
Amendments to PRC Foreign Invested Enterprise Laws

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Following the new amendments to the PRC Company Law, China has published a series of conforming amendments to certain existing regulations governing foreign invested entities in China (FIEs) to reflect the reform introduced by the Company Law amendments. The conforming amendments include changes to the Wholly Foreign Owned Enterprise Law and to Sino-foreign joint venture laws. It is encouraging to see the Chinese government adopting rule amendments to make treatment of domestic companies and FIEs more consistent. It nevertheless remains uncertain to what extent liberalizing reform of the legal regime governing foreign investment in China will continue.

Amendments to the Company Law

The recent Company Law amendments include the following major changes to the prior company registration and administration system, specifically:

- Elimination of the minimum registered capital requirement;
- Elimination of the time requirement within which shareholders must make capital contribution; and
- Elimination of the requirement that cash contribution to a company's registered capital must be no less than 30 percent.

For more details, please refer to our client alert published on March 12: [PRC Company Law Amendment](#).

Amendments to the Wholly Foreign Owned Enterprise Law

Amendments to the Implementing Rules for the Wholly Foreign Owned Enterprise Law echo the changes to the Company Law in the following aspects:

- a)** Under the prior WFOE Law, it was required that, “the amount of the registered capital of a WFOE shall be consistent with its business scope.” This rather aspirational and vague requirement has been eliminated by the amendments. Up until now, local approving authorities have used the quoted language as the basis for exercising their discretion to impose minimum registered capital requirements on WFOEs. Without this language, local approving authorities will no longer have a statutory basis to exercise their discretionary power to require minimum registered capital for various types of WFOEs.
- b)** Under the prior WFOE Law, shareholders of a WFOE must pay at least 15 percent of the registered capital of the WFOE within 90 days after the issuance of the WFOE’s business license and pay the remaining amount within three years after the first payment. The amendments removed this contribution schedule. This alteration, however, does not give foreign investors the right to make contributions whenever they want, because under the amendments they are still required to specify a contribution schedule in the incorporation application letter and the articles of association of the WFOE, which continue to be subject to examination and approval by the relevant approving authorities before formal establishment of WFOEs. This legacy requirement will give the local approving authorities discretionary power to decide whether to approve the contribution schedule.
- c)** Under the prior WFOE Law, contribution of the registered capital in the form of intellectual property right may not exceed 70 percent of the registered capital. The amendments have eliminated this requirement. This fact, plus the similar amendment to the Company Law discussed above (which removes the previous requirement of no less than 30 percent cash contribution by shareholders), makes it at least theoretically possible for a WFOE to be capitalized completely by intellectual property rights and other tangible or intangible assets.

Amendments to Sino-Foreign Joint Venture Law

- a)** The joint venture laws do not specify any minimum registered capital requirement for Sino-foreign joint ventures, whether equity joint ventures or contractual joint ventures, and generally follow the requirements of the Company Law. Absent any amendment in the joint venture law to the contrary, the elimination of such requirement from the Company Law will automatically carry over to Sino-foreign joint ventures.
- b)** The major amendment to the JV law is the abolishment of the Several Rules on Capital Contribution by Joint Venture Partners in Sino-Foreign Equity Joint Venture and their Supplemental Rules, which imposed a contribution schedule by joint venture partners similar to that under the WFOE Law. Accordingly, when to contribute is now entirely a matter of contractual obligations of joint venture partners.
- c)** Disappearance of the rule-based contribution schedule notwithstanding, government authorities continue to retain the power to “veto” any such contractual stipulations by way of examining and approving (or disapproving) a JV’s joint venture agreement and articles of association, which must specify the contribution schedule.

- d)** One widely disliked legacy requirement remains: the registered capital of a Sino-foreign JV cannot be reduced during its operation period unless approved by the JV's original approving authority. This prohibition may cause future JV partners to set the registered capital at as low a level as possible.

Looking to the Future

In the past decades, the Chinese government, both at the national level and at the local level, has enacted hundreds of regulations governing foreign invested enterprises. The recent Company Law amendments, the new amendments to the WFOE law and JV law mark significant improvements in lessening the burdens of foreign investors who invest in China, but they are not sufficient because approving authorities may still use their discretionary power in an unpredictable way (thus keeping China a business-unfriendly place, compared to other jurisdictions). In addition, there remain certain regulations whose applicability is unclear, for example:

- a)** Whether the registered capital to total investment ratio requirement will be abolished or revised so that its applicability is meaningful in light of the various amendments to laws affecting FIEs. Currently, the Sino-foreign Equity Joint Venture Ratio of Registered Capital to Total Investment Tentative Provisions (which also apply to contractual joint ventures and WFOEs) set out the required proportion of registered capital to total investment: the lower the amount of total investment, the higher the proportion of mandatory minimum registered capital contribution of the total investment (the difference between the total investment and the registered capital is the amount of debt an FIE can incur). Since the minimum registered capital requirement has been lifted by the amendments to the Company Law, which elimination is carried over to the WFOE Law and to the joint venture laws, this mandatory ratio requirement should (and likely will) be revised.
- b)** What is the impact of the amendments on the capital contribution schedule for acquisition of domestic companies by foreign investors? The Rules on Acquisition of Domestic Companies by Foreign Investors require that, in the case of acquisition of a domestic company by foreign investors (and thereafter turning the target domestic company into an FIE), the contribution of a foreign investor needs to be fully paid within three months after the issuance of the business license of the FIE, and within six months if the contribution is made in the form of intellectual property rights or other non-cash assets. Ideally, this mandatory contribution schedule should be eliminated.
- c)** What is the impact of the various amendments to laws governing FIEs on the fiduciary obligations of shareholders and directors of an FIE? Once the mandatory capital contribution schedule is removed from the company registration and approval system, there is no longer government "oversight" ensuring that shareholders actually contribute the amount of stated registered capital. Thus, creditors may have one fewer tool to evaluate a company's ability to take on risks and liabilities. In view of that, more emphasis should be placed on the fiduciary duties of the company's shareholders and directors in order to prevent them from using the company for personal gains at the expenses of other stakeholders, especially considering that China still does not have a developed or uniform credit reporting system.

These and many other questions remain unanswered. Our hope is that China will continue to carry out liberalizing reform of the legal regime governing foreign investment in China to make doing business in China easier.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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