



# China's New Foreign Investment Law

June 2019

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# INTRODUCTION

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The new Foreign Investment Law (“FIL”) was passed and published on March 15, 2019 and will take into effect on January 1, 2020. The FIL is composed of six chapters, mainly focusing on the national treatment of foreign investment, including the promotion and protection of foreign investment and investment management system.

As the first unified law in the field of foreign investment, the FIL will replace the existing *PRC Sino-foreign Equity Joint Ventures Law*, *PRC Wholly Foreign-owned Enterprises Law* and *PRC Sino-foreign Cooperative Joint Ventures Law* as well as their respective implementing rules (the “**FIE Laws**”).

Any foreign invested enterprise incorporated after the effectiveness of the FIL shall comply with the Company Law of the PRC or the Partnership Enterprise Law of the PRC as the case may be, in terms of its organizational form and corporate structure.

As for the foreign invested enterprise established before the effectiveness of the FIL, an interim period of five (5) years is provided for its transition. That is to say, the existing foreign invested enterprise may keep its current organizational form and corporate structure (including the highest authority, the voting mechanism and etc.) for five (5) more years commencing from January 1, 2020.

It is currently not clear whether the foreign invested enterprise needs to go through relevant approval/filing/registration process to revise its existing organizational form and corporate structure which may be stipulated in the specific or detailed rule on the implementation of the FIL.

We hereby summarize the key features of the FIL below by comparing the existing laws and regulations on foreign investment.



# DEFINITION OF FOREIGN INVESTMENT



## The existing laws and regulations

### The Wholly Foreign-Owned Enterprise Law

Article 2 The term «wholly foreign-owned enterprise» as used in this Law refer to any enterprises established within the territory of the People's Republic of China (hereinafter referred to as « China ») in accordance with applicable Chinese laws with capital provided solely by Foreign Investors, excluding any branch offices established in China by foreign enterprises or other economic organizations (“WFOE”).

### The Sino-Foreign Equity Joint Venture Enterprise Law

Article 1 In order to expand international economic cooperation and technological exchange, China shall permit foreign companies, enterprises, other commercial organizations and individuals, subject to the approval of the Chinese government, to jointly establish Sino-foreign equity joint ventures with Chinese companies, enterprises and other commercial organizations within the territory of China based on the principles of equality and mutual benefit (“EJV”).

### The Sino-Foreign Cooperative Joint Venture Enterprise Law

Article 1 This Law is enacted for the purposes of increasing economic cooperation and technological exchange with foreign countries and encouraging foreign enterprises, other economic organizations, or individuals to jointly establish Sino-foreign cooperative joint ventures within the territory of China with Chinese enterprises or other economic organizations in accordance with the principles of equality and mutual benefit (“CJV”).

It is worth paying attention to that the FIL specifies the foreign investment including direct and indirect investment and sets a catch-all clause, i.e. “other investment stipulated in laws, administrative regulations or provisions of the State Council”. However, there is as yet no explanation or interpretation to an «indirect foreign investment».

We refer to the first iteration of the draft FIL published in 2015, there was one section in relation to the introduction of the “de facto controller” which appeared to be aimed at combatting variable interest entities (“VIEs”). According to which, a Foreign Investor controlling a domestic enterprise or holding the rights and interests of a domestic enterprise through contracts, trusts and other means shall be determined to be foreign investment and shall be subject to governmental review and obtain governmental approval.

However, the current promulgated FIL does not include “de facto controller” concept or relevant provisions thereof, that is, the VIE structure will at current stage still remain in the “grey” area within China. We cannot rule out the possibility that the VIE investment and/or other alternative foreign investment may be seized in the scope of foreign investment in any further implementation rules of the FIL. In addition, please kindly note that the VIE structure was designed in the first place to circumvent the Chinese government restrictions on foreign investment in certain industries. The PRC Contract Law does not address the VIE structure directly, however, it clearly provides that the court may declare a contract void “when a lawful form is used to conceal an unlawful purpose”.

## Foreign Investment Law (“FIL”)

Article 2 This Law applies to foreign investment carried out within the territory of China.

For the purpose of this Law, «foreign investment» means the investment activities carried out **directly or indirectly by foreign natural persons, foreign enterprises or other foreign organizations (hereinafter referred to as «Foreign Investors»)** within the territory of China, including the following circumstances where:

- (1) a Foreign Investor, independently or jointly with other investors, establishes a foreign invested enterprise in China;
- (2) a Foreign Investor acquires shares, equities, proprietary shares or other similar rights and interests of PRC domestic enterprises;
- (3) a Foreign Investor, independently or jointly with other investors, invests in new projects in China; and
- (4) other investment stipulated in laws, administrative regulations or provisions of the State Council.

