GUIDE TO DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA

Preface

Nufrontiers is a management consulting firm with the objective to offer its clients a one-stop professional advisory platform and assist in setting-up business operations in China – mainly Beijing & Shanghai

Nufrontiers has two locations from which its is presently operating, one in Singapore at Suntec City, Tower Two as it's headquarter and the other office in Beijing China, at Cofco Plaza, Tower B, at the Central Business District.

The firm has been actively operating in **China** since the 2000 and provides the following:

A) Commercial Advisory services (Business Law),
B) Business/Company setups for Clients,
C) Financial Services (Accounting, Audit & Taxation) and
D) Human Resource Consulting (Recruitment Services).

The information in this guide only serves as an illustration of the steps outlining some of the main issues which should be considered by (potential) investors in Beijing and Shanghai can in no way replace existing Chinese laws and regulations.

Content

Basic Data about the PRC

Overview

- China is one of the world's oldest civilizations, with thousands of years of history, literature and culture.
- China has the fastest growing economy and the world's third-largest market.
- GDP in 2001 is about 7.3%
- The export market is mostly concentrated in few cities along the eastern seaboard.
- The People's Republic is a mere 50 years old and most of the laws and regulations governing business and trade have been written in the past twenty years. Over the past twenty years, China has moved from a planned to market economy.
- Exporters who overcome the challenges of exporting to China have a huge market.
- Courtesy toward guests is a virtue in Chinese culture; Chinese people can be extraordinarily hospitable and kind.
- Everyday discourse in China can be seen as rude and confrontational.

Population:

- In year 2001 - Approximately 1.273 billion

Currency:

- RMB8.276 = US$1 average
- RMB4.5 = S$1 average
- RMB8.192 = EUR$1 average
- RMB12.785 = GBP$1 average

China's Major Market:

- Beijing & Tianjin
- Shanghai,
- Guangdong (Guangzhou & Shenzhen)
- 2nd tier: Chongqing, Harbin, Chendu, Shenyang, Wuhan, Xiamen,Nanjing, Dalian, Qingdao, Jiangsu, Zhejiang

Key Natural Resources:

- Coal, iron ore, petroleum, natural gas, mercury, tin, tungsten, antimony, manganese, molybdenum, vanadium, magnetite, aluminum, lead, zinc, uranium, hydropower potential (world's largest)

Key Ports:

- Guangdong/Shenzhen - Imports arrivals in year 2000 US$107.6 billion
- Beijing - Imports arrivals in year 2000 US$37.7 billion
- Shanghai - Imports arrivals in year 2000 US$29.4 billion
- Jiangsu - Imports arrivals in year 2000 US$19.9 billion

Key Industries:

- Iron and steel, coal, machine building, armaments, textiles and apparel, petroleum, cement, chemical fertilizers, footwear, toys, food processing, automobiles, consumer electronics, telecommunications
- The bulk of the Chinese population is engaged in agriculture activities, and the development of agriculture and the rural environment are top priorities. The "Pillar Industries" in current Chinese economic planning are machine building, electronics, petrochemicals, automobiles and the construction industries.
- Light industry and textiles will continue to be developed both as a source of foreign exchange, and to meet domestic requirements.
- The PRC central government is now also encouraging the reform of, and investment in the trading, distribution, banking, insurance and financial services sectors.

Legislative - Government:

- The PRC is governed by one party rule, under the leadership of the Chinese Communist Party.
- The PRC government is organized in two tiers. The top central government, based in Beijing. Directly below the central government are local governments of the provinces, autonomous regions, centrally governed municipalities (Beijing, Shanghai, Tianjin and Chongqing), and special economic zones (Shenzhen, Shantou, Zhuhai, Xiamen and Hainan Province).
- The PRC's administrative system divided into three levels, namely, the central government level, provincial or municipal government level and county government level. Most cases, the higher the level of government the greater authority and responsibility.

Legal System

Shortly after its founding in 1949, the PRC government dismantled the former legal system and installed a socialist legal system. Laws are enacted by the National People's Congress, and administrative regulations are passed by the State Council or organs under the State Council. Government agencies are empowered to interpret legislation within their respective areas of jurisdiction. People's courts at various levels have authority to hear and decide criminal and civil lawsuits. The procurers investigate criminal matters and represent the State in criminal cases.

The PRC's body of laws has undergone and is still undergoing comprehensive reforms since 1979. Several major pieces of legislation have been passed, including laws and regulations applicable to foreign investment.

Foreign Investment Policies

Foreign investment in the PRC is highly regulated. The Ministry of Foreign Trade and Economic Co-operation ("MOFTEC") is the PRC government department charged with administering foreign investment in line with state policy, and is empowered to approve all applications to set up a foreign investment enterprise ("**FIE**"). In many cases, MOFTEC may delegate this authority to its authorized local commissions at the provincial or municipal level, subject to certain imitations based on the amount of investment in the **FIE** and the need for allocation of raw materials and foreign exchange by the state, etc.

The types of business open to foreign investors are circumscribed by central government policy. Formerly, it was not possible to get reliable information on this policy. In 1995, however, MOFTEC, the State Planning Commission and the State Economic and Trade Commission jointly published guidelines on foreign investment, together with a list of encouraged, restricted and prohibited industries, which made government investment policy more transparent to potential foreign investors. These guidelines are constantly amended to reflect changes in policy. In certain industries it is mandatory that the foreign investor have a Chinese partner, or that the Chinese partner hold a majority interest in the **FIE**.

A. Grants and Incentives

The standard tax rate on the taxable profit of an **FIE** is 33%, this is based on a national tax rate of 30% plus a local tax rate of 3%. FIEs may enjoy preferential tax rates and concessions depending on the nature of the **business** activities and where it is established. FIEs incorporated in Special Economic Zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) or production-oriented FIEs incorporated in Economic and Technological Development Zones or in the Shanghai Pudong New Area are entitled to a 15% tax rate on profit. Production-oriented FIEs incorporated in coastal, open port cities or old urban districts of cities where Special Economic Zones or Economic and Technological Development Zones are located are entitled to be taxed at the preferential rate of 24%.

FIEs which are production-oriented and have an operational period of at least 10 years are exempt from paying income tax in the first and second profit-making years and are entitled to a 50% reduction in income tax in the third to fifth profit-making years. In addition, FIEs which either export at least 70% of their production output or are certified as technologically advanced may obtain special benefits and extended tax breaks.

