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**CHINA TO UNIFY CORPORATE INCOME TAX SYSTEMS**

**Key Points:**

- ***FIE to no longer receive preferential treatment***
- ***Earliest possible implementation is 2008***

News reports indicate that China’s State Taxation Administration (“SAT”) is working on a proposal for a unified income tax system for both domestic and non-China-funded firms.

China introduced two different corporate income tax systems for domestic and overseas firms respectively in its 1994 tax reform efforts, with overseas firms enjoying a lower tax burden. The actual income tax rate has remained at 14% for foreign investment enterprises (“FIE”), compared with the 24% rate for domestic enterprises, since China formulated the preferential policy for FIE.

China began the FIE program in the mid-1980s to attract investment from outside China. Preferential tax offers given to FIE have helped China attract such investment, technology and expertise, but experts and local companies have been complaining that the policy does not comply with World Trade Organization principles and discriminates against domestic firms.

The basic goal of the tax reform is to combine the two tax systems into a unified, transparent and fair system that will optimize the use of investment from outside China and the structure of the national economy as well as technologically upgrading various sectors. Nevertheless, no timetable or tax rate for implementation of the future tax system has been proposed.

Pursuant to the 2006 legislative plan of the Standing Committee of the 10th National People’s Congress (“NPC”), the Corporate Income Law is expected to receive its first review in August 2006. SAT officials

suggested that there will likely be a one-year delay between the passage of and actual implementation of the law. In this case, the earliest possible implementation date of the new tax mechanism would be 2008. – *Wei Zhong*

## DRAFT JUDICIAL INTERPRETATION ON CONFLICTING INTELLECTUAL PROPERTY RIGHTS RELEASED

### *Key Points:*

- ***PRC Supreme People's Court draft judicial interpretations on how to apply the law in conflicting IP rights cases released***
- ***Approval time to shorten substantially***

Recently the PRC Supreme People's Court requested comments on four draft judicial interpretations relating to intellectual property rights (IP rights). One of them concerns conflicting IP rights. A case concerning "conflicting IP rights" is a case in which one party sues another for infringing its IP rights, while the defendant raises the defense that it is using its own IP rights. The draft judicial interpretation provides a guideline on how to apply the law in adjudicating these conflicting IP rights cases. Set forth below are the major points of the draft judicial interpretation.

Where a case concerning "conflicting IP rights" involves a dispute of a registered trademark under Article 30 and 41 of the PRC Trademark Law, the court shall notify the plaintiff to file an action with the relevant administrative authorities, and shall not

accept the case as a civil action until the plaintiff has exhausted the administrative remedies.

Where the parties all claim to own a patent to the same invention, the court shall adjudicate the case according to the relevant judicial interpretations issued by the Supreme People's Court.

Where an infringement or unfair competition case involves a domain name that conflicts with the right in a registered trademark or company name, the court shall determine the case according to the Supreme People's Court's Interpretation on Several Issues Concerning Civil Dispute Cases Relating to the Computer Network Domain Name.

In any unfair competition case involving a right in one company's name conflicting with another company's name, the court shall determine the case according to Article 2 of the PRC Unfair Competition Law.

In a case involving a company's name conflicting with a registered trademark (or other IP rights), the court may conduct mediation or order a change of the company's name if its use constitutes trademark infringement or unfair competition.

Once adopted, this draft judicial interpretation will help to alleviate the conflicts of law in IP rights cases and provide better and more efficient protection to IP rights owners. – *Ye Guojun*

## LABOR CONTRACT LAW LIKELY TO PASS THIS YEAR

### *Key Point:*

- ***Emphasizes protecting employees' interests***

The proposed draft of the Labor Contract Law emphasizes protecting employees' interests. Among other rules, the one regulating noncompete agreements may be of interest to investors outside China, who often wish to restrict former employees with trade secrets from working for their competitors. As current local rules in many provinces and municipalities vary, the draft Labor Contract Law for the first time sets up national rules requiring that the noncompetition period set forth in such agreements not exceed two years, and, as consideration, that extra payment be made during the noncompetition period that is not less than the employee's original compensation. Furthermore, in the case of a breach of obligation of noncompetition, the employee is not bound to pay damages over three times such extra compensation as consideration for noncompetition.

