The Establishment of Operations in Hong Kong and Shenzhen

April 2003

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1. INTRODUCTION

Hong Kong is generally perceived by the international business community to be one of the major financial and commercial centres of the world and Shenzhen's status is rapidly emerging.

This note seeks to provide an outline of various matters to be considered when intending to establish operations either in Hong Kong or Shenzhen. Please note that this note only reflects the general features of the laws and legislation currently in force and should not be relied upon in isolation. Specific and detailed advice on all aspects of establishing operations, especially competent PRC legal advice when establishing in Shenzhen, and the specific business and industry entry and continuing requirements should be obtained before action is taken.

2. SUBSIDIARY OR BRANCH?

Once a corporation based outside Hong Kong or Shenzhen (the "Overseas Corporation") has made a decision to extend its presence in one of these regions, the next main issue to be considered by the Overseas Corporation is the form in which the operations to be established in Hong Kong or Shenzhen should operate. Common methods:

(a) In Hong Kong:

- the incorporation of a limited liability private company in Hong Kong as a wholly-owned subsidiary of the Overseas Corporation; or
- the setting up of a branch office of the Overseas Corporation; or
- the setting up of a branch office of another overseas subsidiary of the Overseas Corporation.

(b) In Shenzhen:

- sino-foreign equity joint ventures; or
- sino-foreign contractual and co-operative joint ventures; or
- wholly foreign-owned enterprises; or
- representative offices and branch offices.

There are other ways of setting up operations in Hong Kong and Shenzhen, such as under joint venture arrangements (for Hong Kong, similar to equity joint ventures and sino-foreign contractual and co-operative joint ventures of the PRC), through a partnership or by way of the acquisition of an existing business, but only the choices set out above will be focused upon in this brochure.

HONG KONG

3. INCORPORATING A SUBSIDIARY

Here I have assumed that any subsidiary (the "Subsidiary") incorporated in Hong Kong by the Overseas Corporation would be a private company limited by shares and not a public limited company. Private companies have less onerous public disclosure obligations than public companies (e.g. audited accounts need not be filed with the Registrar of Companies in Hong Kong).

Under the *Companies Ordinance* of Hong Kong (the "Legislation"), a private company in Hong Kong, under its constitution, must:

(i) restrict the right to transfer its shares;

(ii) normally limit the number of its shareholders to 50; and

(iii) prohibit the making of offers by the Subsidiary to the public to acquire its securities.

3.1 Incorporation

To incorporate the Subsidiary, various documents, including its Memorandum and Articles of Association, together with a fee (currently HK$1,720 for a company with an authorised share capital not exceeding HK$30,000 - if unsuccessful, refund of $1,425 will be made) must be delivered to the Registrar of Companies. Further, a capital duty in respect of the authorised share capital is payable, currently, a capital duty of HK$1.00 is payable for every increase of HK$1,000 or part thereof of the authorised capital subject to a maximum of HK$30,000.00.

When the Subsidiary is registered, the Companies Registrar issues a Certificate of Incorporation that certifies its incorporation and limited liability status. The certificate is also conclusive evidence that:

(a) all requirements of the Legislation in respect of registration have been complied with; and

(b) the association is a company authorised to be registered and duly registered.

In the interests of speed, it is possible to purchase a company which has already been incorporated with a standard form Memorandum and Articles of Association "off the shelf" within a day or two (otherwise incorporation can take three to four weeks). Its constitution and name can then be amended as desired. The fee payable for change of company name is HK$295 (if unsuccessful, a refund of $55 will be made), and an additional issue of a Certificate of Incorporation on Change of Name is HK$170. The same considerations will apply to the choice of a new name as are mentioned in paragraph 3.4 below.

3.2 Constitution

The constitution of the Subsidiary is set out in its constitutional documents; namely, its Memorandum and Articles of Association.

The Memorandum is the document fundamental to the formation of a registered company. From 1997, the Legislation provides that only companies intending to apply for a licence to dispose with using the word "Limited" in their names or those whose Memoranda being subject to requirements specified in or under other enactment, are required to have an objects clause (i.e. a clause specifying the proposed business scope or activities and the powers of the company) in their memorandum of association. All other companies are no longer required to state their objects in their memoranda. Though in practice, numerous and full objects and

powers of a company are specified in its memorandum. The Articles of Association deal with the internal regulation of the Subsidiary, such as the rights of the shareholders and the powers and functions of the directors.

3.3 Share Capital

Typically, companies are incorporated with a share capital of HK$10,000 divided into 10,000 shares of HK$1 each, although this may be varied as required. There must always be at least 2 members (i.e. shareholders) for the Subsidiary to keep its limited liability, although one member may hold a share or shares as the nominee of the other. Neither member need be resident in Hong Kong. A member can be an individual or a corporation.

As mentioned earlier, capital duty in respect of the authorised share capital of the Subsidiary is payable. Currently, a capital duty of HK$1.00 is payable for every increase of HK$1,000 or part thereof of the authorised capital subject to a maximum of HK$30,000.00.

3.4 Name

The name of the Subsidiary must, except in very limited cases (such as charitable companies), end with the word "limited" and must not be the same as that of a company already registered with the Registrar of Companies or that of a body corporate established under an Ordinance in Hong Kong.

A company may now be registered with its name expressed either in the English language, or the Chinese language or with names in both languages. Where Chinese characters are used for the Subsidiary's name, four prescribed Chinese characters ("you xian gong si", translated as "limited company") must appear at the end of that name. Some sensitive names such as "Government", "Department" or "Trust" or other names which may give the impression that the company is connected with the Government cannot be taken by a company without the permission of the Chief Executive of the Hong Kong Special Administrative Region. There are other restrictions on the choice of a name for a company. Further, when choosing a company name, companies should be aware of the common law tort of "passing off". This involves using a business name which is deceptively similar to the name of another business so that actual damage has been, or is likely to be, caused to the owner of that other business.

If the Subsidiary is registered under a name which is the same or too similar to that of another company that is already registered, then the Registrar may direct the Subsidiary, within 12 months of registration, to change its name.

3.5 Directors And Secretary

The Subsidiary must have at least two directors and a secretary. One of the directors can also be, subject to certain restrictions, the secretary.

There is no restriction on the choice of directors, provided that they are at least 18 years of age and have not been disqualified from acting as directors (for example, because of bankruptcy or previous defaults under the Legislation). In particular, directors can be of any nationality. A director can be an individual or a corporation

The secretary is usually responsible for performing clerical duties such as keeping the books and records of the Subsidiary, keeping custody of the seal and making sure that all necessary documents are filed with the Registrar of Companies. The secretary must be resident in Hong Kong and can be an individual or a corporation.

3.6 Registered Office

From the day on which the Subsidiary begins to carry on a business, or 14 days after its incorporation (whichever is the earlier), the Subsidiary must have a "registered office" in Hong Kong to which any legal or official notices or communications may be sent. Such notices or communications are properly served if left at or sent by post to that office (s.356) (where served by post they are deemed to be effective at the time they would be delivered in the ordinary course of post: *Treasure Land and Property Consultants v. United smart Development Limited*).

The registered office does not need to be the address from which the Subsidiary operates and could for example be the address of its auditor. The Companies Registrar must be notified if the various statutory registers and documents of the Subsidiary (i.e. registers of debenture holders, members, charges, directors and secretaries and minutes of proceedings of general meetings and meetings of directors) are not kept at the registered office.

3.7 Auditor

The Subsidiary needs to appoint an auditor who must be an accountant, or firm of accountants, with recognised qualifications, which is registered in Hong Kong under the *Professional Accountants Ordinance*.

3.8 Business Registration

When the Subsidiary starts to carry on any new business (whether from its principal premises or a branch) it must apply to the Inland Revenue Department within one month from the commencement of the business for registration under the *Business Registration Ordinance*. Particulars of the new business must accompany the application and any changes must be notified to the Inland Revenue Department.

A fee and levy are usually payable on such application. A business registration certificate and, where appropriate, a branch registration certificate will then be issued (usually between 1 to 2 working days) and must be displayed by the Subsidiary. Business registration can be obtained for:

(a) one year - upon payment of HK$2,600 for the main office and HK$673 for the branch office; or alternatively,

(b) three year – upon payment of HK$7,000 for the main office and HK$1,989 for the branch office.

4. SETTING UP A BRANCH

An Overseas Corporation may, for commercial reasons, prefer to establish a branch office (the "Branch") in Hong Kong or for an overseas subsidiary of the Overseas Corporation to establish a Branch. It is assumed for these purposes that the Branch is a branch of the Overseas Corporation (similar rules apply to a Branch of an overseas subsidiary).

4.1 Formalities

A branch exists where a place of business of the Overseas Corporation has been established in Hong Kong. Although there are no formalities involved in the establishment of a place of business, i.e., the Branch, it must register as an "overseas company" under Part XI of the *Companies Ordinance*. It must however be stressed that Hong Kong's company legislation has never sought to control foreign direct investment by means of such registration

requirement. Subject to specific exceptions, there is no restriction upon the right of foreign investors to hold shares in companies in Hong Kong.