B. Foreign Exchange Control

The RMB is not a freely convertible currency, and all foreign exchange transactions under **capital account** are tightly controlled. Although the PRC government has taken steps in recent years to move towards a partially convertible currency, virtually all foreign exchange activities remain subject to government control, exercised by the State Administration of Foreign Exchange ("SAFE"). Nonetheless, converting RMB earnings to foreign exchange is becoming less of a practical problem, especially for trade, services, profit repatriation and debt servicing. FIEs, like domestic companies, can exchange RMB for foreign currency at the local banks which are authorized to conduct foreign exchange dealings.

FIEs can maintain foreign exchange in special foreign exchange accounts with designated banks, up to a maximum amount set by the SAFE in the case of current account items. Foreign exchange received by an **FIE** in excess of the specified maximum amount must be sold to designated foreign exchange banks for conversion into RMB.

FIEs' **capital accounts** must be maintained in foreign currency. Domestic entities (other than banks and financial institutions which are authorized to provide banking and financial services) must convert all foreign exchange into RMB. All foreign exchange bank accounts, whether offshore or onshore, must be approved by the SAFE.

C. Pre-requisite for Foreign Investment Enterprise (FIE)

An **FIE** takes one of the following forms:

1. An equity joint venture, which is a limited liability company possessing legal person status established by Chinese and foreign investors;
2. A wholly-foreign owned enterprise, which is a limited liability company possessing legal person status established entirely with foreign capital by one or more foreign investors; and
3. A co-operative joint venture, which may be either a form of partnership, or an entity with limited liability and legal person status, established by Chinese and foreign investors.

Corporate Business Structures

A. Formalities

FIEs can only be established after receiving approval from MOFTEC and/or the relevant government approval authority. In most cases, MOFTEC has delegated the authority to approve FIEs to the provinces, autonomous regions, centrally governed municipalities or certain types of special zones, whereby the total investment in the project does not exceed **US$30,000,000**, and to the local governments where the total investment does not exceed **US$10,000,000**. Approval includes approval of the **FIE's** feasibility study, articles of association and, in the case of a joint venture, joint venture contract.

Following approval, an **FIE** is required to register with the local branch of the SAIC. The SAIC will issue the company's business license, which will include the name of the company and business form, its registered address, the name of its legal representative, and its permissible scope of business. Registration with the SAIC is subject to a nominal charge, and must be renewed annually. (Domestic PRC companies such as state-owned enterprises, domestic joint ventures, collectively-run companies and private ventures are subject to a different formation procedure, but any domestic company which is a legal person for purposes of PRC law must register with the SAIC.)

B. The Board

The board of directors, or in the case of some co-operative joint ventures, the "joint management committee", is the highest organ of authority in an **FIE**. The investors in an **FIE** exercise control through their appointed board members. The concept of shareholder voting does not exist in an **FIE** unless it is incorporated under the PRC Company Law as a company limited by shares. Certain major decisions concerning an **FIE** require unanimous decision of the board.

Directors owe a fiduciary duty to the company, and are prohibited from using their position for personal gain. They should not misappropriate company funds, or engage in businesses which compete with the company.

C. Capital and Debt

In order to ensure that they are not undercapitalized, FIEs must maintain a legally prescribed ratio of debt to equity. This ratio is specified in the articles of association and/or joint venture contract. FIEs with a higher amount of total investment are allowed a higher proportion of debt. The equity must be injected into the **FIE** within a period of time ranging from one to three years, depending on the amount of equity. In theory, even longer periods may be allowed where the amount of equity exceeds US$10 million. Failure to pay in equity in a timely manner can result in cancellation of the **FIE's** business license.

D. Parent Company Liability

With the exception of those co-operative joint ventures which are formed as partnerships without limited liability, all FIEs are limited liability companies. The investors' liability in respect of the company is limited to the amount which the investors have subscribed in the company's equity.

E. Letterhead

The name used on a company's stationary must be the same as its registered name as shown on its business license.

F. Annual Filing Requirements

All FIEs must prepare a self-examination report for each year. This report must be submitted to the local branches of respectively MOFTEC, the State Economic and Trade Commission, the SAFE, the State Administration of Taxation, the SAIC, the Ministry of Finance and the General Administration of Customs, by 15th March of the following year. Each of these organizations will verify the report, and notify the local branch of the SAIC. Any violations found during this procedure must be corrected. Failure to do so, or to comply with the self-examination requirement, will result in cancellation of the **FIE's** business license.

Forms of Setup for Foreign Investment Enterprises

A. Representative Office (Rep. Off)

Setting up a representative office is the quickest, cheapest and simplest method for foreign companies to enter the PRC market.

Although representative offices are not limited to particular industries, there are formidable restrictions to how the office is allowed to conduct business. In short, a representative office is prohibited from engaging in direct business activities. Conducting market research, liaison activities, and preliminary market investigations for the parent company are allowed.

Criteria for the establishment of a representative office depend on the nature of the foreign company.

The advantage of establishing a representative office is in that the foreign company has relative autonomy over the direction of business activities and complete control over the management team.

B. Equity Joint Venture (EJV)

An equity joint venture **(EJV)** in China is a corporate structure that allows for foreign investment in Chinese enterprises. It takes the form of a limited liability company in which each party is liable for the capital subscribed to it. According to the 1979 Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (The Joint Venture Law), a foreign joint venture may be companies, enterprises, individuals or other economic organizations that wish to engage in a partnership with a Chinese company, enterprise or other economic organizations. A minimum of 25% of the joint venture's registered capital needs to come from the foreign partner, and while there is no law stipulating the highest limit, it may be more than 50%, but certainly not close to 100%.

When establishing an EJV, the duration of the venture needs to be specified. Profits can only be released according to the proportion of initial investment in the project.

Certain basic requirements necessary for a foreign enterprise to apply for a joint venture; an EJV established within China must promote the development of China's economy through scientific and technological means. The final decision for granting EJV status is with the Minister of Foreign Trade and Economic Co-operation (MOFTEC). A company that applies for a joint venture must demonstrate that the joint venture under application will comply with at least one of the following requirements:

1. It must use advanced technical equipment and scientific managerial methods which help increase the variety, improve the quality and raise the output of products or save energy and materials;
2. It must be open to technical innovation so as to bring about quicker returns and bigger profits with less investment;
3. It must help expand exports and thereby increase foreign currency receipts; and
4. It must help train Chinese technical and managerial personnel.

