



Foreign Direct Investment in China 2015

CHANCE BRIDGE

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1. INTRODUCTION

1.1. WHY INVEST IN CHINA

Area	9,596,960 sq km
Population	1.367 billion (2015)
Administrative Divisions	23 Provinces, 5 Autonomous Regions, 4 Municipalities, 2 Special Administrative Regions
GDP (Exchange Rate)	USD 10.38 trillion (2014 est.)
GDP real growth rate	7.4% (2014 est.)
Unemployment Rate	4.1% (2014 est.)

(Statistics from the World Bank website and the CIA World Fact Book).

China began its policy of opening up in 1979 under Deng Xiaoping. Seeing foreign direct investment (FDI) as one of the keys to its economic growth, China has, over the past three-and-a-half decades liberalized its policies and invited in increasing amounts of FDI. In 2001, China joined the WTO. As a result of these changes, China now proudly offers foreign investors a vast territory with abundant resources and a large work force, supported by world-class infrastructure that is framed in a predictable legal system.

1.2. OUR GUIDE

The present guide attempts to introduce the main legal issues every foreign company or individual should bear in mind when investing in China. First it deals with the sectors that can be invested in and different geographic locations. It then discusses the most convenient vehicles for different kinds of investments. Finally, the guide deals with the others aspects foreign investors are bound to face, such as approvals and registration, tax treatment, the labor regime, etc.

This publication contains general information only and is intended to provide a general guide to the subject matter. Specialist advice relating to your specific circumstances should be sought out. Chance Bridge Partners, its member firms, or their related entities (collectively, “Chance Bridge”) is not, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Chance Bridge shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

2. DECIDING ON AN INVESTMENT

Deciding on an investment in China involves two steps: (1) deciding what sector to invest in; and (2) deciding where in China to invest.

2.1. SELECTING A SECTOR: THE FOREIGN INVESTMENT GUIDANCE CATALOGUE

The *Catalogue for the Guidance of Foreign Investment Industries* (Foreign Investment Guidance Catalogue), the most recent of which was published in 2015, divides industries into four categories with respect to foreign investment: (1) encouraged, (2) permitted, (3) restricted, and (4) prohibited. The "encouraged," "restricted," and "prohibited" sectors are all explicitly defined in Foreign Investment Guidance Catalogue; any remaining unlisted sectors automatically fall into the "permitted" category. The Foreign Investment Guidance Catalogue also states if foreign investment in an industry requires a joint venture with a Chinese partner ("JV") and, if so, if there are minimum requirements regarding the Chinese partners holdings.

Encouraged	In some cases it must be in the form of a JV with a Chinese partner.
Permitted	There are no special regarding JVs with a Chinese partner.

Restricted	May require the establishment of JV with a Chinese partner as the majority shareholder
Prohibited	FDI in these industries is not allowed.

2.2. LOCATION

The issue of location arises mainly when deciding to invest through a Wholly Foreign-Owned Enterprise (described below), because with JV's the location will generally be constrained by the location of the Chinese partner.

2.2.1. Central and Western China

To date, investment in China has been primarily in the Eastern part of the country. In order to tackle this imbalance on May 2013 the NDRC and MOFCOM issued the latest Catalogue of Priority Industries for Foreign Investment in Central and Western China. In this document, foreign investment in several industries is “encouraged” if invested in locations such as Shanxi, Liaoning and Anhui Provinces, Inner Mongolia and Xinjiang Uygur Autonomous Regions; Chongqing Municipality; among many others.

2.2.2. Special Zones

In addition, China offers a number of special zones which give various incentives and benefits to

investments in those regions. The most important of these zones are described in the table below.

Zone Type	Description
Special Economic Zones	Tax and business incentives Better infrastructure and bureaucratic procedures
Economic and Technological Development Zones	Emphasize the development of production enterprises and scientific and technological research institutions Special treatment is available for production enterprises Preferential tax treatment, as well as a higher level of infrastructure and communications
Hi-Tech Development Zones	Strengthen integration among scientific research, education and production, and promote the development of scientific techniques, society and the economy. Preferential tax treatment, as well as a higher level of infrastructure and communications
Free Trade Zones	Goods may be landed, handled, manufactured or reconfigured, and re-exported without the intervention of the customs authorities. Only when the goods move to consumers within China do they become subject to the prevailing customs duties. Preferential tax and currency treatment and provide a high level of infrastructure such as transport facilities, telecommunications and energy supply.

Of special note are the FTZs in Shanghai, Fujian, Guangdong, and Tianjin. These FTZs experiment with

more liberal economic and social reforms. Of particular importance to foreign investment is the negative list i.e. unlike in the rest of China, foreign investment was to be unrestricted by default; only for those sectors on the negative list is foreign investment restricted or prohibited. These FTZs are also home to other liberalizations.

There are a number of other special geographic locations such as export processing zones, bonded logistics zones, coastal development areas, frontier economic cooperative zones and national holiday zones.

3. TYPES OF FOREIGN INVESTMENTS

Once the industry and location of the investment have been decided, the next step is to decide on the type of investment. A broad comparison of the various types of foreign investments can be found in the table below and described herein.

3.1. LIMITED LIABILITY COMPANIES

Wholly Foreign-Owned Enterprises (WFOEs) are by far the most common vehicle for foreign investors in a wide range of economic activities. WFOEs are totally owned by one or more foreign investors.

Equity Joint Ventures (EJVs) are one form of Sino-foreign joint venture. The defining feature of an EJV is that the ownership of the EJV must be the same as the proportion of capital contribution.

Cooperative/Contractual Joint Ventures (CJVs) are the other form of Sino-foreign joint venture. Unlike EJVs, the ownership of the company need not be the same as the proportion of the capital contribution; it can be specified in the CJV agreement and the Articles of Association. In addition, CJVs need not be a separate legal entity; the shareholders can decide if it will be one or not.

