Business exit

Business exit strategies must be considered when or before starting a business establishment in China (setting up a foreign invested enterprise in the form of a wholly foreign-owned enterprise [WOFE] or joint venture [JV], or opening a representative office) in terms of implementing future business restructuring strategies or controlling potential risks. Considering your business exit strategy directly, or even developing a broad idea, will greatly benefit investors guarding against business risks and facilitate your business restructuring plan in the future.

This guideline provides you with an understanding of the different business exit options and procedures as well as the requirements and situations when they may be useful. Attention is given to issues that raise the most questions according to our practical experience.

Table of Contents

1 Overview

When considering business exit strategies, an investor focuses on the following points：

1. Business exit options

Under current Chinese laws, there are several regulated exit options, such as:

- Transfer of the intermediate holding company;
- Voluntary closure of a business;
- Application for bankruptcy;
- Enforced closure by the relevant authorities.

Investors should thus choose the best exit option based on their business plan and operational status.

2. Business exit procedures and timeline

In addition to the business exit options, an investor should also consider exit procedures, general timeline, and complexity of each exit option. A better understanding of such information facilitates the smooth execution of exit procedures.

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2 Business exit options

2.1 Transfer of the intermediate holding company

When foreign investors plan to start a business in China, they may consider two options for entering the market:

1) Establishing a company directly in China;

2) Establishing a second-tier holding company in a tax haven country, such as Hong Kong in most cases, or the British Virgin Island (BVI), Liechtenstein, Monaco, the Cayman Islands, or Bermuda, and then setting up a Chinese company under this second-tier holding company.

Compared to option 1, option 2 is more complicated and time-consuming when starting businesses in China. However, in terms of business exit strategies in China, option 2 is much easier since the investor may consider transferring equities to the second-tier holding company to execute the business exit indirectly. As such, Chinese law will not apply, **but this transaction should be reported to the relevant tax authorities in China, and the investor will probably be required to pay tax in the country for earnings incurred from the transaction.** If investors intentionally do not report the earnings incurred from this indirect business transfer to the relevant tax authority, they will face substantial penalties once the case is exposed to the tax authorities.

2.2 Direct transfer of Chinese establishments

Under this option, the direct investors of companies are changed: Chinese laws apply, and the following complicated procedures are required.

2.2.1 Procedures

1) Internal decisions on the transfer of the shareholder's equity interests in the Chinese company are made by the shareholder company.

2) An application must be made for the approval of the equity interest's transfer with the authority that approved the initial establishment of the Chinese company. The approval must be obtained within 30 days of the date when all application documents were completed and accepted by the approval authority.

3) If all equity interests are transferred to a Chinese investor, the *Approval Certificate for Foreign-invested Enterprise* should be returned to the approval authority or it will be cancelled within 30 days of the transfer of equity interests approved by the authority.

4) Within 30 days after obtaining the new approval certificate from the approval authority mentioned above, the company should apply to the various government authorities to update the new shareholder's name on all incorporation certificates, including the business licence, organisational code certificate, tax certificates, bank permit, financial certificates, foreign exchange card, and statistic certificates, etc.

2.2.2 Documentation

Regarding the equity interests transfer approval, the main documents listed below should be submitted to the relevant authorities:

a. Equity interests transfer agreement;

b. Application letter on equity interests transfer;

c. Company's original contracts and articles of association as well as any amendments bearing the new shareholder information;

d. Approval Certificates for Foreign-invested Enterprise and Business Licences;

e. Resolutions of the board of directors of the Chinese company for the equity interests transfer;

f. List of members of the board of directors after the equity interests transfer.

2.3 Voluntary closure of a business

In this section, we explain how to close a business, including representative office (RO), WFOE, and JV, on voluntary basis in China. The information covered in this section includes the procedures, timeline, and documentation requirements. For better illustration purposes, we also provide several real cases of voluntary business closures.

2.3.1 Representative office

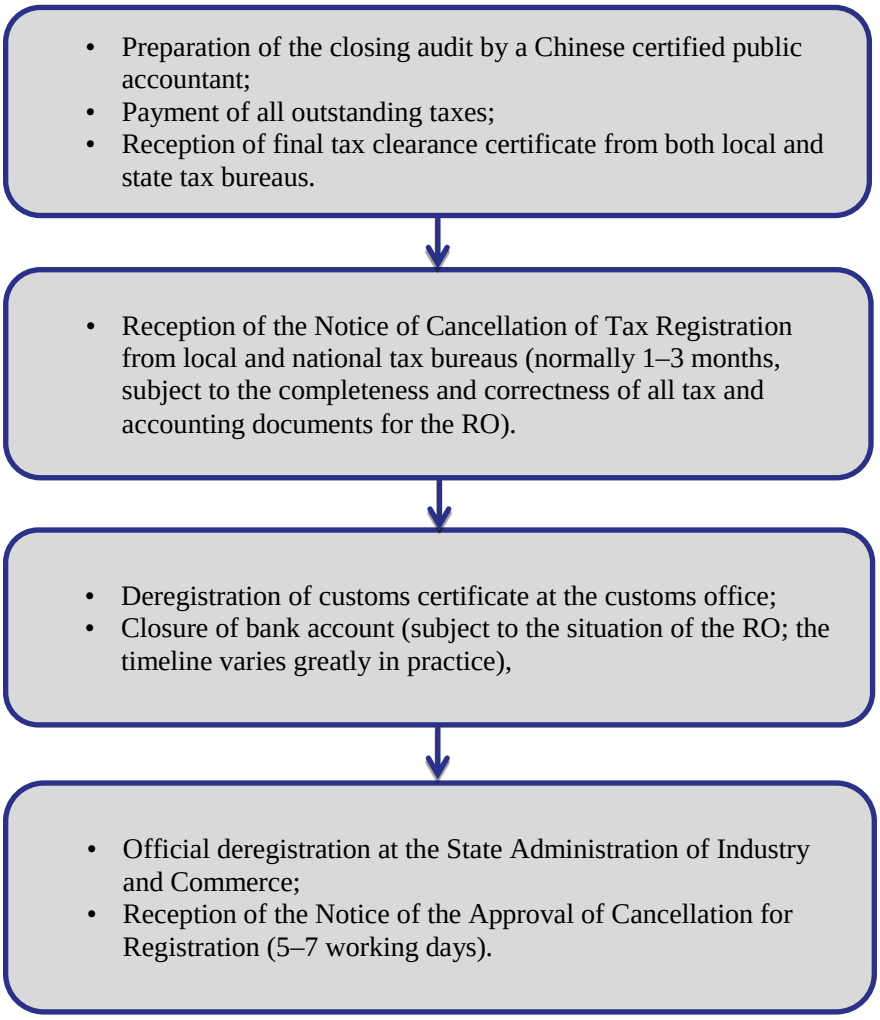
Closing an RO is much easier than with foreign-invested enterprises (FIEs) because an RO is the cost centre for a head office, and it is forbidden for head offices to engage in any profit-making activities other than liaison activities under Chinese laws.

