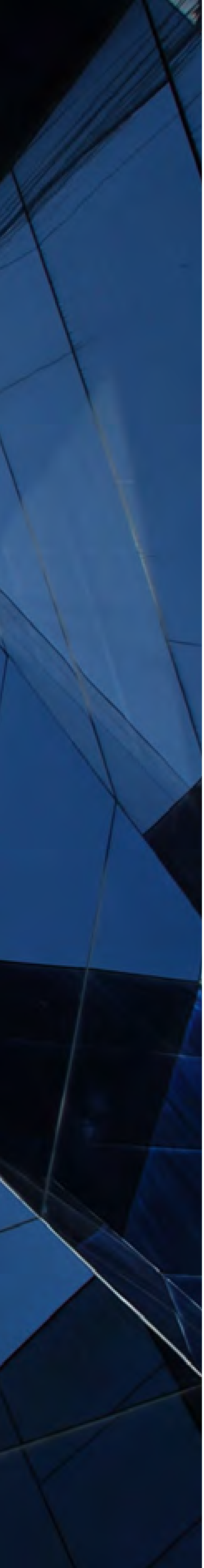
CUATRECASAS

Doing business in China

2021 Edition



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This guide provides general information to investors intending to operate in China on issues on which they may need to be aware of.

It is not intended, and cannot be considered, as a comprehensive and detailed analysis of Chinese law or, under any circumstances, as legal advice from Cuatrecasas.

This guide was drafted on the basis of information available as of May 26, 2021. Cuatrecasas is under no obligation and assumes no responsibility to update this information. This guide results from our study and experience advising foreign companies in China and it represents our understanding of the Chinese legal framework.

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May 26, 2021

Content

List of acronyms

AoA	Articles of Association
APA	Advanced Pricing Arrangement
ASEAN	Association of Southeast Asian Nations
BT	Business Tax
CEPA	Closer Economic Partnership Arrangement
CJV	Contractual Joint Venture
CSA	Cost Sharing Agreement
EIT	Enterprise Income Tax
EJV	Equity Joint Venture
EU	European Union
FIE	Foreign-Invested Enterprise
FIJSC	Foreign-Invested Joint Stock Company
Forex	Foreign Exchange
PFTZ	Pilot Free Trade Zone
GAC	General Administration of Customs
NCA	National Copyright Administration
GDP	Gross Domestic Product
IIT	Individual Income Tax
IP	Intellectual Property
JV	Joint Venture
M&A	Merger and Acquisition
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
New York Convention	Convention on the Recognition and Enforcement of Foreign Arbitral Awards
PE	Permanent Establishment
PRC or China	People's Republic of China
R&D	Research and Development

RO	Representative Office
SAFE	State Administration of Foreign Exchange
SAMR	State Administration for Market Regulation
SAR	Special Administrative Region
STA	State Taxation Administration
CNIPA	China National Intellectual Property Administration
TRE	Tax Resident Enterprise
US	United States
USD	US Dollars
VAT	Value-Added Tax
WFOE	Wholly Foreign-Owned Enterprise
WTO	World Trade Organization

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Introduction

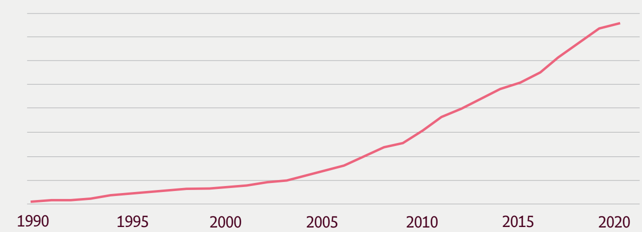
1.1. Economic and business environment in China

GDP growth of 2.3% in 2020

In 2020, China's GPD grew 2.3% and reached RMB 101,598.6 billion. Despite facing a complex global economic environment and the challenges of the coronavirus pandemic, China achieved an impressive recovery, while continuing to implement structural transformations and upgrades.

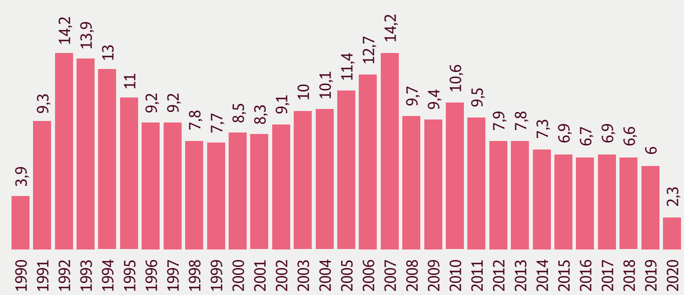
GDP of China

— in billion of RMB



China's GDP growth rate (%) since 1990

Source: National Bureau of Statistics



In 2010, China surpassed Japan to become the second largest economy in the world, just behind the US. Three factors have driven this high-speed growth: domestic consumption, investment and net export.

Based on official statistics, in 2020, China's GDP rose 2.3% compared to 2019, and it was the only major economy with growth during the COVID-19 pandemic. Compared to 2019, the added value of industrial enterprises (above the designated scale) increased by 2.8%; the national investment in fixed assets (excluding rural households)

Remarkable recovery of the economy during the COVID-19 pandemic

increased by 2.9%; however, the total retail sales of consumer goods decreased by 3.9%. All in all, this remarkable recovery was thanks to (i) the successful prevention measures to effectively control infection rates and ensure the swift resumption of economic and social life; (ii) flexible, moderate and effective counter-cyclical macroeconomic policies; and (iii) the proactive and unwavering opening-up measures to stabilize foreign trade, foreign investment and supply chains.

Based on the latest data from the National Bureau of Statistics of China, China's GDP per capita for 2020 is estimated to be USD 10,504, which is still be below the worldwide average published by the International Monetary Fund.

The PRC government fulfilled its promise to encourage foreign investment in 2020 by further opening up market access, simplifying administrative procedures, supporting R&D activities, and extending financing channels.

1.2. Foreign trade and investment

The world's largest country in trading volume

In 2020, China maintained the position as the world's largest country by trading volume, with a total value of imports and exports of RMB 32.16 trillion, a 1.9% increase over that of the previous year. The five major trading partners (i.e., the ASEAN, the EU, the US, Japan and South Korea) accounted for 54.32% of China's total international trade.

After joining the WTO in 2001, China made several changes to its trade regulations, bringing them in line with the WTO's standards. Several economic sectors and industries have been gradually opened up to foreign investment. To bolster the economies of the Hong Kong and Macau SAR, in 2003, the central government signed the CEPA with both SAR governments. CEPA is essentially a free-trade agreement that transcends WTO commitments and gives companies from the two SARs favourable tariff treatment on goods imported to mainland China, before granting this treatment to other WTO members. CEPA sometimes grants privileges that are not part of China's WTO commitment.

In 2020, China overtook the US as the top destination for foreign investment. Foreign investment into China increased by 6.2% to RMB 999.98 billion compared to 2019, and 38,570 foreign-invested enterprises were established in 2020. The foreign investment volume reached a record high, ranking first in developing countries and second in the world.

China welcomes foreign investment and is bound by WTO rules to open further its industries to foreign investors. On March 15, 2019, the second session of the 13th National People's Congress approved the Foreign Investment Law, effective from January 1, 2020, granting, for the first time in law, national treatment to foreign investments outside the negative list in the stage of investment access. Its aim is to create a more equal environment for foreign investors.

National treatment to foreign investments outside the Negative List

For this purpose, on June 23, 2020, the National Development and Reform Commission ("NDRC") and the Ministry of Commerce ("MOFCOM") jointly released a Negative List for Foreign Investment (2020 Edition) and a Negative List for Foreign Investment in Pilot Free Trade Zones (2020 Edition), which apply with a uniform classification system and further reduce prohibited and restricted items to 33 and 30, respectively (jointly "Negative List"). As for now, China has created and will keep improving the unified Negative List regime for foreign investment across the country.

The above Negative List (2020 Edition) reflected the governmental announcement of late 2017 to grant liberation policies for foreign investments in the banking, insurance, securities and automotive sectors.

1.3. Foreign exchange control

In China, the State Administration of Foreign Exchange ("SAFE") and its local branches control foreign exchange. NDRC and the People's Bank of China also enact regulations.

To comply with its WTO commitments, China has to liberalise its forex market gradually: it has freed up current account convertibility, and is simplifying and opening up capital account convertibility, but this remains restricted.

Under the 2008 Foreign Exchange Control Regulations, China does not restrict regular international payments and transfers, but it prohibits the circulation of foreign currency, which, unless authorised by the competent authority, cannot be used for payments in Chinese territory.

Forex controls are implemented in three ways:

Registration: After being incorporated, a FIE must apply for forex registration with its local bank, at the place of its business registration. When the FIE is deregistered or converted to a non-foreign-invested enterprise, it must deregister with its local bank.

Current account: Receiving and paying forex in current accounts must be based on accurate and legal transactions. Financial institutions engaged in settling and selling forex should inspect the accuracy of transaction documents, ensuring they conform to forex receipts and payments.

FIEs can retain forex proceeds received in current accounts, based on their business operation needs.

Capital account: SAFE supervises and inspects currency movements related to transactions involving capital accounts more strictly than payments and receipts of forex in current accounts. For example, all forex classified as "capital account" must be used for purposes established under regulations. Under certain regulations SAFE enacted in 2016, forex received in a capital account can be fully settled on a discretionary basis. Financial institutions in the banking industry can directly offer foreign commercial loans within their approved business scope, but other domestic institutions can only grant foreign commercial loans subject to the quota approved by SAFE.

1.4. Special zones under Customs' supervision

Special zones under Customs' supervision are special areas established in the territory of China with the approval of the State Council under the special supervision of customs, including the Bonded Area, the Bonded Logistic Park, the Bonded Port, the Export Processing Zone, the Crossborder Industrial Zone and the Comprehensive Bonded Zone. As a transformation of how trade is processed, special customs supervision areas have contributed towards promoting foreign trade and developing regional economies.

One common feature of these special areas is the concept of "within the territory and outside the border", which means these areas, although belonging 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.

Special zones under customs supervision are treated as "overseas"

Transactions between companies located in these areas ("Inside Companies") and companies located outside China are exempt from customs duties and import taxes.

Trading, logistics and processing activities are carried out within these areas. However, no manufacturing activities can be carried out in the Bonded Logistic Park. Businesses, such as processing, can apply for bonded status, which means they would be temporarily exempt from customs duties and import taxes provided the finished goods are re-exported overseas. If the finished goods are sold to Chinese companies, customs duties and import taxes apply.

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

Outside companies can apply for export tax refunds once the goods are transported into these areas (except for the Bonded Area). Outside companies cannot apply for export tax refunds when the goods are being transported into the Bonded Area. Instead, they must wait until the goods are physically transported overseas.

In 2012 and 2015, the State Council respectively published a plan to optimise and integrate the different types of special customs supervision areas into "Comprehensive Bonded Zones". Consequently, Comprehensive Bonded Zones have gradually become the dominant type of special zones under Customs' supervision.

1.5. Pilot Free Trade Zones

On August 22, 2013, the State Council approved a plan to create China's first Pilot Free Trade Zone ("PFTZ"), i.e., the China (Shanghai) PFTZ, measuring 28.78 km², within the four special zones under Customs' supervision in Shanghai: Shanghai Waigaoqiao Bonded Area, Waigaoqiao Bonded Logistics Park, Yangshan Bonded Port, and Shanghai Pudong Airport Comprehensive Bonded Zone. The establishment of PFTZ aimed to facilitate trade, the entry and exit of personnel, currency circulation, warehousing, and the export and import of goods. These are the testing ground for a number of economic and social reforms, including finance, foreign exchange, crossborder e-commerce, liberation from foreign investment restrictions, and ad-hoc arbitration.

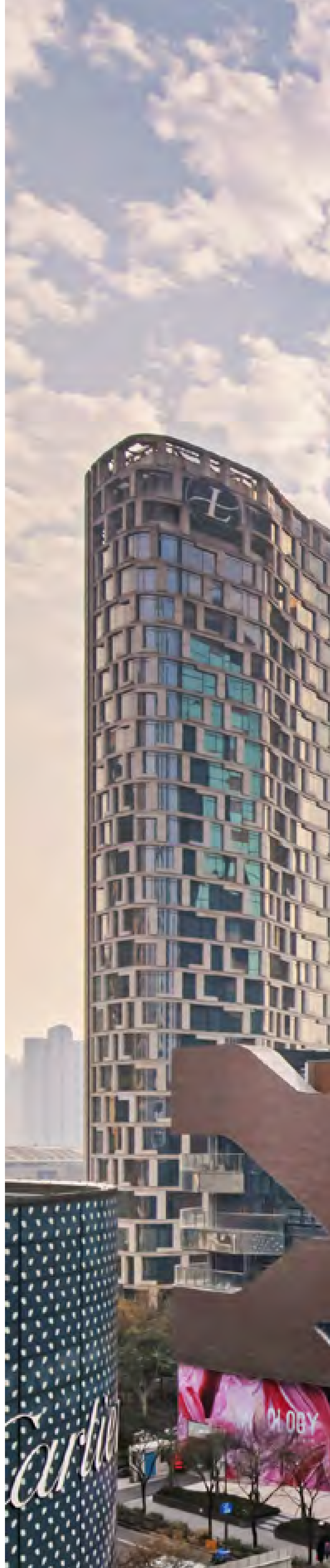
In 2015, the State Council authorised the expansion of the area of the China (Shanghai) PFTZ from 28.78 km² to 120.72 km² to include the Lujiazui Financial District Block (34.26 km²), the Jinqiao Development Block (20.48 km²) and the Zhangjiang Hi-Tech Block (37.2 km²). It also set up another three PFTZs in Fujian, Guangdong and Tianjin.

On August 31, 2016, MOFCOM officially announced the establishment of seven new PFTZs in Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan and Shanxi, with different key areas, bringing the total number to eleven. On March 31, 2017, the State Council approved the establishment of the seven new PFTZs.

Hainan PFTZ was approved by the State Council on September 24, 2018, and became the 12th PFTZ of China. On August 2, 2019, the State Council approved six more PFTZs in Shandong, Jiangsu, Guangxi, Hebei, Yunnan and Heilongjiang.
As the number of PFTZs rose to 18 in 2019, over 319,000 entities were established in these eighteen PFTZs in that year, of which 6,242 were FIEs.

On September 21, 2020, the State Council announced another three new PFTZs in Beijing, Hunan, and Anhui, bringing the total number of PFTZs nationwide to 21.

In the PFTZs, foreign investment is more liberalised than in any other special zone in China. It was in there that many experimental reforms began, which were then extended across the country.

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The Negative List points out restrictions on foreign investment

Foreign investment

2.1. Investment catalogue (Negative List)

The Negative List (2020 version), jointly issued by China's NDRC and MOFCOM, guides foreign investment projects, which was enacted on June 23, 2020, and took effect on July 23, 2020.

The Negative List includes the restricted industries and the prohibited industries for foreign investment. The restricted category involves investment projects that are opening to foreign investment slowly or are in protected industries. Partnerships cannot be established in industries with requirements on Chinese party/parties' shareholding ratio.

