leaf

Legal Handbook

March 2020

I.A Foreign investment options in China

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FOREIGN INVESTMENT OPTIONS IN CHINA

01

GREENFIELD PROJETS

- **Foreign-Invested Enterprises (FIEs):** Foreign investors may establish foreign-invested enterprises in China either alone or together with Chinese investors, usually taking in the following forms:
  i. Foreign-Invested Company **(Foreign-Invested Limited Liability Company/Foreign Invested Companies Limited by Shares):** independent legal person with liabilities limited to the amount of its capital contribution/shares.
  Foreign investor may consider to establishing **Foreign Holding Company** or **Regional Headquarter**, when the FIE meets certain requirements, to help coordinate its investment in China.
  ii. Foreign-Invested Partnerships (General Partnership /Limited Partnership): established with or without a Chinese partner, the distribution of profits and losses is provided by the partnership agreement.
- **Representative Offices** (RO): representing companies but this structure itself is not a company.

INVESTING IN CHINA VIA HONG KONG

A foreign entity should consider **Hong Kong as an entry point for its operations in Mainland China**. Hong Kong corporate and legal environments are more flexible than those in Mainland China, and the company set up remains much faster as **no authorization is requested**.

MERGERS & ACQUISITIONS

- Taking over existing business and assets
- Asset deal or share deal

Every M&A transaction in China carried out by foreign investors will **require establishing an FIE,** the FIE structure will depend on the deal structure and compliance with Mergers & Acquisitions regulations in China.

CONTRACTUAL OPTIONS

- **Distribution Arrangements**: a foreign company may appoint Chinese companies to distribute the foreign company's products in China.
- **Manufacturing Arrangements:** processing and assembly arrangements, compensation trade ...
- **VIE** (Variable Interest Entities): a wholly or partially foreign owned entity enters into agreements with a PRC operating company that has the approved business scope and licenses to operate in a prohibited or restricted sector.
- **Franchise**: Foreign operators can launch franchising operations in China either through cross-border franchising or by setting up a company in China.

Since the PRC Foreign Investment Law comes into force since January 1, 2020, there are substantial changes for FIEs, especially for the foreign invested companies, which shall apply the PRC Company Law as domestic companies unless otherwise provided.

WHAT ARE THE INVESTMENT OPTIONS AVAILABLE IN CHINA?

INVESTMENT OPTIONS

- **FOREIGN-INVESTED LIMITED LIABILITY COMPANIES** – A limited liability company invested by foreign investors alone or together with Chinese investors (See I. A. 1. for details). It includes the former WFOEs and former equity joint venture as well as cooperative joint ventures.

- **FOREIGN-INVESTED COMPANY LIMITED BY SHARES (FICLS)** – Company typically organized for listing purposes (See I. A. 2. for details).

- **HOLDING COMPANY** – Foreign investors with substantial operations in China may set up holding companies to hold their investments in FIEs (See I. A. 3. for details).

- **REGIONAL HEADQUARTERS** – These can be set up to coordinate and provide services to group companies in the region, both inside and outside China. The benefits of regional headquarters depend upon which rules are used to set them upwe take the rules implemented in Beijing or Shanghai for example (See I. A. 4. for details) .

- **FOREIGN-INVESTED PARTNERSHIP** – Structure established by two or more foreign entities or individuals with or without a Chinese partner, with the partnership agreement providing for the distribution of profits and losses (See I. A. 5. for details).

- **REPRESENTATIVE OFFICE** (RO) – Structure set up in China to represent foreign companies (and their affiliates). A representative office itself is not a company. ROs are not permitted to engage in direct business activities (See I. A. 6. for details).

