

# Erecting a Body of Construction Law in the People's Republic of China

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As part of its frenetic drive to build a modern infrastructure and transform its cities, the People's Republic of China has been erecting a substantial body of national and local law governing construction-related activities. Although there is no unified construction law as such, China's Ministry of Construction is reportedly formulating legislation concerning the supervision and management of capital construction.<sup>1</sup> Meanwhile, the existing legislation covers the construction process from the project approval stage, through the design and construction tender process and into the stage of management, quality control and implementation of construction, and also treats relevant matters of taxation and finance.

As is true generally of China's burgeoning legislation, much of the relevant construction law is only in Chinese, is contained in local rather than national legislation, and is available only in obscure publications or through involvement in specific projects in the localities concerned. This article is thus an attempt to provide a basic manual on the types of regulations and restrictions that foreign companies should be aware of when undertaking construction projects in China, either as owner-employers or as contractors. The local regulations of Beijing are discussed with particular frequency, since they are generally representative of regulations in force elsewhere in China.

This article also illustrates the bifurcated development of China's economic legislation. Separate rules pertaining only to foreigners frequently are promulgated to replace or supplement domestically applicable legislation, or sometimes to fill a legal vacuum. This

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1. Qin Xiaoli, *State Set to Decentralize Control Over Investment*, China Daily, Aug. 2, 1988.

phenomenon makes the legislative landscape even more complex than usual for the foreigner seeking to do business in China.

## I. THE ADMINISTRATIVE SYSTEM FOR THE CHINESE CONSTRUCTION INDUSTRY AND CONSTRUCTION PROJECTS

The State Planning Commission (the "SPC") and the Ministry of Construction are at the apex of China's administrative hierarchy for construction activities, directly below the State Council. The SPC is involved in the approval and general supervision of construction projects, while the Ministry of Construction formulates specific guidelines for construction activity, such as setting time periods within which various types of projects must be completed and drawing up construction and design standards. It also participates in construction-related planning and supervision, especially that related to public works.<sup>2</sup> Both the SPC and the Ministry of Construction participate in the legislative process relating to construction.

The People's Construction Bank of China (the "Construction Bank") has unified control over and supervises the use of funds designated by plan for approved construction projects. It often participates in the financial aspects of feasibility studies for construction projects. The State Audit Administration and its local branches are responsible for auditing the project proposal, feasibility study, work commencement report and other materials for proposed capital construction projects.

Local planning authorities and numerous municipal government agencies are involved in construction activity as well, as described in more detail *infra*. The local construction commissions, which directly supervise projects within their jurisdictions, are under the local people's governments and participate in formulating detailed regulations to implement the more general legislation issued by the Ministry of Construction.

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2. Article on the Ministry of Construction, Jingji Ribao [Economic Daily], June 9, 1988, at 4. The Ministry of Construction was created in 1988 out of the former Ministry of Urban and Rural Construction and Environmental Protection and several bureaus under the former State Planning Commission, which was simultaneously reorganized and combined with the former State Economic Commission to create the present State Planning Commission. See Article on the New State Planning Commission, Jingji Ribao [Economic Daily], Feb. 8, 1988, at 4. Some of the functions of the State Planning Commission described in this article may have been transferred to the Ministry of Construction.

## II. GENERAL PRINCIPLES OF FOREIGN PARTICIPATION IN CONSTRUCTION

In principle, China welcomes foreign participation in construction projects. However, such participation is subject to the general policies of adhering to the planned economy and giving preference to domestic services, equipment and materials.<sup>3</sup> This means that all projects involving foreign participation must be properly approved and entered into the relevant plans. Moreover, where Chinese companies can perform the necessary work and provide the necessary goods, Chinese services, equipment and materials are to be utilized. According to the rules, foreigners can only participate as owners and contractors in projects that are funded with foreign investment (including projects using World Bank and soft governmental loans) or where there are technical difficulties that Chinese entities are not equipped to handle.

While national rules requiring cooperation between qualified foreign firms and Chinese counterparts exist in the design area (as discussed below), no other *national* legislation in the construction field is applicable specifically to foreign participation. However, in addition to the domestic regulations relating to construction that apply equally to foreign participation, many localities, such as Beijing, Shanghai, Wuhan, Guangzhou, Guangxi, Sichuan, Shanxi and the Shenzhen Special Economic Zone, have promulgated special provisions that outline the qualifications and responsibilities of foreign contractors that undertake projects in China.<sup>4</sup>

Moreover, in addition to construction-specific legislation, national and local regulations concerning environmental protection, safety, labor, cultural relics, insurance, tax, customs, statistical reporting, contracts and foreign investment also apply to the activities of foreign project owners and contractors in China. As a threshold matter, Article 18 of the 1982 Constitution of the People's Republic of China provides that all foreign enterprises and other economic organizations within China must abide by Chinese law and, in return, their lawful rights and interests are entitled to the protection of Chinese law.

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3. Shewai Gongcheng Chengbao Laowu Hezuo de Falu Wenti [Legal Issues in Foreign Contracting and Labor Cooperation] 16, 238-39 (Zhang Shangjin ed., 1988) [hereinafter Legal Issues].

4. Id. at 17.

### III. PROJECT APPROVALS AND STAGES

Pursuant to the 18 September 1984 Interim Provisions on Some Issues in Reforming the Management System of the Building Industry and Capital Construction (the "1984 Reform Provisions"),<sup>5</sup> the State Council attempted to decentralize certain matters, while introducing some discipline into the highly disorganized and inefficient Chinese construction industry. The regulations stipulate that a construction responsibility system called the system of the "five fixings" — fixing the construction scale, total investment amount, construction period, investment results, and conditions for cooperation — is to be enforced and a competitive system of inviting tenders and bidding for projects is to be implemented. In addition, under the contract responsibility system introduced in the early 1980s, owner-employers and contractors are required to enter into construction contracts stipulating such matters as budget, quality and time schedules, which are to be strictly adhered to.

A construction project in China generally goes through numerous stages, which are discussed in order.

#### A. *Approval of Project Proposal and Design Task Report or Feasibility Study*

Approval of a construction project in China generally requires the project owner-employer to formulate a project proposal (*xiangmu jianyi shu*) and a design task report (*sheji renwu shu*). The design task report consists of a detailed design feasibility study and accompanying design charts and drawings.<sup>6</sup> These two documents<sup>7</sup> must normally be

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5. 3 Commercial Laws & Business Regulations of the People's Republic of China 3 (W.W.S. Lo et al. eds., Tai Dao Publishing Ltd. 1985) [hereinafter 3 Commercial Laws]. See also Rules for the Trial Implementation of the Economic Responsibility System in Undertaking Contract Projects of Capital Construction, [2 Business Regulation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶12-580 (Mar. 3, 1983).

6. *Sheji Wenjian de Bianzhi he Shenpi Banfa* [Measures for the Preparation and Examination and Approval of Design Documents] (State Capital Construction Commission, Sept. 15, 1978), 78 *Jianfa Sheji* 410 [hereinafter Design Document Measures] (on file with author).

