Foreign Direct Investment in the People’s Republic of China
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>2</td>
</tr>
<tr>
<td>Foreign investment policy</td>
<td>2</td>
</tr>
<tr>
<td>Equity joint ventures</td>
<td>3</td>
</tr>
<tr>
<td>Introduction</td>
<td>3</td>
</tr>
<tr>
<td>Nature of equity joint ventures</td>
<td>3</td>
</tr>
<tr>
<td>Procedure for setting up equity joint ventures</td>
<td>5</td>
</tr>
<tr>
<td>Cooperative joint ventures</td>
<td>6</td>
</tr>
<tr>
<td>Introduction</td>
<td>6</td>
</tr>
<tr>
<td>Nature of cooperative joint ventures</td>
<td>6</td>
</tr>
<tr>
<td>Procedure for setting up cooperative joint ventures</td>
<td>7</td>
</tr>
<tr>
<td>Wholly foreign-owned enterprises</td>
<td>7</td>
</tr>
<tr>
<td>Introduction</td>
<td>7</td>
</tr>
<tr>
<td>Nature of wholly foreign-owned enterprises</td>
<td>7</td>
</tr>
<tr>
<td>Procedure for setting up wholly foreign-owned enterprises</td>
<td>8</td>
</tr>
<tr>
<td>Comparison of wholly foreign-owned enterprises with joint ventures</td>
<td>8</td>
</tr>
<tr>
<td>Foreign-invested partnerships</td>
<td>9</td>
</tr>
<tr>
<td>Introduction</td>
<td>9</td>
</tr>
<tr>
<td>Nature of partnerships</td>
<td>9</td>
</tr>
<tr>
<td>Procedure for setting up an FIP</td>
<td>10</td>
</tr>
<tr>
<td>Comparison of FIPs with FIEs</td>
<td>10</td>
</tr>
</tbody>
</table>
Foreword

This overview briefly describes the following principal vehicles for foreign investment in the People's Republic of China (PRC or China): the Sino-foreign equity joint venture enterprise, the Sino-foreign cooperative joint venture enterprise and the wholly foreign owned enterprise. These investment vehicles are collectively referred to as foreign investment enterprises (FIEs). A brief introduction of the new form of vehicle for foreign investment - foreign-invested partnership (FIP), will be set out towards the end of this overview.

Despite the PRC’s continuous efforts in encouraging foreign investment for the past three decades, we wish to emphasise that the legal framework and policies affecting foreign investment in the PRC are still developing and contain certain restrictions and approval requirements. For instance, the Catalogue for Guiding Foreign Investment in Industries updated in 2011 lists specific industries in which foreign investment in China is encouraged, restricted, or prohibited. Such list is subject to review from time to time. The latest revisions to the Company Law of the People's Republic of China, which entered into effect on 1 March 2014, which is also applicable to FIEs in general, although there may be local variations in implementation. The information in this overview is based upon our experience with, and understanding of, publicly available PRC investment laws as of 1 July 2014.

This overview is not intended as an exhaustive discussion of foreign investment in the PRC, but rather to provide general information for reference purposes on foreign investment policy as well as the major types of investment vehicle. In view of the vigorous and rapid development of the PRC economy and legal framework, for those foreign investors planning to do business in China, especially those first-time investors who are not so familiar with doing business in China, it is highly recommended that professional advice and further information (such as the relevant approval requirements) be sought before embarking on foreign investment to China.

Foreign investment policy

First of all, let’s take a look at the general principles of the foreign investment policy in China.

The Chinese government has issued a wide range of laws and regulations to govern foreign investment in the country. Their purpose is to direct foreign investment into certain priority industry sectors while restricting or prohibiting investment in other sectors. The key national regulations for implementing China’s foreign investment policy are the Regulations for Guiding the Direction of Foreign Investment (Guiding Regulations). The Guiding Regulations classify all foreign investment projects into 1 of 4 categories: encouraged projects, permitted projects, restricted projects and prohibited projects. The classification of an investment project under the Guiding Regulations determines the feasibility and establishment method for the project. The principal difference between encouraged and permitted projects is that encouraged projects may be eligible for tax breaks on the import of capital goods under existing foreign investment promotion policies. Restricted projects must be examined and approved by the relevant provincial-level departments. A record of the projects must also be filed with the higher level competent authorities and with the authorities in charge of the industry invested in. If a restricted project exports 70% of its output, it may be treated as a permitted category project with the approval of the relevant state or provincial-level authorities.

