AN OVERVIEW OF THE COMPANY AND FOREIGN INVESTMENT REGULATORY FRAMEWORK IN CHINA

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Abstract: This article provides a brief comprehensive overview of the company and foreign investment regulatory framework in China and focuses on its company law, business structures, governance, and foreign and outbound investment key regulations and guidelines.

It offers a brief introduction of the first comprehensive corporate legal framework in China, its company law, paving the way for the development of the securities market in the country, and a brief comparative analysis of the corporate governance, transfer of shares, financial reports and dissolution regulations governing Limited Liability and Joint Stock companies in China.

Further to an introduction to the general and limited partnerships, the article moves to analyze the main forms of foreign invested enterprises in China and their respective regulatory approval requirements and restrictions, including for the representative office, branch, wholly foreign owned enterprise, equity and cooperative joint ventures and the foreign invested partnership enterprise.

Finally and following an introduction of the popular variable interest entity, the article concludes with an overview of the China outbound investment regulatory framework and its approval requirements and restrictions.

Keywords: Company law; business structures; foreign investment; outbound investment.

I. Introduction to the Company Law of China

A significant development of the People's Republic of China corporate legal system was the promulgation by the National People's Congress of the national Company Law in 1993, which took effect on 1 July 1994 ("CL93").

As provided by its Article 1, the CL93 was intended to "*meet the needs of establishing a modern enterprise system, to standardize the organization and activities of companies, to protect the legitimate rights and interests of companies, shareholders and creditors, to maintain the socio-economic order and to promote the development of the socialist market economy.*"

It stipulated two types of companies, setting their corporate finance and corporate governance structure, and providing or the responsibilities, rights, and liabilities of their shareholders, directors and supervisors, and corporate managers, while effectively establishing, for the first time, a comprehensive corporate legal framework for China as well as facilitating the development of the securities market of the country.

The CL93 was revised four times since its adoption, the latest of which came into force 1 March 2014 (the "Company Law").It still provides for two types for corporate structures: the limited liability company("LLC"); and the joint stock company("JSC"), which is also often referred to as public limited company or company limited by shares.

The term "company" refers to an entity established in China in one of the aforementioned forms according to the provisions of the Company Law[1], which sets the legal framework of the incorporation of both these structures, their scope, share capital, governance (shareholders meeting, board of directors, board of supervisors), operation[2], transfer of shares and dissolution, representing an important text in the modernization process of Chinese company law.

The first twenty-two articles of the Company Law, composing Chapter One of General Provisions, apply both to LLCs and to JSCs. In this Chapter, some features of "*socialism with Chinese characteristics*" are quite evident.[3] The articles in Chapter Two and Three apply to LLCs while the articles in Chapter Four and Five apply to JSCs. From Chapter Six to Thirteen, excluding Chapter Eleven, also apply to both kinds of companies. Chapter Eleven is concerned with branches of foreign companies.

1 See Article 2 of Company Law.

2 Article 8 of Company Law: "*The name of a limited liability company established in accordance with the Law shall feature the words "limited liability company" or "company limited". The name of a company limited by shares established in accordance with the Law shall feature the words "company limited by shares" or "joint stock company"*".

3 For example, Article 1 of Company Law lists, among the aims of corporate legislation, that of "*promoting the development of socialist market economy*"; under Article 17 paragraph 2, a company should use various methods to strengthen the education and the formation of its employees on the job, so as to improve their capabilities; finally, Article 19 states that companies should facilitate the activities of the Chinese Communist Party established within the company in accordance with the Constitution of the Party.

Under Chapter Two of LLCs, there are some special provisions on single shareholder limited liability companies and wholly state-owned companies. To prevent an individual abusing the limited liability structure, Article 57 of the Company Law defines the term, "*single shareholder limited liability company*" as "*a limited liability company with only one natural or legal person as a shareholder*".

The Company Law restricts a natural person to establish only one single shareholder limited liability company and in turn, such a company shall not establish any new single shareholder limited liability company. Article 63 of the Company Law pronounces that, if the shareholder of a single shareholder limited liability company is unable to prove that the property of the company is independent of the shareholder's own property, the shareholder shall bear joint and several liability for the debts of the company. Generally, LLCs are the most common company type in China and are preferred by foreign investors.

The Company Law provides that LLC's and JSC's are legal enterprise entities.[4] As of LLC, the shareholder's liability to the company shall take the liability to debts with its whole assets. As of JSC, its whole assets shall be divided into equal shares, with the shareholder's liability limited to the shares subscribed; the company shall take the liability to debts with its whole assets. The Company Law only governs LLC's and JSC's within Chinese territory. It does not govern other forms of companies within Chinese territory, so the Company Law does not give a common definition of all forms of companies.

II. Overview of the main forms of business structures in China

The main forms of business vehicle in China are the above mentioned LLCs and JSCs, regulated by the Company Law, and the general and limited liability partnerships, both regulated by the Partnership Law that came into force on 1 June 2007 ("Partnership Law").

The LLCs and JSCs are both companies with limited liability, subject to enterprise income tax and stricter supervision. The LLC is the most commonly used form of business vehicle in China, and is subject to looser regulation than a JSC. The JSC can be established by way of promotion or through stock flotation the latter of which typically used for public listings.

According the Partnership Law revised in 2006 ("Partnership Law") there are two types of partnerships: general partnerships and limited liability partnerships, both of which pay no enterprise income tax although their partners

4 See article 3 of the Company Law.

are subject to individual income tax[5]. The supervision of partnerships is looser than for companies.

The partners of general partnerships are jointly and severally liable for the debts of their partnership whereas limited liability partnerships can have two types of partners: general partners jointly and severally liable for the debts of those partnerships; and limited partners liable for the debts of their partnership only to the extent of their respective capital contributions.[6]

A) Essentials on the Limited Liability Company in China

The LLC is a type of company in which shareholders are liable up to the value of the capital they subscribe. Its share capital is the total amount of equity invested in the company, subscribed by a minimum of one (single shareholder limited liability company) and a maximum of fifty shareholders, and registered with the commercial registry.

To prevent abuse of the corporate structure in a single shareholder company, the Company Law provides for a number of restrictions including that a natural person can only establish one single shareholder limited liability company and a single shareholder limited liability company cannot establish a new single shareholder limited liability company[7].

Moreover both the company registration and business license of a single shareholder limited liability company must clearly indicate whether the company is funded by a natural or legal person[8] and where the shareholder of a single shareholder limited liability company is unable to prove that the property of the company is independent of the shareholder's own property, the shareholder is jointly and severally liable for the debts of the company[9].

The share capital must be fully paid in cash or in kind in accordance with the articles of association and the shareholder must deposit the cash contribution in full in a temporary account of the company or legally transfer its contribution in kind which may be in the form of assets with a value that can be determined in cash or legally transferable rights i.e. intellectual property rights, usufruct of land or other intangible assets, excluding the cases specifically provided for by law or administrative provision[10].

5 See article 2 of the Partnership Law.

6 See article 2 of the Partnership Law.

7 See article 58 of the Company Law.

8 See article 59 of the Company Law.

9 See article 63 of the Company Law.

10 See article 27 of the Company Law.

If the shareholders fail to pay their contribution they will remain liable for payment in full to the company as well as potential default towards shareholders who have timely paid up their shares[11].The company must hold verification from a legitimate capital verification institution for each capital contribution made by the shareholders who must register their subscribed capital contributions and date of subscription and there are specific regulations and laws that require a minimum registered capital for specific industries such as banking, insurance, investment companies and international freight forwarding.

(i) Corporate Governance: the Shareholders' Meeting, the Directors and the Supervisors

The Shareholders' Meeting must decide on matters such as the company's business strategy and investment plans, the election and removal of directors and supervisors who are not representatives of employees, the decision on the remuneration of directors and supervisors, the review and approval the reports of the board of directors, the review and approval of the reports of the supervisor or supervisory board, the review and approval of the annual financial budget and financial accounting plans of the company, the review and approval of the profit distribution plans or loss recovery plans of the company, the passing of resolutions on any increase or reduction of the registered capital of the company, the passing of resolutions on the issuance of corporate bonds, the passing of resolutions on any company merger, division, dissolution, liquidation, or change of the corporate form, any amendment to the articles of association and the exercise of any other powers given to the shareholders' meeting by the articles of association. Written resolutions of shareholders are permitted[12].