7. Prior to the simplified procedures adopted in 1984, each large or medium project required initial approval of five documents, the project proposal, feasibility study, design task report, preliminary design and work commencement report, before it could be listed in the long-term plan. *Guanyu Jianhua Jiben Jianshe Xiangmu Shenpi Shouxu de Tongzhi* [Notice Concerning Simplification of the Examination and Approval Procedures for Capital Construction Projects] (State Planning Commission, Aug. 18, 1984), 1984 *Jizi* 1684 [hereinafter Approval Procedure Notice], reprinted in 1 *Chengsha Jianshe Fagui Huibian* [Collection of Legislation on Urban and

approved by the SPC or, if the size of the investment required for the project is less than RMB yuan 30 million, by the local planning authority. The design task report is replaced by the comparable feasibility study (*kexingxing yanjiu baogao*) in the case of a project using foreign capital or technology.<sup>8</sup>

The 1988 Interim Regulations on the Administration of the Construction of Office Buildings, Auditoriums and Guest-Houses (the "Building Construction Regulations")<sup>9</sup> basically govern the construction of all public and commercial structures, other than private residences and manufacturing facilities that are to be constructed on a standard higher than that for "ordinary civilian" structures or where the investment is over RMB yuan 30 million. According to Article 8 of the Building Construction Regulations, the SPC is generally to approve all projects with total investment<sup>10</sup> of over RMB yuan 30 million, after initial review and approval by the local government concerned with the project. However, projects with a total investment of over RMB yuan 200 million must be sent, together with the opinions of the SPC, to the State Council for approval. Proposals for construction of enterprises with foreign investment ("FIEs"), including Chinese-foreign equity and cooperative joint ventures and wholly foreign-owned enterprises, that are subject to the Building Construction Regulations must also first be approved by the Ministry of Foreign Economic Relations and Trade ("MOFERT") or its subordinate local foreign economic relations and trade commissions ("COFERTs"), presumably at the stage where the FIE's feasibility study is approved. This requirement also applies to Chinese-foreign tourist projects with a total investment of less than RMB yuan 30 million.

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Rural Construction] 91 (Beijing Municipal Urban and Rural Construction Commission ed., 1988) [hereinafter Construction Legislation].

8. Qi Tianchang, A Brief Introduction to China's Capital Construction Regulations, Speech Delivered at the Sino-Australian Economic Law Symposium in Beijing (July 1985) (on file with author); see also Approval Procedure Notice, *supra* note 7, art. 3.

9. Loutang Guansuo Jianshe Guanli Zhanxing Tiaoli [Building Construction Regulations] (State Council, Sept. 22, 1988), art. 12, reprinted in Beijing Ribao [Beijing Daily], Sept. 26, 1988 (on file with author). Projects covered by these regulations include tourist hotels and restaurants, office buildings for foreigners, amusement parks, conference halls and auditoriums, hospital wards, high-level dormitories and government office buildings.

10. "Total investment" is defined in article 15 of the Building Construction Regulations as all the funds required for design, survey, land preparation, auxiliary projects required by local governments, interior and exterior decoration, furniture and equipment, and related construction.

Once approval of the project proposal and design task report or feasibility study is given, the project is included in the national or local long-term construction plan. Only then should the detailed design work commence.

#### *B. Site Selection and Site Use License*

If the construction site has not already been selected and allocated by the government (or the use rights sublet from an existing lessee) prior to approval of the project proposal and related documents, a report on the desired project site is to be filed by the owner-employer, which is generally referred to in the relevant legislation as the "construction unit" (*jianshe danwei*). The construction unit will often work on this report together with the survey and design units that are retained for the project. The report must be approved by the municipal or other local planning department and the local people's government.

In Beijing, for example, unless it already has use rights for the desired site, the construction unit must apply first for a construction address, obtaining the approval of the Beijing Municipal Urban Planning Bureau (which reportedly is under the Municipal Planning Commission) as well as other "departments concerned" that must be involved in the site allocation process.

If no objections to the proposed site are raised, a site use license application must then be submitted to the Urban Planning Bureau, which will issue the license jointly with the Beijing Municipal Land Use Bureau, after having reported the matter to the Beijing Municipal Government for final approval.<sup>11</sup> Construction must be commenced within two years of issuance of the license, or else the land may be reallocated for other purposes.<sup>12</sup>

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11. Beijingshi Chengshi Jianshe Gongcheng Guihua Guanli Shenpi Chengxu Zhanxing Banfa [Interim Measures of Beijing Municipality on Procedures for the Administration, Examination and Approval of Urban Construction Project Plans] (Oct. 1, 1987), arts. 3, 4 [hereinafter Beijing Construction Approval Measures], reprinted in Beijing Ribao [Beijing Daily], Sept. 27, 1987, at 2 (on file with the author).

12. Beijingshi Chengshi Jianshe Guihua Guanli Zhanxing Banfa [Interim Measures of Beijing Municipality on the Administration of Urban Construction Planning] (Feb. 10, 1984), art. 10(3), reprinted in Beijing Ribao [Beijing Daily], Feb. 24, 1984, at 2 (on file with author).

### C. Design Work and Budgetary Estimate

After the design task report is approved and the site use license is issued, a design unit (which may be the same one that was engaged to draw up the design task report) is to be entrusted with preparing the detailed design documents, based on the design task report. The design unit or the construction unit can also then enter into a survey contract with a qualified surveyor to survey the site.<sup>13</sup>

#### 1. Design Process

Normally, designs are made in two stages, the preliminary design (*chubu sheji*) and the working drawing design (*shigong tu sheji*),<sup>14</sup> and a general budgetary estimate (*zong gaisuan*) based on the design must be formulated. After approval by the relevant "departments in charge," the design documents and budget are to be reported to the SPC for the record, and any amendments to the design documents must be approved by the original design unit.

In Beijing, for example, the relevant departments for approving preliminary designs include the local governmental subdivision involved and the zoning, environmental, fire protection and construction industry departments.<sup>15</sup> Design conditions and a design plan, together with the general budgetary estimate, must be submitted to and approved by the Beijing Municipal Urban Planning Bureau<sup>16</sup> (which also coordinates with utilities and materials supply agencies), the Construction Bank as to budgets, environmental protection agencies and other relevant units. The Bureau has two to six weeks from the receipt of certain stipulated

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13. See Jianshe Gongcheng Kancha Sheji Hetong Tiaoli [Regulations on Exploration and Design Contracts for Construction Projects] (State Council, Aug. 8, 1983), translated in *Contract Laws of the People's Republic of China* 113 (Jerome A. Cohen ed., Longman Group (F.E.) Ltd. 1988) [hereinafter *Contract Laws*].

14. Design Document Measures, *supra* note 6.

15. Guanyu Gaibian Jianshe Gongcheng Chubu Sheji Jihua Deng Shenpi Quanxian de Tongzhi [Notice Concerning Modification of the Limits of Authority for Examining and Approving the Preliminary Design for Construction Projects] (Beijing Municipal Urban and Rural Construction Commission, Sept. 18, 1984) (effective Oct. 1, 1984), 84 *Jingjianzi* 347 [hereinafter *Beijing Preliminary Design Notice*], reprinted in 1 *Construction Legislation*, *supra* note 7, at 382.

