

# *How to Set Up a Wholly Foreign-Owned Enterprise in China: Procedure and Requirements*

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By Fang Liu

## **Introduction**

A wholly foreign-owned enterprise (WFOE) is a common investment vehicle for foreign enterprises that conduct business in mainland China. Setting up a WFOE does not require the involvement of Chinese investors and is often a preferred choice for foreign investors. However, the procedure for setting up a WFOE in China is much more complicated than what we experience in the United States. This article provides legal practitioners with detailed information on how to set up a WFOE in China.

## **Overview of the Chinese Legal System**

Under the Constitution of China,<sup>1</sup> “the state hierarchy consists of the central, provincial, municipal, county, township, and village levels.”<sup>2</sup> At the central level, the National People’s Congress (NPC), the State Council, the Supreme People’s Courts, and the Supreme People’s Procuratorate possess the legislative power, the executive power, the judicial power, and the procuratorial power respectively.<sup>3</sup> At the local level, the governmental structures are similar to those at the central level.<sup>4</sup> The relationship between the central and local authorities has been described as follows:

Under China’s system, all sovereign state power resides in the central level authorities (as elected by the people) and the power that is enjoyed by provincial level authorities and below is delegated power from the central level authorities. This should be contrasted with the U.S. federal system in which the fifty states are sovereign entities and exercise all sovereign power except those delegated to the federal government by the U.S. Constitution.<sup>5</sup>

As a civil-law country,<sup>6</sup> the statutes, regulations, and various stipulated rules constitute China’s legal norms.<sup>7</sup> Legal practitioners not only need to know the basic laws and

the administrative regulations, but also the implementing rules, orders, measures, and circulars.<sup>8</sup>

## **Corporate Law in China**

In the field of corporate law in China, the leading statute is the Company Law, which became effective in 1994 and was revised in 1999, 2004, 2005, and 2013.<sup>9</sup> In addition to various rules and regulations related to the general corporate law, there are special laws and regulations on foreign-invested enterprises, which include the equity joint ventures (EJVs),<sup>10</sup> the cooperative joint ventures (CJVs),<sup>11</sup> and the wholly foreign-owned enterprises (WFOEs).<sup>12</sup> These entities share the common rules of the general corporate law and are subject to their special rules and regulations at the same time.<sup>13</sup>

## **Setting up a WFOE in China**

Several steps and governmental authorities will be involved in setting up a WFOE in China. The first step is to obtain the advance name registration at the State or local Administration for Industry and Commerce (“SAIC” or “AIC”); the second step is to obtain an approval for setting up the WFOE at the local branch of the Ministry of Commerce (“MOFCOM”); the third step is to formally register the WFOE with the local AIC; and the follow-up step is to complete a series of post-registration procedures at various relevant organizations to fully operate the business.

### *Step One: Obtain the Advance Name Registration for WFOE*

Applying for a Chinese name with the registration authority is the preliminary process to establish a WFOE.<sup>14</sup> As part of the registration process, and depending on whether or not the WFOE’s name includes the character of “China” and whether the registered capital<sup>15</sup> of the company will reach RMB 50,000,000 (about USD \$7.7 million), the SAIC or the AIC will have the authority to grant a name

to the company.<sup>16</sup> Generally speaking, a company's name is composed of the administrative division, trade name, industry name, and the type of entity.<sup>17</sup> In *Shareholder Agreements and Joint Ventures in China*,<sup>18</sup> the author provides a concise introduction about the Chinese enterprises' names:

The names of Chinese enterprises reveal more information than do the names of Western companies. Only certain companies may use the word "national" in their name and, if a company has national, China, or similar characters in its name, its formation must have been approved by the Administration of Industry and Commerce at the Central Government level. Similarly, a name preceded by or containing a provincial designation must be approved by the provincial administration of industry and commerce and, if the name contains a municipality's name, it must be approved by the municipal administration of industry and commerce. The name of a Chinese enterprise therefore identifies the level of the Administration of Industry and Commerce to which it reports and by which it is periodically inspected. Together with the enterprise's address, one can determine the specific office of the Administration of Industry and Commerce that will maintain records on the enterprise. The name of the enterprise should also reveal whether the company is incorporated under The Company Law and whether it is a joint stock company or a limited liability company.<sup>19</sup>

From a company's name, people can instantly know where the company is registered, its business industry, and the type of entity. Assuming that a company has the name "Beijing Xinmei Zhuangshi Ltd.," then "Beijing" is the place where the company is registered. "Xinmei" is the trade name, which means fresh and beautiful. "Zhuangshi" means decoration and is the industry name. "Ltd" indicates that the company is a limited liability company.<sup>20</sup>

To apply for the advance name registration, the following documents are required: (1) an application form for the name registration; (2) power of attorney authorizing a specific person handling the registration matters on behalf of the company; and (3) other documents that may be required by the AIC

