China’s New Foreign Investment Law and its Implementation Regulation Taking Effect

Description

China enacted its new overhauled Foreign Investment Law in March of 2019 amid trade war with USA, which has taken effect as of January 1, 2020, the day of yesterday.

As expected, China State Council shall step up the implementing rules to execute the Law passed by China Parliament or the People’s Congress. The Implementation Regulation was published on December 26, 2019.



Just share a few points of my observation in the new framework of foreign investment systems, embodied in the Law and the implementation Regulation.

1. What is Foreign Investment

The newly published implementation rules have shed no further lights on the issue. So we shall only infer our answer from the Law. It is my understanding, whether it is foreign or domestic investment shall depend on the nationality of the investors, not on where the investment fund comes from. Based on this, when a foreign heir or spouse acquires shares in a domestic company by way of inheritance or divorce, then the domestic company will be turned into a foreign invested company.

However, China has not allowed foreigners within China to use their RMB fund or assets in setting up foreign invested company so far.

2. Round Trip Investment by Chinese Investors

It is a great pity that the final version of the implementation Regulation deletes the provision regarding Chinese investor’s round trip investment. In the initial draft of the Regulation, there is a clause to the effect that a foreign entity wholly owned by Chinese investors (individual or corporate) can invest in

China upon approval, without being subject to the Negative List of foreign investment industry catalog.

China government knows that many of its citizens have set up offshore companies, and some of them come back to China to invest as foreign investors. So far there is no law addressing this phenomena.

As a cross-border estate planning lawyer, I have been personally hoping that this provision in the draft would allow Chinese high net worth individuals to be able to set up their China business succession plan in offshore jurisdiction like Hong Kong, Singapore or even Jersey.

3. Transformation of Corporate Governance of Foreign Invested Companies

The biggest takeaway of the new Law and the Regulation should be the abolishing of three old foreign investment laws, namely, Sino-foreign equity joint venture law, Sino-foreign contractual joint venture law and Wholly Foreign-owned law. The first two laws have created a different pattern of corporate governance from that in China Company Law. In particular, a Sino-foreign joint venture enterprise does not have shareholder meeting in its governance, and instead, the board of directors is given the highest corporate authority in making important decisions.

Now the new law came into effect. It requires that foreign invested enterprises shall adopt the corporate form and organisation and conduct business activities in accordance with China Company Law. The newly promulgated Regulation further prescribes that foreign invested enterprises established prior to the enactment of the new China Foreign Investment Law will have a five year window to adjust their old structure and governance to comply with China Company Law.

It is anticipated that many old foreign-invested enterprises will start looking at their joint venture contract, articles of association and other legal documents, and foreign investors will negotiate with their Chinese partners regarding such transformation and adjustments.

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It is a worthy note that the new implementation regulation makes it clear that terms and conditions regarding transfer of equity interests, distribution of profits and residual assets etc., in the original joint venture contract ***MAY*** continue to be valid and binding.

Despite the declaration of such upcoming changes, the implementation regulation also hints that detailed guidelines on registration of such changes will be announced later on by company registration authority at the central government level.

4. Taking Money Out of China by Foreign Invested Enterprises

This is not something really new and fresh. Still some foreign investors are having the misconception that they cannot take or move their money out of China once they invest in China.

It is not true!

In this new China Foreign Investment Law and the implementation, China reiterates that foreign investors have the freedom to transfer out of China those funds derived from their capital investment, profits, capital gains, asset disposal proceeds, IPR royalties, compensation and damages, and business liquidation proceeds and etc., in RMB currency or foreign exchanges.

Yes, China is very sensitive on money flowing out of the country. History of South East Asia financial

crisis has proven the necessity of controlling foreign exchange movements across a country border.

For that reason, despite the aligning efforts to bring foreign invested enterprises in accordance with China Company Law, it is my personal understanding that a foreign investor won't be allowed to claim greater corporate profits than its contribution ratio in the company's registered capital, which is possible among shareholders of domestic companies. The rationale behind is that such allowance will open the door for money to flood out of China.

5. Investment by Foreign Invested Enterprises

Another surprise is that the implementation Regulation provides in Article 47 that investments made within China by foreign invested enterprises shall be governed by the new Foreign Investment Law and the new implementation Regulation. It seems that the enterprise or company invested by a foreign invested enterprise will be naturally considered also as foreign invested enterprise in nature no matter what.

However, this single provision is too general and sketchy. Further interpretation and guidelines will be sure to come later.

This should indicate a departure from previous regime that is laid out in a particular ordinance from ministry of commerce back in 2001.

6. Overseas Chinese with Permanent Residence

For the first time, the implementation Regulation affirms the "foreign investor" status of overseas Chinese who permanently reside in foreign countries. Thus investments made by overseas Chinese will be considered as foreign investments, and therefore qualify for favorable policies extended to foreign investments.

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So who are overseas Chinese permanently residing in foreign countries?

China has its standards for defining "overseas Chinese":

A. Chinese citizens who have obtained long term or permanent residence, and have been consecutively living in the foreign countries for up to two years during which period the cumulative stay won't be less than 18 months.

B. Chinese citizens who have not obtained the long term or permanent residence but have been consecutively and legally living in foreign countries for more than 5 years (inclusive) during which period the cumulative stay is not less than 30 months.

7. Chinese Individuals Allowed to Set up Joint Venture with Foreign Investors

In the past, except as experimented in some area of China like Shanghai Pudong New Area, Chinese individuals are not allowed to set up joint venture enterprises with foreign investors. Chinese individuals shall have to set up a Chinese domestic company first and the use this domestic company to set up a Sino-foreign joint venture enterprise.

This relaxation will probably boost the small businesses in Chinese economy. After all it is simpler and easier now to set it up a business to grab opportunities arising from cross-border communications.

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