GUIDE TO SUCCESSFUL INVESTMENT AND DEVELOPMENT IN CHINA

JUNE 2012

LPA, Lefèvre Pelletier & associés
GUIDE TO SUCCESSFUL INVESTMENT AND DEVELOPMENT IN CHINA

LPA, Lefèvre Pelletier & associés, opened its first Asian office in Hong Kong in 1998. At the time, no one imagined we would later be opening offices in Guangzhou and Shanghai. With China’s transformation into a major power over the last decade however, LPA’s expansion in this way was an obvious step.

This strong presence in China has allowed our firm to provide better services to clients, and to our European and Chinese clients in particular. Today’s China fascinates and constitutes a force that cannot be ignored by any company with an international dimension. China can also be a source of concern: we help clients to understand it and do business with it. China is unlike any other countries and almost a world apart, as you will learn while reading this “Guide to Successful Investment and Development in China”.

We hope that the overview of the legal framework for doing business in the People’s Republic of China provided by this guide will be of assistance to you. Our three offices in China, our China Team in Paris, and all of our partners in the area will be happy to advise you and help you make your “investment and development in China” a success.

LPA, Lefèvre Pelletier & associés

June 2012

The information contained in this brochure is of a general nature and does not constitute a legal opinion and/or advice.

Lefèvre Pelletier & associés is one of France’s leading law firms. The firm provides advisory and litigation services to its French and international clients by pooling the skills of its teams in all areas of business law.
INTRODUCTION
1. General presentation of the People's Republic of China p.06
2. Economic structure of China p.06 1.
3. The legal system p.06 2.
4. One country, two systems: the case of Hong Kong p.07 3.

I. Foreign investment in China p.08 4.
2. Incentives and constraints p.08

II Setting up in China p.09 5.
1. A minor presence: the representative office p.08 8.
2. Setting up in China via Hong Kong p.09 7.
4. The different company forms p.09 9.

III. Creation of a legal entity in China: the WFOE example p.10 3.
1. Capital, company purpose and minimum number of shareholders p.10 10.
3. Limits of managers’ powers p.12 12.
5. Liability of managers p.12 12.

Acquisition of a company in China by foreigners p.13 1.
General information p.13 1.
The case of Hong Kong p.15 15.

Law of contracts p.15 15.
A law similar to Continental Europe law p.15 15.
With very different contracting parties: negotiation in China p.15 15.

Taxation p.16 16.
Principal taxes payable by legal entities p.16 16.
Main taxes payable by private individuals p.17 17.
Rules specific to real estate assets p.18 18.
The attractive taxation of Hong Kong p.18 18.

General information p.19 19.
Employment contracts p.20 20.
The status of expatriates and seconded personnel p.21 21.
Labour legislation in Hong Kong p.22 22.

VIII. Intellectual property law p.23 4.
1. Trademarks p.23 23.
6. Web sites and domain names p.27 27.
7. Company names p.27 27.
8. Counterfeiting p.27 27.
9. The specific intellectual property regime in Hong Kong p.28 28.

IX. Insurance p.28 28.
2. The legislative framework and the prerequisites for authorizations p.29 29.
3. Reforms and prospects p.29 29.
4. Organization and operation of insurance companies p.29 29.

X. Financial and banking system p.30 30.

XI. Outline of real estate law in China p.31 4.
The land ownership regime p.33 33.
Major principles of real estate acquisition p.34 34.

XII. Sustainable development and the environment p.35 5.
A desire for strong protection in the face of real constraints p.35 35.
Regulatory and tax incentives for companies in China p.35 35.
Operations to implement the Kyoto Protocol in relation to climate change in China p.35 35.
Introduction

1. General presentation of the People's Republic of China

In thirty years, the People's Republic of China has undergone development that is unparalleled by any other country. The West sees this as catching up, China sees it as the end of a decline that began more than two centuries ago. China is now a leader among nations and the second biggest economy in the world, ahead of its only rival in Asia, Japan.

China has always been a country out of all proportion: an immense territory 15 times bigger than France, a population over 1.3 billion or 20% of the world’s population where cities are getting higher and more crowded and where Paris would occupy 35th place. It amazes by its blistering growth, all the more so since the developed countries are mired in a crisis with no end in sight. Known for a long time as the factory of the world, China is above all on its way to becoming the second biggest consumer market in the world.

Improving the fortunes of the Chinese (of all Chinese people) is the main objective of the current administration, which is giving itself the means to realize its ambitions. Today, we see an economic system more and more liberal, a legal system that is increasingly sophisticated, and massive investment in infrastructure: they are all signs to show that China is reaching its goal and becoming one of the world’s wealthiest nations albeit it was still only 127th in terms of GDP per capita in 2011 according to the World Bank. China’s growth and stability make it attractive of GDP per capita in 2011 according to the World

2. Economic structure of China

Everyone is aware of China’s economic progress, and its average annual growth of 9.3% over the past four years is something others can only dream of. When it joined the World Trade Organization (WTO) in 2001, China opened up to the world and increased its development tempo, which was marked by extensive urbanization and increased its development. Moreover, the State’s recent investment in infrastructure is focused on the western provinces. All companies are being encouraged to invest in this area.

China must also face the challenges resulting from such growth. The environment is a major concern in a country where getting richer means more pollution. One in every ten Chinese people has a car – which was the case in the USA in 1990; a coal-fired thermal plant is created every day, and there are countless other examples. If China’s per capita pollution rate equaled that of a French person, the world would not survive.

40% of the working population though it only accounts for 9.6% of GDP.

Economic wealth remains concentrated on China’s coastline and, at present, the only true economic and tax incentives are those that apply to companies that set up in the west of China. Moreover, the State’s recent investment in infrastructure is focused on the western provinces. All companies are being encouraged to invest in this area.

Since its retrocession to China in 1997, Hong Kong benefits from the particular status of Special Administrative Region (SAR) of the People’s Republic of China. Hong Kong thus retains its own institutional, economic and legal framework. This sovereignty allows it to be a full member of international organizations and to conclude international treaties. In this respect and as an example, Hong Kong has especially concluded the following agreements with France:

- the agreement on the encouragement and protection of investments dated November 30th, 1995;
- the customs cooperation agreement dated May 13th, 1996;
- the information and communication technology cooperation agreement dated March 14th, 2002;
- the agreement for the purpose of preventing double taxation with regard to income and wealth taxes and to prevent tax avoidance and tax evasion, dated October 21st, 2010.

On June 29th, 2003, Hong Kong and mainland China also signed a bilateral free trade agreement, the CEPA (Closer Economic Partnership Agreement), whose last modification came into effect on December 13th, 2009. The CEPA provides for a preferential opening of the Chinese market to Hong Kong-based companies, and a range of measures intended to facilitate trade and investment between Hong Kong and Mainland China. Hong Kong also concluded with China, on August 21st, 2006, a tax treaty titled “the Arrangement for the Avoidance of Double Taxation on Income and Prevention of Fiscal Evasion”. This tax treaty aims to prevent double taxation and tax avoidance. It also provides for a significant decrease in taxation on incomes generated by investments stemming from Hong Kong, which allows Hong Kong to consolidate its role as an essential intermediary between China and the rest of the world.

1. Foreign investment in China

At the end of the Cultural Revolution, the several thousand year old legal system and judicial tradition had been destroyed. The rebuilding of the legal system took place at the same time as China’s policy of openness, which began in 1979, marking the start of an unprecedented wave of economic reforms.

1. A specific legal framework

First, on July 8th, 1979 (modified on March 15th, 2001), in order to attract foreign investors to the Chinese market by providing them with a familiar and protective legal framework, China passed the Chinese-Foreign Equity Joint Venture Law. A law concerning companies that were wholly foreign owned (the “Wholly Foreign Owned Enterprise Law”) was promulgated in 1986 (this law was modified on October 31st, 2000). And a law concerning Sino-foreign co-operatives (the “Chinese-Foreign Contractual Joint Venture Law”) was promulgated on April 13th, 1988 (modified on October 31st, 2000). These three laws and their implementing decrees still govern foreign investment in China and play a very important role in opening China to the rest of the world.

In 1994, the first Companies Law of the People’s Republic of China came into effect (this law was last
The representative office allows foreign companies to set up in their own name on Chinese soil without allowing them to do very much. The creation of a representative office requires little investment which may be limited to renting an office and hiring staff. Within this entity, it is possible to employ Chinese as well as foreign local staff (the number of foreign employees is limited to 4). A representative office has no registered capital. To obtain a foothold in China, foreign companies often open a representative office, although this trend is changing.

It is important to emphasize that a representative office has no legal personality and thus has no power to contract. Its scope of action is quite limited, particularly compared to a commercial or profit-making activity. Most of the time, a representative office merely engages in local liaison and coordination operations as well as market research. It is simply an outpost of the principal company which, from a legal point of view, forms part of the parent company.

An internal note of January 4th, 2010 justifies the presence of representative offices by the simple objective to study the Chinese market and to promote the company represented. The representative office benefited from tax exemption measures, but since the publication of Circular 18 of 20th February 2010, the government has imposed on representative offices a strict tax regime with no particular advantages.

1 Setting up in China via Hong Kong

The strong economic and financial relations between Hong Kong and mainland China (particularly, the province of Guangdong, whose capital is Guangzhou) make companies consider Hong Kong as a strategic base to set up their businesses in China, owing to the many tax, legal and financial benefits of creating a Hong Kong holding company.

(i.) Tax advantages

Hong Kong tax policies are favorable for businesses in several respects. Companies are subject to a relatively low profits tax rate (16.5% for income generated in Hong Kong and zero tax for profits generated outside of Hong Kong). In Hong Kong, there is no tax on turnover, dividends or capital gains, and no VAT or tariffs (with a few exceptions).

Furthermore, set up via Hong Kong generally allows investors to benefit from the provisions enacted by the favorable tax treaties between Hong Kong and China, and Hong Kong and France. These agreements especially aim to eliminate double taxation on income and wealth as well as to reduce withholding tax on dividends and royalties.

(ii.) Legal advantages

Company law in Hong Kong stems from the Common Law tradition. As a result, the law is highly flexible. Investors can create relatively freely terms and conditions of their investment in a Hong Kong company as well as the rights and obligations among shareholders. It is also possible to use trust as a mechanism to realize an investment.

Moreover, business confidentiality is largely developed: accounts of limited liability companies are not required to be published and shareholders’ agreements are not required to be recorded. In addition, restructuring operations such as share transfer, capital increases or statutory changes are not subject to administrative approval, contrary to Chinese regulations.

The CEPA agreements give Hong Kong companies preferential access to Chinese market in goods and services.

(iii.) Financial advantages

Unlike rules in China, it exists in Hong Kong a real flexibility in the funding arrangements of a company: for example, no minimum capital is required to form a company in Hong Kong and contributions can be released without any schedule constraints.

Generally, a company wishing to operate in China through Hong Kong choose to establish a holding company in Hong Kong as a private limited company by shares which can be set up quickly and inexpensively.

3 Distribution network - distributor or franchisee

Many foreign companies that are still unsure of the extent to which they should develop in China and the level of investment to commit in this market that is still an unknown factor prefer to rely on local distributors in order to benefit from their networks (logistic or relational networks with Chinese authorities or with the landlords of coveted commercial premises), technical skills and knowledge of the Chinese market. An establishment is consequently not necessary or can be of minor extent in order to deploy controllers of quality and brand image. A simple trademark licensing agreement and sometimes, a know-how licensing agreement, is then sufficient.

But in order for companies to make up for the loss of control implied in using a distributor, without going so far as to distribute their products themselves, a franchise is often chosen in order to develop in China. The creation of a distribution network in the form of a franchise in China is currently governed by the “Regulations for the Administration of Commercial Franchising Operations” (the “Franchising Measures”), published on December 30th, 2004 by the MOFCOM and its implementing regulations.

