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1. Introduction

1.1. Who we are: Change & Bridge Partners and SGLA

Chance Bridge Partners (Chance Bridge) is a specialist law firm that excels in delivering advanced corporate, commercial, and financial legal solutions. All Chance Bridge partners have studied overseas. We pride ourselves on providing expert technical services while maintaining an acute commercial awareness. Our approach to business is sustainable, professional, and personal and we believe that success can be defined in different ways. Chance Bridge distinguishes itself through a firm culture that is defined by teamwork, initiative, innovation, and commitment to those we serve. The three key features of our approach differentiate us: our client-focus, our multiculturalism and our innovation. We have an unwavering dedication to the needs of our clients, rather than staying focused on products. We place the utmost importance in understanding, anticipating, and satisfying their needs. We are multicultural. Our diversity enables us to better understand our clients' objectives and their unstated assumptions. Our innovation stems from our expertise in PRC law, understanding our clients' fundamental objectives, and our ability to apply methods and ideas across situations.

Chance Bridge often collaborates with other firms through the use of integrated teams. We believe that local and leading global firms can provide the best expertise in their own geographical regions or areas of specialization. By integrating other legal experts into Chance & Bridge's teams when working on full-scale or global deals, we help clients receive the highest quality of legal advice, at a competitive cost and with utmost efficiency and clarity. Similar to the way we collaborate with our international partners, when working on domestic projects within China we integrate members from the Sino-Global Legal Alliance (SGLA)[1]. By integrating experts from the local firms into our teams, we provide oversight to ensure that clients receive the same level of advice and solutions wherever their activity is in China. This strategy also allows us to provide clients with resources, such as relationships with local authorities, which would be otherwise unavailable and which can greatly assist in the success of our clients' business ventures. Cities from which we routinely integrate experts into our practice teams to assist with local requirements include: Tianjin, Jinan, Chengdu, Chongqing, Wuhan, Shanghai, Hangzhou, Kunming, Xiamen, Guangzhou and Shenzhen.

As a specialist firm, Chance Bridge is focused on growing organically and demonstrating our expertise in select areas. When necessary, we aggregate the total resources of the firm to provide comprehensive solutions to our clients. Our practice areas include corporate and commerce, capital markets, investments, competition, international trade, dispute resolution, financing and taxation. We also have built up technical expertise in a number of industries. Chance Bridge's primary experience lies in these industries: automotive, banking, funds, internet and ecommerce, manufacturing, media, natural resources and energy, real estate, services and technology.

Please visit the Chance Bridge website at http://chancebridge.com/english/index.html for more information.

[1] The SGLA is the largest and most prestigious legal alliance in China. With 20 member firms, the alliance focuses on bringing together the resources and expertise from the best regional firms. This focus provides higher quality advice and deliverable solutions to clients as all the firms have good government relations and are well-integrated into the local business environments.

1.2. Why Invest in China?

1.2.1. Basic information about China

(Map from the CIA World Fact Book: https://www.cia.gov/library/publications/the-world-factbook/graphics/maps/ch-map.gif).

Table 1: Basic Information

Area	9,596,960 sq km
Population	1.357 billion (2013)
Administrative Divisions	23 Provinces, 5 Autonomous Regions, 4 Municipalities, 2 Special Administrative Regions
GDP (Exchange Rate)	USD 9.24 trillion (2013 est.)
GDP real growth rate	7.7% (2013 est.)
Unemployment Rate	4.1% (2013 est.)

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

Geography and People: China is situated in eastern Asia on the western shore of the Pacific Ocean. With an area of 9.6 million square kilometers, only Russia and Canada are larger. In addition China has a sea area of 4.73 million square kilometers. China's continental coastline extends about 18,000 km and its vast sea surface is studded with more than 5,000 islands. With a population of 1.36 billion, which provides both a large workforce and extensive market size, China has recently became the world's second largest economy and is increasingly playing an important and influential role in the global economy.

Political System: China is comprised of twenty three provinces, four direct controlled municipalities (Beijing, Tianjin, Shanghai, and Chongqing), five autonomous regions (Guangxi, Inner Mongolia, Ningxia, Tibet (Xizang) and Xinjiang) and two special administrative regions (Hong Kong and Macau) both of which are governed by their own law under the system of "one country, two systems." The National People's Congress (NPC) is the highest organ of state power and is empowered with the rights of legislation, decision making, supervision, election and removal of the Standing Committee as well as other powers. The President, elected by the NPC, is the head of state, and the State Council, also known as the Central People's Government, is the highest organ of state administration. The Premier, the head of the State Council, is nominated by the President and confirmed by the NPC. The Communist Party has held power since the People's Republic of China (PRC) was founded in 1949.

Economic Information: China is the world's most populous country and one of the largest producers and consumers of agricultural products. In the past 30 years, China's economy has changed from a centrally planned system to a market-oriented economy. It implements the socialist market economy, whereby the government regulates the economy on the market basis. The supply of resources and the prices of most of the goods and services are market-based whereas a small number of goods and services are either directly priced by the government or priced under the guidance of the government. China's economic reform is making continuous progress with improved structural adjustment. Its social undertakings have correspondingly made great headway. It's rapidly expanding private sector makes the country a significant member of the world economy and China is experiencing fast growth as an emerging economy. The Gross Domestic Product (GDP) of China, in 2013, was approximately USD 9.33 trillion, a 7.7% growth over the previous year (according to the World Bank). China's economy is predominantly manufacturing-based. According to the National Bureau of Statistics of China, at the end of 2011, agriculture (including farming, forestry, fisheries, animal husbandry) accounted for 10.12% of GDP, industry (including mining, manufacturing, electric power, coal and water, construction) accounted for 46.78% of GDP, and the other sectors (including transportation, finance and insurance, post and telecommunication, culture and sport, entertainment and service) account for 43.10% of GDP.

1.2.2. From the 70's to the XXI century

Following Deng Xiaoping's opening up policy which started in 1979, foreign investment and the promotion of foreign trade became the major backbones of the unprecedented growth experienced by China. Foreign direct investment (FDI) was deemed an essential mechanism by which technological and other forms of know-how regarding best practices could be transferred the Chinese economy. This development has positioned China as one of the world's top destination for foreign capital and the second biggest economy in the world. According to MOFCOM, the cumulative level (or stock) of FDI in China by the end of 2013 is estimated at $118.7 billion, making it one of the world's largest destinations of FDI. The largest sources of cumulative FDI in China for 1979-2013 were Hong Kong, Taiwan, the British Virgin Islands, Japan, the United States, and Germany.

As the result of three decades of uninterrupted policies, 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. The top three foreign direct investment concentrated industries are manufacturing, real estate and leasing, and commercial services.

China's acceded to the WTO on December 11th 2001 and both its preparation to join and its continuing membership have played a major role in the construction of a more transparent legal system, the improvement of the foreign investment environment and its compliance with international standards. WTO membership opens up China's market for more international trade and investment, and opens up the world economy for China's exports. Since acceding, China has grown more comfortable with the WTO machinery. Although many industries are still subject to strict restrictions, Chinese legislation is increasingly being adjusted to meet China's international obligations. In the last decade, many new commercial laws governing corporate behavior, bankruptcy, and the behavior of banks and other financial institutions have been enacted by NPC. Furthermore, the Chinese judicial system has been modernized and improved. The practice of litigation is now more wide spread and the number of lawyers has dramatically increased.

On March 2013 the 12th National People's Congress endorsed the political succession from Hu Jintao's fourth generation of leadership to the fifth generation led by Xi Jinping as President and Li Keqiang as Prime Minister. This, China's largest transition in the past three decades, is another example of its long-term political stability which ensures even wider "opening up" policies.

1.2.3. 12th Five-year Plan: new challenges and opportunities

The five-year plans (FYP) endorsed by NPC set the economic objectives for China and direction it will follow. The 12th FYP, currently in force for the period 2011-2015, shows that China is now rebalancing its economy towards domestic consumption while focusing on sustainable development and the creation of an environmentally friendly society. To this end, Chinese authorities will promote urbanization and the creation of a new stable middle class with broader access to domestic consumption. It has placed strong emphasis on promoting consumer demand, addressing income disparities, boosting energy efficiency, reducing pollution, improving the rule of law, and deepening economic reforms. The current industrial structure will be optimized and the following sectors will be especially supported: alternative energy, high-end manufacturing, IT, pharmaceutics, new materials and environmental technology. The government reportedly intends to spend up to $2.1 trillion on these industries during the 12th FYP. During this time, FDI has a major role to play in the development of these industries and will undoubtedly benefit from political favor and goodwill if it contributes to achieve the five-year plan's objectives.

1.3. 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

Since 1995, foreign investments in the Chinese economy have been regulated by the *Catalogue of Industries for Guiding Foreign Investment* (*Catalogue*), together with the *Provisions Guiding Foreign Investment Direction,* the most recent of which was published in 2012 (the *2012 Provisions*). These instruments provide the underlying legal basis for all foreign investment in China, and regulate the scope of foreign investment in different sectors of the Chinese economy. The Catalogue is jointly promulgated by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), China's governing bodies on economic development and trade and investment policy, respectively.

Successive editions of the Catalogue are issued by China as policies towards foreign investment evolve. Foreign investors need to be aware of the changes contained in new iterations of the Catalogue when making their investment decisions. The previous Catalogue was issued in 2007, and on December 24, 2011 (effective January 30, 2012) a new Catalogue was introduced with changes in accordance with the goals established in the 12^{th} FYP.

In the *Provisions* industries in China are divided 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 Provisions; any remaining unlisted sectors automatically fall into the "permitted" category.

Industries in the "encouraged" and "permitted" categories enjoy simplified approval procedures and favorable tax treatment, including but not limited to customs duty and value added tax (VAT) exemptions. "Restricted" industries are subject to more onerous approval requirements and higher levels of government scrutiny. Foreign investment in “prohibited” industries is forbidden.

2.1.1. Encouraged

Although encouraged, foreign investment in the “encouraged” category may, in some cases, require the establishment of a Joint Venture to take advantage of this category’s benefits

Foreign investment generally falls into the “encouraged” category when it:

- Involves new agricultural technologies, comprehensive agricultural development, energy resources, transportation, or important raw material industries (i.e. Technological development in the cultivation of organic vegetables, dried and fresh fruit, and tea, and the relevant production);
- Involves new and high technologies or advanced applicable technologies; improves product performance or increases technological and economic efficiency of an enterprise; or produces new equipment or new materials for which the production capacity is inadequate in China (i.e. Risk exploration and exploitation of oil and natural gas; Exploration and exploitation of unconventional natural gas resources such as shale gas and marine gas hydrate);
- Involves new technologies or new equipment; saves energy and raw materials; comprehensively utilizes resources and recycled resources; or prevents environmental pollution (e.g. the manufacture of key parts and components of new energy automobiles; construction and operation of new energy power stations including, among others, solar energy, wind energy, geothermal energy, tidal energy, wave energy and biomass energy);
- Accommodates market demands and enables the improvement of production levels; expands newly emerged markets; or increases product competitiveness in the international market;
- Utilizes human or other resources in central and western China and conforms with the State's industrial policies;
- Others such as venture capital companies; intellectual property rights services.

2.1.2. Restricted

Investments in the “restricted” category are restricted and may require the establishment of a Joint Venture (JV) with a Chinese partner as the majority shareholder

Foreign investment generally falls into the “restricted” category when it:

- Lags behind the modern technological level;
- Does not save resources or improve the ecological environment;

- Explores or exploits specific types of minerals which are protected (e.g. the exploration and mining of noble metals such as gold, silver and platinum; smelting of nonferrous metals including electrolytic aluminum, copper, lead and zinc);
- Falls within the industries which the State intends to gradually deregulate (e.g. the production of radio and television programs and movies; direct sales, mail orders and online sales; banks; financial companies; trust companies; currency brokerage companies; securities and securities investment fund management companies; insurance and insurance brokerage companies; legal consulting).

2.1.3. Prohibited

Finally，foreign investment is generally prohibited when it:

- Jeopardizes State security or harms social public interest (e.g. manufacturing of weapons and ammunition; gambling and lottery, including horse race tracks for gambling purposes);
- Contaminates or damages the environment and destroys natural resources or harms the health of human beings (e.g. fishing in the sea area and inland waters under China's jurisdiction);
- Occupies cultivated land on a large scale and is detrimental to the protection or development of land resources (e.g. the construction and operation of natural reserves and wetlands);
- Applies processes or technologies that are specially owned by China in the manufacturing of products (e.g. the processing of green tea and special tea with Chinese traditional techniques, including famous and dark teas);
- Jeopardizes the security and efficient utilization of military facilities.

