

A photograph of the Shanghai skyline, featuring the Oriental Pearl Tower and other skyscrapers, viewed from across the water. The image is partially obscured by a dark horizontal band.

Doing business in China: A legal and tax perspective

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Abbreviation

AIC	Administration of Industries and Commerce
AoA	Articles of Association
APA	Advance Pricing Arrangement
BLP	Bonded Logistic Park
BP	Bonded Port
Catalogue	Foreign Investment Industrial Guidance Catalogue
CD	Customs Duties
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual Joint Venture
Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards
CSA	Cost-Sharing Agreement
CT	Consumption Tax
EIQ	Entry-Exit Inspection and Quarantine Bureau
EIT	Enterprise Income Tax Law
EJV	Equity Joint Venture
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FICE	Foreign Invested Commercial Enterprise
FIE	Foreign-Invested Enterprise
FIJSC	Foreign Invested Joint Stock Company
Forex	Foreign Exchange
FTZ	Free Trade Zone
GAC	General Administration of Customs

GCA	General Copyright Administration
GDP	Gross Domestic Product
IIT	Individual Income Tax
IMF	International Monetary Fund
IP	Intellectual Property
JV	Joint Venture
M&A	Merger and Acquisition
MLR	Ministry of Land and Resources
MOC	Ministry of Commerce
NDRC	National Development and Reform Commission
OECD	Organization for Economic Co-Operation and Development
PBOC	People's Bank of China
PRC	People's Republic of China
R&D	Research and Development
RO	Representative Office
SAFE	State Administration of Foreign Exchange
SAIC	State Administration of Industries and Commerce
SAR	Special Administrative Region
SEPA	State Environmental Protection Administration
SIPO	State Intellectual Property Office
TRE	Tax Resident Enterprise
US	United States
VAT	Value-Added Tax
WFOE	Wholly Foreign-Owned Enterprise
WTO	World Trade Organization



1. INTRODUCTION

1.1 Chinese economy

In the late 1970s, China started a progressive economic reform, aiming to shift from a centrally planned economic system to a more market-oriented one. These economic structure changes have contributed to a huge increase in GDP and led to China becoming the second largest economy in the world, following the US. Three factors have driven this dramatic growth: export, domestic consumption and foreign investment. China has been focusing more on export and foreign investment, but now it plans to change its focus to promote domestic consumption.

Agriculture and industry, which together employ more than 70% of China's labor force and produce more than 60% of its GDP, have traditionally been two of China's most important economic sectors. However, there are many disparities between these two sectors, which form an economic-cultural-social gap between rural and urban areas, creating a major division in Chinese society.

Economic development has progressed further in coastal provinces than in the interior, and approximately 200 million rural laborers and their dependants have relocated to urban areas to find work opportunities.


The Chinese per capita income is below the world average level, which was \$7,518 (IMF, 93rd in the world) in 2010. According to China's official statistics, 10.8% of its population still lived on less than \$1 a day in 2006 (purchasing power parity-adjusted). Despite great improvements to the Chinese economy, China faces a number of challenges, including over-dependence on exports and fixed investment for growth, severe pollution, and widening income disparities.

1.2 Foreign trade and investment

China ranks first and second in the world, respectively, for the volume of its annual exports and imports. Its top six trade partners (US, Japan, Hong Kong, South Korea, Taiwan and Australia) form over 50% of China's total international trade.

After joining the World Trade Organization ("WTO") in 2001, China made several changes to its trade regulations, to conform to WTO standards. Various economic sectors and certain industries have been gradually opened to foreign investment. To bolster the economies of the Hong Kong and Macau Special Administrative Regions ("SAR"), the central government signed a Closer Economic Partnership Arrangement ("CEPA") with both SAR governments in 2003. CEPA is essentially a free-trade agreement that exceeds WTO commitments and gives companies from the two SARs favorable tariff treatment on mainland China, before granting the same treatment to other WTO members. CEPA sometimes grants privileges that are not part of China's WTO commitment.

China welcomes foreign investment and is bound under WTO rules to further open its industries to foreign investors. China announced a significant structural change to its foreign direct investment ("FDI") regime in 2004. The decision on reforming the investment system transforms a system that only allowed foreign investment in specific, governmental-designated sectors. However, it does not supersede the old system, to which the catalogue for guiding foreign investment in industries is central. Revised in 2007, the catalogue divides China's business sectors, for foreign investment purposes, into three categories: prohibited, restricted and encouraged. Projects in these categories are subject to different examination, approval and registration requirements. Projects categorized as encouraged face relatively less scrutiny, while those categorized as restricted are subject to stringent requirements and examinations.



In 2010, inbound foreign direct investment into China surpassed \$100 billion for the first time, and investment overseas by Chinese companies in non-financial sectors totaled \$47.56 billion before December 2010.

1.3 Foreign exchange control

In China, foreign exchange is controlled. The competent authorities are the State Administration of Foreign Exchange ("SAFE") and its local branches. Besides SAFE, the National Development and Reform Commission (the "NDRC") and People's Bank of China ("PBOC") also promulgate relevant regulations.

To comply with its WTO commitments, China has to gradually liberalize its foreign exchange market: it has freed the current account convertibility, while the capital account convertibility is still restricted; this remains a long-term goal.

According to the 2008 Foreign Exchange Control Regulations, China does not restrict regular international payments and transfers. The circulation of foreign currency is prohibited and foreign currency may not be used as payment within the People's Republic of China ("PRC") territory, unless otherwise provided by the competent authorities.

Foreign exchange controls are implemented in three ways:

Registration: Within 30 days after being issued a corporate legal person business license, a foreign-invested enterprise ("FIE") must apply for registration of foreign exchange with the SAFE, at the place of its business registration, and obtain a certificate, which is an essential document for the SAFE's annual inspection. When the operation term expires or the business ends, the FIE should, within 30 days and with the approval of the original approval authority, apply to cancel its foreign exchange registration.

Current account: Payments and receipts of foreign exchange in current accounts should be based on accurate and legal transactions. Financial institutions engaged in the settlement and sale of foreign exchange should inspect the accuracy of trade documents and their conformity with the forex receipts and payments. For foreign exchange received in the current account, the FIE may keep a certain amount of it, up to the limit established by the SAFE. Any excess amount must be sold to designated banks.

Capital account: Currency movements related to a transaction involving a capital account are strictly supervised or inspected by the SAFE. For example, all forex classified as a “capital account” should be used for purposes designated by regulations. Forex receipts under a capital account need the SAFE’s approval to be retained or sold to financial institutions engaged in the settlement and sale of forex. Financial institutions in the banking industry may directly offer foreign commercial loans within their approved business scope, but other domestic institutions offering foreign commercial loans need to be approved by the foreign control agencies.



2. INVESTMENT ISSUES

2.1 Investment catalog

The Foreign Investment Industrial Guidance Catalogue (the "Catalogue"), issued by China's National Development and Reform Commission and the Ministry of Commerce, is the basis for guiding the examination and approval of foreign investment projects and the relevant policies applicable to FIEs. The latest version of the Catalogue was issued on October 31, 2007.

The Catalogue divides foreign investment projects into prohibited, restricted and encouraged. Foreign investment projects in the permitted category are not included in the Catalogue. Generally, encouraged categories involve high and new technology and energy or material-saving investment projects. Restricted categories involve investment projects that use outdated technology, are harmful to the environment or are in protected industries. Those that threaten national security or harm the public interest and the environment are prohibited from being foreign invested.

The Catalogue should be referred to at an early stage of an investor's business plan in China, as it identifies activities and sectors in which a Chinese partner is required and, in some circumstances, the proportion of the Chinese partner's shareholding. The Catalogue establishes that these are "limited to equity and cooperative joint ventures", in which "the Chinese parties must hold a controlling interest" or "the Chinese party must hold a relative controlling interest". The phrase "the Chinese parties must hold a controlling interest" means that the percentages of the Chinese parties' investments in the foreign investment project must total at least 51%. The phrase "the Chinese party must hold a relative controlling interest" means that the total percentage of all the Chinese parties' investments in the foreign investment project must be higher than the percentage of the investment of any one foreign party.

