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# China News Alert Issue 86

## Headlines

### Listed companies disclosure levels in annual reports raised

The CSRC has released revised rules concerning listed companies' disclosure in their annual reports, which imposes more stringent requirements on listed companies in the disclosure of information relating to shareholders and senior managers.

Under the *Rules of disclosure contents and forms for listed companies-contents and forms of annual reports No.2*, listed companies must disclose the names of the ten largest tradable shareholders, the number of tradable shares held by each of them and the respective categories of shares (e.g. A, B or H shares). Any relationships existing between the ten largest shareholders must also be disclosed.

The new Rules also require disclosure of the main work experiences of directors, supervisors and senior managers, and their positions in enterprises other than the current companies they are working in. Companies must disclose the performance of independent directors, such as the attendance of independent directors at board meetings. If independent directors have dissenting views on company policies, the listed companies are required to disclose the dissenting views and the names of the independent directors who voiced them.

Finally, items such as "details, reasons and effects of major accounting errors and changes to amounts" have been added to the "Annotations of financial statements" under the revised rules.

### CBRC issues circulars on collective trust funds

The China Banking Regulatory Commission (CBRC) has adopted the *Circular on Issues Concerning Further Regulation of Collective Trust Funds* and the *Circular on Issues Concerning Trust Companies Disclosure of Information on Collective Trust Funds*.

The two circulars include comprehensive provisions concerning trust companies' qualifications for operating collective trust funds, referral methods, management of trust funds, and information disclosure and supervision.

In relation to supervision, collective trust funds must provide a preliminary report on their collective trust funds business operations five days prior to the commencement of operations, and an official report 5 days after the funds issue.

For a trust company commencing collective trust funds operations in foreign localities, the circulars introduce the qualification verification system for the trust company's foreign operations, and set out specific arrangements for the coordination of supervision of foreign operations.

The circulars also establish a due diligence investigation system for collective trust fund operations, explicitly providing that trust companies must conduct due diligence inquiries on the qualifications of trustors participating in the collective trust plan, as well as projects to be invested with trust funds. Trust companies are also required to produce independent due diligence investigation reports.

The circulars establish a trust mechanism, which collective trust fund operations must apply on a trial basis. Where trust investments constituting connected transactions or trust funds are invested in securities, the trust mechanism must be introduced and basic requirements and responsibilities of trustors set out.

The circulars also restrict connected transactions, by providing that, in a given fiscal year, the amount incurred by a trust company's transactions with any connected party must not exceed 50% of the fund's assets, and the conditions of the transaction should be concluded on an "arms-length" basis.

The circulars set out a role for commercial banks in the marketing of collective trust plans, stipulating that commercial banks' services must be limited to agency collection services for trust companies. Commercial banks may not act as agents to execute any trust contract.

Finally, the circulars contain detailed provisions relating to information disclosure during

1. the trust marketing period,
2. within five working days following the end of the marketing period,
3. during the life of the trust scheme,
4. one month prior to termination of the trust scheme and
5. the period following termination of the trust scheme.

Trust companies are required to disclose information in writing, unless the trustor or beneficiary give written permission for the information to be disclosed in some other form. Supervision authorities have the power to request more detailed information in addition to the general disclosure obligations set out in the circulars. Trust companies may also disclose more information at their discretion or, with the consent of the trustor, decrease the amount of information to be disclosed to institutional trustors. Back to top

### China cancels restrictions on commercial franchise operations by foreign investors

In line with China's WTO commitments, the Ministry of Commerce (MOC) has adopted the *Measures for Administration of Commercial Franchise Operations*, which will come into force on 1 February 2005. The Measures provide that restrictions on market access and national treatment of foreign investors carrying out commercial franchise operations in the Mainland will be cancelled, and rules imposed on foreign-funded enterprises relating to, for example, establishment requirements, entitlements and liabilities, information disclosure and advertising, will be consistent with those imposed on domestic enterprises.

There are currently over 1,900 franchise operations in China, covering almost 60 sectors, including supermarkets, convenience stores, special home appliance stores, clothing stores, drug stores, book shops, launderettes and photograph processing shops.

## Capital Markets

### Stock exchanges release detailed rules on online voting

The Shanghai and Shenzhen stock exchanges have jointly released the *Detailed Rules for Online Voting in Shareholders' General Meetings of Listed Companies*. The Rules provide that any listed company intending to hold a shareholders' meeting may apply to have the relevant stock exchange provide shareholders with online voting services. The specific workings of the online voting system will be similar to the subscription procedures for new shares listed on the Shanghai Stock Exchange.

The Rules provide that listed companies proposing to implement online voting for shareholders' meetings must first submit an online voting application to the relevant stock exchange prior to publishing the notice of the particular shareholders' meeting. The notice must include information relating to online voting times, voting procedures, and items to be discussed at the meeting.