The articles of association may also allow the shareholders' meeting to be held by telecommunication means and unless it is established otherwise, the shareholders must be informed of the time and place of the meeting fifteen days in advance[13] and no statutory quorum is required for holding shareholders' meeting.

To the extent that it is not otherwise provided for in the articles of association, shareholders' voting rights at the shareholders' meeting are proportionate to their stake in the capital of the company.

Any resolution made regarding a vital interest of the company such as an amendment to the articles of association, an increase or reduction of its registered capital and any merger, split-up, dissolution or transformation of the company,

11 See article 28 of the Company Law.

12 See article 37 of the Company Law.

13 See article 41 of the Company Law.

must be passed by shareholders representing at least two-thirds of the voting rights[14].Moreover, the provision of security by the company for a shareholder of the company must be approved by a resolution of the shareholders' meeting and in a listed company if the company, within one year, purchases or sells major assets, or provides guarantees to third parties, and the transactional value exceeds 30% of the company's total assets, the transaction must also be approved by a two-thirds majority of the voting rights of the shareholders present in the meeting[15].

An annual shareholders' meeting is not required and the frequency of shareholders' meetings is provided in the articles of association and in practice is held at least once a year. If the shareholder meeting is not called, shareholders who represent one-tenth or more of the voting rights can convene and preside over the meeting on their own initiative[16]. The shareholder can also ask a court to order a general meeting to be called. A shareholder can also petition a court to suspend or nullify a general meeting if the procedure or content of the meeting violates any law, administrative regulation or the company's articles of association.

Any shareholder can challenge a resolution if the procedures for calling or voting at the meeting violate any law, administrative regulation or the company's articles of association, or if any resolution violates the company's articles of association. The time limit for a challenge is within sixty days of the date on which the resolution is passed[17].

The Board of Directors is required to consist of a minimum number of three and a maximum of thirteen members, or an executive director in case of a small-scale limited company (which may simultaneously act as the manager of the company)[18]. The term of office of the directors of the LLC should be stipulated in the articles of association but should not exceed three years and have the right to stay in office if they are re-elected for another term[19].

The rights and duties of the board are, among others established by law, to convene general meetings, to decide on the company's activities and investment plans, to prepare financial budgets, to distribute profits and losses and increase or reduce the company's capital[20].

Generally, directors are subject to fiduciary and due diligence duties to

14 See article 103 of the Company Law.

15 See article 121 of the Company Law.

16 See article 39 of the Company Law.

17 See article 22 of the Company Law.

18 See article 44 of the Company Law.

19 See article 45 of the Company Law.

20 See article 46 of the Company Law.

the company and cannot damage shareholders' interests. In particular, directors are not allowed to damage the company's interests by taking advantage of their associated relationships, take any bribe or illegal income by taking advantage of their power, embezzle the company's funds or assets, deposit the company's funds into an account in their own name or any other person's name, provide a loan or guarantee to any other person using the company's funds or assets which violates the articles of association without the consent of the shareholders or the board, enter into a contract or transaction with the company which violates the company's by-laws or without the consent of the shareholders or the board, take business opportunities which belong to the company for themselves or any other person by taking advantage of their power, or operate a business that is similar in nature to the company for themselves or any other person without the consent of the shareholders or the board, personally take commission from transactions between the company and another person, disclose confidential information of the company, and conduct other activities that breach their fiduciary duty to the company. Damaging shareholders' interests may lead to civil liability for a director.

A Supervisory Board may be set up with a minimum of three members and small medium companies have one or two supervisors without being required to establish a board. The Company Law strictly prohibits any director or senior manager from simultaneously occupying the position of supervisor of the company[21].

Among other duties established by law and the articles of association for the supervisors, there is the responsibility for the supervision of the financial affairs of the company and ensuring that the directors and senior managers carry out their duties[22].

The term of office of a supervisor is three years and the supervisor has the right to stay on if re-elected for another term.[23] The supervisory board must meet at least once a year and any supervisor may convene extraordinary meetings. Unless otherwise provided by the Company Law, the supervisory board's discussion and voting procedures are established in the articles of association. Resolutions of the supervisory board are approved by over half of the supervisors.[24]

The LLC may also have a Manager which answers and can be hired or dismissed at the Board of Directors. The Manager is responsible for organizing the implementation of annual business plans and investment plans of the company, as well as for developing the internal management structure and human resources

21 See article 51 of the Company Law.

22 See article 53 of the Company Law.

23 See article 52 of the Company Law.

24 See article 55 of the Company Law.

among other duties imposed by the board. It attends the board meetings as non-voting representative[25].

An individual is allowed to hold offices as both a member of senior management personnel and a director of a company at the same time.[26]

(ii) Transfer of Shares

The shares in an LLC may be transferred between shareholders or to any third party, provided the transfer is made in accordance with the applicable law as per Article 72 of the Company Law. Shareholders have a preemptive right to acquire the shares of other shareholders. The law gives companies discretion to decide on the methods for the transfer of shares so, if special clauses are included in the articles of association regarding transfer of shares of the company, these special provisions should prevail.

The transfer of shares to a third party outside the company is subject to a right of first refusal by the other existing shareholders. Other restrictions on the transfer of the company's shares can be specified in the company's articles of association and shareholders are entitled to subscribe for capital contributions on a priority basis in proportion to their paid-in capital contributions.[27]

Although Chinese laws do not provide such statutory veto rights to the minority shareholders of a domestically-funded LLC, it is not uncommon that a resolution on the increase or decrease of registered capital requires the unanimous approval of all the shareholders.

A company must register the names of its shareholders with the company registry. If the registered particulars change, the procedures for amending the registration must be carried out[28]. Particulars that have not been registered or for which registration amendment procedures have not been carried out are not enforceable against a third party.

An LLC can repurchase an equity interest from a shareholder at the shareholder's request if the shareholder votes against a relevant resolution at a meeting of the shareholders if the company has not distributed profits to the shareholder for five consecutive years and the company has been profitable during those five years, and the shareholder satisfies the conditions for distribution of profits in accordance with the Company Law[29], if the company merges, is divided,

25 See article 49 of the Company Law.

26 See article 50 of the Company Law.

27 See article 71 of the Company Law.

28 See article 74 of the Company Law.

29 See article 74 section (1) of the Company Law.

or transfers its main assets[30] or if the term of operation specified in the company's articles of association expires or other grounds for dissolution as specified in the articles of association arise, and the shareholders' meeting resolves to amend the articles of association to extend the life of the company[31].

(iii) Financial Reports and Dissolution

At the end of each financial year, the company is required to provide a management report and accounts to be audited by an auditing firm[32]. The Chinese financial year begins on 1 January and ends on 31 December and LLCs must submit the financial report for consideration by the shareholders by the deadline established in the articles of association.

An LLC may be dissolved upon expiry of the business term provided for in the articles of association, the occurrence of any of the situations for dissolution provided for in the articles of association[33], resolution of the shareholders[34], in the event of merger or division of the company[35], if the business license is cancelled[36] or when its dissolution is ordered by a court[37].

B) Essentials on the Joint Stock Company in China

The JSC is a company in which the shareholders are liable in proportion to the shares to which they subscribe and can be incorporated either through the private subscription of capital by promoters, in which case all shares are subscribed by the promoters, or through public subscription of shares, in which case the promoters subscribe to some of the shares that are issued and offer the remaining ones to the general and/or specific public.[38]

A JSC must be established by a minimum of two and a maximum of two hundred promoters with at least half of them domiciled in China[39].