Foreign-Invested Joint Stock Companies (FIJSCs) is an FIE wherein the company is split into number of equal stocks. FIJSCs can be established in two ways: (1) promotion - when the promoters incorporate the company by subscribing all the shares to be issued; and (2) share offering - when the promoters subscribe to a portion of the shares to be issued and offer the rest to the general public or specific quarters. In addition, an EJV, CJV or WFOE can be converted into a FIJSC if it has a profit-making record for three consecutive years.

WFOEs, EJV, CJV, and FIJSCs are all governed by a Board of Directors although they can be governed by an Executive Director if they have a relatively small number of shareholders and are relatively small in scale. In addition, they are required to have a Supervisory Board which (or single Supervisor) which inspects the financial affairs of the company; supervises performance of the directors and senior management to ensure they are fulfilling their duties; and performs other supervisory functions.

In addition, all limited liability companies in China have the following traits:

- Term – they cannot be of unlimited term; the term is generally less than fifty years.
- Business scope – all companies in China must have a business purpose which must be quite narrowly written. Taking part in activities outside the scope (ultra vires activity) can lead to significant penalties.
- Legal representative – in accordance with the law or the articles of association of the legal person, the responsible person who acts on behalf of the legal person in exercising its functions and powers shall be its legal representative.

- Company Seal (“Chops”) – Under Chinese law, the company seal is very important. The company seal takes the place of a signature on behalf of the company and if the company seal appears on a document, there is an almost insurmountable presumption that the company’s legal representative has agreed to it.

3.2. PARTNERSHIPS

Partnerships can, but need not, have a Chinese partner. In either case, the partnership’s capital can be contributed in both freely convertible foreign currencies and/or legally acquired Renminbi (RMB).

Partnerships can be: (i) general partnerships comprised of general partners with unlimited joint and several liabilities for the debts of the partnership; or (ii) limited liability partnerships comprised of both general partners and limited liability partners, the latter only bearing liability for debts to the extent of the capital contributions they have subscribed for.

Limited liability partnerships must consist of at least two but not more than 50 partners (unless otherwise specified by the law) and must have at least one general partner.

The partners shall appoint one or more managing partner(s) to represent the partnership and execute its affairs. Only general partners can be appointed as managing partners. The other partners are entitled to supervise the representatives.

3.3. REPRESENTATIVE OFFICES (“REP OFFICES”)

Rep Offices can be established in China only for liaison purposes and cannot engage in direct business activities. Rep Offices do not constitute separate legal entities from their foreign parent companies, so the parent companies will still be liable for the rep office’s obligations (i.e. tax, labor costs, operative costs, etc.).

Rep offices can engage in the following activities: (i) market investigation, display, publicity activities in connection with the products or services of foreign enterprises; and (ii) liaison activities in connection with product sales, service provision, domestic procurement and domestic.

Rep offices that illegally engage in direct business are taxed on their deemed income.

Rep offices must have one chief representative and may have up to three other representatives.

	WFOE	EJV	CJV	FIJSC	Partnership	Rep Office
Separate Entity	Yes	Yes	Can be both	Yes	No	No
Limited Liability	Yes	Yes	If separate entity	Yes	No	No
Control	Full in control of the foreign party	Subject to ownership proportion Some decisions required unanimous board approval		Subject to shareholding; Board decisions by majority vote	Depends on the partnership agreement	Complete managerial and operational control
Profit Sharing	As established in the articles of association or shareholders' agreement	In proportion to the equity contribution of each partner	As established in the CJV contract	In proportion to each party's shareholdings	As established in the partnership agreement (subsidiary proceedings established by law)	N/A (rep offices are not entitled to engage in commercial activities)

	WFOE	EJV	CJV	FIJSC	Partnership	Rep Office
Capital Recovery	Share net assets upon liquidation; Sale of interest; Capital reduction only in special circumstances	Share net assets upon liquidation; Sale of interest; Capital reduction only in special circumstances	Early capital recovery permissible; Share net assets upon liquidation; Sale of interest; Capital reduction only in special circumstances	Share net assets upon liquidation; Sale of interest; Capital reduction only in special circumstances	Partner retires Share partnership assets upon liquidation; Contribution reduction only in special circumstances	N/A
Approval Required	Yes	Yes	Yes	Yes	No	No
Intellectual Property	Controlled	Possibly – at – risk	Possibly – at – risk	Possibly – at – risk	Possibly – at – risk in Sino-foreign partnerships	N/A

3.4. ORGANIZING THE CORPORATE STRUCTURE

3.4.1. Foreign Invested Investment (Holding) Companies

Foreign-invested Investment (or Holding) Companies are allowed in China to facilitate foreign investors' investment and introduce advanced technologies and management expertise from foreign countries. Holding companies are defined as companies established by foreign companies, enterprises, or economic organizations to engage in direct investments.

Holding Companies must be established as WFOEs or EJVs. Although Holding Companies are incorporated in China, its investment in the establishment of another enterprise in the country will be considered foreign and the new entity will be still considered a FIE if the foreign investment exceeds 25%.

In order to establish a Holding Company, the foreign investor must show that it has good credit standing and meets various criteria regarding assets, previously established FIEs, etc... If the Holding Company is an EJV, the Chinese partner must show that it meets similar criteria.

Holding Companies are limited in the activities they can take. They can invest in sectors where foreign investment is allowed, provide, certain services to its investees, etc... but are not allowed to engage in direct production activities.