The Guiding Regulations provide for the publication of two catalogues, the Catalogue for Guiding Foreign Investment in Industries (Foreign Investment Catalogue) and the Catalogue of Priority Industries for Foreign Investment in the Central and Western Regions (Central and Western Region Catalogue). The Foreign Investment Catalogue, last updated in 2011, lists specific industries in which foreign investment is encouraged, restricted, or prohibited, whereas the Central and Western Region Catalogue, last updated in 2013, lists the industries in which foreign investment is specifically encouraged in the central and western regions of China. Projects not included in the Foreign Investment Catalogue are considered permitted. The two Catalogues constitute the basis for the applicable policies regarding the examination and approval of foreign investment projects.

Following its accession to the WTO, China has been gradually removing restrictions on foreign investment in a wide range of industries, although investment limits in certain sectors are expected
to continue for the time being. The following is a review of the principal types of foreign investment vehicles in China.

**Equity joint ventures**

**Introduction**

The term “joint venture” is often used to refer to a variety of different types of business arrangements in the PRC. However, within the context of Chinese law, an equity joint venture is a specific form of business organisation created through the joint investment by at least one Chinese party and at least one foreign party. The establishment and operation of an equity joint venture are governed by the *Law of the People’s Republic of China on Sino-Foreign Equity Joint Ventures* (*Equity JV Law*) (the latest version was effective as of 15 March 2001), and the *Implementing Regulations for the Law of the People’s Republic of China on Sino-Foreign Equity Joint Ventures* (*Equity JV Regulations*), (the latest version was effective as of 1 March 2014).

**Nature of equity joint ventures**

a. **Legal status:** An equity joint venture is a limited liability company with its own registered capital and a legal identity distinct from its investors. An equity joint venture is an independent legal person capable of contracting and bearing liability on its own behalf.

b. **Scope of operation:** The scope of business of an equity joint venture must be clearly set out in the project documentation. An equity joint venture may operate only within its approved scope of operation and any change in this scope requires the approval of the original approval authority and re-registration.

c. **Registered capital:** Each equity joint venture has a registered capital amount which represents the equity investment contributed by the parties to the joint venture. It may be denominated in Renminbi (the national currency of the PRC) or in foreign currency.

The parties’ contributions to the registered capital may be made in cash or in kind pursuant to a schedule approved by the PRC examination and approval authorities. In-kind contributions such as equipment and raw materials invested by the foreign party must be necessary for production and may not be priced above international market prices. In-kind contributions must be reasonably and realistically valued by the parties.

Specific valuation requirements apply to some types of in-kind contributions, such as the right to use land. A Chinese-registered accountant must verify all contributions and a capital contribution certificate should be issued by the equity joint venture to the parties after the issuance of the capital verification report.

d. **Debt to equity ratio:** On 1 March 1987, the State Administration for Industry and Commerce (SAIC) promulgated the *Provisional Regulations on the Ratio between the Registered Capital and Total Investment of Sino-Foreign Equity Joint Ventures* (*Ratio Regulations*). The total investment refers to the total amount of funds required for the establishment and operation of a joint venture. The total investment amount is composed of both registered capital (equity) and debt (typically composed of shareholder loans and bank loans). The following table sets out the minimum ratio of registered capital to total investment:

<table>
<thead>
<tr>
<th>Total Investment (US$)</th>
<th>Ratio of Registered Capital to Total Investment</th>
<th>Contribution (US$) Minimum Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to $3m</td>
<td>7:10</td>
<td>-</td>
</tr>
<tr>
<td>$3m - $10m</td>
<td>1:2</td>
<td>$2.1m if total investment is less than $4.2m</td>
</tr>
<tr>
<td>$10m - $30m</td>
<td>2:5</td>
<td>$5m if total investment is less than $12.5m</td>
</tr>
<tr>
<td>$30m +</td>
<td>1:3</td>
<td>$12m if total investment is less than $36m</td>
</tr>
</tbody>
</table>
For example, if the total investment in a particular project is $15 million, the registered capital of the joint venture must be at least $6 million and the joint venture may raise the balance of $9 million by way of loans.

