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Foreign Trade in China



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IPBA JOURNAL

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The President's Message



Dear Colleagues,

2007 is now well underway and I hope that all IPBA members are enjoying a busy period of activity as well as taking time out to attend some of the region's networking and social events.

By the time you read this, the 17th Annual Meeting and Conference in Beijing will be a not-too-distant memory. The theme of this year's conference—*'The Lawyer's Role in Promoting Harmonious Development of the Asia and Pacific Region'*—has particular resonance at a time in which the Asia-Pacific region is the focus of sustained economic activity. On behalf of all members, I'd like to thank the IPBA President Elect Gao Zongze and the Host Committee for their efforts in arranging this year's Conference.

Asia M&A Conference

I'd like to extend my thanks to Wilson Chu for his work in organising the highly successful third annual M&A conference held in Hong Kong earlier this year, at which there was a record attendance. I was fortunate to be in Hong Kong for the conference and found the presentations to be of a uniformly high standard. The annual M&A conference has undoubtedly cemented its position as a key event on the calendar for M&A lawyers around the region, which is a credit to the M&A Practice Committee.

The Past Year

As this will be my last message as IPBA President, I'd like to take this opportunity to reflect on some of the highlights of my term and to thank the many individuals who have provided me with such great support.

The 2006 Annual Conference in my home city of Sydney was certainly a memorable event and I was delighted to be part of the Host Committee. The calibre of both the speakers and the conference and social programmes was widely noted and appreciated, and I'd like to thank the member of the Host Committee again for their hard work which helped to make the conference so enjoyable.

I was also delighted to be part of a delegation last year led by Australia's Attorney-General which visited Beijing and Shanghai as part of Australia's FTA negotiations with China. This was my first visit to China since 1988 and I was struck by how much it had changed in such a relatively short period. It is pleasing to note the number of new IPBA members from China who we continue to welcome. As part of my efforts to strengthen the IPBA's networks and links, I also attended a number of conferences last year, including the American Bar Association's 2006 Annual Meeting in Honolulu, Hawaii and the IBA Annual Conference in Chicago. Both were worthwhile events at which I was able to make and renew valuable contacts on behalf of the IPBA.

Another highlight of 2006 was the Mid-Year Council Meeting in London, which over 50 Council members attended. It was at that meeting that Ms Suet Fern Lee submitted the

recommendations of the Strategic Long-Term Planning Committee for improvements to the IPBA's structure and governance, and I am grateful to Fern and the Committee for their hard work in this regard. I believe the IPBA will become a better and stronger organisation as a result of their efforts.

I'd like to extend my thanks to the Council members and to the Secretariat for their friendship and support over the past 12 months, which has helped to make my term so rewarding.

I'd also like to extend my best wishes to the incoming President, Mr Gao Zhongze, for a successful and enjoyable year ahead.

Best wishes,

*Jim FitzSimons
President*



Mr Richard Andrew Shadbolt at the London Mid Year Council Meeting

Publications Committee Guidelines for Publication of Articles in the IPBA Journal

The IPBA Publications Committee is soliciting quality articles for the Legal Update section of the June and September issues of the *IPBA Journal*. It would be appreciated if you could contact **Hiroyuki Kamano**, Publications Committee Chairperson at hkamano@kamanosogo.jp or **(Kevin) Kap-You Kim**, Publications Vice Chair at kyk@BKL.co.kr and/or forward articles by email to Hiroyuki Kamano or (Kevin) Kap-You Kim.

The requirements of the IPBA for the publication of an article in the Journal are as follows:

1. The article has not been previously published in any journal or publication;
2. The article is of good quality both in terms of technical input and topical interest for its members;
3. The article is not written to publicize the expertise, specialization, network offices of the writer or the firm from which the writer emanates;
4. The article is concise (2,500 to 3,000 words) and, in any event, does not exceed 3,000 words; and
5. The article is written by an IPBA member.

US Taxation of a Foreign Person's US Activities and Income Tax Treaty Between The People's Republic of China and The United States



Besides explaining US Taxation Law with regard to foreign tax payers, Gary P Tober discusses how income tax treaties serve to reduce or eliminate double taxation

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This article is intended as an introduction to the subject of US taxation on inbound transactions. It is not a comprehensive treatment of the subject area and should not be relied upon as a reference source. It is intended to touch upon selected areas and issues involved with a foreign person's US activities in summary form. As a result, the article does not attempt to explore all of the issues, nor does it attempt to analyze or discuss in depth the issues that are presented.

Overview

Under current US tax law, there are three classes of foreign taxpayers: (1) those who have income effectively connected with a US trade or business; (2) those with US source fixed or determinable annual or periodical income ('FDAPI') not effectively connected with a trade or business in

the United States; and (3) those whose income is solely from foreign sources. By reason of Sections 871(b) and 882 of the Internal Revenue Code (the 'Code' or 'IRC'),² income effectively connected with a US trade or business is taxed at regular US tax rates. US source income of a foreign taxpayer, which is not effectively connected with a US trade or business, is taxed at a flat rate of 30 per cent (or lower treaty rate) under Section 871(a) or 881. Foreign income is generally exempt from US tax unless business income is attributable to a US office of the foreign taxpayer.

Various types of income earned by foreign persons are specially treated under the Code. For instance, any income from the disposition of real property (whether held as an investment or constituting a business) by a foreign person is treated as if the foreign person were engaged in a trade or business in the United States and the income is subject to US tax.³ Further, capital gains not effectively connected with a US trade or business are taxable to a nonresident alien, only if the individual is physically present in the United States for 183 days or more during the year in which the gain is realized.⁴ Under some income tax

treaties entered into by the United States, capital gains may be exempt from tax without regard to this 183-day rule. In any case, a foreign corporation is not taxed on capital gains not effectively connected with a US trade or business.

The rules for taxation of foreign persons require an understanding of several concepts. These taxation rules are best approached as component parts of a multi-level maze. Consequently, in order to determine whether a foreign person is subject to US taxation, the following factors must be individually analyzed:

- status of the foreign person for US tax purposes—whether the foreigner is a resident or nonresident or whether the corporation is domestic or foreign;
- the source of the income—whether the income received by the foreigner is from a US source or foreign source;
- whether the foreign person is engaged in business activity in the US—that is, whether the taxpayer is engaged in a trade or business within the United States;
- the type of income which is being earned—whether the income is business income attributable to the US activity or whether it is passive income such as dividends, interest, rent, royalties, or the like; and
- applicability of tax treaties or conventions—whether double taxation is reduced or eliminated.

US Inbound Activity

US Taxation of Nonresident Aliens

Residency determination

Section 7701(b) provides two basic tests to determine whether an alien individual is a US resident for any particular calendar year. If the individual fails both the green card test and the substantial presence test, he or she will be considered a nonresident alien.

An alien individual who is a lawful permanent resident under the immigration laws is automatically a resident alien under the green card test. An alien individual present under a non-immigration visa (such as a B-1, B-2, E-1, E-2 or L-1 visa) is subject to the substantial presence test; an objective test based upon time spent in the United States.

Under the substantial presence test, an individual adds the number of days on which he or she was present in the United States in the current year, one-third the number of days on which he or she was present in the first preceding year, and one-sixth of the number of days in which he or she was present in the second preceding year. If this

sum is equal to, or greater than, 183 days, the individual meets the substantial presence test (absent the 30-day or tax home exceptions discussed below).

Under the 30-day exception, if an alien individual is physically present within the United States for 30 days or less during the current year, that individual will not be considered a US resident, even if the 183-day formula would otherwise be met.

Under the tax home exception, an alien individual is treated as not being described by the substantial presence test with regard to any current year if, (1) that individual is present within the United States on fewer than 183 days during the current year, and (2) that individual establishes that for the current year, he or she has a tax home⁵ in a foreign country and has a closer connection to such foreign country than to the United States. It should be noted that the tax home exception is not available for any year in which an individual takes steps to apply for a green card.

Determination of tax of nonresident aliens

Under current US tax law, there are two classes of nonresident aliens: those with US source fixed or determinable income not effectively connected with the trade or business in the United States; and those who have income effectively connected with a US trade or business. US source income of a nonresident alien, not effectively connected with a US trade or business, is taxed at a flat rate of 30 per cent (or lower treaty rate) on gross income. Income effectively connected with a US trade or business is taxed at regular tax rates. Income from dispositions of real property is treated as if the nonresident were engaged in a trade or business in the United States and subject to a minimum tax. Capital gains not effectively connected with a US trade or business are taxed only to nonresident aliens who are physically present in the United States for 183 days or more during the year in which the gain is realized.

a. Not engaged in a trade or business in the United States

Section 871(a) provides that nonresident aliens are subject to a 30 per cent US tax on the gross amount of fixed or determinable income not effectively connected with a US trade or business in the year the income is received. Fixed or determinable income includes US source interest, dividends, rents, royalties, salaries, wages, premiums, annuities, compensation, remuneration, and emoluments. Any person who pays fixed or determinable income from US sources to a nonresident alien must withhold taxes from the

payment. The withholding rate is 30 per cent unless a lower treaty rate is in effect. No withholding is required on payments to foreign taxpayers on income that is effectively connected with a US trade or business. Compensation for services performed in the United States is subject to graduated withholding rates in Section 3402.

b. Engaged in trade or business in the United States

A nonresident alien individual engaged in a trade or business in the United States, but having no office or fixed place of business located here, is potentially subject to tax on income from US sources under two different criteria. First, US source income not effectively connected with the conduct of a US business, consisting only of the same class of income specified in Section 871(a)(1) net capital gains that would be subject to a 30 per cent rate of tax if he were engaged in a trade or business in the United States, is taxable at the 30 per cent (or lower treaty) rate. Second, US source income effectively connected with the US business is taxed on a net basis and under the graduated rates. These statutory rules apply to the entire taxable year if the nonresident alien is engaged in a trade or business within the United States at any time during the year.

c. Engaged in trade or business in the United States and having an office or other fixed place of business in the United States

A nonresident alien individual engaged in a trade or business in the United States with an office or other fixed place of business located within the United States is taxed under two separate criteria but the income must be segregated into three different categories:

- US source income not effectively connected with the conduct of a US business, taxable at 30 per cent, applied to the gross amount;
- US source income effectively connected with the conduct of a US business, taxable at graduated rates on a net basis;
- foreign source income attributable to the office or other fixed place of business located in the United States, taxable at graduated rates on a net basis.

The US source income and the effectively connected foreign source income of a nonresident alien engaged in business in the United States through an office located in the United States is taxable in exactly the same manner as a nonresident alien engaged in business in the United States without an office located in the

United States. However, US tax on the foreign earnings of the nonresident alien may be offset by a foreign tax credit under Section 906.

US Taxation of Foreign Corporations

A foreign corporation is any corporation that is not a domestic corporation. Under Section 7701(a)(4), a domestic corporation is any corporation 'created or organized in the United States or under the law of the United States or of any State.' Therefore, a corporation formed in any jurisdiction other than the United States is a foreign corporation.

Just as in the case of nonresident aliens, a foreign corporation is subject to separate tax regimes depending on whether its earnings are from US or foreign sources and whether those earnings are effectively connected with a trade or business in the United States. A foreign corporation not engaged in a US trade or business is taxed only on its US source income. Only those items specified in Section 881(a), which constitute fixed or determinable income are subject to tax. A flat 30 per cent rate (or lower treaty rate) of tax is imposed on the gross income from those items. Capital gains are not subject to tax.