For the purposes of Part XI of the *Companies Ordinance*, a place of business includes a share transfer or share registration office and any place used for the manufacture or warehousing of any goods but it does not include a place not used by the Overseas Corporation to transact any business which creates legal obligations. A place of business will normally exist if premises are occupied in Hong Kong on a relatively permanent basis from which officers or employees carry on business for the Overseas Corporation. An Overseas Corporation which appoints an agent in Hong Kong and has no office or other place of business of its own in Hong Kong will not generally be deemed to have an established place of business in Hong Kong.

If the Overseas Corporation merely wishes to establish a representative office whose staff do not have the authority to enter into contracts on behalf of the Overseas Corporation, it may be possible to avoid the registration requirements. However the lack of a business registration certificate can make doing business difficult in Hong Kong.

4.2 Registration Requirements

Various documents must be delivered to the Registrar of Companies within one month of establishing its place of business in Hong Kong. The following are required:

(a) the address of the principal place of business of the Overseas Corporation in Hong Kong and the address of its registered office (or equivalent) in its place of incorporation;

(b) certified copies of the Overseas Corporation's constitutional documents and its certificate of incorporation (if the Overseas corporation is incorporated in a place where under the law it is not the practice to issue a certificate of incorporation, the Registrar may accept other evidence of incorporation);

(c) particulars of its directors and secretary (if any) including their name or alias, any former names, residential addresses and identity card/passport numbers (if the director or secretary is a company, the name and registered/principle office of that company); and

(d) the name and address of at least one person (can be a natural person or a firm of practising solicitors or professional accountants) resident in Hong Kong authorised to accept on behalf of the Overseas Corporation service of legal process and other official notices (an authorised representative).

Unless the Overseas Corporation is sufficiently like a private company under Hong Kong law and it is not required in its place of incorporation to publish its accounts or to have its accounts open to inspection by members of the public, the Overseas Corporation must also supply to the Registrar of Companies a certified copy of its latest accounts. The accounts are submitted to the Inland Revenue Department for tax purposes. The Subsidiary will be exempted from the obligation to file certified copies of its accounts in Hong Kong with the Registrar of Companies if it meets **both** of the following conditions:

(1) (a) if it were incorporated under the Ordinance in Hong Kong, it would be a private company within the meaning of section 29. That is the Overseas Corporation which by its articles:

(i) restricts the right to transfer its shares;

(ii) limits the number of its members to 50, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have contained after the determination of that employment to be, members of the company; and

(iii) prohibits any invitation to the public to subscribe for its shares or debentures of the Overseas Corporation;

OR

(b) in the opinion of the Registrar of Companies, the Overseas Corporation has substantially the same general characteristics of such a private company;

AND

(2) the Overseas Corporation is not required by the laws of the country of its incorporation to publish its accounts or to deliver copies to any person in whose office they may be inspected as of right by members of the public.

In practice, the Registrar requires a certification as to the private nature of the Overseas Corporation from a lawyer or an auditor practising in the place of its incorporation or by an independent solicitor or auditor practising in Hong Kong.

For a company incorporated in the USA, its application should confirm, where appropriate, that throughout the period since the date of incorporation or since the first day of its last financial year:

- the company has been either a wholly owned subsidiary of another company, or the actual number of its members has not exceeded 35;
- there has been no provision in its constitution, articles or bylaws for the creation or issue of bearer shares, or share warrants, and its shares have not been transferable by delivery; and
- the company has not by the law of its place of incorporation or origin been obliged to publish its accounts or to deliver copies to any person in whose office they may be rightly inspected by members of the public.

A fee is payable when applying to be registered (for the main office, the current fee is HK$1,720 - if unsuccessful, refund of $1,425 will be made, and HK$20 for each document required to be registered on application) and a Certificate of Registration of Oversea Company will be issued by the Registrar of Companies when the registration requirements have been satisfied. Normally the certificate of registration will be issued in about 22 working days [*Source: Companies Registry website*].

4.3 Name

There are restrictions on the registration of the name of an Overseas Corporation which establishes a Branch in Hong Kong which are similar to those applying to a Subsidiary (see paragraph 3.4 above).

4.4 Business Registration

The provisions of the *Business Registration Ordinance* apply to the establishment of a Branch

as they do to a Subsidiary (see paragraph 3.8 above).

5. CONTINUING OBLIGATIONS

A SUBSIDIARY

5.1 Registers

A number of registers must be maintained by the Subsidiary. These include registers of debenture holders, members, charges, directors and secretaries.

5.2 Books Of Account

The Subsidiary must keep proper accounting records which are sufficient to show a true and fair view of the Subsidiary's affairs and to explain its transactions, and to disclose the Subsidiary's current financial position.

The books of account must be kept at the registered office of the Subsidiary or at such other place as the directors of the Subsidiary think fit. Unlike other records required by the Legislation, e.g. the register of members and the register of charges, the books of accounts need not be kept in Hong Kong. If they are kept overseas, returns which are sufficient to disclose the financial position of the Subsidiary with reasonable accuracy must be sent and kept at a place in Hong Kong at intervals of not more than 6 months. They must also be sufficiently detailed to enable the Subsidiary's accounts to be prepared.

5.3 Annual General Meeting

Every company (other than dormant companies) must hold its first annual general meeting (which is a meeting of its shareholders) within 18 months after its incorporation and thereafter at least once every calendar year. The interval between two annual general meetings must not exceed a period of 15 months. At an annual general meeting the shareholders would usually, amongst other things, receive the audited accounts for the previous financial year and declare a dividend (if it is proposed that one be declared).

5.4 Annual Return

Each year within 42 days of the anniversary of its incorporation, the Subsidiary must file with the Registrar of Companies an annual return (giving details of various matters, including its share capital and its directors). The Subsidiary must forward a copy of the return to the Registrar of Companies. With effect from 1 July 2000, the return may be signed by a director or the company secretary.

If the return is not filed within the statutory time limit, penalties are payable by the Subsidiary and every officer who is in default. The Companies Registry can strike-off companies from the register of companies which have consistently failed to file their annual returns.

5.5 Annual Accounts

The directors (in practice the auditor) are required to prepare and put before the annual general meeting of the Subsidiary a profit and loss account made up to a date normally not more than 9 months before the meeting. At the same time a balance sheet of the Subsidiary made up to the same date should be put before that meeting by the directors. The balance sheet must show a true and fair view of the Subsidiary's financial position at the end of its financial year; the profit and loss account must give a true and fair view of the profit or loss of

the Subsidiary for that financial year.

Various other matters which must be specified in the accounts are detailed in the Tenth Schedule of the Legislation, including details of directors' emoluments, compensations for loss of office and loans to directors. In general, the Subsidiary would also need to disclose the name and place of incorporation of its ultimate holding company in its annual accounts.

As with keeping books of account, a director who fails to lay a profit and loss account or balance sheet before the company in a general annual meeting commits an offence.

5.6 Annual Reports

An auditors' report and a director's report must be attached to the Subsidiary's annual accounts before the same are presented at the Subsidiary's annual general meeting for consideration by its members. The auditors' report must state (subject to exceptions) whether the profit and loss accounts and the balance sheet exhibit a true and fair view of the Subsidiary's financial position. Detailed information about the Subsidiary and its business, in particular the Subsidiary's profit and loss for the financial year and the state of affairs of the Subsidiary as at the end of the financial year, must deal with in the directors' report.

5.7 Registration Of Charges

Particulars of certain charges or other security created by the Subsidiary must be delivered to the Registrar of Companies within 5 weeks of their creation. Additional time of up to three weeks may be granted in respect of charges created overseas and comprising property outside Hong Kong to allow for the normal time to send documents to Hong Kong. This requirement applies whether or not the property over which the charges are created is in or outside Hong Kong. Similarly, when the Subsidiary acquires a property subject to an existing charge, such a charge must be registered within 5 weeks after the date on which the acquisition is completed. Failure to register causes the debt secured by the charge to become immediately repayable (i.e. the obligation to repay the debt is not prejudiced) and the charge itself to be void against any liquidator and any creditor of the Subsidiary and may render the Subsidiary and its officers liable to penalties.

5.8 Registered Particulars

The Registrar of Companies must be notified when there are any changes in the details and particulars registered with him. If a new director is appointed, his written consent to act must be obtained. Certain resolutions passed by the shareholders of the Subsidiary (including all special resolutions passed by shareholders – filed within 15 days), for example any resolution increasing its share capital or amending its Memorandum and Articles of Association must also be filed with the Registrar of Companies within a prescribed period.

5.9 Public Inspection

All documents filed with the Registrar of Companies are open to public inspection and any person, upon payment of fees, can obtain copies of such documents.

5.10 Disclosure

The Subsidiary must exhibit its full and correct name outside every office or place in which it carries on business in Hong Kong in a conspicuous position in legible characters and must state the same on, among other things, all of its business letters, notices and other official publications.

The Subsidiary must also possess a common seal containing the full name of the Subsidiary and must be made of metal.

A BRANCH

5.11 Accounts

The Overseas Corporation need not deliver its accounts to the Registrar of Companies if it is a company of the type described in paragraph 4.2 above. If not, the Overseas Corporation must provide an annual return to the Registrar of Companies, once a year and within intervals of not more than 15 months, confirming that there has been no alteration to the registered documents and copies of its accounts in the form required in its own country. The said annual return must be signed and the said accounts must be duly certified by a director, the company secretary, or the Hong Kong authorised representative of the Overseas Corporation.

