Introduction to Foreign Investment Regulation

CBL Team's Introduction

CBL's translation of an introduction by China's Commerce Ministry personnel provides key insights about how China's foreign direct investment regulation has evolved from a patchwork of regulations, to its current set of unified laws.

Investment Regulation Basics

The previously used Foreign Capital Laws were repealed when the Foreign Investment Act was enacted on January 1, 2020. However, entities that have foreign investment formed under the Foreign Capital Laws are permitted to retain their original entity structure for another five years.

The Foreign Capital Laws governed foreign investment, corporate governance, and operational management in the absence of the current Company Law and Partnership Law; the three laws include the Sino-Foreign Joint Venture Law (1979), Wholly Foreign-owned Enterprise Law (1986), and Sino-Foreign Collaborative Joint Ventures Law (1988). Foreign investors' entities were governed by the Company Law of 1993 with additional and superseding requirements specified in the Foreign Capital Laws. The special rules on corporate governance and operating provided in the Foreign Capital Laws include the review and approval system used by the jurisdictional international trade agency under the State Council and cover company formation, articles of incorporation, collaboration agreements, investor industries, changes in corporate form, operational terms, and any changes or modifications made during company formation and operation. Foreign investors and their Chinese partners may only apply for registration or a change of registration information with the Commercial and Industrial Administrative Agency once they are approved by the jurisdictional international trade agency under the State Council or an agency authorized by the State Council and complete all necessary filings. Now, the Company Act and the Partnership Act governs the business structure, organizational structure, and activities of any foreign investor's wholly-owned subsidiary or collaborative joint venture identically to domestic entities, because the newly enacted Foreign Investment Act has superseded the special rules governing foreign-invested entity corporate governance

and operational management. The Foreign Investment Act specifically regulates foreign investment matters and national treatment in both the pre- and post-establishment phases, while the Exceptions List provides specific administrative procedures. The Exceptions List covers the main industries and fields where foreign investment is prohibited and does not restrict foreign investment in other industries and sectors not on the list. Based on the choice of law principles in Articles 92 and 93 of the Legislation Act, newly enacted laws will apply whenever they conflict with old laws. However, newly enacted laws not specifically enacted to better protect the rights of citizens, legal entities, and other organizations do not have retroactive force. The new Foreign Investment Act eases restrictions on foreign investment to benefit private entities and, therefore, is immediately applicable upon enactment. Any previous activities not covered by the Exceptions List would be governed by the new law, and any actions covered by the Exceptions List should be corrected pursuant to the new law.

The Supreme People's Court issued the Interpretation of the Application of the Foreign Investment Act on December 26, 2019, addressing four core issues: First, the validity of any matters not covered by the Exceptions List would not be affected . Second, any transactions relating to the matters covered by the Exceptions List will be invalidated. Third, the judicial interpretations would only apply to pending cases, and the new law will have no effect on adjudicated cases (including retrial cases under review). Fourth, the interpretation can be used as a

reference in cases involving Hong Kong, Macao, and Taiwan.

Common Questions

1.What is considered a foreign investor?

Foreign investors include foreign individuals, foreign business entities or other organizations, investors from Hong Kong, Macao and Taiwan, Chinese citizens living overseas, and Chinese citizens and business entities.

2. What are the types of foreign investment?

Foreign investment is divided into foreign direct investment and foreign indirect investment. Direct investment includes newly formed entities (i.e., greenfield investments), acquisition of domestic entity equity, and investment in new projects. Indirect investment includes debt investment (i.e., bond subscriptions）, project investments (i.e., BOT), variable interest entities, custodianships, trusts, offshore transactions, and leases. Reinvestment in Chinese entities made by foreign invested entities formed pursuant to Chinese law is still considered foreign investment.

3. Would domestic persons investing in China through offshore entities (i.e., round-tripping investment) be considered foreign investors to national foreign investment regulations?

The Special Administrative Procedures for Admission of Foreign Investments (Exceptions List)(2020 version) provides that foreign investment, international investment, and foreign exchange administrative regulations apply to any domestic entity, company, or

individual that uses a legally formed or controlled international entity located overseas to acquire an affiliated domestic entity company. Therefore, lawyers should characterize round-tripping investment as foreign investment and determine whether such investment is prohibited or restricted by the Exceptions List.

Additionally, under Article 14 of the Foreign Investment Act, “The state shall encourage and attract foreign investors to invest in specific industries, fields, and regions based on socioeconomic development needs. Foreign investors and foreign invested entities may benefit from preferential treatment under the law, central government regulations and State Council regulations.” Furthermore, Article 12 of the Foreign Investment Act Administrative Regulations provides that, “Foreign investors and foreign invested entities may enjoy preferential treatment in government funding, taxes, financing and leasehold pursuant to law, central government regulations, and State Council regulations.” This needs to be considered when determining whether a round-tripping investment is entitled to the same preferential treatment as foreign investment.

In practice, whether or not a company is considered a foreign invested entity is determined based on the origin of the initial capital contribution rather than the nationalities of the shareholders (i.e. ultimate beneficiary). Specifically, the determination needs to be based on the origin of the round-tripping investment’s inbound capital. An investment will be considered a foreign investment if over 25% of the inbound

capital is sourced from overseas.

However, local governments in different locales may use different criteria to determine whether an entity funded through round-tripping investment is treated as a foreign-invested entity.