2.2 Forms of business: RO, WFOE, JV, Partnership, FICE, FIJSC, Regional Headquarter and Holding Company

There are generally two legal forms for companies in China: legal persons and non-legal persons. A legal person company has the capacity for civil rights and civil conduct, and independently benefits from civil rights and assumes civil obligations under the law. A limited liability company or a joint stock company is a legal person. On the contrary, a non-legal person cannot assume civil obligations independently, although there is no unified definition under Chinese law. Non-legal persons can be organized either as partnerships with general or limited liability or as cooperation entities.


Generally, foreign investors may establish different legal forms that are governed by different statutory rules, including branch company, representative office ("RO"), wholly foreign-owned enterprise ("WFOE"), contractual joint venture ("CJV"), equity joint venture ("EJV"), foreign invested commercial enterprise ("FICE"), foreign invested joint stock company ("FIJSC"), holding company, regional headquarter and partnership.

BRANCH

According to PRC Company Law, a foreign company may establish a branch in China in accordance with specific regulations issued by the State Council. However, there are few regulations issued on this. As a result, only foreign commercial banks, insurance companies and petroleum companies are allowed to set up branches in China. A branch is not a legal person; hence, the parent company is responsible for its liabilities.

RO

Foreign companies may set up ROs in China to carry out non-profit activities, including market surveys, displays and publicity activities related to the foreign company's products or services and liaison activities related to the foreign company's sale of products, provision of services, domestic procurement, and



domestic investment. An RO is generally prohibited from conducting any profit-making activity. ROs are not legal persons.

WFOE

A WFOE is a company with capital fully invested by foreign investors. As the WFOE is completely controlled by its foreign investors, it is most commonly adopted. A WFOE is usually incorporated as a limited liability company, which has full capacity to do business within the approved business scope.

CJV

Foreign investors may establish a CJV by entering into a contract with Chinese parties, which addresses issues such as the investment or cooperation conditions, distribution of revenues or products, sharing risks and losses, operation and management methods, and ownership of the properties when the CJV terminates. Most CJVs are organized as limited liability companies, although it is possible to form a CJV as a non-legal person. CJVs can carry out various activities within the approved business scope.

EJV

An EJV is another type of joint venture that foreign investors may establish with Chinese parties. Compared to a CJV, an EJV must be organized as a limited liability company, and profit, control, and risk are divided in proportion to the equity shares invested by the parties. EJVs can carry out various activities within the approved business scope.

FICE

To specifically carry out commission agency, wholesale, retail or franchising in China, a foreign investor may set up an FICE under the specific regulations.

FIJSC

Foreign investors may establish an FIJSC, which allows larger scale and greater liquidity of shares. Compared to the maximum 50 shareholders allowed in a limited liability company, a joint stock company may have up to 200 shareholders, when established. Transfer of shares is not subject to the prior consent of the other shareholders.

Holding company

A holding company offers foreign investors the facility to hold multi-investments in China under a single entity. Through a holding company, foreign investors can make further investments and provide financial, consultancy, technical and other services to affiliated companies. A holding company is a limited liability company.

Regional headquarter

Multinational companies are encouraged to set up regional headquarters in Beijing, Shanghai, Guangzhou, Fuzhou and other cities, under the regulations issued by local governments. A regional headquarter is usually a holding company or a managing company that is managing and providing services to the investments of a multinational company. Depending on the policies stipulated by the local governments, a recognized regional headquarter can benefit from preferential treatment, ranging from visa policy to fiscal subsidies.

Partnership

In lieu of a company as a legal person, foreign investors are able to set up foreign-invested partnerships in China, either by themselves or by partnering with domestic individuals or entities. Under the PRC Partnership Enterprise Law scheme, foreign-invested partnerships can take the form of a general partnership, a limited liability partnership or a limited partnership.

2.3 Establishment procedures

To establish an FIE, two procedures must be carried out: the approval procedure and the registration procedure; for an RO, only one registration procedure is required.

FIEs

Name pre-approval: When foreign investors decide to set up an FIE in China, they have to submit a proposed name to the registration authority - the State Administration of Industries and Commerce ("SAIC") or its local subsidiaries, for name pre-approval. An approved name may be reserved for six months for registration purposes and may be extended with approval.

Approval procedure: After the SAIC approves the FIE's name, the following approvals may be required:

- **Specific investment project approval:** According to the relevant rule promulgated by the NDRC, establishment of an FIE is subject to the NDRC's verification. However, local authorities often do not require FIEs that are non-manufacturing enterprises to obtain this verification. For WFOEs and JVs that are going to carry out manufacturing projects, Investment Project Verifications are required from the NDRC or its subsidiaries, before they apply to the Ministry of Commerce (the "MOC") or its local subsidiaries for establishment approvals.
- **Establishment approval:** Regardless of the type of business activities planned, before establishing a WFOE or JV, approval must be obtained from the MOC or its local subsidiaries. An Approval Certificate will be issued on approval.
- **Preliminary Land Approval and Environmental Impact Assessment Approval:** For investment projects that include acquiring land, Preliminary Land Approvals must be obtained.

ned from the Ministry of Land and Resource or its local subsidiaries; for projects that include construction, Environmental Impact Assessment Approvals must be obtained from the State Environmental Protection Administration or its local subsidiaries.

- **Industry-Specific Approval:** Specific approvals would have to be obtained from the relevant authorities for WFOEs and JVs whose business activities fall into the industries that are supervised by special authorities, e.g., pharmacy, tourism, and education.

Registration procedure: The SAIC or its local subsidiaries are in charge of registration of the establishment of all WFOEs and JVs after approvals are obtained. A business license will be issued when the establishment registration is completed.

Post-establishment registrations: After the approval and registration procedures, WFOEs and JVs are required to go through a number of post-establishment registrations with relevant authorities, for their daily operation. The post-establishment registrations mainly include the common seals record filing, organizational code registration, tax registration, foreign exchange registration, bank account opening approval, capital injection and verification, change of business license after capital injection, finance registration, social security registration, statistics registration and customs ("Customs") registration.

Partnership

Establishment approval from the MOC or its subsidiaries is not usually required for a foreign invested partnership. The name pre-approval, industry-specific approval and registration procedure for foreign invested partnerships are similar to those for WFOEs and JVs.

RO

The establishment of an RO does not require name pre-approval from the registration authority and establishment approval from the MOC or its subsidiaries. The industry-specific approval, registration procedure and post-establishment registration are similar to those for WFOEs and JVs.

2.4 Registered capital and total investment

Under PRC law, all companies, including FIEs, must have a minimum registered capital. For FIEs, in addition to the requirement for minimum registered capital, the requirement for total investment is a unique legal requirement that may impact many aspects of the FIE's business.

According to the legal definition, registered capital is the amount of capital the foreign investors contribute to a company within a fixed period provided by law. It represents the equity that a foreign investor holds in a company. Although, according to law, the required minimum registered capital is only RMB 30,000 for a limited liability company with multiple investors, and RMB 100,000 for a limited liability company with a single investor, in practice, authorities may require a higher amount, based on the principle that the registered capital must be able to support the scale of the business operation. In addition, some regulations require a higher registered capital for specific industries.

Total investment refers to the amount (including registered capital and funds borrowed by the company) that is required for the planned project as stipulated in the joint venture contract and the company's articles of association ("AoA"). Although foreign investors may prefer a smaller registered capital and a larger total investment for funding flexibility, the relevant regulation provides the following ratios of registered capital to total investment.

Total investment	Registered capital (as a percentage of the total investment)
Up to US \$3 million	At least 70%
Over US \$3 million up to US \$10 million	At least 50% (minimum: US \$2.1 million)
Over US \$10 million up to US \$30 million	At least 40% (minimum: US \$5 million)
Over US \$30 million	At least 1/3 (minimum: US \$12 million)

Both the increase and decrease of the registered capital and total investment are subject to government approval and registration, so it is advisable to determine their amounts realistically at the beginning, to avoid applying repeatedly for approval and registration.

2.5 Investment financing

One aspect that needs to be carefully planned before investing in China is how the business will be financed. Foreign investors should remember that leverage in China is limited from both legal and tax perspectives.

The FIE's ability to incur foreign debts is limited to the differences between the total investment and the registered capital and the debt-to-equity ratio. Under Chinese law, the following are considered foreign debts: (i) loans offered by foreign governments, (ii) loans offered by international organizations and (iii) international commercial loans.

The interest expenses the FIE pays to any related parties will only be deductible if they conform to the 2:1 debt-equity ratio. Any interest expenses paid above this threshold will not be deductible, unless they meet the exception provisions.