Foreign investors should refer to the Negative List at an early stage when investing in China, as it identifies activities and sectors in which a Chinese partner is required and, in some circumstances, the Chinese partner's shareholding ratio. In the Negative List, these activities and sectors are limited to 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 total shareholder ratio of all Chinese parties' investments in the foreign investment project must be at least 51%. The phrase "the Chinese party must hold a relative controlling interest" means the total shareholder ratio of all Chinese parties' investments in the foreign investment project must be higher than that of any single foreign party.

2.2. Forms of investment

Generally, there are two legal forms for business enterprises in China: legal person and non-legal person. A legal person enterprise 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 liability company is a legal person. A non-legal person enterprise can conduct civil activities in its own name, but cannot assume civil obligations independently, which means the investor is jointly liable; it can be organised either as a partnership with general or limited liability, or as a sole proprietorship enterprise.

Before the new Foreign Investment Law took effect on January 1, 2020, foreign investments were regulated under the Law on Wholly

Foreign-owned Enterprises, the Law on Sino-foreign Equity Joint Ventures and the Law on Sino-foreign Cooperative Joint Ventures (collectively, the "Three Foreign Investment Laws"), which are now simultaneously abolished.

Before the new Foreign Investment Law, foreign investors can establish different legal forms governed by different statutory rules, including branch, representative office ("RO"), wholly foreign-owned enterprise ("WFOE"), contractual joint venture ("CJV"), equity joint venture ("EJV"), foreign-invested joint stock company ("FIJSC"), holding company, regional headquarter, and partnership. After the new Foreign Investment Law took effect, WFOE, CJV and EJV are all referred to as FIE. Also, the new Foreign Investment Law nullifies the legal form and governance structure established under the Three Foreign Investment Laws and provides a five-year transition period for FIEs to adapt to the PRC Company Law.

Branch

Under PRC Company Law, a foreign company can establish a branch in China under specific regulations issued by the State Council. However, there are few regulations issued on this. Consequently, only foreign commercial banks, insurance companies, construction companies and petroleum exploration companies are allowed to set up branches in China. A branch is not a legal person, which means the parent company is responsible for its liabilities.

RO

Foreign companies can 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 product sales, services, domestic procurement, and domestic investment. Generally, ROs are prohibited from conducting any profit-making activity, unless otherwise established under special regulations. ROs are not legal persons.

WFOE

WFOE is a legal form that applied before the new Foreign Investment Law was enacted. WFOEs are companies with capital fully invested by one or more foreign investors. WFOEs are the most common form adopted in foreign investment in China, because they are completely controlled by their foreign investor(s). WFOEs usually refer to limited liability companies with full capacity to do business within their business scope. As WFOE's legal form, governance structure and activity guidelines are already in accordance with the PRC Company Law, they do not need to make any changes in light of the new Foreign Investment Law.

CJV

CJV is a legal form that applied before the new Foreign Investment Law was enacted. Foreign investors can establish CJVs by entering into contracts with Chinese parties that address issues such as investment or cooperation conditions, distribution of revenues or products, sharing risks and losses, operation and management methods, and ownership of the properties when the CJVs end. Most CJVs are organised as limited liability companies, although it is possible to form a CJV as a non-legal person enterprise. CJVs can carry out several activities within their business scope. In light of the new Foreign Investment Law, during the five-year transition period, all existing CJVs should adopt the legal form, governance structure and activity guidelines according to the PRC Company Law or the PRC Partnership Enterprise Law.

EJV

EJV is a legal form that applied before the new Foreign Investment Law was enacted. EJVs are another type of joint venture that foreign investors can establish with Chinese parties. Compared to CJVs, EJVs must be organised as limited liability companies. EJVs can carry out several activities within their business scope. In light of the new Foreign Investment Law, during the five-year transition period, all existing EJVs should adopt the legal form, governance structure and activity guidelines according to the PRC Company Law.

FIJSC

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

Holding company

Holding companies offer foreign investors the capacity to hold multiple-investments in China under a single entity. Through holding companies, foreign investors can make further investments and provide financial, consultancy, technical and other services to affiliated companies. Holding companies can be established as a limited liability company or a joint stock company.

Regional headquarters

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

Partnership

In lieu of a company as a legal person, foreign investors can set up foreign-funded partnerships in China, either by themselves or by collaborating with domestic individuals or entities. Under PRC law, foreign-funded partnerships can be either a general partnership or a limited partnership.

2.3. Establishment procedures

FIEs

To establish an FIE, three procedures must be carried out:

- Company name self-report
- Record filing/approval procedure
- Registration procedure

Company name self-report: 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 for Market Regulation ("SAMR") or its local subsidiaries, for company name self-report. The company name self-report can be conducted at the same time as the incorporation process.

Record filing/approval procedure: the following record filing/approvals may be required:

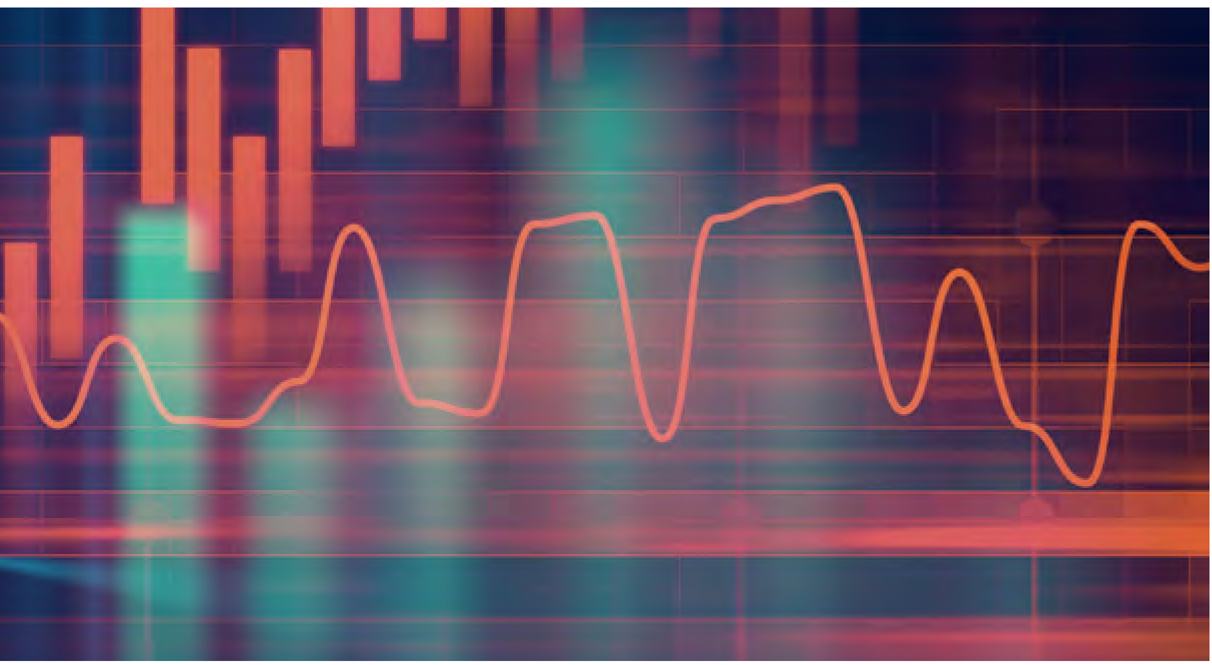
- Specific investment project verification/record filing: under the rule enacted by NDRC, establishing an FIE is subject to NDRC's verification/record filing. However, local authorities do not always enforce this procedure on non-manufacturing FIEs. For manufacturing FIEs, investment project verifications/record filings are required from NDRC.
- Preliminary land approval and environmental impact assessment approval, either before or after the registration, as requested by the relevant authority: for investment projects that involve acquiring land, preliminary land approvals must be obtained from the Ministry of Land and Resource or its local subsidiaries. For projects that involve construction or production, environmental impact assessment approval must be obtained from the State Environmental Protection Administration or its local subsidiaries.

Integration of relevant certificates

- Industry-specific approval: specific approvals must be obtained from the relevant authorities for FIEs with a business activity within the category of industries supervised by specific authorities and industries subject to special foreign investment access administration (Negative List).
- Record filing: foreign investors or FIEs need to report their investment information online with MOFCOM or its local subsidiaries during the registration procedure. Most regions have integrated this procedure into the registration procedure described below.

General description of FIE establishment procedures

Registration procedure: SAMR (or its local subsidiaries) is in charge of registering the establishment of all FIEs. A new registration system has been in place since 2015. So far, this new system has integrated the former business licenses, the organisation code certificate, the tax registration certificate, the social security registration, and the statistics registration certificate into one certificate. After the reform, a business license bearing a unified social credit code is issued when the establishment has been registered. By the end of June 2018, an additional 19 certificates or licenses were integrated, e.g., the customs registration certificate as declaration entity, MOFCOM's record filing, the international freight forwarding record filing, the housing fund certificate, and the record filing for seal engraving. However, administrative licenses and permits, which are subject to the authorities' approval, have not been integrated, e.g., food operation licenses, hazardous chemical operation licenses, and medical and drug operation licenses.



Post-establishment registrations: after the registration procedures, FIEs are required to carry out several post-establishment registrations with the competent authorities, for their day-to-day operation. Post-establishment registrations mainly include the forex registration, opening bank accounts and the customs registration (if any).

Partnership

A foreign-funded partnership is subject to the FIE online report with MOFCOM or its local subsidiaries. Name self-report, industry-specific approval and registration procedure for foreign-invested partnerships are similar to the ones for FIEs.

RO

Establishing a RO does not require name self-report with the registration authority or online report with MOFCOM or its local subsidiaries. Industry-specific approval, registration procedure and post-establishment registration are similar to the ones for FIEs.

2.4. Registered capital and total investment

Requirements on registered capital and total investment

Under PRC law, registered capital is the amount of capital foreign investors contribute to a company within a fixed period, as agreed by the foreign investors. The registered capital represents the equity a foreign investor holds in a company.

In June 2014, MOFCOM annulled several legal requirements and restrictions on contributing minimum amounts of registered capital, the percentage of initial capital contribution, the percentage of monetary contribution and the period of contribution. Except for certain industries, where there is a requirement on the minimum registered capital (e.g., insurance and international freight forwarding), foreign investors can now make their own decisions on these issues, which must be reflected in the company's AoA, which is subject to local authorities' approval/record filing and registration.

For FIEs, the requirement for total investment is unique, as it affects several aspects of the FIE's business. Total investment refers to the amount (including registered capital and funds borrowed by the company) required for the planned project, as stipulated in the joint venture contract (or shareholders contract) and the company's AoA. Although foreign investors may prefer a smaller registered capital and a larger total investment for funding flexibility, the applicable regulation provides the following ratios of registered capital to total investment:

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

Both the increase and decrease of the registered capital and total investment are subject to governmental authorities' approval/record filing and registration, so it is advisable to set realistic amounts at the beginning, to avoid applying repeatedly for approval/record filing and registration.

2.5. Crossborder direct investment in RMB

Subject to several restrictions, foreign investors are allowed to use RMB funds obtained through legal channels outside of China to make crossborder direct investments in China.

However, offshore RMB funds must not be used (directly or indirectly) to provide entrusted loans, nor for investment in negotiable securities and financial derivatives (excluding the strategic investment in listed companies) in China.

2.6. Business scope

The “business scope” is the range of a company’s business activities. A company’s business scope is subject to registration with the relevant SAMR branch, which will ensure the business scope is consistent with the company’s AoA. The company’s business license contains the business scope.

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

General description and procedures for business scope

A company should only conduct activities within its business scope, so it is important for an investor to decide the business scope carefully. If the business scope is too broad, the registration authorities may reject it; if it is too narrow, it may limit the company’s business operation. All changes to the business scope are subject to the approval/record filing of and registration with the relevant authorities. Before setting up a company, it might be helpful to discuss this with the authorities to decide on an appropriate business scope.

2.7. Corporate governance: legal representative

Duties and requirements for a legal representative

The legal representative is the person the company authorises to act on its behalf. For example, a contract signed by the legal representative on the company's behalf is considered legally binding, even if the contract signed is outside the legal representative's authorised scope, unless the counterparty to the contract knew, or should have known, that the legal representative was acting without proper powers when entering into the contract.

Under the PRC Company Law, the chairperson of the board, the executive director, or the general manager assumes the position of legal representative in a company. This person's position must be stipulated in the company's AoA and registered under the law.

Generally, the company, and not the legal representative, is responsible for all civil legal consequences of the legal representative's actions. However, the legal representative may be penalised, or may receive administrative punishment (or even criminal punishment) for the company's illegal actions or crimes.

2.8. Corporate governance: shareholders, directors and supervisors

Duties and requirements for shareholders, directors and supervisors

Under the PRC Company Law, the shareholders meeting is a company's highest decision-making body, which means, after the five-years transitional period since the new Foreign Investment Law came into effect on January 1, 2020, the shareholders meeting will be the highest decision-making body of all FIEs.

The affirmative votes of the shareholders representing at least two thirds of the voting rights are required when the shareholders meeting makes resolutions on (i) amending the company's AoA; (ii) increasing or decreasing the registered capital; (iii) mergers or divisions; and (iv) dissolving or changing the company's form.

The board of directors established by a limited liability company must have at least three (and a maximum of thirteen) members. For a limited liability company with a relatively small number of shareholders, it can have an executive director instead of a board of directors. A joint stock limited company must set up a board of directors with at least five (and a maximum of nineteen) members.

Under the PRC Company Law, companies must 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 monitor the directors and senior management personnel's performance of their duties, and to file an action with the court against the director or senior management personnel if any director or senior management personnel violates the laws, the administrative regulations, or the company's AoA.

2.9. Land

The state owns the land and may allocate or grant the land use rights to a land user

In China, the state owns the land, but in some circumstances, it is owned by collectives. Companies, entities and individuals cannot own land, but they can be entitled to the land use rights to the state-owned land, which may be assigned, leased or mortgaged.

There are two ways to obtain land use rights from the state: by allocation or by grant. Allocated land use rights are allocated in the public interest, without consideration, e.g., for use by government, military, urban infrastructure, energy sources and transportation. Allocated land use rights cannot be transferred or leased unless they are converted into granted land use rights.

The state can grant land use rights to a land user for a certain period, by public listing, 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, the term of the land use right, premium and payment terms, land use purpose, and conditions for terminating the land use right.

Terms for land use right differs, depending on the type of land use:

- 70 years for residential use
- 40 years for commercial use
- 50 years for industrial use, and for education, public health, sports and other purposes

The term of the land use right for residential use is automatically extended on expiration. However, the renewal of a non-residential land use right is not automatic.

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

Transfer of the land use right granted to a land user is usually subject to the following requirements:

- The transferor has paid off the granting price;
- The transferor has obtained the land use right certificate;

- If it involves investment or development of a large plot of land, the conditions for the use of land for industrial or other construction purposes must have been met, which means the planning, the construction of civil infrastructure and public facilities (e.g., water supply, drainage, power supply, heat supply, roads and traffic, and communications) must be completed; and
- In the case of building construction, the transferor must have completed at least 25% of the total development investment, as planned in the land grant contract.

