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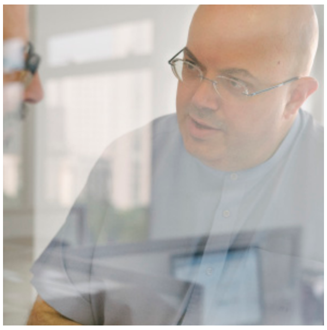

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Investing in China Today

Opportunities in the World's Most Emergent New Market Across Recent Law Reforms

Legal reforms, social changes and market rules

For the past 30-plus years, the world has been witness to a continuous relocation of business enterprises in every commercial sector looking to “get their foot” in the territory of the People’s Republic of China.

During the 19th century, most European enterprises interested in developing business in China have been focused in the relocating of production, largely driven by high taxation in other countries as well as high manpower costs, all pushing the “migration” of enterprises and their operations to China. In the 20th century the situation began to change, and the country thought of as the “factory of the world” gradually became the “Market” — the place where a growing consumer demand was increasingly ready to embrace, firstly, the offer of new items, and more recently, insist on greater quality.

The days when foreign companies looked at China only as an indivisible monolith of 1 billion potential workers has changed. In the actual global economic situation, companies are now focusing on how to make an investment in China genuinely effective and how to capture small and medium segments of China’s giant market. However, none of these segments is as attractive or as full of potential as the country’s rapidly growing — and multifaceted — middle class.

As China’s economy continues to grow, more people are migrating and will continue to migrate to China’s booming metropolises to find better-paying jobs. These working consumers will steadily climb the income ladder and join the new middle class. This means a growing demand in the market.

Companies that can effectively understand the composition and needs of this middle class market will be positioned to reap massive rewards.

The above-mentioned migration was ascendant in two decades. From 1995 to 2005, the population of China’s middle class — defined here as households with annual incomes ranging from US$6,000 to US$25,000 — grew from close to zero in 1995 to an estimated 87 million in 2005. It is estimated that China’s middle class will jump to 340 million by 2016.

The results of this ascendancy is that purchasing power — disposable income minus savings — of China’s middle class is growing accordingly. In 2006, around 39 percent of urban households were middle class. By 2016, it is estimated that the above percentage will likely rise to 60 percent.

Considering its swelling numbers, purchasing power, and trajectory, China’s middle class presents marketing opportunities that foreign companies cannot afford to miss.

Each company may have a different concept of exactly what it means to be “*middle class in China*”.

To understand the real meaning of the said class, it may be assumed that income plays a powerful role in most purchasing decisions for any consumer segment. However, other elements play a role that is sometimes greater than income. When products are relatively inexpensive, income has little influence on a consumer’s decision making process.

Though middle class consumers have rising purchasing power and are increasingly willing to pay more for higher quality, brand names, and differentiated features, a part of this group still remains price sensitive.

Lower middle class shoppers, for example, tend to buy top-tier products that serve to make a show of their wealth and status. These middle class consumers sometimes spend a large portion of their income on expensive goods. By contrast, upper middle class shoppers, who are more experienced with different types of brands, will seek out relatively high-quality products without paying as much attention to brands or will simply choose products based merely on personal tastes.

According to this first view, it can be understood that the continuous change of the business landscape for foreign companies interested in any investment plan in China is influenced by an increase of the market sophistication and consumers’ identification. On the same level, the said business landscape and its change is the result of numerous economic and legal reforms that have and continue to occur in China in during the past ten years.

With reforms, the Chinese government is encouraging development of the Chinese market and its internal consumption. This seems to be demonstrated by China’s 12th Five-Year Plan (2011-2015) which has reached the goal of an average annual growth of 7%, shifting towards domestic consumption as the primary engine of Chinese economic growth, laying the basis for a gradual separation via growth driven by export activities. What’s more, the current 13th Five Year Plan (2016-2020) is focused on a sustainable annual Gross Domestic Product (GDP) of 6.5% with the main objective of reaching a goal of doubling the average income of China’s citizens, activating measures to encourage innovation and to cut rampant pollution.

Therefore, the actual Five-Year Plan has the purpose of increasing the domestic market, a plan that stands to favour foreign investors who can develop and execute a business strategy that leverages the opportunistic, though often complex, China market.

New opportunities are arising in services squarely targeted at Chinese consumers and in the booming e-commerce market.

For companies that are interested in e-commerce and who meet the requirements to access this type of business (for example, licenses and compliance with the relevant consumer safety regulations — if applicable), this business could be executed by foreign companies with less capital and hiring an intermediary to assist them in the logistics and entry into the Chinese market, with a fewer regulatory hurdles than in the past.

For the companies interested in operating and being present and effective in the China Market or operating in business sectors to of which e-commerce is not permitted, there will be the possibility to execute business projects and drive business opportunities more autonomously than in the past.

The sectors requiring majority shareholding by Chinese parties have shrunk from 44 to 35. At the same time, sectors requiring the form of Sino-Foreign equity joint venture have decreased from 43 to 15.

The market as described in the above dissertation represents complex changes in the "liberalization" of some sectors and in the increasing encouragement of the domestic market, but, on the other side, there has been the introduction of many dispositions and new measures to control investments and that require a great attention on anti-tax evasion and environmental protection issues. Therefore, entities that are looking for business in China may adapt their investment to meet these new measures and be in compliance with new laws, rules and regulations.

This is the "new market" of China: a market with opportunities, but which presents new, stringent policies and demands related to legal compliance. A market where the cultural and social substrate continue to represent an important element for the proper management of local business.

In the following paragraphs, the method for entering the China Market and the principal changes in laws that affect foreign investments at the first stage of organization will be analysed.

Foreign investment in the People's Republic of China: The actualization of the "Hong Kong' gateway"

In past years, organizing China-related investments through a Hong Kong holding company has been the method most used by the Foreign Entities.

The above-mentioned structure provided the following benefits:

1. Establishing an entity in Hong Kong could create a vehicle to protect the investment of the Foreign Company avoiding a direct responsibility of the latter.
2. The dividends received by the Hong Kong holding company from a Mainland subsidiary were unlikely to be taxable in Hong Kong.
3. The Hong Kong rules and provisions regarding the company obligations and the governance provided a large flexibility to the holding company.
4. Access to domestic and international funds was relatively easy.
5. A Hong Kong company could receive preferential treatment under the mainland and Hong Kong Closer Economic Partnership Agreement (CEPA) for investing in areas partly or fully restricted to other foreign investors.

With regard to the investment of Italian Entities, one important issue shall be considered at the present moment: the agreement between Hong Kong and Italy for the avoidance of double taxation (hereinafter referred to as the "CDTA") with respect to taxes on income and the prevention of fiscal evasion has entered into force.

The CDTA between Hong Kong and Italy has incorporated an article on exchange of information, which is on par with the international standard. According to this, the Hong Kong Government believes that the present CDTA may remove any concerns on the part of the Italian authorities about Hong Kong's commitment to enhancing tax transparency and combating cross-border tax evasion, thus facilitating the removal of Hong Kong from the 'blacklist' of Italy as early as possible.

