



Establishment of a Foreign Invested Enterprise in China

Wholly Foreign Owned Enterprises and Equity Joint Ventures

Investment is a common entry mode to the Chinese market. It requires the investor to be well aware of market opportunities for his/her business and to be no less familiar with legal, tax and administrative conditions. This guideline shall give an introduction and practical advice on the steps needed for the establishment of a foreign invested enterprise. It is necessary to bear in mind that although national legislation provides the legislative framework for foreign investment, provincial and local authorities may, within discretion given to them by the central authorities, adopt more detailed rules which may then vary locally. It is also necessary to take into account that different industries have different and/or additional rules. In addition to the investment vehicles discussed below, there are other available forms, e.g., partnerships or cooperative joint ventures. However, these are not commonly used at present. We suggest reading below guideline together with some of our other guidelines, e.g., on representative offices or the corporate income tax.

In terms of capital composition, there are currently two types of limited liability companies available for foreign investment in China: **Wholly Foreign Owned Enterprises (WFOE)** with 100% foreign capital and **Joint Ventures (JV)** with both foreign and Chinese capital, where often the ratio between foreign and Chinese capital is based on industry type. Joint Ventures can either have the form of an Equity Joint Venture or a Cooperation Joint Venture.

The majority of foreign investments in China currently take the form of a WFOE which, in terms of control over the management of the company, IPR ownership and other important decision making, provides advantages to its investor(s) as opposed to a JV. However a WFOE might not be suitable or even allowed for every business operation or industry. In some industries, a JV with a Chinese investor is the only permitted option for foreign investment.

Although a WFOE might seem like a preferred choice of operation in China, a JV can present advantages when it comes to, e.g., gaining access to an already developed network of distributors, needing a strategic local partner or simply wanting to share operational costs.

Before engaging in the process of establishing an entity in China, it is highly recommended to be well aware of the advantages and disadvantages of both vehicles, WFOE and JV, as well as comparing the options of a Representative Office (RO) and a Foreign Invested Commercial Enterprise (FICE)¹.

At the initial stages of your business plan you should always include an investigation of at least the following:

- Legal conditions on foreign investment in your industry, specific sector and location;

¹ FICE can be either WFOE or JV and is used mostly for trading, distribution and retail

- Tax issues and incentives;
- Location and industry-related incentives;
- Structure of the profit repatriation;
- Due diligence on your JV partner.

*Note: A **Representative office** (RO) might be an ideal option for the initial stages of investigation of the market and its opportunities for your business, the search and relationship building with potential partners – customers, suppliers, etc. The establishment of an RO is a relatively straightforward process which presents the strong advantage of not needing the injection of capital. However an RO is strictly prohibited from performing any business in China. It cannot issue invoices for its products or services, etc.*

When you already know that China is “your market” and that you cannot or do not want, for various reasons, operate your business from abroad without permanent presence here, it is time to establish a company. Please keep in mind that **ROs cannot be transformed into a company**. There are two separate procedures involved: one is closing a RO and another one is establishing a WFOE or JV.

Establishment procedures are very similar for WFOE and JV. Nevertheless, some steps, such as the authorities that need to be approached and/or documents that need to be provided, may differ. However, the company size (total investment), location and business scope are more important than the capital structure (WFOE or JV) itself.

Depending on the **total investment** and/or the business scope, local, provincial or state level authorities may be involved. The authorities under the *Ministry of Commerce* are responsible for approving foreign investments while the *State Administration of Commerce and Industry* is responsible mostly for the administrative process of establishing the company – e.g., approving the name, registering the company and issuing the business licence. There are other authorities that you will also become familiar with: the *Local and State Tax Bureau*, the *State Administration for Foreign Exchange* and the *Entry and Exit Inspection Office*.

You are strongly advised to **register**, preferably well in advance, all your **IPR** in China before the establishment of the company. For advice please contact <http://www.china-iprhelpdesk.eu>.

Both WFOE and JV are established according to Chinese laws and are subject to Chinese jurisdiction.

1. Industry

The Chinese government regulates foreign investment by several means. Listing industries suitable or less suitable for or forbidden from foreign investment is one of them. The basic guideline to distinguish the industries in which foreign investment are encouraged, permitted, restricted or forbidden can be found in the *Catalogue of Industries for Foreign Investment*. The classification of industries and sectors is, in short, made according to the government’s plans and its intention to support foreign investment or to keep a partial or total control of specific industries.

