



漢坤律師事務所
HAN KUN LAW OFFICES

Newsletter

China Practice

Global Vision



9th Edition of 2012

■ ■ Insights & Ideas

1. Capital Gains Tax for QFIIs on the Horizon

■ ■ Legal Updates

1. CSRC Released New Measures to Supervise Unlisted Public Companies
2. PBOC and MOFCOM's New Rules on Prepaid Cards
3. Brief on the Decision of the State Council on the Sixth Batch of Cancelled and Amended Administrative Examination and Approval Items

Insights & Ideas

Capital Gains Tax for QFIIs on the Horizon (Authors: Jame WANG, Fang JI, Bin XUE)

China's tax regulator may start levying a 10 percent enterprise income tax ("EIT") on capital gains derived from the disposition of securities investments in China by qualified foreign institutional investors ("QFIIs"), according to an official of the China Securities Regulatory Commission ("CSRC") as quoted by several local media sources.

Current Tax Regime for QFIIs

QFIIs are foreign institutional investors approved by the CSRC to invest in the securities market in China. China's QFII program was first introduced in 2002. Two major tax circulars¹ were thereafter issued that specifically apply to QFIIs and set out the current tax regime as follows:

- Business Tax: Capital gains derived from the price difference in the disposing of securities in China are exempt from business tax.
- Enterprise Income Tax: Dividends, bonuses and interest income derived from China are taxable to the EIT at the rate of 10 percent on a withholding basis. QFIIs may apply to benefit from preferential tax treatments under applicable tax treaties where such treaties provide for a lower EIT rate;

However, current PRC tax laws and regulations are silent on the EIT treatment of capital gains derived by QFIIs from China. Pursuant to the *PRC Enterprise Income Tax Law*, foreign investors without a permanent establishment in China should be subject to the EIT at the rate of 10 percent on their China-sourced capital gains, unless such tax is exempt under applicable tax treaties. Theoretically, QFIIs (often without a permanent establishment in China) should be subject to the 10 percent EIT for capital gains arising from the sale of their securities investment in China. This being said, practical tax issues, such as the tax assessment periods and tax payment methods for such tax are rather unclear. In addition, foreign investors were historically exempt from the EIT on capital gains generated from the disposing of B shares and stocks of Chinese companies listed overseas. As a result, in practice, local tax authorities virtually had never attempted to tax the capital gains of QFII's until the Lehman Brothers case.

¹ *Notice on the Business Tax Policies for Qualified Foreign Institutional Investors*, jointly promulgated by the Ministry of Finance and the State Administration of Taxation and effective as of December 1, 2005, and *Notice on Issues Concerning the Withholding of Enterprise Income Tax on Dividends, Bonuses and Interests Paid to QFII by Chinese Resident Enterprises*, promulgated by the State Administration of Taxation and effective as of January 23, 2009.

The Lehman Brothers Case

The European branch of Lehman Brothers had been a licensed QFII since 2004. Lehman Brothers entered into insolvency proceedings in 2008, and all its overseas assets were liquidated, including the QFII's securities investments in China. In late 2010, the State Tax Bureau of Beijing Haidian District assessed the capital gains of the Lehman Brothers' QFII to be around RMB 3.99 billion (presumably, the accumulated capital gains since the inception of the QFII) and levied an EIT of around RMB 399 million on such gains. Upon paying the taxes, the QFII was allowed to repatriate its funds outside of China.

Although the Lehman Brothers case is viewed by some people to be a precedent for taxing the capital gains of QFIIs, it may only provide limited guidance for EIT treatment on the capital gains of other QFIIs. In the Lehman Brothers' case, the EIT on capital gains was only assessed upon liquidation of the QFII. Furthermore, the tax payment was also a necessary condition to effect the foreign exchange payment of the liquidated proceeds (i.e., a tax payment certificate is required for making the relevant foreign exchange payments in an amount more than USD 30,000).

The Expected New Tax Policy

According to the CSRC official as cited in the above mentioned news report, the possible new tax policy may provide for the imposition of the 10 percent EIT on the annual net capital gains of QFIIs after offsetting against losses. Both the QFII's self-owned funds and clients' entrusted funds in the QFII's account would be subject to such tax. The new tax policy is not expected to affect the existing tax treatment on the capital gains of PRC taxpayers (e.g., income tax is currently exempt on income from the disposition of publicly traded stocks and open-ended funds by PRC individual taxpayers).

Additional details of the possible new tax policy are still unavailable. Nevertheless, we expect the new tax policy to clarify the following issues:

- Tax assessment period: EIT on capital gains of foreign investors is in principle assessed on a payment-by-payment basis. This is apparently not practical for QFIIs. It seems that the new tax policy will provide for tax assessment on an annual basis, allowing the offsetting of the capital loss of one transaction from the capital gain of another transaction. The details regarding the provisions remain to be seen.
- Carry-forward of capital losses: Whether unused capital losses (i.e., capital losses after offsetting capital gains) can be carried forward and for how long may such capital losses be carried forward is expected to be clarified in the new tax policy.
- Application of tax treaties: Certain tax treaties concluded by China may exempt capital gains on the disposition of shares derived by foreign investors from being taxed in China. Whether the tax treaty treatment may apply to QFIIs is to be clarified in the new tax policy.