16. Beijing Construction Approval Measures, *supra* note 11, arts. 2, 5, 6.

charts, blueprints, documents and other materials to issue a notice approving or requesting modifications to the design plan.<sup>17</sup>

In general, preliminary designs for industrial projects with an investment of not more than RMB yuan 3 million and non-industrial projects with an investment of not more than RMB yuan 5 million located in the city proper may be approved by the relevant municipal departments and reported to the Municipal Construction and Planning Commissions for the record.<sup>18</sup> Designs for larger projects must be approved by the Municipal Planning and Construction Commissions and sent to the SPC for the record.

A construction project can be listed in the annual plan only after the preliminary design and general budgetary estimate are approved. A construction project license (*jianshe gongcheng xukezheng*) may be issued and construction actually begun only after inclusion of the construction project in the annual plan has been approved.

## 2. Selecting a Design Unit

Qualified Chinese surveyors and design institutes must normally be employed on all construction projects in China. Such units or institutes may be associated with universities or organized by the municipalities, under the local construction and planning authorities. Some are established locally under the China State Construction Engineering Corporation. Such entities must possess certificates of qualification as project surveyors or designers, and are graded according to the nature of their expertise and other qualifications.<sup>19</sup> According to some local

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17. Beijingshi Guanyu Shending Chengshi Jianshe Gongcheng Sheji Fangan he Hefa Jianshe Gongcheng Xukezheng Gongzuo Zhouqi de Guiding [Provisions of Beijing Municipality on the Work Cycle for the Examination and Confirmation of Municipal Construction Project Design Plans and the Examination and Issuance of Construction Project Licenses] (effective Oct. 1, 1987), art. 2 [hereinafter Beijing Work Cycle Provisions], reprinted in Beijing Ribao [Beijing Daily], Sept. 27, 1987, at 2 (on file with author).

18. Beijing Preliminary Design Notice, *supra* note 15, art. 1(1).

19. See, e.g., Quanguo Gongcheng Kancha Sheji Danwei Zige Renzheng Guanli Zhangxing Banfa [Interim Measures on the Administration of Qualification Certificates for Nationwide Survey and Design Units] (State Planning Commission, June 30, 1986), 1986 Jishe 1137, reprinted in 1 Construction Legislation, *supra* note 7, at 395.



regulations, all survey work must be conducted by Chinese surveyors and may not be contracted to foreign firms.<sup>20</sup>

In Shanghai, most design work is required to be put to tender, which represents a trend started by a 1984 SPC document advocating increased competition to stimulate quality work in the design area.<sup>21</sup> The 1988 Interim Provisions of Shanghai Municipality on the Administration of the Invitation and Submission of Tenders for Construction Project Design Work<sup>22</sup> provide that the design of all new projects having a total investment of RMB yuan 30 million and above must be put out to tender.

The Shanghai Municipal Construction Commission is to "lead" the tender process, but the actual work is organized and carried out by the Shanghai Municipal Office for the Administration of the Invitation and Submission of Tenders for Construction Projects, which charges a fee equal to 0.2 percent of the total investment of the project. The tenders may be sought through open invitation, by selective invitation to no less than three design units or through designation by the Municipal Construction Commission of several units to participate.

Beijing apparently has not promulgated any comparable provisions but requires the use of a tender process for selection of the project designer on projects with a "relatively large investment."<sup>23</sup>

### 3. Engaging a Foreign Design Firm

Project designs must often not only meet local design, technical, environmental and safety standards, but must comply with international norms as well. Foreign design firms may be hired only where it is

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20. See, e.g., *Shanghaishi Guowai Sheji Shigong Danwei Chengjio Jianshe Gongcheng Guanli Guiding* [Shanghai Municipal Regulations on the Administration of Construction Projects Undertaken by Foreign Design and Construction Units] (Jan. 1, 1986), art. 8 [hereinafter *Shanghai Construction Regulations*] (on file with author).

21. *Guojia Jihua Weiyuanhui Guanyu Gongcheng Sheji Gaige de Jidian Yijian* [Several Views of the State Planning Commission on the Reform of Construction Design] (State Council, Nov. 10, 1984), 1984 *Guofa* 157, reprinted in 1984 *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* [State Council Gazette of the People's Republic of China] 961.

22. *Shanghaishi Jianshe Gongcheng Sheji Zhaobiao Toubiao Guanli Zhanxing Banfa* [Interim Provisions of Shanghai Municipality on the Administration of the Invitation and Submission of Tenders for Construction Project Design Work] (Oct. 28, 1988) (effective Jan. 1, 1989) (on file with author).

23. *Beijingshi Guanyu Guowai Sheji Danwei Zai Benshi Chengdan Jianshe Gongcheng Sheji Guanli de Guiding* [Provisions of Beijing Municipality on the Administration of Foreign Design Firms that Undertake Construction Design Projects in Beijing] (Oct. 1, 1990) (on file with author).

established that a Chinese design firm could not handle the work or where the project is foreign-funded. Moreover, any Chinese entity or FIE that wishes to engage a foreign design firm to meet its special requirements must also hire a Chinese design unit to work with such firm, pursuant to the Interim Provisions on the Chinese-Foreign Cooperative Design of Engineering and Construction Projects (the "Cooperative Design Provisions"), issued by the SPC and MOFERT on 5 June 1986.<sup>24</sup>

Foreign participation in design work must normally be approved at the time the project proposal or design task report is approved. The Cooperative Design Provisions stipulate that foreign participation in small-scale projects is to be approved locally, the SPC is to approve such participation in medium to large-scale projects, and the State Council is to have the final say with respect to projects that are "especially large-scale." In addition, the foreign design firm must be found to be qualified by the government department in charge of the project or construction unit, both in the country from which it comes and in respect of general technical expertise relating to the project at hand.

Local legislation sheds further light on the foreign design process. In Shanghai,<sup>25</sup> for example, the Shanghai Foreign Economic Relations and Trade Commission ("SMERT") and the Municipal Construction Commission, together with the department in charge of the Chinese party in the case of a project being contracted by a FIE, must all approve an application for a foreign design firm's participation in a project. The firm must then obtain a design license from the Construction Commission and also register as a foreign contractor with China's National Administration of Industry and Commerce, pursuant to the Notice of the State Administration of Industry and Commerce Concerning the Question of Registering Foreign Companies that Come to Our Country to Cooperate in Development and Contract for Projects (the "Foreign Contractor Notice").<sup>26</sup> Only after the design license is

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24. Interim Provisions on the Chinese-Foreign Cooperative Design of Engineering and Construction Projects [hereinafter Cooperative Design Provisions], [2 Business Regulation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶19-516 (June 5, 1986).

25. Shanghai Construction Regulations, *supra* note 20.

26. These regulations are translated as, "Notice of the State Administration of Industry and Commerce Concerning the Question of Registering Foreign Companies that Come to Our Country to Cooperate in Development and Contract for Projects," [Business Regulation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶6-580(2) (Mar. 12, 1983).

obtained can a general design contract with a foreign design firm be signed.

Beijing issued provisions in 1990 on foreign design firms that follow the national Cooperative Design Provisions. Under the Beijing provisions,<sup>27</sup> the Beijing Municipal Survey and Design Administrative Office is responsible for investigating the qualifications of foreign design firms that wish to contract for projects in that city and issuing project design licenses. The Beijing rules also stipulate that, in addition to paying Chinese taxes, foreign design firms are also subject to a 0.5 percent design quality supervision fee, to be deducted from the design fee paid by the construction unit.

