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IMPROVING THE ADMINISTRATION OF CUSTOMS TARIFF COLLECTION

Key Points:

- **Improved rules for Customs revenue collection**
- **Special treatment for five categories of product**

The desire to ensure uniformity in the operation of nationwide Customs procedures has led to the issuing of numerous practice and administration related regulations all of which serve to improve China’s Customs service. An important set of newly issued regulations is the *Administrative Rules Concerning Tariff Collection on Imports and Exports* – effective March 1, 2005 – that replaces the earlier version of the rules issued in 1986. The new rules focus on the procedures to be followed in Customs

revenue collection and in particular, the completion of the Customs declaration process. They also give guidance regarding the manner of determining applicable tariff rates and the procedures for calculating tariffs. In the rules, five categories of imported product are identified as being subject to special customs clearance procedures viz., (a) replacement products, (b) products that are subject to leasing arrangements, (c) products that are imported on a temporary basis only, (d) products that are imported/exported for the purpose of undergoing repair, and (e) products that are exported and then returned. Given the exponential increase in China’s trade, the number of products that fall in these categories has grown enormously and therefore, clarification of the procedures pertinent to these particular cases has been most welcome. The

issuing of the revised rules is but another step in the continuing efforts to promote efficiency of service and uniformity of application in the Customs service.

– Diarmuid O'Brien

SAFE TIGHTENS ADMINISTRATION OF FOREIGN EXCHANGE IN M&A BY FOREIGN INVESTORS

Key Points:

- **More regulation of domestic companies planning to obtain public listing of their off-shore parent companies**

On January 24, 2005, the State Administration of Foreign Exchange ("SAFE") issued the *Circular on Improving Administration of Foreign Exchange in Mergers and Acquisitions by Foreign Investors* ("Circular"). Under the Circular, SAFE imposes a strict regulative regime on domestic companies that are planning to obtain a public listing of their foreign holding companies.

The shareholders of many domestic companies usually incorporate or acquire a listing vehicle in one of the off-shore jurisdictions. The listing vehicle is then used to acquire the domestic company and convert the domestic company into a foreign-invested enterprise ("FIE"). The offshore listing vehicle then may be used to take the business public in overseas stock exchanges. The Circular specifically targets and imposes new regulatory approval requirements over different stages of this process.

First, under the Circular the establishment or acquisition of control in any overseas enterprise, directly or indirectly, by any individual PRC domestic resident now requires compliance with approval and

registration procedures set forth in the *Rules re Administration of Overseas Investment* (issued by SAFE in 1989). The *Rules re Administration of Overseas Investment* originally applied only to overseas investment by domestic enterprises. Thus the Circular extends SAFE's regulation to overseas investment by individuals.

Second, the Circular requires prior verification by the foreign exchange authority before any PRC domestic resident may sell any asset or equity interest in China in exchange for equity interest or other proprietary rights in any overseas enterprise. According to the *Provisionary Rules re Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (issued on March 7, 2003, "M&A Rules"), purchase of equities or assets by foreign investors in M&A transactions must be approved by the Ministry of Commerce. The Circular adds the requirement of verification by the foreign exchange authority.

Third, after the domestic company has been converted into an FIE in accordance with the M&A Rules, the Circular requires strict examination procedures when the converted FIE applies for foreign exchange registration. If the foreign investor is established or controlled by PRC domestic resident(s), or the management of the foreign investor is the same as that of the target domestic company, the foreign exchange registration of such FIEs must be approved by SAFE. This means that when an FIE, converted from a domestic PRC company in preparation of an offshore IPO (though establishment of an offshore holding company), applies for foreign exchange registration, it will be subject to approval by SAFE, because the FIE and the listing vehicle will usually be controlled or owned

by the same domestic resident(s).

The Circular also requires that foreign exchange authorities closely monitor the relevant foreign exchange transactions of FIEs that have already converted in accordance with the M&A Rules and have obtained foreign exchange registration. Last, it is important to note that the term "domestic resident" referred to in the Circular is not restricted to Chinese citizens residing in China. According to the *Provisionary Rules re Administration of Foreign Exchange of Domestic Residents* (issued by SAFE in 1998), "domestic residents" include Chinese citizens residing in China, foreigners residing in China, and foreigners and compatriots from Hong Kong or Macau who have been living in China for a calendar year. – *Shawn Tai*

CIRC ISSUES TENTATIVE ADMINISTRATIVE MEASURE OF RESERVE FUND FOR NON-LIFE INSURANCE BUSINESS OF INSURANCE COMPANIES

Key Points:

- **Require assessment of required types of reserve funds**
- **Require setting aside and carrying forward reserve funds**

As mandated by the Insurance Law, the Chinese Insurance Regulatory Commission ("CIRC") issued the *Administrative Measures of Reserve Fund for Non-Life Insurance Business of Insurance Companies (Tentative)* (the "Administrative Measures") on December 15, 2004. The purpose of the Administrative Measures is to ensure solvency of insurance companies and to protect policyholders' interests. The Administrative Measures became effective on January 15, 2005.

