

Briefing

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Contacts

For further information, please contact

Peter Corne
Managing Director - Shanghai
+86 21 6137 1001
petercorne@eversheds.com

Carl Hinze
Associate
+86 21 6137 1004
carlhinze@eversheds.com

Stella Zhou
Associate
+86 21 6137 1010
stellazhou@eversheds.com

China Tightens Controls on Representative Offices of Foreign Enterprises

What has happened?

On 4 January 2010, the State Administration for Industry and Commerce ("SAIC") and the Ministry of Public Security ("MPS") jointly released a notice (the "Notice") to strengthen the administration and management of foreign enterprises' representative offices ("Rep Offices") in China. The changes specified in the Notice (which is so far only officially available in the Chinese language) are in effect from 15 January 2010.

Why is this relevant?

Many foreign enterprises establish a Rep Office in China as a launch pad for building relationships and carrying out market research before further investing in China in the form of an incorporated subsidiary. In this way, Rep Offices continue to be key vehicles for foreign enterprises in China, and they have been used (and sometimes abused) by foreign enterprises to achieve a relatively straight-forward and yet effective presence in the burgeoning Chinese marketplace. The Notice suggests a further step in the fundamental shift in attitude of the Chinese government towards Rep Offices.

What is the impact?

- *Limits on number of 'representatives'*: Each Rep Office must now have a maximum of 4 representatives, including the Chief Representative. We understand that all foreign staff are regarded as 'representatives', so a Rep Office will only be allowed a maximum of four foreign staff. Existing Rep Offices with more than four representatives will be allowed to reduce, but not further increase, the number of representatives.
- *MPS' involvement*: It has not been commonplace to associate the administration of Rep Offices with the MPS (which among other things governs the presence of foreign nationals in China). The Notice calls for the SAIC to work together with the MPS to report infringements, with a particular emphasis on matters concerning the entry into, and exit from, China of foreign nationals.

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- *Two-year establishment requirement for foreign enterprise:* In theory, a one-year establishment requirement has been in place for some time for a foreign enterprise which is applying to establish a Rep Office, although this requirement was effectively ignored in practice. There is now a requirement that the foreign enterprise which is applying to establish a Rep Office has been in existence for two years. There are stricter requirements regarding the documentation which needs to be supplied to set up a Rep Office, including a notarized and legalized certificate of incorporation of the foreign enterprise to certify that it has existed for at least two years.
- *One-year terms:* The validity period of the registration certificate of any new Rep Office or any extension of any existing Rep Office will be reduced from 3 years to 1 year. Rep Offices will have to renew their registration on an annual basis and, when applying for the renewal, a notarized and legalized document evidencing the existence of the foreign enterprise which established the Rep Office must be provided to the authorities.
- *On-site inspections:* The local SAIC will carry out on-site verifications of registered particulars for newly established Rep Offices which have held their registration certificates for less than 3 months. Emphasis will be placed on checking whether or not the registered address of the Rep Offices is true.
- *Increased supervision of business activities:* The local SAIC will strengthen its supervision of the daily activities of Rep Offices. If a Rep Office conducts business activities and receives revenue in any form from such activities, SAIC can impose penalties on the Rep Office for carrying out business operations without a business licence. Also, any Rep Office which has failed to properly extend its registration or properly change its registered address will effectively be "black-listed" with the relevant authorities.

These changes continue a trend that has emerged over the last year or so where the regulation of Rep Offices has become increasingly strict. For instance, in late 2009 it was announced that the office premises of Rep Offices must pass a verification from the State Security Bureau and obtain a certificate before the premises can be used as the registered office of a Rep Office.

Foreign enterprises with existing Rep Offices in China, or with plans to establish a Rep Office in China, should discuss with us in further detail the potential risks arising out of the regulatory environment facing Rep Offices.

This briefing is intended as general guidance and is not a substitute for detailed advice in specific circumstances.

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