The abovementioned franchising regulations only recognize explicitly the legality of the franchise method that is available to foreign companies established directly in mainland China. In order to be a franchisor in China, foreign companies must, in theory, set up a company in China (whose capital can be 100% foreign since December 11th, 2004). The “Franchising Regulations”, which came into effect on 1st May 2007, bring to equal the treatment of foreign and Chinese franchisees and franchisors by the distinction between foreign invested enterprises and domestic enterprises. “Rules on Disclosure of Information Regarding Franchise” that came into force on 1st April 2012 specify the information that the franchisor must provide to the franchisee.

We cannot emphasize strongly enough that special care must be taken when drafting contracts relating to distribution in China. Every possibility must be taken into account and anticipated, even eventualities that would be unthinkable to companies used to working with Western business partners. Particular care has to be given to brand image, shops and prices, and to ensure that only products created by the company are sold on the premises. A very well known European luxury goods retailer recently had an unpleasant surprise when it learned that fake bags were being sold in its Hong Kong stores and another retailer discovered that unregistered products were being sold in one of its Shanghai outlets. Finally, the rise of selling on the Internet should be noted, which is having a major impact on traditional distribution methods and which is subject to specific rules in China.

4 The different company forms

(i.) Joint ventures

A joint venture is when a company is owned and operated jointly by one or more Chinese partners and one or more foreign investors.

There are two categories of joint venture in China: one is governed by the Chinese-Foreign Equity Joint Venture Law, the other by the Chinese-Foreign Contractual Joint Venture Law.

The equity joint venture is a limited liability company with legal personality. The level of foreign participation must account for at least 25% of company capital. Contributions may be made in cash or in kind (and...
in the form of a partnership. Such partnerships are of particular interest to private equity funds, who find it a useful vehicle for creating local-currency funds.

In the “contractual joint venture”, the rights and obligations of the parties are defined by a cooperation contract. The contractual joint venture can be constituted with or without legal personality. If it has legal personality, the foreign stake must account for at least 25% of capital and the parties’ liability is limited to the contractual joint-venture without legal personality, which is nothing more than a contract, is not very common in practice.

Contrary to the “equity joint venture”, the sharing of the profits generated by the contractual joint venture is not necessarily proportional to the capital stake and can be freely determined by the parties.

(ii.) Wholly Foreign-Owned Enterprise (WFOE)

WFOE is a company that is 100% owned by foreign investors and governed by Chinese law. It generally takes the form of a limited liability company. WFOEs must be one or more natural persons or legal entities of foreign nationality or residents of Hong Kong or Macao. The WFOE is the most popular form of establishment, particularly because of the autonomy it provides.

Today a WFOE can be set up in almost all sectors, except those considered “sensitive” or “strategic” where only a joint venture is accepted when foreign investment of any kind is not prohibited, whatever the form.

(iii.) Partnerships

A partnership is a type of company governed by the Law of the People’s Republic of China on Partnership Enterprises adopted on February 23rd, 1997 and amended on August 27th, 2006. This entity is a partnership in which the partners share the profits and losses of the company in which they all invested together.

For a long time, this type of partnership was reserved to Chinese individuals and entities. However, with the entry into effect on March 1st, 2010, the “Measures for Administration of the Establishment of Partnership Enterprises in China by Foreign Enterprises or Individuals” (Decree 567 of the State Council) and the “Administrative Rules on Registration of Foreign Invested Partnership Enterprises” (Order 47 of the State Administration for Industry and Commerce) state that partnership is now available to foreign individuals and/or companies that wish to develop their business in China. These measures represent a decisive turning point for companies and/or natural persons that want to develop their business in China.

There are various kinds of WFOE but the most popular form by far is the limited liability company. WFOEs have the particular characteristic of being subject firstly, to the Wholly Foreign Owned Enterprise Law and secondly, to the Companies Law.

The Wholly Foreign Owned Enterprise Law does not specify any minimum capital requirement for a WFOE. China’s Companies Law only provides for a minimum capital of RMB 30,000 (approximately €3,500) for limited liability companies and RMB 100,000 (approximately €12,000) for single-member limited liability companies. This provision does not apply however to WFOEs whose capital is subject to the approval of the Chinese authorities on a case-by-case basis according to the specific circulars applied to the various sectors and the negotiations conducted with the administration. The amount is consequently highly variable in practice as are the payment installment conditions over time.

Chinese law requires compliance with the ratio between total investment and registered capital.

<table>
<thead>
<tr>
<th>Total INV* (USD)</th>
<th>&lt; 3M</th>
<th>3M &lt; Total INV &lt; 10M</th>
<th>10M &lt; Total INV &lt; 30M</th>
<th>&lt; 30M</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital/Total INV (USD)</td>
<td>70%</td>
<td>50%. Total INV &lt; 4.2M Min. capital 2.1M</td>
<td>40%. Total INV &lt; 12.5M Min. capital 5M</td>
<td>33.33%. Total INV &lt; 36M Min. capital 12M</td>
</tr>
</tbody>
</table>

*INV = Investment  M = Million

Contributions may be in cash or in kind (for example, of capital equipment, industrial property or know-how). Cash contributions cannot be less than 30% of the capital.

The WFOE’s purpose is also subject to the approval of the Chinese authorities. Once the WFOE has been registered, its activity will be limited by its purpose and it will thus not be able to carry on commercial activities beyond that scope. Modifications or extensions of the company purpose are again subject to the approval of the authority concerned and result in a modification of the business license of the company and are almost as long and complicated as setting up a company.

One member is enough to form a WFOE. It cannot have more than 50 members. Members may be natural persons or legal entities. Members must be foreign nationals (non-Chinese nationals) or residents of Hong Kong or Macao. It should be noted that one refers to members and not shareholders because the capital of these companies is not divided into shares. Consequently, only a percentage of company capital is held.

2 | Management bodies

The Wholly Foreign Owned Enterprise Law and its implementing regulations contain no provisions on the governance of the WFOE. If the WFOE is in the form of a limited liability company therefore, the ordinary company law provisions apply.

Within such a company, there are bodies that are mandatory and others that are optional. The mandatory bodies are the general members’ meeting, the board of directors (or a single director in small firms) and the supervisory board (or one or two supervisors in small firms). Optional bodies include the directors appointed by the board of directors.

(i.) General Meeting of Members

The General Meeting of Members consists of all members and plays a fundamental role in the company. It is the company’s sovereign body. The law endows the general meeting with many powers, including the power to:

- decide company policy and the investment program;
- appoint or dismiss members of the board of directors and of the supervisory board;
- determine the remuneration of the members of the board of directors and of the supervisory board;
- approve the reports of the board of directors and of the supervisory board;
- approve the annual accounts and budgets;
- decide on the distribution of profits and the reduction of deficits;
- authorize a change in company capital;
- authorize a bond issue;
- decide on a merger, split, winding-up and the liquidation of the company;
- amend the articles of association.

(ii.) Board of directors

The board of directors is composed of at least three members and may not have more than thirteen. Nevertheless, in WFOEs with very few members, the members or the single member may appoint a sole director. The board of directors is a collegial body. Each director has a voting right. A chairman of the board of directors is appointed in accordance with the articles of association. The board of directors may appoint a director or directors.

The legal representative of the company is appointed in accordance with the articles of association. The legal representative may be the chairman of the board of directors (or the sole director) or the director.

The powers of the board of directors are set out in article 47 of the Companies Law. The board may:
call a general meeting and provide it with a report on its work;
carry out the decisions of the general meeting;
approve the business and investment plan;
prepare the annual financial statements and budgets;
establish the program for the distribution of profits and the making up of deficits;
prepare the plan relating to the modification of company capital and the issue of bonds;
prepare the plan relating to a company merger, split, dissolution or liquidation;
decide to set up bodies for the internal management of the company;
appoint or dismiss the director and determine his remuneration;
appoint the deputy director and the financial manager and determine their remuneration based on the director’s proposal;
develop the principal company management system;
eexercise the powers conferred by the articles of association.

(ii.) Supervisory board
The Companies Law provides that a company must set up a supervisory board comprising at least three members, except for companies with very few members, which may appoint one or two supervisors. As its name indicates, the supervisory board oversees the management of the company, and its finances in particular. It may convene a general meeting if the chairman refuses to do so.

3 | Limits of managers’ powers

The powers of managers in China are often more controlled than in the West. The limits of managers’ powers lie firstly in the powers vested in the other company bodies. The powers conferred by the law on the general meeting and the supervisory board are reserved to these bodies and cannot be delegated.

Secondly, managers cannot sign certain important contracts, including loan and surety contracts, without the prior approval of the members’ meeting or the board of directors.

Thirdly, the powers of managers may be limited by the articles of association. It should be noted that the board of directors is a collegial body whose chairman cannot exercise powers between two sittings.

4 | Company control

The law grants the supervisory board the power to control the finances of the company, with the option of being assisted by a firm of chartered accountants paid by the company. The supervisory board may, in particular, submit a proposal to members’ meeting for the removal of a manager who fails to comply with the articles of association or the law.

China has not yet provided for the formalism found in a number of Western countries making it possible to record and date the decisions of companies’ management bodies. This will certainly come but, in the meantime, only important operations requiring the “carte blanche” approval of the administration are recorded.

5 | Liability of managers

The liability of managers has many aspects. Company officers may be civilly liable towards the company and/ or members and can also incur criminal liability.

(i.) Civil liability of managers
Article 150 of the Companies Law provides that if a manager breaches legislative, regulatory or statutory provisions within the framework of his duties, he must repair the damage suffered by the company. The civil action may be brought by the supervisory board, the board of directors or one or more members acting on behalf of the company. Article 153 of the above law makes it possible for a member who personally suffers damage caused by the manager to demand reparation. Chinese law does not yet contain any provisions about managers’ civil liability towards third parties.

(ii.) Criminal liability of managers
Company managers incur personal liability for criminal offenses they commit personally. Criminal law recognizes the criminal liability of “danwei” (units), a term which includes companies, but also associations. When units are convicted of a breach of criminal law, the persons directly responsible may also be penalized. Certain texts provide for prison sentences for managers owing to the actions of the company they control in a number of specific situations such as the manager of a company that produces or uses explosives for civil use where a statutory safety regulation was breached, resulting in an accident. Apart from these very rare cases, there is no vicarious criminal liability in China.

6 | Transfer of interests

Unless the articles of association stipulate otherwise, transfers of interests (generally a percentage of company capital) are governed by article 72 of the Companies Law.

Transfers may occur freely between members. However, a transfer of interests to a third party must be authorized by the majority of the members. If the majority of members do not agree to the transfer, those members who oppose the transfer must acquire the interests; if they do not, the transfer to the third party is deemed to have been approved.

Members benefit from a right of pre-emption to the interests being assigned. If several members wish to assert their right of pre-emption and do not agree on how to divide the interests, the interests will be shared in proportion to members’ participation in the company capital.

Interests may be freely transferred by way of succession, unless the articles of association stipulate otherwise.

7 | Winding-up and liquidation

The WFOE is dissolved upon the expiry of its term. No maximum term exists for a WFOE but the term must be indicated in the articles of association. In practice, the administration limits it to 30 to 50 years. Winding-up may also be provided for in the event of bad management or bankruptcy of the WFOE, force majeure or if the company violates the public interest by infringing a Chinese law or regulation. It may also be dissolved for any other reason stipulated in its articles of association.

The procedure for the winding-up and liquidation of a WFOE comprises several steps:

- establishment of a liquidation committee which will prepare the various documents allowing for the liquidation of the WFOE. Creditors must be informed in writing of the procedure within 10 days of the establishment of the committee;
- publication of the intention to wind up the WFOE in a national newspaper but also in a local newspaper (no journal of legal notices exists in China);
- submission to the authorities of the liquidation request and the documents required to obtain the authorization to dissolve;
- registration with the Tax Office at the local and national levels, following the authorization by the competent authorities;
- registration with the customs authorities;
- registration with the State Administration for Industry and Commerce;
- closure of the bank account in China;
- other necessary winding-up formalities.