Article 6 of the Ratio Regulations provides that the ratio of the registered capital to the total investment amount of cooperative joint ventures and wholly foreign-owned enterprises should be determined by reference to the Ratio Regulations.

Different debt to equity ratios apply in case a foreign investor establishes an equity joint venture after purchasing the interest of a shareholder or subscribing to the capital increase of a domestic company. Pursuant to the Regulations Regarding the Acquisition of Domestic Enterprises by Foreign Investors (Acquisition Regulations), revised and effective from 22 June 2009, the equity joint venture (or other type of FIE) established subsequently through the conversion of a domestic company must comply with the following debt to equity ratios:

<table>
<thead>
<tr>
<th>Registered Capital (US$)</th>
<th>Ratio of Registered Capital to Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to US$2.1m</td>
<td>7:10</td>
</tr>
<tr>
<td>US$2.1m - US$5m</td>
<td>1:2</td>
</tr>
<tr>
<td>US$5m - US$12m</td>
<td>2:5</td>
</tr>
<tr>
<td>US$12m +</td>
<td>1:3</td>
</tr>
</tbody>
</table>

e. Regulations on capital contributions by joint venture partners:

i. The capital contributed by a joint venture partner should belong to that partner and be free from any encumbrance.

ii. A joint venture partner may use loans raised on behalf of itself as contribution, but it may not use loans raised on behalf of the joint venture as its contribution, nor may its contribution be guaranteed by the assets of the joint venture or those of the other joint venture party.

iii. The timing of the contributions shall be determined in accordance with the joint venture contract and stated in the articles of association.

The timing of the contributions may differ in the case of an acquisition of a domestic enterprise and the relevant regulations should be consulted. The above requirements are also applicable to cooperative joint ventures that are limited liability companies.

f. Foreign investment share: Foreign investment must normally account for at least 25% of the registered capital of an equity joint venture. However, foreign investment in an FIE may be less than 25% of the registered capital provided it is established in accordance with existing FIE establishment procedures. FIEs with foreign investment of less than 25% will not be eligible for any form of preferential treatment applicable to FIEs.

g. Shareholder loans: Foreign investors may make shareholder loans to their joint ventures. However, when a foreign investor provides cash assistance to the joint venture, the nature of such advance should be clearly identified in the documentation, i.e. whether it is a loan by the foreign party or an equity contribution. Due to China's foreign exchange controls, failure to classify such advance as a loan and to undertake the necessary registrations may preclude recovery of the amount by the foreign party.

h. Liability of joint venture parties: The parties to an equity joint venture share the profits, risks and losses of the joint venture in proportion to their relative contributions to the registered capital of the joint venture. The joint venture company is independently liable for its debts and liabilities, and the parties' liability is limited to the obligation to contribute the full amount of their subscribed portion of the registered capital. Absent express written agreement to the contrary, investors are not liable for a joint venture's debts. Although there is a statutory basis for this limitation of liability, it is usually also expressly set forth in the joint venture contract for the sake of greater clarity.
i. Incorporation: An equity joint venture must be approved by the Ministry of Commerce (MOFCOM) or its designated local bureau and registered with the SAIC or its designated local bureau before it may legally conduct business. A joint venture is officially incorporated on the date its business licence is issued by the SAIC or its designated local bureau.

j. Term of operation: The term of operation of an equity joint venture may be determined by the joint venture parties, subject to the approval of the PRC examination and approval authorities, and are set forth in the joint venture contract. The Equity JV Regulations provide that such term should comply with the Provisional Regulations on the Term of Sino-Foreign Equity Joint Ventures (Term Regulations), effective as of 22 October 1990. The Term Regulations theoretically permit joint ventures with unspecified terms, but such terms have thus far been extremely rare. FIEs (including equity joint ventures) in certain specified sectors are subject to a maximum limit on their term of operation. This is, for instance, the case for those operating wholesale or retail operations which may generally not have a term of more than 30 years.

k. Management: Under the Equity JV Law, the highest authority of a joint venture is its board of directors. The board of directors has a chairman and a vice chairman, one of whom is generally appointed by the Chinese party and the other by the foreign party.

