



# Break Through The Chinese Wall

- Legal and practical guidelines for  
establishing a company in China

# **Break Through the Chinese Wall**

**- Legal and practical guidelines  
for establishing a company in China**

May 2010

© Capital Associates, Beijing – China

© NCO China, Beijing – China

Cover design: lisbethfink.dk

## About the book

“Break Through the Chinese Wall” is an accessible handbook which provides an introduction to the fundamental rules, regulations and common practices related to establishing and running a business in China. The handbook provides answers to the most frequently asked questions from our clients.

The handbook has been jointly written by Capital Associates and NCO China. Capital Associates is a Chinese law firm specialised in providing commercial legal services and assistance to foreign companies investing in and trading with China. NCO China is a consulting firm that offers corporate services with regard to the establishment of an enterprise in China, Hong Kong etc., and provides accounting, tax and HR services to foreign investors in China. Both Capital Associates and NCO China serve a variety of clients; from large multinational companies to small and medium sized enterprises.

China’s rapid development means that regulations and practices are constantly changing. The handbook is meant to be an introduction to the current laws and practices in China. Updates and further information regarding the subjects covered by the handbook can be obtained from our offices or websites. Please refer to the contact information in the back of the book.

Birgitta Bundgaard, Lawyer

Jette Renneberg, Economist

### Disclaimer notice:

Please note that the content of this book is for general information only, and not legal advice. Capital Associates and NCO China take no responsibility for errors or inaccuracies in the information provided, either existing or due to changes in laws, regulations and administrative practices. Any liability that might arise from your or a third person’s use or reliance on the information in the book is expressly disclaimed by Capital Associates and NCO China.

# Contents

<b>Considerations before entering the Chinese market</b>	1
Introduction to China's economy	1
Characteristics of the Chinese market	2
Collect information and gain experience	3
Alone or with a Chinese partner?	4
Support from headquarters	4
Start out small and learn from your experiences	5
<b>Choosing the right location in China</b>	6
Geography	6
Development zones	6
Choosing the right location	7
Frequently Asked Questions	8
<b>Establishing an enterprise in China</b>	13
Different forms of FIEs	13
Business scope	14
Joint Venture	15
Differences between an Equity Joint Venture (EJV) and a Cooperative Joint Venture (CJV)	16
WFOE - Wholly Foreign Owned Enterprise	18
Procedure for establishing a WFOE	19
Minimum capital requirements for a WFOE	20
Foreign Invested Partnership (FIP)	22

Procedure for establishing a FIP	23
Representative Office (RO)	24
Procedure for establishing a RO	26
Establishment through Hong Kong	28
Frequently Asked Questions	28
<b>Employment in China</b>	32
Labour market reforms	32
Chinese labour law	32
Labour contracts	33
Termination of an employment relationship	35
Frequently Asked Questions	37
<b>Visa rules in China</b>	43
Standard procedures	44
Special procedures for foreign Representation Offices	48
Accompanying family members	49
Frequently Asked Questions	50
<b>Introduction to Chinese accounting rules</b>	53
Compulsory accounting requirements	54
Frequently Asked Questions	56
<b>Tax in China</b>	59
Types of taxes	59
Enterprise Income Tax	60

Value Added Tax (VAT)	60
Business Tax	61
Consumption Tax	61
Customs duties	62
Withholding Tax	62
Property Tax	63
Stamp Tax	63
Individual Income Tax	63
Preferential treatment	66
Ongoing changes in rules and regulations	66
Frequently Asked Questions	67
<b>Foreign currency restrictions in China</b>	69
The financial sector	69
Foreign currency certificate	70
Bank accounts and payments	70
Frequently Asked Questions	72
<b>Intellectual property rights in China</b>	74
International treaties and conventions	75
Copyright protection	75
Patent protection	76
Trademark protection	78
The Anti-Unfair Competition Law	79
Frequently Asked Questions	80

<b>The Chinese Anti-Monopoly Law</b>	85
Anticompetitive agreements and abuse of dominance	85
Merger control	86
Enforcement	88
<b>CEPA - Easier access to China through Hong Kong</b>	90
Benefits under CEPA for Hong Kong manufacturers	92
How to enjoy the benefits under CEPA	92
Benefits under CEPA for Hong Kong service providers	93
Qualifying as a Hong Kong service provider under CEPA	95
Increased co-operation in trade and investment	96
More information	97
<b>The legal system in China</b>	98
Legal instruments	99
State structure	99
National People's Congress	100
State Council	101
People's courts	102
People's procuratorates	104
Provincial and local government	105
Hong Kong and Macau – Special Administrative Regions	106
Frequently Asked Questions	107

<b>Chinese business customs and mentality</b>	111
How to negotiate in China	111
Business meals	113
Public behaviour and addressing	115
Small talk and conversations	116
<b>Useful links</b>	118
<b>Abbreviations</b>	122
<b>References</b>	124
<b>Contact information</b>	125
<b>Appendix 1</b>	
Overview of establishment procedures for WFOE or Joint Venture	
<b>Appendix 2</b>	
Overview of establishment procedures for Representative Office	



# **Considerations before entering the Chinese market**

China has exhibited stunning economic growth since it initiated its first economic reforms, and opened its market to the outside world over 30 years ago. In this period, China doubled its economy several times, exhibited high growth in international trade (China overtook Germany in 2010 as the largest exporting country in the world) and has been a main contributor to global economic growth. This year the Chinese economy has become the world's second-largest economy.

## **Introduction to China's economy**

Chinese reforms have focused on industrialization and market liberalization. In 1994, state owned enterprises represented 82% of value added wealth in the industrial sector. By 2005 this number had decreased to 41%. Similarly, the number of employees working in state owned enterprises declined from 80 to 40 millions during the same period. Due to these developments and China's gradual opening-up to foreign investment, the Chinese economy can now be categorized into three different sectors; the state-owned sector, the private sector and the foreign-owned sector.

State-owned enterprises dominate the primary sector (e.g. raw materials, steel, and petrochemical), the utilities sector (e.g. transportation, communication and electricity) and the banking sector. As state-owned enterprises have easy access to financing, they represent a large proportion of capital-intensive and heavy industries in China.

Private enterprises are mainly small companies doing business in the service, trading and light manufacturing industries. Since these companies do not have the same access to financing as state-owned

enterprises, the growth in the private sector is driven by higher employment.

Foreign owned enterprises were initially concentrated in high technology sectors that utilize cheap labor to re-export or sell goods to the Chinese market. China is a country abundant in labor but limited in raw materials. Because raw materials are imported globally and shipped to China for processing, China has earned the reputation of being the "factory" of the world.

Due to large surpluses in China's trade balance in recent years, China has lowered its demands for foreign financing. At the same time, the Chinese government has shifted its requirements with regard to foreign direct investment. The Chinese government now focuses on attracting foreign investments that can bring new technology and know-how to China so that China can become an independent producer of high technology products.

Priority is also given to foreign investments that protect the environment and lead to more efficient use of natural resources. Furthermore, greater foreign investment is encouraged in China's remote west and the northeast rust belt which currently lags behind the coastal regions with regard to the amount of foreign investment received.

### **Characteristics of the Chinese market**

China is a large country with much diversity within its borders. With a population exceeding 1.3 billion people, China is best described as a mixture of different cultures, ethnic minorities and languages. The level of economic development varies tremendously from East to West, as does the average per capita income from one province to another.

Despite the enormous opportunities in China, most foreign investors will agree that succeeding is easier said than done. The Chinese market and the mechanisms behind it are unlike the markets in most western countries. Foreign investors should not expect that transferring existing business solutions and strategies from their country to China will work out just like that. Instead, thorough preparations, hard work and persistence is required to achieve results in the Chinese market.

As you read the following chapters, you will understand that entering the Chinese market will often involve complications and various degrees of uncertainty and risk. Some difficulties can be avoided by being proactive and performing due diligence, while other issues must be dealt with when they occur. China is notorious for its inefficient bureaucracy and obscure rules and regulations. However, it is also well known for its many alternative ways to get around difficulties.

Business success in China will depend on how prepared you are when making an investment in China. In the following chapters we will provide some general advice which may prove useful to you when you enter the Chinese market.

### **Collect information and gain experience**

Collecting information is essential to making the right decisions:

- Use contacts in your existing business network to gather key information and first-hand knowledge and experience from China.
- Spend some time in China and visit different locations to make local contacts there. Information gathered from local sources such as foreign enterprises, embassies, government officials, local business life, etc. often provides a good basis for making

the right decisions on how and where to make your investment in China.

- Do not underestimate the value of your initial efforts to establish personal relationships in China. Personal relations are very important in Chinese business life, both in the short and long term perspective.

### **Alone or with a Chinese partner?**

Carefully consider the benefits from entering the Chinese market with a Chinese partner. The Chinese market is booming with private companies interested in expanding their business operations on the basis of foreign invested capital, advanced technologies and/or management expertise.

A partnership with a Chinese enterprise may give you a head-start in terms of overcoming start-up difficulties, working up necessary distribution networks, attaining vital market information and getting an early grip of the Chinese market.

On the other hand, a partnership may also jeopardise your investment, if you do not choose your Chinese partner carefully. See the chapter “Establishing an enterprise in China” for further information on when to choose a partnership with a Chinese partner.

### **Support from headquarters**

Many foreign investments in China fail due to lack of support from the board and management of the parent/home company.

Before starting out in China, make sure your home company is prepared and able to provide the support needed for the new Chinese enterprise to succeed. Select management and key employees

carefully, allow the management sufficient decision-making power, be prepared to take risks and accept losses, assess developments continuously, and be ready to make quick decisions.

### **Start out small and learn from your experiences**

To most foreign investors, China is still a new and untried market. Allowing your business in China to grow gradually is often the best way to avoid overspending and disappointment.

Start out with small and well-known projects; make an effort to find the right employees; establish or join a local business network; make sure local suppliers meet the quality standards you set out; be patient and learn about the Chinese way of doing things.

With a sound and efficient organization in place, you will have a good foundation for expanding your Chinese business operations.

## **Choosing the right location in China**

Unless the location of a Foreign Investment Entity (FIE) is known in advance, a foreign investor should carry out comparative analyses of potential locations for operation before deciding on the right place to set up a FIE.

In China, conditions vary considerably from one part of the country to another, including factors such as climate, infrastructure, local government support, availability of natural resources and energy, and educational level of the local workforce. The right place for one type of enterprise may not be the right place for another type.

### **Geography**

China has a landmass of 9,600,000 sq km, making it roughly the same size as continental United States. The country stretches from the tropical and subtropical zones in the south to the frigid zones in the north. Cultivated land, forests, grasslands, deserts and mountains cover most of the western part of the country, making the eastern part and the coastal zone the most accessible places for economic development and foreign investment.

### **Development zones**

Since China implemented the gradual opening-up policies in 1978, most major cities in Eastern China, including the surrounding rural areas, have been developed in order to attract foreign investments. With Beijing, Shanghai, Shenzhen and Guangzhou taking the lead, these places offer various advantages such as good infrastructure, modern business facilities, skilled employees, etc.

Economic development in China has been encouraged by the establishment of various development zones such as Economical Development Zones, Economical and Technological Development Zones, Hi-Tech Industrial Development Zones, Free Trade Zones and Export Processing Zones. The purpose of these zones is to attract foreign investments and to direct them to designated areas.

Development zones are relatively small pieces of land traditionally situated in many coastal cities and other open cities in the eastern and southeastern part of China. Taking advantage of the many preferential policies such as reduced taxes, exemption from customs duties and minimized administrative burdens, foreigners investing in manufacturing, export of goods, research & development, etc., often choose to set up their businesses in development zones.

Since 2000, the Chinese government has stepped up efforts to spread economic growth by including cities and regions in the central and western parts of China to the list of development zones. The government has also encouraged foreign investments in key-sectors such as resource development, conversion of arable land back into forests and grassland, processing of plant and animal products, development of local industry and liberalization of social services.

You can learn more about China's development zones by visiting the official website: [www.fdi.gov.cn](http://www.fdi.gov.cn)

### **Choosing the right location**

The below methods may be helpful in choosing the right location in China:

- Define your set selection requirements e.g. utility and transportation needs, access to raw materials and skilled workforce, etc.

- Select locations that are suitable for your needs and visit them. Build up personal networks and gather information from these local areas.
- Find out if you can take advantage of preferential policies in development zones.
- Evaluate options and preferential policies offered by local governments.
- Find out whether you can enjoy local tax incentives.

## **Frequently Asked Questions**

### *1. Is Shanghai or Beijing preferred for setting up a Representative Office (RO)?*

Beijing and Shanghai are often chosen as locations for Representative Offices because of their status and role in China's economic development. These cities have developed significantly in recent years and both offer excellent business facilities and living conditions for foreigners.

Beijing:

As the nation's capital, Beijing is home to central government offices and agencies responsible for obtaining business approvals and licenses. In Beijing, you can also find foreign embassies and other political and non-political representations.

Generally speaking, government plays an important role in China and has greater influence on business than in western countries. It is important for foreign companies to understand and follow state policies as well as liaise with relevant government authorities and agencies, especially for industries where the

government plays an influential role, such as the wind energy industry. As a result, most medium and large sized companies have a government relations department. Being in close proximity to government authorities and agencies is often the main reason why many foreign investment companies choose to set up their headquarters in Beijing.

Shanghai:

Shanghai is the financial centre and China's most modern city. With world-class infrastructure, Shanghai is easily reached from all over the world. Most foreign governments have representations in the form of consulates in Shanghai. Local government agencies in Shanghai have the reputation of being more efficient and service-minded than in Beijing. Shanghai authorities are also said to provide better treatment to large foreign companies by offering them tax incentives and other advantages.

However, the costs of setting up a business in Beijing or Shanghai are among the highest in China. It may, therefore, be more ideal for small and medium sized enterprises to establish production facilities in areas near Shanghai, Beijing or Guangzhou, where costs are lower, but they still have access to a reasonable investment environment and qualified employees.

The choice of location is important, and in some cases, may determine the success or failure of the foreign investment.

## 2. *Is it possible to purchase land in China?*

Despite economic and political reforms in China, the Chinese government has not yet given up the established socialist idea of state ownership of land. In China, individuals or private legal persons cannot own land; land is either collectively owned (rural areas) or state-owned (urban areas).

If you need a site for your production facilities in China, you will have to apply to the local authorities to acquire the necessary land-use rights. Always make sure that the conditions under which you are granted land-use rights meet your specific requirements in terms of period of usage, scope of application, renewal conditions, etc.

When acquiring land-use rights you need to distinguish between allocated land-use rights and granted land-use rights.

Allocated land-use rights are often allocated from the Chinese government for specific investment projects free of charge. Usually, the right is not transferable, and the land cannot be leased or mortgaged. The holder of an allocated land-use right is required to pay a land-use tax on an annual basis.

Granted land-use rights can be acquired by paying a land-grant fee to the Chinese government. The fee varies significantly depending on the market value and location. Within the fixed term of the land-use right, the holder has the right of use similar to that of an owner. The land is transferable and it can be leased and mortgaged.

3. *As regards setting up production facilities in China, what are the main differences between urban and coastal areas as opposed to rural areas?*

Pros urban and coastal areas:

- Large amount of skilled and educated employees.
- Easy to find suppliers, spare parts, service providers, etc.
- Good infrastructure and logistics with an easy access to airports and harbours.

- Less administration and paper work with local governments, as they are experienced in handling foreign investments.
- Living conditions are comfortable for expatriates.

Cons urban and coastal areas:

- Business and living costs are considerably higher compared to more remote places in China.
- Lack of electricity can be a problem in certain areas because of excessive demand.
- Staff retention may be difficult due to many job opportunities.
- Difficult to negotiate special terms for business start up.

Pros rural areas:

- Possible to negotiate good terms and conditions for the business start up as foreign investments are rare and highly welcomed.
- Business and living costs are lower.
- Good access to raw materials.
- Fewer problems with electricity supply.
- Easy to make a difference in the local community.

Cons rural areas:

- Lack of skilled and educated employees.
- More paper work and time spent with local governments must be expected.
- Infrastructure and logistics may be underdeveloped.
- Little experience with foreigners' requirements and needs.
- Very difficult for expatriates to accept the living conditions.

4. *Where are Chinese free trade zones located?*

Like free trade zones in other parts of the world, Chinese free trade zones are specialized areas for international trade and bonded operations in which international trade, bonded warehouses and processing for re-export are allowed.

China has around 15 free trade zones situated in the coastal regions from Dalian in the north to Zhuhai and Haikou in the south.

5. *Where are Chinese export processing zones located?*

Like export processing zones in other parts of the world, Chinese export processing zones are special enclosed areas supervised by customs and reserved for export-oriented enterprises. The zones are operated under a separate legal regime granting exemptions from customs import and export duties and value-added tax.

China has around 58 export processing zones in operation mainly situated along the coast from Huichun in the north to Shenzhen in the south. Chengdu and Wuhan in the Sichuan and Hubei Provinces are inland export processing zones.

## **Establishing an enterprise in China**

Compared to the situation some years ago, it is now much easier to establish a Foreign Investment Entity (FIE) in China. The Chinese government has set up a comprehensive legal framework and adopted many policies that have paved the road to increase foreign investment.

Although the changes have been for the better, many foreign investors still consider the Chinese approval process to be both bureaucratic and frustrating. The Chinese government tends to closely regulate every aspect of commercial life and the approval of a foreign investment is subject to comprehensive examinations by various government agencies.

The establishment of a FIE usually requires approval from governmental authorities in charge of foreign trade and economic cooperation. The submission of an application to the local municipal administration for industry and commerce for obtaining a business license is also required. Depending on the type of investment project, additional approvals may be needed. Once a FIE has been approved by the Chinese authorities, and the business license has been issued, the FIE can commence its business activities.

After the business license has been issued, the FIE is required to carry out a number of post-registration procedures e.g. application to the local tax bureau and the administration for foreign exchange.

