

Regulation of Foreign Representative Offices Further Tightened - But Procedural Certainty Improving

[31st December, 2010 Issue 17]

On 19 November 2010, the State Council promulgated the *Regulations on the Administration of the Registration of Resident Representative Offices of Foreign Enterprises* ("**Registration Regulations**"). The Registration Regulations will take effect on 11 March 2011 and will simultaneously repeal the almost two-decades old *Measures on the Administration of the Registration of Resident Representative Offices of Foreign Enterprises* ("**1983 Measures**"). Another set of existing (and even older) rules, the *Tentative Rules on the Administration of Resident Representative Offices of Foreign Enterprises* ("**1980 Tentative Rules**"), are not repealed by the Registration Regulations, but they are now outdated with respect to matters relating to registration of representative offices that fall within the powers of the State Administrative for Industry and Commerce ("**SAIC**") and its local counterparts ("**AIC**"). As the Registration Regulations and the 1980 Tentative Rules both were adopted by the State Council, pursuant to China's hierarchy of laws a provision of the Registration Regulations will prevail over a conflicting provision of the 1980 Tentative Rules.

Rules Tightened and Restrictions Reiterated

The Registration Regulations continue the recent trend toward tightening the regulatory environment for the establishment, operation and administration of representative offices of foreign companies that began with the issuance of the *Notice on Strengthening the Registration Management for Residential Representative Offices of Foreign Enterprises* (the "**Notice**") in January 2010.

- **Hiring RO's Representatives and "Two-year Rule"**

Like most administrative rules of its type in China, the Registration Regulations contain standard provisions regarding the documentary and procedural requirements for the establishment and change of registration of representative offices. Noticeably, the Registration Regulations reiterate the provisions of the Notice that narrow the qualifications for establishing a representative office and limit the number of registered representatives of a representative office. For instance, the Registration Regulations reconfirm the "two-year rule" introduced in the Notice, pursuant to which the foreign entity (defined, for the purpose of the Registration Regulations, as an offshore profit-making organization) applying for the establishment of a representative office (the "**Head Office**") must have been in existence for at least two years at the time of the application. Hence, a foreign company is prevented from using a new offshore holding company or special purpose vehicle to establish a representative office. In addition, under the Registration Regulations, a representative office may register no more than three representatives besides the chief representative, another restriction first proposed in the Notice. This rule effectively limits the number of foreign nationals that are permitted to work for a representative office.

Under such requirement, 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.

- **New annual reporting obligation**

The Registration Regulations impose a new annual reporting obligation on representative offices. Each representative office is now required to submit a report to the competent AIC between 1 March and 30 June each year to confirm the lawful existence of its Head Office and to describe the operating situation and audited expenses, revenues and costs of the representative office. Currently the representative offices are not subject to an annual inspection applicable to foreign-invested enterprises. It is not clear at this time, however, if this annual reporting procedure is intended to replace the annual renewal procedure for the validity period of a representative office's registration certificate, particularly in light of the fact that the Registration Regulations do not repeat the existing requirement, recently articulated in the Notice, that the validity period of the registration certificate is one year only and is subject to annual renewal. Hopefully the SAIC will issue implementing rules in the coming months to clarify this point.

- **Public announcement in media**

In addition to annual reporting, the Registration Regulations also impose a new requirement that the foreign Head Office publish a public notice in media designated by the competent AIC regarding the establishment of the representative office or any change of the representative office's registration. Similarly, a representative office must make public announcement upon the loss or destruction of the representative office's registration certificate or the registration of any representative of the representative office, including the chief representative.