The chairman of the board of directors is usually appointed to serve as the legal representative of the joint venture. The legal representative has extensive authority and responsibilities with respect to the operations of the joint venture.

While major policy decisions must be made by the board, day-to-day operational management of the joint venture is delegated by the board to a general manager. In practice, it is advisable to agree at the outset and set forth in the joint venture contract which issues require approval by the board and which operating decisions may be left entirely to the discretion of the general manager. Thus, appointment of the general manager is often a key element of operational control of the joint venture and therefore, many foreign investors insist upon making such appointment. Generally speaking, the same considerations regarding management decisions also apply to a cooperative joint venture.

In addition to the board of directors, FIEs are required to appoint a company supervisor or supervisory committee independent of the board of directors and senior management. The supervisor does not need to have any specific qualifications, nor does he need to be a Chinese national or reside in China. His powers include inspecting the company finances, supervising the performance of the directors and senior management, and taking action against directors or senior management who are acting against the interests of the company.

Part of the supervisor’s role is to act as advisor, and he may attend meetings of the board of directors, questioning their resolutions or otherwise offering suggestions. He may also be held liable for damages if he is found to be harming the company’s interests or violating the law or articles of association and thereby causing the company to suffer damages.

l. Treatment of assets upon dissolution: Upon the expiration or early termination of an equity joint venture, after payment of all the company’s debts and obligations, the remaining assets are to be distributed to the joint venture parties in proportion to their respective contributions to the registered capital of the joint venture, unless otherwise agreed in the joint venture contract.

Procedure for setting up equity joint ventures

a. Documentation: After initial discussions, the parties may sign a letter of intent or a memorandum of understanding. Such preliminary documents are generally not legally binding but are intended to establish a framework for further discussions and negotiations. They will, however, be used for obtaining a preliminary approval setting the parameters of the project. After preliminary approval is obtained, the parties should jointly prepare a feasibility study. If after analysis, the findings of the feasibility study are considered acceptable, the parties may advance to negotiate and sign a formal joint venture contract and articles of association for the joint venture company.
b. Approval authorities: The establishment process commences with the application for name pre-approval with the SAIC or its designated local bureau. Following the name pre-approval, the joint venture contract, articles of association, feasibility study and other specified application documents should be submitted to MOFCOM or its designated local bureau in the relevant province, autonomous region or municipality for approval. Smaller projects may be approved by the local authorities, while larger projects must proceed through channels for approval by the provincial or national authorities. Larger encouraged projects may in some instances be approved locally. When a project is approved, MOFCOM or its designated local bureau will issue an approval certificate. FIEs (including equity joint ventures) in certain specified sectors also require the approval of the government authority in charge of their industry. If the establishment of an equity joint venture involves the acquisition of a domestic enterprise it is subject to the Acquisition Regulations and additional approval and documentation requirements will apply.

c. Registration: The joint venture parties must register with the SAIC or its designated local bureau within 1 month of the date of receipt of the certificate of approval. A joint venture is deemed formally established on the date of issuance of its business license by the SAIC or its designated local bureau.

Cooperative joint ventures

Introduction

The establishment and operation of a cooperative joint venture are governed by the *Law of the People’s Republic of China on Sino-Foreign Cooperative Joint Ventures*, (the latest version was effective as of 31 October 2000), and the *Detailed Implementing Rules for the Law of the People’s Republic of China on Sino-Foreign Cooperative Joint Ventures* (Cooperative JV Rules), effective as of 1 March 2014. While the equity joint venture is the more common form of foreign investment vehicle as compared to the cooperative joint venture, the latter is generally preferred by certain types of business (see section (g) “Reasons for choosing cooperative joint ventures” below).

Nature of cooperative joint ventures

a. Legal status: Under the Cooperative JV Rules, there are two types of cooperative joint ventures, those that have legal person status (separate corporate existence) and those that have not. Legal person status is the norm and the Cooperative JV Rules contain certain special regulations which apply to cooperative joint ventures that do not obtain legal person status.

Under the *General Principles of Civil Law of the People’s Republic of China* (China does not yet have a complete civil code), the requirements for an entity to obtain legal person status are as follows:

i. it is established in accordance with the law;

ii. it has the necessary capital or property;

iii. it has its own name, an organisational structure and premises; and

iv. it is capable of independently assuming civil liability.