Debt financing

Financing from a foreign company

As long as the debt-equity ratio is confirmed, FIEs may be able to borrow foreign loans. FIEs may not be able to deduct the cost of interest paid to the related foreign company by an amount that exceeds the prescribed debt-equity ratio.

Foreign currency financing from an international bank

Unlike domestic companies, FIEs may obtain international loans without the SAFE's approval, but registration will still be required.

Under Chinese regulations, there are two types of loans, depending on the term of the loan: (i) medium and long term (more than one year) and (ii) short term (between 90 days and a year) international commercial loans. The reason for the division is that the proceeds of short-term loans may not be used for long-term investment projects or fixed assets loans.

RMB financing from a local bank

In practice, local RMB loans may be obtained from local banks, disregarding the debt financing headroom between the registered capital and the total amount of the FIE borrower's investment. In addition, local banks usually require security arrangements to be in place for the lender.

2.6 Business scope

The "business scope" is the scope in which a company conducts business activities. A company's business scope is subject to the approval of the approval authorities and registration with the relevant AIC; the business scope be consistent with the provisions of the company's AoA and must be stated on its business license.


Business scope is subject to review by the authorities and some business scopes will only be permitted with required licenses. The “licensed business scope” is subject to the approval of the relevant authorities before a company applies for registration. For instance, the business scope of a company that manufactures pharmaceuticals is subject to the approval of the State Food and Drug Administration, while a company engaging in mining industry would be subject to the approval of the relevant department of land and resources. The “general business scope” refers to activities that are not subject to special approvals.

A company’s business scope should include or reflect the industry or business characteristics indicated by its company name; for example, “engaging in wholesale and retail of shoes and apparel” may be included in the business scope of a clothing and shoes trading company.

A company is only approved to conduct activities within its business scope; therefore, it is important for an investor to decide the business scope carefully. If the business scope is too broad, it may not be approved by the approval authorities, but if it is too narrow, it may limit the company’s business operation. Also, any changes to the business scope are subject to the approval of and registration with the relevant governmental authorities. In practice, before setting up a company, it might be helpful to discuss this with the authorities to decide an appropriate business scope.

2.7 Legal representative

The legal representative is the person authorized to act on behalf of the company. For example, a contract signed by the legal representative on behalf of the company is deemed legally binding, even if the contract made is out of the legal representative’s authorized scope, unless the counterpart to



the contract knew, or should have known, that the legal representative was acting without proper powers when entering into the contract.

According to PRC Company Law, the chairman, an executive director, or a manager assumes the legal representative's position in a company. This person must be stipulated in the company's AoA and registered in accordance with the law. However, in an EJV, where investors must appoint a board of directors, the chairman of the board is the legal representative. Similarly, if a board of directors is established in a CJV, the chairman of the board is the legal representative.

To register a legal representative, investors are required to submit a qualification review to the registration authority, declaring that, among others, the legal representative has no criminal records, or has not been deemed liable for illegal acts while being legal representative of another company in the last three years.

Generally, the company, and not the legal representative, is responsible for any civil legal consequences of the legal representative's actions. However, the legal representative may be penalized, or administrative punishment or even criminal punishment may be imposed on the representative for the company's illegal actions or crimes.

2.8 Corporate governance: shareholders, directors and supervisors

Under PRC Company Law, the shareholders meeting is a company's highest decision making body. Thus, the shareholders meeting is the highest decision making body of a WFOE. However, EJVs and CJVs, as stipulated in the applicable regulations, must establish a board of directors as the highest decision making body.

The board of directors established by a limited liability company must have at least three and a maximum of 13 members. For a limited liability company with a relatively small number of shareholders, it may have an executive director instead of a board of directors. A joint stock limited company must set up a board of directors, composed of five to 19 members.


Regarding the joint venture (“JV”), the distribution of the number of directors is determined through consultation by the parties to the joint venture, based on the proportion of investment contributed. With the EJV, one party may appoint the chairman and the other party appoints the vice-chairman. However, a CJV is allowed to establish a board of directors or a joint managerial institution.

Under PRC Company Law, it is compulsory for any company to have a board of supervisors, except for small-scale limited liability companies, which can have one or two supervisors. One of the important statutory tasks of the supervisor or the board of supervisors is to supervise the directors and senior management personnel performing their duties, and to file an action with the court against the director or senior management personnel if any director or senior management personnel violate the provisions of the laws, administrative regulations, or the company’s AoA.

2.9 Land

In China, land is owned by the state, or, in some circumstances, it is collectively owned by rural people. Companies, entities or individuals cannot own land, but they can own land use rights, which may be assigned, leased or mortgaged.

There are two ways to obtain land use rights: by allocation or by grant. Allocated land use rights are allocated for the public interest, without consideration, for the use of government, mili-



tary, urban infrastructure, energy sources, transportation, and so on. Allocated land use rights cannot be transferred or leased unless they are first converted into granted land use rights.

The state may grant land use rights to a land user for a certain period, by public listing and/or auction or tender, in return for the payment of a land grant premium. The land user is required to enter into a land grant contract with the local administration bureau of land and resources, which establishes the boundaries and areas of land, term of land use right, premium and payment terms, land use purpose, conditions for terminating the land use right, and so on.

The term of the land use right differs, depending on the land use purpose: 70 years for residential use, 40 years for commercial use, and 50 years for industrial use, as well as education, public health, sports or other purposes. The term of the land use right for residential use automatically extends on expiration. However, the renewal of non-residential land rights is not automatic.

Buildings on land should be owned by the owner of the land use rights concerned. If the land use right is transferred or disposed of in other ways, the buildings attached to the land will be disposed of together with the land use right.

Transfer of land use right that has been granted to a land user is normally subject to the following requirements:

- The transferor has paid the price;
- The transferor has obtained the land use right certificate;
- The land will be developed for industrial use, which means that the planning, the construction of civil infrastructure, and public facilities such as water supply, drainage, power supply, heat supply, roads and traffic, and communications must be completed; and

- The transferor has completed at least 25% of the total development project as planned in the approved application for the certificate of land use right.

2.10 Importing equipment

An FIE can import self-purpose equipment, material assets, and materials for processing and production. A company in the “encouraged” category is entitled to a reduction or an exemption from tariffs on imported equipment. Used machinery may be imported into China, if it is not listed in the Catalogue of Goods Prohibited from Import or any other list of goods prohibited from import published by the authority. If a company needs to import equipment in the Catalogue of Used Electromechanical Products Restricted from Import, it must apply for approval from the authority before importing this equipment.


Imported machinery is inspected by the Entry-Exit Inspection and Quarantine Bureau (“EIQ”) before being cleared by Customs.

If the equipment is being imported as a contribution of registered capital, the company must retain qualified professionals to evaluate the used machinery and verify the contribution of registered capital. The evaluation report and verification report must be recorded with the authorities.

2.11 Foreign guarantee

Foreign guarantees by an FIE

For overseas financing, an FIE may provide foreign lenders with guarantees (“foreign guarantees”). Under the scheme of foreign exchange control implemented by the Chinese government, foreign guarantees are subject to strict restrictions.



In general, foreign guarantees are subject to the following restrictions:

An FIE must satisfy certain requirements to be able to provide a foreign guarantee. These requirements include maintaining a ratio of net assets to total assets of more than 15%, in principle, and the approved guarantee amount must not exceed 50% of its net asset or its forex revenue in the preceding year.

If an FIE provides a guarantee for the debts of a company other than itself, the borrower can only be a direct subsidiary or holding company of the FIE. Thus, an FIE is generally not allowed to provide a guarantee for the foreign investor's debts.

From a procedural aspect, foreign guarantees must be approved by and registered with the SAFE at the provincial level. Without this approval or registration, the agreement for the guarantee will be deemed invalid or the SAFE will refuse to enforce it.

Equity pledge by foreign investors

A foreign investor may pledge its equity in an FIE to a bank, with the consent of the other investors and with the approval of the approval authority.

However, an investor cannot pledge equity for any portion of its capital contribution that has not been paid up. The approval authority may require that the loan or debt to be secured does not exceed the amount of the FIE's total investment.

The foreign investor's pledge is subject to the authorities' approval and registration. Without the approval and registration, the pledge cannot take effect.