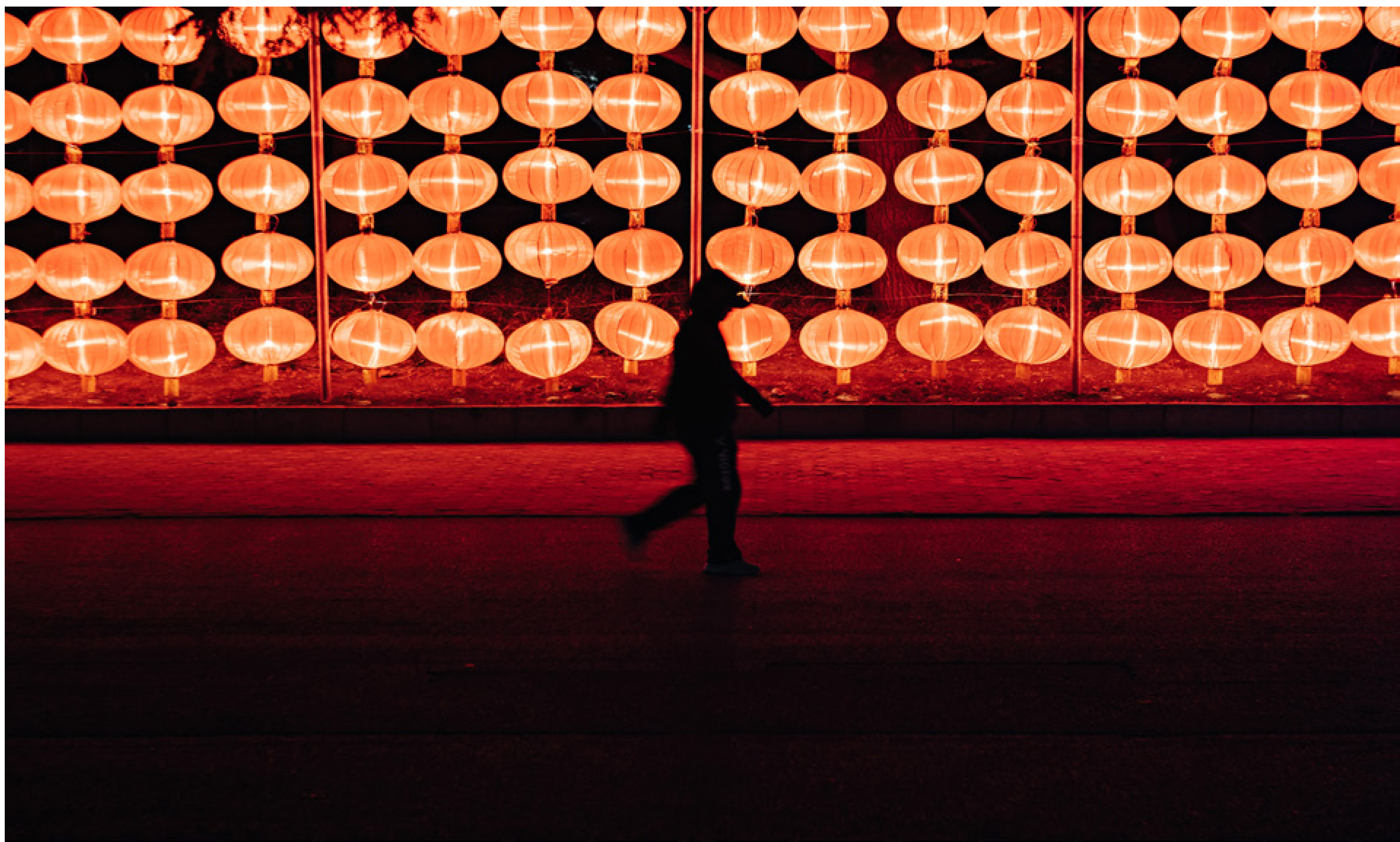
OTHER ARRANGEMENT OPTIONS

- **MANUFACTURING ARRANGEMENTS** – These can be structured as processing and assembly arrangements, compensation trade, or manufacturing arrangements (See I. C. 2. for details).

- **DISTRIBUTION ARRANGEMENTS** – In a distribution arrangement, a foreign company may appoint Chinese companies to distribute the foreign company's products in China (See I. C. 1. for details).

- **VARIABLE INTEREST ENTITY** – Structure where a wholly or partially foreign-owned entity enters into agreements with a PRC operating company that has the approved business scope and the required licenses to operate in a foreign investment restricted or prohibited sector (See I. C. 3 for details).

- **HONG KONG COMPANY** – A foreign entity can use a Hong Kong entity to structure its investments in Mainland China (See I. A. 7. for details).



A QUICK OVERVIEW ...

Several factors should be considered when choosing your investment business vehicle. The chart below summarizes the main differences between the most popular options for structuring foreign investments.

The new Foreign Investment Law ("FIL") and its Implementation Rules have come into effect since January 1, 2020, which has significantly changed the legal framework of foreign investments, especially in relation to the current organizational form and corporate structure of FIEs.

