

Doing business in China: special rules on setting up trading companies in China



Zhixiong Liao sets out the legal requirements for 'trading' in China

In general, an overseas company may set up a company in China as a wholly foreign-owned enterprise, an equity joint venture, or a contractual joint venture. The three basic statutes on foreign-invested enterprises, namely, the *Law on Wholly Foreign-invested Enterprises* 1986, the *Law on Sino-Foreign Equity Joint Ventures* 1979, and the *Sino-Foreign Contractual Joint Ventures Law* (1988), provide for the general requirements and set-up procedures. However, if the company is to be set up for trading (rather than processing or manufacturing) activities, its setting up must also comply with some special rules.

If an overseas company is to be engaged in certain types of 'trading' activities in China, it must set up a 'foreign-invested trading company' in China.

Those types of activities include:

- (a) acting as an agent, broker, auctioneer, or wholesaler to sell products in China for the purpose of obtaining commissions;
- (b) wholesale trading, ie selling goods and/or related services to retailers, enterprises, other organisations, or other wholesalers;
- (c) retailing business, whether at fixed business premises, via television, telephone, post, Internet, or automatic vending machines; and
- (d) franchising.

retailing business, and/or purchase goods in the Chinese market for export. It is not allowed to have business activities that only a wholesale trading company can do, such as wholesale, acting as an agent for commission, and importing not for its own retailing business. Similarly, a wholesale trading company may not have retailing activities. Therefore, it is important to make clear the types of business the proposed trading company will do and make sure all of them are included in the contract, constitution, and the application for overseas investment approval. It is permissible for a foreign-invested trading company to have both wholesale and retailing businesses, so long as both of them are within the company's 'scope of business' recorded in the business licence.

Last but not least, to date, a foreign-invested trading company may only be incorporated as a "Sino-foreign equity joint venture" (a "wholly foreign-owned" or a "contractual joint venture" trading company is not allowed). Therefore, it is necessary for the overseas investor(s) to find a Chinese person (whether natural or legal) to hold shares in the proposed trading company, although the overseas investors may hold up to 99 per cent of the shares.

In addition, a foreign-invested trading company may only be allowed to set up retailing outlets in prescribed cities, such as the five 'special economic zones': Beijing, Shanghai, Tianjing, Guangzhou, Dalian, Qingdao, Ningbo, and other capital cities of each province. It seems this restriction has been lifted up. There may also be restrictions on a foreign-invested trading company selling certain types of goods. For New Zealand companies, it is wise to check with the Free Trade Agreement (FTA) between China and New Zealand, *green* Annex 8, Part I, Clause 4 for details. The China-New Zealand Free Trade Area Joint Commission may review and revise Annex 8 from time to time. Check with the most up-to-date criteria before you make your decisions!

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This means that a commercial presence in China is required. Export (cross-border supply or consumption abroad) is not subject to this requirement.

There are some special criteria for setting up a foreign-invested trading company. First, the proposed company must meet the "minimum registered capital requirement" set out in the *Companies Law of the People's Republic of China* (1993). Section 26 of the *Companies Law* provides that the "minimum registered capital" required for a limited liability company is RMB Yuan 30,000. However, this is not the case in reality. Different government authorities may impose different requirements. The intended business activities of the proposed company may also be relevant. For example, if the company is to do wholesale business, the minimum registered capital is generally RMB Yuan 500,000.

Another issue is the entitlement to issue Value-Added Tax (VAT) special invoices. Generally, if a company's registered capital is less than RMB Yuan 500,000, than it will be very unlikely to be entitled to obtain and issue VAT special invoices, which means the VAT input amounts incurred in its purchasing will not be deductible from the output in the calculation of its VAT tax liability. This will result in a substantial disadvantage in business competition.

A very limited amount of registered capital will also affect the company's reliability in the Chinese business circle and its entitlements as to 'import and export' registration with the Chinese Customs. Therefore, it is wise to consult with the local governmental authorities, especially the local branch of the National Tax Bureau, and the authority in charge of assessment and approval of foreign investments.

Secondly, a trading company must not last for more than 30 years (40 years if set up in Western China). Words to this effect must be written down in the constitution of the proposed company.

Thirdly, if the company needs a fixed location as its shop, the investor should make enquiries with the district plan of the city to make sure the proposed premises are suitable for the proposed activities. There may also be restrictions on how many outlets a company may set up in a particular city.

Fourthly, there are clear restrictions on what types of business that a particular type of trading company can do. For example, a retailing company may retail goods (and related/collateral services), import goods *for its own*

other capital cities of each province. It seems this restriction has been lifted up. There may also be restrictions on a foreign-invested trading company selling certain types of goods. For New Zealand companies, it is wise to check with the Free Trade Agreement (FTA) between China and New Zealand, *agreement* Annex 8, Part I, Clause 4 for details. The China-New Zealand Free Trade Area Joint Commission may review and revise Annex 8 from time to time. Check with the most up-to-date criteria before you make your decisions!

If you have already had a "foreign-invested" company in China, whether it is a wholly foreign-owned, equity joint venture, or contractual joint venture company, that company may apply to set up a trading company as its subsidiary, subject to the special rules stated above, and the requirements set out in the *Provisional Stipulations on Re-Investment in China by Foreign-Invested Enterprises*.

The procedure for setting up a trading company is not substantially dissimilar to the general procedure for setting up foreign-invested companies in China. However, only the government authorities in charge of overseas investments at the provincial level or above may approve the application for setting up a foreign-invested trading company. If your trading company is going to do retail business, the number of retailing outlets and the size of area of each outlet may also affect the authorities' decision making. ②

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