30 See article 74 section (2) of the Company Law.

31 See article 74 section (3) of the Company Law.

32 See article 164 of the Company Law.

33 See article 180 section (1) of the Company Law.

34 See article 180 section (2) of the Company Law.

35 See article 180 section (3) of the Company Law.

36 See article 180 section (4) of the Company Law.

37 See article 180 section (5) of the Company Law.

38 See article 77 of the Company Law.

39 See article 78 of the Company Law.

In JSCs incorporated by private subscription of capital and before all the initial agreed capital is paid, no new shareholder can be introduced, whereas in JSCs incorporated by public subscription, the shares are subscribed by the promoters together with the general and/or specific public[40]. If the shareholders must subscribe to the full amount of the agreed shares provided in the articles of association, they will be liable for breach of contract to other shareholders who have already made their capital contributions[41].

The capital of a JSC is divided into shares carrying the same nominal value and the certificate of ownership of the shares must be issued by the JSC to prove ownership of the shares subscribed. If the JSC is set up by promoters, the capital at registration should be the total capital of the shares subscribed by the promoters at the Commercial Registry of Companies. If the JSC is incorporated by public subscription, its capital will consist of any such amount which has actually been paid corresponding to shares registered with the Commercial Registry but shall not be less than 35 % of the total shares[42].

The articles of association contain the rules that govern the operation of the company. In JSCs, the articles of association must state the company name, the object of the company, the registered office, the registered capital and the capital subscribed by each shareholder, the directors and the rights and obligations of the shareholders, among other issues[43].

(i) Corporate Governance: the General Meeting, the Board of Directors, the Supervisory Board and the Manager

The General Meeting is the supreme corporate body in a JSC and is made up of all the shareholders. The ordinary general meeting of shareholders must be held once a year. However, extraordinary general meetings may be called with two months' prior notice if the number of directors is less than two-thirds of the required number, if the company's losses exceed one-third of the capital, when the board of directors or supervisory board deem it to be necessary, and by any shareholder or group of shareholders holding at least 10% of the shares, among others provided for in the articles of association[44].

The shareholders present at the meeting are entitled to one vote for each share they hold in the company. However, the shares held by the company do

40 See article 80 of the Company Law.

41 See article 83 of the Company Law.

42 See article 84 of the Company Law.

43 See article 81 of the Company Law.

44 See article 100 of the Company Law.

not confer voting rights[45].

Resolutions of the general meeting must be approved by simple majority of the votes of the shareholders attending the meeting. Notwithstanding, issues of greater relevance such as changing the articles of association, increasing or reducing the share capital, changing the company type, merger, division or dissolution of the company, must be approved by two-thirds or more of the votes of shareholders attending the meeting[46]. Moreover the purchase or sales of any important asset or providing guarantees that exceed 30% of the company's total assets within one year must be authorized and approved by the shareholders representing two-thirds of the voting rights present at the meeting.[47]

The shareholders can require information from the board, have the same powers as those of the LLC as mentioned above[48] and must be informed of the time and place of a general meeting and the matters to be considered at it at least twenty days in advance, and for an interim general meeting at least fifteen days in advance. Holders of bearer shares are notified by a public announcement including the above mentioned items at least thirty days in advance. No statutory quorum is required and the general meeting cannot vote on a resolution relating to a matter not listed in the notice for the meeting. The shareholders who hold 3% or more of the shares of the company can submit a written proposal to the board of directors at least ten days in advance of a general meeting.[49]

Any shareholder can challenge a resolution if the procedures for calling or voting at the meeting violate any law, administrative regulation or the company's articles of association, or if any resolution violates the company's articles of association. The time limit for a challenge is within sixty days of the date on which the resolution is passed.[50]

A board of directors must be established made up of at least five and no more than nineteen directors for day-to-day management of the company and the term of office and the powers held by the board are the same as those described above for LLCs[51].

The board must meet twice a year and extraordinary meetings must be held when proposed by shareholders representing one-tenth or more of the voting

45 See article 103 of the Company Law.

46 See article 103 and 104 of the Company Law.

47 See article 121 of the Company Law.

48 See article 99 combined with article 37, both of the Company Law.

49 See article 102 of the Company Law.

50 See article 22 of the Company Law.

51 See article 108 combined with articles 45 and 36 of the Company Law.

shares, at least one-third of the directors, or the supervisory board[52]. The meeting of the board can only take place if more than half of the directors are present and any decision of the board of directors must be approved by more than half of all directors with each director having one vote only.[53]

The supervisory board of the JSC is made up of at least three members which are statutorily required to meet regularly once every six months or whenever proposed by a supervisor. The term of office of its members, functions, discussion methods and voting procedures of the board are the same as that for the LLC, as described above.[54]

The supervisory board or supervisor is responsible for the supervision of the management of the board of directors/executive director, such as appointing auditors to conduct an investigation of abnormalities found in inspection of the company's accounts, requiring the directors and senior management personnel to rectify acts that are not in the interest of the company, and proposing or calling and convening interim meetings of the shareholders when the board of directors are inactive.[55]

JSCs must also have a manager who is hired and dismissed by the directors. The term of office and powers assigned to the manager are the same as those described above for LLCs.[56]

(ii) Transfer of Shares

There are two types of shares in a JSC, namely, registered/nominative stock and unregistered/bearer shares[57].

In a JSC, when new shares are issued, resolutions in respect of the class and amount of new shares issued to existing shareholders are adopted by the shareholders' general meeting.

A company must register the names of its shareholders with the company

52 See article 110 of the Company Law.

53 See article 111 of the Company Law.

54 See article 117 combined with article 52 of the Company Law.

55 See article 118 combined with articles 53and 54 of the Company Law.

56 See article 113 combined with article 49 of the Company Law.

57 See article 129 of the Company Law.

registry. If the registered particulars change, the procedures for amending the registration must be carried out. Particulars that have not been registered or for which registration amendment procedures have not been carried out are not enforceable against a third party.

Registered or nominative shares may be transferred by endorsement or other ways provided for by relevant laws or administrative regulations and unregistered shares or bearer shares are transferred by simply handing them over to the transferee. Shares issued to promoters or legal entities must be registered shares and may only be registered in the name of those promoters or legal entities.[58]

The Company law restricts the transfer of shares to a third party outside the company by making it subject to a right of first refusal by the other existing shareholders. Moreover, the shares of a JSC held by a promoter cannot be transferred for a period of one year from the date of establishment of the company. A director, supervisor or senior officer of a JSC is not allowed to transfer more than 25% of its total holding of the company's shares per year while it is in the service of the company and for a period of one year from the date on which the company's shares are listed for trading, or six months from when they leave the company, they cannot transfer their shares. Other restrictions on the transfer of the company's shares can be specified in the company's articles of association.[59]

The JSC can only purchase its own shares if it is reducing its registered capital, merging with another company that holds shares of the company, granting the shares as an incentive to its staff and workers or a shareholder who opposes a resolution on the merger or division of the company adopted at a shareholders' general meeting requests that the company purchase his/her shares[60].

(iii) Annual Reports, Accounting and Dissolution

At the end of each financial year, the company is required to produce a report on its financial situation prepared by a legitimate auditing firm. In China, the financial year begins on 1 January and ends on 31 December and the report and accounts must be submitted to the shareholders for consideration in the twenty days preceding the annual meeting of shareholders. If the JSC is a listed company,

58 See article 139 of the Company Law.

59 See article 141 of the Company Law.

60 See article 142 of the Company Law.

it should make its management report and accounts public[61].

The documents, books, balance sheets, reports and other accounting documents must be prepared in accordance with the unified accounting rules laid down by the Accounting Law and the JSC may be dissolved in the same terms mentioned above for the LLCs as provided by article 180 of the Company Law.

C) Essentials on the Partnership in China

General partnerships are mainly regulated by the Partnership Law and a written partnership agreement along with a written application for registration of the partnership is required for its establishment along with other required application materials which include the partnership agreement, the identity certificates in respect of the partners and other relevant documents.[62].

If there are items in the business scope of the partnership that are subject to approval before registration under applicable laws or regulations, prior approval must be obtained and the related approval documents must be submitted at the time of registration. The date of issue of the business license for a partnership is the date of establishment of the partnership[63].

