

Are Representative Offices still an option in China?

Foreign companies have been able to set up Representative Offices (ROs) in China since 1980 when the Interim Regulations for Control of Representative Offices were adopted.

These regulations were followed by the Measures on Procedures for the Registration & Administration of Representative Offices of Foreign Enterprises in China (“1983 Measures”).

In addition to such nationwide regulations, specific local regulations which differ markedly from one city or one province to another have been applied to ROs. For example in Shanghai, ROs opened by Hong Kong investors are assessed by the “Inspection Office of National Security of Foreign –related Constructions of Shanghai” in accordance with the Issues on Administration of Instructed Address for Representative office Set-up by Taiwan, Hong Kong, Macao, and Foreign Enterprises; and in Guangzhou for instance, the registered address of a RO must be located within the central area of the city otherwise the RO cannot be set up.

An unmatched popularity for many years

ROs have long been the most popular business model for foreign companies seeking to establish themselves in China for the following reasons :

- Such entities do not need a registered capital;
- They are submitted to relatively low taxes;
- No approval is required for their establishment.

For many years the only possible alternative for foreign investors was to set up joint venture companies in Mainland China with local partners, since the option of setting up a foreign investment enterprises wholly controlled by foreigners was not available or easy, as it has progressively become today. In theory, ROs are prohibited from engaging in profit-making activities, and they exist only for liaison, market promotion, preparation and assistance in Mainland China of the parent companies overseas. However, the historical popularity of ROs has led to a situation where a great number of ROs have *de-facto* engaged in business activities, and Chinese authorities have in practice tolerated this situation, as long as the ROs engaging in business activities would not issue any invoices.

Over the years ROs have thus taken advantage of a flexible administrative and legal environment in both the easiness and the wide range of operations for which they can be used.

A reversal of fortune in favor of Wholly Foreign Investment Enterprises

However, recent legislation has come as a warning that past tolerance will cease and that competent authorities will reign and apply new stricter regulations uniformly to all cities and provinces.



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The Chinese government has indeed undertaken a reform concerning ROs, which has an impact on both the structure itself and tax rules applicable to ROs:

1. The *Notice of the State Administration for Taxation on Issuing the Interim Measures for the Administration of Tax Collection against the Representative offices of Foreign Enterprises* (“Tax Measures”) dated February 20, 2010.
2. The *Notice of the State Administration for Industry and Commerce and the Ministry of Public Security on Further Strengthening the Administration of Registration of Permanent Representative offices of Foreign Enterprises* (“Notice on Further strengthening”) dated January 4, 2010.
3. The *Regulations of Registration and Administration of Permanent Representative office in China of Foreign Enterprises* (“New Regulations”) which came into force

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on 1st March 2011.

The New Regulations are already in force since March 2011, and obviously additional requirements imposed under these regulations have greatly increased both costs and the time needed to set up ROs. In conclusion, it is strongly advisable to consider setting up a wholly foreign owned enterprise (“WFOE”) as an alternative to an RO in the event the foreign investor will engage in profit-making activities, all the more as a WFOE can be set up relatively quickly and with a low level of capital that may be contributed over a period of two years. Besides, it is worth noting that a WFOEs will create more value to a business carried on legally.

Main key changes under the new regulations

	Key changes
1.annual inspection document	The annual report which must include the details on the lawful existence of the Parent Company, the details of the activities conducted by the representative office, the financial balance as audited by the appointed accounting firm as well as other relevant information.
2.registration required	The certificate of the Parent Company's legal existence and operation for over two years
3.permitted scope of activities	Define clearly the non-profit activities of the RO
4.duration	Shall not exceed the duration of the Parent Company
5.legal liability	Directly liable personnel in charge or other staff may be fined not less than RMB 1,000 but not more than RMB 10,000 for (A) submitting false materials in relation to the ROs record or conceal any facts by any fraudulent means (B) forging, amending, lending, borrowing or transferring the Certificate or Representative Certificate