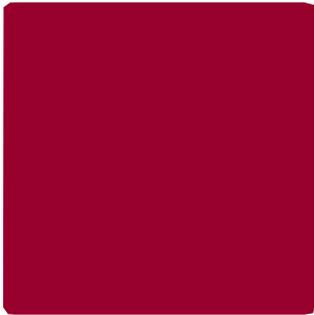
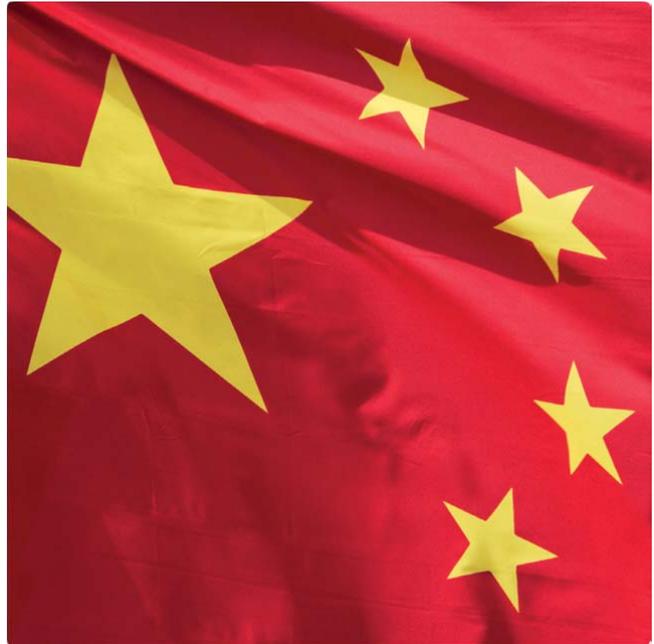


Doing Business in China

Foreign Direct Investment



China

Despite the global financial crisis, foreign direct investment into China continues to grow. With China recently overtaking Japan as the world's 2nd largest economy, foreign investment into China looks set to continue its rise. Nonetheless, foreign investors need to be aware of a number of crucial factors.

Restrictions on Foreign Ownership

- The Industrial Catalogue for the Guidance of Foreign Investment ("Guidance Catalogue") has classified industries as encouraged, restricted, prohibited and permitted for foreign investment. The latest version of the Guidance Catalogue has a strong focus on encouraging investment in green and high-tech industries. Being "encouraged" can bring a number of advantages, including expedited approvals and registrations, and potential fiscal assistance from applicable governments.

Business Vehicles

- Representative Offices.
- Locally incorporated wholly-owned subsidiaries of parent companies (known as "wholly foreign-owned enterprises" or "WFOEs"), which are limited liability companies. This is the most common form of business vehicle used by foreign investors, particularly if no foreign-ownership restrictions apply to the relevant industry.
- Joint ventures - either Sino-foreign equity joint ventures ("EJVs"), Sino-foreign cooperative joint ventures ("CJVs") or foreign-invested

joint venture companies limited by shares ("FICLs"). EJVs and CJVs are almost always limited liability companies, whereas FICLs are companies limited by shares.

- For foreign private equity players, the latest developments have centered around partnering with domestic Renminbi funds.
- For foreign venture capital players, most enterprises have entered China through specific types of joint venture arrangements permitted under Chinese law (though such opportunities are limited to the high-tech sector).

Approval & Registration

- The incorporation of an FIE is registered on the issuance of a business license by the relevant Administration of Industry and Commerce. Prior to this, the applicant will need to obtain approval from the Ministry of Commerce (commonly referred to as "MOC" or "MOFCOM") or its local counterpart (depending on, among other things, the amount of investment).
- Further registrations are then made with the relevant authorities of tax, foreign exchange, customs, etc. In certain industries (e.g. banking,

securities, asset management, insurance, etc) pre-approval from the competent industry administration is required.