In any event, the Branch should prepare branch accounts for tax return purposes.

5.12 Registration Of Charges

Every overseas company is required to register with the Companies Registry particulars of mortgages and charges created by it over property situated in Hong Kong within 5 weeks of their creation. Further, it is also required to register an existing charge on acquired property situated in Hong Kong. Additional time of up to three weeks may be granted in respect of charges created overseas and comprising property outside Hong Kong allow for the normal time to send documents to Hong Kong. The Branch must maintain a register of those charges at its principal office in Hong Kong.

5.13 Registered Particulars

The Registrar of Companies must be notified of any change in the registered documents or particulars of the Overseas Corporation, normally within 21 days of the change.

5.14 Authorised Representative

The Overseas Corporation must have an "authorised representative" in Hong Kong (see section 4.2 above) until at least 3 years after it has ceased to do business in Hong Kong.

5.15 Issues Of Shares

The Overseas Corporation must not offer shares or debentures to the public in Hong Kong unless it adheres to a number of disclosure and registration requirements mainly imposed by the Legislation and the *Securities and Futures Ordinance*.

5.16 Disclosure

An Overseas Corporation which carries on business in Hong Kong must state its name, country of incorporation and (if so) the fact that it is incorporated with limited liability in legible characters in all bill-heads and letterheads, notices and other official publications of the corporation, and, if the corporation is in liquidation, in all advertisements of the corporation with the words "in liquidation" added after its name.

6. SPECIAL CASES

Certain types of business in Hong Kong are regulated by specific legislation and are subject to the supervision and control of various regulatory authorities. Specific advice should be

obtained before establishing operations in each of these areas of business. There follows a non-exhaustive list of such types of business:

- Banking and the taking of deposits
- Insurance business
- Investment management and advice
- Dealing in foreign exchange, derivatives, securities and commodities
- Textiles import-export business
- Employment and travel agencies
- Food and liquor business
- Money changing business
- Media business (including cinema, newspapers, theatres, telecommunications and television)
- Shipping, aviation and transport services
- Professions (including lawyers and accountants)

7. TAXATION ASPECTS OF SUBSIDIARIES AND BRANCHES IN HONG KONG

7.1 Introduction

This section is intended to give a brief outline of the main tax consequences of setting up a Subsidiary or a Branch in Hong Kong.

The Hong Kong system of taxation is based on the principle of territoriality. There are no payroll, turnover, sales, value added, gift or capital gains taxes in Hong Kong. There is no tax on dividends paid by Hong Kong companies. The main Hong Kong tax likely to be payable by either the Subsidiary or the Branch is Profits Tax. They are treated in much the same way under the legislation.

7.2 Profits Tax

Profits Tax is charged on every person carrying on a trade, profession or business in Hong Kong in respect of assessable profits which arise in or are derived from Hong Kong from such trade, profession or business. In certain circumstances, profits tax may be charged in respect of profits deemed to arisen in or derived from Hong Kong.

The source of the profits is therefore crucial in determining whether they are taxable. The courts determine whether assessable profits of a trade, profession or business have arisen in Hong Kong by looking to see what has been done to earn profits and then seek to establish where that operation or the principal elements of it took place.

The source of profits may not always be obvious and it may be necessary to consider this complex question at greater length. Specific advice should be obtained on this point.

7.3 Determination Of Profits

Profits are determined on normal accounting principles on the basis of the Subsidiary's books of account or the Branch accounts.

If the Inland Revenue is satisfied that the Branch accounts show the Branch's true profits, they are adopted and the tax payable is calculated under Profits Tax principles. If not, the Overseas Corporation's world-wide profits are adjusted to conform with Profits Tax

principles and apportioned on the basis of the ratio of Branch turnover to world-wide turnover. If, in the Inland Revenue's opinion, this would be impracticable or unfair, it has the power to assess what it considers to be a "fair" percentage of the turnover of the Branch to Profits Tax.

7.4 Rates Of Profits Tax And Assessments

Corporations are charged to Profits Tax at the current rate of 16% payable by a system of direct assessment following returns being made to the Inland Revenue by the taxpayer within 4 months after the end of a tax year. In Hong Kong the tax year for corporations ends on 31st March in each year.

In addition there is a system of Provisional Profits Tax under which a provisional assessment for the next tax year is made by reference to the agreed assessable profits of the immediately preceding year of assessment. The provisional assessment is payable in two instalments of 75% in the final quarter of the current tax year, the balance three months later. The amount of Provisional Profits Tax paid is set off against the final tax bill for that year. Any excess of final tax liability for that year over the Provisional Profits Tax paid or vice versa is added to or subtracted from the first instalment of Provisional Profits Tax for the following year.

7.5 Double Taxation

Hong Kong has reached an understanding with the relevant tax authorities in the Central People's Government, PRC for avoidance of double taxation between the Mainland and Hong Kong. The arrangement covers airline and shipping operations as well as other business activities. In addition, double taxation relief arrangements in shipping and airline income with other countries has also been concluded. The Overseas Corporation should also obtain advice from its tax advisers in its own jurisdiction on this.

7.6 Losses And Deductions

Loss relief may be available to the Branch or Subsidiary which may, of course, be important in its early years. Also, outgoing and expenses, to the extent to which they are incurred in the production of assessable profits, may count as deductible expenditure. Capital expenditure is not deductible but there is a system of capital allowances relating to buildings, plant and machinery.

7.7 Dividends

There is no withholding tax on dividends paid by a Subsidiary to the Overseas Corporation.

7.8 Transfer Pricing

Arrangements by which the Hong Kong operation charges artificially low prices to, or is charged artificially high prices by, closely connected overseas companies are relatively uncommon due to Hong Kong's rates of taxation being typically lower than elsewhere. In those cases where such arrangements have been made, the legislation contains anti-avoidance provisions. Those provisions also, however, cover arrangements between Hong Kong resident persons and overseas parties which generate profits that are not sourced in Hong Kong. Historically, the Inland Revenue has not exercised these powers frequently, but this practice may be changing.

7.9 Keeping Business Records

All persons carrying on business in Hong Kong are required to keep sufficient records, in English or Chinese, of their income and expenditure to enable their assessable profits to be readily ascertained. There are also statutory requirements to record certain specified details of every transaction. Business records must be retained for at least seven years after the date of the transaction to which they relate.

7.10 Other Taxes

Property Tax is payable on rental income. There is no tax on capital gains or any form of sales tax in Hong Kong but there are special taxes on hotels, entertainment and betting and duties are payable on a number of products, such as alcohol and tobacco. There are also other duties (including stamp duty) and taxes chargeable in Hong Kong (and, in particular, see section 9.2 below).

8. INTELLECTUAL PROPERTY

The Overseas Corporation must also be satisfied that, in setting up operations in Hong Kong, its (and, as the case may be, the Subsidiary's) intellectual property rights, such as copyright, patents and trade marks, are protected from infringement by counterfeits and from other abuse.

There follows a brief outline of the main types of intellectual property protection currently available. The intellectual property laws of Hong Kong have gone through a fundamental change in view of the hand-over of sovereignty to China in July 1997.

8.1 Patents

A Registrar of Patents was established in Hong Kong in July 1997. An application for patent can be made to the Registrar by a proprietor of an invention. An invention is patentable if it is susceptible to industrial application, is new and involves an inventive step (i.e. it is not obvious as part of the state of the art of a person skilled in the art). The proprietor of a "designated patent" (i.e. a patent granted by a designated patent office, normally the UK or China Patent Office) can also apply to the Registrar to record the patent without further examination.

8.2 Trademarks

The Subsidiary, or the Overseas Corporation acting through its Branch, may sell goods or offer services by reference to a particular identifying mark. There is a Trade Marks Registry in Hong Kong at which trade marks in respect of goods and services may be registered provided that they satisfy certain requirements. Civil and criminal remedies are available in respect of infringements of a registered trade mark.

8.3 Copyright

The *Copyright Ordinance* provides for the protection of original literary, dramatic, musical works, artistic works, sound recordings, films, broadcasts, cable programmes and published editions. Copyright works attract copyright protection under the Ordinance automatically upon creation and civil and criminal remedies are available in support of such rights.

8.4 Passing Off

This complex area of the law is based on the English common law. It may be thought of as a form of unfair competition law. It seeks to protect a trader from having his well known goods or services imitated by any person in such a way that it amounts to a misrepresentation to the public thereby causing damage and loss to his business. Provided that all the necessary elements of the alleged passing off are provided, a trader is entitled to civil remedies.

8.5 Registered Designs

The Registrar of Designs has been established in Hong Kong. A person claiming to be the owner of any article or set of articles can apply to register the design in such article or articles to the Registrar.

In order to be registrable, the appearance of the article must not be material. This means that aesthetic considerations are not normally taken into account to a material extent by persons acquiring or using articles of that description, and would not be so taken into account if the design were to be applied to the article. Civil remedies are available in respect of any infringements of the rights of a proprietor of a registered design.

