

CHINA Legal Bulletin

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Executive Summary



Law of Application

The Law of Application of Law for Foreign-related Civil Relations brings clarification to which jurisdiction should apply when foreign parties are involved in a dispute, and when conflicts arise as to the application of law. It stresses the principle of Autonomy of Will, which provides that parties are free to specify via contract their preferred legal forum. When the forum is not provided, it follows legal principles familiar to international standards, such as applying the law of the forum with the most significant relationship to the conflict at hand, favoring the forum that protects the weaker party, and applying the principle that specific provisions will prevail over more general ones. We examine how the Law of Application progresses the handling of foreign-related civil proceedings, as well as some potential areas where the law is still developing.

Tianjin Employment Contracts

This article explores the application of the labor law in the city of Tianjin. The first policy addresses a companies' leeway in adjusting employee salaries during periods of halted production. The second policy concerns reimbursement for wasted training expenses. The article defines each policy, explains how it may affect your employment contracts, and concludes with recommendations on how to adjust your business plan



Clarification of Corporate Income Tax Issues

On June 9, the State Administration of Taxation (SAT) clarified several corporate income tax (CIT) issues. These clarifications, which came into force on July 1, focus mainly on interest rate deductions and tax treatment for building improvements. They also include some minor deductions for CIT such as the expense of company uniforms for staff and airline companies' expenses for training pilots, crew, etc.

Regarding interest rate deductions, the SAT announcement validated Article 38 of the CIT Law Implementation Regulations, which says that interest expenses on loans are CIT deductible when the loan is between two non-financial enterprises as long as the interest rate does not exceed what would be considered appropriate if the loan was from a financial institution. Thus, when a corporation claims this deduction, it is necessary to include a statement showing the interest rate a financial enterprise would charge in a similar situation.

The announcement also explained the tax treatment for building improvements. If a building that has not yet fully depreciated is rebuilt, its net value (which equals original value minus depreciation) should be added to the taxable value of the new building. Depreciation should be calculated starting from the month after the month the new building is opened. Likewise, if a building that has not been fully depreciated is expanded, the expenses of the expansion should be added to the building's taxable value.

EXECUTIVE EDITOR:
WANG JING

EDITOR:
ZACH WORTHAM



The Law of Application: a Choice of Forums

The Law of Application was adopted at the 17th session of the Standing Committee of the 11th National People's Congress on October 28, 2010 and came into force on April 1, 2011. It clarifies aspects of forum selection when civil issues involve foreign parties or laws.

With eight chapters and 52 articles in all, the Law of Application provides systematic and comprehensive provisions for the application of laws for foreign-related civil relationships regarding civil subjects, marriage and family, inheritance, property rights, creditors' rights, and intellectual property rights. It codifies the case law for foreign-related civil cases since the opening up of the PRC, and tightly follows the development of contemporary private international law. The main characteristics of the Law of Application are summarized as follows:

Autonomy of Will

Article 3 of the Law of Application defines the doctrine of autonomy of will, providing that "the parties may explicitly choose the laws applicable to foreign-related civil relationships in accordance with the provisions of law." Though this is only a declaratory provision, it re-emphasizes the importance of autonomy of will and shows deference to the private rights of the parties.

When parties decide which forum's laws they will use in case conflict arises, they usually do so through adding a forum selection clause into the contract. Autonomy of will extends to far more than just contract law: the Law of Application specifies that parties are free to privately select the applicable forum's laws in areas including entrustment of agency, trusts, arbitration agreements, property rights after marriage, movables in transition, intellectual property, unjust enrichment, and general tort liabilities. Undoubtedly, the vast number of fields of law mentioned in the Law of Application indicates

that the doctrine of autonomy of will remains the cornerstone of forum selection law.

The Most Significant Relationship



Article 2 of the Law of Application provides that "if there are no provisions in this law or other laws on the application of laws concerning foreign-related civil relationships, the laws with the most significant relationship to this foreign-related civil relationship shall apply." The doctrine of the most significant relationship functions as a trapping provision within the Law of Application. It applies to all fields concerning civil and commercial matters whenever the existing laws have not provided any applicable rules. The doctrine of the most significant relationship is also secondary to the doctrine of autonomy of will under the Law of Application: where the parties have specifically contracted to use the laws of a certain forum, this will supersede selection through the doctrine of the most significant relationship.