The CDTA between Hong Kong and Italy was signed in January 2013 and came into force 10 August 2015, after completion of ratification procedures on both sides. It is expected to be in effect in respect of Italian and Hong Kong tax 1 January 2016 and 1 April 2016, respectively. It will be in effect in respect of Hong Kong tax for any year of assessment beginning on or after 1 April 2016.

As pointed out by the Hong Kong Government the CDTA between Hong Kong and Italy should bolster the economic and trade connections between the two places, and offer added incentives for companies in Italy to do business or invest in Hong Kong, and vice versa.

The reality of foreign investment administration in China

Currently, the foreign invested enterprises (hereinafter referred to as "FIEs"), i.e. equity joint ventures, cooperative joint ventures and wholly foreign-owned enterprises (hereinafter referred to as the "WFOEs") in the People's Republic of China are subject to special laws and regulations in addition to the PRC Company Law. The above-mentioned laws can be summarized as follows: the PRC Law on Sino-Foreign Equity Joint Venture Enterprises, the PRC Law on Sino-Foreign Corporative Joint Venture Enterprises and the PRC Law on Wholly Foreign-owned Enterprises and their respective implementations.

On 19 January 2015, China's Ministry of Commerce (hereinafter referred to as the "MOFCOM") released a draft Foreign Investment Law (hereinafter referred to as the "Draft Foreign Investment Law") for public comments, together with MOFCOM's explanatory notes (the "Explanatory Notes").

In case it will be promulgated, the Draft Foreign Investment Law would supersede the three fundamental and long-existing PRC laws on foreign investment as previously mentioned.

The Draft Foreign Investment Law would eliminate the priority requirement for the establishment of foreign investment in China, i.e. the MOFCOM prior approval for foreign investments that, according to the present legislation, is applicable to the majority of Chinese business sectors.

Under the current legislation system, during the application procedure for the foreign investment approval, MOFCOM (or its local counterparts) has the right to review the main transaction documents for a proposed investment, including the equity/asset purchase agreements, the joint venture contracts and the articles of association of the new entity to be constituted.

This possibly will mean that during the approval procedure, an approval authority could challenge some of the contractual provisions that have been negotiated and agreed-upon between the parties to a transaction. This right of the approval authorities constituted a limit to the parties' freedom and ability to include deal-specific terms in the main transaction documents, such as closing conditions, price adjustments, etc.

Under the Draft Foreign Investment Law, this practice will be changed considering that the transaction documents have not been included in the list of application information and materials required to be submitted to the approval authority. What's more, MOFCOM has clarified in the Explanatory Notes that the review will be focused on the nature of the investor and the investment, but will not scrutinize the underlying agreements. This will give foreign investors major flexibility to negotiate the terms of their investments and include such terms in the main transaction documents.

According to the above-mentioned "surge" of liberalization of the domestic market, it shall be considered the change of the guidance catalogue regarding the foreign investments.

Since 1995 the Chinese government has adopted a Foreign Investment Industrial Guidance Catalogue (the "Catalogue") which classified the foreign investments in particular industries as:

- "encouraged industries", that include industries for which the Chinese government is actively seeking foreign investments and for which investors are admitted to enjoy certain benefits such as tax incentive, cheaper land cost, simplified approval procedures or other favourable investment terms;
- "permitted industries" that include industries not expressly included in the other categories;
- "restricted industries" that include industries for which the Chinese government intends to impose restrictions such as foreign shareholding ratio's, limits on the operation of the company and special approvals; and
- "prohibited industries" according to which no foreign investment is allowed.

The last version adopted on 10 March 2015 by the Ministry of Commerce ("MOFCOM") and National Development and Reform Committee ("NDRC") of China through the order No. 22 and effective since 10 April 2015 cancelled many restrictions on foreign investment. The main changes of the updated version are the expansion of the encouraged industries and the removal of some sectors in the restricted and prohibited categories. In particular, with regard to the restricted industries category, the industries of chemical manufacturing and general apparatus manufacturing and the industries for e-commerce technology were removed by such category, as for some restrictions in the automotive sector were removed.

Up to the Draft of Foreign Investment Law, the prior approval from MOFCOM (or its local counterparts) was required for any foreign direct investment in China, regardless of under which category it falls. According to the Draft Foreign Investment Law, the State Council is expected to issue a "restricted catalogue" and a "prohibited catalogue" and MOFCOM approval would only be required for foreign investments in the industries listed on the "restricted catalogue". The industries listed on the "prohibited catalogue" will remain closed to foreign investment. Foreign investments in any other industry or sector will no longer be subject to MOFCOM approval.

Even if the Draft Foreign Investment Law lifts the MOFCOM approval requirement for foreign investments in nonrestricted businesses, it expands MOFCOM's approval authority to reach certain offshore transactions. With this, any transaction outside of China that results in the de facto control of a Chinese entity being passed to a foreign investor is deemed as a foreign investment in China. Therefore, if the business of such Chinese entity falls within the "restricted catalogue", the foreign investment approval will be necessary.

This is a significant change from the current position where only on-shore foreign investments are subject to MOFCOM approval. The purpose of this change is that if a foreign investment in a particular sector is restricted, it does not matter if it is a direct onshore investment or an indirect offshore transaction, especially in case de facto control is on the foreign investors.

On this last point, it is interesting to underline that under the Draft Foreign Investment Law the subject that has the "control" represents the cleavage point between the Chinese and the domestic investment: in case the investment under the approval procedure is made by a Foreign Entity and the related business is considered as a "restricted business", if the Foreign Investor can provide sufficient evidences to MOFCOM to demonstrate that the ultimate control is of the Chinese investor, MOFCOM will treat such investment as domestic and the prior approval will not be required. In general, MOFCOM will look at the investor with ultimate control rather than the type of entity used for the investment in determining whether an investment is foreign or domestic.

And on the other side, the Draft Foreign Investment Law defines the "control" of an entity as (a) directly or indirectly holding 50% or more of the stock, equity, property interests, voting rights or other similar rights or interests in the company; (b) possessing the right or ability to (i) directly or indirectly appoint 50% or more of board members, (ii) ensure that its nominees will obtain 50% or more of board seats, or (iii) exert significant influence over decisions of the board or shareholders meeting; or (c) being able to exert decisive influence over operational, financial, human resources or technical matters of the company through contract, trust or other means.

Among the various changes provided by the Draft Foreign Investment Law it will bring a revolutionary change to the legal and regulatory regime for foreign investment in China, as it would reduce government control over foreign investment admission, focus on substance rather than form of investment.

The legal basis of the constitution of a company in PRC: Reform in PRC Company Law and its implications

New Company Law after the last revision has come in force as of 1 March 2014 (hereinafter the "PRC Company Law"), upon the Sixth Session of the Standing Committee of 12th People's Congress that passed the amendment of the said PRC Company Law.

PRC Company Law as modified seems to retrace the principles of "innovate the application" method of supervision and of function of the Chinese government: the changes introduced with recent reforms seems to have been designed to try a method to reduce start-up costs in some parts and to attract more investment projects.