A foreign corporation engaged in a US trade or business, but which has no US office or fixed place of business, is taxed only on its US source income. The foreign corporation will be taxed on items of gross income described in Section 881(a), which are not effectively connected with its US trade or business. The rate of tax is 30 per cent (or lower treaty rate). Capital gain, which is not effectively connected, is not subject to tax. However, a foreign corporation engaged in a US trade or business, but which has no US office or fixed place of business, is subject to tax at regular corporate rates on its effectively connected income. Effectively connected income includes effectively connected capital gain and items of FDAPI. US source income other than capital gain and FDAPI items is treated as effectively connected income.

A foreign corporation engaged in a US trade or business which has a US office may be taxed on three types of income: US source income not effectively connected with a US trade or business; US source effectively connected income; and certain foreign source effectively connected income. The first and second items are treated in the same manner as those items for a foreign corporation engaged in a US trade or business with no US office, as previously discussed.

Foreign source effectively connected income consists of three classes of income: rents and royalties from intangibles; certain dividends, interest, and gain on investment assets; and US office sales income. These income items are

considered effectively connected only insofar as they are attributable to the foreign corporation's US office. They are taxed at domestic rates, as is other effectively connected income. Deductions in a foreign tax credit are similarly available.

US Taxation of Branch of Foreign Corporation

A foreign corporation doing business in the United States may choose between operating with a domestic branch or utilizing a domestic subsidiary. Generally, each form of doing business is subject to the regular corporate income tax on its profits. However, repatriation of those profits, first to the foreign parent (or home office) and then to the ultimate shareholders, may result in significant tax differences between these two forms of doing business. If a domestic subsidiary of a foreign parent corporation repatriates its profits in the form of a dividend, a 30 per cent withholding tax (or lower treaty rate) will be imposed on the distribution. However, when the foreign corporation distributes its profits to its ultimate shareholder, no additional US taxes are imposed.

Branch profits tax

For taxable years beginning after December 31, 1986, Section 884 imposes a branch profits tax on any foreign corporation engaged in a US trade or business. The branch profits tax is in addition to the regular corporate tax imposed on those corporations under Section 882 and is equal to 30 per cent of the 'dividend equivalent amount.' The dividend equivalent amount is the foreign corporation's effectively connected taxable income, with certain adjustments for any increase or decrease of investment of earnings in trade or business assets of the branch. In effect, the branch profits tax is a tax on profits of the branch other than those reinvested in the US business operations. The branch profits tax is not applicable if an existing income tax treaty prohibits a branch profit tax. In that case, the second-level withholding tax on dividends would apply to the extent permissible under the treaty.

Where treaty shopping exists, the branch profits tax will override any existing or subsequently enacted treaty provisions to the contrary. Treaty shopping would be deemed to exist if more than 50 per cent (by value) of the stock of the foreign corporation is owned directly or indirectly or constructively by persons who are not residents of the country where the corporation is organized. Stock of corporations, which is primarily and regularly traded on an established securities market in the country of which it is a resident, would be exempted from this rule.

Secondary withholding tax

The United States imposes a 'secondary withholding tax' on dividends paid by the foreign corporation and not on remittances to the home office by the branch.⁶ The secondary withholding tax is imposed only if 25 per cent or more of the foreign corporation's gross income for a three-year period is effectively connected with the conduct of a US trade or business. If this 25 per cent threshold is reached or surpassed, then the foreign corporation must withhold 30 per cent (or lower treaty rate) of a *pro rata* share of its dividend distributions to foreign persons. By reason of Section 884(c)(3), such dividends are not subject to the second level tax if the foreign corporation is subject to the branch profit tax.

For taxable years beginning after December 31, 1986, any interest paid by a branch's US trade or business is treated as US source and subject to a US withholding tax of 30 per cent, unless the tax is reduced or eliminated by a specific Code or treaty provision.

US Taxation of Investments

Foreign Investment in Real Property Tax Act (FIRPTA)

The United States generally does not tax foreign persons on US source gains on sales and exchanges of property, unless the gains are effectively connected with business done in this country. Under this rule, a foreign taxpayer's disposition of a passive investment in US real estate would not be subject to US taxation.

The FIRPTA, PL 96-499 was enacted in 1980 to insure that foreign persons who own and later divest themselves of an interest in US real estate would be taxed in the same manner as US persons. A US real property interest ('USRPI') includes an interest in real property located in the United States or an interest in a domestic corporation whose assets consist primarily of US real estate.

FIRPTA itself is not a taxing provision. It provides that a foreign person's gain from the disposition of a USRPI is treated as if the gain was effectively connected with a US trade or business. The gain or loss is combined with income, gain, or loss from any business actually carried on by the taxpayer in this country during the year and, if the taxpayer so elects, with other non-business income from real property in the United States.

In order to insure that some portion of the foreign investor's tax liability is collected while the funds are available and, in most instances, in the hands of a third party, withholding provisions were enacted. FIRPTA withholding was not intended to satisfy the taxpayer's total or final tax liability or to obviate the need for the foreign taxpayer to file a

US income tax return.

A USRPI is any interest other than solely as a creditor in real property located in the United States or in the United States Virgin Islands; or any interest (except as a creditor) in any domestic corporation unless the taxpayer establishes that the corporation was not a US real property holding corporation ('USRPHC') at any time after June 18, 1980, during the time the taxpayer owned the stock of the corporation.

There are three categories of domestic corporations that are excluded from the definition of USRPIs: an interest in domestically controlled real estate investment trusts; an interest in a publicly traded corporation the taxpayer holds and has held historically (directly or indirectly) is no more than five per cent of the corporation; and an interest in a corporation that has disposed of its US real estate in a taxable transaction.

The term 'real property' includes any interest or indirect right to share in the appreciation in the value of real estate. Real property includes three categories of property: land and unsevered natural products of the land; improvements; and personal property associated with real estate. A corporation is a USRPHC if, on certain dates, 50 per cent or more of its assets consist of USRPIs.

a. Withholding on disposition of USRPI

Unless an exemption applies, whenever a foreign

person disposes of USRPIs, the transferee of that interest must deduct and withhold a tax equal to 10 per cent of the amount realized on the disposition.⁷

A 'foreign person' is defined to include any person other than a US person.⁸ A foreign person includes a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, but not a resident alien individual. The withholding requirements are triggered by a foreign person's disposition of a USRPI. A transfer of almost any kind will be considered a disposition. This includes a sale or exchange and even a gift.

A USRPI generally is any interest, other than an interest solely as a creditor, in either real property or a domestic corporation that has been a USRPHC during a designated time period. A USRPI includes the ownership and co-ownership of land or improvements, leaseholds or land or improvements, options to acquire land or improvements, and options to acquire leaseholds of land or improvements located in the United States. Finally, a transferee is any person, foreign or domestic, that acquires a USRPI by purchase, exchange, gift, or any other transfer. The withholding obligation is imposed on all kinds of transferees, regardless of whether they are entities or individuals, and regardless of whether they acquired their USRPI by purchase, exchange, gift, or some other transfer.

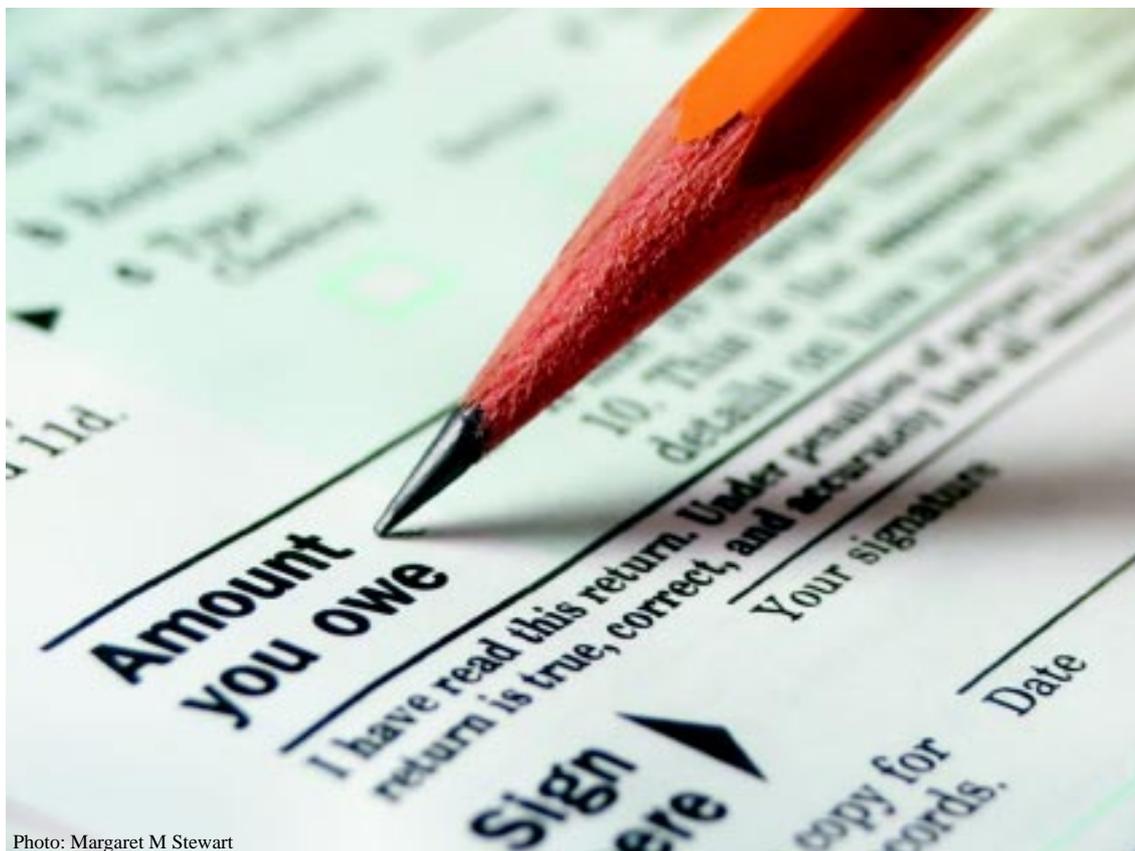


Photo: Margaret M Stewart

b. Withholding procedures

Withholding generally is required at a rate equal to 10 per cent of the amount realized on the disposition. The amount realized is the sum of: the cash paid, or to be paid; the fair market value of other property transferred, or to be transferred; and the outstanding amount of any liability assumed by the transferee, or to which the USRPI is subject immediately before and after the transfer.

Generally, any tax required to be withheld must be reported and paid to the Internal Revenue Service ('IRS') by the twentieth day after the transfer. Forms 8288 and 8288-A are used for this purpose. Where the transferee of a USRPI has an application for a withholding certificate pending with the IRS, any tax withheld by the transferee must be paid over within 20 days after the IRS makes its final determination with respect to such application.

c. Exemptions from withholding requirements

If a seller furnishes to the purchaser an affidavit, referred to as a non-foreign affidavit, stating that the seller is not a foreign person, then no withholding is required. A buyer is not entitled to rely upon a seller's affidavit if the buyer either has actual knowledge that the affidavit is false, or receives notice from an agent of the seller or buyer that such affidavit is false. Also, if a domestic corporation furnishes to the transferee an affidavit by the domestic corporation stating that the domestic corporation is not and has not been a USRPHC during the prior five years, then no withholding is required.

No withholding is required where the USRPI is acquired for use by the buyer as a residence and the seller's amount realized upon the disposition of such property is no more than \$300,000. A USRPI is acquired for use as a residence where, on the date of the transfer, the buyer has definite plans to reside at the property for at least 50 per cent of the number of days that the property is used by any person during each of the first two 12-month periods following the date of transfer.