The liability of a general partner in a general partnership is unlimited and partners are jointly and severally liable for the partnership's debts[64]. Assets are held in the name of the partnership and partners jointly own them, including capital contributions made by the partners, proceeds from the capital contributions and all other property obtained in the name of the partnership.

A partnership does not have legal personality and is not treated as a separate tax entity. The partners must pay taxes on the income derived from the partnership's business operations, in accordance with the applicable tax provisions[65].

Limited liability partnerships (LLPs) are also permitted in China and are made up of both general and limited liability partners. General partners bear unlimited joint and several liability for the partnership's debts while

61 See articles 163, 164 and 165 of the Company Law.

62 See article 14 of the Partnership Law.

63 See articles 9 and 10 of the Partnership Law.

64 See article 2 of the Partnership Law.

65 See article 6 of the Partnership Law.

limited liability partners bear liability for the debts to the extent of their capital contributions[66]

III. Introduction to PRC Foreign Investment Law

A high level review of the business law system in China may lead to a preliminary understanding that domestically-invested companies and foreign invested enterprises (FIEs) are subject to different regulatory regimes and rules with the latter mainly governed by the China Wholly Foreign Owned Enterprise Law ("WFOE Law"), the Sino-Foreign Cooperative Joint Venture Enterprise Law ("CJV Law"), and the Sino-Foreign Equity Joint Venture Enterprise Law (individually "EJV Law" and collectively "FIE Laws").

The impact of the Company Law on FIEs depends on what interests foreign investors are allowed to acquire in China on a given period, and applies only when the special legislations on foreign investment are silent on a particular issue. In the cases where the FIEs laws differ from provisions of the Company Law, the former shall prevail.

Notwithstanding, in January 2015 a discussion draft of the proposed new Foreign Investment Law(FIL) was published by the Ministry of Commerce ("MOFCOM") for public comment confirming the trend that China would be moving toward granting national treatment to FIEs and foreign investors, which would likely lead to the elimination of the differences between the Company Law and the FIE laws. If the draft FIL ends up being passed, it will introduce a uniform foreign investment review framework more comprehensive and consistent foreign investment regime representing what is anticipated to be a significant step towards liberalizing foreign investment in China.

IV. Overview of the main forms of foreign invested business structures in China

The most common options for setting up a foreign invested entity ("FIE") to establish a business in China include:

a. Representative Office ("RO")
b. Foreign Branch Office ("Branch")
c. Wholly Foreign Owned Enterprise ("WFOE").

66 See article 2 of the Partnership Law.

d. Joint Venture (“JV”).
e. Foreign Invested Partnership Enterprise (“FIPE”).
f. Foreign Invested Company Limited by Shares (“FICLS”).
g. Special Foreign Invested Company (“SFIC”)

A. Essentials of the Chinese Representative Office

A common form of foreign investment is through the setting up of RO which is not an independent company, does not have the status of a legal person and is otherwise considered as an extension of its parent company.[67] The RO provides basic market entry for foreign investor without formal legal establishment; it is less demanding in terms of procedure, is not subject to the capital contribution requirement imposed on companies and their investors and takes less time to set up even though in most cases restrictions on direct business activities make them unattractive as an entry vehicle.

ROs established in China by foreign enterprises are regulated by several national regulations, as well as local policies, which supplement the national regulations. In general, an RO is restricted conduct direct business activities. An RO is permitted only to make business contacts and engage in general liaison activities for its head office services and products. Personnel of an RO of a foreign enterprise should not sign contracts on behalf of either the non-resident enterprise or third parties.

It usually serves as a commercial link between the holding company and local companies and it is also used to conduct market surveys and product promotions, to establish contacts with potential consumers, to structure and organize the travel of representatives of the holding company to China and to conduct other not-for-profit activities. They can undertake market investigation, display, publicity activities in connection with the products or services of foreign companies, and liaison activities in connection with the products sales, services provision, domestic procurement and domestic investment of foreign companies.[68]

It is restricted to engage in any activity that generates income, except in the cases where there are intergovernmental agreements for that purpose[69],

67 See article 2 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises.

68 See article 14 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises.

69 See article 13 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises.

which means that they cannot sign contracts, receive income, or issue invoices and business tax receipts, accept payments in Renminbi ("RMB"), open bank accounts, use letters of credit or benefit from other financial services or employ local employees directly, although it may hire local employees through a duly registered human resources agency.

In recent years, fewer foreign companies are setting up ROs in China as a result of further restrictions and requirements imposed such as the limitation on the number of registered representatives (essentially to set a limit of four foreign personnel who can be seconded to a representative office), and the requirement to complete annual reporting to the local industry and commerce authority.

Generally, the foreign company is only required to register with the State Administration for Industry and Commerce ("SAIC") to establish an RO.[70]Some local SAICs require an applicant company to submit application materials through designated agencies, and different registration authorities may require different documents. Documents to be submitted generally include a registration form for the RO, a registration form for each of the RO's foreign personnel (including the chief representative), a letter of creditworthiness from the foreign company's bank, and copies of the foreign company's incorporation certificate, business registration certificate and constitutional document.[71]

In addition the foreign enterprise must register the RO and its foreign personnel with the local tax bureau, and a number of other government departments including the public security bureau (for residence permits) and with the local customs authority (for importation of personal belongings).

Only a few types of ROs are required to obtain approval for establishment, and for any subsequent changes, the majority of representative offices do not need to obtain special approval. Law firms, financial and insurance companies and other certain industries may require substantive approvals, but for most industries no substantive government approval is required.

In a wide range of circumstances, the RO will be subject to both corporate income tax and business tax on the basis that its activities either generate revenue, or through attribution, may be considered to generate revenue for the foreign enterprise. The same rate of corporate income tax that applies to equity joint ventures will generally apply to an RO. In certain limited circumstances, an RO may be eligible for an exemption from enterprise income tax and business tax, depending on the nature and extent of its activities, but it is getting more difficult

70 See article 5 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises.

71 See article 23 of the Regulations on Administration of Registration of Resident Offices of Foreign Enterprises.

to obtain this.

B. Essentials of the Foreign Branch Office

A foreign company can set up a branch office in China if certain prerequisites, which may vary for different industries, are met. However, the implementation measures for examination and approval of branches of foreign companies, other than those of foreign-invested offshore oil drilling operations and foreign financial institutions, have not yet been promulgated and in practice not all industries are permitted to establish a branch office by the foreign company in China.

According to Article 192 of the Company Law, to establish a branch in China, a foreign company "*shall submit an application to the competent authority of China and other relevant documents such as the articles of incorporation, the company registration certificate issued by the country where the foreign company was established. After the application is approved, the foreign company shall go through registration formalities with the company registration authority according to law and obtain a business license"* with "*the measures for the examination and approval of the branches of foreign companies shall be separately formulated by the State Council.*"

Upon approval, it shall go through registration procedures with the company registration authority according to the law and obtain a business license. The approval authority for the establishment of branch offices is generally MOFCOM or its local counterparts. Following the obtaining of approval of establishment, a branch office must apply to the local branch of SAIC for a business license. The branch shall comply with the law of China and may not harm China's social public interests, and correspondingly, the lawful rights and interests of such branch shall be protected by the laws of China.[72]

A branch established within the territory of China by an overseas company is not qualified as a Chinese legal person and therefore the foreign company will bear civil liability for any business activities carried out by its branches within China.[73]It can perform the functions of a representative office and also engage in profit-making commercial activity but because the foreign parent is fully and directly liable for all civil liabilities of the branch, it is not common for foreign companies to set up a branch in China other than for offshore petroleum exploration projects and in the banking sector.

72 See article 196 of the Company Law.

73 See article 195 of the Company Law.

C. Essentials of the Chinese Wholly Foreign Owned Enterprise

A WFOE is an entity established under the WFOE Law and the Implementation Regulations for the Law of the People's Republic of China on WFOEs (the "WFOE Regulations"). A WFOE can be a limited liability company or, upon approval, take another form and composed entirely of foreign capital that is owned by one or more foreign investors[74].

