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CHINA UPDATE

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New Regulations for Representative Offices of Foreign Enterprises

Key Points:

- ***Greater scrutiny of representative offices continues***
- ***Qualifications for chief representative have been enhanced***
- ***Representative offices now required to go through annual review process like companies***

In 2010 the China authorities promulgated important rules that changed or will change major aspects of representative offices (ROs) of non-China-based entities. On 4 January 2010 the State Administration for Industry & Commerce (SAIC) and the Ministry of Public Security (MPS) jointly promulgated the Circular on Strengthening Administration of Registration of Residential Representative Offices of Foreign Enterprises (the Circular), which went into effect on the same date. On 19 November 2010 the State Council promulgated the Regulations on Administration of Registration of Resident Representative Offices of Foreign Enterprises (the New Regulations). The New Regulations will become effective as of 1 March 2011 and replace the Measures for the Administration of Registration of Resident Representative Offices of Foreign Enterprises (the Measures) that were approved by the State Council on 5 March 1983 and promulgated by the SAIC on 15 March 1983. The New Regulations incorporated some new requirements provided under the Circular.

The key points in the New Regulations are summarized as follows:

Business Scope of ROs

The New Regulations emphasize that an RO may not engage in any profit-making activities and explicitly restrict an RO to engaging only in the following activities in connection with the business of the foreign enterprises:

- Market investigation, display and promotional activities in connection with the products or services of the foreign enterprises; and
- Liaison activities in connection with selling products, providing services, domestic procurement and domestic investment.

In the past, the relevant regulations permitted an RO to engage in indirect business activities including business liaison, product introduction, market research and technology exchange. By contrast, the New Regulations are more specific about the permitted scope of activities for an RO, although there is no change to the general nature of the permitted scope.

Qualifications of the Chief Representative

According to the New Regulations, the following persons may not serve as either a chief representative or other representative of an RO:

- Anyone who has been sentenced to a criminal penalty due to committing crimes that were detrimental to the national security or pubic welfare of the PRC; or

- The chief representative or other representative of an RO that has been deregistered, whose registration certificate has been withdrawn or that was ordered to close by relevant authorities due to any illegal activities that were detrimental to the national security or the public welfare of the PRC during the past five years.

Since 4 January 2010 a newly established RO may have no more than four representatives (including the chief representative).

Annual Inspection

Beginning in 2011 each RO must undergo an annual inspection. This is a new requirement. Previously, an RO only needed to file a simple renewal of its registration certificate each year. Under the New Regulations each RO must submit an annual report to the appropriate registration authority – i.e., the SAIC or its local counterpart (the AIC) – between 1 March and 30 June each year. The annual report must include information regarding the existence and "good standing" of the RO's parent company, as well as information regarding the business activities of the RO and information on audited financial statements. It's expected that the SAIC and local AICs may promulgate detailed rules for implementation of the ROs' annual inspection soon.

AICs' Powers and Responsibilities Clarified; Punishments Increased

The New Regulations grant AICs the following powers and responsibilities to investigate the activities of any RO that is suspected of violating the New Regulations:

- To investigate and understand the situation by working with relevant entities and individuals;
- To review, copy, take possession of or otherwise secure contracts, documents, account books and other materials in connection with any activities in violation of the applicable laws;
- To take possession of or otherwise secure the tools, equipment, raw materials, products (commodities) or other property specifically used by the RO to engage in illegal activities; and
- To check the accounts and accounting vouchers, account books, and statements in connection with any savings deposits of any RO that engages in illegal activities.

Furthermore, the New Regulations specify more clearly the liabilities of an RO in the event of a violation of any relevant law or regulation, and increase the penalties for some violations. For example, if an RO violates the New Regulations by engaging in profit-making activities, the AIC must order the RO to correct the error and may confiscate the illegal gains and the tools, equipment, raw materials, products (commodities) and other property used to engage in profit-making activities. The RO in violation can be fined an amount from RMB 50,000 (US$7,462) to RMB 500,000 (US$74,620). For more serious violations, the registration certificate of the RO may be revoked.