9. STAFF

When setting up operations in Hong Kong, the Overseas Corporation must bear in mind its staffing requirements and how they are to be met. If it establishes a Branch, the Overseas Corporation has the choice of either seconding its own employees to Hong Kong, recruiting expatriate staff outside Hong Kong for re-settlement in Hong Kong or recruiting local staff. A Subsidiary would have much the same choices.

Where employees are brought into Hong Kong from overseas, regard must be had to the immigration law consequences. Further, in all cases, there will be tax and employment protection considerations involved.

9.1 Employment Visas

Foreigners working in Hong Kong (with or without pay) must apply to the Hong Kong Immigration Department for employment visas for their prospective employment in Hong Kong (however short or even on a temporary basis). Normally, a senior employee would not experience problems in obtaining a visa. Dependent relative visas may be applied for by spouses and for children below the age of 21.

All persons in Hong Kong must carry some form of identification at all times, normally either a passport or a Hong Kong identity card. Anyone who intends to stay in Hong Kong for whatever purposes for more than a period longer than the visa free period allowed (this visa free period differs for different travellers from different countries) must apply for a visa or entry permit from the Immigration Department before travelling to Hong Kong.

Persons visiting Hong Kong on short business trips may need to obtain a visa in some circumstances.

9.2 Salaries Tax

Salaries Tax is payable on income (including salaries, various allowances, commissions and fringe benefits) from any employment which is fundamentally sourced in Hong Kong, and from any office (such as a directorship of a Subsidiary) or pension fund located in Hong Kong.

(i) Source

Typically, the source of employment is the most difficult matter to determine. Relevant factors are where the contract was concluded and under which law it is governed, where the employer is resident and, to a much lesser degree, where and in what currency remuneration is paid.

The source of employment of an employee of a Subsidiary may well be viewed as being different from that of an employee of the Overseas Corporation working at a Branch. It is a question of fact on which specific advice should be sought. If the source is found to be outside Hong Kong, only income derived from services rendered in Hong Kong will be subject to Salaries Tax, determined on a time-apportionment basis). If the balance is not chargeable to any equivalent income tax in his home, or any other jurisdiction, then that portion of income would be tax-free. The structure of an employee's employment should, therefore, be carefully planned at the outset for maximum tax-efficiency. If the Inland Revenue Department consider that, in substance, the source of any employment, however structured, is really in Hong Kong, then it may assess the employee on that basis.

If a person renders services in Hong Kong by visiting Hong Kong for no more than 60 days in any tax year, then usually no Salaries Tax is payable. If double tax becomes payable on any income, limited relief is available.

In these type of circumstances, separate employment contracts relating to the employee's duties in and outside Hong Kong may be helpful.

(ii) Fringe benefits

If fringe benefits are provided to an employee which could be converted into money by the employee, then those benefits are chargeable to Salaries Tax. Exceptions to this are holiday travel allowances and allowances for the transportation of personal effects. Tax is charged on rent-free accommodation, or where the employer reimburses rental expenses, generally on the basis that the benefit is worth 10% of the employee's total income for the relevant period. If the employer incurs and meets the employee's expenses directly, tax may not be payable on the value of the benefit, save educational benefits. Specific advice on the employee's proposed remuneration package should be obtained.

(iii) Rate

Salaries Tax is charged either at progressive rates of up to 17% or at the maximum rate of 15% of income less any allowable expenses (not personal allowances), whichever results in a lower tax bill. There is a system of Provisional Salaries Tax similar to the one mentioned in paragraph 8.4 for Profits Tax.

(iv) Employer's duties

An employer is not obliged to withhold any of his employee's tax except if the employee has given notice and intends to leave Hong Kong. An employer must file certain returns with the Inland Revenue Department and inform the Inland Revenue when an employee is due to leave Hong Kong.

9.3 Employment Protection

(i) Termination

Employment contracts are treated as being terminable on one month's notice or on

payment of one month's wages in lieu of notice, unless a different notice period (being not less than seven days) is agreed in writing. There are provisions in the legislation (which may be supplemented in the contract) enabling the contract to be terminated by the employer without notice (for example, summary dismissal for the employee's fraud or dishonesty) or by the employee without notice (for example, in cases of disability).

(ii) Terms and discrimination

Employees must be notified of the basic terms of their employment. There are special rules for the employment of women, young persons and children. The Sex Discrimination Ordinance, the Disability Discrimination Ordinance and Family Status Discrimination Ordinance prevent discrimination by an employer against any person on the ground of sex, disability or the family status of a person. An employer is also not allowed to prevent employees from belonging to or being active in trade unions (although unions are not widespread outside the industrial sector).

(iii) Rest days, holidays and leave

There are special rules for the entitlement of employees to holidays and leave, including one rest day in every seven days and the statutory holidays. After the first year of employment, an employee is entitled to annual leave with pay, the length of which depends on the length of his service.

The legislation provides for employees to receive sickness allowance in certain circumstances, amounting broadly to two-thirds of their wages for up to a maximum of 120 days accumulated on the basis of length of service.

(iv) Long service and severance payments

An employee may be eligible for a long service payment when he leaves his job. The amount of the long service payment is based upon the age of the employee, the length of service and the amount of the employee's wages. Generally, the older the employee, the longer the service and the higher the wages, the greater the entitlement (subject to a cap). Similar benefits are available to employees if they are made redundant, are laid off, reach 65 or die in service and would have been entitled to a long service payment. Employers are not allowed to dismiss employees with the intent to reduce or extinguish certain statutory benefits, rights or protection under the Employment Ordinance.

(v) Maternity leave

Women employed under continuous contracts are entitled to maternity leave and leave pay. Leave pay is four-fifths of their normal wages and leave amounts to at least 10 weeks plus additional leave in certain circumstances, including illness as a result of the pregnancy. Continuity of employment is not broken by maternity leave and the employee may return to her job after the leave has been taken. The employer cannot generally terminate the employment in the period from when he becomes aware of the pregnancy until the employee's due date of return to work.

(vi) Mandatory Provident Fund

In March 1998, the Hong Kong Government passed a law for the establishment of a mandatory provident fund for all employees in Hong Kong. Both employers and employees must contribute to the fund, which is to be established in the form of trusts.

The employers will be mandatorily required to contribute 5% of the relevant income (i.e. all monetary remuneration except for housing allowance) of each employee to the fund, subject to a maximum amount of HK$1,000 per month.

The government has established the Mandatory Provident Fund Authority and the employers and employees will be required to make their first contributions from 1st December 2000.

10. PREMISES

Apart from considering the mode of operations in Hong Kong, there is a need to consider obtaining commercial premises from which the business operations can be carried out. In addition, if staff are to be relocated from overseas, some thought must be given to the provision of housing to staff members and their families.

In all likelihood, purchasing either commercial or residential premises will not be a first option as Hong Kong property values are notoriously high and the property market can be volatile. Accordingly, for the purposes of this brochure, only those issues relating to the renting of premises will be addressed.

10.1 Commercial Premises

The terms and conditions of commercial tenancy agreements can vary greatly and market forces will dictate how negotiable the terms are.

As a general comment, market conditions usually favour Hong Kong landlords and usually landlords will only allow fairly cosmetic amendments to their "standard" documentation. Some larger commercial landlords reject changes altogether.

Nevertheless, professional assistance should always be sought in reviewing the terms of a proposed tenancy agreement and advising of the commercial risks. A number of important commercial issues should be borne in mind, including:

(i) Rent

Rent is often quoted as a dollar figure per square foot per month. It is important to determine whether the figure quoted includes such additional charges as management fees, air-conditioning charges, rates and utility charges. Usually the figure quoted for rent will exclude these extra charges and which the tenant is required to pay in addition to rent. In the current rental market it is possible to negotiate rent-free periods for decoration.

(ii) Term

There is no standard term for commercial tenancies in Hong Kong and the length of a tenancy will simply be a matter of negotiation. Options to renew will not always be offered by landlords and legislation does not provide for security of tenure in the case of commercial premises.

(iii) Security Deposit

A security deposit will almost always be required and invariably it will be an amount equivalent to two or three months' rent, management fees and other fees, such as air-conditioning charges. The security deposit will be refunded at the expiration of the term, but without interest, subject to forfeiture or deduction for breaches of the terms of the tenancy agreement. Hong Kong landlords are normally reluctant to accept

bank guarantees in lieu of cash deposits.

(iv) Alienation Rights

Commercial tenancy agreements will seldom include unrestricted right for the tenant to alienate the tenancy. More often than not there will be no right to assign, sublet or otherwise part with possession of the premises, although it may be possible to negotiate the right to share the premises with an associated company.

10.2 Staff Housing

Unlike in some countries where residential tenancy agreements are in a standard form endorsed by the local Law Society or real estate institute, Hong Kong has no standard form residential tenancy agreement. Accordingly, residential tenancies vary in terms just as widely as commercial tenancies.

