

# CHINA *journal*

## Rules for Applying the Revised Company Law on Foreign Investment Enterprises

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On April 24, 2006, the State Administration of Industry and Commerce ("SAIC"), Ministry of Commerce ("MOFCOM"), General Bureau of Custom, State Administration of Foreign Exchange ("SAFE") jointly promulgated the *Executive Opinions on Several Issues on Applying Laws regarding the Examination, Approval and Registration of Foreign Investment Enterprises* (the "**Opinions for Applying the Company Law on FIEs**"). Such action rules tailored for FIEs are long awaited since the adoption of the Company Law in October 2005. The Opinions for Applying the Company Law on FIEs have clarified certain issues upon the overlaps between the Company Law and the FIEs-specific laws. It assists to facilitate the smooth application of the newly revised Company Law in the context of foreign investment, as well as provides more legal certainty in corporate practice.

This issue of **CHINA** *journal* aims to give an introduction to the main provisions of the Opinions and their possible impacts on foreign investment. The readers are recommended to make cross-reference to two previous issues of **CHINA** *journal* in November 2005 and April 2006 regarding the revision of Company Law and its supplementing regulations.

### One-person Limited Liability Company

The newborn one-person LLC is transposed in the FIE's legal form. The Opinion requires that a one-person wholly foreign owned enterprise ("WFOE") must have at least RMB 100,000 registered capital. When the sole foreign investor is a natural person, the one-person WFOE is not eligible to further establish one-person LLC. For those WFOEs that are established before the revised Company Law came into force (i.e. 01.01.2006), their status quo is unaffected. However, when

changing their registered capital or engaging into investment from then on, one-person WFOEs must attend to the above-quoted restrictions.

### Company Organization

The Opinions confirm that the company organization of the Sino-foreign equity joint ventures and Sino-foreign cooperative joint venture would basically be left as it is. Therefore, the board of a Sino-foreign equity or cooperative joint venture continues to be the authority body. The mechanism of unanimous resolution on key issues is left untouched. There is no legal basis for the power and function of the shareholders' meeting.

Contrarily, the corporate organization of WFOE LLCs and joint stock FIEs are explicitly set to follow the models in the Company Law. As such, a WFOE LLC (one-person or not) will have its shareholders' meeting as the authority body, which decides the key matters of the company business. Shareholders' meeting could adopt resolutions by qualified majority vote defined by the articles of associations. Those very important issues (such as merger, division and change of capital or articles etc.) however require 2/3 majority voting right, while in the case of a Sino-foreign equity joint venture a unanimous board resolution is necessary. Accordingly, the board of directors and supervisors are also mandatory bodies for a WFOE LLC with predefined duties and functionalities according to the Company Law. However, when the number of the shareholders of the WFOE LLC is little and the scale of the company is small, only 1 executive director and 1 or 2 supervisors could be appointed without a formal board structure.

The organization of a joint stock FIE should conform to the stipulations of the Company Law regarding the joint stock company limited by shares. The compositions, procedures, functions and duties of the respective shareholders' meeting, board of directors and board of supervisors must adhere to the Company Law. In this sense, the related provisions in *the Interim Regulation on Certain Issues Concerning the Establishment of Joint Stock Limited Companies with Foreign Investment*, promulgated by the Ministry of Foreign Trade and Economic Cooperation on January 10, 1995 ["Decree (1995) No. 1"] become obsolete by the force of the Company Law.

## Approval and Registration Formality in Details

### *Notarization and Legalization*

It is required that the status certificate or ID of foreign investors should be notarized at home country and legalized by the local Chinese embassy or consulate.

### *Authorized Agent to Receive Legal Documents*

When applying for the establishment and/or registration of FIEs, foreign investors are now required to appoint an agent located in the PRC to receive legal documents. For this purpose, they need to submit the power of attorney for the agent together with other required document to the approval and registration authority. The agent could be the existing branches, the company under incorporation or Chinese entities or individuals, such as lawyers or corporate registration services.

### *Relieving Dual Submission of Certain Documents*

Having obtained the approval certificate, founders of FIEs do not need to submit the joint venture contract and credit certificates of the investors to the registration authority, as the approval authority have already these documents in file. Formerly, these documents are dually submitted to both the approval and registration authority, which places unnecessary burden on the documentation handling in the course of company registration.

### *Firm Name of FIEs*

In the future, the firm name of a FIE will be recorded in its business licence as either the LLC or Joint Stock Company Limited by Shares, with additional wording in bracelet to identify its special characters such as (Sino-foreign Equity Joint Venture), (Sino-foreign Cooperative Joint Venture), (Foreign-foreign WFOE), (One-Person WFOE with Legal Person as the Investor), or (One-person WFOE with Natural Person as the Investor) etc.

## Capital Contribution Schedule

The existing rules for capital payment schedule for FIE LLC are kept untouched. Thus, in the event of one-off payment, the registered capital should be paid off within 6 months after the establishment of a FIE LLC. In the event of instalment payment, the first instalment must be no less than 15% of the subscribed amount and be paid off within 3 months. The rest is, according to the Company Law, to be paid off within 2 years.

Capital payment of a FIE joint stock company is set to following the schedule mandated by the Company Law, namely at least 20% upon the incorporation and the rest within 2 years. Nevertheless, a FIE joint stock company incorporated by means of publicly offering shares requires fully paid-off capital upon the incorporation.

At least 20% of increased capital of FIE LLC or Joint Stock FIE should be paid upon changing the registration and the rest be paid off within 2 years after the registration change.

## Mandatory Assets Appraisal

In-kind contributions except for tangible goods, intellectual property and land use right must be evaluated by valid appraisal entities in China, before the SAIC produces detailed rules on such assets. It should be borne in mind that *labour, credit, name of an individual person, goodwill, franchise right or any assets burdened with collaterals* are NOT permissible as capital contribution. Notably, the Company Law also requires the appraisal of non-cash contribution, but it does not

mandate local appraisal entities to do the work. By literal interpretation of the Opinions, the value of contributed tangible goods, IP and land use right could thus be attained through an appraisal by a foreign body while other forms of in-kind contribution must be evaluated by a local evaluation body.

For Sino-foreign equity joint ventures, the value of non-cash contribution such as tangible goods (including equipments) and industrial property etc., excluding the land use right, could be attained through negotiation among the joint venture parties and does not need appraisal.

### Items Filing for Record

The following items need to be filed for record with the registration authority:

- amendments of articles of association which do not affect registration items, such as firm name, domicile, legal representative, registered capital, paid-in capital, legal form, business scope, duration, and particulars of shareholders or promoters;
- directors, supervisors and managers;
- set-up or rescind of branches;
- names of the members of the liquidation committee

### No More Liaison Office of FIE

The Opinions confirm that the liaison offices of FIEs are going to be phased out and replaced by branches of FIEs. Branches of FIEs are permitted to carry out liaising and consulting activities within the business scope of the concerned FIEs.

### Period of Annual Review

Annual review is newly set to between March 1 and June 30, which previously is between January 1 and April 30.

### Conclusion

The Opinions purport to provide operational guidance for implementing the newly revised Company Law in the approval and registration of FIEs. It represents the positive efforts of in-

charging authorities to accommodate the existing FIE legal regime under the new features of the Company Law. Under the general principle of “new law prevailing old one” and “special law prevailing general one”, the Opinions set forth the detailed rules for implementing the Company Law and to certain extent afford to provide better certainty for foreign investment’s corporate practice.

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