WHOLLY FOREIGN-OWNED ENTERPRISES

Legal status

Wholly foreign-owned enterprises ("WFOEs") are entities established under the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises (the "WFOE Law") and the Detailed Implementing Rules for the WFOE Law (the "WFOE Regulations"). A WFOE can be a limited liability company or, upon approval, take another form. Currently, most WFOEs in China are established by one foreign investor, although the WFOE Regulations allow two or more foreign investors to apply jointly for the establishment of a WFOE.

Establishment

Under the existing system, the procedures for establishing WFOEs are similar to those for equity joint ventures. MOFCOM or its local counterpart is the examination and approval authority. In certain cases, where the WFOE is engaged in certain business activities that require prior industry approval, e.g. advertising, transportation, then prior approval is required from the specific industry regulator.

Similar to joint ventures, a WFOE can only register its company name in Chinese. While China does recognize its own accredited "well-known" trademarks and selected Fortune 500 companies, it should be noted that having a prior PRC Trademark registration does not guarantee that the preferred Chinese characters can be registered as a company name in China.

As part of the WFOE formation process, the foreign investor is required to submit to the examination and approval authority the following documents:

- an application letter;
- a feasibility study for the investment project (exempt in some special zones);
- articles of association for the proposed WFOE;
- the foreign investor's certificate of incorporation;
- a letter of creditworthiness issued by the bank of the foreign investor;
- the name of the legal representative, director(s), and supervisor of the WFOE; and
- other items designated by the examination and approval authority.

Typically, the examination and approval authority should announce its decision on the application within seven to twenty days after receiving the application.

Within thirty days after receiving approval, the foreign investor must register the new entity with the local bureau of the SAIC and obtain a business license.

Parties' investments

As in the case of equity joint ventures, foreign investors' capital contributions to a WFOE may be in the form of foreign currency, machinery, equipment, industrial property, proprietary technology or, upon approval, Renminbi profits derived from their other investments in China. Capital contributions are subject to the prescribed debt to equity ratios and restrictions on reduction or increase of registered capital.

Operation

A WFOE is permitted to operate for the period provided for in its approval from the examination and approval authority. Requests for an extension of the term of operation must be submitted to this authority 180 days prior to expiry.

Under the WFOE Regulations and the Catalog for Guiding Foreign Investment in Industry (which is revised and amended from time to time), the establishment of WFOEs is prohibited in certain industries, such as broadcasting and public utilities.

Foreign exchange

WFOEs are generally subject to the same foreign exchange controls as joint ventures.

Management

The daily operations of a WFOE will be controlled solely by its own management, and should not be subject to interference by the government when operating in accordance with its approved articles of association.

Financial administration

The accounting rules applicable to WFOEs are similar to those applicable to equity joint ventures. Accounting books and statements printed by WFOEs themselves must be written in Chinese. Only Chinese registered accountants can verify annual accounting statements. Annual balance sheets and profit-and-loss statements must be submitted to the financial and tax authorities for the record. A WFOE must allocate at least 10% of after-tax profits to its statutory reserve fund for a certain number of years until the aggregated amount reaches 50% of the WFOE's registered capital, whereas in equity joint ventures, the board of directors decides the proportion to be allocated to the reserve fund.

Corporate Maintenance

Similar to joint ventures, a WFOE has annual reporting requirements administered by different local government departments. These annual reporting or annual inspection requirements occur at different times of the year and are subject to local procedures. For example, a WFOE will need to submit periodic information to the local industry and commerce authority, Customs authority, foreign exchange bureau, and taxation authorities, etc.