The said legal reform and its principle basis are aligned with the following reform of the Foreign Investment Law as expressly analysed in the previous paragraph.

The main revisions of PRC Company Law involved Registered Capital and company registration procedure.

The Registered Capital subscription and paid in Capital

New reforms have involved one of the fundamental elements of the company constitution system in China, i.e. the rules of the remittance of registered capital.

According to the Company Law of 2005, before the reform, it was provided that *"The registered capital of a limited liability company shall be the total capital contributions subscribed for by all the shareholders as registered with the company registration authority. The amount of initial capital contributions made by all shareholders shall not be less than 20% of its registered capital and shall not be less than the statutory minimum amount of the registered capital. The shareholders shall pay in the remaining amount of the registered capital within two years as of the date of the company's incorporation; in the case of an investment company, the relevant period may be five years."*

The new article 26, paragraph 1, of the PRC Company Law provides that "*The registered capital of a limited liability company shall be the total capital contributions subscribed for by all the shareholders as registered with the company registration authority.*"

According to the reform the clause which required the initial contribution not less than 20% of the total value of the Registered Capital and a limit of two years (or five years for investment companies) for the payment up of the total registered capital have been removed. On the same line, Article 81 of the PRC Company Law has been completely changed and the paragraph related to the obligations of all the shareholders to contribute to a company not less than 20% of the registered capital, and to pay the remaining amount within two years as of the date of the company's incorporation; in the case of an investment company, the relevant period of five years has been removed.

The above-mentioned changes do not mean that the Shareholders have no obligations related to the payment of registered capital, but it means that the payment of registered capital may be regulated by Shareholders in the Articles Associations of the Company.

Therefore, according to this change, the freedom of the shareholders result increased, and the function of the Government seems to have changed from the supervisor of the paid-in capital to the supervision of the shareholders as per the rules agreed in the constitution documents.

In other words, the subject changes have transformed the payment of Registered Capital from a registration item up to a term upon the agreement of the shareholders.

According to this, the proper drafting of the Articles of Association remains and, as a matter of fact, becomes fundamental for the proper execution of the daily operations and legal and tax compliance of the Company, i.e. for the protection of the investment.

This assumption is enforced by another issue: prior to the recent PRC Company Law reform, one of the application documents requested for the company approval and registration procedure were the business plan that had to evaluate the operations in the term of 3/5 years. The said documents are now not included in the application documents for the constitution procedure.

Prior to the last reform in PRC Company Law, the requirement to produce a business plan as an application document and the obligation by law to pay registered capital according to some specific terms, i.e. at least 20% of the total registered capital or the full capital upon the shareholder decision, oblige the shareholder to analyse in depth the purpose of their investment and the possible development of the New Company, including its daily needs and possible development. With the deletion of the above-mentioned requirements, there could be the risk that the Shareholder does not consider the importance of the business plan and the funds planning pushed by the great simplification of the company registration procedure.

It shall be considered that after the proper verification by the Chinese authorities, the paid-in registered capital becomes working capital and may be used for the daily operations of the Company. At the same time the recent reforms under analysis in the present dissertation has not removed the legal responsibility of Shareholders in case they do not pay the registered capital according to the subscription documents.

In this inauspicious case, the Company may ask the shareholder not paying the registered capital in full and in time to be investigated for its corresponding civil liability and if the Company is involved in debt disputes or dissolution for liquidation, where the Company is faced with insolvency, the shareholders not paying the registered capital in time and full shall pay the capital and shall assume legal liability to the extent of their subscribed amount contribution.

In conclusion, upon the above initial changes applied by reforms in PRC Company Law, it can be assumed that for the establishing of a company in China it is fundamental to focus great attention on the Articles of Association and on the constitution documents that are prepared accordingly. Today, more than in the past, the Articles of Association shall not be simply considered as one of the constitution documents, i.e. a formality. It is representing the rules of the investment. And a proper business plan to be taken as a base under which organize the registered capital contribution method to be included in the Articles of Association and to be binding for the Shareholders. All constitution documents shall be then prepared taking into consideration any possible special rules as especially referred in Article 26, Paragraph 2, of the PRC Company Law that provides that: *"Where the paid-in registered capital and the minimum registered capital for limited liability companies are otherwise provided for in any other laws, administrative regulations and decisions of the State Council, the relevant provisions shall prevail."*

The first implications of the change of the registered capital regulation according to new PRC Company Law: some precautions

As stated in the previous paragraph, the paid-in capital has not to be considered as a registration item after the recent reform.

This can be also confirmed by another important change under Company Law Reform.

The new Article 7 after reforms provides that the Business License of the Company shall include the following information: the company's name, domicile, registered capital, business scope, name of the legal representative and other information.

Compared with the previous version, the new PRC Company Law has removes the "paid-in capital" requirement, and this is an important issue to be considered by a possible third party.

In fact, the business license represents the official documents issued by the China Registration Authority that consents to verify in a timely manner all the most important information of a counterparty. With the deletion of the paid-in capital, any possible counterparty in a transaction should pay more attention to the real assets and credit of the subject company.

After recent reforms, Company Law does not define the specific period for registered capital subscription and, therefore, allows Shareholders the freedom to determine by themselves the time of the contribution. This means that PRC Company Law does not provide a maximum term for the contribution of the registered capital: this should be extended in some years (provided that the operations of a company can be executed) and may be amended by a revision in the Articles of Associations.

Given the above, with the purpose to deal in a transaction with the proper instruments and information, each party should know the real amount of paid-in capital and general information about the amount of registered capital after knowing the amount of registered capital as indicated in the business license.

Removal of the minimum registered capital requirement

According to new PRC Company Law, the minimum registered capital requirement has been removed. The new Article 23 of the PRC Company law provides that: "*To establish a limited liability company, the following conditions shall be met: [omissis] 2. the company has capital contributions in compliance with the articles of association of the related company which are subscribed for by all shareholders*".

Also in this area reform, the freedom of Shareholders seems have been increased.

The limit of RMB 30,000 as the minimum registered capital for a limited liability company; RMB 100,000 as the minimum registered capital for a one person limited company and RMB 5 million as the minimum registered capital for a joint stock limited company have all been removed. In the past, people used to differentiate the joint stock company from the other type of company according to the size of the company; today the difference between the company's type will be defined according to the company's model and not with regard to simply size.

On the other side, two considerations should be evaluated in the present matter.

First, of all the real application of the minimum limit of the registered capital before the PRC Company Law reform. Especially with regard to the limited liability company, the minimum registered capital required by law was a very small amount. As previously mentioned, the registered capital shall become the working capital and may be used for daily operations and management of a company. It might be unrealistic to consider RMB 30,000 as a feasible amount of registered capital for a medium/long term project as an investment in China. At the same time, some local administrations have special requirements for the registered capital amount that could be evaluated as an amount to justify the operations of a company properly and the said requirements should be satisfied to obtain company registration approval.

The second item to be considered is that before proceeding with an investment, special laws, administrative regulations and decisions of the State Council applied to some business sectors should be carefully evaluated.

In fact, for example, current laws and regulations call for particular requirements from banking institutions, futures companies, fund management companies and other special sectors.

