

Briefing

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New Chinese rules on Rep Offices

Background

On 4 January 2010, the State Administration for Industry and Commerce ("SAIC") and the Ministry of Public Security ("MPS") jointly released a notice (the "Notice") to strengthen the administration and management of foreign enterprises' representative offices ("Rep Offices") in China.

The changes specified in the Notice (which is so far only officially available in the Chinese language) are in effect from 15 January 2010.

The new rules follow up on a regulation of Rep Offices that has become increasingly stricter in recent times.

Executive Summary

- All foreign staff will be considered "representatives" and the number of representatives has been limited to 4. Rep Offices already in existence with more staff can decrease, but not increase, the staff number.
- A business applying for a China Rep Office must have been in existence for at least 2 years.
- Licenses for Rep Offices will decrease from 3 years to 1 year, which also impacts work permits since they will be issued for the same period. The documentation requirements both for the initial application and extension application have been raised.
- A Rep Office cannot undertake business activities and receive revenue relating to such activities.
- The Chinese authorities have recently adopted a more stringent approach towards specifically foreign Rep Offices.
- The new rules authorises the local SAIC to introduce a more strict control regime to oversee that Rep Offices acts in accordance with the license and does not undertake disallowed commercial activities. SAIC has been granted access to perform on-site verifications.
- Rep Offices that does not comply risk being "black-listed" and otherwise administrative fines of up to RMB 500.000 could be imposed.
- In order to avoid the grave consequence of being "thrown out" of Chins foreign businesses with a Rep Office in China should verify that they do not undertake business beyond what is allowed in the Rep Office.
- There is no easy way of upgrading a Rep Office to a PRC legal entity as it is not possible to convert directly. The process will involve (i) set up of a new legal entity (WFOE), (ii) transfer of assets, employees, etc. to the new legal entity and (iii) dissolution of the Rep Office.

Overview

Many foreign enterprises establish a Rep Office in China as a launch pad for building relationships and carrying out market research before further investing in China in the form of an incorporated subsidiary. In this way, Rep Offices continue to be key vehicles for foreign enterprises in China, and they have been used (and sometimes abused) by foreign enterprises to achieve a relatively straight-forward and yet effective presence in the burgeoning Chinese marketplace.

The Notice suggests a further step in the fundamental shift in attitude of the Chinese government towards Rep Offices.

Maximum number of representatives

The new regulations puts a limit on the number of 'representatives' so that each Rep Office must now have a maximum of 4 representatives, including the Chief Representative. As the rules are currently interpreted all foreign staff are regarded as 'representatives', so a Rep Office will only be allowed a maximum of four foreign staff.

Existing Rep Offices with more than four representatives will be allowed to reduce, but not further increase, the number of representatives.

License now only given for a 1-year period

The validity period of the registration certificate of any new Rep Office or any extension of any existing Rep Office will be reduced from 3 years to 1 year. Rep Offices will have to renew their registration on an annual basis and, when applying for the renewal, a notarized and legalized document evidencing the existence of the foreign enterprise which established the Rep Office must be provided to the authorities.

As work permits for staff employed in a Rep Office are issued for the same duration as the license for the Rep Office, the validity of the work permits will also be reduced to a maximum of 1 year.

More strict regime for documentation

It has not been commonplace to associate the administration of Rep Offices with the MPS (which among other things governs the presence of foreign nationals in China). The Notice calls for the SAIC to work together with the MPS to report infringements, with a particular emphasis on matters concerning the entry into, and exit from, China of foreign nationals.

There are also stricter requirements regarding the documentation which needs to be supplied to set up a Rep Office, including a notarized and legalized certificate of incorporation of the foreign enterprise to certify that it has existed for at least two years.

In theory, a one-year establishment requirement has been in place for some time for a foreign enterprise which is applying to establish a Rep Office, although this requirement was effectively ignored in practice. There is now a requirement that the foreign enterprise which is applying to establish a Rep Office has been in existence for two years.

Focus on compliance

The local SAIC will carry out on-site verifications of registered particulars for newly established Rep Offices which have held their registration certificates for less than 3 months. Emphasis will be placed on checking whether or not the registered address of the Rep Offices is true.

The local SAIC will strengthen its supervision of the daily activities of Rep Offices. If a Rep Office conducts business activities and receives revenue in any form from such activities, SAIC can impose penalties ranging up to RMB 500,000 on the Rep Office for carrying out business operations without a business licence. Another sanction is delay in issuance of registration renewal. It is envisaged that foreign Rep Offices will specifically be targeted.

Also, any Rep Office which has failed to properly extend its registration or properly change its registered address will effectively be "black-listed" with the relevant authorities.

Increasingly stricter approach on Rep Offices

These changes continue a trend that has emerged over the last year or so where the regulation of Rep Offices has become increasingly strict. For instance, in late 2009 it was announced that the office premises of Rep Offices must pass a verification from the State Security Bureau and obtain a certificate before the premises can be used as the registered office of a Rep Office.

What to do?

Foreign enterprises with existing Rep Offices in China, or with plans to establish a Rep Office in China, should discuss in further detail the potential risks arising out of the regulatory environment facing Rep Offices.

It will be essential in order to maintain a Rep Office that the business undertaken is at all times compliant with the Chinese regulations.

Upgrade to other legal entity

Unfortunately, in China it is not a simple case of "upgrading" a Rep Office (non-legal entity) to a legal entity (usually in the form of a limited liability WFOE or JV). The process actually involves a fairly detailed restructuring.

Very broadly, there are two major phases involved:

- (i) setting up a new limited liability company ("Newco"); and
- (ii) de-registering the Rep Office after the relevant transfers have been made to the Newco.

In the first instance, you would need to confirm that the future business does not fall within one a category of restrict foreign ownership.

After setting up a new company (WFOE or JV) the assets, liabilities, employees, commercial contracts (if any), lease, etc. will need to be transferred from the Rep Office to the new company.

Only after these steps will you be able to complete the legal procedures in connection with the de-registration of the Rep Office (including de-registering the business licence, company seal, organizational code, statistic certificate registration, tax registration, foreign exchange registration and customs registration).

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