



New Law Enabling a Quicker Process to Incorporate China Subsidiaries

Rollover of Negative List and Recordal System Nationwide

On September 3, 2016 China published a new law¹, which amended the four laws² governing foreign invested enterprises ("FIEs") including joint ventures ("JVs") and wholly foreign owned enterprises ("WFOEs"), effective from October 1, 2016. The new law will significantly simplify the establishment of FIEs in China and their post-establishment corporate changes by eliminating the approval step with regard to the FIEs engaging in businesses outside the so-called negative list for foreign investment.

Overview of current FIE incorporation process

The current FIE incorporation process as provided under the four amended FIE laws generally consists of the following steps:

- i. *Name registration* with the PRC Administration for Industry and Commerce or its local counterparts ("**AIC**"). This will allow the foreign investor to reserve a company name in Chinese for the FIE to be established.
- ii. *Approval of establishment* by the PRC Ministry of Commerce or its local counterparts ("**MOFCOM**"). MOFCOM will need to review various supporting documents and the company constitutional documents, including joint venture contract as applicable, Articles of Association and other details about the FIE, such as business scope, term of operation, etc., and issue the approval for establishment of the FIE. Only upon approval by MOFCOM, the foreign investor can move to the next step to register the FIE with AIC.

¹ Decision of the Standing Committee of the National People's Congress on Amending Four Laws Including the PRC Law on Wholly Foreign Owned Enterprises (全国人民代表大会常务委员会关于修改《中华人民共和国外资企业法》等四部法律的决定).

² The four amended laws are the PRC Law on Wholly Foreign Owned Enterprises, the PRC Law on Sino-foreign Equity Joint Venture Enterprises, the PRC Law on Sino-foreign Cooperative Joint Venture Enterprises, and the PRC Law on Protection of Taiwanese Investment.



- iii. *Company Registration* with AIC. AIC will register the FIE and issue the business license. The date of issuance of the business license shall mark the date of incorporation of the FIE.
- iv. *Post-registration* formalities. The FIE will need to handle the other registrations with applicable government authorities including public security, foreign exchange, customs, commodities inspection, etc. as applicable and the bank. Only after completion of those post-registration formalities, the FIE can have its own company seal, bank account, and invoices, etc. to enable it to fully operate and handle various governmental filings as applicable.

In a typical service WFOE set up case, the whole process may take 3 to 4 months to complete on average. This is quite time consuming. Also, when later there is any change of the major corporate particulars concerning an incorporated FIE, such as change of the legal representative, business scope, registered capital, address, term of operation, and other changes to the Articles of Association or joint venture contract, etc. as well as mergers and acquisitions involving the FIE including intra-group restructuring, the investors will go through almost the same incorporation steps (maybe without the name registration step unless it involves a change of company name) in order to have those changes approved and registered with the PRC authorities.

Pilot reform in Free Trade Zones

To further attract foreign investment, China introduced the Shanghai Free Trade Zone ("FTZ") in 2013, and simplified the current FIE incorporation process by introducing a negative list for foreign investment and the recordal regime to facilitate incorporating FIEs in the FTZ only. For this purpose, the Standing Committee of the National People's Congress adopted a special authorization decision³ to temporarily halt the application of the various laws on FIEs with regard to the FIEs to be incorporated in the FTZ for three years from October 1, 2013. Basically, for the businesses that fall within the negative list for foreign investment, the recordal regime shall be applied instead of the approval regime.

³ The Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Temporarily Adjust Administrative Approvals under Relevant Laws within the China (Shanghai) Free Trade Zone (全国人民代表大会常务委员会关于授权国务院在中国（上海）自由贸易试验区暂时调整有关法律规定的行政审批的决定), effective from October 1, 2013.



Since the introduction of the recordal regime in FTZs, we have indeed seen a shorter time for incorporating a WFOE in FTZs on average. However, the Shanghai FTZ is small, even with later added FTZs⁴, the geographical area benefiting from this simplified recordal regime is still very limited.