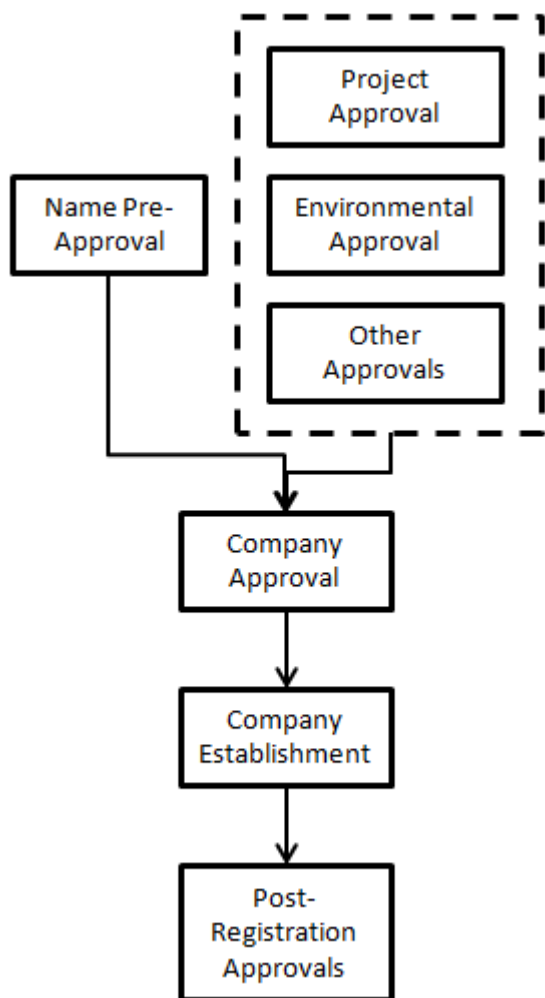
3.4.2. Multinational Companies' Regional Headquarters

Multinational Companies may establish their Regional Headquarters in China through the constitution of a FIE in order to provide management and services to its corporate structure within China and/or other countries. A Holding Company can be recognized as the Regional Headquarters of a Multinational Company if it satisfies the certain requirements.

Beijing, Guangdong province, and the cities of Guangzhou and Shanghai have specific regulations regarding the establishment of regional headquarters.

4. ESTABLISHING AN ENTITY

There are various steps that must be taken in order to establish one of the entities described in section 3. The steps are briefly outlined on the next page and described below.



4.1. PRE-APPROVALS

Name Pre-Approval Enterprise names must consist of the following parts: administrative area (province, city or county) + trade name + trade or business operation characteristics (industry) + organizational form (i.e. LLC). In addition, the enterprise name shall be in Chinese characters and the name in the foreign language must conform to its Chinese name and also be registered.

Project Approval If the project involves fixed assets then the project must be filed with the National Development and Reform Commission (NDRC) or a local Development and Reform Commission (DRC). Some projects require approval whereas others need merely be filed for the record. What action needs to be taken depends primarily on the category of the investment and the total investment amount.

Category	Threshold and Requirement	Approval or Record-Filing	Competent Authority
Encouraged	Total investment USD 1 billion or more and requires the Chinese party to have a	Approval	The competent department of investment under the State Council (usually NDRC).

	controlling share		(†)
	Total investment less than 1 billion and requires the Chinese party to have a controlling share	Approval	Local government
Restricted	Total investment USD 100 million or more (excluding real-estate)	Approval	The competent department of investment under the State Council (usually NDRC). (†)
	Total investment less than USD 100 million	Approval	Provincial government
	Real-estate	Approval	Provincial Government
All other projects		Record-filing	Local government

(†) If the total investment is USD 2 billion or greater, the project must also be reported to the State Council.

Environmental Approval No permission for a construction project shall be granted before an environmental impact assessment report is approved by the Environmental Protection Bureau (or its local branch) and the facilities for the prevention and control of

pollution are examined. Also, enterprises that discharge waste must register before the Environmental Protection Bureau. If they discharge waste in excess of the allowed national or local levels, additional fees must be paid.

Other Approvals Depending on the type of project, pre-establishment approval might need to be obtained from a number of other authorities (e.g. banking, education, etc.).

4.2. COMPANY ESTABLISHMENT

The establishment of a FIE requires the approval of MOFCOM or its competent local branch, depending on the total investment and industry involved. Note that partnerships and rep offices need not go through this step. The following FIEs shall be approved by MOFCOM's competent local branch:

- (i) Encouraged or permitted with a total investment of less than USD 300 million;
- (ii) Restricted with a total investment of less than USD 50 million;
- (iii) Do not require an overall nationwide balance;

(iv) Foreign investment-oriented enterprises and foreign-invested venture capital enterprises with a registered capital of less than USD 300 million.

Together with the required formal documentation (application forms, notice on the pre-approval of the name, etc.), the investors of the FIE shall provide its articles of association setting forth matters such as the purposes, organizational principles, operation and management; together with a feasibility study report establishing the technical and financial assumptions for its operation.

In the case of JVs, investors also need to provide the agreement containing the foreign and Chinese parties' consensus on certain main key points and the contract stipulating the parties' rights and obligations towards each other. In the case of WFOEs, a contract needs to be provided only if there are two or more foreign investors jointly applying for its establishment.

The authority shall decide whether to grant or deny the approval within ninety days (WFOE), three months (EJV) or forty five days (CJV) after receiving all the required documentation.

Investment in certain specific sectors (e.g. financial institutions) and share public offerings require the approval or license issued by the competent government body regulator.

4.3. COMPANY REGISTRATION

WFOE, EJV, CJV Once approved by MOFCOM or its local branch, the investors shall apply for the registration of the FIE before the competent AIC within 30 days of receiving the approval certificate or else the approval certificate will be automatically invalidated.

Upon approval of the registration, the AIC shall issue the FIE's business license. FIEs exist and have independent legal personality from the moment they obtain their business license. Before their business license is issued, FIEs are not allowed to engage in business operations or enter into binding contracts.

Partnerships For partnerships, registration is done directly required with the local AIC. However, if the scope of operation of the partnership enterprise includes industries that need to be approved before registration, the approval documents must be submitted.

The AIC shall decide whether to approve the partnership or not within 20 days from the date of acceptance of the application but can often be done on the spot.

Rep Offices Direct registration before SAIC or its local AIC branch (without prior company establishment approval by MOFCOM) is sufficient to establish a rep office of a foreign advertising, pharmaceutical, trading, manufacturing, freight forwarding, contracting, consultancy, leasing or railway transportation company. However, prior approval granted by the competent industrial regulator is still required to establish a rep office in other sectors.