An audit is required before and during the winding-up procedure. In practice, it generally takes between 4 and 6 months to complete the procedure for the dissolution of a WFOE.

IV | Acquisition of a company in China by foreigners

1 General information

After Japan, China is currently the Asian country with the greatest number of merger-acquisitions transactions. For foreign investors, buying a company directly in China is subject to the approval of the administrative authorities, including the Ministry of Commerce, the National Development and Reform Commission and the State Administration for Industry and Commerce. The application must be filed between the date of execution of the instrument and the date of realization of the operation. There is increased government monitoring of takeovers by foreigners in sectors considered strategic.

The applicable legal provisions differ depending on whether the target company is an exclusively Chinese company or a foreign-invested enterprise. The regulations of April 12th, 2003, amended in September 2006 and in June 2009, apply to acquisitions of companies that are 100% Chinese by foreign invested enterprises. The transfer of interests within foreign invested enterprises is governed by a regulation dated May 28th, 1997. The rules also vary depending on whether an acquisition of assets or interests is concerned. The success of an operation will depend on numerous factors and legal, strategic and cultural factors in particular.
2 Letter of intent and pre-acquisition audit

In a Western acquisition negotiation, the letter of intent provides the framework for the negotiation procedure, specifies the principal bases of the negotiation, and sets out any points agreed by the parties. It is a particularly effective and important tool which makes it possible to save considerable time in the negotiation process. As it is a pre-contractual document, whether or not each clause is binding on the parties will depend on its drafting. In China, it can have much greater binding effect and it is advisable to ensure there is no misunderstanding between the parties regarding this.

The pre-acquisition (or due diligence) audit is carried out to evaluate the strengths and weaknesses of the target company. The liberties that may be taken in pre-acquisition audit depends on the exactness of the titles/possessions/assertions of its Chinese partner, the particular attention to the exactness of the titles/possessions/assertions of its Chinese partner, the legal nature of the Chinese partner and the existence of certain rights such as land rights. Everything must be checked because different practices and a different environment audit. The foreign investor must pay offer guarantees where guaranteed sums are placed in escrow make this a tool of capital importance. It generally consists of a legal, tax, accounting and environmental audit. The foreign investor must pay particular attention to the exactness of the titles, possessions/assertions of its Chinese partner, the legal nature of the Chinese partner and the existence of certain rights such as land rights. Everything must be checked because different practices and a different environment audit. The foreign investor must pay offer guarantees where guaranteed sums are placed in escrow make this a tool of capital importance.

3 Financial aspects

(i.) Registration duties

Transfers of shares are subject to registration duties of 0.05% of the selling price, regardless of whether the transfer instrument is signed in China or abroad.

(ii.) Treatment of capital gains

The 2009 circular No. 59 established the principle of the taxation of capital gains at the ordinary corporation tax or income tax rate according to the regime applicable to the assignor, and special treatment is provided for under the following cumulative conditions:

- the operation has a purely commercial purpose and not a tax purpose;
- if interests are being acquired, such interests must account for at least 75% of the capital of the target company; if assets are being acquired, the transferred assets must represent at least 75% of the assignor’s assets;
- the main activity of the target must not change for 12 months after the operation;
- at least 85% of the selling price must be paid by way of participating interests;
- the assignor may not assign the interests obtained for 12 months after the operation.

This favorable treatment applies primarily to partial contributions of assets and acquisitions by way of exchange of interests.

When the assignor is a company which does not reside in China, it can benefit from the favorable treatment only if it assigns to its wholly-owned subsidiary its interests in a resident company. If its wholly-owned subsidiary (the acquirer) is also a nonresident company, the assignor must provide the Chinese tax authorities with a written commitment not to transfer the shares of its wholly-owned subsidiary.

(iii.) Tax leverage

An LBO (leveraged buyout) has the advantage of allowing the acquirer to deduct the interest on the acquisition debt. In France, the tools used to optimize the arrangement are the parent-subsidiary regime and the fiscal integration regime. China does not yet have a system equivalent to the parent-subsidiary regime, and the application of the fiscal integration regime is significantly limited by article 52 of the Company Income Tax Law. To obtain leverage, a complete legal and tax analysis is essential before carrying out such operations.

4 Labor law

The staff assignment plan is one of the documents which the investor must provide to the Chinese authority in order to obtain permission to buy the shares of a Chinese company. The safeguarding of employment is an important factor for the Chinese authorities.

It is important to note that in the event of a merger or demerger, a previously concluded employment contract remains in effect and must be taken on by the new employer.

It is not necessary to inform staff in the case of most transfers, and staff approval is never necessary.

5 Mergers

Article 173 of the Companies Law provides for two types of merger: merger by absorption and merger by the creation of a new entity. In the first form, the absorbed company disappears. In the second, the two merging companies lose their legal personality and a new company is created.

Mergers between foreign invested enterprises located in China or between a foreign invested enterprise and a private enterprise are governed by the “Provisions on the Merger and Division of Enterprises with Foreign Investment” of September 23rd, 1999, revised on November 22nd, 2001. This operation can be quite attractive depending on the objective to be attained. However, the creditor-nomination procedure and the procedure for obtaining authorizations are long.

After the operation, the foreign investor’s capital stake in the new company or acquiring company may not be less than 25%. Of course, the capital structure must always be in conformity with the “Catalogue for the Guidance of Foreign Investment Industries” and with the legal ratios in relation to total investment and registered capital.

6 The case of Hong Kong

It is easy to carry out transfers in Hong Kong. Transfer operations do not require specific authorization from the governing authorities. It is only a matter of paying a registration fee based on the amount of the transaction or the value of the company whose shares are sold. Such flexibility is important to be emphasized because it contrasts with the complexity and the length of the acquisition process in mainland China. This flexibility, along with the flexibility of Hong Kong’s legal and fiscal framework, explains why most investors choose Hong Kong as a preferred platform for their investments in China. Investors can sell their business in China via the sale of their shares from their Hong Kong holding company. However, it should be taken into consideration that in some cases there are new regulations in China that allow Chinese tax authorities to impose the sales of shares from holding companies offshore (especially when the holding company has the sole purpose to hold shares in their subsidiaries in China).

Regarding the sale of company shares listed in the Hong Kong Stock Exchange (listed company), it is controlled by the Securities and Futures Commission, which is the stock market regulatory body.

V Law of contracts


1 A law similar to Continental Europe Law

The Contract Law contains no less than 23 chapters. Chapters one to eight lay down the general rules applicable to all contracts, and in particular the provisions concerning the formation, validity, performance, modification and assignment of contracts, as well as liability in the event of breach of contract. The next chapters are devoted to the provisions relative to the IS special contracts which are:

- sale contracts;
- contracts for the supply of electricity, water, gas or heating;
- contracts of donation;
- contracts for the loan of money;
- leases;
- leasing contracts;
- subcontracts;
- building contracts;
- contracts of carriage;
- technology contracts;
- bailments;
- warehousing contracts;
- mandates;
- trust contracts;
- brokerage contracts.

This law is significantly inspired by the principles laid down in the Vienna Convention on the International Sale of Goods. It contains concepts which also appear in Western legal systems, including contractual autonomy, the concepts of offer and acceptance, contractual freedom, privity of contract and contract enforceability.

2 With very different contracting parties: negotiation in China

Owing to globalization, the business world obeys codes that are becoming increasingly pervasive, and business in China is no exception. However, certain behaviors and ways of thinking remain unchanged in China and make negotiation different from Western negotiation procedures.
As mentioned previously, doing business in China relies on the existence of a good “Guanxi” (relationship) with your co-contractor. Business relationships are based more on human aspects than on economic interest alone, which never fails to astonish Westerners during their first negotiations in China. This human aspect revolves primarily around trust and the importance placed on individuals. Consequently, negotiations in China can take much longer. Do not be in a hurry to negotiate. Patience and perseverance are needed in order to forge ties that, in many respects, will be much stronger than Western business relationships.

Since the Chinese are extremely pragmatic, it is advisable to pay close attention to the clarity of the contract and to the Chinese party’s understanding of the contract because, for a Chinese contracting party, the contract reflects the agreement of the parties at the time of its signature, but the Chinese party will be tempted to depart from the agreed terms if it finds that the situation justifies this. The contract must therefore be flexible in its evolution but firm and effective as to the means of enforcing it in the event of disagreement.

It is also necessary to be able to detect the Chinese party’s unexpressed intentions. Westerners often say that the Chinese cannot say “no”. The reality is that the Chinese do not say “no” in the same way as Westerners. The way of communicating a negative reply is, in many respects, more subtle in China owing to the tradition of preventing one’s interlocutor from losing face (“Mianzi”). For the Chinese to just say “no!” is often seen as inelegant and even barbarian behavior and may lead to the breakup of a good “Guanxi”.

VI Taxation

1 Principal taxes payable by legal entities

(j) Corporate income tax

The Law on Enterprise Income Tax, passed on March 16th, 2007 and implemented on January 1st, 2008, introduced a single income tax rate of 25% both for Chinese companies and foreign invested enterprises. This principle established, the law introduced preferential rates and tax incentives for those sectors that China wishes to see developed. Thus, the tax rate is 20% for small companies with small incomes and 15% for certain “high technology” companies. Some companies benefit from a long or short-term tax exemption, particularly those involved in State-backed infrastructure projects which encourage environmental protection or water and energy economy. Such projects are exempt for 3 years, and then benefit from an income tax deduction of 50% over 3 years.

For companies set up in the special economic zones after January 1st, 2008, the tax incentives are granted only to companies of the new and/or high technology sector. In contrast to their claims, many zones no longer offer favorable taxation schemes, but they have many other advantages.

(i) VAT

Introduced in 1994, value-added tax applies to sales or imports of goods and services relating to manufacture, repair and installation in China. The rate of VAT is 17% but a reduced rate of 13% exists for essential products. It may be paid every 5, 10 or 15 days or every month, depending on the agreement entered into with the Tax Office. However, VAT on imports must be paid to the customs office within 7 days of the customs declaration. Exports are exempt from VAT.

This tax was introduced on January 1st, 1994 and is a kind of (non-recoverable) VAT on services. It must be paid even if there is no permanent establishment in China. Business tax applies to enterprises having a non-industrial, repair, assembly or transformation activity.

The rate varies according to the branch of industry concerned:

- 3% in the construction, transport and telecommunications sector;
- 5% in the services, transfer of intangible assets and real estate sector;
- 5 to 20% for leisure activities.

(k) The VAT reform

The Chinese Ministry of Finance issued a circular in November 2011 on the VAT reform and the abolition of the Business tax system. This reform aims to achieve a more efficient collection, a better distribution of tax burdens and more transparent business activities.

While the tax reforms are to be put in force over the entire Chinese territory at the beginning of 2013, they were already applied in certain areas in Shanghai since 1st January 2012 through a pilot project.

Since 1st January 2012, the following industries in Shanghai have been subject to the VAT pilot program:

2 Main taxes payable by private individuals

June 30, 2011, the Standing Committee of National People’s Congress of China has decided to amend for the sixth time the law on income tax.

Individuals who have resided in China for at least one year are considered Chinese tax residents. Consequently, their worldwide incomes are subject to Chinese income tax. On the other hand, for a nonresident foreigner, only incomes of Chinese origin are subject to Chinese income tax. The criteria for determining the origin of income are laid down by tax circulars. However, the implementation of these criteria is a subtle and delicate affair because of Chinese fiscal policy and the provisions of double taxation agreements between China and other countries. Consequently, we strongly recommend that advice be obtained from a firm familiar with Chinese tax law as well as the tax law of the investor’s or expatriate’s home country.

