

# Corporate Aspects of Trading and Investing China

## **1. INTRODUCTION**

Below please find a brief article on the different ways to enter the Chinese market, as well as information on how to set up a Chinese subsidiary or holding company. This article outlines the most commonly used profit-driven entities and the basic consequences thereof under Chinese corporate and tax law. This article is specifically not intended to deal with the entire range of Chinese entities and their legal consequences. Most emphasis will be put on the EJV, CJV, WOFE, FICLS or the Foreign Invested Holding Company. These vehicles can be limited liability companies or companies limited by shares as provided by relevant laws or regulations and are the most frequently used vehicles when setting up a Chinese subsidiary or holding company.

## **2. METHODS OF MARKET ENTRY IN CHINA**

### **2.1 CHINESE-FOREIGN EQUITY JOINT VENTURES (EJV)**

Chinese-Foreign Equity Joint Ventures are invested and operated jointly by both foreign and Chinese investors who will share the profits and losses, as well as risks of the EJV, in proportion to their respective shares in the EJV. An EJV is a limited liability company, and possesses the status of Chinese legal person. In most cases, the proportion of the capital contributed by the foreign investor(s) is not less than 25% of the total registered capital of the EJV, for an EJV will not be able to enjoy the preferential treatment if the registered capital subscribed by foreign investor(s) is less than 25% of the total registered capital. An investor could make his or her capital contribution in cash or in the form of non-monetary property whose monetary value can be appraised and which may be transferred in accordance with the laws or regulations, Examples of non-monetary property contributions are buildings, workshops, machinery, industrial property rights, special techniques, and land use rights. The profits or other legal interests which are distributed to foreign investors can be remitted abroad or reinvested in China.

EJVs are governed by the Company Law of the People's Republic of China, the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures and other related laws and regulations. Other specific requirements or provisions concerning establishment and operation of EJV which are not deliberated in this article can be found in those laws and regulation.

### **2.2 CHINESE-FOREIGN CO-OPERATIVE JOINT VENTURES (CJV)**

Chinese-Foreign Co-operative Joint Ventures are enterprises jointly established within Chinese territories by foreign companies, enterprises, other economic entities or individuals and Chinese companies, enterprises or other economic entities, according to their co-operative conditions. Matters such as requirements for investment or co-operation, distribution of earnings or products, apportionment of risks and losses, the form of management and operation and the reversion of property upon termination of the co-operative venture shall be provided in the co-operative venture contract by all the parties to the CJV.

When establishing a CJV, it is usually the case that the foreign investor(s) will provide all or most cash, technology and key equipment, while the Chinese party/parties will provide land, factory buildings, certain usable machines and facilities, and in some cases a certain amount of cash as well.

A CJV may or may not be an independent legal entity with limited liability, depending on the decision made by investors. One of the biggest differences between an EJV and a CJV is that the investors of a CJV can share profit and risk according to their agreement while investors of EJV should share profit and risk in proportion to investors' shares in the registered capital.

### **2.3 WHOLLY FOREIGN-OWNED ENTERPRISE (WFOE)**

A Wholly Foreign-Owned Enterprise is invested entirely by foreign companies, enterprises, other economic entities or individuals within Chinese territory in accordance with relevant Chinese laws. A Wholly Foreign-Owned Enterprise usually takes the form of limited liability companies.

The duration of the WFOE must be set out in the application and is subject to approval from Ministry of Commerce or its local agency. A WFOE is capable of converting profits in Chinese currency into foreign currency for remittance to their parent company outside China. Although a WFOE is permitted to engage in an increasing range of sectors, some restrictions still exist. These restrictions are set out in the Foreign Investment Catalogue and various industry-specific regulations.

### **2.4 FOREIGN INVESTMENT COMPANY LIMITED BY SHARES (FICLS)**

A Foreign Investment Company Limited by Shares is a company limited by shares with investment solely or partially made by foreign companies, enterprises, other economic entities or individuals within Chinese territory.

Newly-published regulations prescribe that foreign investors are permitted to buy A shares of listed companies in the Chinese stock market in order to act as strategic investors of those A share companies. Investment can be carried out by installments and the share held by a foreign investor after initial invest shall not be less than 10% of the issued shares, except for the special industries. The investor should have no less than US\$ 100 million actual assets overseas or manage no less than US\$ 500 million actual assets overseas. The shares bought by foreign investors cannot be transferred again within 3 years. A foreign investor can buy A shares by the methods of transferring agreement, issuing new shares to certain investor by the listed company or other methods prescribed by Chinese laws and regulations.