The Rules also provide that any shareholder casting an online vote shall be deemed to have attended the shareholders' meeting and shall be included in the account of voting number of shareholders present at the meeting. For those items which the shareholder has not voted upon, the shareholder shall be deemed to have waived his voting rights on those items.

The Shenzhen Stock Exchange's online voting system provides for two voting mechanisms, namely the trading system and the Internet voting system. Under the trade system, shareholders may vote by appointing proxies by telephone, online trading and almost all other methods used in the trading of shares. Internet voting requires shareholders to register online for a username and undergo a series of identification verification procedures prior to voting online.

If the trading system is implemented by listed companies, shareholders are not required to undergo identification formalities. On the day of the shareholders' meeting, shareholders only need to subscribe according to the general procedure for new share subscriptions. If voting is conducted through an online or Internet voting system, the Shenzhen Stock Exchange will provide two identification alternatives for investors: a digital certificate and a service password.

### Mainland companies accelerate overseas investment

According to recent statistics issued by the National Bureau of Statistics of China, as of 10 December 2004, 38 Mainland listed companies had participated in overseas investments covering 43 projects and totaling over RMB 7 billion, with a year-on-year growth of RMB 4.8 billion. In 2004, the three largest overseas projects were:

* the TTE Group, jointly established by TCL and Thomson;
* a new company established overseas in which Shanghai Belling Co., Ltd holds a 11.22% stake through Shanghai Huahong NEC Electronics Co., Ltd;
* a urea project established in Bolivia by Sichuan Lutianhua Company Limited.

According to the statistics, listed companies tend to choose Hong Kong as the primary location for overseas investments, followed by the Asia Pacific region generally and Europe. The main investment areas are electronic communications, medicinal products and trade.

Many of the listed companies investing overseas are leaders in their industries, such as TCL and BOE in the electronic communications industry, and Tsinghua Tongfang and Shanghai Belling in the IT industry. In addition, a number of small and medium sized listed companies have also actively invested overseas, including Ma Yinglong, which invested US$ 2.4 million in establishing Mayinglong International Medical Development, and Hangzhou Silan Microelectronics, which invested US$ 2 million in establishing Silan Science & Technology in Hong Kong. Other SMEs such as Supor, Eastcompeace and Septwolves have also established overseas branches.

### Rules on short-term financing bonds of securities companies

On 29 December 2004, the National Interbank Funding Centre of China released the *Rule on Operating Trade of Short-term Financing Bonds of Securities Companies* and the *Rule on Operating Disclosure of Short-term Financing Bonds Information of Securities Companies* to the trading members of the interbank bond market.

Under the rules, short-term financing bonds must be traded through the electronic trade system of the National Interbank Funding Centre. The participants in the trading of short-term financing bonds must be the trading members of the national interbank bond market accessible via the trading center network. The tradeable products of short-term financing bonds include bonds, collateral repos and sell/buy backs. The main trading method consists of price offering, formatted price enquiry and confirmation of purchase, while the secondary method consists of price offering and confirmation of purchase. Securities companies issuing short-term financing bonds must disclose related information on www.chinamoney.com.cn Securities companies must also disclose balance sheet, profit distribution and other financial information by January 20, April 30 and July 30 each year.

### Hong Kong banks account for one quarter of foreign-funded banks in Mainland China

According to data released by the CBRC on 30 December 2004, a number of Hong Kong banks have taken advantage of preferential terms under the Closer Economic Partnership Arrangement (CEPA) in order to invest in Mainland China. Currently, Hong Kong banks have established 58 business "sub-institutions" (including 45 branches, 10 sub-branches, 1 financial company and 2 joint-stock banks) in Mainland China. Of these, 38 have been licensed to operate renminbi businesses and 3 have been approved to hold shares of domestic commercial banks.

Currently, the 58 Hong Kong business sub-institutions account for about one quarter of foreign-invested banks in the mainland. Hong Kong banks also account for about one-third of foreign-funded banks which have been licensed to operate renminbi businesses. In addition, of the foreign-funded banks licensed to operate online banking businesses, six are from Hong Kong.

In 2004, the CBRC approved five Hong Kong banks to establish sub-banks in the mainland under CEPA. The five banks are Wing Lung Bank, Shanghai Commercial Bank and Dah Sing Bank (which all established sub-banks in Shenzhen), and Wing Hang and CITIC Ka Wah Bank (which both established sub-banks in Shanghai).

### SSRB Proposes Five Measures on Audit Regulation

The Shenzhen Securities Regulatory Bureau (SSRB) recently held a working meeting to discuss auditing issues relating to companies listed on the Shenzhen Stock Exchange. The SSRB has proposed nine supervisory requirements and five concrete measures to further regulate auditing work performed on listed companies and to improve the quality of audits.

