LEGALINK

INVESTMENT AND BUSINESS START UP IN CHINA

(A) Legal system

1. What is the legal system (i.e. common law system, civil law system or both) in your country?

The People's Republic of China (PRC or China) has a civil law system, consisting of statutes, administrative regulations etc. In addition, the Supreme Court of China issues judicial interpretations which the lower courts must follow in adjudicating cases.

2. What are the major law courts in your country?

There is a hierarchy within the court structure from the top down: the Supreme People's Courts, the Higher People's Courts, the Intermediate People's Courts and the Basic People's Courts. The Basic People’s Courts are further subdivided into smaller units referred to as people’s tribunals located in towns and villages. Besides, there are a number of specialized courts for example those dealing with railway transportation, forest affairs, the People’s Liberation Army (PLA) and maritime issues.

3. What are the sources of laws (such as constitution, statute law and common law) in your country?

The sources of laws in China include constitution, statutes, administrative regulations, local legislation and international treaty. Additionally, autonomy regulations and specific regulations, Basic Law and laws of special administrative region are also part of sources of laws in China under the specific condition.

4. What is/are the official language(s) in your country?

Chinese is the official language in China.

(B) Foreign investment

5. Are there any restrictions faced by a foreign individual or company when they want to invest in your country? Is an approval or permit required if a foreign individual or company wants to enter a certain industry?

Foreign investment by a foreign individual or company is regulated by various laws and regulations and is classified into four categories based on the Catalogue of Industries for Guiding Foreign Investment:

i. **Encouraged**

This category mainly includes drink production, agricultural machinery manufacture, the development and manufacture of software products and etc. The orientation is to attract foreign individual or company to invest new energy and environmental technology.

ii. **Restricted**

Investment in restricted sectors is subject to various limitations and approval requirements and includes the highway passenger transportation service, legal services, banking services and etc. The government keeps a tight rein on foreign investment in real estate and rare mineral resources etc. which are vital to benefits of citizens.

iii. **Prohibited**

Certain businesses are not open to foreign investment, including elementary education, post offices, TV and radio stations and etc. The category is designed to protect the fundamental infrastructure which may jeopardize the secruity of the nation when foreign is in control.

iv. **Permitted**

Investments that do not fall into any of the other three categories are generally permitted.

All foreign investors who want to enter a certain industry need get an approval from the specific departments of commerce.

6. Are there any exchange control or currency regulations in your country?

There are various exchange control and currency regulations in China. A foreign investor in a foreign investment enterprise (FIE) in China (in which foreign investment accounts for at least 25% of the registered capital) is legally entitled to convert after-tax dividends derived from the FIE into foreign currency and remit it overseas in accordance with these regulations.

7. What grants or incentives are available to a foreign individual or company to encourage investment in your country?

China offers certain incentives to FIEs, mainly tax reductions and exemptions. Foreign investment in prioritized industry, such as high-tech enterprises, software enterprises etc. enjoy tax incentives as well as in national priority area, especially western development. An FIE engaging in business in the encouraged category can be exempt from customs duties when importing equipment for their own use. Also, various incentives may be available to foreign investors based on local practices at provincial or municipal levels.

(C) Business vehicles

8. What is the most common form of business vehicle used by foreign investors in your country?

Wholly foreign-owned enterprises (WFOEs) have become increasingly popular recently and are now the most common form of business entity. Sino-foreign joint ventures (JVs) take second place with equity JVs more popular than co-operative JVs.

i. Registration formalities

A WFOE or JV must be approved by and registered with the Chinese government. Application for approval of the establishment of the WFOE or JV shall be filed with local Administration of Industry and Commerce (MOFCOM) which issues Certificate of Approval as a required certificate. Registration of the WFOE or JV shall be filed with local Bureau of Commerce (AIC) and post registration issues with corresponding local authorities. It usually takes a couple of months to complete the approval and registration procedures.

ii. Minimum (and maximum) share capital

The statutory minimum registered capital is CNY30, 000 for a Chinese company, and CNY100, 000 or its equivalent in hard currency for a company with a single shareholder. Higher capitalization is required to invest in certain regulated business sectors, such as financial leasing which requires more than USD 10,000,000 of registered capital and telecommunications. There is no maximum requirement for the registered capital.