### **Different forms of FIEs**

There are various ways to set up a foreign invested enterprise, however the most common form is either a Sino-foreign Joint Venture (Joint Venture) or a Wholly Foreign Owned Enterprise (WFOE). Joint

Ventures can be established in two different ways: either as an Equity Joint Venture (EJV) or as a Cooperative Joint Venture (CJV).

Beginning 1 March, 2010, foreign investors have been given a third option to invest in China: the establishment of a Foreign Invested Partnership (FIP). This new option offers great flexibility with regard to form and structure and enjoys favourable Chinese tax treatment.

Other forms of investments exist in China, e.g. joint exploitation enterprises and foreign-funded share-holding companies. Due to the limited scope of this book, these kinds of investments will not be further addressed.

To complete the terminology, the Representative Office (RO) should also be mentioned. For many foreign investors, the initial entry into the Chinese market has been in the form of a RO. However, a RO in China can only be used for representation purposes. It is unable to carry out direct business operations like Joint Ventures or WFOEs.

Before we discuss the characteristics, advantages and disadvantages, and the application process for the most common enterprise structures, the business scope should be briefly introduced.

## **Business scope**

An important element when applying for a business license is to define the business scope of the enterprise very precisely. Many applications are rejected because the definition of the business scope is either too broad or too vague.

Furthermore, the business scope must comply with current regulations governing foreign invested enterprises. The business scope must also relate to the industry sector or the business characteristics in the enterprise's name. Finally, the business scope

must be identical with the business area that is mentioned in the enterprise's Articles of Association or partnership agreement.

The business scope must be registered with the enterprise registration authority pursuant to an application made by the investor or the enterprise. In certain cases, depending on the nature and content of the business scope, prior consent from the authorities must be obtained before the enterprise can apply for registration of its business scope.

Once the business scope has been approved and registered, the FIE should carry out business carefully in order not to exceed the approved business scope. If a FIE intends to carry out business in a different area or in another way expand or change its field of business, prior approval from the registration authority is necessary. If the FIE engages in business outside its approved business scope, there is a risk that the competent authorities will stop the business activities that are not covered by the business scope, confiscate the income from those activities, and, if the situation is considered to be serious, dissolve the FIE.

## **Joint Venture**

When China launched its "Open Door Policy" more than 30 years ago, foreign investments were limited to Joint Ventures with at least one Chinese partner. According to the corporate law at that time, Chinese business entities were closely supervised by authorities, and this applied similarly to Sino-foreign invested Joint Ventures.

Though foreign investors can now operate more freely in the Chinese market, the Chinese government still prefers Joint Ventures to WFOEs. In certain industries, investments in form of Joint Ventures are the only option, e.g. investment in the extraction of natural resources.

A foreign investor may prefer a Joint Venture to a WFOE for the following reasons:

- The industry is restricted to Joint Ventures leaving the foreign investor with no other choice.
- The investment requires special approvals from Chinese authorities. A Chinese partner may be more familiar with dealing with the Chinese authorities and bureaucracy, and may have some personal connections.
- A Chinese partner is necessary if the foreign investor wants to take advantage of existing business contracts, product markets, distribution networks, business connections, etc.
- If the Chinese partner is a state-owned enterprise, the Joint Venture may be favoured by governmental assistance in supply of raw materials and allocation of import and export quotas.
- To reduce the business risk of the foreign investor.

### **Differences between an Equity Joint Venture (EJV) and a Cooperative Joint Venture (CJV)**

The basic structure of an EJV and a CJV is very similar. All parties share profits and losses and jointly partake in managing the venture. The Chinese government's expectations to the business scope of an EJV and a CJV are also the same.

However, an EJV and a CJV are subject to different laws and regulations which give them the following main characteristics:

- The CJV is more flexible. The parties can decide on most matters concerning the CJV in the contract setting up the venture, whereas an EJV must comply with more statutory requirements.
- The CJV is also more flexible in terms of the form of capital contributions.
- Unlike the EJV, the distribution of profit in a CJV does not need to be in strictly proportion to the investment contribution of each party.
- In a CJV, foreign investors can withdraw profits from investments ahead of Chinese partners. In return, the ownership of all fixed assets of the CJV shall be reverted to the Chinese partners. In an EJV, all assets belong to the parties in proportion to their subscribed capital contributions.
- Unlike the EJV, a CJV does not need to be registered as a legal person, i.e. a CJV can be organised as a partnership without limited liability.

Some Joint Ventures in China may differ from common EJVs and CJVs in structure and name. For instance, there are special requirements for investments in industries such as extraction of natural resources, energy production, and infrastructure. Although the company form may be different, the basic principles of EJVs and CJVs remain intact.

The application procedure for a Joint Venture partnership between a Chinese and a foreign investor can be complicated, as approvals from several government authorities are required. We therefore highly recommend that you contact a Chinese lawyer before initiating the application procedure.

## **WFOE - Wholly Foreign Owned Enterprise**

Under Chinese law, a WFOE is a legal entity with limited liability. The paid in capital is provided by one or more foreign investors.

Different types of WFOEs exist depending on the area of business. For example, a WFOE engaged in trade, wholesale, retail or franchise is called a trading WFOE or a FICE (Foreign Invested Commercial Enterprise).

Common reasons for establishing a WFOE rather than a Joint Venture are:

- The foreign investor does not want to share its technology, know how and sensitive business information with third parties.
- To avoid the risk of serious disagreement with a Chinese partner. Chinese companies have a management culture that is very different from the one seen in most western enterprises.
- To get the full return on investment.
- A WFOE is subject to less control from the Chinese authorities than a Joint Venture, as no Chinese party is involved.

Nowadays, most foreign investors prefer to establish a WFOE in order to maintain full control of their investment. This trend has become prevalent after the application process for establishing a WFOE has been made easier.

The application procedure is relative simple if the WFOE is engaged in trade (export, import) and consultancy. If the business area is banking, insurance, education or transportation, the application procedure is more complicated, and it is more difficult to obtain a business license.

## **Procedure for establishing a WFOE**

The documents to be submitted to the Chinese authorities when setting up a WFOE depend to a large extent on the area of business and the requirements of the local authorities in the province where the WFOE is to be established. In general, the following documents are required when applying for a business license:

- Application forms signed by the proposed legal representative for the new enterprise.
- An overview and description of the services or products to be imported /exported.
- A Feasibility Study Report, which describes the plans and goals for the enterprise.
- Manufacturing enterprises must submit an Environmental Appraisal Report that describes the expected environmental impact of the project. This report has recently become very important with greater emphasis on the description of the environmental impact of the project.
- Incorporation Certificate of the parent company.
- A list with the names of the new enterprise's board members, directors and owners, including their CVs, copies of their passports and documentation supporting their appointment.
- If the WFOE is established by two or more foreign investors, the Shareholders' Agreement between the foreign owners of the WFOE must be submitted.
- Articles of Association of the new enterprise.
- A credit reference letter issued by the foreign investor's bank.
- Access to business premises must be documented by either a rental or purchase contract.
- An approval letter from the district government in the district, where the WFOE will be established and registered.

All documents must be translated into Chinese and signed by the persons authorised to sign on behalf of the parent company.

When all required documents are submitted to the Chinese authorities, the authorities have 90 days to process the application. However, the processing time is often faster.

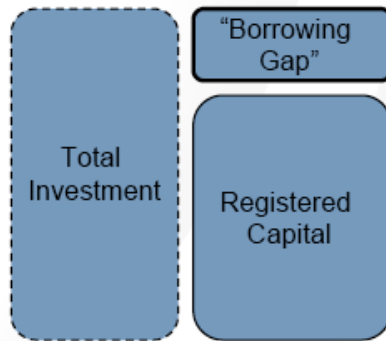
After the business license is issued, the newly established enterprise must strictly adhere to the subsequent deadlines of the post registration procedure. If these individual deadlines are not met, the enterprise may be required to complete the procedures all over again. For example the enterprise must within 30 days register with the State Administration for Industry and Commerce (SAIC). Hereafter, the enterprise must register with the tax authorities and foreign currency administration (SAFE). Finally, the enterprise must obtain approval to handle foreign exchange and open a bank account to pay in the enterprise's invested capital.

Please refer to attachment 1 for an overview of the procedure for establishing a WFOE.

### **Minimum capital requirements for a WFOE**

As it is important to have a well-documented business scope, it is equally important to properly identify the required registered capital for the investment.

Like most countries, China sets minimum capital requirements for establishing an enterprise. The total investment in a foreign owned enterprise consists of the Registered Capital and a "Borrowing Gap". Both are initially deposited in a capital bank account. The loan is granted either by the parent company or a bank.



The following minimum requirements apply to the registered capital:

Total Investment (TI) (USD)	Registered Capital
≅ 3 mil	≅ 70% of TI
> 3 mil ≅ 4,2 mil	≅ 2,1 mil
> 4,2 mil ≅ 10 mil	≅ 50% of TI
> 10 mil ≅ 12,5 mil	≅ 5 mil
> 12,5 mil ≅ 30 mil	≅ 40% of TI
> 30 mil ≅ 36 mil	≅ 12 mil
> 36 mil	≅ 33.3% of TI

The initial deposit must be in an amount equal to at least 15% of the total registered capital. This amount must be deposited within 90 days after the business license is issued. The remaining 85% can be paid in several rates, but must be paid in full within 2 years after the business license is issued.

Minimum capital requirements are imposed to ensure that newly established WFOEs possess sufficient capital for the establishment and implementation of the business plan indicated in the business license. The Chinese authorities may in certain cases impose capital requirements above the minimum thresholds if the authorities believe that the minimums requirements are not sufficient to cover the cost of implementing the business plan.

A WFOE should have a well-documented budget for its current and future plans, since it can be administratively burdensome to increase the registered capital amount. The procedure to increase the registered capital takes at least 3 months to complete, and it is both costly and time consuming.

### **Foreign Invested Partnership (FIP)**

Beginning 1 March, 2010, foreign investors were provided another vehicle to enter the Chinese market: the Foreign Invested Partnership (FIP).

According to the Chinese government, the purpose of introducing this new vehicle is to attract foreign investment in and thereby promote the development of a modern service industry and other industries, especially those related to advanced technologies and management.

A FIP may consist of two or more foreign investors, or foreign investors together with Chinese individuals, legal persons or other entities. Foreign investors can also join an existing domestic partnership by making new contributions or acquiring partnership interest.

A FIP can be in the form of either a general partnership or a limited partnership. A general partnership is formed by general partners who bear unlimited joint and several liability for the debts of the partnership. A limited partnership is formed by a combination of general partners and limited partners where the limited partners bear liability for the partnership's debts to the extent of their capital contributions.

Compared to setting up a Joint Venture or a WFOE, establishing or investing in a FIP is a very flexible way to invest in China.

Partners may make capital contributions to FIPs in foreign currencies or RMBs legally obtained in China. Though the measures governing the FIP do not address the subject clearly, it is expected that non-cash contribution; i.e., goods, land-use rights, intellectual property rights or other property rights permissible for domestic partnerships will also be recognized as valid capital contributions to a FIP.

There are no minimum requirements to contribution of partnership capital or a contribution deadline which means that the partners can freely agree on capital contribution in the partnership agreement.

The FIP differs from Joint Ventures and WFOEs in another very important way: In general, a FIP may be established without the approval of the Chinese Ministry of Commerce (MOFCOM) or its local counterparts. A FIP can be registered with SAIC directly. MOFCOM or its local counterparts need only be informed of the registration.

Finally, being exempt from income tax at the enterprise level, FIPs enjoy favourable Chinese tax treatment,

### **Procedure for establishing a FIP**

The following documents must be submitted to the Enterprise Registration Authority when registering a FIP:

- Application form authorised by all partners
- Partnership agreement executed by all partners
- Incorporation certificates or, for individuals, identity cards (passports) of all partners
- Certificate stating primary business domicile
- Power of attorney executed by all partners for appointing a representative or proxy
- A confirmation letter signed by all partners on the committed or paid-in capital contributions by each partner

- A statement executed by all partners concerning the compliance with industry policies for foreign investment This is an unusual requirement, peculiar to FIPs, and is intended to make up for the fact that the bureau of commerce will not have reviewed the application
- Credit reference letter issued by the financial institution which has a business relationship with the foreign partner
- Agent appointment letter executed by each foreign partner
- Approval letter, if the business of a FIP is subject to prior approvals or its business scope involves a business that requires approvals

Since this method of investment has only been available for a few months, so far only one FIP has been registered with the Chinese authorities. It is therefore not yet possible to provide an estimate of how long it takes to set up a FIP.

### **Representative Office (RO)**

Since the 1980's, opening a Representative Office has been a quick and practical way to enter the Chinese market. Therefore, many foreign investors have used the RO as the first step into the Chinese market.

To crack down on fraudulent applications and abuse of ROs, the Chinese authorities have recently imposed stricter requirements with respect to the granting of registration certificates and approvals of amendments to ROs of foreign enterprises. The authorities have restricted the number of representatives (expatriates), who are allowed to hold work visas, to four per RO. Furthermore, the supervision of RO business activities and annual reporting requirements to authorities have been tightened. Offenders will also receive harsher sanctions.

A RO is subject to significant restrictions regarding its business activities. A RO is not allowed to engage in business activities directly connected with, for instance, sales, marketing or production. Such activities can only be carried out by a FIE, e.g. a Joint Venture, FIP or WFOE. Indirect business activities such as product information, liaison services, market surveys and research are within the legal scope of the RO.

Pros RO:

- No minimum capital requirement.
- Can be quickly established (usually within 1-2 months).
- ROs give foreign investors and their family resident permit in China.

Cons RO:

- A RO is not allowed to generate any kind of income.
- A RO cannot issue invoices.
- A RO cannot sign business contracts.
- A RO may not hire local employees directly. Hiring must take place through an authorized state-owned HR company.
- Only a maximum of 4 representatives are allowed, including the Chief Representative.
- Only offshore companies, which have existed for no less than two years, can establish a RO. For offshore companies established in Hong Kong, Macau or Taiwan the “two years requirement” is not applicable.
- The offshore company behind the RO is always fully responsible for the RO, and liable for all the RO’s activities in China.
- The RO is subject to a tax of 10.94 % on its costs; i.e. tax must be paid on salary, rental, travel expenses, telephone bills etc. related to the RO.

## **Procedure for establishing a RO**

The business scope of a RO must be clearly defined.

A number of documents must accompany the application for a Registration Certificate. The required documentation can vary from province to province, but in general, the following documents must be submitted:

- Letter of application to the authorities in charge of approval.
- The offshore company's incorporation certificate, indicating that the offshore company has existed for no less than two years.
- A list with the names of the board members, directors, owners, including CVs, copies of their passports and documentation that verify their appointments.
- Articles of Association of the offshore company.
- A capital credit certificate issued by a financial institution that has a business relationship with the offshore company.
- Access to business premises in China must be documented by either a rental or purchase contract.
- Application forms signed by the persons authorized to sign on behalf of the offshore company.

All documents must be translated to Chinese and signed by the designated chief representative of the parent company. The parent company's incorporation certificate and the credit reference letter issued by the foreign investor's bank must be notarized and approved by the Chinese embassy or consulate in the parent company's home country.

A RO must apply for registration with the Chinese tax authorities within 30 days after the registration certificate is issued.

Within 3 months of the RO's establishment, the relevant authorities will inspect the RO to verify the RO's existence. At the same time, the

authorities also check the RO's registration certificate, stamps, tax registration certificate, etc.

The registration certificate for a RO is only valid for one year. A declaration from the authorities in the country where the offshore company is registered, indicating that the offshore company still exists, must be submitted when renewing the registration certificate of the RO. The registration certificate may be renewed an unlimited number of times if the requirements are satisfied.

As a consequence of the Chinese authorities' stricter focus on enforcement of the regulations governing ROs, including payment of taxes and the business activities permitted to be carried out by a RO, many foreign investors now prefer to establish a FIE when they enter China rather than setting up a RO.

Another reason is that it is difficult to change a RO to a FIE. The RO and the new FIE cannot legally be registered at the same address. Consequently, the RO must be closed down before a new FIE (WFOE, Joint Venture or FIP) can be established and the address can be used for the new FIE.

It takes approximately 6-8 months to close down a RO. During this period, relevant documentation, e.g. tax and audit reports for the whole period of the existence of the RO must be collected and submitted to the relevant authority. Also an individual income tax check of the chief representative, for at least the last 3 years, is required. The parent company behind the RO will be liable for any discrepancies or missing documents.

See attachment 2 for an overview of the procedure for establishing a RO.

## **Establishment through Hong Kong**

Most foreign investors, who establish an enterprise in China, have direct ownership of the Chinese enterprise. Under certain circumstances, it may, however, be an advantage to establish a foreign holding company in order to lower the tax and administrative burden.

Organizational changes or changes in the ownership of a Chinese affiliate can be made more easily through a Hong Kong holding company due to the more lenient Hong Kong regulations.

In addition, the tax agreement between China and Hong Kong can be advantageous. If a company registered in Hong Kong owns at least 25% of the enterprise established in China, the Chinese enterprise will only pay 5% withholding tax. In comparison, a Chinese enterprise not owned by a Hong Kong holding company is subject to 10% withholding tax.

It is relatively easy, inexpensive and fast (10 working days) to establish a Hong Kong holding company. It is, however, important to note that a Hong Kong holding company cannot legally be set up for tax purposes alone.

## **Frequently Asked Questions**

- 1. Is it possible to sell foreign produced commodities in the Chinese market?*

Yes, it is possible.

When China concluded its negotiations with the World Trade Organization (WTO) in 2001, one of the main commitments undertaken by China was to open up the domestic market for unlimited import and trade of foreign produced commodities in all major product categories. This commitment took effect from

the second half of 2005 making it possible to sell most foreign produced commodities on the Chinese market. In order to do business in China, however, you still need to set up and operate from a Joint Venture, WFOE or FIP.

