FOREIGN INVESTORS IN CHINA

外商投资中国商业领域法律指引

2010

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People's Republic of China / Portugal

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THE ECONOMIC, POLITICAL AND GEOGRAPHICAL PANORAMA OF CHINA

Capital: Beijing
Currency: Renminbi
President: Hu Jintao
Prime Minister: Wen Jiabao
Language: Mandarin
Number of dialects: 1,500
Population: 1.37 billion (2010)
Number of ethnic groups: 56
Majority: Han ethnic group
Minorities: 55 (8.6 % population)
Territory: 9,640,821 km²
Largest city: Shanghai

Administrative Divisions: 34

- 2 Special Administrative Regions: Hong Kong and Macau.
- 4 Municipalities under central jurisdiction: Beijing, Shanghai, Tianjin and Chongqing.
- 5 Autonomous Regions: Tibet, Xinjiang, Inner Mongolia, Guangxi, Ningxia.
- 23 Provinces: Heilongjiang, Jilin, Liaoning, Qinghai, Gansu, Shaanxi, Shanxi, Hebei, Sichuan, Hubei, Henan, Shangdong, Anhui, Jiangsu, Yunnan, Guizhou, Hunan, Jiangxi, Zhejiang, Hainan, Guangdong, Fujian, Taiwan.

PEOPLE´S REPUBLIC OF CHINA (PRC):
ADMINISTRATIVE DIVISIONS & TERRITORIAL DISPUTES

The People's Republic of China (China), as the modern Chinese state is now known, was founded in 1949 when the government progressively took control of all means of production and implemented a planned state economy.

From 1978, Deng Xiaoping initiated the structural economic reforms identified with the economic opening of China in relation to foreign policy, especially concerning Western countries.

With the proposed economic reform and expansion, from 1990, the Chinese government initiated the creation of Special Economic Zones and "Open Door Cities", which now comprise about 28 special areas. These areas or cities offer favourable policies, special treatment and infrastructure aimed at attracting foreign investment. There are export-oriented areas for technological development and for industry, among others.

China's entry into the World Trade Organisation (WTO) on 11 December 2001 gave great impetus to economic and legal reforms, helping to increase transparency in the legal and commercial spheres. Furthermore, various organs of the Central Government and provincial departments have been restructured in order to ensure greater alignment, transparency and government efficiency.

CHAPTER 1

FOREIGN CAPITAL

1.1 General aspects

Within the short period of 30 years, China has become a country that attracts foreign investment from around the world, and has been ranked first among developing countries for nearly 20 consecutive years, concurrently with the creation of over 640 thousand foreign-owned enterprises and an amount of foreign direct investment that exceeds USD 800 billion. Companies from almost 200 countries and regions around the world invest in China.

During the last decade, China has boosted the promotion of bilateral investment and has established protection channels with the main source countries of investment: it has created about 20 institutions for promoting bilateral investment with other countries (regions) and has signed 121 agreements on investment protection, which guarantee the rights and interests of Chinese and foreign investors, as well as businesses.

CHAPTER 2

FOREIGN INVESTMENT VEHICLES IN CHINA

Foreign investment arrangements in China provide for various types of structures that may comprise foreign investors. They are commonly called Foreign-Invested Enterprises - FIEs. Other common trade agreements and partnerships are also available for foreign investment.

Investments in China can be made through the formation of companies in the manners available, or by acquiring equity interest in an existing enterprise. Thus the main investment vehicles available to foreign investors are:

- Wholly Foreign-Owned Enterprise - WFOE, a limited liability company with wholly foreign capital.
- Equity Joint Venture (EJV) - a limited liability company, with capital owned by foreign investors and Chinese investors.
- Cooperative Joint Venture (CJV) - a joint-venture with foreign and Chinese investors. The CJV may be formed as a limited liability company or can exist as an incorporated enterprise.
- Foreign Investment Company Limited by Shares-FICLS - a joint stock company with limited liability.
- Holding - an FIE qualified to invest in and coordinate the activities of affiliates of the investor in China.

- Regional Headquarters - a qualified FIE that can provide management and support services for the regional subsidiaries of an investor.
- Partnership - may be established so as to provide general (unlimited) or limited liability; the foreign investment in partnerships has been possible since 1 March 2010.