– Brenda Xu

Intellectual Property Protection Progress

Key Points:

- ***Government continues to implement the 2008 national intellectual property rights (IPRs) strategy***
- ***Courts continue to improve the quality of IPR judges and staff***
- ***Enhanced IPR protection is good for China-based companies and innovation, as well as foreign investors***

With promulgation of the National Intellectual Property Strategy Compendium in June 2008 and advocacy of the indigenous innovation policy, China has strengthened efforts in IP protection by amending existing patent, copyright and trademark laws and customs IP protection regulations; establishing more detailed implementation regulations; and boosting administrative and judicial enforcement for IP-related cases. In October 2010 the State Council launched a nationwide special campaign on combating IPR infringement and the manufacture and sale of fake and shoddy commodities, with almost all government agencies involved and a schedule lasting until March 2011.

In spite of the promise of a better IP protection environment in China, non-China-based companies still face the frustrating problem of counterfeit products flooding physical and online shops, as well as the theft or preemptive registration of patents, trademarks, trade names or domain names. The owners must tolerate time-consuming administrative and judicial proceedings in the course of protecting their IPRs in China, and sometimes spend significant money without obtaining a satisfactory result due to unfamiliarity with China's IP protection systems.

On 2 December 2010 the Beijing Municipal Intermediate No. 1 People's Court held a briefing on IP cases involving foreign entities, at which the court discussed common problems appearing in such cases that cause delays or failures. For instance, the foreign party might not fully understand:

- The requirements and procedures for the notarization and authentication of its incorporation certificate and of the identity of its authorized signatory who signs the power of attorney to engage a China-based lawyer;
- The scope of authorization granted to the China-based lawyer;
- The burden of proof; and
- Evidence preservation.

As a result, the foreign party might fail to meet the timelines or fail to provide satisfactory proofs.

It takes at least two weeks to process the notarization and authentication of the required documents. However, in most cases the foreign respondent may have only 30 days to respond or appeal. In addition, China's courts value original and direct documentation. Electronic documents such as emails, webpages and Internet posts are required to be notarized. If the foreign party bears the burden of proof, it must provide original and direct documentation to prove its arguments, and any document in a foreign language must be translated into Chinese. Non-original documents without strong supporting proof may not be admitted by the court. Therefore, during the company's operations and dealings with agents or distributors, the foreign party must keep thorough records of all advertising, promotional materials, transaction documents and correspondence.

It is always important to be proactive in IP protection. China follows the first-to-file principle in respect of patent, trademark and domain name registrations. Therefore, the foreign company shall not rely on its agents, distributors or affiliates in China but should secure IP protection by registration before or immediately upon entering the China market.

– Brenda Xu

China Opens the Door for Wholly Owned Hospitals Established by Hong Kong and Macau Service Providers

Key Points:

- ***Greater market access to health care service providers under CEPA program supporting Hong Kong and Macau operators***
- ***Application procedures outlined in newly adopted regulations provide greater detail on the approval process***
- ***Investment thresholds and registered capital outlined in the new measures***

While wholly foreign-owned hospitals are still prohibited in China, as of May 2010 – when China entered into Supplement VII to the Closer Economic Partnership Arrangement (CEPA) with Hong Kong and Macau, respectively – China allows a qualified Hong Kong or Macau "service provider" to set up wholly owned hospitals in five provinces or municipalities in mainland China. Those include Shanghai, Fujian, Guangdong, Hainan and Chongqing. To implement Supplement VII, the Ministry of Health (MOH) and the Ministry of Commerce (MOFCOM) on 22 December 2010 jointly promulgated the Interim Measures for Establishment of Wholly Owned Hospitals in the Mainland by Hong Kong and Macau Service Providers (the Measures), which went into effect on 1 January 2011.