2. *Is it possible to have more than one RO in China?*

It is possible to open several ROs, but most foreign enterprises choose to set up only one RO in either Beijing or Shanghai, where staff can oversee their China operations. If more than one RO is set up, each RO must be registered individually in the city where it is located.

3. *Do I need to carry out business activities continually in order to uphold my business license?*

According to Chinese law, a FIE must have ongoing business activities once the business license has been granted. Otherwise, the business license may be withdrawn.

4. *Can I set up a FIE with the purpose of offering various (consulting) services in the Chinese market?*

With reference to the general remarks on the business scope issue, the Chinese approval agencies will refuse to approve a FIE if the business scope set out in the application documents is too abstract.

In order to get your business approved, you will need to narrow down and specify the (consulting) services you are planning to provide. If the (consulting) services are of different natures, you may need to establish separate FIEs.

It is worth mentioning that foreign service providers are still facing many restrictions in the Chinese market, although China is now liberalising gradually under its WTO-commitments.

5. *What are the requirements to the name of a WFOE?*

The name of a WFOE shall be composed of four parts: the place of registration, the name of the company, the line of business it is engaged in and the organization form. For example, a Beijing-registered WFOE providing consulting services should be named in the following way:

Beijing [business name] Consulting Co. Ltd.

or

[business name] Consulting (Beijing) Co. Ltd.

If a WFOE wants to use “China” instead of the place of registration (i.e. Beijing) or no location at all, it must fulfil certain additional requirements. First, it is a condition that the name of the parent company of the WFOE is included in the name. Second, it must have a minimum registered capital of RMB 50,000,000.

6. *Is it possible to change the name of the enterprise after it has been registered?*

Yes, but approval from the competent authority is required, and the application procedure is costly and time consuming (about 3 months).

7. *Is it possible to change the owner, director, or board members of an enterprise that has already been established?*

Yes, but approval from the competent authority is required, and the application procedure is costly and time consuming (about 3 months).

8. *Is it true that all official documents must be signed with a black pen?*

Yes, documents and contracts are annulled if this requirement is not met.

9. *Must all documents submitted to the Chinese authorities be made out in Chinese?*

Generally speaking, all documents must either be written or translated into Chinese. In case of discrepancies between the Chinese document and the document written in English or another foreign language, the Chinese document takes prevalence – even if the foreign language document is the original document. It is strongly advised to seek professional assistance with collecting and filling out forms.

# **Employment in China**

The Chinese labour market offers many advantages to foreign employers. Despite rapid economic development and societal change, China is still categorized as a developing country with high unemployment, weak protection of workers' rights (despite recent efforts to strengthen such protection through promulgation of new laws), and an inadequate social security system. Educated and highly skilled workers are often in surplus, which makes it easy for FIEs to attract qualified staff at competitive costs.

## **Labour market reforms**

The Chinese labour market has changed tremendously within the past few decades. In the past, when state-owned enterprises and a rigid employment system prevailed, most Chinese workers were provided secure jobs for life, often by taking over jobs from older family member in the employment unit. Wages were fixed and meagre, and the possibilities of changing workplace were limited.

Today, the Chinese government has relaxed restrictions and encourages people to conduct their own businesses, create their own jobs, or find new jobs in the private sector. Many Chinese have responded to these changes and compete with each other, pursuing well-paid jobs in the private labour market, hoping to improve their living conditions and future prospects.

## **Chinese labour law**

Employment and labour issues in relation to FIEs are mainly covered by two important laws: the Labour Law and the Labour Contract Law.

Many details are, however, left for regulation on local government level.

The Labour Law contains provisions on various issues such as:

- Individual and collective contracts
- Working hours, overtime, rest and vacation
- Minimum wages
- Occupational safety and health
- Special protection for female and juvenile workers
- Vocational training
- Labour disputes
- Legal responsibility

In recent years, the Chinese authorities have taken steps to enhance the protection of workers' rights and increase the employment rate. One of these steps is the Labour Contract Law, which came into effect on 1 January, 2008. The Labour Contract Law regulates most relevant aspects concerning the signing and termination of labour contracts. Compared to earlier regulations it imposes more burdens on the employer.

In supplement to the two laws, the Chinese Government has issued several other regulations and decrees in order to deal with employment and labour issues specifically within FIEs.

### **Labour contracts**

The work relations between a FIE and its local employees is usually governed by individual labour contracts. A labour contract must comply with the Labour Contract Law.

The Labour Contract Law prescribes that an employer must enter into a written labour contract with an employee within one month from the date of employment. If the employer fails to do so, the employee

is entitled to double his/her monthly salary for each month, until the contract is signed. If a de-facto employment relationship exists for a year or more, the employee is entitled to an indefinite (open-ended) labour contract. For that reason, and because the law also makes it difficult to terminate a labour contract, the employer should ensure that de-facto employment does not occur.

As regards the content of the labour contract, the Labour Contract Law states that the labour contract shall include a job-description and the term of employment, as well as provisions governing working hours, rest and leave, labour protection, work conditions, remuneration and social insurance. The employer and employee may also agree to include a probation period in the labour contract. The length of the probation period depends on the term of employment, but is usually 1-2 months.

The labour contract can be a fixed-term contract, an open-ended contract, or a contract for the duration of a certain task. Since the new Labour Contract Law made it more difficult for the employer to terminate a labour contract and to revise labour contracts and human resource policies, most employers prefer to sign fixed-term labour contracts when possible.

As an employer you must be aware that you can only sign a fixed-term labour contract twice in succession with the same employee. The third time the employment relationship is renewed, you must sign an open-ended employment contract with the employee, unless the employee requests the conclusion of a fixed-term employment contract.

The Labour Contract Law also requires mandatory consultations with employees on company rules and policies that affect them, such as working hours and benefits. If a company fails to consult staff on these matters, courts and tribunals may not recognize the rules and policies, thus becoming non-binding on the employees.

In certain cases, a labour union set up by the employees within the FIE may negotiate and enter into collective labour contracts with the FIE on behalf of its members. Such collective labour contracts, which usually cover matters such as remuneration, working hours, rest, leave, work safety and health, insurance benefits etc., must be submitted to the labour administrative department or local public labour bureau for registration and approval.

Collective contracts in the form of an industry-wide collective contract or area-wide collective contract may be concluded between labour unions and enterprise representatives in certain industries. Such collective contracts are binding on the employer and the employees in the industry or region concerned.

### **Termination of an employment relationship**

Prior to the labour contract's ending date, an employer can only terminate an employment relationship under the circumstances listed below.

According to the Labour Contract Law, an employer may (after soliciting the opinion of the trade union) terminate a labour contract immediately in the following situations:

- If during the probation period, the employee is shown not to satisfy the conditions of employment.
- If the employee seriously violates the rules and regulations of the employer.
- If the employee commits a serious dereliction of duty, practices graft, or engages in embezzlement, causing material damage to the employer.
- If the employee simultaneously has an employment relationship with another employer seriously affecting the completion of his/her work tasks with the employer, or refuses to rectify the matter.

- If the employee has his/her criminal liability pursued in accordance with the law.

In the following situations, an employer may (after soliciting the opinion of the trade union) terminate a labour contract with 30 days' prior written notice:

- If the employee is unable to take up work after the completion of medical treatment for illness or injury not suffered from work.
- If the employee is unqualified for his/her work and remains unqualified even after having received training or an adjustment to another position.
- If the original labour contract can no longer be carried out because of changes in the objective conditions and the parties cannot come to a new agreement.
- If the enterprise runs into financial problems or difficulties in production and management, and a reduction of personnel of at least 20 people or 10% of the workforce is necessary.

In these situations the employer can choose to pay the employee one month's wage instead of giving notice. The employer is furthermore required to pay economic compensation to the employee in an amount equivalent to one month's salary for every year of employment. The economic compensation can, however, not exceed 12 months' salary.

It is important to note that a labour contract can only be terminated during the probation period, if the employee does not satisfy the conditions of employment.

If the employer terminates a labour contract due to reasons other than those stipulated in the law, the employer must pay compensation to the employee in an amount equivalent to 2 months' pay for each full year of service.

The local trade union must be notified, if the employer unilaterally

terminates a labour contract.

An employee, who wants to terminate the labour contract, must notify the employer in writing at least 30 days in advance. If termination occurs during the probation period, the required notice is only 3 days.

The employer must keep labour contracts that have been terminated or have ended for at least two years for reference purposes.

When hiring employees in China, it is necessary to have a detailed knowledge of the law to avoid unnecessary pitfalls. We recommend that you seek competent legal advice before you start hiring Chinese employees, and again later should you need to dismiss one or more employees.

## **Frequently Asked Questions**

*1. Is it possible to recruit local Chinese employees freely and directly?*

Under normal conditions a WFOE, a Joint Venture and a FIP will face no restrictions in recruiting local Chinese employees directly.

In general, FIEs have greater flexibility to recruit in more developed, rather than less developed areas of China. In the eastern and coastal parts of China, employees have the freedom to choose their jobs and employers, whereas foreign investors may face more constraints in recruiting local workers from inland cities.

ROs in China are on the other hand not allowed to hire employees directly. Instead, employees must be recruited through one of China's national employment agencies, e.g. FESCO. If the FIE already has a candidate in mind that is not

registered with an agency, it is usually possible to arrange a post-registration with one of the agencies. From 2010 the number of representatives in a RO has been limited to four.

2. *What are the costs incurred by FIEs when hiring local workers?*

Besides the basic wage, which shall not be lower than the local minimum standard wage, a FIE is required to make contributions to various social and welfare schemes. The contributions combined may amount to 40% on top of the basic wage.

The social and welfare insurances provide coverage to employees in case of old-age, unemployment, illness, pregnancy and other events. Individual housing funds are also a part of social and welfare contributions.

Most regulations governing the details of social insurance, rates, calculating methods and contributions are issued by local governments. Since the social insurance system is still undergoing reforms, and economic conditions are not consistent across China, the categories of social insurance, their rates, and the benefits, the employees may enjoy, vary substantially from one city or province to another.

3. *What is the level of income tax for Chinese employees?*

According to the Chinese Individual Income Tax Law, income is taxed according to the ranges and rates outlined below. Of the income, the first RMB 2,000 earned is tax deductible for Chinese employees, and the first RMB 4,800 earned is tax deductible for foreign employees.

<b>Monthly taxable income &gt; RMB 2000</b>	<b>Tax %</b>
≦ 500	5
> 500 ≦ 2,000	10
> 2,000 ≦ 5,000	15
> 5,000 ≦ 20,000	20
> 20,000 ≦ 40,000	25
> 40,000 ≦ 60,000	30
> 60,000 ≦ 80,000	35
> 80,000 ≦ 100,000	40
> 100,000	45

The income tax levels may vary from one region to another, as the local tax agencies do not always administer the tax laws uniformly.

4. *Do trade unions play a significant role in China?*

According to the Chinese Trade Union Law, a FIE must support workers to organise trade unions and provide the environment to hold trade union activities. The FIE is also under an obligation to contribute financially to the trade union and to consult the trade union on matters such as wages, welfare, work safety, labour protection and labour insurance.

In addition, the Labour Contract Law sets up a tripartite employment relationship coordination mechanism between the local labour administrative department, the trade union and the representatives of the employer to jointly consider and resolve major issues relating to the employment relationships.

According to the Labour Contract Law, the trade union shall assist and guide workers in concluding and performing employment contracts with the employer in accordance with the

law, and establish a collective bargaining mechanism with the employer, so as to safeguard the lawful rights and interests of the workers.

The influence of trade unions in China may seem rather extensive. However, in practice Chinese trade unions have very little bargaining power compared to workers' organizations in most western countries. In fact, Chinese and most western trade unions have little in common for the following reasons:

- The staff of the FIE are not free to form an independent and autonomous trade union. All unions formed must be within the limits imposed by the government controlled All-China Federation of Trade Unions.
- The trade union is partly financed by the employer, endowing the employer with unique influence on the management of the union.
- Collective agreements are to be agreed on by negotiations and consultations. The parties are not allowed to use means of exerting pressure such as strikes and lockouts.

It is therefore probably more accurate to view Chinese trade unions as service organizations providing workers with help on different work related issues, organising workers' training programs, and assisting workers in case of infringement of their legal rights.

##### 5. *What are the standard working hours in China?*

According to the Labour Law, employees shall work no more than eight hours a day or 40 hours a week on average. Usually this is referred to as a 40-hour working week. Due to requirements of the production or business, the employer can, however, extend working hours by providing overtime pay.

6. *How much leave do Chinese employees enjoy?*

China has 11 statutory holidays:

- New Year's Day (1 January)
- Spring Festival (Chinese New Year): 3 days (January /February)
- Qing Ming Festival: 1 day (usually in April)
- International Labour Day: 1 day (in May)
- Dragon Boat Festival: 1 day (usually in May)
- Mid-autumn Festival: 1 day (usually in September)
- National October Holiday: 3 days (in October)

Every year the Chinese government issues a regulation stating the dates of statutory holidays for the specific year. If a statutory holiday occurs during a weekend, it is normally moved to the preceding Friday or the following Monday. Employees may also work one or more weekend days before or after the statutory holiday in order to gain 5 consecutive days off.

Most enterprises are closed on statutory holidays.

Apart from the statutory holidays, full time Chinese employees enjoy an annual paid leave of up to 15 days, depending on the number of years of service. The right to annual leave takes effect after one year of service.

7. *Are female workers granted special protection in China?*

As in most other countries, the Chinese Labour Law provides female workers with special protection.

Female workers are not allowed to engage in physically hard or similarly improper work, especially during pregnancy. After

childbirth, women are entitled to between 90 and 120 days of maternity leave with pay.

Furthermore, The Labour Contract Law provides that the employer cannot terminate the labour contract if the female worker is in her pregnancy, confinement or nursing period, even if she due to illness is not able to return to her original job, engage in other work, is incompetent, or the employer needs to carry out a personnel cutback.

8. *What are the dispute resolution remedies?*

If a labour dispute between an employer and an employee cannot be settled by amicable means or with assistance from the local trade union, each party may submit a written application to the local labour dispute arbitration commission within 60 days from the date when the dispute arose.

Submitting an application to the labour dispute arbitration commission is mandatory before a suit can be filed in court.

If a party to a labour dispute is unsatisfied with the arbitral award concluded by the arbitration commission, he or she may file a suit with the court within 15 days of receiving the written award.

The trade union shall support and assist the employee in arbitration or legal action instituted by the employee.

## Visa rules in China

Most foreign invested enterprises in China prefer to fill key positions with experienced personnel from overseas. Especially, management level and other important positions within the organization may be held by expatriates for a period of time when the corporate entity is initially set up.

The number of expatriate staff needed to run a business in China, and the duration of their stay, vary considerably from one FIE to another. A common trend is that the need for expatriates decrease after the start up period once appropriate local staff have been found and trained, and the business is up and running.

Generally, it is not a problem for foreigners to obtain an employment visa in China so long as they can demonstrate that a Chinese candidate cannot easily fill the position.

The Chinese government believes that FIEs can provide further employment opportunities for the local work force. Therefore, if a FIE can present the Chinese authorities with a reasonable explanation as to why they are hiring a foreigner rather than a local Chinese, no further questions in that regard should be expected.

Though most foreigners can expect to receive the employment visa they applied for, they should not expect the application procedure to be simple. The procedure tends to be very bureaucratic with the involvement of several Chinese authorities for the presentation and examination of numerous documents, some of which need to be prepared in both Chinese and English.

The inviting company does most of the preparatory paper work from China which can be a burden for those preparing the documents. For that reason, many FIEs choose to have the necessary paper work

prepared by a Chinese lawyer or a company specialised in preparing such documents.

In this section, the basic rules and procedures for obtaining visas and employment and residence permits for expatriates and their families will be described. It is important to be aware that visa rules and procedures are often changed. Updates and current visa information can be obtained from the Chinese embassy or consulate in your country.

### **Standard procedures**

When a foreign employee applies for an employment and residence permit, there are four major steps:

#### Step 1: Employment Licence

First, the FIE must obtain an Employment Licence from the local labour bureau which gives the FIE a legal right to employ foreign workforce on an individual basis.

The task of the labour bureau is to examine whether the vacant position has special needs which cannot be filled by local candidates. The bureau also verifies that the foreign candidate meets the following general requirements for obtaining an employment visa:

- Be at least 18 years old and in good health
- Possess the necessary professional skills and work experience required for the job
- Have no criminal record
- Have a valid passport or other international travel document in lieu of the passport
- The employment must be with a clearly defined employer

The labour bureau also evaluates the application in respect of the number of foreign employees already employed in that area.

The type of documents to submit when applying for an Employment License may vary from one local labour bureau to another. In general, the following documents should be prepared:

- Copy of the candidate's passport.
- Application letter from the FIE explaining why the foreign candidate has been selected and hired.
- Completed application form sealed with the FIE's company chop and attached with a recent two-inch photo of the candidate.
- The FIE's Business License.
- The company charter of the FIE.
- If the FIE is a Joint Venture, relevant Joint Venture and Co-operation Contracts.
- Employment Letter of Intent of the FIE.
- CV of the candidate in both Chinese and English stating his/hers education credentials, e.g. certificates and diplomas. The candidate should have at least a bachelor's degree and two years of work experience.
- Medical Check-up Report.

On the basis of the information and documents provided, the local labour bureau will approve or disapprove the application for an Employment License. The approval process usually takes 10-15 working days to complete.

## Step 2: Employment Visa

Once the FIE has obtained the Employment License for employing a foreigner in China, the foreign candidate can apply for an Employment Visa. The application can be submitted to the appropriate Chinese embassy or consulate in the candidate's home country or to the competent authorities in China.

Chinese visas are categorized into eight types identified by a different letter. An Employment Visa carries the letter “Z”.

To apply for a Z-visa, the following documents are required:

- Completed application form with one recent two-inch photo of the candidate.
- Employment License from the local labour bureau in China.
- Invitation letter from the FIE.
- Candidate’s valid passport.
- Medical Check-up Report.

Once the Z-visa is obtained, the foreigner can legally work in China.