In general, residential tenancies will be for a period of 2 years at a monthly rent fixed for the entire term. The tenant will be responsible for the payment of rates and management fees and charges such as for utilities. Some landlords will grant the tenant a "break right" allowing the tenant to terminate the tenancy after, say, the first 12 months of the term on the giving of 2 months' notice. Options to renew are rarely included. However, the tenant will have some degree of security of tenure by virtue of the Landlord and Tenant (Consolidation) Ordinance. This Ordinance provides a mechanism for renewing a tenancy at the expiration of the term of the agreement at the then "prevailing market rent", unless the landlord can show one of the statutory grounds on which to terminate the tenancy. As with commercial tenancies, a security deposit is almost always required.

11. ANCILLARY MATTERS

There are numerous other matters which need to be taken into consideration by the Overseas Corporation when setting up operations in Hong Kong, including making suitable banking and financial arrangements and insurance arrangements (including taking out compulsory Employees' Compensation Insurance and fire, burglary and public liability insurance) and (if appropriate) pension or provident fund arrangements for employees.

SHENZHEN

12. INTRODUCTION

Shenzhen is the only city in the PRC that borders Hong Kong, giving it an unique regional geographical advantage in terms of logistics. Shenzhen is currently the headquarters to 58 out of the top 500 foreign invested enterprises in the PRC and 11 out of the nation's top 50 enterprises have set up businesses including Epson Engineering (SZ) Ltd., Ricoh Industry (SZ) Ltd., and Huaqiang Sanyo Electronics Ltd.. Up to 2001, there were 1860 projects involving foreign investment, with a total investment of US$ 4 billion.

In 2002, foreign investment in Shenzhen has increased by 36.1% as compared to 2001 to reach a total amount of US$5.186 billion, of which direct foreign investment comprises US$3.191 billion.

Foreign investment covers a wide range of industries such as electronics, foodstuffs, textile and garments, pharmaceuticals, metals and plastics, real estate, finance, transport and catering businesses. The respective share of paid-in foreign investment in the primary, secondary and tertiary industries is 0.2%, 63.77% and 36.5%. The annual increase in actual use of foreign capital amounted to 45.9% in 2001.

Many foreign invested operations have enjoyed excellent performance and handsome returns by establishing in Shenzhen. Evidently, many other enterprises have followed suit in augmenting investments and expanding businesses in Shenzhen.

The majority of foreign investment has been focusing on the high-tech and manufacturing sectors. Shenzhen will continue to target foreign investments in these sectors in 2003.

13. FORMS OF OPERATION

Generally speaking, the majority of foreign investment in Shenzhen (like everywhere else in the PRC) is in the form of direct investment, by way of:

- sino-foreign equity joint ventures;
- sino-foreign contractual and co-operative joint ventures; or
- wholly foreign-owned enterprises (each referred to as “Foreign Investment Enterprise”, and collectively referred to as “Foreign Investment Enterprises”).

Additionally, foreign investors often set up representative offices and branch offices in Shenzhen.

FOREIGN INVESTMENT ENTERPRISES

14. LAWS AND RULES

Set out below is a list of laws, rules and regulations, at both the national and local level, which are relevant when establishing a Foreign Investment Enterprise in Shenzhen as well as to its operations thereafter. Together, these national and local laws and rules provide a legal framework establishing the independent operational rights of Foreign Investment Enterprises and to protect the legitimate rights and interests of both domestic and overseas investors in the PRC.

14.1 Basic Laws for Establishing a Foreign Investment Enterprise

The three basic laws, promulgated at the national PRC level, that one must consider in order to establish a Foreign Investment Enterprise in Shenzhen (as with everywhere in the PRC) are namely:

(a) the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (the "PRC Equity Joint Venture Law") - for the establishment of Chinese-Foreign Equity Joint Ventures;

(b) the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (the "PRC Contractual Joint Venture Law")- for the establishment of Chinese-Foreign Contractual Joint Ventures; and

(c) the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises (the "PRC Wholly Foreign-Owned Enterprise Law") - for the establishment of Wholly Foreign-Owned Enterprises.

14.2 Implementing Rules And Other Laws Relevant To Establishing a Foreign Investment Enterprise

There are also detailed national rules for the implementation of these basic laws and to regulate incidental matters after having established Foreign Investment Enterprises, e.g. taxation and liquidation procedures:

(a) Rules For the Implementation of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (12/1990);

(b) Rules For the Implementation of the Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures (8/1995);

(c) Rules For the Implementation of the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises;

(d) The Company Law of the People's Republic of China;

(e) The Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises;

(f) Interim Provisions for Guiding Foreign Investment;

(g) Industrial Catalogue for Foreign Investment;

(h) Interim Provisions Concerning the Investment within China of Foreign-invested Enterprises;

(i) Provisions Regarding the Merger and Separation of Foreign-invested Enterprises;

(j) Provisions on the Contribution of Capital by Parties To Chinese-Foreign Equity Joint Ventures (8/1988);

(k) Interim Provisions For the Duration of Chinese-Foreign Equity Joint Ventures (10/1990);

(l) Provisional Regulations on the Establishment of Foreign-Funded Joint Stock Companies Limited (1/1995); and

(m) Liquidation Measures for Enterprises with Foreign Investment.

Additionally, the PRC State government has also issued a "Directory of Industries for Foreign Investment" in order to provide guidance and approval of foreign-funded projects by giving four classifications of industries for foreign investment, namely industries which are encouraged; permitted; restricted; or forbidden.

Complementing the above national basic laws and rules, there are also local rules and policies for setting up Foreign Investment Enterprises pertinent to Shenzhen which are outlined below where appropriate.

14.3 Laws Affecting Operations of Foreign Investment Enterprises

Once approved and established, all of the Foreign Investment Enterprises (apart from the unlimited liability type of contractual joint ventures) are considered Chinese legal entities and as such must abide by all PRC laws, decrees, rules and regulations. These include the PRC Labour Law, the Unfair Competition Law, the Product Liability Law, the Advertising Law and various environmental protection laws. Given their Chinese legal entity status, Foreign Investment Enterprises (apart from the unlimited liability type of contractual joint ventures) are allowed to hire Chinese nationals as employees and are able to purchase land use rights on their own account (unlike representative offices which are not able to purchase land use rights on their own account).

Specific laws, many of which are applicable to one or more types of Foreign Investment Enterprises, have also been promulgated by the PRC government in relation to more specific areas of the law, such as taxation, business registration, accounting, foreign exchange, equity requirements and registered capital. These laws have been enacted with a view to increasing international economic co-operation and technological exchange between the Chinese parties and the Overseas Corporations. Through the various legislation, the Government protects the investments of Overseas Corporations, the profits due to them, and their other lawful rights and interests, pursuant to their government approved agreements, contracts and articles of association.

15. GENERAL ESTABLISHMENT PROCEDURES

Generally speaking, applications for the establishment of Foreign Investment Enterprises are usually dealt with at the provincial or local government level in charge of the geographical locality of the operation. Many of the policies of these local governments will vary depending upon their prevailing local, regional and national politics. In our case, application should be made to the Shenzhen Municipal Government. More specifically, stipulations by the Shenzhen Municipal Government provide that applications concerning the setting up of Foreign Investment Enterprises are to be submitted to the Shenzhen Municipal Foreign Investment Bureau (hereinafter referred to as "SMFIB"). However, major projects are nearly always approved at the central government level in Beijing, PRC.

Set out below is a description of the general steps and procedures that the Overseas Corporation must undertake when making an application for one of the three types of Foreign Investment Enterprises described above. These procedures are generally applicable for the applications of any of the Foreign Investment Enterprises, however references will be made where they differ for each different type of Foreign Investment Enterprises (for more specific details please see subsection "*Specific Requirements*" under the commentary for each type of

Foreign Investment Enterprises) or where the Foreign Investment Enterprise engages in certain businesses and activities.

15.1 Materials To Be Submitted Upon Application

(a) Mandatory Documents

The Overseas Corporation must submit the following documents to the SMFIB in order to initiate its application for a Foreign Investment Enterprise:

- 10 copies of the "Project Clearance Form For Foreign Investment in Shenzhen" completed by the Overseas Corporation (including 2 original copies) - upon lodging the application by the Overseas Corporation, the SMFIB will also determine if the case qualifies for a project enjoying duty exemption for imported equipment. And if so, the SMFIB shall issue a "Verification Paper for State Encouraged Projects" pursuant to "The Industry Catalogue for Guiding Foreign Investment";

- upon the receipt of a preliminary clearance from the SMFIB, the Overseas Corporation (or the Chinese party, if setting up an equity or contractual joint venture) 5 original copies of a feasibility study report outlining the necessary steps for the success of the Foreign Investment Enterprise prepared, signed and chopped by the Overseas Corporation (and the Chinese party, if setting up an equity or contractual joint venture);

- for a project which impacts on the environment, the Overseas Corporation must also complete and submit 4 original copies of "Environmental Protection Examination and Approval Form For Construction Projects in Shenzhen" (the Overseas Corporation may first refer to the Municipal Environment Protection Bureau for clearance of its business);

- a copy of the "Notice of Advance Authorization of the Company Name" issued by the Industrial & Commercial Administrative Bureau to the Overseas Corporation for the approval of the proposed name of the Foreign Investment Enterprise;

- a copy of any legal business licence, certificate of incorporation, certificate of business registration, or their equivalent, of the Overseas Corporation issued by authorities its place of incorporation;