The law further stipulates that any application will not be approved should it be detrimental to Chinese sovereignty, violate Chinese laws, hinder economic development, pollute the environment, or impair the rights of one of the parties. In addition, there are regulations that direct investment towards particular industries.

Compared with other forms of investment, an EJV offers the advantage of a fairly well developed regulatory environment. As the EJV platform was the first investment vehicle available to foreign enterprises, there is a wealth of precedents and previous success stories that can be turned to as models for how to make the equity joint venture profitable. Additionally, the larger the project, the more likely the government will promote the benefits of an EJV. In short, while the EJV is the most highly regulated of the investment vehicles offered, this regulation provides for greater stability and security for the foreign investor.

C. Trading Companies

Generally, foreign companies are not permitted to trade in China, with the exception of the products that are manufactured in China. With careful selection, training and constant contact, foreign companies can obtain good market representation from a Chinese trading company, many of which are authorized to deal in a wide range of products.

D. Co-operative Joint Venture (CJV)

A **Co-operative joint venture** (**CJV**) is formed by signing a contract parties from China and other countries or regions. The contract shall define clearly the rights, obligations and interest distribution to each party.

A Co-operative joint venture (CJV) closely approximates a typical partnership and are frequently referred to as contractual joint ventures for the simple fact that it allows the Chinese and foreign parties the opportunity to pursue mutually beneficial ends on a negotiated, contractual basis. To this end, the immediate appeal of a CJV is the flexibility it offers in terms of the size, duration and initial investment in the project.

A CJV registered as a legal entity is a limited liability company, assumes liability for debt within all its properties. As with an EJV, the proportion of investments contributed by the foreign partner cannot be less than 25% of the registered capital. As well, the industries targeted for a CJV are the same as for an EJV. The Chinese partner of a CJV submits all accompanying application documents for a CJV for approval to MOFTEC.

Profit sharing of a CJV is determined under discussions occurring on a yearly basis between partners, rather than the exact distribution of profits according to invested capital associated with an EJV. The intent of this structure is to make the project more appealing to the foreign investor.

Often in the initial stage of a co-operation, the foreign partner will receive a higher profit distribution in order to repay loans. Later on, the Chinese partner would receive a greater proportion of the profits. This flexible profit sharing allows for more versatility in initial investment and earnings.

The duration of a CJV is decided upon by mutual consent by the Chinese and foreign partners and must be clearly stated in the contract. Should the partners wish to extend the project beyond the dates stipulated in the contract, they need to file an application 180 days before the termination of the venture. The CJV contract can stipulate that the foreign partner can recover its investment before the contract is finished. In these situations, however, an extension of the contract is disallowed.

E. Wholly Foreign Owned Enterprise (WFOE)

Wholly foreign-owned enterprises (WFOE) refer to enterprises in China established by foreign companies, enterprises, economic organizations or individuals with funds entirely of their own. They are also called "enterprises exclusively run with foreign funds." All the profits made by a foreign enterprise go to the foreign investors.

A WFOE is an autonomous legal entity in which the ownership resides with foreign investors. It is instituted in China by foreign investors using foreign capital and adhering to Chinese laws. It registers in China as a Chinese legal entity and independently performs production and operation activities subject to a registered business license. It is becoming an increasingly popular investment vehicle, and as of 1997, WFOEs constituted the largest number of newly approved foreign enterprises.

As with the joint ventures, an application for a WFOE needs to be examined and approved by MOFTEC. It takes into consideration the nature of the industry and balances it against the WFOE Law Implementing Rules, which set out the general requirements for the establishment of a WFOE. Aside from yielding "notable" economic benefits, either of the two following conditions must be met:

The enterprise must use advanced technology and equipment, develop new products, save energy and raw materials, upgrade and replace existing products that can be substituted for imports; or,

The value of the products of the enterprise exported each year must account for more than 50% of the total value of all the products produced during the same year, and a balance between foreign exchange and expenditure, or a surplus of foreign exchange, must be achieved.

The duration of a WFOE is fairly open and amenable to revision. The Law on Wholly Foreign-owned Enterprises stipulates that the term of operation of such an enterprise must be stated in the written application, but the contract is both easily extended should profits be abundant and easily dissolved if excessive losses have been accrued.

The greatest advantage to a WFOE is simply that it is controlled entirely by foreign investors. On the down side, a WOFE cannot benefit from the relationships (guanxi) provided by a local partner, and may have more difficulties locating land.

F. Limited Liability Companies

This is one of the two forms of corporate entities allowed under the Company Law. The registered capital of a limited liability company is not divided into shares, but instead is accounted for by the distribution of capital contribution certificates. Capital contribution certificates acknowledge the registered capital investment of the investor and are issued in proportion to the amount invested by each investor. Capital contribution certificates thus serve the role of a share, although they cannot be traded on exchanges. Limited liability companies are required to establish an advisory board, hold shareholder's meetings and establish a business structure otherwise in line with foreign companies. There are several conditions that must first be met before the establishment of a limited liability company. To begin with, a minimum amount of registered capital must be made available, ranging anywhere from RMB100, 000 to RMB500, 000 depending on the sector. A limited liability company must have articles of association, a name and organizational structure in conformity with relevant Chinese laws and a fixed site for production. Furthermore, a limited liability company must have between 2 and 50 shareholders; each of whom is limited to the amount of capital subscribed to it. Limited liability companies are much more prevalent than the other form of existent company, i.e., a company limited by shares.

G. Holding Companies

A holding company in China, as defined by the 1995 Establishment of Companies with an Investment Nature by Foreign Investors Tentative Provision, closely approximates holding companies existent in western countries, with some differences. Holding companies tend to be established by multinationals that already have a presence in China and are seeking means of expanding their presence or else reinvesting their earnings. As of 1998, there were approximately 150 holding companies in China, and their numbers are on the rise.

Criteria to establish a holding company are fairly stringent, and companies applying for a holding company need to satisfy at least one of the following requirements:

1. A minimum asset value of US$400 million in the year before the application with registered capital already contributed to foreign investment enterprises of over US$10 million, and three or more future project proposals approved;
2. At least 10 foreign investment enterprises have been established (either production-oriented or infrastructure-related) and total registered capital contributed in excess of US$30 million.