It is a popular option for foreign business, as the investor has complete control over the business entity with some of the advantages including having all the autonomy of an independent legal entity, with the power to enter into contracts, issue invoices, hire and fire employees, make payments and receive payment in RMB, full management powers and total control by the management board, independence to implement strategies of a global dimension made by the affiliated companies without having to consider the involvement of Chinese shareholders, ability to convert profits earned in RMB to another currency if it intends to distribute them to an associated company located outside China, benefiting from more effective protection for its intellectual property, know-how and technology and greater efficiency in its operation, administration and future development.

Currently, most WFOEs in China are established by one foreign investor, although the WFOE Regulations allow two or more foreign investors to jointly apply for its establishment. The WFOE was originally designed to encourage manufacturing activities aimed at exporting or introducing innovative technology to China and are now increasingly used as a means of investment in services such as management consulting or software development and trading[75].

Similar to joint ventures, a WFOE can only register its company name in Chinese. While China does recognize its own accredited "well-known" trademarks, it should be noted that having a prior Chinese trademark registration does not guarantee that the preferred Chinese characters can be registered as a company name in China.

The WFOE can register with the local bureau of SAIC to obtain a business license and carry out registration with MOFCOM's local counterpart concerning establishment, if its business is not subject to "*special market-entry measures*"[76]. Approval by MOFCOM or its local counterpart is not needed. The WFOE is formally established on the issuance date of the business license.

Capital contributions to a WFOE may be in the form of foreign currency, machinery, equipment, industrial property, proprietary technology or RMB profits

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74 See article 17 of the WFOE Law and article 18 of the WFOE Regulations.

75 See article 1 of the WFOE Law.

76 See article 4 of the WFOE Regulations.

derived from their other investments in China. [77]

A WFOE is permitted to operate for the period provided for in its articles of association registered with SAIC and recorded with the local counterpart of MOFCOM. Requests for an extension of the term of operation must be submitted to the authorities prior to expiry.

The establishment of WFOEs is prohibited in certain industries[78], such as broadcasting and public utilities and in certain cases, itis required prior industry approval, e.g. travel agency or direct sales, then prior approval is required from the specific industry regulator. The WFOE must conduct its activities and its business under the precise category for which the commercial license granted and it should retain formal and independent accountants, keep organized and independent accounting records, approve and register its balance sheets and financial statements and be ready for any kind of supervision by the Chinese regulatory and financial authorities.[79]

Accounting books and statements printed by WFOEs themselves must be written in Chinese[80] and only Chinese registered accountants can verify annual accounting statements. Annual balance sheets and profit-and-loss statements must be submitted to the financial and tax authorities for the record. It has annual reporting requirements administered by different local government departments. These annual reporting or annual inspection requirements occur at different times of the year and are subject to local procedures e.g.it will need to submit periodic information to the local industry and commerce authority, Customs authority, foreign exchange bureau, and taxation authorities.

The daily operations of a WFOE will be controlled solely by its own management, and should not be subject to interference by the government when operating in accordance with its articles of association.

D. Essentials of the Joint Venture

The Joint Venture is another popular vehicle for investment in China which generally combines the market knowledge, favorable market treatment and manufacturing capacity of a Chinese partner, and the technology, know-how and market experience of a foreign partner.

It is usually formed as a limited liability company, either by taking the form of an equity joint venture ("EJV") or a cooperative joint venture ("CJV"). While

77 See articles 25, 26, 27 and 28 of the WFOE Regulations.

78 See article 4 of the WFOE Regulations.

79 See article 58 of the WFOE Regulations.

80 See article 57 of the WFOE Regulations.

the EJV is more strictly regulated and operates more closely to the corporate model, the CJV allows its shareholders greater flexibility when setting out contractual provisions that regulate, for example, distribution of profit, management and registered capital.

Both EJVs and CJVs usually have a joint venture contract and articles of association and are similar in their general management structure, the process of getting governmental approval and their relations with authorities to which they must submit requests for approval. They also share similar contractual formats, tax exemptions, legal status and applicable legal provisions as well as the authorities to which they may resort to settle potential commercial disputes.

EJVs and CJVs must be approved by and registered with the relevant Chinese authorities, including the National Development and Reform Commission ("NDRC"), MOFCOM and SAIC and their local counterparts as well as local authorities for post-establishment procedures, such as the tax authorities.

(i) Equity Join Venture

An EJV is a Chinese legal person with limited liability. It is established on the basis of a joint venture contract and articles of association between Chinese and foreign parties and is primarily regulated by the Chinese-Foreign Equity Joint Venture Law (the "EJV Law") and the Implementation Regulations for the Law of the People's Republic of China on Equity Joint Ventures (the "EJV Regulations"). In addition, supplementary legislation covers such issues as contributions of registered capital, debt-equity ratios, registration, labor, imports and exports, foreign exchange, accounting and taxation while the Company Law also includes certain provisions that apply to EJVs.

These pieces of legislation, however, do not cover all relevant issues and there is a lack of regulations and precedents to provide clear guidance in resolving some issues of corporate organization, management and procedures. In some cases, these issues can be resolved by including appropriate provisions in the joint venture contract or articles of association while in other cases, uncertainties may be resolved by consultation with the MOFCOM" or its local counterpart.

The EJV is most commonly adopted structure for joint Chinese and foreign ownership and is typically used for long-term projects and formed by foreign companies, enterprises, economic organizations or individuals and Chinese companies, enterprises or other economic organizations. An EJV is typically a limited liability company[81] and their investors or shareholders are not personally liable for the debts which the company may incur. As a company, the EJV is able to

81 See article 16 of the EJV Regulations.

acquire property, hire employees independently and execute works, among others,

The procedure for establishing an EJV varies depending on the industry, the location and the ownership structure of the Chinese party. There are general trends placing greater importance on environmental protection specifically for manufacturing EJVs and to relax the regime governing foreign-invested enterprises in non-regulated industries.

The parties will proceed to negotiate and draft the joint venture contract and articles of association and prepare a joint feasibility study, and if the Chinese party is a state owned entity, it will need preliminary approval for the project from its department in charge.

In general, the establishment of an EJV will have to be approved by the NDRC, registered with the local bureau of the SAIC to obtain business license and approved or recorded with MOFCOM or their local government counterparts depending on the size and business nature of the proposed joint venture among other factors. The EJV is formally established on the issuance date of the business license.

The EJV Regulations do not set forth detailed requirements for the form or contents of documents such as the letter of intent, feasibility study, the joint venture contract and articles of association which may be drafted in both Chinese and a foreign language[82] and governed by Chinese[83] law but the authorities have published model forms for joint venture contracts and articles of association that are closely followed by the Chinese parties of the EJVs.

In addition, the parties will often simultaneously negotiate and execute contracts related to the joint venture's operations, such as those for technology transfer, trademark licenses, and supplies of parts or raw materials, as well as for the distribution of finished products. These related contracts may be attached to the joint venture contract as attachments.

In the joint venture legislation, "registered capital" refers to the total amount of paid-in capital contributions by the parties to the joint venture[84] while the "total investment" refers to the "registered capital" plus permitted financing for the EJV.[85] The capital of EJVs must meet certain debt to equity ratios. The minimum proportion contributed registered capital by the foreign investors should not be less than one-fourth[86] and in certain industries, there may be restrictions on the level of foreign ownership in an EJV.