2.12 Special zones under Customs' supervision


The most commonly used special areas under Customs' supervision include Free Trade Zone ("FTZ"), Bonded Logistic Park ("BLP"), Bonded Port ("BP") and Export Processing Zone ("EPZ"). There are also many other special areas, such as the export supervised warehouses and the Zhuhai Cross-Border Industrial Zone. One of the common features of these special areas is the concept of "Within the Territory and outside the Border," which means that these areas, although they belong to China's territory, are treated as "overseas," from the Customs and tax perspectives. The locations of these areas are convenient for export-oriented companies.

Transactions between companies located in these areas ("inside enterprises") and companies located outside China are exempt from Value-Added Tax ("VAT"), Consumption Tax ("CT") and Customs Duties ("CD").

Mainly trading and processing are carried out within these areas. However, no manufacturing activities can be carried out in BLP. Businesses, such as processing, could apply for bonded status, which means they would be temporarily exempt from import VAT and CD, provided the finished goods are re-exported overseas. If the finished goods were sold to Chinese companies, Customs would re-collect the import VAT and CD.

For all the bonded areas, the transactions between inside companies and overseas companies should be denominated and settled in foreign currency. Transactions between inside companies and outside companies may choose to use RMB or foreign currency.

Transactions between inside companies and Chinese companies located outside these areas ("outside enterprises") are treated as imports or exports. Therefore, regulations on importation and exportation should be followed.



Outside companies may apply for export VAT refunds once the goods are transported into these areas (except for FTZ). Outside companies cannot apply for export VAT refunds when the goods are being transported into FTZ, unless (i) it is a transaction between outside companies and overseas companies; (ii) the goods are temporarily stored in BP; and (iii) the goods are physically transported overseas. Customs will not issue Customs declaration forms for export VAT refund purposes until the goods are physically transported overseas.

2.13 Liquidation

Here, liquidation means non-bankruptcy liquidation of a company whose assets are sufficient to repay all of its debts. It occurs in any of the following circumstances:

- the term of operation specified in a company's AoA expires or any other reason for dissolution specified in the company's AoA arises;
- the shareholders meeting or shareholders general meeting resolves to dissolve the company;
- the company's business license has been revoked or it has been ordered to close down or is banned in accordance with the law; or
- Shareholders holding at least 10% of all shareholders voting rights petition a people's court to dissolve the company, if serious difficulties arise in the operation and management of the company and its continued existence would cause a material loss to the interests of the shareholders and the difficulties cannot be resolved any other way.

Within 15 days from the occurrence of the above events that trigger the dissolution, a liquidation committee must be established to commence liquidation. The liquidation committee

of a limited liability company is formed by the shareholders; the liquidation committee of a joint stock limited company is composed of the directors or any other people as determined by the shareholders meeting. The liquidation committee should be filed with the relevant AIC within 10 days from the date it is established.

The liquidation committee will dispose of the company's assets, notify creditors, make public announcements, deal with the assets remaining after settling the company's debts and other issues related to the liquidation.

The liquidation committee must notify creditors within 10 days from the date it is established and publish an announcement in the newspapers within 60 days. Within 30 days from receiving the notice (or within 45 days for creditors who did not receive the notice), the creditors may declare their creditors' rights to the liquidation committee.

Afterwards, the liquidation committee will prepare a liquidation plan and submit it to the board of shareholders, a shareholders general meeting, or a people's court, for confirmation. The company's assets will be distributed in accordance with the liquidation plan and in statutory order.

After the liquidation has been completed, the liquidation committee must prepare a liquidation report and submit it to the board of shareholders, a shareholders general meeting, or a people's court, for confirmation again, and a copy of the liquidation report is sent to the Administration for Industry and Commerce, to apply for de-registration and a public announcement is made stating the company's termination.

If, after the liquidation committee has disposed of the company's assets and prepared the balance sheet and list of assets, the company assets are insufficient to settle the debts, an application is made to a people's court to declare the company bankrupt.



3. MERGER AND ACQUISITION

3.1 Cross-border acquisitions

Over the past several years, China has enacted a preliminary regulatory framework for merger and acquisition (“M&A”) transactions. The framework, while not complete, provides greater guidance for foreign investors engaging in M&A transactions and standardizes practices that have developed on an *ad hoc* basis over the years.

An M&A transaction in China may be carried out through an equity acquisition or an asset acquisition.

The preferred acquisition method generally depends on considerations such as the target’s financial condition, the required government approvals, the necessity of third party consents, the transferability of the assets and the tax consequences of the structure.

Equity acquisition

A foreign investor may directly or indirectly acquire equity (either registered capital or shares) in a target from existing investors. Although an equity acquisition is generally less time consuming, it is important to highlight that such transaction means that the foreign investor assumes all of the seller’s existing or contingent obligations and liabilities.

Asset acquisition

An M&A transaction may also be structured as an asset acquisition. In an asset acquisition, the acquirer may acquire select assets and liabilities of the target, which is an opportunity to carve out unwanted assets and liabilities. Consideration is paid directly to the target, which maintains its separate legal existence. Compared to equity acquisition, this alternative is more

time consuming, but less risky, especially from a tax perspective. Generally, when a foreign investor acquires equity of a non-FIE, or assets of any domestic company, thus changing it into an FIE, parties to the transaction must state whether they are related parties. If the parties belong to the same ultimate shareholder, they must disclose the ultimate shareholder to the examination and approval authority, explaining the purpose of the transaction and whether the assessment results conform to the fair market value.

In addition to the differences between share and asset acquisition mentioned above, in an equity acquisition, the ratio of total investment to the registered capital must comply with certain requirements.


Price and payment methods

Acquisitions launched by foreign investors, which convert domestic companies into FIEs, are mainly regulated regarding the following aspects:

- The parties to an acquisition must calculate the transaction price based on the value of the equity to be transferred or the value of the assets to be sold as appraised by an appraisal institution. It is prohibited to transfer equity or sell assets for a price apparently lower than this appraisal.
- All of the purchase price must be paid within three months of the date on which the FIE's business license was issued. In contrast, there is no time limit for foreign investors to pay the price for equity of an FIE.

3.2 Merger and division of FIEs

Chinese regulations allow FIEs to merge with other FIEs or domestic companies. The Regulations on the Merger and Divi-



sion of Enterprises with Foreign Investment define two types of merger: absorption merger and consolidation merger.

Absorption merger

Absorption merger involves a company acquiring other companies, after which the acquiring company continues to exist and the companies acquired are dissolved. The company that survives the merger succeeds the target companies (dissolved as a result of the merger) in all of their claims and debts.

Consolidation merger

Consolidation merger means the merger of two companies to form a new company, through which the parties being merged are dissolved. The newly established company resulting from a merger succeeds the dissolved companies in all of their claims and debts.

The merger must comply with the provisions of the Catalogue and may not lead to a situation where a foreign investor wholly owns, has a controlling interest in, or holds a dominant position in any company active in an industry in which foreign investors are not permitted to wholly own, have a controlling interest in or hold a dominant position in companies. FIEs should not be merged until the investors have made their capital contributions or provided their cooperation conditions in full and in accordance with the FIE's contract and articles of association, and the FIE has started production or business.

Similar to the merger, an FIE can be divided into two or more companies pursuant to the relevant provisions of the Company Law, through a division resolution made by the company's highest authority.

Survived division

A company is divided into two or more companies, where the company itself survives and one or more new companies are established.

Division by dissolution

A company is divided into two or more companies, where the existing company is dissolved and two or more new companies are established.

3.3 Re-investment of FIEs

FIEs are allowed to invest in and establish a company in China or purchase equity in another company in China in its own name by using its after tax profit. An FIE's RMB fund from the settlement of foreign currency capital cannot be used for domestic equity investment, unless otherwise stipulated by PRC law.

The FIE's investment must comply with the Catalogue.

An FIE's investment in a restricted industry is subject to approval by the approval authority at provincial level, before registration. Investment in an encouraged or permitted industry can go directly to the registration authority. However, if the FIE is making the investment by using its fixed assets, changing the original scale of its operations or the content of its business, it must apply to, and obtain, the consent of its original examination and approval authority before making the investment.

If an FIE invests in a company in central or western parts of China and foreign investment accounts for at least 25% of the registered capital of the investee company, the investee company will be eligible to be treated as an FIE.



3.4 Anti-monopoly review

On August 1, 2008, China's anti-monopoly law became effective. Since then, the Chinese authorities have enacted a comprehensive merger-control regime, issuing both formal filing guidelines and draft filing rules that establish the basic procedures of the Chinese merger-filing regime and provide practitioners and businesses with guidance on how proposed transactions will be analyzed under this regime.