- Tax payment method: The new tax policy is also expected to specify whether the EIT on capital gains is to be withheld by the relevant Chinese stock exchange or an entrusted Chinese company or filed and paid by the QFII directly.
- Effective date of the new policy: Whether the new tax policy will retroactively apply to capital gains accumulated before the implementation of the new policy is another major concern of QFIIs. Due to the lack of clear tax rules, certain QFIIs may not have made any tax provisions in relation to the EIT on capital gains. Relevant financial arrangements may have to be carried out in anticipation of the EIT on capital gains.

The new tax policy, if issued, will clarify the EIT treatment on capital gains for QFIIs. It will also facilitate the foreign exchange procedures for repatriating QFII's investment proceeds outside of China. On the other hand, the tax burden may also affect the investment returns of QFIIs and should thus be carefully analyzed and assessed.

Legal Updates

1. CSRC Released New Measures to Supervise Unlisted Public Companies (Author: Yang CHEN)

On October 11, 2012, the China Securities Regulatory Commission (the “CSRC”) issued the *Administrative Measures for Supervision over Unlisted Public Companies* (the “Measures”), which will take effect on January 1, 2013. The Measures set the scope of unlisted public companies, raise the basic requirements for corporate governance and information disclosure, and clarify the application procedures for public transfer, share transfer and private offering. In particular, unlisted public companies that have more than 200 shareholders are included within the scope of CSRC supervision.

The issuance of the Measures will optimize the supervision over unlisted public companies in the following ways, a) it shall loosen the limitation on object scope and number of private offerings, encouraging innovative enterprises to set up their own equity incentive mechanism; b) it shall loosen the standards on exemption of rapid financing, making the directional finance more convenient; c) it shall explicitly require the unlisted public companies to conduct their public transfer in legally established stock exchanges, reserving some space for “transfer listings.” The 63-article on the Measures has 8 chapters, i.e., general provisions, corporate governance, information disclosure, stock transfer, private offering, supervision and management, legal liabilities, and supplementary provisions. The main contents of the Measures are as follows:

Unlisted Public Companies under Supervision

The unlisted public companies refer to joint stock companies that are under any of the following circumstances and whose shares are not listed or traded on stock exchanges:

- a) Issuing or transferring shares to specific investors to produce over 200 shareholders; or
- b) Transferring shares publicly to the general public.

In current practice, the first situation mainly refers to a) companies that have over 200 shareholders after issuance or transfer on the purpose of executing an equity incentive plan or introducing strategic (financial) investors, while the second situation mainly refers to b) companies which transfer their shares on legally established stock exchanges, including property right exchanges (equity exchanges) and the small and medium-sized enterprise share transfer system (the new third board).

According to the *Company Law of the People’s Republic of China* and other the relevant provisions of laws and regulations in force, the number of shareholders of a joint stock company shall be not

less than two but not more than two hundred. Where a joint stock company that has more than 200 shareholders is to issue shares, it shall meet the conditions as prescribed by the laws and regulations and submit an application to the securities regulatory authority under the State Council for examination and approval. Shares shall be issued in public manners to non-specific persons. Shares shall be transferred on lawfully established stock exchanges or such other ways as may be so prescribed by the State Council. The Measures get rid of the traditional 200 limit of the number of shareholders, allowing the unlisted public company to publicly issue and transfer shares, and the participants are not limited to directors, supervisors, senior managers and key employees. Instead, those who qualify for the relevant regulations, namely natural person investors, corporate investors and other economic organizations, are regarded as eligible participants, thus allowing private investors to participate in the transfer and issuance of unlisted public company shares.

Companies that meet the following conditions are subject to the regulations for unlisted public companies under the Measures:

- a) Joint stock companies whose shares are not listed or traded on stock exchanges and that issue specific investors or transfer shares to specific investors to produce over 200 shareholders, or transfer shares publicly to the public; and
- b) Having a clear shareholding structure, conducting legal and standard operations, having established corporate governance mechanisms and performing the obligation of information disclosure.

In addition, the shares of the unlisted public company shall be registered with and deposited in China Securities Depository and Clearing Corporation Limited.

Joint stock companies that have more than 200 shareholders before the enforcement of the Measures, regulated in accordance with the relevant laws and regulations, after confirmation by the CSRC, may submit an application for examination and approval in accordance with the Measures to be included within the scope of the Measures. This process allows the Measures to regulate the companies that have more than 200 shareholders.

In practice, even during the pilot of the “The new third board,” the number of shareholders is strictly maintained at 200, which limits the development of the company and any potential investment opportunities. The Measures get rid of the limitation, which is helpful for the innovative unlisted public companies in conducting an equity incentive plan to retain key employees and for developing unlisted public companies to finance and expand their scale.

Intensifying the Ability of Corporate Self-governance, Bringing into Play the Role of Intermediaries and Enhancing Investors’ Risk Awareness

The Measures intensify the ability of corporate self-governance based on three aspects: firstly, considering the characteristics of unlisted public companies and actual needs for regulation, the

CSRC set forth principled regulations on unlisted public company governance to guide them to improve corporate governance mechanisms; secondly, focusing on the safeguard of shareholders' legitimate rights and interests, to require the Boards of Directors to discuss and evaluate whether or not corporate governance mechanisms will ensure that all shareholders enjoy full and equal rights, and require companies to set forth the system of voting right exclusion in articles of association as appropriate; thirdly, promoting companies to conduct "self-governance" legally, to require companies to set forth the mechanism of conflict and dispute settlement among shareholders in articles of association, and support shareholders in claiming their legitimate rights and interests in judicial ways including arbitration, mediation and civil litigation.