2.10. Importing equipment

General description of importing equipment by FIE

An FIE can import self-use equipment, machinery and materials for processing and production. A company in the Catalogue of Industries for Encouraged Foreign Investment is entitled to a reduction of or an exemption from tariffs on imported equipment. Used machinery can 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 submit a record to the authority before importing this equipment.

The Entry-Exit Inspection and Quarantine Bureau conducts mandatory inspections on the imported machinery before it is cleared by Customs.

2.11. Investment financing

FIE's foreign debt quota is decided by one of two approaches

Investment financing needs careful planning before investing in China. Foreign investors should remember that leverage in China is limited from a legal perspective, and may have negative tax consequences.

From a legal perspective, the FIE's ability to incur foreign debts is limited to (i) the difference between the total investment and the registered capital (proportioned by the percentage of registered capital contributed), or (ii) the difference between an FIE's latest audited net assets value and the existing foreign debt adjusted by multiplier coefficients established by the authorities.

The second approach is a new system implemented on May 3, 2016. FIEs can currently choose which approach to apply. However, domestic enterprises must apply the new system. For both approaches, the borrower must register its foreign debts with the competent authority within a prescribed period once the loan agreement has been executed.

Since January 12, 2018, the new system automatically applies to foreign-invested financial institutions, while FIEs must wait for further notice from the People's Bank of China and SAFE. To date, no information has published on this subject.

Chinese law states that the following are considered foreign debts:

- Loans offered by foreign governments
- Loans offered by international organisations
- International commercial loans

RMB loans under foreign guarantee are considered contingent foreign debt, and would be considered foreign debt when calculating the limitation after executing guarantee, at which point registration with SAFE is required.

From a tax perspective, interest the FIE pays related parties will only be deductible for tax purposes if the financial expenses meet the 2:1 debt-equity ratio. Any interest paid above this threshold will not be deductible, unless it meets the exception provisions.

Notes on debt financing

Foreign currency financing from an international bank

FIEs can obtain international loans through registration and record filing with SAFE. For domestic enterprises' medium and long-term loans, record filing with NDRC will also be required before registration and record filing with SAFE.

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

RMB financing from a local bank

In practice, local RMB loans can be obtained from local banks, disregarding the debt financing limitation established for FIE borrowers. Local banks usually require security arrangements to be in place for the lender.

On August 6, 2015, the Supreme People's Court of the PRC published a regulation recognizing that temporary loans granted by non-financial enterprises for normal production and business operation needs are valid, while loans provided by a non-financial enterprise as its main business, without having a license, is invalid. This regulation came into effect on September 1, 2015, which means it is no longer necessary to resort to entrusted loans.

Outline of foreign guarantee

2.12. Foreign guarantee

Crossborder guarantee by an FIE

An FIE can provide foreign lenders with guarantees, namely cross-border guarantee. Under PRC law, an FIE can enter into crossborder guarantee contracts at its discretion. SAFE's requirements on registration, filing and approval of the crossborder guarantee are not prerequisites for the crossborder guarantee contract to come into effect.

From a procedural perspective, crossborder guarantee in the form of "overseas lending secured by domestic guarantee," i.e., both lender and debtor are foreign entities, must be registered with SAFE or its local branches. Other forms of crossborder guarantee no longer have to be registered.

Equity pledge by foreign investors

A foreign investor can pledge its equity in an FIE. The foreign investor's pledge is subject to the registration with SAMR. Without the registration, the pledge cannot take effect.

Circumstances causing liquidation

2.13. Liquidation

In China, 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 operation term 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 decides to dissolve the company.

- The company's business license has been revoked or the company has been ordered to close down or is banned under the law.
- 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 in any other way.

Liquidation procedure and responsibilities of the liquidation committee

Within 15 days from the date on which the above events trigger the dissolution, a liquidation committee must be established to start the liquidation process. A limited liability company's liquidation committee is formed by the shareholders, and a joint stock limited company's liquidation committee is formed by the directors or any other people assigned by the shareholders meeting. The liquidation committee should be submitted to the relevant SAMR within 10 days from the date on which 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, as well as any other issues related to the liquidation.

The liquidation committee must notify creditors within 10 days from the date on which 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 can 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, the shareholders general meeting, or a people's court for confirmation. The company's assets will be distributed based on the liquidation plan and the statutory order.

After the liquidation is complete, the liquidation committee must prepare a liquidation report and submit it to the board of shareholders, the shareholders general meeting, or a people's court for confirmation. A copy of the liquidation report is sent to SAMR to apply for deregistration, and SAMR will publish an announcement 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's assets are insufficient to settle the debts, the liquidation committee will submit an application to a people's court to declare the company bankrupt.

According to the Measures for Information Reporting on Foreign Investment, which is jointly promulgated by SAMR and MOFCOM and became effective on January 1, 2020, FIEs no longer need to go through a deregistration record filing process with MOFCOM. By completing the deregistration with SAMR, the SAMR will share the deregistration information with MOFCOM.

According to SAMR's opinions of December 26, 2016, FIEs not subject to special state administration are no longer excluded from the application of simplified liquidation of limited liability companies, non-corporate enterprise legal persons, sole proprietorship and partnerships, which previously only applied to domestic companies. To follow the simplified liquidation procedure, FIEs must publish a public announcement for 45 days using the enterprise's information system. SAMR will pass on the deregistration information to the tax authorities, human resources and social security authorities, as well as to MOFCOM. If there is no objection within 45 days, SAMR will issue a decision on granting the simplified deregistration. The documentation burden is also reduced.

According to the notice jointly issued by five authorities in January 2019, the liquidation procedures will be further facilitated to (i) replace the record filing procedure for liquidation committee and the newspaper announcement by publishing the relevant information on SAMR's online platform; (ii) reduce the burden of application documents; (iii) streamline the deregistration procedures with tax, social security authorities and customs; and (iv) reduce the public announcement of the simplified liquidation procedure from 45 to 20 days.

2.14. Anti-bribery

Both the PRC Criminal Law and the PRC Anti-unfair Competition Law penalise active and passive bribery in the private sector (i.e., commercial bribery). The PRC Criminal Law also penalises bribery in the public sector.

Under articles 6 and 7 of the PRC Criminal Law, these provisions apply to Chinese nationals in and outside China, as well as to all companies incorporated in China (and their management) that carry out business overseas.

3

Mergers and acquisitions

3.1. Crossborder acquisitions

Over the past several years, China has enacted a preliminary regulatory framework for M&A transactions. The framework, while not complete, gives greater guidance to foreign investors engaging in M&A transactions and standardises practices that had developed ad hoc over the years.

Types of M&A transactions

The new Foreign Investment Law now covers foreign investment in China through M&A transactions. Therefore, it can be expected that the current framework will be consolidated with the Foreign Investment Law, under which future M&A transactions are governed.

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

Generally, the preferred acquisition method depends on several issues, including the target's financial situation, the required government approvals, the need for third-party consents, the transferability of the assets, and the structure's tax consequences.

Equity acquisition

A foreign investor can (directly or indirectly) acquire equity (either equity interest or shares) in a target from existing investors. Although an equity acquisition is generally less time consuming, this transaction means that the foreign investor assumes all of the seller's existing or contingent obligations and liabilities to the company and any third party.

Currently, foreign investors may invest in domestic enterprises or FIEs by making capital contributions in the form of equity of FIEs in China. However, the existing law establishes several requirements on the equity being involved as the method of payment in a crossborder M&A transaction.

Also, where a foreign investor uses RMB it lawfully owns as a means of payment, it must obtain SAFE's approval.

Asset acquisition

An M&A transaction can also be structured as an asset acquisition. In an asset acquisition, the acquirer can acquire selected assets and liabilities of the target, which is an opportunity to carve out unwanted assets and liabilities. The target is paid directly, and it maintains a separate legal existence. This alternative is more time consuming than an equity acquisition, but less risky, especially from a tax perspective.

Along with the differences between share and asset acquisitions, in an equity acquisition, the ratio of total investment to the registered capital must comply with several requirements established under the current regulations.

Requirements when foreign investors invest in domestic enterprises

Price and payment methods

Acquisitions launched by foreign investors that convert domestic enterprises into FIEs are mainly regulated as follows:

- 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. Equity must not be transferred and assets must not be sold for a considerably lower price than this appraisal.
- The full purchase price must be paid within three months from the date on which the FIE's business license was issued, unless this period is extended to one year under special circumstances. In contrast, there is no time limit to pay for the purchase price, when foreign investors acquire the equity of an existing FIE.

Special provisions on acquisition of state-owned assets:

Special regulations apply to the acquisition of assets or shares of state-owned enterprises:

- The assets or shares must be appraised by a local Chinese certified public accountant qualified to evaluate state-owned assets, and the appraisal report must be submitted to the state-owned assets supervision and administration commission. The transaction price must not be more than 10% lower than the value stated.
- The transfer of state-owned assets will be conducted through an official equity exchange centre. This authority will make a public announcement of the intended transaction and, if there is more than one interested party, the shares or assets will be sold by public auction or bidding procedure.

Different types of merger and division

3.2. Merger and division of FIEs

Chinese regulations allow FIEs to merge with other FIEs or domestic enterprises. The Regulations on the Merger and Division of Enterprises with Foreign Investment define two types of merger: absorption merger and consolidation merger.

Absorption merger

An 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 through the merger) in all of their claims and debts.

Consolidation merger

A consolidation merger is when two companies merge to form a new company, through which the merged parties dissolve. The newly established company resulting from the merger succeeds the dissolved companies in all of their claims and debts.

The merger must comply with the Negative List and must not bring about a situation where a foreign investor (i) wholly owns, (ii) has a controlling interest in, or (iii) holds a relative controlling interest in any company active in an industry in which foreign investors are not allowed to wholly own, have a controlling interest in, or hold a relative controlling interest in companies.

Similar to the merger, under the PRC Company Law, an FIE can be divided into two or more companies 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 company itself is dissolved and two or more new companies are established.

3.3. Reinvestment of FIEs

FIEs are allowed to invest in and establish companies in China or purchase equity in other companies in China in their own names by using the after-tax profit. On October 23, 2019, SAFE announced that, from January 1, 2020, FIEs can set up domestic subsidiaries or acquire domestic enterprises with their capital funds, provided the investments are genuine and lawful, and they comply with the Negative List.

An FIE's investment in a restricted industry is subject to the industrial department's approval before registration. Investment in a permitted industry can go directly to the registration authority.

4 Special Procedures

4.1. Anti-monopoly review

China's Anti-monopoly Law became effective on August 1, 2008. Since then, the Chinese authorities have enacted a comprehensive merger-control regime. It issued both formal filing guidelines and drafted filing rules, established the basic procedures for the Chinese merger-filing regime, and gave practitioners and businesses guidance on how proposed transactions are analysed under this regime.

Thresholds for anti-monopoly review

Under the Anti-monopoly Law, monopolistic practices include (i) the conclusion of monopoly agreements between operators; (ii) operators' abuse of their dominant market position; and (iii) concentration of undertakings that has or may have the effect of eliminating or restricting market competition.

When the concentration of undertakings reaches certain reporting thresholds, as specified by the State Council, operators must report the transaction to the anti-monopoly law enforcement authorities of the State Council in advance. No concentration can be made without this report.

The thresholds to report a transaction for an anti-monopoly review are as follows:

- The worldwide business volume of all business operators involved in the concentration exceeded RMB 10 billion in the last accounting year, and the business volume in China of at least two of these business operators exceeded RMB 400 million, separately, in the previous accounting year; or
- The business volume in China of all business operators involved in the concentration exceeded RMB 2 billion in the previous accounting year, and the business volume in China of at least two of these business operators exceeded RMB 400 million, separately, in the previous accounting year.

There are several exceptions, even when the above threshold is met:

- One of the business operators holds at least 50% of the voting shares or assets of each of the other business operators; or
- 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.

Along with M&A transactions, joint venture projects are also subject to anti- monopoly review in the case of qualifying investors.

If the facts and evidence show that the concentration resulting from a transaction has excluded or restricted competition, or could exclude or restrict it, the anti-monopoly law enforcement authorities of the State Council can also investigate the transaction, and may:

- order the discontinuation of the concentration;
- order the transfer of shares or assets, the transfer of the business within a specific period, or adopt other measures needed to reinstate the pre-concentration status; and
- impose a fine of up to RMB 500,000.

To simplify the review procedure, since February 2014, a fast-track procedure for "simple cases" that do not appear to raise substantive competition concerns has been implemented.

4.2. Security review

Guidance on the scope and procedures of M&A national security review

M&A national security review

In 2011, a national security review regime was established by the General Office of the State Council and MOFCOM respectively through issuing two regulations: (i) the Notice on Establishing the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors, and (ii) the Provisions of the Ministry of Commerce on the Implementation of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors. These regulations provide the guidance on the scope, content, working mechanism and procedures of the national security review of foreign investments, with a focus on the M&A transactions of foreign investors.

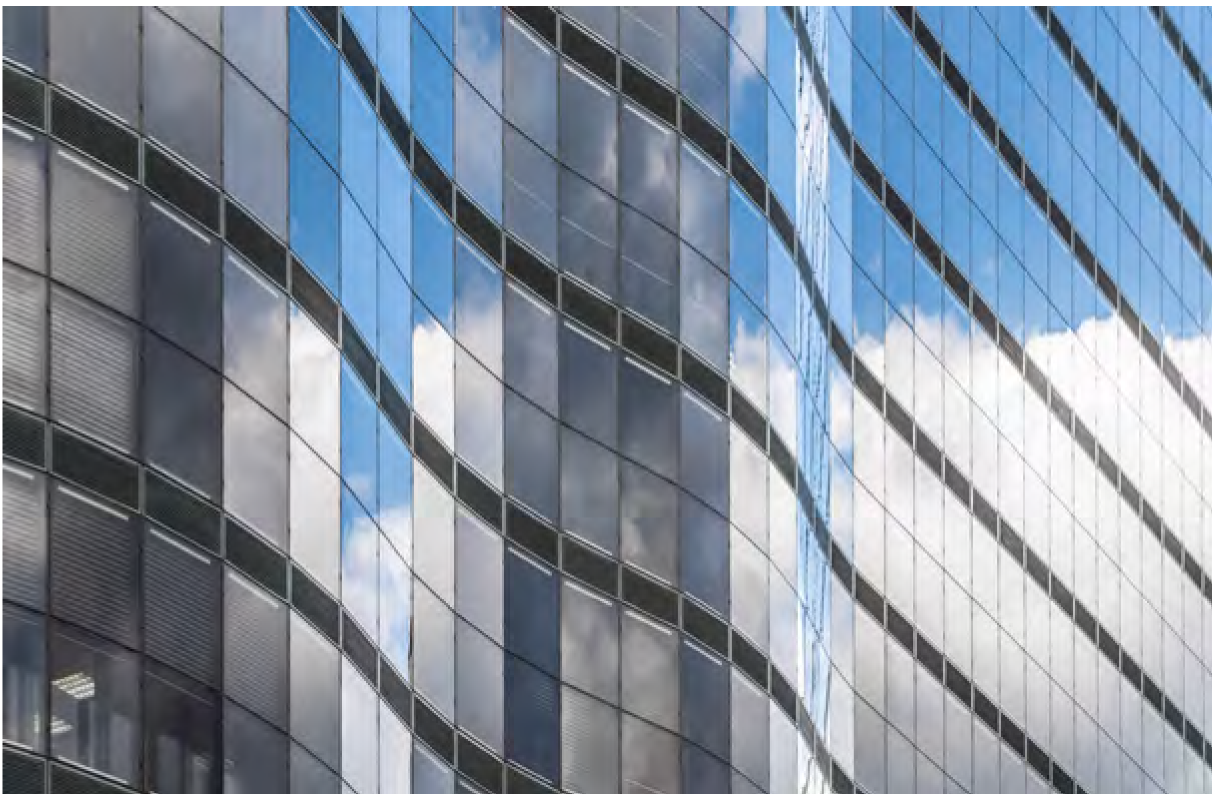
Scope of M&A national security review

The scope of M&A national security review includes (i) foreign investors' M&A of military industrial enterprises or military industry-related supporting enterprises, (ii) enterprises located near key and sensitive military facilities, and (iii) other entities related to national defence, as well as foreign investors' M&A of key domestic enterprises in areas such as agriculture, energy and resources, infrastructure, transport, technology and equipment manufacturing, where foreign investors could acquire actual control.

