

China Business Briefing: Politics & the Economy in 2008

New Legal Developments and Challenges

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I. Employment Contract Law

- Adopted in June 2007, and went into effect on January 1, 2008
- Employer are required to adopt rules and regulations that govern the workplace
- **Requirement of written employment contract**
 - Must enter into w/i one month of employment
 - If signed after one month but before one year anniversary, employee entitled to double salary for the period before signing contract;
 - After one year, employee is deemed to have an open-term contract;
- Employees entitled to open-term contracts:
 - Those with continued employment of at least 10 years and less than 10 years before legal retirement age at the time company implements the new system;
 - Those with continued employment of at least 10 years at the time contract is renewed;
 - Those with 2 term-contracts.
- Probation:
 - Length based on employment term;
 - Less than 3 months: none
 - 3 months to 1 year: 1 month
 - 1 year to 3 years: 2 months
 - More than 3 years: 6 months
 - One probation period only;
 - Pay not less than (i) the lowest pay for the position in the company, or (ii) no less than 80% of the agreed upon salary and not lower than the minimum salary standard in the location
- Termination:

- No termination by employer during probation except for specified “cause”;
 - Termination by mutual agreement
 - Termination by employee with 30 days notice (or 3 days notice during probation), with or without cause;
 - Termination by employer immediately for statutorily prescribed causes;
 - Termination by employer with 30 days notice if (i) employee cannot resume original work or perform other work after an illness or non-work-related injury, (ii) does not have the ability to properly perform the duties after training; or (iii) material change in objective circumstances rendering employment impossible to be performed or modified
 - If, due to financial difficulties, change of business plan and other objective circumstances, company needs to lay off 20 or more people, or if less than 20, 10% or more of the workforce, company must notify union or all employees 30 days in advance and submit workforce reduction plan to the labor administrative department
 - Laid-off employees have right of first offer if company hires again within 6 months
- Employees with “Iron Rice Bowl” – almost impossible to fire:
 - Has been exposed to occupational hazards (unless has had a totally clear occupational health check-up);
 - Has had work-related injury or occupational disease and has lost or partially lost capacity to work;
 - Has had a work-related injury or occupational disease and is undergoing treatment;
 - Women during pregnancy or while nursing;
 - Has worked for company for at least 15 years continuously and has less than 5 years before legal retirement age;
- Severance pay:
 - Almost always have to pay:
 - Termination by employee for prescribed cause;
 - Termination by mutual agreement;
 - Termination by employer after giving 30 days notice (see above underlined item);
 - Termination by employer as a result of workforce reduction;
 - Expiration of term-contract, unless employee chooses not to renew same or better contract;
 - Termination due to employer’s bankruptcy or revocation of business license
 - Other situations as provided by law
 - Amount of severance pay
 - One month’s pay (average of 12 months immediately before termination) for each year of employment;
 - Employment of 6 months to less than 1 year is counted as one year;
 - Employment of less than 6 months: pay ½ month’s salary;

- For employees whose monthly salary is higher than 3 times the average month salary of all employees in the municipality or city for the preceding year, severance pay is limited to 3 times the average monthly salary of all such employees for the preceding year, and payment is for no more than 12 years.
- Noncompetition
 - Allowed for senior management, senior technical personnel and employees with confidentiality obligations only;
 - No more than 2 years after termination;
 - Limited to reasonable geographical location and scope of service
 - Employer must pay during non-compete period
- Others:
 - Companies required to keep copies of all employment contracts for 2 years after termination
 - Hiring employees away from current employment may incur liability to current employers
 - Penalties for violations: fine, awards of double wages, liability for actual damages; and employee has the right to sue
- Discussion:
 - Higher operation costs
 - Many provisions need clarification
 - Unintended side effects: employers refusing to sign second term-contract; terminating employees when approaching 10 years of employment and then re-hire
 - Enforcement (capacity of court; fear of workers for losing jobs)