The Measures bring into play the roles of securities service agencies including securities companies, accounting firms and law firms, which are all regulated by the CSRC. Securities companies, law firms, accounting firms and other securities service agencies that issue special documents to companies shall be diligent, responsible, honest and trustworthy, carefully perform the obligation of prudential examination, offer professional opinions in accordance with legally formulated business rules, industrial practice standards and code of ethics, ensure the authenticity, accuracy and integrity of issued documents, and accept the supervision of the CSRC. When having doubts about the authenticity, accuracy and integrity of documents issued by securities companies and securities service agencies, the CSRC may require relevant institutions to make explanations or supplements, and review their working papers. Companies shall assist securities service agencies that provide service to them and provide required materials in accordance with the requirements. Financial accounting reports in annual reports that are planned to be disclosed shall be audited by accounting firms with business qualifications for securities and futures. Recommendation reports issued by securities companies, documents issued by law firms, accounting firms and other securities service agencies, and other relevant important documents shall be disclosed as documents for reference.

Law firms that issue special documents to companies shall be diligent, responsible, honest and trustworthy, carefully perform the obligation of prudential examination, offer professional opinions in accordance with legally formulated business rules, industrial practice standards and code of ethics, ensure the authenticity, accuracy and integrity of issued documents. Documents issued by law firms and other relevant important documents shall be disclosed as documents for reference. (The Measures provide that specific content and formats of information disclosure documents, rules of formulation and disclosure requirements shall be prepared separately by the CSRC.) Where the unlisted public company is able to conduct any business with respect to merger, acquisition or corporate restructuring, apply for publicly transferring their shares to the general public or targeted issuance (including two circumstances, i.e., issuing shares to specific investors to produce over 200 shareholders and public companies that have more than 200 shareholders issuing shares to specific investors), law firms shall issue relevant legal opinions. Such documents shall be regarded as important parts of the application documents when unlisted public companies apply for CSRC

approval.

The Measures establish the system of investor eligibility, require participants to have corresponding capabilities of risk awareness and tolerance, further enhance investors' concept of "risks are born by buyers" and practically reduce systematic risks. The regulations on investor eligibility management shall be formulated separately by the CSRC.

Information Disclosure Obligations

The Measures provide that unlisted public companies and other obligators of information disclosure shall, authentically, accurately, completely and duly disclose information, and the information disclosure documents include regular reports, public transfer instructions, private share transfer instructions, etc. The specific content and formats, rules of formulation and disclosure requirements shall be formulated by other CSRC documents.

Except for announcements issued by the Boards of Supervisors, the information disclosed by companies shall be released in the form of announcements issued by the Boards of Directors and announced on information disclosure platforms assigned by the CSRC. Companies that transfer shares to specific investors to produce over 200 shareholders may set up other ways of information disclosure in articles of association.

The Measures simplify the information disclosure process of unlisted public companies by stressing several key points, including 1) regular reports that shall be disclosed only to include annual and semiannual reports rather than quarterly reports 2) the information shall be disclosed through information disclosure platforms assigned by the CSRC rather than on newspapers and magazines, which is conducive to the establishment of a unified electronic disclosure platform.

Merger, Acquisition, Reorganization and Takeover

1) Merger, Acquisition and Reorganization

Where an unlisted public company conducts merger, acquisition and reorganization, it shall fulfill the relevant decision-making procedures and hire securities companies and other relevant securities service agencies to provide professional opinions.

2) Takeover

The Measures require either the purchaser or its actual controllers to have sound corporate governance mechanisms and good credit records.

The Measures require a 12-month lock-up period for the shares of unlisted public companies acquired by the purchaser in the purchase of public companies.

Regarding the process of merger, acquisition, reorganization and purchase activities, the Measures introduce intermediaries to provide services, such as ensuring that the ownership of the assets

involved in the major asset reorganization shall be clear and the price of assets involved shall be fair. Also, a sound corporate governance mechanism shall be formed after reorganization in order to safeguard unlisted public companies and shareholders' legitimate rights and interests.

Requirements of Share Transfer

1) Share Transfer by Agreement in a Non-public Way

Shares shall be transferred to specific investors by agreement in a non-public way. Companies that transfer shares to specific investors that produce over 200 shareholders shall, within three months from the date of occurrence of the above-mentioned behavior, fill out application documents in accordance with relevant regulations of the CSRC, and submit application documents to the CSRC for approval.

The Measures set no threshold for companies that transfer shares to specific investors to produce over 200 shareholders, and such companies may apply to the CSRC for examining or reducing the number of shareholders within three months after the occurrence of the above-mentioned circumstances. If the number of shareholders drops to less than 200 within the three months, companies do not need to file applications. At the same time, in order to prevent supervision arbitrage, shares shall not be transferred publicly but be transferred to specific investors by agreement in a non-public way. If planning to transfer shares publicly or issue shares to specific investors, such companies shall apply for examination and approval in accordance with the following regulations.