(e.g., investor's articles of incorporation, photocopy of the passport of the legal representative who signs the application form, etc.).<sup>21</sup> The application form for the name registration itself will contain the information of the new company's proposed name, domicile, the amount of registered capital, type of entity, business scope, and investor's name and nationality.<sup>22</sup> The AIC will either approve or disapprove the proposed name within one day of the application and will issue an Approval Notice of Advance Name Registration to the investor on approval.<sup>23</sup>

#### *Step Two: Obtain an Approval from MOFCOM*

Following the Advance Name Registration at the AIC, the next step is to apply with the local branch of MOFCOM for establishing the WFOE. At this step, the documents required include (1) an application letter that includes the information about the investor(s) and the legal representative of the WFOE; (2) a feasibility study report that explains the business scope, business plan, and financial projection of the WFOE; (3) articles of association of the WFOE, which must include the business purpose, investment scale, organizational framework, and the powers and duties of the officers, foreign exchange, and labor management; (4) a list of names of the WFOE's legal representative, director(s), supervisor(s) and manager, coupled with their appointment letters and a copy of their ID card; (5) a notarized and authenticated certificate of incorporation of the investor(s), a copy of a creditability letter issued by a financial institute to the investor; (6) a written letter from the local government of county-level or above in which the WFOE will be established; (7) a list of items to be imported from foreign countries; and (8) other documents that may be required.<sup>24</sup> On receiving all the necessary documents, the MOFCOM will have up to 90 days to make a decision whether to approve the proposed establishment of the WFOE.<sup>25</sup>

To better understand the documents required during the WFOE's registration process, it is necessary to understand the term "legal representative," who is an individual who is authorized by the board of directors to act on behalf of the company.<sup>26</sup> Only the chairman of the board, the executive director, or the company's general manager is qualified to be the legal representative of the company.<sup>27</sup> "Although the legal representative may entrust another person, e.g. a

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deputy manager, with the power to act as his [or her] agent (i.e. not as a direct agent of the company), each company in China is only allowed to have one legal representative."<sup>28</sup>

As for the importance of a company's legal representative:

"The legal representative" exercises considerable authority within a Chinese enterprise and normally has the power to bind the entity. The legal representative is of sufficient importance that his or her name must be registered with the [registration authority] along with a copy of his or her signature.<sup>29</sup>

The "legal representative...is similar to an agent under U.S. law. [It] is the designated natural person that has authority to act on behalf of and to bind the company."<sup>30</sup>

[Chinese (PRC)] authorities wanted to ensure that questions concerning the legal effectiveness of the acts of a company did not arise and therefore required that every company have a legal representative whose acts clearly bind the company. In addition, by exposing the legal representative to civil and criminal liability for the misdeeds of the corporation, PRC authorities sought to dilute the principle of limited liability in order to discourage corporate misbehavior.<sup>31</sup>

Besides the "legal representative," another term that it is essential to understand is the "articles of association," which are very different from the articles of incorporation in the United States. A company established in China is required to file its articles of association with a registration office; however, the articles of association are not a public document.<sup>32</sup> Because shareholders may specify any matters they deemed necessary in the articles of association,<sup>33</sup> which often include detailed internal governance, the articles of association in China turn out to be more like a company's bylaws in the United States. Generally speaking, the articles of association include (i) the company's name and domicile; (ii) the company's business's scope; (iii) the registered capital; (iv) the shareholders' names; (v) the shareholders' rights and obligations; (vi) the form and amount of shareholders' capital contributions; (vii) the company's organization and the methods of its formation, the organization's functions and powers, and its procedural rules; (ix) the legal representative; and (x) other matters deemed necessary by the shareholders.<sup>34</sup> Shareholders must af-

fix their signatures and seals to the company's articles of association.<sup>35</sup>

### *Step Three: Formal Registration of the WFOE with the AIC*

Within 30 days of obtaining the approval from the MOFCOM, the investor(s) must file with the AIC for formal registration.<sup>36</sup> Documents required at this step include (1) an application for registration signed by the chairman of the board; (2) articles of association of the WFOE and the certificate of approval from the MOFCOM; (3) a feasibility study report; (4) a notarized and authenticated Certificate of Incorporation of the investor; (5) a creditability letter issued by a financial institute to the investor; (6) the name list of the legal representative, director(s), supervisor(s), and manager(s) with their appointment letters and a copy of ID card; and (7) other documents that may be required by the AIC.<sup>37</sup> In this step, many documents required by the AIC are the same as those submitted to the MOFECOM at the second step; therefore, duplicate originals are often required. The AIC will have 30 days to complete the verification of the registration application and issue the business license for the WFOE. The WFOE is legally established on the date when its business license is issued.<sup>38</sup>

