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New Regulation on Administration of Representative Offices of Foreign Enterprises

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On November 19 2010, the State council issued *Regulation on Administration of Registration of Foreign Enterprises Representative Offices* ("Regulation") which will be effective from March 1, 2011. As compared with the existing administration measures ("Measures") issued back in 1983, the Regulation further clarifies the administrative requirements for the representative offices ("RO") of foreign enterprises in the PRC; aiming to standardize the requirements in terms of ROs set-up, renewal as well as cancellation in local practice, tighten up the administration of ROs from regulatory compliance perspective.

The main features of new Regulation

The provisions of new Regulation, in essence, do not deviate from those in old Measures, but clarify various vague issues in implementation and stiffen the supervision on ROs in order to deter ROs from making changes without undergoing proper registration, providing fraudulent documents for set-up and engaging beyond allowed business scope. For law-abiding ROs, the Regulation has no doubt created extra burden for their ongoing compliance, while for new comers, the set-up prerequisites and documentation requirements for the foreign companies have also become more demanding.

The modification of the key contents is highlighted below. The detailed comparisons are tabulated in the appendix for your reference.

- **Reiteration of the allowable business carried on by ROs**

Pursuant to the old Measures, ROs are defined as an office engaging in "non-direct business activities", but without detailed description on nature or types for such "non-direct business activities". In practice, such "non-direct business" has been interpreted by various levels of tax authorities as those activities with no major objective to make profit such as auxiliary services connected with the operation and products/services of the Headquarters.

Now the new Regulation further clarifies the definition of ROs allowable businesses as "non-profit activities" by specifically identifying marketing, display and liaison activities with the products sales, services provision, domestic procurement and domestic

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investment of foreign enterprises.

Technically speaking, the business activities covered in the Regulation, in essence of the nature of business for ROs, are similar with provisions in the old Measures merely with more explicit wording to facilitate the recognition of the allowable business for ROs.

- **Stricter documentation requirements**

In according to the newly issued Regulation, an RO should submit annual report disclosing critical information and accounting data audited by a qualified CPA firm.

It obviously differs from previous requirement of submitting an operation report by an RO when it applies for registration renewal. Specifically, it requires the provision of information on legal existing of RO's Headquarters and thus would be more cumbersome for ROs and their Headquarters to collect full extent of information for annual report purpose.

- **Restriction of ROs' on hiring expatriates**

With respect of the staff of an RO, the Regulation sets a limit on the number of representatives, e.g., no more than 4 including the Chief Representative. Given the current practice that expatriates working for ROs need to be registered as either Chief Representative or Representatives or else they would not be able to apply for working permit in the PRC, the cap of the number of Representatives may post adverse impact to the ROs which need to have more Representatives in China.

Under such requirement, not only new ROs be affected, but existing ROs also need to revisit their current staffing condition to ensure the limit of 4 Representatives is not exceeded. To some extent, the measure may imply that relevant authority likely will curtail the scale and size of ROs.

- **Heavy cost for engaging profit-making activities**

As compared with old Measure, the Regulation explicitly states that if an RO (excluding ROs permitted to engage in profit-making activities such as ROs of law firms, accounting and taxation firms) is engaged in profit-making activities, the registration authority shall confiscate the gains and impose a penalty of from RMB50, 000 to RMB500, 000; where the circumstance is severe, the registration certificate shall be revoked.

Such significantly increased penalty imposed on profit-making activities by ROs is reflection of intention of administrative bodies to strengthen their control and monitoring on the disorder of ROs operation over the past years.

Conclusion

In light of the stricter registration administration brought by the Regulation, along with the *Circular on Taxation Administration of Representative Office* ("Circular 18") released earlier which introduces increased tax costs, the comparative advantage of using ROs to operate in China is diminishing. Foreign companies contemplating to set up a RO in China as well as those existing ROs should critically assess if the RO structure is still appropriate for their operation in China. It may be worthwhile to directly set up / switch into a Wholly Foreign-owned enterprise ("WFOE") especially from a long term perspective. Meanwhile, it is advisable for the existing ROs to review their operation to ensure that they are performing within the allowable scope, maintaining the documentations and accounting records of the RO as required, complying with all procedures in terms of setup, renewal and cancellation to avoid the potential penalty.

Appendix

The table illustrates the detailed major changes brought by the new Regulation compared with

old Measures for your reference.

Key issues	NEW Regulation	OLD Measures
Definition of ROs	The office established in China by a foreign enterprise for the purpose of engaging in non-profit activities related to the business of the foreign enterprise.	The office established in China for the purpose of engaging in "non-direct business activities".
Activities	The typical permitted activities include market investigation, display connected with the products or services of the Headquarter as well as contact activities with the Headquarter's product sales, service provisions and investment. ROs of law firms, accounting and tax service firms may be allowed to carry out profit-making activities upon the approval and should submit the prescribed documents.	Not specified in the Measures
Compliance Requirements	An RO should establish formal accounting books and submit annual report describing the sustainability of the Headquarter, the operation of the RO and the accounting information audited by a qualified CPA firm.	An RO should submit an operation report when it applies for registration renewal.
Registration Procedures	A foreign enterprise should submit documents such as Proof of lawful existence above 2 years of the Headquarter, Articles of Association of the Headquarter and Credit Certificate. No more than 4 representatives including Chief Representative. The Headquarter may select RO's residence place by itself. Relevant departments may require the RO to adjust the residence place.	The registration items include name of the RO, business scope, residence place and residence duration. No limitation on the number of representatives.
Information Disclosure	Headquarter shall put public announcement on the media for RO's set-up and renewal; Registration authority should make announcement on an RO's cancellation and revoke of registration.	Not specified in the Measures.
Legal Responsibilities	Registration authority shall impose a penalty of from RMB50, 000 to RMB500, 000 for RO engaging in profit-making activities; where the circumstance is severe, the registration certificate shall be revoked. The Headquarter shall be forbidden to establish new ROs in China during the next 5 years for RO engaging in illegal activities.	Registration authority shall impose a penalty of up to RMB20,000 for RO engaging in direct business activities. Not specified on the amount of penalty levied on illegal activities.

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