Tax thresholds and rates vary depending on the nature and amount of the income. The calculation is performed as follows:

- For salaries:
  For foreigners, the tax threshold is RMB 4,800 or approximately €500. The following tax scale applies:

<table>
<thead>
<tr>
<th>Monthly income (RMB) per bracket</th>
<th>Rate (%)</th>
<th>Deduction (RMB)</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 1500</td>
<td>3%</td>
<td>0</td>
</tr>
<tr>
<td>&gt; 1500 ≤ 4500</td>
<td>10%</td>
<td>75</td>
</tr>
<tr>
<td>&gt; 4 500 ≤ 9 000</td>
<td>20%</td>
<td>525</td>
</tr>
<tr>
<td>&gt; 9 000 ≤ 35 000</td>
<td>23%</td>
<td>975</td>
</tr>
<tr>
<td>&gt; 35 000 ≤ 55 000</td>
<td>30%</td>
<td>2 725</td>
</tr>
<tr>
<td>&gt; 55 000 ≤ 80 000</td>
<td>33%</td>
<td>5 475</td>
</tr>
<tr>
<td>&gt; 80 000</td>
<td>45%</td>
<td>1 3475</td>
</tr>
</tbody>
</table>

- For commercial profits and the profits of an individual enterprise:

<table>
<thead>
<tr>
<th>Annual income (RMB) per bracket</th>
<th>Tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;5 000</td>
<td>5</td>
</tr>
<tr>
<td>&gt;5 000 &lt; 10 000</td>
<td>10</td>
</tr>
<tr>
<td>&gt;10 000 &lt; 30 000</td>
<td>20</td>
</tr>
<tr>
<td>&gt;30 000 &lt; 50 000</td>
<td>30</td>
</tr>
<tr>
<td>&gt;50 000</td>
<td>35</td>
</tr>
</tbody>
</table>
- For copyright: 20% after an abatement of 30%.
- For capital gains, royalties, dividends, interest, property incomes and exceptional income: 20%.

It is important to specify that the concept of “share” does not exist in Chinese tax law. This means that an unmarried person with no children will be taxed in the same way as the head of a big family (which is rare given the one-child only policy in China).

Income tax may be paid by taxpayers themselves or by the entity that remunerates them. Thus, if taxpayers do not pay their taxes, the Chinese administration can claim the sums due from the employer, applying the following legal penalties:

- in the event of delay: the fine will, in theory, be less RMB 2,000 except in serious cases. In such cases, the fine will be between RMB 2,000 and RMB 10,000;
- in the event of concealed or undervalued income: the tax authorities will demand payment of the outstanding tax, a surcharge for delay as well as a fine of between 50% and 500% of the outstanding sum;
- in the event of a refusal to authorize a direct debit of the tax at source or in the event of obstruction: the tax authorities may impose a fine of less than RMB 10,000 in addition to the sums payable. In serious cases, the fine may be as much as RMB 50,000.

In China, employers must ensure, in particular, that their foreign employees are registered with the tax authorities as from the signing or commencement of the contract.

3 | Rules specific to real estate assets

All real estate transactions must be recorded by the real estate transactions center, and recording expenses must be paid. In addition, a procedure before a notary is required if a foreign party is involved and there are costs associated with this procedure.

(i) If real property is bought or sold

A tax on documents is levied within the framework of a grant of the right to use State land, transfers of rights of use (except for rights of use allocated in respect of collective farmland) and within the framework of transfers of real estate. This tax is calculated based on the price for the concession of the right of use or the selling price of the real estate, and the rate is determined by each local authority.

Stamp duty, whose rate varies according to the nature of the transaction and the type of the real estate, from which certain expenses may be deducted. With a sale or resale of real estate, it is preferable to deduct the initial purchase price. It is then calculated as follows:

\[
\text{Appreciation} = \text{selling price} - (\text{purchase price} + \text{document taxes} + \text{other expenses})
\]

The rate may vary considerably depending on the type of transaction and the vendor’s taxation regime.

A commercial tax will have to also be paid by the vendor, the amount of which differs according to locality.

In addition to all these taxes comes the tax on urban real estate, which only applies to foreign invested entities and foreign individuals, and which is collected periodically at times laid down by the local authorities.

In the case of noncommercial property, natural persons are exonerated from this tax.

(ii) In the event of a lease of real estate

During the lease, both landlord and tenant are subject to stamp duty of 0.1% on the total rents.

The rates of income tax, commercial tax as well urban real estate tax vary according to the type of taxpayer.

In addition, taxpayers may ask the local tax authority to apply a flat rate that encompasses all taxes, including the duties and expenses payable on the occasion of a lease.

4 | The attractive taxation of Hong Kong

There is no VAT, wealth tax, business tax or capital gains tax in Hong Kong. And, there are no customs duties except for a limited category of products. The three main direct taxes are profit tax, salary tax and property tax.

(ii) Profit tax

Profits originating in Hong Kong is taxed irrespective of the taxpayer’s nationality or the legal form of the entity concerned (territorial system of taxation). The origin of the profit is assessed in concrete depending on each case: the place of negotiation, conclusion and execution of the commercial contract in question will be taken into consideration to determine the origin of the profit.

The result taken into account to determine the tax base during the fiscal year as reference is generally established at the end of the contract, but a partial result can equally be established if it is calculated according to a reliable and continuous method.

The profit tax rate is 16.5% of profits originating in Hong Kong; profits generated from outside of Hong Kong may not be taxable in Hong Kong if taxpayers request so.

All current expenditure incurred in the realization of the profit is deductible, regardless of where this expenditure was incurred.

(iii) Income tax

Income tax is calculated after imputing deductible charges, according to a progressive rate of 2 to 17%, and may not exceed 15% of total income.

The tax base includes all income of Hong Kong origin, unless the employee spends less than 60 days per fiscal year in the Hong Kong territory. Benefits in kind that cannot be converted into cash are excluded from the tax base.

Abatements may be granted depending on family status, and certain charges are deductible.

(iv) Property tax

Only the rental income of property in Hong Kong is taxable, at the rate of 15% (after deducting doubtful debts, occupancy duties already paid and a flat-rate deduction of 20% for repairs and maintenance).

Rental incomes received by a property company are considered profits, and are thus taxed at the rate of 16.5%.

(vi) Indirect taxation

Stamp duty is levied especially (i) on transfers of title to land and buildings (HKD 100 for properties whose value is less than HKD 2 million, and a progressive rate of 4.25% in excess of HKD 21,739,120), (ii) to leases (0.5% of the rent) and (iii) to transfers of shares from Hong Kong companies (0.2% of the amount of the transaction or value of the company whose shares are sold).

Since June 2011, residential property transactions are also subject to a new stamp duty (the Special Stamp Duty). This stamp duty applies to properties acquired by individuals or companies (Hong Kong or foreign) as of 20 November 2010 and which would be resold within 24 months after the acquisition. The amount of the Special Stamp Duty varies depending on the date of sale of the property (between 5% and 15% of the value of the sale).

The governmental fees for the registration of a commercial activity are generally between HKD 450 and HKD 2,600 per year.

Land occupancy duties are calculated based on the annual rental value. The rates vary from 3 to 5%.

### VII | Working in China

The “Labor Law” of 1995, revised in 2008, governs the general labor law framework in China and applies both to local companies and foreign invested enterprises. This law is supplemented by other texts such as the “Labor Contract Law” (2007), the “Employment Promotion Law” (2008) and the “Law on Mediation and Arbitration of Labor Disputes” (2008).

In addition to these laws which apply throughout China, each province has adopted local regulations in this area.

1 | General information

(i) Remuneration and compensation

In China, the legal minimum wage varies according to...
city and locality. In 2012, the average minimum wage would be raised to RMB 1,450 or approximately €160 in Shanghai.

Employers must pay compensation to employees in several cases:
- if the employer decides to terminate the contract at the end of its term for certain categories of employees listed in Article 42 of the Labor Contract Law, such as pregnant women;
- if the end of the contract results from the bankruptcy or dissolution of the company;
- if the employee requests the termination of the contract on grounds of the employer’s breach of the law;
- if the employer considers that the employee is no longer qualified or that the circumstances justifying his recruitment have radically changed;
- if the employer reduces the number of employees in compliance with the law.

For expatriates who sign a “local” contract, i.e. one governed by Chinese law, the Labor Contract Law limits the compensation calculation basis for high-earning employees. This basis may not exceed 3 times the local average salary of the previous year and the basis period may not exceed 12 years.

(ii) Working time and paid vacation

In theory, the weekly working time is 40 hours per week, 8 hours per day, with 16 to 26 business days of paid leave for employees with more than one year of seniority. Overtime may not exceed 36 hours per month.

(iii) Staff representatives

In China, no trade union organization is authorized other than the single trade union, the All-China Federation of Trade Unions (ACFTU), directly attached to the Communist Party. Founded on May 1st, 1925, the ACFTU has the legal personality of a company to the Communist Party. Founded on May 1st, 1925, the ACFTU has the legal personality of a company.

The role of the basic trade union falls into two main categories: worker representation and protection and participation in company management. The trade union plays an advisory role in the management of the company. It must be involved in important company decisions such as a change of legal form or the drafting of rules of procedure.

(iv) Social protection

The People’s Republic of China is reforming its social security system. It has reformed the personal taxation for Chinese nationals, and it is extending the scope of these laws to foreigners living in China.

The law on the social security contribution in China (effective from July 2011, still not yet implemented in early 2012) is also the first national legislation to impose an obligation on foreign workers to contribute to the social security system in China.

Social protection in China consists of all mechanisms that protect individuals from the consequences of social risks, and it consists of the following funds: pension, health, unemployment, occupational accident and maternity insurances as well as funds for the mandatory housing.

According to Article 72 of the Labor Law amended in 2008, employers and employees are required to pay social security contributions in accordance with the percentages defined locally (updated annually).

You will find below a summary of contributions for social security in Shanghai, Beijing and Guangzhou:

<table>
<thead>
<tr>
<th>Social security</th>
<th>Paid by the company</th>
<th>Paid by the employee</th>
<th>Paid by the company</th>
<th>Paid by the employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>44%</td>
<td>18%</td>
<td>44.5%</td>
<td>47.3%</td>
</tr>
<tr>
<td>Beijing</td>
<td>22.5%</td>
<td>3%</td>
<td>22.5%</td>
<td>3%</td>
</tr>
<tr>
<td>Hangzhou</td>
<td>36.35%</td>
<td>13.5%</td>
<td>36.35%</td>
<td>13.5%</td>
</tr>
</tbody>
</table>

Total 44% 18% 44.5% 47.3% 22.5% 3% 22.5% 3% 36.35% 13.5% 36.35% 13.5% 45%-31%

2 Employment contracts

Employment contracts are governed by the “Labor Contract Law” of the People’s Republic of China of June 29th, 2007.

(i) Indefinite-term and fixed-term contract

Chinese law distinguishes between the indefinite-term contract and the fixed-term contract. A fixed-term contract may only be renewed once.

The employer may implement a probationary period within the framework of an indefinite-term contract and also within the framework of a contract having a fixed-term of at least 3 months. The rules concerning the probationary period are as follows:
- for a contract with a term of 3 to 12 months: the probationary period may not exceed 1 month;
- for a contract with a term of 1 to 3 years: the probationary period may not exceed 2 months;
- for a contract with a term of more than 3 years: the probationary period may not exceed 6 months.

If one of the parties decides to terminate the employment contract, a notice period of 30 days generally applies. If the employer wishes to terminate the employment contract, it must also inform the trade union of its decision.

(ii) Project contract

A project contract is a contract concluded for the duration of a specific mission. The regulations governing this kind of contract are the same as those governing the fixed-term contract.

(iii) Part-time employment contract

The provisions relative to part-time employment contracts are contained in Chapter V section 3 of the aforementioned law.

The part-time employment contract does not require the drafting of a contract, a simple verbal agreement is sufficient. Moreover, no probationary period may be implemented by the employer.

For this kind of contract, the average work hours of an employee may not be more than 4 hours per day and 24 hours per month. Remuneration is mainly calculated based on work hours.

The contract may be terminated by either party. However, no indemnification will be paid to the employee.