- **Permitted activities by RO**

Though certain types of representative offices, e.g., those established by foreign banks, airlines or law or accounting firms, are permitted to generate revenue under specified rules and conditions, a representative office generally is intended to provide the foreign Head Office with a vehicle for establishing a registered presence in China that only carries out liaison and market research activities without generating revenue. Despite this general prohibition, many foreign companies in recent years have used their representative office as a *de facto* operating company, particularly foreign companies in the service industry or those that wish to provide ancillary services in China such as sales, installation or after-sales services. The Registration Regulations represent a clear attempt by China's central government to curtail the use of a traditional "trading" representative office as an operating vehicle by reiterating the general prohibition of representative offices from undertaking "profit-making activities" (营利性活动) and by further specifying the "permitted" activities of a representative, i.e., (1) Market surveys, product or service displays and promotional activities related to the products or services of the Head Office, and (2) Liaison activities in connection with product sales, the provision of services, domestic procurement or domestic investment by the Head Office, which can cover for instance location of possible investments for investment organizations.

- **Liability and Penalties for Violations Enhanced**

Tightening the regulatory regime of foreign representative offices is backed up by detailed liability and penalties provisions in the Registration Regulations. These provisions not only extend the parties liable

for violation of administrative rules from the representative office to the responsible individual(s) and the Head Office but also impose heavier penalties, especially in fines, than the existing regime.

In contrast with the existing regulations, the Registration Regulations contain a much longer list of violations ranging from making false statement in establishment registration, failing to file for change of registration, to undertaking activities out of the permitted scope. Similar to the existing regime, the penalties for different violations vary from fines and rectification orders to orders to disgorge illegal gain and revocation of the registration certificate in severe cases, but they are imposed in general more heavily than under the current rules. For instance, the amount of fines that may be imposed by the AIC ranges from RMB 10,000 to RMB 500,000, a significant increase from the current range of RMB 5,000 to RMB 20,000 provided in the 1983 Measures.

While the representative office is liable for most of the enumerated violations, the Registration Regulations for the first time also impose liability on the person(s) directly responsible for the activities of a representative office (including the chief representative) who may be fined individually separate from the administrative sanction imposed on the representative office.

Furthermore, liability has also been extended overseas to the Head Office by way of blacklisting. If a representative office's registration certificate is revoked or its registration is invalidated for violation of the Registration Regulations, or it is shut down by the relevant authorities, the Registration Regulations prohibit the foreign Head Office from establishing a new representative office for five years.

- **Improved Certainty and Predictability**

In terms of procedural requirements, the Registration Regulations appear to have made improvements by clarifying some existing ambiguities and providing additional specificity, sometimes at the expense of the discretion held by the administrative authority.

As noted above, the scope of legally "permitted" activities by representative offices is further specified with language much easier to follow than that under the current regime. Similarly, the enumerated violations are clearly defined with corresponding penalties. These improvements should help reduce administrative discretion in enforcement actions.

The Registration Regulations explicitly provide that a chief representative appointed by the Head Office, with authorization from the Head Office, may execute registration application documents for the yet-to-be established representative office on behalf of the Head Office. This procedural change, although small in scope, will significantly facilitate the establishment application process, especially when the appointed chief representative is based in China.

Consistent with the gradual but steady trend toward more procedural transparency and predictability in administrative action, the Registration Regulations set time limits for the competent AIC to issue decisions on matters relating to establishment, change of registration and deregistration of a representative office. Notably, the 1983 Measures do not specify such time limits. Under the Registration Regulations, the competent AIC is required to make a decision on an application for establishment of a representative office within 15 days of accepting the application. If approved, the

registration certificate must be issued within five days after the decision is made. Taken together, these rules effectively set the time limit for procuring establishment registration of a new representative office to 20 days starting from the date on which the application is accepted for processing. In a similar manner, the time for processing an application for change of registration or deregistration is limited to 15 days (10 days for AIC deliberation and five days for the AIC to issue amended registration certificate) starting from the date on which the application is accepted by the AIC.

While the Registration Regulations have taken another major step in further tightening the regulation of foreign resident representative offices by confirming most of the restrictions – some of which are new and some of which, although existing, were not strictly enforced in the past - on the representative office establishment and activities, they have also provided further specificity to related procedures in maintaining representative office operations and complying with ongoing reporting obligations. From this perspective, the Registration Regulations represent a step forward towards enhancing certainty of the regulatory environment for representative offices when this environment is becoming increasingly restrictive.