	Foreign-Invested Limited Liability Company	Foreign-Invested Company Limited by Shares (FICLS)	Foreign-Invested Partnership (FIP)
Ownership	Wholly or partially foreign owned	Wholly or partially foreign owned	As provided in the partnership agreement
Limit on the number of investors	≤ 50 shareholders	2-200 promoters required for the establishment of FICLS, and half of the promoters shall have a domicile in china	At least two partners with at least one foreign partner. Limited liability partnership: ≤ 50 partners (including at least 1 general partner).
Liability	Company's liability limited to its entire assets Shareholders' liability limited to its subscribed capital contribution	Company: liability limited to its entire assets Shareholders' liability limited to its subscribed shares	Joint and several liabilities for general partnerships Limited liability for limited liability partnerships, but with at least one general partner with unlimited liability
Control over the company	Depends on the proportion of ownership; 2/3 voting rights required for major issues; simple majority for other issues	2/3 majority of votes cast by shareholders presenting at the meeting for major issues; simple majority (votes cast by shareholders present at the meeting)	Depends on the partnership agreement; Unanimous partners' agreement required for major issues
Profit-sharing	Proportionate to each shareholders' paid-up equity contribution, but such distribution can be otherwise unanimously agreed by shareholders	Proportionate to each shareholders' shares, unless otherwise provided in the articles of association	As provided by the partnership agreement
Capital recovery	Share net assets upon liquidation Transfer of equity	Share net assets upon liquidation Transfer of shares	As provided by the partnership agreement
Highest Authority	Shareholder's meeting	Shareholders' General Meeting	Partners' Meeting
Set up time and cost	Comparatively easy and fast, depending on the industries No minimum capital requirement	Negotiations may take some time, depending on the industries No minimum capital requirement	Comparatively easy and fast, depending on the industries No minimum capital requirement
Market access in China	Subject to the Special Administrative Measures (Negative List) for Admission of Foreign Investment	Subject to the Negative List	FIP cannot access to the industries which have shareholding restriction to market assess as listed in the Negative List.

GREENFIELD PROJECTS STRUCTURES

Greenfield projects structures are well-suited for entrepreneurs who do not want to work within the constraints of existing infrastructure. For that purpose, several structures with different characteristics are available to set up your business in China.

1. FOREIGN-INVESTED LIMITED LIABILITY COMPANIES

CHARACTERISTICS

- Wholly or partially foreign ownership: foreign individuals, enterprises or other organizations may establish foreign-invested limited liability companies alone or together with other investors. Capital coming from Hong Kong, Macau, and Taiwan is considered as foreign capital.
- Limited liability: company's liability limited to its entire assets; shareholders' liability limited to its subscribed capital contribution/subscribed shares (as the case may be).
- Applies to PRC Company Law unless otherwise provided in FIL and relevant laws. Since the enforcement of FIL, foreign-invested companies, like domestic companies, applies to the PRC company law. (See "2. Changes due to FIL" below for details)

CHANGES DUE TO FIL

Since January 1, 2020, the FIL has repealed the relevant laws on Wholly Foreign-Owned Enterprise(WFOE), Equity Joint Venture(EJV) and Cooperative Joint Venture(CJV), and **FIEs' organizational form, governing structure and business operation shall subject to the PRC Company Law**, streamlining with the domestic companies. However, FIL leaves a 5-year interim period for existing WFOEs, EJVs and CJVs to complete the transformation from original corporate governance to the governance applicable to domestic companies.

The FIL's impacts on the corporate governance structures to WFOEs should be slight as an implementation opinion issued by four ministerial authorities in 2006 provides that the corporate governance of WFOEs shall comply with the PRC Company Law.

In contrast, the FIL generates substantial impacts on Joint Ventures (both EJV and CJV) in corporate governance since the rules under JV laws are quite different from those set out under the PRC Company Law.

The table below reflecting the main differences in the organizational form and corporate structure under the JV laws and the PRC Company Law:

Subjects	EJV Law	CJV Law	FIL & Company Law
Highest authority	Board of directors	Board of directors or Joint Management Committee	Shareholders' meeting
Composition of the board/the Joint Management Committee	No less than 3 directors	No less than 3 directors or members of the Joint Management Committee	3-13 directors or one executive director
Appointment of directors	Determined through consultation by the EJV parties	Determined through consultation by the CJV parties	Appointed by shareholders' meeting
Term of directors	4 years	No more than 3 years	No more than 3 years
Statutory quorum for board/ joint management committee meetings	Two-thirds or more of all directors	Two-thirds or more of all directors or members of the Joint Management Committee	Stipulated in articles of association ("AoA")