Rollover of recordal regime nationwide

Right before the expiry of the special authorization decision on the pilot reform in the Shanghai FTZ, the People's Congress took a more permanent decision to pass the new law, which amended the relevant laws on FIEs and will rollover the negative list and recordal regime nationwide, effective from October 1, 2016.

To implement this new law, MOFCOM just released some draft implementation rules on the recordal regime for public comments. According to the draft rules, the investors may choose to carry out the recordal with MOFCOM either before or after the registration with AIC.⁵ Since it will be a quicker way to incorporate an FIE by conducting the recordal with MOFCOM after the FIE has completed registration with AIC and obtained the business license, we would expect most investors will choose to do so when the relevant businesses fall outside the negative list for foreign investment. Then, the FIE incorporation process in China after October 1, 2016 would look like as follows:

- i. *Name registration* with AIC. This step would be the same as before, in which foreign investor will reserve a company name in Chinese for the FIE to be established.
- ii. *Company Registration* with AIC. This step would be the same as before, in which AIC will register the FIE and issue the business license. The date of issuance of the business license shall mark the date of incorporation of the FIE.
- iii. *Recordal and Post-registration* formalities. The FIE will need to handle the recordal with MOFCOM and other registrations with applicable government authorities.

⁴ Including FTZs in Guangdong, Tianjin, and Fujian. More FTZs are still in proposal.

⁵ While the recordal rules applicable in FTZs also provided that the recordal with MOFCOM can happen either before or after the registration with AIC, in current practice, the AIC still needs to see the recordal certificate issued by MOFCOM before this FIE can be registered with AIC.



It is likely that a typical service WFOE incorporation process would be shortened to no more than 2 to 3 months on average.

Impacts and observations

The immediate and most significant impact of this new law would be time saving for foreign investors when having an FIE incorporated or otherwise changed in China in the context of either greenfield incorporation or restructuring or acquisition.

However, there are quite a number of issues to be answered or to deal with following the issuance of the new law.

First, we still need to see how the nationwide negative list for foreign investment will look like. This nationwide negative list has not yet been issued. There was a negative list applicable only to the FTZ issued by the State Council in 2015, which nonetheless still contained many restrictions on foreign investment. Only a narrower negative list can really benefit the investors. Would the nationwide list be the same as the FTZ list? How to still embody the policy preferential treatment in FTZs after this new law? Would the FTZ list need to be further narrowed down? In this connection, we note that China is negotiating a bilateral investment agreement with US, which also has a negative list under debate but applicable to only US investors. Would the US investors enjoy an even more preferential treatment due to the investment agreement?

Second, the new law will trigger a series of amendments to the existing regulations formulated under the four amended laws on FIEs, just to name a few, the regulations on FIE mergers and acquisitions, and on change of FIE's shareholder, etc. It is unlikely all the amendments can take place overnight from October 1, 2016. It will take some time before the laws and regulations are updated. This will bring in some uncertainty when foreign investors need to handle the relevant businesses under the rules that have not been amended in time to conform with the new law.

Third, the practice of the AIC shall be closely watched. Under the approval regime, MOFCOM is the first government authority that bears the responsibility in approving the establishment of an FIE. Now under the recordal regime, FIE will be established upon registration with the AIC. Can AIC feel comfortable to register the FIE without seeing an



approval from MOFCOM first? Would AIC also introduce more documentation requirements when registering an FIE?

Fourth, we expect that after the new law takes place, it would take some time before China considers adopting a unified foreign investment law as once proposed by MOFCOM in early 2015. Among other things, the draft foreign investment law triggered extensive discussions among the practitioners and investors on the fate of the VIE (variable interest enterprise) structure in China. The passage of the new law has largely retained the effectiveness of the four amended laws on FIEs, which did not touch the VIE issue at all. Would this imply that the VIE structure can maintain the status quo for at least the next 3 to 5 years?

Regardless, the new law is demonstrating that China desires to further liberalize and attract foreign investment into the country.



KEY CONTACTS



Daniel Chan
Partner, Head of Tax - Asia
Hong Kong
T +852 2103 0821
daniel.chan@dlapiper.com



Peng Tao
Partner (Foreign Legal Consultant)
Hong Kong
T +852 2103 0511
peng.tao@dlapiper.com

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