COMMITTEE INSIGHTS

People's Republic of China*

Since the Committee's last report (Spring 1991), the domestic environment discussed in that report has deteriorated further as a result of continued retrenchment within the Chinese Communist society.

I. General Background

In most respects, 1991 was not a good year for China. As the Communist monolith in Eastern Europe and the former Soviet Union disintegrated rapidly, China's leadership struggled to maintain a collective control over the ethnically and economically diverse People's Republic. But, unlike their Soviet counterparts, the Chinese leadership did succeed in maintaining stability at home. Nevertheless, 1992 poses a far greater challenge to the old guard than that of the last couple of years since the Tiananmen incident in June 1989.

The challenge is reflected in the following major areas:

(a) Maintaining popular support for the Communist Party within China, and the disappearance of communist allies abroad;

(b) reviving tourism and increasing foreign exchange revenue;

(c) restoring foreign investor confidence in China;

(d) reducing domestic debt and maintaining the momentum of economic reform;

(e) easing tensions between Britain and China over the future of Hong Kong; and

(f) improving the deteriorating relationship with the United States of America.

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II. China-U.S. Relations

While the Committee was holding a session on the state of current Chinese affairs at the Spring Meeting of the International Law and Practice Section (April 26, 1991), the office of the United States Trade Representative (USTR) cited China (and three other nations) as a "priority foreign country" under "Special 301" on the basis that China had failed to protect adequately U.S. intellectual property in China. Also in April 1991, the USTR released a ten-page list of Chinese barriers to United States Trade, which barriers the USTR claimed had resulted in a 17 percent decrease in U.S. exports to China in 1990. Consequently, the U.S. trade deficit with China in 1990 exceeded $10 billion.

During the remainder of the year, intensive debate in Washington focused on trade issues and human rights. In the case of the latter, heated discussions arose in the context of whether or not to renew to China's Most Favored Nation (MFN) status. The United States House of Representatives voted 409 to 21 to approve the "Conference Report on H.R. 2212 Relating to the Extension of China's MFN Status." Senate ratification (59-39) of H.R. 2212 occurred on February 25, 1992. The votes resulted from the House and Senate conferees on November 26, 1991, reaching agreement on H.R. 2212.

Under H.R. 2212 (and if not vetoed by President Bush) the President will not be able to recommend the continuation of MFN in June 1992 unless he can report that the Chinese Government (i) has accounted for all Chinese "detained, accused, or sentenced" as a result of their participation in Tiananmen-related activities, and (ii) has released all such Chinese so identified. Furthermore, the President must report to Congress that the Chinese Government has made "overall significant progress" in achieving fifteen identified objectives in the areas of human rights, trade, and weapons proliferation. Finally, H.R. 2212 would establish civil penalties for anyone knowingly importing any goods made by PRC prison inmates.

Concurrent with congressional debate on the MFN waiver, the USTR undertook, on October 10, 1991, a formal Section 301 investigation into China's alleged trade barriers. Areas of investigation include: import licensing restrictions; practice of internal guidance (*nei-bu*) commonly referred to as "transparency" issues; various technical barriers to trade; financial restrictions; and import restrictions on certain goods and services.

Separately, U.S.-Chinese negotiations on intellectual property matters (pursuant to the April 26th listing) broke down in November 1991. On December 2, 1991, the USTR published in the *Federal Register* notice for comment on a proposed determination that certain Chinese practices concerning the protection and enforcement of intellectual property rights of U.S. citizens "are unreasonable and constitute a burden or restriction on United States Commerce." The USTR also identified a fifteen-page list of certain products manufactured in the PRC that were targeted for possible increased tariffs. The products ranged from men's and women's clothing, footwear, imitation jewelry, electromagnets, to tape recorders and wrist watches. According to the USTR's office, said products accounted for approximately $1.5 billion worth of Chinese imports to the United States.

Fortunately, Sino-American trade negotiators were able to reach an "eleventh-hour" settlement of the intellectual property dispute, thereby averting a major trade catastrophe. On January 17, 1992, the United States and China executed a Memorandum of Understanding (MOU) that committed "China to provide improved protection for U.S. intellectual rights in China"[1] and terminated the USTR's IPR-related "Super 301" action.[2] The MOU, consisting of seven articles, addresses issues affecting copyrights (China and the United States agreed, inter alia, to establish bilateral copyright relations and to protect U.S. works); patents (PRC to provide patent protection to pharmaceuticals and agricultural chemical substances); and trade secrets (PRC to use its best efforts to enact and implement a trade secrets law by January 1, 1994).

III. Recent Legislation

Despite the generally negative environment discussed above, the Chinese made several advances in the form of more favorable legislation.

A. The Income Tax Law of the People's Republic of China for Enterprises with Foreign Investments and Foreign Enterprises (the New Tax Law)

In April 1991 China passed the New Tax Law for Enterprises with Foreign Investments and Foreign Enterprises.[3] The New Tax Law, effective on July 1, 1991, replaced both the Foreign Enterprises Income Tax Law of 1981 that had applied to foreign corporations doing business in the PRC, and the PRC Joint Venture Income Tax Law of 1980 that had applied to joint venture enterprises in China. Implementing rules for the New Tax Law were promulgated on June 30, 1991, and also became effective on July 1st.[4] Following are some major points in the New Tax Law:

(1) The tax rate under the New Tax Law is 33 percent (30 percent national tax and 3 percent local tax). This rate is substantially lower than the maximum 50 percent rate that applies under the old Foreign Enterprise Income Tax Law to cooperative joint ventures and to wholly foreign-owned enterprises in China.