GREENFIELD PROJECTS STRUCTURES

02

Subjects	EJV Law	CJV Law	FIL & Company Law
Major issues subject to super-majority approval	• Amendments to AoA • Increase or decrease of registered capital • Termination or dissolution • Merger or division	• Amendments to AoA; • Increase or decrease of registered capital; • Dissolution • Mortgage of assets; • Merger, • division or change of organizational form	• Amendments to AoA • Increase or decrease of registered capital • Merger, division or dissolution • Change of company's form
Voting rules for major issues	Unanimous consent of all directors present at a Board meeting	Unanimous consent of all directors or members of the Joint Management Committee present at the meeting	Approval of shareholders holding two-thirds or more of the voting rights
Equity Transfer	Obtain the consent of all other JV parties regardless of whether it is an internal transfer or external transfer	Obtain the consent of all other JV parties regardless of whether it is an internal transfer or external transfer	• Internal transfer: no consent required; • External transfer: consent of more than half of the other shareholders is required. Moreover, if more than half of the other shareholders not only refuse the transfer but refuse to purchase the shares to be transferred, they shall be deemed as giving their consent to such transfer.
Profits distribution	Shall be distributed among shareholders in proportionate to their capital contribution	Based on JV contracts.	Dividends shall also be distributed proportionately among shareholders in accordance with their capital contribution, but such distribution can be otherwise unanimously agreed by shareholders

ACTIVITY

A Foreign-Invested Limited Liability Company may only engage in the activities listed in its business scope, as approved by the Chinese authorities. It is very important that the business scope selected corresponds to the activities carried out by the Foreign-Invested Limited Liability Company. Activities conducted beyond the business scope may lead to penalties and confiscation of the illegal profit.

Although Foreign-Invested Limited Liability Company can engage in a wide range of sectors, its activities cannot belong to the Negative List, which is updated annually by the Chinese authorities. Meanwhile, the Negative List for Free Trade Zones may be more opened to foreign investment than the Negative List nationwide.

02

ADVANTAGES AND DISADVANTAGES

Whether to invest alone by foreign investors, or jointly invest with a domestic partner, maybe one of the most common questions raised by potential investors. Here we summaries the main advantages & disadvantages for investing alone by foreign investors (as previously known as WFOE), so that the corresponding disadvantages & advantage of non-WFOE-type Foreign-Invested Limited Liability Company may be clear as well.

ADVANTAGES OF WFOES:

- There is no need for long negotiations with a domestic partner.
- The establishment process of a WFOE is formal, simple, and streamlined, and takes around 30 days from the date of filing all the necessary documentation.
- Complete management control by foreign investors. There is no need to take into consideration the interests, needs, and schedule of a domestic partner. Therefore, this structure is especially recommended for foreign investors who are already familiar with doing business in China.
- It is easier to protect intellectual property, technology, and know-how.

DISADVANTAGES OF WFOES:

- The foreign investors will not benefit from the assistance of local partners for obtaining government approvals, premises, and land.
- It may take more time for inexperienced foreign investors to access the market in China. There will be no domestic partner to provide for sales through existing distribution channels and local connections.

2. FOREIGN-INVESTED COMPANY LIMITED BY SHARES (FICLS)

A FICLS is a company limited by shares with a share capital divided into a specific number of shares of certain nominal value. In general, investors choose FICLS for the establishment of private equity funds or if they expect their company to be listed in the near future.

CHARACTERISTICS

- **At least one Chinese shareholder** is required in a FICLS.
- Investors own **shares** instead of equity interests.
- A FICLS can be either **newly established or converted** from an existing FIE.
- Important decisions need a **two-thirds majority** of vote casting by its shareholders presenting at a shareholders' general meeting but not a unanimous vote.

ACTIVITY

FICLS can only engage in activities within its business scope.

FICLS are generally set up for **listing purposes**. Subject to approval, FICLS can issue shares to the public, and can be listed on the Shanghai or Shenzhen stock exchanges as well as on overseas stock exchanges.

3. HOLDING COMPANY

Foreign investors can set up holding companies in China to hold their investments in FIEs and to provide services to their subsidiaries.

REQUIRED QUALIFICATIONS

To set up a holding company, foreign investors are subject to **certain requirements:**

- The investor shall **prove good financial standing and its financial ability** to establish and fund a holding company.
- The capital contribution shall be affected by the establishment of new subsidiaries in China and/or the increase of the registered capital of existing subsidiaries.
- A foreign investor must have **a total asset value of no less than USD 400 million** in the preceding year and must have previously established an FIE to which it has already paid up more than USD 10 million in registered capital. Under an alternative requirement, the foreign investor must have **established at least 10 FIEs in China,** representing a paid registered capital of more than USD 30 million; *
- In the situation of a joint venture holding company, a Chinese investor must have good credit standing and necessary economic strength, with a total asset value of no less than RMB 100 million in the preceding year
- The foreign investor shall be a foreign **company, enterprises or economic organization.** If there are two or more foreign investors, at least one foreign investor holding major equity interests shall comply with the second requirement as mentioned above.

