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Doing business in China - 2015 overview



China's position in the Global Economy

- According to IMF World Economic Outlook 2014, China currently covers the first position in World GDP at PPP ranking with 17,632 (US\$bn) followed by US with 17,416 (US\$bn);
- According to E&Y 2013, China currently has around 150 million people earning between US\$10 and US\$100 per day. As long as China continues to grow, and necessary reforms are made, it is expected that 500 million Chinese could enter the Global middle class over the next decade;
- China is now more than 50 percent urban, but 10 million to 15 million people a year will still be moving to cities from the countryside. City governments need to make their cities more livable, more efficient, and better able to integrate their migrants (McKinsey, 2014).

China's position in the Global Economy

- China is home to some of the world's largest, most successful, and innovative Internet-based companies. The pace at which Chinese consumers are embracing the Internet is at the cusp of causing major disruptions to many sectors in China;
- China's wages are set to increase by 10% on an annual basis, driving more low-cost manufactures out of the country and boosting consumption, according to Bank of America Corp. ;
- Chinese companies are poised to enter in the “second wave” of overseas M&A investments, backed by a strong Governmental support, with a specific interest in new technologies, renewable energies, biotech, “smart city” technologies.

Critical issues on the floor

- Chinese Government affirmed that more than half of its groundwater is polluted (The Guardian 2014). Water and air pollution has also hit a point of no return and urgent measures are needed to tackle this emergency;
- Progress in bringing more private capital into state-owned enterprises is slow at the national level, and access to credit for private business is cumbersome and very expensive. Internet based lending platforms and crowd funding are gaining momentum and reshaping the scenario;
- Speculation about the existence of a real estate bubble has been around for a long time and it is difficult to foresee when and to what extent China real estate market will be hit by a crisis, and what will be the consequences for Chinese and global economy.

*The Economist 2013 (?)

What's next for China?

“As China has shifted to a more consumer-driven economy, companies must adapt their offerings and way of doing business”

McKinsey 2013

- **China will remain one of the most attractive destination in the world for FDI** (Foreign Direct Investment). Most foreign investors who started doing business due to low labor costs, mainly for re-exporting finished or semi-finished products, are now interested in the potential of its huge domestic market;
- **Embrace the new trends in urban development:** companies should design city-specific solution-products, marketing approaches, and operating models that meet the quite varied needs of the so called second and third tier cities, that are expanding rapidly;
- **Focus on the growing demand for services and consumer goods:** as disposable incomes rise, consumers will be able to buy more services and goods;
- **Foster new skills and innovation capabilities:** the growth of the urban labor pool is slowing as the country's population ages. Companies will have to increase their productivity through training, automation, more flexible production, and enhanced employee loyalty.

China's Legal Environment

China adopts a civil law system and its statute law is all fairly recent. The main commercial laws are as follows:

- PRC Civil Code (1986);
- Law of the PRC on Sino-Foreign Joint Ventures (1990);
- Contract Law of the People's Republic of China (1999);
- Companies Law of the PRC (2005 + reform 2013-2014);
- Foreign related Contractual Dispute Cases Related to Civil and Commercial Matters (2007);
- Contracts of International Sale (in 1988 PRC has ratified the Vienna Convention on the International sale of goods of 1980 – CISG).

PRC Judicial System



- Chinese Judicial System refers to People's Court System.
 - Courts are judicial organs exercising judicial power on behalf of the State. According to the Constitution and the Organic Law of PRC of 1979, China's system of courts is divided in 4 levels: Supreme People's Courts (based in Beijing) and a local courts (High People's Courts, Intermediate People's Courts and Basic People's Courts).
- Courts of special Jurisdiction are also provided of Maritime, Railway and Military matters.

The Supreme People's Courts	Highest judicial organ of the State. Jurisdiction over the following case: (1) Cases of first instance assigned by laws; (2) Appealed cases against judgment and other orders of higher people's courts; (3) Appealed cases filed by the Supreme People's Procuratorate.
The Higher People's Courts	<p>Courts of provinces, autonomous regions and municipalities directly under the Central Government.</p> <p>Deal with cases of the first instance assigned by laws and decrees, cases of the first instance transferred from People's courts at the next lower level and cases of appeals lodged against judgments.</p>
The Intermediate People's Courts	<p>Established in capitals or prefectures in the provincial level.</p> <p>The scope of jurisdiction covers cases of first instance assigned by laws and decrees, cases of first instance transferred from the basic people's courts, and appealed cases from lower courts.</p>
The Basic People's Courts	<p>Lowest level, normally located at the country municipal districts and autonomous countries.</p> <p>The scope of jurisdiction refers to civil and criminal cases of the first instance.</p>
The Special Courts	<p>Include military courts, railway courts and maritime courts.</p>

