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How to Execute Business Restructuring in China

Commercial and Contracts

Employment and Labor

Corporate, Securities, and Governance

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Cheat Sheet

- **Engage local government early.** Local authorities retain significant influence over licensing, agreements, and operational approvals, making early and ongoing communication essential to avoid delays or resistance.
- **Navigate labor laws carefully.** China's employee-protective labor framework makes workforce reductions complex, requiring strict legal justification, advance consultation, and often severance packages above statutory minimums.
- **Manage data and IP restrictions.** Cross-border data transfers, local storage requirements, and IP transfer approvals create structural challenges that demand meticulous compliance with the CSL, PIPL, DSL, and CNIPA processes.
- **Plan for compliance, tax, and exit risks.** Restructuring can trigger audits, whistleblower actions, anti-bribery scrutiny, and geopolitical disruptions, making comprehensive risk mitigation and exit planning critical.

Whether due to geopolitical tensions, tariff disputes, rising labor costs, increasing compliance burdens, or a combination of the above, more and more foreign companies are reevaluating their business presence in China. In fact, [2024 survey data from ACC] showed that China was the country most frequently cited as a perceived risk among 200 in-house counsel from US-based organizations.

Restructuring operations in China, whether by streamlining entities, selling off units, shifting supply chains, or shutting down completely, is a complex undertaking. For most multinational companies (MNCs) that have benefited from the rapid growth of the Chinese market in past decades, any restructuring requires a serious and in-depth feasibility analysis before a plan is finalized and implemented.

General counsel of MNCs must understand the global business direction, strategic focus or re-focus, and understand the China specific legal issues that need to be taken into consideration before the restructuring plan is crafted or executed.

Engage local government early

One unique feature in China is that despite the streamlining of national legislation, Chinese local governments still have a pervasive ability to influence the operations and restructuring of foreign-invested companies within their jurisdiction.

For example, many foreign-invested manufacturers need a Safe Production License if their business involves hazardous chemicals, construction, or mining. This license has a three-year term and must be renewed regularly. If a company fails to meet all compliance standards, the license may be withheld or rejected, leading to business suspension or disruption.

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In other cases, foreign investors may have an agreement with the local government from when the Chinese subsidiary was first established. These agreements can include not only favorable treatments like subsidies or loans but also foreign investors’ commitments regarding total capital and production capacity. Before these commitments are fulfilled, the local government may not be sympathetic to a company’s desire to downsize, transfer, or relocate.

The reasons for the local government’s decisions are complex and multifaceted, including the desire to increase local tax revenue, respond to policies from higher-level government, or adapt to changes in laws, regulations, or zoning. It is always wise to maintain close and constant communication with the local government to understand policy trends and potential impacts on the local subsidiary.

This doesn’t mean the company must always comply, let alone to its own detriment. If the local government is simply enforcing higher-level directives, the company can try to involve them as an ally rather than an adversary.

Navigate complex labor laws

While most Chinese companies do not have independent and powerful trade unions, China’s labor framework heavily favors employees. Labor law enforcement practices vary significantly across provinces, making workforce reductions a legal minefield.

Terminations related to restructuring must meet strict criteria under Article 40(3) of the Labor Contract Law, which permits dismissals only for “major changes in objective circumstances,” such as business closures or relocations. Even then, layoffs affecting 20 or more employees require consultations with trade unions (or all employees) and 30 days’ advance notice.

Local labor bureaus often encourage severance packages that exceed the statutory minimums to prevent social instability, especially in areas with high unemployment rate. To ensure smooth and peaceful restructuring, companies often lean toward negotiated exits with larger payouts, sometimes even above the legitimate standards.

The labor component of a restructuring plan is therefore a top priority and a key focus for headquarters. Local managers, directors, and supervisors (DSMs) are typically responsible for implementing this, but they might resist if the restructuring threatens their own roles or positions.

> If a restructuring plan involves dissolving an existing company, be prepared for a potentially difficult process.

Tackle data security challenges

Recent data legislation — including the Cybersecurity Law (CSL 2016), Personal Information Protection Law (PIPL 2021), and Data Security Law (DSL 2021) — has made communication between headquarters and Chinese subsidiaries less straightforward. These rules mandate local data storage and security checks for cross-border transfers under specific circumstances, with fines of up to 5 percent of revenue for violations.