For this purpose, an acquisition of "actual control" refers to a situation where a foreign investor (including its parent or subsidiary companies), or several foreign investors, (i) acquire 50% or more of the target company's equity interest or voting rights, (ii) have a significant influence over the target's shareholders meeting or the board of directors, or (iii) obtain actual control over the target company's business decisions, financial affairs, personnel, technology, or other matters.

Types of M&A activity subject to national security review

- Foreign investors purchase equity interest, shares or subscribe to the increase in the registered capital of Chinese non-FIEs and convert these domestic Chinese enterprises into FIEs.
- Foreign investors establish FIEs and use them to purchase assets from domestic Chinese enterprises and operate the assets acquired.
- Foreign investors establish FIEs and use them to purchase equity interest or shares of domestic Chinese enterprises through FIEs.
- Foreign investors purchase assets owned by domestic Chinese enterprises and establish FIEs to operate these assets.
- Foreign investors purchase equity interest or shares Chinese parties own in FIEs, or they subscribe to the increase in the registered capital of FIEs.



The application for M&A national security review is filed with MOFCOM

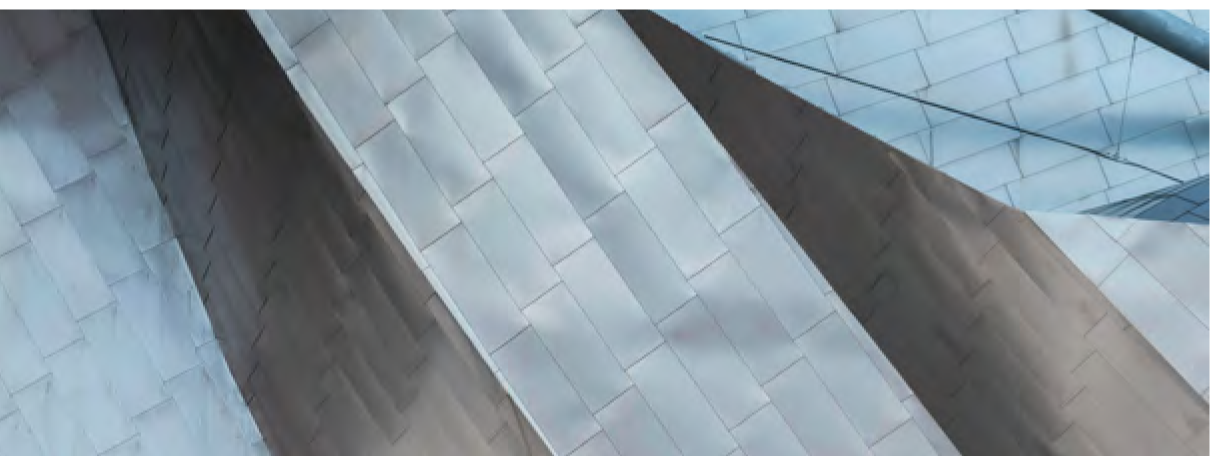
M&A national security review process

If an investment falls within the scope described above, the investors concerned are required to file an application with MOFCOM. The ministerial panel led by NDRC and MOFCOM is responsible for the M&A national security review. The initial (or general) review process can take up to 30 working days.

Applications that are not approved during the general review process are subject to a special review process, which can take up to a further 60 working days. If the ministerial panel determines that the M&A activity under review will have a significant effect on national security, the transaction may be terminated. It may also approve the transaction subject to conditions to address national security concerns. Conditions may include disposal of the concerned equity interest or assets. To avoid termination, transactions can be modified during the national security review process and re-submitted for the ministerial panel's review. State Council departments, national industry associations, and other third parties (including competitors, customers and suppliers) may ask the ministerial panel (through MOFCOM) to investigate whether a foreign M&A activity raises national security concerns.

National security review of FIEs in PFTZs

In 2015, the General Office of the State Council issued the Trial Measures for the National Security Review of Foreign Investments in PFTZs. The regulation demonstrates China's commitment to further modifying the national security review regime by extending the form of foreign investments from M&A to include green-field investments, investments in new projects and investments through others means (e.g., controlling agreements, proxy holding, trusts, reinvestments, overseas transactions, leasing, and the subscription of convertible bonds). However, these regional measures are only applicable to foreign investments in PFTZs.



Foreign investors' investment in the specific PFTZs (in Shanghai, Guangdong, Tianjin and Fujian) in military-related fields, or in key agricultural products, energy, resources, infrastructure, transportation, culture, information technology and equipment manufacturing that concern national security, have been reviewed since May 8, 2015.

Apart from factors arising from the above system nationwide, the impact of foreign investment on national cybersecurity, cultural security and public morality will be examined. However, this has not been clarified.

Legal framework of the new national security review regime

New development of national security review regime

On December 19, 2020, NDRC and MOFCOM jointly published the Measures on Security Review of Foreign Investments, which came into effect on January 18, 2021. The new measures provide a unified legal guidance for the security review of foreign investments, covering both direct and indirect foreign investments. Regarding direct investments, the scope is not limited to M&A, but will also apply to green-field investments, which are not included in the previous regulations.

Under the new regime, foreign investors or concerned parties in China are required to submit a declaration for security review to the office of the working mechanism set up at NDRC and jointly led by NDRC and MOFCOM if they make any of the following investments in China.

- Any investment in areas concerning the security of national defence such as the military industry or the military support industry, or any investment in areas surrounding military facilities and military industrial facilities, regardless of whether control is obtained.
- Any investment in important areas concerning national security that results in the invested enterprises being controlled by foreign investors. Those areas include important agricultural products, important energy and resources, important manufacturing of equipment, important infrastructure, important transportation services, important cultural products and services, important information technology and internet products and services, important financial services, and key technologies.

Foreign investors should assess their obligation for security review before investing in China

Process under the new security review regime

Before investing, foreign investors or the concerned parties in China are obliged to make a declaration for security review by submitting required documents to the authority if the proposed transaction falls within the above scope. If it is not sure whether the proposed transaction is subject to the declaration or if it has any other doubts, they can make a pre-filing consultation with the authority.

The authority is also entitled to order concerned investors to declare within a prescribed period if the investment within the scope of security review has been made without making the prior declaration.

There is also a whistle-blowing mechanism under which any person, enterprise or social group can propose to the authority to start a security review if it considers that a particular foreign investment may pose a national security concern.

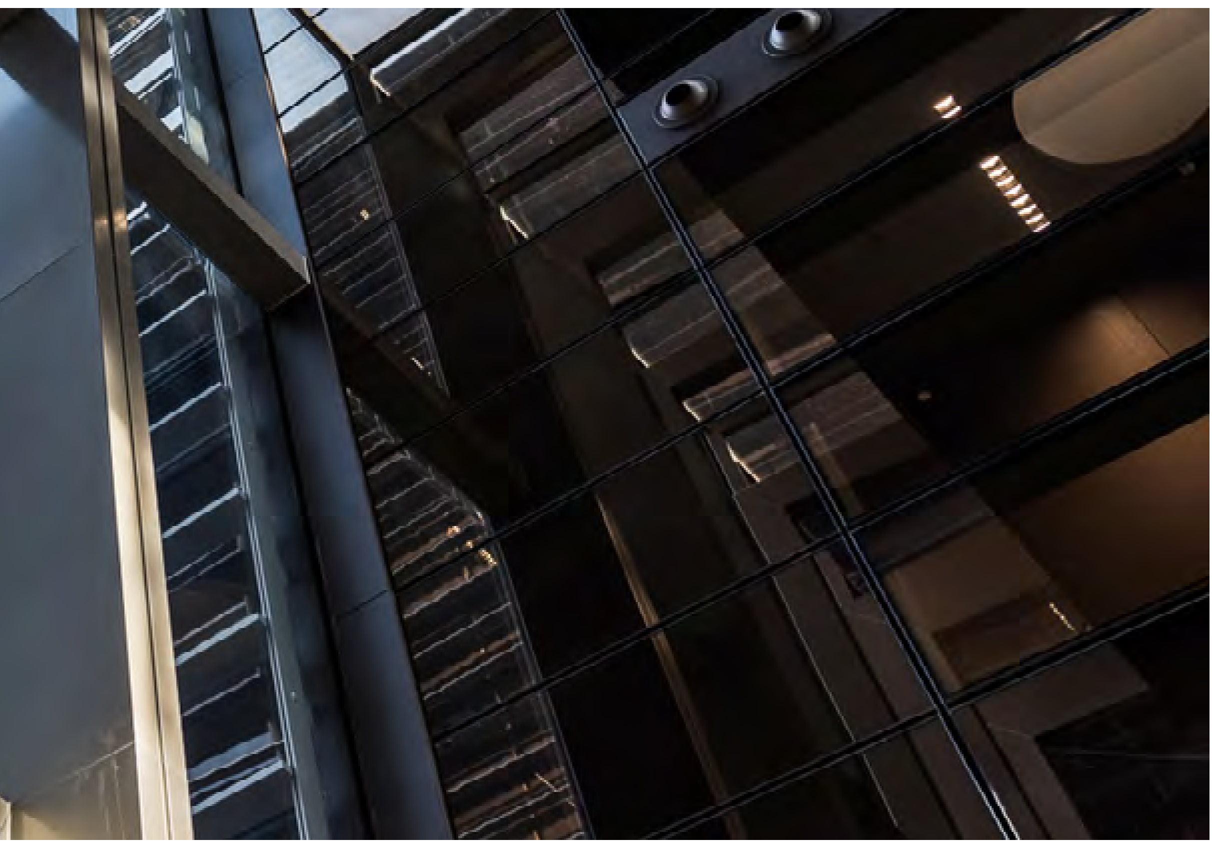
The same security review also applies to investors from Hong Kong, Taiwan, and Macau if any investment affects or may affect national security.

4.3. Due diligence

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

A legal due diligence reviews:

- target company's legal status, including establishment documents, approvals/record filing receipts of any increases in registered capital and transfers of shares/equity interest;
- capital verification of all contributions to the registered capital;
- claims by other parties to the target company's assets;
- legal rights to land and buildings;
- loans and securities;
- contracts;
- related-party transactions;
- environmental survey of the land and operation;
- tax status, including any preferential benefits;
- labour issues that could hinder the transaction;
- business assets;
- insurance;
- subsidies (tax exclusive);
- status of intellectual property rights (e.g., trademarks, patents, know-how, copyrights, software, trade names, domain names, and licenses); and
- identity and contractual status of key employees, whose continued participation in the business would be strategically important.



5

IP protection

Chinese law protects a wide range of IP rights, including patents, trademarks and copyright. With the exception of well-known trademarks, which are granted limited protection, Chinese law only protects patents and trademarks that are registered with the relevant authorities. Additionally, although copyright is protected immediately after the work is created, registration is still advisable for proof purposes.

5.1. Administrative protection

Protection regime for IP rights

The PRC Patent Law, Trademark Law, and Copyright Law establish the administrative protection regime for IP rights.

The main authorities concerned are the China National Intellectual Property Administration ("CNIPA"), SAMR, and the National Copyright Administration ("NCA").

Granting IP rights

Patent and trademark rights are granted through registration. As mentioned above, the only exceptions are well-known trademarks, which can only be recognised by the Trademark Office of CNIPA or the courts, after a trademark dispute and at the trademark owner's request.

A trademark applicant must file a Chinese language application with the Trademark Office, which usually gives a preliminary decision within 9 months of receiving all supporting documents. If no objection is raised within 3 months of the preliminary decision, the Trademark Office will approve the trademark registration application and grant a certificate of trademark registration. The trademark is protected for 10 years from the date of registration.

A patent application must be filed with CNIPA, which usually publishes the application 18 months after the filing date. Invention patents are protected for 20 years from the filing date, utility model patents are protected for 10 years from the filing date, and design patents are protected for 15 years from the filing date following the effectiveness of the amended Patent Law on June 1, 2021.

Passive protection after the right is granted

Anyone may report a suspected infringement of an IP right to the administrative authority, provided there is preliminary proof of the infringement. The IP right owner (or any licensed user) can directly request the administrative authority to investigate the case and penalise the infringing party, without needing to provide further evidence.

The relevant authority is the one located at the place where the infringement is committed (the place of action or the place of result), or 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. CNIPA, SAMR and NCA handle patents, trademarks and copyright infringement disputes, respectively. They may (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 confiscate and destroy the infringing goods or reproductions, and (v) impose a fine.

5.2. Judicial protection

Civil protection for IP infringement

Civil action

Anyone exercising an IP right without being authorised or licensed by the IP right owner may be sued in 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.

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

- For patent infringement, compensation is calculated on the actual loss caused by the infringement or benefits obtained by the infringer, or, if both are difficult to determine, the compensation may be reasonably determined in multiple(s) of the royalties for a license for that patent.
- For trademark infringement, compensation is calculated based on the actual losses suffered by the IP right owner, or the benefits gained by the infringer if determining the actual losses is difficult. When determining both the losses and the infringer's benefits is difficult, compensation may be reasonably determined in multiple(s) of the royalties for a license for that trademark.
- For copyright infringement, compensation is calculated based on the actual losses suffered by the IP right owner or the illegal income earned by the infringer. If it is difficult to compute the actual losses suffered by the IP right owner and the illegal income obtained by the infringer, the compensation may be calculated by referring to the royalties for those rights.

The court may also apply punitive damages in the case of trademark infringement, while after the revised Patent Law and Copyright Law take effect on June 1, 2021, punitive damages will also be applicable to patent and copyright infringements.

If an IP-related contract is breached, a lawsuit can be filed against the breaching party either in the civil court agreed by the parties, which could be the court in the place where the defendant resides, where the contract is performed, where the contract is signed, where the plaintiff resides, where the subject matter is located, or, if there is no agreement between the parties, the court of the place where the defendant resides. Compensation for damages should be the amount of all losses caused by the contractual breach.