The general design contract with a foreign design unit must be in writing and contain the standard information on names and rights and obligations of the parties, breach of contract penalties and the like that are required by the 1985 Law of the People's Republic of China on Economic Contracts Involving Foreign Interests,<sup>28</sup> as well as local regulations such as those applicable to foreign design firms in Shanghai and Beijing described above. This contract must also be approved as a form of technology import contract by MOFERT, its subordinate local COFERTs or other designated authorities.<sup>29</sup> For this purpose, the contract should be submitted to the appropriate approval authority within 30 days of signature and is to be approved or rejected within 60 days of receipt. The contract may also be required under local regulations to be

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27. Provisions of Beijing Municipality on the Administration of Foreign Design Firms that Undertake Construction Design Projects in Beijing, *supra* note 23.

28. The Law of the People's Republic of China on Economic Contracts Involving Foreign Interests (July 1, 1985), translated in *Contract Laws*, *supra* note 13, at 165; see also *Regulations on Exploration and Design Contracts for Construction Projects*, translated in *Contract Laws*, *supra* note 13, at 113 (calling for a 20 percent deposit of the design fee).

29. *Regulations of the People's Republic of China for the Administration of Technology Import Contracts* (State Council, May 24, 1985), art. 2, reprinted in [1 Business Regulation] *China Laws for Foreign Business* (CCH Austl. Ltd.) § 5-570; *Rules for the Implementation of the Regulations of the People's Republic of China for the Administration of Technology Import Contracts* (MOFERT, Jan. 20, 1988), art. 2, reprinted in [1 Business Regulation] *China Laws for Foreign Business* (CCH Austl. Ltd.) § 5-573. Under the Beijing Provisions on the Administration of Foreign Design Firms that Undertake Construction Design Projects in Beijing, *supra* note 23, both the cooperative design contract and the main design contract between a foreign design firm and a construction unit must be approved by the Beijing Foreign Economic Relations and Trade Commission. Pursuant to the Shanghai Construction Regulations, *supra* note 20, the general design contract must be approved by SMERT, but the Shanghai legislation does not address approval requirements for the cooperative design contract.

filed "for the record" (*beian*) with one or more local governmental agencies.

The foreign design firm and the cooperating Chinese firm must also sign a cooperative contract specifying their respective rights and obligations, the sharing of fees and the like,<sup>30</sup> although a three-party contract among the FIE, the foreign design firm and the Chinese design firm is also possible.

The requirement that local designers participate in such projects stems in part from the recognition that designs must take into account the local availability and quality of materials, equipment, labor and plant as well as local standards. In part, however, this requirement is intended to help improve the standards of local architecture and engineering, which are acknowledged by the Chinese to be some ten to twenty years behind those of industrialized countries in many respects.

#### *D. Project Audit*

The precise timing of the audit of projects prior to approval for the commencement of work is not clear from the relevant regulations. However, according to local regulations issued in Beijing pursuant to the Building Construction Regulations,<sup>31</sup> all foreign-invested tourist hotels, projects undertaken by units under the central government and municipal projects with a total investment of RMB yuan 30 million or more are to be audited by the State Audit Administration itself. The auditors examine the project proposal, feasibility study, preliminary design and related materials, required approval documents, evidence that the project has been listed in the capital construction plan, the source of funds for the project, arrangements for such funds and evidence that they have been deposited into a special account with the Construction Bank.

Smaller projects are to be audited by the audit bureau under the competent local people's government at the provincial, autonomous regional or municipal level.

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30. Legal Issues, *supra* note 3, at 242; Cooperative Design Provisions, *supra* note 24, art. 5.

31. Beijingshi Loutang Guansuo Jianshe Xiangmu Kaigong Qian Shenji Zhanxing Guiding [Interim Provisions of Beijing Municipality on Auditing Prior to Commencement of Work on Construction Projects for Office Buildings, Auditoriums and Guest-Houses] (July 21, 1989) (effective Aug. 1, 1989), reprinted in Beijing Ribao [Beijing Daily], Aug. 13, 1989, at 2.

The audit process also includes audit of a project commencement report, prior to its submission to the relevant authorities for approval of the construction license.

#### *E. Project Commencement Report and Construction License*

All projects governed by the Building Construction Regulations must prepare, and have audited and approved, a project commencement report (*xiangmu kaigong baogao*).<sup>32</sup> Projects with a total investment of RMB yuan 30 million or more are to be examined by the SPC in July and August of each year and then submitted to the State Council for final approval. Smaller projects are to be examined and approved by the "departments concerned" or the relevant provincial, autonomous regional or special municipal people's governments during the same time frame and then submitted to the SPC for the record. The SPC then has two months in which to raise any objections to the approved projects. Finally, all projects to be built in the Beijing area are to be submitted to the State Council for approval after initial examination and approval by the Beijing Municipal Planning and Construction Commissions.

After a project is properly approved and included in the annual plan, and before a contractor can be engaged, the construction unit must obtain a construction project license (*jianshe gongcheng xukezheng*) from the local planning authority. In Beijing, this license is to be issued by the Urban Planning Bureau.<sup>33</sup>

#### *F. Inviting Construction Tenders*

Absent special approval, the selection of a general contractor for a construction project must normally be made through an invitation for tenders, pursuant to the 1984 Reform Provisions, as well as national and local rules. Before inviting tenders, the construction unit must have received its site use license and construction project license.

The Interim Provisions on the Invitation and Submission of Tenders for Construction Projects,<sup>34</sup> issued jointly by the SPC and the

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32. Beijing Construction Regulations, *supra* note 9, arts. 7, 12.

33. See Beijing Construction Approval Measures, *supra* note 11, art. 4; Beijing Work Cycle Provisions, *supra* note 17, art. 3.

34. Jianshe Gongcheng Zhaobiao Toubiao Zhanxing Guiding (issued jointly by the State Planning Commission and the former Ministry of Urban and Rural Construction and Environmental Protection, Nov. 20, 1984) (on file with author).

forerunner to the Ministry of Construction, stipulate that most qualified state-owned or collective entities can participate in such tenders, regardless of where they are from or under which department they are organized. Foreign and Chinese-foreign joint venture construction companies, however, are subject to special rules, as discussed below. As a practical matter, local tender offices generally tend to favor entities from within their own jurisdiction, and the selection of an outside firm (whether foreign or from another area in China) may require a good deal of persistence and persuasion. Construction-related tenders are to include bidding for every stage from the project proposal, survey and design and supply of materials to the actual construction.

The national guidelines are fleshed out in detail in local tender rules, which are substantially the same in China's major cities, such as Beijing, Shanghai and Tianjin. The Beijing rules will be discussed here.

Pursuant to the 1987 Interim Measures of Beijing Municipality on the Administration of the Invitation and Submission of Tenders for the Construction of Building Projects<sup>35</sup> (the "Beijing Tender Measures"), unless the Beijing Municipal Construction Commission grants special approval to the contrary, all projects listed in Beijing's annual capital construction plan that cover more than 2000 square meters or have an investment of RMB yuan 500,000 or more must go through a tender solicitation process. All construction firms within Beijing that have valid business licenses and all Chinese construction firms from outside of Beijing that have special tender permits<sup>36</sup> are eligible to participate in the process. In addition, if the construction unit obtains approval pursuant to the Provisional Regulations of the Beijing Municipal People's Government on the Control of Construction Projects Undertaken in Beijing by Foreign Construction Enterprises (the "Beijing

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35. Beijingshi Jianshe Gongshe Shigong Zhaobiao Toubiao Guanli Zhanxing Banfa (Beijing Municipal Government, Nov. 1, 1987), reprinted in Beijing Ribao [Beijing Daily], Nov. 8, 1987, at 4 (on file with author).