2.2. Location

FDI has been playing an increasingly important role in China’s economy in terms of capital formation, employment creation, labor training, export promotion, technology transfer, productivity growth, competition and integration with the world economy, but its distribution among regions has been very uneven. The relatively prosperous eastern coastal regions have attracted the bulk of FDI to date, and the central and western regions, though lagging behind, are now actively competing for FDI.

The issue of location arises mainly when deciding to invest through a Wholly Foreign-Owned Enterprise (described below), because with Joint Ventures the location will generally be constrained by the location of the Chinese partner. From the western provinces of Tibet and Xinjiang to the coastal city of Shanghai, as well as from the northern Inner Mongolia to the southern Guangdong, foreign investors have a vast territory in which they need to decide where to invest.

Coastal regions were the first to be opened up to foreign investment. Because they usually combine better infrastructure and highly qualified personnel along with a more experienced bureaucracy and more compliance with the rule of law, land and labor costs are generally higher. On the other hand, interior regions offer lower land and labor costs and political favor, but they may not have the levels of infrastructure, transport, skilled employees and legal security offered by coastal regions.

With the objective of tackling this imbalance between central/western and eastern/coastal regions, on May 2013 the NDRC and MOFCOM issued the latest *Catalogue of Priority Industries for Foreign Investment in Central and Western China*. For this purpose, a series of industries will be especially encouraged if invested in locations such as Shanxi, Liaoning and Anhui Provinces, Inner Mongolia and Xinjiang Uygur Autonomous Regions; Chongqing Municipality; among many others. Foreign-invested projects falling within this Catalogue are "encouraged" and therefore can enjoy preferential policies for foreign-invested projects.

In the end, the decision of where to invest will mainly depend on strategic conditions such as the particular industry or sector involved, the access to raw materials, the target market, and distribution channels. Also, the availability of preferential treatments can be an important, and sometimes decisive, factor. In this regard, China offers different zones with preferential treatments, such as:

2.2.1. Special Economic Zones (SEZs)

SEZs were created after Deng Xiaoping's reforms were implemented in 1979. Since the approval of Shenzhen's SEZ in 1980, China established SEZs in the province of Hainan and in the cities of Zhuhai (Guangdong), Shantou (Guangdong), Xiamen (Fujian) and Kashgar (Xinjiang). SEZs played an instrumental role in the integration of China into the global economy and in its economic development. SEZs are intended to function as zones of rapid economic growth by using tax and business incentives to attract foreign investment and technology. SEZs mainly offer better infrastructure and bureaucratic procedures combined with preferential tax treatment.

2.2.2. Economic and Technological Development Zone (ETDZ) and High Technology Development Zone (HTDZ)

In the beginning of 1984, to further open to the outside world, the government decided to establish ETDZs along the seas by building upon the successful experience with SEZ in the previous years. ETDZs emphasize the development of production enterprises and scientific and technological research institutions which directly influence China's industrial modernization. Accordingly, unlike SEZs which give universal preferential treatment to both industry and services, special treatment in ETDZs is available for production enterprises.

HTDZs are comprehensive regions that strengthen integration among scientific research, education and production, and promote the development of scientific techniques, society and the economy. Centered around intellectually-intensive industries, HTDZs are established for the purpose of transforming the achievements of science and technology into a practical and productive force through the use of local optimization of policies, infrastructure, etc. Since the first HTDZ was established in 1988, HTDZs have cultivated many high-tech companies in a manner consistent with fast and sustainable development.

To promote investment in technology sectors, ETDZs and HTDZs also offer preferential tax treatment, as well as a higher level of infrastructure and communications adequate to the needs of the industry. Both ETDZs and HTDZs are now hot spots of foreign investment and the main driving force behind exports.

2.2.3. Free Trade Zones (FTZ)

A FTZ is an area within which 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. Since 1990, as approved by the State Council, China has established 15 FTZs. Like free trade zone around the world, China's FTZs are administered in accordance with international free trade zone practices; within the zones the activities of foreign investment, international trade, bonded warehouses and processing for re-export are allowed. Given that imported products can enter into FTZs without customs, these special areas are most attractive for the trading and assembly of products. They offer preferential tax and currency treatment and provide a high level of infrastructure such as transport facilities, telecommunications and energy supply.

Shanghai's Pilot FTZ, established recently in August 2013, is the most recent and liberal FTZ. The scope of the Pilot Zone covers four special customs regulatory zones including Shanghai Waigaoqiao Bonded Zone, Shanghai Waigaoqiao Bonded Logistic Park, Yangshan Bonded Port and Shanghai Pudong Airport Free Trade Zone. The scope of implementation and pilot policies will be gradually expanded according to the progress of pilot tasks and the needs of industrial development and in order to form a linkage mechanism with international economy, finance, trade and shipping centers in Shanghai. The Shanghai Pilot will expand the opening of investment fields as well as facilitate FDI by providing with simplified procedures for creating a company, fewer restrictions on foreign exchange, simpler rules for foreign investment, etc.

2.2.4. Other Zones

Other special geographic locations like export processing zones, bonded logistics zones, coastal development areas, frontier economic cooperative zones and national holiday zones (among others) make it possible to foreign investors to look for preferential treatments according to the specifics of their industry throughout China.

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 Appendix 1. This chapter describes them in greater detail.

3.1. Foreign Invested Enterprises

3.1.1. Limited Liability Companies[2]

Foreign invested limited liability companies can be broken down into two types: those that have both a Chinese investor (Sino-Foreign Joint Ventures) and those that do not (Wholly Foreign Owned Enterprises). There are also Foreign Invested Joint Stock Companies.

a. Sino-Foreign Joint Ventures (JVs)

Joint Ventures are mainly ruled by the *Sino-Foreign Equity Joint Venture* (EJV) and *Sino-Foreign Cooperative Joint Venture* (CJV) *Enterprise Laws of the PRC*, together with their *Implementing Regulations*. Although neither of this regulations provide for express definitions of such enterprises, JVs can be conceptualized as vehicles jointly invested by Chinese and foreign partners (including Hong Kong, Macau and Taiwan investors).

Foreign enterprises and other economic organizations or individuals can establish EJVs or CJVs in China with Chinese enterprises, or other economic organizations. The *Laws* do not allow Chinese individuals to partner with foreigners in a JV. Nonetheless, in the context of acquisitions, the *Provisions on Foreign Investor's Merger and Acquisition of Domestic Enterprises* issued by MOFCOM in 2003 and revised in 2009 allow Chinese individuals who were shareholders of a domestic target company for at least one year to become partners in entities that become JVs as the result of an acquisition.

[2] Please note that one of the types of entities described here, the Cooperative/Contractual Joint Venture (CJV) need not necessarily be a limited liability company (although it generally is). The investors in the company must decide whether or not it will be.

There are two types of JVs, Equity Joint Ventures (EJVs) in which the profits of the company must be distributed strictly in the same proportion as the capital contributions and Cooperative/Contractual Joint Ventures (CJVs) which allow for more flexibility with respect to profit distribution.

(i) Equity Joint Ventures (EJVs)

Corporate Form: EJVs are always limited liability companies.

Minimum Foreign Investment: The investment made by the foreign partner(s) of the JV must constitute at least 25% of the registered capital (exceptions can be allowed by the authorities as the Law establishes that this ratio must "*generally*" be respected).

However, the *Circular on Relevant Matters Relating to Strengthening the Administration of Approval, Registration, Foreign Exchange and Taxation of Foreign-Invested Enterprises* (Circular [2002] No. 575 jointly issued by MOFTEC, SAT, SAIC and SAFE, effective as from January 1st 2003) allows foreign participation of less than 25% if the foreigner invests or acquires equity in a company that is already constituted as a Chinese domestic entity.

Term: Although the EJVs Law and Regulations remain silent about this issue, applicable provisions are established in the *Provisional Regulations on the Duration of Sino-foreign EJVs* (MOFTEC – 1990) and the *Notice on Relevant Issues relating to Implementation of the Provisional Regulations on the Duration of Sino-foreign EJVs* (MOFTEC – 1991).

For of encouraged and permitted projects, EJVs may, but need not, establish a term in the JV contract (although a term still needs to be submitted during registration, approval, etc.). However, in certain specific industries such as service, real estate management, land development, and exploration and exploitation of natural resources (among others), EJVs are required to establish a fixed term in their JV contracts.

Although for encouraged and permitted projects terms of up to 50 years are allowed, the fixed term of FIE is usually registered as 30 years.

Governing Body: The board of directors must be comprised of at least three people with a term of four years. The composition and powers of the board can be determined by the Articles of Association but unanimous approval is needed for the following:

(1) amendment to the articles of association of the joint venture;
(2) suspension or dissolution of the joint venture;
(3) increase in or reduction of the registered capital of the joint venture;
(4) merger or division of the joint venture.

Management Body: The management body of an EJV is in charge of the daily operation and management of the company. It is mainly composed by one General Manager, together with two or more Deputy General Managers, and other positions like sales manager, chief technicians, chief accountant, deputy chief accountants, auditor, etc. All of the management is directly appointed by the parties to the EJV. Board members can also be appointed to senior management positions.

Supervisory Body: As per the *Company Law* an EJV must have a supervisory body. Please see below for details.

(ii) Cooperative/Contractual Joint Ventures (CJVs)

CJVs provide a more flexible structure and the partners are free to regulate many more aspects of their relationship in the JV contract (e.g. investment or cooperation conditions, the distribution of revenues or products, the share of risks and losses, methods of operation and management, ownership of the properties at the termination of the CJV, etc.).

Corporate Form: Note that partners of CJVs can agree on the enterprise having an independent legal personality or not. CJVs with an independent legal personality are limited liability companies.

Minimum Foreign Investment: If the CJV is incorporated as an independent legal entity, it must adopt the form of a limited liability company with a minimum foreign investment requirement of 25%. In these cases, the partners' liability will be limited to their capital contributions.

However, if the CJV is not constituted as a separate legal entity, the partners will bear unlimited civil liability according to the common principles of law. The capital contributions may be owned by each one of the parties' independently; jointly owned by all of them; partly owned by each one of them; or partly owned by all of the parties jointly. However, in all cases the contributions will be under the management of the CJV and all goods or property rights accrued during its operation will be jointly owned by all the parties.

Term: The term of a CJV must be specified in the joint venture contract.

Governing Body: CJVs incorporated as LLCs shall be governed by a Board of Directors, while CJVs without independent legal personality shall be governed by a joint management body.

According to the *CJVs Law*, the following decisions must necessarily be adopted by unanimous decision:

(1) amendment of the articles of association;
(2) increase or decrease of the registered capital;
(3) dissolution;
(4) mortgage over any asset of the CJV;
(5) merger, division, or change of organization form; and (vi) any other matter agreed by the parties.

Management Body: Normally, the board of directors or joint management body must appoint at least one general manager who handles the day-to-day operations of the company.

Alternatively, the operation and management of a CJV can be delegated to a third party. Such delegation is subject to the approval of both the board or management body and MOFCOM. The registration with the Administration for Industry and Commerce (AIC) must be also modified.

Supervisory Body: As with EJVs, a CJV must, in accordance with the *Company Law* have a supervisory body. Please see below for details.

Early Recovery of Investment: As per *the Measures on the Examination and Approval for Priority Recovery of Investment by Foreign Investors if Sino-foreign CJVs issued by MOFCOM* on June 9th 2005, if the parties agree that upon liquidation of the enterprise the remaining fixed assets will be belong to the Chinese partner(s) then the foreign partner(s) can recoup their investment before the Chinese partner(s) get any profit distributions (or according to some other early recoupment scheme). Thus, the parties can engage in a Build Operate Transfer (BOT) agreement.

b. Wholly Foreign-Owned Enterprises (WFOEs)

Originally conceived as an alternative to Joint Ventures in specifically allowed sectors, Wholly Foreign-Owned Enterprises (WFOEs) are now by far the most common vehicle for foreign investors in a wide range of economic activities. As its very name describes, WFOEs are totally owned by one or more foreign investors.

WFOEs are mainly governed by the *Wholly Foreign-Owned Enterprise Law of the PRC* and the *Detailed Implementing Rules for the Wholly Foreign-Owned Enterprise Law of the PRC*.