If the purchaser receives a qualifying statement from the IRS, then there is no requirement to withhold. A qualifying statement is a statement that the transferor either has reached agreement with the Secretary for the payment of any tax due on any gain recognized by the transferor on the disposition of USRPIs, or is exempt from tax on any gain recognized by the transferor on the disposition of the USRPI, and the transferor or transferee has satisfied any transferor's unsatisfied withholding liability or has provided adequate security to cover such liability.

Portfolio debt instruments

Portfolio interests (including original issue discount) from US sources received by a foreign corporation⁹ or by a nonresident alien individual¹⁰ after July 18, 1984, on obligations issued after July 18, 1984, are free of any US tax; therefore, not subject to the 30 per cent withholding tax. The term 'portfolio interest' means interest paid on the following two types of obligations: bearer obligations which are described in Section 163(f)(2)(B) and registered obligations with respect to which the US withholding agent has received a statement to the effect that the beneficial owner is not a US person.

Withholding Requirements

All persons who pay items of gross income from sources within the United States to nonresident alien individuals or foreign corporations must withhold a tax equal to 30 per cent of such gross income except for certain types of income noted below and except where treaty provisions reduce or eliminate the withholding. All fixed or determinable annual or periodical gains, profits, or income ('FDAPI') are subject to withholding.

There are, however, a number of exceptions to the general withholding requirements. For example, certain scholarships and fellowships are exempt from withholding requirements. To the extent that these items would be includable in gross income of a nonresident alien, the rate of withholding is 14 per cent (often waived by treaty).¹¹

No withholding is usually required on income effectively connected with a US business since the tax on the income is determined and collected in the same manner as for a US person.¹² Interest on a deposit with a bank is exempt from withholding if exempt from the 30 per cent tax under Section 871 (i). Portfolio interest is exempt from withholding because it is not taxable under Section 871(a)(c) or 881(a).¹³

Any person having control, receipt, custody, disposal or payment of an item of income subject to withholding must deduct and withhold the applicable tax. The withholding agent must have actual possession and unfiltered power to dispose of it. The Code indemnifies any person required to withhold against claims and demands of any person, for the amount of any payment in accordance with the withholding provisions.

A partnership is required to withhold if it has an item of US source income that is FDIPI and some portion of the item is included in the distributive share of a partner who is a nonresident alien or a foreign corporation, partnership, trust, or estate. If

the trust or estate is domestic, payments to the entity are not subject to withholding, but the trust or estate must withhold if income of a taxable variety is included in the gross income of a foreign beneficiary. However, payments to a foreign trust or estate are subject to withholding since the trust or estate is itself a taxable entity. A withholding agent who fails to withhold the required tax is directly liable for the amount of the tax, together with interest. Civil and criminal penalties may be imposed as a result of noncompliance with withholding requirements.

Income Tax Treaties

Purpose and Scope of Treaties

The primary purpose of income tax treaties or conventions is the reduction or elimination of double taxation. Generally, a treaty reduces the tax, a US taxpayer must pay on income derived from a foreign country and the tax a foreign taxpayer must pay on income derived from the United States. It is readily apparent that the source of income is important in the determination of a taxpayer's correct tax liability when dealing with treaty countries.

The method used by such conventions to avoid double taxation involves, generally, the adoption of common definitions in the determination, by category of income, of the taxing rights of each of the contracting states. To illustrate key features of an income tax treaty, this article will use provisions under the income tax treaty between the People's Republic of China ('PRC') and the United States ('US/PRC Treaty').

Code Versus Treaty

As a general rule, provisions of income tax treaties providing exemption or reduction of tax are treated like provisions of the Code. Section 894(a) states that 'the provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer.' More specifically, Section 7852(d)(1) states 'for purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law.' Therefore, if a statute is enacted subsequent in time to a treaty, and is inconsistent with the treaty, the statute nullifies the treaty to the extent of the conflict if Congress clearly indicates its intention to override the prior treaty.

Discussion of Income Tax Treaty between the PRC and the United States

Taxes covered

Each country having a treaty with the United

States specifies the types of taxes to be covered. Under the US/PRC Treaty, US taxes covered include federal income taxes imposed by the Code. Notably, state and local taxes are not covered. PRC taxes covered by the US/PRC Treaty include individual income tax, income tax on joint ventures with Chinese and foreign investment, income tax concerning foreign enterprises, and local income tax. The treaty applies to substantially similar taxes imposed in addition to or in place of existing taxes.¹⁴ Additionally, the United States can impose its social security tax, personal holding company tax, and accumulated earnings tax. However, Chinese corporations are exempt from the personal holding company and accumulated earnings taxes if they are wholly owned, directly or indirectly, by one or more individual residents of PRC who are not US citizens or by the Chinese government or a government agency.¹⁵ Additionally, the branch profits tax (discussed above) of the United States will not be imposed on a foreign corporation that is a qualified resident of PRC.

One should note that federal estate and gift taxes, as well as social security taxes, are not covered in income tax treaties. However, the United States has entered into a number of estate tax treaties which should be referred to in the appropriate situation. Also, the social security taxes and benefits are addressed in 'totalization' agreements entered into by the United States and several countries.

Residency

Treaty benefits are intended to be limited to residents of a country which is a party to the treaty. Consequently, residence is the key status on which treaty benefits are predicated. An individual is considered a resident for treaty purposes, if the person is treated as a resident for purposes of local tax. This generally means that a country subjects the individual to tax on a worldwide basis. Citizenship does not necessarily establish an individual's residence under an income tax treaty. In the case of corporations, place of incorporation generally establishes residency. However, the residence of a partner, not the partnership, determines the availability of treaty benefits.

Under Article 4 of the US/PRC Treaty, a resident means any person who under local law is liable for tax by reason of domicile, residence, place of head office, place of incorporation, or similar criterion of a similar nature. Normally, an income tax treaty will include tie-breaker rules,¹⁶ which are referred to when a taxpayer satisfies the initial criteria of residency under the law of both jurisdictions. However, the US/PRC Treaty does not include tie-breaker rules usually seen in other US tax treaties.

Permanent establishment

A resident of a treaty country will not be required to pay tax on trade or business income derived from the treaty country of source unless a permanent establishment is maintained there. Most US tax treaties contain a definition of permanent establishment, but the basic concept is essentially the same in each treaty. The term 'permanent establishment' is defined usually to be a fixed place of business through which a resident of one of the contracting States (country signing treaty) engages in industrial or commercial activity.

Under the US/PRC Treaty, a permanent establishment is a fixed place of business where an enterprise carries on all or part of its business. Specifically, it includes a place of management, a branch, an office, a factory, a workshop, or a mine, oil or gas well, a quarry, or other place of extraction of natural resources. It also includes a construction project that continues for more than six months, an installation, drilling rig or ship that is used for more than three months, and the furnishing of services for a project or connected projects that continue for a period or periods aggregating more than six months in a 12-month period.

The term 'permanent establishment' does not include a fixed place of business used for preparatory and auxiliary activities. Those activities are defined by the US/PRC Treaty to include using facilities for storage, display, or delivery of goods or merchandise; maintaining a stock of goods for processing by another enterprise; and maintaining a fixed place for purchasing goods or collecting information.¹⁷

Furthermore, a permanent establishment does not arise merely because a person carries on business in a treaty country through an independent agent acting in the ordinary course of business. However, if a person, other than an independent agent, habitually exercises authority to conclude contracts for an enterprise in the treaty country, the person will be deemed a permanent establishment, unless these activities are merely preparatory or auxiliary. A corporation does not have a permanent establishment merely because it controls or is controlled by a corporation of a treaty country.¹⁸

Business profits

Under Article 7 of the US/PRC Treaty, an enterprise is taxable only if the enterprise carries on business in the treaty country through a permanent establishment and only to the extent of profits attributable to that permanent establishment in the treaty country. When an enterprise of one

treaty country has a permanent establishment in the other country, profits are attributed to the permanent establishment as if it were a separate entity dealing independently with the enterprise. Profits are not attributed to a permanent establishment merely because it buys goods or merchandise for the enterprise.

A treaty country can apply its law dealing with a specific industry to deem profits attributable to a permanent establishment if the law is in accordance with treaty provisions on business income. In determining the profits of a permanent establishment, the US/PRC Treaty allows deduction of expenses that are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the treaty country in which the permanent establishment is situated or elsewhere. However, expenses in the nature of royalties and interest paid by the permanent establishment to an office of the enterprise are not deductible. The profits to be attributed to the permanent establishment must be determined by the same method year by year unless there is good and sufficient reason to the contrary. Finally, items of income dealt with in other articles of the treaty are not affected by the article on business profits.

Treatment of certain income items

a. Dividends

'Dividend' means income from shares or rights to participate in corporate profits, but does not include debt claims. It also includes income from other corporate rights that are taxed as dividends by the source country. Dividends paid by a corporation of one treaty country to a resident of the other treaty country can be taxed by both, but the source country's tax cannot exceed 10 per cent.¹⁹ Dividends effectively connected with a recipient's permanent establishment or fixed base in the source country are taxed as business or personal service income.

b. Interest

Under Article 10 of the US/PRC Treaty, the term 'interest' means income from debt claims, whether or not secured by mortgage, including those carrying a right to participate in the debtor's profits. It particularly includes income, premiums, and prizes from bonds, debentures, and government securities. Interest arising in one treaty country and paid to a resident of the other can be taxed by both, but the source country's tax cannot exceed 10 per cent. Interest arises in a treaty country if it is paid by the government, a political subdivision, a local authority, or a resident of that country. It also arises where if the indebtedness

was incurred by a permanent establishment or fixed base that bears the interest payment. If the payer pays an excessive amount of interest because of a special relationship between the payer and the recipient or between both of them and a third party, the amount treated as interest is limited to the amount that would have been paid between unrelated parties. Interest effectively connected with the recipient's permanent establishment or fixed base in the source country is taxed as business or personal service income. Lastly, the source country cannot tax interest on loans indirectly financed by, or paid to, the government of the other country, a political subdivision, local authority, central bank, or government-owned financial institution.

c. Royalties

Under Article 11 of the US/PRC Treaty, 'royalties' includes payments for the use of, or right to use, literary, artistic, or scientific copyrights, including motion picture films or films or tapes used for radio or television broadcasting; patents, trademarks, secret formulas, or processes; and industrial, commercial, or scientific equipment or information. However, only 70 per cent of the gross amount of royalties paid for the rental of industrial, commercial, or scientific equipment is subject to tax.²⁰ Royalties arise in a treaty country if paid by the government, a political subdivision, a local authority, or a resident of that country. Royalties also arise at the source country if the liability to pay was incurred by a permanent establishment or a fixed base. Further, royalties can arise in a treaty country, even if paid by a nonresident, if the royalty payments are for the use of, or right to use, property or property rights in that country.