2) Public Transfer

For companies that apply for publicly transferring their shares to the general public, the Boards of Directors shall make resolutions on specific plans for the public share transfer in accordance with the law, submit resolutions to general meetings of shareholders for approval, such resolutions of general meetings of shareholders must be adopted by the attending shareholders with two thirds or more vote. Companies shall make application documents for the public transfer in accordance with the relevant regulations of the CSRC, and submit application documents to the CSRC for approval.

For companies that apply to publicly transfer their shares to the general public, the Measures loosen administrative regulation and simplify permit procedures, mainly requiring sound governance mechanisms and standard information disclosure. No financial targets are set and no profiting requirements are raised for companies that apply for public transfer of shares. At the same time, the Measures require that securities companies shall issue recommendation reports, law firms shall issue legal opinions, accounting firms with business qualifications for securities and futures shall issue audit reports, and stock exchanges shall issue examination opinions on approving or disapproving the listing.

Requirements of Private Offering

1) Private Offering Refers to the Issuance to Specific Investors, Including the Following Two Conditions:

- (1) Issuing shares to specific investors to produce over 200 shareholders; or
- (2) Unlisted public companies that have more than 200 shareholders issuing shares to specific investors.

The scope of specific investors includes:

- i. The issuer's shareholders;
- ii. The issuer's directors, supervisors, senior managers and key employees; and
- iii. Natural person investors, corporate investors and other economic organizations that conform to the regulations on investor eligibility management.

In practice, technological or innovative enterprises often need to retain internal employees, especially key employees by setting up the appropriate incentive and restraint mechanisms. The Measures include key employees into its issuance of investors. To identify key employees, the company shall: 1) nominate key employees by the Board of Directors; 2) publicize to all employees and gather their opinion; 3) apply for approval from the Board of Supervisors; 4) submit to a general meeting of shareholders for approval.

The Measures also set a limit to the number of private offering investors, that is, including key employees except shareholders, the total number of issuance to a specific investor will not exceed 35 people, which controls equity incentive within a fixed range.

2) Adopting Shelf Offering as an Issuance Method for Private offering

The system of shelf offering, which comes from the United States, is a special process for public companies refinancing behavior, more specifically, a refinance system of one-time approval, multiple-time issuance. Compared to the traditional security issuance regulation of "one application for one issuance," shelf offering is a regulation pattern that continuously regulates the pre-stage, current-stage, and post-stage of securities issuance process for a package of projects. Companies shall make an initial issuance within three months from the dates of approval by the CSRC and issue the rest within 12 months. The initial issuance volume shall be not less than 50 percent of the total issuance volume, the volume of future issuance shall be determined by the companies, and the companies shall report issuance information to the CSRC for record filing within five working days after each issuance.

3) Exemption of Approval

The Measures establish the system of exemption for the rapid financing of unlisted public companies. Unlisted public companies whose shareholder number do not exceed 200 after the

private offering, or whose accumulative financing amount of share issuance within 12 months is less than 10 million Yuan, such companies may be exempted from applying to the CSRC for approval, and may issue shares on their own. The company shall report issuance information to the CSRC for record filing within five working days after each issuance and disclose such information.

Compared to the draft for comments, the Measures change the standard of small-amount financing from “10 million Yuan exemption” to a relative standard, that is the accumulative financing amount of share issuance within 12 months is less than 20 percent of the companies’ net assets, which is seen as a better way to promote the development of innovative enterprises.

Such regulations apply to unlisted public companies issuing shares to specific investor to purchase assets.

The CSRC practices simple approval procedures for access by unlisted public companies, which differs vastly for companies that publicly issue shares and are listed in terms of access conditions and procedures. On the one hand, no financial targets shall be set in terms of access conditions, and companies shall be required to preferentially define primary businesses, enhance governance mechanisms, improve the quality of information disclosure and disclose relevant information authentically, accurately, completely and duly in accordance with rules of information disclosure. On the other hand, in terms of access procedures, no organizations similar to the Public Offering Review Committee shall be established, no sponsor system shall be practiced, and approval procedures shall be greatly simplified.

Trading Places

Shares of unlisted public companies shall be registered and deposited in China Securities Depository and Clearing Corporation Limited. However, public transfer and private share transfer shall be traded in different exchanges where different rules shall be applied.

1) Public Transfer

Public transfer of unlisted public companies must be conducted in legally established stock exchanges, that is, the National Small and Medium-sized Enterprises Share Transfer System, also called “the new third board”.

2) Non-public Transfer

Those unlisted public companies that are involved in non-public transfer may not list on “the new third board”, but their shares shall be registered and deposited in the China Securities Depository and Clearing Corporation Limited. Shareholders may transfer by contract or transfer directionally in accordance with the relevant regulations.

3) Public Issuance and Listing

Unlisted public companies that issue shares to non-specific investors publicly shall comply with the

Securities Law and relevant provisions of the CSRC, and shall apply for CSRC approval.

Those unlisted public companies that apply for a stock exchange listing shall comply with relevant provisions of the CSRC and stock exchange. The Measures explicitly require the unlisted public companies to apply for a stock exchange listing in accordance with relevant regulations, reserving some space for these companies to be listed, once they meet listing requirements, they could perform a “transfer listing.”

