

China Tax/Business News Flash

A Green Light for Venture Capital Industry

With the issuance of Wai Jing Mo Ji Zi [2001] 62, the PRC government officially opened up the venture capital industry to foreign investors. From 1 September 2001 onwards, wholly foreign owned enterprises or foreign-invested joint ventures engaged solely in investment in high and new technology enterprises in China (hereinafter referred to as "venture capital enterprises") are allowed to set up to conduct the following activities:

- ?? Equity investment in high and new technology areas which fall under "encouraged" or "permitted" categories for foreign investment or other approved areas.
- ?? Provision of investment consultancy services.
- ?? Provision of management consultancy services to its investee enterprises.
- ?? Other activities permitted by the approval authority.

However, foreign investors should be aware that venture capital enterprises are only allowed to use their own capital to make investments. Venture capital enterprises are not allowed to borrow to invest. Investment is restricted to equity investment in high and new technology areas and not allowed for direct or indirect investment in any securities, options, commodity futures or other financial derivatives or real estate (other than properties for self use). Provision of loan and guarantee are also disallowed.

In addition, the circular outlines the conditions foreign investors need to fulfil, ranging from portfolio base, expertise, capital structure, asset base, minimum investment amount, etc. Among various requirements, it is noteworthy to mention that there must be at least one foreign investor who needs to make a minimum investment of USD20 million and the operating period of such a venture capital enterprise generally does not exceed 12 years. The venture capital enterprises may apply for an extension when their operating period expires. The contribution ratio of foreign investors in venture capital enterprises must be at least 25%.

Allowed exit strategies are as follows:

- ?? Initial public offering in any stock markets in China or overseas;
- ?? Transfer of equity interest to other parties; or
- ?? Selling back of interest to the investee enterprises; or
- ?? Other ways allowable in China laws and regulations.

Lastly, consistent with the current principle, in order for an investee enterprise to qualify as a foreign investment

enterprise and enjoy the incentives provided to foreign investment enterprises, the aggregate equity investment in the investee enterprise from a venture capital enterprise and other foreign investors must reach 25% or above.

New Individual Income Tax Treatment on Severance Payment

As a measure to lessen the hardship encountered by a taxpayer in an employment termination, the State Administration of Taxation recently issued a circular to extend to all individuals a lenient individual income tax ("IIT") treatment on severance payment.

Starting from 1 October 2001, severance payment amounts not exceeding 300% of the last year's average salary of the concerned locality can be exempted from IIT. The severance payment portion exceeding that exemption limit is still entitled to the tax rate mitigation scheme. However, as the average salary of a city varies from locality to locality, it is important for both human resources professionals and taxpayers to beware of the local variances in applying the exemption right granted by the above circular.

Positive Attitude shown by Customs

The Central Customs department recently issued a reminder to local branches of customs to urge them to fully implement a relaxation policy on the deposit system for processing factories. The policy facilitates a processing factory to be qualified as a Class A enterprise and be exempted from the administrative procedures imposed by the deposit system. For clarity sake, the said relaxed requirements for being qualified as a Class A factory is as follows:

- ?? No record of misconduct relating to import/export permit or custom duty / tax payment in the past 6-month period before assessment;
- ?? No record of fines exceeding RMB10, 000 due to misconduct relating to import/export permit or customs duty / tax payment in the 6-month period prior to the assessment.

Clearly, the central government appreciates the contribution of processing factories and intends to maintain the livelihood of the industry.

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