The five measures are as follows:

* accounting firms that fail to issue an audit report in accordance with the regulations or a specific explanation for the Occupation of Funds will be required to correct the irregularity and reissue the specific explanation and audit report;
* the SSRB will warn regulatory violators orally and in writing (by circulating a notice of criticism), to admonish listed companies and investors. The SSBC will suggest that accountancy firms replace audit staff who refuse to correct irregularities after being reprimanded on a number of occasions, and will suggest that listed companies change accountancy firms who refuse to correct irregularities following several reprimands;
* the SSRB will report the professional practice of accounting firms and their accountants who perform audits on companies listed on the Shenzhen Stock Exchange to the financial authorities and the Certified Practicing Accountants Association in order that these authorities will pay particular attention to these accounting firms and their accountants during their routine supervision and annual audits;
* the SSRB will request relevant authorities to cancel qualifications of auditors displaying a lack of ethics, incompetence or who cause losses due to breach of duty.
* if accountancy firms fail to perform their auditing obligations in case of accounting malpractice of listed companies, investors are encouraged to bring lawsuits against relevant accountancy firms. In the event that accountants are suspected of violating criminal law, public security agencies will investigate the suspected violations.

### Beijing Capital Tourism successfully implements categorized voting

Beijing Capital Tourism has successfully implemented China's first categorized voting procedure (i.e. separate voting for tradable and non-tradable shares) in an interim shareholders' meeting.

Almost2.4 million shares were voted in favour of the rights issue proposal, accounting for 55.19% of tradable shares participating in the voting. All non-tradable shares participating in the voting, amounting to over 1.6 million shares, were in favour of the proposal.

Beijing Capital Tourism also used the online voting system of the China Securities Depository and Clearing Corporation (CSDCC) as an online voting platform for investors to vote on the rights issue proposal. As a result, the shareholders' meeting attracted considerable attention.

Holders of tradable shares participating in the voting included three institutional investors: Shanghai Employees' Security Benefits Association, Jinying Fund and Guilin Tourism Development Head Office, representing a total of over 3.3 million shares. No individual investors participated in onsite voting.

The online voting began at 9 a.m. and ended at 3 p.m. As shown by the results provided by the CSDCC, holders of 948,400 tradable shares chose to vote online, accounting for only 1.35% of tradable shares.

As disclosed by the CSDCC, during Beijing Capital Tourism's online voting period, network congestion and slow logon times were caused by heavy traffic on the CSDCC website. The CSDCC has urged investors to complete the procedures for online registration, identification verification and downloading electronic certificates at a time outside of online voting time.

In the short term, it is estimated that ten listed companies are planning to hold shareholders' meetings through the online voting system of the CSDCC, including China Minsheng Banking Corporation, North China Pharmaceutical Group Corporation and Huadian Energy.

### The PBOC and CRBC Announce Revision and Abolition of Regulations

The People's Bank of China (PBOC) and the China Banking Regulatory Commission (CBRC) have announced the revision or abolition of a number of financial regulations. 38 rules will be abolished from the date of the announcement, as follows:

1. *Circular of the PBOC on authorizing its branches and business management division to approve applications by representative offices of foreign banks for extension of term of operation*
2. *Circular of the PBOC on problems of market access of foreign-invested financial institutions released after the promulgation of the Detailed Implementation Rules for Regulations governing foreign-invested financial institutions in the PRC*
3. Circular on printing and issuing *Methods for regulating urban credit cooperatives*
4. Circular on printing and issuing *Opinions on further regulating rural credit cooperatives*
5. *Circular on forbidding merger of rural credit cooperatives in suburbs into city commercial banks*
6. Circular on printing and issuing the *Provisional methods for annual inspection on rural credit cooperatives* and carrying out annual inspection on rural credit cooperatives in 1997
7. Circular on printing and issuing the *Opinions on intensifying regulation of credit cooperatives*
8. Urgent circular on intensifying the regulation of city-level rural credit cooperatives
9. Circular on printing and issuing the *PBOC's System of responsibility for financial supervision* (provisional)
10. Circular on [non-spot] inspection on non-bank financial institutions
11. Circular on examination and approval problems related to changes concerning city-level rural credit cooperatives
12. Circular on *Opinions on intensifying supervision on rural credit cooperatives*
13. Circular on printing and issuing *Basic working procedures for supervision on rural credit cooperatives*
14. Circular on further fulfilling supervision responsibility for rural credit cooperatives
15. Circular of the PBOC on printing and issuing the *Implementation methods for rural credit cooperatives' system of supervision responsibility*
16. The PBOC's audit procedures
17. Circular on printing and issuing the *Provisional methods for regulating credit funds of urban cooperative banks*
18. Circular on printing and issuing the *Provisional methods for regulating asset to debt ratios of financial trust investment institutions*
19. Circular on printing and issuing the *Provisional methods for regulating asset to debt ratios of rural credit cooperatives*
20. Circular on revising indicators for regulating asset to debt ratios for rural credit cooperatives
21. Circular on printing and issuing the *Opinions on classified guidance and disposal of rural credit cooperatives*
22. Circular on printing and issuing the *Provisional methods for regulating small-amount loans lent by rural credit cooperatives to farmers*
23. Circular on printing and issuing the *Opinions on improving rural credit cooperatives' management and services of credit extension to support overall economic development of rural areas*
24. Circular on supplementary provisions of articles of charging cross-bank trade relating to *Methods for regulating bank card business*
25. Circular of PBOC on adjusting methods for charging and allocating fees relating to cross-bank trade of bank cards
26. Circular on releasing the *Provisions on foreign exchange business scope of banks at all levels*
27. Provisions on trust deposits in offshore foreign currencies run by non-bank institutions
28. Circular on problems related to procedures examining and approving the foreign exchange business of wholly state-owned commercial banks
29. Circular on printing and issuing *Guidance on supervision on consolidated financial statements of foreign-invested banks*
30. Circular on printing and issuing *Provisional Procedures for examining and approving establishment of financial companies of business conglomerates*
31. Circular on printing and issuing *Provisional provisions on qualifications of middle and senior managers of foreign-invested financial institutions*
32. Circular on forbidding bank staff from taking part-time jobs in enterprises or economic entities
33. Supplementary circular on reviewing qualifications of senior managers of financial asset management companies issued by the office of the PBOC
34. PBOC circular on problems related to calculating coverage of capital sufficiency ratios
35. Circular on printing and issuing Guidance on foreign banks' withdrawal their business branches in China
36. Circular on problems related to current financial management of rural credit cooperatives
37. *Methods for regulating financial companies of business conglomerates*
38. Circular on problems related to implementing *Methods for regulating financial companies of business conglomerates*.

## Trust

### CBRC and CSRC release circular on trust company securities accounts

In order to implement the principle of "separate management and accounting" of trust property, as contained in the Trust Law, the CBRC and the CSRC have jointly promulgated the *Circular on Issues Concerning Trust Companies' Opening of Specific Securities Accounts and Specific Trust Fund Accounts*.

The circular provides that trust companies investing trust funds in securities must use separate accounts for trust securities and trust funds. Upon termination of the relevant trust, trust companies must realise securities assets in the specific trust securities account in a timely manner, and must write-off the specific trust securities account and the specific trust fund account with the China Securities Depository & Clearing Corporation Limited (CSDCC) and related securities companies, as well as preserving all accounting data related to the above accounts.

The CBRC has also released the *Circular on Issues Concerning the Regulation of Trust Companies' Securities Operation and Management*, which sets out rules concerning investments by trust companies in securities operations which involve account opening and fund management.

The circular provides that trust companies must separately manage trust funds and their own funds. Trust companies are required to set up

1. specific trust property accounts with commercial banks,
2. specific trust securities accounts with either the Shanghai or Shenzhen office of CSDCC, and
3. specialized trust accounts with securities companies approved by CSRC.

The total balance of the daily market value of investments in listed stocks, corporate bonds and securities funds by trust companies should not exceed 50% of the net assets of the trust company.

The above two circulars, together with the *Circular on Matters Concerning Trust Companies' Opening and Use of Renminbi Bank Clearing Accounts* issued by the People's Bank of China and the *Circular on Issues Concerning Trust Companies' Opening and Use of Renminbi Bank Clearing Accounts* issued by the CBRC in February 2004, form the foundation of China's trust property account management system.

## Insurance

### CIRC promulgates new rules for insurance agencies

Mr. Wu Dingfu, chairman of the China Insurance Regulatory Commission (CIRC), has recently signed and released the updated *Administrative Rules for Insurance Agencies and Administrative Rules for Insurance Broker Institutions*. The updated rules aim at increasing protection for policyholders and supervision of insurance intermediaries, and improving related administrative procedures. The principal amendments to the rules include the following:

* establishment of the right of policyholders to be informed of, and the obligation to notify policy holders of, immunity provisions in insurance contracts;
* introduction of new provisions relating to the establishment and management of insurance intermediary branches;
* lowering of educational and professional qualification requirements for senior managers of insurance intermediaries; emphasis will instead be placed on the management experience and capability of senior managers;
* increased supervision of professional insurance intermediaries;
* reinforcement of insurance companies' responsibilities for managing and controlling their agencies;
* establishment of insurance intermediary reporting and disclosure systems;
* reform of the State Council administrative review and approval system, and simplification of insurance intermediary licensing procedures;
* reduction of the minimum registered capital threshold for insurance brokers from RMB 10 million to RMB 5 million.