A holding company may invest in fields where foreign investment is encouraged and permitted by the state. It is also authorized to provide certain services to other foreign enterprises for which it has investments.

Acquisitions, Merger and Division

A. Regulatory Environment

A foreign investor may acquire an interest in an **FIE**, which can be a wholly foreign-owned enterprise or a Chinese-foreign joint venture company. Acquiring an interest in an already established **FIE** requires the consent of all other current investors, approval by the government authority which initially approved the **FIE**, and re-registration with the SAIC. In the case of a joint venture, unanimous approval of the joint venture's board is also required.

Merger and division of FIEs are allowed in the PRC. The merger of two or more FIEs requires approval from the relevant examination and approval authorities that originally approved the establishment of each of those FIEs. Similarly, the division of an **FIE** requires approval from its original examination and approval authority. Once the merger or division becomes effective under the law, re-registration or de-registration procedures would have to be carried out with the SAIC.
In the case of a merger of two or more FIEs into a single legal entity, the new or surviving legal entity resulting from the merger is required to carry out the re-registration or change of registration procedures with the local SAIC, while the FIEs which have been absorbed will have to effect de-registration procedures. Similarly, in a case of a division, the newly created FIEs resulting from the division will have to carry out re-registration with the local SAIC.

Furthermore, FIEs are now allowed to invest in domestic Chinese companies which are organized as limited liability companies or companies limited by shares, but the aggregate amount invested domestically by an **FIE** may not exceed 50% of the value of its net assets.

B. Competition Law

There is no competition or antitrust law in **China**. However, there is legislation which deals with price fixing and with unfair competition.

C. Pre-contractual Negotiations

Acquiring an interest in a Chinese company or forming a joint venture with it often involves protracted and difficult negotiations, as the Chinese company negotiates both on its own behalf and on behalf of the State. The approval process can be long and may necessitate renegotiating fundamental terms. It is important to confirm that all government approvals are in good order, and to investigate land use rights, environmental compliance, obligations to the existing workforce, etc.

D. Public Company Acquisitions

Shares in PRC companies listed on the Shenzhen or Shanghai stock exchanges are divided into A shares, which can only be sold to Chinese citizens and organizations, and B shares, which can be sold to foreign citizens and organizations, including persons from Hong Kong, Macau and Taiwan, and (since February 2001) also to Chinese nationals residing inside the PRC.

E. Major Pitfalls

PRC listed companies may not be as strictly regulated and their accounting may not be of international standard. When acquiring an interest in a PRC company by forming a joint venture, particularly problematic areas include verifying land use rights and valuation of assets. Also, it is essential to obtain approval from an approval authority at the correct level of government.

Tax (Company)

A. Tax System / Rates

The PRC imposes individual and company income tax, withholding tax and various turnover taxes.

B. Income Tax

FIEs pay income tax at the rate of 33% on net income derived from both domestic and foreign sources, subject to various concessions. Foreign companies with establishments in the PRC where they engage in business operations are subject to 33% tax on net income arising in the PRC from such operations, subject to limited concessions. Foreign companies with no establishment in the PRC but with PRC source income are subject about 20% withholding on gross income.

C. Customs Duty

Customs duty is payable according to a tariff schedule.

D. Stamp duty

Stamp duty is payable by the parties to certain contracts that are signed in **China**, or "used" in **China**.

E. Turnover Taxes

Value added tax, usually at 17%, is payable on the sale and import of goods. Special exemptions may apply to value added tax on raw materials and components used in the manufacture of goods for export. A consumption tax ranging from 3% to 45% is payable by the manufacturers and importers of tobacco products, liquor, cosmetics, gasoline and diesel fuel, tires and motor vehicles. This is imposed in addition to the value added tax. Business tax of 3% or 5% is payable in respect of the sale of services and 3% to 20% in respect of entertainment.

F. Accounting Periods for Corporate Tax

The fiscal year is the calendar year. Company income tax is payable quarterly.

G. Payments Overseas

Payments of dividends by an **FIE** to its overseas investor are not subject to tax. Interest on loans paid to overseas lenders is subject to 20% withholding, though this amount may be reduced to 10% by treaty or the location of the payer.

H. Transfer Pricing

PRC tax laws require that transactions between associated enterprises use arm's length pricing. PRC tax authorities have the right to make adjustments where they find transfer pricing violations.

Special Investment Zones in China

Special Investment zones are designated by the Chinese government to attract foreign investment and are mostly located in southern China and along the coastline to encourage foreign investment in bringing in advanced foreign technology, and offer platforms for export.

A. Types of zones and locations

1. **Special Economic Zones** (SEZs) -- Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Island
2. **Economic and Technological Development Zones** (ETDZs) -- Guangzhou, Zhanjiang, Nansha
3. **Coastal Economic Open Zone** (CEOZs) -- Beihai, Dalian, Fuzhou, Lianyungang, Nantong, Ningbo, Qinhuangdao, Qingdao, Tianji, Wenzhou, Yantai
4. **New Areas** (NAs) -- Shanghai Pudong

B. Benefits for investors in these zones

These zones offer foreign investors various incentives like national tax reductions, tax holidays, local tax reductions, and other additional concessions offered by local governments.

A foreign enterprise may be a Chinese resident by being either a Foreign Investment Enterprise ('FIE', with its head office in China), or a Foreign Enterprise with establishment in China ('resident FE', with its head office elsewhere) or a foreign enterprise may be a Chinese non-resident by being an Foreign Enterprise without establishment in China ('non-resident FE').

- National Income Tax

SEZs, a Production Foreign Investment Enterprises (FIEs)/resident FEs is taxed only at 15%; if a Production FIE exports at least 70% or more of its output (by value) enjoys a discounted National Income Tax rate at 10%.

ETDZs and **NAs**, a Production FIEs/resident FEs is only taxed at 15%; If a Production FIE exports at least 70% or more of its output (by value) enjoys a discounted National Income Tax rate at 10%.

CEOZs, a Production FIEs/resident FEs is only taxed at 24%; if the investment relates to technology-intensive projects, infrastructure projects, or has a long investment return period with more than US$30m foreign investment value and exports at least 70% or more of its output (by value), the rate is further reduced to 12%.

- Tax Holiday

Production FIEs operating for more than 10 years get a 2-year tax exemption starting from the first profit-making year, followed by a 3-year 50% tax rate reduction. FIEs not engaging in productions must be in one of the priority fields (provided in local regulations) to benefit from this.