Royalties arising in one treaty country and paid to a resident of the other country can be taxed by both, but the tax by source country cannot exceed 10 per cent. If the royalty payment is excessive because of a special relationship between the payer and the recipient, or between both of them and a third party, the amount treated as a royalty payment is limited to the amount that would have been paid in the absence of the special relationship. Finally, royalties effectively connected with the recipient's permanent establishment or fixed base in the source country are taxed as business or personal service income.

d. Real property income

Income derived from the direct use, letting, or any other use of real property is taxable by the country where the real property is located ('situs country'). Article 6 of the US/PRC Treaty includes income from an enterprise's real property and income

from real property used to perform personal services. 'Real property' is defined under the laws of the country where the property is located and it includes property accessory to real property, livestock, agricultural and forestry equipment, landed property rights, usufructs of real property, and payments for working or the right to work mineral deposits.

e. Capital gains

Under Article 12 of the US/PRC Treaty, gains derived from the alienation of property by a resident of a treaty country can be taxed by the other treaty country, if the gain arose there. The situs country can tax gains from the alienation of (1) real property; (2) business assets of a permanent establishment or a fixed base available to the resident for the purpose of performing independent personal services; (3) stock of a company whose property is mainly real property situated there; and (4) more than 25 per cent of the shares of a company which is a resident of situs country. However, a resident's gain from the alienation of ships and aircraft operated internationally can be taxed only by the country of residence.

f. Personal services

Article 13 of the US/PRC Treaty states that income derived by a resident of one treaty country for independent professional services is primarily taxable by the recipient's country of residence. However, if the income is attributable to a fixed base regularly available to the recipient within the country of source, or is derived while the recipient is present at the source country for more than 183 days in a calendar year, then the income will be taxable by the country of source. The term 'professional services' includes scientific, literary, artistic, and educational activities and the activities of physicians, lawyers, engineers, architects, dentists, and accountants.

However, salaries, wages and other similar remuneration earned by a resident of one country for employment in the other country, is taxable only by the country of residence if (1) the employee is not present in the other country for more than 183 days in a calendar year, (2) the employer is not a resident of the other country, and (3) the remuneration is not borne by a permanent establishment or fixed base of the employer in the other country. Otherwise, the country of source can tax the income.

Other treaty articles

a. Double taxation relief—foreign tax credit

Under Article 22 of the US/PRC Treaty, PRC must

allow tax credit for its residents for income tax paid to the United States. However, the amount of the credit is limited to the amount of PRC tax that would have been due on the same income. Additionally, PRC must also allow tax credit for dividend received by a PRC corporation that owns at least 10 per cent of the US payor corporation. The credit must take into account income tax paid by the US payor corporation on the profits out of which the dividend is paid. Reciprocally, the United States must allow its citizens and residents credit for income tax paid to PRC in accordance with US tax law. Also, a US corporation that owns at least 10 per cent of the voting rights of a PRC corporation and receives dividends from said PRC corporation must be credited with PRC income tax paid on the profits from which the dividends are paid.

b. Treaty shopping—limitation on benefits

The competent authorities of each treaty country may consult to deny the reduced treaty rate for dividends, interest, or royalties paid to a corporation of a third country that became a resident of a treaty country principally to receive US/PRC Treaty benefits. Specifically, a person or an enterprise that is a resident of a treaty country will not be entitled to relief from taxation in the other treaty country unless specific qualifications regarding legitimate status (*eg*, citizenship or resident status) or ownership (*eg*, more than 50 per cent of beneficial interest is owned by qualifying persons) are met.

c. Nondiscrimination

Article 23 of the US/PRC Treaty states that a treaty country may not subject citizens of

the other treaty country to more burdensome taxation than its own citizens in the same circumstances. This provision applies even if the citizen is not a resident of a treaty country. Likewise, a treaty country may not subject a permanent establishment of an enterprise of the other country to less favorable taxation than similar enterprises of that country. Lastly, an enterprise of a treaty country may not be subjected to tax burdens merely because one or more residents of the other treaty country owns or controls said enterprise.

d. Treaty based return positions

Section 6114 of the Code provides that a taxpayer who takes a position that a US tax treaty overrides or modifies the Code must disclose such position on his income tax return. IRS Form 8833 has been developed for taxpayers to make the treaty-based return position disclosure required by Section 6114. The disclosure rule applies whether the treaty believed to override a statutory tax rule is an income tax treaty, an estate and gift tax treaty, a treaty of friendship, commerce and navigation, or any other form of treaty obligation, to which the United States is a party.²¹

Closing

Please be mindful that this article is intended to be a primer on the subject of US taxation of inbound transactions. The discussion of various subjects contained herein is not an attempt to explore all of the issues, nor does it attempt to analyze or discuss in depth the issues that are presented. Therefore, this article should not be relied upon as definitive guidance to a certain transaction without independent verification by a US legal counsel.

Notes:

- ¹ Gary P Tober, Esq chairs the tax practice group at Lane Powell PC in Seattle, Washington, USA. He provides tax and business planning for US and foreign corporations, partnerships and individuals, as well as business and legal aspects of cross-border operations and investment transactions.
- ² Unless otherwise indicated, all references are

to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder.

- ³ IRC § 897(a).
- ⁴ IRC § 871(a)(2).
- ⁵ As defined in IRC § 911(d)(3).
- ⁶ IRC § 861(a)(2)(A).
- ⁷ IRC § 1445(a).
- ⁸ IRC § 1445(f)(3).

⁹ IRC § 881(c).
¹⁰ IRC § 871(h).
¹¹ IRC § 1441(b).
¹² IRC § 1441(c)(1).
¹³ *Id.*
¹⁴ Article 2, PRC Treaty.
¹⁵ 1984 protocol of the PRC Treaty.
¹⁶ Under the typical tie-break rules, the residence of an individual who is a resident of both countries is determined as follows: (a) the individual is a resident of the country in which he or she has a permanent home available; (b) if the individual has a permanent home in both or neither of the countries, residence is in the country with which personal and economic relations are closer; (c) if the center of vital interests

cannot be determined, residence is in the country of the taxpayer's habitual abode; (d) if the individual has a habitual abode in both or neither of the countries, the individual is a resident of the country of which he or she is a citizen or natural; and (e) if all of the foregoing rules fail, the individual's residence is determined by agreement between the competent authorities of the two countries.

¹⁷ PRC Treaty, Article 5.4.

¹⁸ PRC Treaty, Article 5.

¹⁹ PRC Treaty, Article 9.

²⁰ US/PRC Treaty, 1984 protocol.

²¹ Temp Regs § 301.6114-1T(a)(1)(ii) requires a return to be filed for purposes of making this required disclosure where a party is not required to file a US tax return.

Recent Update of Maritime Law in China



Ik Wei Chong discusses China's beckoning of foreign participation in freight forwarding and logistics and the new Contract Law of China with regard to recovery claims

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China Opens its Doors to Foreign Freight Forwarders & Logistics Companies

Foreign Freight Forwarders

China agreed to open up its freight forwarding industry to foreign participation upon its accession to the World Trade Organization ('WTO') according to the following timetable:

- 1 Upon accession (December 11, 2001), foreign freight forwarders with at least three consecutive years of prior experience are permitted to establish presence in China in the form of joint venture ('JV') with Chinese partners, with foreign shareholding/ownership not exceeding 50 per cent;
- 2 Within one year after China's accession (December 11, 2002), majority ownership by foreign freight forwarders is permitted;
- 3 Within four years after accession (December 11, 2005), wholly foreign-owned enterprises ('WFOEs') are permitted.

Foreign freight forwarders have therefore been allowed to operate in China by setting up WFOEs since December 11, 2005.

Foreign freight forwarders who satisfy the following requirements are able to establish

presence in China, either in the form of JVs or WFOEs:

- 1 Minimum paid-up capital of USD1 million;
- 2 At least five staff members must have more than three years of working experience in international freight forwarding industry or have obtained relevant qualifications;
- 3 Permanent office premises in China; and
- 4 Equipped with necessary business facilities for communication, transportation, loading/unloading packing *etc.*

The above JVs or WFOEs are in turn able to set up their own branches across China if the following requirements are met:

- 1 The JVs or WFOEs have been operating in China for at least one year;
- 2 All registered capital has been paid up;
- 3 Payment of an additional paid-up capital of USD120,000 for each branch.

Closer Economic Partnership Arrangement ('CEPA')

Freight forwarders in Hong Kong and Macau enjoy greater concessions in China compared with foreign freight forwarders. With effect from January 1, 2004, freight forwarders from Hong Kong and Macau were allowed to set up presence in China either in the form of JVs (equity JV or cooperative JV) or WFOEs, as part of the

preferential treatment available under CEPA. This time frame was earlier than that granted to foreign freight forwarders on December 11, 2005.

Freight forwarders from Hong Kong and Macau also enjoy concessions in terms of the paid-up capital requirements:

- 1 For freight forwarders engaged in international ocean freight services, the minimum paid-up capital is RMB5 million (app. USD625,000);
- 2 For freight forwarders engaged in international air freight services, the minimum paid-up capital is RMB3 million (app. USD375,000);
- 3 For freight forwarders engaged in international land transit services or international courier services, the minimum paid-up capital is RMB2 million (app. USD250,000).

The minimum paid-up capital for the JVs or WFOEs to establish their own branches is RMB500,000 (app. USD62,500) for each branch.

Logistics Sector

There are generally more barriers to entry and higher threshold requirements for foreign logistics companies doing business in China compared to foreign freight forwarders.

It used to be that foreign logistics companies were only allowed to set up joint ventures with Chinese partner(s) and WFOEs were not allowed.

Until March 2006, foreign logistics companies setting up in China had also to meet the following requirements:

- 1 Minimum paid-up capital of USD5 million;
- 2 For logistics companies engaged in international logistics business, the maximum shareholding percentage for foreign investors is 50 per cent;
- 3 Permanent office premises in China; and
- 4 Equipped with necessary facilities for business operations.

Most of these restrictions and barriers have now been lifted by the 'Circular on Improving Efforts in Attracting Foreign Investment into the Logistics Sector' issued by the Ministry of Commerce ('the Circular'). The Circular was published on April 20, 2006 and was effective as at March 31, 2006.

Most importantly, the Circular allows foreign logistics companies to have the option of operating in China either as a joint venture with Chinese partner(s) or as a WFOE. Additionally, the above requirement for a relatively significant paid-up



Photo: Youssouf Cader

capital of USD5 million has been abolished. The minimum capital requirement is now determined by the type(s) of business(es) undertaken by the foreign logistics companies concerned (eg freight forwarding and/or retail and/or wholesale etc).

This is certainly a major step in the right direction in developing China's logistics sector.

Limitation of Liability and Time Limit Issues for Recovery Claims Arising from Inland Carriage (by Road and Inland Waterways) in China

Introduction

There is no specific law in China dealing with inland carriage of cargo by trucks and inland vessels. As a result, the Contract Law of China ('CLC') is treated as the specific law governing such matters. Relevant provisions set out in the

General Principles of Civil Law in China ('GPCL') will also apply in so far as they are not in conflict or inconsistent with provisions in the CLC.

However, in order to clarify and provide guidance on various issues concerning inland carriage of cargo by trucks and inland vessels, the Ministry of Communication in China enacted the Motor Vehicle Cargo Transportation Rules ('MVCT Rules'—came into effect January 1, 2000) and Domestic Waterway Cargo Transportation Rules ('DWCT Rules'—came into effect January 1, 2001) respectively.

In pursuing recovery action against inland carriers (for both road/inland waterway carriage) arising from cargo damage/loss, cargo interests have the option of pursuing their claim in either contract or tort (but not both). However, from our experience, it is usually easier pursuing a claim in contract as the burden of proving the case and providing supporting evidence/documents is generally lower as compared to proving a claim in tort.

Both the MVCT and DWCT Rules contain provisions exempting the carrier from liability for loss of or damage to the cargo resulting from causes such as *force majeure*, inherent vice of cargo, inadequacy/insufficient packing etc.

Limitation of Liability

The MVCT Rules state that compensation for cargo damage/loss shall be based on both fixed amount and actual losses/damages suffered. However, it is not uncommon to find ridiculously low limitation amount in the standard terms and conditions of inland carriers. Such terms and conditions would usually be treated as null and void under Chinese law.

For international ocean carriage by vessels to/from Chinese ports, the Chinese Maritime Code's ('CMC') package/weight limitation regime for claims arising from cargo damage/loss is similar to that in the Hague-Visby Rules (*ie* 666.67 SDRs per package or two SDRs per kilogram of the gross weight of cargo lost or damaged, whichever is higher).

