

**Establishment of a Wholly
Foreign Owned Enterprise in
the People's Republic of China**

Basic principles

The legal basis for the establishment of a Wholly Foreign Owned Enterprise ("WFOE") in the People's Republic of China (PRC) are the *PRC Law on Sole Foreign Investment Enterprises* revised on 31 October 2000 as well as the *Detailed Rules for the Implementation of the PRC Law on Sole Foreign Investment Enterprises* from 12 April 2001. The *Guideline Catalogue of Foreign Investment Industries*, (most recent version took effect 1 December 2007) is also relevant. According to the provisions of the Guideline Catalogue, WFOEs cannot be established in all industrial sectors. For example, it is still impossible to establish WFOEs in the hospital sector.

In recent years, the establishment of a WFOE when legally permitted, has become increasingly popular among foreign investors. This is mostly due to the fact that many investors prefer to be in a position of complete control over their PRC subsidiary rather than sharing their influence with Chinese joint venture partners. However, whether or not the establishment of a WFOE is to be preferred over the establishment of a joint venture company, still largely depends on the individual business requirements of the investor and will have to be carefully considered.

Legal status and capital contribution

A WFOE shall take the form of a limited liability company under PRC law. Only in exceptional cases a different legal structure may be allowed.

PRC law distinguishes between the registered capital and the total amount of investment of a foreign invested enterprise ("FIE"). As with the establishment of joint venture companies, the statutory provisions with regard to the establishment of WFOEs require a certain ratio between the total amount of investment and the registered capital. This ratio depends on the total amount of the investment. For a total amount of investment of up to USD 3 million, the registered capital of the WFOE must be at least 70% of the total investment. For a total amount of investment of more than USD 3 million and less than or equal to USD 10 million, the registered capital must reach at least 50%. For a total amount of investment of more than USD 10 million and less than or equal to USD 30 million, the registered capital must be at least 40%. For total amount of investments of more than USD 30 million, the registered capital must reach at least 33%.

The registered capital can be contributed in cash and/or in kind. Capital contributions may take the form of freely convertible foreign currencies or machinery, equipment, real estate, industrial property or proprietary technology. However, according to the PRC Company Law, the value of industrial property rights and proprietary technology in total generally cannot exceed 70% of the registered capital.

The capital contributions can either be paid as lump sum or in installments. If paid in installments, the first installment shall not be less than 15% of the registered capital and must be paid within 3 months after the issuance of the Business License of the WFOE. The remaining installments have to be paid in accordance with the schedule laid down in the Articles of Association and the relevant statutory provisions. The total amount of the registered capital has to be contributed no later than two years after issuance of the Business License of the WFOE.

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The establishment of a WFOE is subject to the verification by the competent Reform and Development Commission, the approval by the competent examination and approval authority and the registration with the competent registration authority. This process must be completed in different steps.

First, the foreign investor has to pre-register the company name of the future WFOE with the competent Administration for Industry and Commerce.

Then, the foreign investor must submit a project application report, together with other documents such as

- a letter of creditworthiness,
- a certificate of incorporation of the investor,
- preliminary approvals by the local administrations of environmental protection,

to the competent Development and Reform Commission.

After issuance of the Verification Notice by the Development and Reform Commission, the investor needs to apply for approval of establishment of the WFOE with the competent Authority of Commerce. For such, inter alia, the following documents have to be submitted:

- an application to establish the WFOE,
- a feasibility study report,
- the Articles of Association of the WFOE,
- a list of the future members of the board of directors and the supervisors of the WFOE,
- a letter of creditworthiness for the foreign investor,
- the certificate of incorporation of the foreign investor, and
- other documents requested by the authority.

The examination and approval authority must make a decision on the approval of the application within three months of receipt of the application. In practice, the authorities usually act faster. After issuance of the Certificate of Approval, an application for the registration of the company with the Administration for Industry and Commerce has to be submitted within 30 days. This authority will issue the Business License of the company. The date of issuance of the Business License is the date of establishment of the WFOE.

According to PRC law, the investor must instruct a Chinese agency with a special license, a so-called sponsor to submit the application documents to the authorities. Whether or not such sponsor actually has to be involved, depends on the practice of the competent authorities.

Before the company can actually start operating, a number of other registrations have to be completed with the competent administration of foreign exchange, taxation authority and customs, etc.

Term of a wholly foreign owned enterprise

The maximum business term of a WFOE is 50 years. A WFOE can be dissolved at any time before that upon a resolution of its shareholders, and subject to the approval by the competent examination and approval authority. In this case, liquidation has to be carried out in accordance with the PRC Company Law.

For further information and assistance, please contact

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