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Han Kun Law Offices
Newsletter

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HAN KUN LAW OFFICES

7th Edition of 2010

Han Kun Newsletter Working Group

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Insights & Ideas

MOFCOM Issued New Provisions on Divestment of Assets or Business in Anti-trust Review (Author: Lulu HAN)

On July 9, 2010, the Ministry of Commerce ("**MOFCOM**") published on its website the *Interim Provisions on Implementing Divestment of Assets or Business in Concentration of Operators* ("**Interim Provisions**"), stipulating relevant procedures of divesting assets or business in anti-monopoly review.

According to the *PRC Anti-monopoly Law* ("**AML**") and the *Measures on Review of Concentrations of Operators* (the "**Review Measures**"), where MOFCOM makes a decision not to forbid the concentration of operators, it may impose some additional restrictive conditions to reduce the adverse effects the concentration may have on competition, including divesting part of the assets or business of the operators involved in concentration. The Interim Provisions stipulate more detailed provisions with respect to the implementation of decisions to divest assets or business of the operators. The implementation of other restrictive conditions may also refer to the Interim Provisions.

Two Forms of Divestment: Self-Divestment and Entrusted Divestment

During the self-divestment phase, the divestment obligor, i.e., the operator involved in concentration who assumes the obligation of divesting assets or business (the "**Obligor**"), shall find an appropriate purchaser and enter into sale agreements and other relevant agreements with the purchaser to complete the divestment within the term prescribed in the review decision.

In the event that the Obligor does not complete self-divestment within the prescribed term, entrusted divestment occurs where the Divestment Trustee (defined below) shall find an appropriate purchaser and execute sale agreements and other relevant agreements according to the term and ways prescribed in the review decision. The Interim Provisions set forth detailed provisions on the qualifications and duties of the Divestment Trustees.

Supervision Trustees and Divestment Trustees

Both the Supervision Trustee and the Divestment Trustee are appointed by the Obligor and shall report to MOFCOM. The Obligor shall provide necessary assistance and support for performance of duties by the Supervision Trustee and the Divestment Trustee. Without permit of MOFCOM, the Obligor shall not give any instructions to the Supervision Trustee or the Divestment Trustee. Without permit of MOFCOM, the Supervision Trustee or the Divestment Trustee shall not disclose any information obtained in their performance of duties; the Supervision Trustee and Divestment Trustee shall submit regular reports to MOFCOM in respect of their duty

performance progress and keep confidential commercial secrets and other confidential information obtained in their duty performance process.

◆ Supervision Trustee

➢ Definition

A Supervision Trustee refers to a natural person, legal person or other organization that is entrusted by the Obligor to be responsible for monitoring the entire process of business divestment.

➢ Requirements

A Supervision Trustee shall be a natural person, legal person or other organization that has the necessary resources and capacities to be engaged in the entrusted business, be independent from the operator involved in concentration and the purchaser of the divested business, and shall has no substantial interest in these parties.

➢ Appointment of Supervision Trustee

The obligor shall submit the candidate of the Supervision Trustee to MOFCOM within fifteen (15) days after MOFCOM has made the review decision. The Obligor shall enter into a written entrustment agreement with the Supervision Trustee, defining duties and obligations of the parties.

➢ Obligations of Supervision Trustee

From the date when the entrustment agreement becomes effective, till the date of completion of the business divestment, the Supervision Trustee shall, under the supervision of MOFCOM, in accordance with principles of diligence and responsibility, perform the following obligations: (a) monitoring the Obligor to guarantee the value of the divested business and submitting supervision reports to MOFCOM regularly; (b) making assessment against the candidates of purchaser recommended by the Obligor, the sale agreements and other relevant agreements to be signed, and submitting assessment reports to MOFCOM; (c) supervising the performance of the sale agreements and other relevant agreements and submitting supervision reports to MOFCOM; (d) mediating disputes arising from divestment issues between the Obligor and potential purchaser and reporting the same to MOFCOM; (e) submitting other reports related to the business divestment as required by MOFCOM.

◆ Divestment Trustee

➢ Definition

A Divestment Trustee refers to a natural person, legal person or other organization that is

entrusted by the Obligor to be responsible for finding appropriate purchaser and executing sale agreements and other relevant agreement in the stage of Entrusted Divestment.