- The thresholds to report a transaction for an anti-monopoly review are as follows:
- The worldwide business volume of all the business operators involved in the concentration exceeds RMB 10 billion in the last accounting year, and the business volume in China of at least two business operators among them exceeds RMB 400 million, separately, in the last accounting year.
- The business volume in China of all the business operators involved in the concentration exceeds RMB 2 billion in the last accounting year, and the business volume in China of at least two business operators among them exceeds RMB 400 million, separately, in the last accounting year.

Some exceptions apply:

- One of the business operators holds at least 50% of the voting shares or assets of each of the other business operators.
- At least 50% of the voting shares or assets of each business operator involved is held by one business operator not involved in the concentration.

Transactions must be reported to the MOC if they could result in the transfer of control of a domestic company owning famous trademarks, old trade names, important industries, or factors

that could affect the PRC's economic security. If parties fail to report a transaction that could affect the PRC's economic security, the MOC may cancel the transaction.

3.5 Due diligence

The term "*due diligence*" is usually associated with contracts or investment decisions and implies that proper efforts will be made when investigating or examining information provided in a given transaction. The due diligence report is a thorough examination of all aspects of a company.

A legal due diligence reviews the following:

- Target company's legal status, including establishment documents, approvals of any increases in registered capital, transfers of shares/equity interest, etc.;
- Capital verification of all contributions to registered capital;
- Claims by any other parties to the target company's assets;
- Legal rights to land and buildings;
- Environmental survey of the relevant land and operation;
- Tax status, including any preferential benefits enjoyed;
- Labor issues that may hinder the transaction;
- Status of intellectual property rights (e.g., trademarks, patents, know-how, copyrights, software, trade names, domain names, licenses, etc.); and
- Identity and contractual status of key employees, whose continued participation in the business would be strategically important.



4. IP PROTECTION

Intellectual property (“IP”) in China is protected through registration. Chinese law protects a wide range of IP rights, including patents, trademarks and copyright. With the only exception of well-known trademarks, Chinese law only protects patents and trademarks when they are registered with the relevant authorities. Additionally, although copyright is immediately protected after the work is created, registration is still advisable for proof purposes.

4.1 Administrative protection

The main rules setting out the administrative protection regime for IP rights are the Patent Law of the People’s Republic of China (as amended in 2008), the Trademark Law of the People’s Republic of China and the Copyright Law of the People’s Republic of China.

The main authorities concerned are the State Intellectual Property Office (“SIPO”), the “SAIC,” including the Trademark Office and the Trademark Appeal Board, and the General Copyright Administration (“GCA”).

Grant of the IP right

Patent and trademark rights are granted through registration. The only exceptions, as mentioned above, are well-known trademarks, which can only be recognized by the Trademark Office, the Trademark Appeal Board or the courts, after a trademark dispute and at the request of the trademark owner.

A trademark applicant must file a Chinese language application with the Trademark Office, which will give a decision within 36 to 42 months after receiving all supporting documents. The protection term is 10 years from the date of registration.

A patent application must be filed with the SIPO, which usually publishes the application 18 months after the filing date. The protection term is 20 years for invention patents and 10 years for utility model and design patents, all starting on the filing date.

Passive protection after the right is granted

Whenever there is a suspected infringement of an IP right, anyone may report this to the administrative authority, provided there is preliminary proof of the infringement. The IP right owner (or any licensed user) may directly request the administrative authority to investigate the case and penalize the violator, without needing to provide further evidence.

The relevant authority is the one located where the infringement is committed (either the place of action or the place of result), or in the place where the infringing party resides.

Proactive protection after the right is granted

After a suspected infringement is discovered, the administrative authority must carry out investigations. The SIPO, the SAIC and the GCA are responsible for handling patents, trademarks and copyright infringing disputes, respectively. They must (i) order the infringing party to stop the infringement immediately, (ii) apply to the court for enforcement of the order, (iii) mediate the compensation at the disputing parties' request, and, if applicable, (iv) confiscate the illegal income and/or confiscate and destroy the infringing goods or reproductions, and (v) impose a fine.

4.2 Judicial protection: civil and criminal

Civil action

Anyone exercising an IP right without being authorized or licensed by the IP right owner may be sued before the civil courts where the infringement was committed (either the place of tort action or the place of tort result) or where the defendant resides.

The compensation for damages (including the reasonable cost of stopping the infringement) depends on the type of IP right involved:

- For patent infringement, damages will be (i) calculated on the actual loss caused by the infringement or the benefits obtained by the infringer, or (ii) reasonably determined in multiple(s) of the royalties for a license for such patent.
- For trademark infringement, compensation will be calculated based on the benefits gained by the infringer or the loss suffered by the IP right owner.
- For copyright infringement, compensation will also be calculated based on the actual losses suffered by the IP right owner or the illegal income earned by the infringer.

If an IP contract is breached, a lawsuit may be filed against the breaching party either before the civil court agreed by the parties (which might be the court in the place where the defendant resides, where the contract is performed, where the contract was signed, where the plaintiff resides, or where the subject matter is located) or, if there is no specific agreement, before the court in the place where the defendant resides or at the place where the contract is performed. The compensation for damages should be the amount of all loss caused by the contractual breach.

The statute of limitations for civil action is two years from the date the intellectual property right owner or the interested party knew or should have known of the infringing act.

Criminal action

The following persons may be prosecuted for infringement of IP rights:

- A person using an identical trademark on the same kind of merchandise without the registered trademark owner's permission, if the case is serious enough to constitute a crime.
- A seller intentionally selling merchandise under a fake trademark, when the sales volume is relatively large.
- An offender forging or manufacturing without permission, or selling or manufacturing without permission, other people's registered trademark labels, when the case has a serious nature.
- An offender counterfeiting other people's patents, if the case is serious enough to constitute a crime.

Under these circumstances, criminal proceedings may be initiated before the court located at the place where the crime has been committed (either the place of crime action or the place of crime result) or at the place where the defendant resides.

The criminal penalties imposed on the infringer may be as follows (i) imprisonment, (ii) criminal detention, (iii) restriction and (iv) fine (the latter may be imposed separately or with the other penalties).

The statute of limitations for criminal action for IP infringement is generally 10 years.



4.3 Customs protection

The Customs protection regime is established in the Regulations of the People's Republic of China on Customs Protection of Intellectual Property Rights and its implementation measures.

Record filing at the General Administration of Customs ("GAC")

Foreigners may submit record applications to the GAC together with all the relevant evidential documents. On receipt of the application, the GAC will decide within 30 working days whether to grant the record filing. The record filing will be effective from the date the decision is made and is valid for 10 years. The IP right holder may apply to the GAC for an extension of the record filing within six months before it expires. Each extension is valid for 10 years.

Protection of non-record filing IP rights

For an IP right not recorded at the GAC, the IP right holder must submit an application to Customs to take protective measures (detain the goods) and provide a bond equivalent to the value of the goods. In this situation, Customs will detain the suspected infringing goods.

Within 20 working days from the date the goods are detained, the IP right holder must apply to the court for measures ordering the infringing act to stop or to protect the property against the suspected infringing goods. Customs will help execute the court order after receiving the notification.

Protection of recorded IP rights

Whenever local Customs discover the import or export of goods suspected of infringing a recorded IP right, it will immediately notify the IP right holder, which then (i) submits an application to the Customs to take protective measures, and (ii) provides a

bond equivalent to the value of the goods within three working days from the date the Customs' notification is served. Customs will detain the suspected infringing goods only after the above requirements have been fulfilled.

Customs has 30 working days from detaining the goods to investigate and determine whether there is an infringement of a recorded IP right. If this cannot be determined within 30 working days, Customs must notify the IP right holder immediately, so the right holder can apply to the court for measures ordering the infringing act to stop or to protect the property against the suspected infringing goods.



5. TAX

5.1 Tax resident enterprise

The Enterprise Income Tax Law (“EIT”), which came into effect on January 1, 2008, terminated the different tax systems between domestic companies and FIEs and introduced a new concept of tax residence.

Tax resident enterprise (“TRE”) refers to a company that either is legally established in China or is established in accordance with laws of foreign countries but its effective management is in China.

A non-TRE is a company that is established under the laws of a foreign country and its effective management is not located in China, but has an establishment or place of business in China; or a company that has no establishment or place but derives income sourced from China.