- a copy of legal registration papers of directors and shareholders or authorisation papers from the PRC embassy or consulate posted overseas for establishment of the Foreign Investment Enterprise;

- a copy of the Overseas Corporation's "creditability papers" issued by the Overseas Corporation's bank vouching for the financial history, trustworthiness and stability of the Overseas Corporation;

- an original copy of the resolution of the board of directors or shareholders' general meeting of the Overseas Corporation for the establishment of the Foreign Investment Enterprise;

- a copy of the Overseas Corporation's capital verification report or its equivalent, such as an auditors' report);

- a copy of the Overseas Corporation's "liabilities sheet" or its equivalent, such as its balance sheet, clearing showing its liabilities, for the last 3 financial years;

- an original copy of a certificate issued by the relevant taxation authority of the Overseas Corporation's place of incorporation confirming that the Overseas Corporation has no outstanding corporate income tax liability;

- where there is another party or parties involved in the establishment of the Foreign Investment Enterprise, the Overseas Corporation must submit 4 original copies of the agreement entered into by the Overseas Corporation with the party or parties, that have been signed and sealed by the representatives of the Overseas Corporation - wholly foreign-owned enterprises may be established without such an agreement, but instead it must complete and submit an original copy of the "Application Form For Establishing Foreign-invested Enterprise in China";

- 4 original copies of the Foreign Investment Enterprise's proposed articles of association that have been signed and sealed by the representatives of the Overseas Corporation;

- an original copy of the "SMFIB Ratification Paper" with the stub of the said form completed by the Overseas Corporation;

- the first page of the "Notice Sheet of National Institutions and Organisations Codes";

- copy of any powers of attorney where the Overseas Corporation authorises any other person or persons to sign the required documents to be submitted to the SMFIB; and

- any other documents as required by the SMFIB.

In relation to sino-foreign equity joint ventures and sino-foreign contractual and co-operative joint ventures, there are additional documentary requirements. The Chinese party to these "partnership type" Foreign Investment Enterprises must submit, together with the above-mentioned documents to be submitted by the Overseas Corporation, the following additional documents to the SMFIB when making its application:

- an asset evaluation report for the assets to be contributed by the Chinese party towards the establishment of the Foreign Investment Enterprise; and

- if the said assets happens to be State–owned, an additional confirmation from the State Asset Administration for the assets evaluation results as well as a clearance from the department in question with the relevant asset ownership portfolio.

Once the above documents have been submitted to the SMFIB and assuming that the SMFIB approves, it will then issue a "Project Approval Form", which the Overseas Corporation will then use to go through registration procedures with the Industry and Commerce Administration Bureau for a requisite business licence in order to carry out its intended business.

(b) Special Documents In Special Cases

For Foreign Investment Enterprises with proposed businesses in real estate development or property investment and management, or alternatively where part of the capital contribution or terms of cooperation of the Foreign Investment Enterprise comprises of self-owned property, the Overseas Corporation must also submit a copy of the valid documentation for land use rights and property and building ownership to the SMFIB.

For businesses in hotel, catering, recreations and warehousing, the Overseas Corporation must secure and submit to the SMFIB the valid approvals and licences from the relevant PRC authorities authorising its business and the use of its proposed facilities. Further, an approval

issued by the Municipal Planning and Lands Bureau must also be obtained and submitted to the SMFIB for these businesses.

Special approvals and licences, pursuant to current national PRC laws and regulations, are required for Foreign Investment Enterprises engaged in areas such as investment, construction, trade and commerce, leasing, freight forwarding, and transport.

15.2 Points For Attention

Particular attention must be paid by the Overseas Corporation to the following matters when seeking approval for the establishment of a Foreign Investment Enterprise:

(a) Under no circumstances should the Overseas Corporation make an investment in the form of property subject to an existing legal encumbrance such as a mortgage or a charge or property acquired under a capital leasing arrangement.

(b) The Overseas Corporation is responsible for the legality and validity of all the above-mentioned documents submitted.

(c) The SMFIB reserves the right to request the Overseas Corporation for documents to be resubmitted or revised or for further information and documents, within a prescribed time, when it is of the opinion that the submitted documents are inadequate or irrelevant to its consideration for approving a Foreign Investment Enterprise. In that event, the process of application and clearance will be subject to postponement.

16. SINO-FOREIGN EQUITY JOINT VENTURES

16.1 Introduction

A sino-foreign equity joint venture ("EJV") is a limited liability company, with a governing board of directors, established in the PRC with joint investment from the Chinese and foreign parties.

EJV is considered a Chinese legal entity and as such must abide by all laws, decrees, rules and regulations of the PRC. In particular, EJVs are governed by the PRC Equity Joint Venture Law and its implementing rules. According to these laws, the foreign party to the venture, i.e. the Overseas Corporation, must invest at least 25% of the EJV's registered capital. The underlying principle is joint effort and participation - the risks and losses of the EJV are shared by the parties in proportions to their contributions to the registered capital. Any profit that the Overseas Corporation receives may be remitted abroad in accordance with PRC foreign exchange regulations and in the currency specified in the joint venture agreement.

Given its Chinese legal entity status, an EJV is allowed to hire Chinese nationals as its staff and are able to purchase land on their own account (unlike representative offices which are not able to purchase land on their own account). Shareholdings in EJVs cannot be transferred without the prior approval from the government and the consent of all the other parties to the EJV.

16.2 Specific Requirements

The steps and procedures described under the section "*General Establishment Procedures*" applies to the establishment of an EJV. However, the following is various specific requirements particular to the establishment of an EJV.

Memorandum Of Understanding

The first step in forming a EJV is for the Overseas Corporation to find a suitable PRC partner to enter into a non-binding letter of intent, known as a Memorandum of Understanding ("MOU"). Once signed, the Chinese party will seek preliminary approval of the EJV from the SMFIB and relevant government bodies. The MOU usually contains a detailed description of the proposed project, an estimate of the amount of investment required, the equity split between the Chinese and the foreign party, and a general undertaking by both parties to jointly explore and exploit the business opportunities agreed upon. Albeit the non-binding nature of a MOU, its is important to draft the MOU concisely to define the business scope of the EJV. If it becomes apparent that the submitted MOU is clearly inappropriate or requires modification, the SMFIB may require the Overseas Corporation to resubmit its application. It is paramount that the MOU reflects the preliminary views of the parties and state that the final agreement is subject to completion of the joint venture feasibility study and the execution of a binding joint venture contract between the parties and an articles of association of the proposed EJV.

Feasibility Study Report

The next step is for the parties to jointly prepare a feasibility study, which is again a non-legally binding document. Either the Overseas Corporation or the Chinese party may still opt not to proceed with the establishment of the EJV. The report must contain details of the EJV and its business, including:

(a) the EJV partners;

(b) location of its operation, including details of its factory and office premises;

(c) the objectives, structure and form of the EJV, including the amount of investment and contributions from each of its parties and its financing arrangements;

(d) its business and products, including a description of the technical standards of its products, output projections, testing and quality control;

(e) its production technology and equipment, including estimates for the cost of equipment and any technology transfer fees;

(f) a market analysis for its products both domestically and internationally, projected sales, methods of distribution, and an analysis of its competition;

(g) an analysis of the environment impact, if any, caused the EJV's operation, including disclosure of the EJV's by-products and waste;

(h) supply, utility, and transport and warehousing requirements;

(i) foreign exchange requirements and projections;

(j) staff requirements and training programmes; and

(k) financial projections and economic cost and benefit analysis.

Once the feasibility study report is submitted (usually by the Chinese party of the EJV) to the SMFIB, it will be initially reviewed. Then passed, via the local planning commission, to other government organisations, including those involved in labour planning and raw material supplies, finance and utilities, concerned with, or affected by the operation of the EJV.

The contents of the report are important, as the various Chinese governmental organisations rely heavily on the report when making their decisions relating to the operation of the EJV. For example, if the electricity requirement of the EJV factory is underestimated, the Overseas Corporation could find the regular stoppages of the EJV's operation given the lack of power.

Similarly, if export quotas are overestimated, failure to meet quotas may be reason for restricting the EJV's access to the domestic PRC market.

Joint Venture Agreement and Articles of Association

The joint venture agreement sets out the legal rights and obligations of the parties to the EJV and the articles of association deal with the internal organisation and operation of the EJV. They must be written in Chinese, although a version in an agreed second language will have equal validity. The joint venture agreement is governed by PRC laws. It is often supplemented by ancillary contracts, such as technology transfer contracts, technical assistance contracts, trademark licence contracts, and various supply and distribution agreements. The articles of association mirror many of the provisions of the joint venture agreement. However, in the case of conflict or inconsistency between the two, the joint venture agreement usually prevails.

16.3 Time

Once all the necessary documents have been submitted, the review process will normally be completed within 3 months of receipt of the application. If approved, the EJV registers with the Department of Industry and Commerce Administration, which will issue a business licence, allowing the joint venture to carry on business activities in the PRC as a Chinese legal person. After which, operations may begin. From then, the EJV will need to open a foreign exchange account, obtain funding from foreign banks (if required), register for taxation purposes with the local tax authority, register at the Custom House for customs and obtain insurance with Chinese insurance companies.