1. Office of the United States Trade Representative, China IPR Agreement Fact Sheet, Jan. 17, 1992.

2. Memorandum of Understanding Between the Government of the People's Republic of China and the Government of the United States of America on the Protection of Intellectual Property, Office of the United States Trade Representative, Washington, D.C., Jan. 17, 1992. The MOU was signed one day after the deadline had passed.

3. Passed on April 9, 1991, by the 4th Session of the 7th National People's Congress, China Laws for Foreign Business (CCH Australia) § 32-505(6), at 40,309.

4. Detailed Rules for the Implementation of the Income Tax Law of the People's Republic of China for Foreign Investment Enterprises and Foreign Enterprises, *id.* § 32-507(4), at 40,361.

(2) The New Tax Law offers an additional benefit for both joint ventures and wholly foreign-owned enterprises in China by exempting profit distributions from taxation. Under the Joint Venture Income Tax Law and the U.S.-China Tax Treaty, dividends are taxed at a rate of 10 percent.
(3) In addition to the relatively low 30 percent tax rate, the New Tax Law differs from the prior tax law concerning tax holidays and reductions in the following aspects: First, the New Tax Law generally excludes tax holidays for nonproductive, i.e., service industries; second, it extends the tax holidays to cooperative joint ventures and wholly foreign-owned enterprises; third, it provides special benefits for projects in energy, transportation harbors, wharfs, and special nonproductive projects.
(4) Like the Joint Venture Income Tax Law, the New Tax Law allows the refund of 40 percent of income taxes paid if profits are reinvested in the same enterprise or another foreign-invested enterprise in China for not less than five years.
(5) The New Tax Law does not reduce the general 20 percent withholding rate on interest, rental, royalties, and other income, but it does provide exemptions in special circumstances.
(6) In accordance with international tax practice, the New Tax Law states that in business dealings between foreign-invested enterprises or foreign enterprises with establishments or sites in China and their related enterprises, the prices and expense paid or received should be in accordance with those paid or received by independent parties. When this is not the case and tax is not reduced, the tax authorities may investigate and make reasonable adjustments.
(7) The penalties imposed under the New Tax Law are more severe than those provided under the prior law. For example, the legal representative and the person directly responsible for gross violations of the New Tax Law are subject to imprisonment of not more than three years in addition to the payment of the taxes and the fines under article 121 of the Criminal Code. The New Tax Law, however, reduces the daily surcharge for overdue tax payments from 0.5 percent to 0.2 percent.

B. COMPUTER SOFTWARE PROTECTION REGULATIONS

In June 1991, China promulgated the Computer Software Protection Regulations (the Regulations), effective on October 1, 1991.[5] Its major features are as follows:
(1) PRC citizens and work units will enjoy copyright protection for the software developed by them regardless of whether their works are published or not and where their works are published. Foreigners who first published their software within China will enjoy copyright protection in accordance with these Regulations. Foreigners who first publish their software outside

5. Computer Software Protection Regulations, *id.* § 11-704.

of China will enjoy copyright protection only pursuant to bilateral or multilateral agreements to which China is a party.

(2) Software refers to computer programs and related document files. The author's copyright includes the right to decide whether to publish the software; the right to identify himself or herself and affix his or her name to the software; the right to use the software by duplicating, demonstrating, publishing, and so on; the right to license and obtain remuneration for licensing others to use the software and the right to assign to others the right to use and the right to license.

(3) Copyright ownership shall belong to the developer of the software. Software jointly developed by two or more work units or citizens shall be jointly owned unless otherwise agreed. The ownership of software developed on a commissioned basis shall be determined in accordance with the written agreement between the parties. The ownership of the software developed by a citizen in the course of his or her employment resulting from the discharging of his or her work belongs to the work unit.

(4) Software published after the promulgation of the Regulations is to be registered with the Software Registration Department. The registration of software ownership is a precondition for the filing of any claim or lawsuit concerning the software. Registration procedures and identification materials are yet to be identified.

A number of areas of concern to foreign software developers exist that were not addressed in the MOU. Among those of greater significance are: (i) under the "fair-use exemption, universities and research institutes may freely use third-party software if they are "conducting official government business"; (ii) a licensee may assign rights to other third parties (it is unclear if a contract limiting such rights will be valid); (iii) anyone "legally holding software copies" may, without the owner's consent, use software in any computer, make backup copies, and alter software for its own use (it is also unclear what impact contractual restrictions will have); and (iv) infringement liability will not exist for "software which is similar to existing software when it is essential for implementing relevant state policies, laws, rules and regulations or is essential for implementing state technological standards." Close attention should be paid to these and other issues.

C. Other Legislation

Other legislation that will likely impact foreign trade will be under consideration in 1992. In addition to changes in IPR laws and regulations, the Ministry of Foreign Economic Relations and Trade is working on a draft foreign trade law, which is designed to codify under one law all current laws relating to the regulation of foreign trade with and in China. The draft, currently consisting of fifty-nine articles, attempts to clarify the role of state organizations in the handling of foreign trade matters. Whether it will apply to foreign companies doing business in China is unclear at this time.