1) Procedures and timeline

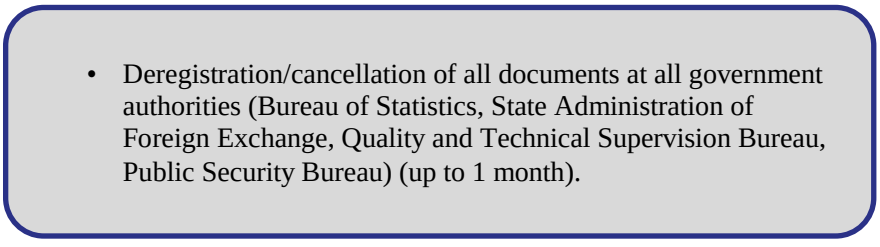
The process of deregistration can be divided into two parts: the RO should first obtain the Notice of Cancellation of Tax Registration from the tax bureau in charge, and then the Notice of the Approval of Cancellation for Registration from the registration authority that issued the registration certificate when establishing the RO. With this notice, the RO is officially closed. The whole process takes three to six months, depending on the completeness of the required documents. The most time-consuming part is tax

clearance and deregistration and, in practice, many ROs are required to reimburse taxes during the winding up procedures due to lack of comprehensive understanding of Chinese tax laws and policies, even though the majority of ROs believe their accounts are in order.

The overall procedure and timeline for closing a RO are illustrated as follows:



From this point onwards, the RO no longer exists. Nevertheless, the RO must also deregister with all other authorities. Thus, the following steps must be carried out to fully close the company:



2) Case study

Company F was established in September 2005 as an RO. It was responsible for collecting and analysing financial data of several multinational companies for its overseas head office and providing investment advice to it. There were 21 employees in Company F, three of whom were foreign staff acting as chief representatives and other senior managers. The company had conducted no tax reporting since its

establishment. In August 2007, it planned to leave the Chinese market. During tax deregistration, the relevant tax authorities found business revenue-generating activities in F; furthermore, the foreign executives earned high incomes but never paid individual income tax. In this regard, the tax authorities in charge immediately initiated a tax investigation. Finally, the company reported and paid USD 3.9 million in taxes on their income generated from bookkeeping business in China, which was done by local employees using overseas network resources and financial systems. According to Chinese tax-related laws, Company F should have reported and paid tax on the income from its bookkeeping business, and the salaries of foreign executives were earned in China, thus being subject to Chinese individual income tax.

2.3.2 Wholly foreign-owned enterprise

WFOE refers to a limited liability company with 100% foreign ownership. The process of WFOE deregistration is time-consuming and normally takes between six to 12 months, or even longer depending on the business scope and completeness and correctness of all documents. The starting point for WFOE closure is the decision of shareholders to close the company in China.

1) Legitimate reasons for winding up

Under Chinese laws, the WFOE is required to present legal reasons for winding up. These statutory reasons are as follows:

a) Expiry of business operation;
b) Investor decision to dissolute the WFOE due to poor operations and serious losses;
c) Incapacity of the WFOE in the operation with serious losses caused by force majeure;
d) Termination reasons as specified in the WFOE's Articles of Association.

2) Liquidation committee

Once the shareholder company resolves to close the WFOE, a liquidation committee is established to manage the entire liquidation process. The members of the liquidation committee are constituted by its shareholder company, and the legal representative of the WFOE is the person in charge of the liquidation committee.

The main responsibilities of the liquidation committee are the following:

a) Clearing WFOE's property and verifying creditors' claims;
b) Preparing the balance sheet and a detailed inventory list;
c) Formulating the principles for properties evaluation and computation;
d) Formulating the liquidation plan;
e) Notifying known creditors in written form as well as unknown creditors through public announcements in the designated newspaper;
f) Paying overdue taxes;
g) Clearing credits and debts;
h) Preparing the liquidation report for the shareholders' approval;
i) Participating in civil lawsuits on behalf of the company during the liquidation process.

During liquidation, the creditor is eligible to claim credit rights with the liquidation committee. The timeline for reporting the creditors' rights to claim differ according to whether or not they are known to the liquidation committee. Known creditors must be notified by the liquidation committee and report their claims within 30 days following receipt of the notice. Unknown creditors have to report claims within 45 days after the public announcement date.

Of course, evidence proving any claims must be provided. If known creditors do not report within the timeframe, their claims are still incorporated into the liquidation plan. Unknown creditors not respecting the timeframe may have their claims settled, but it is not guaranteed. Any claims reported after the execution of the liquidation plan are irrelevant.