1.1 Legislation

- Catalogue of Industries for Guiding Foreign Investment (2012);
- Catalogue of Priority Industries for Foreign Investment in the Central-Western Region.

1.2 Industries according to the level of support or restriction for foreign investment

Encouraged activities are those where the government welcomes the participation of foreign investments and where it supports foreign investors through various means, e.g., tax incentives or less administrative burden. The encouraged industries include, among others, investments in environmentally-friendly industries, new technologies, product quality upgrading, export promotions, etc. From the long list of encouraged activities, the following activities can be noted as especially interesting: development and production of baby foods, health food, water treatment, occupational skills training and many others.

Permitted activities are those not mentioned in the catalogue. This means that such activities do not receive special support, nor are they restricted or forbidden.

Restricted activities are those where investment may be less environmentally friendly, is “outdated” in terms of technology used, or the Chinese government wants to keep stricter supervision on them. Such activities are either subject to a complex approval procedure, where obtaining special permits is very difficult and/or is often limited to companies operating under a JV with a Chinese partner which controls the JV. Such cases include the printing of publications, the production of biological liquid fuels, etc.

Forbidden activities or industries are those where the government wishes to keep control and protect its interests, e.g., natural resources, national interests, cultural heritage (traditional Chinese medicine, tea production), or are, in one way or another, strategic industries for the country.

It is advised to go through the catalogue, check your and related industries, sub-industries and activities which might be suitable to your business purposes and which can bring you support from the government.

The catalogue is regularly updated and published. The last amendment was issued at the end of 2011 and has been effective since January 30th 2012.

2. Location

If, for such reasons as the location of your customers or partners, you are not forced to open your company in a specific city or region, it is highly advisable to consider your options for a possible location. There are various administrative regions or economic zones in China that provide a wide range of incentives in terms of taxes, speed of the administrative process, development of infrastructures, etc.

China’s territory counts 22 provinces, 4 municipalities, 5 autonomous regions and within them about 200 development zones. Currently most foreign investments are concentrated in the eastern part of China and in large cities. Therefore the Chinese central government supports, by various means, investments and development in central and western regions. Local authorities have some discretion

in adopting local rules (within limits given by higher level regulation) which might bring considerable advantages to your business.

The **Development Zones** with preferential policies, developed infrastructure, etc., are divided as follows:

- Special Economic Zones – 5 locations in southern China which can issue their own legislation without respect to the provincial level (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan);
- Economic and Technological Development Zones;
- High-Tech Industrial Development Zones;
- Free Trade Zones;
- Export Processing Zones.

3. Wholly Foreign Owned Enterprises – WFOE

A WFOE is a legal entity and has the legal form of a limited liability company. Liability is limited by the level of the registered capital.

There can be one or more foreign investors (companies or individuals) to it.

Based on scope of business operations, a WFOE is usually involved in one or more of the following activities:

- Manufacturing;
- Service provision;
- Commercial – called Foreign Invested Commercial Enterprise (please see chapter 6, below).

3.1 Legislation

Wholly Foreign-Owned Enterprise Law is a special law related to the establishment of a WFOE. Where the WFOE Law is silent, the Company Law shall apply. Where there is a provision for the same scope in both laws, the WFOE Law shall have priority.

- Wholly Foreign-Owned Enterprise Law (revised 2000);
- Detailed Rules For the Implementation of the Law on Wholly Foreign-Owned Enterprises;
- Company Law;
- Provisional rules on the ratio between Registered Capital and Total Investment of Sino-foreign Equity Joint Venture Enterprises (applies to WFOE as well).

3.2 Establishment

3.2.1 Basic elements

Before you start assembling the paperwork, it is advisable to have answers to the following questions, as it gives you a basis for what to fill in the application forms and supporting documents:

- What business activities will my WFOE perform? – This should cover all your company activities and will equal to the registered business scope.

- Where will be the location of my business operations? = Registered seat/address
- What will my operating costs be before earning sufficient income from my business? = Total investment (registered capital and debt in foreign currency).
- Who will be the person responsible to act on behalf of the company, i.e., the representative with third parties and local authorities? = Legal representative.
- Who will be making decisions with regards to day to day management of the company? = General manager.
- What will be the name of the company? = Registered official Chinese and not official English name.

