Charltons - China News Alerts Newsletter - 19 November 2004

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# China News Alert Issue 80

## Headlines

### Interest rate of financial institutions' foreign currency reserves adjusted to 3%

The People's Bank of China recently promulgated the Financial Institutions Foreign Exchange Reserves Administration Regulations, which will take effect on 15 January 2005. On that date, the interest rate for all financial institutions' foreign currency reserves will be adjusted to 3%.

The Regulations require financial institutions to deposit their foreign currency reserves into a specifically designated foreign currency reserve account at the People's Bank of China before 15 January 2005. US dollars and HK dollars are to be deposited in their original currencies, while other types of foreign currencies must be exchanged into US dollars before being deposited. The exchange rates between various currencies will be calculated in accordance with SAFE's Exchange Rates between Various Currencies and the US Dollar, published on a monthly basis. Back to top

### Amendments to the Company Law finalized

The Legislative Office of the State Council recently finalized amendments to the Company Law, which will soon be submitted to the State Council's Executive Meeting for consideration. Among the most important amendments proposed under the draft legislation are as follows:

* *Restrictions on sole shareholder companies*:
* The draft legislation imposes tighter restrictions on sole shareholder companies, in particular by (i) requiring sole shareholder companies to reflect the nature of the company in the company name, and (ii) allowing a natural person to establish only one sole shareholder company, in order to prevent connected party transactions. In addition, in order to protect the company and its creditors, major decisions made by sole shareholder companies must be filed with the Administration of Industry and Commerce.
* *Reduction in minimum capital*:
* Under the draft legislation, the minimum registered capital of limited liability companies will be reduced to RMB50,000 from the previous amounts of RMB500,000, RMB300,000 and RMB100,000. The registered capital can be paid in installments over a period of 2 years, provided the first installment is at least 20%.
* *Legal successors not automatically entitled to shares*:
* Under the draft legislation, upon the death of a shareholder, successors-in-title will be not be automatically entitled to the deceased's shares, unless there is a provision to that effect included in the Company's Articles of Association.
* *Managerial rights to be prescribed in the Articles of Association*:
* The draft legislation provides that rights relating to the Board of Directors, Shareholder Meetings, the Board of Supervisors, directors and managers are to be determined by the Articles of Association and the Board of Directors.
* *Worker representation on board of supervisors*:
* Currently, only state-owned enterprises are required to have worker representation on their boards of supervisors. However, under the draft legislation, at least one-third of an enterprise's board of supervisors must comprise workers' representatives.
* *Protection of minority shareholders*:
* The draft legislation provides that upon a company’s merger, split or other major transaction, where minority shareholders do not agree to the proposed merger or split (but are unable to vote down the majority shareholders), minority shareholders will be entitled to require the majority shareholders to buy out their shareholdings. Similarly, where a company is in severe financial difficulties, and subject to special conditions, a minority shareholder will be entitled to require a buy-out of his shareholding.

### China to enter post-WTO transition period in 2005

From 2005, China will enter the "post-WTO transition period", with experts predicting that China will speed up its integration into the world trade system.

After 2005, the 3-year transition period granted by the WTO to China will expire, and the commitments that China made to the WTO will be successively realised. The period from 1st January 2005 to the opening up of industries under China's WTO commitments will be known as the "Post-WTO transition period".

The automobile industry will be the first to face tariff reduction. As of 1 January 2005, China will cancel quotas on cars and reduce the import tariff on cars components. Until 1 July 2006, the tariff on automobiles will be decreased to 25%, and the tariff on components will be decreased to 10%.

Until 2005, the average tariff on industrial products is 9.3%, while the tariff on agricultural products is 15.6%. All non-tariff measures will be cancelled and the transition period for banking, insurance, securities and retailing terminated in 2005.

In the post-transition period, the tariff on agricultural products will be decreased to around 15%.

From 2006, China will allow foreign insurance companies to provide health insurance, group insurance and annuity services. China will also cancel regulations pertaining to mandatory reinsurance, decrease the asset requirements applicable to foreign insurance companies and permit the establishment of wholly foreign owned insurance companies.

The establishment of wholly foreign owned enterprises will also be permitted in the construction, tourism and transportation industries.

By the end of 2006, China will cancel restrictions on ownership, business scope and method of establishment of foreign banks, including restrictions placed on branch offices and the issuance system of licenses. China will also allow foreign banks to provide RMB services to Chinese clients, thereby treating foreign banks in the same way as local banks.

By 2007, China will cancel the regional restrictions placed on basic telecommunications services and allow foreign investors to hold up to a 49% interest in telecommunications companies.