Type of FDI

According to “Catalogue Foreign Investment in Industries” (2011) Foreign Investment are divided as follows:

- **Prohibited** : covers 39 items where foreign investment are not allowed (e.g. projects related to State security and harm of public interest; to endanger human health; to endanger the security use of military resources; etc.);
- **Restricted** : covers 74 items where foreign investment are allowed under specific requirements (e.g. projects involving banking and other services; projects where the technology has already been imported; etc.);
- **Encouraged** : covers 354 items where foreign investment are welcome (e.g. projects that involve logistics; venture capital; new agriculture technology; that involve integrated use of China’s resources; etc.);
- **Permitted** : basically includes all the activities that are not mentioned in the above three categories.



**PRC – Company
Incorporation**

Wholly Foreign Owned Enterprise (WFOE)

Capital

- No legal min or max of capital contributed (hard currency or tangible assets);
- Industrial property & technology may not exceed 20% of registered capital;
- Registered capital can be reduced or increased only upon authorization;
- When capital is contributed in installments, the first installment must not be less than 15% of the total contributed capital and delivered within 90 days from the date of issuance of business license.

Shareholders

If two or more investors jointly apply to establish a WFOE, a copy of the joint investors' agreement must be filed with the authorities.

Directors

No mandatory structure. AoA (Article of Association) must spell out and provides details. AoA must also specify procedures for termination and liquidation.

Shares

These types of companies does not issue shares

WFOE – Part II

Disclose

Formal application documents:

- Standard application for establish WFOE
- Feasibility study
- Articles of Association
- Certificate of incorporation of investors
- ID documents of directors
- List of equipment to be imported
- Letter of creditworthiness issued by local bank with which foreign investor has opened a bank account

Taxes

CIT – Corporate Income Tax (Standard 25%)

WT – Withholding Tax (20%, currently reduced to 10%)

BT – Business Tax (3-20%)

VAT – Value Added Tax (0-17%)

Control

Solely in the hands of foreign investors.

Legal representative has the power to represent the enterprise

Sino – Foreign Equity Joint Venture

Capital

- The minimum level of foreign participation is 25%, no max. limit;
- Industrial property & technology provided by foreign investor may not exceed 50% of foreign investor's contribution or 20% of total EJV registered capital;
- Capital can be contributed in cash and/or assets, after authority approval;
- The ratio of the registered capital to the total investment amount must be as follows: where the total investment is US\$ 3m or less, registered capital must account for the 70% of the total; for US\$ 3m-4.2m, registered capital must be at least US\$ 2.1m; etc. ;

Shareholders

There are no specific limits on the number of foreign or Chinese partners (but Chinese partners need to be LTDs or Joint Stock companies, not individuals).

Directors

The management structure of EJV consists of board of directors (must have at least three members, including chairman and vice-chairman), management, staff and workers.

The board of directors must at least meet once a year, decide on all major issues in accordance of AoA – Article of Association.

Shares

These types of companies do not issue shares per se in exchange for capital.

EJV – Part II

Authorization

Formal application documents:

- Authority in charge SAIC – State Administration for Industry and Commerce
- JV contract, AoA, Approval certificate;
- Project proposal and Feasibility study;
- Company certificate of investors;
- Certificate indicate the credit standing of the investors;
- List of board of directors and management
- JV must submit un-audited quarterly and audited annual accounts to the relevant authorities, with the auditing done by Chinese CPA

Taxes

CIT – Corporate Income Tax (Standard 25%)

WT – Withholding Tax (20%, currently reduced to 10%)

BT – Business Tax (3-20%)

VAT – Value Added Tax (0-17%)

Control

The voting power is directly proportional to each partner's share of the registered capital.

Contractual JV

Capital

- Capital is contributed in a ratio agreed by the parties in CJV contract
- Industrial property & technology provided by foreign investor may not exceed 50% of foreign investor's contribution or 20% of total EJV registered capital.
- Contribute capital may take form of cash, land-use right, technology, materials, equipment, trademarks and other property rights.
- CJVs are divided in “hybrid” and “true”. Each type has a different capital contribution process. In contrast to an EJV, parties to a CJV may share profit in a ratio that differs from the ratio of capital contributions.