- Local Income Tax

The standard rate is 3%. In the special investment zones, the rate may be reduced at the discretion of the local authority, sometimes to 0%. The length of reduction also depends on the local authority. In addition, Local Income Tax Holidays are granted in many zones in relation to technologically advanced or export-oriented projects.

- Withholding Tax

Only Non-resident FEs are subject to a standard rate of 20% withholding tax on their China-generated gross income, or the amount of gain in the disposal of buildings or the transfer of land-use. Such 'gross income' may include dividends, interest, rental and royalties.

In addition to the various benefits available to certain non-resident FEs in specific part of China, more advantageous terms are available to non-resident FEs in SEZs, ETDZs, NAs and the CEOZ. The rate of withholding tax sourced in these areas is reduced to 10%. In addition, if the terms are favorable and the technology transferred is advanced, royalties may even be exempted.

Employment

A. Regulatory Environment

The Provisions on the Administration of Labor in governs all employment matters, including those of FIEs, but excluding those of PRC representative offices. Local labor bureau are in charge of monitoring compliance.

B. Employment Contract

The parties are required to enter into a written employment contract, which may be collective or individual. The contract must be filed with the local labor bureau within one month of signing. The labor bureau has 15 days to raise objections to a collective contract. The labor bureaus have developed their own standard forms, and reportedly have been zealous in encouraging their use. However, there is no legal requirement to do so, and parties are theoretically entitled to negotiate labor contracts within the constraints set by legislation.

C. Minimum Wage

There is a system of guaranteed minimum wages and salaries for Chinese workers. Local People's Government will formulate its own specific standards for minimum wages and salaries. An employer may not pay its workers with wages and salaries lower than the local minimum wage and salary standards.

D. Working Day and Holidays

The daily working hours of Chinese workers shall not exceed eight and the average working hours in a week shall not exceed 44. This can be varied if need be, subject to approval by the labor bureau. Workers can be requested to work up to one hour overtime per day, or three hours overtime per day under exceptional circumstances, up to a maximum of 36 hours of overtime per month. If an employer extends working hours of workers, it has to pay its workers remuneration at 150% to 300% of the regular wages of the workers depending on whether the workers are requested to work overtime on a working day, rest day or statutory rest day.

There are seven (7) statutory holidays. Workers who work for one or more years are entitled to paid annual leave. Further, employees from other provinces or who are separated from spouses may be entitled to home leave.

E. Sick Pay

There are no national requirements concerning short term sick leave. However, there are regulations governing long term convalescence, under which an employee may be entitled to a convalescence period of between 3 and 24 months, depending on the length of service.

F. Maternity Leave

Female employees are entitled to at least 90 days maternity leave. Employers may not terminate the employment contracts of female employees during the prenatal, birth or nursing period. There are additional labor regulations applicable to female workers to protect their health, and a female worker with a baby under one year is entitled to feeding breaks.

G. Dismissal / Redundancy and Economic Compensation

Termination of employees is legally permissible under certain limited circumstances. An employer can terminate an employee's contract at the end of the contract term, or if the employee fails to meet the standards for the job during the probationary period, seriously violates discipline or rules, or is sentenced for a crime. A company which is suffering severe problems may be allowed to reduce staff after "consulting" the workers and the union, and making a report to the labor bureau. Although dismissal is legally allowed, it may be difficult in practice.

Economic compensation is payable to an employee upon the retirement or death of that employee, or upon cessation of employment.

H. Restrictive Covenants

Confidentiality undertakings are legally recognized in **China**, and can be included in the employment contract or concluded separately. There is no prohibition on non-competition provisions which can also be included in employment contracts, though PRC courts may refuse to enforce such a provision if it renders an individual unemployable.

I. Cost of Employment

Though Chinese wages are relatively low, employers must participate in social insurance funds covering old-age pensions, unemployment, medical care, industrial accident, and maternity. In addition, employers may be liable for various allowances and subsidies, such as housing and education.

J. Worker Consultation / Participation

Workers have the right to establish trade unions, and union representatives are entitled to attend meetings of the board of directors as non-voting members when the board is discussing labor-related matters or important production or operational issues.

K. Employment of Foreigners

In most cases, employers must recruit Chinese nationals if at all possible. In order to bring in a foreign employee, the employer must first apply to the local labor bureau for an employment permission certificate to bring in the intended employee. Once the employer has received the employment permission certificate, the foreign employee must apply for a work visa at his local Chinese consulate. After entering **China**, the employee must obtain a work permit and residence card prior to commencing employment. "Foreign experts", offshore petroleum workers, cultural and artistic performers, and representatives of representative offices enter **China** under different procedures.

L. Individual Income Tax

There is a unified system for taxation of domestic and expatriate employees, with graduated rates ranging from 5% to 45%. In general, foreigners are subject to tax on income sourced in the PRC only, unless they have been resident in **China** for five years or more, in which case they are subject to PRC tax on worldwide income. Individuals, who live in **China** for less than 90 days in a given tax year, or 183 days if covered by tax treaty, are exempted from payment of income tax on **China**-related income paid by an overseas employer. Hong Kong residents are subject to the 183 day rule where their remuneration is not paid by a mainland employer.Currently, assessment is on a monthly basis. Employer withholding is required.

Procedure for Foreign Investors to Enter China

i) Visa

Foreign investors who wish to visit China for business may approach the Chinese partners directly with the purpose and time of visit. The Chinese partner will apply for 'visa notification' on behalf of the foreign investors at a local foreign affairs organization for such approval. Once the foreign investors have received the 'visa notification' from the Chinese domestic authorized organization, the foreign investors may apply for entry visa to China at a local Chinese embassy or consulate.

ii) Application for Employment License, Expatriates & Residence Certificate

A foreign invested enterprise, which intends to employ expatriates, may apply for the "Employment license for the expatriates at the People's Republic of China" (hereinafter referred to as employment license) at the Labor & Social Insurance Bureau.

With the employment license, the enterprise may apply for the profession visa notification at the Ministry of Foreign Affairs of the People's Republic of China. The expatriates can apply for the profession visa to enter China at a local Chinese Embassy with the fax copy of the profession visa notification and the employment license.

Marketing Arrangements

Marketing activities in **China** are circumscribed by restrictions on the types of business that PRC companies can legally conduct.