## Capital Markets

### Applications for secondary fund no longer accepted, new policies to be promulgated

The China Securities Regulatory Commission ('CSRC') has announced that as of 8 November it will no longer be accepting applications for secondary fund raisings from listed companies. The CSRC has not specified how long the suspension will remain in place. This is expected to be a severe blow to the many companies who are planning to raise finance through secondary offerings.

In July 2004, the CSRC ceased examining and approving IPO applications (although it continues to accept such applications). There are currently over 60 applications pending, half of which are IPOs and the other half being secondary issue applications. These applications have been pending for over 3 months. The Stock Exchange Stock Issue Department and the Stock Issue Examination Committee do not expect to complete their examination of outstanding applications before the end of the year.

At the same time, the Measures for Management of Listed Enterprises, which incorporate the main financing management models, have been approved by the State Department, and are now awaiting promulgation by the CSRC. The measures will cover 5 financing methods, namely IPOs, secondary fund raisings, stock dividends, convertible debt securities and placements. The previous Measures for Management of Initial Public Offering of Listed Companies, and Provisional Measures for Management of Convertible Debt are to be repealed.

### RMB capital items now partially convertible

The Deputy Director General of the State Administration of Foreign Exchange ('SAFE'), Mr Wei Ben Hua, recently announced that RMB capital items are now partially convertible. In the 43 capital transaction items categorized by the International Monetary Fund, currently half of China's capital item transactions are basically unrestricted or have relatively few restrictions placed upon them. The full convertibility of the Renminbi is a long term goal in China's reform of its foreign exchange system. According to Mr Wei, speaking during the opening ceremony of the 14th HSBC Headquarters Annual Meeting, the goals of the PRC Government in this regard are:

* to regularize financial adjustment and control;
* selectively to relax the restrictions currently placed on cross-border capital transactions for the purpose of risk prevention; and
* to implement full convertibility of Renminbi capital items on a step by step basis.

## Insurance

### CIRC and Public Security Ministry to crack down on illegal insurance policies

The China Insurance Regulatory Commission ('CIRC'), together with the Public Security Ministry, has issued a Notification concerning Cracking Down on the Sale of Illegal Overseas Insurance Policies. The Notification requires local insurance regulatory commissions and public security organisations to cooperate in order to crack down on the sale of illegal overseas insurance policies. Recently, some overseas insurance organisations incorporated in Hong Kong and Macau have unlawfully sold overseas insurance products in Guangdong, Fujian, Shanghai and Jiangsu, gradually spreading to other provinces in China.

The Notification stresses that all local insurance regulatory commissions and public security organisations should (i) conduct a thorough investigation into illegal sales (ii) set up a system to report findings from their investigations, (iii) ensure the effective transfer of cases, and (iv) improve the dynamics of investigations, by immediately investigating public security units suspected of being involved in criminal activities, and where their activities do not amount to criminal activities, by referring those units to the CIRC for penalization. The Notification also requires all ministries to strengthen their efforts in the disclosure of information and the spread of social awareness in this regard.

## Real Estate

### Restrictions on purchasing residential land in the countryside

The National Land Resource Ministry recently promulgated an Opinion regarding the Strengthening of the Administration of Residential Sites in the Countryside to prohibit town dwellers from purchasing residential sites in the countryside and to prohibit the government from issuing Land Use Certificates to houses purchased and unlawfully built by town dwellers in the countryside.

The National Land Resource Ministry now requires all national land resource administration departments to apply strict application requirements in relation to the purchase of residential land. A family unit in the countryside may only apply for one residential site and the area is not allowed to exceed the standard established in the relevant province.

### Compensation for land requisition

The National Land Resource Ministry recently released Guidelines concerning Reinforcement of the Compensation System for Requisition of Land, to determine the standard of compensation in land requisition cases.

The consolidated annual land compensation and resettlement grant is to be fixed within the scope regulated by the law, but shall also be at a level which maintains the original living standards of the peasants from whom land was requisitioned.

According to the National Land Administration Law, the compensation for the requisition of land includes land compensation and a resettlement grant. The land compensation is to be 6 to 10 times the average yearly production value of the land for the last 3 years prior to requisition. The resettlement grant will be 4 to 6 times the average yearly production value for the last 3 years prior to requisition. If this standard cannot maintain the original living standards of the farmer, the settlement grant may be increased with the approval of the provincial government. However, the total value of these two amounts cannot exceed 30 times the average yearly production value for the last 3 years prior to requisition.

## WTO

### US anti-dumping tariff on wooden bedroom furniture

The US Commerce Bureau recently announced that the US is planning to levy an anti-dumping tariff up to a maximum of 198.08% on imported Chinese wooden bedroom furniture, valued at approximately USD 1.2 billion.

