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○ ISSUE 2 | ○ VOLUME 5 | ○ MARCH/APRIL 2007



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# CHINA Legal Bulletin

## Executive Summary

### ***New Corporate Tax Law Standardizes the Chinese Business Landscape***

The recently promulgated corporate tax law will drastically redesign the business environment in China. Businesses face a standardized corporate tax rate of 25%, even those operating in SEZs and Low Tax Zones, with few exceptions. Sectors such as environmental protection and technology are now being encouraged over manufacturing. The new tax rate will go into effect 1 January 2008.

*By Maarten Roos and Pan Yingfan*

### ***Antitrust Actions Target Multinationals in China***

In Shanghai a line is being drawn concerning the future of competition in the China. Chinese battery manufacturers are collaborating to bring a lawsuit against electronics powerhouse Sony for tying its digital cameras to its INFOLithium batteries, claiming that this creates an unfair monopoly. More such cases will likely be brought after the new Antitrust Law comes into effect, perhaps as early as next year.

*By Peng Kai*

## NEW DEVELOPMENTS

On 8 March 2007, the Ministry of Commerce (MOFCOM) supplemented the *Rules on Acquisitions of Domestic Companies by Foreign Investors* (2006) with the *Antitrust Filing Guidelines for Acquisitions of Domestic Companies by Foreign Investors* (hereinafter the Filing Guidelines), designed to guide foreign investors on when and how to report acquisitions that may be anti-competitive. They include:

- (1) Clarification of procedural and documentary requirements for an antitrust filing.
- (2) Shortening of the review period from 90 to 30 business days, with extension to 90 permitted.
- (3) Providing considerable detail on the contents of an antitrust filing, which should essentially be a comprehensive report of the effects of the intended transaction on competition within the relevant market. Reference is to be made to the definition of the relevant product and geographical market, pre- and post-transaction sales volumes and market shares, market structure, the structure of competition and the five biggest competitors, costs and barriers of entry to the relevant market, recent entry into and exits from the relevant market, the role of intellectual property, and so forth. Relevant evidence should complement this comprehensive market analysis.
- (4) Encouraging companies to approach the authorities for a pre-filing consultation concerning whether a filing is necessary and how to define relevant markets. Since companies are advised to include all documentation that would also be part of the antitrust filing, it is unclear how practical this would be.

# New Corporate Tax Law Standardizes the Chinese Business Landscape



*The Law of the Peoples Republic of China on Corporate Income Tax  
Promulgated on March 16th by The National Peoples Congress*

On March 16<sup>th</sup> China's top legislature, the National Peoples Congress (NPC), formally passed a law that will have far ranging effects on anyone doing business in China. The promulgation of the long-awaited *Law of the Peoples Republic of China on Corporate Income Tax* is undoubtedly the most important tax-related legislation since the previous Income Tax Law passed in 1991. Designed around four themes – a simplified tax system, a widened tax base, a lower tax rate and tougher administration – the law completely overhauls China's taxation of corporate income.

## Adjusted Tax Rates for Foreign-invested Enterprises

Most significantly, the new law merges the corporate tax regimes for Chinese- and foreign-invested enterprises (now designated as *taxable resident enterprises*) into one, and thereby takes radical leave from its earlier policy to attract foreign investment with lower tax rates. Foreign investors will in many cases face higher marginal tax rates, and will have to compete with others in the market on an equal level. Foreign-invested enterprises already established, and all enterprises in Pudong and the Special Economic Zones (such as Shenzhen and Zhuhai) low-tax zones (including Special Economic Zones like Shenzhen and Zhuhai and Coastal Open Economic Zones such as Guangzhou and Shanghai) are given only a limited number of years to adjust. Only some autonomous governments will retain the right to (partially) exempt companies of their local tax-share; the minimum tax rate in these locations is 15%.

Beneficial tax rates and tax incentives will be offered equally to all China-registered companies. Beneficial tax rates will be offered to qualified small and low-profit enterprises as well as those companies using new or high level technology,

irrespective of their geographic location. Reductions and exemptions will be used under the new tax-incentive policy to attract investments into industrial sectors that are favored by the state, including agriculture, basic infrastructure, environmental protection and conservation, product safety, capital venture, and advanced technologies. This excludes, most notably, foreign-invested manufacturing enterprises.