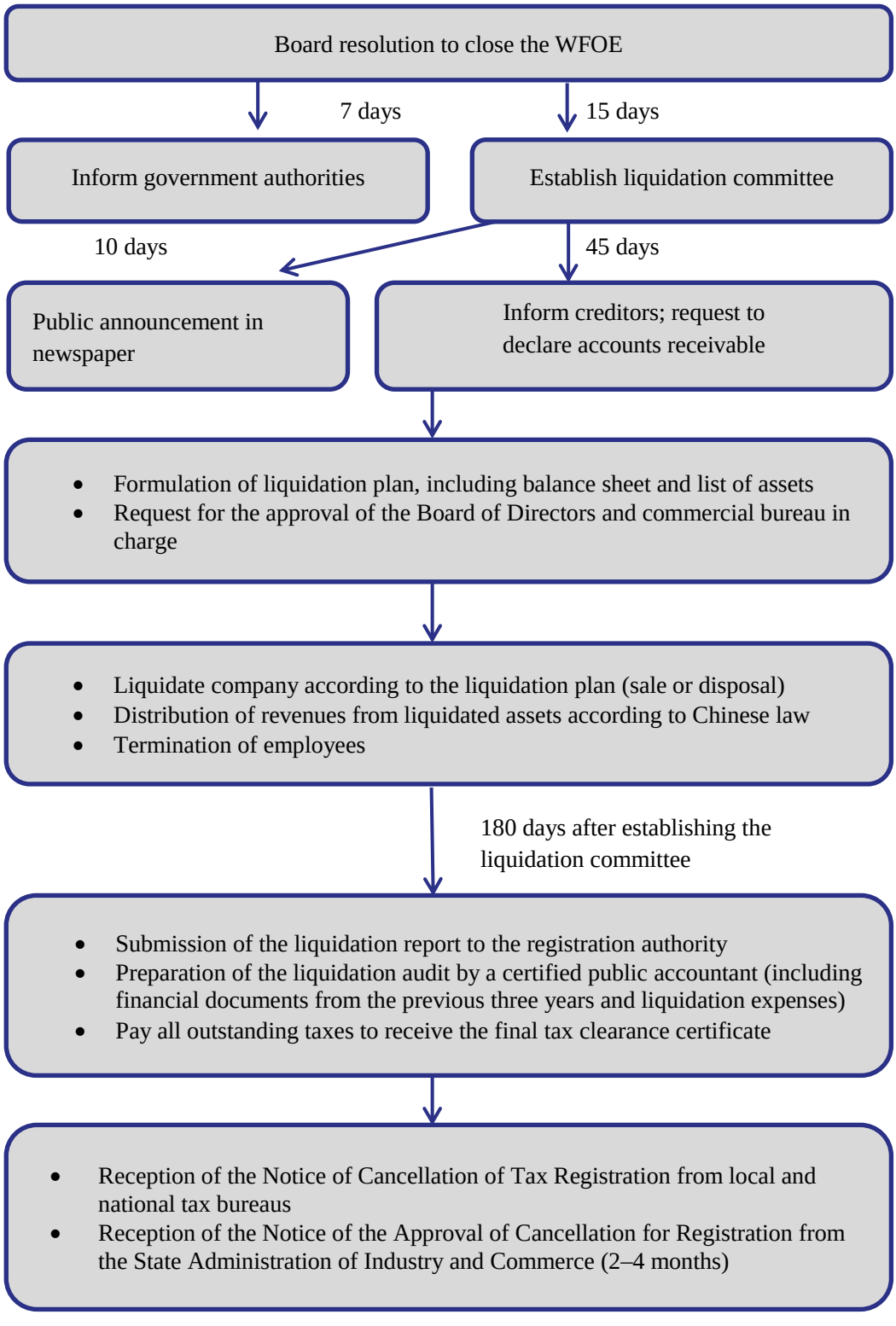
All claims are to be verified by the liquidation committee. If creditors are unsatisfied with the results, they may request a re-verification within 15 days. If they are still not satisfied, in the instance of underestimation of claims, they have the right to file a lawsuit at the People's Court within the following 15 days.

The liquidation committee writes the liquidation plan, and the priority of payments in the liquidation plan is according to the following order:

a) Expenses in relation to or incurred in liquidation, such as management costs, costs caused by the sale and disposal of property by the liquidation committee, expenses incurred through announcements, lawsuits, or arbitration, etc.;
b) Salaries and social insurance contributions of the employees;
c) Taxes (overdue taxes and taxes occurred during the liquidation process);
d) Secured credit rights;
e) Unsecured credit rights.

If the assets are insufficient to cover all of the liquidation costs, the liquidation committee has the right to apply for bankruptcy with the relevant People's Court.

3) Timeline



4) Case study

In 2004, Company G was incorporated as a WFOE in Haidian District, Beijing.

The shareholders of Company G decided to dissolve and deregister G due to changes in investment strategy. As per the members of the liquidation committee, there are no legal limitations, but the following general practices should be respected:

- The members of the liquidation committee should be in the majority with regard to voting and making decisions;
- The liquidation committee must have accountants and lawyers to handle legal and financial issues during liquidation;
- The legal representative of the company should assume the position of the person in charge of the liquidation committee.

Company G began the liquidation procedures. However, its legal representative, Mr S, was a foreigner and had lived overseas for many years. He had no knowledge of liquidation procedures, especially regarding the legal responsibilities of the liquidation committee. Thus, he made inquiries with a professional consultant, who told him to set up a liquidation committee and hand over the current business as soon as possible to that committee. The liquidation committee would be responsible for all matters during the liquidation period until the liquidation was finalised. The members of the liquidation committee should be devoted to their duties and not accept any bribery, make other illegal income, or occupy the company's properties by exploiting their rights and duties. If members of the committee violate laws, administrative regulations, or the articles of association of Company G, resulting in damages for the company or its creditors, then Company G and its creditors have the right to claim compensation at the People's Court in charge.

2.3.3 Joint ventures

A JV refers to either an equity joint venture (EJV) or contractual/cooperative joint venture (CJV).

1) Legitimate cause for winding up

The closure of a JV should be based on one of the statutory reasons. A JV can apply for deregistration with the various governmental departments for any one of the following reasons:

a) Expiry of operational term;
b) Suffering insolvency and unable to continue business due to heavy losses;
c) Unable to continue business due to a failure to fulfil the obligations prescribed in the EJV agreement, contract, or articles of association;
d) Unable to continue business due to heavy losses incurred by force majeure;
e) Unable to achieve the business operation objectives or develop in the future;
f) Other reasons prescribed in the contract or Articles of Association.