iii. Whether shares can be issued for non-cash consideration, such as assets or services (and any formalities)

Share capital can be in non-cash consideration, such as contribution in kind, industrial property rights, land use rights and other property rights. The maximum amount of intellectual property is capped at 20% to be contributed as registered capital for WFOE and 30% for JV. Investment in kind commonly includes equipment, material, components and parts etc. which shall be necessary to production of WFOE or equity JV.

iv. Any restrictions on foreign shareholders

There are restrictions and special shareholder requirements for foreign investment in certain businesses. The catalogue of Industries for Guiding Foreign Investment defines restricted and prohibited industry which shall be paid attention to.

v. Management structure and any restrictions on foreign managers

The board of directors (board) is the highest authority of a JV when the establishment of board of shareholders is not required by law or either the board of directors or the board of shareholders is the highest authority which is regulated in the Articles of Association. The general manager is its top executive and is normally nominated by the shareholders and appointed by the board. The General manager is in charge of the company’s daily management. There are no specific restrictions on foreign managers.

vi. Directors' liability

Directors assume fiduciary duties and must not act against the company's interests.

vii. Parent company liability

A shareholder's liability is limited to its contribution to the company’s registered capital. However, in certain cases, the corporate veil can be pierced. For example, if a shareholder causes damage to the company’s creditors, it can be liable jointly and severally with the company for its debts.

viii. Reporting requirements (including filing of accounts)

A company must have its financial books audited every year by a qualified accounting firm, and undergo annual inspections conducted by the relevant government authorities (for example, tax and customs authorities). The cost of these inspections is minimal.

(D) Employment

9. What are the main laws regulating employment relationships in your country?

The PRC Labor Law 1995, the PRC Labor Contract Law 2007 which is modified in 2013, and various administrative regulations regulate (at central and local levels), among other things: the formation and termination of employment contracts, labor standards, overtime pay, maternity leave and etc.These laws apply to foreign employees working in China if these employees are directly employed by the Chinese entity, but do not usually apply to Chinese employees working abroad if relevant employment contracts are signed between the employees and a foreign company under foreign law. Employment contracts between a Chinese company and its employees must be governed by Chinese law, regardless of the choice of law in the employment contract.

10. Is a written contract of employment required in your country, and if so, must it contain any particular language? Are any agreements and/or implied terms likely to govern the employment relationship?

A written employment contract is required and must be written in a language that is capable of being understood by all parties. Terms not identified in an employment contract can be incorporated in, for example, provisions of employee handbooks and collective labor contracts, as well as the PRC laws.

11. Do foreign employees require work permits and/or residency permits if they work in your country? If so, how long does it take to obtain them and how much do they cost?

Both work permits and residency permits are required for foreign employees. Work permits should be applied for with the labor bureau and a residency permit with the local police. The process (not including the application for the work visa, which depends on the time frame set out by the Chinese embassy) usually takes two or three weeks. The cost of the permits is nominal.

12. Are employees entitled to management representation and/or to be consulted in relation to corporate transactions (such as redundancies and disposals) in your country?

At least one-third of an FIE's supervision committee must be employee representatives. The committee supervises: (1) the company's operation and financial conditions; (2) directors' and senior managers' fiduciary duties. The FIE's trade union must be consulted if the employer intends to implement mass layoffs as a result of operational difficulties. The FIE must seek the trade union's opinion when adopting important rules or considering restructuring.

13. Are there any employment protection laws (such as minimum wage law and/or maximum working hours law) in your country?

There are several laws made to protect the legal interests of employees. For instance, the Labor Law regulates the legal working hours, rests, and leaves for employees;

Special Rules on the Labor Protection of Female Employees regulates the rules for female employees' rights.

14. Is there any pension system in your country? Is it on a mandatory or voluntary basis? If so, please give details.

The multiple level system of endowment insurance adopted in China includes: basic endowment insurance, enterprise supplementary endowment insurance with staff individual save endowment insurance. The basic endowment insurance, shall be jointly paid by employers and employees according to the law. An individual participating in the basic endowment insurance shall receive a monthly basic pension provided that he/she has contributed premiums for a cumulative period of 15 years or more when he/she reaches the statutory retirement age.