3.2.2 Company name

Only a Chinese company name will be registered and considered as official. The choice of the name is important and should not only be a phonetic transcription of the English/foreign name of your company. Chinese people do not only use the name as an identification but also pay attention to whether “it sounds good”, which means whether the characters have an auspicious meaning. When you have chosen your company name in Chinese (it is advisable to prepare a few options in advance in order to save time with the application in case your chosen name is already taken), verify with the SAIC whether it is available for registration. If the name is already taken or if it sounds too close to that of an existing company, you will have to modify it and apply again.

3.2.3 Business Scope

The business scope is the list of activities which your company has been authorised to perform. The activities should not be stated too generally as they may not be accepted by the registration office (e.g. consulting or food production is not sufficient). At the same time it should not be so specific that it limits your business activities (e.g. production of strawberry jam might be too limiting).

3.2.4 Documents for the investor(s)

Some documents must be prepared to certify the legal existence and the good financial situation of the investors. Such documents include, but are not limited to:

- Business licence or certificate of incorporation;
- Creditworthiness letter;
- Photocopy of the passport of the legal representative of the investor company;
- Board of directors resolution or any other documents certifying that the person who signs the documents is authorized to sign on behalf of the investor;
- Audited financial statements report (1-3years) – this is not requested in all cases.

3.2.5 Documents for the company

The following documents which outline the organization and business plan of your enterprise should be drafted:

- Feasibility study;
- Articles of association;
- Shareholders agreement in case there are two or more investors;
- Environmental protection report;

- Lease contract for premises or ownership certificate, certificate for land use right;
 - Photocopy of the passport of the legal representative of the company and appointment letter;
 - CV and photocopy of the passport of the company's general manager and appointment letter.
1. **Feasibility study:** This is an analysis of the company's business plan that will be carefully studied by the authorities in charge of the approval. The relevant authorities will check whether your aims are realistic, in favour of the Chinese market and the development of the Chinese economy, and whether the resources allocated (financial, human, etc.) are sufficient. It is important to pay attention to the document. The feasibility study shall describe the purpose of the enterprise, its scope and scale of business, its products, technology and equipment, the land area needed and all related requirements, conditions and quantities of water, electricity, natural resources or other energy resources required, as well as the requirements for public facilities.
 2. **Articles of association:** A document describing the cornerstones of the company and its operation. Do not underestimate the importance of this document, the content of which can facilitate your operation or make it more difficult. You will not only need articles of association for the initial approval, but also for every important change during the life of your company, e.g., an increase of the registered capital, a change in the number of directors in the board, profit repatriation, and for the liquidation of your company. The minimum content shall cover the following:
 - Name and registered address of the company;
 - Purpose and scope of business;
 - Total amount of investment, registered capital and time limit of capital subscription;
 - Form of the company;
 - Establishment of the internal departments and their functions, powers and rules of procedures, duties and power limits of the legal representative and relevant employees (i.e., general manager);
 - Principles and system of financial affairs, accounting and auditing;
 - Labour management;
 - Operating period, termination and liquidation of the enterprise;
 - Procedures for amending the articles of association.
 3. **Environmental protection evaluation report:** This report is required especially for manufacturing companies and FICE and shall contain information on raw materials, machinery and other equipment, safe disposal of toxic products, and other information which might affect the environment.

The complete list of documents and application forms, language and notarization requirements, can be found out by direct request at the local administration office in addition to the above. It is strongly suggested to hire a legal advisor as the requirements may differ between authorities, industries and locations.

3.2.6 Registered capital and total investment

The minimum **registered capital** for WFOE as stipulated in Company Law is RMB 100,000 for a company with limited liability and with one investor, and RMB 30,000 where there are two or more (up to 50) investors. However, it is important to note that the required registered capital amount varies from one industry to another. Make sure to check applicable local regulations as well. Moreover, the

amount of RMB 100,000 is very often insufficient for your company’s business operations as it constitutes, together with foreign debt (see below), your only source of financing until you are able to support your business from your company income.

The total investment is composed of the registered capital and the allowed amount of foreign loan (usually from parent company but not necessarily).

Total investment (in USD)	Registered capital
Less than 3 million	No less than 70% of total investment
Above 3 and less than 10 million	No less than 50% of total investment with a minimum of 2.1 million if total investment is below 4.2 million
Above 10 and less than 30 million	No less than 40% of total investment with a minimum of 5 million if total investment is below 12.5 million
Above 30 million	No less than 1/3 of total investment with a minimum of 12 million

The foreign investor can make a contribution in instalments, provided that the last instalment is made within two years from the date of issue of the business license. The first instalment may not be less than 15% of the total amount to be contributed by the foreign investor, and shall be made within 90 days from the date of issue of the business license.