### Step 3: Employment Permit

Within 15 days after the foreign candidate’s arrival in China, the FIE should go to the office of the local labour bureau (the same office that issued the Employment License) to apply for an Employment Permit. The Employment Permit is a formal certificate stating the names of the FIE and the expatriate, the term of employment, and type of work.

When applying for an Employment Permit, the following documents should as a minimum be prepared and presented:

- Candidate’s valid passport
- Employment License from the local labour bureau in China
- Employment Contract

Which additional documents to submit when applying for an Employment Permit, varies from one local labour bureau to another. Besides the above mentioned documents, Beijing Labour Bureau will ask the FIE to provide a Foreigner Employment Registration form, one recent two-inch photo of the candidate, Residence Registration Certificate, Medical Check-up Report, etc.

The approval process for an Employment Permit usually takes 5 working days to complete.

The Employment Permit must be renewed annually by the local labour bureau.

#### Step 4: Residence Permit

After receiving the Employment Permit, but within 30 days after arrival in China, the foreign candidate must apply to the Entry-Exit Administration of the local public security bureau for a Residence Permit.

In general, the following documents will be required when applying for a Residence Permit:

- The candidate's valid passport and Z-visa
- Completed application form with one recent two-inch photo of the candidate
- Residence Registration Certificate from the local police station
- Business License of the FIE
- Medical Check-up Report
- Employment Permit

The Residence Permit must be renewed every year by the Entry-Exit Administration office.

In principle, the expatriate has an obligation to carry the Residence Permit with him or her at all times, and to show it to the police upon request.

## **Special procedures for foreign Representative Offices**

Representatives of ROs in China do not need to carry out the process of obtaining an Employment Licence before applying for an Employment Visa. They can apply for a Z-visa directly at the nearest Chinese embassy or consulate by presenting the following documents:

- Valid passport
- Completed application form with one recent two-inch photo
- Invitation letter from the RO
- Registration Certificate of the RO

The individual Chinese embassy or consulate may require further documentation.

When arriving in China, the representative must carry out the standard procedures of applying for an Employment Permit and a Residence Permit. The document requirements, however, are to a certain extent different.

Document requirements for the Employment Permit:

- Valid passport
- Completed application form with two recent two-inch photos
- Registration Certificate of the RO
- CV of the Representative
- Medical Check-up Report. The medical check is provided by the local Entry-Exit Inspection and Quarantine Bureau.

Document requirements for the Residence Permit:

- Valid passport and Z-visa
- Completed application form with two recent two-inch photos
- Residence Registration Certificate
- Employment Permit

- Registration Certificates and Operation Certificates of the RO
- Medical Check-up Report

### **Accompanying family members**

It is common that expatriate staff bring along their spouse and children when taking up employment in China. In general, expatriates will face no restrictions in doing so as long as the expatriate carries a valid Employment Visa in China.

Usually, the filing of visa applications for accompanying family members will take place in conjunction with the application process for the employment visa of the expatriate staff, but it can also be carried out separately at a later time. By presenting the required documents together, spouses and children can obtain Z-visas similar to the ones given to the expatriate.

It is important to note, however, that the Z-visa does not give the accompanying family members the right to work in China. In case they want to work for a FIE or a Chinese employer, the procedures for obtaining an Employment License and Employment Permit should be observed. This can be done either as a part of the visa application process before leaving for China, or after arriving in China.

Within 30 days after arriving in China, spouses and children should carry out the procedures of applying for a Residence Permit as well.

## Frequently Asked Questions

1. *I represent an overseas company that has decided to set up a FIE in China. In the process of setting up the enterprise, recruiting staff, and starting up production, I will need to make several trips to China. Do I need to apply for an Employment Visa?*

No, unless you hold a position in the FIE, you do not need to go through the complicated procedures for applying for an Employment Visa (Z-visa). However, you will need to apply for an “F” (Business) or alternatively an “L” (Tourist) visa. Both of them can be used for business trips and usually last for a period of up to six months. Only F-visas can have multiple entries (do not forget to ask for it) and may be valid up to 12 months. With an “F” or “L” visa you do not need to apply for neither an Employment Permit nor a Residence Certificate when arriving in China.

2. *Besides my family, I plan to bring our overseas maid to work for us in China. Will that be a problem?*

Yes. Due to the fact that many Chinese maids are short of work, overseas maids will find it difficult to obtain an Employment Visa to China. Even if the maid has served you and your family for many years, the chance of approval is very low.

3. *During my term of employment in China, family members and friends plan to come to China and stay with me for shorter periods of time. What type of visas do they need?*

On condition that they only intend to stay in China for periods of no more than six months, they should apply for an ordinary “L” visa (tourism and visiting relatives). Family members may need

to present Marriage Certificates and Kinship Certificates as well as an invitation letter and a return air ticket.

Since the rules regarding issuance of L-visas are often changed, the relevant Chinese embassy or consulate should always be contacted before applying for visa, in order to make sure that the correct documents are submitted.

4. *Is it possible to alter a visa from inside China?*

It depends on the situation. Extensions of visas are usually possible, whereas changes from one type of visa to another can be more problematic. Some changes can only be made from a Chinese Embassy or Consulate outside China, giving you no other option but to leave China and re-enter with a new visa.

For more details on alterations, including document requirements, please contact your local public security bureau. For guidance, see the website of Beijing Municipal Public Security Bureau [www.bjgaj.gov.cn](http://www.bjgaj.gov.cn).

In general, the public security bureaus tend to be little helpful and very bureaucratic. Many foreigners have reported great despair and irritation over the strict application of formal rules and requirements in their struggle to change their visa type or simply obtain an extra entry into China. The best advice is to apply for any changes well in advance and, if possible, to bring along a Chinese speaking person.

5. *Do I need to apply for a new Employment Visa, if I change my job in China from one FIE to another?*

No, you do not need a new visa. However, after your new employer has applied to the local labour bureau for permission to recruit a foreigner (Employment Licence), you need to apply for a new Employment Permit.

## **Introduction to Chinese accounting rules**

The Accounting Law of the People's Republic of China sets out the general accounting principles for all enterprises. The Accounting Law also empowers the Ministry of Finance to administer accounting affairs and establish uniform accounting regulations, accounting standards and systems. Under this mandate, the Ministry of Finance has issued various accounting regulations, including accounting standards.

Initially, Chinese accounting standards were designed to measure how well production targets were met under a planned economy. Such an accounting system is not very suitable for managing corporations in a market economy like the one China is gradually moving towards. For that reason, a new set of accounting standards called "Accounting Standards for Business Enterprises" (ASBE) came into effect on 1 January, 2007.

The ASBE have brought Chinese accounting practices more in line with international best practices, and a large number of Chinese accounting standards have been replaced with International Financial Reporting Standards (IFRS). The adoption of the ASBE has also made it easier to compare or merge accounts across countries and companies.

Finally, for the first time, China's accounting standards have been officially accepted by a major international capital market; the European Securities Committee, which has approved the ASBE. The EU has decided during a transitional period from 2009 to 2011 to allow "adoption" of the Chinese accounting standards when entering the European market.

At present, ASBE are only mandatory for listed companies, but non-listed companies and FIEs, including WFOEs, are allowed and

encouraged to use the standards, as they are likely to be mandated to conform to the new standards in the near future.

The recent changes to the Chinese accounting standards and other regulations about bookkeeping, accounting and financial reports have made the Chinese accounting concept more similar to the US and EU standards and concepts. While making it much easier to manage international business in China, it also increases the level of information, training, and knowledge of the new rules, required by those drawing up financial statements. Developing such expertise is neither an easy nor a particularly fast process. For detailed information regarding the new accounting procedures, including the accounting system, bookkeeping rules, and reports required by the authorities of China, and their potential impact on foreign investment in China, it is highly recommended that you contact an accounting professional specialized within the area.

### **Compulsory accounting requirements**

FIEs are required to implement the Accounting System for Business Enterprises. That means that FIEs are not allowed to apply international accounting systems that do not comply with Chinese laws and regulations.

Accounting information provided by an enterprise shall reflect all important transactions or events that relate to its financial position, operating results and cash flows. The law also requires that employees, who do bookkeeping and accounting, possess certain qualifications.

Enterprises established in China shall prepare a yearly financial and accounting report. Some enterprises may also be required to prepare semi-annual, quarterly and monthly reports. The fiscal year runs from 1 January to 31 December under the Gregorian calendar.

According to Chinese law, a financial report is a written document, which shows the financial situation and business results of the enterprise. The financial report must include accounting statements, notes and a descriptive overview of the financial situation of the enterprise and other information or data that describe the ongoing business in the FIE.

The yearly accounting report should reflect comparative data for at least two years or two interrelated periods. Accounting elements include a balance statement (assets, liabilities, owners' equity), revenue, expenses, profit and cash flow statements. Small enterprises are not required to include a cash flow statement when preparing financial statements.

The Chinese currency, renminbi (RMB) shall be used as the base currency for bookkeeping in financial and accounting reports. Where an enterprise primarily uses foreign currency in its operations for revenue and expenditure, a foreign currency may be selected as the bookkeeping base currency, but the compiled accounting statements shall be shown in RMB converted from the foreign currency.

Written accounting records, including accounting vouchers, accounting books and accounting statements, are required to be maintained in Chinese. The books can, however, be kept simultaneously in a foreign language.

The master accounting books of the FIE cannot be taken abroad.

A registered accountant or accounting firm must carry out the auditing of the financial and accounting reports of an enterprise in accordance with relevant laws and administrative rules and regulations.

It must be emphasized that rules and regulations within this area are constantly amended. The above description of the compulsory

requirements to FIEs should therefore not be relied upon as a complete and static image of Chinese accounting law.

## **Frequently Asked Questions**

1. *What are the rules regarding the issue of official receipts (fapiao)?*

The rules regarding the issue of fapiaos are detailed and depend on the nature and location of the FIE. Normally, the rules dictate how many fapiaos the FIE is allowed to issue per month, the maximum amount of each fapiao, and finally the maximum total amount of the fapiaos issued.

2. *What are the differences between ASBE and IFRS?*

ASBE is substantially in line with IFRS, but some differences remain, such as:

- Certain specific standards allow only a cost model to compute the value of fixed and intangible assets with the IFRS allowing a revaluation model.
- IFRS provides an option to class all borrowing costs as expenses while ASBE maintains, under certain circumstances, that borrowing costs should be capitalized.
- Biological assets must be measured using a cost model under ASBE, rather than the fair value model allowed in IFRS, unless evidence exists to warrant the use of fair value.
- The new ASBE prohibits reversing impairment losses, but IFRS allows it under some circumstances, preventing only goodwill impairment.
- ASBE have different requirements for presenting the financial report. Expenses, for instance, are presented in different ways depending on the particular aspect of the statement.

3. *Which accounting information must be recorded by the FIE?*

The following information must be recorded by the FIE:

- Receipt and payment of funds and negotiable securities
- Receipt and dispatch of, increase or decrease in, and use of funds and property
- Incurring and settlement of claims or debts
- Increase or decrease in capital and funds
- Calculation of income, payments, expenses and costs
- Calculation and handling of financial results
- Other matters of importance

4. *What are the requirements to an Annual Audit report?*

All FIEs must be audited on an annual basis. Annual audit of the statutory accounts of FIEs must be conducted by a Certified Public Accountant (CPA) registered in China under Chinese law. The deadline for the filing of annual audits is April the following year.

Before the auditor arrives you need to have the following documents prepared and available:

- Accounting vouchers
- Accounting books
- Financial statements
- Tax filing records
- Bank statements
- Other related documents and reports

All invoices (fapiao) must be sealed with the official stamp of the FIE.

Key areas of the audit:

Costs/Expenses report	<p>All expenses must be declared. Official invoices must be provided as supporting documents.</p> <p>Items of special importance:  Interest expenses  Audit fees  Rental/lease expenses  Employer's contribution to overseas social security plans  Costs paid on behalf of head office</p>
Cash	Bank statements reconciled with cash flow
Tax	<p>Business Tax, Enterprise Income Tax, Withholding Tax etc. shall be excluded from the expenses report.</p>
Balance	<p>Valuation of assets  Disposal of gains and losses</p>
Other	<p>Business License (registrations and tax licenses, etc).  All employees' registrations, labour contracts, work permits and other administrative matters are up to date.  Accounting methods, including currency conversion.</p>

# Tax in China

The government agency in charge of tax policy is the Ministry of Finance, whereas the State Administration for Taxation (SAT) is the agency responsible for tax collection. SAT is also responsible for drafting relevant regulations and detailed rules for the implementation of tax laws, supervision of local tax administrations, and organizing and executing the collection of taxes.

## Types of taxes

Under the Chinese tax system there are currently 26 taxes, which can be classified into 8 categories:

- Turnover taxes (including Value Added Tax, Consumption Tax and Business Tax)
- Income taxes
- Resource taxes
- Property taxes
- Taxes for special purposes
- Behaviour taxes (including Vehicle and Vessel Usage Plate Tax, Stamp Duty, Deed Tax and Slaughter Tax)
- Agricultural taxes
- Customs duties

14 of the 26 taxes are currently applicable to enterprises with foreign investment and/or foreigners. The 9, which are most relevant for FIE's, will be discussed in detail below. They are:

- Enterprise Income Tax
- Value Added Tax
- Business Tax
- Consumption Tax

- Customs Duties
- Withholding Tax
- Property Tax
- Stamp Tax
- Individual Income Tax

## **Enterprise Income Tax**

The Enterprise Income Tax rate for all enterprises in China, both foreign and domestic, is 25%.

The Enterprise Income Tax is calculated from the net income in a financial year. The tax is settled on an annual basis but paid quarterly with adjustments refunded. The final calculation is based on a year-end audit.

Enterprises that began operating before 1 January, 2008, when Enterprise Income Tax rates were calculated differently depending on whether the enterprise was a domestic or foreign enterprise, can enjoy the previous tax rate or tax exemptions for a defined period. The transitional preferential tax period is 5 years at tax rates to be increased from current tax to full tax rate. Enterprises involved in the high or new technology sector can obtain some tax incentives.

## **Value Added Tax (VAT)**

All enterprises engaged in the sale or importations of goods to China are subject to a Value Added Tax. The standard rate of Value Added Tax is 17%. However, a reduced rate of 13% applies to specific products such as books and certain types of oils and gases.

Small businesses with a turnover of less than RMB 500,000 for industrial enterprises or RMB 800,000 for commercial enterprises pay a Value Added Tax of 3%.

Exports from China are not subject to Value Added Tax. Neither are:

- Imported goods processed for export
- Instruments and equipment imported for direct use in scientific research, experimentation and education
- Imported materials and equipment granted by foreign governments or international organizations

## **Business Tax**

Business Tax is imposed on enterprises that provide services like consulting, entertainment, or transportation companies.

The Business Tax rate is between 3% and 20%, depending on the type of services provided. For most types of services the rate is between 3% and 5%.

Business tax may be exempt for some services, such as medical services provided by medical institutions, and educational services provided by schools and other educational institutions.

## **Consumption Tax**

Consumption Tax is imposed on luxury goods, such as tobacco, alcohol, cosmetics and skin care products, jewellery, cars, motor-cycles and fuel.

All enterprises engaged in production or imports of taxable consumer goods within the territory of the PRC are subject to Consumption Tax. Enterprises processing taxable goods for others shall pay Consumption Tax based on the value of the raw material and the processing fee. Exported consumer goods are exempt from Consumption Tax.

The Consumption Tax rate depends on the type of good. The highest rates (up to 50%) are imposed on tobacco, alcohol and cars.

Consumption Tax must be filed and paid monthly.

## **Customs duties**

The payers of customs duties include consignees, who import goods permitted by China, and consignors who export goods permitted by China. The former shall pay import duties and the latter shall pay export duties.

The tariff rates for imports fall into two categories: general tariff rates and preferential tariff rates. The general tariff rates apply to imports originating in the countries with which China has not concluded most-favoured-nation trade agreements. The preferential tariff rates apply to imports originating in countries with which China has concluded most-favoured-nation trade agreements.

## **Withholding Tax**

In China, Withholding Tax is levied on overseas companies providing services to enterprises based in China. For example, when a company transfers net income (dividends, royalties, rentals or capital gains) from a Chinese affiliate to the foreign parent company, Withholding Tax is collected.

The general Withholding Tax rate is 10% with some exceptions; e.g. if the parent company is located in Hong Kong or Singapore, the Withholding Tax rate is only 5%. To obtain the 5% withholding tax rate, the parent company is required to own 25% or more of the shares of the Chinese affiliate. If the parent company owns less than 25% of the Chinese affiliate, the Withholding Tax rate is 10%.

## **Property Tax**

Foreign invested enterprises, foreign organizations and foreign individuals only need to pay real estate tax levied on residential property. Taxpayers are owners, mortgagees, custodians and users of such properties.

The tax is calculated on a residual amount following a deduction of between 10% and 30% of the original value of the property. The provincial government, autonomous region or municipality directly under the central government determines the amount of the deduction.

## **Stamp Tax**

Any enterprise, unit, business, individual, household or other who executes or receives specific contract documents, e.g. sales contracts and title transfer documents, are liable to pay Stamp Tax.

The tax rates are in general between 0.03% and 10% depending on the type of document.

## **Individual Income Tax**

China has a global system of tax liabilities. That means that Individual Income Tax (IIT) is imposed on all income earned both in China and outside of China.

The IIT liability status is determined on the basis of the number of days the foreigner has effectively spent in China following a 90 (183) days rule. The 90 days rule applies to foreigners from a country, which has not signed a double taxation treaty with China, and the 183 days rule applies to countries that have signed such a double taxation treaty.

For the first 90 (183) days a foreigner spends in China, he/she only needs to pay IIT of the income earned in China from a Chinese source. If the stay is longer than 90 (183) days but less than 1 year, the foreigner also needs to pay IIT of income earned from a Chinese source and paid outside of China.

If the stay in China is longer than 1 year but less than 5 years, the income in China from non-Chinese sources, for instance income from the home country, will also be taxable.

