

Company Law and Practice In China

ALFRED CHAN

**KUALA LUMPUR
 JULY 16 – JULY 17, 2012**

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Relevant PRC Law and Regulations for Establishing Foreign Investment Enterprises

1. Sino-foreign Equity JV Enterprise Law (EJV Law) and the Implementation Regulations of EJV Law
2. Sino-foreign CJV Law, and the Implementation Regulations of the CJV Law
3. WFOE, and the Implementation Regulations of the WFOE Law
4. The Company Law, and the Regulations for the Registration of Companies

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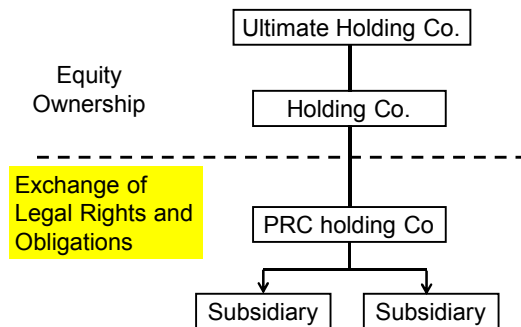
PRC Company Law and Foreign Investment Enterprise laws

- a) Where the FIE law and the Company laws overlap or cover the same issues, the provisions of the FIE law shall take precedence.
- b) Some provisions that don't exist in FIE law will not concern the foreign investors (State owned enterprises);
- c) Some provisions that don't exist in FIE law shall apply to the FIE (i.e. supervising board).

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Legal Structure - I

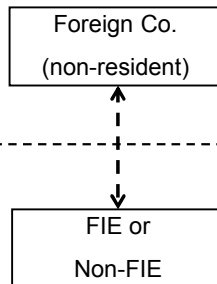


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Legal Structure - II

Exchange of Legal
 Rights &
 Obligations only



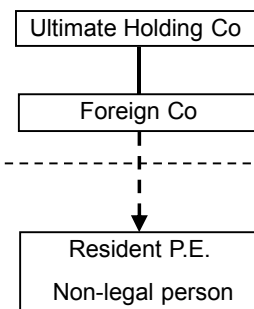
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Legal Structure - III

Property
 Ownership

Exchange of
 Legal Rights
 and
 Obligations



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Legal form vs. income tax liabilities

	Legal form	Tax treatment
I	FIE including FICE	Tax on net income
II	Foreign Enterprise with PE in China	Tax on net income, or gross income
III	Foreign Enterprise with no PE in China	Tax on gross income, except for capital gain

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Legal Structure vs. Scope of Tax Liability

	Scope of tax	Tax on dividend
FIE / FICE	Tax on worldwide income	Taxable <exempt b/4 2008>
FE with PE	Tax on PRC-sourced income	Not applicable

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Company and Enterprise in China

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Legal form of business in China

- State owned enterprise, privately owned enterprise, foreign investment enterprise
- Sole proprietor, partnership, private company, public company, unlisted and listed companies

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Similarity between Company and Enterprise

- Both company and enterprise use organizational hierarchy and authority as substitute for price mechanism in market. (The Nature of the firm, Ronald Coase 1937)
- A PRC company is a legal person, while an enterprise can also be a legal person.
- The PRC Company Law shall apply to both entities, The provisions in the FIE law shall take precedence over the CL. (Article 218)

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Difference between company and enterprise

The following legal rules (the FIE laws) apply to foreign investors:

- EJV Law
- CJV Law
- WFOE Law

* Foreign investors may set up companies in China with a share capital. See MOFTEC decree no. 1 (1995)

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Difference between company and enterprise

- A joint venture must provide for a period of business operation.
- The BOD is the highest authority for the EJV.
- The EJV or CJV agreement is a must.

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Difference between company and enterprise

- A CJV may not be a legal person.
- A company must be a legal person. (but a sole proprietor business or a partnership is called “enterprise” in China)

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Organization structure - 1

- Board composition for EJV and CJV: EJV law and CJV law
- Board composition for WFOE: Company Law

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Organization structure - 2

	WFOE	PRC Co. Law
BOD	3 – 13	Art. 45
Term of office (director)	3 years	Art. 46
Supervising board	=> 3	Art. 52
Term of office (SB)	3 years	Art. 53

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Organization Structure – 3 (alternative)

	WFOE	PRC Co. Law
MD	1	Art. 51
Term of office	3 years	Art. 46
Supervisor	1	Art. 52
Term of office	3 years	Art. 53

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FICE

- Foreign Invested Commercial Enterprise (FICE): a FICE can do wholesale and retail business, franchise, or acting as commission agent.
- A FICE can be an EJV, a CJV or a WFOE.
- Legal rule: Administrative Order of MOFCOM (2004) No. 8

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Comparing a domestic and foreign funded company (1)

- Source of funding
- Foreign ownership no less than 25%
- PRC nationals cannot own equity in a JV in personal capacity (except for the case where a domestic company sells most of its shares to foreign investors, the minority shareholders can be PRC nationals.)