The statute of limitations on civil action is three years from the date on which 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 infringing IP rights:

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

Under these circumstances, criminal proceedings can be initiated in the court located at the place where the crime was committed (either the place of the crime's action or the place of the crime's result), or at the place where the defendant resides.

Criminal penalties imposed on the infringer include (i) imprisonment, (ii) criminal detention, (iii) public surveillance, and (iv) fine (which may be imposed separately or with the other penalties).

5.3. Customs protection

Customs protection for potential IP infringement

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

Record filing at the General Administration of Customs

Foreign IP-rights holders can submit record filing applications to the General Administration of Customs ("GAC") with all relevant evidential documents. On receipt of the application, GAC decides within 30 working days whether to grant the record filing. The record filing will be effective from the date on which the decision is made and is valid for 10 years. The IP rights holder can apply to GAC for an extension of the record filing within six months before it expires. Each extension is valid for 10 years.

Protection of recorded IP rights

When local Customs suspects import or export goods of infringing a recorded IP right, it immediately notifies the IP rights holder, which can (i) submit an application to Customs to take protective measures, and (ii) provide a bond equivalent to the value of the goods within three working days from the date on which the Customs' notification is served. If these requirements are met, Customs will detain the (allegedly) infringed goods.

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 rights holder immediately, so the IP rights holder can apply to the court for interim measures ordering the infringing act to stop or granting property preservation.

Protection of non-record filing IP rights

For an IP right not recorded with GAC, the IP rights holder must submit an application with all the required evidential documents to request 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 on which the goods are detained, the IP rights holder must apply to the court for interim measures ordering the infringing act to stop or granting property preservation; otherwise, Customs will release the detained goods. Customs will help enforce the court order after receiving the notification.

6 Tax

Unified EIT treatment for domestic and foreign enterprises

6.1. Tax Resident enterprise

The Enterprise Income Tax ("EIT") Law, which came into effect on January 1, 2008, ended the different tax systems between domestic enterprises and FIEs and introduced a new tax residence concept.

A tax resident enterprise ("TRE") is an enterprise that is legally established in China or is established under the laws of a foreign country, but whose effective management is in China.

A non-TRE is an enterprise established under the laws of a foreign country whose effective management is not located in China, but it has an establishment or place of business in China; or an enterprise that has no establishment or place of business in China, but earns Chinese-sourced income.

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

6.2. Enterprise income taxation

Tax rate

The standard tax rate is 25%. The EIT rate is reduced to 20% for small and low- profit enterprises that meet regulatory requirements (until December 31, 2022, the effective tax rate is lowered to 2.5% for the part of annual taxable income up to RMB 1 million, and to 10% for the part of taxable income from RMB 1 million to RMB 3 million), to 15% (i) for state-encouraged high and new technology enterprises; (ii) for certified technologically advanced service enterprises nationwide; (iii) until December 31, 2030, for enterprises engaged in encouraged industries in the western regions of China; and (iv) before 2025, for companies registered and effectively operating in the Hainan Free Trade Port ("Hainan FTP") and engaging in the encouraged industries; afterwards, before 2035, for all companies registered and effectively operating in the Hainan FTP, except for those engaging in the negative list industries, and to 10% (i) for stage-encouraged key software enterprises, and (ii) stage-encouraged key integrated circuit design enterprises.

Taxable income

An enterprise's taxable income in a tax year is the amount remaining from its gross income after adjusting non-taxable income, tax-exempt income, deductible expenses, and tax losses carry forward.

Tax losses an enterprise incurs in a tax year can be offset against the taxable income it generates in the next five years. The period to carry forward tax losses are extended from five years to ten years for (i) certified high and new technology enterprises, (ii) certified technological small and medium-sized enterprises, and (iii) state-encouraged integrated circuit manufacturing enterprises with an integrated circuit line width not exceeding 130 nanometres.

Tax year

The tax year starts on January 1 and ends on December 31. If in a tax year an enterprise operates for less than 12 months, based on when it starts and 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 treasury bonds and local government bonds
- Dividends distributed between qualifying resident enterprises; i.e., dividends obtained by a resident enterprise from its directly invested resident enterprise, except for those obtained from holding the shares of a listed resident enterprise for less than 12 consecutive months
- Dividends a TRE distributes to a non-TRE that has an establishment or place of business in China and which are effectively connected to this establishment or place of business
- Dividends obtained by TREs from holding H shares for at least 12 consecutive months through Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect
- Qualifying income received by non-profit organizations, excluding income obtained by non-profit organizations through conducting operational activities
- Income obtained by investors from securities investment funds' distribution

Income from qualifying business activities in agriculture, forestry, animal husbandry and fishery projects benefit from a 100% or 50% EIT exemption.

Income from qualifying business activities in agriculture, forestry, animal husbandry and fishery projects benefit from a 100% or 50% EIT exemption.

Income from investments and business activities in state-encouraged public infrastructure projects, qualifying environmental protection projects, and qualifying water and energy saving projects is 100% EIT exempt for the first three years, and 50% EIT exempt from the fourth to sixth years, starting from the first year to which manufacturing or business operational revenue from the project is attributable.

Income from state-encouraged integrated circuit manufacturing enterprises or projects with an integrated circuit line width that does not exceed 28 nanometres and an operational period of more than 15 years is 100% EIT exempt for the first 10 years; income from state-encouraged integrated circuit manufacturing enterprises or projects with an integrated circuit line width that does not exceed 65 nanometres and an operational period of more than 15 years is 100% EIT exempt for the first five years, and 50% EIT exempt from the sixth to tenth years; income from state-encouraged integrated circuit manufacturing enterprises or projects with an integrated circuit line width that does not exceed 130 nanometres and an operational period of more than 10 years is 100% EIT exempt for the first two years, and 50% EIT exempt from the third to fifth years, starting from the first year to which manufacturing or business operational revenue from the project is attributable.

Income from state-encouraged integrated circuit design, equipment, materials, packaging, testing enterprises, and state-encouraged software enterprises is 100% EIT exempt for the first two years, and 50% EIT exempt from the third to fifth years, starting from the first year to which the profit from the project is attributable.

Income from state-encouraged key integrated circuit design enterprises and state-encouraged key software enterprises is 100% EIT exempt for the first five years, starting from the first year to which the profit from the project is attributable.

Income from qualifying transfers of technology by a resident enterprise in a tax year is EIT exempt for an amount not exceeding RMB 5 million and has a 50% EIT exemption on the excess amount. Transfer of technology refers to resident enterprises transferring the ownership or the right to use their qualified technology for at least five years.

Qualifying R&D expenses related to activities developing new technology, new products and new processes are entitled to an additional 50% deduction. If the R&D expenses are capitalised, the tax base for amortization of the resulting intangible asset is 150% of their cost. Until December 31, 2023, this percentage increases to 75% (or 175% for the amortization of intangible assets) for all companies. From January 1, 2021, this percentage increases to 100% (or 200% for the amortization of intangible assets) for all manufacturing enterprises.

For manufacturing enterprises, from January 1, 2019, they can shorten the tax depreciation period or adopt tax accelerated depreciation methods (i.e., double declining balance method or the sum of the years' digits method) for newly purchased fixed assets.

Until December 31, 2023, if any enterprise purchases instruments or equipment, and if the unit value does not exceed RMB 5 million, the enterprise can choose to deduct the total acquisition cost as an expense of the year; if the unit value is more than RMB 5 million, the enterprise can shorten the tax depreciation period or adopt tax accelerated depreciation methods for these instruments and equipment.

If a venture capital company invests in a Chinese unlisted high and new technology company of small or medium-size or a Chinese technology company at the seed or start-up stage for at least two years and meets the qualifying conditions, 70% of the total investment can be credited against its taxable income earned in the second tax year of investment, and this credit can be carried forward to subsequent tax years.

If an enterprise uses the resources specified under the EIT law as its main raw materials for manufacturing qualifying products, a 10% deduction can be applied to the income from these products before it is included in the total taxable income.

If special equipment is purchased for environmental protection, for saving energy and water, and for work safety in production, 10% of these investments can be deducted from the tax payable and can be carried forward for five years.

Tax collection

TREs file tax in the place where the enterprise is registered or the place of the enterprise's effective management, and consolidate the EIT with their branches.

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

EIT prepayments are filed monthly or quarterly, and are verified by the tax authorities. Annual EIT filing is due by the end of May of the following tax year.

6.3. Individual income taxation

Individuals who are domiciled in China (i.e., habitually residing in China due to household registration (hukou), or family or economic ties) or who are not domiciled in China but reside in China for 183 cumulative days or more in a tax year are considered tax residents in China.

Individuals who are not domiciled in China, and who do not reside in China or reside in China for fewer than 183 days in a tax year are considered non-tax residents in China.

For counting the cumulative days of residence in China of non-domiciled individuals (that is, expatriates), only the presence of full 24 hours for the day is considered.

Generally, Chinese tax residents are subject to individual income tax ("IIT") in China on their worldwide income, and non-residents are only subject to IIT in China on their China-sourced income. For this purpose, remuneration paid for work performed in China is Chinese-sourced income, regardless of whether the employer or the payer of the income is based in China.

However, there are two exceptions:

- Expatriates who resides in China for up to 90 cumulative days (or 183 days if a tax treaty is applicable) are entitled to the IIT exemption on their income from employment activities in China, provided this income is not paid or borne by a Chinese employer (including the domestic establishment or business place of a foreign employer). As the remuneration paid to foreign representatives of ROs is generally paid or borne by the RO, representatives are subject to IIT from the first day of their stay in China.
- Expatriates who are (i) tax residents in China for under six consecutive years, or (ii) tax residents in China for six consecutive years, but have a single absence of over 30 days outside China in a tax year during this six year period, after filing with the tax authorities, can be exempt from IIT on the portion of foreign employment income received for work they perform outside China and on other non-employment income sourced overseas (e.g., interest, dividend, royalty, capital gain and rental income that are not Chinese-sourced) and paid and borne by a foreign payer ("Six-year Rule").

It is advisable for expatriates to leave China for over 30 consecutive days in a tax year before completing their sixth year of tax residence in China, as this interrupts the six-year period, and they will be eligible for the IIT exemption while maintaining their tax resident status.

The Six-year Rule became effective on January 1, 2019. Therefore, the time spent in China before January 1, 2019, will not be considered when counting the six-year period. Consequently, for the 2019 – 2024 tax years, all expatriates who are non-China-domiciled tax residents can benefit from the IIT exemption granted by the Six-year Rule.

Categories of personal income

Tax calculation

The IIT rate depends on the type of income. The new IIT Law, fully effective January 1, 2019, divides personal income into the following categories:

- Salary and wages, including basic salary, pay increases, bonuses, incentive plans, cash allowances, severance pay, and any other income related to employment
- Service income
- Author's remuneration
- Royalties
- Operational income
- Interest and dividends
- Property rental income
- Property transfer income
- Incidental income

Tax rates for resident taxpayers' annual Comprehensive Income

Bracket	Annual taxable income (RMB)	Tax rate (%)	Quick deduction
1	Up to 36,000	3	0
2	Over 36,000 up to 144,000	10	2,520
3	Over 144,000 up to 300,000	20	16,920
4	Over 300,000 up to 420,000	25	31,920
5	Over 420,000 up to 660,000	30	52,920
6	Over 660,000 up to 960,000	35	85,920
7	Over 960,000	45	181,920

For resident taxpayers, the income in the first four categories received in a tax year (collectively, "Comprehensive Income") is consolidated to calculate the IIT for a tax year, applied with a progressive scale of tax rates ranging from 3% to 45%, as shown in the below table. For nonresident taxpayers, the income in these four categories is calculated separately for the IIT on a monthly basis or every time a payment is made, with the converted monthly progressive scale of tax rates for Comprehensive Income.

For both resident and nonresident taxpayers, the income in the remaining five categories is calculated separately for the IIT. Operational income is applied with a progressive scale of tax rates ranging from 5% to 35%; other income categories are taxed at 20%.

For resident taxpayers, Comprehensive Income can subtract the following items to determine the taxable amount:

- Statutory deduction of RMB 60,000
- Special deductions (i.e., taxpayers' contributions to the basic social security and housing fund)
- Special additional deductions within the deductible limits (including children's education, continued education, medical treatment for serious illness, interest on mortgage for first property, housing rental, and support for the elderly)
- Other qualified deductions under the law (including payments for qualified enterprise annuities and occupational annuities, expenditures for purchasing qualified commercial health insurance and tax-deferred commercial pension, and other items specified by the State Council).
- Qualified donations to public welfare and charity.

Only resident taxpayers can apply these special deductions, special additional deductions and other qualified deductions. For nonresident taxpayers, the monthly salary income can subtract the statutory monthly deduction of RMB 5,000 to be applied with the converted monthly progressive tax rates. From January 1, 2019, to December 31, 2021, expatriate tax residents in China can choose to claim the above special additional deductions, or they can continue applying the tax-exempt benefits accessible to all expatriates (i.e., allowances for housing, meals, laundry, relocation, business travel, home leave, language training, and children education in China). Once the choice is made, it cannot be changed in a tax year. From January 1, 2022, expatriates will no longer benefit from the tax-exempt allowances; instead, they must claim special additional deductions accordingly, the same as Chinese nationals.

Before December 31, 2021, resident taxpayers can (i) choose to separate the annual bonus from Comprehensive Income and calculate IIT independently by applying the current preferential tax treatment (i.e., the annual bonus is divided by 12 for the applicable tax rate in the converted monthly progressive tax rates applicable to Comprehensive Income); or (ii) add the annual bonus to the Comprehensive Income to calculate IIT. From January 1, 2022, all resident taxpayers' annual bonus must be consolidated into Comprehensive Income to calculate IIT.

For expatriates working in the Guangdong-Hong Kong-Macau Greater Bay Area who are qualified as top or urgently needed talents, the subsidies granted to them, based on the difference in the IIT burden between the mainland and Hong Kong, are tax exempt (it means the effective tax burden is 15%).

From January 1, 2020, to December 31, 2024, for the top-level or urgently needed talents working in the Hainan FTP, IIT burden over 15% for Comprehensive Income, operational income and subsidies recognized by the Hainan Province is tax exempt. Afterwards, before 2035, for individuals staying in the Hainan FTP for 183 cumulative days or more in a tax year, the Comprehensive Income and operational income arising from the Hainan FTP will be applied with three-tier progressive tax rates of 3%, 10% and 15%.

Tax collection

Individuals who earn incomes are taxpayers, and individuals or entities who pays the incomes are withholding agents. Employers are obliged to withhold IIT from salary incomes and pay it to the tax authorities on a monthly basis. Different withholding methods are applicable depending on the tax residency status of the employees in China:

- **Resident taxpayers: monthly accumulative withholding method**

  IIT to be withheld for the current month = (accumulated taxable income x withholding tax rate – quick deduction) – accumulated tax deduction and exemption amount – accumulated withheld tax in the previous periods

  Accumulated taxable income = accumulated income – accumulated tax-exempt income – accumulated statutory deduction – accumulated special deductions – accumulated special additional deductions – accumulated other qualified deductions

- **Non-resident taxpayers: monthly withholding method**

  IIT to be withheld for the current month = monthly taxable income from employment x withholding tax rate – quick deduction

  Taxable income = salary income – statutory monthly deduction of RMB 5,000

Withholding agents must declare and pay the withheld IIT to the tax authorities within 15 days in the month following the IIT withholding.