When a foreigner has stayed more than five years in China, without residing outside of China for more that 90 consecutive days within the 5 years period, the Chinese government considers the foreigner as a full tax resident, and the foreigner must pay tax in China of his/her worldwide income; also of income from non-Chinese sources.

<b>Days in China</b>	<b>China Source; income paid in China</b>	<b>China Source; income paid outside of China</b>	<b>Non-China Source; income paid in China</b>	<b>Non-China Source; income paid outside of China</b>
Less than 90(183) days	Yes	No	Top Manager: Yes Staff: No	No
> 90 (183) ≡ 1 year	Yes	No	Top Manager: Yes Staff: No	No
> 1 year ≡ 5 years	Yes	Yes	Yes	No
More than 5 years	Yes	Yes	Yes	Yes

If a foreigner resides outside of China for more than 90 consecutive days, a new “5 years tax calculation” starts when the foreigner enters China again.

The IIT rate is calculated using a progressive scale. IIT is not

imposed on the first RMB 4,800 of the monthly earnings. Of the amount exceeding RMB 4,800, a tax rate of between 5% and 45% is used to calculate the IIT.

The below table lists the salary brackets, tax rates, and quick tax deduction amounts.

<b>Monthly Taxable Income (RMB) &gt; RMB 4.800</b>	<b>Tax %</b>	<b>Estimated "quick" deduction (RMB)</b>
≦ 500	5	0
> 500 ≦ 2,000	10	25
> 2,000 ≦ 5,000	15	125
> 5,000 ≦ 20,000	20	375
> 20,000 ≦ 40,000	25	1,375
> 40,000 ≦ 60,000	30	3,375
> 60,000 ≦ 80,000	35	6,375
> 80,000 ≦ 100,000	40	10,375
> 100,000	45	15,375

The total tax liability is calculated as follows:

$$\text{IIT} = (\text{Income} - \text{RMB } 4,800) \times \text{tax rate} - \text{quick tax deduction}$$

Example with an income of RMB 60,000:

Monthly taxable income:  $60,000 - 4,800 = 55,200$  RMB  
 Tax:  $55,200 \times 30\% - 3,375 = 13,185$  RMB

Individuals in China with annual incomes of more than RMB 120,000 have to complete and submit an annual self-declaration of their income by the end of March the following year.

An expatriate package often includes a number of non-taxable benefits, such as housing, tuition fees for children, health insurance etc.

## **Preferential treatment**

In 2008, a new Enterprise Income Tax Law was adopted. The law shifted the focus of incentives from a regional to a national level. Furthermore, the law signalled a move away from an export oriented to a domestically driven economy.

Another key point to note is that there was a considerable shift in emphasis towards the environmental industry rather than just attracting business regardless of its nature or impact on the environment.

Benefits are no longer granted to more traditional industries, such as manufacturing, but shifted to the budding technology and hi-tech sector, which is now eligible for a low 15% tax rate regardless of location, and a deduction for qualifying research and development expenses.

China also offers tax incentives (exemptions) to investments in projects relating to environmental protection, agricultural development, water conservation, production safety, high-tech development and public welfare undertakings. Certain tax breaks may also be granted to enterprises in special development zones and less developed western areas of the country with the “Go West Policy”.

## **Ongoing changes in rules and regulations**

The tax law and system in China is complex, and rules and regulations are often amended. It can be very difficult and time consuming to stay updated on changes in rates, declaration requirements, deadlines and interpretation of the numerous laws and regulations. It is therefore recommended that you seek professional advice for accounting and tax issues.

## Frequently Asked Questions

1. *When does a company need to register for tax purposes?*

Within 30 days after a FIE obtains its Business License, the foreign enterprise needs to register with the SAT.

2. *When should taxes be reported and paid?*

The tax year in China ends on 31 December of a calendar year. If an enterprise commences business or terminates its business activities during the taxable year, and the actual business period of such taxable year is less than 12 months, the actual business period shall be treated as the taxable year.

It is compulsory to file a report and pay advances monthly or quarterly. Enterprises shall submit a prepaid tax return to the competent tax authority within 15 days of the end of the month, or the quarter, as the basis for tax prepayment.

Enterprises shall submit an annual tax return to the competent tax authority within five months of the end of the year and settle the payable and refundable tax payment. A financial report and other relevant information shall be attached to the tax return.

Taxes shall be calculated in renminbi. Where the income is calculated in a currency other than renminbi, it shall be converted into renminbi for tax payment.

3. *What is the timetable for tax declaration for RO and WFOE?*

The tax declaration requirements for RO and WFOE are:

<b>Type of tax</b>	<b>RO</b>	<b>WFOE</b>
Enterprise Income Tax	Every quarter + an annual declaration	Every quarter + an annual declaration
Business Tax	Every quarter	Every quarter
Consumption Tax/VAT	Monthly	Monthly
Individual Income Tax	Monthly for all employees	Monthly for all employees

4. *When a WFOE buys goods that are subject to VAT from a Chinese sub-supplier or a foreign sub-supplier, how much VAT can be “offset” in the accounts of the WFOE?*

Whether a WFOE purchases goods from a domestic supplier or an international supplier, the WFOE is required to pay VAT of 17% of the purchase value. The VAT can be fully offset by sales VAT as long as a proper special VAT fapiao is obtained.

## **Foreign currency restrictions in China**

Since July 2008, China has adopted a fixed exchange rate policy against the US Dollar. The policy maintains a stable RMB against a basket of currencies, but in practice there are only US dollars in the basket. China's central bank, the People's Bank of China (PBOC), uses two tools to keep the RMB stable: Traditional intervention in the currency market and foreign currency restrictions.

The RMB exchange rate against the world's major foreign currencies is published daily by PBOC via the China Foreign Exchange Trading System. Banks can trade foreign currencies within the bands determined by PBOC.

Since China is the world's largest exporting country and one of the largest receivers of foreign direct investments, there are many cross border transactions in and out of the country. Currency restrictions are imposed on both inward and outward transactions which makes getting money in and out of China cumbersome.

### **The financial sector**

The financial sector in China is dominated by the banking sector, where the biggest banks are state-owned. The bond and stock market is still relatively undeveloped.

Chinese banks are subject to restrictions from the PBOC on the rates they can charge when they lend money. They cannot charge a higher interest rate to compensate for higher credit risk. This means that state-owned enterprises usually have easier access to financing than small and medium sized enterprises and foreign companies.

Although the Chinese government recognize the problems in the financial sector and have, to some extent, liberalized the sector, the

government is still reluctant to initiate further liberalizations. State ownership is considered the most effective way to maintain control of economic development.

The integration of China's financial market with the international financial market, and financing abroad in the form of bank borrowing or securities, is still limited. Financing from a Chinese bank or the foreign parent company is not prevalent either. Therefore, when setting up a Chinese enterprise, it is important to have sufficient capital to meet the enterprise's expected operating and development costs. For more information on the relevant regulations and specific recommendations on how to handle the financing of a new FIE please refer to the chapter "Establishing an enterprise in China".

### **Foreign currency certificate**

When a FIE has been registered and received its business license, the company must apply for a foreign currency certificate (IC card of Foreign Exchange Registration Certificate) from the State Administration of Foreign Exchange (SAFE). The certificate makes it possible for the company to open a currency bank account to convert foreign currency to RMB and vice versa.

The currency certificate is valid for one year, after which the certificate must be approved again to be renewed. It is therefore important that the FIE continually fulfills its obligations in regard to the foreign currency management.

### **Bank accounts and payments**

FIEs may only deposit RMB and foreign currencies in banks that are approved to handle foreign currencies; i.e. banks that have a foreign currency account with the central bank. Most large banks have foreign currency accounts. Due to the bank's obligation to monitor

foreign currencies transactions made by FIEs, all transactions involving foreign currencies must take place from these accounts. The banks must continually report their clients' holdings of foreign currencies, and whether the clients follow procedures (information on type of goods, quantity and amount) applicable to the receipt of foreign currencies when exporting and the payment of foreign currencies when importing.

Given currency restrictions in China, foreign currencies cannot be used as the currency for payment in China. A FIE is obliged to open a currency account to hold its foreign currencies (capital account) and a RMB account to be used for daily operational payments (operating account).

The capital account and the operating account are subject to different regulations.

The capital account is used to deposit investment capital, i.e. the investment capital required for start-up, loans and/or equity increase. In contrast to the operating accounts, capital accounts are subject to a numbers of restrictions. During the approval process, the authorities go in depth into the substance of the application, including the future usage of the capital.

The operating account can only be used for payments related to ordinary business transactions, including salaries and payments from the sale and purchase of goods and services. Opening an operating account is not subject to many restrictions, but it can be administratively tedious. Approval is normally achieved, but it can be a slow and painful process.

For a foreign investor in China, there are a number of issues that should be considered before the FIE can start operating:

- The enterprise's local bank must be approved to handle foreign currency.

- It is necessary to open a number of bank accounts (both capital accounts and RMB accounts for ongoing operations and financial purposes).
- China's currency restrictions mean that cross border transfers (e.g. increase in equity investment or transfer of the surplus of the Chinese company to the parent company) is an administrative process that requires both approval and involvement of Chinese authorities.

## **Frequently Asked Questions**

1. *Should the invested capital for a FIE be paid in foreign currency or RMB?*

Given Chinese currency restrictions, it is only possible to bring in foreign currency (USD, JPY, GBP, EUR, KRW, CHF, AUD or CAD), which is subsequently exchanged into RMB. The currency amount shall be consistent with what is stated on the business license.

2. *Can a FIE get a currency loan from a foreign bank?*

Yes, but the bank must be approved by SAFE to handle foreign currency, and the loan must be reported to SAFE. Regulations for the transfer of foreign currency to China must be followed.

3. *Can a foreign company borrow RMB from a Chinese bank?*

In principle, yes, however, in practice it is difficult. Chinese banks prefer to lend to large Chinese (often state-owned) enterprises, where the credit risk is considered lower compared to foreign companies with whom Chinese banks are less familiar. The

banks are subject to restrictions from PBOC with respect to the rates they can charge on their loans, and cannot charge a higher rate to cover the higher credit risk. Collateral for loans is not widely used in China. Therefore credit risk can only be brought down to a limited extent. If a FIE needs to bring in additional capital, the best solution is to apply for an increase in the company's equity.

4. *Can a FIE obtain an overdraft facility from a Chinese bank based on a guaranty from a foreign bank?*

In principle, yes, however, in practice it is difficult for the same reasons stated above in question 3.

5. *Is it difficult to get foreign currency into China?*

No, it is not difficult, but it can be an administrative burdensome process.

## Intellectual property rights in China

Infringement of Intellectual Property Rights (IPRs) is still a matter of great concern in China, which any foreign investor must take into account before entering the Chinese market. The more popular a product gets in China, the more likely it will soon be met with rival products with similar characteristics, appearances, and brands.

The Chinese government realises that IPR infringement can discourage foreign investment. In response to increasing international criticism, the Chinese government has, in recent years, launched a variety of measures to combat and crack down on violators of IPRs.

In order to enforce IPR legislation and implement government action plans more effectively, the central administrative system has been reformed dramatically. For instance, a cross-ministry national work group with high-ranking officials has been established; an IPR training program for government officials has been initiated; forums for communication and co-ordination with FIEs have been prepared, etc. Awareness of IPRs is also improving at the local government level due to on-going training and positioning of IPR trained personnel.

The court system is undergoing reforms to improve the handling of IPRs cases too. Local courts all over the country take part in extensive IPRs training activities, and new specialized IPR courts and divisions have been established in most major cities.

Despite these efforts, which undoubtedly have improved the general awareness and recognition of IPRs in China, the progress achieved in terms of getting counterfeited goods off the streets has not been impressive. Local protectionism, corruption, and the lack of co-operation between Chinese authorities are still an everyday

occurrence in China. Until these obstacles are fully addressed by the Chinese government, no broad scale enforcement and protection of IPRs is to be expected.

### **International treaties and conventions**

China is a member to the World Intellectual Property Organization (WIPO) and has acceded to most international treaties and conventions related to the protection of IPRs, including the Paris Convention for the Protection of Industrial Property, the Patent Cooperation Treaty, the Madrid Agreement for the International Registration of Marks, the Nice Arrangement concerning the International Classification of Goods and Services for Registration of Marks, the Berne Convention, the WIPO Copyright Treaty, the Universal Copyright Convention, and the Geneva Phonograms Convention.

Since China's admission to the World Trade Organization (WTO) in 2001, the Chinese government has strengthened the legal framework of IPR legislation, in order to comply with the WTO agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

### **Copyright protection**

By virtue of China's Copyright Law, the owner of a work receives protection without being required to register the work with a Chinese copyright agency. However, since seeking redress for violations can be difficult without prior registration, it is highly recommended that the copyright for literary works be registered, in order to avoid disputes concerning to ownership.

If the copyright is held by an individual, protection is provided during the life of the author and extends fifty years beyond his or her death. If the copyright of the work belongs to a legal entity, the work is

protected for a period of fifty years from the first publication of it. The period of protection for cinematographic, television, video, or photographic works is fifty years from the first publication of the work, regardless of who owns the copyright. If the work is not published within fifty years of its completion, the work is not protected under the law.

A work may be used without permission or compensation in certain "fair use" situations, such as use for the purpose of education or scientific research, or use by a state entity for the purpose of carrying out official duties.

China's Copyright Law only provides protection to works that cause no harm to China's public interest and do not violate Chinese law.

### **Patent protection**

In December 2008, the Standing Committee of the National People's Congress enacted a new Patent Law, which took effect as of 1 October, 2009. The purpose of the amendment of the law was to strengthen the protection of patent rights in China and encourage new inventions.

The State Intellectual Property Office (SIPO) under the State Council is responsible for the administration of the law, including the handling of patent applications. SIPO has set up 21 local receiving offices in different cities across the country. In 2009, SIPO granted more than 580,000 patents of which more than 80,000 belonged to foreign applicants.

The Chinese Patent Law protects patent rights for "inventions-creations"; i.e. inventions, utility models and exterior designs. Foreign patents must be registered in China in order to obtain protection under the law. Any entity or individual intending to file a patent application in a foreign country for an invention-creation made in

China, shall apply in advance for a confidentiality examination conducted by the patent administrative department under the State Council. If this obligation is not fulfilled, the foreign patent application will not be granted a patent right, if the patent is applied for in China.

If filed in China less than twelve months after the filing of the original application in a foreign country, the priority date of a patent application will be deemed to be the date of the original application in that country, if this is decided by any agreement concluded between the said foreign country and China, by any international treaty to which both countries are parties, or on the basis of the principle of mutual recognition of the right of priority. For design patents, the application must be filed in China within six months from the date of the original application.

Patent right will not be granted to an invention-creation that is contrary to Chinese law or social morality, or is detrimental to public interests.

While the duration of patent rights for inventions is twenty years, the duration of patent rights for utility models and designs is ten years counted from the date of filing.

Disputes arising as a result of infringement of the patent right of the patentee shall be settled through consultation between the parties. Where the parties are not willing to consult with each other, or where the consultation fails, the patentee or any interested party may institute legal proceedings in the competent People's Court, or request SIPO to handle the matter. Legal proceedings concerning infringement of a patent right must be instituted within two years from the date on which the patentee or any interested party obtained or should have obtained knowledge of the infringing act.

The Patent Law of 2008 raised the maximum fine for patent counterfeiting, and recent case law shows improvements in the

capability of Chinese courts to render a judgment consistent with international standards as regards patent suits.

## **Trademark protection**

Trademark registration in China is normally an integral part of the initial entry into the Chinese market for any FIE wanting to protect its trademarked products or services in China. Sometimes registration is mandatory before a FIE can obtain its business license, e.g. if the products falls under the categories of tobacco or drugs.

Besides traditional trademarks on goods and services, the Chinese Trademark Law offers protection to collective marks and certification marks.

If a trademark is not registered, it will receive no protection under the Chinese Trademark Law. Therefore, there are no legal restrictions regarding the use of unregistered trademarks in China, since China has not yet adopted the concept of use giving rise to trademark rights. According to the Chinese Trademark Law, prior use of a trademark in China will not provide the user with exclusive rights to the mark, unless the trademark falls within the category of “well-known trademarks”. The term “well-known trademarks” refers to trademarks that are widely known to the relevant public and enjoy a relatively high reputation in China. Therefore, most foreign trademarks must be registered in order to obtain protection.

If filed in China within six months from the date of filing the original application in a foreign country, the priority date of a trademark application will be deemed to be the date of the original application in that country, if this is decided by any agreement concluded between the said foreign country and China, by any international treaty to which both countries are parties, or on the basis of the principle of mutual recognition of the right of priority.

The Chinese Trademark Law protects against “bad faith” registration of trademarks. If the registration of a trademark violates the rights of a trademark owner, the owner may request the Trademark Review and Adjudication Board to revoke the trademark within five years from the date of registration. If the trademark is “well-known”, no time limit for the revocation apply.

A registered trademark is protected for a period of 10 years, calculated from the date on which the registration is approved. In case a registered trademark needs to be used for a longer period, an application for extension of the registration period must be filed minimum six months prior to the expiration of the period. If the extension is granted, the trademark will be registered for an additional 10 years.

### **The Anti-unfair Competition Law**

The Anti-unfair Competition Law provides intellectual property protection to items not covered by the trademark legislation and protects trade secrets.

The general aim of the Anti-unfair Competition Law is to ensure a sound development of the market economy, to encourage and safeguard fair trade, and to protect lawful rights and interests of business operators and consumers.

According to this law, a business operator may not harm competitors by:

- Passing off a registered trademark of another party
- Causing confusion by unauthorised use of names, packaging or trade dresses of well-known products
- Unauthorised use of enterprise name or personal name of another party

- Use quality marks such as certification marks, marks of fame, and marks of excellence that are counterfeit or used without authorization

In general, the law prohibits any form of bribery when selling or buying products, misleading or false advertising of own products or those of the competitors, infringements of trade secrets, predatory pricing in order to force out competitors from the market, and unfair tendering practices.