Therefore, it may be assumed that it is true that PRC Company Law has applied an important chance with the removal of the minimum registered capital amount. However, it is also true that, in practice, the registered capital amount should be evaluated carefully according to some conditions and the investment plan, as in the past, should also be evaluated.

Connected with the cancellation of the minimum registered capital there is the cancellation of the minimum value of the capital contribution by cash: the provision included in the old Article 27, paragraph 3, providing that there "be no less than 30% of the registered capital of a limited liability company" has been cancelled, removing the restriction to the contribution system and making it easier for investors to evaluate and chose the type of contributions.

Along the same lines, the registered capital increase procedure has been simplified providing that the capital increase is not subject to the requirement of the minimum amount of 20% to be paid (Ref. Art. 179 New PRC Company Law).

Conclusions on PRC Company Law reform and associated reforms: registered address of a Company and its yearly obligations

The reforms of the PRC Company Law represent a big change in the PRC legal system. The changes of the contribution system, the cancellation of the minimum registered a capital and the modification and, in some cases, the simplification of the registration formalities could encourage the investors, including the foreign investor, to organize the investment according to their needs and business project, but maintaining a great attention in the constitution documents with particular regard to the Articles of Associations.

Following the above reform and principles, a part of the annual formalities under which a company in China shall operate have changed. The annual inspection system has been changed to the annual reporting system to make relevant information more transparent, with the purpose of establishing a fair and standardized random inspection system, reducing the number of on-site inspections and improving fairness and effectiveness of government.

In this panorama of reforms there is further modification that affects the first phases of investment planning, which is an important point for foreign companies interested in the Chinese market to note.

The said modification is related to the definition of the registered office of a New Company.

On 3 March 2015, the Shanghai People's Government issued the Administrative Measures on Address Registration of Companies Located in Shanghai ("Address Measures") that took effect retroactively on 1 March 2015 with a validity term until 31 December 2019 and provides that several companies in Shanghai may have the same registered address under some conditions.

In the past, it was not possible in Shanghai to use the same premises as registered address of several companies. Under the above mentioned reform several companies can use the same address for registration in the event that they meet the following circumstances:

1. They are equity investment companies and equity investment management companies which undertake management responsibilities; or
2. There is an investment relationship between the companies and they also share the same office.

It is not specified, and therefore unclear, whether the term "investment relationship" only includes subsidiaries or also other affiliated companies, such as sister companies. According to the information of the Shanghai Administration for Industry and Commerce ("AIC"), for the time being, only wholly owned subsidiaries are covered. However, the future interpretation of the district level AICs remains to be seen.

What's more, according to the Address Measures, companies in rural areas of Shanghai, such as Fengxian and Jinshan districts, etc., are allowed to register in premises for residential use. However, in such cases, the concerned company shall obtain the consent of the interested parties (which might include neighbours) and an approval certificate issued by the local village neighbourhood committee.

The situation is different in downtown areas, where if a company wants to register its company address in premises designated for residential use, first the nature of the premises must be changed from residential to industrial or commercial use.

Despite these reforms, the requirement that a company shall have the registered address and the operations in the same place is still valid, or better, its results reinforced. According to the PRC Regulations on Administration of Registration of Companies, the registered address of a company shall be the place where the company carries out its main business operations. Therefore, if a company carries out business operations in places other than its registered address, it must register a branch office.

The above-mentioned Address Measures requires the competent AICs makes selective examinations according to complaints made by third parties or based on information published by a company itself, e.g. on its website, and if it is discovered that the company carries out business operations in an address not registered with the competent AIC, the AIC should impose punishment according to the law, which may result in a fine of RMB 10,000 to RMB 100,000. In serious circumstances, the business license of the company may be also revoked.

Guangzhou, Chengdu and Zhejiang Province have already implemented similar measures.

Given the above explanation, the issuance of the Address Measures by the Shanghai Government is aimed at relaxing restrictions and reducing administrative burdens on companies, but on the other hand, the Address Measures are also a sign that in the future authorities might check more closely on companies.

The reality of E-commerce in the China market: short notes

In conclusion, in the present period, a mention of e-commerce is worthwhile.

With the 12th Five-Year Plan (2011-2015), the Chinese government's Ministry of Industry and Information Technology provided policies to make China a global e-commerce leader. With that, the speed at which the Chinese e-commerce industry has grown, and the way in which it affects businesses and consumers, has been of major significance in recent years.

The e-commerce market in China seems ready to lead in the B2C and C2C transactions. One of the most important actors in e-commerce, the founder of Alibaba, Mr. Jack Ma, declared that "e-commerce in China is a lifestyle".

The number of the internet users in China has grown exponentially year by year, and during 2015 has reached some 668 million of active internet users. This growth has also been greatly influenced by the immense growth and development China's middle class.
The Chinese Government has recognized the importance of the e-commerce and is promoting reforms that could very well create opportunities for investors.

All the world has attended to the magnificent growth of Alibaba, which is considered China's undisputed market share leader of B2C and C2C e-commerce. In fact, Alibaba said it took just half a day for sales generated on its Chinese and international marketplaces to exceed last year's 24-hour total of $9.3 billion.

However, despite Alibaba's dominant market position, the e-commerce market in China is large enough for other competitors and niche players to thrive, including some regional platforms.

In line with the above-mentioned data, recently, the State Council has issued the Official Reply to Approving the Establishment of Cross-border E-commerce Comprehensive Pilot Areas in 12 Cities including Tianjin Municipality (hereinafter referred to as the "Reply").

According to the Reply, the State Council has approved the establishment of cross-border e-commerce comprehensive pilot areas in 12 cities, namely, Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen and Suzhou. The Reply requires said cities to learn from the experience and practice of the China (Hangzhou) Cross-border E-commerce Comprehensive Pilot Area, highlight their own specialties and advantages depending on their local conditions. They should further lead and experiment in technical standards, business processes, regulatory modes, information construction and other aspects related to the business-to-business (B2B) model for cross-border e-commerce. The latter has the objective of providing experience that can be replicated and popularized for promoting the development of cross-border e-commerce nationwide, as well as bring new support for foreign trade development by using new modes.

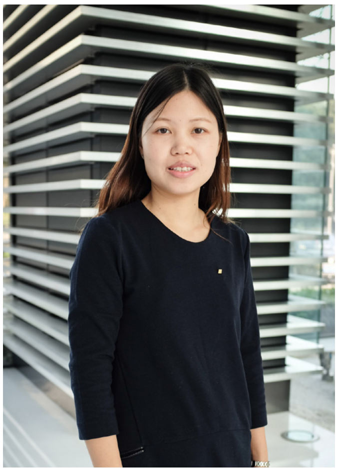
Conclusion

Today there's differing commentary extolling alarming information about China's current situation, with particular reference to the GDP growth of 2015 reaching "only" 6.9% — the lowest in 25 years — and to the recent crisis in the financial markets.

It can be assumed that the Chinese Government well expected some aspects of the above events and has prepared the country to face up its setbacks while putting in motion a number of reforms.