The Administrative Measures are applicable to property insurance companies and reinsurance companies established within China, including Chinese domestic insurance companies, as well as Sino-foreign equity joint insurance companies, wholly foreign owned insurance companies and branch offices of foreign insurance companies. Non-life insurance business as referred to in the Administrative Measures includes property insurance, liability insurance, credit insurance, short-term health insurance, accident insurance and the reinsurance thereof.

The Administrative Measures require insurance companies to make assessment of the required types of reserve funds in accordance with non-life insurance actuarial principles and methods and prudential principles, and to accurately set aside and carry forward the reserve funds according to the assessment results. The types of reserve funds for non-life insurance business include potential liabilities reserve funds, pending liabilities reserve funds and other reserve funds as may be directed by CIRC, and the methods for drawing each type of the reserve funds are specified in the Administrative Measures. Finally, insurance companies are required to submit to CIRC regular assessment reports of the reserve funds, which should be signed off by the person in charge of actuary.

The Administrative Measures and other related CIRC regulations are important components of the financial safety system that the government is putting into place for Chinese insurance companies. Under Article 145 of the Insurance Law, revised as of October 28, 2002 and effective as of January 1, 2003, if an insurance company fails to set aside or

carry forward any liability reserve funds, CIRC should order rectification and impose a fine of between RMB 50,000 and RMB 300,000, and if the circumstances are serious, CIRC may restrict the insurance company's scope of business, order cessation of the acceptance of new business or revoke the permit for insurance business operations. – Wang Liang

THE LATEST SUPREME PEOPLE'S COURT INTERPRETATION ON TECHNOLOGY CONTRACTS

Key Points:

- **Defines “technological achievements”**
- **Imposes non-competition obligations to protect “technological achievements”**

On December 16, 2004, the Supreme People's Court promulgated the *Interpretation on Several Issues Concerning the Application of Law to the Trial of Dispute Cases Involving Technology Contracts* (the “Interpretation”). Intended to improve the application of PRC Contract Law, Patent Law and Civil Procedure Law, this Interpretation provides detailed rules on technology contracts including technology development contracts; technology assignment, or licensing and technology services, contracts; and some related procedure issues.

First, the Interpretation defines the term “technological achievements” found in Chapter 18 of the Contract Law. For the first time, “technological achievements” are expressly defined to include patents, applications for patents, technology secrets, computer software, integrated circuit layout designs and new plant breeds.

Second, and more controversially, according to the Interpretation, if an employee, within one year of

termination of employment, proceeds to work on technological developments related to duties or tasks assigned by the employee's former employer, in the absence of an agreement to the contrary with the former employer, the achievement arising from the technological developments will be deemed as an “employment technological achievement” that belongs to the former employer. As no former employer is likely to be interested in granting such releases to technical employees who leave the company, the Interpretation has the effect of putting all new employers at risk in hiring experienced technical workers.

Lastly, the Interpretation also confirms the validity of technology contracts entered into by research and development organizations that do not have independent legal person status, or lack permits. It seeks to prevent technology monopolies by setting forth situations that constitute monopoly. By providing that the use right of the innocent party survives the invalidation of a technology contract, so long as the innocent party pays a reasonable fee for the use, it protects the rights of innocent technology users. The Interpretation further provides that disputes on technology contracts generally shall be heard by the intermediate people's courts.

–Zhang Wei

BEIJING RELAXES ITS VISA REQUIREMENTS

Key Points:

- **Extends the time span of foreigners' visa and residency permits**
- **Initiates “Foreigner Residency Permits” to replace existing “Foreigner (Temporary) Residency Certificates”**

By relaxing visa requirements for international

visitors, Beijing became the first to implement the *Measures for Administration of Foreigners' Visa and Residency Permits*, which were issued by the Ministry of Public Security.

In the past, foreigner visitors were able to renew their visas only twice, each time for a period of three months. Now, they are able to extend visas for six to 12 months, for as many times as they need.