2) Procedures and documentation

The exit procedures for the JV are not shorter or easier than the initial establishment process and usually take at least six months. Firstly, the resolution to deregister the JV is made after the unanimous agreement of all directors present at the board meeting. Secondly, the JV needs to notify the relevant government authorities within seven days after the resolution.

During the business exit procedure, companies – regardless of their status as JV, RO, or WFOE – **should make a public announcement about their termination after obtaining approval from the relevant authority.** The company should publish an announcement in a provincial-level newspaper. The announcement must indicate the relevant deregistration information, including the company name, registration ID, person in charge of the liquidation committee with contact details (normally, the legal representative of the company is in charge of liquidation committee). **The most important part of the public announcement is informing unknown creditors to claim outstanding credit and debt from the liquidation committee within 45 days of the announcement date.**

After liquidation, the JV deregisters with various governmental departments to cancel all incorporation certificates. After outstanding tax is paid and all the incorporation certificates are cancelled, upon approval, the investors in the JV can recoup any funds that remain. After the dissolution of the JV, all accounting books and materials shall be under the custody of the Chinese partners as per Chinese laws; foreign partners cannot remove accounting-related books and materials.

2.3.4 Documentation under voluntary closure

Regarding the main documentation to be submitted under a voluntary winding up process, we take WFOE closure as an example for illustration purposes as shown in the following table:

PROCEDURES	**DOCUMENTS**
Approval from the Ministry of Commerce (MOFCOM)	✓ Application letter; ✓ Shareholder resolution; ✓ Original approval certificates.
Recording the liquidation committee with the State Administration for Industry and Commerce (SAIC)	✓ Standard application form for recording liquidation committee members; ✓ Approval letter from the MOFCOM; ✓ Information about liquidation committee members.
Public notice in designated paper to notify unknown creditors	✓ Closure reasons; ✓ Contact details for liquidation committee member in charge.
Liquidation audit	✓ All financial documents, receipts, and invoices from the previous three years.
Notice of Cancellation of Tax Registration	✓ Application and examination form; ✓ Liquidation audit and liquidation report; ✓ Tax clearance certificate from local and national tax bureau; ✓ Approval letter for liquidation.
Liquidation report	✓ All documents confirming residual value of liquidated assets or liabilities.
Deregistration from customs office	✓ Original customs certificate; ✓ Written board resolution for WFOE closure.
Deregistration from SAIC **Notice of the Approval of Cancellation for Registration**	✓ Duly signed application form; ✓ Original and electronic business licence (USB & CD); ✓ Notice of custom and tax certificate deregistration; ✓ Bank account closure notification; ✓ WFOE's official stamp; ✓ Liquidation audit and liquidation report; ✓ Approval letter for liquidation; ✓ Copy of public announcement in newspapers; ✓ Copy of ID card(s) for authorised representative(s); ✓ Organisation code certificate and code certificate; ✓ Application form for organisation code deregistration certificate.
Deregistration from the State Administration of Foreign Exchange	✓ Foreign exchange registration certificate; ✓ IC card of foreign exchange bank account; ✓ Name, address, and business scope of enterprise; ✓ Approval of foreign exchange capital account; ✓ Copy of SAIC deregistration certificate.
Closure of bank account	✓ All unissued cheques; ✓ All unutilised debit slips.
Deregistration from Quality and Technology Supervision Bureau (QTSB)	✓ Organisation code certificate and code certificate; ✓ Application form for organisation code deregistration; ✓ Copy of SAIC deregistration certificate.

2.4 Compulsory dissolution

The business licence may be revoked by the registration authority, if the JV is found to be doing the following:

a) Providing false registration information when setting up the company;
b) Engaging in business activities that are not included in the business scope specified in the business licence;
c) Not opening without adequate reasons for more than six months after the company establishment or closing down without approval more than consecutive six months after opening;
d) Failing to complete annual inspection procedures as required;
e) Leasing or lending the business licence.

Once the business licence is revoked, the company must be dissolved and forbidden to continue to operate. The consequences are as follows: 1) the company's name is forbidden from being used within three years following its revocation; 2) the legal representative of the company is prohibited from taking positions – such as director, supervisor, or manager – in any other company within three years following its revocation.

Even if the business licence is revoked, the company is still required to go through the deregistration procedure with the tax authority within 15 days of revocation; failing to do so results in a maximum fine of CNY 10,000.

In practice, some foreign shareholder companies hold the view that the deregistration procedure is very complicated, time-consuming, and even costly; as such, they prefer to "walk away" without going through the proper deregistration procedures, especially when the business licence is revoked. In other cases, they may not know that they are still obliged to carry out the deregistration. The potential consequences incurred therefrom are listed as follows:

a) The assets of other subsidiaries in China will be collected to pay any outstanding debts;
b) If the country where the foreign shareholder resides has mutual judicial assistance and extradition treaties with China, the foreign shareholders will probably be investigated by the courts in their home country following the judgment made by the People's Court of China.

2.4.1 Case study

The shareholder of Company M, an RO in Beijing, made the decision to close the company. However, they believed that the deregistration of the RO had to go through many procedures, such as tax clearance, public announcement, approval from relevant authorities, and so on. They believed that revoking the business licence by the industrial and commercial authority would save time and energy. The company deliberately refused to take part in the annual inspection as required and waited for the business licence to be revoked. The business licence was finally revoked, but the company name was prohibited to be used for a period of three years, and the legal representative was prohibited from serving as a director, supervisor, manager, or legal representative of another company in China for a period of three years following the date of revoking the business licence.