A. Distribution

As a general rule, importing must be handled through a government-authorized Foreign Trade Corporation ("FTC"), and foreign suppliers often appoint FTCs to import, distribute and market their goods in **China**. It is possible for a supplier to enter into arrangements with domestic independent distributors, which in turn must contract with the FTC for importing the goods into **China**.

Under current legislation, a foreign company can form a joint venture FTC with a Chinese partner in the Shenzhen Special Economic Zone or the Shanghai Pudong New Zone.

The foreign supplier may set up representative offices in strategic cities to increase the degree of influence over distribution. Representative offices cannot engage in direct business activities, and sales contracts must be signed in the name of the head office. However, representative offices can supervise the implementation of contracts, carry out market research, prepare promotion plans and liaise with distributors.

FIEs may appoint domestic distributors or marketing agents to sell their products domestically. To gain control over domestic marketing and distribution, FIEs may form new companies with local partners to market the **FIE's** products or, like foreign suppliers, establish representative offices in target markets.

B. Franchising

Franchising activities in the PRC are governed by some specific commercial franchising regulations. The forms of franchising arrangement allowed in the PRC include:

(1) Direct franchising; and
(2) Sub-franchising (regional franchising).

Under direct franchising arrangement, the franchisor grants the franchise to the franchisee directly. The franchisee has the right to establish its own outlets and operate the business according to the franchise agreement, but will have no right of sub-franchising. Under sub-franchising (regional franchising) arrangement, the franchisor grants the franchisee the exclusive right of franchising and sub-franchising within a designated region.

A franchisor is obliged to provide requisite training and guidance to the franchisee before the commencement of business, and to provide long term operational advice and training to the franchisee.

Under a franchise arrangement, a franchisor shall have the right to receive the following fees from the franchisee:-

I. Initial franchisee fee: a one-off fee charged by the franchisor for the granting of the franchise to the franchisee.
II. Utilization fee: periodic payment to be made by the franchisee to the franchisor for the use of the franchise right.
III. Security fee: a fee charged by the franchisor to ensure the due performance of the franchise agreement by the franchisee which is refundable upon the expiry of the franchise agreement.
IV. Other fees: other fees may be charged by the franchisor for the provision of relevant services in accordance with the franchise agreement.

Intellectual Property

A. Regulatory Environment

The PRC has a comprehensive regime of intellectual property laws which provide a wide range of remedies and channels for enforcement, including civil and criminal courts, several different administrative enforcement authorities, prosecutors and police. Legislation facilitating private prosecution by intellectual property owners came into effect in 1997. **China** is a party to most of the international conventions on intellectual property rights, such as the Madrid Agreement for the International Registration of Trademarks, the Paris Convention for the Protection of Intellectual Property Rights, the Patent Co-operation Treaty, the Berne Convention and the Universal Copyright Convention. The level of infringement and the inadequacy of enforcement has been the subject of disputes with her trade partners, particularly the U.S.A.

B. Patents

Patent protection is available in **China** for inventions, utility models and designs. An invention is any new technical solution to a process or product, or an improvement to a process or product. A utility model is any new technical solution relating to the shape, structure, or their combination of a product which can be effectually used. In order to be patentable, an invention or utility model must possess novelty, non-obviousness and practical applicability.
A design is a new design of the shape, pattern, color, or their combination of a product which has an aesthetic effect and is suitable for industrial application. In order to be patentable, a design must not be identical or similar to any design which has been used publicly in **China**, or which has been publicly disclosed in **China** or abroad. The duration of patent right is 20 years for an invention and 10 years for a utility model or design, commencing from the date of the patent application.

C. Trademarks / Service Marks

A new Trademark Law was promulgated on October 26, 2001 and came into force on December 1, 2001. A trademark can be any word, design, alphabet, numerals, 3-dimensional sign, color combination or their combination, used to distinguish the source of goods or services. A trademark must be distinctive and cannot include certain words or designs, including national names or flags, generic names of goods, or direct references to the quality or other features of the product or service. The use of unregistered trademarks is not prohibited. However, pharmaceutical and tobacco products must bear at least one registered trademark as a condition to sale. The PRC basically operates under a "first-to-file" system. Furthermore, the Trademark Law permits cancellation of "widely known" trademarks registered by other parties in bad faith. The period of validity of a trademark is 10 years from the date of approval of the registration, and registrations are normally obtained within 20 to 24 months after filing an application with the PRC Trademark Office. The registration is renewable for additional 10 year periods. The Trademark Office can cancel a registered trademark which has not been used for three consecutive years. Trademark licenses must be recorded with the Trademark Office within 3 months of entering into the license.

D. Unfair Competition

The Anti-Unfair Competition Law prohibits unfair trade practices and this also provides for the protection of a well-known or unique brand name, packaging or trade dress. The law specifically prohibits the passing off of a registered trade mark, the unauthorized use of the name, packaging or trade dress unique to well-known products or use of a name, packaging or trade dress similar thereto thereby causing confusion with the well-known products of another party and prohibits also the unauthorized use of the enterprise or personal name of another party thereby causing consumers to mistake the products or services for the products or services of another party.

E. Copyright

The amendments to the PRC Copyright Law were passed and implemented on October 27, 2001. Copyright protection in the PRC extends to the creators of literary, artistic and scientific works. Both economic rights (the right to remuneration) and moral rights (including the right to determine whether to publish the work, to get acknowledgement as the creator of the work, to control amendment of the work, and to preserve its completeness), are protected.

In most cases the period of copyright protection extends for the life of the author plus 50 years. The copyright protection period for film, television, video and photographic works is 50 years, commencing on the date of the work's original issue.

F. Software Protection

China has issued rules specifically on copyright protection for computer software. Under these rules, software can be registered with the National Copyright Administration to provide prima facie evidence of ownership. However, foreign computer programs are protected as literary works and do not require registration as a condition to enforcement. Foreign computer software programs are protected for 50 years.

A software copyright holder or his assignee can license the software for a period up to ten years; upon expiry the license may be renewed. A party legally holding a copy of software is entitled to load it into its computer, makes a back-up copy, and alters the software as necessary for use. It is permissible to make a limited number of copies without authorization or payment of remuneration for "fair use", including classroom teaching, scientific research, or as needed by the State.