Resident taxpayers are obliged to make an annual self-declaration for their Comprehensive Income with the tax authorities in the following year from March 1 to June 30, if:

- they obtain Comprehensive Income from more than one source, and the annual amount after subtracting the special deductions exceeds RMB 60,000;
- they obtain Comprehensive Income consisting of one or more items of service income, author's remuneration and royalties, and the annual amount after subtracting the special deductions exceeds RMB 60,000;
- the withheld and prepaid tax amount during the year is lower than the tax payable amount in a tax year; or
- they need a tax refund.

If a taxpayer only has one source of salary income, and all the taxes have been duly withheld and prepaid during the year, there is no need for a further annual self-declaration.

For Comprehensive Income received in 2019 and 2020 tax years, resident taxpayers are exempt from submitting an annual self-declaration if:

- their annual Comprehensive Income is no more than RMB 120,000 (unless there is a tax refund to claim); or
- the additional tax to be paid through the annual self-declaration is no more than RMB 400, provided the tax withheld and prepaid during the tax year is done according to the law.

6.4. Value-added tax

VAT regime in China

In the past, business tax ("BT") in China applied to the supply of services, and VAT applied to delivery of goods and processing, repair and replacement services. On January 1, 2012, the city of Shanghai ran a trial subjecting certain services to VAT instead of BT. This was an important step towards modernizing China's tax system, bringing it closer to international best practices. It aimed to promote the Chinese service industry by shifting the country away from being a manufacturing-dependent economy.

Following Shanghai, the VAT reform was implemented in eight other provinces and cities: Beijing, Jiangsu, Anhui, Fujian, Guangdong, Tianjin, Zhejiang, and Hubei. Starting August 1, 2013, it was extended throughout China.

Before May 1, 2016, taxable services under the scope of this reform were transportation, postal and telecommunication services, and the so-called modern services, including R&D and technical services, information technology services, cultural creative services, logistics support services, leasing of corporeal movables, radio, film and television services, and attestation and consulting services.

From May 1, 2016, the VAT reform has been fully implemented in China and expanded to all industries, including real estate, construction, finance and consumer services, marking the start of a new era in China's taxation system, and the end of BT.

Three-tier VAT rates

From April 1, 2019, the following VAT rates are applicable:

- 13% on the sale and import of goods (except agricultural products), the provision of processing, repair and replacement services and leasing of corporeal movables;
- 9% on the sale and import of agriculture products, the provision of transportation, postal and basic telecommunication services, construction services, leasing and sale of immovable property, and transfer of land use right; and
- 6% on the provision of value-added telecommunication, financial and consumer services, modern services other than leasing services, and transfer of intangible assets other than land use right.

Taxpayers with annual sales revenue from taxable activities exceeding RMB 5 million are considered VAT general taxpayers. Others qualify as VAT small-scale taxpayers, to which the applicable VAT rate is 3%. Small-scale taxpayers cannot deduct the input VAT they pay on acquiring goods and services for their business activities.

If entities and individuals in the Chinese territory provide qualifying crossborder taxable services, VAT exemption can apply, provided the taxpayers meet the filing requirements. Input VAT on goods and services acquired for the provision of VAT-exempt services cannot be offset against output VAT. However, some qualifying crossborder taxable services can also benefit from the zero-rated VAT regime, meaning input VAT on goods and services acquired for the provision of VAT zero-rated services can either be offset against output VAT or refunded.

From January 1, 2018, asset management services are subject to 3% VAT rate and are governed by the simplified VAT method, meaning no deduction of input VAT related to the provision of these services.

To reduce the tax burden of small enterprises, from April 1, 2021, to December 31, 2022, small-scale VAT taxpayers with a monthly revenue of up to RMB 150,000 can benefit from VAT exemption.

Also, from February 1, 2019, to December 31, 2023, free lending of funds among entities within the same group is exempt from VAT.

From April 1, 2019, a VAT refund mechanism for domestic transactions was introduced, and taxpayers can claim a refund of non-deducted input VAT credits, provided they:

- have VAT credits above zero for six consecutive months (or for two consecutive quarters, if they declare VAT on a quarterly basis), and the incremental VAT credits in the sixth-month period is at least RMB 500,000;
- have an A or B tax credit rating;
- they did not commit VAT fraud in the 36 months before the application;
- they were not penalized twice or more times for tax evasion in the 36 months before the application; and
- they have not benefitted from other VAT collection and refund policies since April 1, 2019.

Since June 1, 2019, taxpayers in certain advanced manufacturing industries (i.e., non-metallic mineral products, general equipment, special equipment, computers, communication devices, and other electronic equipment) can benefit from the VAT refund policy without reaching the RMB 500,000 threshold. Since April 1, 2021, the scope of advanced manufacturing industries has been expended to pharmaceutical, chemical fiber, railway, ships, aerospace and other transportation equipment, electrical machinery and equipment, and instruments, and the incremental VAT credit should be above zero compared with the VAT credit on March 31, 2019.

Also, from April 1, 2019, to December 31, 2021, taxpayers in manufacturing and consumer service industries can deduct an additional 10% of input VAT (i.e., introducing a VAT super-deduction mechanism). This additional deduction ratio was increased to 15% for consumer service industries, effective from October 1, 2019.

6.5. General foreign investor taxation

Non-TREs are subject to tax on income obtained through a permanent establishment ("PE") in China and on Chinese-sourced income earned not in connection with a PE.

Taxation on non-TRE's business profits from China

Taxation on business profits

Non-TREs' business profits earned from business activities carried out in China are subject to EIT. However, under tax treaties, business profits are only taxed when the non-TRE operates through a PE in China.

PEs in China are subject to tax on the income attributable to the PE (on the income connected with the PE). In principle, PEs must keep accounting records of their activities based on the profits and losses attributable to them according to the functions and risks they assume.

However, in practice, it is usually not feasible for PEs to have a reliable and complete accounting system, so under Chinese regulations, they can be taxed on a deemed profit basis, applying one of the following methods:

- Deemed profit based on revenue
- Deemed profit based on costs and expenses
- Deemed profit based on expenditure

The tax authorities can refer to the following standard deemed profit rates:

- Contract engineering, design and consultancy services: 15% to 30%
- Management services: 30% to 50%
- Other services or business activities: at least 15%

However, the tax authorities may adopt higher deemed profit rates, if they consider the actual profit rate of a transaction is higher than the above standard.

Capital gains of non-TREs are taxed in China unless exempt by tax treaties

Taxation on capital gains

Under the EIT Law, capital gains that non-TREs obtain are taxed at 10%.

Under some tax treaties (e.g., the tax treaty with Portugal), capital gains on alienation of shares are exempt from EIT in China.

Under many tax treaties, capital gains on an alienation of shares in a Chinese company are exempt from EIT in China, provided the transferor, at any time during the 365 days preceding the alienation, held directly or indirectly less than 25% of that company's capital. However, the exemption would not apply if that company's primary value derives directly or indirectly from real estate in China.

Taxation on dividends

Domestic rates: under the EIT Law, dividends a Chinese company pays to a non-TRE are subject to 10% withholding tax.

From January 1, 2017, if non-TREs use the distributed dividends to reinvest in qualified encouraged projects directly (on September 29, 2018, this requirement was extended to all non-prohibited projects for foreign investment) and meet certain conditions, the withholding tax will not have to be paid when the dividend is distributed by the Chinese company. In other words, withholding tax can be deferred to a later stage.

Tax treaty rates: tax treaties may grant lower rates than the domestic withholding tax rate. The application of tax treaties is subject to (i) filing the tax treaty treatment with the competent tax authorities; and (ii) keeping the required documents available for the tax authorities' future review, including a tax resident certificate issued for the tax year obtaining the income or for the previous year, and the evidence proving that the recipient is qualified as the beneficial owner of the income.

Taxation on interest and royalties

Domestic rates: under the EIT Law, interest and royalties a Chinese company pays to a non-TRE are subject to 10% withholding tax.

Certain service fees related to the licensing of intangibles may be considered royalties instead of business income, unless the service activities constitute a PE in China.

Tax treaty rates: tax treaties may grant lower rates than the domestic withholding tax rate. Applying tax treaties is subject to (i) filing for tax treaty treatment with the competent tax authorities, and (ii) keeping the required documents available for the tax authorities' future review, including a tax resident certificate issued for the tax year obtaining the income or for the previous year, and the evidence proving that the recipient is qualified as the beneficial owner of the income.

The interpretation of beneficial ownership for dividends, interest and royalties was further explained in the State Taxation Administration ("STA") Announcement [2018] No. 9. [1] Although the commercial substance-focused approach remains applicable, STA has (i) clarified the substance requirements by using detailed examples; and (ii) expanded the "safe harbour" scope.

On June 7, 2017, China signed the Multilateral Convention to Implement Tax Treaty related Measures to Prevent Base Erosion and Profit Shifting ("MLI"). The MLI covers all tax treaties signed by China, except for those entered into with Chile, India, Hong Kong, Macau and Taiwan[2].

1 The STA Announcement [2018] No. 9 was released on February 3, 2018, and took effect on April 1, 2018.

2 The existing China-Spain Tax Treaty is not covered by MLI, because Spain has not included this tax treaty in its notification. However, China and Spain recently signed a new tax treaty on November 28, 2018 to replace the existing one, updating the articles through this bilateral agreement.

Treaty rates	Dividends		Interest[1]	Royalties
	Individuals and companies	Qualifying companies		
Albania	10	10	10	10
Algeria	10	5 [2]	7	10
Armenia	10	5 [2]	10	10
Australia	15	15	10	10
Austria	10	7 [2]	10	10
Azerbaijan	10	10	10	10
Bahrain	10	10	10	10
Bangladesh	10	10	10	10
Barbados	10	5	10	10
Belarus	10	10	10	10
Belgium	10	5 [2]	10	7
Bosnia and Herzegovina[3]	5	5	10	10
Botswana[17]	5	5	7.5	5
Brazil	15	15	15	15/25 [4]
Brunei	5	5	10	10
Bulgaria	10	10	10	7 [5]/10
Cambodia	10	10	10	10
Canada	15	10 [6]	10	10
Chile	10	10	4 [9]/10	2 [13]/10
Croatia	5	5	10	10
Cuba	10	5 [2]	7.5	5
Cyprus	10	10	10	10
Czech Republic	10	5 [2]	7.5	10
Denmark	10	5 [2]	10	10 [7]
Ecuador	5	5	10	10
Egypt	8	8	10	8
Estonia	10	5[2]	10	10
Federal Democratic Republic of Ethiopia	5	5	7	5
Finland	10	5[2]	10	10 [7]
France	10	5[2]	10	10 [8]
Georgia	10	0/5 [15]	10	5
Germany	10/15 [14]	5 [2]	10	10 [8]
Greece	10	5 [2]	10	10
Hong Kong	10	5 [2]	7	7
Hungary	10	10	10	10
Iceland	10	5[2]	10	

Treaty rates	Dividends		Interest[1]	Royalties
	Individuals and companies	Qualifying companies		
India	10	10	10	10
Indonesia	10	10	10	10
Iran	10	10	10	10
Ireland	10	5[2]	10	10[8]
Israel	10	10	7[9]/10	10[7]
Italy	10	10	10	10[7]
Jamaica	5	5	7.5	10
Japan	10	10	10	10
Kazakhstan	10	10	10	10
Korea (Rep.)	10	5[2]	10	10
Kuwait	5	5	5	10
Kyrgyzstan	10	10	10	10
Laos	5	5	10	10
Latvia	10	5[2]	10	7
Lithuania	10	5[2]	10	10
Luxembourg	10	5[2]	10	10[8]
Macau	10	10	7[9]	5/7
North Macedonia	5	5	10	10
Malaysia	10	10	10	10/15[10]
Malta	10	5[2]	10	10[7]
Mauritius	5	5	10	10
Mexico	5	5	10	10
Moldova	10	5[2]	10	10
Mongolia	5	5	10	10
Morocco	10	10	10	10
Nepal	10	10	10	15
Netherlands	10	5[2]	10	10[8]
New Zealand	15	5	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[6]	10	10/15[10]
Poland	10	10	10	10[7]
Portugal	10	10	10	10
Qatar	10	10	10	10

Treaty rates	Dividends		Interest[1]	Royalties
	Individuals and companies	Qualifying companies		
Romania	3	3	3	3
Russia	10	5 [16]	5	6
Saudi Arabia	5	5	10	10
Serbia and Montenegro3	5	5	10	10
Seychelles	5	5	10	10
Singapore	10	5 [2]	7 [9]/10	10
Slovak Republic	10	10	10	10
Slovenia	5	5	10	10
South Africa	5	5	10	10 [7]
Spain	10	5 [2]	10	10
Sri Lanka	10	10	10	10
Sudan	5	5	10	10
Sweden	10	5	10	10 [7]
Switzerland	10	5 [2]	10	9
Syria	10	5 [2]	10	10
Tajikistan	10	5 [2]	8	8
Thailand	20	15 [2]	0 [11]/10	15
Trinidad and Tobago	10	5[2]	10	10
Tunisia	8	8	10	5 [12]/10
Turkmenistan	10	5 [2]	10	10
Turkey	10	10	10	10
Uganda[17]	7.5	7.5	10	10
Ukraine	10	5 [2]	10	10
United Arab Emirates	7	7	7	10
United Kingdom	10/15 [14]	5[2]	10	10 [8]
United States	10	10	10	10 [7]
Uzbekistan	10	10	10	10
Venezuela	10	5 [6]	5 [9]/10	10
Vietnam	10	10	10	10
Zambia	5	5	10	5
Zimbabwe	7.5	2.5	7.5	7.5

Note:

1. Some tax treaties provide an exemption for certain types of interest, including interest paid to public institutions, banks and other financial institutions.

2. The qualifying participation percentage (or voting rights) is generally 25%.

3. Treaty signed with the former Yugoslavia is applicable to Bosnia and Herzegovina.

4. The higher rate applies to trademark royalties.

5. The lower rate applies to royalties relating to industrial, commercial and scientific equipment.

6. The rate generally applies to participations (or voting rights) of at least 10%.

7. Royalties from the use of or the right to use industrial, commercial and scientific equipment benefit from a 30% withholding tax reduction.

8. Royalties from the use of or the right to use industrial, commercial and scientific equipment benefit from a 40% withholding tax reduction.

9. The lower rate applies to payments to a bank, in the case of Venezuela; a bank, insurance company or financial institution in the case of Chile; and a bank or financial institution in all other cases.

10. 10% for payments from patents, trademarks, designs or models, plans, secret formulas or processes (or know-how or copyright of any scientific work under the treaty with Malaysia), or for the use of, or the right to use, industrial, commercial and scientific equipment and information (under the treaty with the Philippines, the Philippine authorities must approve contracts giving rise to royalties from the Philippines); 15% for copyright of literary or artistic work (or scientific work under the treaty with the Philippines), including cinematographic films, and tapes for radio or television broadcasting.