## **Frequently Asked Questions**

### *1. What general precautions should be taken against IPR infringements in China?*

Many FIEs in China fail to take adequate measures to protect their intellectual property. Although it is impossible to completely protect an enterprise against IPR infringement, many things can be done to reduce serious risks.

Most proactive measures can be adopted internally within the enterprise by setting up procedures and routines on how to handle and exchange sensitive information and IPRs, and by making sure that these procedures are followed strictly by all employees as well as third parties working with or for the enterprise.

External measures are often more expensive and complicated as they usually require the involvement of third party service providers. External measures are normally only taken when infringement of IPRs has been reported.

Please find below some guidelines on how to protect your company against IPR infringements internally and externally:

#### Internal measures:

- Make sure that all trademarks and patents are legally protected in China at all times by completing the necessary registration procedures.
- Make sure that all employees, suppliers, distributors, etc. are informed in writing about the company policy on IPR, and the consequences of infringement.
- IPRs and the protection thereof are relatively novel disciplines in China, and many Chinese people are not aware of the legal impact of infringing IPRs. Training of staff, suppliers, distributors, etc. is often the only solution to this problem.

#### External measures:

- Carry out background checks on especially suppliers and distributors before hiring them. If they have a record, or a reputation, of supplying or selling fake products of other companies, cooperating with them should be reconsidered.
- Setting up a telephone hotline is a simple and efficient way to collect accurate information from disappointed customers and consumers on IPR infringement. Make sure the hotline telephone number is obtainable from company brochures, product labels, website, etc.
- Hiring an agent may be the only way to obtain crucial information on where pirated products are produced, and how they are distributed.
- Always contact your local Chinese lawyer, if you need further advice on how to protect yourself against IPR infringement, or if you need to initiate legal action.

2. *What are the chances of obtaining redress if someone counterfeits our products?*

The increasing number of successful actions brought by owners of IPRs against manufacturers and distributors of counterfeited products in recent years indicates that Chinese courts are now taking the protection of IPRs more seriously.

In 2009, Chinese courts heard more than 20,000 IPR-cases, with copyright disputes ranking first.

In 2007, a verdict made by the Supreme People's Court announced a record compensation amount among all the IPR infringement cases involving foreign participants. In the verdict, the Supreme People's Court affirmed the original judgment of awarding Japan's Yamaha Motor Co., Ltd. record damages of RMB 8,300,440.43 for trademark infringement, based on the evidence gathered showing the defendant's obvious infringement intent and lack of sufficient financial information. This verdict shows that the Chinese courts are increasingly willing to award damages acceptable to international standards to stop the infringement of IPRs.

3. *Is it necessary to wait for a court order in order to crack down on manifest IPR infringements?*

No. In China IPR infringement may be pursued in two different ways; either by obtaining a court order, or by directly involving police authorities.

Though the administrative procedure is the fastest, it is only feasible if definite proof of an infringement can be demonstrated.

4. *What is the best way to protect a trademark?*

Trademarks are best protected, if both a block letter form of the mark (which will protect the trademark in all styles) and the stylised form is registered, in case the block letter form is rejected due to lack of distinctiveness.

You should always consider registering a foreign language trademark with a Chinese language equivalent, as most consumers make purchase decisions based on an associated Chinese character trade name. Otherwise, there is a risk that consumers will make up their own colloquial names that may not be the most desirable for your products.

5. *Can a foreign company submit a trademark application by itself?*

Yes. According to the Implementing Regulations of the Chinese Trademark Law, local branches and subsidiaries of foreign companies are allowed to register trademarks directly with the Trademark Office of SIPO without using a Chinese agent. However, if the foreign investor has not set up a legal entity in China yet, a registered trademark agent is required.

The trademark registration process usually takes 9 to 12 months to complete.

6. *Can a foreign company submit a patent application by itself?*

Yes. Under the Chinese Patent Law, any foreign person or entity with a business address in China can file a patent application without the use of a patent agent. However, if the foreign investor has not set up a legal entity in China yet, a registered patent agent is required.

The approval process for a patent application normally takes 12 to 24 months to complete.

# **The Chinese Anti-Monopoly Law**

One of the most important laws passed by China since its entry into the WTO is the Anti-Monopoly Law, which came into effect on 1 August, 2008.

The Anti-Monopoly Law, which was 14 years on the drawing board, is the first comprehensive competition law in China's history, and represents a major step forward in China's transformation into a market economy. Generally, it applies equally to foreign and domestic enterprises, but it also includes some protectionist provisions.

The law is influenced by European anti-monopoly law and covers the traditional range of antitrust topics, including restrictive agreements, abuse of dominance, merger clearance and trade cartels. In addition, it covers a fourth area; the prohibition of "administrative monopoly", which is known as abuse of administrative powers by public agencies and organizations.

The Anti-Monopoly Law is broad in scope and its provisions are somewhat vaguely defined. Companies that intend to complete a business transaction that falls within its scope should become familiar with these provisions as they can significantly increase the time, costs, and risks connected with such transactions.

## **Anticompetitive agreements and abuse of dominance**

The Anti-Monopoly Law bans monopolistic arrangements, such as cartels and other forms of collusion, and provides for the investigation and prosecution of monopolistic practices.

However, the law also lists some situations where an agreement will be immune from the law; for example, an agreement will not be prohibited if the business operator can prove that:

- the purpose of the agreement is to improve technology or the research and development of a new product,
- the market competition in the relevant market will not be seriously prejudiced, and
- consumers will enjoy the benefits brought about by such agreement.

It is, however, important to be aware that there is little experience in China with such provisions for exemption, and it may take some time before a stable body of judicial and administrative experience develops.

Besides prohibiting anticompetitive agreements, the Anti-Monopoly Law prohibits monopolies from using their dominant status in the market to curb competition, fix prices, enforce package sales, and refuse or enforce trade.

It is important that foreign investors and foreign invested enterprises are fully aware of the monopoly activities proscribed by the law, and ensure that their activities in China comply with them.

## **Merger control**

One consequence of the Anti-Monopoly Law is that big mergers must now be approved in 3 places in the world: the EU, the US and China.

In China, all companies seeking mergers or acquisitions must notify the relevant anti-monopoly law enforcement department, if the transaction meets either of the following two alternative turnover thresholds:

- The total worldwide turnover of all parties to the transaction in the previous fiscal year exceeded RMB 10 billion, and the China turnover of each of at least two parties to the transaction exceeded RMB 400 million.
- The total turnover in China of all parties to the transaction in the previous fiscal year exceeded RMB 2 billion, and the China turnover of each of at least two parties to the transaction exceeded RMB 400 million.

However, it must be emphasized that even if the turnover of the companies involved do not meet either of the two standards listed above, law enforcement bodies can still carry out investigations if evidence show that a company could potentially limit competition. For instance, although the turnover of companies in some industries is low, their market share could be large enough to restrict competition.

The filing obligation applies to:

- Mergers and acquisitions
- Share or asset sales that give one company control over another
- Deals in which one company can gain control of or be able to impose decisive influence over another firm through the signing of contracts or other means

The Anti-Monopoly Law provides two exemptions that would allow companies to avoid submitting a transaction for review. Under the first exemption, no notification is required when a company possesses more than 50 percent of the voting shares or assets of each of the other companies involved in the transaction. To qualify for the second exemption from notification, a company not involved in the concentration must possess more than 50 percent of the voting shares or assets of each company that is involved in the concentration.

Regardless of the thresholds and exemptions stated above, foreign investors should always apply for approval from the Ministry of Commerce in the following situations:

- The purchase of a domestic company affects national economic security
- The purchase takes place in a key sector
- The purchase causes a transfer of the operating rights of a famous domestic brand

The list of strategic sectors, in which the state wishes to retain control, includes military-related manufacturing, power production and grids, petroleum, gas and petrochemicals, telecom manufacturing, coal, civil aviation, and shipping.

Natural monopolized industries, which are mainly owned by the state, are exempted from the Anti-Monopoly Law for reasons of economic development and public interest.

## **Enforcement**

The Anti-Monopoly Law is expected to have a significant impact on the development of business activities in China. However, the actual effect will depend on the proper, impartial, and effective implementation of the law by various enforcement authorities.

The Anti-Monopoly Law Enforcement Agency (AMEA) has primary responsibility for enforcing the Anti-Monopoly Law. The AMEA is comprised of three government authorities: the Ministry of Commerce, the National Development and Reform Commission (NDRC) and the State Administration for Industry and Commerce (SAIC).

AMEA is empowered to perform on-the-spot inspections, question interested parties, examine and copy relevant data, retain evidence

and make inquiries into a company's bank accounts. Further, AMEA is authorized to delegate its powers to other government agencies, thereby making it possible to increase the overall enforcement of the Anti-Monopoly Law.

The Ministry of Commerce is responsible for anti-monopoly investigation of issues such as mergers and acquisitions, while the NDRC will decide on price issues, and SAIC will decide on issues related to the abuse of dominant positions.

The Supreme People's Court has designated specialized intellectual property courts as the courts responsible for hearing cases brought forward under the Anti-Monopoly Law. This includes damage action cases and cases involving judicial review of the decisions of AMEA.

As regards decisions concerning merger control, the parties will need to apply to the Ministry of Commerce for administrative reconsideration, before they can bring an administrative lawsuit to challenge such decisions. In contrast, as to decisions arising from the investigation of monopoly agreements or abuse of dominance, parties may directly challenge such decisions before the courts.

Companies that violate the Anti-Monopoly Law can be subject to severe penalties. Among other things, fines of between 1% and 10% of the violator's turnover can be imposed, and mergers or acquisitions that trigger merger review in China and other parts of the world may not be closed, until merger clearance is obtained from the Chinese authorities.

## **CEPA – Easier access to China through Hong Kong**

The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) is a bilateral free trade agreement between mainland China (the customs territory of China) and Hong Kong, which came into effect in January 2004. CEPA was initiated with the purpose of getting the Hong Kong economy back on track after a long period of economic malaise due to fierce competition from neighbouring countries, including China, and the SARS outbreak in 2003.

CEPA has fulfilled its purpose as it has injected momentum into the Hong Kong economy over the past years by facilitating human, goods and capital flow between Hong Kong and China.

CEPA is not a one-of agreement but an open platform as the agreement provides a mechanism for further liberalizations as and when the two parties agree on them. Since the initial agreement (CEPA I), which put up the framework for the partnership arrangement, came into effect, China and Hong Kong have signed five supplements to CEPA. The five supplements have greatly enhanced the close economic co-operation and integration between mainland China and Hong Kong. The most recent, Supplement V (often referred to as CEPA VI), was signed on 29 June, 2008 and came into effect on 1 January, 2009.

Under CEPA, China has agreed to exempt tariffs for all products of Hong Kong origin and allow preferential treatment to Hong Kong service suppliers in certain service sectors. As part of CEPA VI mainland China has also agreed to implement a package of services liberalization and facilitation measures for deepening economic and

trade co-operation between Hong Kong and the neighbouring mainland province of Guangdong.

Even after China's WTO commitments have been fully implemented, Hong Kong manufacturers and service providers can enjoy greater market access to China compared to other FIE's, because CEPA goes beyond China's WTO commitments.

CEPA covers the following three areas:

- Trade in goods: Starting from 1 January, 2006 all goods of Hong Kong origin imported into China enjoy tariff free treatment upon applications by local manufacturers and subject to satisfying the agreed CEPA rules of origin (ROOs).
- Trade in services: Hong Kong service suppliers enjoy preferential treatment when entering the Chinese market in various service areas. Professional bodies of Hong Kong and the regulatory authorities of China have also signed a number of agreements or arrangements on mutual recognition of professional qualifications.
- Trade and investment facilitation: China and Hong Kong have agreed to enhance co-operation in various trade and investment facilitation areas to improve the overall business environment.

The CEPA-rules are very liberal as regards the definition of a Hong Kong company, and applies to any Hong Kong-based company regardless of its nationality and size. For that reason, it may be a strategy for some overseas investors not yet in Hong Kong to partner with or acquire eligible companies based in Hong Kong and thereby take advantage of the CEPA-rules when entering the Chinese market.

## **Benefits under CEPA for Hong Kong manufacturers**

China has agreed to eliminate tariffs on 1,503 items of goods of Hong Kong origin, which basically includes all types of products currently produced in Hong Kong.

China has also agreed to eliminate tariffs on goods of Hong Kong origin covered by other product codes from January 2006 upon application from Hong Kong manufacturers. The elimination of tariffs on these products is, however, subject to a process of consultation and ratification by Chinese and Hong Kong authorities performed twice a year.

The elimination of tariffs on goods under CEPA provides significant tariff savings compared to both current tariff rates and tariff rates under WTO commitments.

Besides the elimination of tariffs on goods, China and Hong Kong have agreed not to apply anti-dumping or countervailing measures to goods imported and originating from the other side. China has also agreed not to apply tariff rate quotas against goods of Hong Kong origin. CEPA does, however, provide measures that safeguard against injury to domestic industries arising as a result of CEPA. Specifically, if the import of goods from one side to the other increases in quantity, so as to cause or threaten to cause serious injury to the domestic industry of the other, CEPA concessions may be suspended and consultations may be commenced.

## **How to enjoy the benefits under CEPA**

Overseas manufacturers do not need an office in Hong Kong to benefit from CEPA, but as mentioned above, goods exported from Hong Kong to China must fulfil the CEPA rules of origin (ROO) in order to claim zero (the tariff preference) tariff under CEPA. In other words, all classified “Made in Hong Kong” goods that meet the ROO

from approved local manufacturers are imported, tariff free, into mainland China.

To meet CEPA standards, in essence, foreign products must have been substantially transformed in Hong Kong and each shipment of goods exported to China must be accompanied by a Certificate of Hong Kong Origin - CEPA (CO (CEPA)) issued by the Trade and Industry Department (TID) or one of the five Government Approved Certification Organizations (i.e. the Hong Kong General Chamber of Commerce; Federation of Hong Kong Industries; the Chinese Manufacturers' Association of Hong Kong, the Chinese General Chamber of Commerce and the Indian Chamber of Commerce, Hong Kong).

Furthermore, before applying for CO (CEPA), the Hong Kong manufacturer must apply for a Factory Registration (FR) with the Trade and Industry Department. A FR validates that the manufacturer's factory has the capabilities to produce the goods for export.

Overseas companies, not based in Hong Kong, can also take advantage of CEPA by outsourcing to, or partnering with, a CEPA-qualified manufacturer or service provider in Hong Kong.

### **Benefits under CEPA for Hong Kong service providers**

Compared to China's WTO commitments, CEPA permits early and preferential access for Hong Kong companies to selected service sectors in China.

The following 40 service sectors are open under CEPA from 1 January, 2009:

- Accounting services
- Advertising services

- Airport services
- Audiovisual services
- Banking services
- Building-cleaning services
- Computer and related services
- Convention and exhibition services
- Cultural services
- Distribution services
- Environmental services
- Freight forwarding agency services
- Individually owned stores
- Information technology services
- Insurance services
- Job referral agency services
- Job intermediary services
- Legal services
- Logistics services
- Management consulting services
- Market research services
- Medical and dental services
- Patent agency services
- Photographic services
- Placement and supply services of personnel
- Printing and publishing services
- Public utility services
- Professional qualification examinations
- Real estate and construction services
- Services incidental to mining (only including oil and natural gas)
- Related scientific and technical consulting services
- Social services
- Sporting services
- Storage and warehousing services
- Securities and futures
- Telecommunications services
- Tourism services
- Trademark agency services

- Translation and interpretation services
- Transportation services (including road freight/passenger transportation services and maritime transportation services)

Furthermore, in industry sectors such as logistics, freight forwarding, architectural and engineering, real estate, transportation, management consulting, advertising, and exhibition and convention, Hong Kong companies can set up WFOEs in China ahead of other foreign investors.

Smaller Hong Kong companies can benefit from several specific CEPA measures, lowering the asset, capital, turnover or operational requirements for market entry. Examples include banking and legal services. Under China's WTO commitments, the thresholds for entry into the Chinese service sector are much higher.

### **Qualifying as a Hong Kong service provider under CEPA**

Hong Kong service providers, including those that are foreign invested, can benefit from the CEPA arrangement only if they can fulfil certain criteria. While different rules apply to banks, insurance companies and law firms seeking advantages under CEPA, the majority of other kinds of businesses must:

- Be incorporated or established pursuant to the Companies Ordinance or other relevant laws of the Hong Kong Special Administrative Region, and have obtained a valid Business Registration Certificate.
- Have substantive business operations in Hong Kong. The criteria for determination are:
  - The nature and scope of the services provided by a service supplier in Hong Kong should encompass the nature and scope of the services it intends to provide in China.

- A Hong Kong service supplier should be incorporated or established in Hong Kong, and have engaged in substantive business operations for at least 3-5 years.
- During the period of substantive business operations in Hong Kong, the Hong Kong service supplier should have paid profits tax in accordance with the law.
- A Hong Kong service supplier should own or rent premises in Hong Kong to engage in substantive business operations. The scale of its business premises should be commensurate with the scope and the scale of its business.
- More than 50% of the staff employed in Hong Kong by the Hong Kong service supplier should be residents staying in Hong Kong without limit of stay, or people from China staying in Hong Kong on a One Way Permit.

### **Increased co-operation in trade and investment**

Besides the specific advantages given to Hong Kong manufacturers and service providers, China and Hong Kong have come to an agreement on some general trade policies.

The two parties have promised each other to increase co-operation in trade and investment facilitation through greater transparency, conforming standards and enhanced information exchange. Specifically, CEPA currently provides for increased co-operation in the following 9 areas:

- Trade and Investment Promotion
- Customs Clearance Facilitation
- Quarantine and Inspection of Commodities, Quality Assurance and Food Safety
- Electronic Commerce
- Transparency in Laws and Regulations
- Co-operation of Small and Medium-Sized Enterprises
- Co-operation in Chinese Medicine and Medical Products

- Protection of Intellectual Property
- Co-operation on Branding.