Shareholders

There are no specific limits on the number of foreign or Chinese partners.

Directors

“Hybrid” CJV adopts management systems resembling those of EJV, “True” CJV instead tends to take a more flexible form of a joint-management office. Under the latter structure, no general manager as such exists, though the parties usually appoint a legal representative. Under the revised CJV laws, the chairman of the board of directors or the head of the management committee serves as legal representative of the CJV.

Shares

These types of companies do not issue shares per se in exchange for capital.

CJV – Part II

Authorization

Formal application documents:

- Authority in charge SAIC – State Administration for Industry and Commerce
- JV contract, AoA, Approval certificate;
- Project proposal and Feasibility study;
- Company Certificate of investors;
- Certificate indicating the credit standing of the investors;
- List of board of directors and management;
- JV must submit un-audited quarterly and audited annual accounts to the relevant authorities, with the auditing done by Chinese CPA

Taxes

CIT – Corporate Income Tax (Standard 25%)

WT – Withholding Tax (20%, currently reduced to 10%)

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VAT – Value Added Tax (0-17%)

Control

The partners have control of the CJV, though the CJV law permits management to be delegated to a third party, with government approval. This is a standard mode of operation for hotels, which usually appoint an outside hotel-management company.

PRC Company Law Reform 2014

Major Reformatory Policies:

- (a) **Change of paid-in capital registration system to subscribed capital registration system:** unless otherwise specified by laws and regulations, the requirement on the duration or timing of capital contribution – i.e. shareholders should pay up the registered capital within two years after incorporation of the company – is cancelled;
- (b) **Relaxation of requirements on registered capital:** the amended Company Law scraped the requirements of minimum registered capital – i.e. CNY 30.000 for limited liability companies; CNY 100.000 for one-person limited liability companies and CNY 5.000.000 for joint stock limited companies;
- (c) **Simplified registration particulars and registration documents:** in line with the above mentioned amendments, the paid in capital of the company will not be registered and no verification report will need to be submitted for company registration.

PRC Company Law Reform 2014 – Part II

Background and Purpose of the Reform:

- (a) **Evolution of the two capital registration system:** change of the paid-in capital registration system to subscribed capital registration system is the core of the discussed reform. The paid-in capital registration system requires that the amount of money in the company's capital verification bank account shall equal to the amount of paid-in capital as shown on the company's business license; while the subscribed capital registration system does not require verification or registration of the paid-in capital, but only registers the total registered capital subscribed by all shareholders of the company;
- (b) **Failure of the paid in capital registration system:** the original purpose of the paid-in capital registration system is to provide credible evidence for a company's contract performance capabilities so as to protect the interests of the transaction counterparties. As the registration authority finds it impossible to actually verify a company's contract performance capabilities, it can only require the company to support its own capabilities by its paid-in capital. However, the paid-in capital can only reflect the amount of capital at the time point of capital contribution. In contrast, the contract performance capabilities of a company is a dynamic concept depending on the company's then current assets, which may be subject to constant change as a result of the company's operation activities.

China (Shanghai) Pilot FTZ

Testing Ground

FTZ (Free Trade Zone) will serve a pilot test area for undergoing reform and testing new policies for Foreign Direct Investments

RMB
Internationalization

China has the 2nd largest economic in the world, but RMB only ranks as the 9th active currency in the global foreign exchange market

- More than **12.000 new companies** were established as of September 2014 (among which 1.677 are foreign companies);
- Average time required for import customs clearance is **41 % less** than outside FTZ and for export customs clearance is **36 % less** than outside FTZ;
- From January to August 2014 foreign trade volume within the FTZ was equal to **500 billion CNY (around 81 billion USD)**.

China (Shanghai) Pilot Free Trade Zone

Expected opening up to services currently restricted.

Finance	Allow set-up wholly-owned banks, joint-venture banks by private and foreign capital, and /or restricted license bank.
Finance	Allow set-up foreign medical insurance company and investment companies. Remove capital limit for leasing companies to set-up ship and aircraft financing vehicles.
Shipping	Loosen the shareholding limits for foreign shipping companies.
Trade services	Allow leasing companies to conduct factoring business.
Entertainment	Allow production and sales of gaming console.
Social services	Allow to set up health care institutions.