In addition, according to the *Decision of the State Council on Straightening out and Rectifying Various Types of Trading Venues to Effectively Prevent Financial Risks* (Guo Fa [2011] No. 38), other local market places are not allowed to engage in any standardized transaction and centralized auction. Only shares of non-public companies that have less than 200 shareholders are allowed to be traded in such market places. However, it is beyond the scope of the trading places regulated by the Measures where unlisted public companies are allowed to conduct trading.

Authority Division between the China Securities Regulatory Commission and the Securities Association of China

The Measures provide that the CSRC and its subordinate institutions shall, in accordance with the law, perform their responsibilities for supervising companies’ share transfer, private offering and information disclosure. The CSRC has the right to take supervisory measures in accordance with the law, which includes conducting on-the-spot inspection, ordering relevant companies to make corrections, arranging supervisory talks, ordering them to make explanations, and issuing written warnings.

The Securities Association of China (the “**SAC**”) shall bring into play the role of self-regulation and administration to supervise securities companies engaged in corporate share transfer and private offering. When finding securities companies in violation of the laws, administrative regulations and relevant regulations of the CSRC, the association shall report those violations to the CSRC and take self-regulatory and administrative measures.

In practice, although the CSRC takes on the lead supervisory role during the pilot of “the new third board”, the SAC performs its management duty. The Measures require the CSRC to manage the issuance, listing and trading of unlisted public companies shares, reassuring the supervision rights of the CSRC from a legal level.

2. PBOC and MOFCOM’s New Rules on Prepaid Cards (Authors: Rea LIU, Xiao LI, Baoyu WANG)

In recent years, the market of commercial prepaid cards has witnessed rapid growth in order to adapt to the development of information technology and the market innovation needs of

micro-payment services. On the whole, commercial prepaid cards have been helpful to a certain extent in reducing the use of cash, facilitating payments, and stimulating consumption. With a view to regulating the administration of commercial prepaid cards, enforcing financial and economic discipline, guarding against financial risks, promoting anti-corruption and advocating clean governance, the PBOC (“**PBOC**”) has put forward several decrees and announcements since 2010, such as the *Measures for the Administration of Payment Services of Non-Financial Institutions* (Decree No. 2 [2010] of the PBOC, the “**Decree No. 2**”) in June 2010 and the *Implementing Regulations of the Measures for the Administration of Payment Services of Non-Financial Institutions* (Announcement No. 17 [2010] of the PBOC, the “**Announcement No. 17**”) in December 2010; afterwards, seven departments including the PBOC issued the *Opinions on Regulating the Administration of Commercial Prepaid Cards* (Guo Ban Fa [2011] No. 25, hereinafter referred to as “**Document No. 25**”) in May 2011.

With a view to implementing Decree No. 2 and Document No. 25, maintaining the order of the payment service market and further strengthening the administration of prepaid card business, the PBOC issued the *Notice of the PBOC on Further Strengthening the Administration of Prepaid Card Business* (Yin Fa [2012] No. 234, the “**Document No. 234**”) on September 26, 2012 and the *Administrative Measures for the Prepaid Card Business of Payment Institutions* (Announcement No. 12 [2012] of the PBOC, hereinafter referred to as “**Announcement No. 12**”) on September 27, 2012. Before that, the Ministry of Commerce (“**MOFCOM**”) also issued the *Measures for the Administration of Single-purpose Commercial Prepaid Cards (for Trial Implementation)* (Decree No. 9 [2012] of the Ministry of Commerce, the “**Decree No. 9**”) on September 21, 2012. This article will mainly focus on Announcement No. 12 and Decree No. 9.

Definition and Classification of Prepaid Cards

Decree No. 2 and Announcement No. 17 regulate the payment services of non-financial institutions. Under these two regulations, prepaid cards refer to cards or pins issued with value stored using technologies such as magnetic stripes and chips that can be used to purchase goods and services provided not by the card issuer with the purpose of gaining profits, however excluding: (1) prepaid cards for the sole purpose of issuing social security benefits; (2) prepaid cards for the sole purpose of using public transportation; (3) prepaid cards for the sole purpose of paying phone bills and other communications fees; and (4) prepaid cards of which the issuing institution and the contracted merchant belong to the same legal person. These restrictions are reflected in Document No. 25 stating that “commercial prepaid cards are divided into two types categorized by card issuers: the first is the multi-purpose prepaid card, issued by specialized card issuers that may be used by multiple legal persons in multiple regions and for multiple sectors; and the other is the single-purpose prepaid card, issued by commercial enterprises that can only be used for purchasing goods and paying for services in the card issuing enterprises or the chain commercial enterprises sharing the same brand.”

These regulations combined with the definition in Announcement No. 12 stating that “prepaid cards refer to any prepaid value that is issued by a card issuer using a specific carrier and in a specific form and can be used for purchasing goods or services at places outside the card issuer,” and the one in Decree No. 9 stating that single-purpose prepaid cards refer to “prepaid vouchers issued by enterprises in the industries of retailing, lodging, and catering, and residential services to pay for commodities and services in the enterprise (group) or the chain enterprises under the same brand, including physical cards such as magnetic strip cards, chip cards, and paper coupons as carriers, as well as virtual cards such as passwords, code strings, graphics, and biometric information as carriers” all suggest that in regulating commercial prepaid cards, the nation classifies prepaid cards into two categories supervised by different administrations according to different regulations and policies. In a word, multi-purpose prepaid cards are supervised by the PBOC in accordance with Announcement No. 12, which states that without the approval of the PBOC and the acquisition of a payment business license, non-financial institutions may not issue multipurpose prepaid cards, and violators will be investigated and punished for illegally conducting payment and settlement businesses. However, single-purpose prepaid cards are supervised by the MOFCOM pursuant to Decree No. 9, so the issuance of single-purpose prepaid cards does not require the acquisition of a payment business license from the PBOC.