16.4 Capital Contribution

Under the PRC Equity Joint Venture Law, the Overseas Corporation must contribute at least 25% of the total investment: there is no minimum investment for the Chinese partner. The initial equity investment can take the form of cash, buildings, machinery, equipment, intellectual property rights, land-use rights, and technology, but cannot include labour.

The theory behind the formation of EJVs is that EJVs are usually established to exploit the market knowledge and manufacturing capabilities of the Chinese party, and the technologies, know how and marketing experience of the foreign partner. Accordingly, it is usually the Chinese partner who contributes the buildings, land and other assets from their existing operations, while the foreign party contributes machinery, equipment, industrial technologies and know how. All contributions must be recorded in the joint venture agreement or in the articles of association of the EJV, together with respective values.

In addition, there are strict ratios of debt to equity laid down by the PRC Equity Joint Venture Law according to the size of the EJV:

(a) less than US$3million - equity must constitute 70% of the investment;

(b) more than US$3 million, but less than US$10 million - equity must constitute at least 50% of the investment;

(c) more than US$10 million but less than US$30 million - 40% must be equity; and

(d) more than US$30 million - 33% of the investment must be equity.

Timing of the capital contributions, whether in cash or in kind, is also important. Failure to make timely contributions will result in financial penalties in the nature of default interest and may eventually result in a cancellation of the EJV's business licence. If the parties decide to

make their contributions to the registered capital of the EJV in one lump sum, the contribution must be paid up within 6 months of the issuance of the EJV's business licence. If the contribution is to be made in installments, the first installment of not less than 15% of the EJV's registered capital must be paid within 3 months of the issuance of the EJV's business licence. Thereafter, the time frame for the payment of outstanding capital contributions is as follows:

Amount:	**Time following the issue of the EJV's business licence:**
US$500,000 or under	one year;
US$500,000 - US$1 million	One and a half years;
US$1 million -3 million	Two years;
US$3 million -10 million	Three years; and
US$10 million and above	Subject to specific approval.

16.5 Duration

The operation periods of EJVs vary according to the particular line of business and circumstances in each case. EJVs engaged in some business will specify the operation period of the in the joint venture agreement, while EJVs engaged in other types of business may choose not to do so. Where the operation period is specified, and if the parties decide to extend it, an application must be made to the SMFIB 6 months prior to the expiration of the operation period. The SMFIB shall decide whether to approve the extension within 1 month of the application.

Termination of the EJV may be affected by agreement of the parties, subject to approval by the SMFIB and registration with Industry and Commerce Administration Bureau.

17. CO-OPERATIVE/CONTRACTUAL JOINT VENTURES

17.1 Introduction

Broadly speaking, the aim of a co-operative or contractual joint venture ("CJV") is to expand economic co-operation and technological exchange between China and foreign countries: export-oriented or technologically advanced CJVs are actively encouraged.

CJVs are governed by the PRC Contractual Joint Venture Law and its implementing rules, and must abide by Chinese laws and regulations and must not operate contrary to the public interests. Any transfer of rights to the CJV must be agreed by the other party to the CJV and approved by the SMFIB.

17.2 Legal Status

A CJV may be of limited liability with the status of a Chinese legal person, or alternatively, of unlimited liability in a non-legal person form, akin to a partnership.

The limited liability CJV in many ways resembles the structure of an EJV, with a joint venture agreement and an articles of association setting out the relationship between the parties and the internal organisation of the CJV respectively. However, there is a key difference being that in an EJV, profit distribution must be in proportion to the registered capital contributions of the parties to EJV, whereas for a CJV, profit distribution may be determined by contractual arrangements irrespective of the proportion of capital contributed by the parties. This allows for a more flexible schedule for return on investment where one investor provides cash while the other party's investment is primarily in kind.

The unlimited liability CJV is similar to a partnership whereby the parties jointly incur unlimited liability for the debts and obligations of the CJV. No separate legal personality is created. The precise division of liability and profit share is agreed between the parties in the joint venture agreement. Management, technical and marketing functions are also allocated contractually. A joint management committee is formed by representatives (delegated by the parties) to manage the joint venture. There are no articles of association for this kind of CJV.

17.3 Capital Contribution

Like an EJV, the investment contribution or the conditions of co-operation provided by each of the parties to the CJV may be in cash, in kind, or property rights such as industrial property rights, know-how and land-use rights.

For a limited liability CJV, the investment made by the Overseas Corporation must be at least 25% of the registered capital of the CJV. For an unlimited liability CJV, the specific requirements for the investment made are subject to Ministry of Foreign Trade and Economic Co-operation ("MOFTEC") regulations.

Similar to an EJV, it is usually the foreign investor provides the majority of the funding, whilst the Chinese party provides land, equipment, industrial property rights, non-patent technology, and other facilities.

17.4 Specific Requirements

The SMFIB authorised by the State Council to grant approvals for the establishment of CJVs, which may approve CJVs in the following, amongst other, circumstances:

(a) the total amount of investment is within the authorisation for approval as set by the State Council;

(b) the capital will be raised by the applicants themselves; and

(c) export quotas are not imposed upon the exportation of the CJV's products and do not require licences, or if they do, the consents of relevant competent departments have been obtained prior to submitting the application for establishing the CJV.

Approval will not be granted if the CJV:

(a) is of detriment to PRC's sovereignty or public interests;

(b) would jeopardise State security;

(c) pollutes or damages the environment; or

(d) violates any laws, administrative rules or State industrial policies.

The steps and procedures described under the section "*General Establishment Procedures*" applies to the establishment of a CJV. Further, the considerations involved when preparing the feasibility study report, the joint venture agreement and the articles of association for an EJV (please see subsection "*Specific Requirements*" under "*Sino-Foreign Equity Joint Ventures*") applies equally to the establishment of a CJV. But emphasis must be place upon the joint venture agreement. This should contain details of the registered capital (which may be in Renminbi or any other freely convertible currency), investment contributions and/or the conditions for co-operation, management structure, ownership of property, and termination events. The parties shall stipulate in the joint venture agreement, based on the production and operation requirements of the CJV, the duration of the investment and/or the co-operation. Most importantly, it must provide for the distribution of earnings and sharing of risks and

losses given that with CJVs such matters do not commensurate with each of the parties' contributions. Any future modifications to the joint venture agreement will require further approval from the SMFIB.

17.5 Time

Normally, it may take up to 45 working days for the SMFIB to approve the application for the CJV. Upon approval, the SMFIB will grant a certificate of approval and then in turn submit the approval documents to MOFTEC within 30 days of approval being granted. Thereafter, the CJV should apply to the administrative authority for industry and commerce for registration and obtain a business licence.

17.6 Management And Operation

Once established, a CJV may, by presenting its business license, open a foreign exchange account, obtain loans from financial institutions, and purchase insurance. If within its approved scope of operation, the CJV may import its raw material requirements and, as strongly encouraged by the PRC State Government, export its products.

The board of directors (comprising of at least 3 members), which is the governing body of the CJV, shall meet at least once a year. Decisions which require unanimous resolution by the board of directors, including:

(a) amendments to the CJV's articles of association;

(b) increase or reduction of the CJV's registered capital;

(c) dissolution of the CJV;

(d) mortgage of CJV's assets;

(e) merger or change in the form of the CJV; and

(f) any other matters previously agreed upon by the parties.

For unlimited liability CJVs, a joint management committee, which essentially has the same functions as a board of directors, must be established.

With unanimous consent from the board of directors or the joint management committee and approval from the SMFIB, a limited liability CJV or an unlimited liability CJV respectively, may entrust a third party with the management and operation of the CJV. This type of arrangement is common, for example, in the hotel and hospitality industry, where an outside hotel management team is often appointed.

17.7 Taxation

For unlimited liability CJVs, each party may either compute and pay its own income tax in accordance with the relevant tax laws and regulations or alternatively may, with the approval of the local tax authority, compute and pay their taxes collectively as an entity.

Limited liability CJVs are required to pay a national income tax of 30% and a local income tax of 3%. Depending on its locality and business activities, there are several concessions that allow for either reductions or complete exemptions from taxation.

All CJVs are also subject to value-added tax, business tax, consumption tax, capital appreciation tax, customs duties, and import taxes.

17.8 Duration

The parties shall stipulate in the joint venture agreement, based on the production and operation requirements of the CJV, the duration of the investment and/or the co-operation. Any transfer of rights to the CJV must be agreed by the other party to the CJV and approved by the SMFIB.

Where there is no time limit as to the term of the CJV, the Overseas Corporation is allowed to withdraw its registered capital at any time. On the expiration of the joint venture, all the fixed assets belong to the Chinese party on a gratuitous basis. The Overseas Corporation may apply to the SMFIB for early recovery of its investment, provided that any losses have been fully paid. The profits it receives as its share, other legitimate income, and any equity returned as its share upon the termination of the venture, may be sent abroad by the Overseas Corporation.