### New rule on insurance companies' non-life insurance businesses and reserves

The CIRC has recently adopted the *Provisional Measures on Managing Insurance Companies' Non-life Insurance Business and Reserves Issues*. The new measures are designed to adapt China's insurance regulatory framework, in particular in relation to liability provisioning methods and maintenance of sufficient reserves, to changing market conditions.

The measures standardize the classification of non-life insurance reserves of insurance companies, and provide that non-life insurance reserves include unearned premium reserves (including long-term and short-term unearned premium reserves), outstanding loss reserves (including both reported and unreported outstanding loss reserves that are incurred) and other liability reserves.

The rule also aims to standardize provisioning methods. Insurance companies must

1. apply the method of 1/24 or 1/365 to draw out unearned premium reserves,
2. apply methods such as case-by-case estimation and average payment to draw out incurred reported outstanding loss reserves,
3. apply at least two of such methods as ladder method, average payment, reserve progression and B-F to draw out incurred reported outstanding loss reserves.

Insurance companies must also test the sufficiency of unearned premium reserves. Where reserves are insufficient, insufficient-premium reserves should be drawn out. Insurance companies are required to establish a non-life insurance actuarial system and designate actuarial employees to assess non-life insurance reserves. Finally, insurance companies are required to regularly submit to the CIRC non-life insurance reserve assessment reports.

It is anticipated that the CIRC will soon adopt detailed implementing legislation to supplement the new measures, setting out specific requirements for reserves assessment and reports.

## WTO

### US decreases anti-dumping tariffs on Chinese furniture products

The Bureau of Fair Trade for Imports and Exports of the Ministry of Commerce, has announced that the US Department of Commerce has decreased the average anti-dumping tariff on Chinese furniture enterprises from 8.64% to 6.65%. The decision of the US Department follows an anti-dumping case in respect of wooden bedroom furniture exports.

### China to reduce import tariffs of 900 Tax Items from January 2005

The Office of Customs Tariff Commission, State Council has announced that China will reduce the general tariff rate on imports from 10.4% to 9.9% from 1 January 2005. The reduced tariff rate will apply to over 900 items.

In line with WTO commitments, it is foreseen that, in 2005, the average tariff rate of agricultural products will be reduced from 15.6% to 15.3%; while that of industrial products will be reduced from 9.5% to 9.0%.

The average tariff rate on aquatic products will be 10.5% in 2005. The rate on other specified products are as follows: lumber, paper and related products, 4.6%; textile and clothing, 11.4%; chemical products, 6.9%; vehicles, 13.3%; machinery products, 8.0%; and electronic products, 9.1%.

In 2005, China will levy a provisional most favored nation tariff on over 200 imported goods and will continue to impose customs quotas on 10 products, including wheat and bean oil, and certain chemical fertilizers, including diammonium phosphate. China will also levy specific duties and compound duties on frozen chicken, beer, video cameras and other products.

### Supreme Court lowers criminal prosecution threshold for IP infringements

The Supreme Court of the People's Republic of China and the Supreme Procuratorate of the People's Republic of China have jointly issued an interpretation on legal aspects of intellectual property criminal cases, reducing the threshold for criminal prosecution on four categories of criminal offences, including counterfeiting of registered marks.

The newly issued judicial interpretation adjusts the prosecution standard for four of the seven categories of intellectual property infringements set out in the Criminal Law. In relation to counterfeiting trademarks, selling goods with counterfeited trademarks, and manufacturing and selling goods with counterfeited trademarks, the prosecution threshold will be reached once the volume of the illegal business is equivalent to 50,000 yuan or the illegal income is over 30,000 yuan.

## Corporate & Commercial

### State Council approves coal-electricity price linkage mechanism

The scheme on coal-electricity price linkage has been approved by the State Council and detailed rules are expected to be adopted in early 2005. Recently, the National Development and Reform Commission of China (NDRC) released the *Opinion on Establishing a Coal-Electricity Price Linkage Mechanism*, specifying important issues such as the method of calculating price linkage, initial price linkage calculation baseline, power price adjustment intervals and the interaction between electricity sale prices and the supply prices of electricity generation plants.

It is understood that the initial coal-electricity price link will be based on the "truck-loading" price (i.e. the settlement price when coal is loaded on trucks) of coal for electricity generation (electric-coal) provided by coal enterprises at the end of May 2004. The link between the price of electricity on the power grid and coal prices are measured and adjusted based on average growth rates of electric-coal truck-loading prices between June and November, as well as the coal-electricity price linkage formula. For areas where coal price growth is subject to large fluctuations, provincial, regional and city adjusted prices respectively may be applied.

When electricity sale prices are adjusted, the sale price provided for users by network operators is to be adjusted according to the principle of maintaining the operators' transmission and distribution prices relatively stable. Sale prices for residential, agricultural and small and medium chemical fertilizer electricity are to adjusted at most once a year. With the exception of residential electricity prices, electricity prices are to be adjusted according to the change in grid price.