*NOTE: *From local perspective, Shanghai Municipality has relaxed the requirements for establishing a holding company in Shanghai since September 1, 2019, and now the following requirement has been lifted: the total assets of the foreign investor for the previous year before the application shall be not less than USD 200 million, as well as the requirement that the requirement for domestic paid-in registered capital or the number of investment enterprises. For more details, please find: Several Opinions of the Shanghai Municipal People's Government on the City Promoting the Development of Regional Headquarters of Multinational Companies.*

PERMITTED OPERATIONS

The holding company's business scope is quite restricted as it is strictly an investment and services company, which may not engage, for example, in manufacturing operations.

The permitted operations of a holding company are the following:

- **Investments operations**: a holding company can invest in areas where foreign investments are encouraged or permitted, for example, in R&D centers for new products and high technology.
- **Services operations:** a holding company can provide services and consultancy services related to business operations to its subsidiaries in China, Foreign Exchange Balance, Technical supporting, training for employees, and intra-enterprise personnel management. It may assist its subsidiaries to seek loans and providing a guarantee for them.
- **Establishment of R&D centers**: a holding company can establish research and development center or department in China to engage in the research and development of new products and high and new technologies, transfer of the research and development results, and provision of the corresponding technical services.
- **Consulting operations**: a holding company can provide consulting services to the investors and its affiliated companies, such as market information, investment policies, and other reports related to its investments.
- **Undertaking outsourcing business:** undertaking the service outsourcing business of its parent company and affiliated companies

ADVANTAGES AND DISADVANTAGES

ADVANTAGES

- **Centralized coordination of operations**, such as marketing, distribution, training, and other administrative functions;
- **Higher levels of debt financing** than other investment options;
- **The status of regional headquarters**: a holding company can directly apply to be recognized as regional headquarters.

DISADVANTAGES

- **Restrictions in operations;**
- **High requirements for its investor:** the investor shall comply with the requirements mentioned above.

4. REGIONAL HEADQUARTERS

Regional headquarters may be set up to provide support to group companies within the region. The purpose of regional headquarters is to attract multinational corporations to set up regional or global headquarters in China, and to boost the local economy. The requirements for setting up the regional headquarter and relevant preferential policies may differ from region to region. Here, we focus on the local regulations of Beijing and Shanghai, as being top popular foreign investment destinations, for your consideration.

BEIJING REGIONAL HEADQUARTERS

- WHAT ARE THE REQUIREMENTS TO SET UP REGIONAL HEADQUARTERS IN BEIJING?

An already established foreign-invested holding company may apply directly for recognition as a Beijing **regional headquarter** upon approval; or

A foreign-invested **management company** may apply for recognition as a Beijing regional headquarter subject to fulfilling the following requirements:

- The parent company's total assets must be of no less than USD 400 million.
- The parent company's total paid-in registered capital in China must be of at least USD 10 million, and with no less than three enterprises inside or outside China that are invested or authorized to be managed by the parent company; OR no less than six enterprises inside or outside China that are invested or authorized to be managed by the parent company.
- The management company's paid-up registered capital must be of no less than USD 2 million.
- The Beijing regional headquarters shall be the parent company's sole highest operating management entity within China.

- WHICH ACTIVITIES SHALL BE MENTIONED FOR BEIJING REGIONAL HEADQUARTERS' BUSINESS SCOPE?

Beijing regional headquarters may engage in the following activities within their business scope: group treasury, domestic distribution, import and export, research and development, technical support, logistics operations, shared services among group companies, outsourcing services for multinational companies and overseas companies, and any other operation, management, and services activities, permitted by the law.

- WHAT ARE THE INCENTIVES FOR BEIJING REGIONAL HEADQUARTERS?

- setting up subsidy up to RMB 10 million;
- financial award up to RMB 10 million when the annual revenue first reaches RMB 1 billion;
- a 3-year rental subsidy, or a onetime subsidy (RMB 1,000 per square meter) for building or buying an office (subsidized areas shall not exceed 5,000 square meters);
- government's assistance in obtaining residence permits for staff; and
- tax incentives and exemptions on personal income tax.

SHANGHAI REGIONAL HEADQUARTERS

- WHAT ARE THE REQUIREMENTS TO SET UP REGIONAL HEADQUARTER IN SHANGHAI?

A foreign-invested company (either holding company or management company or in other forms) may apply for recognition as a Shanghai regional headquarters.

A Shanghai regional headquarter shall meet the following requirements:

- It is an FIE with an independent legal person status.
- The registered capital shall be of no less than USD 2 million.
- The parent company's total assets must be of no less than USD 200 million.
- Upon authorization by the parent company, it assumes the functions of a headquarters, such as management decision-making, capital management, procurement, sale, logistics, settlement, research and development, and training, in a region covering more than one country.
- The status of regional headquarters may be considered if the entity meets the aforesaid requirements and makes outstanding contributions to local economic development.