The following structures may also be suitable for foreign companies wishing to do business in China:

- Representative Offices (RO) - are created in China to represent foreign companies. A representative office has no legal status per se. Intended only for activities of representation, ROs are not allowed to contract directly, issue invoices, etc.
- Production Agreements - may be structured as part of an assembly process, as trading or as a manufacturing agreement. The underlying idea is a Chinese entity making foreign products in China. Protecting intellectual property and maintaining quality control are key factors in these production agreements.
- Management Agreements - a foreign company may provide certain management services in exchange for a fee.
- Distribution Agreements - a foreign company may appoint Chinese enterprises to distribute their products in China. Protecting intellectual property is crucial in these cases.

CHAPTER 3

TAX SYSTEM

3.1 Enterprise Income Tax (EIT)

Since the EIT Law (Enterprise Income Tax Law) came into force in January 2008, foreign-funded enterprises and Chinese-funded enterprises have been subject to the same rate of income tax.
The standard rate of corporate income tax for domestic enterprises and FIEs is 25% (twenty-five percent). EIT considers a chargeable event to be the profits earned during the accounting year, based on the calculation of the amount of revenue less the company's operating costs and expenses.
Foreign companies and individuals with no tax residency in China are subject to a 10% withholding tax for income derived from China, unless a treaty to avoid double taxation sets a lower amount.

Tax incentives

The tax/accounting year for purposes of EIT is 1 January to 31 December. Tax legislation provides various incentives available for both FIEs and
- Small low-income businesses (those with annual taxable incomes of less than RMB 30 thousand = € 3,209.94), subject to a tax rate of 20%;
- Key high-tech companies taxed at 15% (an applicant for this special rate will be assessed on a number of criteria, including industry and possession of intellectual

property for the core technology in the context of their research and development activities. High-tech status is granted for a period of three years;
- Some tax reductions or exemptions for agricultural and forestry projects, as well as environmental protection projects and infrastructure that meet specific requirements;
- Some tax concessions for key venture capital companies to invest in and encourage certain industries (small and medium-sized high-tech companies in particular);
- Tax incentives continued for other companies (as is the case for firms located in central and western China).

Unlike the tax incentives that guided government policy over a long period before 2007, current tax policy does not provide any incentives for manufacturing or export-oriented FIEs.
It should also be noted that local authorities have some discretion in granting additional incentives. However, if local authorities offer tax incentives that go beyond national regulations, they may be revoked at any time by the national government.

Taxation of dividends and withholding tax
Dividends paid by FIEs to foreign investors were exempt from tax until December 2007. Since 1 January 2008, dividends have been taxed at a rate of 10%. However, dividends paid to foreign investors coming from one of the following three jurisdictions may be taxed at a flat rate of 5%:

- Mauritius - If the effective beneficial owner of the dividends is resident in Mauritius.

- Hong Kong - If the effective beneficial owner of the dividends is a resident of Hong Kong and directly holds at least a 25% shareholding in the company paying the dividends.

- Singapore - If the effective beneficial owner of the dividends is a resident of Singapore and directly holds at least a 25% shareholding in the company paying the dividends.

However, the investor will not be considered a beneficial owner if their primary purpose is to take advantage of the the lowest rates in the relevant tax treaties.

Capital gains tax
The sale of assets in China is subject to capital gains tax on the difference between the sales value and cost of the capital transferred. Historically, many investors have opted to create an offshore holding company for the specific purpose of investment in an FIE. One advantage of this option would be that the company could be sold without incurring capital gains in China.
However, in December 2009, the Chinese government introduced anti-abuse rules that allow the sale of certain offshore holding companies to be subject to capital gains tax in China.
The regulation was issued with retroactive effect from 1 January 2008. The sale of an offshore holding company that invests in an FIE may now be subject to capital gains tax if one of the conditions below exists:

- If the offshore holding company is subject to an income tax rate of less than 12.5% in the country or region where it was established, or
-If the company is not subject to tax on its overseas earnings.

In both cases, the offshore holding company must submit a series of documents to the Chinese tax authorities in charge of FIE investment within 30 days of signing the capital transfer agreement.
If the tax department considers that the offshore holding company was formed in this way to avoid tax in China, then the tax department may (subject to confirmation by the State Taxation Administration) disregard the existence of the offshore holding company and require the seller of the capital to pay the capital gains tax in China.