- Requirements

Divestment Trustee shall be a natural person, legal person or other organization that has the necessary resources and capacities to be engaged in the entrusted business, be independent from the operator involved in concentration and the purchaser of the divested business, and shall has no substantial interest in these parties.

- Appointment of Divestment Trustee

The Obligor shall submit the candidate of the Divestment Trustee to MOFCOM 30 days prior to entering the divestment phase. The Obligor shall enter into a written entrustment agreement with the Divestment Trustee, defining duties and obligations of the parties. The Obligor shall grant in writing the Divestment Trustee the authorization to independently handle divestment business in the entrustment agreement.

- Obligations of Divestment Trustee

From the date when the entrustment agreement becomes effective, till the date of the end of the stage of entrusted divestment, the Divestment Trustee shall, under the supervision of MOFCOM, according to the term and ways prescribed in the review decision, find an appropriate purchaser and execute sale agreements and other relevant agreement with the purchaser.

Requirements for the Purchaser of Divested Business

The purchaser of divested business shall satisfy the following requirements: (a) the purchaser shall be independent from and have no substantial interest in the operator involved in the concentration; (b) the purchaser shall have necessary resources and capacities and is willing to maintain and develop divested business; (c) the purchase of the divested business will not raise the problem of eliminating or limiting competition; (d) where approvals of other relevant administrations shall be obtained in purchasing the divested business, the purchaser shall meet the necessary requirements in obtaining such approvals.

Prohibited Articles in the Agreement

Any agreement executed by and between the Obligor and the purchaser, including divested business sale agreements, transition agreements, etc., shall not contain any provisions in violation of the review decision.

Term of Divestment

Unless otherwise approved by MOFCOM, the Obligor shall transfer the divested business to the purchaser and complete the transfer of ownerships and other relevant legal procedures within three (3) months as of the execution of the sale agreements and other relevant agreements.

Duties of the Obligor

Before the completion of the divestment, the Obligor shall perform the following duties to guarantee the value of the divested business: (a) to keep the divested business independent from other business and manage the divested business in its best interest; (b) not to conduct any behaviors which have adverse effects on the divested business, including employing staff involved in the divested business and acquiring commercial secrets and other confidential information of the divested business; (c) to appoint a special manager to manage the divested business and perform the duties provided in items (a) and (b) above. The manager shall perform its obligations under the supervision of the Supervision Trustee and the appointment and change of the manager shall be subject to the approval of the Supervision Trustee; (d) to make sure potential purchasers can obtain sufficient information regarding the divested business in fair and reasonable manners to assess the value, scope and business potential of the divested business; (e) if required by the purchaser, to provide necessary supports and assistances to guarantee smooth transfer and stable operation of the divested business; (f) to transfer the divested business to the purchaser in time and to perform relevant legal procedures.

Supervision of the Divestment by MOFCOM

MOFCOM will evaluate the candidates of Supervision Trustee, Divestment Trustee and the purchaser, the entrustment agreement, the divested business sale agreement and other relevant agreements, to make sure they are in compliance with the requirements provided in the review decision. MOFCOM shall monitor and evaluate the duty performance status of the Supervision Trustee and Divestment Trustee.

Legal Updates

1. China Eases Rules on Provision of Security to Foreign Entities by Domestic Institutions (Author: Na CAI)

China's State Administration of Foreign Exchange ("**SAFE**") promulgated the *Notice on Issues in the Administration on Foreign Security by Domestic Institutions* (the "**Notice**") on July 30, 2010, which became effective on the promulgation date. With PRC-invested offshore companies' increasing demand of domestic credit support, SAFE promulgated the Notice aiming at promoting the convenience of trading and investment and providing more policy support to security as provided by domestic enterprises to PRC-invested offshore companies.

Applicability Scope

For the purpose of the Notice, "foreign security" refers to a promise provided by the domestic institution (the "guarantor") to the offshore institution (the "beneficiary") in the form of guarantee, mortgage or pledge according to relevant regulations, that the guarantor shall fulfill the obligations or the beneficiary shall get firstly repaid with the proceeds from auction or selling off of the collaterals according to the *PPC Guarantee Law* and the *PRC Property Law* in the event that the debtor (the domestic or offshore institution) fails to fulfill the contractual obligations. The security provided by a domestic institution to another domestic institution as the beneficiary shall be regarded as a foreign security and be applicable to the Notice if the secured party of such security is an offshore institution.