Local DSMs, particularly legal representatives, might be reluctant to provide data requested by overseas headquarters due to fears of personal liability under PIPL’s Article 66, especially when U.S. headquarters push conflicting priorities. European companies also feel this pressure, often siloing their IT systems to comply with China’s rules, which 28 percent report as widening the gap with their headquarters and sacrificing efficiency and innovation. Tesla’s Shanghai data center, built by 2021 and updated in 2024, demonstrates how DSMs can ensure DSL compliance during restructuring, a model US firms may follow.

Ensure smooth exit

If a restructuring plan involves dissolving an existing company, be prepared for a potentially difficult process. Local government, vendors, distributors, and management may all have conflicting interests in the remaining assets. A tax audit is inevitable and typically lasts for months, often leading the tax authority to impose penalties for past violations.

Joint venture partners might also resist control shifts, especially if they want to continue the business while foreign shareholders are leaving. Local management, if dissatisfied with their personal settlement plan, might hesitate to execute the plan or even defect to competitors during the transitional period, which could take over a year.

Therefore, careful planning is crucial if your business plan necessitates the closure of a Chinese subsidiary.

Safeguard intellectual property (IP)

China's IP regime presents unique challenges during restructuring, particularly when transferring patents, trademarks, or copyrights across borders. Any cross-border IP transfer requires approval from Chinese authorities, with varying timelines and procedures.

For instance, patent transfers are only effective after approval by the China National Intellectual Property Administration (CNIPA), while trademark transfers can take six to eight months to process. Delays or non-compliance can invalidate ownership or lead to disputes.

A critical tax consideration for IP transfers is that due to the complexity, intangibility, and mobility of IP assets, MNCs increasingly place IP in low-tax jurisdictions, creating a misalignment between "legal ownership" and "economic ownership."

These aggressive tax planning practices through complex related-party transactions have become a significant factor in "Base Erosion and Profit Shifting (BEPS)." To counter this, the OECD's BEPS Action 8-10 (2015) specifically targets the abuse of IP transfer pricing arrangements. As a result, tax authorities worldwide have intensified "anti-avoidance investigations."

Therefore, IP transfers must be structured with strong "commercial substance" to ensure alignment between legal and economic ownership and mitigate anti-avoidance risks.

> Any restructuring plan must take into account current geopolitical tensions, trade pressures, and potential sanctions.

Mitigate compliance risks

Bribery risks are also a major concern, with China's Anti-Unfair Competition Law and the US Foreign Corrupt Practices Act (FCPA) cracking down on corruption, in addition to other applicable laws. Some sectors, like pharmaceuticals, are heavily regulated and inherently high-risk.

During a restructuring, it is not rare to uncover past "guanxi" dealings that were previously unknown to stakeholders, which can widen compliance risk exposure. These risks can arise from heightened government scrutiny, which may be used to signal a desire to correct non-compliant business models or even to overturn an unreasonable business decision.

Risks can also come from local DSMs who may whistle-blow to gain an advantage or to cover up past dealings with the local government, or from disgruntled employees who are not satisfied with the severance plan. There have been cases where a US cable company had to heavily discount the value of its China business upon exiting the market due to last-minute anti-bribery allegations.

Factor in geopolitical and trade dynamics

The latest wave of US tariffs has had a deep and widespread chilling effect globally. Any restructuring plan must take into account current geopolitical tensions, trade pressures, and potential sanctions.

While such restrictions can be impossible to foresee or fully mitigate, in-house counsel must remind headquarters of these risks and try to build solutions into business contracts.

For example, to protect a transaction from potential government interference, one should specify the types of acts or events that could frustrate the deal by expanding the definition of “force majeure” or including separate clauses. If possible, one should seek break-up fees or similar arrangements from the other party should the transaction fall apart unexpectedly.

Conclusion

For general counsels of MNCs, restructuring in China is a high-stakes puzzle of legal risks, from labor and data to geopolitics. The experiences of companies like Mitsubishi and Tesla show how costly missteps can be. Local DSMs offer on-the-ground knowledge but need to be aligned, while legal counsel must decipher regulatory complexities.

The trend of MNCs siloing their operations and undergoing some form of restructuring, driven by compliance and geopolitical factors, is likely to be a frequent topic in boardrooms for the next few years. Engaging stakeholders early is key to keeping restructurings compliant and competitive in this fast-moving market.

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