II. Property Rights Law

- Adopted in March 2007 and went into effect on October 1, 2007
- Hotly debated for many years (first proposed in 2002)
- Significance: The fact it is passed – for the first time in the history of the PRC, basic private property ownership rights are legally recognized and protected – a big step away from communism
- Basics:
 - Equal protection of state, collectives and private individual ownership rights
 - Property rights include: right to occupy, use, enjoy the benefits of, dispose of, and create security interests in the property
 - Unified registration of all interests in real property
 - Ownership of real property is effective upon registration
 - Ownership of real property is determined based on registration information; if there is discrepancy between the registration and the owner's ownership certificate, the registration controls;
 - Any interested party can petition to correct errors on the registration if the registered owner agrees to the correction in writing and can prove that an error has occurred; if the registered owner does not agree, the interested party can petition to register his disagreement and petition the court to make a decision within 15 days; if no action is initiated within 15 days, the disagreement registration will be cancelled;
 - Can pre-register a pending purchase of real property – sale of the property to a third party will be void unless the pre-registered owner consents;
 - Owner must register within 3 months after closing, otherwise the pre-registration will expire;
 - Generally, ownership of personal property becomes effective upon delivery; exceptions:
 - Occupancy before transfer
 - Continued occupancy after transfer
 - Court/arbitration commission-ordered, or government-determined, transfer, modification or cancellation
 - Inheritance
 - Construction and demolition
- Specifically allows the creation of usufructuary rights and security rights in property rights
- Usufructuary rights include: right to farm, right to build, right to use residential housing land collectively-owned, and easement
- Security rights include: right to create security interest or mortgage in property to secure performance of debt, and right to pledge (tangible and intangible property),

and right of creditor to create lien; and right of creditor to possess pursuant to contract

- Allows “eminent domain” for the purpose of public interest, with compensation
- Specifically provides what are exclusively owned by the state and the collectives and what can be owned by private parties
- Creation of joint ownership (co-ownership by proportion and common ownership)
- Sweeping law –
 - Detail provisions regarding ownership and management of apartment buildings – common areas, roads inside apartment complex, parking garages, utility facilities, garbage, noise, security, etc.;
 - Protection of bona fide third party purchaser;
 - Handling of lost property
- Discussion:
 - Legally recognize private property ownership rights;
 - Broaden the scope of properties that can be use as security and simplifies the procedures for realizing security interests – creating more financing options
 - Should enhance confidence of foreign investors and encourage foreign debt financing;
 - Encourages of foreign ownership of real property
 - What doesn't it do:
 - Does not provide for marketable ownership of land;
 - Farmland cannot be sold or borrowed against;

III. Enterprise Income Tax Law

- Adopted in March 2007 and went into effect on January 1, 2008
- Unified enterprise income tax for both domestic and foreign companies at 25%
- Reduced rate of 20% may be applicable to “small and low-profit enterprises” (for industrial enterprises: taxable income of no more than 300,000 RMB, employees of no more than 100, and assets of no more than 30 million RMB; for other enterprises: taxable income of no more than 300,000 RMB, employee or no more than 80 and assets of no more than 10 million RMB)
- Agricultural, public infrastructure, environmental-protection, energy-saving and technology transfer – tax exempt or reduced tax for up to six years (certain agricultural products indefinitely)
- New and high-tech industries – 15%
- Withholding tax rate of 20% on interests, royalties, capital gains and dividends, subject to bilateral treaties
- Current rates:
 - Foreign investors in “special zones/parks” – 10%
 - Foreign investors outside of “special zones/parks” (real estate, services and trading companies) – 33%
 - Domestic business – 33%
- Existing FIEs have 5-year grandfathering period to graduate to the new rate, and may use up remaining tax holiday (must start on 1/1/08)
- Repealed incentives:
 - Two year tax exempt and three year 50% rate reduction for manufacturing FIEs
 - 50% rate reduction for export FIEs
- Strengthening implementation of new tax laws:
 - Documentation required for all related party transactions;
 - Disallow business transactions without reasonable business purpose;
 - “Thin capitalization” rule – if the interest paid by a company exceeds the prescribed debt/equity ration, it is be disallowed
- Discussion:
 - Historical roles of incentives: to attract FDI (FDI in China in 2002: USD \$440bn in 2002) and to promote regional development
 - More in-line with WTO rules

- Simpler and fairer tax system is appealing to foreign investors
- Reduced inconsistency in enforcement
- Removed geographical limitation for investment;
- Attract high technology to China
- FIEs in real estate, trading and service sectors will also benefit