Main Contents and Changes

The main contents of the Notice include:

- Loosen restrictions on qualifications of the secured party and expand the scope of foreign security

In the event of a financing foreign security provided by a bank, the secured party is no longer subject to its equity ownership relationship with domestic intuitions, net asset ratio and profitability conditions. In the event of a foreign security provided by a non-banking financial institution, the secured party shall be a legal person entity duly established within China or an offshore enterprise established or held directly or indirectly by a domestic institution. In the event of a security provided by an enterprise, the scope of the qualified secured party is expanded from first-level subsidiaries of a domestic company inside or outside China to companies established or held directly or indirectly by the guarantor inside or outside China. Besides, the Notice cancels the relevant requirement that where the secured party is a PRC or offshore equity joint venture, the amount of security provided shall be proportionate to the capital contribution ratio thereof.

◆ Relax restrictions on the guarantor and lower the profitability requirements of the secured party

In the event of a foreign security provided by an enterprise, the required ratio between its net asset and total asset is unified to be no less than 15% from the two separate standards which used to be applied to overseas trading enterprises and non-overseas trading enterprises respectively. The amount of net asset of the secured party shall be positive and the profit requirement is changed from non-loss in record to that there shall be at least one year with profit over the past three years (the requirement for long-term projects of resource exploitation can be relaxed to the extent that there shall be at least one year with profit over the past five years).

◆ Adjust the scope of administration of quota balancing for foreign security

Financing-type foreign security provided by a bank to domestic or offshore institutions is now subject to a quota balancing system. Previously, banks had to obtain case-by-case SAFE approval where the underlying obligor was a domestic entity. Under the Notice, no such approval is needed as long as the foreign security is within the bank's annual quota. Financing-type and non-financing-type foreign security provided by non-banking financial institutions or enterprises can implement quota balancing administration upon approval. Quotas of foreign security provided by a bank shall not exceed 50% of its combined RMB and foreign exchange paid-in capital or working capital, or its foreign currency net asset. The foregoing regulation shall be applied to non-banking financial institutions by reference. In case of a foreign security provided by an enterprise, quotas shall not exceed 50% of the amount of its net assets.

◆ Clarify rules on non-financing security provided by banks

Non-financing–type security provided by banks is no longer subject to the restriction of net asset ratio and profitability condition of the secured party and no SAFE pre-approval is required as well. However, either the secured party or the beneficiary shall be a domestic institution or an offshore institution that is held directly or indirectly by a domestic institution.

◆ Remove approval requirement on performance of foreign security provided by the bank

The Notice explicitly removes the pre-approval requirement on performance of a foreign security provided by a bank and provides that the bank has its own discretion to deal with the performance matters. However, performance of foreign security provided by non-banking financial institutions and enterprises remain subject to case-by-case SAFE application and approval procedures and the non-banking financial institution and the enterprise may purchase foreign exchange performance required by such performance upon approval. Besides, the Notice provides that foreign security provided by a foreign-invested enterprise

shall apply similar administration principles applicable to other enterprises and be subject to case-by-case SAFE approvals and registrations as well.

Conclusion

The Notice simplifies the administration procedures on foreign security and clarifies relevant administration requirements, which is conductive to promote the "going out" progress of domestic institutions, making it easier for PRC-invested offshore companies to obtain domestic credit support and enhance the risk management level of domestic financial institutions. The Notice strengthens relevant risk control mechanism on foreign security and optimizes relevant forms for regular filing for foreign security, which is beneficial to promote the statistical monitoring early-warning on risk and risk control system on balance of payments.

2. SAIC Issued Examination Criteria on Trademarks Containing the Word of 'China'(中国) or Initial Word of 'Nation'(国) (Author: Jiaxin LIU)

To regulate the application of and examination on the trademarks containing the word of 'China'(中国) or initial word of 'Nation'(国) and prevent the abusive use of such words with special connotation in trademarks, the State Administration for Industry and Commerce ("**SAIC**") promulgated *Examination Criteria on the Trademark with the Word of 'China'(中国) or Initial Word of 'Nation'(国)*, key points of which are as follows.

