

4.3. Company Law, company organs and business license (RC)

Introduction

While in the western world legal entities often have similar forms (e.g. GmbH / Ltd. / AG / S.E. /...) and similar key functions according to the corporate law, there might be some important differences in China with serious impact on people in their function that have to be understood for an adequate risk assessment. In this article I will have a short look at the key staff in a WFOE Limited which should represent the majority of the readers of this article.

The procedures and structure of WFOE is described in the Company Law of the People's Republic of China.

While the law itself is an interesting read and can provide detailed information, this article is intended to give a key outline to the organs and their responsibilities in a WFOE formed as a Limited Company.

The law itself is structured in several chapters:

1. General provisions
2. Establishment and Organizational structure of a Limited Liability Company
3. Equity Transfer of a Limited Liability Company
4. Establishment and Organizational Structure of a Company Limited by Shares
5. Issuance and Transfer of Shares of a Company Limited by Shares
6. Qualifications and Obligations of the Directors, Supervisors, and Senior Management Personnel of a Company
7. Corporate Bonds
8. Finance and Accounting of a Company
9. Merger, Division or Capital Increase or Reduction of a Company
10. Dissolution and Liquidation of a Company
11. Branches of a Foreign Company
12. Legal Liabilities
13. Supplementary Provisions

Since the law is pretty extensive, this article describes the most relevant regulations

concerning one of the most typical setups of Wholly foreign invested Entities, a single-person shareholder limited liability company.

Allowed/Encouraged/Forbidden industries

The regularly updated catalogue of industries for guiding foreign investment distinguishes possible business scopes for companies and whether they are encouraged, restricted or prohibited. Furthermore, while not mentioned in the catalogue, the category "allowed" would be used for all businesses which are not explicitly mentioned in the catalogue.

If a company is classified as "encouraged", it can bring additional benefits, for example tax-free import of equipment, domestic profit reinvest withholding tax by another local company with the same international shareholder.

Limited Company: Definition, Compliance with Laws

A limited company is defined as a legal person which enjoys protection of the rights and interests by law, at the same time it must abide the rules and regulations of the country. If laws are not being followed, this might lead to liabilities of the organs and/or might lead to invalidity of decisions.

Articles of Association

A requirement to receive the business license are the articles of association which are binding for the company, shareholders, Directors, Supervisors and senior management.

They also describe

- business scope
- election procedure for directors, their office terms (with a maximum of 3 years)

The specific minimum requirement for the articles of association are detailed in Article 25 of the law.

Business license

After a limited company has been formed a business license will be issued. It specifies,

amongst others, the ID number, name, address, legal person and business scope. Please keep in mind that the business should only operate in the allowed business scope, otherwise it might get punished

Shareholders

The shareholders as the owners of the company can strongly influence the company operations by approving financial plans of the company and setting certain guidelines in place. They set the frame in which the other organs can operate, can decide which people will fill out the other organs and can decide on issues regarding the registered capital and dividends.

Board of Directors

The board of directors can make suggestions to the shareholders and implement their decisions in board resolutions. Their influence is more operational and their main task is in general to execute the decisions of the Shareholders and to formulate plans for the company.

Company Supervisors

The company supervisors are an internal control institution which can inspect the books and supervise the senior management and the board of directors.

Legal Representative

The legal representative represents the company in legal issues to the outside and his power – and responsibility - is hardly limited by law to the outside.

When choosing the legal representative, the company should be very careful due to this since a wrong choice can lead to serious troubles. Internal Regulations set by the board and/or shareholders can at least internally restrict his power to certain limits.

Manager

The (senior) manager of the company, mostly the General Manager, is the operational leader of the business.

Qualifications and Obligations of key personnel

The company law describes in detail that certain forms of misconduct or other attributes of people that can bring a risk to the company have to lead to a denial of employing the services of a person in one of the described key positions.

Furthermore it makes clear that misconduct in the function of one of the company's organs will lead to an obligation to compensate for the loss of the company.

It additionally stresses that inquiries from the company supervisors have to be answered truthfully.

Common pitfalls and best practices

- During forming a new limited company, the company needs a domicile/an address it can be registered to. At the same time, renting space or buying land using rights requires the existence of a legal entity to do so.
- If a company address, legal representative, article of associations or other critical information about company changes, the changes must be updated in the relevant authorities together with required documents for proof.
- Board Decisions might be required for some changes in the company organization or for some business activities. Getting the original signatures if the board is not located in China and the added time for express mail might lead to delays. Since the application to change the registered senior personnel with authorities often has a time limit, choosing a date in the future for the board decisions might be an adequate measure.
- In multi-national companies there often exist rules and regulations that should limit the possible activities of the general managers of a company. To make them legally effective, a board decision is required to make them legally valid.

- If the obligations and rights of the legal representative are not defined in a right way and if the legal representative is not chosen well, this can lead to a lot of problems. Even while his acting power to the outside cannot be limited, as a best-practice it should be internally regulated that for unauthorized transactions he is personally responsible for compensating damages to the company.
- Due to the high responsibility of legal representatives, (experienced) companies in the chinese market often define the legal person as someone who is not living in China since there is no requirement specifying the residency. With the chop of the legal representative, which has to be adequately controlled by an independent person, the personal attendance of the legal representative is not really required.

DRAFT