36. See Beijingshi Renmin Zhengfu Guanyu Waidi Jianzhu Qiye Lai Jing Shigong Guanli Zhanxing Guiding [Interim Provisions of the Beijing Municipal Government on the Administration of Construction Enterprises from Outside the Area that Come to Beijing to Build Projects] (July 1, 1988) [hereinafter Outside Enterprise Construction Provisions], reprinted in Beijing Ribao [Beijing Daily], Aug. 7, 1988, at 2 (on file with author). These provisions technically also cover foreign construction firms from outside China.

Foreign Construction Provisions”),<sup>37</sup> foreign construction firms may also submit tenders, as discussed below.

The Beijing Tender Measures stipulate that the construction unit must apply to the Beijing Municipal Office for the Administration of the Invitation and Submission of Tenders for Construction Projects, under the Municipal Construction Commission (the “Tender Office”), for approval to invite tenders openly or selectively. In the case of selective bidding, invitations must be sent to at least four qualified contractors. With special approval, as few as two contractors can be invited to submit proposals, and the Municipal Construction Commission may, under unspecified special circumstances, permit the tender process to be dispensed with altogether.

After the bidders have been qualified, a meeting is to be held to distribute the tender documents, which are compiled by the construction unit and approved by the “relevant departments.”<sup>38</sup> Normally, the period between the distribution of the tender documents and the opening of the sealed tenders is not to exceed one month but, in the case of medium and large projects, the period may be extended to two months.

The construction unit determines the floor price and submits it for approval to the Municipal Construction, Installation and Public Works Project Contract and Budget Examination Office (the “Budget Examination Office”). The floor price is then reported on a confidential basis to the Tender Office for verification and final approval.

The sealed bids are opened in the presence of an evaluation committee composed of representatives from the Tender Office, the Construction Bank, a public notary's office and the construction unit. In general, the period for selecting the successful bidder should not exceed fifteen days, and a construction contract between the construction unit and the successful bidder should be signed within one month of announcement of the outcome of the tender process.

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37. Provisional Regulations of the Beijing Municipal People's Government on the Control of Construction Projects Undertaken in Beijing Municipality by Foreign Construction Enterprises, [2 Business Regulation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶19-544(4) (Dec. 3, 1987).

38. Legal Issues, *supra* note 3, at 253.

### G. *Qualification of Foreign Contractors*

Although many localities have published regulations governing the undertaking of construction projects by foreign contractors, no national legislation in this area yet exists.<sup>39</sup> The Beijing Foreign Construction Provisions are fairly typical of the existing local legislation on point. Under those provisions, a construction unit (including an FIE) may in certain circumstances invite a foreign construction company to participate in the tender process for a project or, with special approval, to be engaged without having to go through such a process. Projects covered by the Provisions include construction of new buildings, fitting of room interiors, equipment installation and municipal works projects, whether undertaken solely or in cooperation with a domestic Chinese entity, and whether as the general contractor or a subcontractor. However, a foreign contractor may be engaged only if the project is entirely funded with foreign investment or donated funds or is a project that would present “technical difficulties to a domestic enterprise if undertaken by itself.”<sup>40</sup>

The engagement or invitation of a foreign contractor must be approved first by the department in charge of the construction unit and then by the Municipal Construction Commission, which must also verify the qualifications of the foreign contractor. Unless the project approval document issued by the Municipal Construction Commission expressly states that tenders need not be solicited, foreign contractors will have to go through a tender process as outlined above.

Any foreign contractor that has been selected pursuant to direct engagement or tender must then obtain a foreign construction enterprise project contracting license (*waiguo jianzhu qiye chengbao gongcheng xukezheng*). This license is issued by the Municipal Construction Commission based on its approval of documentation, including a report from the construction unit and a business license from the foreign firm's home jurisdiction, financial information, descriptions of the personnel and equipment to be provided by the contractor and resumes of personnel to be in charge of the project. Only after obtaining such a license can the foreign contractor sign a construction contract with the construction unit.

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39. Id. at 249-50.

40. Beijing Foreign Construction Provisions, *supra* note 37, art. 2.



The foreign contractor must further submit a copy of the construction contract to the Budget Examination Office for examination of the budgeted costs of the project. It would appear that this step can be dispensed with if the foreign contractor has already gone through the tender process. In addition, a foreign contractor apparently must pay an administrative fee to the Municipal Construction Industry Administrative Office, the amount of which depends on the manner in which it is to be compensated.<sup>41</sup>

Finally, the signed construction contract must be approved by the Beijing Foreign Economic Relations and Trade Commission (unless the project was originally approved by MOFERT, in which case MOFERT is to approve the contract). After approval, the foreign contractor must then register with the State Administration of Industry and Commerce or the Beijing branch thereof pursuant to the Foreign Contractor Notice and obtain a foreign contractor registration certificate, which will be valid for the duration of the project.<sup>42</sup>

## H. Construction

### 1. Construction Commencement Certificate

In Beijing, after obtaining the construction project license and making all other necessary arrangements to begin work, the construction unit must then apply for a construction project commencement certificate (*jianshe gongcheng kaigongzheng*) from the Municipal Construction Commission.<sup>43</sup> Before this certificate is issued, the Commission must be satisfied that the project has been included in the annual municipal

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41. Outside Enterprise Construction Provisions, *supra* note 36, art. 8.

42. The Foreign Contractor Notice, *supra* note 26, and the explanation thereof issued May 4, 1983 (on file with the author) actually specify that a "foreign contractor" (*waiguo hetongzhe*), which is defined to mean a foreign company, including a foreign general contractor (*waiguo zong chengbaozhe*) that signs a contract with the head office of a Chinese company, is to receive a business license (*yingye zhizhao*). A "foreign subcontractor" (*waiguo chengbaozhe*), which is defined to mean a foreign company that signs a contract with a foreign contractor, is to receive a registration certificate (*dengji zheng*). Thus, there seems to be some confusion about the status of foreign construction contractors in the Foreign Construction Provisions. One would think they should be given business licenses.

43. See Beijingshi Jianshe Gongcheng Kaigong Guanli Zhanxing Banfa [Interim Provisions of Beijing Municipality on the Administration of the Commencement of Work on Construction Projects] (Beijing Municipal Government, Dec. 1, 1989), reprinted in Beijing Ribao [Beijing Daily], Dec. 3, 1989, at 2 (on file with author).

plan; the site has been cleared and prepared;<sup>44</sup> necessary funds, materials, equipment and utilities have all been arranged; the working drawing design has been prepared by a qualified design firm; the construction project license has been issued; the contractor has already been confirmed through bidding; the higher level department in charge has approved the arrangements; construction fees have been paid; and any other conditions have been met. After obtaining the certificate, the construction unit and the contractor must both register at the county or district construction commission office where the project is located, which office will also be responsible for supervising the construction process.

