

New Guidance on Domestic Investment by Foreign Investment Enterprises

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On July 25 2000, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Administration of Industry and Commerce (SAIC) issued the Investment Within China by Foreign Investment Enterprises Tentative Regulations (the Regulations). The Regulations clarify the nature, the conditions and the relevant approval procedures of domestic investment by Foreign Investment Enterprises (FIEs) in an effort to further standardize domestic investment activities of FIEs.

Application

FIEs that take the form of limited liability companies or stock limited companies shall comply with the Regulations in their incorporation or acquisition of equities in other enterprises on the mainland.

Domestic investment by investment companies established by foreign investors must apply the Establishment of Companies With an Investment Nature by Foreign Investors Tentative Regulations Provisions (issued by MOFTEC on April 4 1995), together with other PRC law and regulations on foreign investment.

Besides the Regulations, Changes in Equity Interest of Investors in Foreign Investment Enterprises Several Provisions (jointly issued by MOFTEC and SAIC on May 28 1997) is also to be complied with where enterprises thus invested in are FIEs.

Status of the Enterprises Invested in

In the 1986 Notice on Co-investment by the Sino-Foreign Equity Joint Ventures and Domestic Enterprises, according to the Ministry of Finance, the enterprise invested in would be considered as a Sino-foreign equity joint venture if the newly established enterprise undertakes encouraged projects with its equity interest over 25%. According to the Regulations, if a FIE invests in the mid-west areas and the "foreign capital" is not less than 25% of the registered capital of the invested in enterprise, the enterprise is entitled to FIE preferential treatment.

Conditions and restrictions

According to the Regulations, a FIE engaged in domestic investment activities, should conform to the following conditions:

- a. the registered capital has been paid up;
- b. it is making profits; and
- c. it operates in accordance with the law and has no illegal operation record.

The Regulations no longer require the approved project to be completed, or the enterprise to start to pay its enterprise income tax, which is different from earlier regulations.

The foreign investor should contribute at least 25% to the registered capital when it co-invests with a FIE. The ratio excludes the foreign interests of the FIE. The foreign currency contributed by an investment company established by a foreign investor may be counted in when it co-invests with a foreign investor.

An enterprise invested in by a FIE is not entitled to a tax refund and the FIE shall invest its net profits in the enterprise. The original approval authority is responsible for approving

investments of fixed assets that change the business scale or businesses. The total investment by a FIE should not exceed 50% of its net assets, calculated at the time of investment.

Regarding investment in restricted investment fields, the earlier laws and regulations state that equity interests of all FIEs shall not exceed 25% of the registered capital of the invested enterprise. However, the Regulations only require that investment in these fields be approved by relevant authorities and do not set an upper limit on the foreign investment to the enterprise invested in.

Approval Procedures

Application and approval procedures are also clarified in the Regulations so as to standardize domestic investment activities by FIEs.

In Fact, according to a recent explanation from the officials of MOFTES, restrictions on domestic investment by FIEs are the same as those on investment to FIEs. The domestic investment shall also be examined with respect to the investment industries, but the approval procedure is simpler. the term "invested by an FIE" endorsed in the column of "Enterprise Classification" on the business license of the enterprise invested in is to remind the authorities of the necessary examination on the investment and change of scope of business of the enterprise invested in.

Regarding the approval authority, the Regulations require the establishment of a company or purchase of equity by FIE shall be approved by the provincial foreign trade and economic authority of the place where the enterprise invested in is located. This is instead of the original authority as required by the earlier laws and regulations.