### **More information**

Full text documents and detailed information on the CEPA arrangement can be obtained from the Hong Kong Trade and Industry Department (TID) and Hong Kong Trade Development Council (HKTDC) on the following websites:

[www.tid.gov.hk/english/cepa/index.html](http://www.tid.gov.hk/english/cepa/index.html)

[www.tdctrade.com/econforum/index.htm](http://www.tdctrade.com/econforum/index.htm)

## **The legal system in China**

The Communist Party of China (CPC) is involved in all levels of legislative, administrative and judicial functions. From central to local governments, in ministries and commissions, and people's courts, members of the CPC hold central posts with few exceptions.

Both the national State Council, including the heads of its ministries and commissions, and the Supreme People's Court are responsible to the National People's Congress, where members of the CPC hold power. At provincial, municipal, county and village levels, local governments and people's courts are responsible to local people's congresses dominated by CPC-members.

For these reasons the CPC holds much decision-making power in all major matters concerning China, and the concept of separation of powers between legislative, judicial and executive institutions is not well-established as in most western countries.

However, it is evident that the open door policy and the impressive economic growth during the last 30 years have had a significant influence on the legal system in contemporary China. In order to attract foreign investment and maintain a stable and modern business environment, the Chinese government has been working hard to adopt a more transparent judicial framework to replace a regime based mainly on political decrees. Over the years, the Chinese government has adopted - and still is adopting - a large number of new laws and regulations, many of which are strongly influenced from the West.

## **Legal instruments**

China's highest legislative authority is the National People's Congress (NPC). It has the right to revise the Constitution and create major legal codes referred to as "basic laws". Apart from this, the NPC also enacts laws, rules and resolutions.

Chinese government directives exist in a hierarchy, which is defined by the Legislation Law of the People's Republic of China. The hierarchy of regulations are:

1. The Constitution.
2. National laws, which are issued by the NPC.
3. Administrative regulations, which are issued by the State Council.
4. Local decrees, which are issued by local people's congresses.
5. Administrative and local rules, which are issued by an administrative agency or by a local People's Government.

In China, laws are usually broadly drafted with much discretion left to implementing authorities. Some laws amounts to little more than statements of principle, so real clarity exists only at the level of administrative rules, circulars or bylaws.

## **State structure**

Besides the CPC, the primary organs of state power are the National People's Congress (NPC), the President (the head of state) and the State Council.

Other important organs are the people's courts and the people's procuratorates.

## **National People's Congress**

The National People's Congress (NPC) is defined in the 1982-constitution as "the highest organ of state power" without being identified, as it was in the previous 1975-constitution, as "under the leadership of the Communist Party of China." Although the trend has been to enhance the individual role of the NPC, the given image of a true and democratic parliament is somewhat theoretic. With the CPC exerting full control of the NPC, the NPC is perceived by many observers as nothing but a base for the CPC to legitimize and exercise their powers.

The formal functions of the NPC are as follows:

- To amend the state constitution and enact laws governing criminal offences, civil affairs, the state organs and other matters
- To supervise the enforcement of the state constitution and the law
- To elect the president and the vice president of the republic
- To select the Premier of the State Council upon nomination by the president
- To elect major officials of the State Council, commissions, courts, and procuratorates
- To examine and approve national economic plans and budgets
- To supervise the Standing Committee and the State Council

3.000 deputies of the NPC serve 5-year terms and are elected by people's congresses at the provincial level and by the armed forces. The deputies, who meet once a year, are organized into delegations according to the units they are elected from. Each delegation is headed by a chairman and a number of vice chairmen.

Because of its infrequent meetings, the NPC functions through a permanent organ called the Standing Committee, and several other committees. The Standing Committee is composed of the Chairman, Vice Chairmen, Secretary-general and members. The constitution

empowers the Standing Committee to enact and amend laws, with the exception of those, which should be enacted by the NPC, thus giving the Standing Committee extensive legislative powers. The Standing Committee is responsible to and reports to the NPC on a regular basis.

The NPC establishes special committees to examine, discuss and draw up relevant bills and draft solutions under the direction of the NPC and its Standing Committee.

According to the Legislation Law of the People's Republic of China, the following four steps are required for a bill to become legislation:

1. Submission of the bill to the NPC by qualified persons or organizations such as the President of the NPC, the State Council, or a delegate to the NPC.
2. Discussion and deliberation on the bill by the delegates, the relevant special committees and the NPC's Law Committee. The Law Committee shall submit a report on the results of the deliberation and a revised draft law to the President.
3. Adoption and voting on the bill at the NPC. The bill will be passed if a majority of the NPC-delegates votes in favour of it. If a majority votes against it, the law will be either rejected or referred back to the drafting committee for further discussions.
4. Promulgation of the law by the President of the PRC after the NPC has approved the final version.

The legislative procedure under the Standing Committee is very similar to the one under the NPC.

## **State Council**

The State Council of the People's Republic of China is the highest organ of state administration in China, equivalent to a cabinet or council of ministers in most other countries.

Members of the State Council include the Premier (the head of government), a variable number of vice premiers (at present 4), five state councillors, a number of ministers (at present 25), the Auditor-General, the governor of the People's Bank of China and the Secretary-General of the State Council who is responsible for the day-to-day work of the State Council.

Although the NPC and its Standing Committee are the main legislative bodies, the State Council is empowered by the constitution to perform the following legislative activities:

- To adopt administrative measures, enact administrative rules and regulations, and issue decisions and orders.
- To submit proposals to the NPC or its Standing Committee.
- To issue rules governing administrative affairs with respect to national economic and social development, the state budget, urban and rural development, education, science, culture, public health, sports, population control, internal affairs, public security, judicial administration and national defence.
- To alter or annul inappropriate orders, directives and regulations issued by the ministries or commissions.

## **People's courts**

The court system in China is divided into four levels, from top to bottom, as follows:

- The Supreme People's Court at the national level.
- The Higher People's Courts at the provincial level.
- The Intermediate People's Courts at the municipal level.
- The Basic People's Courts at the county or district level.

Special courts (Courts of Special Jurisdiction) have been set up separately to handle matters affecting the military (Military Court of

China), railway transportation (Railway Transportation Court of China), maritime law (Maritime Court of China) and forestry.

Local people's courts are responsible to and report on their work to the local people's congresses at corresponding levels and their standing committees, while the Supreme People's Court is directly responsible to the Standing Committee of the NPC, which elects the court's president.

Within each court, there are usually several divisions, such as civil, economic, criminal, administrative, and enforcement divisions. Simple civil cases and minor criminal cases can be tried by a single judge, whereas bigger and more complicated cases and second trial cases are heard by a panel of three to five judges.

The Supreme People's Court is the highest judicial organ in China. Located in Beijing, it has jurisdiction over all lower and special courts, for which it serves as the ultimate appellate court.

The court employs over 200 judges who meet in smaller tribunals to decide on cases. The Supreme People's Court has a criminal division, a civil division, and an economic division. It may create other divisions if deemed to be necessary.

According to the constitution and statutes, the main responsibilities of the Supreme People's Court are as follows:

- Handling legal cases that:
  - a) are of the greatest influence;
  - b) are appeals or protests against judgements and orders of Higher People's Courts and special courts;
  - c) are deemed by it that it should try.
- Supervising the administration of justice by local people's courts and special courts at all levels.
- Giving judicial interpretation of questions concerning specific applications of law in judicial proceedings.

In the Chinese adjudication system, a case is decided after two trials. This means, first, that a judgment or order of a first instance court must come from a local people's court, and that a party may bring an appeal only to the people's court at the next higher level. Secondly, judgments or orders of the first instance of the local people's courts at various levels become legally effective if, within the prescribed period for appeal, no party makes an appeal. Thirdly, judgments and orders of the court of the second instance shall be seen as final decisions of the case. However, any judgments and orders rendered by the Supreme People's Court as the court of the first instance shall become immediately legally effective.

The Chinese legal system is a civil law system. It does not contain the doctrine of stare decisis. There is no legal precedent or standards from higher courts for inexperienced judges to follow and no guidance system to ensure uniformity in the interpretation and application of the law. Only selected court decisions from the Supreme and Higher People's Courts are released to the public.

### **People's procuratorates**

A hierarchy of prosecuting organs called people's procuratorates parallels the court system. At the apex of this structure stands the Supreme People's Procuratorate.

The people's procuratorates are state organs for legal supervision. Besides having the overall responsibility for public prosecution, including the combat of corruption, bribery, tax-related fraud and other economic crimes, the procuratorates exercise legal supervision over activities conducted in prisons and reform-through-labour institutions.

The Supreme People's Procuratorate is responsible to the NPC and the Standing Committee.

## **Provincial and local government**

China has 22 provinces, 5 autonomous regions, including Tibet, and 4 municipalities directly under the State Council (including Beijing and Shanghai).

The governors of the provinces and autonomous regions and mayors of the centrally controlled municipalities are appointed by the central government after receiving consent from the NPC.

The provinces and autonomous regions are divided into autonomous prefectures, counties, autonomous counties and cities, and the counties and autonomous counties are divided into townships, ethnic townships and towns.

The municipalities directly under the Central Government and large cities in the provinces and autonomous regions are divided into districts and counties; and autonomous prefectures are divided into counties, autonomous counties and cities.

People's congresses are established in provinces, autonomous regions and municipalities directly under the Central Government, autonomous prefectures, counties, autonomous counties, cities, municipal districts, townships, ethnic townships and towns. Standing committees are established at people's congresses at and above the county level.

Local people's congresses at various levels ensure the observance and implementation of the Constitution and the law and the administrative rules and regulations in their respective administrative areas. Within the limits of their authority, they adopt and issue resolutions and examine and decide on plans for local economic and cultural development and for the development of public services.

The people's congresses of provinces, autonomous regions, municipalities directly under the Central Government of cities which

are capitals of the provinces or autonomous regions as well as large cities approved by the State Council have the right to adopt local regulations in the light of their regional political, economic and cultural characteristics.

Local people's congresses at their respective levels elect and have the power to recall governors and deputy governors, or mayors and deputy mayors, or heads and deputy heads of counties, districts, townships and towns. Local people's congresses at and above the county level shall examine and approve the plans for economic and social development and the budgets of their respective administrative areas and examine and approve the reports on their implementation. They have the power to alter or annul inappropriate decisions of their own standing committees. While most of the jurisdictions are run by appointed officials, some lower-level jurisdictions have direct popular elections.

### **Hong Kong and Macau - Special Administrative Regions**

The Hong Kong and Macau Special Administrative Regions (SARs) have some local autonomy since they have separate governments, legal systems, and basic constitutional laws. They are, however, under Beijing's control in matters of foreign affairs and national security, and their chief executives are handpicked by the central government.

Hong Kong and Macau have their own separate judicial systems based on British common law traditions and Portuguese civil law traditions respectively, and are out of the jurisdiction of the Supreme People's Court and the People's Procuratorate.

## Frequently Asked Questions

### 1. *Can I expect a fair trial if I take legal action in a Chinese court?*

In general, you can expect a fair trial in developed places such as Beijing, Shanghai, Guangzhou and Shenzhen. In these cities, courts are capable of handling most business-oriented disputes in a legally satisfactory way, with better facilities and better educated judges than in other parts of the country.

However, in terms of judiciary independence, the Chinese courts do not meet the standard of courts in western countries. The lack of fundamental checks and balances in the legal system, poor funding of the courts and the judges, and a heavy influence from the CPC, local governments and other powerful institutions, can make it difficult for courts to deliver judgements based solely on a strict application of law.

### 2. *Is litigation the typical means for dispute resolution in China?*

Traditionally, China has placed less emphasis on litigation and more reliance on alternate dispute resolution mechanisms such as mediation. Resolving a legal dispute in court is not considered a serious option by most Chinese people and enterprises.

By opening up to foreign investments and introducing new laws and regulations, the traditional approach to dispute resolution is now less prevalent. Nowadays, the need for formal dispute resolution mechanisms in China is in demand, and many companies use Chinese courts to seek remedies despite their inherent weaknesses.

In order to obtain a fair, swift and flexible settlement of commercial disputes, foreign enterprises often make use of arbitration clauses when entering into commercial agreements.

China has a variety of local arbitrations commissions, however only two of them are internationally recognized: the China International Economic and Trade Arbitration Commission and the China Maritime Arbitration Commission.

3. *Do all courts in China have jurisdiction to handle foreign related cases?*

No, according to the Chinese Law on Civil Procedure, only Intermediate and Higher People's Courts have jurisdiction to give first instance decisions in foreign related cases. Basic People's Courts, however, may also have jurisdiction if approved specifically by the State Council.

4. *Is it difficult to enforce court decisions in China?*

Yes. Even with a clear court order in hand, the enforcement of it may turn out to be difficult, sometimes even impossible.

The reason is usually attributed to corruption, local protectionism and various conflicts of interest rather than insufficient means of enforcement provided by law. Despite the fact that the Chinese government and the Chinese media have brought these problems into focus, they still exist in the Chinese judicial system, especially outside major cities.

In the following situations, enforcement obstacles can be expected:

- Due to limited jurisdiction, court orders from one province have little chance of being enforced in another province.

- Court orders made against persons or enterprises with strong relations to CPC-members are almost impossible to enforce due to the omnipotence of the One Party State.
- Court orders made against persons or enterprises with strong relations to local court divisions of enforcement or the police are also very difficult to enforce due to conflict of interests.

The fact, that local courts and police departments are dependent on economic funding from the local government, can make it difficult to enforce court orders against major tax payers in the local community.

It must be noted, though, that the Supreme People's Court has realised this issue and has made tremendous efforts to improve enforcement in recent years, hence the situation has been improving.

#### 5. *Can I appeal a court decision?*

Yes. According to Chinese law, each case shall have at most two trials, which means that litigants to a case and their legal representatives, who challenge a judgment made by a local court in the trial of first instance, have the right to appeal the case to the next higher level court, but only once. In other words: A decision made by an Intermediate People's Court can be appealed to a Higher People's Court.

Once an appeal is filed, the next higher court must try the case again. The judgment of the second trial shall be final and cannot be appealed.

However, the parties to litigation may challenge the final decision or the effective decision through the trial supervision procedure

by appealing to the appellate court or the higher court. After reviewing the complaint, the president of the appellate or higher court may ask the Judicial Committee to make a decision to accept or reject the appeal. It must be noted, though, that under no circumstances does the retrial initiated by the trial supervision procedure suspend the enforcement of the effective judgment that is challenged.

# Chinese business customs and mentality

Despite the fast economic development in major parts of the country, and the increasing appetite of Chinese people to adopt western lifestyles, China is still a country with its own very special character. Many first time visitors to the "middle kingdom" will without doubt find the Chinese mentality and culture interesting but also challenging.

Considering the differences between Chinese culture and the "western way of doing things", the success of your business efforts in China may very well depend on how well you understand and get along with your Chinese counterparts. Insight into Chinese traditions and habits and careful preparations prior to important meetings are essential.

## How to negotiate in China

- It is a good idea to bring your own Chinese interpreter when negotiating. The interpreter can help you understand everything that is said in a meeting, both explicitly and between the lines, which is especially useful when English is poorly spoken or when Chinese is the language used.
- Expect to make several presentations and to different levels of the other party, as the structure of Chinese organizations tend to be hierarchical.
- Expect that meetings can be arranged and cancelled with short notice and that you may have to attend a meeting during the weekends.

- Chinese people love colours and impressive numbers and figures. Presentation materials should be eye-catching and there should be enough copies for everyone.
- Chinese businessmen rely largely on subjective feelings and personal experiences. First hand impressions are therefore very important.
- In Chinese business culture one of the most important concepts is “saving face”. Making a Chinese person lose face is the same as saying that you don’t owe the person your respect. Causing embarrassment or loss of composure, even unintentionally, can be a disaster for successful negotiations.
- A meeting begins with the ceremonial exchange of business cards. In Chinese business culture, this is the formal way to determine who the key-person(s) in the decision making process are. Business cards should therefore always show your full professional title(s).
- To make a good impression, have business cards made with English on one side and Chinese on the other side. Make sure the Chinese characters are precise and correct.
- Chinese people are keen on things that demonstrate prestige and prosperity. If your company has a reputation of being the oldest, biggest or best, or if you are recognized as a supplier of a royal family, don’t forget to mention it on your business card.
- Always remember to present your card with both hands, pretending to give away something precious. The business card is your face and should be treated with respect. Likewise, when you receive a business card, show your appreciation by reading the card carefully, praise the design and content, and place it

gently in your time manager, breast pocket, or on the table in front of you.

- There is a strong emphasis on hierarchy in Chinese business culture. Always remember to think of hierarchical orders when you and your colleagues enter the meeting room, shake hands, speak aloud and lead discussions. Subordinates are not supposed to lead the way or interrupt any discussion.
- At the end of a meeting, the guests are expected to leave the room first and in hierarchical order.
- In China, humility and politeness towards foreigners is a true virtue. Chinese find it very difficult to say “no” directly, instead ambivalent answers such as “I need to think more about it”, “maybe”, “I am not sure”, etc. are often used.
- Chinese business people have a reputation of keeping negotiations going on “forever” in order to tire you out and gain advantage. Try to set up a deadline, albeit don’t expect your Chinese counterparts to take too much notice of it.

### **Business meals**

- Business lunches and dinners are popular in China. Business breakfasts, however, are not a part of the Chinese business culture.
- Dinners start between 6.00 p.m. and 7.00 p.m. and rarely last for more than a few hours.
- Chinese seating etiquette is based on hierarchy; therefore always wait to be seated. Generally, the seat at the middle of the table, facing the door, is reserved for the guest of honour or most

important person (senior member). Usually, the host sits besides the guest of honour to the left. Other guests are seated in descending order of status.

