

# CHINA LEGAL REPORT\*

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## **Revised Wholly Foreign-owned Enterprise Law**

### **I. Introduction**

Since the Wholly Foreign-Owned Enterprise Law of 1986, a Wholly Foreign-Owned Enterprise (hereinafter “WFOE”) has to complete a procedure regarding its establishment. Such procedure basically includes: a reply from local government regarding investment report, a name permitted by Administration for Industry and Commerce of the People’s Republic of China (“AIC”); an approval from Ministry of Commerce of People’s Republic of China or its local authorities (“Referring Authorities”); and a final registration on AIC. The materials to be approved by the Referring Authorities at least consisted of the application form, the Article of Association (“AoA”), a feasibility study report.

However, on 3 September, 2016, the Standing Committee of the National People’s Congress concluded the Decision on Revising Wholly Foreign-Owned Enterprise Law, the Sino-Foreign Equity Joint Venture Enterprise Law, the Sino-Foreign Cooperative Joint Venture Enterprise Law, and the Law on the Protection of Investment of Taiwan Compatriots (“Decision”), which has changed the approval procedures in referring authorities into so-called “filing mode”.

### **II. Establishment of WFOE**

#### **1. Practice in the Past**

The registration at AIC is a condition for enterprises in China to conduct their business. However, an approval acquired by foreign investors from Referring Authorities is an essential document to be submitted to AIC for registration. For 30 years, the Referring Authorities made approvals for WFOE on their establishment procedure.

In particular, the establishment of WFOE was basically completed as follows:

- a) Submission of a report to country-level or above local government regarding the needs on water, gas, electricity, utilities, site area and the likes. The competency principally depended on the amount of investment and the registered address. Within 30 days of receipt of such materials, a written reply from local government regarding the submitted documentations is issued. The authorities’ reply is a pre-procedure of formal establishment for WFOE.

- b) Following the reply, foreign investors applied to AIC for a name of the prospective WFOE.
- c) With a permitted name from AIC, foreign investors submitted further materials to the Referring Authorities. Further materials normally consist of:
- application form for establishment of WFOE;
  - the written reply from local government;
  - feasibility study report;
  - AoA of WFOE;
  - name of legal representative of WFOE;
  - legal documents and creditworthiness documents of the foreign investor
- Depending on the specific regulations, additional documents might be required to submit. Within 90 days the Referring Authorities gave eventual approval to the application of establishment. However, at this stage of the procedure, foreign investors submitted all their materials online, and received an order for the handover of the documents in paper form.
- d) Registration of the WFOE at the AIC within 30 days after the approval from Referring Authorities.

In any event of unsatisfactory submissions, foreign investors were notified to supplement or modify their application. Statutory time bars of the procedure were extended in such events.

Thus, the approval regime according to the initial WFOE Law regarding the establishment of WFOE was in fact an administrative licensing. Since administrative regulations and documents with regard to particular matters vary in different regions and cities, the “approval before registration” procedure was too time consuming, expensive and complex.

## **2. Record-filing Mode & Negative List in Free Trading Zones**

On 3 September 2016, however, the Standing Committee of the National People’s Congress has addressed these issues, after having conducted a trial phase of a new regime for such matters, and adopted a decision to change the so called “approval mode” into a so called “filing mode” in entire China.

The aforesaid trial of the filing mode was launched in the four Free Trading Zones (“FTZ”) in Shanghai, Tianjin, Guangzhou and Fujian Province in October 2013. The trial intended to examine the effect of a new mode in the establishment of WFOE where the approval from examination and approval authorities does not constitute the pre-condition of registration.

During the trial, a WFOE in the FTZ could make registration at the AIC first and then merely file all required materials to Referring Authorities online within 30 days after the registration. Alternatively, a WFOE still may file the materials online prior to the registration. Whatever option a WFOE chose, the Referring Authorities will finish filing procedure within 3 days and the filing procedure is principally online.

The negative list in the four FTZ listed exceptions of such filing mode. If a prospective WFOE was enlisted in the negative list, it still had to go through approval procedure at referring authorities.

The experiences that were made during the trial phase were satisfactory. According to Xinhua News, paper work was cut down by 90%, and the average duration of procedure was reduced from more than 20 days to 3 days. The Development Research Center of the State Council concluded in an assessment that, all investigated enterprises agreed that the new regime for registration was significantly more convenient and simplified.

### **3. The New Law**

#### **3.1 Overview**

The Decision on 3 September 2016 made amendments to several statutes. According to the decision, a record-filing mode replaced the approval mode at some authorities for the WFOE establishment procedure. The Decision, however, aims the equal treatment of domestic and foreign invested enterprises in China in principle, but a nationwide applicable Negative List providing exceptions will be adopted.

On 8 October, 2016, the State Council issued its Announcement No. 22 which provided the scope of the Negative List. The Negative List provides limited and prohibited categories in a Catalogue of Industries for Guiding Foreign Investment (Revision 2015)<sup>1</sup> (“Investment Guidance Catalogue”), as

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<sup>1</sup> <http://images.mofcom.gov.cn/wzs/201503/20150317134821983.pdf>, MOFCOM, only in Chinese.

well as the regulation of equity control and executives control for businesses within encouraged categories of business.