Capital Requirements

- Theoretically, the minimum capitalization for a standard limited liability company is CNY30,000 (about US\$4,615). However, in practice, the minimum requirements for FIEs are much greater and vary greatly across districts and regions in respect of the types of companies permitted and from industry to industry. For example, in regulated industries such as banking, securities and asset management, minimum capital requirements are considerably high.

Shareholder & Director Nationality

- No restrictions apply on the nationality of shareholders and directors. As mentioned above, WFOEs are not permitted in certain industries (e.g. in the finance sector).

Management Structure

- Management and control of a Chinese company is 3-tiered – (i) the shareholders' general meeting (not required if there's only one shareholder); (ii) the board of directors; and (iii) the general management. These are subject to the scrutiny and supervision of the supervisory board.
- For FIEs in the form of limited liability companies, there are only two tiers with the board of directors being the ultimate authority, instead of the shareholders' general meeting. In addition to the formal structures of management, the company is also required to consult with representatives of its labor union (if it exists) and employees for matters such as restructuring of the company, major issues concerning operation and other significant rules and regulations of the company.

Directors' Liability

- Directors, senior management and supervisors are subject to duties of loyalty and diligence to the company. Among other restrictions, directors, senior managers and supervisors are also prohibited from embezzling funds of the company, depositing company funds in a bank account in his/her name or another person's name, lending company funds to others, taking advantage of his/her position to obtain commercial opportunities belonging to the company.

Parent Company Liability

- Limited liability companies are similar conceptually to proprietary or private companies found in most jurisdictions. They are intended to be 'closed' companies which are not open to public investment. Their investors assume liabilities towards the company to the extent of their respective subscribed capital contributions and the company is liable, to the extent of all its assets, for its debts.
- Companies limited by shares are similar conceptually to public companies found in most jurisdictions. Public investment is permitted but, compared with a limited liability company, a larger capital investment is required and the requirements for formation and governance are generally more restrictive. The total capital of a company limited by shares is divided into equal shares. Shareholders assume liabilities towards the company to the extent of their respective subscribed shareholdings and the company is liable, to the extent of all its assets, for its debts.

Work/Residency Permits

- Foreign employees need to obtain a work ("Z") visa, work permit and residency permit to work in China. Generally, it takes up to 15 working days to apply for work permits and 5 working days for residency permits, after all the necessary application documents have been properly compiled. The procedure and timeline varies in different locations.

Thin Capitalization Rules

- Debt investments to equity investments from related parties must not exceed a certain amount, otherwise the interest from the excess debt will be deemed to be non-deductible for tax purposes. China has statutory ratios governing registered capital and total investment amounts for FIEs. Money borrowed by an FIE from foreign affiliates cannot exceed the balance of total investment minus registered capital. In respect of foreign-invested investment (or "holding") companies incorporated in China, the mandatory borrowing threshold has been increased to six times the amount of paid-up registered capital, provided that the registered capital of the company is not less than US\$100 million. For foreign-invested investment companies with a registered capital of less than US\$100 million, the threshold imposed is four times the amount of their paid-up registered capital.

Competition

- Restrictive agreements and certain other anti-competitive practices are regulated mainly through Unfair Competition Law, Provisional Rules on Banning Exorbitant Profits, Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, Anti-Monopoly Law. Activities such as monopoly agreements, the abuse of dominant market position, large-scale consolidations, and administrative monopolies are regulated.

Restrictions in the Financial Services Sector

- Business activities in the financial services sector are strictly regulated and are subject to the obtaining of certain approvals. Foreign equity participation in entities in regulated industries (like banking, securities, asset management, insurance) is restricted to specific limits.

Governing Law of Documents

- The preferred choice of governing law and enforcement mechanisms (i.e. litigation or arbitration) will depend to a large extent on the specific details of the transaction including, amongst other things, the type of agreement being entered into, the location of the parties and their assets, the complexity of the proposed arrangements, whether any of the contracts are to be governed by foreign law and the existence of offshore asset security or guarantees.