4.4. POST-REGISTRATION APPROVALS

Once the business license is obtained, the FIE must apply for the following post-registration approvals (which may vary depending on the specific business scope of each FIE):

- Company seal registration: Public Security Bureau;
- Registration of organizational code: Administration for Organizations Code Allocation;
- National and local taxation registration: State Administration of Taxation and Local Taxation Bureau, respectively;

- Foreign exchange registration: State Administration of Foreign Exchange;
- Statistical registration: Bureau of Statistics;
- Public security registration: Public Security Bureau;
- Finance registration: Finance Bureau or its district or county level;
- Import and/or export: Local Customs Bureau;
- Products inspection and quarantine registration: Inspection and Quarantine Bureau; and
- Labor registration: Local Labor Bureau.

5. CAPITAL AND FUNDING

The 2014 amendments to the *Company Law* removed the general minimum registered capital requirements. Nonetheless, other laws and regulations do specify minimum registered capital requirements for companies in particular sectors or that engage in particular activities.

5.1. REGISTERED CAPITAL

5.1.1. Types of Capital Contributions

Capital contributions may be made in the form of currency or alternatively, in other non-currency property such as: materials, intellectual property rights,

land use rights, etc. However, capital contribution cannot be made in the form of “labor services, credit, the name of a natural person, business goodwill or franchising right, or property on which there is a guaranty on the basis of valuation.”

If currency is contributed, foreign investors can pay in freely convertible currency or RMB (if the RMB was obtained through investment in another FIE and subject to the approval of MOFCOM). For FIJSCs established through share offerings, the shares subscribed by the sponsors must amount to at least 35% of the total.

If non-currency assets are contributed, they must be evaluated and priced by a qualified institution, (except for CJVs without independent legal personality because no capital will be registered).

5.1.2. Schedule of Capital Contribution

The parties can agree on the schedule for the contribution of the registered capital, which must be specified in the application for establishment of the FIE and its articles of association. The capital can be contributed in one lump sum or installments.

However, in the specific case of holding companies, the investors must contribute at least USD 30 million within two years from the date of issuance of the business license, and the remaining capital contributions can be paid in within five years from that same date.

5.2. EQUITY FUNDING

Although the Company Law no longer specifies minimum registered capital requirements, there are still requirements for JVs and WFOEs that a certain percent of the Total Investment Amount be registered capital. This percent depends on the Total Investment Amount and is shown in Table 3 below.

Total Investment Amount (equity funding + loans)	Minimum portion of the total investment required to be registered as capital
USD 0 – 3 million	70%
USD 3 – 10 million	50% (min: USD 2,1 million)
USD 10 – 30 million	40% (min: USD 5 million)
USD 30 million or more	1/3 (min: USD 12 million)

5.3. LOANS

FIEs can borrow loans in either RMB or foreign currency without any prior approval. However, foreign currency loan agreements must be registered with the State Administration of Foreign Exchange (SAFE).

In general the total debt incurred by a FIE can never exceed the difference between their total investment and registered capital. However, in the specific case of holding companies, the incurred debt must respect the following ratios:

Registered capital (USD)	Maximum amount of loans
30 – 100 million	Four times the paid in capital
More than 100 million	Six times the paid in capital

Loans that exceed the limitations but are required in virtue of the FIE's operations may only be obtained after prior approval from MOFCOM. If the approval is not granted by MOFCOM, the FIE must reduce its incurred debt or increase its registered capital (see next section).

5.4. INCREASE OF DECREASE IN REGISTERED CAPITAL

Increasing the registered capital of a FIE requires prior approval of MOFCOM and the subsequent registration

amendments before the AIC. On the other hand, in principle the capital of a FIE cannot be decreased during its term of operation, but MOFCOM may approve a decrease if it is truly necessary due to changes in the total investment, production and operation scale, etc.

If the FIEs capital is increased or decreased, the articles of association (and, in the case of JVs, the contract) need to be amended to reflect such modification

5.5. FOREIGN EXCHANGE

An FIE must apply for foreign exchange registration after receiving its business license. Once the registration is approved, SAFE will issue the Foreign Exchange Registration Certificate for Foreign-Invested Enterprise after which the FIE will be entitled to open and maintain foreign exchange accounts in Chinese banks allowed to engage in foreign exchange business. If the FIE intends to open a foreign exchange account outside China, prior approval from SAFE's is required.

As the RMB is still not fully convertible, the Provisions for the Administration of Domestic Foreign Exchange Accounts issued by the People's Bank of China on October 1997 make it necessary to distinguish between "current account items" and "capital account items.

5.6. FINANCIAL AND ACCOUNTING ISSUES

The accounting years shall be from January 1st to December 31st each year

The profits must be distributed in the following order: (i) payment of taxes; (ii) make-up of previous accounting years' losses; (iii) withdrawal of funds; and (iv) distribution to the investors. Undistributed profits from previous accounting years can be distributed in current accounting years.

Regarding the allocation of funds, all FIEs must withdraw from its profits (1) reserve funds (up to 50% of the registered capital, meant to cover losses); and (2) rewards/welfare funds for the employees. EJVs must additionally withdraw the enterprise development funds.

6. LABOR

6.1. THE LABOR RELATIONSHIP

All labor requires written labor contracts. If no written contract, there are significant penalties, as described below:

Time	Action
Within the first month	Must sign a written labor

	contract
From the end of the first month to the end of the first year	The employer must pay the employee double his/her monthly salary
At the end of one year	An open-ended labor contract is deemed to have been concluded

However, if the employer notifies the employee of the need to conclude a written contract but the employee fails to do so within one month, the employer is entitled to terminate the labor relationship without paying any compensation.

There are three types of labor contracts:

- (i) fixed (with an agreed upon ending date);
- (ii) open-ended (no agreed upon ending date); and
- (iii) subject to the completion of an entrusted assignment.