For coastal/inland waterway carriage, there used to be some confusion whether carrier's liability arising from cargo damage/loss in the course of coastal/inland waterway carriage should be half the amount stated in the CMC (*ie* 333.34 SDRs per package or one SDR per kilogram of the gross weight of cargo lost or damaged). We can confirm that there is in fact no such package/

weight limitation for cargo damage/loss arising from coastal/inland waterway carriage.

On ship owner's entitlement to rely on global limitation of liability for all claims arising from any maritime casualty, a distinction should be made between coastal carriage and inland waterway carriage. In coastal carriage between two Chinese sea ports (*eg* between Shanghai/Nanjing or Guangzhou/Dalian *etc*) and between a Chinese sea port and an inland port (*eg* between Shanghai/Chongqing), the limitation regime is generally half of the relevant limitation figures found in the CMC.

On the other hand, there is no applicable global limitation of liability regime for purely inland waterway carriage between Chinese ports (*eg* between Wuhan to Chongqing *etc*).

Time Limit

On truck carriage, there is no provision in the MVCT Rules providing for time limit to commence recovery proceedings. In the circumstances, time limit for bringing proceedings against truck carrier would generally be two years as stipulated by the CLC.

On carriage by vessels, as above, a distinction should be made between coastal carriage and inland waterway carriage. In coastal carriage between Chinese sea ports (*eg* between Shanghai/Nanjing or Guangzhou/Dalian *etc*), Article 257 of the CMC applies and imposes a time limit of one year for bringing proceedings against carrier.

On the other hand, the CMC does not apply to inland waterway carriage between two Chinese inland ports (*eg* between Wuhan/Chongqing or Nanjing/a destination further up the river *etc*). The MVCT Rules also do not set out the relevant time limit. Reference will therefore have to be made to the GPCL which provides the time limit to be two years from the date the claimant knows or should have known that its interests have been affected. However, this is in conflict with a judicial interpretation issued by the Supreme Court in May 2001 stipulating that time limit for claims arising from carriage of cargo in both coastal and inland waterways shall be one year. In the circumstances, it would be prudent to also treat the time limit for bringing proceedings against carrier arising from inland waterway carriage as one year after delivery of cargo or the date when it should have been delivered.

Chinese courts do not recognize time extensions for commencement of proceedings as agreed between the parties.

New Challenges— Effects of Recent Changes in Chinese Legal System on Korean Companies’ Investments in China



This paper addresses the adoption of China’s foreign investment policies and the adverse effects it might have on Korean companies in China

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Introduction

China has made great strides in legal reform since becoming a member of the World Trade Organization (‘WTO’). For example, legislations numbering around 200 or more have been enacted or amended annually since China’s induction to the WTO. This is a direct testament to how far China had fallen behind in terms of development when compared with the rest of the world. That said, it also demonstrates how fast China has adapted itself to the ever-changing world since becoming a WTO member. Noteworthy among the recent changes to the Chinese legal system include an amendment to the Labor Act, an amendment to the Income Tax Act, changes in the method of disposing industrial sites, and stricter environmental regulations. These rapid changes in the Chinese business environment entail higher costs of doing business in China and do not bode

well for the future survival of labor-intensive, energy-consuming or pollution-causing industries. Against this backdrop, this paper evaluates potential effects of recent changes in the Chinese legal environments on Korea’s investment in China.

Recent Changes in the Chinese Legal Environments

Uniformity in the Corporate Income Tax Act

Under the Chinese Corporate Income Tax Act, local companies are subject to a corporate income tax at the flat rate of 33 per cent, as compared to foreign-invested companies in a domestic free economic zone or free economic-technology zone which are subject to a flat tax rate in the range of 15 per cent to 24 per cent, depending on the region in which such companies are situated. This taxation was fiercely criticized as a form of reverse discrimination against domestic companies, and after extensive debate, the Chinese Government announced a bill that would apply a uniform corporate income tax rate of 20 per cent on all companies, domestic and foreign alike. Assuming this bill is passed at the People’s National Congress

in 2007, all companies doing business in China will be subject to the above uniform tax rate on corporate income. From the perspective of foreign-invested companies, however, which have enjoyed a relatively lower tax rate, the uniform tax rate would, in effect, mean an increase in tax rate and eventually a heavier tax burden. This change in policy is indicative of a broader shift in how the Chinese Government views foreign investment and signals future changes in foreign investment policies generally. Pending such changes, tax benefits are supposed to remain available to high-tech, environmentally friendly, energy-saving and other preferred industries.

Changes to the Labor Act

Amendments to the Labor Act will eventually increase costs to be borne by foreign-invested companies. A new bill in respect of the Labor Act, which is being prepared by the Chinese Government, would give even greater powers to labor unions, including the powers to enter into a collective agreement and to refer a dispute to a court or an arbitral tribunal. Under such bill, a company would be able to reduce its personnel only if it meets more stringent requirements. That is, in order to reduce personnel by 20 or more employees or to layoff 10 per cent or more of its total employee, an employer must (i) provide a 30-day notice to the labor union, (ii) hearing

back from such union before implementing such layoff and (iii) report such layoff to the labor authority.

Under the new Labor Act, an employer would have to provide economic compensation to its employee if it refuses to renew the employment agreement upon expiration against such employee's wishes. Also, the maximum probationary period would be defined based on the term of a labor agreement, and wages during the probationary period must be at least the minimum wages assigned to the same type of work or 80 per cent of the wages agreed to under the labor agreement. No dismissal during the probationary period would be allowed for any non-objective cause, including for inadequate ability and negative job attitudes. In addition, a seconding company would have to enter into a labor agreement with any worker who is on secondment for two or more years, which would, in turn, mean that the host company would be required to enter into an agreement for two or more years with such workers on secondment.

Reduction or Elimination of Value Added Tax

Since 2006, the Chinese Government has endeavored to reduce or eliminate value added tax, which is expected to have direct consequences on the industries which are focused on processing trade. The Chinese Government announced that, effective as of November 22, 2006, processing



trade would be banned on a total of 806 products. In general, trade processing involves import of raw materials in bond, processing in China, and export in the form of finished goods, essentially using China's cheap labor, which has been recognized as a key factor for its trade surplus. In this context, the Government's ban or reduction of processing trade is apparently aimed at reducing trade surplus arising from foreign companies' use of China's cheap labor in their exports, and it appears likely that such measures will be expanded in the future.

Stricter Environmental Regulations

China is also expected to implement even stricter regulations under the environment related statutes. Specifically, industries that pollute the environment would be banned or be required to relocate and to make new or additional contribution for any pollution caused by them. Hence, some Korean companies in China will be compelled to relocate their factories or pay more contributions.

According to the Outline of National Environment Protection for Year 2006 published by the State Environmental Protection Administration, as environment-related laws and regulations are constantly amended, illegal acts will be closely monitored and strictly punished and environment standards will be newly established or constantly amended. In order to protect water supply sources, more surveys and punishments would be carried out in respect of companies which generate waste water. Actions will be taken to prevent environmental pollution within a development zone, including: comprehensive inspection, disposition and other measures; reorganization of companies found in violation of the paper, cement, or chemical related statutes; vigilant monitoring of operation of pollution preventing facilities; rearrangement of the mining industry in collaboration with the national territorial resources authority; safety inspection of industries (including chemical and refining industries) that poses high risk of environmental pollution; and aggressive protective measures for maritime ecosystems.

Also, the Chinese Government has, in effect, announced its plans, among other things, to closely screen environment polluting construction projects, to force out outdated technologies or highly polluting technologies or products, and to closely control environment impact evaluators so as to ensure more tight assessment specific to individual industries, such as the steel industry, petrochemical industry, and hydraulic power generation. In line with these plans, seven departments and subdivisions of the State Council,

including the State Environmental Protection Administration and the National Development and Reform Commission, resolved on May 31, 2006 to closely regulate companies that illegally discharge wastes harmful to public health.

Anti-monopoly Legislation

The anti-monopoly legislation, which has been delayed for as many as 12 years, will probably be enacted in the near future. The necessity of such legislation, in terms of correcting the administrative monopoly of state-owned local companies that are primarily owned by local governments and of regulating the recent increase in market shares of multinational conglomerates in some sectors, has been subject to much debate within the Chinese Government. The new bill has been prepared by the Government based on the opinions it gathered from sources both inside and outside China and purportedly seeks to regulate, among other things, cartel, unfair trade practices and other acts interfering with market order. Under the anti-monopoly legislative framework, with the Chinese Government, is intent on preserving the market order, many changes are expected in the market environment which will affect Korean companies doing business in China. Given that governments throughout the world organically collaborate with each other in tackling corporate cartels, the Chinese Government would be able to apply the Chinese anti-monopoly legislation offshore and impose a fine on a Korean company at any time for participating in a cartel in Korea. Accordingly, Korean companies must be prepared for extra-jurisdictional application of the anti-monopoly legislation by the Chinese Government.

In addition, merger and acquisition in China as well as abroad that may have an impact on the Chinese market would have to be reported to the Chinese Government if certain conditions are satisfied. A report must be filed with the Ministry of Commerce and the State Administration for Industry and Commerce for examination before the merger and acquisition can be consummated. This appears to be intended to prevent excessive market concentration or interference with fair competition by the acquiring company. The Government may reject a proposed merger and acquisition: (i) if the acquiring company's revenue in China is RMB 1.5 billion or more; (ii) if there are more than 10 local companies in the industry in which the merger and acquisition is proposed to take place within a year; (iii) if the acquiring company or its associated company has a 20 per cent share in the Chinese market; or (iv) if the proposed merger and acquisition would result in one company having a 25 per cent market share. Special examination is

necessary if the acquiring foreign company owns assets valued in the aggregate at RMB3 billion or more in China.

Effects on Korea's Investment in China

Increase in the Production Costs in China

As discussed above, manufacturing environments in China have changed rapidly. In line with its reform and open policy, the Chinese Government has been to date eager to attract foreign investment, regardless of the nature of, and the industry targeted for, investment, *etc.* However, that is no longer the case. Skyrocketing land prices and changes in the Government's policies on corporate tax, environment, labor, anti-monopoly and other issues are indicative of the Government adopting substantially different foreign investment policies. That is, the Government appears intent on attracting foreign investment only for certain selected sectors which are currently essential to China, including environment-friendly and high-tech industries, rather than haphazardly attracting foreign investment of any nature. After all, China may no longer be attractive to those Korean companies that have entered the Chinese market mostly because of low labor costs, and they would have to pay greater costs in the future for doing business in China. Any Korean company already in China or that plans to enter into China would have to carefully consider how they will respond to the increased production costs in China.

Increased Competition in China

The Chinese market is already an international market, in which most of the 500 largest multinational conglomerates compete. On the other hand, privately-held local companies have grown rapidly enough to compete head-on with these multinational conglomerates. Even local companies, which have previously sought to

aggressively attract foreign investment by granting incentives, now appear more interested in collecting higher taxes. Naturally, given these circumstances, foreign investment environments would be subject to substantial changes.

Furthermore, in light of recent awareness of excessive or redundant investment in some industries, large-scale restructuring and merger and acquisitions are anticipated, to be followed by a gradual reshaping of the market. Consequently, the Chinese market is expected to be the center of fiercer competition among multinational companies equipped with brands and designs on the one hand and price-competitive local private companies on the other. It is therefore essential for Korean companies to pay keen attention to the changes in the market conditions in China and implement a corporate policy that is responsive to such changes.