Corporate Form: In principle, WFOEs must adopt the form of Limited Liability Companies. Hence, the WFOE will have an independent legal personality and the liability of the foreign investor(s)' will be limited to their capital contribution. However, WFOEs can adopt another corporate form if approved by MOFCOM.

Term: The *WFOEs Law* and *Regulations* do not provide any specific limitation for the term of operation of a WFOE. The term must be specified by the foreign investor(s) in the application for establishment in accordance with the particular economic sector involved and shall be subject to the approval of MOFCOM. If the term needs to be extended, an application must be filed before MOFCOM at least 180 days before the expiration date.

Governing Body: WFOEs shall have a Board composed by three to thirteen members, including a Chairman, and may have a Vice-Chairman. The measures for the election of the Chairman and Vice-Chairman shall be established in the articles of association.

However, if the WFOE has a relatively small amount of shareholders and is relatively small in scale, it may just have an Executive Director instead of a Board, who may also be the manager of the company. The powers and functions of such Executive Director shall be determined in the articles of association.

The articles of association can freely determine the rules for decision making of the Board, but in accordance with the *Company Law*, the one-person one-vote system must be implemented. The *WFOEs Regulations* do not provide for any decision that must be adopted by the unanimous decision of the partners.

Management Body: The *WFOEs Regulations* remain silent about the management body, but the *Company Law* stipulates that LLCs may have managers appointed and dismissed by the Board of Directors. A Director may concurrently serve as manager. The manager is entitled to attend the Board of Directors' meetings as a non-voting attendant.

Supervisory Body: As with EJVs and CJVs, a WFOE must, in accordance with the *Company Law* have a supervisory body. Please see below for details.

c. Foreign-Invested Joint Stock Companies (FIJSCs)

In accordance with the *Interim Provisions on Certain Issues Concerning the Establishment of Foreign-Invested Joint Stock Companies* (January 10th 1995), foreign companies, enterprises, or other economic organizations or individuals can establish Foreign-invested Joint Stock Companies (FIJSCs) jointly with Chinese companies, enterprises, or other economic organizations (not individuals).

Corporate Form: FIJSCs are independent legal entities with its whole capital consisting of shares of equal value. The shareholders' liability is limited to their respective subscribed shares.

As FIJSCs are also foreign invested enterprises (FIEs), all FIE regulations are applicable to this corporate vehicle. In absence of specific regulations for FIJSCs, the provisions of the Company's Law regulating Companies Limited by Shares are applicable.

Shareholders: The Chinese and foreign shareholders jointly hold the Company's shares, but the foreign shareholder(s) must hold at least 25% of its registered capital. In order to establish a FIJSC, there must be at least two promoters but no more than 500. At least half of the promoters must be domiciled in China.

Establishment: FIJSCs can be established by promotion or share offering:

Promotion: when the promoters incorporate the company by subscribing all the shares to be issued. There must be at least one foreign promoter.

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. There must be at least one foreign promoter and at least one promoter with a profit-making record for the three years prior to the offering. The promoters must subscribe to at least 35% of the total shares issued.

The promoters are jointly and severely liable for the subscription before the shares issued by the Company are fully paid up by the promoters. If the establishment of the Company fails, the promoters shall bear joint and several liabilities for expenses and debts that have arisen.

Conversion: An EJV, CJV or WFOE can be converted into a FIJSC if it has a profit-making record for three consecutive years. If a limited liability company is converted into a FIJSC, the total amount of the share capital actually received and converted shall not be greater than the amount of its net assets.

Governing Body: FIJSCs' Boards of Directors must be composed by five to nineteen members, including a Chairman, and may have a Vice-Chairman. The Chairman and Vice-Chairman must be elected by more than half of all the Directors.

Among its members, the Board of Directors may have representatives of the staff and workers. Such representatives shall be democratically elected by the staff and workers through a conference of their representatives, their general meeting, or some other way.

Board meetings must be held at least twice a year and interim meetings can be proposed by: (i) shareholders representing more than 10% of the voting rights; or (ii) more than one-third of the Directors. If this happens, the Chairman of the Board must convene the interim meeting within 10 days of receiving the proposal.

Management Body: The requirements in the Company Law of the People's Republic of China are entirely applicable.

Supervisory Body: As with EJVs, CJVs and WFOE, FIJSCs must, in accordance with the *Company Law* have a supervisory body. Please see below for details

d. Limited Liability Companies in China

This section describes certain unique traits of Chinese companies. The information here applies to EJVs, CJVs, WFOEs and FIJSCs.

Governing Body and Supervisory Body: Like in some but not all jurisdictions, there is a distinction in China between the governing body and the supervisory body of a company.

The governing body is usually a Board of Directors but, if the company is relatively small an Executive Director can suffice. Different types of investment vehicles have slightly different rules as to what powers the governing body must have but in all cases the *Company Law* specifies that the rule of one person-one vote must be followed. The governing body is responsible for specifying the overall direction of the company.

In contrast, the supervisory body (usually a Board of Supervisors but, if the company is relatively small a single supervisor can suffice) has the following functions and powers:

(1) inspect the financial affairs of the company;
(2) supervise performance of the directors and senior managements of their respective company duties and propose the removal of any director or senior management who violates any law, administrative regulation, the articles of association or any resolution of the shareholders' meetings;
(3) require any director or senior management to take corrective action where his/her actions damage the interests of the company;
(4) propose the calling of interim shareholders' meetings and call and preside over shareholders' meetings where the board of directors does not exercise its functions in this regard as prescribed in the Law;
(5) put forward proposals at shareholders' meetings;
(6) initiate lawsuits against a director or senior management in accordance with Article 152 of the Company Law; and
(7) any other function or power specified in the articles of association.

<u>Term:</u> Unlike in some other jurisdictions, companies in China cannot have a perpetual life – they must have a fixed term after which they cease to exist. The term must be specified in the articles of association. The maximum term of a corporation is determined by its corporate form and the industry it is in. In some cases, the term can be extended by applying to MOFCOM.

<u>Business Scope:</u> All companies in China must have a business purpose which must be quite narrowly written (e.g. it cannot be "to engage in all profitable activity."), approved (if needed) and registered. Taking part in activities outside the scope (ultra vires activity) can lead to significant penalties.

<u>Legal Representative:</u> 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. The enterprise bears all civil liability for the operational activities of its legal representatives and other personnel. All companies must have one, and only one, legal representative.

The legal representative of a company shall, in accordance with the articles of association, either be the chairman of its board of directors, its executive director or its manager and shall be registered as such in accordance with law.

<u>Company Seal ("Chops"):</u> 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. As such, measures must be taken to prevent improper use of the seal, such as keeping it in a safe which only a few key personnel can open.

3.1.2. Partnerships

Partnerships, as regulated in the *Partnership Law* (effective from January 1st 2007), were initially available only for Chinese individuals or legal entities. However, on November 25th 2009 the State Council issued the *Measures for the Administration of the Establishment of Partnership Enterprises in China by Foreign Enterprises or Individuals* (effective from March 1st 2010, revised March 1, 2014), allowing foreign investors to participate in this much more flexible vehicle.

Hence, partnerships can now also be established between: (i) two or more foreign enterprises or individuals among themselves (without the participation of any Chinese partner); or (ii) foreign enterprises or individuals and Chinese natural persons, legal persons and/or other organizations. In either case, the partnership's capital can be contributed in both freely convertible foreign currencies and/or legally acquired Renminbi (RMB).

The general *Partnership Law* applies regarding all those aspects not regulated by the *Measures*

Form: 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. If a partnership is established as a limited liability partnership with only limited liability partners (i.e. no general partners) then it shall be dissolved and transformed into a general partnership.

Wholly state-owned companies, state-owned enterprises, listed companies, public welfare institutions or social groups cannot be general partners.

Investment: There are no minimum capital requirements.

Representatives: The partners shall appoint one or more managing partner(s) to represent the partnership and execute its affairs. For`of limited liability partnerships, only general partners can be appointed as managing partners. Those partners not designated as representatives are entitled to supervise the representatives.

Name: The characters "普通合伙" (general partnership) or "有限合伙" (limited liability partnership) shall be part of the name for the general or limited liability partnerships, respectively.

3.2. 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.).

Activities: The *Regulations on Administration of Registration of Resident Offices of Foreign Enterprises* (amended July 18, 2013) provide that rep offices have a non-profit nature and can only 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.

Although rep offices cannot engage in direct business, they are a useful way of entering the Chinese market fast before considering other possible investment vehicles such as WFOEs or JVs, allowing foreign companies to perform market studies, supervise suppliers and/or distributors, and establishing presence in restricted or prohibited sectors.

Government Oversight: Although not legally allowed to engage in direct business, it has become common practice for rep offices to do so. In response to this practice, the *Regulations* mentioned above now allows the taxation authorities to tax rep offices with poor accounting books, that are incapable of accurately auditing their revenues or costs and expenses and are unable to declare their taxation situation on an actual basis (as required by Article 6 of the *Regulations*). The authorities may adopt one of two methods of assessing income tax:

(1) Assessment Made on the Basis of Converting Appropriation Expenditure Into Income:

This is applicable for those Representative Offices that are able to accurately reflect the appropriation expenditure but unable to accurately reflect the income or cost and expenses.

The calculation is done as follows:

- Income = Current Appropriation Expenditure/ (1 – Assessed Profit Ratio – Tax Rate of Business Tax);
- Taxable Enterprise Income Tax = Income * Assessed Profit Ratio * Tax Rate of Enterprise Income Tax.

The Current Appropriation Expenditure includes: wages and salaries, bonus, allowance, welfare expenses, procurement expenses (including automobiles, office equipment and other fixed assets), communication expenses, travel expenses, rental, equipment leasing fee, transportation fee, entertainment expenses and other expenses paid to employees within and outside China.

- For expenditure from (i) the purchase of fixed assets and (ii) decoration that takes place due to the establishment or move of the representative offices or other reasons, the expenditures shall be converted into income for taxation one at a time as and when the appropriation expenditure takes place.
- Interest income may not be offset the appropriation expenditure; for entertainment expenses, the actual amount thereof shall be calculated into the appropriation expenditure.
- Donations, late payment fee and fines of the nature of public welfare and/or relief that are made in cash and used within China and the expenses advanced for their head offices which do not fall into the scope of expenses taken place in their own business activities, shall not be treated as appropriation expenditure of the Representative Offices;
- Other expenses including that could be included as part of the appropriation expenditure include: the sample fee and transportation expenses paid for purchasing samples within China for head offices; the warehousing fee and customs declaration fee within China for the transportation of foreign samples to China; expenses for hiring of interpreters when the staff from head offices visit China; expenses paid for purchasing of biding documents by Representative Offices due to their Head Offices bidding for some Chinese projects, etc.

(2) Assessment of Taxable Income Made on Total Income

This is applicable to Representative Offices that can accurately reflect income but unable to accurately reflect cost and expenses.

The calculation is done as follows:

- Taxable Enterprise Income = Total Income *Assessed Profit Ratio * Tax Rate of Enterprise Income Tax

Representatives: A foreign enterprise establishing a rep office in China must designate one chief representative who will be its legal representative. Depending on the activities to be performed by the rep office, the foreign enterprise can designate up to the three other representatives.

Representatives can be: (i) foreign citizens (except diplomats and students); (ii) Chinese citizens with valid permanent residence in another country; (iii) Hong Kong, Macau and/or Taiwan citizens; and (iv) any other Chinese citizen that are hired through a government-appointed personnel company (such as FESCO or one of its branches).

Name: The name of a rep office has to be formed by the following subsequent parts: (i) nationality and Chinese name of the foreign enterprise translated according to its pronunciation or its meaning; (ii) name of the city where the rep office is going to be located; and (iii) the words "representative office" ("代表处"). The name of the rep office does not require pre-approval.

Term: The term of the rep office cannot be longer than the term of the existence of the foreign enterprise.

3.3. Organizing the Corporate Structure

Foreign investors can organize their corporate structure through the following vehicles:

3.3.1. Foreign-invested Investment (Holding) Company

In accordance with the *Provisions on the Establishment of Investment Companies by Foreign Investors* issued on November 17th 2004 (amended and complemented by *the Supplementary Provisions on the Establishment of Investment Companies by Foreign Investors* issued on May 26th 2006), 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.

Corporate Form: Holding Companies must be established as WFOEs or EJVs. Consequently, they will be independent legal entities and business transactions with its invested entities will be treated as any other transaction between independent enterprises. 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%.