Employers are entitled to require their employees to go through a probationary period during which the employer can pay the employee a lower amount (subject to limits) and terminate the employee without notice. The maximum length of the probationary period depends on the length of the contract.

Term of Labor Contract	Maximum Probationary Period
Three months to one year	One month

One year to three years	Three months
Longer than three years	Six months

In general, the employer can only terminate the employee under certain circumstances (relating to the employee's ability to fulfill his/her function, changes in circumstances, or the situation of the company) and must give the employee 30 days notice. Termination without notice can be given in certain, enumerated, serious circumstances (e.g. if the employee seriously violates labor discipline or the employer's rules and regulations). However, under certain circumstances, an employee cannot be fired (e.g. if the employee is receiving medical treatment).

After termination, the employee is entitled to one month of compensation for each year he/she worked at the employer.

Employees can resign with 30 days notice but can dispense with the notice under certain serious circumstances (e.g. if the employer fails to pay the entire salary on time).

Part-time employment, at most four hours per day and twenty hours per week, is not subject to the rules

regarding written labor contracts, probationary periods, and termination.

In addition, foreign investors should be aware of the following relating to labor issues:

- With some exceptions, the employment of minors under the age of 16 is strictly forbidden.
- Unless otherwise approved by the competent labor department, employees shall not work more than eight hours a day and forty four hours per week and must be given one day off a week.
- Overtime work requires consultation with the labor union and is subject to certain limits (generally one hour a day but can be higher if there are special circumstances). In addition, overtime pay ranges from 150% to 300%.
- Employees are entitled to a minimum amount of paid leave, the amount of which depends on how long the employee has been employed.
- Governments of the provinces, autonomous regions or municipalities set minimum wage requirements.
- Labor disputes are settled through mediation and/or arbitration, the results of which can be challenged in court.

- Social insurance payments must be made by both the employer and the employees.
- Employees have the right to organize and participate in trade unions to represent and safeguard their rights and interests which can enter into collective bargaining agreements.

6.2. FOREIGN EMPLOYEES

In general, labor relationships with foreign employees are governed by the same laws and regulations as those with local employees. There are, in addition, certain requirements for the hiring of a foreign employee.

In principle, foreigners can be hired for positions where special skills are required and local employees are temporarily unavailable. To be hired in China, foreigners need to satisfy the following requirements:

- (i) be 18 years old or more and in good health ;
- (ii) have the skills/experience required for the position;
- (iii) have no criminal records;
- (iv) have a specific employer; and
- (v) hold a valid passport or other required documents.

In order to hire a foreign employee, the following steps must be taken:

1. The employer must apply for, and receive, a permit allowing them to hire foreigners.
2. The foreigner must apply for his/her working visa.
3. The foreigner must enter China and apply for the employment permit within 15 days of entry.
4. Finally, the foreigner must apply for the residence permit before a public security authority within 30 days of entry.

The term of labor contracts concluded with foreigners cannot exceed five years although the employer can file for an extension 30 days prior to the expiration date.

6.3. DISPATCH OF FOREIGN EMPLOYEES TO CHINESE SUBSIDIARIES

Senior management employees or senior technical officers of multinationals companies are often dispatched to China to work for Chinese subsidiaries. If they entered into employment contracts with the overseas holding company, without any labor contractual relationship with the Chinese subsidiaries, they will be treated as having established labor contractual relationship with the overseas employer rather than with the Chinese enterprise where they perform their job.

However if a foreign employee has worked in China for more than 3 months, his or her employment in the Chinese subsidiaries shall be also regulated by PRC laws and regulations and the foreign employee must apply for the relevant working permits. Meanwhile, such foreign employee will be entitled to Chinese welfare and benefits provided by PRC laws and regulations, e.g. the rest and vacations

According to the relevant rules of State Administration of Taxation of PRC on individual income tax (IIT) declaration, a foreign employee working in China under the dispatching arrangement, whose remunerations are paid by the offshore employer rather than by the Chinese subsidiaries, does not need to file IIT declaration and pay IIT as long as he or she stays for no more than 90 consecutive or cumulative days in China within a tax-paying year (or 183 days for employees from countries that have specific treaties with China). Otherwise, the foreign employee shall file IIT declaration and pay IIT.

7. MERGERS AND ACQUISITIONS

The M&A targets of foreign investors can be domestic Chinese companies or FIEs. In both cases, foreign

investment regulations regarding the available sectors for foreign investment and capital requirements must be respected and complied with.

If the target entity is a domestic company and after the M&A operation the foreign investor holds more than 25% of its capital, it must be converted into a FIE.

7.1. ACQUISITIONS

Acquisitions can be (1) direct; or (2) offshore/indirect.

	Direct	Offshore/Indirect
Description	Direct purchase of the equity interest of the target company or subscription to its capital.	Offshore purchase of shares of the target’s foreign parent company or companies
Approvals Required	MOFCOM or its competent local branch Modification of the registration before the Administration of Industry and Commerce.	Anti-trust review may be needed. Note: other reviews might be required by the other jurisdictions.

In addition, acquisitions can be (1) equity acquisitions; or (2) asset acquisitions.

For equity acquisitions, each type of FIE has different limitations regarding the acquisition of its equity:

JVs	The consent of all the non-selling parties is required. In the specific case of EJVs, the non-selling parties have a right of first refusal regarding the intended transfer.
WFOEs	Only the consent of more than half of the partners is required to transfer equity, which does not create major problems when it is owned by one single foreign investor.
FIJSCs	The promoters cannot transfer their shares within three years from the establishment of the company. Afterwards, they can only transfer their shares upon MOFCOM'S approval.

Asset acquisition are subject to strict regulatory burdens and must always be approved by local authorities. Due to the variety of assets and liabilities that may be involved, the acquisition may be more complex.

Special regulations govern foreign investors' acquisitions of state owned enterprises and private corporations with state-owned interests.

