

Establishment of a Joint Venture Company in the People's Republic of China

Basic principles

Under the law of the People's Republic of China ("PRC law"), joint venture companies can legally be structured either as an Equity Joint Venture ("EJV") or as a Contractual (or Cooperative) Joint Venture ("CJV").

The legal basis for the establishment of an EJV are both the PRC Law on Sino-foreign Joint Equity Enterprises (last revised on 15 March 2001) and the Regulations for the Implementation of the PRC Law on Sino-foreign Joint Equity Enterprises as amended on 22 July 2001.

CJVs are subject to the PRC Law on Sino-foreign Cooperative Enterprises updated on 31 October 2000 as well as the Detailed Rules for the Implementation of the PRC Law on Sino-foreign Cooperative Enterprises of 4 September, 1995.

The establishment as well as the Joint Venture Contract and the Articles of Association of joint ventures are mandatorily subject to PRC law.

Establishment of a joint venture company

Both the establishment of an EJV as well as the establishment of a CJV are subject to

- verification by the competent Development and Reform Commission,
- approval by the competent examination and approval authority, and
- registration with the competent registration authority.

This process must be completed in different steps. First, the parties have to apply for pre-registration of the company name of the future foreign-invested enterprise ("FIE") with the competent Administration for Industry and Commerce.

Secondly, the parties must submit a project application report to the competent Development and Reform Commission, together with other documents such as

- a letter of intent,
- a letter of creditworthiness of the foreign investor,
- a certificate of incorporation/business license of the investors, and
- preliminary approvals by the local administrations of environmental protection.

In the next step, the parties jointly have to conduct a feasibility study report. The feasibility study report is a business plan which describes in detail the economic background and goals of the project as well as the economic feasibility. The feasibility study has to be submitted to the competent Authority of Commerce for examination and approval, together with

- a written application for the establishment of the FIE,
- the Joint Venture Contract, the Articles of Association,
- a list of the members of the future board of directors and the supervisor(s) of the FIE,
- a letter of creditworthiness for the foreign investor, the certificates of incorporation of the investors,
- as well as other documents requested by the examination and approval authority.

The examination and approval authority will decide within three months of receipt of the application whether or not to approve the application. In practice most authorities act faster. After issuance of the Certificate of Approval, an application for the registration of the FIE with the Administration for Industry and Commerce has to be submitted within 30 days. This authority will issue the Business License of the FIE. The date of issuance of the Business License is the date of establishment of the FIE.

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

Equity joint venture

According to PRC law an EJV has to take the form of a limited liability company and as such, an EJV has the status of a legal person under PRC law.

The investment contributed by the foreign shareholder as his share of the registered capital must normally be at least 25%. Should foreign shareholders hold less than 25% of the registered capital, the company will not be entitled to the incentives which are available specially to FIEs.

PRC law distinguishes between the registered capital and the total amount of investment. Statutory provisions require a certain ratio between the total amount of investment and the registered capital. This ratio depends on the amount of the total investment. In case of a total amount of investment of up to USD 3 million, the registered capital must be at least 70% of the total investment. In case of a total amount of investment is larger than USD 3 million, but less than or equal to USD 10 million, the registered capital must be at least 50%, however, not less than USD 2.1 million. 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 reach at least 40%, however, not less than USD 5 million. For a total amount of investment of more than USD 30 million, the registered capital must reach at least 1/3, however, not less than USD 12 million.

The registered capital can be contributed in cash and/or in kind. Capital contributions can 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 the cash contribution must be at least 30% of the total registered capital.

The capital contributions can either be paid as lump sum or in installments. If paid in installments, the first installment cannot be less than 15% of the registered capital and must be paid within three months after issuance of the Business License of the FIE. The remaining installments have to be paid in accordance with the schedule laid out in the Articles of Association and the relevant statutory provisions. According to the PRC Company Law, the maximum time for contribution of the entire registered capital is two years after issuance of the Business License.

Contractual joint venture

A CJV can be established as a limited liability company or as an entity without the status of a legal person. In the first case, the equity share of the foreign shareholder must reach at least 25%.

A CJV is more flexible than an EJV. For example, the composition of the board of directors or joint management body of the CJV does not need to reflect the shareholding ratios of the parties to the joint venture. Instead of or in addition to capital contributions, the Chinese partner can also contribute so-called terms of cooperation, e.g. in the form of cash, machinery or know-how. Terms of cooperation do not become part of the registered capital.

Further, the parties can decide to distribute profits differently from their shareholding ratios. The foreign partner may even recover its investment during the term of the enterprise should the parties agree. However, such prior recovery is only permitted if the parties agree in the Joint Venture Contract that on expiry of the duration of the term of the joint venture, all fixed assets of the company will revert to the ownership of the Chinese partner without need for compensation or payment. The parties can also agree that the Chinese party receives a fixed return instead of dividends according to its shareholding ratio.

A CJV, therefore, is more suitable for short-term cooperations, where the foreign investor usually places greater importance on the fast recovery of his investment, or for cooperations, where the influence of the Chinese partner should be restricted as much as possible. An EJV, on the other hand, due to its more extensive statutory regulation, offers less potential for conflicts and is more suitable for a long-term partnership. In practice, most investors prefer the form of an EJV over the CJV.

Term of a joint venture company

In China, a joint venture company can have a term between ten and fifty years, depending on the business sector. However, in certain cases of projects with a large investment or own acquired land use rights, even a longer business term is possible in practice. In any case, an application for extension of the business term can be submitted at the latest 6 months before expiration of the ongoing term.

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