11. Tax rate applicable to interest paid to the government of the other contracting state.

12. 5% for royalties from technical and economic studies and for technical assistance.

    10% for royalties from copyright of literary, artistic or scientific work, including cinematographic films, and films and tapes for radio and television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial and scientific experience.

13. 2% withholding tax rate on royalties from the use of or the right to use industrial, commercial and scientific equipment.

14. 15% of the gross amount of dividends paid out of income or gains earned directly or indirectly from immovable property under article 6 of the tax treaties through an investment vehicle that distributes most of this income or gains annually, and whose income or gains from this immovable property is exempt from tax.

15. 0% of the gross amounts of dividends if the beneficial owner is a company holding directly or indirectly at least 50% of the capital of the company paying the dividends and has invested more than €2 million in the capital of the company paying the dividends.

    5% of the gross amounts of the dividends if the beneficial owner is a company holding directly or indirectly at least 10% of the capital of the company paying the dividends and has invested more than €100,000 in the capital of the company paying the dividends.

16. 5% of the gross amounts of the dividends if the beneficial owner is a company (other than a partnership) holding directly at least 25% of the capital of the company paying the dividends and the holding is at least €80,000 or its equivalent in another currency.

Tax treatments for M&A transactions

6.6. 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 recognises the gain or loss on the transfer of the shares/assets under shares/assets acquisition. The transferee books the shares/assets purchased based on their fair value.

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

Under the special tax treatment, there are requirements relating to both the acquisition percentage and the percentage of equity payment. Effective January 1, 2014, the purchase percentage of both shares/assets acquisition must be at least 50% (previously 75%) of the target company's total shares/assets, and the percentage of equity payment must be at least 85% of the total consideration.

Other requirements to qualify for the special tax treatment include:

- reasonable commercial purpose for acquiring the shares/assets;
- no material change in operational activities within 12 consecutive months after the transaction; and
- any equity payment received by original shareholder cannot be transferred within 12 consecutive months after the transaction.

The requirements for applying the special tax treatment to crossborder M&A are stricter, mainly relating to the holding percentage and the lock-up period for transferring the shares/assets acquired.

Companies that apply for the special tax treatment must file the transaction with the competent tax authority, attaching documents such as the shares/assets transfer agreement and the evaluation report on the shares/assets.

Legal framework of transfer pricing in China

6.7. Transfer pricing

The EIT law and its implementing regulations provide a framework for transfer pricing rules in China. The former main transfer pricing regulation, Guoshuifa [2009] No. 2 on Provisional Administrative Measures on Special Tax Adjustment ("Circular 2"), gave more detailed guidance on the administration of related-party transaction reporting, transfer pricing documentation, advanced pricing arrangement ("APA"), cost sharing agreement ("CSA"), controlled foreign enterprises, thin capitalization, and general anti-avoidance rules.

As a result of China's involvement in the G20 and OECD's Base Erosion and Profit Shifting ("BEPS") Action Plan, over the past couple of years, SAT has been working on amending Circular 2.

A first draft regulation was released for public opinion in September 2015. However, instead of the draft regulation addressing all necessary amendments in one regulation, STA decided to issue separate announcements focusing on issues that were needed to be implemented urgently to comply with China's international commitment.

Since then, STA has issued Announcement [2016] No. 42, on improving related-party transaction reporting and administration of transfer pricing documentation ("Circular 42"), Announcement [2016] No. 64 on improving the administration of APA ("Circular 64"), and Announcement [2017] No. 6 on improving the administration of special tax adjustment investigation and mutual agreement procedures ("Circular 6"). With the release of these announcements, amendments to Circular 2 are now almost complete.

Transfer pricing rules in China are based on the arm's length principle, achieved by applying the methods OECD applies in its Transfer Pricing Guidelines. Accepted transfer-pricing methods previously provided under Circular 2 include the comparable uncontrolled price method, the resale price method, the cost-plus method, the transactional net margin method, and the profit split method. Circular 6 also adds three new methods: cost method, market method and income method. Each method must be applied to the transaction according to the outcome of the comparability analysis.

Under these regulations, some taxpayers must prepare the relevant documentation for transactions with related parties, and all taxpayers must provide minimum information on those transactions. It is also possible for taxpayers to enter into CSA and unilateral, bilateral and multilateral APAs with the Chinese tax authorities.

Related-party transaction reporting and transfer pricing documentation

Circular 42 defines related-party relationship as follows:

1. One party directly or indirectly holds 25% or more of the other party's shares, or a third party directly or indirectly holds 25% or more of the shares in both parties. If one party holds the other party's shares indirectly through a third party, that third party's share ratio will be considered its share ratio when the party holds 25% or more of the third party's shares. Where two or more individuals with the relationship of husband and wife, lineal relatives, siblings or any other support relationship jointly hold the shares of the same enterprise, their shareholding will be calculated on a consolidated basis to determine any related-party relationship.
2. One party holds the other party's shares, or a third party holds shares in both parties without reaching the shareholding percentage provided under (1), but debts that one party owes the other party (except for third-party financial institutions) exceed 50% of that party's capital, or 10% or more of one party's total debts is guaranteed by the other party (except for third-party financial institutions).
3. One party holds the other party's shares, or a third party holds shares in both parties without reaching the shareholding percentage provided under (1), but one party's production and operation activities depend on licenses granted by the other party (including patents, non-patented know-how, trademark and copyright).
4. Where one party holds the other party's shares, or a third party holds shares in both parties without reaching the shareholding percentage provided under (1), but one party's business activities in purchasing, selling, providing and receiving services are controlled by the other party.
5. Where over half of one party's board of directors or senior management (including the secretary of the board of listed companies, the general manager, the deputy general manager, the manager in charge of finance personnel, and other personnel defined under the companies' AoA) is appointed by the other party, or also serve on the board of directors or as senior management of the other party; or more than half the board of directors or senior management of both parties is appointed by a third party.
6. Where two or more individuals with the relationship of husband and wife, lineal relatives, siblings or any other support relationship respectively have one of the relationships provided under (1) – (5) with both parties.
7. Where both parties have other substantial mutual interests.

Under PRC law, taxpayers must provide information on their annual related-party transactions. Circular 42 specifies that the subjects of related-party transactions reporting are (i) resident companies with accounting books, and (ii) non-resident companies with establishments in China being taxed based on actual accounting. These companies must comply with reporting requirements when submitting the EIT annual return, i.e., by May 31 of the following year.

As a significant step for implementing the BEPS Action Plan, Circular 42 also defines the subject and content for country-by-country ("CbC") reporting.

The following resident companies must fill the CbC reports attached to the related-party transactions reporting forms:

- The resident company that is the ultimate parent entity of a multinational enterprise ("MNE") group, and the MNE group's total income in the previous year's consolidated financial statements exceeds RMB 5.5 billion (more or less equivalent to the €0.75 billion threshold under BEPS Action 13).

A constituent entity of the MNE group is:

- any separate business unit of an MNE group included in the consolidated financial statements for financial reporting purposes;
- any business unit that would be included in the consolidated financial statements if the equity interest was traded on a public securities exchange;
- any business unit excluded from the MNE group's consolidated financial statements based solely on size or materiality grounds; and
- any PE of any separate business unit of the MNE group, provided the PE has independent accounting and prepares separate financial statements.

- The resident company appointed by the MNE group prepares the CbC reports.

When a resident company is not included in the above scope, but the MNE group it belongs to prepares CbC reports under the laws of another country, the Chinese tax authorities can require the resident company to provide the CbC reports during a special tax adjustment inspection if:

- the MNE group does not disclose its CbC reports to any country;
- the MNE group discloses its CbC reports to another country with which China has not established an information exchange mechanism for CbC reports; or
- the MNE group discloses its CbC reports to another country with which China has established an information exchange mechanism for CbC reports, but the CbC reports have not been successfully exchanged with China.

There are three types of CbC reports: (i) an overview of the allocation of income, taxes and business activities by tax jurisdiction; (ii) a list of all the MNE group's constituent entities in each tax jurisdiction; and (iii) additional information.

Along with reporting related-party transactions, taxpayers must also prepare transfer pricing contemporaneous documentation annually, if they meet the respective thresholds.

Further to BEPS Action 13, China has developed a three-tier approach to transfer pricing documentation, including master file, local file and special item file.

Master file's thresholds and content:

- A resident company must prepare the master file if:
  - it carried out related-party crossborder transactions during the year and the ultimate parent entity of the MNE group that prepares the consolidated financial statements has already prepared the master file; or
  - Its total annual related-party transactions exceeds RMB 1 billion.
- The master file must describe the MNE group's (i) organizational structure, (ii) businesses, (iii) intangibles, (iv) intercompany financial activities, and (v) financial and tax positions.

Local file's thresholds and content:

- A resident company must prepare the local file if:
  - its transfers of tangible assets exceed RMB 200 million;
  - its transfers of financial assets exceed RMB 100 million;
  - its transfers of intangible assets exceed RMB 100 million; or
  - the total of its other related-party transactions exceeds RMB 40 million.

- The local file must describe (i) the local entity, including the organizational structure, the management structure, the business and its strategy, segmental financial data and any corporate restructuring or transfer of intangible assets that may affect the local entity; (ii) related-party relationships, including basic information, tax position and any changes made; (iii) related-party transactions, including a detailed analysis of the value chains, foreign investment, related-party equity transfers and related-party services; (iv) benchmark analysis; and (v) choice and use of transfer pricing methods.

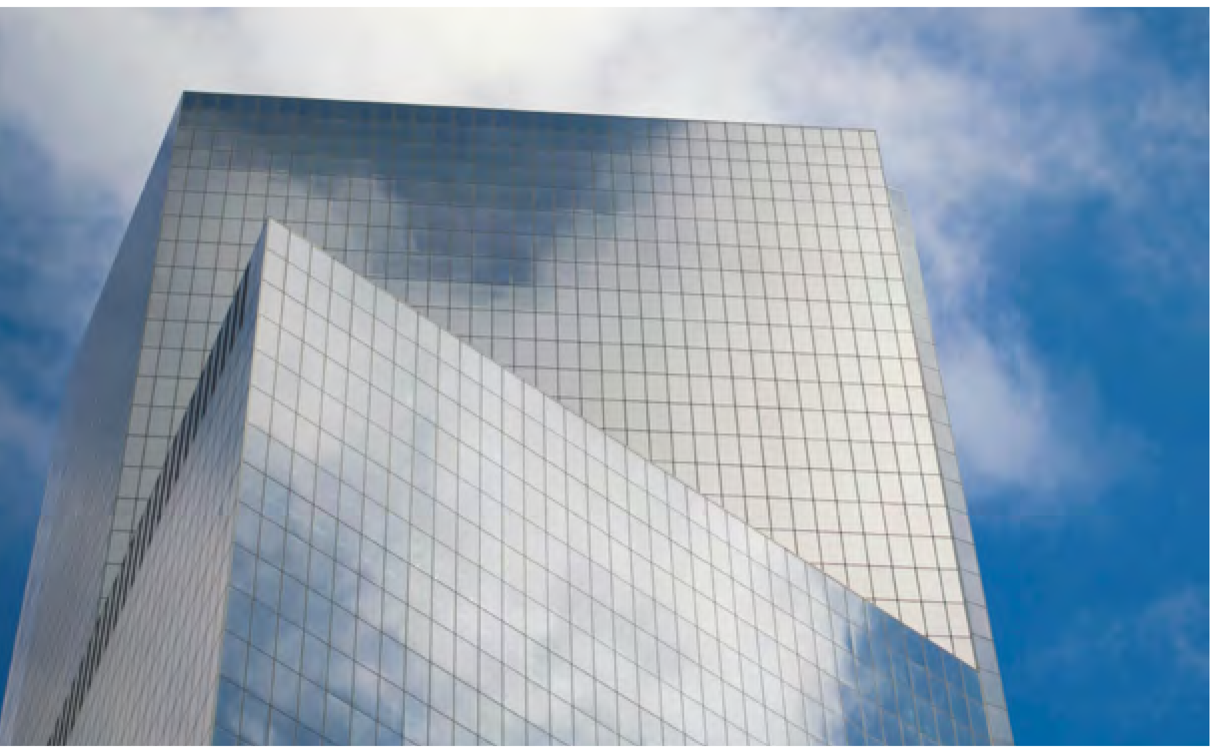
Special item files includes:

- CSA file; and
- thin-capitalization file.

Circular 42 does not set a threshold for the special item files. Therefore, any company signing a CSA must prepare it. Any resident company whose ratio of related-party debts to capital exceeds the standards (5:1 for financial institutions and 2:1 for other companies) must prepare the special item file on thin capitalization.

Circular 42 also grants the following exemptions:

- Related-party transactions covered by an APA can be excluded from the local file and the special item files; and
- Resident companies that carry out only domestic related-party transactions are not required to prepare any file.



APAs can be negotiated unilaterally, bilaterally or multilaterally

Advanced pricing arrangement

One of the safest ways to avoid transfer-pricing risks is to negotiate an APA with the Chinese tax authorities, which have been repeatedly encouraging 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 from the year the letter of intention to sign is submitted. Once approved by the tax authorities, APAs can be used to assess and adjust previous years' related party transactions for up to 10 previous years.

Qualified applicants must have carried out related-party transactions of over RMB 40 million in the three years before submitting the notice of letter of intent. An APA includes the following six phases: (i) pre-file meeting, (ii) submission of a letter of intent, (iii) analysis and evaluation, (iv) formal application, (v) negotiation and signing, and (vi) implementation and monitoring. Once the APA is signed, the tax authorities will monitor the transactions subject to the APA and the taxpayer must provide an annual report on the execution of the APA.

STA has been releasing the China APA Annual Report since the first release in 2009. The Report describes China's APA system, execution procedures and practice development, and covers statistical data and analysis of APA signed since 2005.

General description of CSA

Cost sharing agreement

The EIT law has introduced a new concept: 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 CSA 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, limited to group purchasing and marketing activities.