### **Post-Registration Matters**

Immediately after obtaining the business license from AIC, the WFOE must complete several post-registration matters, including making a set of seals (i.e., the corporate seal, the financial seal, and the legal representative's signature seal) at the Public Security Bureau,<sup>39</sup> applying for an Enterprise Organization Code with the Bureau of Quality and Technical Supervision,<sup>40</sup> making a registration with the Administration of Foreign Exchange to obtain a Certificate of Foreign Exchange Registration,<sup>41</sup> opening bank accounts (both a foreign exchange account and a RMB bank account),<sup>42</sup> completing local and state tax registration,<sup>43</sup> etc. The WFOE may hire employees and must enter into a written employment contract with each employee.<sup>44</sup> The WFOE must also pay the social insurances for its employees, which include pension, medical and hospitalization, and unemployment and housing fund.<sup>45</sup>

### **Conclusion**

Foreign-invested enterprises in China (i.e., EJV, CJV, and WFOE) generally share



the similar registration procedures and follow registration steps that are similar to those described in this article. Because setting up a WFOE does not require contract negotiations between foreign investors and Chinese investors, it usually takes less time to set up a WFOE than to set up an EJV or CJV. However, due to different government authorities and the amount of documents involved, it is quite typical for foreign investors to take three to six months to set up a WFOE in China. Therefore, it is advisable that foreign investors who plan to conduct business in China and set up a WFOE there start the preparation and process as early as possible.

## NOTES

1. Zhonghua Renmin Gongheguo Xianfa (中华人民共和国宪法) [The Constitution of the People's Republic of China] (hereinafter "XIANFA") available at [http://hk.lexiscn.com/law/constitution-of-the-peoples-republic-of-china-revised-in-2004.html?keyword=&t\\_kw=&eng=0&access=content\\_detail&lang=cn](http://hk.lexiscn.com/law/constitution-of-the-peoples-republic-of-china-revised-in-2004.html?keyword=&t_kw=&eng=0&access=content_detail&lang=cn).

2. Vai Io Lo & XiaoWen Tian, Law and Investment in China: The Legal and Business Environments after WTO Accession 6 (2005).

3. XIANFA art. 58, 85, 127, 132.

4. Vai Io Lo et al, at 7.

5. *Id.* at 87.

6. See William P. Alford & Yuanyuan Shen, *Limits of the Law in Addressing China's Environmental Dilemma*, 16 Stan Envtl L J 125, 128 (1997) ("Given the nature of the PRC's civil law system, the decisions of its courts do not subsequently bind the judiciary as a formal matter. China's organization as a unitary state means that provincial and lower level legislative and regulatory enactments are valid only insofar as they are consistent with national measures.").

7. Vai Io Lo et al., at 7.

8. See generally James M. Zimmerman, *China Law Deskbook: A legal Guide for Foreign- Invested Enterprises* 60-61 (2d ed. 2004).

9. Gongsi Fa (公司法) [Company Law], available at [http://hk.lexiscn.com/law/company-law-of-the-peoples-republic-of-china-revised-in-2013.html?keyword=&t\\_kw=&eng=0&access=content\\_detail&lang=cn](http://hk.lexiscn.com/law/company-law-of-the-peoples-republic-of-china-revised-in-2013.html?keyword=&t_kw=&eng=0&access=content_detail&lang=cn).

10. (i) See Zhongwai Hezi Jingying Qiye Fa (中外合资经营企业法) [Sino-foreign Equity Joint Venture Law], available at <http://hk.lexiscn.com/law/implementing-regulations-of-the-law-of-the-peoples-republic-of-china-on-sino-foreign-equity-joint-ventures-revised-in-2001.html?eng=0>.

(ii) See Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli (中外合资经营企业法实施条例), available at <http://hk.lexiscn.com/law/implementing-regulations-of-the-law-of-the-peoples-republic-of-china-on-sino-foreign-equity-joint-ventures-revised-in-2014-edited-by-lexiscncom.html>.

11. (i) See Zhongwai Hezi Jingying Qiye Fa (中外合作经营企业法) [Sino-Foreign Co-operative Joint Venture Law], available at <http://hk.lexiscn.com/law/law-of-the-peoples-republic-of-china-on-sino-for->

[ign-cooperative-joint-ventures.html?eng=0](http://hk.lexiscn.com/law/law-of-the-peoples-republic-of-china-on-sino-foreign-co-operative-joint-ventures.html?eng=0).

(ii) See Zhongwai Hezi Jingying Qiye Fa Shishi Xize (中外合作经营企业法实施细则), available at <http://hk.lexiscn.com/law/implementing-rules-of-the-law-of-peoples-republic-of-china-on-sino-foreign-co-operative-joint-ventures.html?eng=0>.