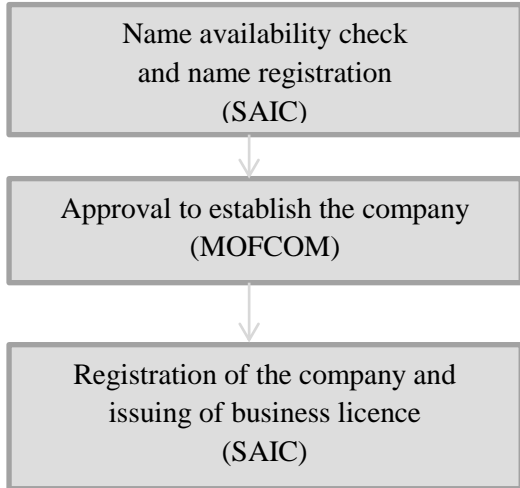
3.3 Procedure for registration

In the following, the procedural steps for the establishment of a WFOE will be introduced. The procedure consists of two phases: before and after the issuance of the business licence. From the moment the temporary business licence is issued, the company legally exists and can conclude contracts, start generating an income, etc.

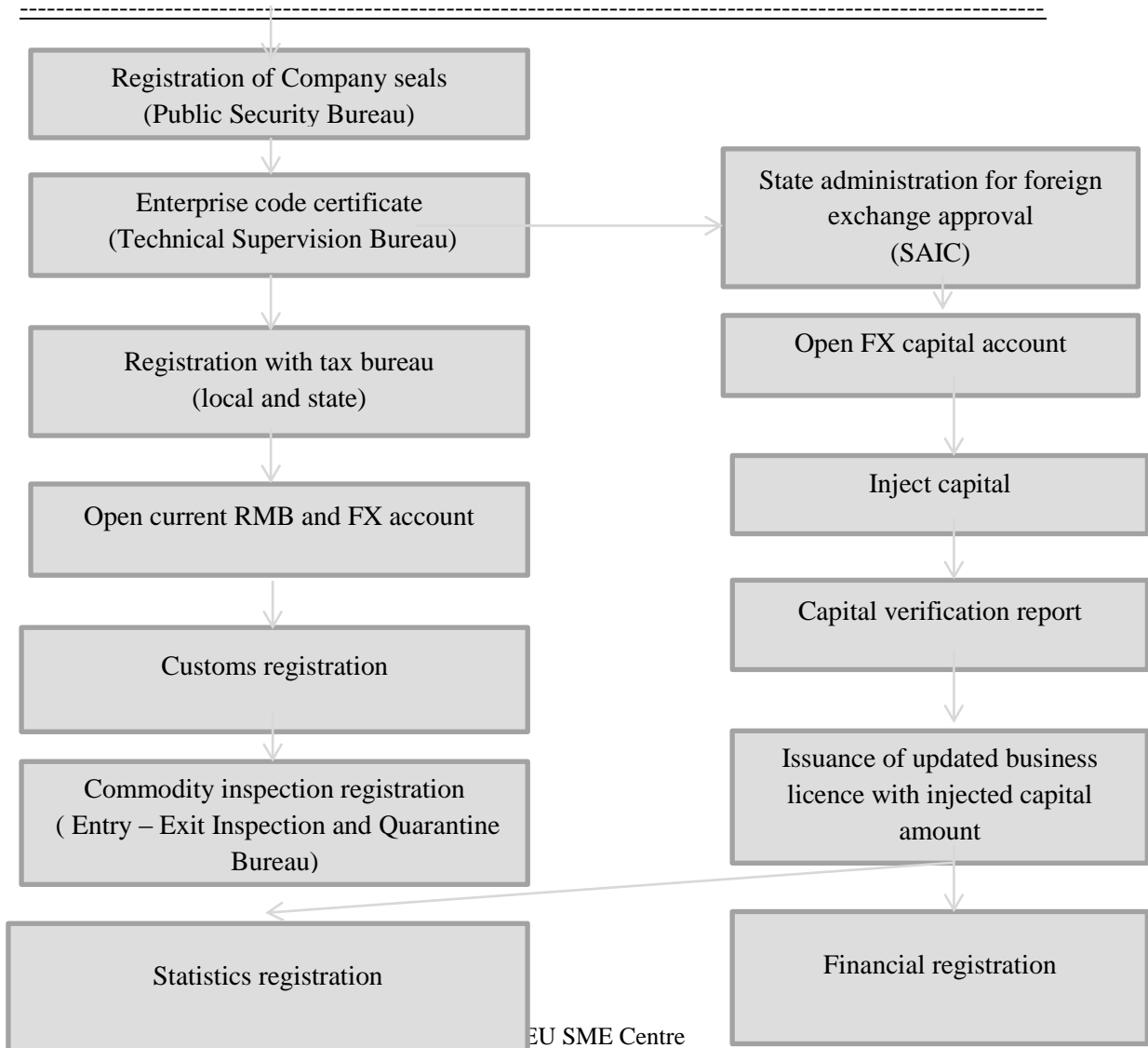
There are differences in the establishment and registration of a manufacturing, service providing or commercial WFOE (FICE), e.g., a service providing WFOE does not need to apply for a Commodity Inspection Registration. In addition, there are different requirements for the approval request of special permits or licences depending on the industry and/or the region/location of application. It is very important to verify with the local authorities and with the assistance of your Chinese legal advisor what documents you are to submit.