For the purpose of this Law, «foreign invested enterprise» means the enterprise registered and established within the territory of China in accordance with Chinese laws, which is wholly or partly invested by Foreign Investors.



# MARKET ENTRY MANAGEMENT

# 03

## The existing laws and regulations

### The Wholly Foreign-Owned Enterprise Law

Article 23 Where the establishment of a WFOE does not involve the implementation of special access administrative measures prescribed by the State, the items stipulated in Article 6, Article 10 and Article 20 hereof **shall be subject to record-filing management**. The special access administrative measures prescribed by the State shall be promulgated by or approved for promulgation by the State Council.

### Sino-Foreign Equity Joint Venture Enterprise Law

Article 15 Where the establishment of a EJV does not involve the implementation of special access administrative measures prescribed by the State, the items stipulated in Article 3, Article 13 and Article 14 hereof **shall be subject to record-filing management**. The special access administrative measures prescribed by the State shall be promulgated by or approved for promulgation by the State Council.

### Sino-Foreign Cooperative Joint Venture Enterprise Law

Article 25 Where the establishment of a CJV does not involve the implementation of special access administration measures prescribed by the state, the items stipulated in Article 5, Article 7, Article 10, and Article 24 hereof **shall be subject to record-filing management**. The special access administrative measures prescribed by the state shall be promulgated by or approved for promulgation by the State Council.

**Special Management Measures for the Market Entry of Foreign Investment (Negative List) (2018 Version) issued by the National Development and Reform Commission and the Ministry of Commerce on June 28, 2018.**

**Negative List for Market Access (Version 2018) is issued by the National Development and Reform Commission and the Ministry of Commerce on December 21, 2018.**

Foreign investment in China was previously subject to a case-by-case approval based regulatory mechanism which classified the industries of foreign investment into four catalogues as «encouraged», «restricted», «prohibited» and «permitted».

In recent years, foreign investment regulatory mechanism is evolving to the “filling/registration” mode in accordance with the Interim Measures for Record-filing Administration of the Establishment and Change of Foreign Invested Enterprises (the “**Interim Measures**”), except for the foreign investment in certain industries subject to special management for market entry according to the Special Management Measures for the Market Entry of Foreign Investment (the “**Negative List**”).

The FIL, in the form of law, sets forth a management scheme consisting of national treatment in conjunction with a Negative List for foreign investment. Under such scheme, equal treatment to domestic and foreign investment will apply except as required pursuant to the Negative List.

The FIL further grants the foreign invested enterprise equal treatment and participation in governmental procurement activities (Article 16) and also specifically reiterates that the foreign invested enterprise is allowed to raise funds by publicly issuing stocks, corporate bonds, and other securities in accordance with law (Article 17). Please note that these are general principles on fair competition and expanding financing channels of foreign investment, and it is expected that detailed implementation rules will be issued for clarifying and refining the provisions.

## Foreign Investment Law (“FIL”)

Article 4 **The State implements the management scheme of pre-establishment national treatment plus negative list with respect to foreign investment.**

As used in the previous paragraph, «pre-establishment national treatment» means granting Foreign Investors and their investment treatment, during the investment access stage, no less favourable than that granting to Chinese domestic investors and their investment, and «negative list» means to the special administrative measures on access of foreign investment in specific industries as prescribed by the State. The State grants national treatment to the foreign investment that is not in the negative list.

The negative list is to be published by or published as authorized by the State Council.

Article 28 Foreign Investors shall not invest in fields or industries prohibited in the negative list for foreign investment.

Foreign Investors that intend to invest in the fields or industries restricted by the negative list for foreign investment shall satisfy the conditions stipulated in the negative list.

Fields or industries not covered in the negative list for foreign investment are to be managed according to the principle of consistency between domestic and foreign investment.

Article 31 The provisions of the «PRC Company Law» and the «PRC Partnership Enterprises Law» apply to the organizational forms, institutional frameworks, and standards of conduct of the foreign invested enterprise.

