Investment Companies Law Amended

——— David Yu

On February 12 2004, the ministry of Commerce (MOC) further amended the *Establishment of Companies with an Investment Nature by Foreign Investors Provisions* (Provisions), apparently in response to criticisms of earlier amendments made on June 10 2003, which some foreign investors claim failed to consider their needs. The new amendments should help China attract more investment from multinational companies (Investors) that are interested in setting up a company with an investment nature (Company).

Entry thresholds

The Provisions make two amendments to Investor qualifications: i) for an Investor with a total asset value of US$400 million or more in the year before application, the requirement of three approved investment project proposals is waived; and ii) for an Investor with 10 or more established foreign-invested enterprises (FIEs), the requirement that the FIEs be engaged in production or infrastructure projects has been removed. A multinational company that wishes to minimize risk by establishing a shell holding company, or which cannot satisfy the capital requirements itself, can now set up a Company under the Provisions provided it has established 10 FIEs with a capital contribution of more than US$30 million of the registered capital actually paid in. However, these FIEs must be directly invested in by the Investor. The Provisions are not clear on this point, but experience indicates that this requirement will be strictly adhered to by the MOC.

Fewer restrictions

The Provisions have introduced a three-level scope of business:

General business scope: i) making permitted investment; ii) providing certain services to its FIEs; iii) setting up R&D facilities, assigning R&D achievements and providing corresponding technical services; iv) providing consultancy services to its Investor and its affiliated companies; v) providing outsourcing services to its Investor and affiliates (v) is newly permitted).

Business scope of Companies in compliance with certain conditions in Article 14: i) engaging in certain businesses; ii) exporting domestic merchandise; iii) purchasing and selling domestically and abroad the products of its FIEs; iv) providing certain technical training; v) importing for trial sale a limited quantity of products; vi) providing commercial leasing services to its FIE; vii) providing after-sale services; and viii) participating in foreign project contracting by Chinese enterprises.

Business scope of Companies approved by the MOC to be regional headquarters (discussed below).

Companies now have greater investment powers. A Company is now able to acquire all or part of the equity stakes in its FIEs that are held by domestic companies. The Provisions also raise the aggregate value of permitted imports each year from 35% of the Company's registered capital contributed in foreign exchange to the value of the registered capital actually paid in.

Regional headquarters

The amended Provisions introduce the concept of "regional headquarters" (RHQ) and set out the MOC's approval requirements in this regard. An RHQ has a broader permitted scope of business than a Company and, among other things, may: i) import and sell the Investor's products on the domestic market; ii) import raw material and components required for offering repair services; iii) undertake contracted-out service business; iv) engage in physical distribution services; v) establish a finance company and provide certain financial services; and vi) participate in foreign project contracting and investment.

However, this new development has brought the Provisions into conflict with local regulations in such places as Beijing and Shanghai. It appears that the Provisions have superseded local regulations and that existing RHQs should apply to the MOC for recognition of their status. For companies that meet the requirements of the Provisions, the broader benefits offered under the Provisions give a strong incentive for registration. However, the position is less clear for existing RHQs that do not qualify under the Provisions - can they continue to operate with only the recognition of the relevant local foreign economic relation and trade commission? This and other questions need to be answered in practice or by further refinement of the Provisions.

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