2.5 Role of the People's Court during the business exit

During the business exit – whether due to voluntary closure, compulsory dissolution, or bankruptcy – company shareholders, creditors or other persons may resort to the People's Court to correct any wrong actions or seek help. Below are some examples:

a) Shareholders have the right to file a request with the People's Court to revoke the illegal board resolution within 60 days of the date on which the resolution is made, if the content of the resolution violates the company's Articles of Associations or the procedure for concluding the resolution is illegal. Once the People's Court declares the resolution invalid or cancels it, the company may file an application with the relevant company registration authority to cancel or change the registration, which must be done based on the illegal resolution.
b) If a liquidation committee fails to be formed within 15 days as required by law, the company creditors may apply to the People's Court to set up a liquidation committee. The People's Court shall accept the application, and in a timely manner, organise a liquidation committee to execute the liquidation.
c) If the property of the company is not sufficient for paying off the debts during the liquidation, the liquidation committee shall file an application to the People's Court for bankruptcy. Once the People's Court makes a ruling to declare the company bankrupt, the liquidation committee must hand over the liquidation matters to the court.

3 Bankruptcy

The *Enterprise Bankruptcy Law* (EBL) came into force on June 1st 2007 and sets the legal framework for the declaration, liquidation, and deregistration of insolvent companies. However, the EBL also provides options for the insolvent company to restructure or find a compromise with creditors so to avoid bankruptcy.

EBL is generally applicable to all companies, regardless of whether they are state or privately owned, although financial institutions, such as banks and insurance companies are exceptions. Chinese EBL also covers all overseas assets of the company as long as they are related to the Chinese business. However, in practice, this standard is hard to uphold since it depends on the cooperation of the authorities in foreign jurisdictions. Moreover, the EBL regulates management liability if it is obvious that the current bankruptcy is the result of disqualification or breach of duties and diligence; in other words, the management or its legal representative(s) may be required to indemnify the losses incurred. Non-compliance with the EBL results in penalties and even jail sentence to the persons in charge.

In this chapter, we explain the following key points:

- Application to the People's Court;
- Role of the administrator;
- Creditors' meeting and committee;
- Distribution plan and report;
- Company deregistration;
- Timeline.

3.1 Application to the People's Court

The People's Court is the starting point for all of the following bankruptcy procedures. The company's legal representative or creditors can submit the bankruptcy application to a competent People's Court. If the company is already in the process of liquidation and has acknowledged its insufficient assets, the liquidation committee can apply for bankruptcy under EBL. A decision as to whether or not to accept the application is usually made by the court within the 15 days of receiving the bankruptcy application. When making the decision, the court always takes into account whether the company's assets are insufficient to pay off the debts. Therefore, the company has to prove either of the following:

a) It did not pay its debts, and its assets are not high enough to cover its liabilities, (also known as balance sheet insolvency);
b) It is unable to pay its debts when due and discharge its liabilities in the future (also known as cash-flow insolvency).

Further documents necessary for the application are as follows:

a) Bankruptcy application, including the basic information about the applicant, purpose of application, and fact and grounds of the application;
b) Financial position of the company, including a complete list of all debts and claims;
c) Financial statements from the past three years;
d) Plan for employee arrangements, including wages, severance pay, and social insurance contributions;
e) Other documents as demanded by the People's Court.

3.2 Role of the administrator

The administrator is the leading person in the liquidation process under EBL. The position is similar to the function of the liquidation committee when winding up a solvent company because the board authorises their responsibilities to the administrator. The administrator is responsible to the People's Court, playing a vital role in any communication between the company, the People's Court, creditors, and other government authorities. Normally, only the People's Court can appoint or remove the administrator. The administrator must have "relevant professional expertise and qualification," as would be the case for members of legal, accounting, or special bankruptcy firms. Moreover, the administrator shall be independent in order to ensure objective decisions.

The responsibilities of the administrator are as follows:

a) Investigating the company's financial position and preparing the financial status report;
b) Initiating and holding creditors' meetings;
c) Taking over the company's seals, accounting books, documents, and so forth;
d) Participating in litigation, arbitration, or other legal proceedings;
e) Deciding on the company's daily expenses;
f) Deciding on the company's internal management affairs.

The administrator is responsible to the People's Court but also subject to the supervision of the creditors' meeting.

3.3 Creditors' meeting and committee

The People's Court is responsible for informing all known creditors about the bankruptcy within 25 days after accepting bankruptcy. Creditors declaring claims within the set timeframe – usually 30 days after the notification of court on the acceptance of bankruptcy – have the right to attend the creditors' meeting. This applies to known creditors, whereas unknown creditors can declare their claims within 90 days after the first public announcement. For their report to be taken into consideration within the liquidation plan, they need to provide sufficient evidence, such as invoices, contracts, and so on.

The place and time of the first creditors' meeting is mentioned in the notification of the People's Court, which includes information such as applicant name, date of acceptance of bankruptcy, title, name, and office address of the administrator, and deadline, location, and notes for declaring claims.

The creditors' meeting has the following duties and responsibilities:

a) Supervising the administrator;
b) Checking declared claims;
c) Obliging the company and its management to give full and truthful responses;
d) Approving debt compromise agreements;
e) Discussion and approval of the disposition plan of bankruptcy properties;
f) Discussion and approval of distribution plan.

The creditors' meeting can decide if a creditors' committee is necessary. The creditors' committee is composed by legal representatives of the initiative creditors and a representative of the employees or labour union of the creditors. The committee needs the approval of the People's Court.

A resolution by the creditors' meeting is taken if creditors – representing more than 50% of the total claims – are in agreement. The voting right is determined by the amount of claims that creditors have against the company but also by their status. As such, unsecured creditors enjoy full voting rights, whereas secured creditors are not eligible to vote when debt compromise agreements or distribution plans are in question.

If creditors representing more than two-thirds vote for a reorganisation or debt compromise agreement, they have the power to offer alternatives instead of the declaration of bankruptcy.