China (Shanghai) Pilot FTZ

- September 29th, 2013 Official launch of the China (Shanghai) Pilot FTZ

With reference to the time of the opening, FTZ ' main goals

- **Pre establishment national treatment:** foreign companies treated as domestic ones during establishment of new companies in China;
- **Negative list: 18 categories and 190 items: (?)**
 - Adopted in China for the first time;
 - Updated time to time (June 2014);
 - Sectors not specifically prohibited, subject to simple filing procedure.

China (Shanghai) Pilot FTZ

Optimized Administration

- **Simplified registration:**

- Temporary and partial suspension of “Wholly Foreign-Owned Enterprises Law, Sino-Foreign Equity Joint Ventures Law and Sino –Foreign Co-operative Joint Ventures Law”;
- No minimum registered capital (in line with the New Company Law 2013-2014).

- **Outbound investments:**

- Company within FTZ may conduct outbound investments without any approval, only filing procedure needed;
- Qualified individuals working in the FTZ may invest in foreign securities and conduct other outbound investments;
- Qualified companies in the FTZ may invest in offshore securities markets, including derivatives.

China (Shanghai) Pilot FTZ

Cross-border Investments & Transactions

- **FTA – Free Trade Accounts:**

- Funds can be transferred freely between FTAs (FTAs opened by residents in the FTZ), FTNs (FTA opened by non-residents at bank inside the FTZ), and other offshore accounts and on-shore non-resident accounts;
- Funds can be transferred between a non financial entity's FTA and its other onshore accounts for cross-border transactions (e.g. current account business, repayment of loans, investments, though may be subject to quota in future).

- **Use of cross-border CNY:**

- Financial institution in Shanghai may process cross-border CNY transactions related to current accounts and direct investments upon payment instruction from an individual or company in FTZ;
- Financial institutions and companies (not limited to Foreign Invested Enterprises) in FTZ may borrow offshore CNY;
- Companies in FTZ may conduct centralized receipt and payment for current account transactions between their domestic and foreign affiliates.

China (Shanghai) Pilot FTZ

Financial Regulation

- **Liberalized interest rates and exchange rates:**
 - Ceiling rate on small foreign currency deposits has been removed;
 - Qualified financial institution in FTZ will have priority to issue large negotiable certifications of deposit.
- **Free conversion of capital account:**
 - Local and foreign currency in FTAs can be freely converted when conditions mature;
 - Foreign exchange registration related to FDI is handled by banks instead of Authority;
 - Foreign currency can be freely converted in CNY for FDI.
- **Capital markets:**
 - Financial institutions and companies in FTZ may invest in Shanghai securities and futures;
 - Patent (?) companies of companies in FTZ may issue CNY-denominated bonds in domestic market.

China (Shanghai) Pilot FTZ

Opening of Service Industry

- **Banking:**

- Qualified foreign institutions may established foreign-invested banks;
- Qualified domestic capital or domestic investor may established banks with foreign financial institutions;
- Subject to further regulations, qualified domestic-funded banks in FTZ may conduct offshore activities.

- **Financial leasing:**

- Financial leasing companies may carry out commercial factoring related their main business, i.e. the factoring related to their clients;
- Financial leasing companies carrying out commercial factoring business shall meet the minimum requirement for registered capital of 50 million CNY and it shall be contributed all in cash.

- **Shipping, Medical services and Education:**

- Under specific regulations, foreign investors may establish JV or WFOE.

PRC – Employment Law

Contract

Witness: *John Harrison* First Party
Witness: *Mary Barker* First Party

This Agreement made this
between *John Harrison*
Mary Barker

at in consideration
the part of said

Main Characteristics / I

Principle of Mutual Consent

The contract is concluded by means of the Parties' legitimately express consensus (general rule, exceptions exist):

CONTRACT = OFFER + ACCEPTANCE

The contract is concluded and the Transaction closed when the person who made the offer comes to learn the other Party's acceptance.

PRC – Contracts

PRC Contract Law – Main principles

- Equality (Article 3);
- Party Autonomy (Article 4);
- Fairness (Article 5);
- Good Faith (Article 6);
- Public Interest (Article 7).

The afore mentioned principles are likewise embodied in the UNIDROIT Principles.

International Sales Contract

- China is a member to the 1980 Vienna Convention on the international sale of movable goods (“CISG”);
- Domestic law on international sales contracts is shaped on the basis of CISG;
- Chinese Judges tend to apply domestic law, so it is important to expressly foresee in the contract that CISG applies.