Core Content of Announcement No. 12 and Decree No. 9

1) Three Systems

Both Announcement No. 12 and Decree No. 9 require the full implementation of three systems of card purchases by real name, non-cash card purchase, and a limited sum card purchase. For entities or individuals that purchase or recharge registered cards and those that purchase an unregistered card worth RMB 10,000 or more, card issuing enterprises shall conduct real-name registration. Where an entity makes a one-time purchase of cards worth RMB 5,000 or more, or an individual makes a one-time purchase of cards worth RMB 50,000 or more, he/she/it shall purchase the cards by bank transfer rather than in cash. The maximum sum of a single registered card shall be RMB 5,000 and the maximum sum of a single unregistered card shall be RMB 1,000. These three systems help to avoid the use of prepaid cards for the purpose of money laundering or arbitrage. As to the responsibilities of payment institutions or enterprises that have violated the three systems, Decree No. 9 specifically provides that “competent commerce departments above the county level in places where the violation takes place shall order them to make corrections within specified time limits; If they fail to make corrections within the time limits, a fine of more than RMB 10,000 and less than RMB 30,000 shall be imposed on each enterprise.” However, Announcement No. 12 stipulates nothing about such responsibilities except generally stating that in cases of violation, the PBOC can punish the relevant entities in accordance with Decree No. 2.

2) Convenience and Consumer Protection

In respect of convenience, both documents maintain the flexibility of the system by promoting the positive effects of prepaid cards in the field of small amount payment. For example, Announcement No. 12 allows for the convenient purchase and top-up of prepaid cards with a maximum amount of less than RMB 200, redemptions of the widely-used unregistered prepaid cards in the field of public transportation with a balance of less than RMB 100 despite the general rule that unregistered prepaid cards shall be irredeemable, and online payment of utility fees through prepaid cards. Decree No. 9 allows refunds of less than RMB 100 to be paid in cash in cases of the returning of goods or the returning of cards.

Regarding the protection of consumers' rights, both documents safeguard the right to: (i) information - card issuers shall notify purchasers of and provide them with the rules on prepaid cards or enter into agreements with them on prepaid cards, clarifying the methods for purchase, top-up, use, return of the card, declaration and assignment, charging items and standards, etc. so as to avoid damaging the interests of the card holders due to an unclear or incomplete agreement or lack of knowledge thereof; (ii) usage of funds - registered prepaid cards may not have a term of validity, and unregistered prepaid cards may not have a term of validity of not less than 3 years, and with regard to prepaid cards whose term of validity has expired but there are still unused funds, the card issuers shall provide renewal, activation, replacement, and other services to ensure that the card holders can continue to use such cards; (iii) basic services - payment institutions shall provide basic services such as balance inquiry, declaration, return of goods, and return of cards; (iv) information confidentiality - card issuers shall strengthen protection of the information of card purchasers and card holders, and avoid the disclosure or abuse of identity information and transaction information.

3) Supervisory System

(1) Supervision of Qualifications of Payment Institutions or Card Issuers

Announcement No. 12 is different from Decree No. 9 in that the former adopts a "license system" and requires payment institutions to acquire a payment business license, i.e. they shall either be card issuers permitted to conduct the "prepaid card issuance and acceptance" business, or acceptance agencies permitted to conduct the "prepaid card acceptance" business, according to the conditions set forth in Decree No. 2. The latter adopts a "record-filing system," and clarifies the issues regarding the record-filing time limit, authority, necessary materials, and alteration under the principle of territorial jurisdiction and categorized supervision. Additionally, the enterprises issuing large amounts of cards, the major card issuance enterprises, and the card issuance groups are all required to provide information such as their financial positions so that the record-filing authorities can conduct the competent risk-based supervision. As for other card issuance enterprises, Decree No. 9 has simplified the procedure of their record-filing.

(2) Safety Management of Client Prepaid Fund

Announcement No. 12 requires card issuers to directly transfer settlement funds to its franchised merchants through its custodian bank for customer reserve funds, and acceptance agencies may

not participate in the fund settlements. Where a card issuer entrusts a cooperative selling agency to sell its prepaid cards, it shall have the proceeds of sale directly deposited into its bank account for reserve funds so as to avoid fund risks that may occur in the prepaid card business. On the other hand, Decree No. 9 has established the system of deposit and custody of prepaid funds, which specifies that for the enterprises issuing large amounts of cards, the card issuance groups and the major card issuance enterprises shall entrust a portion of the pre-collected funds to commercial banks for custody in order to avoid an excessive or arbitrary issuance of prepaid cards by card issuers and reduce prepaid fund risks. Considering that prepaid funds have become important sources of funding for some enterprises, Decree No. 9 also stipulates offset measures for depository funds by allowing card issuers to replace the fund custodian agreement with guarantee insurance policies, warranties, bank guarantees, etc. so as to lessen the operational burden of the enterprises.