The time for the establishment of a WFOE varies according to the industry, the business scope, the total investment and the region, but it is usually somewhere between 4 and 10 months from the “name application” to “the updated business licence” (see below). It is important to be aware that all application documents must be complete and accurate for them to be accepted by the authorities, and only from that moment on the time for application is officially counted.

Procedure for registration:



Company legally exists



4. Equity Joint Venture

There are two types of JVs: the Equity JV and the Cooperative JV. The Equity JV is the more commonly used of the two. An Equity JV is a limited liability company with mixed Chinese and foreign capital. Foreign investment is usually requested to be more than 25% of the registered capital. According to the Catalogue of Industries for Guiding Foreign Investment, in some specific industries, the Chinese party is required to have control over the JV, in which case the foreign party is not allowed to own more than 49%.

The establishment of the JV requires more planning and consideration than for the establishment of a WFOE. Right from the beginning, and during the whole life of the JV, all decisions will need to be made in consultation with your JV partners. It is therefore crucial that, from the very beginning, you set the conditions in a way that corresponds to your business interest and protects yourself against surprises.

Special attention should be paid to your intellectual property and the protection of your technology. It is always a good idea not to transfer all your know-how to the new JV, but to keep vital parts in your home company abroad under your sole control.

You should always have your own staff in positions crucial to your interests, e.g., the general manager or the vice general manager with sufficient powers, the chief engineer, the financial director, the risk manager, the human resources or procurement manager, etc.

It is not always true that, by establishing a JV, you save money. It all depends on an **accurate evaluation of your partners' contribution**, e.g., land, employees, distribution net. You must know the status and conditions of all the assets of your partner. If your partner contributes to the JV capital with land use rights, check the status of such rights (there are different levels of these rights).

4.1 Legislation

- Law on Chinese-Foreign Equity Joint Ventures;
- Regulations for the implementation of the Law on Chinese-Foreign Equity Joint Venture;
- Company Law;
- Provisional rules on the ratio between registered capital and total investment of Sino-foreign Equity Joint Venture.

4.2 Establishment

The information provided under point 3.2 above for the establishment of a WFOE can be used here with the modifications below. There are at least two major steps to be added in the establishment process by comparison to the establishment of a WFOE:

- Due diligence on your future partner: the depth of such due diligence shall depend on the size and complexity of the company as well as on its contribution to the JV;
- Joint Venture contract.

The **Joint Venture contract** shall define basic elements of the company and clearly state the rights and obligations of JV partners during the establishment of the company as well as during the life of the company. The contract shall at least cover the way each partner contributes to the registered capital, the distribution of the management positions, the duties and the shared cost during the establishment of the company, the priority right to the partner share, the business management organization, the profit distribution, the liquidation, the applicable law and details on dispute resolution.

The **articles of association** shall be consistent with the JV contract, but shall focus more on the organization of the company instead of the rights and duties of the party. However, the content will in majority be the same as in the JV contract. It shall contain at least:

- Name and registered address;
- Business scope;
- Registered capital and total investment;
- Composition and powers of company bodies (board of directors, board of supervisors or supervisor etc.);
- Internal organization structure;
- Internal regulations;
- Finance;
- Profit distribution;
- Labour provisions and trade union;
- Duration and liquidation.