Transfer pricing
The Chinese tax authorities may adjust the taxable income of a company that performs operations with their associates at different prices from those established on the basis of full competition.

3.2 VAT (Value Added Tax)

As set out in the Interim Regulation on VAT of the People's Republic of China, a company/unit/person who markets products, provides processing services, maintenance and replacement parts, or imports products into China should levy VAT, whose rate varies between 13% (thirteen percent) and 17% (seventeen percent).
FIEs whose activities receive "incentives" may be eligible for certain exemptions on importing equipment for their own use. With some exceptions, goods for export are not subject to VAT.

3.3 Business Tax

Entities and individuals providing certain services provided by law, sell intangible goods or sell real estate are subject to Business Tax at rates between 3% and 5% for certain services, including insurance, construction and assignment of intellectual property rights in various forms. Recreational services and are taxed at a rate that varies between 5% and 20%.
The tax is calculated based on gross revenue earned by the business and as per rates specific to each service or good.

3.4 Customs Duties

Customs duties are levied on imported goods and materials, as well as exported goods, based on their transfer price. The rates applicable can vary widely. FIEs whose activities receive "incentives" may apply for certain exemptions on importing equipment for their own use.

3.5 Consumption Tax

Entities or individuals involved in producing or importing certain products, including some luxury and "hazardous" goods, are subject to consumption tax at values ranging from 1% to 45%.

Products considered hazardous include: Cigarettes (30% for Class B and 45% Class A + RMB 0.003 per cigarette), cigars (25%), cut tobacco (30%), white spirits (20% + RMB 0.5 per 500 gr), yellow wine (RMB 240/tonne), beer (Class A RMB 250 and Class B RMB 220 per tonne), other spirits (10%) and alcohol (5%). Luxury products include: Cosmetics (30%), Jewels (5% and 10%), golf equipment (10%), luxury watches (20%) and yachts (10%).
Besides the products mentioned above, fireworks (15%), refined petroleum products (ranging from RMB 0.10
to RMB 0.28 per litre), tyres (3%), motorcycles (3% to 10%), vehicles (1 to 40%), wooden toothpicks (5%) and wooden flooring (5%) are also subject to the above-mentioned tax.

3.6 Other Taxes

- Tax on Acquisition of Vehicles: purchases of various types of motor vehicles (including cars, motorcycles and certain trucks) are taxed at 10%.

- Deed Tax: transfers, donations and exchanges of land and building use rights are taxed at rates between 3% and 5%.

-Land use tax; local governments can levy a tax on land use at a rate determined by the local government (within the guidelines set by the State Council).

- Land valuation tax; after the alienation of immovable property, the seller will be liable to pay land valuation tax at progressive rates ranging from 30% to 60%.

CHAPTER 4

EMPLOYMENT LAW IN CHINA

4.1 Employment contract requirements

According to Chinese Employment Contract Act, in force since 1 January 2008, a written employment contract between the FIE and its employees must be entered into when an employment relationship is established.
In accordance with Article 82 of the Employment Contract Act, the employer will be required to pay the employee twice their monthly salary for each month of service provided without a signed contract for up to 12 months. If the written employment contract is still not signed, the employment contract becomes a contract for an indefinite period.
Regarding the contents of the employment contract, the inclusion of the following information is necessary:

(i) Employer's name, address and legal representative or person in charge;
(ii) Employee's name, address and identity number;
(iii) Period of the employment contract;
(iv) Purpose and place of work;
(v) Working hours, rest periods and holidays;
(vi) Employment compensation;
(vii) Social insurance;

(viii) Protection and working conditions; and
(ix) Protection against occupational diseases.
Although not mandatory, employer and employee may agree on the inclusion of other items in the employment contract, such as a trial period, training, confidentiality and profit sharing, among others.
Employment contracts concluded in China are governed by Chinese law. Collective bargaining agreements may also be negotiated with the union or employee representative. Collective bargaining agreements aim to improve working conditions for all employees. Collective bargaining agreements may specify the minimum wage for a particular workplace.