Requirements: In order to establish a Holding Company, one of the following requirements must be satisfied by the foreign investor:

(i) good credit standing, the financial strength required to establish an investment company, total assets of at least USD 400 million in the year prior to the application and an already established FIE in China with an actual paid-up capital contribution of more than USD 10 million; or
(ii) good credit standing, the financial strengths required to establish an investment company and ten or more already established FIEs in China with its actual paid-up capital contribution of more than USD 30 million;

If there are two or more foreign investors, it is the one that holds the majority equity interest that must comply with the aforementioned requirements.

If the holding company is established as an EJV, its Chinese investor must have good credit standing, the financial strength required to establish an investment company and total assets of at least RMB 100 million in the year prior to the application.

<u>Business Scope:</u> Once approved by MOFCOM (or a local branch of it) and registered before NAIC (or a local branch of it), holding companies are entitled to conduct the following business:

(i) invest in sectors where foreign investment is allowed;
(ii) provide, certain services to its investees if the investee gives written consent and has unanimous board approval (e.g. assist or act as an agent in the purchase of machinery, equipment, raw materials, etc.; balance foreign exchange; technical support; among others);
(iii) establish R&D centers or divisions;
(iv) provide consulting services to its investors and affiliates; and
(v) service outsourcing business from its parent company and affiliates or other companies outside China.

If the Holding Company is recognized as a Regional Headquarter (as per Articles IX, X and XI of the *Supplementary Provisions to the Provisions on the Establishment of Investment Companies by Foreign Investors*), or has a clean record and its registered capital is actually paid up and used in accordance with the purposes established in the *Provisions*, its business scope is further broadened.

The activities of a Holding Company in China are not restricted by its places of registration. Holding companies are not allowed to engage in direct production activities but may, with the approval of the China Banking Regulatory Commission, provide financial services to investees that it has established.

3.3.2. 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 Companies as Regional Headquarters

The *Provisions on the Establishment of Investment Companies by Foreign Investors* stipulate that a Holding Company can be recognized as the Regional Headquarters of a Multinational Company if it satisfies the following requirements:

(1) (i) Paid in capital of not less than USD 100 million; or (ii) Paid in capital of not less than USD 50 million, total assets of at least RMB 3 billion and total profit of at least RMB 100 million;
(2) At least USD 30 million of the Holding Company's registered capital must be used: (i) for capital contribution to the newly established FIEs; (ii) as investment to establish R & D centers or other organizations; or (iii) to acquire equity interests from the shareholders of the companies in China; and
(3) Have an already established R & D organization.

b. Regional Headquarters in Beijing

In accordance with the *Measures for the Implementation of Certain Provisions on Encouraging the Establishment of Regional Headquarters in Beijing by Multinational Companies* (effective as from June 2th 2009), the following companies may be recognized as Regional Headquarters of a Multinational Company in Beijing:

(1) Approved Holding Companies
(2) Foreign invested management companies which satisfy the following requirements:
    a. Total assets of its parent company of at least USD 400 million;
    b. Actually paid in registered capital in China by its parent company of at least USD 10 million and at least three enterprises within and outside China invested or managed under the authorization of its parent company; or at least six enterprises within and outside China invested or managed under authorization by its parent company;
    c. Registered capital of at least USD 2 million; and
    d. The company is the principal management body solely responsible for its parent company's operations in China.

The authority in charge of recognizing Regional Headquarters in China’s capital is the Beijing Municipal Commission of Commerce. If the multinational company is internationally well-known, the aforementioned requirements may be relaxed.

<u>Business scope:</u> Once established, regional headquarters can engage in investment operations and decision-making, production and operation management, fund operation and financial management, technical support, research and development, marketing services, import and export, domestic distribution, logistic distribution service, information service, provision of outsourcing service and staff training and management for multinational companies and overseas companies, and may engage in other operations, management and service activities as allowed by laws, regulations and rules.

<u>Incentives:</u> Regional Headquarters established in Beijing will benefit from migration policies for its employees and economic advantages such as: (i) lump-sum fund subsidies from RMB 5 to 10 million over three years depending on the amount of registered capital; (ii) lump-sum monetary awards from RMB 1 to 10 million upon the achievement of specific annual operation revenues; (iii) lump-sum subsidies for the construction or purchase of its own offices; (iv) rental subsidies over a period of three consecutive years for rent of offices; and (v) awards to one primary responsible person of a Regional Headquarters of 80% of the local government fiscal revenue contributed by such responsible person in one year with a maximum of RMB 500,000 over three consecutive years.

c. Regional Headquarters in Other Places

Different regulations are applicable regarding the establishment of Regional Headquarters of Multinational Companies in Guangdong province and the cities of Guangzhou or Shanghai.

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 in Appendix 2. This chapter describes those steps in greater detail.

4.1. Pre-Establishment Procedures

Before registering the company for approval, the investor must obtain the necessary pre-approval approvals. All companies must register for name pre-approval. In addition, depending on the nature of the project, a number of other pre-establishment approvals must be obtained.

4.1.1. Name Pre-Approval

All FIEs are required to register the FIE's name with the State Administration for Industry and Commerce (SAIC) or its competent local branch prior to the application for the establishment of the company.

The *Measures for Implementing the Administration of Enterprise Name Registration* stipulate that enterprise names shall 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.

The FIE's name will be validly registered for a period of six months, within which the FIE must apply for establishment. A single six-month extension can be granted. If the FIE fails to do so, the registered name shall be automatically invalidated at the expiry of the six (or twelve) months.

4.1.2. 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). On June 17, 2014 the *Administrative Measures for Approval and Record-filing of Foreign Investment Projects* came into force and radically changed the project approval. Prior to this measure coming into force, all projects involving fixed assets required approval by the NDRC or a local DRC. Now, however, only certain projects require approval; other projects need be merely filed for the record. Table 2 describes what projects need to be filed or approved and form what level of government

Table 2 Level of Approval/Filing Necessary for Projects Involving Fixed Assets

Category	Criteria	Approval/Filing	Level of Government
Encouraged	USD 300 million or more	Approval	NDRC
Restricted	USD 50 million or more		
Restricted	Less than USD 50 million	Approval	Local DRC
Restricted	Real Estate Project		
Items 1 to 11 in the Approved Catalogue		Apply as per the catalogue's instructions	
All other projects		File for record	Local DRC

4.1.3. Environmental Approval

The *Environmental Protection Law of the PRC* was issued by the Standing Committee of the National People's Congress on December 26th 1989 and other specific laws and regulations have been issued in the past years addressing environmental concerns (prevention and control of water pollution, prevention and control of environmental production by solid waste, etc.).

Hence, 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.

The Construction Site Planning Permit shall be applied for before the competent Commission of Urban Planning (or its local branch) and the issuance of a preliminary review opinion letter about the land to be used for the construction projects shall be applied for before the competent Bureau of Land and Resources (or its district or county level).

Opinion letters of other competent authorities may be required depending on the business scope of the FIE to be established.

On April 24, 2014, the National People's Congress adopted the Amendment to the PRC Environmental Protection Law (“EPL Amendment”). This is the first amendment to the EPL since it was first enacted 25 years ago. The EPL Amendment will become effective on 1 January 2015.

The major changes will be brought about are:

- Stricter penalties for repeated illegal acts;
- Environmental public interest litigation;
- Disclosure of pollution information and public participation.

4.1.4. Other Approvals

Depending on the type of project, pre-establishment approval might need to be obtained from a number of other authorities. Thus, for example, approval may need to be obtained from the China Banking Regulatory Commission if the project involves banking, Ministry of Education if the project involves 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.

In accordance with the *Notice of the Ministry of Commerce on Issues Related to Delegating Powers on Examination and Approval of Foreign Investment to Authorities at Lower Levels* (effective as from October 6th 2010), the following FIEs shall be approved by MOFCOM’s competent local branch:

(i) Foreign-invested enterprises categorized as encouraged or permitted with a total investment of less than USD 300 million;
(ii) Foreign-invested enterprises categorized as restricted with a total investment of less than USD 50 million;
(iii) Foreign investment enterprises which fall within the encouraged category and 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 (i.e. market requirements, production program, technical engineering, labor organization and requirements and economic benefit analysis, among others).

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. Regarding the contract, its conclusion, validity, interpretation, performance and resolution of disputes will be governed by the laws of the PRC and in case of conflict with the agreement, the contract shall prevail. 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.

Other documentation that may be required by the approval authority are: a letter of intent or memorandum of understanding establishing the general structure of the project of a JV and regulating matters such as exclusivity, confidentiality, etc.; a project proposal of the JV or WFOE including a summary of the project to be developed and other issues like name, purposes, activities, organization, etc.; or other documents the approval authority stipulates.

The applicable regulations stipulate that 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. The agreement, contract, and articles of association shall be effective as from the date of issuance of the approval certificate.

4.2.1. Approval or License by Sectorial Industry Regulator

Investment in certain specific sectors and share public offerings require the approval or license issued by the competent government body regulator. For example, the approval by the China Securities Regulatory Commission is required for the establishment of joint stock companies through a share offer; the approval of the China Banking Regulatory Commission is required for the establishment of financial institutions; etc.

4.3. Company Registration

4.3.1. FIEs

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. If the investors do not apply for registration within the aforementioned time limit, the approval certificate will be automatically invalidated.

Besides the formal required documentation (application form, name pre-approval, approval certificate, etc.), the investors are required to file the contract and articles of association; their legitimate qualifications (company registration, individual identification, proof of credit, etc.) and credit standing certificates; the lease contract or a showing of having rights to the property at the FIE's registered address; a certificate listing the members of the Boards of Directors; etc.

The AIC will decide whether to approve or reject the registration within 30 days from the reception of the application. The registration is 0.8% of the FIE's total registered capital. If the total registered capital exceeds RMB 10 million, a rate of 0.4% will be applied to the part exceeding RMB 10 million. No charge will be applied for the part of the capital exceeding RMB 100 million.

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.

4.3.2. Partnerships

The procedures to establish a partnership are simpler than those required to set up a WFOE, EJV or CJV. To begin with, no company establishment approval by MOFCOM is required; 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 (i.e. the approvals discussed in section 4.1.2 – 4), the approval documents must be submitted.

The partners need to submit to the AIC, among other documents: (i) the partnership agreement entered into by all of the partners; (ii) a letter of confirmation regarding the capital contribution undertaken or actually paid by each partner; (iii) a description of compliance with industry policies for foreign investment signed by all the partners; and (iv) credit certificates issued by financial institutions for the foreign partners.

The AIC shall decide whether to approve the partnership or not within 20 days from the date of acceptance of the application. For restricted projects which are subject to prior review and approval in accordance to the *Catalogue* or involve duties of other relevant departments, the AIC shall seek the opinions of those relevant departments in writing before approving and issuing the business license.

However, if the documentation submitted by the partners is complete; complies with the required format; and the AIC is able to process the registration on the spot, then the application may be processed on the spot and the business license issued immediately after the application is submitted.

In addition, partnerships may establish branch institutions simply by applying for its registration before the local AIC in the place where the intended branch is to be located.

4.3.3. 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, such as accounting firms (Ministry of Finance); law firms (Ministry of Justice); financial institutions (China Banking Regulatory Commission); insurance institutions (China Insurance Regulatory Commission); etc. In this cases where prior approval is required, the foreign company must file the rep office registration application within 90 days after the approval is granted.

Among the documents required to be submitted before the AIC for registration, the foreign company needs to file its business license (which must be valid for at least two years after submission); articles of association or organization agreement; documentation crediting the appointment of the chief representative and/or representatives; creditworthiness certificate; tenancy agreement; etc.

The AIC shall decide whether to approve the rep office registration or not within 15 days from the acceptance of the application and, if necessary, may request the opinions of other departments prior to the decision. Upon approval, the AIC shall issue the registration certificate within 5 days and the newly established rep offices are required to open a bank account and register before the tax authority and customs office (if applicable) within the subsequent 30 days.

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

5.1. Minimum Registered Capital

Until recently different types of companies had different registered capital requirements. However, 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.

Although there is no need for a minimum registered capital anymore, it is worth noting that the registered capital of a company is still recorded and printed on the business license.

5.2. Capital Contributions

The registered capital is given via capital contributions. There are restrictions on both what can be used as a capital contribution and the schedule of contributions.

5.2.1. Types of Contributions

In accordance to the *Provisions on the Administration of Registered Capital Registration of Companies* and the specific regulations of each type of FIE, 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).

5.2.2. Schedule of Contributions

Prior to the 2014 amendments the *Company Law* specified a time frame within which capital contributions had to be made. After the amendments, however, the law no longer specifies such a schedule. Nonetheless, 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.