4.3 Procedure

The steps to follow for the administrative procedure are the same as the establishment of a WFOE. The difference will be in the documents required to submit for approval, e.g., the JV contract. The procedure also depends on the industry your company is active in and the special permits needed. Usually the time needed to establish a JV is longer compared to a WFOE.

5. Foreign Invested Commercial Enterprise

A Foreign Invested Commercial Enterprise (FICE) is capable of conducting the commercial activities described below in its business scope. It can have the form of either a WFOE or JV.

The business scope of a FICE includes one or more of the following:

- Import/export;
- Retailing – Selling goods and related services to individual persons from a fixed location as well as through TV, telephone, mail order, internet, and vending machines;
- Franchising – either to franchise the business model or brand directly or pass the franchise to other local companies
- Wholesaling – Selling goods and related services to retailers, customers from industry, trade or other organizations, and other wholesalers;

- Commission agency activities – Act as a sales agent, broker or auctioneer for goods, or as a wholesaler who charges fees and conducts sales, related services or other goods on a contractual basis;
- A FICE is not allowed to engage in selling certain products, including: pharmaceutical products, agricultural chemicals, chemical fertilizers, processed oil, grains, vegetable oil, edible sugar and cotton. A FICE has to have the form of a JV (49% max for foreign investment) if you wish to establish more than 30 retail stores in China and distribute the products mentioned above.

5.1 Legislation (in addition to legislation applicable to WFOE and JV)

- Administrative Measures on Foreign Investment in the Commercial Sector (2004), as amended;
- Measures for Administration of Export License of Goods (2008);
- Regulations on the Administration of Import and Export of Goods (2001).

5.2 Establishment

The same general information mentioned under 4.2 and 5.2 applies here.

1. Documents for the investor

- Business licence or certificate of incorporation;
- Creditworthiness letter;
- Photocopy of the passport of the legal representative of the investor company;
- Audit report of all investors, compiled by an accountant firm during the last year.

2. Documents for a FICE

- Feasibility study report;
- Contract for JV when JV is established;
- Articles of association;
- Evaluation report on state-owned assets invested into the JV by Chinese investors;
- Catalogues of import and export commodities;
- Name list of the members of the board of directors of the planned foreign-funded commercial enterprise and the appointment letter for directors;
- Notice of pre-approval of the enterprise name as issued by the Administrative Department for Industry and Commerce;
- Certificate documents (photocopy) of the use right of the land used for the planned store and/or house lease agreement (photocopy), except when the business area of the store to be opened is less than 3,000 square metres;
- Documents of statement of conformity with the requirements for city development and urban commercial development as issued by the competent commerce department of the government at the locality of the store;
- Other documents as required by local administration.

5.3 Procedure

The steps to follow are similar to those on 3.3.

6. Tax

We add limited information on main taxes applicable to companies in China. However, you are strongly advised to pay attention and seek professional advice in your particular case. For detailed information on taxes kindly consult EU SME Centre's website.

The tax system in China consists of more than 20 different taxes, of which the following are generally the most important ones for companies, including foreign investment, and will likely be applicable to FIE.

Corporate Income Tax

- 25% for general taxpayers;
- 20% for small and medium enterprises;
- 15% for specific encouraged industries (e.g., new technologies).

VAT

- 17% or 13% for general taxpayers (input VAT can be deducted);
- 3% for small tax payers (input VAT cannot be deducted).

Import VAT

- 17% or 13%.

Business Tax

- Is payable against turnover when providing services;
- 3%, 5% and up to 20% (for entertainment industry).

There is a pilot program for the unification of VAT and BT in certain industries and regions (Shanghai as of January 1st 2012). In the future, some industries or activities there are going to be charged VAT.

Consumption tax

- Also called "luxury" tax as it applies mainly to luxury goods (alcohol, jewellery, etc.) but also to goods where environmental protection is required.

Other taxes include stamp duty, property tax, education tax, real estate property tax etc.



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Contact the Centre at:

Room 910, Sunflower Tower
37 Maizidian West Street
Chaoyang District
Beijing, 100125

T: +86 10 8527 5300
F: +86 10 8527 5093

www.eusmecentre.org.cn
enquiries@eusmecentre.org.cn

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