Examination Criteria on Trademarks with the Word of 'China'(中国)

In regard to application for registration of a trademark containing the words that are identical with or similar to the name of the nation, the applicant and the trademark to be registered shall satisfy the following four requirements simultaneously to pass the preliminary examination:

- The applicant shall be approved to be established by the State Council or its authorized authority. The name of the applicant shall have been duly registered with the name registration administration;

- The trademark to be registered shall be consistent with the name or the short name of the applicant enterprise, which shall have been approved by the State Council or its authorized authority;

- The trademark to be registered shall be closely corresponding to the applicant;

- The commodities or service scope to which the trademark to be registered is to be applied shall be consistent with the approved business scope.

Examination Criteria on Trademarks with Initial Word of 'Nation'(国)

The examination on application for registration of the trademark with initial word of 'Nation'(国) shall be subject to the following criteria:

- With respect to the application for registration of a trademark composed of 'Nation + name of the designated commodity under the trademark' (国+商标指定商品名称) or containing 'Nation + name of designated the commodity under the trademark', it may be rejected on the grounds of 'constituting exaggerated advertising and being deceitful', 'lack of distinctive characteristics' and 'having harmful influence';

- The treatment on application for registration of a trademark that has the initial word of 'Nation'(国) but is not composed of 'Nation + name of the designated commodity under the trademark' (国+商标指定商品名称) shall be subject to circumstances. The application shall be rejected in the case that the trademark on the designated commodity directly represents the quality and characteristic of the commodity or is deceitful, or even harmful to the fair competition of the market.

The application for registration of the trademarks containing the word of 'China'(中国) or initial word of 'Nation'(国) shall be subject to stringent examination. The applicant may submit relevant evidence materials during the trademark registration application process.

3. SAT Introduces New Administrative Rules on Enterprise Income Tax Treatment of Enterprise Restructuring (Author: Xiaolan CHEN)

The State Administration of Tax ("**SAT**") issued the *Administrative Measures on the Enterprise Income Tax Treatment of Enterprise Restructuring* on July 26, 2010 ("**Measures**"). The Measures was effective from January 1, 2010. In April 2009, the Ministry of Finance and the SAT promulgated *the Circular on Several Issues concerning Enterprise Income Tax Treatment of Enterprise Restructuring* ("**Circular 59**"). The newly issued Measures clarify the uncertain issues in Circular 59 and provide more detailed provisions on the compliance and application.

Clarify unclear issues in Circular 59

In regard to the payment in equity, according to Article 2 of Circular 59, in the case of enterprise restructuring, the equity or shares of the acquiring enterprise or its controlled enterprise can be used to acquire or swap the assets of another enterprise. However, Circular 59 did not define the controlled enterprise. The Measures clarify that the controlled enterprise refers to the enterprise in which the equity interest is directly held by the acquiring enterprise.

Circular 59 defined asset acquisition as a transaction in which an enterprise acquires the substantial operating assets of another enterprise. The Measures provide that substantial operating assets refer to assets directly used in the manufacturing, business operations, and generating business related income, including various assets for operation, business information and technology owned by the enterprise, accounts receivable generated from business operation, investment assets, and etc.

The term "date of restructuring" ("**DOR**") was frequently used but not defined in Circular 59. The Measures provide definitions of the DOR in different cases. In the event of debt restructuring, the DOR refers to the date on which the debt restructuring contract or agreement takes effective. For equity and asset acquisitions, the DOR means the date on which the transfer agreement is effective and the procedures of equity transfer or asset transfer have been completed. In terms of the enterprise split and merger, the DOR is the date on which the split or merging enterprise obtains the legal titles to the assets of the enterprise being split or merged and such changes have been registered with competent administration of industry and commerce.

Circular 59 also provides where the shareholders receive the equity payment that is no less than 85% of the total transaction price or the merger is under the same control with no payment of consideration in need, they may elect to apply for the deferred tax treatment and temperately not to confirm the income and loss. The Measures clarify the definition of same control which means enterprises being merged are under the ultimate and non-temporary control of the same party or parties before and after the merger. The same parties that exert ultimate control over the enterprises being merged before and after the merger refer to the investor group having right of decision and control over the financial and operation of the merged enterprises according to the contract or agreement. The Measures further require the enterprises being merged prior to the merger and the entity incorporated after the merger shall all be under the ultimate control for more than 12 months (inclusive).