The establishment of WFOE not enlisted in the Negative List will require the following:

- a) Application for a name of the WFOE at AIC;
- b) Submission of a report to local government;
- c) Registration of WFOE at AIC;
- d) Submission of information and upload of documents regarding WFOE under indications from online system (<http://wzzxbs.mofcom.gov.cn/WebProBA/app/entp/approve>). Such record-filing process shall be completed within 30 days after registration at AIC.
- e) Complete registration at AIC if the WFOE chose to apply for a name in above step b).

### **3.2 Significant Changes**

#### ***i) Law of the People's Republic of China on Wholly Foreign-owned Enterprises***

According to the Decision, the establishment, merger and division, as well as change to operating period of WFOE all follow the record-filing mode. Exceptions are regulated in the Negative List.

However, for a merger of a FIE with non-foreign invested domestic enterprises the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors* applies. To listed companies the *Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors* applies. Whereas, enterprises shall manage their changes under filing mode and negative list after the merger. And, for any announcement that is required by laws and regulations, enterprises shall give information of its completion when apply for filing records.

#### ***ii) Provisional Measures for Filing Administration of Establishment and Changes of FIE***

On 8 October 2016, *Provisional Measures for Filing Administration of Establishment and Changes of Foreign-invested Enterprises* ("Provisional Measures") were announced by the Ministry of Commerce

of the People's Republic of China ("MOFCOM"). The previous administrative measures for FTZ have expired and the new Provisional Measures shall be applied.

According to the Interpretation on Provisional Measures from Director of Treaty & Law Department in MOFCOM, the record filing procedure before referring authorities regarding establishment and changes of FIE are simplified into four steps:

- a) Submit the information and upload documents for filing application via online filing system;
- b) Filing authorities shall review the form integrity and veracity of filing information, and determine whether applications are within the scope of filing or not. Eligible applications shall be filed within 3 working days;
- c) Referring authorities shall notify foreign investors to supplement documents once for all. The term for foreign investors is 15 days after such online notice.
- d) Foreign investors decide to get a filing receipt.

The interpretation on Provisional Measures from Director of Treaty & Law Department in MOFCOM further explains the requirement of "original actual controller" for FIEs or its foreign investors. Such declaration is newly settled as requirement for the establishment and changes of WFOE in the record-filing mode procedure. The original actual controller is a natural person, enterprise, government institute or international organization who control the FIE directly or indirectly through shares, contracts, trust or other methods.

According to the Provisional Measures, in addition to the establishment of WFOE, several changes regarding FIEs are subjected to record-filing mode as well:

- Changes to the basic information of the FIE, including name, registered address, enterprise type, operation duration period, invested industry, nature and scope of business, whether falling within the scope of tax reduction/exemption for imported equipment as stipulated by the State, registered capital, total investment, organizational structure, legal representative, details of ultimate controller and contact details;

- Changes to the basic information of investors of the FIE, including name, nationality/region or address (place of registry or registered address), certificate type and number, subscribed capital contribution, capital contribution method and duration, territorial source of funds and investor type;
- Changes to equity (share) as well as right and interest in cooperation;
- Merger, division and termination;
- Pledge and transfer of property rights and interests of a wholly foreign owned enterprise;
- Advance recovery of investment by foreign co-investors of a Sino-foreign contractual enterprise; and
- Entrusted operation and management by a Sino-foreign contractual enterprise.

### **3.3 Timing**

The new Law of the People's Republic of China on Wholly Foreign-owned Enterprises has entered into force on 1 October 2016, whereby the Provisional Measures have been effected on 8 October 2016, as it has the Negative List.

In addition, all approval applications submitted prior to the implementation of provisional measures shall be stopped, and foreign investors shall go through the record-filing mode in accordance with the provisional measures.

### **III. Conclusion**

This new regulation will provide a nationwide applicable legal regime to WFOE. It will simplify procedures and decrease costs and expenses of WFOE with regard to their establishment and related activities. Foreign investors can directly register at AIC without approval from Referring Authorities, which rises up stability and predictability of their investment and provide WFOE with some more freedom regarding the establishment. The record-filing mode allows WFOE to register at AIC faster than before, which also benefits WFOE to conduct its business more efficiently. Since the Investment Guidance Catalogue has been relevant for decades, however, the Negative List will not improve things for FIE as long as its content remains similar to the Investment Guidance Catalogue. The unequal treatment of domestic and foreign enterprises will continue, if the Negative List only provides the Investment Guidance Catalogue.

Further, the requirement of declaring the “original actual controller” seems to strengthen the management to foreign investors for P.R.C. government. And there may be conflicts between AIC and MOFCOM in practice of record-filing mode. It happened that an approval from MOFCOM is still required in the change of WFOE procedure, even though the filing mode is regulated in laws and officers have confirmed such filing mode (but not approval mode) in phone calls. Such conflict occurred in the change of WFOE, but it is still considerable to foreign investors of their WFOE establishment in China.



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