Moreover, the draft Labor Contract Law, aimed at solving the existing common problems of infringing employees' legitimate interests (especially in small to middle-sized firms), imposes penalties on employers who maliciously arrears the salaries of workers. It also gives employees the right to terminate the employment relationship if their employers fail to purchase social insurance for them in compliance with the law and to limit the length of their probation period. The draft also strongly requires that employment agreements be written, setting forth administrative fines on employers who fail to comply

with that requirement and defining factual employment relationships that may exist in the absence of written contracts.

However, observers have also commented that the draft law fails to give protection to special groups of workers such as babysitters and hourly workers and is silent on employers' liability for their employees' work-related injuries. – *Lesley Li*

## STATE COUNCIL AMENDS COMPANY REGISTRATION RULES

### *Key Points:*

- ***Payment schedule of registered FIE altered***
- ***Company registration applications permitted by mail, fax or email***
- ***Some registration fees lowered***
- ***Annual inspection period changed***

The revised PRC Administrative Rules on Company Registration ("Company Registration Rules") took effect January 1, 2006 and replace the 1994 rules with the same name. The new regulations do not differ remarkably from the old regulations, but reflect changes to the recently updated PRC Company Law, which also took effect January 1.

One of the changes that may be significant to investors outside China relates to the payment schedule of the registered capital of FIE. Currently, although the relevant regulation requiring shareholders of a FIE to contribute at least 15% of

the registered capital of the FIE within three months of issuance of the business license and the remaining part within one to three years (depending on the amount of registered capital), was abolished in 2004, approval authorities are still applying this rule in practice. According to the new Company Registration Rules, however, the balance of registered capital should be paid within two years of issuance of the business license, regardless of the amount of registered capital. It is not clear whether the Company Registration Rules will replace the existing practice but, given that the Rules are issued by the State Council, they should be followed by all government agencies in China.

Interestingly, the new Company Registration Rules, for the first time, allow company registration application by mail, fax or email. There are, however, no details on how this will be implemented. It is expected that the state and local Administration of Industry and Commerce ("SAIC"), the agency in charge of company registration, will eventually adopt an electronic application system.

The Company Registration Rules lower the registration fee from 0.1% to 0.08% for companies with registered capital of not more than RMB 10 million and 0.05% to 0.04% for companies with registered capital of more than RMB 10 million. The Rules also change the period of annual inspection. Previously, the local SAIC carried out the annual inspection on companies from January 1 to April 30. From this year, the inspection will take place from March 1 to June 30. – *Lindsay Zhu*

## NPC ANNOUNCES ITS 2006 LEGISLATIVE SCHEDULE

### *Key Point:*

- *Draft Antimonopoly Law to be reviewed*

The Standing Committee of the 10th National People's Congress ("NPC") of China recently announced its 2006 legislative plan, involving 39 draft laws. Specifically, the Standing Committee will conduct a first-round review of 16 laws, including the long-awaited Antimonopoly Law, Corporate Income Tax Law, Amendments of Postal Law and Telecommunication Law. The Standing Committee plans to review nine laws carried over from past years, including the Property Law, the Bankruptcy Law, the Labor Contract Law and the Criminal Law Amendment VI. In addition, if the 2006 schedule permits, NPC will review 14 additional laws for the first time, including the State-Owned Assets Law, the Anti-Unfair Competition Law and the Construction Law.