The US Commerce Bureau announced that there are seven Chinese manufacturers and exporters who will be subject to the tariff from zero to 198.08%. The exports of these enterprises account for close to 35% of total furniture exports from China to the US. The remaining 115 companies, whose exports account for around 65% of total exports, will be subject to a tariff of 8.64%.

## Corporate & Commercial

### New policy for the steel industry

The National Development and Reform Committee recently announced that China is in the process of formulating a new policy for its steel industry, which will stipulate new requirements for technical equipment, introduce the concept of economy cycles and facilitate the transformation of the industry into a capital intensive industry. While acknowledging the crucial role played by the steel industry in the country's economy, the Committee recognised that structural changes are necessary and that the country's reliance on heavy industries, in particular the steel sector, cannot continue to increase.

According to the Committee, the steel industry is an energy-intensive, investment-intensive, highly polluting industry. Sustainable growth cannot be maintained if adjustments to the industry are not made and the quality of end products improved, in order to create a more energy-saving development model. Even though the annual production of China's steel industry is currently the largest in the world, China is still unable to produce many of the high-end products, such as equipment exclusively used for electricity generation, and big inch pipelines.

### First direct sales laws to be promulgated

The Direct Sales Administration Laws drafted by the Commerce Bureau were submitted to various bureaus for their opinions last week, following which they will be submitted to the Legislative Office of the State Council. The discussion on the 6th draft of the National Commerce Bureau's Laws Prohibiting Multi-level Marketing has also proceeded smoothly. It is anticipated that both Laws will be adopted by 11 December 2004, together with the Regulations regarding training of marketing personnel. These three measures will form the legislative framework for the direct sales industry in China.

### Growth in China's exhibition industry

The Vice Committee Chairperson of the China International Trade Development Committee, Gao Yan, recently announced that China's exhibition industry is one of the fastest growing industries in the country. The industry has grown by close to 20% this year, and its direct production value reached RMB 8 billion in 2003.

According to Gao, who was speaking at a press conference for China's International Cooperation Discussion Group Committee, there is still a huge gap between China's exhibition industry and the advanced international exhibition industry, in terms of competitiveness, standardization and efficiencies. In an effort to reduce this gap, and to promote foreign investment and cooperation in China's exhibition industry, the China Economic Development Committee, in conjunction with the United Global Exhibition Association, the International Exhibition Management Association and the Independent Exhibitors Association, will hold a China Exhibition Industry International Cooperation Forum in Beijing between 11 and 13 January 2005.

## Taxation

### New regulations targeting tax evasion by multinational companies

On 11 November, the National Tax Bureau promulgated the revised Regulations concerning Tax Management between Connected Companies.

According to statistics released by the Commerce Bureau, there were 494,025 foreign-invested enterprises in China as at the end of August 2004, more than half of which are suffering losses. China's tax experts have pointed out that a considerable portion of these losses were created for tax evasion purposes, and that transfer pricing between connected companies is one of the principal methods of tax evasion used. The Commerce Bureau estimates that tax evasion by multinational companies results in over RMB 30 billion loss of revenue to China, 60% of which is achieved by means of transfer pricing.

The typical means of transfer pricing is through overseas purchases and sales. The general procedure involves the PRC subsidiary of the multinational company purchasing raw materials from an overseas connected company at a high price and then after processing and production, selling the products at a low price back to the overseas connected company. In this way, the PRC subsidiary will be in deficit and the profits will be transferred to an overseas connected company which enjoys a lower tax rate.

The revised Regulations shall deem the trade financing between connected companies and its interest as part of the "transaction volume" between the connected companies. Such transactions will also be checked annually by tax auditors. Other items also deemed to be included within the transaction volume of connected companies are (i) the amount paid or charged for the sale of products or for services rendered between the company and its connected companies, (ii) the transfer of tangible assets between the company and its connected companies, and (iii) the amount paid or charged for licences to use assets between the company and its connected companies.

## Other

### Labour Insurance Supervision Law Promulgated

The Prime Minister, Wen Jia Bao, recently signed a State Council Order to enact the Labour Insurance Supervision Law, which will come into effect on 1 December 2004.

The Law comprise 5 chapters, including responsibilities for labour insurance supervision, implementation of labour insurance supervision and legal liability.

The Law provides that labour insurance supervision may be carried out via daily inspections, examination of written materials, complaint mechanisms and other means. During the inspection, there is to be no less than two labour insurance supervisors involved, and each supervisor must show the labour insurance supervision department's badge and present his or her identification documentation.

Under the Law, companies who delay paying wages to their employees will be required to pay compensation to the employees of between 50% and 100% of the relevant outstanding wages.

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