exceed 30;

Only for FICE's intending to engage in one of the following activities, approval from MOFCOM at national level will still be necessary:

(a) Sales activities conducted via television, telephone, mail order, internet, vending machines, and so forth;
(b) Trading and distribution of fundamental raw materials for industrial use, including steel, precious metals, iron ore, fuels, rubber, and so forth;
(c) Trading and distribution of products such as books, newspapers, periodicals, refined oil, automobiles, edible sugar, cotton, pharmaceuticals, and so forth, which are specifically mentioned in the Administrative Regulations.

Conclusions

The Circular has been welcomed as a positive step in facilitating approval procedures, not only for the establishment of new FICE's but also for expansion of business scope, opening of branches and new stores, amendments, and so forth. In particular, it will hopefully lead to faster approvals by and more direct communication with provincial level authorities.

One issue not yet resolved is if provincial level authorities will introduce new requirements, in particularly as regards to documentation. In current practice, local approval authorities in different districts, municipalities and provinces, while generally following national guidelines, hold their own specific rules and policies for documentation necessary to establish manufacturing and service FIE's, and constant discussion with such authorities is often necessary during the course of establishment to ensure timely approval.

Maarten Roos
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❑ Personal Income Tax on Property Transactions – Guangzhou Leads the Way

A new business tax for resale of residential property has been in effect since 1 June 2005, with a 5% business tax to be paid on the sale of properties that were purchased less than two years prior. This has helped to curb some of the speculation in real estate markets, but in further pursuit of curbing unhealthy development of such markets the State Administration for Taxation (SAT) on 7 October 2005 issued the *Notice of Several Specific Issues on Implementation of Integrated Administration of Real Estate Taxes* (reference No.: Guo Shui Fa [2005] No. 156) to reiterate the strict implementation of all taxes incurred in the course of real estate transactions, including business tax, city maintenance and construction tax, education additional tax, personal income tax, land value-added tax, stamp duty and deed tax. The said Notice's particular focus on personal income tax for the resale of real estate has initiated a response from local tax offices as well.

Back in 2003, the local tax authorities in Beijing already issued a similar notice to levy the said personal income tax at a rate of 20%, but due to difficulties in implementation this tax failed to have significant effect on the market. While it has been reported that Beijing and Shanghai are currently preparing detailed implementation rules for this personal income tax, the Guangzhou Administration of Local Taxation has announced that a new personal income tax for individual transfer of real estate will be levied from 1 January 2006. This announcement caused large numbers of people to queue up at the local real estate transactions bureaus to complete transfer formalities before the passing of 2005. However it is untrue that from 1 January 2006 the new 20% tax policy is the only way to calculate and levy the said personal income tax. Actually, this method will co-exist with the previous tax-calculation method; the recently released the *Supplementary Notice of the Issues on Personal Income Tax for Individual Transfer of Property* (Reference No.: Sui Di Shui Fa [2005] No. 317) on 12 December 2005 elaborates on the way to calculate and levy personal income tax for the individual transfer of property (hereinafter referred to as “the personal income tax”). The key content thereof is summarized as follows:

<u>Calculation and Levy Methods</u>

1. <u>Levy on Actual Proceeds</u>: where the tax-payers can provide legitimate and valid sales and purchase contracts of the property, vouchers for the property’s original value and other supporting documents, the personal income tax will be levied as follows:

   Personal Income Tax = (Proceeds from the transfer of property – Property’s original value – Reasonable costs) * 20%

   Reasonable costs include the business tax, city construction tax, education additional tax, land value-added tax, stamp duties, land grant funds, agency service fees, transaction commissions and so forth, incurred in the course of the real estate transaction; any loan interests will be excluded.

2. <u>Levy by Verification</u>: where the tax payers fail to provide legitimate and valid sales and purchase contracts of the property and relevant vouchers for the property’s original value, for reasonable costs and so forth, or the declared transaction price is lower than the price verified by the Verification Report of Real Estate Prices without justifiable reasons, the calculation and levy of personal income tax will be as follows:

   Personal Income Tax = Proceeds from individual transfer of property * Taxable Rate * 20%

   The applicable Taxable Rate for transfer of residential property is 5% (and for transfer of non-residential property 7.5%), i.e. the same as previous calculations:

   Personal Income Tax = Proceeds from individual transfer of property * 1% (or 1.5%)

<u>Favorable Tax Policies</u>

1. Where individuals transfer the sole household property that has been used for more than five years, the aforesaid personal income tax is exempted.