Prior to the 2014 amendment to the *Company* Law, after the total capital contributions were paid, a certified public accountant had to issue a capital verification report and the company had to file it to the AIC. After the amendment, this is no longer required.

5.3. 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.

Table 3: Minimum Percent Registered Capital

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% (minimum: USD 2,1 million)
USD 10 – 30 million	40% (minimum: USD 5 million)
More than USD 30 million	1/3 (minimum: USD 12 million)

5.4. 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:

Table 4: Loans Allowed for Holding Companies

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 can reduce its incurred debt or increase its registered capital (see next section).

5.5. Increase and Decrease of 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

5.6. Foreign exchange

In accordance with the *Issues Concerning the Improvement of the Examination, Registration, Foreign Exchange and Tax Administration of Foreign-invested Enterprises* issued by the SAFE and effective from 2013, a FIE shall 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 obtaining the aforementioned certificate, 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":

- RMB can be converted into foreign currency and kept in the foreign exchange accounts if related to current account items, such as: (i) foreign exchange paid or collected by domestic organizations who act as agents in foreign businesses or in businesses which operate outside China; (ii) foreign exchange required to pay unsettled foreign exchange insurance premiums; (iii) payment of interest and fees in virtue of foreign exchange debts incurred inside or outside of China (among others).

- Foreign currency can be deposited in foreign exchange accounts and then converted into RMB if related to capital account items, such as: (i) foreign exchange loans borrowed by domestic organizations; (ii) foreign exchange used by domestic organizations to repay principal of overseas debt in foreign currency; (iii) foreign exchange paid in capital; (iv) foreign exchange remitted by overseas legal or natural persons for the establishment of FIEs (among others).

5.7. Financial and accounting

FIEs' financial and accounting policies must be in accordance with the laws and regulations of China and the provisions of financial authorities. 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; and (2) rewards/welfare funds for the employees. EJVs must additionally withdraw the enterprise development funds.

<u>Reserve Funds:</u> at least 10% of the after-tax profit must be withdrawn to the reserve funds, but withdrawals can cease when the funds reach 50% of the registered capital. Besides covering losses of

the FIE, and after MOFCOM's approval, reserve funds can be used for capital increases and production expansions.

Rewards/Welfare Funds For the Employees: the amount of the withdrawal can be discretionally determined by the FIE.

Enterprise development funds: withheld for the expansion and development of the EJV's operations.

6. Hiring Employees

6.1. Local Employees

Labor relationships with local employees are mostly governed by the following regulations: (i) the *Labor Law* (effective as from January 1st 1994); (ii) the *Labor Contract Law* (effective as from January 1st 2008); and (iii) the *Regulations on Implementation of the Labor Contract Law* (effective as from September 18th 2008).

Labor Contracts: Written labor contracts must be concluded when a labor relationship is established. If no written contract is concluded at the time of employment, the following occurs:

Table 5: Consequences of No Written Labor Contract

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.

Term: The term of labor contracts can be:

(i) fixed (the ending date of the labor relationship is agreed between the parties);
(ii) open-ended (the parties agree not to stipulate a definite ending date); or
(iii) subject to the completion of an entrusted assignment (the parties agree that the period for completion of the given job is the term of the contract).

If the contractual fixed term of an employee who has worked for the same company for ten or more consecutive years is going to be extended by mutual agreement, the employee is entitled to request to switch to a non-fixed contractual term.

Probationary Period: Labor contracts with a term of more than three months may include a probationary period. The maximum allowed length of the probationary period is dependent on the term of the labor contract:

Table 6: Maximum Probationary Periods

Term of Labor Contract	**Maximum Probationary Period**
Three months to one year	One month
Longer than one year up to three years	Three months
Longer than three years	Six months

Probationary periods shall be included in the term of the labor contracts and the salary of employees in probation period cannot be lower than: (i) the lowest salary level for the same job in the company or 80% of the salary agreed in the labor contract; and (ii) the minimum salary of the place where the employer is located.

During the probationary period the employee can resign with three days advance notice.

Child Labor: The employment of minors under the age of 16 is strictly forbidden. Only institutions related to literature, arts or physical culture may hire minors, subject to the government prior examination and approval. In any case, the minors' right to compulsory education must always be respected.

Working Hours and Weekly Rest: The "English week" system is used in China: employees shall not work more than eight hours a day and forty four hours per week. The employer must ensure that its employees have at least one day off per week. However, if an employer cannot comply with these requirements due to the nature of its business, other rules may be adopted upon approval of the competent administrative labor department.

Overtime Hours: After consulting with the union, the employer may extend the working hours if required by its production or business operation, but such extension shall not be of more than one hour per day. If additional working hours are still required for special reasons, such extension shall not be of more than three hours per day and thirty six per month. The health condition of the workers must be guaranteed.

The remuneration for the overtime hours must be the following: (i) 150% of the normal salary for normal overtime hours; (ii) 200% of the normal salary if the overtime hours are worked on days off; and (iii) 300% of the normal salary if the overtime hours are worked in statutory holidays.

Leave: Employees who work for more than one successive year are entitled to a paid annual leave. The statutory minimum annual leave the employer must grant an employee depend on the length of employment: (i) five days after one year of work; (ii) ten days after ten years of work; and (iii) fifteen days after more than twenty years of work.

Employees can also benefit from maternity, matrimonial, medical and funeral leaves, among others. For example, maternity leave must be at least 90 days.

Salary: Minimum salaries are established by the governments of the provinces, autonomous regions or municipalities. For example, Beijing's minimum wage for the year 2013 was established in RMB 1,400 per month and RMB 8.05 per hour.

Termination: If an employer intends to terminate an employee, it shall notify the trade union of the reasons in advance.

Where an employer violates the provisions of laws or administrative regulations or a labor contract, the labor union has the right to require the employer to make rectification. The employer shall take into consideration the opinions of the labor union and notify in writing the labor union of the handling result.

Termination With Prior Notice: Employers may terminate employees with a prior 30 days' written notice if any of the following circumstances arise:

(i) The employee is unable to resume his original work or any work specially arranged by the employer after the period of medical treatment for illness or other non work-related injury is finished;
(ii) The employee is unqualified for his position and remains unqualified even after receiving training or readjustment; and
(iii) Major changes in the objective conditions taken as the basis for the conclusion of the employment contract, in virtue of which the contract cannot be performed and, after consultations, no agreement is reached between the parties as to modifying the labor contract.

Further, if the employer is about to go bankrupt or suffers deep production and management difficulties, the workforce may be reduced after explaining the situation to the union or all its staff with 30 days in advance; asking for their opinion; and reporting the circumstance to the corresponding administrative labor department. If the employer then recruits personnel within six months from the reduction of its workforce, the terminated employees must be prioritized.

Termination Without Prior Notice: Employers may terminate employees without any prior notice if any of the following circumstances arise:

(i) The employee does not satisfy the requirements for recruitment during the probation period;
(ii) The employee seriously violates labor discipline or the employer's rules and regulations;
(iii) The employee causes great losses to the employer due to his/her gross negligence or malpractice;
(iv) The employee is investigated for a criminal offence;
(v) The labor contract is invalid because it was concluded or modified against the employer's true intent by means of deception or coercion, or the employer was in a precarious situation;
(vi) The employee concurrently establishes a labor relationship with another employer which seriously affects the accomplishment of the original labor relationship, or the employee refuses to rectify after the original employer brings the matter to his/her attention.

Despite the aforementioned, employers cannot terminate a labor relationship if the employee:

(i) is engaged in activities exposed to hazardous labor diseases, he/she is not provided with labor health examinations and is under medical observation or in the process of being diagnosed;
(ii) totally or partially lost his/her working capabilities due to an occupational disease or injury;
(iii) is receiving medical treatment;
(iv) is a female and is pregnant or in the breast-feeding period;
(v) has been working for the employer for continuous fifteen years and is less than 5 years away from the statutory retirement age; or
(vi) is under other circumstances prescribed by laws or administrative regulations.

<u>Compensation:</u> After a labor contract has been terminated, the employee is entitled to financial compensation based on the number of years he/she worked for the employer:

Table 7: Post-Termination Compensation

Length of Employment	Amount of Compensation
Less than six months	Half a month's salary
Six or more months but less than one year	One month's salary
A year or more	One month's salary per year employed

In this context, "one month's salary" means the average of the employee's monthly salary during the 12 months prior to the termination of the labor contract.

If the employer terminates the labor contract in violation of the conditions discussed above, the employee may judicially demand to continue performing the contract. However, if the employee does not demand performance of the contract, or said performance becomes impossible, the employer must pay the employee twice the corresponding compensation for termination.

<u>Competition Restrictions:</u> Competition restrictions may be only included in labor contracts concluded with senior managers, senior technicians and other employees who are under a confidentiality obligation. The parties will agree on the scope, geographic area and term of the competition restriction.

However, obligations restricting the employee from working for a competing company or establishing his/her own company to produce the same products or operate the same business than the former employer cannot exceed two years.

<u>Resignation:</u> If the employee wants to resign, he/she must give the employer a 30 days' prior written notice. However, no prior notice is required in the following circumstances:

(i) the employer forces the employee to work through violence, intimidation or any other illegal limitation of his/her personal freedom, or orders to perform dangerous activities that endanger his/her safety;
(ii) the employer fails to pay the entire salary on time;
(iii) the employer fails to provide labor protection or working conditions as agreed in the labor contract;
(iv) the employer fails to pay the employee's social insurance premiums in accordance with the law;
(v) the employer has rules which violate laws or regulations and therefore affect the worker's rights and interests;
(vi) the labor contract is invalid because it was concluded or modified against the employee's true intent by means of deception or coercion, or the employee was in a precarious situation.

<u>Dispute Resolution:</u> If a dispute arises, parties may apply to the labor dispute mediation committee for mediation and, if the mediation does not lead to an agreement, to the labor dispute arbitration committee for arbitration. They may also forego mediation and directly apply for arbitration. The results of the arbitration are not immediately binding however. If one of the parties disagrees with the arbitral award, a lawsuit can be filed before the competent Court within 15 days from the date of its issuance.

<u>Part-time Employment:</u> A part-time employment relationship is established when the employee works an average of no more than four hours per day and no more than twenty four hours per week for the same employer. In this case, the remuneration is calculated per hour.

A written labor contract is not required and the parties do not need to agree on a probationary period. Either party is entitled to terminate the labor relationship at any time and employers are not required to pay any compensation.

<u>Social Insurance:</u> The *Social Insurance Law* was issued on October 28th 2010 and entered into force on July 1st 2011. It established, for the first time, a national social insurance system. Until the issuance of this law, the social insurance plans and calculation methods varied according to each region.

The social insurance system includes:

(i) basic pension insurance;
(ii) basic medical insurance;

(iii) labor injury insurance;
(iv) unemployment insurance; and
(v) maternity insurance.

The basic pension, medical and unemployment insurance premiums are jointly paid by the employer and the employee, while the labor injury and maternity insurance premiums are solely paid by the employer (the employees do not have to pay for these premiums).

Unions and Collective Contracts: Employees have the right to organize and participate in trade unions to represent and safeguard their rights and interests.

The trade unions can enter into collective agreements with the employer regarding salary, working hours, rest and vacations, occupational safety and health, insurance and welfare. If, in a company, a union has yet to be established, collective employment contracts may be entered by the elected representatives of the employees.

Once concluded, the collective employment contracts must be submitted to the competent administrative department of labor. If no objections are made by the department, the contract will enter into force 15 days after submission. Collective contracts shall in no case stipulate conditions lower than the ones established in the labor laws and regulations.

6.2. Foreign employees

In order to hire foreigners, both Chinese companies and FIEs need to comply with the *Provisions on the Administration of Employment of Foreigners in China* (effective as from May 1st 1996). These Provisions are not applicable to personnel of foreign Consulates or Embassies, UN representative institutions or other international organizations with diplomatic privileges and immunity.

Requirements: 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 the satisfy the following requirements: (i) be 18 years old or more and in good health conditions; (ii) have the skills and experience required for the position; (iii) have no criminal records; (iv) have a specific employer; and (v) hold a valid passport or other required international travel documents.

Permits: Foreigners who intend to work in China need first to enter the country with a working visa and then obtain the employment and residence permits before being employed.