Lastly, the construction unit must notify the contractor to erect a billboard (setting forth the name of the project, the license-issuing authority and date and number of the construction project license) at the construction site before any work begins.<sup>45</sup>

## 2. Materials Supply

Most municipalities have a construction bureau or commission, which supervises a number of construction and construction-related companies and organizations, such as building materials suppliers and mechanical and electrical installation companies. The 1984 Reform Provisions stipulated that each department and region was to establish independent project contracting companies, which are to compete for projects across regional boundaries.

Capital construction materials are supplied according to the state plan, pursuant to supply contracts signed between the materials supplier and the contractor and/or the construction unit.<sup>46</sup> Materials suppliers are under the direction of the Ministry of Materials and Equipment. Key projects whose construction is organized by the State are to be contracted to the China Capital Construction Materials Contracting Joint Company, while key projects in the various provinces, autonomous regions and special municipalities should be contracted to similar local companies. Materials that are not covered by the state plan may be

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44. Cf. *Chengshi Fangwu Chaqian Guanli Tiaoli* [Administrative Regulations on the Demolition and Removal of Urban Buildings] (State Council, June 1, 1991), reprinted in *Fazhi Ribao* [Legal Daily], Apr. 15, 1991, at 4.

45. *Beijing Construction Approval Measures*, *supra* note 11, art. 7(2).

46. *Id.* art. 10.

supplied by materials suppliers or purchased on the market directly by the contractor or the employer.

### 3. Foreign Contractors

Pursuant to the Beijing Foreign Construction Provisions, a foreign contractor is to observe Chinese construction specifications and quality standards and accept supervision by the municipal project quality supervisory authorities.<sup>47</sup> If the project requires adoption of foreign construction specifications and quality standards, these must be presented, in Chinese, to the quality supervisory authorities before construction begins.<sup>48</sup>

Chinese subcontractors to be employed by a foreign contractor must be approved by the construction unit and the Municipal Construction Commission, and any proposed foreign subcontractors must go through the same qualification process as foreign general contractors.<sup>49</sup> The Beijing Foreign Construction Provisions imply that all engineering services must be supplied by Chinese companies, and all engineering and other service personnel to be hired in China must be recruited through the municipal Foreign Enterprise Service Corporation (FESCO).<sup>50</sup>

#### I. Acceptance and Handover

The final stage of construction procedures is the acceptance and turning over (*gongcheng jiaogong*) of the project. Key projects are to be accepted under the supervision of the SPC or State Council, while others may be accepted at local levels, depending on the size and importance of the project.<sup>51</sup> In Beijing, checking and acceptance are to be carried out by the Urban Planning Bureau. Normally, the design unit and

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47. See Beijingshi Jianshe Gongcheng Zhiliang Guanli Jiandu Banfa (Shixing) [Measures for Trial Implementation of Beijing Municipality on the Administration and Supervision of the Quality of Construction Projects] (Oct. 1, 1985), reprinted in Beijing Ribao [Beijing Daily], Oct. 8, 1985, at 2 (on file with author).

48. Beijing Foreign Construction Provisions, *supra* note 37, art. 9.

49. *Id.* art. 10.

50. *Id.* art. 11.

51. Guanyu Jiben Jianshe Xiangmu Jungong Yanshou Zhanxing Guiding [Interim Provisions Concerning the Completion and Acceptance of Capital Construction Projects] (State Capital Construction Commission, Aug. 21, 1973), art. 4 (on file with author).

contractor are to carry out a preliminary check, which will be given to and preserved by the construction unit.

After acceptance and handover, the contractor remains liable for any accidents due to quality problems and for quality defects generally, pursuant to the Measures (For Trial Implementation) on the Guarantee of Repair of Construction Projects.<sup>52</sup> The guarantee period for most civilian and public construction projects is one year from handover. In the case of foreign contractors, the construction unit is to deduct when settling accounts an amount to cover "project insurance" equal to 0.5 percent of the construction cost, which amount is to be refunded at the end of the applicable guarantee period, if no issues over quality have arisen.<sup>53</sup>

#### IV. CONSTRUCTION CONTRACTS

Domestic construction contracts, including those between FIEs (which are Chinese legal persons) and Chinese construction and service companies, are governed generally by the Economic Contract Law of the People's Republic of China<sup>54</sup> and the more specific Regulations on Contracts for Building and Installation Work (the "Construction Contract Regulations").<sup>55</sup> In addition, many localities such as Beijing have adopted their own standard form construction contracts, which they may insist on using, or at least incorporating into the final construction contract. However, some foreign construction companies have been successful in concluding contracts with Chinese entities based on the standard contract formulated by the International Federation of Engineers (the "FIDIC IV Contract"), which has also been translated into Chinese.

While Article 17 of the Construction Contract Regulations stipulates that the Regulations are not to apply to "contracts involving foreign interests," in the absence of any other specific regulations on point,<sup>56</sup>

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52. Jianzhu Gongcheng Baoxiu Banfa (Shixing) (Ministry of Urban and Rural Construction, Mar. 3, 1984), 84 *Chengjianzi* 79, reprinted in 2 *Construction Legislation*, supra note 7, at 348.

53. Beijing Foreign Construction Provisions, supra note 37, art. 12.

54. The Economic Contract Law of the People's Republic of China (July 1, 1982), translated in *Contract Laws*, supra note 13, at 49; see especially articles 18 and 39.

55. Regulations on Contracts for Building and Installation Work (Aug. 8, 1983), translated in *Contract Laws*, supra note 13, at 116.

56. The Law of the People's Republic of China on Economic Contracts Involving Foreign Interests, supra note 28, does not address particular types of contracts but establishes general principles.

it can be assumed that at least the general principles enunciated in those Regulations may be applied to construction contracts entered into with foreign construction companies.

The Construction Contract Regulations stipulate that a construction contract must be entered into between legal persons with the capacity to perform the contract and must be reduced to writing. Before a contract is concluded, the preliminary design and total estimated budget should be approved, and the funds and centrally-allocated goods and materials required for the project should be entered into the state plans. The parties may first sign a general contract, to be followed by subcontracts between themselves or with third parties covering specific work. If the contractor acts as general contractor and enters into subcontracts with other entities, Article 12 of the Regulations makes clear that the general contractor is liable to the employer for work performed pursuant to the subcontracts. The contractor is also prohibited from attempting to make a profit on the awarding of subcontracts.

In general, the Construction Contract Regulations specify that the construction unit or employer is responsible for: obtaining and preparing the construction site; providing the design, utilities and road connections; handling the funds and accounts; sending a representative to be stationed at the site; arranging inspection and acceptance of intermediate construction work, as well as the final acceptance; and generally carrying out its responsibilities as assigned in the contract.

Under the Construction Contract Regulations, the contractor is, unless otherwise agreed by the parties, to carry out construction; procure and manage materials and equipment as provided in the contract; notify the employer of the construction progress schedule and of the commencement of work; provide monthly construction statistics and reports; provide periodically required reports on such matters as the completion of concealed construction work; ensure the quality of construction; and hand over the work on schedule.