## Liabilities of Foreign Companies & Miscellaneous Issues

Similar to many other jurisdictions, China will tax enterprises based on the residency principle. Therefore the new law may also have consequences for foreign companies that are deriving income from China but have not established a subsidiary structure. Such companies will be regarded as taxable resident enterprises and will be taxed on their worldwide income if their effective management a term not yet defined is based in China. If their effective management is not in China, they will only be taxed on their China source income, and only if they are regarded as a Permanent Establishment.

Another key amendment in the new law concerns deductibles, which are more clearly defined and standardized for all China-registered companies. Charitable donations can be deducted up to 12% of annual profits, and wages may be deducted on an accrual basis, as well as R&D expenses for new technology, new products, and new craftsmanship. Shorter tax depreciation life or accelerated depreciation is allowed for certain fixed assets of advanced technology. Finally, from 1 January 2008 onwards, sponsor expenses cannot be deducted, making it necessary for companies to differentiate advertisement and sponsor expenses.

“ Foreign investors will in many cases face higher marginal tax rates, and will have to compete with others in the market on an equal level. ”

## CONTRACT LAW UPDATE Second Draft

The second draft of the China Labor Contract Law was submitted at the National Peoples Congress on December 24, 2006. Now the issue has been raised third and final draft should be issued before the end of the year. Some of the main differences between the second draft and the first draft are listed below.

- ◆ Part time employees will now be classified as 4 hours a day or 24 hours per week
- ◆ The second draft significantly encourages open-ended contracts by placing tougher restrictions on fixed term contracts
- ◆ Non competition and confidentiality agreements were not clearly defined in the second draft.
- ◆ There appear to be more clearly defined and very specific guidelines and definitions for mass layoffs in the second draft
- ◆ Seconded employees will receive greater protection
- ◆ Training will have less stringent requirements than in the first draft but will still be required to have at least month of off the job training.
- ◆ Probationary periods in the second draft appear to be based on the length of the contract

To read our discussion of the first draft in our Employment Special from June 2006 click here:

<http://www.wjnco.com/downloadFile/1163500816.pdf>

# New Corporate Tax Law Standardizes the Chinese Business Landscape



Numerous items will have to be further clarified in implementing rules and regulations. Among the issues that remain unanswered are; whether withholding taxes will be charged on dividends paid by foreign-invested enterprises to their foreign parent companies, which should lead to renewed considerations for establishing holding structures in jurisdictions with favorable tax treaties such as Hong Kong; and whether there will be any changes to the current taxation of business restructuring such as mergers and acquisitions, in-kind contributions of capital and so forth.

## Conclusions

The new law provides fundamental changes to China's policies of taxation towards foreign investors. Among others, it creates a more favorable tax environment for some service and trading companies, but especially foreign-invested manufacturing enterprises will see their tax rates increase. Companies will have to wait for detailed implementing regulations, expected later this year, to get a more precise view.

Maarten Roos/Pan Yingfan  
Wang Jing & Co.

## Points to Note

- ◆ *Chinese- and foreign-invested enterprises, regardless of industry and location, shall be taxed at 25%.*
- ◆ *Preferential tax rates for qualified small and thin-profit companies (20%) and high or new technology enterprises (15%) will be available.*
- ◆ *Tax incentives will be provided to encouraged industries.*
- ◆ *New tax regime will be applied as of 1 January 2008.*
- ◆ *Companies enjoying existing holidays will be given a transition period which will have a maximum of five years.*
- ◆ *Companies established after 16<sup>th</sup> of March 2007 may fall under new regime immediately.*
- ◆ *Foreign companies with effective management in China may be taxed on their global income.*
- ◆ *Foreign companies may possibly be charged a new withholding tax on dividends remitted from PRC FIEs.*
- ◆ *China's regime on deductibles has been clarified.*
- ◆ *From 2008, tax returns should be filed within 5 months of year-end rather than 4 months.*

## Wang Jing & Co. Abroad

Between 29 March and 7 April 2007, managing partner Mr. Wang Jing and Corporate Group partner Mr. Shen Xiangman visited Taiwan. On this trip they met with several Clients and strengthened cooperation ties with some of Taiwan's leading law firms. Mr. Wang and Mr. Shen also attended the 3rd Asia Pacific Regional Meeting of Terralex, a leading network of international law firms, as a guest of Taiwan member and host of the event, Pamir Law Firm.

## ALB CHINA LAW AWARDS 2007 NOMINATIONS

The nominations are in at the 2007 ALB China Law Awards and Wang Jing & Co. has received three of the nods, for the following categories:

***Insurance Law Firm of the Year***

***Shipping Law Firm of the Year***

***Guangdong Law Firm of the Year***

As always, Wang Jing & Co. is proud to be acknowledged for our work and by our esteemed peers.