### **2.5 FOREIGN INVESTED HOLDING COMPANY**

A foreign invested holding company may be an EJV or WFOE engaged in direct investment activities within Chinese territory. A foreign investor, who applies to establish a foreign invested holding company must possess great assets and a good reputation, establish a certain amount of companies within China, and own over US \$30 million of paid-in part of registered capital. Upon the approval of the Chinese government, foreign invested holding companies could enjoy a broader field of managing than other ordinary companies, an attempt to encourage multinationals to carry out their series of investment plans. At present it is possible for foreign

invested holding company to invest in the fields of industry, agriculture, infrastructure and energy that the county encourages and permits.

A foreign investor can form a holding company when it decides to combine two or more of its investment vehicles across China into a fully integrated company group that can combine sales, marketing, manufacturing, centre services, subsidiary investment and maintenance services for a board range of product lines.

### **3. FORMATION OF A CORPORATION**

Chinese company law defines two types of companies: limited liability company and company limited by shares. Both types of companies shall be liable for its debts to the extent of all their assets. Shareholders of a limited liability company shall be liable to the company to the extent of the capital contributions they have made, and shareholders of a company limited by shares shall be liable to the company to the extent of the shares they have subscribed for.

When a company with foreign investment is to be established, an application for registration of its establishment shall be made to the company registration authority after Ministry of Commerce or its local commissions has approved the establishment of the foreign invested enterprise ("FIE"). If the contemplated company satisfies the conditions as prescribed in relevant laws and regulations, the company registration authority shall register it as a limited liability company or a company limited by shares. In practice, the company registration authority is the State Administration for Industry and Commerce or its local agencies.

If laws or administrative regulations provide that the establishment of a FIE shall be subject to examination and approval of a certain competent authority, the examination and approval procedures shall be carried out according to law prior to such company's registration. For example, the establishment of a telecommunication EJV in China is subject to examination and approval of the information industry regulatory agency.

#### **Contribution /Payment on Shares**

##### *A Limited Liability Company*

The minimum amount of the registered capital of a limited liability company shall be RMB thirty thousand (30,000.00), which is equivalent to around € 3.000,00. If any provisions of laws or administrative regulations specify a higher minimum amount of the registered capital of a limited liability company, such provision shall prevail.

The total amount of the first instalments of capital contributions made by all the shareholders of a FIE company shall not be less than either fifteen percent (15%) of the registered capital of the company or the statutory minimum amount of the registered capital of a company, and the balance of the registered capital shall be paid up by the shareholders within two (2) years of establishment of the company or, in the case of an investment company, within five (5) years.

The shareholders of a company may make their capital contributions in currency or in the form of non-currency property, such as material goods, intellectual property rights, and land use rights, whose monetary value can be appraised and which can be transferred according to law, unless otherwise provided by laws or administrative regulations. The contributions in cash

made by all the shareholders of a limited liability company shall not be less than thirty percent (30%) of the registered capital of the company.

#### *A Company Limited by Shares*

The minimum amount of the registered capital of a company limited by shares shall be RMB 5 million (5,000,000.00), which is equivalent to around €500,000.00. If any law or administrative regulation provides for a higher minimum amount of the registered capital of a company limited by shares, such provisions shall prevail.

A company limited by shares may be established by means of promotion or by means of share offer. If a company limited by shares is established by promotion all the shares to be issued by the company are subscribed by the promoters, while in case of establishment by way of a share offer, investors other than those promoters may subscribe to the registered capital. When a company limited by shares is established by promotion, the first instalments of capital contributions made by all the promoters of the company shall account for no less than twenty percent (20%) of the registered capital and the balance shall be paid in by the promoters within two (2) years after the date of establishment of the company or within five (5) years in the case of an investment company. No capital shall be raised by means of share offer until all the registered capital is paid in.

The promoters of a company limited by shares can make a capital contribution by the method applicable to the shareholders of a limited liability company.

### **Transfer of Shares**

#### *A Limited Liability Company*

The shareholders of a limited liability company may transfer all or part of the company's equity among themselves.

If any shareholder is to transfer its equity to a party other than to another shareholder, such transfer shall be subject to the consent of a majority of the other shareholders. The shareholder shall notify the other shareholders of the particulars of his or her equity transfer in writing and solicit their consent. The other shareholders shall be deemed to have granted consent to such transfer if they fail to reply within thirty (30) days of the date of receipt of such written notice. If more than half of the other shareholders do not consent to such transfer, those shareholders who withhold their consent shall purchase the equity to be transferred. If they fail to make such purchase, they shall be deemed to have granted consent to such transfer. On the same terms, the other shareholders shall have the right of first refusal to purchase the to-be-transferred-equity whose transfer has obtained the shareholders' consent. If two or more than two shareholders propose to exercise such right of first refusal, they shall determine through consultation the proportions of the equity they may purchase respectively. If such consultation proves unsuccessful, they shall exercise their right of first refusal in proportion to the capital contributions they have made by the time of such transfer.

If the articles of association of the company provide otherwise in respect of equity transfer, such provisions shall prevail.