15. How is the termination of individual employment contracts regulated in your country? Under what circumstances is the dismissal of an employee unlawful?

An employer cannot terminate an employment contract except for justified reasons specified in the PRC Labor Law and PRC Labor Contract Law. These include but not limited to the employee's serious violation of the employer's code of conduct; the employee's incompetence; the employee's poor health status; major changes to the objective circumstances under which the employment contract was concluded. If an employer intends to terminate an employment contract with proper ground, except under certain circumstances that justify immediate termination, it must provide the employee with written notice 30 days before the dismissal or payment in lieu of such notice and severance pay. Where an employer is to terminate the employment contract unilaterally, the employer must inform the trade union (if any) of the reasons in advance and consider its opinions.

For unjustified dismissals, the employee can submit the dispute to a labor dispute arbitration committee for arbitration, and either party can bring a court action if the arbitration award is not acceptable to it. Remedies for unjustified dismissal include reinstatement of employment or compensation equivalent to twice the amount of the statutory severance payment at employee's discretion.

16. Are redundancies and mass layoffs regulated in your country? If so, please give details.

The employer shall explain the mass layoff plan and reasons for it to the trade union or all employees of the company 30 days in advance and hear their opinions. The layoff plan shall be reported to the relevant labor authority as well. The justified circumstances are specifically regulated and limited to reconstructing pursuant to the Enterprise Bankruptcy Law; serious difficulties in production and/or business operation; redundancies still need to be taken after the amendment of employment contracts; major change to the objective circumstances under which the employment contract was concluded.

(E) Tax

17. In relation to employees, what is the basis of taxation (i.e. whether territorial source principle, tax residency principle or other principle is adopted) in your country?

Individuals who have their domicile in China or live in China continuously for one full calendar year are tax resident. A foreign national living in China is considered to be resident for one full calendar year if he leaves China for no more than either: (1) 30 days for one single trip; (2) 90 days for multiple trips during that year.

18. Under what circumstances are employees subject to taxation in your country?

i. Tax resident employees

A tax resident employee must pay China individual income tax on his worldwide income. However, an expatriate who has stayed in China continuously for between one and five years can be exempt from payment of individual income tax in China in respect of his non-China source income that is paid by overseas entities or individuals.

ii. Non-tax resident employees

Non-tax resident employees only pay PRC individual income tax on their PRC-source income. If a non-tax resident employee has been in China for 90 days or less (or 183 days for tax residents of countries which have a bilateral tax treaty with China) in a calendar year, he is not required to pay China individual income tax on his PRC-source income that is paid or borne by an overseas employer.

19. What income tax or social security contributions must be paid by:

i. Employees

For the tax resident employees and their salary income received from employment, the individual income tax payable is calculated at extra progressive rates between 3% and 45%, depending on the employee's taxable income. For income received from independent services, the individual income tax rate is 20%, 30% or 40% depending on the service fee income received each time. The individual income tax rate on royalty, interest, dividends, rental and capital gains income is 20%. The rates of non-tax resident employees are the same as for tax resident employees, subject to any applicable bilateral tax treaty (see above, Tax resident employees).

Social security contributions must typically be paid by both employees and employers, except as indicated below, and include: pension; medical insurance; work-related injury insurance (paid by employers only); unemployment insurance (paid by employers only); maternity insurance; and housing fund. However, only a few cities allow expatriates to participate in the social security program.

ii. Employers, in relation to their employees

(a). Resident Employer

Resident employer refers to an enterprise that is established inside China, or which is established under the law of a foreign country (region) but whose actual office of management is inside China. A resident employer shall pay the enterprise income tax on its incomes derived from both inside and outside China. The enterprise income tax rate shall be 25%.

(b). Non-resident Employer

Non-resident employer refers to an enterprise established under the law of a foreign country (region), whose actual institution of management is not inside China but which has offices or establishments inside China; or which does not have any offices or establishments inside China but has incomes sourced in China.

For a non-resident employer having offices or establishments inside China, it shall pay enterprise income tax on its incomes derived from China as well as on incomes that it earns outside China but which has real connection with the said offices or establishments. The enterprise income tax rate shall be 25%.

For a non-resident employer having no office or establishment inside China, or for a non-resident enterprise whose incomes have no actual connection to its institution or establishment inside China, it shall pay enterprise income tax on the incomes derived from China. The tax rate herein shall be reduced to 10%.