One of the most central determinations regarding which forum's laws holds the most significant relationship to the conflict at hand is that of habitual residence, or where a person normally lives. Article 41 of the Law of Application stipulates that in the absence of any expressed choice of applicable law to the contract by the parties concerned, "the laws at the habitual residence of the party whose fulfillment of the obligations best reflects the characteristics of the contract or the laws that have the most significant relationship to the contract shall apply." The habitual residence is taken as a main connecting point to determine the applicable laws

regarding civil relationships such as a person's identity, civil rights/acts capabilities, persons missing or deceased, and issues of marriage, family, and inheritance.

Protection of the Weaker Party

Although not always specified, many provisions of the Law of Application reflect an emphasis on protecting the interests of the weaker party. In regards to marriage and family issues, the Law specifically lays out three types of relationships where this applies: parent-child, caretaking, and guardianship. In a parent-child relationship where there is no mutual habitual residence, the court will select laws that favor the weaker party. This could be the laws of either party's habitual residence. Likewise, in a caretaking relationship and in a guardianship, the laws that favor the dependent or person under guardianship respectively are chosen. Once more, the selected laws could be from either party's habitual residence.

Other laws that favor the weaker party do so more tacitly. For example, laws governing consumer contracts favor the consumer. This is because the consumer can choose either the laws of his habitual residence or those of the locality where the good was provided. Laws regarding labor contracts follow a similar pattern. In this case, the laws at the working locality of the laborer apply. Additionally, in the case of IP infringement, the infringed can pick between the laws of his habitual residence, those of the locality of the infringement, or those at the main business place of the infringer. The Law also extends this weak-party benefit to victims of infringement via the internet, stating that the laws at the habitual residence of the infringed will be applied. This provision is a positive response by legislators to growing internet infringement and should help regulate and suppress it. Because of the choice of laws and the fact that the law of habitual residence is normally the most familiar to, and convenient for, the weaker party, they now have a more powerful tool to claim their rights.



Determining which Laws Apply to Foreign-Related Civil Relationships

The Law of Application clarifies that Chinese law will be used to determine the nature of foreign-related civil relationships. This coincides with the international norm. The Law goes on to say that a foreign country's respective law of application cannot be applied to a foreign-related civil relationship. However, there are cases where Chinese law may simply refer to a foreign law. If this is the case, the Chinese court will only use the substantive foreign law and ignore any relevant conflict rules.

Directly Applicable Laws



In the PRC, where any mandatory provision for foreign-related civil relationships is relevant, it must be directly applied. Some mandatory provisions are applied exclusively by courts and administrative organs. Because these provisions are mandatory, their application supersedes that of a conflict rule.

For example, the Contract Law states, "When completing a contract in the People's Republic of China concerning Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, and Sino-foreign cooperation for exploring and exploiting natural resources, the laws of the People's Republic of China shall apply." Thus, some mandatory provisions are noteworthy as they could pose hurdles that foreign investors may want to consider.

Conflict Rules

The Law of Application acknowledges that previous laws may have special provisions that relate to the subject matter of this new law. If that is the case, the Law states that those special provisions should be applied. While this idea corresponds with the principle that specific subject matter related to a general law should supersede a general law, it could result in a coexistence or even incongruity between the new and the old conflict rules.

To remedy this potential problem, the Law includes a supplementary section showing where it supersedes previous special provisions. Specifically, they are laws regarding civil law (infringement, marriage, and inheritance). These overruled laws generally act to eliminate the jurisdiction choices the Law of Application provides. They state that the law of the locality of an act of infringement should always be used and that laws regarding the marriage of a Chinese person and a foreigner should follow the laws of the locality of the marriage, whereas

the laws governing a divorce should be those of the place that accepts the case. Concerning inheritance, the rejected law stipulates that if a foreigner inherits an estate in the PRC or if a Chinese person inherits an estate outside of the PRC, the law of the habitual residence of the descendant applies to moveable property whereas for immovable property, the law of its location applies. This supplementary section thus establishes the position of the Law of Application within the PRC's conflict rules.

Conclusion

The Law of Application is a significant step forward for Chinese civil law which stresses the rights of parties to choose the applicable law while promoting justice with forum selection rules which consider the most significant legal relationship, fairness to the weaker party, and directly applicable laws. The Law of Application helps protect the legal rights and interests of the subjects of foreign-related civil relationships, promotes the efficiency of civil and commercial activities, helps determine the applicable law for foreign-related civil relationships in courts, administrative organs and arbitration institutions, and improves judicial and administrative efficiency. Although some parts of the law are still developing, the Law of Application brings clarity to forum selection issues in civil disputes that will ultimately promote stronger foreign relationships.