Conclusion

Korea's investment in China is anticipated to rise, but in a form that is unprecedented. First, the form of investment in China, which has been driven by labor-intensive industries relocating there, will be displaced by investment driven by business expansion through mergers and acquisitions. Second, such investment would be in preparation for full scale competition with multinational conglomerates and local companies in China and/or in service and distribution industries, which are yet in early stages of development. Steady growth is anticipated also for investment in SOC and real estate development, sectors in which investment has not been sufficiently realized. Lastly and foremost, it is critical for Korean companies to keep apprised of great changes in the legal and economic environments of China and to reevaluate their investment strategies and implement appropriate measures that are responsive to the changing environment.

'Window on Beijing'



This is a prelude to the subjects to be examined by the Employment and Immigration Law Committee at the forthcoming 2007 Conference in Beijing

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Year 2007 will see not only the Annual Conference of the IPBA in Beijing but will be the year for the introduction of the new Labor Contract Law (LCL) for the People's Republic of China.

The first draft of the new, comprehensive law was released for public comment in March 2006. This gave rise to nearly 200,000 responses which, in turn, has resulted in a revised exposure draft being released in December 2006.

It is likely that the LCL will be implemented in early 2007 although no precise date for that event has been announced.

It is timely that the Employment and Immigration Law Committee will enable presentations to be made to conference delegates for their consideration of this new law at the IPBA 17th Annual Conference to be held at Beijing in April 2007.

Members of the IPBA who have any interest in labor law as it operates and will operate in the PRC will find this session of immense interest. It matters not, whether as lawyers they advise employers with operations in the PRC or are concerned with the location or relocation or secondment of expatriate staff to operations in the

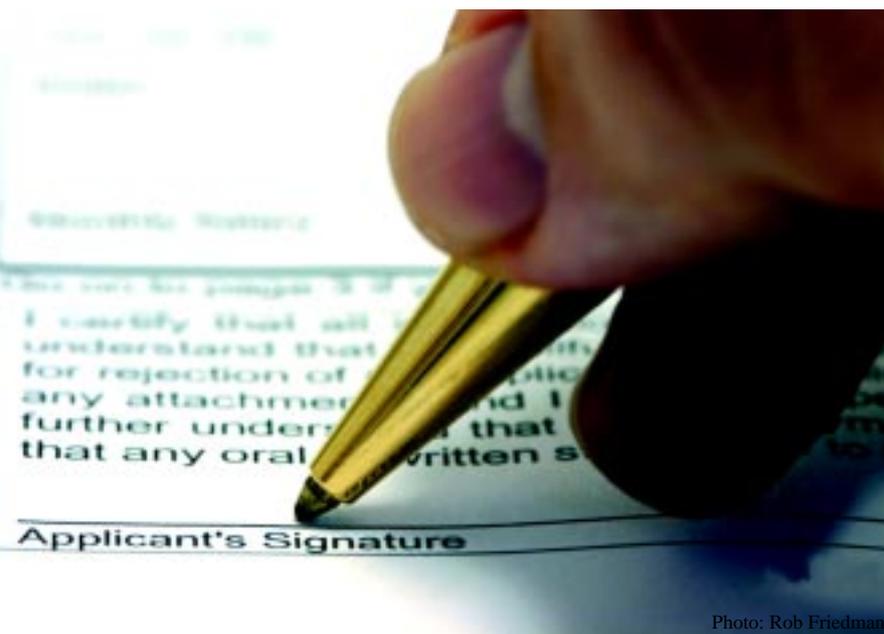
PRC, there promises to be something of value for them in the presentations to be made.

Mr Ralph Koppitz, of Taylor Wessing, Shanghai, will present an analysis of the LCL to the Committee's session entitled 'Chinese Labour Law—a suitable model for the new world?'

It is likely that the LCL, once activated, will apply with immediate effect and will have an immediate impact upon extant employment relationships—not merely those to be established after its commencement.

The LCL will probably have a significant impact upon what have been, hitherto, flexible working/service relationships and will likely require the establishment of a formal employment contract. What impact this might have upon costs of operations will be explored.

Similarly, it seems that there will be changes effected in very many areas of employment relationships, such as with respect to probationary employment; to the manner of interpretation of labor contracts (*ie* should one partly be favored where more than one interpretation is open?); the scope and content of company rules which impact upon employment and employees and the degree of involvement of labor unions in their formulation. Further, there seems likely to be an impact upon such vitally important commercial matters as the scope and effect of non-compete clauses in employment contracts and the extent of protection for trade secrets and confidential information; the extent to which employer supplied or paid training



can be linked to service after training is completed and the requirement for labor unions to be involved in the process of termination of employment.

All of the above areas will be explored and will be open for comment by members who attend this session.

How appropriate, if at all, this new LCL regime might be for application beyond the PRC might be thought to be an open question. Indeed, the session will attempt to explore how appropriate these changes will likely prove to be for the PRC itself quite apart from other areas of the New World.

The LCL will comprise some 96 Articles and it seems it will be virtually all embracing—save for those civil servants governed by the Civil Servants Law. Otherwise it will regulate any conclusion, performances, notification, rescission and termination of labor contracts by employers and employees. The LCL will be applicable to any establishment of labor relationships by and between, and any conclusion, performance, notification, rescission and termination of labor contracts by and between, enterprises, individual economic organisations and privately owned non-enterprise entities and employees within the territory of the PRC: see Article 2.

Commercial lawyers with professional interests in the PRC and the employment of staff there (be it expatriate or not) will have a keen interest in participating in this session.

Dovetailing with the presentation by Mr Koppitz, will be a presentation by Dr Ivo Hahn, the founder and CEO of Xecutive Group of Hong Kong, Beijing and Shanghai. Dr Hahn is a specialist recruiter who has experienced the commercial world in the PRC from inside companies as a senior executive and as an external adviser now with some twenty years experience in Asia.

Dr Hahn's presentation will be dealing with the problems for recruitment of staff to work in, and already working in, operations in the PRC (both expatriate and non-expatriate) and also with retention of such staff and the issues which might be involved in such retention. The persistent difficulty of competition amongst employers for skilled staff and the spectre of non-competition clauses in employment contracts present their own sets of problems now and will continue to do so. The impact of the new LCL in these areas is a 'bread and butter' issue for employers and for labor and commercial lawyers advising clients or their employers operating in the PRC.

I am confident that this session with its far reaching and complementary presentations will prove of significant worth to all who participate in it.

An open invitation is extended to all IPBA members with an interest in this topical and critically important area of legal practice, to come along and participate.

In addition to the above session, the Employment and Immigration Law Committee will join with the Dispute Resolution and Arbitration Committee to present a wide ranging session on the subject of 'Ethical factors in Arbitration and Litigation in Asia'. This session will examine such issues as ethical standards and guidelines in arbitration and litigation, emergent ethical issues facing in-house counsel in Asia, the elimination of bias in the legal profession in Asia, confidentiality and privilege issues in arbitration and litigation and many more closely related significant matters.

This joint session will be of interest to a wide section of the IPBA membership.

The Coming Battleground for Technology: The Protection of Trade Secrets



This article explains the historical emergence of trade secrets and the importance of practicing it effectively in order to gain foreign joint ventures in technology-based companies

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Nearly every country in the world searches for new ways to compete and achieve economic superiority over its rivals. The specific battleground on which this is played out, however, changes with time. Over the last 25 years, a rapid and radical shift has occurred in how a nation's economic strengths and future prospects are measured. Today, the ability of a nation and its leading businesses to innovate, control, apply and obtain valuable commercial technologies is the key in determining which nations over the long run will become winners or losers. This revolutionary shift is not yet well understood around the world.

Let's start by looking at some 'battlegrounds' of the past. Prior to the 19th century in the West, a nation's strength was usually measured by the perceived size of its army or navy. Nations projected military strength as the means to gain a competitive advantage over trade partners and neighbors. The Spanish, the Dutch, the English, the Portuguese and others all became wealthy and powerful because of their trade routes spread

around the world. However, those routes for transporting trade goods were only as good as the military forces available to protect them. Declines in military strength usually indicated a decline in a nation's economic wealth and power.

This suddenly changed about 150 years ago. The birth of the Industrial Revolution, first in England and then elsewhere, altered all dynamics. Because of the Industrial Revolution, the ability to efficiently utilize labor and natural resources, thus creating a broad variety of affordable manufactured products, sparked massive economic growth throughout the Western world. The middle class emerged as societies become less agricultural and more industrial. The greater a nation's industrial base, the greater its chances for political power and economic success.

From the mid-19th century onward, the number of steel mills, machine tools, miles of railroads, coal mines, and natural resources a nation owned or had access to became a far better gauge of a nation's strength than the size of its armies. Some noted historians argue that the real reason the Axis Forces were defeated in World War II was because, unlike the Allied Forces, they lacked broad enough industrial bases and access to critical commodities like oil, rubber, iron ore, and coal.

With the defeat of the Axis Forces in 1945, another shift occurred. Nations became less

important and multinational corporations ('MNCs'), first in America and later in Europe and Asia, gained enormous strength and influence in their place. As the MNCs became more numerous, governments began to fear their growing influence. In the United States, the federal government launched legal attacks on large MNCs for what were viewed as excessive market shares and monopolistic practices. Antitrust and anticompetition lawsuits consumed the attention of the US Congress and the Executive Branch for a decade. In 1969 the US Department of Justice Antitrust Division filed a major lawsuit against International Business Machines Corporation charging that IBM was attempting to monopolize the market for general-purpose digital computers in violation of Section 2 of the *Sherman Act*. This was one of the most public efforts by the US government to break up what was viewed as a monopoly. I remember working as a staff counsel in the US Senate in the mid-1970s. Back then, if there were 100 issues pending before the US Congress, the top five in importance always included antitrust. Among the issues viewed as least important was intellectual property (patents, trademarks, and copyrights). IP was on no one's radar then—but that was about to change.

The Emergence of IP

Unfortunately, it was not until the 1980s when America began to realize it was technology which was critical to its future prospects for economic growth. The Europeans quickly caught on as the

Japanese, the Koreans, and the 'Tigers' of Southeast Asia very effectively competed head-to-head with the Americans and Europeans because of their lower-priced quality manufactured goods. As it declined in the fields of steel production, automobiles, and then electronics, it was only because of technological innovation that the West remained competitive.

As public awareness of the unique role played by technology was embraced in the West, intellectual property emerged as a key issue in trade talks. Americans and Europeans demanded that their Asian competitors acknowledge that intellectual property protection was essential. Vast resources were devoted to educating trade partners of the US and major European economies about the role played by patents, trademarks and copyrights. Countries, particularly in Asia, were pressured into enacting or strengthening their national patent, trademark and copyright laws. The US Congress through its 'Special 301' of the Trade Act of 1974 mandated that the US Trade Representative on behalf of the US Executive Branch conduct periodic reviews of America's trade partners. This essentially graded them on how well their laws protected the patent, trademark and copyright interests of American companies around the world. The emphasis on intellectual property protection became an even higher priority as China rapidly emerged as the world's leader in contract manufacturing during the 1990s. The World Trade Organization ('WTO') officially adopted intellectual property protection as one of the fundamental requirements needed in order to



qualify for and maintain WTO membership. When China was admitted to the WTO, many felt that IP had finally arrived on the world scene and things would get better. However, as always happens, things changed again when no one was looking.

What Constitutes a Trade Secret?

The importance of protecting your intellectual property is paramount. But, what if your most valuable technologies and applications are such that they cannot be adequately protected by traditional IP methods? The fact is that the vast majority of valuable corporate information can only be protected by trade secrets, not by patents or copyrights.