82 See article 7 of the EJV Regulations.

83 See article 12 of the EJV Regulations.

84 See article 18 of the EJV Regulations.

85 See article 17 of the EJV Regulations.

86 See article 4 of the EJV Law.

Capital contributions may take several forms, including cash, real estate, equipment, technology, materials, right to use land, intellectual property rights, or other assets, such as equipment. However, only advanced technology and equipment that meet Chinese needs can be treated as foreign joint venture investment and if the capital contributions are in a form other than cash, the parties must agree on the appropriate value of the contributions on the basis of fairness and reasonableness or agree to have a third party make the evaluation.[87] In addition, the valuation is subject to verification by official appraisers.[88] The parties can agree upon the schedule for the capital contributions which need to be set forth in the articles of association, in accordance with the business plan, and are allowed to increase or reduce its registered capital.[89]

EJVs in China are typically limited to a fixed term, which must be stipulated in the joint venture contract. Indefinite terms are sometimes permitted, but EJVs in certain service industries, land development and real estate, natural resource exploration and exploitation projects, and other areas which are restricted must have a fixed term. Upon the expiration of its term, an EJV is to be dissolved[90], with the property remaining after clearance of debts to be distributed in accordance with the ratio of the parties' capital contributions except where the joint venture agreement, contract or articles of association have other stipulations.

The business scope should be brief and specific and requires careful drafting as it is often subject to negotiations in the pre-establishment stage between investors and the government authorities which need to approve it and specify the range of activities in which the EJV is permitted to engage.

Any transfer of capital to the EJV by any investor requires authorization from the other shareholders and should be made by consensus. It should also be approved by the supervisory authority with jurisdiction to grant approval and must follow the procedures for changes with the registration and administration office. Its partners have pre-emptive rights to acquire other partners' shares[91].

An EJV is required to adopt accounting procedures based on a dual-entry, accrual system. All accounting records, books and statements are required to be prepared and kept in Chinese. The accounting system adopted by the EJV must be reported, for the record, to the competent government authorities and the local

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87 See article 5 of the EJV Law and articles 22, 24 and 25 and 26 of the EJV Regulations.

88 See article 27 of the EJV Regulations.

89 See article 21 of the EJV Regulations.

90 See article 13 of the EJV Law and article 90 of the EJV Regulations.

91 See article 4 of the EJV Law and article 20 of the EJV Regulations.

financial and tax departments.[92] Chinese legislation also requires an accountant registered in China to act as the auditor of the EJV.[93]

An annual profit distribution plan has to be prepared and distribution of profits among the parties is usually in proportion to their respective contributions to the registered capital of the EJV which is required to allocate a certain percentage of after-tax profits to a reserve fund, enterprise expansion fund and incentive and welfare fund for staff and workers[94].

A good local partner may contribute market knowledge and strong marketing and distribution channels, and they may help reduce the costs and risk of market entry. In certain restricted sectors, such as automotive and insurance, forming an EJV with a Chinese company is still the only permitted route for establishing a permanent presence in China. The challenge of establishing and running a successful EJV is finding and nurturing the right partnership. Partners have to overcome issues such as mismatched expectations and differences in business culture and practices. The ability to maintain effective communication, and control where necessary, is also crucial.

(ii) Cooperative Joint Venture

A CJV is a company operated under a contract between Chinese and foreign enterprises.[95]The Chinese-Foreign Cooperative Joint Ventures Law ("CJV Law"), regulates the established practice of cooperative joint ventures, in which the Chinese and foreign parties cooperate on the basis of a joint venture contract and articles of association.

Typically the preferred investment vehicle for joint construction and management of hotels, commercial complexes, and infrastructure and mining projects, the CJV is often adopted for shorter-term projects or built-operate-transfer projects, and are formed with join capital or terms of cooperation between foreign enterprises, other economic organizations or individuals and Chinese enterprises or other economic organizations.

The CJV is also referred to as "Contractual joint venture" and can take one of two different forms: (i) a "pure" CJV in which no legal entity separate from the contracting parties is established and the parties make their contributions to the project and bear the risk of profit and loss directly; and (ii) a "hybrid" CJV in which a separate business entity is established and registered and the parties'

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92 See articles 69 and 78 of the EJV Regulations.

93 See articles 71 and 79 of the EJV Regulations.

94 See article 76 of the EJV Regulations.

95 See article 2 of the CVJ Law.

liabilities are generally limited to their capital contributions to the entity.

Although the CJV Law does not explicitly distinguish between these two types of ventures, it provides that cooperative joint ventures that meet the relevant legal requirements may qualify as "legal persons" under Chinese law.[96] The Implementation Regulations for the Law of the People's Republic of China on Cooperative Joint Ventures ("CJV Regulations") make further distinctions concerning the treatment of cooperative joint ventures with legal person status and those without.

A hybrid form cooperative joint venture would generally qualify as a legal person by satisfying the relevant requirements under Chinese law to obtain such status, while a pure form cooperative joint venture would not. The CVJs generally has more lenient requirements of capital contribution and the possibility of contractual agreement for foreign parties to recoup their investments first[97] and it should set up a board of directors when it has the status of legal person or a joint management committee when with no status of legal person.[98]

The documentation required for the establishment of a CJV and the procedures for obtaining approval or registration of the project are very similar to those of an EJV.[99] The CJV with legal person status can register with the local bureau of the SAIC to obtain a business license and carry out registration with the local counterpart MOFCOM concerning establishment and it is considered formally established on the issuance date of the business license[100].

Investors are able to make their contributions to the CJV in forms other than those allowed for in an EJV e.g. by being made responsible for providing the required local labor, including the payment therefor and/or for providing the necessary factory or office facilities. In some cases, it may not be permitted to count some of these forms of assistance as joint venture contributions, although practice in this regard varies considerably and therefore foreign investors should focus on how to categorize and structure the parties' contributions to a CJV[101].

Moreover, also unlike in EJVs, a foreign party's investment in a CJV may be repatriated prior to the expiration of the term of the joint venture, if the joint venture contract provides that ownership of all of the fixed assets of the joint venture shall revert to the Chinese party upon expiration of the joint venture term. However, the methods by which early repatriation may be accomplished

96 See article 2 of the CVJ Law and article 4 of the CVJ Regulations.

97 See articles 2, 8 and 22 of the CVJ Law.

98 See article 12 of the CVJ Law and article 12 and 53 of the CVJ Regulations.

99 See articles 7, 12 and 13 of the CVJ Regulations.

100 See article 6 of the CJV Law.

101 See article 19 and 20 of the CJV Regulations.

are limited, and careful planning is required before establishment of the CJV.

Chinese companies usually provide the workforce, land and manufacturing infrastructure, whereas the foreign companies normally provide technology, equipment and capital. CJVs are therefore favored for hotels and commercial complexes and in infrastructure projects where the parties intend that the joint venture assets will stay with the Chinese party at the end of the joint venture term.[102]CJVs are also commonly used for projects where the Chinese partner lacks material assets to contribute to the joint venture and are generally discouraged in manufacturing. The operational activities of cooperative joint ventures are restricted in much the same way as those of equity joint ventures.[103]

It is common for CVJ contracts, especially those of pure cooperative ventures, to provide for the reversion of all of the assets of the joint venture to the Chinese party upon termination of the venture.[104] In other cases, the liquidation procedures follow those applicable to EJVs[105].

The profits, risks and losses of CJVs may be allocated between the parties in a proportion that differs from the equity contributions by the parties. A substantial advantage of CJVs is that the parties may agree on the distribution of profits at a ratio different from that of the parties' capital contributions. It may also be possible for the foreign investor to recover its investment before the end of cooperation term of the CJV.[106]

An accountant registered in China must be engaged to audit and verify accounts and the parties may engage the accountant jointly or individually.[107] A CJV without legal person status must keep unified account books, and the parties must, in addition, keep their own separate account books[108].

E. Essentials of the Chinese Foreign Invested Partnership

The Administrative Measures on the Establishment of Partnership Enterprises in China by Foreign Enterprises or Individuals ("FIPE Regulations") allow foreign individuals or organizations to participate in partnership enterprises, offering a further alternative to the RO, WFOE, EJV and CJV. FIPEs allow

102 See article 44 of the CJV Regulations.

103 See articles 11 and 12 of the CJV Law.

104 See article 44 of the CJV Regulations.

105 See article 49 of the CJV Regulations.

106 See article 44 of the CJV Regulations.

107 See article 46 of the CJV Regulations.

108 See article 54 of the CJV Regulations.

for partnerships between two or more foreign enterprises or individuals, or a combination of foreign enterprises or individuals and Chinese individuals, legal persons or other organizations[109].

