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VINGE

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China Practice Group

NEWSLETTER FROM VINGE

ABOUT THIS NEWSLETTER

The materials in this newsletter are of general, informational nature. The content does not purport to be exhaustive and should not be relied upon as a substitute or replacement for individual legal advice on any specific matter. If you have a specific legal question you are welcome to address it to one of our lawyers.

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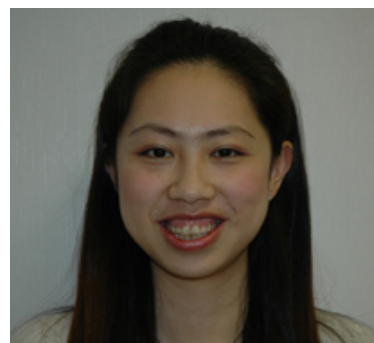
Vinge is one of the leading law firms in Scandinavia. The worldwide staff exceeds 450 of which more than 290 are lawyers. Vinge is the first Swedish law firm with offices in Hong Kong and China (Shanghai).

Vinge's China Practice Group assists clients in all aspects of their business activities in China. Many foreign clients, including Chinese clients, have chosen Sweden as their base for investments and business operations not only in Sweden but also within the European Community.

Lanymers from Vinge's China Practice Group are represented on the Board of Directors of professional organisations such as the Sweden China Trade Council and the China Forum in Gothenburg



Paulo Fohlin (Member of the Swedish Bar Association) has moved to Hong Kong. Paulo has been associated with Vinge since 1988 and has established himself as one of Sweden's leading practitioners in international arbitration. Paulo, also a Resident Partner in Hong Kong together with Björn Aschan, will be focusing on China related international arbitrations in China, Hong Kong and in Sweden.



New associate in Shanghai

Vinge is very pleased to announce that Ms **Ji Lijia** on 1 Februari 2007 started working at our office in Shanghai .

Lijia has previously worked at the Rep.Office of a European law firm in Shanghai, a Chinese law firm and at the Shanghai Court of Second Instance as assistant to the Judge.

Lijia has a law degree from the East China University in Shanghai and a degree in International Business and Economic Law from the University of Groningen in the Netherlands.

Lijia speaks Mandarin and English.

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New M&A regulations implemented

A comprehensive set of “Regulations Concerning the Merger and Acquisition of Domestic Enterprises by Foreign Investors” (the “New M&A Regulations”) came into effect in China on 8 September 2006.

Scope of application

The New M&A Regulations distinguishes between two types of mergers and acquisitions of Chinese domestic, non-foreign-invested, enterprises by foreign investors: **Equity Acquisitions** and **Asset Acquisitions**. An **“Equity Acquisition”** is defined as the acquisition by a foreign investor of equity interest in a Chinese domestic company, or the subscription by a foreign investor of new equity in a Chinese domestic company, resulting in the conversion of the Chinese domestic company to a Foreign Investment Enterprise (“FIE”). An **“Asset Acquisition”** is defined as including both (i) the establishment of an FIE by foreign investors for the purpose of using such FIE to acquire and operate assets purchased from Chinese domestic companies; and (ii) the direct acquisition of assets from Chinese domestic companies by foreign investors who then use those assets for establishing an FIE.

Mergers and acquisitions of Chinese domestic enterprises by FIEs *already established* in China are, however, primarily governed by the regulations for reinvestment of FIEs. The New M&A Regulations apply to such transactions only to the extent relevant rules are lacking in the reinvestment legislation.

Legal consequences of the transaction

It is of key importance to remember that in legal terms performing an M&A transaction in China will *transform the target company to an FIE*. Consequently, when merging or taking over a domestic enterprise, the foreign investor shall satisfy all those legal requirements, such as policies on industry, land, environmental protection, etc, that are applicable to other types of foreign investments in China. Transfer of only part of the equity or assets of the domestic Chinese enterprise to a foreign enterprise will result in the application of the joint venture legislation.

Equally, the M&A transaction must comply with the rules in the **“Catalog of Industries for the Guidance of Foreign Investment”** (the “Investment Guidelines”). Thus, for such industries where, according to the Investment Guidelines, it is required that a Chinese party controls or relatively controls the shares, the same applies in relation to an M&A transaction. The transaction must not result in foreign control of the enterprise in question. In the same way no foreign investor may merge or take over a Chinese enterprise in an industry where, according to the Investment Guidelines, foreign investors are prohibited from operating.