G. Confidential Information and Trade Secrets

Trade secrets are legally protected in the PRC under the Anti-Unfair Competition Law. Trade secrets are defined as technical or economic information which is non-public, which can bring economic benefits to the party that has rights in such secrets and is practical. The owner of the trade secrets must take reasonable precautionary measures to protect them.

It is advisable to include confidentiality undertakings in employment contracts and technology transfer agreements. In addition, reasonable procedures should be implemented to protect confidential information revealed to employees, licensees and trading partners in the PRC.
Third parties who obtain, use or divulge trade secrets of others that they know (or ought to know) are trade secrets of third parties will be deemed to have infringed trade secrets.

H. Customs

Recorder registration with the General Administration of Customs is available to trademarks registered with the PRC Trademark Office, patents issued by the PRC Patent Office and copyright works (recorder documents issued by the National Copyright Administration or equivalent bodied in other countries such as the US Copyright Office as evidence of ownership in a work). Recorders are valid for 7 years, provided that the rights in the protected work do not expire before the said period and applications for renewal can be submitted.

Customs have powers to detain suspected infringing goods at the ports. If the goods are confirmed to be infringing, customs may destroy the infringing goods and imposes fines on the infringer.

Environmental Protection

A. Environmental Protection Law

The Environmental Protection Law of the PRC (the "Environmental Protection Law") is the national law governing all environmental protection matters in the PRC. Apart from the Environmental Protection Law, the PRC government has also formulated other laws and regulations, such as the Prevention of Atmospheric Pollution Law and the Prevention of Water Pollution Law, in order to protect different parts of the environment. Different provinces and municipalities have also formulated their own environmental protection regulations which are of regional application. It should be noted that the PRC government has not separately formulated a set of rules and regulations concerning environmental protection matters for FIEs. In this regard, FIEs within the territory of the PRC are subject to the same standards as domestic PRC entities.

B. Civil and Criminal Liabilities

Under the Environmental Protection Law, anyone who creates environmental pollution hazards shall be responsible for eliminating such hazards and shall compensate any entity or individual who has sustained direct losses as a result of the hazards. Such kind of civil liability is a "strict" liability in the sense that there is no need to prove fault in order to establish the liability. Generally, an individual or entity will be liable under the Environmental Protection Law if it has caused environmental hazards, and if someone has suffered losses as a result, and where a causal relationship can be established between the discharge of the hazards and the loss suffered.

It should be noted that under **Article 42** of the Environmental Protection Law, the time limit for bringing an action for damages in connection with environmental pollution is 3 years commencing from the time when the party concerned knows of or should have known the sustained pollution damage.

Under **Article 43** of the Environmental Protection Law, where a violation of the Environmental Protection Law has resulted in serious environmental pollution problems which cause substantial damage to public or personal property or cause personal injury or death, the person directly responsible for causing the environmental pollution will incur criminal liability in accordance with the law. Since the promulgation of the PRC Criminal Law in 1997, penalties have been laid down for the creation of certain environmental hazards. Penalties for certain criminal liabilities are severe, as an imprisonment of up to 10 years or above can be imposed for serious violation of the environmental law.

C. Administrative Sanctions

If an individual or enterprise has violated the Environmental Protection Law, the environmental protection administration department can exercise its powers of environmental supervision and administration by giving warnings to, or imposing fines on, the relevant individual or enterprise. In certain circumstances, the environmental protection administration department may also order the closure of the enterprise or factory if such enterprise or factory has committed a serious breach of the Environmental Protection Law.

Tips on Doing Business in China

1. **Do your due diligence -- twice**

The scouts are right: be prepared. Some firms believe that China is so different and so opaque that they cannot obtain the information they would usually require, so they enter the market without it. This is foolish. It is difficult to perform due diligence in China, but not impossible.

2. **Choose the right partners**

Before you settle into a long-term relationship, take time to get to know your potential partners. Visit their facilities. Talk to their employees, clients and competitors. And remember that your partners are not just the firms you want to joint venture with, but everyone you do business with: your distributors, your customers, your suppliers and your advisors.

3. **Pay attention to “guanxi”**

A lot is said about Chinese “guanxi” (relationships). Relationships are important everywhere, not just in China. The key things to remember is that a good guanxi is a network of relationships with people at various levels across a broad range of organizations and that guanxi is created and cultivated.

A partner whose “guanxi” consists of a single relationship to a key government official is usually not a good partner-you want to be supported by a complex web, not a single string. With manners, diligence, courtesy and goodwill, you can construct your own web of supporting relationships.

4. **Patience**

Patience is utmost important when doing business (any kind of business) in China. It is not because Chinese do not treasure time, only that they view things and behave differently.

5. **Saving Face**

"Saving face" is an important concept to understand. In Chinese business culture, a person's reputation and social standing rests on this concept. Causing embarrassment or loss of composure, even unintentionally, can be disastrous for any business relationship.

6. **Don't be afraid of the short-term**

Many U.S. firms are attracted to China by its long-term potential. Long term plans are great, but the rapidly changing Chinese market often presents excellent short term opportunities. American firms should not be afraid to avail themselves of an opportunity that may disappear in a year or two.

7. **Be flexible . . .**

China is unique. Where else can you find "a socialist market economy with Chinese characteristics"?

The Chinese legal and regulatory regime can force firms to find creative solutions to business problems, but China is large enough and growing rapidly enough to be worth some flexibility.

8. **But don't be afraid to say "no"**

The Chinese market may not be right for you. Your products may be too advanced, subject to prohibitive tariffs, banned from import or otherwise unsuitable for this market. Know what your bottom line is. China is changing so rapidly that the idea that you must be in China today to compete in fifteen years is utterly rubbish. Being out of the market is better than losing money in the market.

9. **China is not a single market**

From Harbin to Haikou, from Canton to Kashgar, China encompasses diverse topographies, climates, cultures and peoples. There are five languages on the Chinese currency and Chinese "dialects" (such as Shanghaiese or Cantonese) are actually mutually unintelligible languages. Provinces and cities compete fiercely for investment and trade, and regional protectionism is a big problem for Chinese firms-let alone foreign firms.

10. **Get professional help . . .**

Don't sign a contract or agreement that hasn't been reviewed by a qualified local attorney. If you need office space, hire a professional realtor. Reputable, reliable, professional service providers are increasingly available in China, so use them.