*By PAN Lidong, LIN Zhibin,
James Craven, & Stephen Chermekoff*

Tianjin Employment Contracts

Employment Contracts: Navigating Tianjin's New Labor Law Policies

Employee management is important to any company, and Chinese corporations are no different. Improperly managed, employees can become a burden on the company when collecting pay during production stoppages or creating

training expenses without actually performing the trained-for work. We discuss how to tackle these issues, and their legal ramifications, in the article below.

What is the standard for employee wages during periods of stoppage?

When a company must halt production due to non-worker

related causes, workers must be paid according to the terms of their original labor contract for the first pay period following the stoppage (usually one month). If the time of stoppage exceeds one pay period, companies may reduce their workers' contractual salary. However, workers must agree to the modification, and if they subsequently resume work then their salary must remain above the local minimum wage.



Tianjin Employment Contracts

There is no national policy in China about stoppage that exceeds one pay period in which employees remain inactive. Although the Tianjin local government has yet to establish any rules that clearly address this issue, Tianjin's Labor Bureau explains that companies can renegotiate with inactive employees after one month of stoppage. Furthermore, companies may adjust these inactive employees' salary to a level below the local minimum wage as long as the employees agree to such a modification.

How can you avoid paying full salaries during halted production?

In practice, employees are often unwilling to agree to a reduction in wages despite a work stoppage. In these circumstances, employers can unilaterally reduce their employees' salary, although this entails a substantial amount of risk. Employees can initiate arbitration, which could potentially result in a decision that is unfavorable to the company.

Employers should seek to minimize loss due to stoppage by being specific in their employment contracts at the time of hiring. For example, the following points should be addressed in the employee contracts:

- In the event of stoppage of more than one month, the employee's salary shall be reduced to XX% of original pay, as long as this amount is not below Tianjin's minimum wage.

- If stoppage exceeds one month and the employee remains inactive, wages will be reduced to the current rate provided by Tianjin's official "minimum subsistence standard."

For employees hired under contracts without the above-mentioned conditional language, employers can ask their employees to sign supplemental agreements that clarify wage adjustments during periods of stoppage.

The best approach is to be proactive about avoiding losses during stoppage. Have your attorney draft an employment contract that is within the bounds of China's labor laws and mitigates excess expenditures as far as possible.



Can companies collect training expenses when workers quit before their probation period is over?

Employers cannot demand compensation for training expenses from employees who quit during their probationary period. But this does not imply that probationary

employees are free from responsibility. Employees must bear the costs of training expenses if they violate rules, neglect their duties, cause damage, or do anything else that causes their dismissal during this period. For their part, employers must show proof of expenditures made specifically towards training the individual employee.

How can you minimize the risk of training expenses?

Companies should normally provide basic/less expensive training during the probationary period, and save advanced/more expensive training for employees who have already acquired a permanent position. Employees who have achieved a permanent position with their company may be required to pay compensation for wasted training expenses. If a permanent employee quits in the midst of an agreed period of service, his company has the right to demand compensation for expenditures made towards training the employee during that time period.

The amount of compensation is determined by the proven expenditures made towards training, offset by the percentage of the agreed work period that the employee has already completed. But both for the sake of clarity and minimizing future conflict, companies should always be sure they sign a detailed training agreement with their employees so as to clarify both parties' rights and obligations.

By Josh Katz and Sun Hua

GUANGZHOU

Tel. (+8620) 8393 0333
Fax (+8620) 3873 9633
info@wjnc.com

SHANGHAI

Tel. (+8621) 5887 8000
Fax (+8621) 5882 2460
shanghai@wjnc.com

TIANJIN

Tel. (+8622) 5985 1616
Fax (+8622) 5985 1618
tianjin@wjnc.com

XIAMEN

Tel. (+86592) 268 1376
Fax (+86592) 268 1380
xiamen@wjnc.com

BEIJING

Tel. (+8610) 5785 3316
Fax (+8610) 5785 3318
beijing@wjnc.com

SHENZHEN

Tel. (+86755) 8882 8008
Fax (+86755) 8284 6611
shenzhen@wjnc.com

QINGDAO

Tel. (+86532) 8666 5858
Fax (+86532) 8666 5868
qingdao@wjnc.com

FUZHOU

Tel. (+86591) 885 22000
Fax (+86591) 8354 9000
fuzhou@wjnc.com

HAIKOU

Tel. (+86898) 6672 2583
Fax (+86898) 6672 0770
hainan@wjnc.com