Distribution Agreement

- Distribution / Concession of sale are atypical contracts in China. There is no express regulation, so they are ruled by the contractual covenants and by the general principles of law;
- Re-sale price maintenance is prohibited, but it is not prohibited fixing of a maximum price;
- No general provision of indemnities for contract termination, jurisprudence grants to distributor the right to a reasonable termination notice (the period which the agent / distributor would require to find a similar position on the market and to amortize the investments made);
- Foreign law can be applied to the contract, as a general rule, but one should avoid the situation where litigation is commenced before a Chinese judge, with application of a law other than China's, as Chinese judges are not familiar with the application of any law other than the domestic one;

Commercial Agency Agreement

- Atypical contract → no particular formality nor registration;
- Agent does not have the authority to conclude contracts on behalf of the principal (unless it is provided on the contrary)
- Applicable rules: General Principles of Civil Law (民法通则) Contract Law (合同法) anti-Monopoly Law (反垄断法) Law against Unfair Competition (反不正当竞争法) Law on Trademarks (商标法) Law on Patent (专利法).
- Very important to craft carefully exclusivity (not as default rule) and non compete covenants (not as default rule);
- Duration → no minimum notice period (only “reasonable”)
- No general right of Agent’s indemnity for termination.

Franchising

- Ruled by Administration of Commercial Franchise Operations Regulations of 2007
- Franchise agreements have to be in writing
- Franchisor must already have 2 active franchises internationally and must have been operating for at least one year
- Licensed resources: registered trademark, enterprise logo, patent or proprietary technology, know how
- Re-sale price maintenance is prohibited
- Duration: minimum term of three years unless the parties agree otherwise
- Detailed disclosure 30 days before contract execution → sanctions:
 - fine is to be between 10,000 and RMB 100,000 + public announcement
 - termination of the contract
- No competition/exclusivity → not as default rule, but the principle of good faith has to be respected
- No Goodwill termination indemnity

Labor Law I

Labor Law of the PRC

It major elements covering the following areas:

- **Workers ‘ rights:** workers in all types of enterprises have equal rights to select an occupation and obtain employment, receive remuneration for their work, rest and take holyday, and receive training;
- **Unions:** workers have the right to organize and participate in trade unions, which must organized in accordance with law;
- **Recruitment:** employers are liable for “economic damage” to the previous employer of their newly recruited employees if those employees leave before completing their original labor contract;
- **Labor contracts:** employees rights and obligations must be clearly defined in a written labor contract.

Labor Law II

Labor Law of the PRC

- **Health, safety and insurance:** employers are responsible for health and safety measures;
- **Working hours:** there are limits on an employer's freedom to extend working hours;
- **Resignation:** article 31 of the Labor Law guarantees employees the right to resign, subject to 30 days' notice;
- **Termination:** the Foreign Invested Enterprises labor regulation allow both employer and employee to terminate employment without notice if the other party fails to fulfill the labor contract.

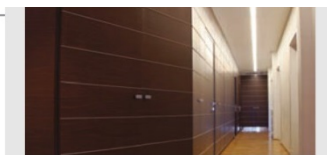
Labor Law III

Labor Law of the PRC

- **Dismissal:** The Labor Law makes it more difficult to make employees redundant than under previous regulations, which permitted FIEs (Foreign Invested Enterprises) to dismiss staff as result of technical and production changes. Now, only imminent bankruptcy and major production problem can justify redundancy. Moreover, Art. 30 stipulates that trade unions are entitled to raise objections to dismissals they consider inappropriate;
- **Termination of employment:** The Labor Law allows FIES to dismiss workers (without advance notice) if they do not fulfill requirements during the probation period, if they “seriously” violate labor provisions or company regulations, if they are “seriously” derelict in their duties, or if they engage in raft, favoritism or other activities that cause “serious” damage to the employer, or other reasons. These provision are stricter and most foreign partners find that firing employees is almost impossible without the support of the union and local labor service bureau (LSB);
- **Part-time and temporary help:** FIEs are allowed to hire temporary workers, but local regulations govern hiring and registration procedures in each locale. So-called temporary-work periods vary among the regions, from 3-12 months, but national regulations define temporary workers as those employed for up to one year for temporary or seasonal work. These regulations are in the “Administration of Temporary Workers in State Enterprises Tentative Provision”, October 05th, 1989).

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Thank you !
谢谢你们



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