FIPEs do not need to obtain the approval from MOFCOM. They only require registration with the local branches of SAIC. However, businesses in certain sectors will need to comply with other specific regulations and the FIPE should submit approvals from relevant authorities when applying for its registration.

The types of FIPEs include foreign-invested general partnership and foreign-invested limited partnership.[110] Solely State-owned companies, State-owned enterprises, listed companies and public welfare institutions and social organizations shall not be general partners of FIPEs. Limited partners cannot be the executive partner of a FIPE.[111]

The FIPE provides a good channel to enter into Chinese market for foreign investors, especially for those private equity firms. Profits and losses are distributed according to partnership agreement. Income tax is assessable on each partner, and not on the partnership.

V. Introduction to Foreign Investment Approvals and Restrictions

The establishment of a Foreign Investment Enterprise (FIE) in China is subject to the approval of the Chinese government. The approval process begins with a name reservation application to the SAIC to check on the proposed name for the FIE.

After the company name has been reserved, the applicant must obtain substantive examination and approval of the investment by MOFCOM. Examination and approval by MOFCOM is the key stage in the approval process as it requires submission of the full definitive documents and may also require a feasibility study report describing background on the project, along with other supporting documents. MOFCOM has the flexibility to request documents not expressly set forth in the statutes if they understand them to be useful to its decision.

Project verification from the NDRC is technically required for any foreign investment project, but in practice, the NDRC's approval is critical only in specific industries such as automotive industry, and oil exploitation industry. After approvals from MOFCOM and, if necessary, the NDRC, the FIE may be registered

109 See article 2 of the FIPE Regulations.

110 See article 3 of the FIPE Regulations and article 7 of the Measures for the Registration of Partnership Enterprises.

111 See article 9 of the Measures for the Registration of Partnership Enterprises.

with the SAIC for issuance of a business license for which the date of issuance is the date of incorporation of a company. After obtaining the business license, the FIE should complete the remaining required registrations with the relevant authorities including the State Administration of Foreign Exchange ("SAFE"), General Administration of Customs of the People's Republic of China ("Customs") and State Administration of Taxation ("SAT"), among others.

For some certain industries, the FIE should obtain special approvals. Some typically regulated industries (including, for example, securities, banking and insurance) involve special approval regimes in addition to, or in place of, MOFCOM examination and approval. The China Securities Regulatory Commission ("CSRC") reviews applications to set up or acquire securities companies, the China Banking Regulatory Commission ("CBRC") covers banks, and the China Insurance Regulatory Commission ("CIRC") reviews insurance company applications. Environmental approval from State Environmental Protection Agency ("SEPA") may be required prior to applying to MOFCOM for manufacturing enterprises, or for any investment project that entails a construction project. Before registration with SAIC, for companies involving food or pharmaceutical production, they have to get the approval from State Food and Drug Administration ("SFDA"). The approval from State-owned Assets Supervision and Administration Commission ("SASAC") will be required for investments involving Stated-owned assets.

The Provisions on Guiding the Orientation of Foreign Investment of 2002 ("FI Guidelines"), generally classify foreign investment areas into four different categories:(i) encouraged, where foreign investment is encouraged and may be subject to policy incentives; (ii) permitted, which can be subject to wholly foreign owned investment; (iii) restricted, which have stricter investment requirements or limitations, e.g. requiring joint investment by Chinese and foreign investors, or limiting foreign investment interest to a minority stake or a threshold, among others; and (iv) prohibited, which the ones which cannot subject to foreign investment.[112]

The Catalogue for the Guidance of Foreign Investment Industries("Catalogue"), jointly issued by the NDRC and MOFCOM, is meant to further specify and categorize which areas are prohibited, restricted, permitted and encouraged for foreign investment, and therefore "*partly adjust*" and the foreign investment framework to the "a*ctual situation*" and specific up to date needs of the economy, being the "*basis of the application of relevant policies in directing and examining and approving projects with foreign investment and enterprises*

112 See article 4 of the FI Guidelines.

with foreign investment"[113].

The 2017 Revision of the Catalogue ("2017Catalogue")sets out the traditional encouraged category and introduces the "Special Management Measures for Foreign Investment Access (Negative List for Foreign Investment Access)" which it divides the listed areas into restricted and prohibited categories, while those not listed are considered as being permitted.

The number of restrictive measures for the entry of foreign investment was reduced from ninety three sectors to sixty three in the 2017 Catalogue, with several industry sectors like services, manufacturing and mining being now more open for foreign investment. There are now only thirty five areas in the restricted category and twenty eight in the prohibited category.[114]

VI. Introduction to the Variable Interest Entities

The variable interest entity ("VIE") has long been a popular structure for foreign parties to invest in foreign investment restricted or prohibited sectors in China and for Chinese domestic entities could list offshore on international capital markets.

A VIE refers to a structure where enters into contracts with a PRC operating company and holds the necessary licenses to circumvent restrictions and operate in a foreign investment restricted or prohibited sector.

A VIE structure refers to a structure whereby a wholly or partially foreign owned entity in China ("FI Company") has control over an operating company ("PRC Company") that has the approved business scope and holds the necessary licensing to circumvent and operate in a foreign investment restricted or prohibited sector.

Given foreign investors are not able to directly invest in the PRC Company and in order to circumvent the relevant restrictions and prohibitions, the foreign investors enter into several contractual arrangements between the FI Company and the PRC Company in order to obtain *de facto* control over the operation and management of the PRC Company. The profits of the PRC Company flow back to the FI Company allowing foreign investors to consolidate them in their results. For domestic companies in foreign restricted or prohibited industries, without sufficient resources and assets, the VIE structure has been widely used to obtain financing from overseas market through overseas listings.[115]

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113 See article 3 of the FI Guidelines.

114 See 2017 Catalogue.

115 See Maximilian J Chapman, "China's Variable Interest Entities in Context: Past, Present and Future.

The first well known VIE structure was adopted by the Chinese online media company, Sina Corp. ("Sina"), in its 2000 listing on the NASDAQ stock exchange. Sina used the VIE as a workaround structure to avoid restrictions on foreign direct investment in the value-added telecom services sector and since then, both foreign and Chinese investors alike, such as high-profile Alibaba, Baidu and Tudou, interactive digital media advertising company Focus Media and education services company New Oriental, have replicated the VIE structure in many other sectors of China's economy where foreign investment is either restricted or prohibited to foreign investors.

Although there is no clear prohibition against the VIE structure in China, there has also been no official approval or the backing of the authorities which are circumvented leaving the VIE structure in a grey area of the Chinese legal system.[116] Its inherent flaws and significant risks also include (i) the lower level of protection of the beneficial owners under the relevant contractual arrangement, compared to the level of protection of owning a legal stake in the PRC Company; (ii) the potential conflict of interests between the legal shareholders of the PRC Company and the beneficial owners of the relevant contractual arrangement; and (iii) the level of uncertainty in the enforceability of the relevant contractual arrangements between the PRC Company and the FI Company in the event of a dispute.

As such, despite its popularity and benefits to the Chinese economy, regulators have posed several challenges based on arguments that VIE structures are used to circumvent industry investment regulations, restrictions and controls, as well as potentially entailing price transferring and consequent tax evasion.

VII. Introduction to Chinese Outbound Investment Regulatory Framework

Further to an abrupt and fast short-term drop of foreign exchange reserves and continued depreciation of the RMB in 2016,regulators in China have started implementing regulatory measures to control large outward remittances of foreign exchange to guard against overseas investment risks, irrational investment trends and other unusual conducts from Chinese enterprises going global.