We look forward to seeing you at the event and good luck to all the other nominees in Shanghai!

Congratulations should also go out to Mr. Wang Jing and Mr. Chen Xiang Yong for their nominations as two of Asia's Leading Lawyers by Asia Law and Practice.

The ALB China Law Awards are organized each year by Key Media, to recognize China's leading law firms and law practitioners. Since the inaugural China Law Awards in 2004, Wang Jing & Co. has been nominated for the same three categories each year. Moreover, the firm took home the prize for Insurance Law Firm of the Year in 2004, and in 2005 was awarded the title Guangzhou Law Firm of the Year.

The partners of Wang Jing & Co. have asked us to convey their gratitude to all our Clients and friends for their continued support over the years. So, thank you.

# Antitrust Actions Target Multinationals in China



Sichuan Dexian Technology Co. Ltd. filed a lawsuit against Sony Corporation and Shanghai Suo Guang Electronics Company for suspected unfair competition practices. The case was heard by Shanghai No.1 Intermediate Peoples Court On January 17 2007. Sichuan Dexian is demanding that Sony stop using InfoLITHIUM intelligent recognition technology on Sony-branded Li-ion batteries in China and in its digital cameras and video cameras. By using intelligent recognition technology, Sony is excluding other companies from manufacturing batteries that can be used in Sony digital products. Once consumers purchase Sony digital products, they can only choose Sony batteries. Sichuan Dexian, a manufacturer of batteries, claims that Sonys conduct equates to monopolizing activity in the form of tying, which unfairly prejudices the consumers right of choice.

In 2003, following complaints from several Chinese companies about possible monopoly conduct by Swedish multinational Tetra Pak, the Fair Trade Bureau of the State Administration for Industry & Commerce (SAIC) began an investigation which culminated, in May 2004, in a report entitled Manifestations and Strategies for Restricted Competition Conduct of Multinational Companies in China. This report suggested that many multinationals tended towards monopoly management, which was unfavorable for a fair competition environment in China. However without laws to define and combat antitrust activities, conduct which is strictly forbidden in other jurisdictions

including monopoly agreements and tying, cannot be curtailed. As a result, the legislative process to draft and promulgate Chinas first law governing antitrust activities has been accelerated.

A comprehensive Antitrust Law has been discussed for more than twelve years, but may come into force as early as next year. Among other things, it will aim to prevent large foreign companies from monopolizing respective Chinese markets. The latest draft, which the State Council submitted to the Standing Committee of the National Peoples Congress (NPC) for deliberation in June 2006, cites activities of monopolizing conduct to include the creation of monopoly agreements; abuse of a dominant market position; and business concentrations built through the elimination of or restriction of competition. Although Antitrust Law is not specifically aimed at multinational companies, as market movers with broad influence it is probable that these companies will likely be the first targets of civil and administrative actions.

The passing of new antitrust legislation to counter anti-competitive practices has become a priority at various levels of government. Domestic companies such as Sichuan Dexian are leading the effort to limit the power of larger companies creating what could become an increasingly serious problem for multinationals in China.

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*Note: A column by Wang Jing & Co. on recent developments in Antitrust Law is published in the May 2007 issue of Asialaw magazine, published by Asia Law & Practice*

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*This newsletter is published by the Corporate & Commercial Group of Wang Jing & Co, a PRC law firm assisting Chinese and multinational clients in business operations in China and abroad.*

## WANG JING & Co. COMPANY NEWS

Wang Jing & Co., in keeping up with its international vision and standards, has recently joined the Intellectual Property Owners Association based in Washington DC, U.S.A. As a result of our membership and desire to reach out to more American law firms and businesses we will also be attending IPOs annual meeting on India and China in June in Washington DC. Any of our clients or colleagues who will also be in the DC area from the 10th to the 17th of June are encouraged to contact Zachary Wortham or Maarten Roos to set up a meeting.

Wang Jing & Co. has also been actively participating in local events attending several conferences and seminars over the past two months. Some of the events were happy to participate in include:

- ◆ Hewitt Associates and Baker McKenzie seminar on the Second Draft of the China Labor Contract Law
- ◆ German Chamber of Commerce in China and Ernst and Young seminar on The New Chinese Corporate Income Tax Law
- ◆ Sutherland, Asbill, and Brennan and Advance China seminar on U.S. Patent Prosecution and ITC Section 337 Litigation Process