The Cooperative JV Rules recognise that most cooperative joint ventures satisfy the foregoing conditions and therefore should acquire the status of a separate legal entity once approved and registered by the relevant authorities.

b. Liability of cooperative joint venture parties: The Cooperative JV Rules provide that a cooperative joint venture which obtains legal person status shall be a limited liability company. In such case, the liability of the joint venture investors is limited to the extent of their investment in the cooperative joint venture company (unless otherwise stipulated in the contract).
c. Similarity with equity joint ventures: Under the Cooperative JV Rules, limited liability cooperative joint ventures share most of the characteristics of equity joint ventures, and in particular they have a registered capital and the liability of the joint venture partners is limited to their respective contributions to the registered capital.

d. Distinguishing feature from equity joint ventures: A distinguishing feature of cooperative joint ventures from equity joint ventures is that the parties may agree on an arrangement for sharing profits and losses which need not correspond with the ratio of the parties’ respective contributions to the registered capital (as is in the case of equity joint ventures). Greater flexibility is also allowed in the form of permitted capital contributions.

e. Contractual rights and obligations: As with equity joint ventures, it is advisable to stipulate in the joint venture contract the exact rights and obligations of the parties, particularly in relation to the ownership of the assets contributed by the parties both during the term of their cooperation and upon its expiration or termination.

f. Treatment of assets upon dissolution: Under the Cooperative JV Implementing Regulations, the foreign party is permitted to take a larger share of the profits relative to its contribution to the capital and/or to recover its investment during the period of cooperation. Under such an arrangement the fixed assets of the cooperative joint venture pass to the Chinese party at the end of the period of cooperation. If this option is not stipulated in the contract, the treatment of assets upon dissolution is similar to that of equity joint ventures.

g. Reasons for choosing cooperative joint ventures: Generally speaking, a foreign party may wish to consider a cooperative joint venture if the Chinese joint venture partner’s role is very limited and the foreign investor wants to stipulate a profit distribution ratio in the joint venture contract allowing the foreign investor to take a larger profit relative to its share of equity ownership in the joint venture.

Procedure for setting up cooperative joint ventures

The examination and approval procedure for forming a cooperative joint venture is basically similar to that for an equity joint venture. The parties are required to register with the SAIC or its designated local bureau within 30 days of the date of receipt of the certificate of approval.

Wholly foreign-owned enterprises

Introduction

The Law of the People’s Republic of China on Wholly Foreign-Owned Enterprises (WFOE Law), (the latest version was effective as of 31 October 2000), permits foreign investors to establish and operate wholly foreign-owned enterprises in the PRC and thus provides an opportunity for foreign investors to make independent investments in the PRC without the participation of a Chinese partner. In addition to the WFOE Law, the other key statute governing the establishment and operation of a wholly foreign-owned enterprise is the Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises (WFOE Law Implementing Rules) (the latest version was effective as of 1 March 2014).

Nature of wholly foreign-owned enterprises

a. Legal status: A wholly foreign-owned enterprise is usually a limited liability company although the WFOE Law Implementing Rules permit other liability structures subject to approval. A wholly foreign-owned enterprise with limited liability has its own registered capital and a legal identity distinct from its foreign investor. It is an independent legal person capable of contracting and bearing liability on its own behalf.

b. Scope of operation: The scope of business of a wholly foreign-owned enterprise must be specified in its articles of association. A wholly foreign-owned enterprise may operate only within its approved scope of operation and any change in this scope requires the approval of the original approval authority and re-registration.
c. Approval criteria: Wholly foreign-owned enterprises are prohibited in certain industry sectors. More industry sectors are gradually being opened up to wholly foreign-owned investment in connection with China’s WTO accession but certain sectors will remain off limits to this type of investment for the foreseeable future.