Employers must make social security contributions for their employees.

20. In relation to corporations, what is the basis of taxation (i.e. whether territorial source principle, tax residency principle or other principle is adopted) in your country?

Tax residency principle is applicable in China. Chinese resident enterprises include all business entities established in China and business entities established outside China but with their effective places of management in China.

21. Under what circumstances are incorporations subject to taxation in your country?

The taxation derived from the process of incorporation shall be born by established corporations.

22. What are the main taxes that potentially applicable to a corporation and what are their tax rates?

i. Corporate income tax

A PRC tax resident business vehicle must pay corporate income tax on its worldwide profits. The standard rate is 25%, unless a reduced rate or special exemptions or deductions apply.

ii. Value added tax (VAT)

VAT is payable on the following activities in China, usually at 17%: （1）Sale of goods; (2) Provision of processing, repair and replacement services; (3) Import of goods into China.The pilot project of collecting VAT instead of Business tax in transportation industry and modern services regulates respective 11% for transportation industry and 6% for modern services specially stipulated in the notice.

iii. Business tax (BT)

BT is payable on the following activities in China, usually at 5%: (1) Sale of intangible assets; (2) Transfer of immovable properties; (3) Provision of services.

iv. Land appreciation tax (LAT)

LAT is imposed on the appreciated value of real properties (including land use rights and buildings) in case of the transfer of real property in China at progressive rates between 30% and 60%, depending on the appreciated value compared with allowable deductions.

v. Stamp duty

Stamp duty is imposed on various dutiable contracts, the enterprises' accounting books, certificates and licenses, as well as evidence of title transfer. Share/equity transfer agreements are subject to stamp duty as they fall within the category of evidence of title transfer. A 0.05% stamp duty is imposed on transfer of equity interest (shares) in Chinese companies. Both the seller and buyer are liable for this stamp duty, and each of them must pay 0.05% stamp duty for each original equity transfer agreement or duplicate copy used as an original.

23. Please explain how each of the following is taxed in your country:

i. Dividends paid to foreign corporate shareholders?

Dividends paid to foreign corporate shareholders are subject to a withholding tax at 10%, which can be reduced based on a applicable bilateral tax treaty.

ii. Dividends received from foreign companies?

Dividends received from abroad are subject to either:

(a). China corporate income tax, if received by Chinese tax resident enterprises.
(b). China individual income tax, if received by Chinese tax resident individuals.

Income taxes already paid outside China in respect of these dividends can be used towards income taxes payable in China.

iii. Interest paid to foreign corporate shareholders?

Interest paid to foreign corporate shareholders is subject to withholding tax at 10%, which can be reduced based on the relevant bilateral tax treaty.

iv. Intellectual property (IP) royalties paid to foreign corporate shareholders?

IP royalties paid to foreign corporate shareholders are subject to withholding tax at 10%, which can be reduced based on a relevant bilateral tax treaty.

24. Are there any thin capitalization rules (i.e. restrictions on loans from foreign affiliates) in your country? If so, please give details.

There is thin capitalization rule in China. A business cannot deduct interest paid to related parties exceeding the permitted related party debt-to-equity ratio (Article 46, PRC Corporate Income Tax Law). The permitted debt-to-equity ratio is:

i. 5:1 for financial enterprises.
ii. 2:1 for other enterprises.

25. Are there any controlled foreign company rules (i.e. the profits of a foreign subsidiary must be imputed to a local parent company) in your country? If so, please give details.

The profits of a foreign subsidiary do not need to be imputed to a China tax resident parent company. However, if the foreign subsidiary of a China tax resident is established in a country where taxation is lower than in China, and the profits of this foreign subsidiary are not distributed (or are partially distributed) without reasonable operation needs, the portion of the profits attributable to the China tax resident are imputed to the income of the China tax resident. Dividends obtained by a China tax resident from its foreign subsidiary are taxable in China.

26. Are there any transfer pricing rules (i.e. restrictions on the pricing of transaction between a local entity and a foreign entity) in your country? If so, please give details.

For transactions between a company and its related parties, if the transaction is not on an arm's length basis (which decreases the taxable revenue or income) the Chinese tax authority can make reasonable adjustments.