Coal and electricity prices will be linked on a semi-annual basis. Electricity prices will be adjusted using the linkage formula if the fluctuation in average coal price equals or exceeds 5% of the price in the last six-month period. Otherwise, the price will not be adjusted until the aggregate change in price exceeds 5% in the next period.

The NDRC Opinion also aims to regulate coal distribution by prohibiting random increases in prices through intermediary distribution links. Coal to be delivered under supply contracts between coal suppliers and power plant operators must be delivered directly without an intermediary distribution link. In addition, in order to encourage market participants to execute medium and long-term contracts, transportation departments must give priority transportation to such contracts.

The major underlying factor affecting coal prices remains market supply and demand. On the demand side, the large thermal power plants constructed in the past two years are to be put into operation in 2005 and 2006, thus ensuring that demand for coal for power generation will continue to grow. On the supply side, transportation bottleneck difficulties continue to restrict coal supply. As a result, the growth momentum of coal prices in recent years is likely to remain strong.

### SDRC sets conditions for access to calcium carbide, coke and ferroalloy industries

The State Development & Reform Commission (SDRC) has recently set out a number of conditions for access to the calcium carbide, coke and ferroalloy industries, which came into force on 1 January 2005. A series of specific standards will strictly apply to newly-established projects in the three industries.

Under the *Conditions on Access to the Calcium Carbide Industry*, operators will not be permitted to manufacture calcium carbide equipment alongside major rivers, tourist spots or residential communities. Generally, newly-established calcium carbide devices must have a furnace capacity of at least 25,000 kVA. In certain underdeveloped areas of west and central China with independent micro hydropower projects and which enjoy advantages in mineral resources, furnace capacity must be not less than 12,500 kVA. Calcium carbide furnaces with capacity below 5,000 kVA, and open calcium carbide furnaces, must be decommissioned.

The *Conditions on Access to the Ferroalloy Industry* set out strict provisions in relation to techniques, equipment, energy and resource consumption and environmental protection. Ferroalloy mine thermoelectric furnaces (in semi-closed shape with furnace hood, or in closed shape) must have a capacity of at least 25,000 kVA (or 12,5000 kVA in the west and central areas, as explained above). Furnaces must be equipped with dust removal and collection, and smoke and waste water online monitoring devices. Ferrosilicon units' smelting power consumption should be no more than 8,500 kWh per tonne, and 2,600 kWh per tonne for high carbon ferromanganese. The water recycling ratio should at least 95%.

The *Conditions on Access to Coking Industry* prohibit the construction of coking plants alongside major rivers, residential communities, nature conservation areas, scenic spots and protected drinking water source areas. Newly-established, renovated or expanded coke ovens must have a retort height of not less than 4.3 metres, and an annual production capacity above 600,000 tonnes. Coke facilities must also incorporate dust removal devices, gas purification and collection devices, and waste water biochemical treatment devices.

Previous notices issued by the State Development and Reform Commission and other governmental departments, have expressed concern at perceived over-capacity and inefficiencies in the calcium carbide, ferroalloy and coke industries. At present, the combined capacity of established coke enterprises and those under construction amounts to 360 million tonnes, while the capacity of calcium carbide and ferroalloy stands at 17 and 19 million tonnes respectively, or between two to three times actual output in 2003. The production capacity of the three industries is far ahead of market demand. The State Development and Reform Commission has stipulated that relevant authorities must comply with the above industry access conditions, including investment management, land supply, environmental evaluation, credit financing and electricity supply for calcium carbide, ferroalloy and coke production and construction projects.

### New measures on advertising

The State Administration for Industry and Commerce has recently formulated the *Advertisement Licence Management Measures, Rules for Implementation of the Advertisement Management Regulations*, and *Printed Advertisement Management Measures*, which became effective on 1 January 2005.

The *Advertisement Licence Management Measures* stipulate that broadcasting stations, TV stations, newspaper and periodical publishers and other entities required to undergo advertising examination, approval and registration processes will be required to hold advertising licences.

The *Rules for Implementation of the Advertisement Management Regulations* increase the conditions under which special advertising agencies may be established and advertising professionals employed. In addition, the new measures provide that the Administration of Industry and Commerce will no longer issue approvals for such entities to acts as agents for advertising work produced by entities in the same category as themselves.

The Rules further provide that domestic enterprises advertising abroad, or foreign enterprises advertising in China, must entrust a business entity registered in China with the requisite advertising qualifications.

Entities engaging in advertising without licences will be penalized according to relevant provisions. Persons issuing misleading advertisements, and advertising operators who assist clients in misleading consumers, will be required to broadcast corrected advertisements, and will be fined an amount equivalent to not more than three times the illegal income received on foot of the misleading advertisement, up to a maximum of RMB30,000. Operators will also be liable for any damages caused to consumers. In the case of serious damages, operators may have their advertising or business licences revoked.