Working Visa: In order for the foreigner to request the working visa (i.e. Z visa), first his/her future employer needs to apply for a working permission before the department in charge of trade at equal level to the department in charge of labor administration by providing the following documentation:

(i) Curriculum vitae of the foreigner intended to be employed;
(ii) Letter of intent for the employment;
(iii) Report stating the reasons for hiring the foreigner;
(iv) Credentials of the foreigner crediting his qualification for the position;
(v) Health certificate of the foreigner; and
(vi) Any other documentation required by laws and regulations.

Once the working permission is granted, the foreigner must apply for his/her working visa before the competent Chinese embassy, consulate or office in his/her country of origin by submitting:

(i) his/her future employer’s employment license issued by the Ministry of Labor;

(ii) the visa notification letter issued by the employer (an authorized organization); and
(iii) his/her valid passport.

Permits: After the working visa is granted, the foreigner must enter China and apply for the employment permit within 15 days from the date of entry by submitting: (i) the employment license; (ii) the labor contract; (iii) the passport; and (iv) the registration form for foreigners. Employment permits are only valid within the area specified by the approving authority.

Finally, the foreigner must apply for the residence permit before a public security authority within 30 days from the date he/she entered China by submitting the employment permit.

The *Provisions* also establish certain cases where employment licenses and permits are not required (i.e. if the foreigner is a technically qualified professional or manager directly invited by the Chinese government; if the foreigner holds a permit for foreigners undertaking off-shore petroleum operation in the PRC; etc.).

Term: The term of labor contracts concluded with foreigners cannot exceed five years. Labor contracts will be automatically terminated upon the expiration of their agreed term and employment permits will be invalid as from the moment the labor contract expired.

However, if the labor contract needs to be renewed, the employer can file an application for extension before the labor administrative department within the 30 days prior to the expiration date.

Applicable Regulations: The labor relationship with a foreigner will be governed by the Chinese labor regulations. In this sense, the *Provisions* expressly establish that PRC's relevant provisions shall be applicable regarding working hours, rest hours, holidays, labor safety, etc., and that labor disputes arising from an employer and its foreign employees shall be resolved in accordance with the *Labor Law* (mediation and arbitration, or arbitration directly, with the final possibility of appealing before the competent Court).

Social Insurance: The *Provisions* establish that PRC's regulations regarding health and social insurance will also be applicable to labor relationships with foreigners. Moreover, the *Social Insurance Law* expressly stipulates that foreigners working within the territory of China participate in the social insurance system with reference to the provisions of said Law.

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.

But 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.

In practice, the payrolls under this dispatching arrangement are usually paid by the employer through an offshore bank, rather than paid in China. However, for the purpose of convenience, remunerations of dispatched foreign employees are often paid directly from account of the Chinese subsidiaries.

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. Merger and Acquisition (M&A):

Besides general laws (i.e. *Company Law*, *Contract Law*, *Anti-Monopoly Law*) and specific laws and regulations applicable to each kind of FIEs (WFOE, JVs, FIJSC), foreign investors' mergers and acquisitions are governed by specific sets of regulations (i.e. *Certain Provisions on Change of the Equity Interests of the Investors of a FIE* issued by MOFTEC and SAIC – May 28th 1997; *Provisions on Foreign Investors' Merger with and Acquisition of Domestic Enterprises* issued by MOFCOM in 2006 and amended in 2009; etc.).

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. This means that, for example, foreign investors cannot target companies operating in prohibited sectors; target companies already established as JVs cannot be converted into a WFOEs as a result of the M&A operation if its business sector is allowed only for JVs; and if as a result of an M&A operation a target company established as a JV becomes wholly-foreign owned, it must be converted into a WFOE.

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 structured as direct or indirect acquisitions and as asset or equity acquisitions:

Direct Acquisition: The foreign investor directly purchases all or part of the equity interest of the target company or subscribes for its capital. Direct acquisitions require the approval of MOFCOM or its competent local branch and the modification of the registration before the Administration of Industry and Commerce.

Offshore/indirect Acquisition: The foreign investor will acquire or increase control of the Chinese target company by the offshore purchase of shares of the target's foreign parent company or companies. In this case, no administrative approval within China is required besides the antitrust review if applicable (see Article 51 of the Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, amended by MOFCOM in 2009).

Equity Acquisition: 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: Acquisition of assets is 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. However, the foreign investor can acquire only specific and preferred assets of the target company.

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

7.2. Mergers

Mergers are mainly governed by the *Provisions on Merger and Division of Foreign Invested Enterprises* issued on November 22nd 2001, which establish that mergers can be divided between mergers by absorption and mergers by a new establishment.

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 merger's approval authority will be determined in accordance to the type of merger, total investment and location. After the preliminary approval is granted, the merging companies' creditors shall be notified within 10 days and the public announcement published at least three times within 30 days. The merger shall be submitted for final approval if no objection is raised by the creditors within 90 days from the first announcement.

7.3. General procedure

Undertakings in China usually follow the following seven basic steps:

(1) Careful screening and selection of the target and analysis of the asset value of the target company;
(2) Initial stage and meetings;
(3) Drafting of the transaction structure
(4) Due Diligence
(5) Drafting of deal documents
(6) Regulatory approvals and registration
(7) Process management

Although letters of intent or memorandums of understanding in relation to merger and acquisitions are not legally required, they are highly recommended. Chinese parties may expect that those preliminary agreements to be taken seriously.

In the initial stages, PRC law firms can help foreign investors to select the proper targets by anonymously accessing corporate records and providing information about the legal standing of the company (existence, business scope, shareholder structure and other types of essential internal and commercial information).

Foreign investors should then pay special attention to proper due diligence and gaining as much accurate information of the target company as possible. The business scope and target should be carefully selected because of strict regulations and monitoring of foreign investments in China.

The purpose of due diligence is to ensure that no hidden liabilities are contained and the business and assets of the target company are in the condition represented in the documents. Due diligence usually includes at least financial and legal due diligence. Additionally, disputes, litigation, environmental, commercial, labor, intellectual property and technical matters may be contained.

The purchaser and its advisors will define the checklist about areas which will be included in the due diligence investigation and sent to the target undertaking. After the due diligence investigation, the documentation and agreements are required, depending on the exact nature and type of assets included in the target company. The closing requirements of due diligence will depend on the nature and structure of the transaction.

<u>Legal due diligence:</u> Contracts such as supply agreements, sales and distribution agreements, IP or technology licensing agreements, both passive and active, must be checked. Independent valuation of target's assets and structure of the ownership, land rights and ownership, employee contracts, annual audits and tax returns must be properly investigated.

<u>Financial due diligence:</u> compliance with China's *Corporations Act* should be verified in addition to the financial statements checked by an accounting firm. Debts, liabilities and possible litigation, even pending and future ones, of the target company must be searched. Unfortunately China still lacks of a clear legal framework on how to access non-public companies' financial information.

<u>Others:</u> environmental regulations have become an important aspect of proper due diligence analysis. The possible target company's liabilities and how the environmental regulations may effect on the target company's value are important issues to be aware of.

7.4. Anti-monopoly review

In virtue of the *Anti-Monopoly Law* and its *Guidelines*, MOFCOM's anti-monopoly approval is required prior to the closing of certain M&A transactions. Antitrust filings must be submitted before MOFCOM's Anti-Monopoly Bureau (AMB).

All onshore or offshore M&A transactions must be reported to the AMB for review and approval if they are deemed as "concentrations" in accordance with the definitions provided by the Chinese Anti-Monopoly Law (AML) and meet the thresholds promulgated by the State Council.

The AML stipulates that the following operations will be considered as "concentration of business operators":

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

The control during the concentration of undertakings includes sole control and common control.

According to the *Guiding Opinions on Declaring the Concentration of Undertakings* (Revised in 2014), the declaration threshold is met when:

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, with 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

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, with 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.

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

7.5. Security Review

The security review was recently established after the issuance of the *Notice of the General Office of the State Council on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (effective from March 4th 2011) and the *Provisions of the Ministry of Commerce on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (effective from September 1st 2011).

M&A activities between FIEs and domestic companies or between foreign and domestic companies must submit for national security review if they operate in the following sectors:

- foreign investors' M&A of domestic military industry enterprises and military industry support enterprises, enterprises around key and sensitive military facilities, and other units which have impact on national defense security; or
- foreign investors' M&A of domestic enterprises, which have impact on the national security, in fields of important agricultural products, important energy and resources, important infrastructure, important transport service, key technology and major equipment manufacturing, etc. 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, including domestic product manufacturing capacity, domestic service provision capacity, and relevant equipment and facilities needed for the 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 does not affect national security, the subsequent M&A transaction formalities can be carried on. However, 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 Regime

8.1. Corporate income tax (CIT)

Enterprises are classified into resident and non-resident enterprises under the Unified Enterprise Income Tax Law.

Residents: 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. Certain industries and qualified businesses, such as new-high technology enterprises, may be entitled to lower CIT rate of 15%. Some tax holidays are also available to qualified taxpayers, such as, in addition to the 15% rate that applies to new high-technology enterprises, a two-year tax holiday followed by three years of tax levied at a 12.5% rate.

Non-residents: A non-resident enterprise refers to an enterprise incorporated outside of China and whose actual management organ is also located outside of China. 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' IIT liability in China depends on the duration of stay. Foreigners and Chinese from Hong Kong, Macao, and Taiwan have to pay IIT on the following sources of income:

Table 8: Individual Income Tax

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 signed a treaty on the avoidance of double taxation with China.

(‡) This 90 (183) day window does not apply to senior managers. Please see below.

Residing in China for one year means that, in a one year period, temporary absences from China are less than 30 days continuously and 90 days altogether.

A number of special rules should be mentioned:

- A distinction has to be made between junior staff and senior management. The 90 (183) day foreign employment exemption rule does not apply if the employee holds a senior management position in China. Foreign senior managers (e.g. CEOs, General Managers, Chief Representatives, etc.) are liable for their full income derived from Chinese sources from the first day in China.
- The above paragraph notwithstanding, 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. This rule does not apply for senior officials of WOFEs, because they are registered as Chinese companies and pay their employees from within China.

Although subject to numerous rules and exceptions, in general the IIT rate for wages and salaries is as follows:

Table 9: IIT Rates for Wages and Salaries

Level	Monthly Taxable Income	Tax Rate (%)
1	if not exceeding CNY1, 500	3
2	for the part exceeding CNY1, 500 but no more than CNY4, 500	10
3	for the part exceeding CNY4, 500 but no more than CNY9, 000	20
4	for the part exceeding CNY9, 000 but no more than CNY35, 000	25
5	for the part exceeding CNY35, 000 but no more than CNY55, 000	30
6	for the part exceeding CNY55, 000 but no more than CNY80, 000	35
7	for the part exceeding CNY80, 000	45

(Note: The "Monthly Taxable Income" as mentioned in this table refers to the balance after deducting CNY3, 500 from the monthly revenue and any additional deductible fee.)

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 are:

Table 9: IIT Rates for Other Income

Level	Monthly Taxable Income	Tax Rate (%)
1	not exceeding CNY15, 000	5
2	for the part exceeding CNY15, 000 but no more than CNY30,000	10
3	for the part exceeding CNY30, 000 but no more than CNY60, 000	20
4	for the part exceeding CNY60, 000 but no more than CNY100, 000	30
5	for the part exceeding CNY100, 000	35

(Note: The "Annual Taxable Income" as mentioned in this table refers to the balance after deducting the costs, fees and losses from the total revenue of each taxable year.)

8.3. Turnover Tax

All units and individuals providing services as prescribed in *Interim Regulations of the People's Republic of China on Business Tax* (Revised in 2008), transferring intangible assets or selling immovable property within the territory of the People's Republic of China shall be taxpayers of business tax, and must pay business tax in accordance with these Regulations.

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

Tax Payable = Turnover * Tax rate

Generally speaking, if no amendment is decided by State Council, the following tax rate should be applied.

Table 11: Turnover Tax Rates

Taxable Item	Tax Rate
1, Transport Sector	3%
2, Construction Sector	3%
3, Finance and Insurance Sector	5%
4, Post and Telecommunications Sector	3%
5, Culture and Sport Sector	3%
6, Entertainment Sector (†)	5%-20%
7, Service Sector	5%
8, Transfer of Intangible Assets	5%
9, Sale of Immovable Properties	5%

(†) The specific tax rates applicable to taxpayers engaged in the entertainment industry shall be determined by the people's governments of provinces, autonomous regions and municipalities directly under the central government within the range prescribed by these Regulations.