Procedure for setting up wholly foreign-owned enterprises

a. Approval procedure: The procedure for establishing a wholly foreign-owned enterprise is similar to the procedure for a joint venture. The first step in the establishment process is name pre-approval with the SAIC or its designated local bureau. Following the name pre-approval, the investor or investors shall submit the required application documents to MOFCOM or its designated local bureau. The documents include a feasibility study report, articles of association of the enterprise to be established, the applicant’s certificate of incorporation, a letter of creditworthiness from the applicant’s bank and other required documents. In addition to MOFCOM (or the designated affiliate) approval, wholly foreign-owned enterprises in certain specified sectors require the approval of the government authority in charge of their industry. If the establishment of a wholly foreign-owned enterprise involves the acquisition of a domestic enterprise it is subject to the Acquisition Regulations and additional approval and documentation requirements will apply.

b. Registration requirements: Within 30 days of obtaining the approval from MOFCOM or its designated local bureau, the applicant must register with the SAIC or its designated local bureau. The date of issuance of the business licence by the SAIC or its designated local bureau is the date of establishment of the wholly foreign-owned enterprise.

It is noticeable that the general statutory requirements on minimum registered capital (i.e. RMB30,000) and time limit of capital contribution (i.e. 2 years after issuance of the business licence) have been revoked following the latest Company Law since 1 March 2014. Technically speaking, the registered capital could be nominal and the term for capital contribution could be as long as the operation term. However, under the current foreign exchange regime in China, foreign investors are not allowed to freely make payment into China under the capital account, and all foreign debts (e.g. loans granted by the foreign shareholders) shall not exceed the difference between the total investment amount and registered capital. In this connection, foreign investors may wish to determine the amount of registered capital, with reference to the funding required for covering the operation costs (such as rental, employee salary etc) for the initial period after the establishment, from a commercial perspective.

Comparison of wholly foreign-owned enterprises with joint ventures

a. Potential advantages: Without a Chinese partner, the often protracted and sometimes difficult negotiation of a joint venture contract is avoided. Thus, the establishment of a wholly foreign-owned enterprise may be simpler and faster. Furthermore, because a wholly foreign-owned enterprise is wholly owned by the foreign investor, management decisions may be made – and day-to-day operations conducted – unilaterally without the need for a partner’s agreement. Proprietary technology is also less widely exposed, since there is no partner who may be able to use the technology in its own operations. Thus, management and operational issues may be simplified.

b. Potential disadvantages: Investors new to China may find it difficult going it alone. Knowledge of local conditions is important and good local contacts, particularly with government and administrative authorities, are often essential in China. A good joint venture partner may be able to supply these attributes. In the absence of PRC experience and qualified personnel, a foreign investor may find it difficult to acquire such tools without a local partner.
Foreign-invested partnerships

Introduction

The *Measures on Administering the Establishment of Partnerships in China by Foreign Enterprises or Foreign Individuals* (FIP Measures) were promulgated on 25 November 2009 (effective as of 1 March 2010), on the basis of the existing PRC Partnership Enterprise Law (Partnership Law) (effective as of 1 June 2007). Further, the *Measures on Administering the Registration of Foreign-Invested Partnerships* (FIP Registration Measures) were recently revised and the latest version was effective as of 1 March 2014. Accordingly, an FIP can be set up in the PRC by two or more foreign enterprises or individuals, or by one or more foreign enterprises or individuals together with qualified PRC natural persons, legal persons or other organizations. Such partnership shall be in compliance with the Partnership Law, other related laws and regulations and foreign investment policy.

Nature of partnerships

a. Legal status: A partnership does not have independent legal person status although it is entitled to hold assets under its own name.

b. Liability of partners: There are two types of partnership under the Partnership Law, namely, the general partnership (GP) and the limited liability partnership (LLP). The GP comprises two or more general partners who shall bear unlimited joint liability for the partnership's debts. The LLP comprises at least one general partner who shall bear unlimited joint liability for the partnership's debts, and the limited liability partners who shall bear the liabilities limited to their capital contribution. Note that stated-owned enterprises, solely state-owned companies, listed companies, units carrying out charitable business, and social groups cannot become general partners.

c. Capital contribution: Mode, amount and time for capital contribution to a partnership is determined in accordance with the partnership agreement. There is no registered capital for partnership. Capital contribution can be made by the general partners or limited liability partners in the form of cash, in kind, intellectual property, land use right or other property rights. In case of capital contribution in kind, intellectual property, land use right or other property rights, the agreed price shall be evidenced by a confirmation signed by all the partners or valuation report issued by a statutory valuation organization authorized by all partners. In addition, the general partners are also entitled to contribute capital in the form of labour service. Such mode of contribution by way of labour service, however, does not apply to limited liability partners.