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Comparing a domestic and foreign funded company - 2

- The FIE should contribute capital in foreign currency. With approval from SAFE, foreign investor can contribute capital in RMB:
- (1) Reserves, retained profits, dividend payable and accrued interests by FIE;
 - (2) Foreign currency loans, previously duly registered at the SAFE;
 - (3) Funds obtained from the transfer of equity in FIE, the return of capital or reduction of capital in FIE.

See Hui Fa [2003] No. 30, SAFE, PRC

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Form of capital and capital contributions

- Cash and non-cash capital
- Non-cash capital: LUR and property, machinery, inventory, IPR, non-patent technology; all of these should be valued by asset appraisal agent.
- Cash capital consists of no less than 30% of total amount of registered capital.

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Capital paid by installments - FIE

- by Installments: 1st installment =>15% within 3 months from issue of BL, balances payable within 2 years;
- One-off payment: 6 months from issue date of BL

SAIC decree: 外企字 Waiqizi [2006] No. 81

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Minimum capital

- Registered capital (C) + Loan (L) = Total investment (A)
- Capital Structure: the ratio of total amount of investment and equity (paid up capital)

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FIE - Minimum capital requirements (USD) Capital / total investment ratio

Amount of total investment is capped	Amount of registered capital
10 / 7	=< 2.1 million
2 times	Between 2.1 M and 5 M
2.5 times	Between >5M and 12M
3 times	>12M

By MOFCOM Decree (2009) No. 6

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➤ FICE capital requirement: 0.5 M (wholesale), 0.3 M (retail) RMB

- Minimum capital PRC domestic company
- a) Private company: RMB 30,000 (RMB 100,000 for sole shareholder company) in general
- b) Public company: RMB 50 Million

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Steps in incorporation

- Incorporation and then capital contribution
- Capital Examination Report is needed

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Foreign currency loan: inception

Approval and Foreign Debt Registration:

- Approval by MOFCOM
- Statutory time: within 15 days of concluding loan agreement

Administrative Body: SAFE

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Foreign currency loans:

(1) redemption

- a) Approval by SAFE
- b) Loan agreement
- c) FDRC
- d) Repayment notice
- e) May either use own forex, or use RMB to buy forex

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Foreign currency loan: (2) Interest payment

Interest payments: Loan agreement, FDRC,
Payment of withholding income tax (10%)

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Consequences of non-registration?

→ Creditors face conversion problems

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Joint Venture

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- JV agreement **and AOA** to be approved by MOFCOM; Feasibility Study Report by NDRC
- Where the industry is regulated by other ministries, administrative approval precedes the approval by MOFCOM.

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Scope of business – Foreign investment?

- PRC State Council: Policy for Guiding Foreign Investment
- National Development and Reform Commission (the NDRC) : Catalogue for Guiding Foreign Investment in Industries: prohibited category, restricted category, encouraged category (permitted category not listed), See 2010 edition.
- 100% foreign ownership is not allowed for projects under restricted category

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Scope of business – Micro level

- Ultra vires not allowed;
- Failure to obtain administrative approval or holding no business license are punishable offences

State Council Decree No. 370

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About JV Contract (I)

- WFOE has no contract;
- The JV contract shall take precedence over AOA where there exists conflict between the two;
- Contract comes into existence and takes effect at different dates.

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About JV Contract (II)

- Provision for settlement of disputes: either by law suit or by arbitration.
- China is member of New York Convention.

The PRC law shall apply in contract concluding, validity, interpretation, and settlement of dispute. (Article 12, Implementation Regulations, PRC EJV Law)

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Joint Venture with State Owned Enterprises (SOE)

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Chinese party contributes State Owned Assets to FIE.

■ SOE must comply with the following requirements:

1. Consent from the supervising department of the Chinese party;
2. An asset appraisal report issued by authorized agent;
3. A confirming report given by the State Owned Assets Supervision and Administration Commission.

See PRC State Owned Assets Law 2010 中华人民共和国国有资产管理法.