TREs are subject to EIT on their global income, while non-TREs are only taxable on their China sourced income.

The concept of effective management is one of the key elements to assessing the status of a tax resident enterprise. It includes situations where the overall management or control of a company’s manufacturing, personnel, accounting and assets takes place in the Chinese territory.

5.2 Enterprise income taxation

Tax rate

The standard tax rate is 25%. EIT rate is reduced to 20% for small-scale companies meeting regulatory requirements and to 15% for state-encouraged new technology and high technology enterprises as a tax incentive.

Taxable income

A company's taxable income in a tax year is the amount remaining from its gross income after offsetting non-taxable, tax-exempt, and other deductible items, and the carried forward losses.

Losses incurred by a company in a tax year can be offset against the taxable income it generates in the following five years.

Tax year


The tax year starts on January 1 and ends on December 31 of each calendar year. When a company's operational period in a tax year is less than 12 months, due to when it starts or terminates its operating activities, the tax year will be its actual operational period.

Exemptions and tax incentives

The following income is tax exempt:

- Interest on government bonds;
- Dividends and other distributions relating to equity interest paid between qualifying resident companies;
- Dividends and other distributions relating to equity interest derived from resident companies received by a non-resident company in connection with its establishment in China;
- Qualifying income received by non-profit organizations.

Income deriving from investments or business activities in public infrastructure projects with the support of the state, qualified environmental protection projects, and water or energy saving projects, are exempt for the first three years, from the first profit-making tax year, and will be taxed at half rate from the fourth to the sixth year.



Research and development ("R&D") expenses related to activities developing new technology, products and craftsmanship are entitled to a 50% extra deduction. If an intangible asset has been formed, such expenses can be amortized at 150% of the cost of the intangible asset.

If a venture capital company invests in a Chinese unlisted small or medium sized high and new technology company for at least two years, 70% of the total investments may be credited and may be carried forward.

With the purchase of special equipment for environmental protection, for saving energy and water, for work safety, etc., 10% of investments may be deducted from the tax payable and may be carried forward for five years.

Tax collection

Tax is filed in the place where the company is registered or the place of the company's effective management.

TREs are allowed to consolidate the company's income tax filing with its branches, with approval from the tax authority.

Non-TREs file tax in the place where their fixed place of business is located or the registration place of the withholding agent.

EIT is filed monthly or quarterly. Annual EIT filing is due by the end of May of the next tax year.

5.3 Individual income taxation

Individuals with a registered address (Chinese nationals with a personal residence record) in China are regarded Chinese tax residents and subject to individual income tax ("IIT") on their worldwide income.

Tax residence of foreign expatriates is determined based on the duration of their stay in Chinese territory. Expatriates staying in China for the full tax year will be regarded tax residents. Any absence of fewer than 30 consecutive days, or fewer than 90 cumulative days, is counted as time spent in China.

Expatriates' tax liability is determined based on the time spent in China.

Expatriates spending less than 90 days (183 days if a tax treaty is applicable) in a tax year are not subject to tax on income paid by an employer outside China, as long as their remuneration is paid by a non-Chinese company and not charged back to a Chinese company, permanent establishment or representative office of a foreign company.

Remuneration paid to chief representatives of representative offices is generally paid by the representative offices, so they may be subject to tax from the first day spent in China.

Expatriates spending more than 90 days (183 days if a tax treaty is applicable) are subject to tax on Chinese sourced income.

Remuneration paid for services rendered in China is regarded Chinese sourced income, regardless of where it is paid or who pays it.

Expatriates living in China for more than one year and less than five full years are subject to IIT on China-sourced income.

Expatriates living in China for more than five years are subject to IIT on their worldwide income. Foreign nationals are not subject to tax on their worldwide income for any year in which they are not resident. Therefore, it may be advisable for expatriates to leave China for 30 or more consecutive days or 90 or more cumulative days in their fifth year of residence, to break the tax residence period.



Tax rates

The IIT rate depends on the type of income. Income from wages and salaries is taxed based on a progressive scale ranging from 5%-45%.

Income from business activities, royalties, interest, dividends, leases on or assignment of property is taxed at a flat rate of 20%.

Tax collection

The income earner pays the individual income tax, and the entity or individual that pays the income is the withholding agent. Employers usually withhold IIT from wages or salaries and submit it to the tax authority on a monthly basis.

A taxpayer in any of the following circumstances must file tax returns with and pay tax to the tax authority:

- Annual income exceeds RMB 120,000;
- Wages or salary derive from two or more sources inside China;
- Income derives from sources outside China;
- Income derives without withholding agents; or
- Other circumstances specified by the State Council.

IIT returns must be filed within 15 days following the end of each month. A taxpayer with an annual income exceeding RMB 120,000 must file tax returns with, and pay tax to, the tax authority, within three months after the end of the year.

5.4 General foreign investor taxation

Non-resident companies are subject to tax on income derived in China and on profits obtained through a permanent establishment in China.

Business profits

Business profits obtained by non-TREs from business activities carried out in China are subject to EIT. However, under tax treaties, the taxation of business profits only takes place when the non-TRE operates through a permanent establishment in China.

Permanent establishments are taxed on a deemed profit basis. If the accounting records are incomplete, or when income cannot be accurately calculated, the EIT taxable base is determined applying one of the following methods:

- Total income method
- Cost-plus method
- Expenses-plus method

The standard deemed profit rates are the following:

- Consultancy, construction and design: 15% to 30%
- Management services: 30% to 50%

Other services: At least 15%:

- Tax authorities may adopt higher deemed profit rates.
- Interest and royalty payments made by the permanent establishment to the head office are not tax deductible for EIT.

Taxation on capital gains

Capital gains derived by non-TREs are taxed at 10%.

Under certain tax treaties (such as tax treaties with Switzerland and Portugal), capital gains on shares are exempt.

Taxation of dividends, interest and royalties

Domestic rates: Under the EIT law, dividends, interest and royalties paid by a Chinese company to its foreign shareholder are subject to 10% withholding tax.

Some exemptions apply to royalties on the licensing of high technology. Certain service fees related to the licensing of intangibles are regarded royalties if a permanent establishment is not created in China.

Tax treaty rates: Tax treaties may reduce domestic withholding tax rates. The application of tax treaties is subject to submitting a tax treaty residence certificate.

TREATY RATES	DIVIDENDS		INTEREST 1	ROYALTIES
	Individuals and companies	Qualifying companies		
Albania	10	10	10	10
Algeria	10	5	7	10
Armenia	10	5	10	10
Australia	15	15	10	10
Austria	10	7	10	10
Azerbaijan	10	10	10	10
Bahrain	5	5	10	10
Bangladesh	10	10	10	10
Barbados	5	5	10	10
Belarus	10	10	10	10

Belgium	10	10	10	10
Bosnia and Herzegovina 3	5	5	10	10
Brazil	15	15	15	15/25
Brunei	5	5	10	10
Bulgaria	10	10	10	7 /10
Canada	15	10	10	10
Croatia	5	5	10	10
Cuba	10	5	7.5	5
Cyprus	10	10	10	10
Czech Republic	10	10	10	10
Denmark	10	10	10	10
Egypt	8	8	10	8
Estonia	10	5	10	10
Finland	10	10	10	10
France	10	10	10	10
Georgia	10	10	10	10
Germany	10	10	10	10
Greece	10	5	10	10
Hong Kong	10	5	7	7
Hungary	10	10	10	10
Iceland	10	5	10	10
India	10	10	10	10
Indonesia	10	10	10	10
Iran	10	10	10	10
Ireland	10	5	10	10
Israel	10	10	7/10	10
Italy	10	10	10	10
Jamaica	5	5	7.5	10
Japan	10	10	10	10
Kazakhstan	10	10	10	10
Korea (Rep.)	10	52	10	10
Kuwait	5	5	5	10
Kyrgyzstan	10	10	10	10