The *Printed Advertisement Management Measures* stipulate that printed advertisements for medicines, medical apparatuses, agricultural chemicals, veterinary medicines and similar products must obtain corresponding approvals.

### China to launch automatic import licensing management for cars

Pursuant to its WTO commitments, China will cancel quota licensing for car imports from 1 January 2005. The Ministry of Commerce has announced that automatic import licensing management will be implemented for cars from that date. The *Rules for Implementation of Granting and Management of Automatic Import Licences for Cars* have been adopted in order to monitor car imports and maintain and standardize the domestic car market, and will also come into force on 1 January 2005.

The specific commodity names and codes are contained in the Commodity Catalogue for Cargo Automatic Import Licensing. The Ministry of Commerce will be responsible for the management of car import licensing. Car products stated in the Commodity Catalogue as being under the administration of the Ministry of Commerce will be issued automatic import licences by the Ministry of Commerce. Other cars (i.e. those not under the administration of the Ministry of Commerce) will be issued import licences by local electromechanical products import and export offices.

The Ministry of Commerce announcement states that in addition to the documentation required under the *Management Measures for Cargo Automatic Import Licensing*, entities applying to import cars must also submit authorization certificates for car distribution for sale of the imported cars. Entities applying to import cars through general trading methods for their own use must submit their business licences or company code certificates. Those applying for import of complete sets of car parts (including SKD and CKD) and assembly systems for production must submit the "Bulletin of Road Motor Vehicle Manufacturers and Products" in which their products are listed.

## Real Estate

### Circular to strengthen administration of property leasing

Six government ministries, including the Ministry of Public Security, the Central Committee Office for Comprehensive Management of Public Security, the Ministry of Civil Affairs, the Ministry of Construction, the State Administration of Taxation and the State Administration for Industry and Commerce have jointly issued a circular concerning the penalization of breaches of property leasing administration rules. Among the breaches which will attract serious censure are the following:

* failure to comply with lease registry formalities;
* leasing of properties which do not satisfy leasing conditions;
* failure to sign a guarantee on public security liability with the local security authority after registering a property lease and refusing to correct such act upon receiving a related notice;
* leasing property to any person without a valid certificate;
* breaching fire safety and security rules;
* leasing properties with serious hidden fire hazards and refusing to correct such act upon receiving a notice from security authorities;
* failure to apply for registration of temporarily-residing employees according to related rules

## Foreign Investment

### SAFE rules for utilizing foreign capital in disposition of non-performing assets

The State Administration of Foreign Exchange (SAFE) recently adopted the *Circular on Foreign Exchange Management concerning Disposition of Non-performing Assets by Financial Asset Management Companies*, which came into effect on 1 January 2005. The Circular is aimed at facilitating financial asset management companies to utilize foreign capital in disposing of non-performing assets and to protect stakeholders' interests during such dispositions.

The Circular provides that financial asset management companies must be examined and approved by relevant national authorities prior to disposing of non-performing assets with foreign capital. Overseas investors (or their domestic agents) must submit the relevant documentation to SAFE in relation to a series of procedures, including non-performing asset transfer record and registration, profit remittance approval and write-off records.

Foreign investors (or their domestic agents) may, by purchasing foreign exchange, remit proceeds of resale, transfer or operation of non-performing assets. The remittance procedures should be conducted through local branches of SAFE.

Where the assets to be registered include equity, the enterprises accepting the transfer of equity must follow applicable national laws and regulations concerning, among other things, equity capital verification and circularization procedures, subject to the related rules of foreign exchange.

Financial asset management companies establishing foreign investment enterprises in which non-performing assets are contributed as capital, must conduct the relevant procedures at the local branch of SAFE with which the relevant foreign investment enterprise is registered.

When disposing of non-performing assets with foreign capital, financial asset management companies must make efforts to protect the interest of the guarantor of the original debt contract.

The Circular also specifies that the rules set out therein are equally applicable where financial asset management companies sell or transfer non-performing assets to organizations or individuals in Hong Kong, Macao and Taiwan, to foreign nationals, and other domestic financial institutions permitted by the relevant authorities to utilize foreign capital in disposing of non-performing assets.

## Taxation

### Circular on VAT deductions in northeast China

The Ministry of Finance and the State Administration of Taxation have recently promulgated the *Urgent Circular on Implementing Policies concerning Extending the Areas for VAT Deductions*. The Circular supplements existing policies on extending the areas of China benefiting from VAT deductions.

Heilongjiang Province National Taxation Bureau has explained that enterprises in the relevant areas should first use the tax deductions received from fixed asset purchases to set off VAT owed. This process should be done strictly according to the rules on deducting VAT set out in the 2004 *Provisional Rule concerning Extending Value-added Tax Deduction Areas in Northeast China*.