Comments

The issuance of Announcement No. 12 and Decree No. 9 plays a positive role in improving the following protruding issues existing in the market of commercial prepaid cards, such as lax supervision and regulation, violation of financial discipline, lack of a risk prevention mechanism, using taxpayers' money to pay for personal consumption, and taking bribes offered in the form of prepaid cards. Decree No. 9 in particular, has made up for the legislative deficiency in the field of single-purpose credit cards, strengthened the regulation of the qualifications of card issuers, and set restrictions as well as supervisory measures and punishments on the issuance, purchase, and risk control of prepaid cards, which would contribute to the compliance of card issuers. At the same time, some shortcomings exist in both new regulations.

1) Improvement in the Redemption System of Prepaid Cards

Announcement No. 12 explicitly stipulates the redemption system of registered prepaid cards. As for single-purpose prepaid cards, Decree No. 9 makes no distinction between registered cards and unregistered cards by stating that the rules or purchase agreements on single-purpose prepaid cards shall contain the method of returning cards, and card issuers shall provide redemption services in accordance with the rules or agreements. After redemption, card issuers or card sellers shall request the card holders to show their effective identification and provide their names, effective ID Number, Card Number and amount, etc. The balance shall be returned to the bank account, which shall be recorded by card issuers or card sellers as well, under the same name as the card holder. Where the balance is RMB 100 or less, it can be paid in cash. This has effectively restricted the use of unreasonable terms like "ONCE SOLD, NO REFUND" in the field of especially single-purpose commercial prepaid cards and the scalping market thus created, which is conducive to promoting the market order and protecting consumer rights.

2) Application Scope Limit of Decree No. 9

Pursuant to Article 2 of Decree No. 9, the decree only applies to enterprises in the industries of retail,

lodging and catering, and residential services, to which an exhaustive classification scheme of the specific business is attached. Therefore, the application scope of the decree is limited, leaving gaps in the widespread enterprises in entertainment industries such as theatres, KTVs and pubs.

3) Possible Circumvention Method

If an unregistered prepaid card worth the minimum sum or more is purchased, such a card shall be purchased using the individual's real name. Both Announcement No. 12 and Decree No. 9 stipulate that individuals or entities who buy unregistered prepaid cards at one time in the amount of more than RMB 10,000 (inclusive) shall use their real name and provide their valid identity certificates. Despite careful consideration by the administrators, risks still exist, undeniably, that sums may be broken into parts and supervision may be evaded, as card purchasers might well circumvent the real name requirement by purchasing several unregistered cards on multiple occasions.

3. Brief on the Decision of the State Council on the Sixth Batch of Cancelled and Amended Administrative Examination and Approval Items (Authors: Irene CAI, Lan LI)

On September 23, 2012, the State Council officially promulgated the *Decision of the State Council on the Sixth Batch of Cancelled and Amended Administrative Examination and Approval Items* (the "**Decision**"). The Decision cancelled and amended 314 administrative examination and approval items, among which 171 items were cancelled and 143 items were amended. Following the principle of simplifying the examination and approval procedures and reducing the examination and approval fees, the State Council has rescinded and adjusted 2,497 administrative examination and approval items in six rounds, accounting for 69.3% of the existing items.

The cancelled and amended administrative examination and approval items in the Decision mainly focus on three areas: investment, social projects, and non-administrative permission examination and approval items. This article summarizes some of the cancelled or amended administrative examination and approval items therefrom.

Investment

1) Ministry of Commerce (the "MOFCOM")

The examination and approval power of eighteen items regarding foreign investment in the service business has been handed down to the administrative departments of commerce at the provincial level by MOFCOM, mainly cover: the establishment and changes of, foreign-invested commercial performance brokerage agencies, foreign-invested insurance brokerage agencies, foreign-invested enterprises specializing in online sales, foreign-invested enterprises engaging in vending machine

sales, the Sino-foreign equity or cooperative medical institutions, Sino-foreign cooperative audiovisual product wholesalers, foreign-invested travel agencies (excluding outbound travel), foreign-invested international shipping enterprises, etc. Moreover, MOFCOM has abrogated the examination and approval on contracting operations² of Sino-foreign joint ventures and the entrusted management of joint ventures by enterprises in foreign countries or in Hong Kong, Macao and Taiwan regions.

2) **China Securities Regulatory Commission (the “CSRC”)**

CSRC has cancelled and amended 32 items, which account for one tenth of the 314 administrative examination and approval items in the Decision. Among the foregoing items, twenty (20) were cancelled, ten (10) were delegated to the lower level governmental agencies, and two (2) were amended to be examined and approved by the lesser departments.