(iv) Collective bargaining agreements

There exist three types of collective bargaining agreement:
- enterprise collective bargaining agreements which apply to members of the same enterprise;
- regional collective bargaining agreements which have a territorial scope;
- branch collective bargaining agreements which apply to a specific industrial sector.

Collective bargaining agreements fill in the gaps existing in certain employment contracts and apply in the event of a dispute, where no agreement can be reached.

3 The status of expatriates and seconded personnel

The reform of the Companies Law in 2005 abolished the employee wellbeing reserve which consisted in allocating between 3% and 10% of net profit to employees’ benefit.

In China, the official retirement age is 60 for men and 55 for women, and sometimes 50 in the case of difficult jobs. The basic pension covers all Chinese employees of companies established in cities, independent entrepreneurs and persons with flexible forms of employment.

Herewith, secondment refers to employees sent by their employer abroad for a limited time and who remain affiliated to the foreigner’s social welfare system if any. The employee’s employment contract with the original employer is therefore suspended. The contract automatically resumes at the end of the mission.

Expatriates, whether salaried employees or not, come under the regime of the host country. If an employment contract exists between such persons and the company in their home country, then this contract will be suspended for the period of expatriation. Another contract with the local company must be concluded.

As an example, no international social security agreement exists between France and China that specifies how long entitlements to the French social security regime last. Consequently, the maximum secondment duration for a French employee sent to China is 3 years, renewable once. There are only a few countries which entered such agreements.

In China, the Chinese social security system did not apply to foreigner until July 1st, 2011. Foreign...
employees must now pay into the Chinese social security system. This contribution is fixed at 20% of their wages within the limit of RMB 2,500 or approximately HKD 3,000 per month for all expatriates who cannot be attached to his home country social security regime have to adhere to a local insurance fund and a health insurance fund in order to continue to benefit from this regime as expatriates. In the absence of such social security agreement, foreigners employed under a Chinese contract who adhere to a home country social security insurance plan will be forced to pay contributions in both countries.

In addition, for countries such as France, as regards unemployment, employers are obliged to subject their expatriated employees to the home country regime.

4 Labour legislation in Hong Kong

(i.) Employment contracts

Any person working more than 4 weeks and at least 18 hours a week for the same employer is considered an employee within the framework of a permanent employment contract, and is consequently subject to the provisions of the Employment Ordinance.

Employer and employee can freely negotiate the stipulations of the employment contract (which can be written or verbal) as long as these stipulations comply with the provisions of the Employment Ordinance. An employment contract has a term of one renewable month in the absence of specific provisions by the parties.

The Minimum Wage Ordinance, came into force on 1 May 2011, establishes for the first time in Hong Kong a minimum hourly wage of HKD 28. Wages must always be paid within 7 days after the end of the month.

Employees are entitled to a minimum of (i) one day off per week, (ii) 12 public holidays per year, and (iii) 7 days paid leave after 12 months of continuous work under the same contract. Additional paid vacation days are granted according to seniority.

Employees may claim 2 sick days per month the first 4 years, and 4 days per month in subsequent years. Sick pay amounts to 4/5 of salary.

Severance pay may be paid to any employee who has worked for more than 24 months for the same employer and who was laid off as part of a collective redundancy procedure (redundancy). The indemnity is equal to 2/3 of the last months’s salary (capped at HKD 22,500) or a compensation of up to HKD 5,000 multiplied by each year of service; the total amount payable cannot exceed HKD 390,000.

Seniority compensation may also be paid to any employee who has worked for over 5 years for the same employer. The compensation amount to be paid is similar to the severance pay amount. It should be however noted that employees are not entitled to both redundancy pay and seniority compensation.

(ii.) Social security

Unemployment compensation and health insurance are not mandatory in Hong Kong. Therefore, employers and employees are not required to pay employer or employee (respectively) contributions, but they may purchase private insurance.

Employers and employees are however required to contribute to the Mandatory Provident Fund (MPF) for the employees who are Hong Kong residents and usually work in Hong Kong. The amount that the employer contributes monthly to MPF is 5% of the monthly salary of the employee, not exceeding HKD 1,250. The employee must also contribute monthly up to 5% of his/her monthly salary, not exceeding HKD 1,250 (the contribution is deducted directly by the employer from the employee’s salary). However, foreigners who come to Hong Kong for an employment lasting less than 13 months or who are already covered by foreign pension schemes, may be exempted.

It should be stressed that financial support (Comprehensive Social Security Assistance) is provided to persons in need to cover their basic requirements. In addition, the public health system is practically free, with costs being borne by the Hospital Authority, but only the holders of a permanent HKID card can benefit from it.

VIII Intellectual property law

Intellectual property law as it is actually applied in China is quite different from Western clichés. China’s intellectual property law is growing stronger every day and it has adhered to all of the major international agreements on intellectual property, including the:

- Paris Convention for the Protection of Industrial Property (1884);
- Berne Convention for the Protection of Literary and Artistic Works (1993);
- Patent Cooperation Treaty (1994);
- Madrid System for the International Registration of Marks (2003);

1 Trademarks

Adopted on August 23rd , 1982 and effective since March 3rd, 1983, the Chinese Trademark Law was the subject of a first modification in 1992. Following its adhesion to the World Trade Organization in 2001, China had to adapt its legislation in order to meet its commitments. Accordingly, the Chinese Trademark Law and its implementing regulations were the subject of a second modification in 2001, and will undergo a new draft amendments, expected during 2012.

The draft of the third amendment to this Trademark Law was prepared by the National Trademark Office and was submitted to the State Affairs Council on November 18th, 2009 and will soon be put to the vote. The objective of this third amendment is to make the examination procedure more effective and strengthen anti-counterfeiting measures.

(i.) Registration of a mark in China

Choosing the name of the mark is an essential question in connection with the supply of products and services in China. The main reason for this is that the Chinese language consists of characters and not of Western letters, which often leads to errors of pronunciation or understanding of foreign terms. Moreover, the originality contained in the name of a mark may be lost in its Chinese translation. However, companies can choose to adopt a Chinese transliteration of the foreign mark or to affirm their foreign identity by keeping their mark as is. The last option is often preferred by luxury brands that are known throughout the world (in particular well-known marks).

A trademark registration application in China may be filed by a natural person or legal entity with the Trademark Office located in Beijing. A foreign applicant must go through a trademark agent authorized by the government because the registration request must be drafted in Chinese. Such registration is necessary so that the mark can benefit from protection on Chinese territory. It is important to specify that China has signed the Paris Convention and that a six-month right of priority is granted to all nationals of countries that have signed this Convention that registered a trademark in one of the signatory countries to file the same trademark in another country that is a party to the Convention.

When applying, the applicant must specify the products and services covered by the registered trademark. The time between the application and the registration of a trademark can be more than two years. Once the trademark is registered, it is protected for 10 years as from the registration and may be renewed for 10-year periods as often as the holder wishes. The holder of a registered trademark thus benefits from an exclusive right to use the trademark for the designated products and services. However, no protection exists in Hong Kong, Taiwan or Macao for a trademark registered in Mainland China. An application will therefore also have to be submitted to the corresponding Trademark Offices.

(ii.) Signs that may be protected

Signs that are eligible for registration include all visual signs that are sufficiently distinctive: words in any language, Chinese characters, Latin letters, a three-dimensional sign, a drawing, a combination of colors or the abovementioned elements.

In accordance with article 6 ter of the Paris Convention, Chinese legislation lists a certain number of signs for which a trademark may not be registered:

- signs identical or similar to the name, flag, emblem, military flag or medal of the People’s Republic of China;
- signs identical or similar to the names of the specific sites or names and design of the symbolic buildings of the places where the organs of the central government are located;
- signs identical or similar to the name, flag, emblem or military flag of a foreign government, except
Chinese legislation distinguishes between a well-known mark registered in China and a well-known mark not registered in China. If a well-known mark has not been registered in China, its protection is limited to products and services that are identical or similar, whereas a well-known mark that has been registered in China will benefit from protection that extends to products and services that are not similar to those that it designates.

(iii.) License agreement and trademark assignment contract

A license or trademark assignment agreement may be concluded between the holder of a registered trademark in China and a natural person or legal entity. This contract must contain the conditions of exercise of the license or of the transfer, the amount of the royalties or the transfer price, the geographical restrictions and the period of validity of the contract. This kind of contract must be filed with the Trademark Office within three months of the entry into effect of the contract.

2 | Patents

The Patent Law was first adopted in 1984 and was amended in 1992 and 2000. The last modification came into effect in February 2010. The institution in charge of patents in China is the Chinese Patent Office, known as the SIPO. The office periodically publishes in the “Patents Bulletin” all information relative to patents (the grant of a patent, and the various requests for examination of the content of a patent application for an invention).

(i.) Acquisition conditions and protection granted to the invention

Before an invention can obtain a patent from the SIPO, it must meet the conditions of patentability and must not be excluded from the patentable domain laid down by legislation.

The patentability conditions defined by article 22 of the Patent Law are: novelty, inventiveness and industrial usefulness. The 3rd amendment modified the novelty criterion by adapting the criterion of “absolute novelty”.

The following are not patentable:
- inventions contrary to public order and morals;
- discoveries;
- methods in the exercise of intellectual activities;
- therapeutic treatments and diagnostic methods;
- substances obtained by the reaction of atomic nuclei.

A patent issued by the SIPO offers 20-year protection as from the date of filing of the application.

(ii.) Registration and examination methods

Patent applications, just like trademark applications, are governed by the first-to-apply principle, which may be problematic since any ill-meaning person can register your invention and benefit from the associated rights. What is more, opposition and appeal procedures may take several years and entail considerable expenditure.

The reform of the law introduced an examination of confidentiality prior to all patent applications abroad, in respect of an invention made in China. The invention is then subject to a confidential examination carried out by the SIPO. If this examination is not carried out, the patent right in China will be lost. The examination concerns inventions of which “the essence of the technical solution” was realized in China.

Applications for inventions and patents are submitted to the SIPO. The registrant must present a detailed description of the invention and provide certain information about it. The SIPO determines, within 6 months, if the invention falls into one of the secrecy categories.

(iii.) The utility model

China offers protection by means of the utility model. The utility model makes it possible to obtain protection for a product presenting a visible technical innovation quickly and for a minimum cost. Under Chinese law, the new product must present a “new technical solution relating to the shape, the structure, or their combination”. In most cases, utility models are used for mechanical innovations, and “minor” improvements made to existing products.

Applicants can simultaneously submit an application for a patent and for a utility model in respect of the same invention, but they will then have to choose between the two during the examination.

Once granted, the utility model is the subject of a publication in the “Patents Bulletin” and affords the invention 10 years of protection as from the filing date.

(iv.) Employee inventions

The employee invention regime applies to patents, utility models and industrial designs.

In the case of inventions by employees, Chinese law distinguishes between “service inventions” and “non-service inventions”. Service inventions are inventions realized during a mission for the employer or mainly using the employer’s material conditions or techniques. Service inventions belong to the employer, but, in the case of an invention made thanks to the material or technical conditions of the employer, title may be attributed to the employee-inventor by agreement between the employer and the employee. All other inventions which do not fall into the category of service inventions are considered non-service inventions and are the property of the inventors.

The company to which the patent is issued must pay the inventor a bonus and a reasonable fee calculated on the basis of the profitability and scope of the invention.

The implementing decree of the Patent Law specifies the minimum amount of the bonus (RMB 3,000 for a patent, RMB 1,000 for a utility model and industrial designs) and the method for calculating the fee (2% of the exploitation profits for patents and a confidence model, 0.2% of the exploitation profits for industrial designs). These sums provided for by the implementing decree are not legal minimum amounts. They only apply (i) in the absence of a collective agreement or contract providing for sums in conformity with article 16 of the Patent Law or (ii) if the bonus or fee provided for in the agreement is incommensurate to a considerable degree.