According to a vice director of the Division of Exit-Entry Administration of the Beijing Municipal Public Security Bureau, five groups of people can now enjoy the new visa policy:

- (i) foreigners who are the spouses of Chinese; spouses, parents and children under 18 years old of foreigners who are working or studying in Beijing;
- (ii) foreign nationals of Chinese origin who are older than 60 and have purchased real estate in Beijing;
- (iii) those who are older than 60 and have direct relations in Beijing but not abroad;
- (iv) foreign children who were adopted in Beijing; and
- (v) foreigners who have come to Beijing for a short visit, cultural exchanges and activities, or business.

In addition, Beijing has simplified the procedure to facilitate foreigners' use of their residency permits. In the past, foreigners were required to obtain separate "Foreigner Residency Certificates" or single-paged "Foreigner Temporary Residency

Certificates," which they were required to use together with their valid visas when entering and exiting China.

Now, foreigners are required only to place their one-page "Foreign Residency Permits" on the visa page of their passports. In addition, people with such permits no longer need to obtain re-entry visas as they previously did.

Also, the maximum time span of foreigners' residency permits has been increased to up to five years. Investors looking to invest more than US\$3 million in Beijing can apply for a two- to five-year residency permit.

Foreigners in the following categories can now enjoy the residency permit policy:

- (i) top foreign professionals and investors;
- (ii) foreign legal representatives;
- (iii) returning citizens of foreign nationalities; and
- (iv) foreign students.

– Maureen Meng

CHINA OPENS THE ROAD TRANSPORTATION INDUSTRY TO WFOE

Key Points:

- **WFOE is allowed to engage in road goods transportation and other services in connection with road goods transportation**
- **SAR companies are allowed to engage in road passenger transportation in some areas**

As China entered its fourth-year as a member of the

World Trade Organization, the Ministry of Communications (“MOC”) and the Ministry of Commerce (“MOFCOM”) jointly issued the *Second Supplement on Administration Regulation on Foreign Investment in Road Transportation Industry* (“Second Supplement”), which became effective on December 28, 2004. The purpose of the Second Supplement is to allow Wholly Foreign-Owned Enterprises (“WFOE”) to invest in and operate some sectors in road transportation.

Generally speaking, the road transportation industry includes (1) road passenger transportation, (2) road goods transportation, (3) road goods movements and loading and unloading, (4) road goods storage, and (5) other ancillary services and vehicle maintenance in connection with road transportation.

In the past, foreign investors were permitted to establish transportation companies in the form of equity joint ventures or cooperative joint ventures to conduct activities described in (2), (3), (4) or (5) above. Under the Second Supplement, now WFOEs can be set up to engage in road goods transportation, road goods terminals and vehicle repair. The Second Supplement also allows eligible existing WFOEs to expand their business scope to engage in such businesses.

In addition, the Second Supplement permits qualified bus companies in the Hong Kong SAR and Macau SAR to provide express service between the two cities/regions and mainland China as well as public passenger transportation and taxi transportation within mainland cities.

– Carole Fan

REGULATION ON PURCHASE OF LARGE-SIZE MEDICAL EQUIPMENT UPDATED

Key Points:

- *Replaces the provisional regulation of 1995*
- *Purchase of any large size medical equipment subject to permit requirement*

On March 1, 2005, the Administrative Measures on Purchase and Use of Large-Size Medical Equipment took effect. Jointly promulgated by the Ministry of Health, State Development and Reform Commission and the Ministry of Finance, this new regulation replaces a provisional regulation on the same subject matter adopted in 1995.

The new regulation maintains the core substance of the old regulations while adding more details. Under the new regulation, the purchase of large-size medical equipment, now with a more specific definition that includes items under relevant catalogues published by the Ministry of Health plus those outside the catalogue but with a unit price of over RMB 5 million, remains subject to planning and permit control by the Ministry of Health and its local counterparts. Since the regulation applies to all medical institutions in China, privately owned and foreign invested hospitals are also subject to the requirement of obtaining a permit to purchase and use any piece of large-size medical equipment.

Application and approval procedures are provided, and the time for the Ministry of Health or its local counterparts to make a decision is limited to 60 days. The regulation expressly prohibits the import of used large-size medical equipment from abroad.

The use of large-size medical equipment is also subject to the supervision of the Ministry of Health

and its local counterparts, which may impose penalties such as ordering a shutdown of the

equipment or imposing a fine for any violations of the regulation. – *Zhao Yong*

Other articles and publications

Please let us know if you would like copies of any of the following:

James Zimmerman, *China Law Deskbook, Second Edition (2005): A Legal Guide for Foreign-Invested Enterprises*. More information is available on ABA's Web site:

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

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