Term of Contract and Trial Period
Employment contracts in China may be concluded for the following time-periods:
- Fixed (ends after a certain period of time);
- Indefinite (has no set date for termination), or
- Fixed task (ends after the completion of a specific task).

A contract of indefinite duration is mandatory in any of the following three situations:
- The employee has worked for the employer for at least 10 years consecutively;
- The employee has a period of 10 years to reach retirement (and a series of other conditions are satisfied) and
- If the employee has already signed at least two consecutive fixed-term contracts with the same employer.

Where an employment contract for an indefinite period is mandatory, but the parties cannot reach an agreement on the terms, conditions stated in law will apply. In other words, failure to agree the terms of a contract for an indefinite period does not exempt the employer from concluding such a contract with the employee.
If the employer wishes to transfer an employee to a new employer (for example, within a corporate group), the latter must also comply with the term of the contract concluded with the first employer.

Where an employer has sufficient evidence to prove that an employee on a trial period is not qualified for the position, the employer is entitled to dismiss the employee without being required to pay any employment compensation. For a better understanding, the following table shows the trial period applicable according to the duration of employment contracts:

Type of contract / Duration of the Contract	Trial Period
Employment contract of less than 3 months	N/A
Employment contract for a fixed period (3 to 12 months)	Up to 1 month
Employment contract for a fixed period (1 to 3 years)	Up to 2 months
Employment contract for a fixed period (more than 3 years)	Up to 6 months
Employment contract for an indefinite period	Up to 6 months

4.2 Recruiting foreigners in China

FIEs may recruit foreigners only for functions with special requirements and only if there is a shortage of qualified Chinese citizens.

Besides the laws and regulations applicable to Chinese workers, foreigners employed by Chinese companies, with the exception of legal representatives, must comply with the Rules of Administration of Employment of Foreigners in China, which provides that employers must seek permission if they want to recruit foreigners, which should occur after obtaining approval and a specific licence for employing foreigners in China.

According to the Rules of Administration of Employment of Foreigners in China, the employers and their foreign employees are required to conclude a written employment contract for a maximum period of five years.

With regard to remuneration, the salary paid to the foreign worker shall not be less than the minimum wage established in the area where service is provided.

Working hours, rest periods and holidays, work safety and hygiene as well as the social welfare of foreign workers in China must follow Chinese laws and employment regulations.

Upon termination of the employment contract with a foreign worker, the employer must immediately inform the employment and police authorities, return the foreigner's employment authorisation and certificate of residence, as well as complying with the formalities for their exit from China.

Records necessary

Foreigners must hold work permits and visas appropriate for employees in China. Work permits shall be issued only for functions with special needs and if there is a lack of Chinese nationals applying for this position.

Obtaining a work permit and a visa can take several months depending on the sector. Generally, the following steps are required:

- Application for and issue of a work permit;
- Application for a work visa from the Chinese consulate in the foreigner's country of origin;
- Registration with the Public Security Bureau within 24 hours of arrival in China;
- Medical examination in China;
- Application for and issue of a residence permit;
- Registration with the local tax department;
- Registration with the customs authorities when personal belongings are sent from overseas.

Foreigners seconded to China or doing business in China for relatively short periods of time may request a business visa, which may have a duration of 3 months to 1 year.

Taxes

The tax year for purposes of individual income tax is 1 January to 31 December. For tax purposes, any foreigner who is habitually resident in China, whether for family reasons or due to economic interests, shall be considered a taxpayer. Any foreigner who spends at least 30 consecutive days, or 90 cumulative days, outside China shall not be considered a resident.

Foreigners staying in China for less than 90 days during a tax year are not subject to tax on income paid by an employer outside China, provided that the foreigner's costs are not paid by a corporation or an office in China. The period of 90 days is replaced by 183 days in many double taxation treaties in China. Among the countries with double taxation treaties with China, Portugal, Brazil, the United States, Britain, France and Australia are of particular interest.
Legal representatives of representative offices in China cannot enjoy the 90/183-day period of tax exemption, since their salaries are considered a cost of the representative office. They are thus subject to individual income tax for each day they spend in China, starting from the first day.
Foreigners living in China for over 5 years are, from the sixth year, taxed on income earned in any country or territory. It is common for foreigners in their 5th year of residence to remain outside China for 30 or more consecutive days (or even 90 days or more cumulatively) to ensure that their income will not become taxable on a worldwide scale.