7.2. MERGERS

Mergers in China are possible as onshore transactions between FIEs and FIEs or between FIEs and domestic companies. But the merger of a FIE must always result in the establishment of a new FIE, it cannot result in the establishment of a domestic Chinese company (namely, the foreign investors must hold at least 25% of the

registered capital). FIEs cannot be merged (or divided) until their registered capital has been fully paid and their production or operation has actually commenced.

The approval process for mergers requires

1. Preliminary approval
2. Public announcement published at least three times within 30 days
3. Final approval

7.3. ANTI-MONOPOLY REVIEW

M&A transactions must be submitted for anti-monopoly review before the Anti-Monopoly Bureau (AMB) if:

- (i) They are deemed as “concentrations”; and
- (ii) Certain thresholds are met.

A “concentration” is defined as:

- (i) Mergers of business operators
- (ii) Acquisition of control over another business operator through acquisition of equity or assets; or
- (iii) Acquisition of control or the capacity to impose decisive influence over another business operator by contract or any other means.

The thresholds are:

The total amount of the global turnover realized by all the participating business operators of the concentration during the previous accounting year exceeds RMB 10 billion	or	The total amount of the turnover within China realized by all participating business operators of the concentration during the previous accounting year exceeds RMB 2 billion
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And

At least two of the business operators involved each achieving a turnover of more than RMB 400 million within China during the previous accounting year; or

If MOFCOM concludes that the concentration under review might eliminate or restrict competition, the transaction can be prohibited or approved subject to restrictive conditions.

7.4. SECURITY REVIEW

Certain M&A activities also require security reviews:

- Certain investments related to the military or national defense; and
- Those which have impact on the national security or in other important areas and such M&A may result in foreign investors' acquirement of actual control over the enterprises

The security review shall analyze the impact of the M&A on:

- (i) national security;
- (ii) the stable operation of national economy;
- (iii) basic societal order and people's living conditions;
and
- (iv) R&D capacity for key technologies related to the national security.

If the M&A is likely to affect national security and it has not been implemented yet, the parties must terminate the transaction and complete the appropriate adjustments, modifications and formalities for re-examination.

If any foreign investors' M&A of a domestic enterprise has impacted, or is likely to impact, national security, the security review authority shall require MOFCOM together with relevant departments to terminate the transaction or to require parties to the transaction to transfer relevant equities or assets or adopt other effective measures so as to eliminate impact of the transaction on national security.

8. TAX

8.1. CORPORATE INCOME TAX (CIT)

Enterprises are classified into resident and non-resident enterprises

A resident enterprise refers to (i) an enterprise established according to Chinese law (including all FIEs); or (ii) an enterprise established according to foreign laws but with its effective management located in China. A resident enterprise is subject to CIT rate of 25% on its worldwide income (with some tax breaks in certain industries).

Non-resident foreign enterprise are subject to 25% CIT rate for incomes sourced inside the territory of China and incomes sourced outside the territory of China but actually connected with the said organ or establishment within China. Foreign enterprises are subject to 10% CIT rate on incomes originating in China if its incomes have no actual connection to its organ or establishment inside the territory of China.

8.2. INDIVIDUAL INCOME TAX (IIT)

Chinese employees are taxed on the basis of the balance of their monthly income after deductions.

Foreign employees' (including from Hong Kong, Macao, and Taiwan) IIT liability in China depends on the duration of stay.

Duration of Stay	Taxable Income
Less than 90(†) days.	Income derived from Chinese sources for work in China. (‡)
90(†) days to one year.	Income derived from any source for work in China.
One year to five years.	Income derived from any source that is attributed to a Chinese based entity.
More than five years	Worldwide income.

(†) This 90 day income is extended to 183 days for citizens of countries that have double taxation treaties with China.

(‡) Note that senior managers are taxed on their full income derived from Chinese sources from the first day in China.

Note that the portion of the salary of a Chief Representative (of a Representative Office) that is issued by the parent company abroad is taxed on a prorated basis even for durations of stay of less than 90 (183) days per year.

Although subject to numerous rules and exceptions, in general the IIT rate for wages and salaries ranges from 3% to 35%. For income gained by self-employed industrial and commercial households from production or business operations and income gained by enterprises

and institutions from contracting or leasing operations the rates range from 5% to 35%.

8.3. TURNOVER TAX

For taxpayers providing taxable services, transferring intangible assets or selling immovable property, the tax payable is computed as follows:

$$\text{Tax Payable} = \text{Turnover} * \text{Tax rate}$$

The tax rate generally ranges from 3% to 5% depending on sector. However, in the entertainment sector, the tax rate is set by people's governments of provinces, autonomous regions and municipalities directly under the central government and can range from 5% to 20%.

There are various exemptions to the turnover tax as well such as various nursing services, services provided on individual basis by the disabled, etc...

8.4. VAT

Entities and individuals selling goods and providing processing, repairs or maintenance services in China, or importing goods to China, shall be identified as taxpayers of value-added tax, and shall pay value-added tax under the Regulations. The tax paid shall be:

$$\text{Tax Payable} = \text{Taxable Amount} * \text{VAT Rate}$$

The formula for the taxable amount is:

$$\text{Taxable Amount} = \text{Output Tax in the Current Period} - \text{Input Tax in the Current Period}$$

The VAT rate can range from 3% to 17%.

8.5. M&A TRANSACTION TAXES

All M&A transactions are fraught with complex tax issues that require dedicated expert attention. A few notable points are listed below.

- Regarding CIT, when undergoing restructuring, gains or losses arising from the transfer of assets should be recognized at the time of the transaction.
- Regarding VAT, the transfer of fixed assets and inventories are subject to VAT based on their fair values. However, the transfer of entire or partial tangible assets in all forms of asset restructurings, including mergers, are exempt from VAT if the assets are transferred along with all the relevant creditor's rights, liabilities and manpower.
- The transfer of all or part of the tangible assets in all forms of asset restructurings, including mergers, are

outside the scope of business tax, if the assets are transferred along with all the relevant creditor's rights, liabilities and manpower. The transfer of immovable property and land use rights involved therein is exempt from business tax, as well.