27. How are imports and exports taxed in your country?

Import VAT is payable (usually at 17%) for imported goods and customs duty rates depending on the goods involved. Export of products is generally exempt from VAT. In addition, Chinese taxpayers might be refunded a certain percentage of the input VAT they have paid their Chinese suppliers regarding the exported products. The export of a few types of goods is subject to customs tariff at various rates depending on the goods involved.

28. Is there a wide network of double tax treaties in your country? If so, please give details.

China has signed double tax treaties with more than 80 countries, including the US, France, Germany and the UK.

(F) Competition

29. Is there any competition law in your country? If so, please give details.

There are two typical competition laws in China which are Anti-Monopoly Law of the People's Republic of China and Anti-Unfair Competition Law of the People's Republic of China.

30. Are restrictive agreements and practices regulated by competition law in your country?

Any competing entities are prohibited from reaching any of the following monopoly agreements with each other. Among other things:

i. Fixing or changing the price of products;
ii. Restricting the production quantity or sales volume of products;
iii. Dividing the sales market or the raw material procurement market;
iv. Restricting the purchase of new technology or new facilities or the development of new technology or new products;
v. Conducting boycott transactions

Entities are also prohibited from reaching any of the following monopoly agreements with their trading parties, among other things:

i. Fixing the price of commodities for resale to a third party;
ii. Restricting the minimum price of commodities for resale to a third party

31. Is unilateral (or single-firm) conduct regulated by competition law in your country?

Entities with a dominant market position are prohibited from committing any of the following abuses of their dominant position:

i. Selling products at unfairly high prices or buying products at unfairly low prices;
ii. Selling products at prices below cost without any justifiable cause;
iii. Refusing to trade with a trading party without any justifiable cause;
iv. Restricting their trading party so that it may conduct deals exclusively with themselves or with the designated business operators without any justifiable cause;
v. Implementing tie-in sales or imposing other unreasonable trading conditions at the time of trading without any justifiable cause;
vi. Applying discriminatory treatments on trading prices or other trading conditions to their trading parties with equal standing without any justifiable cause

Other forms of abuse of a dominant position are determined by the Anti-monopoly Law Enforcement Agency.

32. Are mergers and acquisitions subject to merger control in your country?

Any mergers and acquisitions which are deemed as a "concentration of business operators" will be subject to merger control. Concentrations of business operators are mergers or takeovers, whether voluntary or by the acquisition of shares, or through the exertion of influence (for example, through contract).Combinations are subject to merger control if either the:

i. Aggregate global turnover in the previous fiscal year of all the entities to the concentration exceeds CNY10 billion, of which at least two business operators each has a turnover of more than CNY400 million in China;
ii. Aggregate turnover in China in the previous fiscal year of all the entities to the concentration exceeds CNY2 billion, of which at least two business operators each has a turnover of more than CNY400 million in China

Foreign-to-foreign acquisitions are subject to the Chinese merger control laws as long as they constitute a "concentration of business operators". There are no foreign exemptions.

(G) Intellectual property

33. Please outline the main intellectual property rights that are capable of protection in your country. In each case, please state:

i. What is the nature of the right?

ii. How is it protected?

iii. How is it enforced?

iv. How long is it protected?

A. Patents

i. **Nature of right.** Patents include:

(a). Invention patent.
(b). Utility model patent.
(c). Design patent.

To be patentable, an invention or utility model must be novel, inventive and practically applicable. A design must have distinctive features which are easy to recognize and not conflict with other prior and existing legal rights of other persons. The patent owner has the exclusive right to use the invention and prevent others from using it without his consent.

ii. **Protection.** Patent applications for registration must be made to the State Intellectual Property Office (SIPO).

iii. **Enforcement.** The SIPO and the court are responsible for enforcing patent rights and can impose the following penalties:

(a). Fines.
(b). Confiscation of illegal proceeds.
(c). Injunctions.
(d). Damages.

The infringer can also be criminally liable for serious violations, for example, if the illegal turnover is more than CNY200, 000.

iv. **Length of protection.** The length of protection is 20 years for invention patents and ten years for utility model patents and design patents. These periods are not renewable.

