

## Mind whom you are doing business with – transit trade with China

### Description

Frauds in international trade with China take many forms.

We talk about a very common trick that often leaves the buyer outside of China in a very hopeless situation in recovering losses arising out of the trick: transit trade or whatever name you call it. It involves a third party in a separate jurisdiction in the international trade conducted by actual seller and buyer.

To illustrate, a Chinese manufacturer or supplier sets up an offshore entity in BVI, HK or other low-tax jurisdictions. When there is a deal to be made with the manufacturer, the manufacturer will have the deal made directly between the buyer and the offshore entity, say HK company, and in turn, the Chinese manufacturer will sign a contract with the HK company but ships the goods directly to the buyer. Such arrangement is often designed to lower the tax burden on the Chinese manufacturer by leaving a part of its profits in HK company which is subject to a much lower tax in HK.

However, as the offshore company is very often a shell company without any substantial business operation or assets except for serving as a nominal seller, the buyer will find it difficult or impossible to seek damages or compensation from the nominal seller when there is a dispute arising from the deal such as quality, delay and etc., simply because the offshore company does not have any meaningful assets at all.

Recently, I was approached by a Iranian client for advice in relation to a dispute over a sale & purchase contract signed between the client with a company in either Iran or China, but the goods were shipped from China directly to Iran. The quality was far less satisfactory than that stipulated in the contract. The client wished to seek damages from the Chinese company as it was clearly aware that the deal was made indeed with the Chinese company though a third party was involved in the middle. He asked me whether it was possible to sue the Chinese company here in China.

The answer is disappointing at large. Sometimes, international trade does not involve a very formal contract but written email communications with a proforma invoice without being executed by both parties (actual seller and buyer). On the proforma invoice, the seller is named to be another entity. In such a case, it is possible for a Chinese court to entertain the case and exercise jurisdiction over the dispute. We have filed a case in the said circumstance.

So what should a foreign buyer do in order to prevent the difficult situation and have recourse to the Chinese supplier directly?

Legally speaking, the buyer may ask the de facto Chinese seller to guarantee, as a surety, the performance of the nominal seller in respect of the performance of the deal contract, which allows the buyer to seek damages from the Chinese surety. However, this may have problem in practice as such guarantee provided to a foreign company is subject to approval of Chinese foreign exchange authority without which Chinese court may be reluctant to enter a judgment that cannot be enforced then.

Ideally, the buyer may ask the nominal seller to provide a guarantee from a company in a country there is no much foreign exchange control or restriction. But such requirement may well dampen and kill the deal after all.

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