



NEW REGISTRATION REQUIREMENTS FOR REPRESENTATIVE OFFICES OF FOREIGN ENTERPRISES

One of the methods of establishing a presence in China used by foreign companies is the representative office. A China representative office provides a permanent base from which a foreign company's personnel may conduct business in China. The regulations governing representative offices have been in force since 1983, and recently the State Administration for Industry and Commerce ("SAIC") released some new regulations, which we discuss below. The Regulation on the Registration of Resident Representative Office of Foreign Enterprises ("Draft Regulation") is a new regulation circulated as a draft for comments by September 25, 2008. The Draft Regulation will replace the Registration of Resident Representative Office of Foreign Enterprises ("1983 Provisions") after being officially approved by the state council, which were implemented by the SAIC and became effective as of March 15, 1983. This *Commentary* discusses the differences between the Draft Regulation and the 1983 Provisions, and highlights the issues that may have a positive or adverse impact on foreign enterprises intending to set up a representative office in China or

those representative offices that have already been established in China.

In brief, the Draft Regulation has made revisions in three main areas of the 1983 Provisions. First, the Draft Regulation defines the nature and scope of the resident representative offices of a foreign enterprise. Second, the Draft Regulation summarizes the registration procedures and improves on the existing registration management system. Third, the Draft Regulation clarifies the rules for carrying out business activities in order to provide for the actual needs of representative offices.

In general, the Draft Regulation has substantially increased the amount of fines that can be levied against representative offices. It has also further elaborated the rights and obligations of representative offices and the registration authority. It has empowered the registration authorities (*i.e.*, SAIC and its local counterparts) to supervise the activities of representative offices and punish any illegal activities accordingly. In

addition, it has raised the requirement for foreign enterprises to set up representative offices in China and has imposed more scrutiny on the situation of the foreign enterprises in their home countries as well as the situation of the representative office in China. Consequently, more costs and additional management burdens will be imposed on the foreign investor.

NATURE OF REPRESENTATIVE OFFICES

In the Draft Regulation, a representative office is defined as an office established by a foreign enterprise within China in accordance with the Draft Regulation. The office does not have legal person status and is not allowed to undertake profit-making activities unless such activities fall within the activities to which the Chinese government has agreed in an international convention or treaty. The penalty for undertaking profit-making activities ranges up to RMB 500,000, and in serious cases, an order can be made to revoke the business license of the representative office. Foreign investors should be aware that these new requirements are more stringent than those in the 1983 Provisions. Under the 1983 Provisions, representative offices were only vaguely defined as offices that do not undertake profit-making activities, and the penalty was restricted to a sum of less than RMB 20,000.

To fulfill China's commitments under the WTO obligations, the Draft Regulation also provides that if China is a signatory to an international convention with a different interpretation on the nature of a representative office, then the international convention prevails. Foreign law firms, accounting firms, auditing firms, bookkeeping service firms, tax service firms, and management consultation service firms will benefit under such WTO commitment and are allowed to conduct business activities that will generate profits.

BUSINESS SCOPE OF REPRESENTATIVE OFFICES

Under the Draft Regulation, a representative office is only permitted to carry out activities related to market research, presentation, promotional activities, and liaison activities with the foreign enterprise in relation to product sales, service provision, domestic procurement, and investment of the foreign enterprise. The strict business scope under the Draft Regulation requires the representative office in China to ensure the compliance of its current activities with the business scope set out under the Draft Regulation. Failure to comply will expose the representative office to a fine of

between RMB 10,000 and RMB 30,000. In comparison, the 1983 Provisions restrict the business scope to only nonprofit activities. The 1983 Provisions do not substantially confine activities to certain types. The Draft Regulation is more explicit regarding what activities may be engaged in by a representative office and thus makes the subject more transparent and provides less discretion to the registration authority regarding the interpretation of the business scope of a representative office.

NAME OF REPRESENTATIVE OFFICES

The name of the representative office must include the nationality of the foreign enterprise, the Chinese name of the foreign enterprise, and the city of residence of the representative office. The Draft Regulation has incorporated a number of new requirements regarding the name of a representative office. In particular, the name of a representative office should not conflict with any previously registered Chinese names of other companies or entities. In the event of any conflict, the earlier registration prevails. If a representative office fails to conduct thorough research before its application or fails to correct its Chinese name after the warning period, it will be subject to a fine ranging from RMB 1,000 to RMB 10,000 and will be ordered to change its name accordingly. In serious cases, the registration authority has the power to revoke the business license.

Also, foreign investors should be aware of the high risk of conflict between Chinese names due to translation difficulties. In light of the high penalties and translation risks, foreign investors are encouraged to conduct thorough research before submitting their application for registration. Despite the administration and cost burden during the research period, there is an overall positive impact of increasing intellectual property (in this case, the Chinese name) protection for those names already registered.

VALIDITY PERIOD OF REGISTRATION

Under the Draft Regulation, a representative office's operational term is valid as long as the foreign enterprise remains in existence. The validity period is more flexible than the 1983 Provisions, which required annual re-registration (changed to re-registration every three years in Notice No.73 on September 7, 1983). The new validity period reflects the actual needs of a representative office by removing the administrative burden of re-registration every three years.

OFFICE LOCATION OF A REPRESENTATIVE OFFICE

Under the Draft Regulation, foreign enterprises are allowed to choose the location of their representative offices, subject to the examination of national security and social benefits. Unlike the 1983 Provisions, the Draft Regulation empowers the registration authority to order a representative office to relocate its office. Therefore, it is strongly recommended that before signing a lease for the representative office, the foreign investor should make sure the location is suitable and acceptable to the registration authority. It should be noted that currently, some local authorities, such as the registration authority in Shanghai, only accept applications where the contemplated representative office location is in certain approved business buildings. Most other cities, such as Beijing, do not have any special requirements in terms of the location of a representative office. The Draft Regulation provides the registration authorities with greater discretion than before in this regard.