- WHAT ARE THE INCENTIVES FOR SHANGHAI REGIONAL HEADQUARTERS?

- RMB 5 million sets up subsidy for newly established regional headquarters with ten or more employees in Shanghai of a holding company with the paid-up registered capital exceeds USD 30 million;
- 3-year rental subsidy, or a onetime bonus for self-building or buying an office in subsidized areas;
- financial award (RMB 5-10 million) when the annual revenue reaches RMB 500 million or more criteria;
- one-time subsidy (RMB 3 million) if the regional headquarter update with higher level (eg. becoming Asian headquarter, Asian-pacific headquarter or even higher).
- centralized management of foreign exchange funds;
- cross-border RMB business;
- entry-exit formalities for the employees' visa;
- custom clearance; and
- talent introduction.

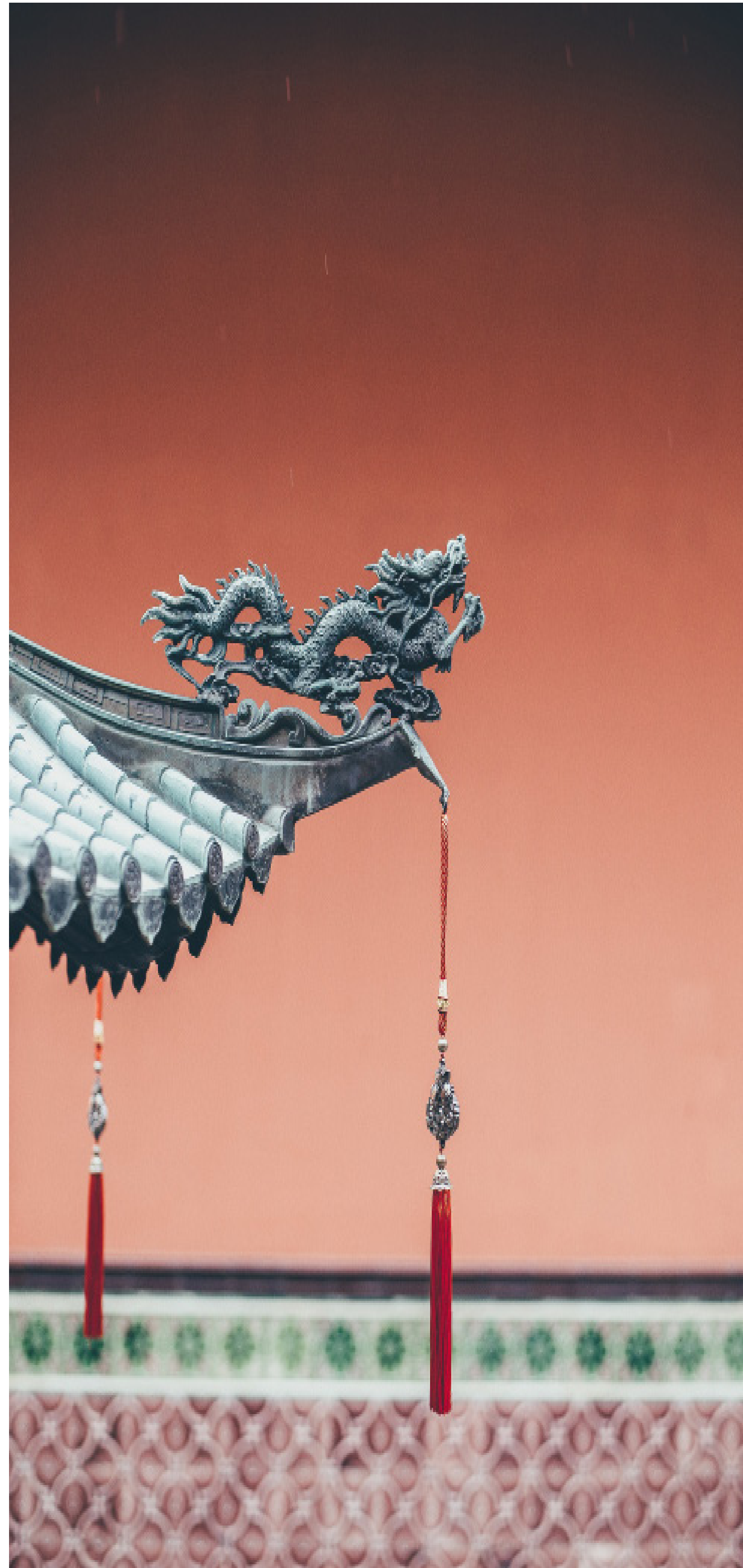
- WHAT ARE THE REGULATIONS FOR FIES THAT FAIL TO MEET THE STANDARDS FOR BEING THE HEADQUARTERS OF A MULTINATIONAL CORPORATION?