2. Where the individual purchases a new residential property within one year from the date of sale of his former residential property, the personal income tax paid for the transfer may be fully or partially refunded (depending on the value of the properties).

The Guangzhou Administration of Local Taxation rather than the seller is entitled to determine which method to apply on the basis of the documents provided.

Vivian Chen
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In each issue's Feature Article, we respond to readers' suggestions to discuss a topic related to investment, law or this law Firm. Please send your ideas to mjroos@wjnco.com.

Feature Article: Looking Back at 2005

2006 has arrived, our Clients are gradually coming back from their well-deserved end-of-the-year holidays, and at Wang Jing & Co. we are going into the final stretch before the Chinese Lunar New Year, which this year starts on 28 January 2006. Perhaps this is a good moment to look back one final time at 2005, before we put those developments and lessons behind us for good, and move on towards making 2006 a great success.

China, over 2005, has continued to grow rapidly. National statistics indicated that GDP grew by approximately 9.6 percent, slightly higher than earlier estimates and despite government measures to slow growth in certain overheating sectors (e.g. real estate). It has also been reported that while manufacturing remains a key element in such growth, trade and services are becoming more important – a diversification which we find encouraging. We see the same reflected as well in our own business; we will come back to this later.

One important event over the past year was the revaluation of the Chinese currency, the Yuan (or Renminbi) on 21 July. International pressure aside, this long-awaited move indicates a rising awareness of China's policy makers on the importance of being flexible, and adapting to domestic and international trends. The revaluation was small (2.1%), and the adoption of a "Managed Floating Exchange-rate Regime" (see our Legal Newsletter (2005) 8 issue) has lead to only a slight further appreciation. If this is due to continued government intervention or due to the market remains to be seen; expect the (international) debate on currency matters to continue in the coming year.

On legal matters, one late 2005 surprise was the amendment of the Company Law. The amended law, discussed in our Legal Newsletter 2005 (10) issue, is a welcome step towards giving private enterprises more corporate freedom, and shareholders better ways to protect their interests. Certain international concepts have been adopted, even though the law continues to rely on "Chinese characteristics". Even more significant is the question of implementation – how, and how quickly, will administrative authorities and the people's courts enforce the new rules?

One other main development, reported on several times in the past year, is the increasing of opportunities offered to foreign investors wanting to engage in commercial activities – wholesale, retail, agency and franchising. As per the *Administrative Regulations on Foreign-invested Commercial Enterprises* of April 2004, more and more foreign companies are looking to take advantage of the new regime to establish such commercial enterprises, allowing them to bypass middlemen and trade directly with their customers. In this way too, foreign-invested enterprises are getting more choices to structure their activities in China.

The lawyers at Wang Jing & Co. follow such trends closely. The Firm's Maritime Group continues to compete at the highest level, and to support its activities, the Firm's correspondent offices in Qingdao and Xiamen were turned into full branch offices in 2005, with new offices and more lawyers and support staff. The Firm's decision to send senior partner and Asialaw Leading Lawyer Mr. Zhong Cheng to head the Shanghai Office, and to welcome back senior associate Wang Hongyu, have boosted the Firm's strength in this region, with immediate results.

In Guangzhou and Tianjin, the most important developments have been on the corporate / commercial side. In Tianjin, newly-hired corporate lawyer Mr. Jin Zhaohui and client service manager Mr. Yamada Hiroki have led the Firm into Tianjin's corporate market, with a fast-growing portfolio of new Clients, especially from Japan. The Corporate Group in Guangzhou has continued its steady growth; its current 15 lawyers have worked on numerous foreign investments, transactions, commercial litigations, and other related matters for foreign or foreign-invested Clients all over the Pearl River Delta. At the same time, plans to boost its Intellectual Property practice through external hires have been concretized in late 2005, and will likely show fruits in the coming months. We will report to you on this soon.

Taking the above into consideration, Wang Jing & Co. is extremely satisfied with its achievements over 2005, but looks forward to surpassing these in 2006. As always, the Firm's partners, associates and other staff are grateful for the continued support of its loyal Clients and business partners, and look forward to an exciting year ahead!

The Editors

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