Among such 20 cancelled items, (1) items in connection with security companies include: registration of sponsor representatives, amendment on premises of domestic branches of security companies, establishment of collective asset management schemes of security companies; (2) as to items concerned with the merger, acquisition, and reorganization of listed companies, four (4) items of administrative permission were abrogated with respect to exemption from tender offer obligations, where the equity held by a party in a listed company reaches or exceeds 30% of the issued shares of that company, and after one year as of the occurrence of such fact, the increase of the party's equity per 12 months in that company does not exceed 2% of the issued shares of that company; where the equity held by a party in a listed company reaches or exceeds 50% of the issued shares of that company, a further increase of the party's equity in that company does not affect the status of that company as a listed company; where the equity held by a party in a listed company exceeds 30% of issued shares of that company due to inheritance; and where the equity held by the controlling shareholder in a listed company exceeds 30% of issued shares of that company upon acquisition approved by non-affiliated shareholders in the general meeting of that company, the controlling shareholder promises not to transfer his equity within 3 years and the general meeting of that company agrees to exempt him from tender offer obligation. In addition, the CSRC has cancelled the examination and approval on share repurchase by listed companies.

3) **Banking Business and Foreign Exchange Business**

Nine (9) items in the banking business and sixteen (16) items in the foreign exchange business were abrogated, which conforms to the general trend of loosening supervision over financial institutions and control of foreign exchange. The cancelled items concerning the banking business mainly

² Contracting operation refers to the operation and management conducted by a contractor over a joint venture through the handover of all or part of the operational and management rights in the joint venture to the contractor for a specified period by way of concluding a contracting operation agreement between the joint venture and the contractor, as provided in *the Provisions of the Ministry of Foreign Economic Relations and Trade and the State Administration for Industry and Commerce on Contracting Operations of Sino-Foreign Equity Joint Ventures* [(90) Wai Jing Mao Fa Zi No.22]

include: the approval of the business qualifications of the financial institutions in the banking business for engaging in the settlement of financial futures; the approval of qualifications of the financial institutions in the banking business for conducting futures margin deposition; the examination and approval on changes to the operating funds and premises of branches of Chinese-invested financial institutions in the banking business, non-banking institutions and foreign-invested banking business institutions. The items concerning the foreign exchange business that have changed comparatively well, mainly involve the foreign exchange system, such as the cancellation of examination and approval items of exporters claiming for the verification and writing off of documents for export proceeds, the record-filing of import payment in foreign exchange at places other than its registration place, etc.

Social Projects

The Decision strengthens the reforms on clearing, simplifying and adjusting administrative examination and approval items in the field of education, medical treatment and healthcare, culture, and other social projects as well as public services. It mainly covers:

Items	Previous Department	Department upon Delegation
The establishment of schools for the children of aliens	The Ministry of Education	The Administrative Departments of Education at the Provincial Level
The establishment and changes of foreign-invested enterprises engaging in the distribution of books, newspapers and periodicals	The Ministry of Commerce	The Administrative Departments of Commerce at the Provincial Level
The establishment and changes of Sino-foreign equity or cooperative medical institutions	The Ministry of Commerce	The Administrative Departments of Commerce at the Provincial Level
The qualifications of units other than studios for engaging in the film-making business	The State Administration of Radio, Film and Television	The Administrative Departments of Radio, Film and Television at the Provincial Level
The establishment of film projection units, change of its business scope, and merger, consolidation and division of film projection units	The Administrative Departments of Radio, Film and Television at the County or Municipal Level	The Administrative Departments of Radio, Film and Television at the County Level

Other Noteworthy Amended Administrative Examination and Approval Items and Non-administrative-permission Examination and Approval Items

For example, the pre-examination by the Ministry of Industry and Information Technology for profit-making internet information service providers going through the process of domestic listing is cancelled; instead it requires CSRC soliciting opinions to the Ministry of Industry and Information Technology at the time of examination and approval of the listing by the CSRC. The examination and approval by the tax authorities at the next upper level of competent tax authorities at the domiciles of the tax payers was cancelled for tax payers deducting property loss before paying income tax, the examination and approval by administrative departments of publishing at the county level for establishment of enterprises engaging in business card printing. The examination and approval of the assignment of mining rights was delegated by the departments in charge of geology and mineral resources at the provincial level to the municipal and county level. The examination and approval of permission for the presale of commercial apartments was handed down from real estate management departments from the county level to the municipal and county level, the examination and approval of projects as well as the establishment of branches of foreign-invested advertisement enterprises were handed down from the State Administration for Industry and Commerce and its authorized local administrative departments for industry and commerce to the administrative departments for industry and commerce at the levels of provincial, autonomous region, and municipality, and other administrative departments for industry and commerce that are competent for the approval and registration of foreign-invested enterprises according to the related laws and regulations.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:



Contact Us

Beijing Office

Tel.: +86-10-8525 5500
Suite 906, Office Tower C1, Oriental Plaza
No. 1 East Chang An Ave.
Beijing 100738, P. R. China

Wenyu JIN Attorney-at-law

Tel.: +86-10-8525 5557
Email: wenyu.jin@hankunlaw.com

Shanghai Office

Tel.: +86-21-6080 0909
Suite 5709, Tower 1, Plaza 66, 1266 Nanjing
West Road,
Shanghai 200040, P. R. China

Yinshi CAO Attorney-at-law

Tel.: +86-21-6080 0980
Email: yinshi.cao@hankunlaw.com

Shenzhen Office

Tel.: +86-755-3680 6500
Suite 4709, Excellence Times Plaza, 4068
Yitian Road, Futian District,
Shenzhen 518048, P. R. China

Jason WANG Attorney at-law

Tel.: +86-755-3680 6518
Email: jason.wang@hankunlaw.com