Since February 1st, 2017, eligible WFOEs and their branches that do not meet the standards for multinational companies headquarters but that effectively support service functions may be recognized as **quasi-headquarters entities** and benefit from the same preferential policies offered for Shanghai regional headquarters if they meet the following criteria (further relaxed since September 1, 2019):

- It is a foreign-invested enterprise or any of its branches with an independent legal person status.
- The registered capital must be of no less than USD 1 million; where the entity is established in the form of a branch, the working capital allocated by the parent company shall not be less than US$1 million.
- The parent company's total assets must be of no less than USD 100 million.
- Upon authorization by the parent company, it assumes the functions of headquarters, such as management decision-making, capital management, procurement, sales, logistics, settlement, research and development, and training in a region covering more than one country.

Quasi-headquarters are entitled to the benefits of preferential policies for the following activities:

- centralized management of foreign exchange funds;
- cross-border RMB business;
- entry-exit formalities for the employees' visa;
- custom clearance; and
- talent introduction.



5. FOREIGN-INVESTED PARTNERSHIPS

A foreign-invested partnership may be a general or a limited liability partnership with at least one foreign partner.

CHARACTERISTICS

- A foreign-invested partnership is **established by two or more foreign entities or individuals with or without Chinese partner(s).**
- There are 2 kinds of partnerships: **general** (every partner shall take **joint and several liabilities)** or **limited liability partnership** (consisting of at least one general partner with one or more partners with liability limited to the extent of their capital contributions).
- Partnerships do not have independent legal person status.
- Capital contribution by partners may take the form of cash, in-kind benefits, intellectual property rights, land use rights or other forms of property right, or take the form of **labor services.**
- Limited liability partnerships may not have more than 50 partners, and shall include at least one general partner.
- Executive partner (one or more) shall be appointed to conduct partnership affairs. A limited partner shall not act as an executive partner.
- **No minimum capital requirement** except otherwise regulated by the PRC laws. Capital can be contributed to foreign currency or RMB.
- The **profits and losses** are distributed according to the partnership agreement.
- A foreign-invested partnership does not issue shares, and therefore **cannot be listed.**
- Setting up the process: registration with the SAMR (State Administration for Market Regulation).

WHY CHOOSING A PARTNERSHIP?

- A foreign-invested partnership offers more flexible than an FIE as the partnership agreement sets out the partners' governance arrangements.
- Allocation of profits is not required to be in proportion of partners' capital contributions.
- The income tax is assessable on each partner and not on the partnership.
- Regarding partnership transfer: (i) in case of internal transfer all or part of the partnership interest within the existing partners, notification shall be sent to other partners. (ii) in case of transfer all or part of the partnership interest to a third-party, unanimous consent shall be obtained among all other partners, but the partnership agreement may provide otherwise.

6. REPRESENTATIVE OFFICES

Representative offices are set up in China to represent foreign companies and their affiliates, but a representative office itself is not a company.

CHARACTERISTICS

- Representative offices are set up by foreign companies who want a **presence in China**. In order to be entitled to register a representative office in China, the foreign company must have been incorporated for at least 2 years.
- A representative office **cannot carry out direct business operations.**
- Representatives offices may carry out the following activities: market research and presentation and promotion of the parent company's products or services; and liaison activities relating to the sale of products, provision of services of the parent company.
- **Non-legal person status**: the parent company assumes all legal liabilities of the representative office in China;
- Representative offices must hire PRC citizens through designated **local labor agencies.**
- **There is no minimum capital requirement.**

ADVANTAGES AND DISADVANTAGES

ADVANTAGES

- A representative office provides foreign companies with a **basic entry** to the Chinese market.
- It works for such purposes as business liaison, product introduction, market research, information gathering, and technological exchange;
- Its key role rests in **building up the business and administrative relationships for the parent company.**

DISADVANTAGES

- **There is no separate legal entity** so that representative offices cannot undertake legal liabilities.
- **There are restrictions on direct business activities,** so that representative offices are not permitted to generate profit.
- Representative offices **cannot directly hire PRC citizens.**

- WHAT HAPPENS IF A REPRESENTATIVE OFFICE VIOLATES THE OBLIGATION NOT TO ENGAGE IN COMMERCIAL OR MANUFACTURING ACTIVITIES?

In such case, the representative office shall be ordered by the authority to **make correction**, illegal income shall be **confiscated**, tools, equipment, raw materials, products(commodities) and other properties which are used specifically for the profit-making activities shall be **confiscated**, a **penalty** ranging **from RMB 50,000 to RMB 500,000** may be applied, and the **cancellation of the registration certificate** of the representative office.