### *A Company Limited by Shares*

Shares of a company limited by shares may be transferred according to law. Shareholders shall transfer their shares at stock exchanges established according to law or by such other means as prescribed by the State Council.

Shares of a company held by its promoters shall not be transferred within one (1) year from the date of establishment of the company. Shares issued by a company prior to its public issue of shares shall not be transferred within one (1) year after the date the shares of the company are listed and traded on a stock exchange.

The directors, supervisors and senior officers of a company shall declare to the company the shares of the company they hold and any changes in their shareholding. During their term of office they shall not transfer more than twenty-five percent (25%) of the total of the shares of the company they hold every year, and they shall not transfer any of the shares of the company they hold within one (1) year after the date the shares of the company are listed for trading. Within half a year after the aforementioned individuals quit the company, they shall not transfer any of the shares of the company they hold. Other restrictions on the transfer of the company's shares held by the directors, supervisors and senior officers of the company may be provided for in the articles of association of the company.

## **4. MANAGEMENT OF A CORPORATION**

A PRC corporation's corporate governance structure includes (I) a board of directors or an executive director, (II) a board of supervisors or one or two supervisors, (III) and senior managers. The board of directors or the executive director shall be accountable to the shareholders' meeting and shall exercise the following functions and powers:

- to be responsible for convening shareholders' meetings and to report on its work to the shareholders' meeting;
- to implement the resolutions of the shareholders' meeting;
- to decide on the business plans and investment plans of the company;
- to formulate the proposed annual financial budgets and final accounts of the company;
- to formulate the profit distribution plans and plans for making up losses of the company;
- to formulate plans for the increase or reduction of the registered capital of the company and for issue of bonds by the company;
- to draft plans for the merger, split, restructuring or dissolution of the company;
- to decide on the establishment of the company's internal management organization;
- to decide on the appointment or dismissal of the manager of the company and on matters concerning his remuneration, and to decide on the appointment or dismissal of the deputy manager(s) and chief financial officer as proposed by the manager and on matters concerning their remuneration;
- to formulate the basic management system of the company; and
- other functions and powers specified in the company's articles of association.

A corporation in China shall have a legal representative who can be the chairman of the board of directors, the executive director or the manager. The legal representative shall be named in the articles of association and shall be registered with company registry according to law.

## 5. OFFICERS' LIABILITY

According to the new Company Law, obligations of directors, supervisors and other senior officers include:

- obligation to abide by laws, administrative regulations and the company's articles of association;
- obligation not to take advantage of any affiliation it has to do damage to the interests of the company and shall pay compensation for any such losses that the company may suffer as a result of violation of this provision;
- obligation not to take advantage of their functions and powers to accept bribes, seek other illicit gains, or seize any property of the company;
- obligation not to disclose any secret of the company without authorization;
- obligation not to misappropriate any funds of the company; and
- obligation not to lend funds of the company to a third party or not to use assets of the company as security for a third party in violation of the articles of association of the company or without approval of the shareholders' meeting, the shareholders' general meeting or the board of directors.

If a director, a supervisor or any senior officer violates any provisions of laws, administrative regulations or the articles of association of the company in the performance of his official duties, thus causing any losses to the company, he shall be liable to compensate the company for such losses.

Directors bear liability for board resolutions if any resolution violates laws or provisions of the articles of association and loss is thereby caused to the company.

If a director or senior officer violates any provisions of laws, administrative regulations or the articles of association of the company in the performance of his official duties, thus causing any losses to the company, the shareholders of a limited liability company or the shareholders of a company limited by shares that have individually or collectively held more than one percent of the shares of the company for more than 180 consecutive days may petition in writing to the board of supervisors, or the supervisors of a limited liability company (that has not established a board of supervisors), to initiate legal proceedings against such director or senior officer in the people's court;

If it is a supervisor who commits such a violation, the aforementioned shareholders may petition in writing to the board of directors or the executive director of a limited liability company (that has not established a board of directors), to initiate legal proceedings against such supervisor in the people's court.

## 6. TAXATION OF PROFITS

Chinese tax system is complicated but evolving quickly. The main tax items in China are, inter alia, value added tax, consumption tax, business tax, tariff, corporate income tax, individual income tax, resource tax, real estate tax, vehicle tax. Usually, tax incentive is a very important factor for a foreign investor to decide where to invest. In China, tax incentives are different in different areas and different sectors. Further, tax rate change is also common in China. So, arranging tax skillfully can save a lot for the enterprises and the investors.

### Corporate Income tax

Corporate income tax rate is 25%. Losses incurred during a tax year may be carried over to the next tax year and set off against a corresponding amount of income in that second year. If the income in the following tax year is insufficient to cover such losses, the balance may be set off against the income in subsequent years for a maximum period of five years.

The central government has indicated that it will unify the tax regime applicable to foreign investment enterprises and domestic companies in the near future.

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