China began drafting the Antimonopoly Law about 10 years ago; several authorities, such as the SAIC, the National Development and Research Committee ("NDRC") and the Ministry of Commerce ("MOFCOM") have been involved in its drafting. In order to understand the facts on monopolies and draft the Antimonopoly Law, the SAIC has investigated monopoly activities of multinationals in China and prepared a report based on its study, which confirms that unfair market practices such as selling tie-in goods, applying unreasonable conditions and treatment discrimination, as well as predatory pricing, are typical unfair competition methods used by global companies in China. The report also indicates that the existing laws lack efficient provisions to deal with the monopoly and

dominant-market-position-abusing activities of multinationals.

The latest draft Antimonopoly Law was prepared at the end of 2005. According to the draft, this law will be applicable to monopoly activities within China's territory as well as monopoly activities outside of China, but may eliminate or have a restrictive effect on competition in the domestic market of China. According to the draft, monopoly agreements and abuse of dominant market position are prohibited. In addition, the draft Antimonopoly Law contains provisions regarding "concentrations," meaning mergers of companies, or direct or indirect acquisition of control of other companies. In the draft, "monopolistic conduct" and "dominant market position" are defined for the first time in China's legislation.

At the end of 2005, the State Council further revised the draft Antimonopoly Law and entirely deleted the sections regarding anti-administrative monopoly. Only one provision was kept with regard to administrative monopoly, which provides that administrative authorities and other organizations with public affairs management functions are prohibited from abusing their administrative powers and eliminating or restraining competition. Some believe this is because China wants the draft Antimonopoly Law to focus on economic monopolies rather than administrative monopolies. – *Jennifer Liu*

## Articles and Publications

**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>.

**Amy L. Sommers**, "Foreign Investment Verification: Reform, Status Quo, or Bafflement?," *China Business Review*, November-December 2005. Access to the article is available at:

[http://www.ssd.com/publications/pub\\_detail.aspx?pubid=9426](http://www.ssd.com/publications/pub_detail.aspx?pubid=9426)

"Cal Law 2005 Roundtable Series: Doing Business in China," *GC California Magazine*, November 2005. The article features **Jerome J. Joondeph Jr.**, partner in Squire Sanders' Palo Alto office, on a panel discussing US companies and law firms setting up operations in China. Access to the article is available at:

[http://www.ssd.com/resources/news\\_detail.aspx?newsid=12381](http://www.ssd.com/resources/news_detail.aspx?newsid=12381)

**Wei Zhong**, "Legal Analysis for International Protection of Chinese Brands," *China Development Observation*, Issue 12, 2005. Mr. Zhong is an associate in the Beijing office. *China Development Observation* is a journal published by the State Council Development Research Center, the most influential think-tank in China. Access to the article (in Chinese) is available at:

<http://www.chinado.cn/ReadNews.asp?NewsID=466>

## Presentations and Recent Events

**Dan Roules**, partner in Squire Sanders' Beijing and Shanghai offices, and **Amy L. Sommers**, national partner in the Shanghai office, spoke as part of "Mergers & Acquisitions in China: A Discussion of the Current Environment" on February 23 at the American Bar Association Section of International Law Offices in Washington DC. The dial-in program shared information on potential obstacles to cross-border mergers and acquisitions involving PRC entities.

**Mark A. Nadeau**, partner in Squire Sanders' Phoenix office, will discuss resolving disputes in China at JPMorgan Chase's seminar "China: Building an Effective Strategy" on March 3 in Phoenix. The seminar will focus on China's evolving marketplace and navigating its complex financial and business regulatory landscape.

**China Business Immersion Trip**, March 24-31, 2006. Squire Sanders joins with China Centric Associates, LLC, a project management firm dedicated to helping North American enterprises develop and execute results-oriented initiatives, to offer this opportunity, designed especially for business decision makers and line operations managers seriously exploring China market initiatives. The trip will provide them with a unique opportunity to

spend eight days in China receiving a thorough grounding in everything they need to know to make their next steps in Asia's largest market successful. More information is available at:

[http://www.ssd.com/resources/event\\_detail.aspx?eventid=11545](http://www.ssd.com/resources/event_detail.aspx?eventid=11545)

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

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