3.4 Distribution plan

The distribution plan composed by the administrator is similar to a liquidation plan and includes a complete list of all assets and claims. It tries to resolve how to settle the company's debts via liquidation. Thus, the distribution plan needs the approval of the creditors' meeting or committee. The contents of such a distribution plan must cover the following issues:

a) Titles, names, and domicile of creditors with claims to bankruptcy property;
b) Amount of claims of the creditors;
c) Total amount of the bankruptcy property available for distribution;
d) Order and proportion of the bankruptcy property distribution;
e) Method for distributing bankruptcy property.

The plan must be composed according to the standards of the *PRC Enterprise Bankruptcy Law*.

3.5 Contractual obligations

The administrator has the right to decide whether to apply or rescind a contract's obligation. This right is applicable if the contract was signed within a year prior to the bankruptcy declaration. Furthermore, the administrator has the right to request that the court revoke past transactions. This applies to any transaction deemed against the ordinary business course, such as:

a) Transfer of property without consideration;
b) Transaction at clearly unreasonable prices;
c) Provision of property guarantee to unsecured debts;
d) Unjustified preference to creditors (e.g., early repayment of debts within six months prior to bankrupt declaration).

The purpose behind these regulations is to ensure no illegal diminishment of the asset value. The administrator therefore has the right to recover any assets reported lost through any of the described contractual obligations or through any other action to conceal or embezzle assets, even if the transactions were made by senior management. This includes the discovery of "fake" claims by creditors.

The administrator is eligible to demand any outstanding payments from debtors of the company. Nevertheless, the debtors have the right to request a set-off if the company owes them any debts. However, the set-off is not permitted if the creditor of the company obtains credit rights against the company from another third party after the People's Court accepts bankruptcy.

The distribution plan details how the liquidation gains are shared among creditors. The creditors' claims can be cleared only in cash. If the assets are insufficient to cover all of the company's liabilities, the range and priority of how to proceed in the distribution is listed as below*:*

a) Bankruptcy fees and joint interest debts, including any costs occurring due to the liquidation process, such as administrator's fees, fees paid to the authorities, and taxes from the previous years;
b) Employment costs, including unpaid wages, social insurance payments, housing fund contributions, and severance pay;
c) Taxes, including taxes from the current year, those relating to the liquidation process, turnover taxes on the sale of assets (value-added tax, business tax, consumption tax, land appreciation tax), liquidation gains or losses subject to the enterprise income tax, and reimbursement of tax or customs exemptions;
d) Other creditor's claims, including secured creditors (e.g., bondholders), which rank above unsecured creditors (e.g., shareholders).

Any payments not in compliance with the above orders as specified in the EBL are to be declared invalid or, even worse, may be deemed as an attempt to embezzle company property. In the latter case, the responsible person can be made civilly liable.

3.6 Distribution report

The distribution report is conducted once the execution of the distribution plan is finalised. This final report states the residual values of the insolvent company's assets and liabilities. It is required to apply for deregistration and, thus, is vital for terminating the liquidation. Furthermore, the report must cover the following aspects:

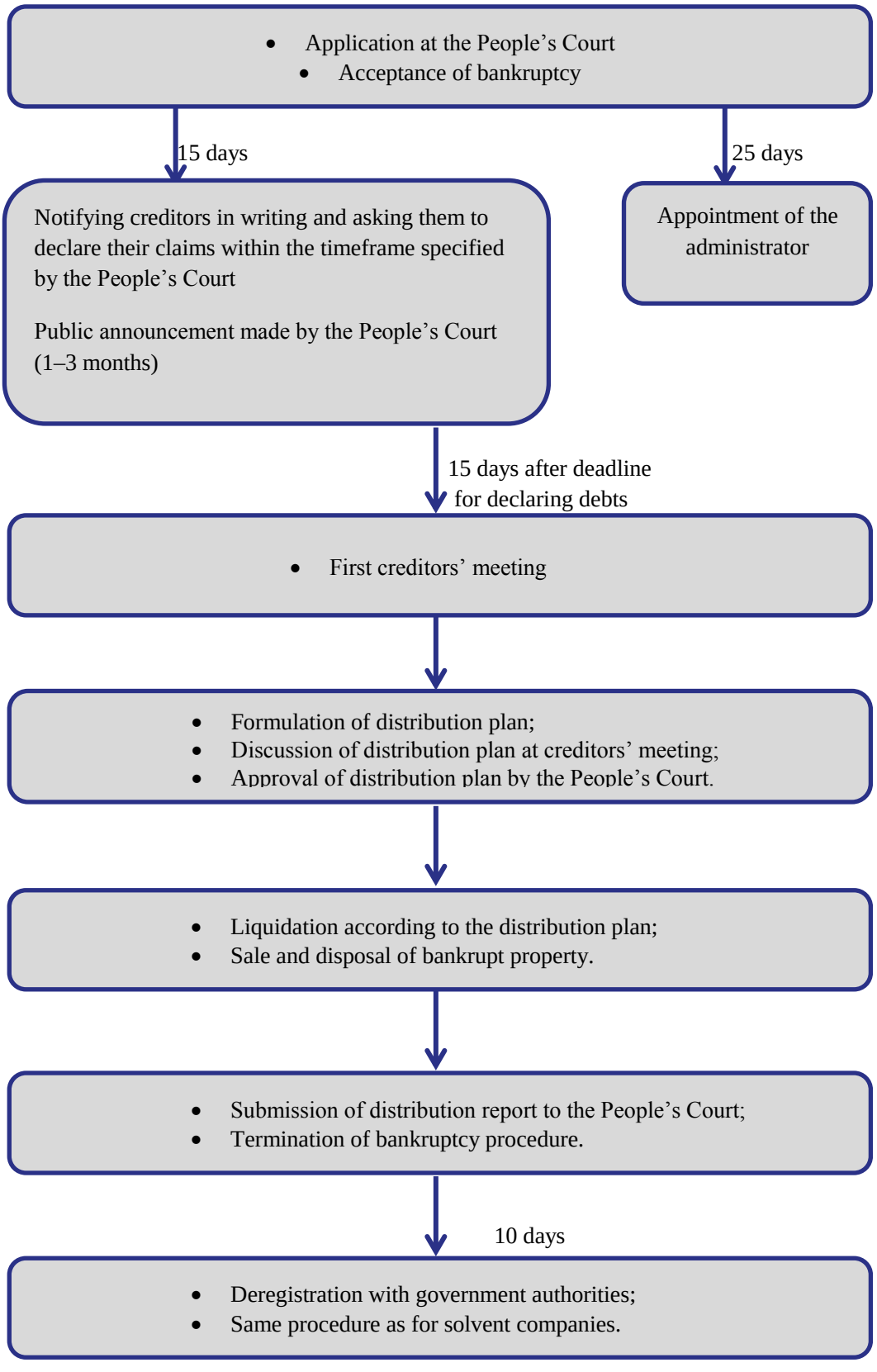
a) Introduction to the situation, including a description of the appointment of the administrator and starting date for the bankruptcy procedure;
b) Status and details of the insolvent company, including number of employees, business operation status, and bankruptcy reasons;
c) Status of liquidation activities, including details of asset distribution, outstanding liabilities clearance, and asset evaluation;
d) Status of assets and liabilities of the insolvent company, including the confirmation of asset and liability status at the date of the bankruptcy declaration;
e) Status of debt collection, including details of debt recovery and debtors;
f) Status of liabilities, including the settlement of liabilities and creditors' situations.