Asian countries seeking to attract American technology companies urgently need to focus on the importance of enacting effective trade secrets laws and to promote the willingness of local courts

and judges to enforce protection of trade secrets. The American-based companies I have worked with often base their decisions on where to invest outside the US, or in which countries to form a joint venture, on how well trade secrets are protected. Recently I met with one highly successful US-based technology company with operations in Europe. This company needed to set up a base of operations in Asia and looked at Japan and China as the best two candidates. Based on the fact that Japan has a trade secrets law (passed in the early 1990s), the US company selected Japan over to China for its Asian headquarters.

In conclusion, I believe the next battleground for technology-based companies looking to do business outside the US and Europe will focus on trade secret protection. Where protection is weak or non-existent, these companies will be less likely to invest or pursue joint ventures.

What is a 'trade secret'? All companies possess valuable corporate information and trade secrets. This is true whether or not a company considers itself to be a technology company. There is no universally-accepted definition of what constitutes a trade secret. Begin by thinking of trade secrets as corporate assets. They are valuable and must be protected. Trade secrets can be tangible or intangible and may consist of things such as an unpatented device, a chemical formulation, non-disclosed customer information, corporate documents, or a conversation about undisclosed corporate planning strategy. What is most peculiar about trade secrets is that a valuable trade secret in one industry will not be viewed as a trade secret in another. Although a precise definition of what constitutes a trade secret is elusive, there are three common aspects: *novelty*, *value*, and *secrecy*. **Novelty** refers to the nature of the information. To possess novelty in a trade secret sense, the information or process need not be totally unique, but it cannot be commonplace and readily available to anyone outside your company. Using the term novelty in a trade secret sense may be confusing to a person with knowledge of patents. Novelty is a prerequisite to obtaining a patent and requires that an idea must be so unique as to be highly valuable and reduced to practice for the first time by the inventor. That level of sophistication or degree of complexity of novelty in a patent sense is not applicable to trade secrets.

A trade secret must also have *value*. Examine value from two perspectives. First, commercial

information which enables your company to save money or to compete more effectively in the marketplace than it would otherwise has value in a trade secret sense. The other perspective from which to view value is to examine whether a company has expended money or resources to obtain or develop commercial information which it views as a trade secret. However, this is not to suggest that an improvement on a product discovered by accident lacks value. Another way to look at value is by evaluating the information and deciding if it is something competitors would want to own. Willingness of a competitor to expend resources to own it is a reflection of value. This analytical approach is particularly applicable where your company possesses corporate information and for good business reasons decides not to exploit it.

The single most important element of a trade secret is *secrecy*. The key is to create a reasonable envelope of secrecy around trade information and yet maintain enough flexibility so that it can be commercially exploited.

There are three distinct situations to watch out for when handling trade secrets. First, secrecy procedures within your own company are needed to maintain confidentiality of valuable secrets among existing employees. Second, care must be taken to control when, how, and why your secrets are revealed to third parties such as subcontractors, suppliers, consultants and financial institutions. Third, you must be prepared to deal with the difficult problem of needing to reveal trade secrets when a license or joint venture is contemplated.

The Law and Regulation of Electricity in Myanmar (Burma)



This paper discusses foreign investment opportunities for power generation projects in Myanmar

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Introduction

Power consumption in Myanmar has risen rapidly since 1988 due to the increase in the country's population as well as demand from the state sector. An example that illustrates the increase in consumption is that just over 1,500 megawatts of electricity were consumed in 1988. In 2005, 5,000 megawatts of electricity were consumed. There are three principal means by which electricity is generated in Myanmar: (i) hydropower; (ii) gas-fired power; and (iii) power fired by hydrocarbons other than gas.

Hydropower plants now supply about 40 per cent of the above need. The bulk of the remainder comes from both on-shore and off-shore natural gas. It has been estimated that as much as 40,000 megawatts of electricity could be produced from rivers and creeks in Myanmar. Only a fraction of this has been utilized at present. The Myanmar government, therefore, hopes that hydropower plants will become the nation's primary energy

source for electricity and that gas-fired power stations will become only a secondary source. For now, however, most electricity comes from natural gas.

To meet the demand for electricity thirty hydropower plants that produce 517 megawatts, four gas-fired power plants that produce 281 megawatts, one steam power plant that produces 120 megawatts and four recycled materials power plants that produce 152 megawatts were built between the period of 1988 and July 29, 2006. Approximately 16 hydropower projects are presently in the implementation stage and approximately 15 more projects are in the planning stage. In addition, wind-powered power plants, waste heat recovery power plants, bio-fuel power plants and bio-diesel power plants are being built in order to save natural gas.¹

The Basic Legal Grounds for Investing in the Electricity Sector

The basic Laws relating to electricity in Myanmar are the Electricity Law of 1984 ('the Electricity Law'), Procedures relating to the Electricity Law issued in July 1985 ('the Electricity Procedures') and the Board of Yangon City Electric Power Supply Law of 2005 ('the Electric Power Supply Law'). The Electricity Law relates to the work carried out in the search for, generation, transmission, supply and use of electric energy throughout the country and to electricity inspection work with the objective of carrying out these

activities safely and free from the dangers posed by electricity.² The Electricity Procedures contain, *inter alia*, procedures relating to granting permission of electricity rights (see below), generation, transmission, supply and use of electricity; prevention of dangers posed by electricity and modes of inspection. The Electric Power Supply Law relates mainly to the supply of electric power in the area of Yangon.

The Electricity Law defines 'electric power' as electrical energy generated by steam power generators, hydro electric power generators, fuel-oil power generators, natural gas turbines, nuclear power generators or by any other means.³ The term 'electricity rights' is defined as rights to search for, generate, transmit, supply and use electric power.⁴ Under Section 4 of the Electricity Law the following may have electricity rights granted to them by the government: (a) the Electric Power Corporation established by the State or an organization responsible to the Corporation [now the Myanmar Electric Power Enterprise ('MEPE')⁵]; (b) mills, factories and work establishments under various Ministries; (c) co-operative societies registered under the Co-operative Society Law (The relevant law was enacted in December 1992.); (d) private enterprises registered under the Private Enterprise Authority Law (This law was repealed in July 1988.); and (e) other separate organizations.

Section 4(d) of the Electricity Law mentions 'private enterprises'. Under a reading of The Private Enterprise Authority Law,⁶ 'private enterprises' is interpreted to include Myanmar citizens who are entrepreneurs. Thus, members of the Myanmar public can receive electricity rights. As to foreign investors, Section 4(e) of the Electricity Law includes 'other separate organizations,' and this term has been interpreted as including foreigners. According to paragraph 18(e) of the Electricity Procedures, however, separate organizations are entitled to invest in projects that generate up to 500 kilowatts of electricity only. Pursuant to Section 9 of the Electricity Law, discussed below, and as otherwise as discussed below, foreigners may invest in larger projects, with government approval.

The Electricity Law provides for rights and duties⁷ of electricity rights holders. The rights of the electricity rights holder being granted orders under Section 4 of the Electricity Law are set forth therein.⁸ The Electricity law also contains criminal provisions.⁹

The Electricity Law contains restrictions on a person conferred electricity rights ('electricity rights holder'). For example, the electricity rights holder being granted orders under Section 4 of the Electricity Law is not entitled to work jointly with

others who want to supply electricity or with those having the right to supply electricity without the approval of the Government.¹⁰ The electricity rights holder is not entitled to sell, mortgage, loan, exchange or transfer his rights or enterprise in whole or part thereof without the approval of the Government.¹¹

The Electricity Law gives the reasons for revocation of orders relating to electricity rights.¹² In addition, orders relating to electricity rights may be revoked.¹³

A Second Legal Avenue for Investing in Power Projects

The search for electricity, electricity generation, electricity transmission and supply of electricity are covered by the Electricity Law and therefore, as discussed above, one avenue for investment in this sector is under the Electricity Law. Under Section 3(k) of the State-owned Economic Enterprises Law of 1989 ('the SEE Law'), however, electricity generating services other than those permitted by law to private and co-operative electricity generating services¹⁴ is included in the list of state-owned economic enterprise carried out solely by the government. Section 4 of the SEE Law, in turn, allows the government to permit any other person or economic organization to carry out such electricity generating services by (a) forming a joint venture with the relevant state-owned economic organization or (b) independently, under conditions that are not specifically specified by law. Moreover, under Section 5 of the SEE Law, the government may prohibit or prescribe conditions regarding the purchase, procurement, improvement, storage, possession, transport, sale and transfer of products derived from or produced by or used by such electricity generating services. Legally, therefore, an investor may also enter this sector via the SEE Law. For example, the Ta Sang Hydropower project on the Thanlwin River has been granted permission for electricity rights by the government in connection with special electrical energy under both Section 4 of the SEE Law and Section 9 of the Electricity Law.

Projects Greater than 500 Kilowatts

While there is no definition in the Electricity Law or Electricity Procedures of a 'special' project (though special projects are mentioned in Section 9 of the Electricity Law), major hydropower projects involving foreign investment like the Ta Sang hydropower project are in practice considered special projects.

Practically, in light of the above, it may be concluded that 'special' electricity rights mean those greater than those provided for by Section 4 of the Electricity Law and that the legal basis for

the granting of such projects are Section 9 of the Electricity Law and Section 4 of the SEE Law. With approval of the government, these projects may be granted to foreign investors. From the point of view of government policy oversight, the Special Projects Implementation Committee, headed by the Chairman of the State Peace and Development Committee makes policy decisions in connection with these projects. Likewise, the State Electric Power Development Project Leading Committee also headed by the Chairman of the State Peace and Development Council, has jurisdiction over them.¹⁵ The procedure to obtain the approvals will be discussed below.

Legal Vehicles for Foreign Investment

Foreign companies interested in power projects in Myanmar can participate in two ways:

- a Acting as contractors on projects for whom others have obtained approvals. Examples of this would be implementation contracts; detailed design contracts; design, supply and supervision contracts and contracts for feasibility studies. The contract might be with either a Myanmar government entity or with a foreign investor who had already invested as set forth in 5(b), below. If the contract is with a government entity i) in the case of hydropower the contract would be with the Irrigation Department of the Ministry of Agriculture and Irrigation and/or the Hydroelectric Power Implementation Department ('HPID') of the Ministry of Electric Power No (1); ii) in the case of natural gas the contract would be with the Yangon City Electric Power Supply Board ('YESB') of the Ministry of Electric Power No (2) if the intended project is within Yangon city area or MEPE of the Ministry of Electric Power No (2) if the intended project is outside Yangon city area; iii) in the case of other sources of energy the contract would be with YESB if the intended project is within Yangon city area or MEPE if the intended project is outside Yangon city area.
- b Entering into an agreement directly with the government under the legal grounds discussed in 2, 3 and 4, above. Either
 - i on a build-operate-transfer ('BOT') basis. The legal basis of BOT projects is Section 5 of the Myanmar Foreign Investment Law, discussed below, and paragraph 3 of the Procedures relating to the SEE Law or
 - ii pursuant to a joint venture agreement with HPID (see below) for the construction of hydropower plants and generating electricity there from.

The Structure of the Ministries of Electric Power

Before the emergence of the Ministry of Electric Power No (1) ['MOEP (1)'] and the Ministry of Electric Power No (2) ('MOEP (2)'), discussed below, the Ministry of Industry No (1) was responsible to handle all electric power projects. To promote and effectively operate of the power sector, the Ministry of Electric Power ('MOEP') was organized under notification number 1/97 of the State Peace and Development Council dated November 15, 1997. MOEP consists of the MEPE



Photo: Pali Rao

and the Department of Electric Power ('DEP'). MEPE was previously under the Ministry of Energy and was later transferred to the MOEP after MOEP was formed. The date of transfer to the MOEP was not published in the gazette. DEP was formed as a new department under notification number 14/98 of MOEP dated May 25, 1998. MEPE is an implementing agency responsible for power generation, transmission and distribution of electricity throughout the country. DEP acts as a planning and policy making body as well as a secretariat to MOEP.