- In an asset transaction, gains from the transfer of state-owned land use rights, buildings and their attached facilities are subject to a land appreciation tax based on the amount of appreciation.¹ The rates range from 30 percent to 60 percent.
- A 0.03 percent to 0.05 percent stamp tax is imposed on the share or asset transfer price for both sellers and buyers.

9. INTELLECTUAL PROPERTY (IP)

It is highly recommended that all IP be filed locally in China even if the IP holder's rights extend to China through an international system. Filing in China, and in Chinese, will significantly increase the holder's rights of success in the case of any disputes.

¹ Under Chinese Property Law urban land is generally state-owned and rural land is generally owned by a collective.

9.1. PATENTS

The duration of patent protection is

Invention Patents	20 years
Utility Model Patents	10 years
Design Patents	10 years

In all cases, the protection period begins from the filing of the patent application.

In order to file an application, local patent attorneys must be used if the company does not have a registered office in China. There are three ways to file a patent in China:

- (i) direct filing in China;
- (ii) filing first in another country which is member of the Paris Convention and then filing in China within 12 months from the date of the first application (6 months for designs);
- (iii) filing an international patent application under the provisions of the Patent Cooperation Treaty (PCT) and naming China as the designated state.

9.2. TRADEMARKS

The Chinese trademark regulation is based in the “first-to-file” rather than the “first-to-use” system, thus the rights of unregistered trademarks are weak.

Holders of well-known trademark should not rely exclusively on the protection granted by the Article 6bis Paris Convention on “well-known” trademarks. The Chinese system for well-known trademarks:

- Is decided case-by-case
- Passive (i.e. no protection until a complaint is filed)
- Has an exceedingly high threshold. Typical examples of such trademarks are McDonalds, Jaguar. and Hugo Boss.

Although a trademark holder can file under the Madrid Protocol through World Intellectual Property Organization (WIPO), it is highly recommended that, in addition, the holder file under the Chinese national system and obtain a Chinese language certificate.

9.3. COPYRIGHTS

The *Copyright Law* automatically secures copyright protection for foreign entities that first publish in China and also protects works published outside China under

the scope of international copyright conventions and bilateral agreements. However, foreign investors are highly recommended to register their copyrights before the National Copyright Administration as material evidence of the copyright ownership if a dispute arises.

In order to own the copyright of a work in China, the interested party must be either the creator of the work or the employer of the creator. Copyrights can be also acquired through succession, donation, assignment or other contractual arrangement. Normally, the copyright protection will cover the life of the author plus the subsequent 50 years. But if the vested copyright owner is an enterprise, the copyright protection will be of 50 years from the date of its first publication.

9.4. OTHER ISSUES

There are other issues to consider regarding IP. A few of them are listed below.

- Computer software is protected against unauthorized online distribution.
- One can file one's IP rights with the General Administration of Customs (GAC) to allow them to prevent counterfeit versions of their products from being imported and exported.

- The Anti-Monopoly Law is applicable to the business operators who eliminate or restrict market competition by abusing their intellectual property rights".

10. COMPETITION LAW

There are three different agencies responsible for the enforcement of the fair competition on the market of China:

- (i) The SAIC, responsible for issues covering non-price anti-competitive behavior;
- (ii) The NDRC, responsible for price related matters; and
- (iii) MOFCOM, responsible for conducting the antitrust review of concentrations between undertakings.

According to Anti-Monopoly Law (AML), "monopolistic practices" include:

- (i) The conclusion of monopoly agreements between operators;
- (ii) The abuse of dominant market position by operators; and

(iii) The concentration of operators which has or may have the effect of eliminating or restricting market competition.

In addition, it is a violation of the AML for an administrative organ to “abuse of administrative power to eliminate or restrict competition.”

In accordance to the AML, activities restricting or with the potential to restrict the competition in China will be subject to administrative investigation conducted by SAIC or NDRC, even if the anti-competitive activities are conducted outside China.

10.1. MONOPOLY AGREEMENTS

For the purposes of the AML, "monopoly agreements" refer to agreements, decisions or other concerted actions, which eliminate or restrict competition. Agreements either horizontal (between competitors on the same level of the distribution chain) or vertical (between upstream and downstream undertakings) might contain provisions restricting the effective competition or potentially restricting competition.

Exemptions are provided for agreements which create benefits for the economic development or public

interest, such as improvement of technology, product quality, cost reductions and operational efficiency, among others. However, none of the exemptions may significantly impede the effective competition.

10.2. ABUSE OF DOMINANT MARKET POSITION

Various factors, such as the market share or ability to control the market, are used to determine if a business operator has a “dominant market position.”

If a business operator does have a dominant market position, certain practices are prohibited. For example, it is prohibited to buy/sell commodities at an unfairly low/high price, refuse to trade with a trading partner without a justifiable reason, etc...

10.3. CONCENTRATION OF OPERATORS

Please see section 7.3.

11. EXITING CHINA

Dissolution and liquidation regulations as well as insolvency proceedings must be considered when investing in China. Simply abandoning the FIE is not a recommended option because of business risks related to branding and IP issues, the liabilities that might arise

from the violation of a JV contract (in the case of JVs), etc.

Special consideration must be given to the possibility of the relationship between the foreign and Chinese partners deteriorating to the point that it compromises the enterprise's future operations. In such situations, the solution is usually to buy out the Chinese partner's equity and restructure the JV into a WFOE. However, certain considerations must be taken into account:

- (i) WFOEs cannot operate in certain sectors.
- (ii) If the Chinese partner is a SOE, its equity must be evaluated in accordance to the *Administration of State Asset Valuation Procedures* issued by the State Council on November 16th 1991.
- (iii) If the Chinese partner has managerial and *de facto* control, the foreign partner needs to gain leverage. However, its actions might be limited.

If dissolution and liquidation is to occur WFOEs are easier to terminate since there is no Chinese partner.

Liquidation proceedings are divided into non-bankruptcy and bankruptcy proceedings.