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Disposal of SOA or change in percentage of state owned equity in JV

■ The same procedure for asset appraisal by authorized agent shall be followed.

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Articles of Association

1. AOA must include legally specified contents (i.e. Merger & acquisitions, increase in capital, winding up, etc)
2. (a) Business that requires the approval of all board members (i.e. amendment to AOA),
(b) Business that only requires the approval by majority of the board members.

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Company Name and Principal place of business

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Company name structure:

- City + Firm name + Industry + Legal form
广州市 大大 钟表配件制造 有限公司 (Or)
- firm name + Industry + (City) + Legal form
大大 钟表配件制造(广州) 有限公司

Place of principal business

■ It should be located in the city over which the local SAIC office has jurisdiction.

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Incorporation of FIE

Investment direction	Refer to <Catalogue for Guiding Foreign Investment in Industry>
Capacity to form a JV	PRC nationals in general have no such capacity
Set-up procedure	Requirement to obtain administrative approval
JV agreement and AOA	Should adopt prescribed / mandatory contents
Composition of BOD	EJV and CJV law shall apply
Capital: currency, structure, and contribution	Legal requirement for structure Follow the time frame either by installment or one-off

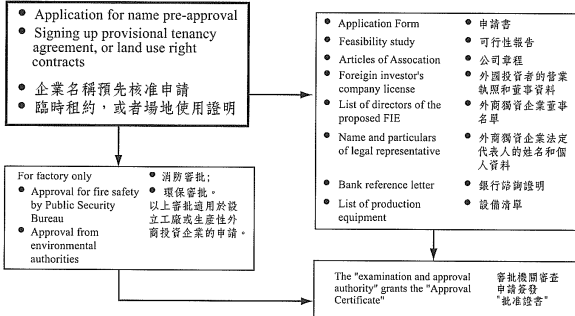
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FIE Incorporation: Flowchart

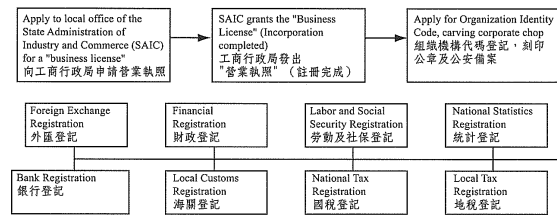
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This is a sample of a 'Certificate of Approval for Establishment of Enterprises with Investment of Taiwan, Hongkong, Macao and Overseas Chinese in the People's Republic of China'. It includes the company name '百得(深圳)有限公司', address '深圳湾山道', and investment details. The certificate is issued by the relevant authority and includes the approval date and registration information.

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This is a sample of a 'Business License' for the company '百得(深圳)有限公司'. It lists the company name, address, legal representative, registered capital (港币400万元), and business scope. The license is issued by the State Administration of Industry and Commerce and includes the registration number and date.

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Issues preceding the establishment of an FIE

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Before setting up an FIE

- Signing of lease agreement
- Notarization of Investor's company documents
- Preparing application documents, with feasibility study report, JV contracts and Articles of Association
- Obtaining pre-approval for special industries before approval for setting up FIE

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Notarization of foreign public docs

- I. Notarization: done through embassy and consulate channels
- II. Apostille: only applicable between member countries of the Apostille convention

http://en.wikipedia.org/wiki/Apostille_convention#States_parties

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Jurisdiction	Members of Apostille Convention?
Mainland China	No
China Hong Kong	Yes
China Macau	Yes

Convention Abolishing the Requirement for Legalization for Foreign Public Documents (1961)

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Comparing jurisdictions

- 1) Continental law jurisdictions
 - China, Japan, Germany
 - Macau, Taiwan
- 2) Common law jurisdictions
 - UK, USA
 - Common Wealth Countries
 - BVI
 - Hong Kong

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Case

- A Singapore Company is to set up a representative office in China, and assign an employee to act as the chief representative of the office, who is a US national.

How to notarize foreign public docs?

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Notarization requirement: FIE incorporation; subsequent changes of particulars for the foreign investor; merger & acquisition

- ◆ Notice jointly issued by SAIC, Ministry of Commerce, General Administration of Customs, SAFE under administrative order (2006) No. 81

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Incorporation Date

- After obtaining approval, foreign investor should apply for the business license within 30 days.
- The FIE comes into existence on the day the BL is granted.

Article 12: Implementation Reg.

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Acquisition Date

- What is the acquisition date if the foreign investor buys an existing company or FIE?
- Date of amended business license or date of acquisition contract?

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