In compliance with the generation expansion strategy which leads to develop hydropower plants both for short and long term plans, the Department of Hydro-electric Power ('DHP') was established on January 24, 2002 to increase MOEP's capability on implementation of the hydropower projects. This new department was formed basically with the engineers and staff of the former Hydropower Development section of MEPE.

MOEP was reorganized as MOEP (1) and MOEP (2) under Order No 5/2006 of the State Peace and Development Council dated May 15, 2006 in order to effectively carry out the economic, nation-building and development tasks. Therefore, MOEP was divided into two ministries. According to a government newspaper, the Hydroelectric Power Administration Department ('HPAD'), the Hydroelectric Power Implementation Department ('HPID') and the Hydroelectric Power Production Enterprise ('HPPE') are under MOEP (1). Also according to such newspaper, the DEP, the MEPE, the YESB¹⁶, the Electric Power Supply Enterprise ('EPSE') are under MOEP (2). The above structure of MOEP (1) and MOEP (2) has not yet been published in the Myanmar gazette.

Both MOEP (1) and MOEP (2) may administer the Electricity Law and the Electricity Procedures. For entire projects, as discussed in 5(b) above, foreign investment in hydropower projects above must be done through MOEP (1), and power projects relating to natural gas and other sources must be done through the MOEP (2). As a contractor for less than an entire project, the foreign party would deal with the agency or investor as discussed in 5(a), above.

The Procedure by Which a Foreign Investor Would Initiate a Power Project

The following is the basic procedure in connection with initiating an entire power project as discussed in 5(b) above with MOEP (1) or the MOEP (2).

a The foreign company is required to submit a proposal to the proper entity, such as HPID under MOEP (1) or YESB or MEPE under MOEP (2) describing the amount it wishes to

invest, either on a BOT or a JV basis, and the type of power plant it is interested in. For example it might be interested in a hydropower plant, gas turbine, and combined-cycle or coal-fired plant. The foreign company must also mention in the proposal its financial capabilities and experience in the construction, operation and maintenance of similar power plants.

- b The government entity must submit the proposal to MOEP (1) or MOEP (2), depending on the entity, together with its comments thereupon.
- c If MOEP (1) or MOEP (2) considers that the proposal is inappropriate for further submission, MOEP (1) or MOEP (2) will advise the applicant to improve the proposal. If the proposal is agreed on, a draft agreement is negotiated between the relevant government entities such as HPID or YESB under MOEP (1) or MOEP (2), respectively, as discussed above, and the foreign company.
- d The draft agreement agreed by both parties will then be submitted to the Myanmar Office of the Attorney General for its comments.
- e After receiving the comments from the Office of the Attorney General, the proposal and the final draft agreement will be sent to the Myanmar Investment Commission ('MIC'), the body that evaluates proposals under the Myanmar Foreign Investment Law of 1988 ('MFIL') through MOEP (1) or MOEP (2) for approval.
- f Following MIC approval, final, high level governmental approval is required.¹⁷ The procedure for obtaining this approval is not set forth statutorily, but in practice it is the responsibility of MOEP (1) or MOEP (2) to initiate this process. Ultimately, in Myanmar, such an approval is a Cabinet-level decision.
- g If there is high-level government approval of the agreement, the foreign company and the foregoing relevant government entities under MOEP (1) or MOEP (2) sign the agreement. The MIC permit (through which investment incentives, discussed below, are granted) will then be given to the foreign company if operation will be on a BOT basis, and to the joint venture company to be formed if operation will be on a JV basis.
- h The foreign company or the joint venture company to be formed, after obtaining the permit from the MIC, must apply for registration of the foreign company or the joint venture company to the Directorate of Investment and Companies Administration under the Ministry of National Planning and Economic Development.

Incentives for the Foreign Company or the Joint Venture Company

There are incentives under the MFIL for the foreign company or the joint venture company. In general, there is a three-year tax holiday from the date of commencement of commercial operation with the possibility of extension. In addition, the

foreign company or the joint venture company may receive the right to accelerate depreciation, carry forward losses and enjoy exemption or relief from custom duties on capital equipment imported during the start-up phase.¹⁸ There is, moreover, a guarantee against expropriation for MFIL projects.¹⁹

Notes:

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- ¹ *Sustainable Development in the Sectors of Electric Power, Information, Urban and Rural Areas, and Social Welfare*, Printing and Publishing Enterprise, Ministry of Information, First Edition, February 2006, pp 2-13; *Chronicle of National Development Comparison between Period Preceding 1988 and After* (up to 31-12-2005), Printing and Publishing Enterprise, Ministry of Information, March 2006, p 352; *The New Light of Myanmar*, July 30, 2006.
- ² Section 2 of the Electricity Law.
- ³ Section 3(a) of the Electricity Law.
- ⁴ Section 3(b) of the Electricity Law.
- ⁵ The Electric Power Corporation was renamed as MEPE under Government Notification No 2/89 dated March 31, 1989.
- ⁶ Private Enterprise Authority Law, Sections 2(c) and 4. Though the Private Enterprise Authority Law was repealed in 1988, it is still used for the interpretation mentioned in this context.
- ⁷ The duties of electricity rights holders under the Electricity Law are set forth at length in its Sections 14, 15 and 29.
- ⁸ Also see Section 13 of the Electricity Law.
- ⁹ Offences and penalties are provided in the Electricity Law in its Sections 23 through 31.
- ¹⁰ Section 10 of the Electricity Law.
- ¹¹ Section 11 of the Electricity Law.
- ¹² Section 7 of the Electricity Law.
- ¹³ Section 8 of the Electricity Law.
- ¹⁴ Under paragraphs 18(c) and 18(d) of the Electricity Procedures, co-operative societies and private enterprises are entitled to generate up to 750 kilowatts and 300 kilowatts of electricity respectively.
- ¹⁵ The State Electric Power Development Project Leading Committee headed by the Chairman of the State Peace and Development Council, and the State Electric Power Development Project Work Committee headed by the Prime Minister were formed in March 2004 under the State Peace and Development Council Order No 3/2004 in connection with electric power sector, and were reorganized in October 2004 under the State Peace and Development Council Notification No 73/2004.
- ¹⁶ YESB was formed under Notification Nos 11/2006 and 12/2006 dated March 29, 2006 of the MOEP pursuant to the Board of Yangon City Electric Power Supply Law of 2005.
- ¹⁷ Paragraph 4 of the Procedures relating to the SEE Law and paragraph 7 of the Procedures relating to the MFIL.
- ¹⁸ Section 21 of the MFIL.
- ¹⁹ Section 22 of the MFIL.



An Invitation to Join the Inter-Pacific Bar Association

The IPBA is an international association of business and commercial lawyers who reside or have an interest in the Asian and Pacific region. The IPBA has its roots in the region, having been established in April 1991 at an organizing conference in Tokyo that was attended by more than 500 lawyers from throughout Asia and the Pacific. It is now the pre-eminent organization in the region for business and commercial lawyers, with over 1,600 members from 70 jurisdictions.

The growth of the IPBA has been spurred by the tremendous growth of the Asian economies. As companies throughout the region become part of the global economy, they require additional assistance from lawyers in their home country and from lawyers throughout the region. One goal of the IPBA is to help lawyers stay abreast of developments that affect their clients. Another is to provide an opportunity for business and commercial lawyers throughout the region to network with other lawyers of similar interests and fields of practice.

Supported by major bar associations, law societies and other organizations throughout Asia and the Pacific, the IPBA plays a significant role in fostering ties among members of the legal profession with an interest in the region.

IPBA Activities

The breadth of the IPBA's activities is demonstrated by the number of specialist committees overleaf. All of these committees are active and have not only the chairs named, but a significant number of vice-chairs to assist in the planning and implementation of the various committee activities. The highlight of the year for the IPBA is its annual multi-topic four-day conference, usually held in the first week of May each year. Previous annual conference have been held in Tokyo (twice), Sydney (twice), Taipei, Singapore, San Francisco, Manila, Kuala Lumpur, Auckland, Bangkok, Vancouver, Hong Kong, New Delhi, Seoul and Bali, attracting as many as 700 lawyers plus accompanying guests.

The IPBA has organized regional conferences and seminars on subjects such as Practical Aspects of Intellectual Property Protection in Asia (in five cities in Europe and North America respectively) and Asian Infrastructure Development and Finance (in Singapore). The IPBA has also co-operated with other legal organizations in presenting conferences—for example on Trading in Securities on the Internet, held jointly with the Capital Market Forum.

The IPBA also publishes a membership directory and a quarterly *IPBA Journal*.

Membership

Membership in the Association is open to all qualified lawyers who are in good standing and who live in, or who are interested in, the Asia-Pacific region.

- Standard Membership US\$195 / ¥23,000
- Three-Year Term Membership US\$535 / ¥63,000
- Lawyers in developing countries with low income levels US\$ 100 / ¥11,800
- Young Lawyers (under 30 years old) US\$ 50 / ¥6,000

Annual dues will cover the period of one year starting from January 1 and ending on December 31. Those who join the Association before August 31 will be registered as a member for the current year. Those who join the Association after September 1 will be registered as a member for the rest of the current year and for the following year.

Qualified lawyers who attend the IPBA Annual Meeting and Conference and pay the non-member conference fee will be automatically registered as a member for the then current year ending on December 31.

Membership renewals will be accepted until July 31.

Selection of membership category is entirely up to each individual. If the membership category is not specified in the registration form, standard annual dues will be charged by the Secretariat.

Further, in order to encourage young lawyers to join the IPBA, a Young Lawyers Membership category (age under 30 years old) with special membership dues has been established.

IPBA has established a new Three-Year Term Membership category which will come into effect from the 2001 membership year.

There will be no refund of dues for cancellation of all membership categories during the effective term, nor will other persons be allowed to take over the membership for the remaining period.

Corporate Associate

Any corporation may become a Corporate Associate of the Association by submitting an application form accompanied by payment of the annual subscription of (¥50,000/US\$500) for the then current year.

The name of the Corporate Associate shall be listed in the membership directory.

A Corporate Associate may designate one employee ('Associate Member'), who may take part in any Annual Conference, committee or other programs with the same rights and privileges as a Member, except that the Associate Member has no voting rights at Annual or Special Meetings, and may not assume the position of Council Member or Chairperson of a Committee.

A Corporate Associate may have any number of its employees attend any activities of the Association at the member rates.

- Annual Dues for Corporate Associates US\$500 / ¥50,000

Payment of Dues

Payment of dues can be made either in US dollars or Japanese yen. However, the following restrictions shall apply to payments in each currency. Your co-operation is appreciated in meeting the following conditions.

1. A US dollar cheque should be payable at a US bank located in the US. US dollar cheques payable in Japan may be returned to sender depending on charges.
2. A Japanese yen check should be payable at a Japanese bank located in Japan.
3. Japanese yen dues shall apply to all credit card payment. Please note that the amount charged will not be an equivalent amount to the US dollar dues.
4. Please do not instruct your bank to deduct telegraphic transfer handling charges from the amount of dues. Please pay related bank charges in addition to the dues.

IPBA Secretariat

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See overleaf for membership
registration form



IPBA SECRETARIAT

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- Young Lawyers (under 30 years old) US\$ 50 or ¥ 6,000

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