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 file the CSA with the relevant tax authority within 30 days of its signature. Also, when declaring its annual EIT, the enterprise must provide relevant information on the CSA in its reporting forms on annual related-party transactions. Once a CSA has been signed, the reporting forms should be filed regardless of whether they have been executed. Since the tax year 2016, enterprises entering into a

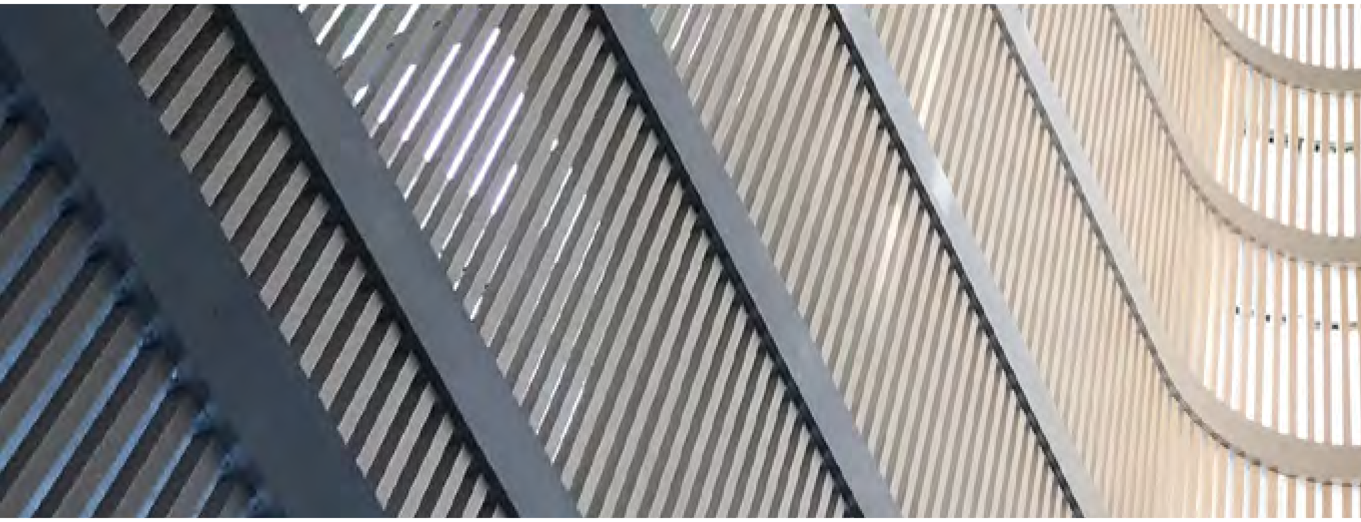
CSA must also prepare transfer pricing documentation in a special item file for CSA.

The cost-contributors do not have to pay royalties to use intangibles developed or transferred under the CSA.

Regarding the tax treatment of a CSA, cost contributions are tax deductible in China for the duration of the CSA, provided:

- 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 the CSA parties receive;
- the Chinese taxpayer has filed or prepared, maintained and provided the additional CSA documentation required under this regulation; and
- the operation lasts for at least 20 years, starting on 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.



The tax authorities may conduct random tax audits or tax reviews

6.8. Tax inspection

Companies are required to file annual EIT returns. The tax authorities are entitled to review and inspect the filed documents to check whether the correct amount of tax has been filed.

The tax authorities may randomly select companies for tax audits or tax reviews. Certain industries are selected to do regular self-reviews before the tax authorities formally conduct their audit. These are usually high-profit industries.

The tax authorities also may conduct 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 overdue tax amount, from the date the tax payment should have been made, in addition to any applicable penalties.

The tax authorities are 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 and withholding agents may face penalties if they fail to fulfil the obligations stipulated by laws and regulations. Serious cases may involve criminal liabilities.

7

Labour issues

7.1. Labour contracts

Under PRC law, an employer must enter into written employment contracts with its employees. If an employer does not sign a written contract with an employee within one month from the date on which the employment relationship starts, the employer must pay the employee twice the salary amount from the second month until the twelfth month, unless the employee refuses to sign the written contract after the employer offers it.

Different types of labor contracts and working hour schemes

There are three types of employment contracts:

- Fixed-term employment contracts
- Open-ended employment contracts
- Employment contracts that terminate upon the completion of a certain task

After an employee has already worked through two consecutive fixed-term employment contracts, to renew the employment contract further, the employer must enter into an open-ended employment contract with an employee. If an employer does not sign a written employment contract with its employee within one year from the date on which the employment relationship starts, it will be considered that the employee and employer have entered into an open-ended employment contract.

An employment contract must describe the work, the place of work, the working hours and vacation time, labour remuneration, social security, work protection, production safety conditions, and prevention of occupational hazards, as well as any other issues required under labour laws and regulations.

There are three types of working hour schemes under PRC law:

- Standard working hour scheme
- Flexible working hour scheme
- Comprehensive working hour scheme

The standard working hour scheme requires employees to work no longer than 8 hours per working day and 40 hours per week. The employer must pay the employees the labour rates for overtime work, following the standards specified by the state and local labour regulations and rules. The employer can adopt a flexible working hour scheme or comprehensive working hour scheme for special positions, which the local authority must approve.

An employer can terminate the employment contract with its employee based on one of the statutory grounds stipulated in the PRC Employment Contract Law. Under specific circumstances, the employee must receive severance pay on termination of his or her employment relationship. If the employer terminates the employment unilaterally (without statutory grounds), the employee can ask the employer to continue performing the employment contract, otherwise the employee will be entitled to receive twice the amount of the statutory severance pay.

7.2. Welfare

Employers must provide employees with statutory social security and housing fund

Employers must register with social security and provide employees with statutory social security and housing fund. Employers have to resort to local authorities to determine the amounts and methods of social security and housing fund payments.

Social security includes pension insurance, medical insurance, unemployment insurance, work injury insurance and maternity insurance.

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

7.3. Trade unions

Rights and obligations of trade unions

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

Trade unions are entitled to represent employees and to supervise the employer's compliance with labour 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, e.g., salaries, welfare, labour safety and hygiene, 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 fewer 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 labour contract unilaterally,

it must inform the trade union of the reasons in advance. The trade union can require the employer to review the decision if it finds that the employer violates laws, administrative regulations or the labour contract. The employer must consider the trade union's opinions and notify the trade union in writing of the reviewed decision.

7.4. Foreign employees, except for Hong Kong, Macau and Taiwan residents

General description for foreign employees to work in China

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

The company that hires the foreign employee has to apply to the local labour authority for a work permit notice.

The foreign employee must 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 work permit. The documents to be submitted include a health report issued by a health care centre designated by the labour authority.

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

If a foreign employee works without a valid work permit or related residence permit, or works beyond the scope permitted by the work permit, he or she will be considered illegally employed in China. These foreigners will be fined or, in serious cases, detained and fined. These foreigners may also be repatriated and will not be allowed to re-enter China for a certain number of years. Both illegal employees and their employers will be fined, and the illegal gains of these employers will be confiscated.

Starting from April 1, 2017, China adopted the reform on the foreign employees' work permit system, which combines the previous one for foreign experts and general employees, as well as introducing the categorisation (Grades A, B and C) and scoring system. Foreigners who are not qualified under the old system (with a bachelor's degree and two years of relevant work experience) can now apply through the scoring system. In practice, a foreigner can also apply for a work permit directly, regardless of the other requirements, provided the annual salary reaches four times the local average for Grade B or six times the local average for Grade A.

In addition to the Z visa, foreigners who qualify as Grade A foreigners can apply for the R visa, which is easy to apply for and offers a longer duration period per stay, as well as longer validity. Moreover, there are no application and process acceleration fees, making the application for a work permit easier.

Under the PRC Social Security Law, enacted October 28, 2010, and effective July 1, 2011, foreigners employed in China should be included in the Chinese social security system. New regulations and rules have been published to develop this issue. However, in a few locations, these are not mandatory, but are mutually agreed between the company and the foreign employee.

To date, China has signed bilateral social security agreements with Germany, South Korea, Denmark, Finland, Canada, Switzerland, the Netherlands, France, Spain, Luxembourg, Japan, and Serbia (except for that with France, all agreements are now effective). These bilateral agreements aim to exempt employees from either country from having to contribute to certain mandatory social security in the other country (e.g., pension and unemployment insurance).

The bilateral social security agreement between Spain and China, which came into force on March 20, 2018, allows individuals to maintain social security contributions in the country of origin for 72 months (six years). The relevant authority in that country issues the authorisation (in Spain, the Ministry of Employment and Social Security; in China, the Ministry of Human Resources and Social Security). This period can be extended by applying to the relevant authority at least three months before its expiration. The Chinese authorities have confirmed that the Agreement will apply to all employees dispatched from Spain to China, regardless of whether the Spanish employees enter into a local contract in China, required by the local authorities to obtain a work permit, if the relevant authority in Spain can issue the similar participation certificate for these employees. They can then present this certificate to the competent authority in China and apply for the exemption of the relevant social security contribution in China.

New residence cards available for Hong Kong, Macau and Taiwan residents working in mainland China

7.5. Hong Kong, Macau and Taiwan residents

On July 28, 2018, the work permit regime for Hong Kong, Macau and Taiwan residents working in the Mainland was abolished. Starting September 1, 2018, Hong Kong, Macau and Taiwan residents who have lived, worked or studied in Mainland China for more than six months can voluntarily apply for residence cards, which have a five-year term, enabling them to (i) enjoy labour rights; (ii) participate in the social security and housing fund regime, compulsory education and basic medical services; (iii) take domestic flights and trains; (iv) stay in hotels; (v) carry out formalities for bank, insurance, securities and futures trading; (vi) register vehicles and apply for driving licenses; and (vii) take professional examinations and apply for related qualifications. The interim measures for the above residents to join the social insurance regime in Mainland China and to allow them to avoid double payment was released on November 29, 2019 and took effect on January 1, 2020.

8 Dispute settlement

8.1. Litigation: jurisdiction and procedure

Jurisdiction

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 substantial and materially influences the regions, it will be accepted and heard by the intermediate people's courts.

Cases in China are mainly subject to level jurisdiction and territorial jurisdiction

In addition to the jurisdiction of the level of courts, a case is also subject to 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, in addition to the court of the defendant's residence, the jurisdiction will also fall under the court where the contract is performed or where the infringement takes place, which includes not only the places where the infringement occurred, but also the 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 judgment is final, and no further appeal is allowed. However, in simple civil cases in which (i) the facts are evident, (ii) the rights and obligations are clear, (iii) the disputes are trivial in nature, and (iv) the dispute amount in a summary procedure is lower than 30% of the annual average salary of employees in the previous year in the province where the court is located, the first instance judgment must be final. Also, if the final judgment was in error, a retrial can be requested through the trial supervision procedure.

A trial case includes the following procedures: (i) filing and defence; (ii) evidence submission and cross examination; and (iii) hearing and judgment. If the claimant or the defendant is not satisfied with the judgment, they can appeal the case (within 15 days of receiving the judgment in a domestic case, or 30 days for a party not residing in China in a case involving a foreign element), by initiating the second instance procedure. Failure to appeal the case within these timeframes 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, cases involving foreign elements are not subject to these time limits. The law is silent on the time limit for the court to issue its judgment on 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 can be provided at the parties' request (at their own expense).

During court proceedings, before or during the hearing, or even after the hearing, judges usually attempt to mediate the case. If the parties reach a mediation agreement and it is served to them, it will have the same effect as a judgment. If the mediation effort fails, the court will issue its judgment.

Specialized court

In recent years, under the growing trend of judicial specialization, China has established several specialized courts, including specialized IP courts in Beijing, Shanghai and Guangzhou, cyberspace courts in Hangzhou, Beijing and Guangzhou, and financial court in Shanghai. These specialized courts are respectively dedicated to hearing a broad variety of IP, internet and finance-related cases.

International Commercial Court

On June 29, 2018, the Supreme People's Court established International Commercial Court No. 1 in Shenzhen and No. 2 in Xi'an as its standing branches.

The two courts can hear, among others, (i) international commercial cases of first instance, provided the parties agree to the jurisdiction of the Supreme People's Court and the subject amount is higher than RMB 300 million; and (ii) application for interim measures before or during the arbitration proceedings and annulment or enforcement of international commercial arbitral awards, provided the arbitration is carried out by, or arbitral award is made by, international commercial arbitration institutions recognised by the Supreme People's Court, which currently include CIETAC, SHIAC, SCIA, BAC/BIAC and CMAC. The list of recognised arbitration institutions does not cover foreign arbitration institutions.

8.2. Arbitration: offshore and onshore

Offshore arbitration is the best choice to resolve China-related disputes

Offshore arbitration

Offshore arbitration (held outside mainland China) would be the best way for foreign investors to resolve their China-related disputes. However, only disputes considered foreign-related can 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 are not considered "foreign"). For individuals, this condition is determined based on the nationality criterion.
- The habitual residence of at least one of the parties is outside China.
- The subject matter is wholly or partly outside China.
- The legal fact that leads to establishment, change or termination of the civil relation happens outside China.

The enforcement of foreign awards is subject to the provisions of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York 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 the New York 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 recognise and enforce a foreign award will be reviewed by the high people's court in its jurisdiction. If this court agrees that the arbitration award should not be recognised or enforced, its opinion will be reported to the Supreme People's Court, which will issue its final decision. This reporting system also applies to any people's court decision to not enforce or set aside a foreign-related award issued by an arbitration institution in China.

On December 26, 2017, the Supreme People's Court released two interpretations on judicial review of arbitration cases, which aim to regulate the judicial review procedures and the approval mechanism for both domestic and foreign arbitrations.

Onshore arbitration

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

As the PRC Arbitration Law leaves room for interpretation as to whether a foreign arbitration institution can qualify as an arbitration commission within the meaning of the Arbitration Law, whether foreign arbitration institutions can administer cases in the PRC has long been debatable. Consequently, it is often recommended avoiding PRC-seated proceedings administered by foreign arbitration institutions. Under the PRC law, the parties cannot agree ad-hoc arbitration if the seat of arbitration is in mainland China. China International Economic and Trade Arbitration Commission ("CIETAC") and Shanghai International Arbitration Centre ("SHIAC") are the arbitration institutions most trusted by foreign investors.

On March 25, 2013, the Supreme Court of the PRC issued a decision confirming the validity of a dispute resolution clause that submitted any disputes between a company incorporated in China and a foreign company to arbitration in the International Court of Arbitration of the International Chamber of Commerce, with the seat of arbitration being in Shanghai. This is the first time the Supreme Court of the PRC expressly admitted the validity of an arbitration agreement with its seat in the PRC being administered by a foreign arbitration institution. On December 30, 2016, the Supreme People's Court issued a notice aiming to strengthen judicial support to develop PFTZs, which provides disputes between two enterprises (at least one of them an FIE) registered in the PFTZs can be submitted to arbitration outside mainland China. An arbitration agreement between two PFTZ-registered enterprises, which stipulates an ad-hoc arbitration in a specific location within mainland China under specific arbitration rules, can also be considered valid. On March 23, 2017, the Management Committee of Hengqin New Zone and Zhuhai Arbitration Commission jointly published the Ad-hoc Arbitration Rules of Hengqin Pilot Free Trade Zone, effective from April 15, 2017, which are the first ad-hoc arbitration rules in China. However, there is still much to be done, e.g., amending the current PRC Arbitration Law to allow ad-hoc arbitration in the PRC and training and attracting more professionals to be ad-hoc arbitrators.

As a recent development, both the Beijing FTZ and the Lin Gang New Area of Shanghai FTZ have been open to foreign arbitration institutions, which are allowed to set up business offices to administer foreign-related cases in China. However, there is still no guidance on how the arbitration awards should be enforced, and it remains unclear how the court will carry out a judicial review on the arbitration proceedings and how interim measures will be provided. Until these issues are clarified, parties are advised to select a PRC arbitration commission to conduct the proceedings (CIETAC or SHIAC).

One of the main concerns surrounding onshore arbitration is how national arbitration commissions appoint arbitrators. Foreign investors are advised to establish the neutrality of the arbitral tribunal in the arbitration agreement.

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