When a foreign investor intends to achieve control of a domestic enterprise that affects an “important industry”, or if it has an impact on, or may have an impact on, “national economic security”, or it will lead to the transfer of actual control of a domestic enterprise which holds a “famous trademark” or “China Time-honored Brand”, the parties to the transaction shall file an application with the Ministry of Commerce (“MOFCOM”). In such circumstances, MOFCOM has the authority to order the parties to terminate the transfer of equities/assets or take other measures to eliminate the impact of the M&A transaction on the national economic security. The New M&A Regulations contain an element of uncertainty to foreign investors as none of the concepts of “important industry”, “national economic security” and “China Time-honored Brand” are clearly defined.

Purchase price and payment

The transaction price shall be set by an asset assessment institution through application of a “common international assessment method”.

In general the full purchase price shall be paid in full within 3 months from the date of issuance of the business license of the FIE, though under certain circumstances extensions of up to 1 year on payment of part of the purchase price may be granted.

Special rules have been introduced in the New M&A Regulations with regard to so called “equity-payment-based M&As”, i.e. where the foreign investor uses the shares of the foreign enterprise as consideration to pay the purchase price for purchasing the equity or for subscribing for new equity of a Chinese domestic company. Equity-payment-based M&As require approval by MOFCOM. Further rules include an obligation on the overseas enterprise or its shareholders to hire a recognized intermediary M&A consultant registered in China to conduct a due diligence to inspect the genuineness of the M&A application documents, the financial status of the overseas company and to prepare an M&A consultant report on the compliance of the proposed transaction with the requirements of the New M&A Regulations.

The amounts of registered capital and total investment of an FIE to be formed from an Equity Acquisition or Asset Acquisition shall comply with the following ratios:

Registered Capital

Less than US\$2.1 million

US\$2.1 million to US\$5 million

US\$5 million to US\$12 million

More than US\$12 million

Total Investment

Cannot exceed 10/7 times the amount of registered capital

Cannot exceed 2 times the amount of registered capital

Cannot exceed 2.5 times the amount of registered capital

Cannot exceed 3 times the amount of registered capital

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Debts

When a foreign investor performs an equity-based merger, the foreign-invested enterprise established after the acquisition shall succeed to the credits and debts of the domestic Chinese target company. In the case of asset-based takeovers, the domestic target company remains responsible for its existing credits and debts. The foreign investor, the domestic target company, the creditors and other parties concerned may enter into a separate agreement on the disposal of the credits and debts of the target company, provided that this agreement does not impair the interests of any third party or public interests. Any agreement on the disposal of credits and debts shall be submitted to the examination and approval organs.

Competition law aspects

Through the New M&A Regulations new detailed competition law provisions have been introduced. The New M&A Regulations authorizes MOFCOM and the State Administration for Industry and Commerce (“SAIC”) to review all M&A transactions, whether implemented in China or abroad. The parties to an M&A transaction are obliged to report the transaction to MOFCOM and SAIC under the following conditions.

Domestic transactions

If (i) the business volume of any party to the proposed M&A transaction in the Chinese market exceeds RMB 1.5 billion in the current year; (ii) the foreign investor has accumulatively acquired more than 10 Chinese enterprises in the domestic affiliated industries; (iii) the market share in China of any party to the proposed M&A transaction has reached 20%; (iv) the proposed M&A transaction would result in the market share in China of any party to such transaction reaching 25%. The reference to any party to a proposed M&A transaction includes the affiliates of the foreign investor.

Overseas transactions

If (i) any overseas party to the transaction owns more than RMB 3 billion yuan worth of assets inside the territory of China; (ii) the business turnover in the Chinese market of any party to the transaction exceeds RMB 1.5 billion in the current year; (iii) the market share in China of any party to the overseas transaction (including its affiliates) has reached 20%; (iv) the overseas transactions would result in the market share in China of any party to the transaction (including its affiliates) reaching 25%; (v) due to the overseas transaction, there will be more than 15 FIEs in the relevant domestic industry with direct or indirect ownership of shares of any party to the overseas transaction.

It is worth noting that the New M&A Regulations do not contain any provisions on how to calculate the market share of a party/parties to a transaction.

