

Break Through the Chinese Wall

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

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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.

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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

www.tdctrade.com/econforum/index.htm

Useful links

Help and advice when establishing a FIE in China

- www.capitallaw.cc
Capital Associates' website.
- 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
Official website of the Beijing Municipal Government.
- www.shanghai.gov.cn
Official website of the Shanghai Municipal People's Government.
- www.china.org.cn
Government portal site to China that offers broad access to news about China.
- 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
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- www.tdctrade.com
Hong Kong Trade Development Council's website. Provides information about CEPA.
- 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
Website of the Asian Development Bank.

Other sources of information about China

- www.transparency.org
Website of Transparency International, a coalition against corruption.
- 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
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- www.worldbank.org/transitionnewsletter
World Bank newsletters on developing economies.

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

Logistics

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

News in English

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

Chambers of commerce

- www.amcham-china.org.cn
The American Chamber of Commerce in China.
- www.europeanchamber.com.cn
The European Chamber of Commerce in China.
- www.pek.britcham.org
The British Chamber of Commerce in China.
- www.ccifc.org/
The French Chamber of Commerce in China.
- www.dccc.com.cn
The Danish Chamber of Commerce in China.
- 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.

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