Despite the above data, it shall be considered that in the current economic situation, China continues to experience growth, continues to activate measures to develop the domestic market, continues to be an active buyers of foreign companies around the world and continues to require products, innovation and technology.

It can be surmised that China has maintained a relatively high GDP, despite last years drop, and that in the actual economic global market, remains a serious player in both inbound and outbound investment. For those with the proper business acumen to address, navigate and leverage China’s rules and regulations, as well as its cultural nuances, for its benefit, success lies waiting. ■



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Individual Income Tax in China for Expatriates

A 'By the Book' Overview

There has unfortunately been a lot of nonsense spoken about filling individual income tax (IIT) for expatriates living and working in China. How much tax should be paid in China? And what about taxes in the employee's home country? Can you divide a work salary between Chinese renminbi and an employee's homeland currency? How does tax affect long-term employees working in China on tourist visas?

The real picture in assessing liabilities, payment and the filling of individual income tax in China has become rather muddled.

This article outlines the circumstances, including the liabilities and procedures for filling individual income tax. It also explains the rationale and hopefully will take some of the pain out being a taxpayer in China.

Basically, individuals residing in China[1] are subject to the country's IIT, which is normally withheld from wages and salaries by employers and paid to the competent tax authorities on a monthly basis.

The IIT liability of a foreign individual in China depends on a number of things, including the individual's duration of stay in China and his/her source of in-come.

Basic definitions related to individual income tax in China

Tax resident
There is no specific definition of a tax resident for personal tax purposes under China domestic law. However, the test for domicile in China is whether an individual is usually or habitually residing in China because of household registration, family or economic involvement.

An individual who has a domicile in China or who has no domicile but has stayed in China for one year or more shall pay individual income tax in accordance with IIT Law for his incomes obtained in and/or outside of China.

Duration of stay in China
It is notable that "one year" in the context of the IIT Law refers to one tax year. A tax year in China is the same as the calendar year, i.e. 1 January 1 to 31 December, and "residing in China for one year" is defined as residing in China for 365 days in a tax year. However, a nonresident who has taken temporary absences from China for less than 30 days continuously or 90 days total in a tax year will still be considered having resided in China for 365 days of the tax year.

The duration of stay in China includes days that fall under public holidays, individual holidays and training days the individual employee enjoyed within or outside of China while working in China.

1 In this article, unless otherwise stated, "China" indicates mainland China, which does not include Hong Kong, Taiwan and Macao. The Individual income tax system in mainland China is different from that of Hong Kong, Macau and Taiwan.

Examples
Duration of Stay in China

1. Mr. Right, an Italian national, who works for a Chinese resident Company, spent 1-20 May in Italy during the 2015 calendar year. His twenty days spent in Italy is considered a temporary trip out of China and may not be deducted from the days in China for year 2015. Therefore, he is considered to have resided in China for one full year in 2015.
2. If Mr. Right had been in Italy 1-15 Jan., 1-20 May, 1-15 Oct. and 10-31 Dec., although he has been out of China a number of times, each trip has been less than 30 days and cumulative not more than 90 days. Therefore, he is still considered to have resided in China for one full year in 2015.
3. If Mr. Right had been to Italy from 1 May-1 June 1 in 2015, which represents and absence from China of more than 30 continuous days, then he is considered to have resided in China for less than one year in 2015.

Source of income
For the wages and salaries derived by foreign individuals working in China, the place where he/she works is considered the source of income. The location of payment is not relevant in determining the income source.

China's IIT law defines China-sourced income as income received by the individual while working in China, regardless of whether the income is paid by an employer domestically or overseas; foreign-sourced income refers to income received by an individual for work outside of China, regardless of whether the payment is made by an employer in China or overseas.

In addition, the following income types are deemed as China-sourced income regardless of who makes the payment:

- "Prohibited industries" according to which no foreign investment is allowed.
- Income derived from on the job, employed or contracted labour service per-formed within the territory of China;
- Income derived from leasing of property to others for use within the territory of China;
- Income derived from transfer of buildings, land use rights or other property within the territory of China;
- Income derived from granting of various franchises to be used within the territory of China; and
- Income derived from interests, dividends and extra dividends from companies, enterprises and other economic organizations or individuals within the territory of China.

IIT liabilities for foreign employees in China

As stated above, the IIT liability of a foreign individual in China depends on the individual's duration of stay in China and his/her source of income. The IIT Law of China stipulates that:

- An individual "domiciled" in China is subject to individual income tax on his/her worldwide income.
- A non-domiciled individual staying in China for less than one year is subject to personal tax only on China-source income.
- A non-domiciled individual staying in China for one full year, but less than five consecutive full tax years, is subject to individual income tax on China-source income, plus foreign income borne by Chinese entities or establishments.
- A non-domiciled individual staying in China for more than five consecutive full tax years is taxed on worldwide income as from the sixth year for each full tax year spent in China.

Tax liabilities for foreign individuals

Foreign Individuals Residing in China for less than 90/183[2] Days in a Tax Year ("90/183 day Rule"). A nonresident individual who has worked in China continuously or cumulatively for less than 90 days or those from tax-treaty countries having worked in China for less than 183 days in a tax year shall pay IIT on income paid by their employers within China or on income not paid but incurred by foreign establishments located within China.

Foreign Individuals Residing in China for More than 90/183 Days but Less than One Year ("One-year Rule"). An individual who has resided in China for more than 90 days (183 days for those from tax-treaty countries) but less than one year during the tax year is subject to IIT on all China-sourced income, which includes income paid by both Chinese and overseas entities for his/her work in China. Income earned while working overseas (i.e. foreign-sourced in-come) in the tax year is not Chinese IIT taxable.

Foreign Individuals Residing in China for More than One Year Consecutively but Less than Five Years. A foreign individual who has resided in China for more than one year but less than five years must pay IIT for income received from both Chinese and foreign employers for work conducted in China (China-sourced income), and also for income paid by Chinese employers during any temporary absences from the country.

Under these circumstances, income obtained from foreign employers for work done during a temporary absence is still not taxable in China.

2 If there is a double taxation agreement (DTA) in place between the foreigner's home country and China, the 90-day limit may be extended to 183 days, depending on the relevant DTA.

Foreign Individuals Residing in China for More than Five Years Consecutively. A foreign individual who has resided in China for more than five years continuously may face IIT liabilities identical to those of a resident individual of China, depending on the duration of his/her residency in China starting from the sixth year.

If a foreign individual resides in China for one year in the sixth or any following single year, they are considered a resident individual under IIT and remain taxable on income received globally for that specific tax year; if the individual resides in China for less than one year in the sixth or any following single year, he/she is subject to IIT on only China-sourced income, and the One-year Rule applies.

The five-year threshold will be reset if the individual resides in China for less than 90 /183 days in any single tax year starting from the sixth year, in which case the "90/183 day Rule" will apply for that tax year.

Understanding the "five-year rule" is especially important for foreign companies with expatriates working in China for the long-term as their IIT burden may be significantly reduced if their stay in China is managed properly.