Reporting of a transaction according to the above may also be called upon by a domestic Chinese competitor, a relevant authority or an industrial association. If MOFCOM or SAIC under such circumstances make the assessment that the parties to the transaction hold a large market share or that there are other factors to the transaction which seriously impact market competition, they may order the foreign investor to prepare a report about the proposed transaction.

The parties to an M&A transaction shall state whether there is affiliated relationship between them. If both parties are controlled by the same entity, the identity of that entity must be disclosed to the examination and approval authorities and accompanied by an explanation regarding whether the purpose of the M&A transaction and expected result of the transaction correspond to the fair value of the market.

Under certain circumstances the parties to an M&A transaction may, however, apply to MOFCOM and SAIC for an exemption of examination. Such exemption may be granted if (i) the M&A transaction is capable of enhancing fair competition in the market place; (ii) the M&A transaction will restructure a loss making enterprise and can safeguard the employment of the staff working for that enterprise; (iii) the M&A transaction will attract advanced technology and management talent, and can enhance international competitiveness of PRC enterprises; (iv) the M&A transaction in question can improve the environment.

Conclusion

M&A transactions in China remain legally complex. M&A transactions may convert the target company into an FIE, which, depending on foreign ownership share, may make the joint venture legislation applicable. When a foreign investor performs an equity-based merger, the foreign-invested enterprise established after the acquisition shall succeed to the credits and debts of the domestic Chinese target company. Under certain circumstances transactions must be reported to MOFCOM/SAIC for competition law approval. In all events M&A transactions in China require careful planning and the performance of a thorough due diligence of the target company is necessary.

China's new Unified Corporate Income Tax Law

During the National People's Congress meeting in Beijing in 8 to 15 March 2007 the long-awaited new unified Corporate Income Tax Law ("CIT") was passed. The enactment of the CIT will have a significant long-term impact on the income tax situation for Chinese Domestic Enterprises ("DE"), for Wholly Foreign Owned Enterprises ("WFOE") including Foreign Commercial Enterprises ("FICE") and Joint Ventures ("JV"). Where the foreign ownership is more than 25% these foreign owned entities are jointly, from an income tax point of view, referred to as Foreign Invested Enterprises ("FIE").

With the new CIT the Chinese Government wants to provide a fair and equal taxation of DEs and FIEs and provide a simple tax system with a wide tax base, a low tax rate and a stringent tax administration. The taxation of DEs and FIEs should, in principle, be equal and preferential tax treatments should be limited to certain specific business areas.

Important "bullet points" of the new CIT are as follows:

- The CIT will come into effect on 1 January 2008
- The Corporate income tax rate is standardized at 25% for both DEs and FIEs (compared to the "old" tax rate of 33%)
- Preferential Tax treatments are amended
- Reduced tax rate at 20% for small and low profit companies
- Reduced tax rate at 15% for "encouraged" high/new-tech companies
- Expansion of tax incentives for venture capital businesses and for investments in environmental protection, energy and water saving and safe protection techniques
- Retention of tax incentives for investments in agriculture, forestry, fishery and infrastructure projects
- Replacement of tax incentives for labor service companies, welfare enterprises and companies making comprehensive use of resources
- Continuation of tax incentives for newly established high/new-tech enterprises in Special Economic Zones and Shanghai Pudong New Area and for "encouraged" enterprises in the Western Regions of China
- Cancellation of existing tax holidays available to general production- and export oriented companies
- New tax reduction, or exemption, for income generated from environmental protection projects and technology transfers that meet certain prescribed criteria
- "Grandfathering" of current preferential tax treatments will be allowed
 - Current reduced tax rates (15 or 24%) for existing FIEs will gradually be increased to the standardized rate (25%) within a five year period from the effective date of the CIT
 - Unused tax holidays for existing FIEs can be used until expiry of the approved tax holiday period
 - Where the tax holiday hasn't started because of a loss situation in the FIE the tax holiday shall be deemed to commence from the effective date of the CIT
- A concept of Tax Resident Enterprise ("TRE") is introduced
 - A TRE is an enterprise, which is established in China, or an enterprise established outside China where effective management is based in China
 - A TRE is subject to CIT on its world wide income, and non-TRE only on its China source income
- Anti-avoidance Rules are introduced focusing on transfer pricing, thin-capitalization rules and controlled foreign corporation rules ("CFC").