CHAPTER 5

Real estate purchases in China

Real estate laws and regulations in China are complex. In part this is because the legal system governing property is relatively recent, but also because there are significant differences at at local level.

5.1 Rights to use land by assignment and concession

Land and buildings in China are state owned or owned by local authorities. Thus, neither domestic firms nor FIEs may own buildings, although they may retain the rights to land use. There are two types of use rights governing state land:

- Land use rights by assignment - this form of land use right is assigned to state enterprises, the army, state schools and businesses and similar units. Generally, rights to use land by assignment cannot be transferred or leased without first being converted to the category of land use rights by concession (for which a rate of subsidy must be paid to the government). The government may reclaim the right to use land by assignment at any time, without compensation.

- Rights to use land by concession - the right to use land for a particular purpose and for a fixed period is granted. A concession fee must be paid to the government for the concession of land use rights. Land use rights granted are alienable, transferable and may be leased.
  Lands owned by local authorities can only be used for industrial purposes under limited circumstances.

5.2 Duration of rights to use land by concession

Land use rights are granted under different terms based on the proposed use. The periods are as follows:

Residential - 70 years	Commerce, tourism and entertainment - 40 years
Educational, scientific and technological, cultural, public health and sports, combined use or other - 50 years Industrial - 50 years	

CHAPTER 6

Intellectual Property

Protecting intellectual property (IP) in China requires a multi-faceted approach, including registration with the competent authorities, workplace safety, employment contracts and commercial agreements.
The different regulations for registering IP in China are generally in line with international standards.

6.1 Trademarks

Trademarks are protected under the principle of priority of registration. An exception exists for well-known brands, though difficult to prove that a particular brand is "well-known" in the market, especially if it is only in the western market. Rights of priority may also derive from international treaties. If a trademark uses words, the equivalent in Chinese should also be registered.
China has adopted the international classification of goods and services of the Nice Convention. International registrations are made under the Madrid system for the international registration of trademarks.
As well as the trademark, it is important to protect the company name. In this case, a company name must be reserved with the local SAIC before applying for the founding of an FIE. The company name must be in Chinese. The registration of the company name, however, only affords the right to protection of the company name in Chinese, and in particular within the administrative area in which it is registered. China does not have a national registry of commercial names. Registers trademarks offer better protection in this regard and should, therefore, be part of any investment strategy in China.

6.2 Patents and Designs

Patents and designs are also protected under the principle of priority of registration. Registrations in another member countries of the Paris Convention, within certain time limits, may also guarantee priority in China.
Patents for inventions originating in China can be presented outside of China before being archived in China. However, the applicant must submit the request to the Chinese patents office for confidential examination and approval before the filing of patents outside China. Failure to obtain approval from the administration department of the State Council will preclude later presentation of the same patent in China.
Compulsory patent licences may be refused if:

(i) The patentee does not fully exploit the patent within three years from the granting of the patent, or within four years of filing the patent;
(ii) The exercise of patent rights by the holder is deemed a monopoly and its anti-competitive effects should be eliminated or reduced; or
(iii) In the event of a national emergency.

Many foreign companies have chosen not to register patents for sensitive technology in China.

6.3 Copyright and Software

Copyright material can be registered with the Chinese National Copyright Administration. Registration can be useful proof of ownership of copyrighted work, but it is not a prerequisite for the exercise thereof.
Software can also be registered with the Chinese National Copyright Administration. However, registration requires the filing of the source code (albeit with some code removed or deleted). Many foreign companies do not register software in China on the grounds that the risks of disclosure of information are greater than the benefits of registering.

6.4 Domain Names

Domain names are registered in China under the principle of priority of registration. Registration of "names.cn" domain names have sporadically increased since the beginning of 2007.