Another major issue in Circular 59 is regarding the reasonable business purpose. Circular 59 did not explain what the reasonable business purpose is and how to decide it. The new Measures set out the following rules for tax payers to prove the reasonable business purpose when filing a record or submitting the application with tax authorities:

- the structure of transaction, namely the form of the restructuring, the background and time of the transaction, the operation mode prior to and after the transaction, and relevant business practices;

- the form and nature of the transaction, namely pro forma legal rights and obligations, in other words, the legal consequence of the transaction, and the actual or business outcome as eventually happened;

- changes as may be brought to the parties to the restructuring with respect to the tax;
- changes to the financials that parties to the restructuring may acquire from the transaction;
- whether the restructuring will generate unusual economic benefits or potential obligations which are not resulted from the market principles for parties to the restructuring; and
- the extent to which the non-resident enterprises participate in the restructuring.

Circular 59 requires that the original major shareholder receiving the equity payment in the enterprise restructuring shall not assign the equity received within 12 consecutive months after the transaction. The Measures made it clear that the original major shareholder refers to those who held at least 20% of the equity interests in the enterprise being transferred or merged.

Additional Requirements on Compliance and Application

The Measures provide requirements on application and document preparation in various restructuring cases, including the merger and split of general restructuring, debt restructuring, equity acquisition, and asset acquisition of special restructuring. Note only PRC qualified asset valuation agencies are allowed to issue asset valuation related documents if applicable.

The Measures introduce a new concept of the leading party of the restructuring. Pursuant to the Measures, in the case of enterprise restructuring, at the election of parties, the leading party of the restructuring will apply with the competent tax authority for approval. The leading party of the restructuring shall be determined based on principles as follows:

- the debtor in the case of debt restructuring;
- the transferor for equity or asset acquisition;
- the surviving enterprise in the event of merger by absorption and the enterprise having more assets for the merger by incorporation; and
- the split or surviving enterprise in a split.

In accordance with Circular 59, where the deferred tax treatment is in case, the enterprise shall not change the previous substantial operation of assets having been reorganized within 12 consecutive months after the restructuring and the original major shareholder receiving the

equity payment shall not transfer the equity received during the same period. The Measures further set forth that at the time of conducting enterprise income tax return in the next year after the restructuring, parties that elect the deferred tax treatment shall provide the competent tax authority with relevant documents indicating the satisfaction with the requirements for the deferred tax treatment during the 12 consecutive month period.

Unclear Issues in the Measures

Notwithstanding the Measures set out required documents for the purpose of evidencing the reasonable business purpose, the definition and interpretation of reasonable business purpose are still left vague. This might increase potential risks and uncertainty to the application of deferred tax treatment.

Although the definition of the controlled enterprise is clarified, the Measures fail to provide applicable standards for determination, to be specific, whether the shareholding percentage of equity interests in the controlled enterprise held by the acquirer, the impact that may be imposed on the management of the controlled enterprise, or a comprehensive weighing of above elements should be applied.

In regard to the cross border restructuring, the Measures merely provide regulations on application documents. From the perspective of tax, the rigorous requirements as set out in Circular 59 and the Measures may impede the application of deferred tax treatment in the cross border restructuring.

Tax authorities are expected to further provide interpretation and regulations on unclear issues in the Measures in future.

4. Shenzhen Released New Rules on Promotion of the Equity Investment Fund Industry (Author: Kaiying WU)

In order to promote the development of equity investment fund industry, and thus consolidate and upgrade the status of Shenzhen as the regional financial center, through the adoption in principle by the municipal government on June 30, 2010, the Service Office for Development of Finance Industry of Shenzhen released the *Provisions on Promotion of the Development of the Equity Investment Fund Industry* (the "**Provisions**") on August 5, 2010.

Scope of Application

The Provisions apply to domestic, wholly foreign-owned and Sino-foreign equity joint venture equity investment funds, including industry investment funds and venture capital funds ("**EIFs**"), equity investment fund management enterprises ("**EIFMEs**") and private equity

(particularly securities) investment fund management enterprises ("**PEIFMEs**"), which are registered within the city of Shenzhen. To be eligible, the aforesaid enterprises shall also satisfy the conditions below: (a) regarding EIFs, its registered capital shall be no less than RMB 100,000,000, its capital contribution shall be made in cash in the name of its shareholders or partners, and the first installment paid-in capital shall be no less than RMB 50,000,000; (b) regarding EIFMEs, in case the EIFME is a company limited by shares, its registered capital shall be no less than RMB 10,000,000; while, the minimum paid-in capital of an EIFME registered as a limited liability company shall be RMB 5,000,000; (c) a PEIFME shall hold a minimum registered capital of RMB 10,000,000 and manage a minimum value of assets of RMB 100,000,000.