CHIEF EXECUTIVE OFFICER

Under the Draft Regulation, the chief executive officer of a representative office is permitted to sign contracts on behalf of the foreign enterprise if authorized by the foreign enterprise in writing. The Draft Regulation outlines certain criteria that must be met before any person qualifies as the representative of a representative office. For example, the person must have no previous convictions related to bribery and must not have been the representative of any representative office that has been ordered to close within the previous five years.

INITIAL APPLICATION MATERIALS

Materials required for registration under the Draft Regulation are more stringent. In addition to the materials specified in the 1983 Provisions, the Draft Regulation requires that the foreign enterprise must be established for more than one year before it can apply to set up a representative office in China. Furthermore, except for documents requested in the 1983 Provisions, the articles of association or organization agreement of the foreign enterprise will also need to be submitted for approval. The Draft Regulation also requires that several of the application materials for the establishment of a representative office need to be notarized in the home country of the foreign enterprise and authenticated by the Chinese embassy or consulate. The 1983 Provisions did not have such a requirement and in practice, many cities, such as Beijing, will accept photocopies of application documents. Such legalization

requirement will certainly prolong the application procedure and impose upon foreign investors more financial burdens.

FILING REQUIREMENT FOR ANY CHANGE OF INFORMATION

The Draft Regulation specifies that a representative office is required to file documents to the registration authority in respect of any changes in legal structure, capital, business scope, and representation of the foreign enterprise within 30 days. Failure to file such documents will incur penalties, including fines ranging from RMB 1,000 to RMB 10,000, and could even lead to the revocation of the business license of the representative office. Since these items are not specified in the 1983 Provisions, the Draft Regulation provides extra filing liabilities on representative offices and may accordingly result in occurrence of more filing costs and management expenses.

TIME FRAME FOR APPROVAL AND FILING

The maximum time periods for registration by foreign enterprise applicants and application processing by the registration authorities are clearly delineated in the Draft Regulation. The registration authority is required to notify the foreign enterprise within 10 days as to whether the establishment or change application is accepted. If accepted, the registration authority is required to issue the relevant registration certificates within five days; otherwise it must notify the applicant by issuance of a written notice and provide reasons for the decision.

Similarly, existing representative offices are required to register any change of registration items within 30 days. A representative office that fails to register these changes will be subject to a fine ranging from RMB 10,000 to RMB 30,000 and, in serious cases, the revocation of its business license. Additionally, representative offices are required to publish registration information to the public. A representative office that fails to comply with such requirement will be subject to a fine ranging from RMB 1,000 to RMB 10,000.

Under the Draft Regulation, the foreign enterprise and its representative office should be aware of any time requirement for registration and filing in order to file documents in a timely manner; otherwise, such delay will lead to fines or even revocation of the business license. Such higher penalties imposed in the Draft Regulation should incentivize exist-

ing representative offices to comply with the publication and reporting requirements. It is hoped that clearly specifying the time frame for the registration authority will make the application process more transparent and efficient and will benefit applicants accordingly.

DEREGISTRATION

The Draft Regulation specifies the situations in which a representative office must apply for deregistration at the relevant registration authority within 90 days. The situations under the Draft Regulation encompass those in the 1983 Provisions, which require deregistration only if the company was closed by the registration authority or the foreign enterprise is insolvent. In addition, the Draft Regulation requests the representative office to apply for deregistration when the foreign enterprise ceases to operate, which could include more possibilities than insolvency. Foreign investors should be aware that penalties for failure to apply for the deregistration will range from RMB 10,000 to RMB 30,000 and, in serious cases, revocation of the business license. Foreign investors should also note that in the Draft Regulation, if a representative office has been ordered to close or its business license has been revoked by the registration authority, no new representative office will be approved in China within five years. In the 1983 Provisions, there is no such stringent requirement.

ANNUAL REPORTING SYSTEM

The annual reporting requirement is a new requirement under the Draft Regulation. Representative offices are required to publicize their annual audited reports during the period from March 1 to June 30. The penalty for failure to submit annual reports is a fine of between RMB 1,000 and RMB 10,000. If annual reports are not submitted for two consecutive years, then the license of such representative offices is revocable. Although the annual reporting system enhances the transparency of company information, extra auditing and administrative costs will likely be incurred in order to comply with such disclosure requirements.

MORE POWERS TO REGISTRATION AUTHORITY

Unlike the 1983 Provisions, the Draft Regulation provides considerable powers to the registration authorities, including powers to conduct on-the-spot investigations, to seal and search suspected premises, and to freeze bank accounts related to illegal funds, etc. If the representative office refuses or hinders such investigation conducted by the registration authority, it will be considered an activity in violation of relevant security administration law, and in such case the public security department can penalize such activities accordingly. In serious cases, any person who is in violation of the criminal law during such rejection of the investigation will be exposed to criminal liability. In contrast, the Draft Regulation has also imposed liabilities on the registration authority and its officials if they violate any provisions in this Draft Regulation or any other law or regulation.

CONCLUSION

The Draft Regulation is an elaborate regulation with strict registration requirements. The new requirements, however, are reasonable since many provisions clarify the previous ambiguities under the 1983 Provisions, and many of them are the same as those appearing in China's corporation law and regulations for the establishment of foreign-invested enterprises. Some of the registration procedures and requirements under the 1983 Provisions were vague, and the Draft Regulation has made the whole process more transparent. Under the Draft Regulation, stringent scrutiny and penalties should incentivize foreign investors and existing representative offices to completely comply with the legal requirements listed, although it is likely to lead to more expenses being incurred.

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