- Remember not to begin eating or drinking before the host.
- The Chinese have a keen interest in food and the process of eating can best be described as a social event. By using your chopsticks you nibble at one dish after the other. It is perfectly all right to reach in front of each other, although the revolving glass plate on which the dishes are located usually will bring your chosen dish well in reach. You may experience that the host as a courtesy places food for you to taste on your plate.
- During a meal, expressing enthusiasm about the food is normal social behaviour.
- Alcoholic drinks in form of wine and beer are common and your Chinese host may try to test your ability to handle alcohol by serving various local strong liquors. The reason for this is that the Chinese believe that alcohol brings out your true face.
- During the meal it is very common that the host makes a toast by giving a little speech appreciating your mutual friendship and business relationship. You may experience that the host ends the speech by saying “ganbai” which means “bottoms up” or “empty the glass”. You are expected to return the toast by giving a little speech later. It also quite often happens that the other participants in the meal approach you one by one in hierarchical order to have a private toast with you. In this situation, you are also expected to return the toast individually.
- Smoking is fully acceptable, both during and after a meal. Remember to offer cigarettes to the rest of the table.

- The serving of fruit and the presentation of hot towels signals that it is time to leave the dining table. According to Chinese business etiquette, it is the guest who should make the first move, as the host will not initiate a guest's departure.
- It is well seen to reciprocate the hospitality of your Chinese host by hosting a business lunch or dinner yourself. Despite your obvious interest in making a good impression, do not surpass your Chinese counterpart by arranging a more lavish gathering. This may cause your Chinese counterpart to lose face.
- Chinese people love Chinese food. Take them to a good Chinese restaurant rather than a fancy Italian restaurant, unless you are very sure that your Chinese counterpart has a true taste for western food.
- Generally, tipping is considered an insult in China rather than an expression of appreciation. Do not tip unless you are in an international restaurant or a big hotel.

### **Public behaviour and addressing**

- Initial greetings are done by a handshake. Do not attempt any intimate contact such as hugs or kisses on the cheeks, unless your Chinese counterpart initiates such gestures.
- On formal occasions, most Chinese people should be addressed with their official title and name. Alternatively, "Mr.", "Madam", and "Miss" in conjunction with the last name will normally also do. You may find many Chinese names difficult to pronounce and remember. If a Chinese has adopted an English first name, which is very popular among young people, you can also use this name.

- If you are invited to workplaces, conferences or other places with many Chinese people gathered, it is likely you will be welcomed with applause. Show your gratitude by applauding back.
- If you wish to give a present or pay for a meal, you will need to insist on it at least three times before Chinese people will give their acceptance. This is the Chinese way of showing hospitality and friendship. Don't forget to show equal reluctance if it is you who are offered something.
- The concept of Chinese politeness can sometimes be difficult to understand for foreign people. Because it is so essential in Chinese culture not to lose face, many Chinese people will rather tell you to go a wrong way than admitting that they don't know the way. You may also find that people do not open the gift you presented in front of you because according to Chinese custom it may be considered as showing greediness.

### **Small talk and conversation**

- Chinese people prefer to chitchat before turning to serious talks or negotiations. Expect to be asked about your journey and your opinion on the city, the Chinese people, the Chinese food etc.
- Chinese people are easy to impress if you can demonstrate a little knowledge of Chinese history, culture, geography, or topical issues. Do a little preparation, e.g. by reading Chinese newspapers on the Internet.
- Be aware that certain topics are sensitive in China. Avoid initiating any discussions on the Tibet issue, the China-Taiwan dispute and the communist party.

- Learn a few Chinese words. Your Chinese host will appreciate your initiative, even if he/she finds your pronunciation difficult to understand.

# Useful links

## Help and advice when establishing a FIE in China

- [www.capitallaw.cc](http://www.capitallaw.cc)  
Capital Associates' website.
- [www.ncochina.com](http://www.ncochina.com)  
NCO China's website.

## Government and organizations

- <http://english.gov.cn/index.htm>  
The official website of the Chinese central government.
- [www.ebeijing.gov.cn](http://www.ebeijing.gov.cn)  
Official website of the Beijing Municipal Government.
- [www.shanghai.gov.cn](http://www.shanghai.gov.cn)  
Official website of the Shanghai Municipal People's Government.
- [www.china.org.cn](http://www.china.org.cn)  
Government portal site to China that offers broad access to news about China.
- [www.fdi.gov.cn](http://www.fdi.gov.cn)  
Website of the Chinese Ministry of Commerce directed to foreign investors. The site comprises government news and information about investment directions, economy, statistics and law.
- <http://english.mofcom.gov.cn/>  
Official website of the Chinese Ministry of Commerce.

- [www.chinainvest.com.cn](http://www.chinainvest.com.cn)  
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- [www.tdctrade.com](http://www.tdctrade.com)  
Hong Kong Trade Development Council's website. Provides information about CEPA.
- [www.tid.gov.hk/english/cepa/](http://www.tid.gov.hk/english/cepa/)  
Website of Hong Kong Trade and Industry Department. Provides full text documents on all CEPA agreements and annexes.
- [www.adb.org](http://www.adb.org)  
Website of the Asian Development Bank.

### **Other sources of information about China**

- [www.transparency.org](http://www.transparency.org)  
Website of Transparency International, a coalition against corruption.
- [www.hoover.org/publications/clm](http://www.hoover.org/publications/clm)  
Website of the Hoover Institution of Stanford University. Provides information about China's leadership politics and its foreign and domestic policies.
- [www.chinaeconomicreview.com](http://www.chinaeconomicreview.com)  
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- [www.worldbank.org/transitionnewsletter](http://www.worldbank.org/transitionnewsletter)  
World Bank newsletters on developing economies.

- [www.cia.gov/library/publications/the-world-factbook/](http://www.cia.gov/library/publications/the-world-factbook/)  
U.S. CIA World fact book.
- [www.expatsinchina.com](http://www.expatsinchina.com)  
A guide for foreigners living in China.

## **Logistics**

- [www.maps-of-china.com](http://www.maps-of-china.com)  
Maps of Chinese cities, provinces and regions in the principal areas of China.
- [www.primecargo.com](http://www.primecargo.com)  
Website of the international transportation and freight forwarding company Primecargo.
- [www.dsv.com](http://www.dsv.com)  
A transportation company that offers end-to-end transport and logistics solutions.

## **News in English**

- [www.chinadaily.cn](http://www.chinadaily.cn)  
Website of China Daily, the Chinese government's official mouthpiece.
- [www.scmp.com](http://www.scmp.com)  
Website of South China Morning Post, which is a little less censored than China Daily.
- [www.shanghaidaily.com](http://www.shanghaidaily.com)  
Website of the local Shanghai newspaper
- <http://english.peopledaily.com.cn>.

## **Chambers of commerce**

- [www.amcham-china.org.cn](http://www.amcham-china.org.cn)  
The American Chamber of Commerce in China.
- [www.europeanchamber.com.cn](http://www.europeanchamber.com.cn)  
The European Chamber of Commerce in China.
- [www.pek.britcham.org](http://www.pek.britcham.org)  
The British Chamber of Commerce in China.
- [www.ccifc.org/](http://www.ccifc.org/)  
The French Chamber of Commerce in China.
- [www.dccc.com.cn](http://www.dccc.com.cn)  
The Danish Chamber of Commerce in China.
- [www.swedishchamber.com.cn](http://www.swedishchamber.com.cn)  
The Swedish Chamber of Commerce in China.

## Abbreviations

AIC	Administration of Industry and Commerce
AMEA	Anti-Monopoly Law Enforcement Agency
ASBE	Accounting Standards for Business Enterprises
BLTB	Beijing Local Tax Bureau
CAS	Chinese Accounting Standards
CBRC	China Banking Regulatory Commission
CCPIT	China Council for the Promotion of International Trade
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual or Cooperative Joint Venture
CO (CEPA)	Certificate of Hong Kong Origin (CEPA)
COFCOM	Commission of Commerce
CPA	Certified Public Accountant
CSRC	China Securities Regulatory Commission
DTT	Double Taxation Treaty
EJV	Equity Joint Venture
EPZ	Export Processing Zones
FESCO	Foreign Enterprise Service Corporation
FIE	Foreign Investment Entity
FIP	Foreign Invested Partnership
FR	Factory Registration with TID (CEPA)
HKTDC	Hong Kong Trade Development Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LoI	Letter of Intent
MII	Ministry of Information Industries
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NPC	National People's Congress

PBOC	People's Bank of China
PRC	People's Republic of China
RMB	Renminbi
RO	Representative Office
ROOs	Rules of Origin (CEPA)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAR	Special Administrative Region (Hong Kong and Macau)
SAT	State Administration for Taxation
SIPO	State Intellectual Property Office of the PRC
TID	Hong Kong Trade and Industry Department
TRIPs	Trade-Related Aspects of Intellectual Property Rights (agreement under WTO)
WFOE	Wholly Foreign Owned Enterprise
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

## References

We have found inspiration for the handbook on the websites listed under “Useful links”. In addition, various materials from events and presentations together with “Danmarks Nationalbank, Quarterly Review 1, 2009” have been used.

Last, but not least, we have drawn on the long experience of Capital Associates and NCO China in advising clients.

# Contact information

## Beijing

Capital Associates

Tel: + 86 8447 9588

Email: [lukalu@capitallaw.cc](mailto:lukalu@capitallaw.cc)

[www.capitallaw.cc](http://www.capitallaw.cc)

NCO China, Beijing

Tel: + 86 10 8447 8118

Email: [enquiry@ncochina.com](mailto:enquiry@ncochina.com)

[www.ncochina.com](http://www.ncochina.com)

## Shanghai

NCO China, Shanghai

Tel: + 86 21 51699589

## Guangzhou

NCO China, Guangzhou

Tel: + 86 20 8751 4381

## Tianjin

NCO China, Tianjin

Tel: + 86 22 8210 1281

## Denmark

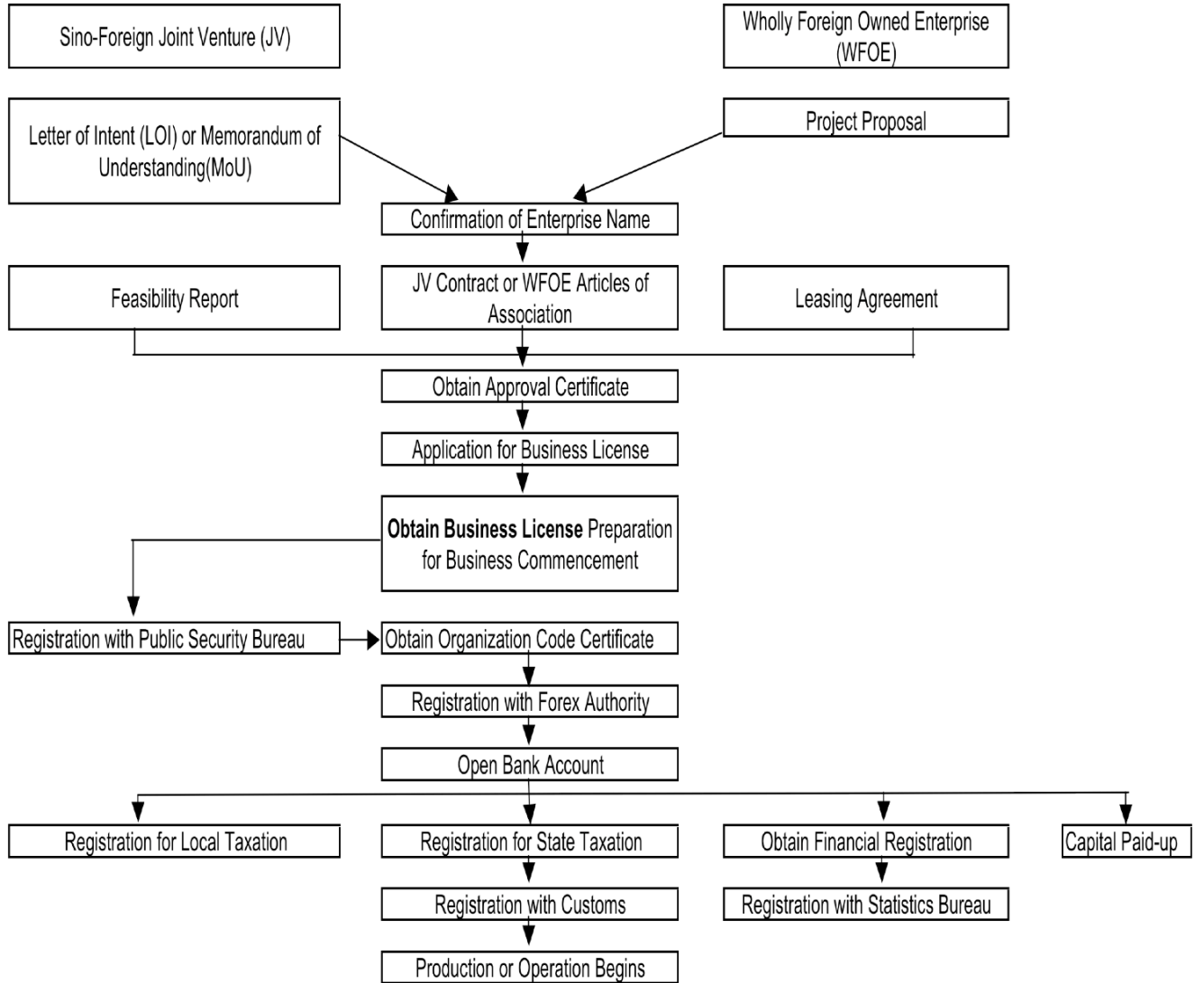
NCO (China Consult APS)

Tel: + 45 3917 9895

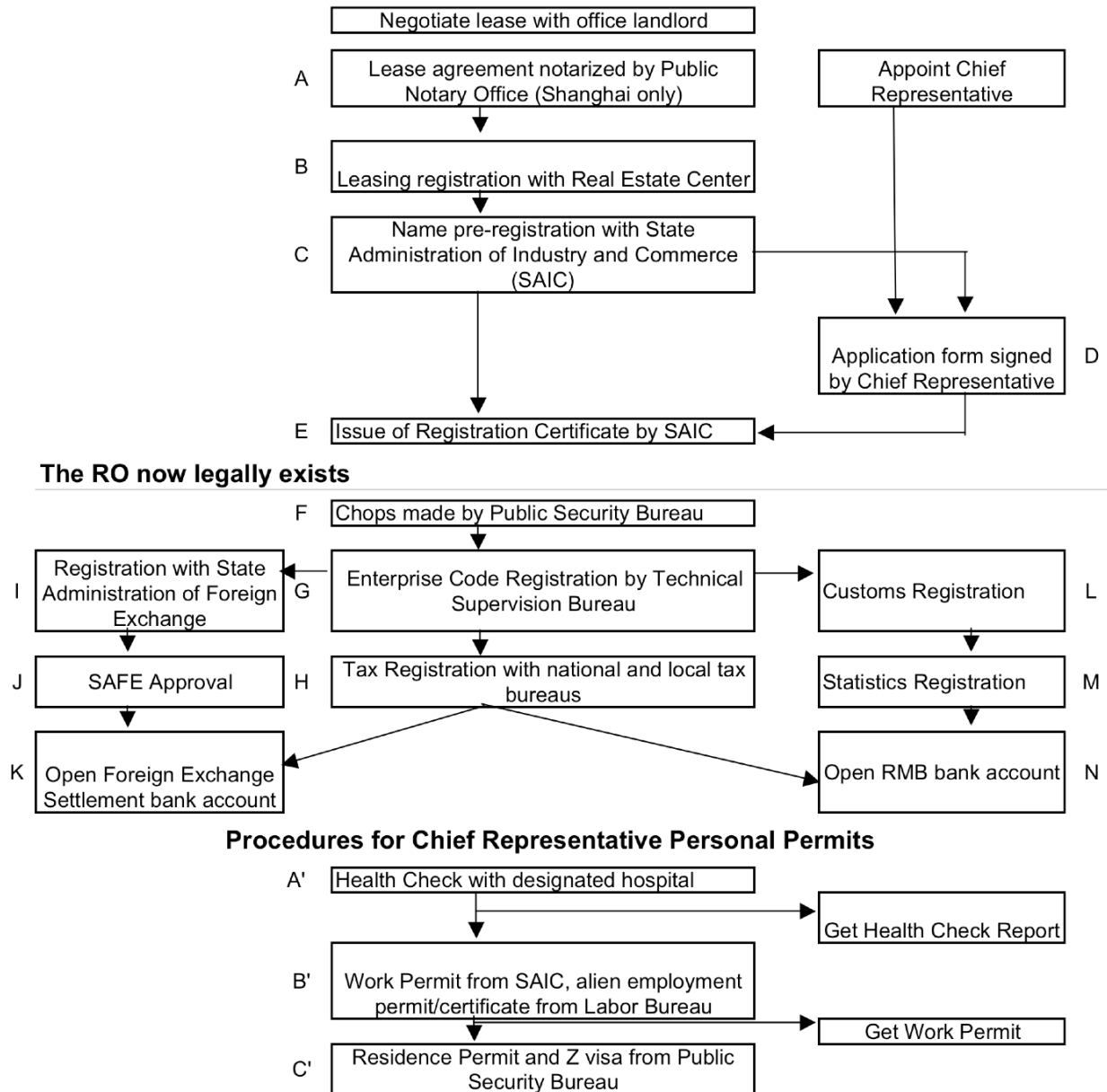
NCO China is an affiliate of AFP Group, with offices in  
Hong Kong - Taipei - Singapore - New Delhi – Zurich



## Appendix 1: Overview of establishment procedures for WFOE or Joint Venture



## Appendix 2: Overview of establishment procedures for Representative Offices



Notes-there are some regional variations to this process

1. Shenzhen-SAFE registration/approval not required
2. Guangzhou-lease agreement does not need to be notarized; customs registration usually not required; foreign exchange account not required
3. Beijing-only commercial buildings can be used as registration address; some minor differences to registration of leasing agreement

# Break Through The Chinese Wall