The following items shall be exempt from business tax:

(1) Nursing services provided by nurseries, kindergartens, homes for the aged, welfare institutions for the handicapped, matchmaking and funeral services;
(2) Services provided on individual basis by the disabled;
(3) Medical services provided by hospitals, clinics and other medical institutions;
(4) Educational services provided by schools and other educational institutions and services provided by students participating in work-study programs;
(5) Agricultural mechanical plowing, irrigation and drainage, prevention and treatment of plant diseases and insect pests, plant protection, insurance for farming and animal husbandry, and related technical training services; breeding and the prevention and treatment of diseases of poultry, livestock and aquatic animals;
(6) Admission fees for cultural activities conducted by memorial hall, museum, cultural center, art gallery, exhibition hall, academy of painting and calligraphy, library and cultural protective units; admission fees for cultural and religious activities conducted at places of religious worship; and
(7) Insurance products provided by domestic insurance institutions to export.

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:

Taxable Payable = Taxable Amount * Value-Added Tax Rate

The formula for the taxable amount is:

Taxable Amount = Output Tax in the Current Period - Input Tax in the Current Period

Value-Added Tax Rates:

(1) Taxpayers who sell or import goods and do not fall within the scope as specified in following paragraph 2 and 3 shall be subject to 17% tax rate.
(2) Taxpayers who sell or import the goods listed below shall be subject to 13% tax rate:
    (i) food and edible vegetable oil;
    (ii) tap water, heat supply, air-conditioners, hot water, gas, liquefied petroleum gas, natural gas, methane and civil-use coal products;
    (iii) books, newspapers and magazines;
    (iv) feeds, chemical fertilizers, pesticides, agricultural machineries and mulching films; and
    (v) other goods specified by the State Council.
(3) Taxpayers who export goods are subject to a zero percent tax rate, unless otherwise specified by the State Council.
(4) Taxpayers who provide processing, repairs and maintenance services (taxable labor services) shall be subject to 17% tax rate.
(5) The above notwithstanding, small scale taxpayers shall be subject a 3% tax rate if they have successfully applied for this status.

8.5. M&A transaction taxes

All M&A transactions are fraught with complex tax issues that require dedicated expert attention. An effective navigating on the myriad of tax issues common to transactions is critical to ensuring the FIE minimize the risks and maximize the returns in China.

The following types of tax may be involved in M&A transaction:

<u>CIT:</u> Under China's CIT law, income arising from the transfer of equity and assets is subject to CIT. For resident enterprises, a standard 25 % CIT rate applies; for non-resident enterprises, the withholding tax rate on capital gains is 10%. The CIT Implementing Laws further provide that, when undergoing restructuring, gains or losses arising from the transfer of assets should be recognized at the time of the transaction.

<u>VAT:</u> With respect to VAT, according to China's regulations, the transfer of equity is outside of the scope of VAT, but the transfer of fixed assets and inventories are subject to VAT based on their fair values. However, in 2011, the State Administration of Taxation (SAT) released Announcement No. 13 stipulating that 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.

<u>Turnover Tax:</u> As to the turnover tax, a 5% business tax will be levied on the transfer of intangible assets such as copyrights, trademarks and patents based on the fair market value. However, technology transfers may be exempt. According to SAT Announcement [2011] No. 51, 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, too.

Land Appreciation Tax: 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.[3]

The rates range from 30 percent to 60 percent.

Stamp Tax :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 Rights

As a basic rule for intellectual property holders, all kinds of intellectual property rights (IPRs) (patents, trademarks, copyrights) that are essential for making business in China should be registered. Relying on only overseas registration alone may not be sufficient in most of the circumstances. Registration in China will also provide better intellectual property protection if a dispute arises.

It is highly recommended to implement a comprehensive IP strategy including legal, political, technical and administrative issues. Protecting IPRs should be thought of as an essential part of the undertaking's strategy.

9.1. Patents

The *Patent Law* was initially passed in 1984 and was amended recently on October 1st 2009. In 2010 the Supreme's Peoples Court issued a judicial interpretation of the Patent Law and the State Council issued *Implementing Regulations*. In addition, China is a member of the Paris Convention for the Protection of Industrial Property (1985), the Patent Cooperation Treaty (1994) and the TRIPS agreement.

The *Patent Law* protects: (i) invention patents for 20 years after the filling of the patent application; (ii) utility model patents for 10 years after the filling of the patent application; and (iii) design patents for 10 years after the filling 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.

As mentioned above, the amended patent law came into force in 2009 and soon thereafter the Supreme People's Court issued a judicial interpretation and the state council issued Implementing regulations. Among the changes therein, two deserve to be highlighted:

(1) The patent license requirements are now more stringent. Prior to the amendments, China used a "relative novelty standard" which allowed technologies that were patented and used exclusively abroad to be patented separately in China. Under the new "absolute novelty standard" such technologies cannot be patented.

[3] Under Chinese *Property Law* urban land is generally state-owned and rural land is generally owned by a collective.

(2) The scope of damage compensation within the discretion of the court has been increased the range from the old range of RMB 5,000 – 50,000 to the new range of RMB 10,000 – 1,000,000.
(3) On April 1, 2013, the *Certain Provisions on Issues Concerning the Application of Law in the Hearing of Patent Dispute Cases* was modified by the Supreme People's Court, allowing the Supreme People's Court to designate district courts to have the jurisdiction to hear patent disputes of first instance (formerly only under to the jurisdiction of the intermediate courts). This change makes it more convenient for litigants to adjudicate cases as they can do so nearby.

9.2. Trademarks

Trademarks are regulated by the *Trademark Law* promulgated in 1982, later amended in 1993, 2001 and 2013. 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 6*bis* Paris Convention on "well-known" trademarks. The Chinese regime for the protection of well-known trademarks follows the principles of case-by-case identification and passive protection (i.e. no protection until a complaint is filed). For well-known trademarks that have not been registered, the threshold of necessary popularity for a mark to be recognized as well known is exceedingly high. Typical examples of such trademarks are McDonalds, Jaguar and Hugo Boss.

Thus, in the vast majority of cases, trademarks must be registered with the Chinese Trademark Office in order to gain protection in China. Trademarks can be registered through:

(i) the national system; or
(ii) the international system available under the Madrid Protocol through World Intellectual Property Organization (WIPO).

Using the international system may be easier for foreigners wishing to register trademarks in China because the application can be made in English, French or Spanish, while applications through the Chinese national system can only be made in Chinese. However, if the trademark application is filled through the Chinese national system, a Chinese language certificate will be obtained, which facilitates subsequent proceedings and enforcement actions.

9.3. Copyrights

The *Copyright Law* has been effective since June 1st 1991 and was amended on April 1st 2010 to increase consistency with the provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) provisions. Further, *Implementing Regulations of the Copyright Law of the People's Republic of China* was revised in 2013 and came into force on March 1st 2013.

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.

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 (the Berne Convention for the Protection of Literary and Artistic Works, the Convention for the Protection of Producers of Phonograms Against the Unauthorized Duplication of Their Phonograms, Paris Convention for the Protection of Industrial Property and the WIPO Convention) 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.

9.4. Software Protection Regulations

Computer software is protected against unauthorized online distribution under the *Copyright Law* and the *Regulations for the Protection of Computer Software*, amended on March 1st 2013. The amendments established fines for the unauthorized reproduction and distribution of software. The minimum charge is now “no less than the one time value of the product.” For the other types of violations the maximum fine amounts to RMB 200 000.

9.5. Customs protection of intellectual property

Customs registration with the General Administration of Customs (GAC) is a convenient and cost effective way to enforce one’s IP rights against infringers. If IPRs are registered with the GAC, it allows them to prevent counterfeit version of their products from being imported and exported. In accordance with the *Regulations on Customs Protection of Intellectual Property Rights*, the IP rights’ registration will be valid for 10 years, renewable within the six months prior to the expiration of the original period.

9.6. Unfair Competition and Intellectual Property Rights

The *Anti-Monopoly Law* (AML) (described in greater detail in section 10) can apply to intellectual property holders in certain situations. According to Article 55, the AML is not applicable to business operators who exercise their intellectual property rights in accordance with the laws and administrative regulations on intellectual property rights. However, the AML is applicable to the business operators who eliminate or restrict market competition by abusing their intellectual property rights".

The SAIC released, in June 2014, *Provisions of the Industry and Commerce Administration Organs on the Prohibition of Abuse of Intellectual Property Rights to Exclude or Restrain Competition* (Draft for Comments). The draft provisions recognize the potential anti-competitive use of intellectual property rights in certain conditions. Depending on the dominance of the undertaking, practices such as refusal of licensing, unreasonable trading conditions on licensing IP rights and special issue of technology protection measures in copyrights may cause anti-competitive concerns when their primary aim is to restrict competition. It is predicted that the provisions will be issued in the near future in order to protect the fair competition more comprehensively.

9.7. IP Issues to Consider in M&A

In M&A transactions, special attention should be given to IP issues related to ownership, validity, strategic value, enforceability and transferability, as well as the effects of IP licensing contracts and the possibility of sub-licensing.

In an effective due diligence review the value and the time of existence of the target company’s IP assets should be analyzed, the failure to register IP rights is more common in China compared to western practice. The acquirer should also pay attention to the possibilities of protecting its IP rights when entering new geographic markets and new product segments.

10. The Protection of Fair Competition

There are mainly three sets of law protecting the fair competition in Chinese market:

(1) The Anti-Monopoly Law
(2) The Anti-Unfair Competition Law
(3) The Price Law

In addition, there are a number of other laws and regulations that are relevant.

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

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

According to AML, "monopolistic practices" include:

(1) The conclusion of monopoly agreements between operators;
(2) The abuse of dominant market position by operators; and
(3) 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.

As the AML came into force on August 1st 2008 and is therefore recent, investors should be aware of its continuous development and the lack of clarification in Courts.

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.

The AML lists the following prohibited monopolistic practices for horizontal agreements:

(i) fixing or changing prices of commodities;
(ii) limiting the output or sales of commodities;

(iii) dividing the sales market or the raw material procurement market;
(iv) restricting the purchase of new technology or new facilities or the development of new technology or new products;
(v) making boycott transactions; and
(vi) other monopoly agreements as determined by the Anti-monopoly Authority under the State Council.

Regarding vertical agreements, the following practices are prohibited:

(i) fixing the price of commodities for resale to a third party;
(ii) restricting the minimum price of commodities for resale to a third party; and
(iii) other monopoly agreements as determined by the Anti-monopoly Authority under the State Council.

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

In accordance to the AML, the issue of determining if a business operator has dominant market status is determined by considering the following factors:

(i) market share of a business operator in relevant market, and the competition situation of the relevant market;
(ii) the capacity of a business operator to control the sales markets or the raw material procurement market;
(iii) the financial and technical conditions of the business operator;
(iv) the degree of dependence of other business operators upon of the business operator in transactions;
(v) the degree of difficulty for other business operators to enter the relevant market; and
(vi) other factors related to determine a dominant market position of said business operator.

The AML additionally stipulates certain circumstances which can be taken into account to determining this status, such as the fact that the relevant market share of a business operator accounts for half or more of the relevant market; the joint relevant market share of two business operators accounts for two thirds or more; or the joint relevant market share of three business operators accounts for three quarters or more.

For business operators with dominant market status, the following behaviors are prohibited:

(i) selling commodities at unfairly high prices or buying commodities at unfairly low prices;
(ii) selling products at prices below cost without any justifiable cause;
(iii) refusing to trade with a trading party without any justifiable cause;
(iv) requiring a trading party to trade exclusively with itself or trade exclusively with a designated business operator(s) without any justifiable cause;
(v) tying products or imposing unreasonable trading conditions at the time of trading without any justifiable cause;
(vi) applying dissimilar prices or other transaction terms to counterparties with equal standing; and
(vii) other conducts determined as abuse of a dominant position by the Anti-monopoly Authority under the State Council.

10.3. Concentration of operators

The concentration of business operators is relevant during M&A transactions. Please see section 7.4.

11. Exiting China

Risks are inherent to commercial activity. Thus, 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) In accordance to the *Catalogue* WFOEs cannot operate in certain sectors.
(ii) If the Chinese partner is a State Owned Enterprise, 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. For example, the foreign partner might decide to close down the JV in order to put pressure on the Chinese partner. However, it should be noted that, in accordance to the *Regulations of the PRC on Registration Administration of Companies*, if the business is suspended for six consecutive months at its own discretion, its business license shall be revoked by the SAIC.