CHAPTER 7

Mergers and Acquisitions

7.1 General aspects of Mergers and Acquisitions in China

Foreign investors are generally not permitted to effect business in China without setting up an FIE. As a result, a Merger & Acquisition transaction will result in an FIE if capital assets or both are purchased.
Foreign investors cannot circumvent restrictions on foreign investment through mergers and acquisitions. In particular, the acquisition of a domestic company, or even assets, in a prohibited sector is forbidden. Laws relating to competition law and the protection of the economic order must also be considered. The legal regulations of China must be observed, which often slows the pace of transnational mergers and acquisitions involving operations with assets or materials in China. Not only is governmental approval necessary for many types of transactions, but the payment of transfer fees may also be required prior to the purchase of securities.

Moreover, social stability is a key driver of mergers and acquisitions in China. This can be seen through the raft of rights conferred on workers and the continuous control of key sectors of the Chinese economy. In addition, various legal reforms have resulted in a legal framework that offers greater certainty and predictability.

7.2 Due Diligence
Due diligence is the key to determining the real situation of a potential partner and the possibility of reaching an agreement on the acquisition. However, it can be challenging and time consuming due to a lack of familiarity with the due diligence process on the Chinese side.

Financial Issues
Financial reports presented by target Chinese enterprises are often not prepared by an international accounting firm. Corrections may be necessary to align the accounts with international accounting standards. Determining the value of a target company based on its financial accounts can be a challenge.

Independent investigations
Some foreign investors conduct independent assessments of companies', potential partners' and their main contributors' reputations. This can often be a crucial question about whether there is real willingness to do business with the potential partner.

Legal Due Diligence
Legal due diligence encompasses a range of issues, including analysis of the company, assets, regulatory compliance, contractual rights and obligations, and any disputes or claims against the company concerned. These issues can dramatically affect the value of a business.
Some of the anomalies that may be detected in legal due diligence are:
- Documents of incorporation that have not been amended to reflect changes that have occurred in practice;
- Insufficient documentation to substantiate ownership of land and buildings or other assets;
- Land and buildings on the same land being owned by different entities;
- Warranties and liabilities are not adequately documented;
- Buildings constructed without proper permits and approvals;
- Obvious labour disputes;
- Poorly formalised contracts, with unclear provisions.

Environmental Due Diligence
In some places in China environmental standards may be below standards required by foreign investors. If the project involves building on land, an environmental impact assessment must be carried out and approval obtained before starting work. Environmental impact assessments are also needed if the project involves the renovation of existing facilities. It is therefore crucial to know the environmental status of any land before closing any deal.

7.3 Overseas transactions
One way to acquire an FIE is to buy its offshore holding company. The acquisition of an offshore is generally simpler, and allows greater flexibility due to the absence of governmental approval in China. Records relating to competition law may be needed.

Waiver of approval
Except for the requirements of competition law, governmental approval in China is not required to purchase an offshore holding company with subsidiaries in China.
If the offshore holding company owns an interest in a joint venture, its Chinese partner's consent is also not required by law (although consent may be contractually required).

Capital Gains Taxes
The sale of shares in an FIE is subject to capital gains tax.
The sale of an offshore holding company may also incur to capital gains tax in China.

Alternatives
FIEs are not always clearly held by offshore holding companies. If this is the case, you can work with the seller to restructure the target company before the acquisition. This restructuring may also involve conversion of a Chinese partner into an "offshore".

However, it is not always possible to structure a business as an offshore operation. For example, investments in some sectors require that the investor is experienced in the sector. Offshore holding companies (including wholly-owned subsidiaries) are not always sufficient.
Maintaining an offshore operation may be simpler than buying (or selling) equity or assets in China. This applies to WFOEs, joint ventures and FICLs. It may, however, be particularly relevant for joint ventures. Offshore partnerships with a Chinese partner may significantly increase flexibility and exit options.

Chinese partner in a JV
The ease of finding an offshore Chinese partner will depend on whether it is an individual or a company, a private company or a public company, and if you already have a vehicle of investment or offshore funds.
Assuming it is possible, an offshore partnership may result in a number of advantages, such as:
Depending on the choice, representation on the board of the offshore holding company need not reflect the shareholding of the JV.
The partnership agreement may be governed by non-Chinese law.
Financing options may be broader.

Registration with SAFE
Exchanges of capital assets or shares in foreign companies have been relatively common for private equity investments. Since 2005, Chinese citizens, Chinese companies and foreign residents in China are obliged to register any foreign investments with SAFE before establishment or before taking control. Overseas investments in the following forms must be registered:
Exchange of capital of a Chinese company.