3 | Industrial designs

In China, industrial designs are protected by a 10-year patent commencing on the date of the application. As with the utility model application described above, applications for the protection of industrial designs are only subject to a simple preliminary examination. If, following the examination, there are no valid reasons for rejecting the application, then the protection is granted.

This status makes it possible to protect a new design relating to the shape or structure of a product, combined, as the case may be, with color, which creates an aesthetic impression associated with an industrial product. The protected design may not be identical or similar to another design that was publicly revealed before the application was filed nor impinge upon the rights of another person.

4 | Copyright

This field is governed by the Copyright Law of June 1st, 1991 whose last reform of February 26th, 2010 came into effect on April 1st, 2010. According to article 2 of this law, the absence of a registration does not prevent the protection of copyright.

(i.) Contents of copyright

Copyright offers the holder the moral and property rights listed in article 10 of the Copyright Law.
5 Protection of software

Software is protected by copyright. Its protection is specified by the “Regulations on Computer Software Protection” promulgated on December 12th, 2001 by Decree 339 of the State Council. The term “software” covers computer programs and the associated documents.

The registration of software with the Copyright Administration Department of the State Council has no longer been mandatory since 2002. But registration and publication constitute very effective proof in the event of a dispute over the holder of the right.

 Certain rights are specific to the creators of software such as the right of disclosure, the right of modification and the right to paternity, i.e. the right to affirm the identity of the developer on the software.

If the beneficiaries of the rights are natural persons, upon their death, their heirs will enjoy the copyright to the software developed by the deceaseds, but not the paternity right.

If the software is developed by an employee pursuant to a mission of the employer or by mainly using the material conditions or techniques of the employer, then the employer is the beneficiary of the rights, except for the paternity right. The additional fee and bonus are not obligatory in this case.

Works of collaboration

(i) If several persons contributed to the development of the software, the co-developers will have to agree on how ownership will be attributed.

However, if the software can be divided into several independent works that may be used separately, co-developers will be able to enjoy the copyright to that part of the software which they themselves have created.

If the software cannot be divided, it will then be exploited jointly by all co-developers and each use will be the subject of a contract.

(ii) Where software is developed through the collaboration of several developers, the copyright lasts for 50 years after the death of the last creator.

License agreement and rights assignment contract

The beneficiary of the copyright protection in respect of a software application can authorize the exploitation of his rights via a license agreement, or their transfer in exchange for a fee via a rights assignment contract.

These contracts must be in writing and may be the subject of a registration recognized by the Copyright Administration Department of the State Council.

On the other hand, for technology transfer contracts between a Chinese entity and a foreign entity, registration is mandatory. If the assignor or licensor is Chinese, the technology transfer requires the prior approval of the Chinese authority. This provision applies to all license agreements or transfers of patents, software or know-how.

6 Web sites and domain names

In the People’s Republic of China, the China Internet Network Information Center (CNNIC) is responsible for the registration and administration of domain names.

Foreigners and individuals cannot register a domain name with the CNNIC. Only corporations can register it. In order to guarantee the protection of a mark on the Internet, it is strongly advised to reserve it as a domain name. Reservation and the geographical extension “.cn” for example are available to all companies. The radical of the domain name may consist of letters and figures, which may be separated by a hyphen. There must be at least 3 but no more than 63 characters.

The domain name may not use terms that may impinge on third parties or their rights, or interfere with international systems of protection.

7 Company names

The formalities concerning the company name constitute the first stage in setting up a company in China.

The entrepreneur must obtain a notification of approval of the desired company name. This name must be in Chinese characters and contain, in the following order, the place of establishment, the name of the company, the branch of industry and the company form.

The request for approval can be submitted to the Administration of Industry and Commerce (AIC). A decision will be issued within 10 to 15 days of the request.

8 Counterfeiting

Counterfeiting is penalized under Chinese law, not only by intellectual property laws and the Unfair Competition Law, but also at the penal level. Criminal penalties include prison sentences of up to 15 years. However, in practice, despite the existence of repressive legislation, counterfeiting is still rife.

(i) Chinese culture with regard to counterfeiting

The counterfeit market represents between 15% and 30% of China’s industrial production, employing more than 5 million people. This market is developing in many areas: clothing, leather goods, electronic products, DVDs, cigarettes, drugs, cosmetic products and many other areas.

The great number of products counterfeited in China is explained by the fact that from a traditional Chinese point of view, counterfeiting is not considered disputable and although the authorities are combating this plague, there is still a long way to go.

There exist three types of imitations: approximate imitations, those produced in independent factories where the least details are copied, and finally, identical copies manufactured in the same factory as the originals. It then becomes very difficult to distinguish the real product from the forgeries.

(ii) The debate over a harsher crackdown on counterfeiting

The problem of counterfeiting in China does not arise at the level of the law since counterfeiting is illegal, but rather at the level of its application. In certain areas where counterfeiting is the main driver of the local economy, it can be difficult to eradicate. The central government of the People’s Republic of China is working to reinforce its power against local protectionism.

However, a surprising fact is now changing matters, and calling into question the very fight against counterfeiting. Indeed, counterfeiters are no longer solely targeting foreign brands. Chinese brands are about to become their first targets. The debate pits the defenders of intellectual property against the protectors of the Chinese people. The former want to see the development of leading Chinese brands and understand the principle of reciprocity. The second group refuses to grant protective rights to foreign companies on its territory and wants to stern the wave of foreign products flooding into China.

This reversal could very well encourage the Chinese authorities to act more decisively against counterfeiting, all the more so since China is in full development and wants to open and develop its market abroad.

These formalities are specific to company names.

Company names

The formalities concerning the company name constitute the first stage in setting up a company in China.

The entrepreneur must obtain a notification of approval of the desired company name. This name must be in Chinese characters and contain, in the following order, the place of establishment, the name of the company, the branch of industry and the company form.

The request for approval can be submitted to the Administration of Industry and Commerce (AIC). A decision will be issued within 10 to 15 days of the request.

The formalities concerning the company name constitute the first stage in setting up a company in China.

The entrepreneur must obtain a notification of approval of the desired company name. This name must be in Chinese characters and contain, in the following order, the place of establishment, the name of the company, the branch of industry and the company form.

The request for approval can be submitted to the Administration of Industry and Commerce (AIC). A decision will be issued within 10 to 15 days of the request.
The specific intellectual property regime in Hong Kong

(iv.) Trademarks

The trademark protection regime was considerably improved with the new Trade Marks Ordinance of April 4th, 2003. The system for the registration of trademarks in Hong Kong is autonomous; therefore, trademarks that are registered only in China will not be protected on the Hong Kong territory.

A trademark is defined as a sign that may be graphically represented and that allows the goods or services of a company to be identified. Registration confers on the owner the exclusive right to use the trademark for the goods and services specified at the time of registration (there are 45 classes of goods and services).

The application is filed after carrying out a search for prior registrations. The administration will then check the validity of the application and, if accepted, publish it in Hong Kong’s intellectual property journal. If no objection is expressed within 3 months, a registration certificate is issued for a term of 10 years renewable per period of 10 years.

(vi.) Patents

The regime for the protection of patents is autonomous and governed by the Patents Ordinance of May 30th, 1997. A patent that is only registered in mainland China will not be protected on the territory of the SAR, and in this case, registration in Hong Kong will be necessary. In addition, since Hong Kong is a signatory of the Paris Convention of March 20th, 1883, the applicant for a patent will have 12 months to submit applications in other States that signed the Convention.

Any new invention with the potential for industrial use may be patented. An ordinary patent is valid for 20 years, while the limited patent is valid for 4 years, and may be renewed once.

(iii.) Designs and models

The law of reference is the Registered Designs Ordinance. It grants the owner an exclusive right to use the design or model, offering a protection term of 5 years, renewable 4 times at the most.

The registration of a design or model is subject to a condition of novelty. The average time to obtain the registration certificate is 3 months from the date of receipt of the application.

(iv.) Copyright

The Copyright Ordinance of June 27th, 1997 offers protection in Hong Kong for any human creation in the broad sense (there is specific legislation for optical disks, CD-Rom, DVD, which is the object of the Prevention of Copyright Piracy Ordinance).

Once the work is made available to the public, the author has a monopoly of use, reproduction and exploitation. Thus, there are no pre-protection formalities. Generally, the term of protection will be 50 years as from the death of the author or the first publication/reproduction.

(v.) Protection of sensitive products

The Lay-out Designs of Integrated Circuits Ordinance protects original creations of semiconductor circuits for 10 years as from the first year of commercial exploitation, or 15 years in the absence of exploitation. This protection is automatic and does not require a prior registration.

The Plant Varieties Protection Ordinance protects horticulturists’ exclusive right to reproduce their creation. To benefit from this protection (which lasts 20 to 25 years), the plant variety must be new, distinct, homogeneous and stable.

(vi.) Company name

A new company can register a name as long as it is not strictly identical to an existing company name or mark.

(vii.) Counterfeiting

The Hong Kong administration, and in particular, the Intellectual Property Investigation Bureau, has made it possible to significantly reduce the production of imitations in Hong Kong. The repressive policy is still rigorously implemented.

IX Insurance

1. Configuration of the Chinese insurance sector

It was not until 1979 that an insurance sector reappeared in China, and the first establishment of an insurance company in China dates from 1992. Following the admission to the WTO and the associated commitments made, the insurance market gradually opened up and now counts many foreign players in this sector where it is now even possible to set up directly in one’s own name.

2. The legislative framework and the prerequisites for authorizations

The Chinese Insurance Law was passed in 1995 and modified in 2002 and 2009. This law only applies to commercial insurance.

Created in 1998, the China Insurance Regulation Commission (CIRC) is responsible for overseeing the implementation of insurance law and promoting the harmonious development of the insurance sector. It is the sole competent body for control and oversight of the insurance sector in China.

Since 2004, foreign investors can create insurance companies in the form of a VOOE, except for life insurers, for which the share of company capital held by foreign investors may not exceed 50%. All insurance activities are open to foreign investment except for motor vehicle insurance. Nonetheless, the insurance sector is still regarded as a restricted sector by the 2007 Catalogue for the Guidance of Foreign Investment Industries. Consequently, the creation of an insurance company in China is subject to the approval of the CIRC and to strict substantive and formal conditions.

The minimum capital of an insurance company is RMB 200 million and may only consist of cash contributions in convertible currencies. A Chinese branch of a foreign company must also have a working capital in convertible currencies of at least RMB 200 million.

In particular, the foreign parent company must meet the following cumulative conditions:

- have carried on insurance activities for more than 30 years;
- have had a representative office in China for more than 2 years;
- have had total assets of at least 5 billion US dollars at the end of the last financial year;
- have an insurance monitoring system in its home country;
- be subject to the supervision of the competent authority in its home country;
- satisfy the solvency conditions of its home country;
- be approved by the competent authority of its home country;
- satisfy the CIRC’s prudential requirements.

These are significant requirements, and it is only after the receipt of the request and all required documents that the CIRC carries out a preliminary examination within a period of 6 months. After this examination, it will decide either to carry out a thorough examination or to reject the application.

If the CIRC decides to carry out a thorough examination, it provides the applicant with the official application form. The applicant then has one year in which to submit its creation project; this period may be extended by 3 months with the agreement of the CIRC. During this period it is strictly prohibited to carry on any insurance activity.

The applicant will be informed of the CIRC’s final decision within 60 days of receipt of the complete file. If the applicant obtains CIRC authorization, it can apply to the Administration for Industry and Commerce for its business license.

3. Reforms and prospects

It is now more than 10 years since China joined the WTO. The CIRC is considering the option of opening up the compulsory motor insurance market to foreign investors and insurance companies. The Catalogue for the Guidance of Foreign Investment Industries is currently being modified. It is probable that China’s insurance market will open up even more to foreign investment.

4. Organization and operation of insurance companies

Insurance companies take the form of a limited liability company or a joint stock company. The organization of an insurance company must conform both to the provisions of the Companies Law and to the provisions of the Insurance Law.