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

Non-bankruptcy liquidation is mainly ruled by the *EJV*, *CJV* and *WFOE Regulations*, the *Company Law* and the *Guiding Opinions on Improving the Work Related to Dissolution and Liquidation of Foreign-Invested Enterprises in Accordance with the Law* issued by the General Office of the Ministry of Commerce issued on May 5th 2008.

11.1.1. Grounds for liquidation

FIEs must be dissolved in the following circumstances:

(i) Expiration of its term;
(ii) Being unable to continue with its operation due to severe losses;
(iii) Being unable to continue with its operation because one of the partners failed to perform its obligations under the agreement, contract, and/or articles of association;
(iv) Being unable to continue with its operation due to severe losses caused by force majeure events such as natural disasters, wars, etc.;
(v) Failure to reach its business operation goals and therefore having no development future;
(vi) Decision of the partners to dissolve the enterprise;
(vii) Occurrence of any other circumstance included by the partners in the articles of association, contract (in the case of JVs) or partnership agreement (in the case of partnerships).
(viii) When it is legally required due to a violation of any law or administrative regulations.

Additionally, in accordance with the *Partnership Law*, a partnership must be dissolved when the legally required number of partners is not respected for 30 days or more;

11.1.2. Liquidation proceedings

a. JVs and WFOEs

The Board of Directors must first resolve to dissolve the FIE and then submit a written application for dissolution and liquidation to MOFCOM or its competent local branch.

For JVs, if the ground for termination is the inability to operate due to a partner's failure to perform its obligations under the agreement, contract, and/or articles of association; then the performing party is entitled to submit the dissolution and liquidation application unilaterally, together with the decision rendered by a People's Court or an arbitral tribunal ruling over such failure.

MOFCOM or its competent local branch shall decide on the dissolution and liquidation application within 10 working days from the reception of the required documentation. Once 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 committee will conduct the liquidation proceedings and shall be entitled to exercise the following powers:

(i) convene creditors' meetings;
(ii) take over and liquidate the enterprise's properties;
(iii) prepare a balance sheet and a property inventory;
(iv) propose the prices of the properties to be valued and the corresponding calculation method;
(v) formulate a liquidation plan;
(vi) recover creditor's rights and cancel debts;
(vii) recover any amount that is due but still unpaid by the shareholders;
(viii) distribute the remaining property; and
(ix) represent the enterprise in litigation and arbitration; among others.

The liquidation committee shall notify the creditors within 10 days from their entrustment and announce the dissolution in a newspaper within 60 days. Creditors can declare their rights within 30 days of receipt of the notification or 45 days of the newspaper announcement if no notification is received.

Once the balance sheet and property inventory are prepared, the liquidation committee shall prepare a liquidation plan and submit it to the Board of Directors. After the confirmation of the plan by the Board and its execution, the committee shall prepare a liquidation report for MOFCOM or its competent local branch.

b. Partnerships

The partnership's dissolution will be carried out by liquidators, who can be:

(i) all the partners;
(ii) one or more partners appointed by more than half of the partners: or
(iii) any other entrusted third person(s).

If no liquidators are entrusted within 15 days from the occurrence a cause for dissolution, any partner or other interested party may request the competent People's Court to appoint them. The list of liquidators shall be submitted to competent AIC within 10 days from their designation.

Liquidators shall:

- (i) prepare a inventory of the partnership's property and a statement of its assets and liabilities;
- (ii) manage the partnership affairs related to the liquidation proceedings;
- (iii) pay the due taxes;
- (iv) cancel creditors rights and debts;
- (v) dispose the remaining property of the partnership after cancelling the debts; and
- (vi) represent the partnership in litigation or arbitration.

The liquidators shall notify the creditors within 10 days from its entrustment and announce the dissolution in a newspaper within 60 days. Creditors can declare their rights within 30 days from the reception of the notification or 45 days from the newspaper announcement if no notification is received. The partnership cannot engage in any activity unrelated to the liquidation during these proceedings.

Once the liquidation expenses, wages, social insurance premiums, statutory compensations to the employees, due taxes and other debts are cancelled, the remaining assets shall be distributed among the partners in accordance to the partnership agreement. If the distribution method is not clearly established in the agreement, the assets shall be distributed in as agreed upon by the partners. However, if no decision is reached by the partners, the assets shall be distributed *pro rata* in accordance to each partner's capital contribution (if each partner's capital contributions cannot be determined, the assets shall be equally distributed).

If the partnership's assets are not enough to cancel its debts, creditors can request bankruptcy liquidation before the People's Courts. General partners are liable for the partnership debts, and they will bear unlimited joint liability even for debts incurred during the partnership's existence even after deregistration.

11.2. Bankruptcy proceedings

The *Enterprise Bankruptcy Law* was issued in August 27th 2006 (effective since June 1st 2007) and is applicable 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:

(1) The enterprise can apply for its reorganization, compromise or bankruptcy;
(2) Creditors may apply for the enterprise's reorganization or bankruptcy; and
(3) 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. Said term cannot be shorter than 30 days or longer than three months from the acceptance of the application. If creditors fail to declare their claims within this time frame, they may declare them afterwards (so long as they do so before the final distribution of the enterprise's property) but they will bear the costs of examining and confirming these claims.

An administrator must be appointed by the People's Court, who will have the right to request the annulment of the following acts carried out by the enterprise in the year prior to the acceptance of the application for bankruptcy: (i) the free transfer of property; (ii) trade at obviously unreasonable prices; (iii) the provision of security to unsecured debts; (iv) the cancelation of debts before due; and (v) the abandonment of claims.

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 shall be repaid with the specific guaranteed property. Then, after repaying the bankruptcy proceedings' expenses and other debts incurred for the common good of all the creditors, the bankruptcy property must be distributed in cash (unless otherwise decided by the creditors' meeting) in the following order:

(i) Wages, subsidies, old-age and medical insurance premiums, and compensations.
(ii) Other social insurance premiums and taxes; and
(iii) Unsecured claims.

If the bankruptcy property is not enough to satisfy the debts of the creditors within one of the same aforementioned groups, it will be distributed in a *pro rata* basis. The salaries of directors, supervisors and senior managers will be determined by looking at the average wages of the employees of the enterprise as a basis.

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

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) by submitting the following documentation:

(i) Written application for deregistration;
(ii) Court's decision regarding bankruptcy or dissolution; enterprise's decision ordering dissolution and liquidation; administrative decision ordering dissolution and liquidation; or any other document crediting the termination of the enterprise;
(iii) Certified liquidation report;
(iv) Business license; and
(v) Any other required documentation as specified in laws or administrative regulations.

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.

Then, deregistration must be requested with the AIC by submitting an application letter; the certifications of deregistration before tax, customs and foreign exchange authorities; and any other documentation that may be required. If the rep office required approval for its establishment due to the sector of its parent company's activities (please refer to Article 33 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises), such approval documentation also needs to be submitted.

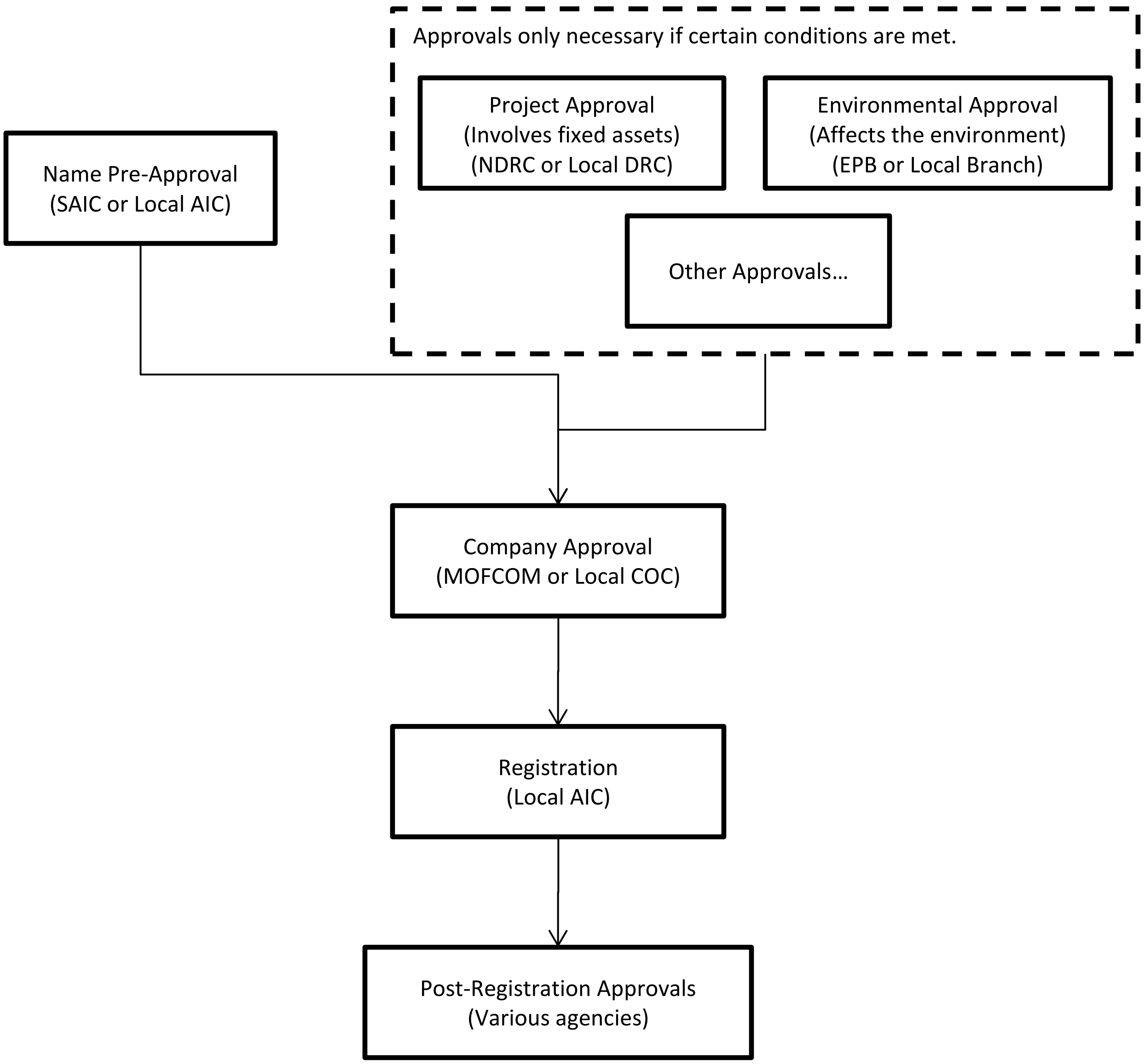
The AIC shall decide on the deregistration within ten days of the acceptance of the application. If deregistration is approved, the SAIC shall issue the notice within five days from the decision and withdraw the registration certificate and representative card. If deregistration is rejected, the SAIC shall also issue a notice within five days, explaining the reasons for such rejection.

Appendix 1: Types of Foreign Investment

Vehicle	Wholly Foreign-Owned Enterprise (WFOE)	Equity Joint Venture (EJV)	Cooperative Joint Venture (CJV)	Foreign-Invested Joint Stock Companies (FIJSC)	Partnership	Representative Office (Rep Office)
Separate Legal Entity	Yes	Yes	To be decided by the parties	Yes	No	No
Limited Liability	Yes	Yes	Only if the CJV is incorporated as an LLC, otherwise not	Yes	Only for limited liability partners	No
Management Control	The foreign partner(s) enjoy full managerial and operational control	Subject to proportion of ownership; Unanimous board resolutions on certain matters required by law	Subject to contract and proportion of ownership; Unanimous board resolutions on certain matters required by law	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)

Vehicle	Wholly Foreign-Owned Enterprise (WFOE)	Equity Joint Venture (EJV)	Cooperative Joint Venture (CJV)	Foreign-Invested Joint Stock Companies (FIJSC)	Partnership	Representative Office (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 retired; Share partnership assets upon liquidation; Contribution reduction only in special circumstances	N/A
Approval Procedure before MOFCOM	Yes	Yes	Yes	Yes	No	No
Intellectual Property	Controlled	Possibly at risk	Possibly at risk	Possibly at risk	Controlled in 100% foreign owned partnerships. Possibly at risk in Sino-foreign partnerships.	N/A

Appendix 2: Approval Procedure



Appendix 3: List Of Abbreviations

AIC	Administration for Industry and Commerce
AMB	Anti-Monopoly Bureau
AML	Chinese Anti-Monopoly Law
Catalogue	Catalogue of Industries for Guiding Foreign Investment
CIT	Corporate Incom 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