According to the CEPA, a qualified service provider in Hong Kong or Macau must satisfy, among others, the following conditions:

- The provider must have been incorporated pursuant to the applicable laws in Hong Kong or Macau and obtained a valid business registration certificate, as well as special licenses or permits for providing the services concerned if required by law; and
- It must have been engaged in substantive business operations, which must encompass the services to be provided in the mainland, in Hong Kong or Macau for three years or more.

With such restrictions, a holding company established by a foreign enterprise in Hong Kong for the purpose of investing in the mainland would not qualify as a service provider. In addition to the foregoing requirements, the Measures require that a service provider that wishes to establish a wholly owned hospital in the mainland should be equipped with advanced hospital management experience and management and service methods, and should be able to offer global advanced medical skills that are supported by documentary evidence. There is, however, no clear definition of such terms as “advanced hospital management experience” and “global advanced medical skills” under the Measures. As a result, the applicable authorities – i.e., the MOH and the MOFCOM – are left with full discretion to determine whether a given applicant meets the foregoing requirements.

Apart from the requirements for a service provider, the Measures also set forth detailed requirements for the wholly owned hospital to be established in the mainland, including:

- Such hospital must reach the standards for a Class II hospital with respect to its facilities, medical devices, physicians and management systems; and
- The total investment for such hospital must be at least RMB 50 million in the case of a Class III hospital or RMB 20 million in the case of a Class II hospital, with certain exceptions applicable for hospitals in boundary or poverty areas.

The application for the formation of a wholly owned hospital by a Hong Kong or Macau service provider should be submitted first to the local counterpart of the MOH in the city where the hospital is to be located. The city-level health authority will evaluate whether the proposed hospital conforms with the local hospital formation plan and, if satisfied, will submit the application to the provincial-level counterpart of the MOH for review. The MOH will make the final decision based on the opinion of both its city-level and provincial-level counterparts. It is noteworthy that the hospital formation plan developed by the local government, which as noted above is a significant factor considered by local authorities, is not always publicly available; even worse, some cities have not developed their plans at all. Consequently, an applicant may face substantial uncertainties in determining whether the proposed hospital is encouraged or discouraged by the local government.

Upon the approval of the MOH, an applicant needs to seek the approval of the MOFCOM for the formation of a for-profit wholly owned hospital, whereas only a simple registration with the MOFCOM is required for a non-profit hospital. With the MOFCOM’s approval, a for-profit hospital will become a foreign-invested enterprise and therefore should also perform company registration formalities with the local AIC. Any change in the founder or equity of a wholly owned hospital, whether for-profit or non-profit, is subject to the approval of both the MOH and the MOFCOM.

The recent health care system reform in mainland China, especially the policies that encourage the flow of non-governmental funds into the medical institution industry, has intrigued many foreign investors targeting the surging health care market in China. Supplement VII together with the Measures create an advantageous position for service providers in Hong Kong and Macau. The potential challenges, however, cannot be overlooked. As an example, whether a wholly owned hospital may be designated as a social insurance-covered hospital could affect whether it can attract sufficient patients.

– Ryan Chen

China Continues to Unify Its Tax System

Key Points:

- ***State Council regulations effective 1 December 2010 provide that local governments may impose taxes for local services and education***
- ***New regulations appear to apply equally to China-based and foreign companies***

According to a State Council announcement issued on 18 October 2010, starting from 1 December 2010 foreign enterprises shall be subject to city maintenance and construction taxes as well as taxes supporting education, all of which were previously levied only upon domestic enterprises. These measures to unify the taxation system are an attempt by China's authorities to create a level playing field in terms of tax for all companies operating in the country. Currently, the rate for city and construction maintenance taxes is 7 percent at the municipal level, 5 percent at the county level and 1 percent at lower levels, and the rate for education-supporting taxes is 3 percent.

– Celia Xu

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