Contribution to assets of an FIE.
Increase in the share capital of a domestic company.

7.4 Acquisition of shares in China
Buying an existing company in China is an alternative to creating a new FIE. However, existing companies may bring unknown liabilities and risks. With this in mind, proper due diligence is the key to determining whether a particular target company is appropriate for the investor's purposes.

Restrictions on foreign investment
The purchase of an existing FIE or an existing business entails respecting Chinese foreign investment laws and regulations. In particular, businesses can only be bought by those who operates in open sectors.

Acquisition of a WFOE
The approval of more than half of investors in a WFOE is required by law to transfer a shareholding. However, most WFOEs only have one investor, for which reason this requirement does not usually create any problems. The transfer agreement and the changes to the articles of association are subject to government approval.

Acquisition of a share in a joint venture
The part of an EJV that is not selling has the right of first refusal when acquiring the share capital of the seller. Its consent to any transfer is also required. The acquisition agreement and the changes to the articles of association are subject to government approval. Additional requirements may exist if the assets are transferred by a Chinese state group.

Acquisition of a Chinese company
Chinese entities may be acquired through a transfer of capital or capital increase. Governmental approval for the acquisition and amendment of the articles is needed. The resulting entity will be an FIE, which will be responsible for the debts and liabilities of the local company. A series of special procedures applicable to the purchase of state enterprises, as well as assessments of state assets, may also be needed.
Often, issues related to human resources may take on particular importance during negotiations for the acquisition of a domestic company.

The acquisition vehicle
If participation in the JV or WFOE has not been arranged through an offshore holding company, it is advisable to create a holding company to make the purchase. Alternatively, the seller may be required to undertake restructuring before the acquisition.

Corporate Documentation
Any transfer of capital registered in an FIE requires changes in its articles of association. At least the identity of the new investor needs to be declared in the articles. It is also an opportunity for a new investor to adapt the articles of association to their own specific needs. Joint venture agreements also may require renegotiation or modification.

Approval and registration
Any transfer of capital registered in an FIE requires approval by the authority that originally approved the establishment of the FIE. Transfers also require registration with the relevant local SAIC.

Share Swaps
Foreign investors may issue preference shares to pay for capital in China. Certain criteria must be met, including:

Shares used for payment in China must be listed on a foreign stock market (except for certain vehicles for special purposes controlled by Chinese residents); The trading price of the shares must have been stable during the most recent year, and a financial advisor qualified in China should investigate and compile a report on the foreign company listed on the stock exchange.

Security reviews of the domestic economy
In addition to the requirements of competition law and national security reviews (see below), any transaction must be reported to MOFCOM (Ministry of Commerce) if it leads to a change of control of a domestic company and:
- The transaction involves a key industry;
- The transaction has had or could have an impact on domestic economic security, or
- The domestic company has a well-known brand or a "long-established" Chinese brand.

This requirement seems to be a reaction to the speed with which foreign investors have been trying to acquire some Chinese companies in various sectors.

Long-established brands - MOFCOM recognises several traditional brands as being "long-established". Periodically, MOFCOM publishes lists of long-established brands.

Key Industries - The NDRC (National Development and Reform Commission) has named seven industries considered key to the security and stability of the domestic economy. The seven sectors are: armaments; energy management and distribution; petroleum and petrochemicals; telecommunications; coal; aviation; and shipping. Although these seven industries have not been identified by the NDRC in the context of MOFCOM special reviews, the importance accorded to these industries suggests

that a MOFCOM special review may be required for any foreign acquisition involving these industries. Other industries may also be considered key sectors. Although the review mechanism is not extensive, MOFCOM may use its general powers to block or change a transaction.

Comments on national security

In addition to reviews of domestic economic security and merger and requirements control, an operation may also be subject to a national security review if the Chinese government considers that the transaction involves State security. Although the requirement for national security reviews is defined in the Anti-Monopoly Law, it does not define all the details of the analysis of national security. In the event of divergence between domestic economic security reviews and national security reviews, it is likely that the latter will take precedence.

LEGAL GUIDE

FOREIGN INVESTORS IN CHINA

外商投资中国商业领域法律指引

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