In Beijing, the Budget Examination Office and the Beijing Municipal Administrative Bureau for Industry and Commerce have formulated a standard Contract for the Construction and Installation of Public Works (the "Beijing Standard Contract"),<sup>57</sup> which implements the general provisions of the Construction Contract Regulations and

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57. On file with author.

which is to be used for virtually all construction projects in Beijing.<sup>58</sup> The Beijing Standard Contract contains brief articles describing the scope of the project, the construction period, arrangements for the supply of goods and materials, project cost, methods for carrying out construction and design changes, procedures for inspection and acceptance of completed work and for guarantee by the contractor of repair, and the parties' respective responsibilities. The Contract is to be effective upon signature, but then must be examined and "acknowledged" by the Budget Examination Office before any Chinese bank can extend credit for the project.

In some localities, a copy of the signed construction contract (and any amendments thereto) is to be filed for the record with the local administrative bureau for industry and commerce.<sup>59</sup> One Chinese source reports that construction contracts involving FIEs or foreign construction companies must be approved by MOFERT or other designated approval authority.<sup>60</sup> Although this is true in Beijing,<sup>61</sup> such approval does not appear to be universally required.

To the Western eye, the Beijing Standard Contract is overly simplistic and lacking in necessary detail, such as definitions of the work to be performed, practical completion date, payment provisions, insurance requirements, performance bonds, force majeure, termination provisions and so forth. In some transactions, however, the Beijing authorities have permitted the parties to supplement the Beijing Standard Contract with a much more detailed contract that was referred to therein and appended thereto.

In Beijing and elsewhere in China, FIEs and foreign construction companies have been quite successful in using or adapting standard forms in use in Hong Kong and other areas outside China, such as the FIDIC IV Contract. The diversity of provisions required by different projects and the introduction of foreign companies into the socialist

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58. Jianzhu Anzhuang Gongcheng Chengbao Hetong Beian Shishi Banfa (Shixing) [Implementing Measures on Filing for the Record of Contracts for the Contracting of Construction and Installation Projects (For Trial Implementation)] (Beijing Municipal Capital Construction Commission and the Beijing Municipal Administrative Bureau for Industry and Commerce, Feb. 7, 1984), 84 *Jingjianzi* 28, art. 1 [hereinafter *Beijing Contract Filing Measures*], reprinted in 1 *Construction Legislation*, *supra* note 7, at 498.

59. *Id.* arts. 2, 6.

60. *Legal Issues*, *supra* note 3, at 255.

61. *Beijing Foreign Construction Provisions*, *supra* note 37, art. 6.

construction system necessitate flexibility on the part of the Chinese contract-approving authorities.

## V. TAXATION

Within thirty days after commencing work in the case of a foreign design firm, and fifteen days after having obtained its foreign contractor registration certificate in the case of a foreign contractor, a foreign company must register with the local tax bureau to pay certain Chinese taxes. These consist of the aggregate thirty-three percent Foreign Investment Enterprise and Foreign Enterprise Income Tax on net income<sup>62</sup> and the Consolidated Industrial and Commercial Tax ("CICT"), which is imposed on construction, design and contracting enterprises at the rate of three percent of gross revenue (usually the contract price, as the same may be adjusted by the parties, less any amounts paid to subcontractors and certain amounts paid for equipment purchased for the project).<sup>63</sup> In addition, the Vehicle and Vessel Usage Tax must be paid on means of transportation used by the project.<sup>64</sup>

In Beijing, the Interim Measures of Beijing Municipality for Administration of the Taxation of Foreign Construction Enterprises that Contract for Construction Projects,<sup>65</sup> which summarize and consolidate in one piece of legislation the basic tax registration and calculation requirements contained in the relevant tax legislation, must also be complied with. For example, those measures provide that, unless a

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62. Income Tax Law of the P.R.C. Concerning Enterprises with Foreign Investment and Foreign Enterprises art. 5, translated in Timothy A. Gelatt, *China's New Tax Law for Foreign Business: A Rational System Emerges*, E. Asian Exec. Rep., May 15, 1991, at 9, 25.

63. Regulations of the Consolidated Industrial and Commercial Tax of the People's Republic of China (Draft), [Taxation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶31-500 (Sept. 11, 1958); Detailed Rules and Regulations for the Implementation of the Regulations of the Construction Industry and Commercial Tax of the People's Republic of China (Draft), [Taxation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶31-510 (Sept. 13, 1958); see also Ministry of Finance Notice (June 23, 1987), 87 Caishuizi 134 (on file with author); Ministry of Finance Notice (Jan. 21, 1988), 88 Caishuiwaizi, reprinted in [1988] 3 Zhongguo shuiwu [Chinese Taxation] 47.

64. Provisional Regulations of the People's Republic of China on Vehicle and Vessel Usage Tax, [Taxation] China Laws for Foreign Business (CCH Austl. Ltd.) ¶34-568 (Sept. 15, 1936).

65. These regulations are rather misleadingly translated by CCH as the "Provisional Measures of Beijing Municipality for Administration of the Levying of Building Tax on Foreign Construction Enterprises Contracting for Building Projects," [2 Special Zones & Cities] China Laws for Foreign Business (CCH Austl. Ltd.) ¶96-306 (May 30, 1988) [hereinafter *Beijing Foreign Construction Tax Measures*]. Foreign construction enterprises are not, in fact, subject to the domestically applicable building or construction tax (*jianzhu shui*).

foreign contractor and the construction unit seek the advance approval of the tax authorities of any settlement of the contract price, the construction unit cannot deduct such price as a business expense in computing its taxable income.<sup>66</sup>

Foreign design firms that work on construction and other projects in China but, apart from sending personnel to China to carry out site inspections and collect information prior to preparing the design, perform all of their work outside of China may be exempted from tax.<sup>67</sup> However, if such firms subsequently send personnel to China to explain the drawings and supervise and give technical instruction in respect of the construction work, they will be deemed to have a taxable establishment in China and will be subject to both enterprise income tax and CICT. Nevertheless, if such firms can show how much of the contract price is attributable to work performed outside China, they may be exempted from tax on such overseas-source income. Although a detailed tax discussion is beyond the scope of this article, if such firms pay income tax on the deemed profit basis,<sup>68</sup> they will be taxed on a deemed profit of fifteen percent of their design fees.<sup>69</sup>

Foreign employees of a foreign design firm or contractor who work in China must also generally register to pay Individual Income Tax,<sup>70</sup> within seven days after they arrive in Beijing to commence work on the project.<sup>71</sup>

Construction contracts are subject to stamp tax at the rate of 0.03 percent of the contract amount, and survey and design contracts for construction projects are taxed at the rate of 0.05 percent of the fees

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66. *Id.* art. 9.

67. Notice of the General Taxation Bureau (July 15, 1986), 86 *Caishuiwaizi* 172 [hereinafter *Design Contractor Notice*] (on file with author).

68. See Timothy A. Gelatt & Richard D. Pomp, *China's Tax System: An Overview and Transactional Analysis*, in *Foreign Trade, Investment and the Law in the People's Republic of China* 42, 52-53 (Michael J. Moser ed., 2d ed. 1987). Although the joint venture income tax and the foreign enterprise income tax have been consolidated in the 1991 Income Tax Law of the People's Republic of China Concerning Enterprises with Foreign Investment and Foreign Enterprises, *supra* note 62, the basic taxation principles established by the two predecessor tax laws continue generally to be implemented.

69. *Design Contractor Notice*, *supra* note 67, art. 3.