TREATY RATES	DIVIDENDS		INTEREST 1	ROYALTIES
	Individuals and companies	Qualifying companies		
Laos	5	5	10	10
Latvia	10	5	10	10
Lithuania	10	5	10	10
Luxembourg	10	5	10	10
Macau	10	10	7/10	10
Macedonia	5	5	10	10
Malaysia	10	10	10	10/15
Malta	10	10	10	10
Mauritius	5	5	10	10
Mexico	5	5	10	10
Moldova	10	5	10	10
Mongolia	5	5	10	10
Morocco	10	10	10	10
Netherlands	10	10	10	10 8
New Zealand	15	15	10	10
Nigeria	7.5	7.5	7.5	7.5
Norway	15	15	10	10
Oman	5	5	10	10
Pakistan	10	10	10	12.5
Papua New Guinea	15	15	10	10
Philippines	15	10	10	10/15
Poland	10	10	10	10
Portugal	10	10	10	10
Qatar	10	10	10	10
Romania	10	10	10	7
Russia	10	10	10	10
Saudi Arabia	5	5	10	10
Serbia and Montenegro 3	5	5	10	10
Seychelles	5	5	10	10
Singapore	10	5	7/10	10


Slovak Republic	10	10	10	10
Slovenia	5	5	10	10
South Africa	5	5	10	10
Spain	10	10	10	10
Sri Lanka	10	10	10	10
Sudan	5	5	10	10
Sweden	10	5	10	10
Switzerland	10	10	10	10
Tajikistan	10	10	10	10
Thailand	20	15	-/10	15
Trinidad and Tobago	10	5	10	10
Tunisia	8	8	10	5/10
Turkey	10	10	10	10
Ukraine	10	5	10	10
United Arab Emirates	7	7	7	10
United Kingdom	10	10	10	10
United States	10	10	10	10
Uzbekistan	10	10	10	10
Venezuela	10	5	5/10	10
Vietnam	10	10	10	10

5.5 M&A related taxation

There are two types of M&A related tax treatments: general tax treatment and special tax treatment.

Under the general tax treatment, the transferor recognizes the gain or loss on the transfer of the shares/assets under shares/assets acquisition. The transferee books the shares/assets purchased at fair market value.

Under the special tax treatment, the transferor may temporarily not recognize any gain or loss and the transferee may book the shares/assets purchased at their historical book value.



The special tax treatment imposes requirements regarding both the purchase percentage and the percentage of equity payment. The purchase percentage of both shares/assets acquisition must be at least 75% of the total shares/assets, and the percentage of equity payment must be at least 85%.

Other requirements must also be complied with to qualify for the special tax treatment, including:

- Reasonable commercial purpose for acquiring the shares/assets;
- No material change within 12 consecutive months after the transaction;
- No equity payment received can be transferred within 12 consecutive months after the transaction.

The requirements for applying the special tax treatment to cross-border M&A are stricter, mainly relating to the holding percentage and the time limit for transferring the share purchased.

Companies that apply for the special tax treatment must file a record with the relevant tax authority, including certain documents, such as the shares/assets purchase agreement, the evaluation report on the shares/assets, and so on, before the end of the period for filling annual enterprise income tax.

Companies must keep all documentation relating to the application of the special tax treatment for the tax authority's review.

5.6 Transfer pricing


The EIT law and its implementing regulations provide a framework for transfer pricing rules in China.

This is based on the arm's length principle achieved by applying

the methods that the Organization for Economic Co-Operation and Development (“OECD”) applies in its Transfer Pricing Guidelines. These regulations establish, for some taxpayers, the obligation to prepare the relevant documentation for transactions with related parties, and, for all taxpayers, the general obligation to provide minimum information on transactions. They also give taxpayers the possibility to enter into cost sharing agreements and unilateral, bilateral and multilateral advance pricing arrangements (“APAs”) with the Chinese tax authorities.

“Related party relationship”

- Companies directly or indirectly holding 25% or more of another company’s shares; or a third party directly or indirectly holding 25% or more of the shares in both companies. If a company holds another company’s shares indirectly through a third party, that third party’s share ratio will be deemed its share ratio when the company holds 25% or more of the third party’s shares.
- Debts a company owes another company (except for third-party financial institutions) exceed 50% of the company’s capital, or 10% or more of the company’s total debts is guaranteed by another company (except for third-party financial institutions).
- More than half of a company’s senior management (including the board of directors and the general manager), or at least one executive director, is appointed by another company; or two companies with more than half of their senior management (including the board of directors and the general manager), or at least one executive directors, is appointed by a third party.
- More than half of a company’s senior management (including the board of directors and the general manager) also serves as senior management (including the board of directors and the general manager) in another company, or



at least one executive director also serves as executive director in another company.

- Company's production and operation activities depend on an intangible licensed from another company (including industrial property, know-how, etc.).
- Company's purchase and sale activities are controlled by another company.
- Company provides or receives services controlled by another company.
- Other relationships that control the company's production, operations, and transactions, including when major shareholders of the two companies have the same economic benefits, even if they fall below the 25% shareholding threshold, or have other connected interests, including family.

Thus, not only would shareholding and management relationships fall under transfer-pricing rules, but also situations where there is a control or decision-making power over a third party based, for example, on an exclusive business relationship.

According to PRC law, all taxpayers must provide detailed information about their related parties and their transactions. Those information obligations give tax authorities a complete picture of taxpayers' related-party transactions.

Taxpayers must prepare additional contemporaneous documentation annually, unless they fall under one of the following exemptions:

- Annual related-party purchases and sales are lower than RMB 200 million and other related party transactions are lower than RMB 40 million.
- Related-party transactions are covered by an APA.

- Foreign share in a company lower than 50% and only related-party transactions with domestic related parties.

PRC law also describes the applicability of transfer-pricing methods and the comparability analysis. The accepted transfer-pricing methods include the comparable uncontrolled price method, the resale price method, the cost plus method, the transactional net margin method and the profit split method. Each method must be properly applied to the transaction in accordance with the outcome of the comparability analysis.


Advance-pricing agreements

One of the safest ways to avoid transfer-pricing risks is to negotiate an APA with the Chinese tax authorities, which have repeatedly encouraged taxpayers to enter into APAs. APAs can be negotiated unilaterally, bilaterally or multilaterally, and may apply to the related-party transactions for three to five consecutive years after the year the formal APA application is submitted. Thus, the year the application is submitted would not be covered by the APA and could be tax audited, unless the circumstances were the same as those approved by the APA.

The APA negotiation could last six to nine months. Its phases include pre-file meeting (can be anonymous, if needed), formal application, review and evaluation, and signing. Once the APA is signed, the tax authorities may monitor the transactions subject to the APA and the taxpayer must provide an annual report on the execution of the APA.

Cost-sharing agreements (“CSA”)

The EIT law has introduced a new concept: the CSA and its tax regime. CSAs are schemes multinational groups commonly use to establish compensation for the group companies developing intangibles, to ensure that all the group companies are involved in the risk of developing intangible activities and creating more efficient intra-group transaction structures.



Multinational groups operating in China welcomed the introduction of CSAs in the new tax legislation. Since January 1, 2008, Chinese subsidiaries can enter into CSAs with related parties to jointly develop and assign intangibles, or to supply or receive services.

From a tax perspective, any payment under a CSA would be based on costs incurred rather than market prices, although these costs must comply with the arm's length principle. The parties must report to the State Administration of Taxation within 30 days of signing the CSA.

The cost-contributors do not have to pay royalties to use intangibles developed or transferred under the CSA, so there should be no withholding tax in China relating to the developed intangible assets.

Regarding the tax treatment of a CSA, costs contributions are tax deductible in China for the duration of the CSA, if all the following conditions are met:

- The CSA has a reasonable business purpose and economic substance.
- The CSA complies with the arm's length principle.
- The costs are consistent with the benefits received by the CSA parties.
- The Chinese taxpayer has filed or prepared, maintained and provided the additional CSA documentation required under this regulation.
- The operation is for at least 20 years, starting the date the CSA is signed.

If compensation adjustments are made, they should be included in the taxable period for the year they are made. Also, if there are buy-in or buy-out payments, or if the termination triggers

the distribution of the results generated under the CSA, any related income should be taxed as an asset purchase or an asset transfer.

5.7 Tax inspection

Companies are required to file tax annually. A China-registered CPA firm must be engaged to conduct an annual audit for this purpose. The tax authority is entitled to review and inspect the filing documents and check that the correct amount of tax has been filed.

The tax authority may randomly select companies for tax audits or tax reviews. Certain industries are selected to do self reviews every year before the tax authority conducts its audit. These are usually high-profit industries. The tax authority also requires a tax audit before liquidation.

Where a taxpayer fails to pay tax or a withholding agent fails to submit the tax withheld within the specified time limit, they may face a daily surcharge of 0.05% of the amount of tax in arrears, from the date the tax payment should have been made.