To better clarify IIT liabilities, a demonstration of the above rules is given in the table below:

Duration of Stay	Tax Income	Tax Liability
≤ 90/183* days	China-sourced income	Subject to IIT on China-sourced income based on the number of days worked in China
90/183 days < period of stay < 1 year	China-sourced income + foreign-sourced income	Subject to IIT on China-sourced income and foreign-sourced income based on the number of days worked in China
1 year ≤ period of stay ≤ 5 years	China-sourced income + foreign-sourced income	Subject to IIT on China-sourced income based on the number of days worked in China and outside China + foreign-sourced income based on the number of days worked in China
> 5 years	Worldwide income	Subject to IIT on both China-sourced income and foreign-sourced income

Notes:
(1) If tax treaty protection applies, 183 days is applicable, otherwise, 90 days is applicable.
(2) The 90/183-day and one-year rules do not apply to foreign individuals holding senior positions in the enterprises located in China. They get taxed Chinese IIT at the moment they enter China on both locally-obtained income and on the Chinese in-come derived from abroad. As for the foreign-income received in China and world-wide income, it follows the same taxation as the ones explained above.

IIT calculation

In China, income from wages and salaries by a foreign employee shall be taxed by progressive rates ranging from 3% to 45% after a monthly deduction of RMB 4,800 (effective from 1 Jan 2006). Non-employment income is taxed at a variable rate depending on income type.

The formulas for calculating an individual's tax payable are:

Monthly taxable income = Monthly income - Standard deduction – Mandatory Social Security

Tax payable = Monthly taxable income × Applicable tax rate – Quick deduction

Of which:

Monthly income
Monthly income is defined as wages and salaries which include any kind of bonuses, allowances, and/or other income received from the employment of the individual. Certain employment benefits for foreign individuals may be treated as nontaxable under IIT law if relevant requirements are fulfilled. These include (with supporting invoices where applicable):

- The reasonable subsidies for lodging and boarding obtained by a foreign individual in non-cash form or in the form of reimbursement.
- The relocation income obtained by a foreign individual from holding a post or resigning from China in the form of reimbursement.
- Home leave fare of two trips per year for the employee, within reason.
- Reimbursement of certain meals, laundry, language training costs, and children's education expenses in China, within reason.

Tax authorities will only permit these allowances to be deducted if they are included in the employee's contract. The employee needs to produce an official "fapiao" (invoice) every month for the expenses, in addition to meeting other conditions.

Standard Deduction
Foreign individuals employed in China are eligible for a standard deduction of RMB 4,800.

Social Security
China's Social Insurance Law provides that foreigners working in the country are required to participate in the national social insurance scheme. The social insurance system is complex because the local implementation of the rules and regulations varies greatly, giving rise to differing contribution rates as well as difficulties in transferring social insurance accounts across regions. The basic contribution rate for both employer and employee is as follows:

Contributions by	Pension	Medical	Unemployment	Maternity	Work-related Injury
Company	12-22%	5-12%	0.2-2%	0.5-1%	0.5-2%
Individual	8%	0.5-2%	0-1%	n/a	n/a

Mandatory social security contributed by individuals may be deducted from the taxable monthly income for the IIT calculation purpose.

Tax rate and quick deduction
The relevant tax rate for wages and salaries is as follows:

Level	Monthly Taxable Income (RMB)	Tax Rate	Quick Deduction
1	TI ≤ 1,500	3%	0
2	1,500 < TI ≤ 4,500	10%	105
3	4,500 < TI ≤ 9,000	20%	555
4	9,000 < TI ≤ 35,000	25%	1,005
5	35,000 <TI ≤ 55,000	30%	2,755
6	55,000 < TI ≤ 80,000	35%	5,505
7	TI > 80,000	45%	13,505

When calculating foreign employees' IIT amount, expatriates need to proportion their total taxable income based on income source and duration of stay in and outside of China during the month. The specific formula are listed in the accompanying table:

Step 1:

Calculate the tax payable on the worldwide income no matter of the duration of stay:

a. Monthly taxable income = Monthly income - Standard deduction – Mandatory Social Security
b. Tax payable = Monthly taxable income × Applicable tax rate – Quick deduction

Step 2:

Calculate the IIT taking the consideration of duration of stay:

i. If duration of stay less than 90/183* days, the IIT is subject to China-sourced income based on the number of days worked in China

IIT = Tax payable * (Income paid by Chinese Entity / worldwide income) *(work days in China / total days of the month)

ii. If duration of stay exceeds 90/183 days but less than one year, the IIT is subject to China-sourced income and foreign-sourced income based on the number of days worked in China

IIT = Tax payable *(work days in China / total days of the month)

iii. If duration of stay exceeds 1 year but less than 5 years, the IIT is subject to China-sourced income based on the number of days worked in China and outside China plus foreign-sourced income based on the number of days worked in China

IIT = Tax payable * (1-(income paid by foreign entity / worldwide income) * (work days overseas / total days of the month))

iv. If duration of stay exceeds 5 years, the IIT is subject to both China-sourced income and foreign-sourced income.

IIT = Tax payable

Special regulations

Duration of stay in China
When counting the number of work days in China for IIT calculation purposes, the day on which an individual enters or exits China is counted as a half-day.

The day on which the individual enters or exits China is considered a full day in determining his/her duration of stay in China.

Income for multiple tax periods
A non-domiciled individual derives income for multiple tax periods after entering in China or leaving China, the income refers to the individual working in China shall be Chinese IIT liability.

A non-domiciled individual derives all items of bonuses other than the annual one-off bonus, such as half-year bonus, quarterly bonus, over-off work bonus and attendance bonus, and the individual has no tax payment liability in China in the very month, or has worked for less than one month in China in the very month, his/her bonuses may be regarded as one month's salary independently and the total bonus is taxable income without standard monthly deduction (RMB 4,800 for foreign employees) which has deducted from the calculation of IIT for monthly wages and salaries. What's more, the IIT for this bonus shall not calculate on the basis of duration of stay in China.

Bonus method
A non-domiciled individual derives annual one-off bonus (tax-inclusive) and the calculation for this income is on the basis of "Bonus method" which is different from the calculation method of wages and salaries. The calculation of IIT for "Bonus method" includes:

(1) Working out the relevant applicable tax rate and quick calculation deduction in light of the quotient by dividing the annual tax-inclusive bonus into 12;

(2) Payable Tax = Annual Tax-inclusive Bonus * Applicable Tax Rate - Quick Calculation Deduction

This Bonus Method for IIT calculation may be adopted only one time each year.

Non-employment income
Apart from wages and salaries, other non-employment income subject to IIT includes:

1. Income from sole proprietors and merchants' production and business operations;
2. Income from leasing of property provided to enterprises and institutions;
3. Remuneration for labour services;
4. Remuneration from writing;
5. Income from royalties;
6. Income from interests, stock dividends, and extra dividends;
7. Income from the lease or transfer of property;
8. Contingent and other forms of income.

Non-employment income is taxed at a rate generally ranging from 5% to 35%, depending on the income source.