On 6 December 2016, the NDRC, SAFE, MOFCOM, the People's Bank of China (PBOC) held a joint press conference and issued a press release stating that that the Chinese government had observed some irrational investment activities in real estate, hotels, movie studios, entertainment industry, and sports clubs in

116 See Serena Y. Shi "Dragon's House of Cards: Perils of Investing in variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States".

dictating that outbound transactions involving these sectors and those outside the investors' main line of business, overseas investments by limited partnerships, overseas investments by small parent companies with large subsidiaries, overseas investments by enterprises established hastily or rushing to go global, among others, would be subject to additional scrutiny by the Chinese regulators.

Potential risks associated with certain investments were highlighted and, as part of its internal review process, it was set that provincial MOFCOM authorities would have to seek consent of the central MOFCOM before issuing a certificate for the completion of the approval or filing process for any outbound investment that, among others: (i) falls within one of above mentioned sectors; (ii) exceeds a certain deal value threshold; (iii)is not related to the core business of the investor; (iv)is made by a limited partnership; (v) is made in an offshore target with an asset value greater than that of the investor's own value; or (vi) is conducted by a newly-established entity which has no business substance.

On 18 August 2017, China's State Council, together with other regulatory bodies, issued the Opinions on Further Guiding and Regulating the Directions of Overseas Investments ("OI Guidelines") which provide the most important clarification on Chinese outbound investments since the market uncertainty and abrupt decline in Chinese outbound investments that followed the above mentioned measures.

Significantly, the Guidelines officially formalized previously published piecemeal regulations and classified overseas investments into three main categories of investments: (i) encouraged[117]; (ii) restricted[118]; and (iii) prohibited[119].

The guidelines do not specify whether an investment that does not belong to one of these sectors should be permitted for overseas direct investment and it is also unclear whether any restricted investments, previously subject to close scrutiny of the PRC regulators and that are not specifically mentioned in the guidelines are subject to rejection by relevant PRC regulators, as was the case in practice before the guidelines were issued.

However, the sectors in each category reflect the current national economic and social policies and are consistent with previous positions of the authorities, which support competent enterprises that: (i) actively engage in outbound investment projects which promote the 'One Belt, One Road' strategy; (ii) deepen cooperation in international production capacity; (iii) promote the transfer of quality domestic production capacity, equipment, and applicable technologies overseas; (iv) enhance China's technology R&D, production, and manufacturing

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117 See section III of the OI Guidelines.

118 See section IV of the OI Guidelines.

119 See section V of the OI Guidelines.

capacity; (v) help resolve the country's energy shortage problems; (vi) promote industrial upgrade; and (vii) protect the image of China as a responsible overseas investor.

VIII. Introduction Chinese Outbound Investment Restrictions and Approvals

The Guidelines "encouraged" sectors for "*Qualified and capable*" Chinese companies include, among others:(i)to actively engage in the "One Belt One Road" investments and related infrastructure and connectivity; (ii) investments that export China's quality production capacity, equipment and technical standards; (iii) investments that strengthen cooperation with overseas high-tech and advanced manufacturing companies – Chinese companies are encouraged to establish overseas research and development centers; (iv) prudent participation in resources exploration and development; (v) expanding agricultural cooperation with foreign countries by carrying out mutually beneficial and win-win investments in agriculture, forestry, animal husbandry and fishery; (vi) investing in commercial, cultural, logistical and other services sectors in an orderly manner; (vii) qualifying financial institutions establishing branches and service networks abroad.[120]

The "restricted" sectors for overseas investments that are not aligned with China's national development, macroeconomic, international cooperation and foreign policies, include a, among others (i) investments in real estate, hotels, film studios, entertainment, sports clubs etc.; (ii) establishing equity investment funds or investment platforms outside China without specific industrial projects; (iii) carrying out investments using outdated production equipment that does not meet the technical requirements of the destination country; (iv) investments that do not meet the environmental protection, energy consumption and safety standards of the destination country; (v) investments in sensitive countries/regions with no diplomatic relations with China or that are in a state of war or chaos[121]

The "prohibited" sectors include, among others (i) investments involving exporting core military industrial technology and products without the approval of the Chinese government; (ii) investments involving exporting technology, crafts and products that China prohibits from being exported; (iii) investments in gambling and lewd industries; (iii) investments prohibited by international treaties to which China is party; and (iv) other investments that endanger or may endanger China's national interests and national security.[122]

120 See section III of the OI Guidelines.

121 See section IV of the OI Guidelines.

122 See section V of the OI Guidelines.

Moreover, the Guidelines outline the following core overseas investment principles[123]:

- For overseas investments by Chinese companies, the market will play a decisive role in the allocation of resources and the Chinese government will also better fulfil its role. Under the government's guidance, Chinese companies will make their own decisions and accept responsibility for profits, losses and investment risks.
- The Chinese government will continue to make policy reforms for overseas investments, improve related government functions and primarily use a filing-based system for supervising overseas investments (rather than a pre-approval system).
- Chinese companies should take into account the circumstances of the investment destination and its actual needs, and focus on mutually beneficial cooperation with foreign governments and companies.
- Emphasis will be placed on risk prevention, legal compliance as well as prior, interim and post investment supervision.

The Guidelines also outline policy measures relating to Chinese overseas investments, stating that the Chinese government will adopt different policy approaches for each category of overseas investment. Importantly, the Chinese government intends to (i) provide more favorable and convenient tax, foreign exchange, insurance, customs and other services for encouraged overseas investments; (ii) support the development of relevant services such as legal, arbitration, accounting, tax, valuation, investment consulting and risk assessment; (iii) strengthen authenticity and compliance reviews of overseas investment to prevent non-genuine investments; (iv) establish a foreign investment blacklist regime and penalize illegal overseas investment activities; (v) establish an overseas investment capital regime for state-owned enterprises; (vi) improve the overseas investment auditing regime for SOEs and safeguard the security of foreign state-owned assets; and (vii) encourage Chinese companies to obtain in-depth understanding of overseas investment policies, regulations and international practices, improve their overseas investment decision-making, financial management, legal and regulatory compliance, risk assessment, risk management and accountability systems, strengthen supervision and management of their overseas subsidiaries, comply with laws and regulations of the investment destination and strengthen guidance and supervision of investments in high risk countries and regions, provide timely warnings about significant political,

123 See section II of the OI Guidelines.

economic and social risks and put in place preventive measures.[124]

Furthermore, the Guidelines need to be interpreted together with the existing regulatory regime in China governing outbound investment by Chinese investors. An outbound investment by a Chinese privately-owned enterprise has to be either approved by or filed with the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) at either central or local level, depending on the nature and size of the transaction and the jurisdiction where the funds are to be invested. In the case of an outbound investment by a Chinese state-owned enterprise (SOE), the SOE may also need additional approval from the State-owned Assets Supervision and Administration Commission (SASAC).

In addition to the above generic regulatory regime applicable to Chinese investors, regulated entities in China are subject to additional approval or filing procedures with their respective regulators in China, e.g.in an outbound acquisition by a Chinese bank, the bank needs to obtain the approval of the CBRC, as the regulator for the banking sector in China. Furthermore, if a Chinese investor is a PRC listed company and if the proposed outbound transaction is of such a size that it would constitute a "major assets restructuring" transaction for the listed investor under PRC law, then the Chinese investor would need to go through additional regulatory procedures and approvals under the applicable listing rules.

Finally, in respect of the regulatory control over the remittance of funds by a Chinese investor for outbound investment purposes, the formal position is that a Chinese investor who intends to remit an amount above a predefined threshold out of China is required to engage in a "conversation or consultation" with the relevant branch of SAFE before it can remit funds offshore.

Although in general these measure have increased deal uncertainty and raised concerns among Chinese buyers and foreign sellers in transactions that fall into the restricted areas, the Guidelines made clear that continued support will be given to China's 'Go Global' policy and 'One Belt One Road' strategy with authorities likely reigning in overzealous investments in non-strategic areas, while strategic investments by Chinese companies that fall in line with China's broader strategy likely to continue to grow under more favorable policies and efficient procedures where Chinese companies are incentivized to place greater emphasis on cost-benefit analysis, due diligence, risk management and legal compliance in making and managing overseas investments.

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124 See section VI of the OI Guidelines.