# INVESTMENT PROTECTION

# 04

The FIL provides protection for investment in respect of profit remittance, intellectual property rights protection, administrative interference, governmental commitments and trade secrets. Please find the details below in the table:

## 1. Administrative interference and governmental commitments

The existing laws and regulations	Foreign Investment Law (“FIL”)
N/A	<p>Article 13 As needed, the State may establish special economic zones or implement experimental policy measures on foreign investment in certain areas to promote foreign investment and expand the scope of opening-up.</p> <p>Article 14 Based on the needs of national economic and social development, the State may encourage and guide Foreign Investors to invest in certain industries, fields or regions. Foreign Investors or foreign invested enterprises may enjoy preferential treatment in accordance with the provisions of laws, administrative regulations, or the State Council.</p> <p>Article 18 Local people’s government at or above the county level may, in accordance with the provisions of laws, administrative regulations, or local regulations, with their legally prescribed authorities formulate policy measures on the promotion and facilitation of foreign investment.</p> <p>Article 25 The various levels of local people’s governments and their relevant departments shall fulfil the policy commitments made to Foreign Investors or foreign invested enterprises and contracts concluded in accordance with law.</p> <p>Where the policy commitments or contractual agreements need to be changed or modified for the national or public interest, the authorities shall proceed in accordance with statutory authority and procedures and compensate the Foreign Investors or foreign invested enterprises for any loss incurred thereby in accordance with laws.</p>

## 2. Protection of trade secrets

The existing laws and regulations	Foreign Investment Law (“FIL”)
N/A	<p>Article 23 Administrative organs and their personnel shall, in accordance with law, maintain the confidentiality of the trade secrets of Foreign Investors or foreign invested enterprises that they learn in the course of performing their duties, and must not disclose or unlawfully provide them to others.</p> <p>Where the policy commitments or contractual agreements need to be changed or modified for the national or public interest, the authorities shall proceed in accordance with statutory authority and procedures and compensate the Foreign Investors or foreign invested enterprises for any loss incurred thereby in accordance with laws.</p>

# INVESTMENT PROTECTION



## 3. Foreign currency

### The existing laws and regulations

#### The Wholly Foreign-Owned Enterprise Law

Article 19 Foreign Investor(s) of a WFOE may remit abroad legitimate profits earned from the WFOE and other income and funds lawfully obtained following the liquidation of the WFOE.

Wages and other legitimate income earned by a foreign employee of a WFOE may be remitted abroad after the individual income tax has been paid in accordance with the laws.

#### The Sino-Foreign Equity Joint Venture Enterprise Law

Article 11 Foreign Investor(s) of an EJV may, remit abroad (1) the net profit distributed upon its performance of the obligations as specified in the laws and the agreements or contracts thereof, (2) the funds distributed upon the expiration of an EJV period or suspension of the EJV and (3) other legitimate income, in accordance with the Administrative Regulations of China on Foreign Exchange and in the currency specified in the equity joint venture contract.

Foreign Investor(s) shall be encouraged to deposit in the Bank of China any amount of foreign exchange which is entitled to remit abroad.

#### The Sino-Foreign Cooperative Joint Venture Enterprise Law

Article 22 Foreign Investor(s) of a CJV may, remit abroad (1) the net profit distributed upon its performance of the obligations as specified in the laws and the agreements or contracts thereof, (2) the funds distributed upon the expiration of an CJV period, and (3) other legitimate income, in accordance with relevant laws.

Wages and other legitimate income earned by a foreign employee of a CJV may be remitted abroad after the individual income tax has been paid in accordance with the laws.

### Foreign Investment Law (“FIL”)

Article 21 Foreign Investors’ capital contributions, profits, capital gains, income from asset disposal, intellectual property right royalties, compensation or indemnification obtained in accordance with law, liquidation income, and etc., that are made or obtained in China, may be **freely remitted into or out of China in RMB or any other foreign currencies in accordance with laws.**

## 4. Protection of intellectual property rights

### The existing laws and regulations

#### Implementing Regulations for the Sino-Foreign Equity Joint Venture Enterprise Law

Article 43 A technology transfer agreement concluded by an EJV shall be submitted to the competent authority for approval.

A technology transfer agreement shall meet the following stipulations:

...

**(4) After the expiration of a technology transfer agreement, the receiving party of technology shall be entitled to continue to use the technology;**

### Foreign Investment Law (“FIL”)

Article 22 The State protects the intellectual property rights of Foreign Investors and foreign invested enterprises; protects the lawful rights and interests of intellectual property rights holders and relevant rights holders; and strictly pursues legal liabilities against infringement on intellectual property rights in accordance with law.

