
China Simplifies Its Legal Administration of Foreign Direct Investments

Understanding the New Filing for Recording System

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In order to implement the State Counsel's decision issued on September 3, 2016 (State Counsel's Decision), which simplifies the original substantive review and approval process (Approval System) to a new simple filing system (Filing System) for the establishment and any subsequent changes for eligible foreign invested enterprises (FIEs), the Ministry of Commerce (MOFCOM) issued the Interim Administrative Measures regarding Filings for the Incorporation and Changes of Foreign Invested Enterprises (Filing Measures) on October 8, 2016, after it published a draft version on September 3, 2016, for public comments. There are no substantial changes reflected in the final Filing Measures compared to the draft version.

The issuance of the Filing Measures signals that from October 8, 2016, foreign investment in industries that are not subject to special entry administration measures (see discussion below) will no longer be subject to the examination and approval by MOFCOM or its local counterparts (Approval Authority); instead, foreign investors or the relevant FIEs can directly apply with the applicable Administration for Industry and Commerce (AIC) for the registration of the establishment of the FIEs or any significant changes thereto, similar to the establishment of and later corporate changes in domestic companies without foreign investment.

On October 8, 2016, along with MOFCOM's Filing Measures, MOFCOM and the National Development and Reform Commission also jointly issued a circular (Circular) and clarified what industries require special entry administration measures for any foreign investment.

Even before the Circular and the Filing Measures, the State Administration for Industry and Commerce (SAIC) issued its *Notice on Properly Handling the Registration of Foreign Invested Enterprises after the Implementation of Filing Administration* (SAIC Registration Notice).

In our [September 12, 2016 alert](#), we discussed the background on the shift from the Approval System to the new Filing system. In this article, we will focus on explaining how the Filing System will work under the Circular, SAIC Registration Notice and MOFCOM's Filing Measures.

I. Key Issues of the Filing System

- **Scope of Filing.** Filings apply to the incorporation and defined subsequent corporate changes¹ of FIEs, unless FIEs engage in industries which are subject to special entry administration measures (Specially Administered Industries, i.e., the so-called negative list as it is widely known to the public). Based on the Circular, Specially Administered Industries include Encouraged industries with special requirements for shareholding and/or senior management composition, Restricted industries and Prohibited industries as specified in the 2015 *Foreign Investment Industrial Guidance Catalogue* (Guidance Catalogue).
- **Filing Authorities.** Filing authorities refer to local counterparts of the MOFCOM in each province, autonomous region, municipality directly governed by the central government, any city under separate state planning, Xinjiang Production and Construction Corps, sub-provincial municipality, FTZ, national economy and technology development zone (Filing Authorities).
- **Filing Timeline.** For the incorporation of FIEs, any filing can be made either before the issuance of the business license but after the FIEs obtain the AIC's name pre-approvals, or within thirty days after the issuance date of the business license of the relevant FIE. For corporate changes of FIEs, filings must be made within thirty days after the governance body of any FIE passes relevant resolutions for the proposed changes, if resolutions are needed for the relevant changes. Filing Authorities will complete the filings within three business days if they believe the filing documents are complete and accurate.
- **Record Filing is not a Condition Precedent to the Establishment or Subsequent Changes of an FIE.** For foreign investments in any non-Specially Administered Industries, a foreign investor can directly go to the AIC to register the establishment of its FIE and the FIE can directly register its changes with the AIC. Evidence showing the completion of filings with Filing Authorities is not required by the AIC for the registration, unlike the Approval System, where the Approval Authority's approval is a prerequisite for the registration with the AIC.
- **Takeover of Domestic Companies by Foreign Investors and Reinvestment by FIEs in China.** Acquisition of domestic companies by foreign investors (both equity and assets acquisitions) in any industries are still subject to the Approval Authority's approval. Nonetheless, after the takeover of domestic companies by foreign investors, the new Filing System applies for subsequent changes to the target companies taken-over by foreign investors, unless the target companies engage in Specially

¹Article 6 provides for a defined scope of changes which are subject to the Filing System, which include:

- (i) Changes in any FIE's basic information, such as the company name, registered address, type of business structure (i.e., wholly foreign owned enterprises (WFOE), equity joint ventures (EJV), cooperative joint ventures (CJV) or companies limited by shares), operation term, investment industry, business scope, registered capital and total investment amounts, information about directors, supervisors, ultimate controlling shareholders, contact person, etc.;
- (ii) Changes of basic information regarding FIEs' investors, including company name, nationality (for individual investor) or place of registration (for corporate investor), type and number of identify certificate, amount of subscribed registered capital, methods and timeline for capital contribution, place of origin of investment funds;
- (iii) Changes of equity interest (for WFOE and EJV) or cooperative conditions (for CJV);
- (iv) Merger, split or termination;
- (v) Mortgage or transfer of assets of FIEs.
- (vi) Two additional changes specifically for CJV: accelerated recovery of investment by any foreign investor and entrusted operation and management of a CJV.

Administered Industries. Reinvestment by FIEs in China in Restricted industries is still subject to the Approval Authority's approval.

- **Foreign Acquisition of Listed Companies.** FIEs which are listed on any PRC stock exchanges or in the National Equities and Exchange and Quotations do not need to file for changes in equity ownership unless the accumulated change in equity interest of the foreign investor(s) reaches 5 percent or if there is a change in the foreign investor(s)' controlling shareholder position.
- **Equity Pledge.** Compared to the draft measures, the final Filing Measures removed any equity pledge from the subsequent corporate change matters which are subject to filings. The execution of any equity pledge triggers a change of equity interest of FIEs. If the FIEs are in the non-Specially Administered Industries, any changes in equity interest are subject to filings since any such equity change is within the defined corporate changes subject to filings. If FIEs are in the Specially Administered Industries, their changes in equity interest are subject to the Approval Authority's approval. We hope MOFCOM will clarify in the future whether the creation of any equity pledge of FIEs, whether or not in any Specially Administered Industries, is subject to approvals or filings.
- **Other Requirements for the Record Filing.** If a public announcement is required based on other laws and regulations for matters which are subject to filings, such as the announcement for any merger, split or decrease of registered capital of an FIE, such FIE is required to specify the status of such public announcement when it submits any filing for such matters.
- **Foreign Investors.** In addition to investors registered and based outside mainland China, investment companies (holding companies) and venture capital investment enterprises established in China by overseas investors are also considered to be foreign investors. The Filing System will also apply to FIEs backed by those two types of investors.
- **Transitional Arrangement.** If the Approval Authority received applications for any incorporation or changes of FIEs before the implementation of the Filing Measures (October 8, 2016) which fall within the scope of filings, and if the Approval Authority has not completed the approval procedures, the approval procedures shall be terminated. The FIEs or the relevant foreign investors need to follow the new filing procedures.

II. Our Observations and Suggestions

The most important improvement in the Filing System is that it speeds up the incorporation of FIEs. This will save foreign investors one to three months in their investment process.

Secondly, the Filing System provides more flexibility for foreign investors and their Chinese partners (if any) regarding how to operate and manage FIEs. Filings will be made through an online filing system only. The Filing Authorities will not require filings of any constitutional documents of FIEs—such as articles of association or joint venture contracts—or bank creditworthiness reference letters, feasibility study reports, lease agreements, board and shareholder resolutions, etc. Although some of the above materials will still be required to be submitted to the AIC for AIC registrations, since such constitutional documents will not be reviewed by the Approval Authority, investors can freely stipulate terms and conditions that are acceptable to them provided such terms and conditions will not violate relevant PRC law or impact the public interest or national security of China.

Thirdly, under the Approval System, investors only need to disclose immediate investors of proposed FIEs; however, under the new Filing System, the Filing Authorities require the disclosure of information regarding the ultimate controlling shareholders of both FIEs and each investor of FIEs. The purpose and possible impact of such disclosure requirement will be clearer after a certain time of implementation of the Filing Measures.

In order to benefit from this new Filing System, we recommend any foreign investors discuss investment structure options with their legal counsel in China before making investments or reorganizations.

We will closely monitor the latest developments and keep you updated.

If you have any questions about the content of this Alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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