3.7 Company deregistration

The process of deregistration follows the same rules as deregistration for solvent companies. The tax deregistration has to be completed before requesting deregistration at the State Administration of Industry and Commerce. Afterwards, procedures for deregistering at other relevant government authorities, such as the State Administration of Foreign Exchange and Quality and Technical Supervision Bureau, and cancelling bank accounts and customs duty need to be completed.

For insolvent companies, the appointed administrator has the duty to complete this step. It is observed that the liquidation period under bankruptcy law is deemed as the operational time of the business. Thus, the whole process is subject to taxes and needs to be included in the final closing audit.

3.8 Timeline



In practice, investors inject the registered capital in accordance with the Articles of Association. Under Chinese bankruptcy law, if the investors fail to fulfil the obligation of contribution and file for bankruptcy at the People's Court, the court will also require investors to pay subscribed capital after accepting the bankruptcy application. In addition, some investors may attempt to evade debts through bankruptcy fraud, filing for bankruptcy to courts or making use of judicial processes to evade their debts, which is prohibited by the law.

4 Tax

4.1 Introduction

Tax clearance and deregistration is the most time-consuming procedure due to multiple rounds of communications necessary with the relevant tax authorities. Before applying for tax deregistration, the relevant tax authority usually requires the company's tax and accounting data from the past three years, including but not limited to accounting books, trading contracts, original receipts, invoices, and so on. The tax authority will verify the documents one by one to determine whether the company has any underpaid or overdue taxes. Taxes must be settled before the tax deregistration procedure starts. It usually takes six to 12 months to complete the entire process of tax deregistration. It is highly suggested to have a full understanding of the tax clearance procedures, requirements, and timeline information. We explain such in details in the following chapters.

4.2 Tax clearance procedures

For the tax clearance procedures, please refer to the following flow chart:

4.3 Documentation

4.3.1 Representative office

Tax deregistration from the local tax bureau. The following documents must be submitted to the local tax bureau:

a) Original tax clearance return;
b) Tax registration certificate (original and duplicate);
c) Original approval for the RO deregistration certificate;
d) Deregistration application issued by the headquarters (original and duplicate);
e) Original tax registration form;
f) Tax code chop/stamp;
g) Original business tax (BT) recognition notification form and recognition of BT filing method registration form;
h) Business licence (original and duplicate);
i) Original audit/clearance report and copies of the tax payment certificate (TPC);
j) Detailed salary information for local Chinese employees;
k) Original contracts (including rental, insurance, and service contracts, etc.) signed by the RO in the tax clearance year;
l) Other documents required by the tax authorities.

Tax deregistration from the state tax bureau. The following documents must be submitted to state tax bureau:

a) Written application;
b) Copy of decision of alteration, withdrawal of RO;
c) Original tax registration certificate (original and duplicate);
d) Appendix to the tax registration form;
e) Audit report for RO with cost-plus method as well as audit report for the deregistration and previous year;
f) Copy of contracts for RO with deemed profit method and copy of contracts for the deregistration and previous year;
g) Application form: tax deregistration form;
h) Annual corporate income tax (CIT) return and copy of tax refund certificate (for the RO, this is refundable after CIT clearance; if no refund is requested, a statement is required);
i) Headquarter business operation statement and structure chart (for RO with deemed profit method);
j) RO: copy of deregistration certificate issued by local tax bureau;
k) Other documents required by the tax authority.

Regular CIT tax filing is required before obtaining deregistration approval from the tax authority; otherwise, the RO faces a penalty for noncompliance.

4.3.2 Wholly foreign-owned enterprise and joint venture

Tax deregistration from the local tax bureau. The following procedure is required to complete tax deregistration with the local tax bureau:

1) Complete tax filing and pay all tax liabilities. Required documents include:
   a) Original tax registration certificate (original and duplicate);
   b) Receipt for purchase and collection of official tax invoices (*fapiao*);
   c) Company and financial seals;
   d) Tax payment certificates for all taxes, fees, penalty, fines, and official tax invoices (*fapiao*) for cancellation;
   e) Other relevant tax certificates and documents.

2) Begin tax deregistration with collection and management in the legal section of the tax registration authority, with the Approval of Tax Deregistration being issued by the tax office with the official seals of the tax bureau and company;
3) Tax bureau issues Tax Deregistration Certificate after checking and stamping the Approval of Tax Deregistration.

Tax deregistration from the local tax bureau is completed after going through the above procedure. At most, it takes 30 working days after submitting the completed documents.

Tax deregistration from the state tax bureau. Tax deregistration from state tax bureau is required before cancellation is accorded by the industrial and commercial authority. The following procedure is required to complete tax deregistration at the state tax bureau:

1) Pay all unpaid taxes, fees, penalty, and fines, and submit payment certificates;
2) Hand in official tax invoices (*fapiao*), tax registration certificates, and other tax certificates for cancellation.