11. **. . . And hire an interpreter**

Interpretation and translation are professional skills that firms neglect at their peril. Being bilingual does not qualify one to interpret and having your professionally written, carefully conceived product literature translated by a graduate student from a local Chinese university will not impress your clients. If communication is important to your business, hire a professional interpreter.

12. **Be polite**

Be tough, be firm, but be polite. The two most important words in Chinese are “xie xie,” which mean “thank you.” Learn them and use them.

Litigation and Arbitration

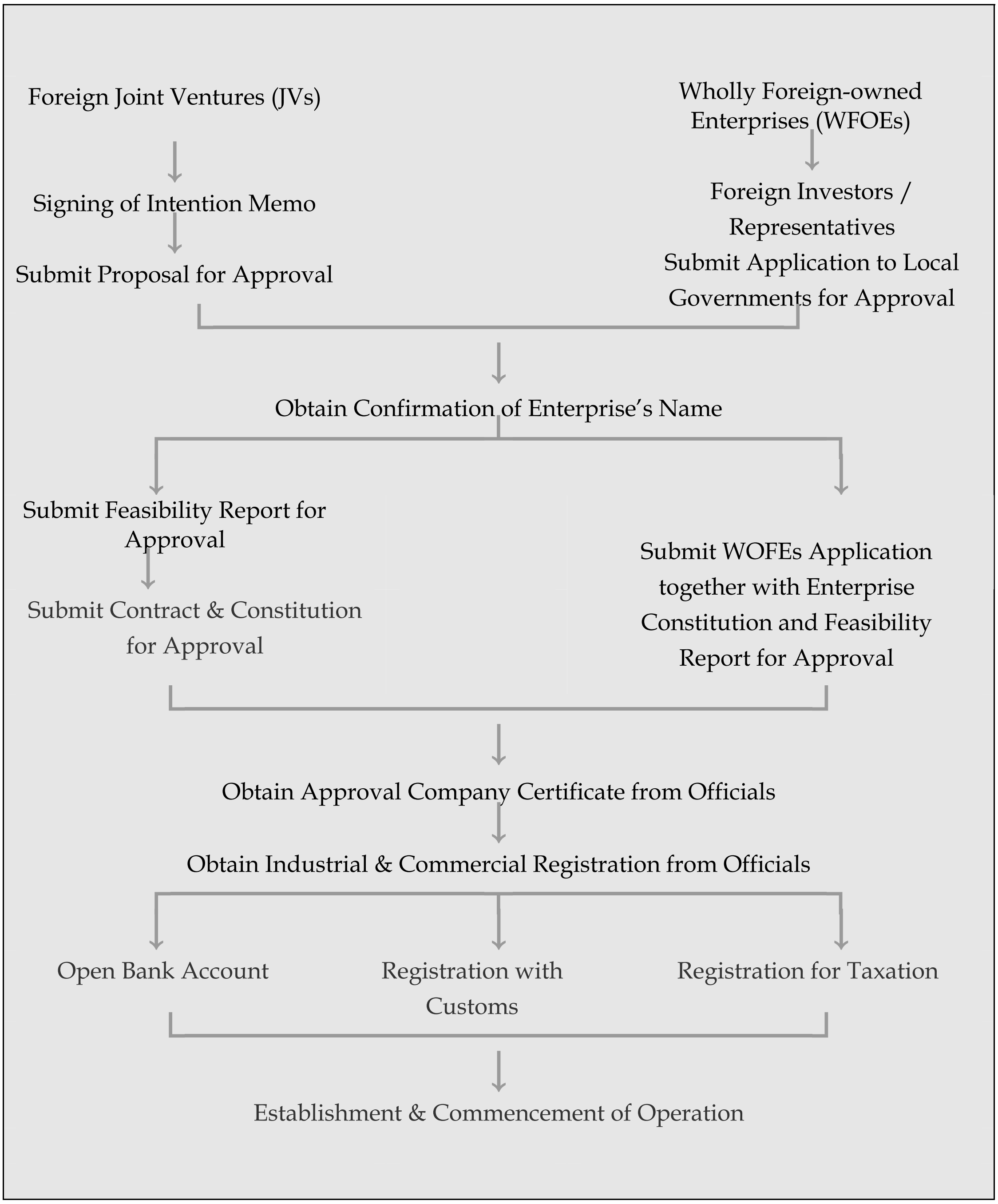
Civil and commercial disputes can be resolved through PRC Courts. Disputes exceeding RMB 1 million are normally dealt with at the first instance by an Intermediate People's Court but depending on the jurisdiction of the People's Court in a particular province; large claims are sometimes dealt with at the first instance by a Higher People's Court. A judgment granted by the First Instance Court can as of right be appealed to an Appellate Court whose ruling is final. Under certain exceptional circumstances, e.g., when there arises serious misapplication of law, a serious procedural irregularity or when new evidence comes to light, etc., the ruling of the Appellate Court can further be reviewed.

At present, **China** is a signatory to a number of treaties with Poland, France, Mongolia, Russia, Ukraine, Cuba and Spain pursuant to which, judgments obtained in these countries could, subject to certain conditions laid down in the treaties, be enforced in the PRC. Other than these countries, there is no reciprocal enforcement of judgments. Civil or commercial disputes in **China** can also be resolved through arbitration. If one of the parties to the arbitration is a foreign entity or if the matter in dispute is "foreign-related", then arbitration will normally be conducted in the PRC by the **China** International Economic and Trade Arbitration Commission ("CIETAC") or overseas by another arbitration organization depending on the wording of the arbitration agreement.

Arbitral awards made in the PRC are enforceable in the PRC as if they were judgments delivered by PRC Courts. Arbitral awards made outside of the PRC are also enforceable in the PRC provided that the arbitral awards are rendered by a contracting state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards to which the PRC has acceded.

Overview Procedure for Setting-up Business

The procedure for setting up a business in China can be quite bureaucratic. There are variety forms of business enterprise now permitted in China – Representative Office, Joint Venture (JV) and Wholly Foreign Owned Enterprise (WFOE). The graph below shall illustrate the principal procedures for setting up business in China.



Contact Us

Helping clients to establish a Business in China is **Nufrontiers** foremost service. Our deep understanding of the environment, the tailor-made solutions and our professional execution of services helps our clients to save valuable time, resources and ultimately money. **Nufrontiers** offers management services in various packages, which allows clients to choose their preferred solution package from us.

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