Preferential Policies

The Provisions set forth a wide range of preferential policies, which include awards for registration, business registration facilitation, tax policy preferences, housing subsidy, talents introduction and training, projects matchmaking, industrial park services, etc. The relatively prominent preferential policies are as follows:

◆ Awards For Newly Established EIFs

Newly registered EIFs may be granted awards of different amount depending on their respective amount of registered capital, and the maximum award reaches RMB 15,000,000. The Provisions stipulate that from the date the Provisions come into force until December 31, 2011, newly registered EIFs can enjoy the preferential policies below:

- A one-off registration award will be given to EIFs established in the form of a company depending on their respective amount of registered capital. Where the registered capital reaches: RMB 500,000,000, an award of RMB 5,000,000; RMB 1,500,000,000, an award of RMB 10,000,000; RMB 3,000,000,000, an award of RMB 15,000,000.

- Regarding an EIF established in the form of partnership, a one-off registration award will be granted to the EIFME entrusted by the said EIF, of which the amount of award shall be in accordance with the scope of fund it raises: in case the fund raised reaches RMB 1,000,000,000, an award of RMB 5,000,000; RMB 3,000,000,000, an award of RMB 10,000,000; RMB 5,000,000,000, an award of RMB 15,000,000.

◆ Awards For Investments to the Local Area and Subsidies

In case an EIF invests to enterprises or projects within Shenzhen, it can be granted a one-off award, which equals to 30% of the local fiscal revenue herein derived after the project exit or profit obtain, but an award for single project shall not exceed RMB 3,000,000.

However, the Provisions require that EIFs which enjoyed the registration awards shall not relocate outside of Shenzhen within 5 years. In addition, qualified fund enterprises, in certain periods, and in accordance with circumstances, can enjoy subsidies which equal to 100% or 50% of local fiscal revenue derived from their operating income or enterprise income.

The housing subsidies granted to fund enterprises by the Provisions include: in case an EIF or EIFME needs to procure an office space for its own use, it will be granted a maximum one-off subsidy of 1.5% of the purchase price, and the maximum subsidy amount is 5,000,000. However, to enjoy the above said subsidy, the office space may be not sold or rented to others within 10 years. Where an EIF or EIFME rents an office space for its own use, it will be granted a subsidy which equals to 30% of the guide price on housing rental market for 3 consecutive years, but the total amount of the subsidy shall not exceed RMB 1,000,000.

Clarification on Tax Policy

The Provisions also clarify tax policy for qualified enterprises. EIFs and EIFMEs in the form of partnership will not be deemed as income tax payers, and the tax method of "distribute first, then tax" shall be adopted, where partners shall pay personal income tax or enterprise tax respectively. Individual general partners who operate the limited partnership shall pay personal income tax in accordance with the 5%-35% excess progressive rate under the tax item of "Production and Operation Income of Individual Business (个体工商户的生产经营所得)"; meanwhile, individual limited partners who do not operate, shall pay a 20% proportional personal income tax under the tax item of "Income of Interests, Dividends, Capital Bonuses (利息、股利、红利所得)". In addition, EIFs and EIFMEs which have made equity investment into unlisted small and medium high-tech enterprises (SMEs) for over 2 years, and satisfy the conditions set forth in the *State Administration of Taxation: Circular on Implementing Income Tax Benefits for Venture Capital Investment Enterprises* (SAT: [2009]87;《国家税务总局关于实施创业投资企业所得税优惠问题的通知》), shall be granted a taxable income deduction of 70% of the investment amount they invest into those SMEs.

Finally, the Provisions require relative authorities of the city to give business registration convenience to EIFs, EIFMEs and PEIFMEs, and allow them to include the wording of "Fund(基金)" or "Investment Fund(投资基金)" in their enterprise names.

Important Announcement

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