(i.) Insurance company bodies

The mandatory bodies of an insurance company as provided by the Companies Law are the general meeting, the board of directors and the supervisory board. Article 85 of the Insurance Law provides for the obligation to have actuaries within the company.

(ii.) Conditions relating to the managers of insurance companies

Article 81 and article 82 of the Insurance Law lay down conditions of eligibility which apply to the officers of the insurance company. The organization for the Guidance of Foreign Investment Industries is currently being modified. It is probable that China’s insurance market will open up even more to foreign investment.
Financial and banking system

After twenty years of intensive reform, China now possesses adapted banking and financial legislation which is open to the establishment of foreign banks in China, but still characterized by barriers in practice.

The major focus of the reform consisted in reinforcing banking and financial regulation, improving the prudential framework and setting up a clear and effective anti-money laundering mechanism. The overhaul of supervisory authorities was a key element of the reform.

In 1992, to allow for devolution of the powers originally held by the People’s Bank of China, the China Securities Regulatory Commission (CSRC) was founded. Today, the CSRC’s role is to supervise the stock markets. And in April 2003, the China Banking Regulatory Commission (CBRC) was established, which acts as a prudential authority, limiting the role of the People’s Bank of China to questions of the country’s monetary policy.

The People’s Bank of China possesses adapted banking and financial legislation. It controls the People’s Bank of China to questions of the country’s monetary policy. Thus, the People’s Bank of China controls the general financial stability of the country and the interest rate, as well as the implementation of the anti-money laundering policy.

4. The financial market

China is rapidly modernizing its financial legislation. An important revision of the “Initial Financial Securities Law” took place on October 27th, 2003. It allowed for a greater opening of the Chinese financial market to foreign investors and put in place a more stable and secure regulatory framework, in particular, by improving the securities issuance system and increasing market supervision.

(i) General information

There are three main types of securities that may be issued in China:

- A shares are registered shares issued by companies established in China on a regulated Chinese market;
- B shares, which are registered securities expressed in Renminbi but must be subscribed for in foreign currencies;
- H shares, which may be issued by a company registered in mainland China on the regulated markets of Hong Kong.

Even recently, foreign investors were only allowed to buy A shares. Local investors could only buy B shares. This distinction no longer holds true. Certain local investors were allowed to invest on the B market and the CSRC authorized certain foreign investors to acquire category A shares.

To acquire securities on the A market, the company must submit a request for approval to the Ministry of Commerce, and to the CSRC in the case of a direct placement. Foreign investors must produce proof of a solid and healthy financial situation, a sophisticated internal monitoring and management system as well as an appropriate system of governance.

Foreign investors are allowed to buy securities in certain public enterprises. If the acquisition of the securities involves a company reorganization, the investor must obtain the prior consent of the State Economy and Commerce Commission, which generally requires that the investor provide solid guarantees as regards capital, financial situation and the capacity to improve the structural organization and development of the company.

(ii) Market access

In order to have its securities or bonds admitted to trading on a regulated market, a company must apply directly to the regulated market concerned by providing all the requested documents (e.g. resolution of the general meeting of shareholders, the articles of association of the company, the business license of the company, the financial statements of the last three years, the last prospectus, etc.).

Foreign invested enterprises must also meet a certain number of additional conditions for listing on the A or B market. The foreign investor’s holding must hold at least 10% of the total participating interests in the listed company.

(iii) Issue of security

The issue of securities can take place either by public offering or by private placement.

For a public offering, the issuing company must provide the CSRC with a specific plan for the issue of securities, a feasibility study on the use of the funds raised and must obtain the approval of its shareholders. The CSRC carries out a preliminary examination before making its final decision. The offer must be made to the public or to at least two hundred investors and cannot last for more than 90 days. If, at the end of this period, the securities sold represent less than 70% of the total volume of securities offered to the public, then the issuer must refund the issue price plus interest to the subscribers.

Companies can also choose to issue securities to specific investors by means of a private placement. The number of investors who receive the offer must be limited to 200. In addition, the quantity of securities issued may not exceed the financing needs for the project in question and the issue of securities must not be intended to finance investment projects.

The company can also choose to issue bonds: to do so, it must submit its request to the CSRC. If the CSRC authorizes it to issue bonds, the issuer is required to publish a prospectus within a period of two to five days prior to the bond issue.

The CSRC is assisted by the Stock Issuance Examination and Verification Committee, which examines the request to issue securities prior to the review by the CSRC, which will make the final decision.
5. The fight against money laundering

China has gradually passed legislation to combat money laundering. In 1997, Chinese criminal law was revised in order to include a specific article on the crime of money laundering. In 2003, the People’s Bank of China enacted a body of rules which clearly defines the supervision procedures that financial institutions are required to follow within the framework of the fight against money laundering. This body of rules provides for procedures allowing banks to report suspicious transactions and to forward information relating to the fight against money laundering. The rules enacted by the People’s Bank of China specify that the central bank “is to guide and make plans for the fight against money laundering in the banking industry, and to be responsible for monitoring the use of the funds earmarked for the fight against money laundering”.

The “Anti-Money Laundering Law”, which has been in force since January 1st, 2007, broadened the definition of money laundering, thereby reinforcing the power of the authorities to combat financial crime in China. This law specifies the roles and responsibilities of financial institutions, as well as the powers of the administrative authority, the People’s Bank of China. The latter also has broad powers of investigation in connection with suspicious activities, and constitutes the interface with international organizations for the transmission of information on prevention and the fight against money laundering. The action taken by the People’s Bank of China is supplemented by that of the Anti-Money Laundering Monitoring and Analysis Center, which receives the suspicious transaction reports and forwards them to the People’s Bank of China. The Center maintains a database and, in this regard, can demand information from financial institutions.

In accordance with the abovementioned texts, financial institutions must have an internal monitoring system for the prevention of money laundering.

They are also required to declare suspicions of money laundering or financing of terrorism raised by transactions. This declaratory obligation is accompanied by an increased vigilance obligation. All financial institutions must verify the identity of their customers by means of any written evidentiary document and in particular, the true identity of the beneficiaries of a transaction if they suspect that the person requesting the transaction may be acting on behalf of another. Moreover, if a transaction exceeds a certain amount and is unusually complex, the financial institution must transmit a suspicious transaction report to the People’s Bank of China and the Anti-Money Laundering Monitoring and Analysis Center within 10 business days. Failure to comply with these obligations can result in a fine of up to 5 million Rennminbi for the financial institution and a temporary suspension of or a permanent ban on its activities.

Financial institutions must file a report if they suspect a customer of being associated with terrorist activities.

6. Prudential regulation

Following the adoption of the Basel I, Basel II and Basel III mechanisms, China plans to apply the requirements as regards stockholders’ equity to the seven main Chinese banks by the end of 2013, in order to better prepare them for banking and credit risks.

In November 2009, the CBRC adopted a guide on risk reserves, which sets out the principles, procedures and techniques for a healthy management of liquidity risk and in particular, the management of banks’ assets and liabilities, as well as their self-financing capacity. The People’s Bank of China has already increased the reserve deposit ratio three times since the start of 2010, which now corresponds to 17% for the major financial institutions.

Foreign funded credit institutions must maintain a reserve for doubtful debts and for deposits if they engage in deposit-taking. In addition, a branch of a foreign bank must observe a liquidity ratio of 25% and the value of its total assets in China must exceed its total debts in China.

The Chinese government has an important influence on the control of Chinese banks. In certain circumstances, it can appoint managers, decide their remuneration and exercises control over the approval of credit. However, it should be noted that the authorities are placing greater emphasis on the application of international standards as regards corporate governance. For this purpose, the People’s Bank of China adopted, in addition to the ‘Governance Code enacted in 2001, a best practices guide in connection with the role and obligations of managers, their remuneration, conflicts of interest and internal control.

The CBRC has increased capital adequacy requirements and is forcing banks to reinforce their risk management systems with regard to credit expansion. Moreover, the CBRC regularly carries out inspections of banks in order to prevent capital transfer risks.

The CBRC is responsible for supervising the financial obligations on the market, as well as the risk management systems of commercial banks.

7. Banking services

For a long time, foreign funded credit institutions and joint venture banks could only buy and sell foreign currencies. On December 11th, 2007, to meet its WTO undertakings, China granted foreign banks permission to carry out Rennminbi transactions.

In addition, foreign funded credit institutions and joint venture banks can accept money deposits from their customers, grant loans, buy and sell Treasury bills, financial obligations and all other foreign currency instruments except for shares. They can also provide guarantees and letters of credit, make national or international payments, grant interbank loans, etc. They can offer related banking services, subject to the authorization of the People’s Bank of China.

Foreign funded credit institutions and joint venture banks may also provide personal asset management services, subject to the prior approval of the People’s Bank of China.

Since June 2004, foreign funded banks’ ability to negotiate loans abroad (including interbank loans) has been restricted. Foreign funded banks wishing to borrow abroad must submit a request before February of each year to the Development and Reform Commission, which will set a quota which the banks must observe, except if the Commission authorizes an adjustment.

8. Regarding Hong Kong

The retrocession of Hong Kong to China in 1997 did not modify its Anglo-Saxon type banking system. Banking supervision is ensured by the Hong Kong Monetary Authority, and credit institutions fall into 3 categories:

- Licensed Banks: banks which may engage in all activities;
- Restricted License Banks, which may only accept term deposits of at least HKD 500,000;
- Deposit Taking Companies, which may only accept deposits of at least HKD 100,000 with a minimum term of three months.

Contrary to mainland China, there is no exchange control in Hong Kong, funds may be freely repatriated and the internal and external convertibility of the Hong Kong dollar is total.

The Hong Kong Stock Exchange ranks 7th in the world in terms of market capitalization. It has many advantages: an effective and transparent regulatory framework, a modern technological platform, a local economy mainly geared towards services and a wide range of products.

The CEPA made it easier for Hong Kong’s banks to access the Chinese market and gives them a competitive edge over foreign banks, particularly by allowing them to offer certain banking services in Rennminbi.

XI Outline of real estate law in China

1. The land ownership regime

Chinese real-estate law reposes on a fundamental contradiction: land belongs to the Chinese State but the real estate which is built on it may be privately owned. Article 17 of the Law on the General Principles of Chinese Civil Law of April 12, 1986 introduces the notion of private property in mainland China or, more precisely, grants natural persons and legal entities a right of use comparable to the right of ownership.

(i) The property of the State and of local authorities

In China, private individuals cannot own land. In theory, urban land belongs to the State and the lands located around cities and in rural areas are administered by local authorities.

The Chinese right of property ownership is mainly regulated by the “Land Management Law” of June 25, 1986 (revised on August 28, 2004) as well as its implementing decree of January 1, 1999, the “Regulations on the Administration of Urban Land” which came into effect on January 1, 1995 and the “Law on Property” which came into effect on October 1, 2007 and which introduced the principle of private property into the Chinese constitution. However, it did not call into question the principle of the public ownership of land.

Theabove texts classify land belonging to the State into two categories:

- Constructible land (land for housing, public and/or industrial use);
- Agricultural land (tilled land, forests, grassland, etc).

It should be noted that changing agricultural land to constructible land is authorized but strictly regulated and will only be permitted if the change does not affect
the objectives stated in the annual general agricultural plan.

(ii.) The granting of a right of use to land

Despite the fact that a private person may not own land, Chinese law nonetheless provides for a right of use of limited duration from 30 to 70 years for agricultural use and from 40 to 70 years for residential use in an urban environment. The right of use may be granted by the authorities or acquired from a preceding holder, pursuant to a transfer.

Local authorities, and in particular, those in charge of land management, may grant an attribution, concession or lease in the name of the Government depending on how the land will be used.

The Law on Property confirms that rights of land use are rights in rem which can be freely assigned, mortgaged and leased. These rights benefit from protection equivalent to that of freehold. The land concerned may only be “requisitioned” in the public interest and in exchange for the payment of compensation the principle and the extent of which are reinforced by the amended law. The text establishes the principle whereby residents’ “living conditions” may not be affected by the requisition, therefore making decent re-housing mandatory.