12. (i) See Waizi Qiye Fa (外资企业法) [*Wholly Foreign-owned Enterprise Law*] (promulgated by Nat'l People's Cong., Apr. 12, 1986, amended Oct. 31, 2000, effective Oct. 31, 2000) (China), available at <http://hk.lexiscn.com/law/law-of-the-peoples-republic-of-china-on-wholly-foreign-owned-enterprises-revised-in-2000.html>.

(ii) See Waizi Qiye Fa Shishi Xize (外资企业法实施细则) [*Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises*], available at <http://hk.lexiscn.com/law/implementing-rules-for-the-law-of-the-peoples-republic-of-china-on-wholly-foreign-owned-enterprises-revised-in-2014-edited-by-lexiscncom.html>

13. *Id.*

14. Qiye Mingcheng Dengji Guanli Shishi Banfa (企业名称登记管理实施办法) [*Measures for the Implementation of the Administration of Enterprise Name Registration*], art 22, available at [http://hk.lexiscn.com/law/law-chinese-1-10541.html?keyword=&t\\_kw=&eng=0&access=content\\_detail&lang=cn](http://hk.lexiscn.com/law/law-chinese-1-10541.html?keyword=&t_kw=&eng=0&access=content_detail&lang=cn).

15. See Company Law, art. 26, 80 (providing that the registered capital of a limited liability company is the total amount of capital contribution subscribed by all the shareholders and that the registered capital of a joint stock company is the total amount of share capital subscribed by all the sponsors, or the actual total paid-up share capital if the company is established through share offer).

16. Measures for the Implementation of the Administration of Enterprise Name Registration, art. 5.

17. *Id.* art. 9.

18. Owen Nee, Shareholder Agreements and Joint Ventures in China, WL BLC-SHARE § 3:3 (2011).

19. *Id.*

20. In China, Limited Liability Company is a type of corporations. Unlike the LLC in the U.S., LLC in China does not enjoy the tax-flow through treatment.

21. Qiye Mingcheng Dengji Guanli Shishi Banfa (企业名称登记管理实施办法) [*Measures for the Implementation of the Administration of Enterprise Name Registration*] art. 23, available at [http://hk.lexiscn.com/law/law-chinese-1-10541.html?keyword=&t\\_kw=&eng=0&access=content\\_detail&lang=cn](http://hk.lexiscn.com/law/law-chinese-1-10541.html?keyword=&t_kw=&eng=0&access=content_detail&lang=cn).

22. Measures for the Implementation of the Administration of Enterprise Name Registration, art. 23.

23. *Id.* art. 25.

24. Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, art. 10.

25. *Id.* art. 11.

26. Qiye Faren Dengji Guanli Tiaoli Shixing Xize (企业法人登记管理条例施行细则) [Implementing Rules for the Administrative Regulations of the People's Republic of China on the Registration of Enterprise Legal Persons] art. 25, available at <http://hk.lexiscn.com/law/implementing-rules-for-the-administrative-regulations-of-the-peoples-republic-of-china-on-the-registration-of-enterprise-legal-persons-revised-in-2014.html>.

27. Company Law, art. 50 (stating that a limited liability company with few shareholders, or of a small scale, can choose one executive director, rather than the board of directors).

28. *Id.* at 34-35.

29. Nee at § 3:3.

30. *Id.* at 359.

31. *Id.* at 360.

32. Owen Nee, Shareholder Agreements and Joint Ventures in China, WL BLC-SHARE § 4:1 (2011).
33. Company Law, art. 25(8).
34. *Id.* art. 25.
35. *Id.*
36. Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, art.12.
37. Qiye Faren Dengji Guanli Tiaoli Shixing Xize (企业法人登记管理条例实施细则) [*Detailed Implementation Rules for the Administrative Regulations on the Registration of Enterprise Legal Persons*], art. 33, available at <http://hk.lexiscn.com/law/implementing-rules-for-the-administrative-regulations-of-the-peoples-republic-of-china-on-the-registration-of-enterprise-legal-persons-revised-in-2014.html>.
38. Regulations on the Administration of Company Registration, art. 3.
39. Detailed Implementation Rules for the Administrative Regulations on the Registration of Enterprise Legal Persons, art. 16.
40. Zuzhi Jigou Daima Guanli Banfa (组织机构代码管理办法) [*Regulations on Enterprise Organization Code*], art. 9, available at [http://www.gov.cn/jfg/2009-02/13/content\\_1230562.htm](http://www.gov.cn/jfg/2009-02/13/content_1230562.htm).
41. Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, art.52.
42. *Id.* art. 16.
43. *Id.* art. 12.
44. Laodong Fa (中华人民共和国劳动法) [*Labor Law of the People's Republic of China*] art. 16, available at <http://hk.lexiscn.com/law/labor-law-of-the-peoples-republic-of-china.html>.
45. *Id.* art. 73.



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