B. Trade marks

i. **Nature of right.** To register as a trade mark, a sign must:

(a). Have distinctive, easily recognizable features.
(b). Not conflict with another person's prior and existing legal rights.

The owner of a registered trade mark can use the mark exclusively and prevent others from using the mark without his consent.

i. **Protection.** Applications for trade mark registration must be filed with the Trademark Office of the State Administration for Industry and Commerce (SAIC). Unregistered marks are not protected unless they are well known.

ii. **Enforcement.** The SAIC and the court are responsible for enforcing trade mark rights. The liabilities and remedies are similar to those for patents (*see above, Patents*).

iii. **Length of protection.** Trademarks are continuously protected, subject to renewal every ten years.

Registered designs

Registered designs can be protected through patent law (*see above, Patents*).

Unregistered designs

Unregistered designs can be protected under copyright law (*see below, Copyright*).

C. Copyright

i. **Nature of right.** Copyright applies to intellectual creations in literary, artistic and scientific domains, provided they are capable of being reproduced in a certain tangible form. The owner of a copyright has the same rights as those of trademarks and registered designs (*see above, Trademarks and Registered designs*).

ii. **Protection.** Copyrights are automatically protected upon the work's creation.

iii. **Enforcement.** The General Administration of Press and Publication and the court are responsible for enforcing copyrights. The liabilities and remedies are similar to those for patents (*see above, Patents*).

iv. **Length of protection.** Protection lasts for:
(a). The life of the author plus 50 years, for copyrights owned by a natural person.
(b). 50 years from first publication, or from creation if unpublished, for copyrights owned by a legal entity.

D. Confidential information

i. **Nature of right.** Commercial secrets can be protected in China. It refers to technical or business information which has the following characteristics:
(a). Not known to the public.
(b). Can bring practical economic benefits to the right holder.

ii. **Protection.** Confidential information is protected by the courts and by confidential measures taken by the right holder (for example, for example, a non-disclosure agreement). No registration is required.

iii. **Enforcement.** Commercial secrets are protected under civil, criminal, company, employment and competition law. Civil, company and employment law allows right holders to sue for damages. The criminal law can apply to serious infringements of commercial secrets. Anti-unfair competition law prohibits the unauthorized use and disclosure of commercial secrets. A person who violates the provisions under the anti-unfair competition law can be imposed with a government fine of up to CNY200,000, must return the information back to the right holder and destroy any products which may disclose the commercial secrets. The right holder may report to the administration of industry and commerce for infringement of commercial secrets under the anti unfair competition law.

iv. **Length of protection.** The right is protected for as long as the information remains confidential.

(H) Marketing agreements

34. Are marketing agreements regulated in your country? If so, please give brief details in respect of the following arrangements:

- **i. Agency;**
- **ii. Distribution; and**
- **iii. Franchising**

There are no specific laws regulating agency and distribution. However, franchises are regulated in China by the Measures for the Administration of Commercial Franchises 2007, issued by the State Council. A franchiser must have established at least two direct sales outlets after engaging in the business for more than a year in China.

(I) E-commerce

35. Are there any laws regulating e-commerce (such as electronic signatures and distance selling) in your country? If so, please give brief details.

The Electronic Signature Law 2005 regulates, among other things:

(a). The scope of electronic signatures.
(b). The requirements for effective electronic signatures.
(c). The storage and transmission of data.
(d). Certification services in connection with electronic signatures.

(J) Data protection

36. Are there any data protection laws in your country? If so, please give brief details.

There is no specific data protection law yet.

(K) Product liability

37. Are there any laws regulating product liability and product safety in your country? If so, please give brief details.

i. The Product Quality Law 1993 regulates the:

(a). Quality of products;
(b). Obligations and liabilities of manufacturers and sellers.

For product defects, the seller must indemnify consumers against losses on request. The seller can seek recourse from the manufacturer if the manufacturer is responsible for the defects.

If a business entity finds that its goods or services have a serious defect that might cause personal injury or asset damage, it must immediately:

(a). Make a report to the authorities.
(b). Inform the public.
(c). Adopt measures to prevent injury and damage.

ii. The Food Safety Law 2009 regulates the:

(a). Quality of food.
(b). Obligations and liabilities of food manufacturers and sellers.

For food safety accidents, the relevant party must deal with the accident immediately and report to competent governmental authorities.