Income in foreign currency
Income in foreign currency shall be taxed on the equivalent amount converted into RMB according to the middle price of exchange rate of RMB on the last day of the previous month before the tax payment receipt is issued.

Following provisions of the Tax Law, the final settlement after the end of each year will not re-convert the advance payment on monthly instalments or each time on the income in foreign currency; the part which needs to supplement payment of the deficiency shall be taxed on the equivalent amount converted into RMB according to the mid-price of the exchange rate of RMB on the last day of the previous tax year.

IIT filing and declaration

Registration procedures for paying China IIT
If the employee is liable for China IIT filing, the following procedures for registration apply and the following documents are required:

- Original salary certificate from overseas employer
- Copy of employment contract
- Copy of all pages of passport
- If the employer is a "permanent establishment" in China, then: employee's work permit, employer's tax registration certificate and employer's business license are required.

Tax filling and procedure
China's IIT is normally withheld from wages or salaries by employers and paid to the tax authorities on a monthly basis (within 15 days of the end of each month). Individuals receiving overseas income should file an IIT return on the overseas income with the relevant tax authority within 30 days from the end of the tax year.

In addition, an annual IIT declaration should be submitted to the relevant tax authorities within three months of the end of the previous calendar year (i.e., between 1 January 2016 and 31 March 2016 for the 2015 calendar year) for taxpayers who are subject to IIT in China and meet at least one of the following five conditions:

- Have an annual income exceeding RMB 120,000;
- Derive income from two or more places in China;
- Derive income from sources outside of China (note: this applies only to a resident or nonresident individual in China who has resided in China for more than 1 year);
- Received taxable income for which there is no withholding agent; or
- Other conditions required by the State Council.

It is particularly emphasized that individuals with an annual income of more than RMB 120,000 are required to submit their IIT declarations, regardless of whether all the IIT liabilities have been fulfilled. The annual income includes both employment income and non-employment income. However, a nonresident individual residing in China for less than one year during the tax year is exempt from such requirement.

Several possible modes of tax declaration include online, mail or direct to the local tax authorities. Tax payers may also entrust intermediary agencies or other persons qualified for tax agency service with their tax declarations.

Related regulations

Withholding agent
The income earner shall be the taxpayer of individual income tax and the entity or person that effects the payment shall be the withholding agent.

Liabilities for non-payment of China Individual Income Tax
Where a taxpayer fails to pay taxes or a withholding agent fails to remit taxes within a prescribed time limit, the tax authority shall, in addition to ordering the taxpayer or withholding agent to pay or remit the taxes within the prescribed time limit, impose a late fee at the rate of 0.05% per day of the amount of tax-es in arrears, on the day the tax payment is overdue.

Repatriation of salary paid in RMB in China
Foreign employees may repatriate their total monthly net salary back to their home country. In order to convert their RMB salary into foreign currency, they will need to present to their local bank proof of tax payment of China individual income tax, their Alien Employment Permit, proof of income as well as other documents required by the bank.

Final thoughts

The regulatory environment for China has been evolving and becoming stricter for both employees and employers. While there is an opportunity to exclude income from Chinese taxation under certain income tax treaties, enforcement has picked up against individuals trying to take ad-vantage of the treaty benefits.

It should also be noted that China has instituted mandatory Social Security payments for individuals from countries that have laws and regulations on Social Security, including regulations for expatriate employees.

It should also be noted that from October 2011, all foreigners legally working in China (including both locally hired and those under secondment arrangement from abroad) are required to participate in the same Social Security scheme as their Chinese counterparts. However, the enforcement may vary in different cities.

Chinese income tax laws are generally favourable to expatriate individuals on assignments. China residents are generally subject to tax on their China-source and non-China-source income. Non-residents are subject to tax on their China-source income only.

Employer requirements for reporting have also seen an increase in enforcement in recent years. Companies granting equity to employees are required to report these plans with the Chinese tax authorities. Addition-ally, visa requirements have increased with new entry and exit laws to more stringently determine the length of time an individual will be permitted in China. ■

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The Basics of Fixed-Term and Open-Term Labour Contracts in China

Paying Attention to Details

In the People's Republic of China, labour contracts are classified into fixed-term labour contracts, labour contracts without a fixed term and labour contracts that set the completion of specific tasks as the term to end contracts.

A labour contract without a fixed-term refers to a labour contract in which the employer and the employee stipulate no certain time to end the contract.

An employer and an employee may, through negotiations, conclude arrange a labour contract without a fixed-term. Under any of the following circumstances, if the employee proposes or agrees to renew or negotiate a new a labour contract, a labour contract without a fixed-term shall be arranged unless the employee proposes a fixed-term labour contract:

- The employee has worked for the employer for 10 full years consecutively.
- When the employer initially adopts the labour contract system or when a state-owned enterprise re-concludes the labour contract due to restructuring, the employee has already worked for this employer for 10 full years consecutively and he attains to the age which is less than 10 years up to the statutory retirement age.
- The labour contract is to be renewed after two fixed-term labour contracts have been concluded consecutively, and the employee is not under any of the circumstances as mentioned in Article 39 and Paragraphs (1) and (2) of Article 40 of Labour Contract Law of the People's Republic of China.

** Article 39. Where an employee is under any of the following circumstances, his employer may dissolve the labour contract:*
1) It is proved that the employee does not meet the recruitment conditions during the probation period;
2) The employee seriously violates the rules and procedures set up by the employer;
3) The employee causes any severe damage to the employer because he seriously neglects his duties or seeks private benefits;
4) The employee simultaneously enters an employment relationship with other employers and thus seriously affects his completion of the tasks of the employer, or the employee refuses to make the ratification after his employer points out the problem;
5) The labour contract is invalidated due to the circumstance as mentioned in Item (1), paragraph 1, Article 26 of this Law; or
** Article 26. A party employs the means of deception or coercion or takes advantage of the other party's difficulties to force the other party to conclude a labour contract or to make an amendment to a labour contract, which is contrary to his will;*
6) The employee is under investigation for criminal liabilities according to law.
** Article 40. Under any of the following circumstances, the employer may dissolve the labour contract if it notifies the employee in writing 30 days in advance or after it pays the employee an extra month's wages:*
1) The employee is sick or is injured for a non-work related reason and cannot resume his original position after the expiration of the prescribed time period for medical treatment, nor can he assume any other position arranged by the employer;
2) The employee is incompetent to his position or is still so after training or changing his position.

- If the employer fails to sign a written labour contract with an employee after the lapse of one full year from the date when the employee begins to work, it shall be deemed that the employer and the employee have concluded a labour contract without a fixed term.

Note: According to Labour Contract Law in China, commencing 1 January 2008, an employer is permitted to enter into a maximum of two term-contracts with the employee. If the employee continues on after the expiration of a second term-contract, the subsequent employment contract is deemed to be an "open-term contract".

What you need to know about employee probation periods

If the term of a labour contract is not less than three months but less than one year, the probation period shall not exceed one month. If the term of a labour contract is not less than one year but less than three years, the probation period shall not exceed two months. For a labour contract with a fixed term of three years or more or without a fixed term, the probation term shall not exceed six months.

An employer can only impose one probation period on an employee.