The tax authority is entitled to inspect a taxpayer's accounting books, vouchers for the accounts, statements, and relevant information, and to inspect a withholding agent's accounting books, vouchers for the accounts, and relevant information relating to the amount of tax withheld and remitted or collected and remitted. Accounting books, accounting vouchers, financial statements, tax payment vouchers, invoices, exportation vouchers and other tax-related documents must be kept for 10 years.

Taxpayers may face penalties if they fail to fulfill the obligations stipulated by laws and regulations. Serious cases may involve criminal punishment.



6. LABOR ISSUES

6.1 Labor contracts

To employ any person in China, a written employment contract must be drawn up. Employers that fail to provide written contracts for employees will be penalized. Meanwhile, employees have the right to claim double salary, for up to 12 months' salary, for working without a written contract.

The employment contract must include the scope of work, the working conditions, the place of work, occupational hazards, production safety conditions, salary and other issues required by laws and regulations.

Employment contracts are classified as fixed-term contracts, open-ended contracts and contracts that terminate when a particular task has been completed. After performing two consecutive fixed-term contracts, an employee has the right to require the employer to offer an open-ended contract for any renewal of the employment contract.

The standard working scheme allowed by law is eight hours per working day and 40 hours per week. The employer must pay statutory minimum wage for employees' overtime work, which ranges from 150% of the normal salary for overtime work on an ordinary working day to 300% of the normal salary for overtime work on holidays. For special positions, the employer may adopt a non-fixed time working scheme, which must be approved by the local authority.

Employers are generally prohibited from terminating unilaterally any kind of employment contract; its unilateral termination of an employment contract must be based on one of the specific grounds stipulated by law.

In certain circumstances, the employee must receive severance pay on termination of the employment contract. If the employer violates the labor law by terminating the labor contract, it has to pay the employee severance pay at twice the rate.

6.2 Welfare

Employers must register with social security and provide employees with statutory social security, although there are no national regulations specifying the social security standard. Employers have to resort to local authorities to determine the amounts and methods of social security payments.

Social security includes pension insurance, unemployment insurance, medical insurance, work injury insurance and housing fund. Employers have to apply different rates to local-resident employees and non-local resident employees.

In addition to making social security contributions, employers must also withhold the employees' contributions and make the payment on their behalf.

Certain pension and medical insurance contributions are calculated based on the average salary during the previous year, which the corresponding local authority publishes annually.

6.3 Trade unions

Under PRC Trade Union Law, companies with 25 or more employees who are union members may establish a basic-level trade union. Collective employment agreements between the employer and the labor union are encouraged.

Trade unions are entitled to represent employees and to supervise the employer's compliance with labor laws and regulations.



The employer must consult the trade union before making any major decisions concerning the company's operation, management and development. When the employer holds a meeting on issues that may affect employees' interests, such as salaries, welfare, labor safety, hygiene and social insurance, the trade union's representatives must be invited to attend. If any of the statutory circumstances make it necessary to reduce the workforce by 20 employees or more, or less than 20 employees but accounting for 10% or more of the total number of employees, the employer must explain the reasons to the trade union or to all of its employees 30 days in advance, and then consider the trade union's or the employees' opinions.

If an employer intends to terminate a labor contract unilaterally, it must inform the trade union of the reasons, in advance. The trade union can demand that the employer reviews the decision if it finds that the employer is violating laws, administrative regulations or the labor contract. The employer must consider the trade union's opinions and notify the trade union in writing of the reviewed decision.

6.4 Foreign employees

To regularly work in China, a foreign employee must obtain a work visa, employment permit and residence permit.

The company that hires the foreign employee has to apply to the local labor authority for an employment license.

Then, the company submits the employment license to the local commercial authority to apply for the work visa invitation.

Finally, the foreign employee has to go to the Chinese embassy or consulate in the foreign employee's home country to apply for a work visa, which is called the Z visa.

With the work visa, the foreign employee can enter China and apply for the employment permit. The documents to be submitted include a health report issued by a health care center designated by the labor authority.

After obtaining the employment permit, the foreign employee must go to the local public security bureau to apply for the residence permit.

Under PRC Social Security Law, which was enacted on October 28, 2010, and comes into force on July 1, 2011, foreigners employed in China should be included in the Chinese social security system. New regulations developing this issue further are expected soon.



7. DISPUTE SETTLEMENT

7.1 Litigation: jurisdiction and procedure

Jurisdictions

There are four levels of courts in China: the basic people's court, the intermediate people's court, the high people's court and the supreme people's court. Most cases fall under the jurisdiction of the basic people's courts, but if the case involves complex foreign elements, or if the disputed amount is huge and materially influences the regions, it will be accepted and heard by the intermediate people's courts.

In addition to the jurisdiction of the level of courts, a case is also subject to the territorial jurisdiction. In principle, the claimant must initiate the litigation with the people's court in the place where the defendant resides, including the place of its business operation. However, in special cases, the jurisdiction will fall under the court where the infringement takes place, which includes not only the places where the infringement occurred but also places where the infringement's consequences occurred.

Procedure

Under the Civil Procedure Law, judicial proceedings occur in two instances: trial and appeal. An appellate court's decision is final, and no further appeal is allowed. However, if the appellate decision was in error, a retrial may be requested through the trial supervision proceeding.

A trial case includes the following procedures: (i) filing and defense; (ii) evidence submission and cross examination; (iii) hearing and judgment. If the claimant or the defendant is not satisfied with the judgment, they may appeal the case (within 15 days of receiving the judgment for a Chinese party or 30 days for a foreign party), by initiating the second instance

procedure. Failure to appeal the case within these time limits will result in the judgment taking effect.

In most cases, the court will render judgments within six months after filing, for the first instance, and within three months after the appeal is accepted, for the second instance. However, this time limit does not apply to cases involving foreign interests. The law is silent on the time limit for rendering judgments for foreign-related cases.

A three-judge panel usually hears foreign-related cases. All documents and evidence, and the hearing, must be in Chinese, and translations may be provided at the parties' request at their own expense.


During the court proceedings, before or during the hearing, or even after the hearing, the judges usually attempt to mediate the case. If a mediation agreement is reached by and served on the parties, it will have the same effect as a judgment. If the mediation effort fails, the court will render a judgment without delay.

7.2 Arbitration: offshore and onshore

Off-shore arbitration

Off-shore arbitration (held outside mainland China) would be the best way for foreign investors to solve their China-related disputes. However, only disputes considered foreign-related may be validly arbitrated outside the PRC. A dispute is considered foreign related if it meets one of the following conditions:

- At least one of the parties is "foreign". Companies are considered "foreign" if their place of incorporation is outside mainland China (FIEs, and JVs between a Chinese and a foreign party, would not be considered "foreign").



For individuals, this condition is determined based on the nationality criterion.

- The subject matter of the contract is wholly or partly outside China.
- The rights and obligations arising from the contract are created, modified or extinguished outside China.

Enforcement of foreign awards is subject to the provisions of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“Convention”). Therefore, the grounds on which a court may deny enforcement are limited to serious procedural defects and the principle of “public policy”. To improve the implementation of this Convention, the Supreme People’s Court issued a Notice establishing an “internal reporting system,” through which any refusal by an intermediate people’s court to recognize and enforce an international or a national foreign-related award will be reviewed by the high people’s court in its jurisdiction. If the latter agrees that the arbitration award should not be recognized or enforced, its opinion will be reported to the Supreme People’s Court, which will render a final decision. This reporting system also applies to any people’s court decision to vacate or set aside a foreign or a foreign-related award.

On-shore arbitration

On-shore arbitration refers to all arbitration proceedings held in mainland China (which excludes the territories of Hong Kong, Macau and Taiwan).

Under Chinese law, all arbitration proceedings held in the PRC must be administered by a national arbitration institution. Hence, the parties must not agree *ad hoc* arbitration if the seat of arbitration is on mainland China. The China International Economic and Trade Arbitration Commission (“CIETAC”) or

the local arbitral commissions of Beijing and Shanghai are the arbitration institutions most trusted by foreign investors. It is still uncertain whether arbitrations in the PRC can take place under the auspices of an international institution. Until there is greater clarity on this issue, parties are advised to select a PRC arbitration commission to conduct the proceeding (i.e., CIETAC).

One of the main concerns regarding on-shore arbitration is how national arbitration commissions appoint arbitrators. Foreign investors are advised to foresee the neutrality of the arbitral tribunal in the arbitration agreement.

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