The State encourages technological cooperation to be conducted in the process of foreign investment by the investment parties upon equal negotiation. **Administrative organs and their personnel shall not force the transfer of technological through administrative means.**



# INVESTMENT PROTECTION



Following the issuance of the FIL, the new amendments to the Regulation on the Administration of the Import and Export of Technologies has been promulgated on 18 March 2019 with immediate effect. Three articles below in relation to the import of technologies have been removed, which closely follow the overarching principle set out in the FIL, and encourage the counterparts to negotiate and allocate risks in the technology transaction.

Articles removed from the Regulation on the Administration of the Import and Export of Technologies	
Article 24 (3)	Where the transferee of a technology import contract infringes upon the legitimate rights and interests of any other person due to exploiting the technologies provided by the transferor according to contractual agreements, the transferor shall assume corresponding liabilities in this regard.
Article 27	During the term of a technology import contract, the achievements made from technology improvement shall belong to the party making the improvements.
Article 29	<p>A technology import contract shall not contain any of the following restrictive clauses:</p> <ol style="list-style-type: none"><li>(1) Clauses requiring the transferee to accept conditions that are not essential for technology import, including the purchase of non-essential technologies, raw materials, products, equipment or services;</li><li>(2) Clauses requiring the transferee to pay royalties or undertake relevant obligations for the technologies whose patent has expired or has been declared invalid;</li><li>(3) Clauses restricting the transferee from making improvements to the technologies provided by the transferor or restricting the transferee from using improved technologies;</li><li>(4) Clauses restricting the transferee from obtaining, from other sources, technologies similar to or competitive with the technologies provided by the transferor;</li><li>(5) Clauses placing unreasonable restrictions on the channels or sources from which the transferee may purchase raw materials, parts and components, products or equipment;</li><li>(6) Clauses placing unreasonable restrictions on the quantity, types or sale prices of the products manufactured by the transferee; or</li><li>(7) Clauses placing unreasonable restrictions on the export channels of the products manufactured by the transferee using imported technologies.</li></ol>



# NATIONAL SECURITY REVIEW

# 05

## The existing laws and regulations

### National Security Law

Article 59 The State shall establish a review and regulation system and mechanism for state security, and carry out state security review against foreign investments, specific items and key technologies, network information technology products and services, construction projects involving national security matters, as well as other major events and activities that affect or may affect national security, and effectively prevent and resolve national security risks.

### Notice on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors

The scope of security review for mergers and acquisitions shall be: Foreign Investors' mergers and acquisitions of military industrial enterprises or military industry related supporting enterprises, enterprises located near key and sensitive military facilities, and other entities relating to national defense; Foreign Investors' mergers and acquisitions of key domestic enterprises in areas such as agriculture, energy and resources, infrastructure, transport, technology, assembly manufacturing, etc., whereby the Foreign Investors might acquire the actual controlling right thereof.

### Notice on the Trial Measures for the National Security Review of Foreign Investment in Pilot Free Trade Zones

The scope of security review for mergers and acquisitions shall be: Foreign Investors' investment in pilot free trade zones in military industry, supportive military industry, and other fields relating to national defence security, or in areas surrounding major or sensitive military facilities; and Foreign Investors' investment in pilot free trade zones in the fields relating to national security such as important agricultural products, important energies and resources, important infrastructural facilities, important transportation services, important culture, important information technology products and services, key technologies, and manufacturing of major equipment, whereby the Foreign Investors acquire the actual controlling right thereof.

Foreign Investors' investment in pilot free trade zones shall refer to any of the following circumstances:

- (1) Foreign Investors solely or jointly invest with other investors in new projects or formation of enterprises;
- (2) Foreign Investors have obtained, through merger and acquisition, equities or assets of the enterprises which have been established;
- (3) Foreign Investors make investment through agreement-based control, holding shares for others, trust, reinvestment, overseas transaction, lease, subscribing for convertible bonds, and other means.

Under the current legal regime, merger and acquisition projects as well as foreign investment in free trade zones in relation to certain security-related industries, e.g. military and national defence, are subject to national security review. The previous draft of the FIL published in 2015 attempted to set up a comparative comprehensive legal regime for the national security review. However, in the current promulgated FIL, only general principle related to the national security review has been released, and it is expected that detailed implementation rules will be issued for clarifying and refining the provisions.