70. Individual Income Tax Law of the People's Republic of China, [Taxation] *China Laws for Foreign Business* (CCH Austl. Ltd.) ¶30-500 (Sept. 10, 1980); Detailed Rules and Regulations for the Implementation of the Individual Income Tax Law of the People's Republic of China, [Taxation] *China Laws for Foreign Business* (CCH Austl. Ltd.) ¶30-520 (Dec. 14, 1980).

71. Beijing Foreign Construction Tax Measures, *supra* note 65, art. 4.



received, under the Interim Stamp Tax Regulations of the PRC.<sup>72</sup> However, pursuant to a notice issued by the Ministry of Finance on April 15, 1989,<sup>73</sup> FIEs and foreign companies that pay CICT on their income are exempted from having to pay stamp tax.

## VI. DOMESTIC ASPECTS OF PROJECT FINANCE

Only projects that have been approved and included in the annual construction plan are eligible for domestic bank financing.

Since 1 January 1985,<sup>74</sup> all construction projects using state-budgeted investment must obtain their funds not through state allocations but by means of interest-bearing project loans granted by the Construction Bank, which obtains its funds from the State.<sup>75</sup> All construction funds must, pursuant to the Building Construction Regulations,<sup>76</sup> be deposited with the Construction Bank for centralized management. If the construction funds are to be "self-raised," that is, provided by the enterprise itself without state assistance, they are nevertheless to be deposited in the Construction Bank prior to approval of the project.

It is not clear whether the above rules apply to construction funded by FIEs, although an official in the Construction Bank states that they do if the construction investment is more than RMB yuan 500,000. However, when construction loans are required by FIEs, the funds may be obtained from a variety of domestic as well as foreign banks,

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72. Interim Stamp Tax Regulations of the PRC §§ 1,3 (State Council, Oct. 1, 1988). See Jamie P. Horsley, *China Imposes a Stamp Tax on Business Documentation*, E. Asian Exec. Rep., Mar. 15, 1989, at 8, 26 (including a translation of the tax regulations).

73. Ministry of Finance Notice (Apr. 15, 1989), 89 Caishuizi 10, reprinted in [1989] 6 Zhongguo shuiwu [Chinese Taxation] 49, 50.

74. Interim Regulations of the State Planning Commission, Ministry of Finance and People's Construction Bank of China on the Replacement of Allocations by Loans for Investment in Capital Construction within the State Budget (Dec. 14, 1984), reprinted in 3 Commercial Laws, *supra* note 5, at 43.

75. Jiben Jianshe Daikuan Zhanxing Tiaoli [Interim Regulations on Providing Loans for Capital Construction Projects] (approved for transmission by the State Council, Aug. 28, 1979), reprinted in 1 Commercial Laws and Business Regulations of the People's Republic of China 71 (V.F.S. Sit ed., Tai Dao Publishing Ltd. 1983) [hereinafter 1 Commercial Laws]; Jiben Jianshe Daikuan Shixing Xize [Rules for the Implementation of the Interim Regulations on Providing Loans for Capital Construction Projects] (issued by the Construction Bank of China, Dec. 8, 1979) (a standard loan contract is attached) (on file with author).

76. Building Construction Regulations, *supra* note 9, art. 23.

including the Bank of China<sup>77</sup> and the Industrial and Commercial Bank of China,<sup>78</sup> in addition to the Construction Bank. Certain early Chinese-foreign joint ventures were indeed told that they had to deposit construction funds, regardless of their source, in the Construction Bank and complained of interference by the local branches of the Construction Bank, which attempted to participate in construction management and approve all disbursements made from accounts with them.

Purely domestic loans traditionally have not been secured by guaranties, assignments or mortgages, although the practice respecting security arrangements is slowly changing. Whereas the 1979 regulations of the Construction Bank on capital construction loans do not contain any provisions for obtaining security for its loans,<sup>79</sup> subsequent loan regulations do contemplate obtaining guaranties or security interests in assets and other property, rather than relying solely on the income of the borrower as previously.

Perhaps the earliest of these subsequent regulations were the 1981 Interim Procedures of the Bank of China for the Handling of Loans to Chinese-Foreign Joint Ventures,<sup>80</sup> which were superseded by the 1987 Procedures of the Bank of China for Loans to Enterprises with Foreign Investment.<sup>81</sup> While the earlier Bank of China provisions did not specifically contemplate construction loans, they did provide for obtaining guaranties or collateral security for all loans to joint ventures. The successor provisions, in contrast, define fixed assets loans specifically to include loans for capital construction and go into greater detail on the kinds of security that may be used to secure the loan, including buildings, machinery and equipment, marketable commodities, foreign currency deposits, negotiable securities, shares and other transferable rights and interests.<sup>82</sup> Similarly, the 1985 domestically-applicable Regulations on Loan Contracts contemplate the

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77. See, e.g., Procedures of the Bank of China for Loans to Enterprises with Foreign Investment (State Council, Apr. 24, 1987), translated in 1:1 China Current Laws at 1 (on file with author).

78. Zhongguo Gongshang Yinghang Diya Daikuan Guanli Zhanxing Banfa [Interim Measures of the Industrial and Commercial Bank of China on Secured Loans] (July 24, 1987) [hereinafter ICB Secured Loan Measures] (on file with author).

79. Rules for the Implementation of the Interim Regulations on Providing Loans for Capital Construction Projects, *supra* note 75.

80. 1 Commercial Laws, *supra* note 75, at 83.

81. Procedures of the Bank of China for Loans to Enterprises with Foreign Investment, *supra* note 77.

82. *Id.* art. 16.

use of property as loan security,<sup>83</sup> and the Industrial and Commercial Bank of China is now authorized to make secured fixed assets loans to domestic Chinese enterprises and FIEs alike.<sup>84</sup>

On the local level, Shanghai published in 1988 regulations on secured renminbi and foreign exchange financing, which would appear to apply to construction financing,<sup>85</sup> and the Shenzhen Special Economic Zone issued secured loan regulations in 1986.<sup>86</sup>

While Chinese and foreign banks are reluctant to lend for construction projects on a non-recourse basis, especially since the enforceability of security interests in China is still a relatively untested issue, China's developing legislation on secured lending is making this possibility increasingly attractive.

## VII. CONCLUSION

As more foreign companies participate in various ways in China's construction industry, we will learn more about the regulatory scheme for this important area of activity. Pending the clarification that will come with experience, both on the part of the Chinese authorities in charge of construction and the foreign participants therein, this article should serve as a useful starting point for those contemplating construction-related projects in China.

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83. Regulations on Loan Contracts (effective Apr. 1, 1985), reprinted in *Contract Laws*, *supra* note 13, at 101.

84. See *ICB Secured Loan Measures*, *supra* note 78, arts. 2, 6.

85. Interim Provisions of Shanghai Municipality for the Administration of Secured Loans (June 9, 1988), reprinted in 1:5 *China Current Laws* at 5; Provisional Regulations of Shanghai Municipality on Renminbi Mortgage Loan Administration, [2 *Special Zones & Cities*] *China Laws for Foreign Business* (CCH Austl. Ltd.) ¶91-064 (June 9, 1988).

86. Regulations on Mortgage Loan Administration in Shenzhen Special Economic Zone, [1 *Special Zones & Cities*] *China Laws for Foreign Business* (CCH Austl. Ltd.) ¶73-516(5) (Feb. 16, 1986).