2. Major principles of real estate acquisition

(i.) Mandatory registration

The transfer of ownership of real property in China is subject to registration with the local Land Office. However, this system is deficient today in practice, because registrars are often slow to register sales and transfers, creating legal insecurity in the interval. One of the principal innovations of the Law on Property resides in the priority right conferred on the purchaser as from the registration of a deed of conveyance by the Chinese authorities. The purchaser is thus better protected during the transitional period pending final registration in the Land Office register.

(ii.) Distinction between the right of ownership and the right of use

It is necessary to distinguish the right of ownership of the building from the right of use of the land on which the building is built. The acquisition of the ownership of a building built on ceded land is possible, but the right of use of the land on which the acquired building was built must be transferred to the purchaser along with the right of ownership of the building.

The Law on the Administration of Urban Land provides that the authorization must be granted when the request relates to the renewal of a right of use on urban land, except if the State decides to exercise its right of requisition. In theory, if the right to use the land is not renewed one year before its expiry, the State can recover the right of use and thus become the owner of the building without having to pay financial compensation.

The “Decision relating to the Standardization of Access and Management of the Foreign Investment in the Real Estate Market” of July 11, 2006 imposed stricter legal conditions in relation to the acquisition of property in mainland China. The reform of 2006 established new legal requirements for the acquisition of immovable property by natural persons and, more particularly, for foreigners. Foreign persons who wish to acquire real estate can now only do so after spending one year in China as a resident. Moreover, the regulations authorize the acquisition of real estate only for the personal use of the purchaser. The real estate in question may not be leased to a third party.

These restrictions were however alleviated by local measures, as was the case in Beijing. At the beginning of 2009, the municipality of Beijing enacted a decree on the promotion of healthy development of real estate ownership. This decree repeals the rule whereby foreign investors can acquire only one property.

As far as legal entities are concerned, only acquisitions of immovable property by companies established in mainland China are authorized. Since the reform of 2006, the acquisition of immovable property by a foreign investor must be effected by means of a “Foreign Invested Real Estate Enterprise” or “FIREE” established in mainland China.

(iii.) The real estate reform of 2006

The “Decision relating to the Standardization of Access and Management of the Foreign Investment in the Real Estate Market” of July 11, 2006 imposed stricter legal conditions in relation to the acquisition of property in mainland China. The reform of 2006 established new legal requirements for the acquisition of immovable property by natural persons and, more particularly, for foreigners. Foreign persons who wish to acquire real estate can now only do so after spending one year in China as a resident. Moreover, the regulations authorize the acquisition of real estate only for the personal use of the purchaser. The real estate in question may not be leased to a third party.

These restrictions were however alleviated by local measures, as was the case in Beijing. At the beginning of 2009, the municipality of Beijing enacted a decree on the promotion of healthy development of real estate ownership. This decree repeals the rule whereby foreign investors can acquire only one property.

As far as legal entities are concerned, only acquisitions of immovable property by companies established in mainland China are authorized. Since the reform of 2006, the acquisition of immovable property by a foreign investor must be effected by means of a “Foreign Invested Real Estate Enterprise” or “FIREE” established in mainland China.

XII Sustainable development and the environment

1. A desire for strong protection in the face of real constraints

Since the early 1990s, the Chinese economy has undergone formidable growth, with the result that China today accounts for 15% of the worldwide demand for energy: it is the second biggest producer and consumer of energy in the world, and will soon be the first.

Coal represents between 65% and 70% of Chinese energy production: China consumes as much coal as the United States, the European Union and Japan combined. Thanks to coal, China’s energy self-sufficiency comes to 90%, or 20% higher than for the OECD countries. This very strong predominance of coal is at the heart of the environmental question in China. From 1996 to 2006, emissions of greenhouse gases (GHG) doubled and China became the world’s highest GHG emitter in 2009.

Progress in the area of energy efficiency is highly significant because China uses 2.4 times more energy than the world average per unit of GNP produced. In addition to the abundance of coal – one of the most polluting energy sources – the question arises as to the cost of energy, which remains very low. Any reform in this area also comes with the problem of inflationary risks and social stability.

Environmental degradation in China has become more and more obvious over the past decade. China is currently seen as an “environmental threat”. The Chinese authorities are not indifferent to these issues. On the contrary, they are very aware of the situation. There is a desire to improve energy efficiency within the framework of Chinese economic development. At the same time, the China that is growing richer considers that it is entitled to the same living conditions, and therefore the same pollution, as developed countries.

2. Regulatory and tax incentives for companies in China

According to article 88 of the implementing decree of the Law on Enterprise Income Tax, companies that carry out projects favorable to the environment can benefit from a tax exemption for the first 3 years, and a tax reduction of 50% from the 4th to the 6th year inclusive. Tax Circular No. 166 (2009) contains a table specifying the precise conditions to be met in order to benefit from this advantage. A tax credit may also be granted to companies which buy and use equipment that is conducive to sustainable development and that is specified in lists drawn up by the Chinese tax authorities. This tax credit is equal to 10% of the sum spent to buy the equipment conducive to sustainable development and may be deferred over the following 5 fiscal years.

Incentives are offered not only at national but also at local level. Shanghai, for instance, strongly encourages investment in the sustainable development sector.

3. Operations to implement the Kyoto Protocol in relation to climate change in China

The “Kyoto Protocol” was adopted on December 10th, 1997 at the “United Nations Framework Convention on Climate Change” (UNFCCC). The objective of the “Kyoto Protocol” is to reduce greenhouse gases within a certain time. The countries appear in Appendix I of the UNFCCC are committed to reducing emissions of carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), hydrofluorocarbons (HFCs), perfluorinated hydrocarbons (PFCs) and sulfur hexafluorides (SF6). In a general way, the Protocol states that the countries featuring in Appendix I must together reduce their greenhouse gas emissions by 5% between 2008 and 2012. The Kyoto Protocol also introduced a Clean Development Mechanism (CDM) by which industrialized States are encouraged to devise projects to invest in clean technologies in developing countries.

China signed the Protocol in 1998 and ratified it in 2002. As a developing country it is not bound by the requirements to reduce greenhouse gas emissions for the first Kyoto Protocol commitment period. However, as one of the planet’s major emitters of CO2, it is having to deal with ever increasing international pressure. In the face of this pressure, the Chinese government announced at the end of November 2009 a voluntary effort to reduce by 40% to 45% its carbon intensity i.e. its GHG emissions per unit of GDP, by 2020 compared to 2005 levels.

As far as the implementation of the CDM is concerned, China published in 2005 the “Measures for Operation and Management of Clean Development Mechanism Projects in China”. On this basis, the NDCRC, via the National Coordination Committee on Climate Change, organizes concrete actions for the implementation of CDM projects. These are divided into 3 areas identified in article 4 of the measure: improvement of energy efficiency, the development and utilization of...
renewable energies and the improvement of the system for the recovery and use of methane in coal plants. The principal sectors concerned are those of industry, renewable energy, sustainable habitation and transport.

Enterprises that sponsor a CDM project and that wish to obtain carbon credits will have to prove that their project meets the technical criteria laid down by the United Nations. In addition, the measures impose two conditions for the implementation of CDM projects: firstly, the CDM project must comply with Chinese regulations, strategies and sustainable development policies and secondly, the CDM project must promote the transfer of environmental technology to China.

Applicants for carbon credits must address their request directly to the NDRC and to their local NDRC authority. Final approval of projects is subject to 4 mandatory stages: filing of the application with the NDRC, evaluation by an expert, meeting of the Committee and decision making. The procedure for the approval of CDM projects may not take longer than 60 days as from the NDRC’s receipt of all requisite documents.
Contacts

Paul-Emmanuel Benachi
Partner in charge of Asia
pbenachi@lpalaw.com.cn
Tel: + (86) 21 6135 9966

Raphael Chantelot
Partner responsible for Asia in Paris
rchantelot@lpalaw.com
Tel: + (33) 1 5393 3946

Naïma Zitouni
Partner France and China
nzitouni@lpalaw.com
Tel: + (33) 1 5393 3000

Newsletters and events on China

You can register to the LPA newsletters, notably to our quarterly newsletters on: www.lpalaw.com

and ask to be invited to the LPA events on China throughout the year at lesrencontreslpa@lpalaw.com

Newsletters and events on China

China is implementing numerous tax reforms in order to control a mature economy that is in a consolidation phase. These reforms are profound and fundamental, but are first tested on a small scale before being extended to the whole country. It is the famous “crossing the river by feeling the stones” of Deng Xiaoping. The areas concerned include value-added tax (VAT), foreign investment, sectors offering privileged taxation and Hong Kong.

I- THE PILOT PROJECT FOR A REFORM OF VAT IN SHANGHAI

On November 18th, 2011, the Chinese Finance Ministry published a long-awaited circular on the VAT reform. VAT will now replace the “business tax”. The reform aims to make the collection of tax more effective and easier to manage by aligning the indirect taxation mechanism with those of the majority of the member countries of the Organization for Economic Cooperation and Development (OECD). Business tax primarily related to services which were not subject to VAT. The business tax came to approximately 6% and was not recoverable or deductible.

In 2010, revenues from indirect taxes (including customs duties) accounted for approximately 75% of China’s tax revenues, whereas in France they only represent around 55%.

This tax reform must be implemented over the entire Chinese territory at the beginning of 2013. It was launched in Shanghai as part of a pilot project applied to certain services from January 1st, 2012. Beijing should also apply this reform from July 1st, 2012. Guangzhou has also been mentioned.

Which taxpayers are subject and what are the VAT rates?

Two categories of taxpayers liable for VAT are defined in the pilot program:

- The “general VAT taxpayer”: any taxpayer providing pilot services with an annual turnover of at least RMB 5 million; or any taxpayer providing pilot services with an annual turnover lower than RMB 5 million, but which expressly asks to be subject to the general taxpayer statute.
- The “small-scale taxpayer”: any taxpayer providing pilot services with an annual turnover of less than RMB 5 million.
Lefèvre Pelletier & associés is one of France’s leading law firms. The firm provides advisory and litigation services to its French and international clients by pooling the skills of its teams in all areas of business law.

PARIS
136, avenue des Champs-Elysées – 75008 Paris – France
Tel. : +33 (0)1 53 93 30 00 – Fax : +33 (0)1 53 93 30 30 | Email : paris@lpalaw.com

ALGIERS
Lotissement Ricour Omar, villa n°5 – Ben Aknoun, Algiers – Algeria
Tel. : +213 (0)21 91 24 83 – Fax : +213 (0)21 91 42 46 | Email : algiers@lpalaw.com

CASABLANCA
3, rue Bab Mansour – Espace Porte d’Anfa – Bâtiment C – 2nd Floor – 20050 Casablanca – Morocco
Tel. : +212 (0)522 97 96 60 – Fax : +212 (0)522 94 19 18 | Email : casablanca@lpalaw.com

FRANKFURT
Taunusanlage 19 D-60325 Frankfurt – Germany
Tel. : *(49) 69 133 44 56 59 – Fax : *(49) 69 710 456 450 | Email : frankfurt@lpalaw.com

GUANGZHOU
Suite 1610, Guangdong International Hotel Main Tower
339 Huanshi Dong Lu – Guangzhou 510098 – China
Tel. : +86 20 2237 8609 – Fax : +86 20 2237 8619 | Email : guangzhou@lpalaw.com

HONG KONG
44/F, Cosco Tower, Unit 4405 – 183 Queen’s Road Central – Hong Kong
Tel. : +852 2907 7882 – Fax : +852 2907 6682 | Email : hongkong@lpalaw.com

SHANGHAI
41/F, Hong Kong New World Tower, Unit 4102
300 Middle Huai Hai Road – Shanghai 200021 – China
Tel. : +86 21 6135 9966 – Fax : +86 21 6135 9955 | Email : shanghai@lpalaw.com

www.lpalaw.com