## Foreign Investment Law ("FIL")

Article 35: The State establishes a security review system for foreign investment and conducts security review of foreign investment that affects or may affect national security.

Security review decisions made in accordance with law are final decisions.



# FOREIGN INVESTMENT INFORMATION REPORTING SYSTEM



## The existing laws and regulations

**Interim Regulations on the Disclosure of Enterprise Information** issued by the State Council in 2014 establish the liability on the enterprises and the competent authority to disclose and publish enterprise information through enterprise credit information disclosure system.

**Notice on further strengthening the information reporting system for foreign investment and the construction of Information disclosure platform (2015)** further strengthen the reporting system of foreign invested enterprises.

## Foreign Investment Law (“FIL”)

Article 34: The State establishes a foreign investment information reporting system. Foreign Investors or foreign invested enterprises shall submit investment information to the competent departments through the enterprise registration system and the enterprise credit information disclosure system.

The content and scope of foreign-investment information reports are to be determined according to the principle of true necessity; investment information that can be obtained through interdepartmental information sharing shall not be required to be resubmitted.

In the current promulgated FIL, only general principle related to the foreign investment information report system has been released, and it is expected that detailed implementation rules will be issued for clarifying and refining the provisions. In addition, please note that in case of violating the obligation of information report, the foreign invested enterprise will be ordered to make corrections with a prescribed time limit and imposed a penalty of not less than RMB 100,000 yet not more than RMB 500,000 if the corrections have not been made within the timeline (Article 37).

# REPLACEMENT OF THE FIE LAWS

# 07

According to the Article 42 of the FIL, the FIL will replace the existing laws and regulations on foreign invested enterprises, including the PRC Sino-foreign Equity Joint Ventures Law, the PRC Wholly Foreign-owned Enterprises Law and the PRC Sino-foreign Cooperative Joint Ventures Law and their respective implementing rules and the FIL shall become the main legal basis for foreign investment in the PRC.

According to the Article 31 of the FIL, the organizational form and corporation structure of a foreign invested enterprise shall be subject to the provisions of the PRC Company Law and the PRC Partnership Enterprise Law, as the case may be. Then the existing foreign invested enterprise, especially for the EJV and CJV, may need to transit its organizational form and corporation structure in accordance with the FIL and relevant laws and regulation.

The FIL grants an interim period of five (5) years in which the foreign invested enterprises established prior to the effectiveness of the FIL may retain their current existing organizational forms. It is advisable for the foreign invested enterprise to pay attention to the differences on the organizational form and corporation structure between the existing FIE Laws and the FIL. We take the examples of the organizational form and corporation structure of an EJV below to illustrate the major differences.

Item	EJV Law	Company Law
The highest authority	Board of directors	Shareholders' meeting
Minimum number of directors	At least three directors	One executive director
Term of the office	4 years	No more than 3 years
Power and responsibility	The following matters are subject to unanimous adoption by the directors who attend the board meeting: (1) amendment of the articles of association; (2) suspension or dissolution; (3) increase or decrease of the registered capital; (4) merger or division of the EJV; and (5) resolution on other matters may be made in accordance with the rules of procedure set forth in the articles of association.	Any resolutions made at a shareholders' meeting on the following issues shall be adopted by the shareholders representing more than two thirds of the voting rights.: (1) amendment of the company's articles of association; (2) increase or decrease of the registered capital; and (3) merger, division, dissolution, or conversion of the company.

However, it is not clear whether the joint venture agreement and the articles of association of the existing foreign invested enterprise need to be revised and whether it is necessary to go through relevant approval/filing/registration process for transition. It is foreseeable that investors will start a new round of negotiation on the organizational form and corporation structure in relevant investment agreements, including but not limited to the joint venture agreement and articles of association in order to make them in compliance with the FIL and applicable laws.



# WHO WE ARE

We are corporate lawyers based in China.  
Our team is composed of 25 Chinese and internationally qualified attorneys.

Each member of our team has been trained in international law firms and is familiar with cross-border transactions. Our experience allows us to fully understand the legal implications and risks of doing business in China.

We work as a bicultural team to provide efficient solutions to navigate through the complex legal environment around the world. Our true added-value is to manage complex transactions in a changing legal and business environment.

We are entrepreneurs providing solutions that actually work. And We are in position to assist you to evaluate the level of risks and propose pragmatic solutions. We have a creative approach to solve your problems in China and are attached to a “boutique” spirit.

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