The Circular also provides that if a balance remains after deduction for tax owing from VAT paid on fixed assets between 1 July and 30 November 2004, the tax reimbursement may not be calculated based on VAT accruals, but is to be calculated based on VAT revenue passed into account in 2004. The balance of VAT paid on fixed assets should be deducted in the next year.

The Ministry of Finance and the State Administration of Taxation require tax authorities at all levels to reimburse VAT paid on fixed assets strictly in line with relevant auditing requirements. Deductible VAT should be refunded to taxpayers before 31 December 2004.

The Ministry of Finance and the State Administration of Taxation promulgated the *Rule on Several Issues concerning Extending Value-added Tax Deduction Areas* in September 2004, which covered Liaoning, Jilin and Heilongjiang Provinces and Dalian. The aim of the Rule was to launch a transition from a "production" to a "consumption" type VAT.

The VAT reform is applicable to VAT general taxpayers who are primarily engaged in equipment manufacturing, petrochemical businesses, metallurgy, ship manufacturing, automobile manufacturing and farm products processing. Enterprises involved in the manufacture of military and state-of-the-art products may also apply. The Rule provides that the deductible VAT may not exceed the VAT accruals in that year. Where there are no or insufficient VAT accruals in a particular year, VAT may be deducted in the following year ("incremental deduction").

### Export tax refund system for electrolytic aluminum and ferroalloy abolished

The Ministry of Finance and State Administration of Taxation recently adopted a circular on increasing the export tax refund rate on certain IT products to 17%. The products include integrated circuits, mobile communication equipment and PCs. In addition, the Ministry of Finance and State Administration of Taxation adopted a second circular abolishing export tax refunds (exemptions) on certain goods, including electrolytic aluminum and ferroalloy, primarily involving non-forged and non-alloyed aluminum, non-forged aluminum alloy, ferromanganese, silicon iron, and silicon manganese iron, as of 1 January 2005.

### New textile export tax rate

The Department of Commerce adopted a textile export tax rate on 31 December 2004. The tax rates are set in two classes with respect to goods that are measured through pieces (suit, item), including 0.3 Yuan/piece (suit, item) and 0.2 Yuan/piece (suit, item). In relation to goods that are measured through quantity, the tax rate is set at 0.5 Yuan/Kg.

## Other

### Judicial interpretation of technology contracts

The Supreme Court has issued a judicial interpretation on technology contracts, which will come into effect on 1 January 2005. According to Mr. Jiang Zhipei, the presiding judge of No.3 Civil Division of the Supreme Court, the differentiation of service technical achievements and non-service technical achievements should be in line with any agreement between the parties concerned.

The judicial interpretation provides that, in accordance with principle of freedom of contract as contained in the Contract Law, the courts will recognize provisions in technology contracts on rights and interests relating to "technical achievements" made during or outside the tenure of office by employees.

The courts will subsequently determine whether the technological achievements have arisen as part of the duties of the relevant employee.

The judicial interpretation further states that, unless otherwise defined in relevant laws and regulations, a bona fide third party who has received access to technology secrets may continue to use such information upon payment of reasonable royalties to the owner.

The judicial interpretation lists six types of "technological achievements", including material scientific and technological improvements, information and experience, including patents, patent applications, technology secrets, computer software, integrated circuit mapping designs and new plant breeds.

### New regulations to come into effect in 2005

Several new regulations will come into effect in China from the beginning of 2005, including those listed below.

* As of 1 January 2005, the State General Administration of Quality Testing and Supervision will implement a food safety market access system for ten categories of foodstuffs, including meat products, dairy products, convenience food, bulk refrigerated food, condiments and beverages. Bulk refrigerated foods without food production licenses, eligible verification and QS marks will not be permitted to be placed on the market. The first phase of the food safety market access systems, covering food products such as rice, flour, oil, sauce and vinegar, came into effect at the start of 2004.
* The compulsory standard of *National General Safety Technical Code for Textile Products* will be put into effect on 1 January 2005. It provides new rules on textile product safety.
* The State Administration of Taxation will impose a direct tax on acquisitions of real estate from 1 January 2005. On 31 December 2004, other departments ceased imposing taxes for the acquisition of real estate when processing house property ownership certificates.
* From 1 January 2005, China's average tariff level on imported goods will be decreased from 10.6% to 10.1%.
* Tariffs of digital cameras and components will be cancelled.
* From 2005, tariffs on imported lip and eye cosmetics and face powder will be limited to 10%, while tariffs on other imported cosmetics will gradually be reduced to 19.2%, 16%, 12.8% and 9.7% between 2004 and 2007. A final tariff of 6.5% will be implemented from 2008.

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