11.1. NON-BANKRUPTCY LIQUIDATION

FIEs can be dissolved for a number of reasons including the expiration of its term, being unable to continue with its operation (for one of a variety of reasons), etc... In addition, the AOA, JV Agreement, and/or Partnership Agreement can specify additional criteria for dissolution. Additionally a partnership must be dissolved when the legally required number of partners is not respected for 30 days or more.

For JVs and WFOEs, generally the Board of Directors must resolve to dissolve the company after which MOFCOM must approve the dissolution. If approved, a liquidation committee must be established within 15 days.

The members of liquidation committee shall be the directors (for a JV) or the legal representative, the representative of the creditors and the representative of the competent authority (for a WFOE). Certified public accountants and PRC lawyers can also be appointed as members of the liquidation committee. The liquidation must prepare a liquidation plan which must be approved by both the Board of Directors and MOFCOM. The liquidation committee's powers include

convening creditors' meetings, recovering creditor's rights and cancel debts, etc...

For partnerships, the liquidation is carried out by liquidators who can be some or all of the partners or an entrusted third-party. The liquidators shall prepare a inventory of the partnership's property and a statement of its assets and liabilities, manage the partnership affairs related to the liquidation proceedings, etc... Once liquidation expenses, wages, taxes, etc... are paid, the remaining assets are distributed to the partners. If the assets are not enough to cover these amounts, the general partners are liable for them.

11.2. BANKRUPTCY PROCEEDINGS

Bankruptcy can occur when: (i) an enterprise cannot pay its due debts and its assets are not enough to pay the totality of the debts; or (ii) the enterprise apparently lacks the capacity to cancel its debts. If any of these circumstances arise:

- (i) The enterprise can apply for its reorganization, compromise or bankruptcy;
- (ii) Creditors may apply for the enterprise's reorganization or bankruptcy; and

(iii) The liquidation committee may apply for the enterprise's bankruptcy, if the enterprise has already been dissolved but the liquidation has not been completed and the assets are not enough to cancel the debtors.

11.2.1. Bankruptcy

The People's Court will specify the time limit for creditors to declare their claims after accepting the application for bankruptcy, though creditors can still declare claims after this time period (so long as they do so before the final distribution of the enterprise's property).

An administrator must be appointed by the People's Court. The administrator must prepare a realization plan and submit it to the creditors' meeting. The bankruptcy property must be converted to cash as a whole or partially, in both cases through auctions (unless otherwise decided by the creditors' meeting or provided by specific regulations).

Secured creditors are paid with the guarantee property and then, after repaying the bankruptcy proceedings' expenses and other debts incurred for the common

good of all the creditors, the bankruptcy property is distributed in the following order:

1. Wages, subsidies, old-age and medical insurance premiums, and compensations.
2. Other social insurance premiums and taxes; and
3. Unsecured claims.

11.2.2. Reorganization

The enterprise or its creditors may directly apply for reorganization instead of bankruptcy. If bankruptcy has already been accepted by the People's Court after the request made by a creditor, the enterprise or its partners/shareholders representing one-tenth or more of the registered capital may still apply for reorganization.

The enterprise or its administrator must submit a draft plan to both the People's Court and the creditors' meeting within six months from the acceptance of the reorganization application (the period may be extended one time for three months). If the enterprise or its administrator fails to submit the plan on time, the reorganization proceedings will be concluded and bankruptcy declared.

11.2.3. Compromise

The enterprise may directly apply for compromise after the application for bankruptcy is accepted but before the bankruptcy is declared. A draft agreement must be jointly submitted with the application.

If the People's Court understands that the application complies with the law, the compromise shall be announced and a creditors' meeting shall be held to discuss it. A resolution about the compromise must be adopted by more than half of the creditors with voting rights who are present in the meeting and who together represent two-thirds or more of the total amount of unsecured claims (the secured creditors can exercise their rights once the Court rules in favor of the compromise).

11.3. DEREGISTRATION

11.3.1. FIE Deregistration

For FIEs, the liquidation committee must file an application for deregistration before the SAIC within 30 days from the completion of the liquidation proceedings (15 days in the case of partnerships). The enterprise

shall be formally terminated after completion of the formalities before the SAIC.

11.3.2. Rep Office Deregistration

Rep offices must be closed if any of the following circumstances occur:

- (i) its term expires;
- (ii) it is legally required to deregister;
- (iii) the foreign parent company revokes the rep office;
- or
- (iv) the foreign parent company is dissolved.

In order to close a rep office, deregistration before the tax, customs and foreign exchange authorities must first be obtained. To this end, all tax debts must be cancelled after which deregistration must be requested with the AIC.

12. LIST OF ABBREVIATIONS

AIC	Administration for Industry and Commerce
AMB	Anti-Monopoly Bureau
AML	Chinese Anti-Monopoly Law
CIT	Corporate Income Tax
CJV	Cooperative Joint Venture
EJV	Equity Joint Venture
ETDZ	Economic and Technological Development Zone
FDI	Foreign Direct Investment
FIE	Foreign Invested Enterprises
FIJSC	Foreign-Invested Joint Stock Companies
FTZ	Free Trade Zones
FYP	Five-Year Plans
GAC	General Administration of Customs
GDP	Gross Domestic Product
HTDZ	High Technology Development Zone
IIT	Individual Income Tax

IPR	Intellectual Property Rights
JV	Joint Venture
LLC	Limited Liability Company
M&A	Merger and Acquisition
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOFTEC	Ministry of Foreign Trade and Economic Co- operation
NDRC	National Development and Reform Commission
NPC	National People's Congress
PCT	Patent Cooperation Treaty
PRC	People's Republic of China
Rep Office	Representative Office
RMB	Renminbi
SAFE	Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce

SAT	State Administration of Taxation
SEZ	Special Economic Zones
SGLA	Sino-Global Legal Alliance
USD	US Dollar
VAT	Value Added Tax
WFOE	Wholly Foreign-Owned Enterprise
WIPO	World Intellectual Property Organization