7. WHY CONSIDERING INVESTING IN CHINA VIA HONG KONG

02

As the legal and corporate environments in Hong Kong have allowed this Special Administrative Region to be more flexible than Mainland China, a foreign entity may use Hong Kong as an entry point for its operations in Mainland China.

IMPACT OF CEPA (MAINLAND AND HONG KONG CLOSER ECONOMIC PARTNERSHIP ARRANGEMENT)

When joining the WTO in December 2001, China committed to the liberalization of access to its market for WTO member states. In June 2003, the CEPA's 1st phase was executed by Mainland China and Hong Kong. Since then, CEPA provides for enhanced mutual market access, facilitation of measures for bilateral trade and investment between China and Hong Kong. The CEPA takes the form of a Free Trade Agreement, and provides for several measures for both sides:

- **Import of goods to China**: Hong Kong products covered by CEPA are imported in Mainland China at zero tariffs.
- **Facilitations to establish foreign investment enterprises in Mainland China for "Hong Kong Service Suppliers (HKSS)":** to qualify as a HKSS, a company must be incorporated in Hong Kong, have carried out three to five years of substantive business operations in Hong Kong in the relevant service sector, have fulfilled its profits tax payment obligations, must comply with requirements related to local staffing, and comply with requirements related to business premises.
  The range of sectors within the HKSS' scope is quite extensive, including such businesses as distribution, banking, insurance, transportation, and advertising among others. The preferential treatment takes various forms, including allowing wholly-owned operations and relaxing restrictions on equity shareholding.
- **Trade and Investment Facilitation (TIF)**: the CEPA has also improved and streamlined bilateral trade and investment.

SAVING TIME & MONEY

- A faster setting up process as **no authorization is requested**: the incorporation process in Hong Kong takes 3 to 4 days whereas it takes around 30 to 40 days in mainland China.
- The **cost** to set up a company in Hong Kong is low.
- The **documentation** to provide in Hong Kong is easier to comply: unlike in mainland China, no official translation certified by the Chinese embassy of the country of the investor is requested in Hong Kong,
- **Chinese authorities process corporate documents of Hong Kong companies in a more expedient manner**: Hong Kong documents are drafted in both Chinese and English, which excludes the need for official translation and notarization.

LEGAL FLEXIBILITY

Foreign investors may use a Hong Kong holding company in the structure, involving their mother holding company in their home country and their operating company in mainland China. This structure will provide the foreign company with the flexibility offered by Hong Kong which presumes:

- **Easy share issuing mechanism**: Hong Kong companies enjoy the ease and freedom of issuing shares to investors without the approval of any authorities.
- **Issuance of shares to shareholders at different prices:** the share price of a private company in Hong Kong can be set without limitation and does not require any approval from Hong Kong authorities. Therefore, the amount of investment does not always correlate with the shareholding in a Hong Kong company.
- **Issuance of different classes of shares:** the issuance of different kinds of shares in a Hong Kong company gives the possibility to organize the rights and obligations of the shareholders. Basic mechanisms may be used, such as non-voting shares, preferred shares with a ratchet mechanism, redemption rights, or specific liquidation rights.

TAXATION

Hong Kong's taxation system is based on the "**territoriality principle**" which means that only profits derived from trade, business, and a profession in Hong Kong are subject to taxation so that the taxpayer's residence is irrelevant.

- Hong Kong does not impose any payroll tax, turnover tax, sales tax, value-added tax, or capital gains tax.
- Dividends (after the deduction of withholding tax by Chinese tax authorities) received by a Hong Kong holding company from a Mainland subsidiary are usually not likely to be taxable in Hong Kong.

ORGANIZING THE EXIT OF SHAREHOLDERS

Hong Kong also offers a good option for a way out for a Chinese operating company.

- SELLING AN OPERATING COMPANY BASED IN CHINA OWNED BY A HONG KONG COMPANY:

It is advised to sell the Hong Kong Company holding the PRC entity instead of the operating entity registered in Mainland China. Both the seller and the buyer will enjoy several advantages:

- setting up the price, conditions and timeline for payment without limitations;
- stronger capacity to enforce the implementation of any exit clause such as tag/drag along clauses;

- EQUITY TRANSFERS:

TTransfers of equity in Hong Kong **do not require any approval** and can be done in a limited period of time, whereas equity transfers in China need to be approved and are controlled by the authorities.

The PRC regulations apply value-added tax in the case of equity transfers of Hong Kong Company holding the capital of a Chinese company.

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