d. Management: In general, the partners may agree to the way of management of partnership business matters, voting system for meetings etc. pursuant to the partnership agreement. This provides flexibility in management of partnerships to a certain degree.

e. Distribution of assets upon dissolution: Upon the dissolution of a partnership, after repayment of all the partnership's debts and obligations, the remaining assets shall be distributed to the partners in proportion to their respective actual contribution except as otherwise agreed in the partnership agreement. If the distribution cannot be determined by the partnership agreement or the actual contribution ratio, such remaining assets shall be equally distributed among all partners. Note that the original general partners shall remain liable for the indebtedness incurred during the course of the partnership on an unlimited liability basis, even after deregistration of the partnership.
Procedure for setting up an FIP

The application procedures for setting up an FIP are quite straightforward. The establishment process commences with the application for name pre-approval with the SAIC or its designated local bureau. Following the name pre-approval, a set of application documents shall be submitted to the SAIC or its designated local bureau for registration and obtaining a business license. An FIP is deemed formally established on the date of issuance of its business license. Although the registration information shall be notified by the SAIC or its designated local bureau to MOFCOM or its designated local bureau at the same time of the registration, prerequisite approval by MOFCOM (or its designated affiliate) is not required. This may be regarded as an edge over the FIEs which usually require approvals from MOFCOM or its designated affiliate.

Having said that, similar to FIEs, the application for setting up an FIP is still subject to the foreign investment policies in China (as explained in earlier section of this overview). Pursuant to Article 5 of the FIP Measures, apart from the application documents, the applicant is also required to submit an explanation to the relevant registration authority regarding its compliance with China foreign investment policies. This also means that the FIP may also be required to apply for an approval to comply with any special industry requirements in accordance with the applicable foreign investment policies.

Comparison of FIPs with FIEs

a. Potential advantages: Given the more flexible capital requirements and simpler establishment procedures as mentioned above, the set-up costs in respect of FIPs may be less expensive than other forms of FIEs. Another advantage lies on the tax position. An FIE’s after-tax profit may be further subject to PRC income tax at the time when it is distributed to the shareholders of FIEs. This does not apply to the partnerships. Unlike FIE, a partnership itself is not subject to PRC enterprise income tax liability as indicated in the current PRC Enterprise Income Law. Instead, its partners shall be responsible for their respective income tax liability in respect of the production and business operation income and other income of the partnership.

b. Potential disadvantages: One of the obvious disadvantages of an FIP is that the general partners shall bear unlimited joint liabilities for the debts of the partnership even after the partnership has been dissolved. Another disadvantage lies on the lack of implementation details of the FIP at this initial stage. Given that only general principles and registration procedures regarding FIPs have been provided for under the FIP Measures and the FIP Registration Measures respectively, it remains to be seen how they will be implemented in practice and whether any further implementation rules will be enacted by relevant authorities.

Want to know more?

Keith Cole  
keith.cole@deacons.com.hk  
+852 2825 9532

Franki Cheung  
franki.cheung@deacons.com.hk  
+852 2825 9499

Cynthia Chung  
cynthia.chung@deacons.com.hk  
+852 2825 9297

Toh Guat Kim  
kim.toh@deacons.com.hk  
+852 2825 9622

Edwarde Webre  
edwarde.webre@deacons.com.hk  
+852 2825 9730

Myles Seto  
myles.seto@deacons.com.hk  
+852 2825 9754

Machiuanna Chu  
machiuanna.chu@deacons.com.hk  
+852 2825 9630

Iris Cheng  
iris.cheng@deacons.com.hk  
+852 2825 9458

Hiroko Nakamura  
hiroko.nakamura@deacons.com.hk  
+852 2825 9200

Helen Lu  
ehelen.lu@deacons.com.cn  
+86 10 8518 2338

Jenny Jin  
jenny.jin@deacons.com.cn  
+86 21 6340 3588

Joyce Mu  
joyce.mu@deacons.com.cn  
+86 20 8778 5678

Whilst every effort has been made to ensure the accuracy of this publication, it is for general guidance only and should not be treated as a substitute for specific advice. If you would like advice on any of the issues raised, please speak to any of the contacts listed.