For a labour contract that sets the completion of a specific task as the term to end the contract or with a fixed term of less than three months, no probation period may be stipulated.

The probation period shall be included in the term of a labour contract. If a labour contract only provides the term of probation, the probation shall be null and void and the term of the probation shall be treated as the term of the labour contract.

Standard benefits package for employers and employees

Social insurance is a mandatory, nonprofit social security system established by law in China. It is administered by the government's labour and social security departments. Different regions may have somewhat different contribution rates for employees and employers. The following is an example using the city of Shanghai.

Shanghai

Social Insurance	Employers Contribution Rate	Employee Contribution Rate
Pension insurance	21% of the insured salary	8% of the insured salary
Medical insurance	11% of the insured salary	2% of the insured salary
Unemployment insurance	1.5% of the insured salary	0.5% of the insured salary
Working injury insurance	0.5% of the insured salary	None
Birth insurance	1% of the insured salary	None
Housing fund	7% of the insured salary	7% of the insured salary

Note: Insured salary refers to an employee's monthly salary subject to a lower limit and an upper limit of 60%-300% of the local social average monthly salary of the preceding year.

Participation in social insurance and housing fund is not mandatory for foreign employees in Shanghai, but optional.

Social Security package

Expatriates working in Shanghai are eligible for social welfare benefits enjoyed by local Chinese, such as pension insurance, medical insurance, unemployment insurance and work-related injury insurance.

To enjoy China's social welfare benefits, an employee must pay insurance premiums as a Chinese citizen. The premiums are calculated according to the employee's monthly salary in the previous year, but their total should be no less than 60 percent of or no more than three times the average salary income of the city.

Currently, an employee needs to pay 8 percent of their salary for pension insurance, 2 percent for medical insurance and 0.5 percent for unemployment insurance. In this circumstance, the employer must pay 21 percent, 11 percent and 1.5 percent of the employee's salary for the respective insurances. The employer must also pay 1 percent and 0.5 percent of the employee's salary for maternity insurance and work-related injury insurance. When an employee leaves Shanghai, they can cash out their insurance policies or keep them for future use if they intend to return to Shanghai.

Economic compensation when dissolving or terminating a contract

When dissolving and terminating an employee's labour contract, an employer shall, under any of the following circumstances, pay the employee economic compensation:

- The employee dissolves the labour contract in pursuance of Article 38 of Labour Contract Law of the People's Republic of China.

**Article 38. Where an employer is under any of the following circumstances, its employees may dissolve the labour contract:*
1) It fails to provide labour protection or work conditions as stipulated in the labour contract;
2) It fails to timely pay the full amount of remuneration;
3) It fails to pay social security premiums for the employees;
4) The rules and procedures set up by the employer are contrary to any law or regulation and impair the rights and interests of the employees;
5) The labour contract is invalid or are partially invalid if a party employs the means of deception or coercion or takes advantage of the other party's difficulties to force the other party to conclude a labour contract or to make an amendment to a labour contract, which is contrary to his will;
6) If an employer forces any employee to work by the means of violence, threat, or illegally restraining personal freedom, or an employer violates the safety regulations to order or forces any employee to per-form dangerous operations that endanger the employee's personal life, the employee may immediately dissolve the labour contract without notifying the employer in advance.

- The employer proposes to dissolve the labour contract, and it reaches an agreement with the employee on the dissolution through negotiations.
- The employer dissolves the labour contract according to Article 40 of this Law.

**Article 40. Under any of the following circumstances, the employer may dissolve the labour contract if it notifies the employee in writing 30 days in advance or after it pays the employee an extra month's wages:*

1) The employee is sick or is injured for a non-work related reason and cannot resume his original position after the expiration of the prescribed time period for medical treatment, nor can he assume any other position arranged by the employer;
2) The employee is incompetent to his position or is still so after training or changing his position; or
3) The objective situation, on which the conclusion of the labour contract is based, has changed considerably, the labour contract is unable to be performed and no agreement on changing the contents of the labour contract is reached after negotiations between the employer and the employee.

- The employer dissolves the labour contract according to the first Paragraph of Article 41 of this Law.

Article 41. Under any of the following circumstances, if it is necessary to lay off 20 or more employees, or if it is necessary to lay off less than 20 employees but the layoff accounts for 10% of the total number of the employees, the employer shall, 30 days in advance, make an explanation to the labour union or to all its employees. After it has solicited the opinions from the labour union or of the employees, it may lay off the number of employees upon reporting the employee reduction plan to the labour administrative department: It is under revitalization according to the Enterprise Bankruptcy Law.

- The termination of a fixed-term labour contract according to Article 44 (i) of this Law unless the employee refuses to renew the contract even though the conditions offered by the employer are the same as or better than those stipulated in the current contract.

**Article 44 (i). A labour contract may be terminated when the term of a labour contract has expired.*

- The labour contract is terminated according to Article 44 (iv) and (v) of this Law.

**Article 44 (iv) the employer is declared bankrupt*
**Article 44 (v) the employer's business license is revoked or the employer is ordered to close down its business or to dissolve its business entity, or the employer makes a decision to liquidate its business ahead of the schedule;*

- Other circumstances as proscribed in other laws and administrative regulations.

An employee shall be given an economic compensation based on the number of years they have worked for the employer and at the rate of one (1) month's wage for each full year they worked. Any period of not less than six months but less than one year shall be counted as one year. The economic compensation payable to an employee for any period of less than six months shall be one-half of monthly wages.

If the monthly wage of an employee is higher than three times the average monthly wage of employees declared by the People's Government at the level of municipality directly under the Central Government or at the level of a districted city where the employer is located, the rate for the economic compensation to be paid to the employee shall be three times the average of their monthly wage and shall be for no more than 12 years of their work.

The term of "monthly wage" mentioned in this article refers to the employee's average monthly wage for the 12 months prior to the dissolution or termination of their labour contract.

Win-win solution for structuring allowance and bonus systems

Work allowances

For foreign employees, with the approval of the tax authority, the following categories of income shall be exempted from individual income.

- Rental allowance
- Laundry fees
- Removal of indemnity
- Meal allowance
- Children's educational fund in China

Work bonus

All employees are vested in their annual "net" bonus. The following annual bonus sheet is a reference. Amounts are in Chinese RMB.

Annual Bonus	Individual Income Tax	Net Bonus
18,000	540	17,460
18,001	1,695.1	16,305.9
54,000	5,295	48,705
54,001	10,245.2	43,755.8
10,8000	21,045	86,955
10,8001	25,995.25	82,005.75

Conclusion: Chinese Labour Law in short

Chinese labour laws and regulations are fairly well written and reflect internationally recognized workers' rights.
The Labour Law sets out fundamental workers' rights for all employees in China, including the following rights:

- equal employment opportunity
- choice of job
- compensation for labour
- rest periods, vacations and holidays
- workplace safety and healthy working conditions vocational training
- social insurance and benefits
- the right to resolve labour disputes

The Labour Law stipulates that all employers are required to execute labour contracts with their employees to establish terms and conditions of the employment relationship. ■

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