17.9 ADVANTAGES OF CJVs

In many instances, establishing a CJV can be a better option for a foreign investor rather than establishing an EJV. As a starting point, the Overseas Corporation does not need to set up a new corporation in China - the Overseas Corporation and the Chinese partner participate in the CJV by relying heavily on the Chinese party's existing business license, under a contractual arrangement. Often such an arrangement is used in land and hotel projects due to the tax advantages. If the business vehicle is a straightforward EJV, upon the Chinese party transferring the land to the EJV, a liability to transfer tax will arise. However, under a CJV, the land stays in the possession of the Chinese partner and therefore no transfer taxes are payable. Also, where the Chinese partner is in possession of the land but does not have clear legal title (a common occurrence in China) - under an EJV the land would have to be bought from the Chinese Bureau of Land Control if the title was to be transferred to the EJV entity. Whereas under a CJV, provided that the status of the Chinese partner is high enough to maintain possession of the land, no such transfer will be required.

Flexibility is another key factor in choosing a CJV. The percentage of the CJV owned by each partner can change throughout the CJV's life, with the idea being that the Overseas Corporation can receive a faster return on their investment whilst ensuring that the Chinese partner maintains long term control. A Overseas Corporation usually want control over the joint venture at its inception because of the capital amount it has injected, such control being transferred over to the Chinese party as and when the CJV becomes profitable. The Chinese party is safe with the knowledge that even though initial changes may be made, they will maintain control in the long term and, in all likelihood, benefit from seeing modern management and marketing techniques being utilised by their foreign partner.

18. TERMINATION OF EJVs and CJVs

The duration of an EJV or a CJV must be stated in the joint venture agreement. For most EJVs and CJVs, the approved term is usually between 10 to 30 years, although in cases where the amount of investment is large, or the construction time is long, the term may be extended to 50 years (with prior approval of the State Council). If an extension is required, a formal application must be made to the SMFIB 180 days before expiry of the current term. However, the duration will not be extended if the joint venture agreement allows the Overseas Corporation to first recover its investment and the said investment has been fully recovered.

An EJV or a CJV may be dissolved in the following situations:

(a) end of its contractual term;

(b) inability to continue operations due to financial losses or heavy losses caused by force majeure;

(c) inability to continue operations due to the failure of one party to fulfil its contractual obligations under the joint venture agreement;

(d) for any other reasons stipulated in the joint venture agreement and its articles of association; or

(e) revocation ordered by PRC authorities according to law due to violation of laws and/or administrative regulations.

19. WHOLLY FOREIGN-OWNED ENTERPRISES

19.1 Introduction

Wholly foreign-owned enterprises ("WFOEs") are governed by the PRC Wholly Foreign-Owned Enterprise Law and its implementing rules. Its investment are solely contributed the Overseas Corporation and takes profits and risks all on its own account. Although most WFOEs are established by one foreign investor, there are no legal restrictions on the number of foreign investors participating in such enterprises.

19.2 Legal Status

WFOEs are usually set up as limited liability companies with separate legal person status. Only upon general approval may a WFOE be established with other forms of liability. Its status as a limited liability company is confirmed in its articles of association.

The liability of the Overseas Corporation is limited to the amount of capital it contributed. However, the limited liability nature of the company should be distinguished from the unlimited potential liability of a WFOE's directors, managers, advisors or suppliers under product liability, worker safety or environmental protection regulations.

A WFOE must abide by all Chinese laws, decrees, rules and regulations. Given its separate legal entity status, it is allowed to enter into contracts with appropriate government authorities or Chinese business entities in order to acquire land use rights, rent buildings, and receive utility services etc. Labour must be employed in accordance with the applicable PRC labour laws.

19.3 Advantages Of WFOEs

The most striking difference between a WFOE and an EJV is the absence of a Chinese party, which brings about its own advantages and disadvantages. The procedures for the establishment of a WFOE is greatly shortened and simplified, as lengthy negotiations with a Chinese party are not required. As long as the relevant law and rules have been are complied with, the Overseas Corporation is free to determine the scope of the WFOE's operation, the number of its employees, the percentage of its exports as compared to its imports etc.

A further advantage is the Overseas Corporation's technologies and commercially sensitive information remains confidential. Given the co-operative nature of an EJV or a CJV, the technologies, know how and commercial information of the Overseas Corporation must, to certain extent be disclosed and/or shared with its Chinese partner, which in turn may be tempted to make use of such information without the prior consent of the Overseas Corporation.

The other side to this argument is that its knowledge of China and the Chinese culture and its social connections, a Chinese partner may prove useful in dealings with PRC officials and maintaining good relations with the relevant local authorities. However, WFOEs often solve or ameliorate the disadvantages of not having a Chinese partner by hiring PRC nationals to assist with its interactions with the various authorities.

19.4 Specific Requirements

The underlying principle of the PRC Wholly Foreign-Owned Enterprise Law is that a WFOE must be conducive to the development of China's national economy and yield notable economic benefits, and accordingly must meet at least one of the following criteria:

(a) use internationally advanced technology, the application of which is of benefit to China;

(b) develop new products, save energy and raw materials, and upgrade and replace existing products that can be substituted for imports; or

(c) export at least 50% of the total value of all its products manufactured and maintain a positive balance of foreign exchange in Renminbi.

There are also limitations in the types of business in which a WFOE may engage in. The following types of business are absolute prohibitions:

(a) news, publishing, radio broadcasting or movie making;

(b) postal industries; and

(c) any other industry prohibited from time to time by the relevant authorities.

In general, the establishment of a WFOE engaged in the following businesses requires special approval from MOFTEC:

(a) public utilities;

(b) transportation;

(c) real estate;

(d) trust and investment; and

(e) leasing.

Documentary requirements for the establishment of a WFOE vary slightly from those of an EJV or a CJV. The main difference being the requirement of a project proposal.

19.5 Approval

Approvals for WFOEs are granted more sparingly than for EJVs or CJVs. This is mainly due the fact that WFOEs enjoy exclusive management control of their business activities and are autonomous in their management, with little interference from the PRC government. The application process is usually also more expensive and lengthier due to the absence of a Chinese partner to guide the project through the approval process and regulatory issues.

REPRESENTATIVE OFFICES AND BRANCH OFFICES

20. REPRESENTATIVE OFFICES

20.1 Introduction

Representative offices are a favoured option for Overseas Corporations with a genuine need for a permanent presence in the PRC. Such offices may engage in non-direct business activities within the PRC. Their function is limited to representing an Overseas Corporation in conducting business liaison with trade organisations or related industries, product introduction, market surveys and research, and technological exchange within the business scope of the Overseas Corporation.

A representative office is a good way for the Overseas Corporation to gain experience and acquire a better understanding of the size and potential of the PRC market. The representative office is a means for the Overseas Corporation to work out its long-term PRC objectives, oversee its business operations running in the PRC (for example a CJV), and forge stronger links with the domestic PRC market.

It is important for Overseas Corporations to establish representative offices to signal their intention in conducting businesses in the PRC and that they view China as a long term investment. The presence of a representative office is often a good bargaining tool in subsequent joint venture negotiations, showing that the Overseas Corporation intends to further invest in the PRC.

20.2 Specific Requirements

To set up its representative office, the Overseas Corporation must:

(a) be legally registered in its country of incorporation;

(b) have good commercial credibility;

(c) provide various "true and reliable" materials required by the implementation rules of the PRC; and

(d) complete the application procedures in accordance with the implementation rules.

There are a number of prohibitions in relation to representative offices: only certain specified activities may be undertaken in the representative office, and the representative office cannot generate income including any fees received for services rendered or sign contracts that generate income. However, a representative office is allowed to negotiate contracts which are later executed in the name of the Overseas Corporation.

Under rules of the State Administration of Industry and Commerce, a Overseas Corporation must register a representative office within six months of establishing a business presence in China. Failure to comply, will result in a fine (around US$1,150) and, in serious cases, the Overseas Corporation may be banned from engaging in further business activity in the PRC. The State Administration of Industry and Commerce enforces this requirement by carrying out random checks and using informants.

Unless a representative office is registered, the company will be unable to employ Chinese nationals, open a bank account, import duty-free personal effects, import office equipment without an import licence, obtain telephone lines, display company signs, or use business cards identifying the Overseas Corporation's presence in China. Further, the Overseas

Corporation's representative will only be able to obtain a multiple entry visa for the PRC and legally rent accommodation once its representative office has been registered.

21. BRANCH OFFICES

A branch office does not have Chinese legal person status, but is permitted to carry out certain manufacturing and selling activities, as allowed by the Company Law of the PRC (enacted on 29 December 1993 and effective 1 July 1994). The Company Law was enacted for the purpose of allowing Overseas Corporations to conduct sales and manufacturing businesses in China without requiring them to make sizeable investments, as is required when setting up a WFOE.

Given that its lack of legal entity status, the branch office instead relies upon the separate legal entity status of the Overseas Corporation. Accordingly, the Overseas Corporation would be liable for all obligation, liabilities and wrongdoings of the branch office.

A representative office is unable to import products or sell samples, whereas under the Company Law, a branch office may do so and representatives of a branch office can engage in sales negotiations. However, a representative from the Overseas Corporation must execute and sign any sales agreements entered into in the PRC. All sales must be invoiced and imported from overseas.

April 2003