Tax deregistration from the state tax bureau is completed after going through the above procedure. At most, it takes 60 working days after submitting the completed documents.

4.4 Case study

Here are some problems that RO and WFOE deregistration may encounter in practice:

For RO tax deregistration, deregistering the chief representative (CR) is quite complicated. The main concern lies in the CR's individual income tax (IIT) clearance. The tax authorities request all documents, including the CR's salary certificate, copy of all passport pages, bank transaction details for the CR's salary payment, and if CR has foreign tax credits or meets the requirements of double taxation in the home country, and foreign tax payment certificates. Sometimes, the authorities also request official documents on the laws or regulations with regard to foreign taxes applicable to the CR. All underpaid or overdue IIT is required to be settled before beginning the CR deregistration.

For WFOE, if it has signed contracts but has not filed a stamp duty – or taking a lease contract, as an example – some companies may have already paid the rental costs. However, *fapiao* is not acquired and stamp duty on this contract is not filed or paid. In this case, the tax authority would assume that the tax is underpaid. Backlog filing of business tax due on rental and stamp duty is required, and late payment interest is triggered based on the tax underpaid and days due.

5 Employment

Dismissals are always part of the process of business exit strategies. However, they are a sensitive issue since employees have to find new jobs in a hostile environment for job creation, which is a social problem. Therefore, the approval authority for the company's dissolution and even the local government keep a watchful eye on company's dismissals, especially mass redundancies. Sometimes, failing to deal with staff issues hinders the business exit progress. In practice, employees who cannot emotionally accept their dismissal may file for labour arbitration or lodge complaints with government departments, so that the approval authority disapproves or delays the company's application for dissolution and liquidation, which means that the business exit cannot be completed. Therefore, to avoid the public's attention and smoothly effectuate the dissolution or bankruptcy approval by the government authority, it is recommended that the investor communicate with the local labour department and trade union to make proper plans on staff issues.

It is highly recommended to first collect comprehensive information on all employees, including the types, terms, and employee information of all labour contracts, and then to consider different termination reasons relevant to the situation of employees.

For the employees whose labour contract will expire in the near future (e.g., one or two months), termination upon expiration is the first option. The management will inform the employees that the labour contract will not be renewed upon its expiration, giving one-month written notification and making severance payments.

For the employees with a flexible-term labour contract or fixed-period contract for the long term, mutual negotiation should be considered. Mutual negotiation has lowest legal risk and no limitation on the number of employees. The only legal requirement is to reach an agreement through consensus. A mutual negotiation agreement will be agreed and signed by both the employer and employee after reaching mutual consent on the compensation package and any other relevant matters. However, management may need to pay more to meet the employees' expectations.

Aside from the abovementioned ways, if the company has more than 20 employees or less than 20 employees but 10% of the total number is being dismissed, management may dismiss the remaining employees through a mass redundancy. Mass redundancy is strictly regulated by laws, the details of which are explained below.

1) Legitimate reasons for mass redundancies

The management can opt for mass redundancies in the following circumstances:

a) Restructuring pursuant to the Chinese Enterprise Bankruptcy Law;
b) Serious difficulties in production and/or business operations;
c) Business model changes or significant technology renovation occurs;
d) Significant changes in economic circumstances upon which labour contract was concluded, making the fulfilment of the labour contract impossible.

2) Procedures for mass redundancies

a) Explain the circumstances to the trade union or all employees (if there is no trade union) 30 days in advance and provide information about the company's production and business;

b) Provide a workforce reduction plan, including a redundancy employee list, downsizing time and process, and compensation plan according to the laws, regulations, and agreements in the collective contract;
c) Consider the proposals of the trade union or all employees and adjust the workforce reduction plan;
d) Report the workforce reduction plan and opinions of the trade union or all employees to the labour administration department and consider its advice;
e) Formally announce the workforce reduction plan, go through termination procedures, compensate dismissed employees in accordance with the relevant regulations, and provide certifications of dismissal to employees.

Under current Chinese laws, the following employees should be kept on a priority basis during mass redundancies:

- Employees signing a much longer fixed-term labour contract;
- Employees signing an open-ended labour contract;
- Employees who are the only employed member of their family and with the elderly or young people under the age of 16 years in their care.

If the employer terminates the labour contract with the above employees and then rehires people within six months after the mass redundancy, these employees should be rehired on a preferential basis.

An employer cannot terminate a contract through a mass redundancy or with one month's notice if employees are in any of the following situations:

a) Employees on occupational disease work leave without doing the occupational disease check-up or during a medial observation period;
b) Employees suffering from a work-related injury or occupational disease, confirming the loss of all or part of their working capacity;
c) Employee suffering from a sickness or non-work-related injury and still in the medical period;
d) Female employee in the pregnancy, labour, or nursing period;
e) Employee working at least 15 years for the current employer and awaiting retirement in five years or less.

In conclusion, employee issues are very important during the business exit procedure and should be handled in a wise way. A well-planned contract termination will help the business exit go smoothly and avoid any complications. For further practical information on internal labour rules for employers and employees in China, please see the Centre's guideline here or visit:
http://www.eusmecentre.org.cn/content/internal-labour-rules-and-social-insurance

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The EU SME Centre assists European SMEs to export to China by providing a comprehensive range of free, hands-on support services including the provision of information, confidential advice, networking events and training. The Centre also acts as a platform facilitating coordination amongst Member State and European public and private sector service providers to SMEs.

The Centre's range of free services cover:

- Business Development – provision of market information, business and marketing advice
- Legal – legal information, 'ask the expert' initial consultations and practical manuals
- Standards – standards and conformity requirements when exporting to China
- HR and Training – industry and horizontal training programmes
- Access to a service providers directory and information databases
- Hot-desking – free, temporary office space in the EU SME Centre to explore local business opportunities
- Any other practical support services to EU SMEs wishing to export to or invest in China.

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